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DOCTOR OF PHILOSOPHY

A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain

Salh, Shamsalden

Award date:
2017

Awarding institution:
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**A Critical Evaluation of the Legal and Sharia Aspects of
the Iraqi Islamic Banking System, Using the Case Studies
of Malaysia and Bahrain**

Shamsalden Aziz Salh

**Thesis submitted to the Law School of Bangor University
for the degree of Doctor of Philosophy**

January 2017

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I Dedicate This Thesis To:
My Late Father, My Mother, My Wife and My Son

Acknowledgment

All praise and thanks are due to Allah, Lord of the worlds, who provides me with the ability to finish this thesis. And it is my privilege to express my profound gratitude to my supervisor, Dr. Mark Hyland, for his invaluable assistance throughout my study at Bangor University. Indeed, he carried this work with useful and constructive comments and feedbacks for its improvement. In addition, I would like to give my great thanks to my second supervisor, Professor Dermot Cahill, dean of the School of Law at Bangor University, for his vital suggestions and recommendations, which enriched the merit of the work.

I would like to thank Soran University and especially its president, Dr. Muslih Mustafa, for providing me with all assistances during my study.

I also wish to thank everyone, who did not hesitate to provide me with kind assistance and advice to arrive at the end of the journey of this study, especially Mrs Mairwen Owen, the Law Librarian, for her assistance throughout the study.

I would also like to thank my colleague and friend Jing Wang for her assistance during the writing of this thesis.

I also wish to thank my friend Ha Junsheng for his support throughout my study.

Furthermore, my great appreciation goes to all the interviewees, who kindly agreed to participate in the interviews that strengthened this study and made it more effective.

Finally, I would like to thank Cihan Islamic Bank for providing me with information about Islamic banking practices in Iraq.

Abstract

A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain

In Iraq, like other countries, the Islamic banking industry plays an important role in developing the country's economic system. The Islamic banking industry of Iraq is regulated by the Islamic Banking Law, 2015. However, Iraq's Islamic Banking Law of 2015 consists of an incomplete set of rules and regulations. The law does not contain certain fundamental elements such as the licensing requirements. In addition the law does not determine the highest Sharia body in case of Islamic banking problems. Thus, the Islamic banking industry in Iraq is also regulated by the Banking Law 2004 and the Central Bank Law 2004 but they do not make specific reference to Islamic banking. Therefore, the Islamic banking industry in Iraq faces challenges which are both legal and Sharia in character. In this context, the lack of a comprehensive Islamic banking legal framework and unclear relationship between the CBI and Islamic banks are the two main legal problems. Accordingly, the Islamic banking industry of Iraq is regulated by conventional laws and this may result ultimately in legal problems for the Islamic banking system.

The Sharia challenge faced by the Islamic banking industry in Iraq is the lack of a proper Sharia framework. In effect, the Sharia supervision of the Iraqi Islamic banking system is not as robust as it should be. Thus, a central Sharia board does not exist and the individual Sharia supervisory boards of Islamic banks are not sufficiently strong because there is a shortage of qualified Sharia scholars to act as members of the Sharia supervisory boards of Islamic banks. In addition, the shortage of qualified Islamic banking experts is another important problem for the Islamic banking system of Iraq. The lack of Sharia scholars for the Sharia supervisory boards of Islamic banks and the lack of qualified staff to run the Islamic banking industry are the main human resource challenges faced by the Iraqi Islamic banking system.

Thus, this thesis attempts to find solutions for these problems affecting the Iraqi Islamic banking industry. In this regard, the thesis considers the Islamic banking systems of both Malaysia and Bahrain. Both of these countries are developed and successful and each has a proper regulatory framework for its Islamic banking industry. In Malaysia, the Islamic Financial Services Act 3013 (IFSA) is a special law for the regulation of the Islamic financial sector including Islamic banks. Similarly in Bahrain, Volume 2-Islamic Bank is a set of regulations which govern Islamic banks. In addition, both countries have a proper Sharia

regulatory and supervisory system because they have a sufficient number of Sharia scholars to supervise their Islamic banking business. Furthermore, many qualified Islamic banking experts can be found in Malaysia and Bahrain as those countries house universities and centres that offer Islamic banking degrees or courses.

By drawing inspiration from the Malaysian and Bahraini Islamic banking industries, Iraq can develop and improve its own Islamic banking industry. This can be done by amending the Islamic Banking Law, 2015 and establishing a central Sharia board, similar to Malaysia's Sharia Advisory Council. In addition, the Banking Law 2004 and the Iraqi Central Bank Law 2004 should be amended so as to cater more to the Islamic banking industry. It is the responsibility of the Central Bank of Iraq to resolve all problems that are faced by Islamic banks in the country. By drawing judiciously on the Bahraini and Malaysian experiences, CBI regulators will be able to reform the Iraqi Islamic banking industry and find solutions for both legal and Sharia challenges.

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Glossary of Arabic Terms Which are Used in the Thesis

<i>Amana</i>	Deposits in trust
<i>Aqad</i>	Contract, consisting of all tenets of a contract
<i>Bai Ad-Dayn</i>	Sale of Debt
<i>Bai Inah</i>	2-party Sale (for Cash)
<i>Salam</i>	Trust Sale
<i>Bai Bithaman Ajil</i>	Deferred Payment Sale, over a period of time contract.
<i>Fatwa</i>	Islamic legal discussion
<i>Fiqh</i>	Islamic jurisprudence.
<i>Gharar</i>	Uncertainty, unmitigated risk
<i>Hadith</i>	Sayings of the Prophet Muhammad (pbuh)
<i>Hajj</i>	Pilgrimage to city of Mecca and other holy places. Hajj, the fifth pillar of Islam.
<i>Halal</i>	Permissible
<i>Haram</i>	Unlawful.
<i>Hilah</i>	Trick
<i>Ijara</i>	A leasing agreement
<i>Ijarah Wa Iqtina</i>	Rental with intention to own / gift at end of period (Financial Lease)
<i>Ijarah Thumma Al Bai</i>	Rent with eventual sale (Hire-purchase / Financial Lease)
<i>Ijma'</i>	Consensus of Muslim Jurist
<i>Istisna</i>	Progressive Financing
<i>Manfa'a</i>	The right to use goods
<i>Maysir</i>	Gambling
<i>Mazhab</i>	School of Thoughts
<i>Mudaraba</i>	An Investment partnership.
<i>Mudarib</i>	In a mudaraba contract, the person or party who acts as entrepreneur.
<i>Murabaha</i>	Cost-plus sale (financing)
<i>Musharaka</i>	Partnership, Joint-venture

<i>Muwakkil</i>	Principal (as in Principal Person)
<i>Nahu Sarf</i>	Arabic Grammar
<i>Qard al-hassan</i>	Free Loan
<i>Qard</i>	Loan
<i>Qiyas</i>	Analogy to derive a decision
<i>Rab-al-maal</i>	In a mudaraba contract the person who invests the capital.
<i>Riba</i>	Usury or interest
<i>Salam</i>	Advance payment
<i>Sarf</i>	Exchange (of foreign currency)
<i>Sharia Board</i>	A committee of Islamic scholars available to an Islamic financial institution
<i>Sharia</i>	Islamic law as revealed in the Quran and Sunna
<i>Sukuk</i>	Certificates (Securitized Assets – objectives similar to bonds)
<i>Sunnah</i>	Actions of the Prophet as recorded
<i>Takaful</i>	Islamic insurance.
<i>Wadia</i>	Islamic safekeeping deposit
<i>Waqf</i>	Benevolent Endowment (no human ownership)
<i>Zakat</i>	Islamic tax

Abbreviations and Acronyms

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ATM	Automatic Teller Machine
BIBF	Bahrain Institute of Banking and Finance.
BMA	Bahrain Monetary Agency
BNM	Bank Negara Malaysia
CBB	Central Bank of Bahrain
CBI	Central Bank of Iraq
CBI Law	Central Bank of Iraq Law
CPA	Coalition Provisional Authority
FSA	Financial Services Authorities.
GCC	Gulf Cooperation Council
GDP	Gross Domestic Products
HSBC	Hong Kong and Shanghai Banking Corporation
IBFIM	Islamic Banking and Finance Institute Malaysia
ID	Iraqi Dinar
IDB	Islamic Development Bank
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IIRA	International Islamic Rating Agency
IMF	International Monetary Fund
LMC	Liquidity Management Centre
LR	License Requirements
MENAFATF	Middle East North Africa Financial Action Task Force
OIC	Organisation of Islamic Cooperation
PLS	Profit and Loss Sharing
SAC	Sharia Advisory Council

SSB	Sharia Supervisory Board
UAE	United Arab Emirates
UHD	University of Human Development
UK	United Kingdom
US	United States
USAID	United States Agency for International Development

Chapter One: Introduction to the Thesis

1.1. Background

Islamic banking is one area that has an important role in the current growth of the financial system.¹ Islamic finance is growing 50% faster than commercial banking and is worth £1.3 trillion internationally, reaching an expanding market of over 2 billion people.² Due to legal and Sharia issues, the Islamic banking system in Iraq is not developing as robustly as other countries such as Malaysia and Bahrain.³ Therefore, this thesis attempts to address the problems the country faces, which include legal challenges, such as an incomplete Islamic banking legal framework, and Sharia challenges, such as an ineffective Sharia supervisory system. As part of this thesis, the Malaysian and Bahraini Islamic banking systems are examined and critically analysed.

For the Islamic banking industry to be well-developed and well-managed, there is a need to establish a proper legal framework. Thus, the Islamic banking industry should be regulated by a set of rules and legislations.⁴ These can either be in the form of a special Islamic banking act, such as introduced in Malaysia with the Islamic Financial Services Act 2013 (IFSA 2013) for the regulation of the Islamic financial sector, or as a part of a general banking law, for example in Egypt where there is no separate Islamic banking act.⁵ The purpose of both forms of law is the same, namely the regulation and governance of the Islamic banking industry. However, a separate Islamic banking law is preferable⁶ as this helps the industry to grow faster.⁷ This is

¹ Inwon Song and Carel Oosthuizen, 'Islamic Banking Regulation and Supervision: Survey Results and Challenges' (International Monetary Fund, WP/14/220, 2014) 5 <<http://www.imf.org/external/pubs/ft/wp/2014/wp14220.pdf>> accessed 31 August 2015.

² Foreign & Commonwealth Office, 'UK and Bahrain working together to promote Islamic Finance' <<https://www.gov.uk/government/news/uk-and-bahrain-working-together-to-promote-islamic-finance>> accessed 28 May 2014.

³ Malaysia and Bahrain have advanced Islamic banking systems as they have a comprehensive legal and Sharia framework for their Islamic banking industries.

⁴ Several laws and rules regulate the Islamic banking industry, such as the Islamic Banking Law, Financial Law, Banking Law, Central Bank Law, etc., along with guidelines and instructions for facilitating Islamic banking regulation.

⁵ Dahlia El-Hawarya, Wafik Graish and Zamir Iqbalb, 'Diversity in the regulation of Islamic Financial Institutions' (2006) 46 *The Quarterly Review of Economics and Finance* 778, 788.

⁶ A specific Islamic banking law could regulate the Islamic banking industry better because all articles and sections of the law would only involve Islamic banks. The law could focus on Islamic banking and provide details on all parts of the Islamic banking industry.

⁷ Muhammad Hanif in his article entitled 'Differences and Similarities in Islamic and Conventional Banking' states that 'Two issues at hand demands [sic] attention of policy makers immediately including a separate law of Islamic banking to regulate the industry'. Thus, the author believes that a separate Islamic banking law is important

certainly the reason behind the success of the Malaysian and Bahraini Islamic banking systems.⁸ In fact, providing a holistic legal framework for the regulation and supervision of Islamic banking not only helps the industry grow at a faster rate, but allows it to compete with the conventional banking industry more fairly and effectively.⁹

Therefore, every country requires an authoritative body, with legal power provided by the government, for administering and monitoring Islamic banks and their transactions in order to ensure that these financial institutions abide by the laws. In both practice and theory, this body for most countries is the central bank,¹⁰ which is responsible for monitoring and regulating the entire banking sector by acting as a financial regulator.¹¹

In addition, the existence of Sharia supervisory boards, as a bank's internal religious supervisory body, ensures that all services and transactions conducted by the Islamic banks are Sharia-compliant.¹² The Sharia supervisory board is a unique body that distinguishes Islamic banks from conventional banks.¹³ The board must be independent in order to conduct its responsibilities without any undue outside influences.¹⁴ Furthermore, all activities and operations of the Sharia supervisory board are regulated by the law. Therefore, to ensure strong supervision of Islamic banking institutions, both the bank's Sharia supervisory board and the central bank should act as two responsible bodies. In some countries, such as Malaysia and Bahrain, in addition to individual Sharia supervisory boards in the Islamic banks, there are also central Sharia boards at the level of the central bank. Currently, however, a central Sharia board does not exist in many other countries, such as Iraq.

for the regulation of the Islamic banking industry. Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking' (2011) 2 International Journal of Business and Social Science 166, 173.

⁸ Sohaib Omar, 'Regulatory Clarity Key to Islamic Banking Growth' (World Islamic Banking Competitiveness Report, 2013-14) 23.

⁹ Having a proper legal framework for the Islamic banking industry can manage the relationship between central banks and Islamic banks. In addition, the laws that regulate Islamic banks c also enhance these banks so that they operate in a better way.

¹⁰ Inwon Song and Carel Oosthuizen, 'Islamic Banking Regulation and Supervision: Survey Results and Challenges' (International Monetary Fund, WP/14/220, 2014) 13
<<http://www.imf.org/external/pubs/ft/wp/2014/wp14220.pdf>> accessed 31 August 2015.

¹¹ In other words, central banks have the authority to supervise the entire banking sector. It is the central banks' role to monitor all banks in the country via financial regulators who are experts in banking and finance. However, for the Islamic banks, besides financial regulators, there should be Sharia experts to supervise these banks.

¹² Elmelki Anas and Ben Arab Mounira, 'Ethical Investment and the Social Responsibilities of the Islamic Banks' (2009) 2 International Business Research 123, 127.

¹³ Conventional banks do not have a Sharia supervisory board because religion does not interfere in their operations. On the other hand, a Sharia supervisory board is part of the Islamic banking system, which operates according to Islamic banking principles.

¹⁴ In order for the Sharia supervisory boards of the Islamic banks to be effective, they should consist of qualified scholars who have extensive knowledge in Islamic banking.

The Iraqi Islamic Banking Case

In Iraq, there are nine Islamic banks in the country,¹⁵ and they operate in accordance to Sharia rules. Compared to other countries,¹⁶ the Islamic banking industry in Iraq is relatively new.¹⁷ As a result, current legislation is inadequate for regulating the industry.¹⁸ For example, Iraqi Islamic Banking Law 2015 consists of an incomplete set of rules and regulations. The Banking Law 2015 lacks a number of important elements such as loose licensing conditions of Islamic banks. Furthermore, the current relationship between the Central Bank of Iraq (CBI) and Islamic banks in Iraq is ineffective as it is based on interest (*riba*).¹⁹

The absence of a supportive Sharia framework is another problem in the Iraqi Islamic banking system,²⁰ as is the shortage of qualified Islamic banking experts.²¹ In order for the industry to progress, all problems must be identified and resolved.²²

What Makes the Iraqi Banking System Distinct?

In Iraq, the banking system, particularly Islamic banking, is different from other countries due to the current political instability and security concerns,²³ with many factors in the past painting a negative picture on the country's banking industry. Several years of economic sanctions imposed on Iraq during the 1990s, together with the two Gulf Wars, significantly affected this sector. In addition, after the second Gulf War, many banks faced the problem of looting,²⁴ especially the two largest government banks – the Rashid and Rafidain Banks. The second Gulf War negatively impacted the banking sector's reputation in Iraq and, in fact, still does, as the majority of Iraqis do not have confidence in the banks and thus do not make deposits with them.

¹⁵ Iraqi Islamic Bank, 'About us' <<http://www.iraqiislamicb.com/IIB%20English/aboutus-eng.html>> accessed 24 January 2016.

¹⁶ Malaysia and Bahrain as two examples.

¹⁷ Islamic banking operations started in 1993 when the first Islamic bank was established by the Iraqi government.

¹⁸ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 38.

¹⁹ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 351 (as translated from the original Arabic text by the author).

²⁰ There is no central Sharia board in Iraq for dealing with Sharia issues of the Islamic banking industry. Thus, each Islamic bank has its own Sharia supervisory board but these suffer from a lack of qualified scholars.

²¹ Sahar Nasr, 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North Africa Region, 2010) 24.

²² See Chapter Three on the Iraqi Islamic banking system.

²³ In June 2014, the Islamic State in Iraq and Syria (ISIS) gained control of Mosul, the second largest city in Iraq after Baghdad. At present, the city remains under ISIS control and the Iraqi army is still fighting with this group in order to regain control of Mosul and other cities. See: BBC News, 'How can militants take over Iraqi cities?' <<http://www.bbc.co.uk/news/world-middle-east-25588623>> accessed 18 June 2014.

²⁴ US & Foreign Commercial Service, 'Doing Business in Iraq, Country Commercial guide for U.S. Companies' 51 <http://www.trade.gov/iraq/build/groups/public/@tg_iqtf/documents/webcontent/tg_iqtf_003872.pdf> accessed 9 June 2014.

The most prominent function of banks in Iraq is to act as a conduit for government offices. In other words, they work as middlemen between the people and the government offices where financial transactions are concerned. In 2004, the Banking Law 2004 was introduced for the regulation of conventional banks and is considered an important achievement in the banking sector. The Banking Law 2004 has, to some extent, enhanced the banking industry and rebuilt the banking system. It has created a good environment for conventional banks to grow properly and has helped the CBI to better and more closely regulate the sector. Currently, the general state of the Islamic banking industry has improved especially with the enactment of the Islamic Banking Law 2015. However, there are still some shortcomings with the law, such as the lack of detailed conditions and requirements for licensing Islamic banks.²⁵

The regulatory system for the Iraqi Islamic banking industry is based on the same system as that of the conventional banking sector.²⁶ Therefore, the CBI is the sole regulator for the banking sector with both Islamic and conventional banks being regulated and supervised by the CBI. However, the CBI does not have sufficient qualified experts who understand the Islamic banking sector as well as conventional banks.²⁷ Currently, conventional banks in Iraq are better organised than Islamic banks because the current banking regime is more suitable for this type of bank, as the CBI Law 2004 and Banking Law 2004 are designed for conventional banks. As compared to other countries, the Islamic banking system in Iraq is very weak.²⁸ Thus, the Islamic banking framework should be reformed in order to achieve a level where it is able to attract more clients and depositors who wish to invest in accordance to Sharia principles. This is particularly important as 99% of Iraqis are Muslims.²⁹

Using Malaysia and Bahrain as Case Studies

In order to build a proper Islamic banking system in Iraq, the country's Islamic banking situation is evaluated and its weaknesses addressed.³⁰ This research uses Bahrain and Malaysia

²⁵ The Iraqi Islamic Banking Law consists of 16 Articles only, which is insufficient to regulate the Islamic banking industry. In addition, the law lacks many important principles, such as licensing conditions and requirements.

²⁶ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 38.

²⁷ Sahar Nasr, 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North Africa Region, 2010) 24, see also the Interview with Hashm Ahmed, University Lecturer, Soran University (Soran, May 2015). He states that the CBI does not have Islamic banking experts, and thus, he recommends establishing an Islamic banking department in the CBI.

²⁸ For example, Gulf countries, Malaysia, Pakistan and Turkey.

²⁹ CIA, 'Iraq' (The World Factbook) <<https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html>> accessed 2 September 2016.

³⁰ See Chapter Three of this thesis.

as case studies³¹ as these countries are two models that Iraq can emulate in reforming its Islamic banking system. In fact, there are many reasons for choosing Malaysia and Bahrain. Malaysia, with its long history of conducting Islamic banking transactions, has also been established as one of the most advanced Islamic banking systems in the world. Malaysia follows a dual banking system where both conventional and Islamic banks operate side by side without many problems. In addition, most of the articles and books that are written on the Malaysian Islamic banking industry are in English that will assist in writing this thesis. Furthermore, it is also one of the countries that has a central Sharia board in the central bank. Finally, Malaysia has strong legislations with the establishment of the Islamic Financial Services Act 2013 for regulating the Islamic banking industry.

Bahrain is chosen because it is an international centre for Islamic finance and it has played an important role in developing the Islamic banking system. Similar to Malaysia, Bahrain too has a set of regulations for governing the Islamic banking industry. In addition, it is also an Arab state which shares a resembling social structure with Iraq in the sense that their populations include both Sunnis and Shias. Furthermore, Bahrain is the host location for several organisations and centres that regulate the Islamic banking industry, such as the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).³² In general, Malaysia and Bahrain are appropriate models because they have a long history of Islamic banking.³³ Furthermore, they have a proper legal framework for their Islamic banking systems.

Thus, this thesis examines the current challenges that are being faced by the Islamic banking industry in Iraq, which involves legal and Sharia issues, and propose solutions to these problems by analysing the steps adopted by Malaysia and Bahrain. It is worth mentioning that the evaluation of the Iraqi Islamic banking situation is not possible without observing the Islamic banking systems of other countries.³⁴ In light of these countries' experiences, models, regulatory framework and supervisory systems, the weaknesses of the Iraqi regulation system can be identified. Consequently, a proper Islamic banking system for Iraq can be proposed.

³¹ The Islamic banking systems of other countries, such as Pakistan, will also be examined in this thesis when relevant elements from their systems are found.

³² Shamsalden Aziz Salh, 'Impact of the Islamic banking System of Bahrain on the OIC Countries' (2nd Internal Conference on Islamic Economics & Economies of the OIC Countries, Kuala Lumpur January 2013).

³³ Malaysian Islamic banking system dates back to 1983 while Bahraini Islamic banking system dates back to 1979.

³⁴ Therefore, in this research, legal and Sharia aspects of the Islamic banking industry in Iraq will be critically evaluated in comparison to the Islamic banking systems of Malaysia and Bahrain.

1.2. Research Issues

Islamic banking in its contemporary form is considered a new manifestation, which has many problems both legal and Sharia.³⁵ As an important financial sector, all aspects of Islamic banking should be supervised and regulated efficiently and prudently.³⁶ Due to the absence of a comprehensive legal and Sharia framework for the Islamic banking industry in Iraq, a number of challenges are faced. More importantly, these issues must be clearly identified before they can be addressed. Problems are particularly evident in Iraq, whose Islamic banking system is undeveloped as compared to that of other countries, especially neighbouring ones.³⁷

The challenges that hamper Islamic banking development in Iraq are affecting the economy of the country. Some of the challenges are faced by many Islamic banks in the world while some are specific to Iraq.³⁸ After carefully analysing primary and secondary sources, this author posits that the Iraqi Islamic banking system has a number of problems.

The first is the lack of a comprehensive legal framework and an effective law for the Islamic banking industry.³⁹ A proper legal framework is necessary for the regulation of Islamic banking operations and activities due to the difficulties of the Islamic banking institutions to operate without a practical framework. In that context, the Iraqi Islamic Banking Law 2015 is incomplete and ineffective because many important elements are not addressed in the Law.⁴⁰ Furthermore, improper relationship between the CBI and Islamic banks is also a challenge⁴¹ for the Islamic banking industry.⁴² This inappropriateness derives from the fact that the CBI deals with Islamic banks on an interest-based relationship which is not allowed under Sharia

³⁵ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 38. See also: Interview with Bashir Hadad, Sharia supervisory board member, Cihan Islamic Bank (Erbil, May 2015).

³⁶ There should be rules and regulations for governing the sector. In addition, experts who understand the banking business are also needed for running the sector.

³⁷ The Islamic banking systems of countries like Bahrain and Saudi Arabia are more developed than those of Iraq as these countries have a number of Islamic banking experts and proper Islamic banking legal framework.

³⁸ Ineffective Sharia supervision is a specific issue to Iraq while the shortage of Islamic banking experts is a general issue for most Islamic banks in the world.

³⁹ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 38. See also: Interview with Hashm Ahmed, University Lecturer, Soran University (Soran, May 2015).

⁴⁰ See Chapter Four of this thesis for more detail about Iraqi Islamic Banking Law 2015 and its issues.

⁴¹ Tania Qadir Abdulrahman and Mustaq Mahmud Al-Sabaawi, 'Evaluating The Performance Of Islamic Banks By Using Financial Analysis Composite Comparative study of the Iraqi Islamic Bank Performance with the Jordan Islamic Bank for the Period (2000–2008)' (2011) 1 *Journal of Kirkuk University For Administrative and Economic Sciences* 152, 161 (translated from the original Arabic text by the author). See also: Interview with Abdulla Hama, University Lecturer, University of Sulaymaniyah (Erbil, June 2015).

⁴² The legal issues and challenges of the Iraqi Islamic banking system will be discussed in detail in Chapter Four of this thesis.

law. For example, in the case of liquidity crises, the CBI, which acts as the lender of last resort, provides loans to Islamic banks based on interest which is religiously impermissible.

Another problem is the weakness of Sharia regulation and supervision of the Iraqi Islamic banking system. Internal Sharia supervisory boards are not only ineffective,⁴³ but also experience a shortage of qualified Sharia scholars who can be appointed as members of these boards.⁴⁴ In addition, the absence of a central Sharia board as a means of external Sharia supervision for Islamic banking transactions pose another impediment. Such a board could operate as part of the CBI or as a separate body.⁴⁵ A central Sharia board could cover all national Sharia matters related to the Islamic financial sector and would boost confidence in Islamic banking, especially among shareholders, clients and depositors.⁴⁶

Inexperienced staff is considered another main challenge for the Iraqi Islamic banks.⁴⁷ Experts are needed to serve Islamic banking institutions both as members of their Sharia boards and also as employees and managers.⁴⁸ With the identification of numerous challenges faced by the Iraqi Islamic banking system, it can be concluded that this system should be reformed and rebuilt. All the aforementioned challenges will be discussed in this thesis together with some sub-challenges.⁴⁹

Thesis Statement

This thesis critically evaluates the Islamic banking system in Iraq to find solutions to those challenges being faced by this system. After all the challenges have been identified, an attempt will be made to resolve them with assistance from the Islamic banking systems of other countries. Malaysia and Bahrain have been chosen as case studies given their successes in the area. Therefore, it is hypothesised that an effective Islamic banking practice and legal

⁴³ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 361 (translated from the original Arabic text by the author).

⁴⁴ Sahar Nasr 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North Africa Region, 2010) 24. See also: Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank (Erbil, May 2015).

⁴⁵ See Chapter Five for details on Sharia regulation and supervision of the Iraqi Islamic banking system.

⁴⁶ Due to the fact that people in Iraq do not have confidence in Islamic banks, the central Sharia board can bolster the people's support that Islamic banks follow Sharia rules in their transactions as it will monitor Islamic banks and their Sharia supervisory boards to ensure that their activities are in compliance with Sharia principles.

⁴⁷ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 38. See also: Interview with Hashm Ahmed, University Lecturer, Soran University (Soran, May 2015). See also: Sahar Nasr 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North Africa Region, 2010) 24.

⁴⁸ The human capital resource issues in Iraq will be critically evaluated in Chapter Six of this research.

⁴⁹ There are a number of other Iraqi Islamic banking problems, such as shortage of clients, the lack of a special department in the CBI for Islamic banking, political and security issues, and the relationship between the CBI and Islamic banks.

framework for Iraq can draw inspiration from elements of both the Malaysian and Bahraini Islamic banking systems.

1.3. Research Questions

The current research aims to examine the Islamic banking system in Iraq with particular focus on its legal framework, resources and operations by using the case studies of Malaysia and Bahrain. To accomplish these goals, the following specific research questions have been formulated:

- 1- How are Islamic banks governed and regulated in Iraq, and what are the weaknesses in the Iraqi Islamic banking system?⁵⁰
- 2- What are the legal shortcomings in Iraq's Islamic banking system, and how should they be resolved in light of other countries' experiences, particularly Malaysia and Bahrain?⁵¹
- 3- What are the principal Sharia regulatory and supervisory problems affecting the Iraqi Islamic banking system, and how can they be resolved, by using examples from other countries?⁵²
- 4- What are the human resource issues that negatively impact the Iraqi Islamic banking system, and how can they be resolved as accomplished by other countries' Islamic banking systems?⁵³

1.4. Research Objectives

The research will focus on the Islamic banking system in Iraq, covering both legal and Sharia aspects, and will evaluate the Iraqi Islamic banking system by using the case studies of the Bahraini and Malaysian Islamic banking systems. The specific objectives are the following:

- 1- To examine the Islamic banking systems of Bahrain and Malaysia in order to identify and determine the weaknesses and strengths of each country.
- 2- To critically evaluate the Islamic banking system of Iraq by using the Bahraini and Malaysian Islamic banking systems as models, with eventual applications of elements from these systems that could benefit a country with a nascent Islamic banking industry.

⁵⁰ See Chapter Three of this thesis.

⁵¹ See Chapter Four of this thesis.

⁵² See Chapter Five of this thesis.

⁵³ See Chapter Six of this thesis.

- 3- To provide useful legal information to Islamic banking regulators in the CBI to assist them in building a stronger Islamic banking system in the country.
- 4- To provide recommendations and suggestions to Islamic bankers in Iraq in hopes of improving the current Islamic banking system to enhance its effectiveness and overall structure.

1.5. Literature Review

Many authors have researched and discussed the legal and Sharia aspects of the Islamic banking industry from various angles and using a variety of case studies. This literature review expands on the thesis' main themes. Therefore, it is divided into four parts: challenges facing the Iraqi Islamic banking system, legal aspects of the Islamic banking industry, Sharia supervision of the Islamic banking industry and shortage of Islamic banking experts.

1- Challenges Facing the Iraqi Islamic Banking System

In order to find possible solutions to the issues present in the Islamic banking industry of Iraq, there is a need to identify these issues first. Since Islamic banking is relatively new in Iraq, there are very few published materials on the country's Islamic banking system. The paucity of research and academic literature on the Iraqi banking system, especially the Islamic banking industry, can be attributed to the shortage of professionals and academics who understand Islamic banks in Iraq, and also to the current nature of Islamic banking in the country. In the following paragraphs, the challenges facing the Iraqi Islamic banking industry are presented in the chronological order of publication dates.

According to the secondary data and sources, the Islamic banking industry of Iraq has both legal and Sharia problems. This is confirmed by the 2011 World Bank review of the financial sector in Iraq in which Nasr⁵⁴ mentions that the Iraqi Islamic banking industry has two main issues: a lack of an effective legal framework and a shortage of qualified Islamic banking experts.

Furthermore, in an interview with the Al-esbuyia newspaper,⁵⁵ Dr. Sadiq Ashmary, the manager of the National Iraqi Islamic Bank, stated that the Iraqi Islamic banking industry is lacking in Islamic banking laws. The absence of an Islamic banking legal framework in Iraq is

⁵⁴ Sahar Nasr, 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North Africa Region, 2010) 24, 42-43.

⁵⁵ Sadiq Ashmary, 'Asking for Islamic Banking Law' *Alesbuyia Newspaper* (2011) <<http://www.alesbuyia.com>> accessed 20 March 2012.

also mentioned by Matlub⁵⁶ who emphasizes that the Iraqi Banking Law 2004 does not refer to Islamic banks at all.

In addition, Hamoudi⁵⁷ expands on the issue of Islamic banking experts in Iraqi Islamic banks. The author confirms that a lack of qualified Islamic banking experts in Iraq is one of the problems surrounding Islamic banks in the country. Therefore, Islamic banks depend on conventional banking staff who are not experienced in Islamic banking transactions. Furthermore, he confirms that current laws and regulations are not suitable for regulating Islamic banks in Iraq.

Jawad⁵⁸ states that the Iraqi banking industry faces legal problems as Islamic banks have to operate under the Banking Law 2004 which is designed for conventional banks. The author also mentions that the absence of a special Islamic Banking Department could be considered an issue for Islamic banks in Iraq. Jawad also notes that the relationship between the CBI and Islamic banks is based on interest, which is not allowed under Sharia rules.

Iraqi Islamic banking legal issues are also discussed by Muhammad⁵⁹ who confirms that the lack of a specific Islamic banking law is considered an obstacle for these banks. He examines a number of Sharia issues as well, such as ineffective Sharia supervision, lack of Sharia scholars at the CBI and a shortage of Islamic banking experts. Furthermore, Muhammad also explains that Islamic banks in Iraq cannot accept help from the CBI during liquidity crises due to the fact that the CBI deals with interest. The author mentions another issue faced by the Islamic banks in Iraq, which is that people are ill-informed of Islamic banking and their products and operations even though Islamic banks conduct 25% of activities of private banks.

From the above-mentioned literature on the Islamic banking system of Iraq, it can be summarised that the Iraqi Islamic banking industry has both legal and Sharia problems. The two serious issues for Islamic banks in Iraq are the lack of a comprehensive legal framework and the shortage of qualified experts with expert knowledge of the Islamic banking field. Thus,

⁵⁶ Mustafa Natiq Salih Matlub, 'Obstacles to the Work of the Islamic Banks and Ways of Curing Them for Development' (2012) *Research and Islamic Studies Magazine* 287, 294 (translated from the original Arabic text by the author).

⁵⁷ Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 *Tikrit Journal for Administration and Economic Science* 251, 260.

⁵⁸ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 38.

⁵⁹ Saad Abd Muhammad, 'The Relationship between the Central Bank and Islamic Banks' (2014) 40 *Baghdad College for Economic Science* 349, 355-361 (translated from the original Arabic text by the author).

Sharia supervision of the Iraqi Islamic banking industry will be affected due to insufficient qualified Sharia scholars in individual Sharia supervisory boards of each Islamic bank.

2- Legal Aspects of the Islamic Banking Industry

Legal aspects of the Islamic banking system present a number of problems. These problems can be divided into two, which are the lack of a comprehensive Islamic banking legal system and the absence of a separate legal Islamic banking framework.

Lack of a Comprehensive Islamic Banking Legal System

It is evident that with no comprehensive Islamic banking system in place, Islamic banks can only follow the conventional banking system. In that regard, the banking, central bank and tax laws, which are enacted to regulate the commercial banking sector, are applied to Islamic banks despite possibly being irrelevant.

Therefore, Iqbal, Ahmad and Khan⁶⁰ explain that it is important for the Islamic banking industry to have a comprehensive regulatory and supervisory system. They conclude that treating Islamic banks the same way as conventional banks is unfair and represents a substantial legal problem for Islamic banks. The laws, which outline the regulation and supervision of Islamic banks by a central bank or any other authoritative body, are unrelated to Islamic banks and only suitable for conventional banks. This is because the commercial activities of Islamic banks are different from conventional banks in that an Islamic bank is an interest-free bank whereas a conventional bank is interest-based.

Errico and Farhbaksh⁶¹ also focus on the legal system. They state that the supervision of Islamic banks should be regulated by the law and argue that it is essential for Islamic banks to have laws and regulations for governing their operations, which should determine the nature and operation of such banks and also regulate the relationship between the central bank and Islamic banks. According to the authors, any legal framework must clearly define the remit and conduct of an Islamic bank and the most important issue is specifying the body responsible for

⁶⁰ Munawar Iqbal, Ausaf Ahmad and Tariqullah Khan, 'Challenges Facing Islamic Banking' (Islamic Development Bank occasional paper 1, 1998) 36 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 23 October 2016.

⁶¹ Luca Errico and Mitra Farhbaksh, 'Islamic Banking: Issues in Prudential Regulations and Supervisions' (International Monetary Fund 98/30, 1998) 19 <<http://www.imf.org/external/pubs/ft/wp/wp9830.pdf>> accessed 24 October 2016.

supervising these Islamic banks. Similar to Errico and Farhbaksh, Holden⁶² calls for a specific Islamic banking law for the regulation of Islamic banks and to manage their activities.

Emphasizing the legal issues of the Islamic banking industry too, Nia'ma and Najim⁶³ outline some of the challenges faced by Islamic banks. The authors argue that the lack of a comprehensive regulatory system is one of the main problems in the Islamic banking industry, and thus, Islamic banks have to operate under conventional laws and regulations in some countries. Therefore, the authors believe that enacting an Islamic banking law for the regulation of Islamic banks is necessary.

Abdulrahman and Al-sabaawi⁶⁴ illustrate some of the challenges faced by Islamic banks. The authors emphasize that the relationship between the central bank and Islamic banks is a problematic issue. If the central bank is called upon as a lender of last resort, it will deal with Islamic banks in terms of interest, which is prohibited under Sharia law. Therefore, this relationship is another legal problem in the Islamic banking industry.

Absence of a Separate Legal Islamic Banking Framework.

Due to the fact that Islamic banking is different from conventional banking, separate Islamic banking legal framework is necessary for the industry. Thus, the lack of this legal framework is an issue in the Islamic banking industry. By establishing this framework, it would enhance the development of the Islamic banking industry.⁶⁵ Alshamrani⁶⁶ states that the Central Bank of Bahrain (CBB) issued a second volume of the Rulebook containing guidelines on the regulation of Islamic banks.⁶⁷ Thus, in Bahrain, there is a separate piece of legislation for

⁶² Kelly Holden, 'Islamic Finance: Moot Point, Problematic Future Bigger Concern' (2007) 25 Boston University International Law Journal 341, 362.

⁶³ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 2 Journal of Qadisiah for Management and Economic Science (translated from the original Arabic text by the author).

⁶⁴ Tania Qadir Abdulrahman and Mustaq Mahmud Al-sabaawi, 'Evaluating the Performance of Islamic Banks by Using Financial Analysis Composite Comparative Study of the Iraqi Islamic Bank Performance with the Jordan Islamic Bank for the Period (2000-2008)' (2011) 1 Journal of Kirkuk University For Administrative and Economic Sciences 161 (translated from the original Arabic text by the author).

⁶⁵ Sohaib Omar, 'Regulatory Clarity Key to Islamic Banking Growth' (World Islamic Banking Competitiveness Report 2013-14) 23.

⁶⁶ Ali Alshamrani, 'A Critical Evaluation of the Regulatory Framework for the Application of Islamic Financial Derivatives in the Kingdom of Saudi Arabia' (2014) 2 Journal of Islamic Banking and Finance 269.

⁶⁷ 'The government adopted a set of industry-specific regulations in 2001. Issued in 2005, Volume 2- Islamic Banks of the CBB Rulebook provides a comprehensive regulatory framework for Islamic financial institutions in Bahrain'. See: Bahrain, 'Economic Development Board' <<http://www.bahrainedb.com/en/EDBDocuments/Bahrain-Economic-Yearbook.pdf>> accessed 12 August 2016.

regulating the Islamic banking industry. Baba⁶⁸ too makes the same point about this separate volume.

However, in other countries like Kuwait, Islamic banks are already mentioned in their legislation; therefore, no separate Islamic banking laws are necessary. In contrast, Malaysia has a separate legislation for governing its Islamic financial sector including the banking industry, namely the Islamic Banking Act 1983.⁶⁹ Furthermore, Radzi and Muhamed⁷⁰ state that in Malaysia there are four statutes for governing Islamic banking institutions and takaful industries, which are the Central Bank of Malaysia Act 2009, the Islamic Banking Act 1983, the Takaful Act 1984 and the Banking and Financial Institutions Act 1989. Thus, every country has different types of regulation for their Islamic banking sector.

According to Iqbal, Ahmad and Khan, Errico and Farhbaksh, Nia'ma and Najim, Abdulrahman and Al-sabaawi, Alshamrani, and Radzi and Muhamed, a proper legal framework is necessary for regulating and governing the Islamic banking industry. Thus, the lack of a suitable Islamic banking legal framework could negatively impact the industry. The absence of the Islamic banking law and the treatment of Islamic banks by the central banks the same way as conventional banks is a serious problem for the Islamic banking industry in Iraq.

3- Sharia Supervision of the Islamic Banking Industry

The supervision of Sharia practices in the Islamic banking industry is another critical issue. Islamic banks have their Sharia supervisory boards for monitoring the transactions and activities that occur in order to ensure that those activities are Sharia-compliant. However, some countries, such as Malaysia and Bahrain, have Sharia supervisory boards in the Islamic banks as well as a central Sharia board in the central bank. Nevertheless, there are a number of issues relating to this industry's Sharia supervision which are faced by Islamic banks, such as ineffective Sharia supervision.

Sharia supervision of Islamic banks can be divided into two categories: Internal and external Sharia supervision.

⁶⁸ Ricardo Baba, 'Islamic Financial Centres' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (1st edn, Edward Elgar 2007) 384-391.

⁶⁹ In fact, in Malaysia, the Islamic Banking Act 1983 was superseded by the IFSA 2013, which replaced both the Islamic Banking Act 1983 and the Takaful Act 1984.

⁷⁰ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on Shariah Governance Supervision of Sukuk Defaults' (2012) 8 *Journal of Islamic Economics, Banking and Finance* 20, 27-28.

Internal Sharia Supervision of the Islamic Banking Industry

Internal Sharia supervision is carried out by Sharia supervisory boards of the Islamic banks with each bank commonly having its own board. Iqbal, Ahmad and Khan⁷¹ describe the roles of both central banks and Sharia supervisory boards in administering the Islamic banks. They claim that the supervision is inadequate because of problems relating to the efficacy of roles played by both the central bank and the Sharia supervisory boards. The article also discusses the issue of inconsistencies between the Sharia boards of each Islamic bank. Having different boards is a problem for these institutions since each board can take a different view on the same product. Therefore, this is considered a Sharia issue in the Islamic banking industry.

The role of the internal Sharia supervisory board is also expounded by Hasan.⁷² He describes the roles and responsibilities of the Sharia committees of Islamic financial institutions in Malaysia, noting that the decisions made by the Sharia committee cannot be subsequently overruled by the board of directors. One of the roles of the committee is to advise its respective Islamic financial institutions on any Sharia-related issues; therefore, the members of the committee should be knowledgeable in Islamic financial law. Furthermore, the role of the central bank, Bank Negara Malaysia (BNM), with its regulation of the individual Sharia boards is also mentioned. Hence, the central bank guides the Sharia committees via a set of guidelines.

Holden⁷³ looks at the limitations of the Sharia supervisory board and determines that there is a need for better regulation and supervision of Islamic banks. Each Islamic bank has its own Sharia supervisory board and each of these boards may have a different view on the same transaction. As a result, there can be conflict between these boards, which may cause customer confusion and a decreased level of confidence in Islamic banks. For example, some of these boards are more lenient while others are stricter.⁷⁴

⁷¹ Munawar Iqbal, Ausaf Ahmad and Tariquillah Khan, 'Challenges Facing Islamic Banking' (Islamic Development Banks occasional paper 1, 1998) 36 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 23 October 2016.

⁷² Zulkifli Hasan, 'The Roles and Responsibilities of the Shariah Committee of Islamic Financial Institutions in Malaysia' (2006) 14 *Jurnal Syariah* 77, 78-80.

⁷³ Kelly Holden, 'Islamic Finance: Moot Point, Problematic Future Bigger Concern' (2007) 25 *Boston University International Law Journal* 341, 362.

⁷⁴ Due to the different interpretations of the Sharia texts by scholars, their decisions on Islamic banking transactions and products could be different. In such cases, the central Sharia board could resolve this problem by standardising decisions made by different Sharia supervisory boards of different Islamic banks in a country.

Saffiddine⁷⁵ also highlights the executive role of the Sharia supervisory board on the compatibility of Islamic banking transactions with Islamic law. The author explains the functions and structure of the board, noting that the independence of the board is key to the success of Islamic banking operations. This will attract customers as the board's existence helps increase their assurance of the bank's integrity. In addition, he points out that members of the Sharia supervisory board should not only have knowledge about Sharia law but also finance and economics.⁷⁶ This is because scarce knowledge in both fields together with a lack of independence are issues facing Sharia supervisory boards in Islamic banks.

External Sharia Supervision of the Islamic Banking Industry

External Sharia supervision is conducted by a central Sharia board which can be found in a country such as Malaysia; this board is part of the BNM. Garas and Pierce⁷⁷ mention that the Sharia supervision is one of the key principles of the Islamic banking system. They explain that Sharia supervision of the Islamic banking industry has two levels, internal and external, and that there is a role for Sharia supervision in legal, economic and religious aspects, which gives confidence to stakeholders in these financial institutions. The authors also explain different types of Sharia supervision, namely micro and macro level supervisions.⁷⁸ The benefits of Sharia supervision are also clearly explained by clarifying the objectives and functions of these bodies. In all cases, members of Sharia supervisory boards should be qualified experts.

Saeed and Saeed⁷⁹ emphasize the external Sharia supervision of the Islamic banking industry. In their article, they explain several principles related to external Sharia supervision of Islamic banks such as the role of scholars in issuing a fatwa, which is a central duty of the Sharia board. Thus, the importance of the external Sharia supervisory board and scholars is the main focus

⁷⁵ Aseem Saffiddine, 'Islamic Financial Institutions and Corporate Governance: New Insight for Agency Theory' (2009) 17 *Corporate Governance: An International Review* 152.

⁷⁶ Expert knowledge in Sharia, finance and legal aspects of Islamic banking transactions should be the criteria for being a Sharia supervisory board members. Members of the Sharia supervisory boards of Islamic banks should have knowledge in many areas in order to be considered qualified scholars.

⁷⁷ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 386.

⁷⁸ The external level of Sharia supervision is vital for the Islamic banking industry. Lack of a central Sharia board for supervision of the Islamic banking industry in Iraq is one of the main issues in the Iraqi system.

⁷⁹ Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements for Activating Legitimate External Control in Islamic Banks' (2013) 9 *Tikrit Journal for Administration and Economic Science* 256, 260 (translated from the original Arabic text by the author).

of this article. However, most Sharia supervisory board members are not qualified to issue fatwas, contributing to another Sharia issue for Islamic banks.⁸⁰

Aldohni⁸¹ also discusses Sharia supervision of Islamic banks, stating that Malaysia has strong and proper Sharia supervision. Islamic banks have an additional method of supervision which deals with Sharia-related issues. He mentions that the Sharia supervisory board is a main player in overseeing aspects of the Islamic banking transactions. The board's main role is to ensure that all services and transactions conform to Sharia principles. Moreover, the author explains the role of the central Sharia body, which in Malaysia is the Shariah Advisory Council (SAC), in the supervision of Islamic banks. He states the importance of the guidelines for establishing Sharia supervisory boards in Malaysia which were issued by the BNM in 2004. These guidelines determine the duties, roles, functions and responsibilities of the Sharia supervisory boards in Malaysia. In addition, they also manage the relationship between Sharia supervisory boards with the SAC being the highest Sharia authoritative body in the country. This article is particularly important as it underlines the crucial roles of the SAC and emphasizes the requirement for the central Sharia board. In addition, the importance of, and need for, Sharia supervision of Islamic banks is noted.

For their part, Hasan and Asutay⁸² illustrate the role of the central Sharia board in court cases related to Islamic banking in Malaysia. They divide the civil court's decisions into two periods: the first period until 2008, a time when the court made decisions without referring to the SAC; the second from 2008 onwards, when the court started to refer to the SAC in determining the verdicts on matters related to Sharia issues. The authors indicate that, to some extent, the judges of the civil court do not have sufficient knowledge of Islamic banking issues to deal successfully with Sharia matters. Therefore, such cases require referral to the SAC, which has been made mandatory by the civil court in accordance to the Central Bank Act 2009.

Similarly, Islamic banks in many countries have judicial problems if there are no special Sharia courts for resolving Islamic banking cases. Furthermore, civil courts do not refer to the central Sharia boards or, in some countries, there is no central Sharia board.

⁸⁰ In the case of non-qualified scholars of the sharia supervisory board wanting to issue fatwas, there is a need to depend on outside bodies for fatwas on new products. Thus, it would be better for scholars who are appointed as members of the Sharia supervisory boards of Islamic banks to be qualified themselves to issue fatwas.

⁸¹ Abdul Karim Aldohni 'Islamic Banking Challenges Modern Corporate Governance: The Dilemma of the Sharia Supervisory Board' (2008) 29 *Company Lawyer* 156.

⁸² Zulkifli Hasan and Mehmet Asutay, 'An Analysis of the Courts' Decisions on Islamic Finance Disputes' (2011) 3 *ISRA International Journal of Islamic Finance* 41, 49-53.

In addition, Radzi and Muhamed⁸³ discuss Sharia governance in the form of individual Sharia supervisory boards and also the central Sharia supervisory council. In Malaysia, the SAC acts as a central Sharia supervisory board with a remit that includes acting as an authority in the civil court. Yaacob⁸⁴ further explains the role of the SAC in civil court matters and provides cases as examples, including ones where the court decided that referring to the SAC was unnecessary.

According to the above literatures, Sharia regulations and supervision of the Islamic banking industry significantly impact transactions and activities pertaining to Islamic banking. The absence of a central Sharia board in some countries and ineffective Sharia supervisory boards of individual Islamic banks are two of the main problems in the Islamic banking industry. The opinions of the Sharia supervisory boards of various Islamic banks is also a problematic issue because in some cases they have different views on the same product. Therefore, there are still some concerns related to the Sharia regulations and supervision of the Islamic banking industry at both internal and external levels. For the Islamic banking industry to have a strong Sharia supervisory system, there should be both internal and external Sharia supervisions. Thus, a Sharia supervisory board and central Sharia board should be established.

4- Shortage of Qualified Islamic Banking Expertise in the Islamic Banking Industry

The Islamic banking industry has a shortage of qualified Islamic banking staffs and Sharia scholars. For the Islamic banking industry to be managed properly, it is necessary to have qualified Islamic banking experts. It is also essential to have experienced Sharia scholars for the individual Sharia supervisory boards of the Islamic banks. In addition, the managers and employees who work in the Islamic banks should have in-depth knowledge and vast experiences in Islamic banking transactions. Therefore, better human resources is needed for the Islamic banking industry.

Shortage of Qualified Islamic Banking Staff Members

Islamic banks need staff members such as managers, regulators and employees for managing their operations. Karbhari, Naser and Shahin⁸⁵ state that Islamic banks' regulations and

⁸³ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on Shariah Governance Supervision of Sukuk Defaults' (2012) 8 Journal of Islamic Economics, Banking and Finance 20, 27-28.

⁸⁴ Hakimah Yaacob, 'The Role of the Shariah Advisory Council (The SAC) In Governing Islamic Financial Matters: An Evaluation of The Central Bank of Malaysia Act 2009' (2012) 27 Journal of International Banking Law and Regulation 222.

⁸⁵ Yusuf Karbhari, Kamal Naser and Zerrin Sahhin, 'Problems and Challenges facing the Islamic Banking System in the West: The Case of the UK' (2004) 46 Thunderbird International Business Review 521, 524.

supervision are simply not as rigorous as those for conventional banks. The reason for this, they argue, is that the regulators do not fully understand the operations and structure of Islamic banks. Therefore, in this case, a central Sharia board in the central bank is necessary. Furthermore, far greater numbers of qualified Islamic banking managers, regulators and staff members are also needed. Therefore, this article identifies that the shortage of Islamic banking experts in the central bank should be considered a concern for the Islamic banking system.

This problem is also explored by Iqbal and Molyneux.⁸⁶ These authors believe that most of the employees that work in Islamic banking institutions come from a commercial banking background. In addition, there are only a few trained employees and managers, some of whom have little or no specific training in Islamic banking operations. At present, Islamic banks are in great need of experts and managers who understand both Islamic and conventional banking systems. Thus, these represent further unresolved challenges and difficulties in need of attention in order to establish a new legal framework for Islamic banking. All Islamic banks require a sufficient number of experts, ranging from scholars, economists and lawyers, to employees and risk analysts, to support such developments.⁸⁷ In that context, Hassan and Lewis⁸⁸ mention several factors that resulted in the vital role currently undertaken by Bahrain with regards to Islamic finance. One of these factors is that Bahrain has a large number of experts, both local and foreign, to efficiently run the Islamic banking industry, including regulators, managers and employees. According to the CBB 2009 annual report, the CBB has provided training courses for a significant number of employees in the areas of conventional and Islamic banking, insurance, management and computer skills.

Moreover, Nia'ma and Najim,⁸⁹ and similarly Awawdeh,⁹⁰ mention that the shortage of qualified experts is considered a serious issue for the Islamic banks as they suffer from a paucity of qualified Islamic banking experts. These authors suggest that enacting an Islamic banking law is necessary in order for Islamic banks to develop. Furthermore, they suggest that attending training courses should be a requirement for staff members of Islamic banks. Finally, the

⁸⁶ M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and Prospects* (1st edn, Palgrave Macmillan 2005) 121.

⁸⁷ The lack of qualified Islamic banking experts in Iraq is the main issue for this system. Therefore, this article supports the idea that it is important for experts to run Islamic banking business.

⁸⁸ Ricardo Baba, 'Islamic Financial Centres' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (1st edn, Edward Elgar 2007) 384-391.

⁸⁹ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 2 *Journal of Qadisiah for Management and Economic Science* (translated from the original Arabic text by the author).

⁹⁰ Aladin Awawdeh, *Islamic Banking for Development, Principles, Concepts, Methods* (1st edn, Lap Lambert 2011) 124.

authors consider that the weak relationships between Sharia supervisory boards of Islamic banks with their respective banks are an issue for the Islamic banking industry.

Shortage of Qualified Sharia Scholars for Sharia Supervisory Boards

It is necessary to have qualified Sharia scholars for Sharia supervisory boards. These scholars should have appropriate experiences and qualifications to be appointed as members of the Sharia supervisory boards. On this issue, Malik and Mustafa⁹¹ state that, due to the shortage of qualified and experienced scholars of both finance and religion, it is difficult for the Sharia supervisory boards of Islamic banks to appoint qualified scholars. The same point has been made by Zedanain⁹² who expands on all the principles necessary for the establishment of the Sharia supervisory boards of Islamic banks. He also comments on a number of challenges and issues being faced by these boards, one of which is the shortage of qualified scholars who are experts in economics and finance.

Furthermore, Hasan and Asutay⁹³ indicate that because the courts in Malaysia refer to the SAC in certain cases, the SAC should therefore consist of Sharia scholars who have extensive knowledge of Islamic financial laws to ensure the best outcomes are produced when they are referred to by the courts regarding specific cases.

In fact, the shortage of Sharia scholars may force several Sharia supervisory boards to appoint the same scholar to more than one Islamic bank. Arman⁹⁴ points out that appointing one Sharia scholar to more than one Sharia supervisory board of an Islamic bank may lead to a conflict of interest. He also mentions that other issues are faced by Sharia supervisory boards, such as independence, confidentiality, competence, consistency and disclosure.

It is clear that the lack of qualified Islamic banking experts can be considered an issue for most Islamic banks in the world. Most scholars and staff members who work in Islamic banks are unqualified to hold their positions because they are not experts in Sharia, finance and skills

⁹¹ Muhammad Shaukat Malik, Ali Malik and Waqas Mustafa, 'Controversies that Make Islamic Banking Controversial: An Analysis of Issues and Challenges' (2011) 2 *American Journal of Social and Management Sciences* 41, 42.

⁹² Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks Between Originality and Practice' (2013) 40 *Sharia Science and Law Studies* 89, 101 (translated from the original Arabic text by the author).

⁹³ Zulkifli Hasan and Mehmet Asutay, 'An Analysis of the Courts' Decisions on Islamic Finance Disputes' (2011) 3 *ISRA International Journal of Islamic Finance* 41, 49-53.

⁹⁴ Saleh Md Arman, 'Shariah Compliance Features of Islamic Financial Institutions and its Challenges' (2013) 3 *Arabian Journal of Business and Management Review (Oman Chapter)* 91, 93.

related to Islamic banking transactions. Indeed, the lack of Islamic banking centres and training courses in some countries are reasons behind the shortage of Islamic banking experts.

In general, the aforementioned literatures show that the Islamic banking system still faces both legal and Sharia problems. One example of the legal problems is the lack of an effective Islamic banking legal framework in some countries such as Iraq. In addition, Islamic banks are regulated under the conventional banking system by the central banks. Thus, these legal challenges are major problems for the current Iraqi Islamic banking system.

On the other hand, ineffective Sharia supervision, both internal and external, of the Islamic banking industry is considered a Sharia issue for the Islamic banking system. Furthermore, the lack of qualified Islamic banking experts is also a problem. Therefore, the Iraqi Islamic banking system encounters all these problems as elaborated by the scholars.

1.6. Methodology and Data Collection of the Thesis

An evaluation of the Iraqi Islamic banking system is necessary to investigate the weaknesses of this system and find ways to address them. The Iraqi Islamic banking system will be examined by using case studies of Malaysia and Bahrain to compare Iraq to both Islamic banking systems in terms of the legal and Sharia aspects of their Islamic banking frameworks.

To achieve this goal, a variety of methodologies, such as comparisons and case studies, will be used to provide a full and comprehensive analysis of the legal and Sharia aspects of the Iraqi Islamic banking system. Firstly, analysing laws and regulations,⁹⁵ including all laws and rules relevant to this thesis, is conducted. The Islamic Financial Services Act 2013 (IFSA) of Malaysia, Volume 2- Islamic Bank of Bahrain, the Banking Law 2004 of Iraq and a number of other acts will be used as references in this thesis.⁹⁶ Secondly, analysing books, reports from the World Bank and International Monetary Fund (IMF), conference papers, newspapers, journal articles and theses is also conducted as sources of data. Thus, the methodology includes analysing and criticising all literature written on the Islamic banking system from the legal and Sharia points of view. Thirdly, empirical research, in particular interviews conducted in Kurdistan in May and June 2015, is another element of the methodology.

⁹⁵ Black letter law refers to the basic standard elements or principles of law, which are generally known and free from doubt or dispute. The term describes the basic principles of law that are accepted by a majority of judges in most countries.

⁹⁶ Examples are the Malaysia IFSA 2013, and Volume 2- Islamic Bank of Bahrain.

Furthermore, an investigation of other countries' Islamic banking systems will be undertaken in order to emulate the successes that they have experienced. For the purpose of this thesis, two countries with advanced Islamic banking systems and long histories of Islamic banking have been chosen, one from the Middle East, namely Bahrain,⁹⁷ and the other from Southeast Asia, which is Malaysia. Both countries have played crucial roles in developing Islamic banking systems globally and both have well-organised Islamic banking systems where Islamic banks operate alongside conventional banks. In general, these countries' Islamic banking systems are ideal for this thesis as they are pioneers in the field with advanced Islamic financial systems that should provide valuable insights and knowledge. It is worth mentioning that this thesis does not apply the comparative methodology in its classical form because there are not many similar elements shared between the Iraqi Islamic banking system and both Malaysian and Bahraini Islamic banking systems. However, due to the non-comparison in classical approach,⁹⁸ this thesis claims that the comparative study is not the main method of this thesis.

Furthermore, with regards to Malaysia and Bahrain, the laws and regulations pertaining to Islamic banks in these countries will be analysed in order to determine the relative weaknesses and strengths of their systems. Their Islamic banking systems will be critically reviewed to provide a thorough evaluation and comparison to the Iraqi Islamic banking system. The financial regulators of Iraq can gain insights into the Islamic banking of these countries in order to enhance the development and growth of the Iraqi Islamic banking system.

For the purpose of this thesis, the qualitative approach will be followed. This type of research method aims to uncover the purpose of the subject. Corbin and Strauss define qualitative

⁹⁷ 'Bahrain has functioned as a major regional banking centre since 1976, hosting the Association of Accountants of the Islamic Finance Industry (AAOIFI), the Bahrain Institute of Islamic Banking and Finance (BIBF), the International Islamic Finance Market (IIFM), and the Bait al Bursa of the Bahrain Financial Exchange (BFX). In contrast to other Gulf Co-operation Council (GCC) states, such as Saudi Arabia and Kuwait which have licensed only majority-locally-owned institutions, Bahrain has kept its market open to foreign banks. As a result, Bahrain has the most Islamic banks in the GCC, with 24 Islamic banks and 11 *Takaful* companies. Furthermore, currently, even though all six GCC states host Islamic financial institutions, Bahrain is the only GCC nation that hosts a centralized national Sharia board. Even the DIFC and QFC, both of which serve as platforms for Islamic financial business, are not equipped with a central Sharia board. Furthermore, 'on a regional basis, there are conflicting decrees regarding interpretations of the Sharia. Such conflicts might be resolved—and Islamic finance advanced—should each GCC state possess a national Sharia Board (as does Bahrain, which extends jurisdiction over its financial free zones) and should a central Sharia Board be created for the GCC, along with the GCC monetary union and uniform currency'.

See: Diaz Reus, 'The Current State of Islamic Finance in the Gulf Co-operation Council' (December 2013) <<http://www.lexology.com/library/detail.aspx?g=6e13f9e9-c048-4c30-b60e-9fdeddbb5fc1e>> accessed 12 August 2016.

⁹⁸ The classical method is used to identify differences and similarities between the Malaysian and Bahraini Islamic banking systems. Thus, the classical method just identifies similarities and differences. However, the comparison in this thesis mentions important points that may be absent in both Malaysian and Bahraini systems.

research as ‘a form of research in which the researcher or a designated co-researcher collected and interpreted data, making the researcher as much a part of the research process as the participants and the data they provide’.⁹⁹ The qualitative approach is appropriate for this thesis because critical evaluations of two countries’ Islamic banking systems together with the Iraqi Islamic banking system will be conducted. In addition, this author is integral to the research as he offers his opinions and analyses when necessary. Furthermore, qualitative research enables a researcher to collect data from different sources, both primary and secondary. Therefore, the qualitative approach deals with both texts and case studies, similar to the approach undertaken in this thesis.¹⁰⁰ Hence, investigations into Iraq, Bahrain and Malaysia, and a critical assessment of the Iraqi Islamic banking system are considered as qualitative research.

Collecting Data for the Thesis

The thesis makes use of both primary and secondary data in order to give a comprehensive outlook of the research topic. For the purpose of this thesis, the researcher will collect information and data from all relevant sources, such as academic books, articles, treaties, acts and related reports from both governmental and non-governmental organisations. Thus, both primary and secondary sources are considered. Online sources will also be utilised in this thesis where relevant.

It should be mentioned that most of the books and articles used in this research are written in English. However, there are also a number of sources in Arabic as Iraq and Bahrain are both Arab countries. Where such sources are used, all relevant data and information will be translated from Arabic to English.

Methods for Collecting Data

In collecting data for this thesis, four methods are used: legal analysis, Sharia analysis, black letter law analysis and empirical study.

⁹⁹ Juliet Corbin and Anselm Strauss, ‘*Basics of Qualitative Research, Techniques and Procedures for Developing Grounded Theory*’ *Prospects* (4th edn, Sage 2015) 4.

¹⁰⁰ ‘Qualitative research is multimethod in focus, involving an interpretive, naturalistic approach to its subject matter. This means that qualitative researchers study things in their natural settings, attempting to make sense of, or interpret, phenomena in terms of the meanings people bring to them. Qualitative research involves the studied use and collection of a variety of empirical materials - case study, personal experience, introspective, life story, interview, observational, historical, interactional, and visual texts - that describe routine and problematic moments and meanings in individuals' lives. Accordingly, qualitative researchers deploy a wide range of interconnected methods, hoping always to get a better fix on the subject matter at hand’.
See: Norman K Denzin and Yvonna S Lincoln, ‘*Handbook of Qualitative Research*’ (1st edn, Sage 1994) 2.

1- Legal Analysis

This thesis will analyse the legal theories related to the Islamic banking systems in Iraq and some selected countries, in particular Malaysia and Bahrain. The thesis will draw on a variety of books, journal articles, conference papers, newspapers and also reports and working papers from the World Bank and IMF in order to identify the legal issues within the Iraqi Islamic banking system. The literature on Malaysia and Bahrain will also be analysed in order to discover how these countries deal with the issues facing the Iraqi Islamic banking industry.¹⁰¹

2- Sharia Analysis

The thesis will attempt to examine the Sharia theories related to Sharia issues in the Iraqi Islamic banking system, particularly by analysing information from books and articles that were written on Sharia aspects of the Islamic banking industry. The literature from Malaysia, Bahrain and other carefully selected countries, such as Pakistan and Kuwait, will be analysed to find the best solutions to the Sharia issues of the Iraqi Islamic banking system.¹⁰²

3- Black Letter Law Analysis

Because some of the challenges that are faced by the Iraqi Islamic banking system are legal challenges, it is necessary to analyse certain articles of the laws and regulations which are related to the Islamic banking system. As the Malaysian and Bahraini Islamic banking systems are part of this thesis and both countries have laws and regulations for their respective Islamic banking industries, analysing a number of particularly relevant articles of their laws will be included in the methodology of this thesis. For instance, the IFSA 2013 of Malaysia, Volume 2- Islamic Banks in Bahrain, Islamic Banking Law 2015 of Iraq, the Iraqi Banking Law 2004, and the Central Banking Law 2004 in Iraq are the main pieces of legislation in this thesis. However, there are other laws and rules related to the Islamic banking industry which will also be analysed.¹⁰³ In general, provisions from some of the acts that form part of the financial system in Iraq and other countries such as Malaysia and Bahrain will be analysed as these provisions are also connected to the legal issues present in the Islamic banking system.

¹⁰¹ The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia is one of the books that explains the legal aspects of the Islamic banking system and is written by Abdul Karim Aldohni.

See: Abdul Karim Aldohni, *The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge 2011).

¹⁰² Zulkifli Hasan, 'Sharia governance in Islamic Financial Institutions and the Effect of the Central Bank of Malaysia Act 2009' (2010) 25 *Journal of International Banking Law and Regulation*.

¹⁰³ Such as Malaysian Financial Services Act 2013 (FSA 2013), Malaysian Central Bank Act 2009, Internal Instruction 2006 of the Iraqi Islamic Bank and Anti-Money Laundering Law 2004 of Iraq.

4- Empirical Study

Empirical research, in particular the interview method, is chosen to be part of this thesis because there are few books and articles on the Iraqi Islamic banking system. This shortage of books and articles is due to the industry being relatively new as compared to other countries' Islamic banking systems, such as that of Malaysia, and because of a scarcity of experts in the Islamic banking area in Iraq. Therefore, empirical study, particularly interviews, is one of the methodologies in this thesis. Through interviews, more data on the Iraqi Islamic banking system will be collected to develop the arguments that will be discussed later in the thesis.

The first aim of these interviews is to give a general overview of the Iraqi Islamic banking system and the challenges that are currently being faced by the Islamic banks in Iraq. The second aim is to discover the views of Islamic banking experts and practitioners on the issues in Iraq. The third aim is to expose the weaknesses and highlight the strengths of the Iraqi Islamic banking system. To do this, the discussions focused on the legal and Sharia aspects of the current Iraqi Islamic banking system. Participants in the interviews were academics and bankers in the Islamic banking area to respectively identify theoretical and practical challenges of the current Iraqi Islamic banking system. The interviews had a number of advantages and this has enabled a high level content for this thesis. They enhanced and supported arguments made in the thesis and filled a gap in the literature about the Iraqi Islamic banking system. In addition, these interviews also reflected the opinions of the bankers who have practical experiences in Iraqi Islamic banks, which are important to support this thesis.

In the interviews, a number of questions related to the Iraqi Islamic banking system, both on legal and Sharia aspects, were asked. They were semi-structured, thus allowing impromptu questions to be asked if necessary. All interviews were conducted in Iraq to provide a critical analysis of the country's Islamic banking system. It is worth mentioning that only a small number of participants were interviewed. This was due to two reasons; first, the researcher could not travel to the middle and south of Iraq to interview Islamic banking experts there due to political instability and security concerns. Therefore, all the interviews were conducted in the Kurdistan region.¹⁰⁴ Second, the small number of Islamic banking experts in Iraq led to the researcher being able to conduct only a few interviews.¹⁰⁵

¹⁰⁴ The researcher focused on the Kurdistan region as he could not go to other parts of Iraq because of the war between the Iraqi army and ISIS. In addition, most of the Islamic banks are located in Baghdad, which was unsafe at the time for the researcher to travel to.

¹⁰⁵ Some of the bankers either did not agree to being interviewed or they did not have information about the Islamic banking system.

1.7. Scope and Limitations of the Thesis

Scope of the Thesis

It is important to describe the scope of the thesis with regard to case studies in order to give the reader a vivid picture of elements being covered and, therefore, the limitations that exist. This thesis critically evaluates the Iraqi Islamic banking system in light of two other countries, namely Malaysia and Bahrain, whose Islamic banking systems are considerably more advanced than that of Iraq. Thus, the scope of this thesis includes these three countries with their respective Islamic banking systems. However, other countries may also be referred if relevant elements are found in their Islamic banking systems.¹⁰⁶

In this thesis, three main challenges of the Islamic banking system of Iraq are highlighted. First, legal problems that are related to the legal framework of the Iraqi Islamic banking industry, particularly issues relating to the Islamic Banking Law 2015, are investigated. Second, problems pertaining Sharia regulations and supervision will be focused in this thesis. Both internal and external Sharia-related matters are emphasized, particularly the lack of a national Sharia board and the weaknesses of Sharia supervision on the Iraqi Islamic banking system in general. Third, the human resources of the Iraqi Islamic banking industry are also examined in a separate chapter, especially the shortage of qualified Islamic banking experts.

In addition to these main issues, a number of other issues are also covered but in less detail as they are supplementary to this thesis.¹⁰⁷ Accordingly, the limitations of this thesis are the challenges mentioned above that face the Iraqi Islamic banking system.

Finally, the thesis focuses on the Iraqi Islamic banking system and evaluates the current situation of this system in order to provide regulators with sufficient information on the Islamic banking industry when compared to systems in other countries.

Limitations of the Thesis

It is important to mention the limitations of this thesis and explain the elements that are not included. Thus, this thesis will be limited to addressing the basic principles of the Iraqi Islamic banking system from both legal and Sharia aspects. This doctoral thesis will not address dispute resolutions and matters related to cases of Sharia court or Islamic banking court. Information

¹⁰⁶ Other countries' Islamic banking systems will also be referred to if there are useful elements that could help the Iraqi Islamic banking system. These countries include Pakistan and Kuwait.

¹⁰⁷ Examples include the limitations of the Islamic banks' clients and security, and the political situation in Iraq.

on the disputes between Islamic banks and their clients and among Islamic banks in Iraq is not included in this thesis. Problems related to civil and common courts are also excluded. This is because the Iraqi Islamic banking system lacks basic legal and Sharia principles such as the lack of comprehensive Islamic banking legal framework and shortage of Sharia scholars. In any case, there is no account of an Islamic banking court case that can be found in the literatures about Iraq. Therefore, in this early stage of the Iraqi Islamic banking system, no meaningful discussions of the related court matters can be conducted. More important issues which are directly related to the Islamic banking system, such as a lack of a comprehensive legal framework and issues related to Sharia supervision, have instead been chosen for investigation. Furthermore, the literatures are also a limitation in this thesis. Islamic banking is a new subject in Iraq with a limited number of academics who have written about the Iraqi Islamic banking system. Therefore, there is an inadequate number of journal articles and books about Iraqi Islamic banking businesses. Moreover, most of the published articles are general and lacking specificity. Hence, very little research could be found that examines the system in-depth.

1.8. Contribution of the Thesis

As part of the contribution to the Iraqi financial sector, especially the Islamic banking industry, this thesis is important as it will provide financial regulators in Iraq with some clear conclusions to establish an efficient Islamic banking system. In addition, the thesis highlights the main issues in Iraqi Islamic banking and contributes to the reform of the Iraqi legal Islamic banking framework. In fact, to date there has been no similar research on the Islamic banking system of Iraq that includes all three challenges of the present system in one research paper. Therefore, this thesis will benefit the CBI and Islamic banking institutions as it examines both legal and Sharia aspects of the Islamic banking system in Iraq.

This thesis covers the main problems of the Islamic banking sector of Iraq in one single project.¹⁰⁸ Given that the main issues are addressed with a number of proposed solutions in light of other countries' Islamic banking systems, the CBI and financial regulators in Iraq will gain important insights into other countries' Islamic banking systems. Consequently, these insights will then enable them to find solutions to some issues of the Islamic banking system in the country. As a whole, this research may contribute to building and reforming the Iraqi Islamic banking system.

¹⁰⁸ This thesis covers all legal and Sharia issues related to the Iraqi Islamic banking system in one single document since there is currently no thesis or document that has gathered together and critically evaluated all these problems.

Research Structure

Chapter One of this research is the introductory chapter, which includes background information, research questions, aims and objectives of the thesis. In addition, a literature review, a description of the scope and contributions of the thesis, and research methodology are also included in Chapter One of the thesis.

In Chapter Two, the Islamic banking industry in general is explained, including an overview of Islamic banking as a whole and the reason for the development of Islamic banks. Islamic banking tools and transactions are also illustrated in this chapter, together with a discussion of the Islamic banking legal framework requirements. The modes of finance for Islamic banks will also be explained, with the ways in which they are applied in Islamic banking transactions.

In Chapter Three, the current situation of the Islamic banking system of Iraq is discussed. Facts and figures relating to the Iraqi banking industry in general is part of this chapter, with explanations of Iraq's banking system, covering both government and private banks, and including Islamic banks. In addition, the situation of Islamic banking in Iraq under its current laws and regulations are also examined. In this chapter, the regulatory and supervisory aspects of Iraq's Islamic banking system is critically evaluated with the Iraqi Islamic Banking Law 2015 that regulates the Islamic banks in the country being analysed and criticised. Finally, the challenges facing the Islamic banking industry in Iraq are identified.

Chapter Four of this research then shifts its focus to the first issue of Iraqi Islamic banking system, which is legal issues such as, weaknesses of the Iraqi Islamic Banking Law 2015. This chapter analyses and criticises the Iraqi Islamic Banking Law 2015 and the role of the central banks of Iraq, Malaysia and Bahrain. In this chapter Islamic banking system of the selected countries are explained and thoroughly evaluated. Islamic banking laws of these countries are also examined and analysed in order to assess the legal Islamic banking framework of Iraq. Hence, the Volume 2-Islamic Bank of Bahrain and the Malaysian Islamic Financial Services Act 2013 are evaluated and analysed. Then, the new Iraqi Islamic Banking Law 2015 and the Internal Instruction 2006 for the regulation of the Iraqi Islamic banking industry are extensively evaluated in order to identify their weaknesses. The licence conditions and requirements of Islamic banking in selected countries are also discussed in this chapter.

Chapter Five proceeds to critically evaluating the Sharia regulations and supervision of the Iraqi Islamic banking system. In this chapter, the necessity of the central Sharia body in various countries for the regulation of Islamic banking is explained with particular emphasis on Iraq.

The structures of the central Sharia body of Malaysia, Bahrain and other countries are also examined, with a view of choosing the best structure for Iraq. Therefore, the functions and roles of the central Sharia boards of Malaysia and Bahrain are evaluated and comprehensively analysed. The Sharia supervisory boards of Islamic banks are also discussed to propose the best form of Sharia supervision for the Islamic banking system in Iraq. Both the Malaysian and Bahraini approach to Sharia supervision, including internal and external levels, are, therefore, explained. In addition, several challenges faced by Sharia supervision of Islamic banks are identified. Finally, a number of recommendations are made for resolving issues related to Sharia regulations and supervision of the Iraqi Islamic banking system.

The focus of Chapter Six is on the human resources of the Iraqi Islamic banking system. The shortage of qualified Islamic banking experts in Iraq who understand Islamic banking transactions is critically assessed in this chapter. This chapter also examines the facts and figures relating to the shortage of Islamic banking experts and the impact of this issue on Islamic banking practices and services. The Islamic banking experts in Bahrain and Malaysia are discussed in this chapter. A number of solutions to this issue are offered in hopes of identifying the best approach for Iraq to potentially adopt. In addition, qualifications of the scholars who work as Sharia supervisory members in various countries are evaluated. The responsibilities of both the CBI and Islamic banking institutions in Iraq are clarified, with a view of creating Islamic banking experts. A number of methods for resolving this issue are also mentioned in this chapter which could be valuable for the development of effective human resources in the Islamic banking sector of Iraq.

The final chapter, Chapter Seven, presents the conclusions. The results of this research are summarised and discussed, with an explanation of the best elements for developing the Islamic banking industry in Iraq. In addition, each of the research questions are systematically answered. Furthermore, in this chapter, the establishment of a proper Islamic banking legal framework for Iraq is proposed. Elements of the Bahraini and Malaysian Islamic banking systems are identified which could be applied in Iraq. Finally, a number of recommendations are proposed to regulators in the CBI and Islamic banks for improving the Islamic banking system in Iraq, especially in relation to the regulatory and supervisory systems.

Chapter Two: Islamic Banking: Its Modern Form

2.1. Introduction

The objective of this chapter is to describe the modern form of the Islamic Banking industry in order to provide a general understanding of the Islamic banking system.¹⁰⁹ The legal and Sharia features of the Islamic banking industry are examined. Furthermore, Sharia supervision of Islamic banks are also analysed in detail. In addition, the most important investment products and modes of finance that are used by Islamic banks to deal with their customers are also explained.

It is clear that the Islamic banking industry plays a crucial role in the current economic situation.¹¹⁰ It is based on Sharia principles,¹¹¹ which is the main distinction between Islamic banks and the western banking system.¹¹² Banks in the latter system are based on charging interest.¹¹³ Indeed, the core principle of conventional banks is interest, which is why they are called ‘interest-based’ banks. In contrast, interest in all its forms is prohibited and unacceptable under Islamic law.¹¹⁴ Islamic banks conduct their activities according to profit and loss sharing (PLS) contracts¹¹⁵ where both the bank and client share the profit and the risk,¹¹⁶ according to their pre-agreed contract.¹¹⁷ Consequently, profit is not guaranteed and also the capital could

¹⁰⁹ It is important to explain about Islamic banking and its operations and transactions before analysing the Iraqi Islamic banking system in the country.

¹¹⁰ For example, the private banks’ capital in Iraq is distributed as follows: 53.5% with conventional banks, 22.5% with Islamic banks (considering the problems and challenges that are faced by Islamic banks in Iraq, their capital is rather high), and 2.7% with branches of the foreign banks working in Iraq. The state-owned banks represent 21.3% of the banking system’s total capital and the banking system’s capital percentage of GDP reached 2.4% in 2012. See: Mohammad Ahmed Jawad, Iraqi Council of Representatives, ‘Finance Committee Report on Banking System Reform Requirements in Iraq’ (Iraq Report, Council of Representatives Finance Committee, 2014) 16.

¹¹¹ According to Sharia principles, receiving and paying interest (*Riba*) are prohibited. All Islamic banking transactions should exclude interest.

¹¹² Islamic banking can be described as a ‘miracle’ for Muslim investors who reject the conventional investment system on religious grounds. Before the development of Islamic banking, Muslims did not have any option but to deal with conventional banks.

¹¹³ Rifaat Ahmed Abdel Karim, ‘International Accounting Harmonization, Banking Regulation, and Islamic Banks’ (2001) 36 *The International Journal of Accounting* 169, 178.

¹¹⁴ Abdul Qawi Othman and Lynn Owen, ‘The Multi Dimensionality of Carter Model to Measure Customer Service Quality (SQ) In Islamic Banking Industry: A Study In Kuwait Finance House’ (2002) 3 *International Journal of Islamic Financial Services* 1.

¹¹⁵ According to the principle of profit and loss sharing in the Islamic banking industry, the Islamic bank and the customer share both profits and losses, such as in *musharaka* and *mudaraba* contracts. Thus, the customer shares the risk of loss with the bank based on the profit and loss sharing transactions.

¹¹⁶ Dennis Olson and Taisier A Zoubi, ‘Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region’ (2008) 43 *The International Journal of Accounting* 45, 46.

¹¹⁷ The relationship between the Islamic bank and the clients is managed according to some special contracts and transactions. Thus, these tools are considered as modes of finance that are used by the Islamic bank to deal with its customers. Later in this chapter, the tools and modes of finance that are used by Islamic banks will be explained.

be lost.¹¹⁸ Therefore, in this sense, the nature of Islamic banking is fundamentally different from conventional banking. Unlike conventional banking, which is separate from religious considerations,¹¹⁹ Islamic banking is regulated by religion. It obtains its rules and regulations from the Quran,¹²⁰ the Sunnah,¹²¹ which comprises the sayings and practices of the Prophet Muhammad, peace be upon him (pbuh) and also some jurists' opinions (which should not conflict with these two primary sources).¹²²

Despite their differences, Islamic banks play a vital role in developing the world economy alongside conventional banks.¹²³ They contribute in building a strong financial sector as already observed in some countries with advanced Islamic banking systems.¹²⁴ Recently, Islamic banking has expanded. It is no longer restricted to Islamic countries but it has been established in some non-Islamic countries in the West,¹²⁵ for example, in the UK as the Islamic Bank of Britain (IBB) is a fully Sharia-compliant bank following strict Islamic principles. The IBB operates without the use of interest and is founded on the principles of Islamic finance, which are derived from trade, entrepreneurship and risk-sharing.¹²⁶ Other banks include the International Islamic Bank in Luxembourg and Al Baraka Bank in USA.¹²⁷ It is not surprising that Islamic banking has become a major player in the financial sector because in both Muslim

¹¹⁸ In a *Mudaraba* contract, there is a possibility for some of the capital to be lost while the Islamic bank acts as a fund manager and the client as a fund provider. If the loss happened, the capital provider will lose its capital and profit while the manager (usually the Islamic bank) will lose its effort.

¹¹⁹ In the conventional banking system, religion does not interfere in the business and customers do not share the risk with the bank. The main principle of the conventional banking system is interest; receiving and paying interest is a key link between the bank and the customer.

¹²⁰ 'Quran or Koran is the Islamic holy book believed to be the words of ALLAH as dictated to Prophet Muhammad, peace be upon him. 'The Qur'an is the holy book for Muslims, revealed in stages to the Prophet Muhammad over 23 years. Qur'anic revelations are regarded by Muslims as the sacred word of God, intended to correct any errors in previous holy books such as the Old and New Testaments. There are 114 chapters in the Qur'an, which is written in the old Arabic dialect'.

See: BBC, 'The Quran' <http://www.bbc.co.uk/religion/religions/islam/texts/quran_1.shtml> accessed 14 December 2015.

¹²¹ Najeb Masoud, 'Does Islamic Banking Contribute to Sharia Law: Critical Issues on Libyan Banking and Financial Markets' (Working paper, Middle East University - Accounting and Finance Department, 2014) 1, 3.

¹²² In other words, the Quran and the Prophet Muhammad's sayings, actions and reactions are considered as the two primary sources in the religion of Islam.

¹²³ Just as conventional banks have their customers, Islamic banks also have their own clients. Thus, conventional and Islamic banks participate in developing a country's financial sector each in its own way and methods.

¹²⁴ For example, in Malaysia, Islamic banks operate alongside conventional banks.

¹²⁵ Rania Kamla, 'Critical Insights into Contemporary Islamic Accounting' (2009) 20 *Critical Perspectives on Accounting* 921, 925.

¹²⁶ IBB, 'Home' <<http://www.alrayanbank.co.uk/useful-info-tools/about-us/>> accessed 19 November 2016.

¹²⁷ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq Report, Council of Representatives Finance Committee, 2014) 37.

and non-Muslim countries,¹²⁸ most Muslim investors choose to invest their money with Islamic banks.¹²⁹

A number of important aspects are explained in this chapter, namely the historical background of the Islamic banking system, the nature of Islamic banking businesses and the sources of Sharia in general and Islamic finance in particular. In addition, modes of finance and their roles in Islamic banking transactions are also elaborated.

2.2. Historical Background of Islamic Banking

The Islamic finance sector has been growing in recent years due to demands from Muslim investors on ways to invest according to Islamic law.¹³⁰ This growth can be clearly seen worldwide especially in the Middle East and Far East.¹³¹ Nonetheless, the development of Islamic banks is not a new phenomenon, which dates back to many years. Determining the exact beginning of Islamic banking operations is difficult but most experts in the field are of the opinion that Islamic banking emerged in 1963. The *Mit Ghamr* in Egypt was the first Islamic bank that started operations, which followed the Sharia law.¹³² By 1967, the number of Islamic banks in the country had reached nine branches, all of which applied an interest-free banking system. In 1971, the Nasir Social Bank was founded in Egypt and was also a non-interest paying bank.¹³³ However, it was the founding of the inter-governmental Islamic Development Bank in Jeddah in 1975 that was considered the most significant event in the development of Islamic banking in the 1970s. In fact, this organisation remains the strongest supporter of Islamic banking institutions around the world.¹³⁴

During the 1970s, after the changes in the political scenario of many Muslim countries, for example the rise of the Islamic resurgence movement in the Middle East and the 1979 Islamic revolution of Iran, Islamic banks became very popular.¹³⁵ A number of Islamic banks came into being in the Middle East, such as the Dubai Islamic Bank in 1975, the Faisal Islamic Bank

¹²⁸ In fact, the majority of Islamic banks are in Muslim countries, particularly Middle Eastern countries, but there are also Islamic banks in non-Muslim countries, for example, the UK and the Philippines.

¹²⁹ Because the Islamic faith does not allow Muslims to charge and pay interest which is considered immoral from a Sharia perspective, Muslims have a desire to invest and deal with Islamic banks rather than conventional banks.

¹³⁰ Fadzlan Sufian, 'The Efficiency Of Islamic Banking Industry: A Non-Parametric Analysis With Non-Discretionary Input Variable' (2007) 14 *Islamic Economic Studies* 53, 54.

¹³¹ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 833.

¹³² Beng Soon Chong and Ming-Hua Liu, 'Islamic banking: Interest-free or interest-based?' (2009) 17 *Pacific-Basin Finance Journal* 125.

¹³³ Mohamed Ariff, 'Islamic Banking' (1988) 2 *Asian Pacific Economic Literature* 46, 48.

¹³⁴ Diederik van Schaik, 'Islamic Banking' (2001) 3 *The Arab Bank Review* 45.

¹³⁵ Rika Nakagawa, 'The Evolution Of Islamic Finance In Southeast Asia: The Case Of Malaysia' (2009) 25 *The Journal of Applied Business Research* 117.

of Sudan in 1977, the Faisal Islamic Bank of Egypt in 1977 and the Bahrain Islamic Bank in 1979.¹³⁶ However, the emergence of Islamic banks was not limited to the Middle East, it also occurred in Asian countries. In 1973, the Philippines Amanah Bank was founded and a decade later the first transacting Islamic bank appeared in Malaysia. Looking at the situation in Western countries,¹³⁷ the first Islamic bank in Europe was established in Luxembourg in 1978 which is now called the Islamic Finance House. This was Islamic banking's first foray into the Western world.¹³⁸

The most important period in the history of the development of Islamic banking was from 1975 to 1990. During this period, Islamic banks grew significantly in size and number, and several financial products were developed according to Sharia law. As a result of the expansion of such products, the success of Islamic banks grew. At that time, several countries including Pakistan, Iran and Sudan decided to remove the notion of interest from their entire economic system.¹³⁹ During the same period, several important multinational banks began to offer Islamic financial products. Furthermore, the World Bank and the International Monetary Fund (IMF) recognised Islamic financial products as a genuine means of financial intermediation and produced papers to that effect.¹⁴⁰ Therefore, the period from 1975 to 1990 was in many ways a golden era in the history of Islamic banking.¹⁴¹

In recent years, interest in Islamic finance has increased sharply due to heightened demand from Muslim investors and some remarkable developments have occurred in the Middle East and Far East.¹⁴² It is now allowed, for example, for conventional financial institutions to conduct their operations according to the Islamic financial system, such as HSBC Amanah

¹³⁶ Mohamed Ariff, 'Islamic Banking' (1988) 2 Asian Pacific Economic Literature 46, 48.

¹³⁷ There is a number of western banks that provide Islamic banking services. For example, in the UK there is a number of fully Islamic banks and conventional banks with Islamic windows. Fully Sharia-compliant banks in the UK are the Bank of London and The Middle East, European Islamic Investment Bank, Gatehouse Bank, Islamic Bank of Britain, QIB UK, and Abu Dhabi Islamic Bank. On the other hand, examples of conventional banks in the UK with Islamic windows are ABC International Bank, Ahli United Bank, Bank of Ireland, Barclays, BNP Paribas, Bristol & West, Citi Group, Deutsche Bank, Europe Arab Bank, IBJ International London, Lloyds Banking Group, Royal Bank of Scotland, Standard Chartered, UBS, and United National Bank. See: UK ifs, 'Islamic Finance' <<https://www.fstib.com/assets/Reports-/Islamic-finance-2013.pdf>> accessed 23 November 2016.

¹³⁸ Mohamed Ariff, 'Islamic Banking' (1988) 2 Asian Pacific Economic Literature 46, 49.

¹³⁹ Dennis Olson and Taisier A Zoubi, 'Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region' (2008) 43 The International Journal of Accounting 45, 46.

¹⁴⁰ M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and prospects* (1st edn, Palgrave Macmillan 2005) 37-38.

¹⁴¹ In other words, this period saw the rise and the biggest development of the Islamic banking industry. For example, the first Islamic bank established in Malaysia was in that period with the Malaysian Islamic Banking Act 1983 also being enacted. Therefore, 1975 to 1990 can be considered the best time for the Islamic banking industry.

¹⁴² Bahrain as an example for Middle East and Malaysia is the best example of the Far East (Asian countries).

Islamic bank in Malaysia.¹⁴³ Moreover, Islamic banks have opened the door to non-Muslims to invest their funds with them.¹⁴⁴

What is Islamic Banking?

The basis of Islamic financial business is *fiqh al-muamalat*,¹⁴⁵ which deals with all commercial transactions in accordance to Sharia law.¹⁴⁶ Under Islamic Sharia law, all types of buying and selling transactions are permitted unless they involve interest (*riba*) as this is not allowed under Sharia law.¹⁴⁷ This prohibition can be clearly seen in the following verses of the Muslim holy book, the Quran:

Those who devour usury (*riba*) will not stand except as stands one whom the Evil One by his touch hath driven to madness. That is because they say: 'trade is like usury', but Allah has permitted trade and forbidden usury.¹⁴⁸

And whatever you lay out as usury, so that it may increase in the property of men, it shall not increase with Allah; and whatever you give in charity, desiring Allah's pleasure -- it is these (persons) that shall get manifold.¹⁴⁹

O you who believe! do not devour usury, making it double and redouble, and be careful of (your duty to) Allah, that you may be successful.¹⁵⁰

According to the above verses of the Holy Quran, dealing with interest is a big sin. Thus, Islamic banking should be free from interest in order to be compliant with Sharia rules. The prohibition of interest by Islamic banks represents a distinct difference between them and commercial banks.¹⁵¹

¹⁴³ Besides Malaysia, HSBC also offers Islamic banking services in Saudi Arabia.

¹⁴⁴ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 834.

¹⁴⁵ Islamic commercial jurisprudence or the rules of transacting in Islamic law; all Islamic banking transactions are built on *fiqh al-muamalat*. Thus, *fiqh al-mumalat* is the Islamic commercial law that deals with the buying and selling of goods. In the financial system, *fiqh al-mumalat* deals with Islamic financial products.

¹⁴⁶ Rima Turk Ariss, 'Competitive conditions in Islamic and conventional banking: A global perspective' (2010) 19 *Review of Financial Economics* 101, 102.

¹⁴⁷ *Riba* is prohibited in all religions (Judaism, Christianity and Islam). See: Rima Turk Ariss, 'Competitive conditions in Islamic and conventional banking: A global perspective' (2010) 19 *Review of Financial Economics* 101, 102.

¹⁴⁸ Quran, Chapter 2, Verse 272 (translated from the original Arabic text).

¹⁴⁹ Quran, Chapter 30, Verse 39 (translated from the original Arabic text).

¹⁵⁰ Quran, Chapter 3, Verse 130 (translated from the original Arabic text).

¹⁵¹ Dr Nisar Ahmad, 'Islamic Banking System: Partnership in Sharing Business Risk' (2014) 2 *Journal of Islamic Banking and Finance* 149, 150.

Conventional banks are well-organised and establish their rules based on common or civil law.¹⁵² In contrast, Islamic banks do not have similar strong legal framework.¹⁵³ The core idea of Islamic banking is that both the bank and the client contractually share the risks.¹⁵⁴ Thus, Islamic banking is defined as follows: ‘Islamic banking is a financial institution that operates and provides banking services according to Sharia principles. Islamic banking aims to offer services to the society’.¹⁵⁵ Thus, Islamic banking is a modern banking system built on Sharia concepts, which were developed in the first centuries of Islam that uses risk-sharing as its main model and excludes financing based on a fixed, pre-determined return.¹⁵⁶

Generally speaking, as it is built on religion, the purpose of Islamic banks is to serve society and ensure fairness¹⁵⁷ to all.¹⁵⁸ The services that are provided by Islamic banks look similar to those of conventional banks but the methods used for managing investments and dealing with their depositors and customers are different. These differences are found in their attitudes towards interest and the foundational source of their supervisory and regulatory frameworks.

The Fundamental Differences Between Conventional and Islamic Banks

Islamic banking and conventional banking are different on the basis that Islamic banking is religion-based while conventional banking is a western-based system.¹⁵⁹ Thus, they are

¹⁵² In other words, the conventional banking sector has some laws and regulations in the form of codes which are much easier to apply than the rules of the Islamic banks as in some cases there are differences between scholars or religious branches. Thus, due to the fact that Islamic banks take their rules from Sharia law, there is a possibility for different interpretations from different scholars.

¹⁵³ Owing to the interpretation of some verses of the Quran and *Ahadith* by different scholars or Islamic scientists, there may be differences in some decisions and Islamic banking contracts, such as *bay Inah*.

¹⁵⁴ Dennis Olson and Taisier A Zoubi, ‘Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region’ (2008) 43 *The International Journal of Accounting* 45, 46.

¹⁵⁵ Iftikhar Muhammad Al-rufaii, Khamis Muhammad Hasan and Ahmad Yasin Abid, ‘Islamic Banks and their Rules in Economic Development’ (2012) 31 *Journal of Baghdad College for Economy Science* 17, 21.

¹⁵⁶ Emirates Islamic Bank, ‘Islamic Banking Terms’ <<http://www.emiratesislamicbank.ae/en/islamicBanking/index.cfm>> accessed 5 September 2016.

¹⁵⁷ Dr Nisar Ahmad, ‘Islamic Banking System: Partnership in Sharing Business Risk’ (2014) 2 *Journal of Islamic Banking and Finance* 149, 150.

¹⁵⁸ All religions (Judaism, Christianity, Islam and other eastern religions or philosophies) stand against social injustice and tyranny, and can contribute to the critical school agenda to defend and foster humanity. Thus, the purpose of all religions is the same which is to serve and bring justice to the people: Rania Kamla, ‘Critical Insights into Contemporary Islamic Accounting’ (2009) 20 *Critical Perspectives on Accounting* 921, 923.

¹⁵⁹ The laws and regulations of the Islamic banking industry are Sharia-based while the conventional banking system is a Western system which follows positive law. Sharia law which regulates Islamic finance is drawn from the Muslim holy book, the Quran, and the Sunnah, which contains the sayings and practice of the Prophet Muhammad (pbuh), as a second source. These two sources are the primary references of Islamic finance law. However, in addition to the Quran and the Sunnah, the legal opinions (*Fatwa*) of Islamic financial scholars is a secondary source of Islamic finance law. This is in contrast to the source of conventional finance, which is common or civil law, i.e. positive law.

See: Shah M Nizami, ‘Islamic Finance: the United Kingdom's Drive to Become the Global Islamic Finance Hub and The United States' Irrational Indifference to Islamic Finance’ (2011) 34 *Suffolk Transnational Law Review* 219, 221-222.

dissimilar in relation to their views on money. For example, the conventional system looks at money as a commodity that can be bought and sold while in Islamic finance, money is a unit of account and a means of exchange.¹⁶⁰ The conventional banking system follows positive law¹⁶¹ while the Islamic banking system follows divine law.¹⁶²

In the conventional banking system, fixed interest is assured by the banks while in the Islamic banking system, the risk of loss is shared as both the bankers and investors are contributors to the risks and profits.¹⁶³ Furthermore, the conventional banks do not deal with *zakat* (Islamic tax) as Islamic banks do.¹⁶⁴ In fact, it is one of their main areas of operation as all Islamic financial institutions pay *zakat* annually.¹⁶⁵

In addition, the fundamental operation for conventional banks is to lend money to customers with a repayment that includes interest. This action in Islamic banks is prohibited; in contrast, participation in business partnerships is the main function of Islamic banks,¹⁶⁶ such as through *musharaka*, *mudaraba* and *murabaha*.¹⁶⁷ In the case of default, conventional banks charge customers extra fees for a non-payment. In contrast, Islamic banks do not charge extra money for a default; however, if they do charge any compensation for a default, they will give it to charity. The relationship between conventional banks and their customers is that of creditor and debtor whereas in Islamic banks it is a partnership. The conventional banks guarantee all

¹⁶⁰ Jasim Al-Ajmi, Nadhem Al-Saleh and Hameeda Abo Hussain, 'Investment appraisal practices: A comparative study of conventional and Islamic financial institutions' (2011) 27 *Advances in Accounting*, incorporating *Advances in International Accounting* 111, 113.

¹⁶¹ Shah M Nizami, 'Islamic Finance: The United Kingdom's Drive to Become the Global Islamic Finance Hub and The United States' Irrational Indifference to Islamic Finance' (2011) 34 *Suffolk Transnational Law Review* 219, 221-222

¹⁶² According to positive laws, interest is allowed to be received and paid. However, according to divine law, Islamic banks are not allowed to deal with *Riba*

See: Muhammad Ayub, *Understanding Islamic Finance* (John Wiley and Sons 2007) 21-22.

¹⁶³ Dennis Olson and Taisier A Zoubi, 'Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region' (2008) 43 *The International Journal of Accounting* 45, 46.

¹⁶⁴ 'Zakat is the compulsory giving of a proportion of one's wealth to charity. It is regarded as a type of worship and of self-purification. Zakat is the third Pillar of Islam. It does not refer to charitable gifts given out of kindness or generosity, but to the systematic giving of 2.5% of one's wealth each year to benefit the poor'.

See: BBC, Religion, 'Zakat: charity' Terms' <<http://www.bbc.co.uk/religion/religions/islam/practices/zakat.shtml>> accessed 19 November 2016.

¹⁶⁵ Z El-Gawady, *Possibility of Cooperation between Islamic Banks and Conventional Banks* (University Giza, Egypt) 4, 6, 23, 24.

¹⁶⁶ Beng Soon Chong and Ming-Hua Liu, 'Islamic banking: Interest-free or interest-based?' (2009) 17 *Pacific-Basin Finance Journal* 125, 126.

¹⁶⁷ These are modes of finance that are based on PLS contracts that are applied by the Islamic banks to deal with their customers. For example, *musharaka* is a type of partnership of two or more parties; they all provide capital or labour and skills in order to share the profits and losses. *Mudaraba* contracts usually include at least two parties – one is the capital provider and the other representing the investment manager. This contract is usually limited to a certain period of time. *Murabaha* is a selling and buying contract between two parties, known as seller and buyer, without any financial intermediation.

For more details, see 2.6. Islamic Banking Modes of Finance or Instruments.

types of deposits, such as current and savings accounts. In contrast, the Islamic banks guarantee the deposit account only, which is called *wadia* (safe keeping).¹⁶⁸

It seems that the operations of conventional banks are more straightforward than Islamic bank operations. This is because there are many restrictions for Islamic banks, which they must deal very carefully with their clients.¹⁶⁹ The operations of conventional banks, on the other hand, are wider and the laws that govern them are not as strict as Sharia law.

Sources of Sharia Law

Sharia law regulates Islamic financial institutions as they are based on the Islamic faith.¹⁷⁰ This law is unchangeable¹⁷¹ since it is considered by Muslims to be divine law and not man-made law. Sharia law was described by Lord Justice Khalil-Ur-Rehman Khan in the case of *Shamil Bank of Bahrain v Beximco Pharmaceuticals and Others* as:

The law laid down by the Qur'an, which is the holy book of Islam, and the *Sunnah* (the sayings, teachings and actions of Prophet Muhammad [pbuh]). These are the principal sources of the *Shari'a*. The *Sunnah* is the most important source of the Islamic faith after the Qur'an and refers essentially to the Prophet's example as indicated by the practice of the faith. The only way to know the *Sunnah* is through the collection of *Ahadith*, which consists of reports about the sayings, deeds and reactions of the Prophet.¹⁷²

It is clear then that the two primary sources of Islam – the Quran and Sunnah – regulate all aspects of a Muslim's life.¹⁷³ The Quran, which is divine law as revealed to the Prophet (pbuh), is supplemented by the Sunnah, which describes the actions and sayings of the Prophet, known as *Ahadith*.¹⁷⁴ In addition, there are also secondary sources of Islamic law. These are:

¹⁶⁸ 'In Islamic banking, *wadiah* refers to the deposited property, the acceptance of sums of money for safe-keeping in a Sharia-compliant framework under which it will be repaid. Islamic banks use the concept of *wadiah* (and *amanah*) to accept deposits from customers. A bank is deemed as a keeper and trustee of funds and becomes fully responsible and liable for its safekeeping with a guaranteed refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands repayment. The bank may at its discretion and in certain circumstances reward the customer with a payment in the form of *hibah* as appreciation for keeping the funds with the bank. Also termed as *al wadiah* and *wadia*'.

See: Institute of Islamic Banking and Insurance (IIBI), 'Glossary of Financial Terms' <http://www.islamic-banking.com/glossary_W.aspx> accessed 19 November 2016.

¹⁶⁹ Islamic banking transactions are based on the religion which are directly related to people's faith, thus, those transactions should not go beyond the borders of Sharia. Hence, the borders of the Islamic banking transactions are narrower than conventional banking due to the Sharia principles.

¹⁷⁰ Dennis Olson and Taisier A Zoubi, 'Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region' (2008) 43 *The International Journal of Accounting* 45, 47.

¹⁷¹ The Quran and the Sunnah of the Prophet Muhammad (pbuh) cannot be changed. However, if some matters are not found in these two primary sources, then the opinions of Islamic jurists' (*fatwas*) are used.

¹⁷² *Shamil Bank of Bahrain v Beximco Pharmaceuticals and Others* [2004] EWCA Civ 19, para 2.

¹⁷³ Najeb Masoud, 'Does Islamic Banking Contribute to Sharia Law: Critical Issues on Libyan Banking and Financial Markets' (Working paper, Middle East University - Accounting and Finance Department, 2014) 1, 3.

¹⁷⁴ Muhammad Ayub, *Understanding Islamic Finance* (John Wiley and Sons 2007) 21-22.

- a) *Ijma'a* - the rules and regulations that are issued by the consensus of the Islamic community.¹⁷⁵
- b) *Qiyas* - according to this source, decisions depend on previously-found solutions, which can be applied to similar cases in modern situations.¹⁷⁶
- c) *Ijtihad*¹⁷⁷ - refers to the opinions of Islamic jurists on particular matters.¹⁷⁸

2.3. The Core Idea of Islamic Banking: Prohibition of *Riba*

The prohibition of interest is a fundamental tenet of the Islamic banking system. The reason behind this prohibition is that no one should benefit from another's risk or tenacity; in other words, wealthy individuals cannot exploit underprivileged people for their benefits.¹⁷⁹ Thus, the bank and customer should participate in both profits and risks, as is the case in *musharaka*¹⁸⁰ and *mudaraba*¹⁸¹ transactions.¹⁸²

The prohibition of interest (*riba*) is evident in the Quran,¹⁸³ which includes all forms of interest. Interest, or *riba*, can be described as any amount charged over and above the initial sum.¹⁸⁴

¹⁷⁵ 'Consensus, usually on a given issue as represented by the agreement of the jurists. It has traditionally been recognised by most Muslim jurists as an independent source of Islamic jurisprudence along with the Qur'an, Sunnah and *Qiyas* (analogical deduction)'.

See: Institute of Islamic Banking and Insurance (IIBI), 'Glossary of Financial Terms' <http://www.islamic-banking.com/glossary_I.aspx> accessed 19 November 2016.

¹⁷⁶ 'The process of analogical reasoning as applied to the deduction of juridical principles from the Qur'an and the Sunnah (the normative practice of the community). With the Qur'an, the Sunnah, and *ijma* (scholarly consensus), it constitutes the four sources of Islamic jurisprudence. As a result of this method, the ruling of the Sunnah and the Quran may be used as a means to solve or provide a response to a new problem that may arise. This, however, is only the case providing that the set precedent or paradigm and the new problem that has come about will share operative causes (*illah*). The *illah* is the specific set of circumstances that trigger a certain law into action. Both the *Sunni* branch of Islam and *Shi'a* branch of Islam share Qur'anic interpretation, the Sunnah, and *Ijma* (consensus) as sources of Islamic law, although the two sects differ significantly with regard to the manner in which they use these sources. The sects also differ on the fourth source. *Sunni* Islam uses *qiyas* as the fourth source whereas *Shi'a* Islam uses *aql* (intellect)'.

See: Institute of Islamic Banking and Insurance (IIBI), 'Glossary of Financial Terms' <http://www.islamic-banking.com/glossary_Q.aspx> accessed 15 August 2016.

¹⁷⁷ 'Lit: effort, exertion, diligence. Independent or innovative legal reasoning or interpretation (by qualified Islamic legal scholars) to formulate a ruling on a given issue on the basis of evidence found in Islamic sources'.

See: Institute of Islamic Banking and Insurance (IIBI), 'Glossary of Financial Terms' <http://www.islamic-banking.com/glossary_I.aspx> accessed 15 August 2016.

¹⁷⁸ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 834.

¹⁷⁹ Frederick V Perry, 'The Corporate Governance of Islamic Banks: A Better Way of Doing Business?' (2011) 19 Michigan State Journal of International Law 251, 261.

¹⁸⁰ See 2.6.1 for more details about *musharaka* transaction.

¹⁸¹ See 2.6.2 for more details about *mudaraba* transactions.

¹⁸² Scheherazade S Rahman, 'Globalization of Islamic Finance Law' (2008) 25 Wisconsin International Law Journal 625, 631.

¹⁸³ Timur Kuran, 'The Logic of Financial Westernization in the Middle East' (2005) 56 Journal of Economic Behavior & Organization 593, 595.

¹⁸⁴ See 2.3.1 for details about *riba*.

Behind the prohibition of interest is a belief in the establishment of justice and fairness among people. As fairness and justice are considered principles in Islam, Muslims are encouraged to conduct business fairly and engage in just financial transactions with each other.¹⁸⁵ This is because the earning of a predetermined sum of fixed income by the lender is considered unmerited.¹⁸⁶ Although it is the investor's right to be rewarded according to his capital and agreement with the bank, he should consider participating in the investment's risk, based on a PLS contract.¹⁸⁷

2.3.1. Prohibition of Interest (*Riba*)¹⁸⁸

The scholar Zaid Bin Aslam¹⁸⁹ describes the nature of interest during the pagan times. He reports that interest in pagan times followed this logic: 'when a person owed money to another man for a certain period and the period expired, the creditor would ask: "you pay me the amount or pay the extra". If he paid the amount it was well and good, otherwise the creditor increased the loan amount and extend the period for payment again.'¹⁹⁰

The purpose of prohibiting interest is to establish justice between the parties, i.e., the financier and the entrepreneur.¹⁹¹ In many verses of the Quran, it can be found that interest is prohibited. This can be seen, for example, in *Surah al-Rum* verse 161, *Surah al-Nisa* verse 161, *Surah alemran* verse 130 and *Surah al-Baqra* verses 275-28.

¹⁸⁵ Abdussalam Mahmoud Abu-Tapanjeh, 'Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles' (2009) 20 *Critical Perspectives on Accounting* 556, 563.

¹⁸⁶ In other words, the fixed interest which is received by conventional banks to provide loans to their customers is prohibited by the Islamic principles.

¹⁸⁷ Abdus Samad, Norman D Gardner and Bradley J Cook, 'Islamic Banking and Finance in Theory and Practice: The Experience of Malaysia and Bahrain' (2005) 22 *The American Journal of Islamic Social Sciences* 69, 73.

¹⁸⁸ *Riba* literally means increase and, technically, refers to the increase in the exchange of two commodities, one against its own kind. *Riba* is composed of two kinds: *Riba al-fadl* and *Riba al-Nasi'ah*. In fact, the jurists have agreed on their prohibition. First, the prohibition of *Riba al-fadl* involves the exchange of one commodity against itself and covers all commodities which are exchanged by volume or weight regardless of whether the quantity exchanged is small, for instance one date for two dates or one grain for two grains. However, *Riba al-Nasi'ah* is involved in the exchange of two commodities, one of which is not the price. See: M Umer Chapra, 'The Nature of Riba in Islam' (2006) 2 *the Journal of Islamic Economics and Finance* 1, 19.

¹⁸⁹ Zaid Bin Aslam is a Muslim scholar who lived during the period of the second Khalifah of Islam Umar Bin Khattab. He narrated various Ahadith from the Prophet's companions.

¹⁹⁰ Muhammad Ayub, *Understanding Islamic Finance* (John Wiley and Sons 2007) 46.

¹⁹¹ Md Abdul Awwal Sarker, 'Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm' (1999) 1 *International Journal of Islamic Financial Services* 1, 2.

Some Ahadith on Prohibition of Riba

In support of these verses of the Quran, there is a significant number of traditions of the Prophet (pbuh) that explain the prohibition of interest under Sharia law. The following are some *Ahadith*¹⁹² in which the prohibition of *riba* is reiterated:

- 1- From Jabir: ‘The Prophet (pbuh) cursed the receiver, the payer of interest, the one who recorded it and the witness to the transaction and said: “they are all alike”.¹⁹³
- 2- From Abu Hurayrah: The Prophet (pbuh) said: ‘On the night of Ascension I came upon people whose stomachs were like houses with snakes visible from the outside. I asked Gabriel who they were. He replied that they were people who had received interest.’¹⁹⁴
- 3- The Prophet (pbuh) announced the prohibition of *riba* in express terms on the occasion of his last Hajj,¹⁹⁵ which was a well-attended gathering of his companions. The prophet said: ‘Every form of *riba* is cancelled: capital indeed is yours which you shall have, wrong not and you shall not be wronged. Allah has given his commandment totally prohibiting *riba*. I start with the amount of *riba* which people owe to my uncle *Abbas* and declare it all cancelled.’ He then, on behalf of his uncle, cancelled the total amount of *riba* due on his loan capital from his debtors.
- 4- The Prophet (pbuh) said: ‘Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, like for like, equal for equal and hand to hand; if the commodities differ then you may sell as you wish, provided that the exchange is hand to hand.’¹⁹⁶
- 5- Abu Hurayrah reports that the Prophet (pbuh) said: ‘Refrain from seven deadly things: The companions asked him: What are these? He said: To associate partners with Allah, sorcery; to kill a soul without valid reason in the eyes of Allah; to devour interest; to devour the property of the orphan; to flee from the battlefield; and to falsely implicate chaste, innocent, believing women of vulgarity.’¹⁹⁷

¹⁹² *Ahadith* is the plural of *hadith* in Arabic.

¹⁹³ Narrated by Muslim, Tirmidhi, and Ahmad.

¹⁹⁴ Ibn Majah, Kitab al-Tijarah, Bab al-taghliz fi al-riba.

¹⁹⁵ The word Hajj is an Arabic term referring to an annual pilgrimage performed by Muslims to the city of Mecca in the Kingdom of Saudi Arabia. All Muslims are required to perform this pilgrimage at least once in their lifetime as a duty to the Islamic religion (if they have the ability and sufficient funds for the trip). This pilgrimage is the largest pilgrimage in the world, is the fifth pillar of Islam and occurs on the 8th to 12th day of Dhu al-Hijjah, the last month of the Islamic calendar.

¹⁹⁶ Muslim, Kitab al-Musaqat, Bab al-sarf wa bay al-dhahab bi al-waraq naqdan;

¹⁹⁷ Narrated by Bukhari, Muslim, Abu Dawud and Nasai.

- 6- From Anas ibn Malik: The Prophet (pbuh) said: ‘When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favours mutually.’¹⁹⁸

However, Islamic banks can take payment for services which are presented to the customers. The charge should not extend beyond the cost of the actual work that has been completed by the bank in bringing the facilities to fruition.¹⁹⁹ On the other hand, penalties or other charges imposed on clients by a bank because of default or late payment are considered *riba*.²⁰⁰

2.3.2. Prohibition of Speculation (*Gharar*)²⁰¹

Gharar is prohibited under Sharia law. It means uncertainty or incomplete information about a transaction.²⁰² Avoiding *gharar* is essential for Muslims as it prevents them from using their resources to pay for products with uncertain values. Since *gharar* contains ambiguities, any contract containing *gharar* is voidable.²⁰³ However, in reality, the determination of certainty is complicated because not everything in life is certain, especially future events. Therefore, guidelines for ‘certainty’ and adequate rules for determining the degree of *gharar* should be developed to determine the extent to which it is acceptable. This is because if *gharar* is applied too carefully, it will complicate the people’s economic lives.²⁰⁴

Therefore, it is necessary to explain the types of *gharar* that nullify a contract. Generally, *gharar* is not acceptable in the following situations:

- a) If the risk or uncertainty is significant and noticeable.
- b) If the risk has a significant impact on the price or purpose of the contract.

¹⁹⁸ Sunan al Bayhaqi, Kitab al-Buyu, Bab kullu qardin jarra manfa’atan fa huwa *riba*.

¹⁹⁹ It is not allowed for an Islamic bank to take service payment more than the actual cost. If the bank charges the clients more than the actual cost, then it will be considered *haram*. In such cases, there is the possibility for some Islamic banks to charge more service payments to customers which is considered a legal trick of receiving interest (*riba*) in another form. Thus, these service payments may be unclear for the Islamic bank’s customers with some customers considering them as a *riba*.

²⁰⁰ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 837.

²⁰¹ ‘The Arabic word *gharar* means risk, uncertainty, and hazard. Unlike *riba*, *gharar* is not precisely defined. *Gharar* is also considered to be of lesser significance than *riba*.’

See: Concepts in Islamic Economic and Finance, ‘Definition of *Gharar*’ <<https://cief.wordpress.com/2006/02/13/definition-of-gharar/>> accessed 19 August 2016.

²⁰² Md Abdul Awwal Sarker, ‘Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm’ (1999) 1 International Journal of Islamic Financial Services 1, 2.

²⁰³ Najeb Masoud, ‘Does Islamic Banking Contribute to Sharia Law: Critical Issues on Libyan Banking and Financial Markets’ (Working paper, Middle East University - Accounting and Finance Department, 2014) 1, 5.

²⁰⁴ Bashar H Malkawi, ‘Financial derivatives between Western Legal Tradition and Islamic Finance: A Comparative Approach’ (2011) 26 Journal of International Banking Law and Regulation 276, 282.

- c) If the risk cannot be satisfactorily determined through comparison with other available products which are Sharia-compliant.²⁰⁵

A good example of uncertainty and risk is an insurance contract, for instance life assurance, which is not acceptable under Sharia law because it includes uncertainty about the future as no one can predict the events of the future. Therefore, this contract contains inherent risks and uncertainties.²⁰⁶ In addition, Sharia law prohibits the sale of goods that are not in the hands of the seller, for example selling birds in the sky or fish in the sea. The seller cannot be certain that he or she can catch the bird or the fish. Therefore, this contract is invalid until the delivery of the goods has been guaranteed.²⁰⁷ In this context, contracts that depend on luck or chance are also impermissible as they too contain elements of uncertainty.²⁰⁸ It is worth noting that financial contracts based on *gharar* and *riba* are also prohibited in Abrahamic religions.²⁰⁹

2.3.3. Prohibition of Gambling (*Maisir*)²¹⁰

Maisir refers to speculative contracts of which the outcome is regarded as unforeseeable. This type of contract is prohibited in Islam because the outcome depends on chance or luck.²¹¹ In other words, it is risky and sometimes one party can earn a significant amount of money without any efforts. *Maisir* also includes gambling, which is strictly prohibited in Sharia law as it relies on chance.²¹² In short, any financial contract that depends on chance or luck is considered as *maysir* and is unacceptable from the Islamic point of view.²¹³

²⁰⁵ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 838.

²⁰⁶ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 838.

²⁰⁷ Bashar H Malkawi, 'Financial derivatives between Western Legal Tradition and Islamic Finance: A Comparative Approach' (2011) 26 *Journal of International Banking Law and Regulation* 276, 282.

²⁰⁸ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 839.

²⁰⁹ M Shahid Ebrahim and Shafiqur Rahman, 'On the Pareto-Optimality of Futures Contracts Over Islamic Forward Contracts: Implications For The Emerging Muslim Economies' (2005) 56 *Journal of Economic Behaviour & Organization* 273, 274.

²¹⁰ 'Gambling a game of chance, originally a game of chance played by the Arabs before Islam, maysir came to refer to any game of chance.'

See: Islamic Bankers, 'Definition of Maysir' <<http://www.islamicbanker.com/dictionary/m/maysir>> accessed 19 August 2016.

²¹¹ Najeb Masoud, 'Does Islamic Banking Contribute to Sharia Law: Critical Issues on Libyan Banking and Financial Markets' (Working paper, Middle East University - Accounting and Finance Department, 2014) 1, 5.

²¹² Ali Alshamrani, 'A Critical Evaluation of the Regulatory Framework for the Application of Islamic Financial Derivatives in the Kingdom of Saudi Arabia' (2014) 2 *Journal of Islamic Banking and Finance* 269, 276.

²¹³ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 839.

2.3.4. Prohibition of Illegal Activities (*Haram*)²¹⁴

Islamic law prohibits Islamic banks from being involved in activities and commodities which are considered as illegal or *haram* according to Sharia law, such as the selling of pork.²¹⁵ All activities and transactions that are conducted by Islamic banks should be legal (*halal*). Therefore, Islamic banks should avoid dealing with individuals or firms that are involved in *haram* goods or activities, such as alcohol, gambling or drugs.²¹⁶ The reason for the prohibition of these activities by Islamic law is that they have a negative influence on society.²¹⁷

Sharia Law in the Islamic Banking Industry

As a part of general Islamic finance, the Islamic banking industry is regulated by a specific body of law called Sharia or Islamic law.²¹⁸ Sharia law treats everybody equally; there are no differences between wealthy and underprivileged individuals.²¹⁹ Hence, Islamic banks that are regulated by Sharia law can prevent the exploitation of unfortunate people.²²⁰

Like all other sectors, the Islamic financial sector is also regulated and supervised by a set of rules and guidelines. Islamic financial institutions are bound by Sharia law; therefore, all activities should be compliant to this law. To ensure compliance, Islamic banks, representing Islamic financial institutions, are regulated and supervised by a body called the Sharia supervisory board. This internal supervisory body reviews the Islamic bank's products and activities to ensure that all bank activities are Sharia-compliant. This, in fact, can be considered the board's main function.²²¹ All new products must therefore be approved by the Sharia supervisory board before the bank is allowed to use them in their activities.²²²

²¹⁴ Haram is illegal activities of the Sharia point of view, such as buying and selling wine.

²¹⁵ Jasim Al-Ajmi, Nadhem Al-Saleh and Hameeda Abo Hussain, 'Investment appraisal practices: A comparative study of conventional and Islamic financial institutions' (2011) 27 *Advances in Accounting*, incorporating *Advances in International Accounting* 111, 113.

²¹⁶ Wahida Jabir Khalaf al-Munshid and Saif Kadhmi Zabun al-Saadi, 'Evaluation Investment Tools Performance of Islamic Banks in Selected Arabic Countries' (2013) 36 *The Journal of Administration & Economics* 15, 19 (translated by the author from original Arabic text by the author).

²¹⁷ Patrick Imam and Kangni Kpodar, 'Islamic Banking: How Has it Diffused?' (International Monetary Fund 10/195, 2010) 4 <<http://www.imf.org/external/pubs/ft/wp/2010/wp10195.pdf>> accessed 11 November 2015.

²¹⁸ Najeb Masoud, 'Does Islamic Banking Contribute to Sharia Law: Critical Issues on Libyan Banking and Financial Markets' (Working paper, Middle East University - Accounting and Finance Department, 2014) 1, 2.

²¹⁹ Governor Amando M Tetangco, Jr, Bangko Sentral NG Pilipinas, 'Islamic Banking and Finance in the Philippines: Opportunities and Challenges' (Islamic Banking and Finance Workshop, 11 March 2014) <<http://www.bsp.gov.ph/publications/speeches.asp?id=456>> accessed 19 August 2016.

²²⁰ Frederick V Perry 'The Corporate Governance of Islamic Banks: A Better Way of Doing Business?' (2011) 19 *Michigan State Journal of International Law* 251, 261.

²²¹ Elmelki Anas and Ben Arab Mounira, 'Ethical Investment and the Social Responsibilities of the Islamic Banks' (2009) 2 *International Business Research* 123, 127.

²²² Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 386, 387.

In conclusion, a legal and Sharia framework is essential to avoid all forms of interest in Islamic banking. To reiterate, there are five basic principles which should be followed by Islamic banks as to ensure that they are acceptable under Islamic law. These principles are as follows:

- 1- Any predetermined payments on the customers of the Islamic banks²²³ over the actual amount of the initial investment is not allowed.²²⁴
- 2- The investors and lenders should share the profits and losses.²²⁵
- 3- The act of profiting from money is impermissible under Sharia law.
- 4- All activities that are practised by Islamic banks should be clear and certain.²²⁶
- 5- All activities and investments that are practised by the bank should be acceptable under Islamic law. It is prohibited for a bank to invest in activities dealing with goods such as alcohol, pornography or weaponry.²²⁷

2.4. Islamic Banking Legal Framework

As one of the most important financial players in the market today, Islamic banks should have a comprehensive legal framework.²²⁸ The legal framework consists of laws and regulations for governing the Islamic banking industry.²²⁹ A sufficient number of qualified staffs and scholars for running the industry is also necessary. In terms of the laws of Islamic banks, there should be an Islamic Banking Act such as the one introduced in Malaysia.²³⁰ Other related laws and regulations of the financial sector should also consider the Islamic banking industry.²³¹ In that context, a central bank law and a banking law are two main laws that have regulatory functions over Islamic banks.

²²³ In other words, a fixed amount is not allowed to be guaranteed to customers of Islamic banks in most of the transactions and contracts that are provided by Islamic banks. In contrast, a fixed amount for customers of conventional banks is essential in lending and borrowing money.

²²⁴ Scheherazade S Rahman, 'Globalization of Islamic Finance Law' (2008) 25 Wisconsin International Law Journal 625, 630-631

²²⁵ Dennis Olson and Taisier A Zoubi, 'Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region' (2008) 43 The International Journal of Accounting 45, 46.

²²⁶ M Shahid Ebrahim and Shafiqur Rahman, 'On the Pareto-Optimality of Futures Contracts Over Islamic Forward Contracts: Implications For The Emerging Muslim Economies' (2005) 56 Journal of Economic Behavior & Organization 273, 274.

²²⁷ Scheherazade S Rahman, 'Globalization of Islamic Finance Law' (2008) 25 Wisconsin International Law Journal 625, 630-631.

²²⁸ See Chapter Four for more details about the Islamic banking legal framework.

²²⁹ Dr Bashar Zanun Al-Shakrchi and Halla Sami Khuthair, 'Islamic Banking: Performance and Challenges, Analysis Study of Iraqi Islamic Bank for Investment and Development between 1993-2003' (2007) 19 Journal of Bhuth Mustaqbalyah (translated from the original Arabic text by the author).

²³⁰ IFSA 2013 which is a specific act for Islamic financial institutions in Malaysia.

²³¹ The Banking Law and the Central Banking Act in any countries, or as can be seen with Malaysia and the IFSA 2013.

In some countries such as Malaysia, there are laws in addition to the Islamic banking law that regulate Islamic banks. On the other hand, some countries, such as Iraq, have financial laws and regulations that do not include the Islamic banking industry.²³² In contrast, in some countries, such as Iran and Sudan, the entire financial system is based on Sharia principles.²³³ These countries removed the notion of interest from their financial systems in order to establish a conducive environment for Islamic banking to be practised.

Islamic banks have become important participants in world financial markets. It is therefore necessary for this industry to have an adequate legal framework and a healthy environment to develop faster and compete with the conventional banking sector. An Islamic banking law should clearly define the nature of Islamic banks and their relationships with the central bank and other conventional banks.²³⁴ The legal framework needs to contain provisions relating to licensing and permissible modes of finance. All requirements for the establishment of Islamic banks must be stated clearly in the law or in these provisions. Thus, the law should facilitate Islamic banking transactions and create a suitable environment to offer Islamic banking services.²³⁵ In addition, some instructions and guidelines for assisting transactions and contracts²³⁶ are also necessary for the Islamic banking industry;²³⁷ as each country may have different conditions and situations,²³⁸ the instructions and guidelines are also different.²³⁹

Sharia Governance of the Islamic Banking Industry

Sharia governance is one of the most important aspects of the Islamic banking industry. All transactions and services of Islamic banks should be supervised by Sharia scholars who are members of the Sharia governance system. The structure of the Sharia governance consists of

²³² In Iraq, financial laws such as the CBI Law 2004 and Banking Law 2004 do not refer to the Islamic banking industry.

²³³ Dennis Olson and Taisier A Zoubi, 'Using Accounting Ratios To Distinguish Between Islamic and Conventional Banks In The GCC Region' (2008) 43 *The International Journal of Accounting* 45, 46.

²³⁴ For any Islamic banking law to be effective and complete, the law should contain all necessary principles and elements for the regulation and supervision of the Islamic banking industry.

²³⁵ Abdul Karim Aldohni, *The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge 2011) 122.

²³⁶ In Iraq, for example, besides the Islamic Banking Law 2015, there should be some guidelines and instructions issued by the CBI to facilitate in Islamic banking transactions and services.

²³⁷ Islamic banking laws and regulations will be explained in detail in Chapter Four of this research.

²³⁸ For example, a country like Iraq that does not have a comprehensive Islamic banking legal framework should have different instructions from other countries with strong Islamic banking legal frameworks.

²³⁹ For instance, the conditions and requirements of the Islamic banking licence may be different from one country to another. For countries that have unstable security, such as Iraq, the licence requirements should be stricter than those with stable security, such as the UAE. In Iraq, due to the political instability, some parties control the government making it easier for them to break the law. In this case, stricter laws and punishments are necessary for Iraq. While in countries, such as UAE and Saudi Arabia, where the government is strong and no conflict among political parties is experienced, breaching the law will not be an easy feat to materialise.

a Sharia supervisory board and a Sharia unit which focus on Sharia compatibility of all transactions and services that are conducted by Islamic banks.²⁴⁰ Islamic banking institutions are monitored by a special council, such as the central Sharia board in Malaysia known as the SAC, in order to ensure that their operations are Sharia-compliant.²⁴¹ Thus, one of the most important pillars of Islamic banking is a strong and effective supervisory system and framework.

Islamic banks in some countries have two Sharia supervisory bodies – one external supervisory body and another internal body – for the regulation and supervision of all banking activities. The external body is usually a central Sharia board at the level of the central bank.²⁴² However, if a country does not have a central Sharia board, the central bank will play the role of the external supervisory and regulatory body.²⁴³ In contrast, the internal body is represented by the Sharia supervisory board in each Islamic banks.²⁴⁴ Together, these two bodies aim to play a strong and effective role in the supervision of Islamic banks.²⁴⁵

Regulatory and Supervisory Roles of Central Banks

In most countries around the world, central banks are responsible for the regulation and supervision of the banking sector,²⁴⁶ including Islamic banks. In fact, in some countries, Islamic banks are subject to the same rules and regulations as conventional banks.²⁴⁷ In other words, both types of banks are regulated and supervised by the central bank.²⁴⁸ However, in other countries, there are special rules and regulations for the supervision of Islamic banks which oversee their relations with the central bank, such as in Jordan and Egypt. Other countries such as the UAE and Malaysia, on the other hand, have specific Islamic banking laws that exist

²⁴⁰ Wafik Grais and Matteo Pellegrini, 'Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services: Issues and Options' (World Bank, WPS4054, 2006) 14.

²⁴¹ In most of the cases, the Sharia supervisory board is responsible for monitoring Islamic banking transactions. This board is part of the bank's structure and it is necessary for every Islamic bank to establish such a board in order to be licensed.

²⁴² More details on the central Sharia board are given in Chapter Five of this thesis.

²⁴³ It is preferable for the central bank to establish a central Sharia board for the regulation and supervision of the Islamic banking industry. However, in a country where there is no central Sharia board, the central bank itself has the duty of regulating and supervising Islamic banks. In that context, the central bank should include professionals and experts who understand Islamic banking transactions and business.

²⁴⁴ See Chapter Five for more details on Sharia supervisory boards of Islamic banks.

²⁴⁵ Munawar Iqbal, Ausaf Ahamad and Tariqullah Khan, 'Challenges Facing Islamic Banking' (Islamic Development Banks occasional paper 1, 1998) 37 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 20 September 2016.

²⁴⁶ Andrew Campbell, 'Insolvent Banks and the Financial Sector Safety Net – Lessons from the Northern Rock Crisis' (2008) 20 Singapore Academy of Law Journal 316, 320.

²⁴⁷ The Iraqi Islamic banking industry is the best example.

²⁴⁸ Mohammed El Qorchi, 'Islamic Finance Gears Up' (2005) 42 Finance & Development 1, 5.

alongside conventional banks to regulate and supervise Islamic banks. The enactment of special laws for Islamic banks reduces the challenges and difficulties that the countries may face.²⁴⁹

Problems may arise when Islamic banks are given the same treatment as conventional ones by the central banks or other higher authorities.²⁵⁰ As Islamic banking transactions are based on Sharia principles, it is difficult for them to be regulated under the same rules and regulations as conventional banks.²⁵¹ In addition, there is a recognised shortage of experts in the central banks, including the CBI, who understand the nature of the Islamic banking system.²⁵² As a result, the establishment of a special law, division and court for the respective regulation, monitoring and settling of case disputes is the best solution for Islamic banks. This means that the central bank's regulatory and supervisory roles in the Islamic banking industry have to be reassessed. Therefore, the formation of a central Sharia board as the highest Sharia body for the Islamic financial sector is necessary.²⁵³

Central Sharia Board

Some countries, such as Malaysia, have a central or national Sharia board²⁵⁴ whilst other countries, such as Kuwait, do not have such a board that is linked to the central bank.²⁵⁵ The central Sharia board represents an external Sharia supervisory body for monitoring Islamic financial institutions and their respective Sharia supervisory boards. Some scholars, such as Qaradadghi,²⁵⁶ are of the opinion that the establishment of a central or national Sharia supervisory board is necessary.²⁵⁷ It can be argued that such a board can reinforce the internal

²⁴⁹ Munawar Iqbal, Ausaf Ahamad and Tariqullah Khan, 'Challenges Facing Islamic Banking' (Islamic Development Banks occasional paper 1, 1998) 37 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 20 September 2016.

²⁵⁰ Such as in Iraq, Islamic banks are subjected to the same rules and regulations as conventional banks and the CBI treats all banks the same way. See: Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

²⁵¹ Therefore, it is better for Islamic banks to be treated differently from conventional ones since the nature of Islamic banks is different. The best way is to have a specific law, which is composed of conditions and licence requirements that are only applicable for Islamic banks.

²⁵² Sahar Nasr 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North Africa Region, 2010).

²⁵³ See Chapter Five, 5.4 for more details on the necessity for the establishment of a central Sharia board.

²⁵⁴ The Sharia Advisory Council (SAC) in Bank Negara Malaysia.

²⁵⁵ Elwaleed M Ahmed, 'The Current State of Islamic Finance in the Gulf Co-operation Council' (2013) <<http://www.sudaneseconomist.com/?p=292>> accessed 22 May 2014.

²⁵⁶ Dr Ali Al-Qaradaghi is the Secretary-General of the International Union of Muslim Scholars and an Islamic financial expert in modern financial systems.

²⁵⁷ The International Union of Muslim Scholars <<http://www.iuonline.net/ar/Default.asp?ContentID=4896&menu>> accessed 20 September 2016.

Sharia supervisory boards of Islamic banks, especially by standardising their decisions.²⁵⁸ In addition, it can help the central bank in understanding Islamic banking and monitoring these Islamic banks and their Sharia supervisory boards. Therefore, it can be said that the central Sharia board minimises the responsibility of the central bank.²⁵⁹

Individual Sharia Supervisory Board

The internal supervisory body for Islamic banks is the Sharia supervisory board which comprises of experts in Sharia law. Currently, most Islamic banks have their own Sharia supervisory boards as a general practice.²⁶⁰ The most significant function of this board is to ensure that all transactions and activities conducted by the Islamic bank is in compliance with Islamic law.²⁶¹

Members of the Sharia supervisory board are represented by individuals who are proficient in Sharia, more specifically, *fiqh al-muamalat*. In addition, these scholars, who are appointed by the Islamic banks, should also be experts in law, Islamic banking and finance, and modern economics.²⁶² Usually, the minimum number of board members is three qualified scholars.²⁶³ Nonetheless, their selections vary between countries. In some countries, such as in Bahrain, they are appointed by the shareholders,²⁶⁴ whilst in other countries, such as in Kuwait, they are appointed by the General Assembly of the Islamic banks.²⁶⁵ However, in all cases, the Sharia boards of Islamic banks are not independent as they are paid by the Islamic banks.²⁶⁶

The most important function of the Sharia supervisory board is to monitor Islamic banking transactions and advise the bank staff members. However, the Sharia supervisory board cannot give directives to the banks because most of the Sharia board members do not have the

²⁵⁸ When there are different views on the same product or contract among Islamic banks, the central Sharia supervisory board can standardise these decisions. In a way, the central Sharia supervisory board has power to block or amend the decisions.

²⁵⁹ See Chapter Five for more details about the central Sharia board of the Islamic banking industry.

²⁶⁰ Bilal Khan and Emir Aly Crowne-Mohammed, 'Islamic Banking and Current Financial Crisis' (2010) 29 *Review of Banking and Financial Law* 441, 459.

²⁶¹ Mohd Hairul Azrin Haji Besar, Mohd Edil Abd Sukor, Nuraishah Abdul Muthalib and Alwin Yogaswara Gunawa, 'The Practice of Shariah Review as Undertaken by the Islamic Banking Sector in Malaysia' (2009) 5 *International Review of Business Research Papers* 294, 295.

²⁶² Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 *Sharia Science and Law Studies* 89, 100 (translated from the original Arabic text by the author).

²⁶³ Elmelki Anas and Ben Arab Mounira, 'Ethical Investment and the Social Responsibilities of the Islamic Banks' (2009) 2 *International Business Research* 123, 127.

²⁶⁴ Wafik Graiss and Matteo Pellegrini, 'Corporate Governance in Institutions Offering Islamic Financial services, Issues and Options' (World Bank Policy Research, WPS 4052, November 2006) 19.

²⁶⁵ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on *Shariah* Governance Supervision of *Sukuk* Defaults' (2012) 8 *Journal of Islamic Economics, Banking and Finance* 20, 35.

²⁶⁶ Amir Shahrudin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 *Journal Ekonom* 53, 54.

necessary experiences or skills in bank management.²⁶⁷ Therefore, the role of this board is purely advisory. It has been argued that interference by the Sharia advisory board in the bank's business may be considered a breach of the laws and regulations set by the central bank.²⁶⁸ One issue is that, as different Islamic banks have different Sharia boards, they can sometimes have different views on the same product. Hence, this may affect the public confidence in Islamic banks as a whole and leave a negative impact on the industry. In this case, the establishment of a national Sharia board is necessary in order to unify the Sharia boards' decisions; the best example is the Sharia Advisory Council (SAC)²⁶⁹ in Malaysia which is a part of Bank Negara Malaysia (BNM)²⁷⁰

2.5. Islamic Banking Operations: Services and Activities

Islamic banks offer several transactions and services to society. Some of these services are based on PLS, such as *mudaraba*, while others are based on a special service, such as *qard al-hasan*.²⁷¹ Islamic banks use various approaches and offer different accounts to achieve this. Below are some operations and services that are provided by Islamic banks to their customers.

Islamic Bank Accounts

Islamic banks serve their customers in the same way that conventional banks do by offering several types of services. Providing bank accounts is one of these services. Some of these accounts are profitable while others are not, and in some accounts, the capital is guaranteed while not in others. The bank can offer some services through these accounts for customers to conduct their businesses or daily activities. The following is a description of the types of accounts that are provided to customers by Islamic banks:

Current Account: The bank takes a deposit from the customer and keeps these funds in its custody as *wadia*.²⁷² The bank guarantees the capital and does not give any rewards, whilst investing the funds with the permission of the customer.²⁷³ The client

²⁶⁷ Shamsalden Aziz Salh, 'Sharia Supervision of Islamic Banking Institutions, Challenges and Achievements' (Islamic banking Finance Conference, Oxford, England May 2013).

²⁶⁸ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 875.

²⁶⁹ See Chapter Five, 5.5 for more details on SAC of Malaysia.

²⁷⁰ See Chapter Five, 5.6 for more details about the individual Sharia supervisory boards of the Islamic banks.

²⁷¹ *Qard al-hasan* is an interest-free loan that is given to poor people in a society by an Islamic bank. Usually, this zero interest loan is provided to needy students or poor farmers. See: Anjum Siddiqui, 'Financial Contracts, Risk and Performance of Islamic Banking' (2008) 34 *Managerial Finance* 680, 684.

²⁷² Bank Islam Malaysia, 'Current Account' <<http://www.bankislam.com.my/en/pages/CurrentAccount-i.aspx?tabs=1>> accessed 11 November 2015.

²⁷³ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 *IKIM Law Journal* 1, 7-8.

is entitled to withdraw all or part of the money from the current account at any time.²⁷⁴ The bank also provides a variety of normal services to current account holders.

Savings Account: The bank accepts deposits from its clients who are looking for a safe place to keep their funds as a *wadia*.²⁷⁵ The bank can use these funds but all profits accrued returns to the bank. There is also a possibility of the customer getting a reward from the bank from time to time, depending on the savings account, in accordance to the Islamic principle of *wadia*.²⁷⁶ The customer can withdraw part or all of the funds whenever desired.²⁷⁷ Furthermore, the financial institution provides customers with all the usual services associated with a savings account.²⁷⁸

General Investment Account: This account is based on *mudaraba* as the client acts as the capital provider and the Islamic bank as the entrepreneur.²⁷⁹ Hence, the bank accepts the deposit from its customers on the basis of this transaction. Investment account funds can be withdrawn by the client with one month advance notice.²⁸⁰ According to the *mudaraba* contract, clients looking for investments give their funds to the bank for this purpose. The bank accepts the deposit for a specific period according to the agreement with its clients. The bank acts as a manager of the fund and the customer acts as a financier. Any profits are distributed between both parties according to their pre-agreement while any losses are assumed by the provider of the fund, i.e., the client, with the bank losing its expended and unrewarded efforts.²⁸¹

Special Investment Account:²⁸² This type of account accepts deposits from governmental departments or corporations. It also operates according to the *mudaraba*

²⁷⁴ Islamic Bank of Britain, 'Current Account' <<http://www.islamic-bank.com/savings/instant-access-savings/>> accessed 25 April 2015.

²⁷⁵ *Wadia* is an agreement between the customer and the Islamic bank to keep their deposit in the bank's custody. The bank may pay a *hibah* (gift) as a show of gratitude to the customer but only at its own discretion. See: RHB, Islamic Banking, 'Wadia Saving Account' <http://www.rhb.com.my/islamic_banking/deposit/wsa-i.html> accessed 10 September 2016.

²⁷⁶ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 IKIM Law Journal 1, 7-8.

²⁷⁷ Islamic Bank of Britain, 'Savings' <<http://www.islamic-bank.com/savings/instant-access-savings/>> accessed 17 June 2014.

²⁷⁸ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 IKIM Law Journal 1, 7-8.

²⁷⁹ Bank Islam Malaysia, 'General Investment Account' <<http://www.bankislam.com.my/en/pages/GeneralInvestmentAccount-i.aspx?tabs=1>> accessed 11 November 2015.

²⁸⁰ Martin Čihák and Heiko Hesse, 'Islamic Banks and Financial Stability: An Empirical Analysis' (2010) 38, J Finance Serv Res 38, 99.

²⁸¹ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 IKIM Law Journal 1, 7-8.

²⁸² Special Investment Account operates under the same basic principles as the General Investment Account. The significant difference is that the Special Investment Account is more in tune with the requirements of the client

contract with the profits being divided between the bank and the other party on a pre-agreed basis.²⁸³ In other words, the profits earned from the investment will be shared between the client and the Islamic bank in accordance to the pre-agreed profit sharing ratio.²⁸⁴

2.6. Islamic Banking Modes of Finance or Instruments

It is important to understand how the Islamic banking industry deals with customers or account holders. Islamic banks, like conventional banks, are profit-making institutions but they conduct their activities according to contracts and transactions that are permissible under Sharia law.²⁸⁵ The relationship between an Islamic bank and its clients is based on these contracts, which are called financial instruments. Therefore, a financial instrument can be defined as a contract whose terms and conditions describe the risks and profits of the contract.²⁸⁶ The following are some important modes of finance or instruments by Islamic banking institutions.

2.6.1. *Musharaka* Transaction (Partnership)

Musharaka is a kind of partnership of two or more parties who all provide capital or labour and skills with the aim of sharing the profits and losses in accordance to their agreement.²⁸⁷ In other words, in *musharaka*, losses are in proportion to the capital contribution while the profits are according to the parties' agreement as they are free to decide on the profit division.²⁸⁸ According to *musharaka* transactions, all parties have similar rights and responsibilities.²⁸⁹ *Musharaka* is one of the most important Islamic banking modes of finance as the nature of this mode is the core idea of Islamic banking transactions. This transaction is based on PLS between parties. *Musharaka* can be described as a financial contract governed by Sharia law that refers

due to the handling of huge sums of money from the government or companies which may include their own conditions when making a contract with the Islamic bank.

See: Affin Islamic Bank Berhad, 'Special Investment Account' <<http://www.affinislamic.com.my/getdoc/768e0c65-cbe5-4ce0-bf17-4e2b53c5fca6/Affin-Islamic-Bank---Special-Investment-Account-i.aspx>> accessed 11 November 2015.

²⁸³ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 IKIM Law Journal 1, 7-8.

²⁸⁴ RHB, Islamic Banking, 'Mudaraba Special Investment Account' <http://www.rhb.com.my/islamic_banking/deposit/msiai.html> accessed 20 September 2016.

²⁸⁵ The nature of these contracts and transactions made by Islamic banks is different from the conventional ones. In Islamic banks, the profit - or in some transactions, the capital too - is not assured. In contrast, the capital and the profit (which is called interest) are assured in conventional banks.

²⁸⁶ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 75.

²⁸⁷ Dr Natalies Schoon, *Islamic Banking and Finance* (1st edn, Spiramus Press 2010) 29.

²⁸⁸ Bruce Hearn, Jennifer Piesse and Roger Strange, 'Islamic Finance and Market Segmentation: Implication for the Cost of Capital' (2012) 21 International Business Review 102, 104.

²⁸⁹ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 86.

to an agreement where two or more parties participate in a commercial project.²⁹⁰ The parties can contribute capital, labour and/or management of the business according to their agreement. Furthermore, in *musharaka* contracts, all parties can share both capital and management according to the agreement and mutual consent.²⁹¹

Conditions and Features of *Musharaka*

- 1- There should be a written contract between the partners, which provides details of all the terms and conditions of the agreement. It should explain the method of managing the capital and illustrate the distribution of any profits or losses among the parties.
- 2- The profits are distributed among the partners in accordance to the agreement while the losses are borne by all partners according to their capital ratio.
- 3- Every partner can participate in a *musharaka* contract either by cash or asset. When an asset is contributed in the form of capital that belongs to a firm, the contributing partner is relieved of the share of risks and returns attached to ownership.²⁹²
- 4- Every partner is an agent for the others.²⁹³

Applying *Musharaka* in Islamic Banking

Islamic banks use the *musharaka* transaction as a tool of finance and it is a contract between the bank and the client. Thus, in this contract, a bank and its client contribute jointly to finance a project.²⁹⁴ They use *musharaka* transactions in one of two ways. Firstly, the client deposits the money with the bank according to the *musharaka* contract and the bank invests this money together with its own money in a project. In this case, the bank acts as a manager for the capital and the client acts as a sleeping partner. The profits are divided between the bank and its customer in accordance to their agreement but the losses are shared between them according to the capital contribution.

Secondly, the bank may advance money to the client according to the *musharaka* transaction. The client will then invest this money together with his own money in a specific transaction or project. In this case, the bank becomes a sleeping partner while the customer becomes the

²⁹⁰ M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and prospects* (1st edn, Palgrave Macmillan 2005) 20.

²⁹¹ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 12 *Journal of al-Qadisiah for Management and Economic Science* 122, 133 (translated from the original Arabic text by the author).

²⁹² Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking' (2011) 2 *International Journal of Business and Social Sciences* 29.

²⁹³ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 87.

²⁹⁴ Mohammed El Qorchi, 'Islamic Finance Gears Up' (2005) 42 *Finance & Development* 1, 2.

manager of the funds. Profits and losses are divided between them according to the *musharaka* transaction. In most cases, the first way is the norm: the bank plays the managerial role and the client remains the sleeping partner.²⁹⁵ The *musharaka* transaction is a core idea in Islamic banking but in practice it is not used as widely as *murabaha* and *ijara* transactions by the banks,²⁹⁶ because through these transactions, the Islamic bank's profit is assured.

Diminishing Musharaka

In diminishing *musharaka*, the financier, which is the Islamic bank, invests in the customer's business on the basis that the client buys out the bank's share over a period of time. This type of transaction is commonly used for home mortgage financing where over a period of time, the customer purchases the bank's shares in the instalments.²⁹⁷

2.6.2. Mudaraba Transaction (Finance by Way of Trust)

Mudaraba is a partnership contract and is one of the common modes of finance used by Islamic banks. The *mudaraba* contract is between an entrepreneur (*mudarib*) and a funds provider (*rabul mal*).²⁹⁸ This contract usually includes at least two parties – one is the capital provider and the other is the investment manager. It is also usually limited to a certain period of time.²⁹⁹ According to the *mudaraba* contract, the profit is distributed between both parties in accordance to the ratio that has been agreed upon when drafting the contract. In contrast, any loss is borne by the capital provider, with the investment manager losing only personal efforts and management costs. In the case of the *mudaraba* transaction, the manager should act with utmost honesty because this transaction is a fiduciary contract. If the capital manager deals with the funds in a dishonest manner, he is considered to have committed a grave sin. Furthermore, in *mudaraba* transactions, the capital provider does not have the right to become involved in the management of the project. Even though it is the capital provider's prerogative to set any rules when negotiating the contract, once the contract comes into effect the financier cannot impose any new rules or conditions unless in mutual agreement with the investment manager.³⁰⁰ In fact, there is cooperation between the parties in *mudaraba* as there are

²⁹⁵ M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and prospects* (1st edn, Palgrave Macmillan 2005) 20-21.

²⁹⁶ Feisal Khan, 'How "Islamic" is Islamic Banking?' (2010) 76 *Journal of Economic Behavior & Organization* 805, 809.

²⁹⁷ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 848.

²⁹⁸ Bruce Hearn, Jennifer Piesse and Roger Strange, 'Islamic Finance and Market Segmentation: Implication for the Cost of Capital' (2012) 21 *International Business Review* 102, 103.

²⁹⁹ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 90.

³⁰⁰ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 848.

individuals who have funding but cannot work, while there are others who do not have funding but can work. Therefore, this transaction creates equality between members of society as is the purpose of Sharia law.³⁰¹

Conditions and Features of *Mudaraba* Contracts

- 1- The capital provider is to act only as a provider. He can impose certain pre-agreed conditions on the manager but he cannot impose any new conditions or interfere in the day-to-day management of the investment.
- 2- The manager cannot conduct any *mudaraba* transactions for any sum greater than the principal contributed by the capital provider.
- 3- The manager is not allowed to spend money for personal expenses, except in the case of expenses that are related to the *mudaraba* project.
- 4- Both parties have the right to terminate the contract at any time upon providing reasonable notice. Both parties can set conditions for termination when drafting the contract.
- 5- The profits can be distributed between parties when all liabilities have been settled or at the end of the contract.³⁰²

Applying *Mudaraba* in Islamic Banking

Islamic banks use *mudaraba* as a mode of finance in one of two ways. The first is when the bank acts as an investment manager and the customer acting as a finance provider, in accordance to the contract.³⁰³ For example, the investor deposits funds into a bank that has developed a certain expertise in the financial market and in identifying profitable projects, which the bank eventually uses to invest those funds on behalf of the investor. After a specific period, the Islamic bank and the depositor share the profits according to their pre-agreement.³⁰⁴ The second way is when the bank acts as a capital provider and the client acts as a capital manager, who uses the capital in an investment project.³⁰⁵ The profit is distributed between

³⁰¹ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 12 Journal of al-Qadisiah for management and Economic Science 122, 137 (translated from the original Arabic text by the author).

³⁰² M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and prospects* (1st edn, Palgrave Macmillan 2005) 21-22.

³⁰³ Haitham Hashim Alkafaf, 'Accounting Approaches to Investment forms in Islamic Banks and the Impact of the World Financial Crisis on It (An Applied Study on Iraqi Islamic Bank for Investment and Development –Mosul Branch)' (2012) 17 AL-Mansour Journal (translated from the original Arabic text by the author).

³⁰⁴ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 90.

³⁰⁵ Beng Soon Chong and Ming-Hua Liu, 'Islamic Banking: Interest-free or Interest-based?' (2009) 17 Pacific-Basin Finance Journal 125, 129.

them in accordance to the agreed upon ratio. In *mudaraba* transactions, many fund providers can participate and provide capital to the Islamic bank which acts as a *mudarib*. Thus, the bank can use this capital for many projects in accordance to the contract between the Islamic bank and the investors.³⁰⁶

There are two types of *mudaraba*: general and strict. In general *mudaraba*, the capital manager is allowed to invest the money in any projects or businesses. Strict *mudaraba*, on the other hand, does not allow the capital manager to invest the money in any projects that he wants. Instead, the capital provider instructs him to invest in certain projects.³⁰⁷ In the case of Islamic banks, they usually conduct *mudaraba* transactions on the basis of general *mudaraba*. It is difficult for Islamic banks to use strict *mudaraba* because they have a lot of clients and capital providers.³⁰⁸

2.6.3. Murabaha Transaction (Cost plus Profit)

Murabaha is a selling and buying contract between two parties – seller and buyer – without any financial intermediation. There are three players in a *murabaha* transaction: the supplier, the seller and the user of the product, i.e., the buyer who ordered the specific goods.³⁰⁹ The nature of this contract is that the buyer asks the seller to buy a specific commodity which will then be resold to the buyer for the original price plus a specific profit. *Murabaha* transaction is the most used mode of finance by Islamic banks³¹⁰ because the profit is guaranteed.

Conditions and Features of *Murabaha* Contract

- 1- The commodity must exist at the time of the contract.
- 2- The commodity should be in the possession of the seller at the time of the contract.
- 3- The goods must be in physical or determined possession of the seller.³¹¹
- 4- There should be certainty of the goods' delivery to the purchaser.
- 5- The price of the goods, on which the parties have agreed upon, must not increase under any circumstances, even in cases of default.

³⁰⁶ Bill Maurer, 'Anthropological and Accounting Knowledge in Islamic Banking and Finance: Rethinking Critical Accounts' (2002) 8 Journal of the Royal Anthropological Institute 645, 654.

³⁰⁷ Md Abdul Awwal Sarker, 'Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm' (1999) 1 International Journal of Islamic Financial Services 1, 5.

³⁰⁸ M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and prospects* (1st edn, Palgrave Macmillan 2005) 21.

³⁰⁹ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 83.

³¹⁰ Feisal Khan, 'How "Islamic" is Islamic Banking?' (2010) 76 Journal of Economic Behavior & Organization 805, 809.

³¹¹ Abdul Rahim Abdul Rahman, 'Islamic Microfinance: A Missing Component in Islamic Banking' (2007) 1 Kyoto Bulletin of Islamic Area Studies 38, 49.

6- The time of delivery and the payment schedule must be specified in the contract.³¹²

Applying *Murabaha* in Islamic Banking

Islamic banks use *murabaha* transactions as a mode of finance. According to *murabaha*, the Islamic bank buys goods for a client and resells it to the client at a pre-agreed price.³¹³ The client promises the bank that he will purchase the goods from the bank once they have been bought but at a different price, which includes the original cost plus an agreed profit.³¹⁴ For *murabaha* to be legal under Sharia law, there should be two contracts: first, a contract between the supplier of the goods and the Islamic bank; and second, a contract between the bank and the client who commissioned the Islamic bank to purchase the commodity. The bank must have the goods in its possession according to the first contract before drafting the second contract. Usually, the Islamic bank purchases the goods in cash and then resells them to the clients at a price which includes a mark-up that is payable as a lump sum or in instalments.³¹⁵ In *murabaha* contracts, the bank appoints the client who commissioned the bank to purchase the commodity as its agent to receive the purchased goods.³¹⁶ It is worth mentioning that this type of transaction is widely used by Islamic banks and it has been used ever since Islamic banks started their operations.³¹⁷ To avoid the credit risks of *murabaha*, the Islamic bank can request an *urboun* (a third party financial guarantee) from the other parties.³¹⁸

2.6.4. Salam Transaction (Advanced Purchase)

Salam is a contract where an advanced payment is made against the delivery of goods at a future time as arranged through the mutual agreement of the seller and buyer.³¹⁹ *Salam*, which is a forward sale, is useful for both parties. The seller can obtain money for the investment in the production process whilst the buyer removes any elements of uncertainty concerning the

³¹² M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History Performance and prospects* (1st edn, Palgrave Macmillan 2005) 22-23.

³¹³ Beng Soon Chong and Ming-Hua Liu, 'Islamic Banking: Interest-free or Interest-based?' (2009) 17 *Pacific-Basin Finance Journal* 125, 129.

³¹⁴ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 12 *Journal of al-Qadisiah for Management and Economic Science* 122, 139 (translated from the original Arabic text by the author).

³¹⁵ Haitham Hashim Alkafaf, *Accounting Approaches to Investment forms in Islamic Banks and the Impact of the World Financial Crisis on It (An Applied Study on Iraqi Islamic Bank for Investment and Development –Mosul Branch)* (2012) 17 *AL-Mansour Journal* 208 (translated from the original Arabic text by the author).

³¹⁶ M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History, Performance and Prospects* (1st edn, Palgrave Macmillan 2005) 22.

³¹⁷ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 12 *Journal of al-Qadisiah for Management and Economic Science* 122, 139 (translated from the original Arabic text by the author).

³¹⁸ Abdul Rahim Abdul Rahman, 'Islamic Microfinance: A Missing Component in Islamic Banking' (2007) 1 *Kyoto Bulletin of Islamic Area Studies* 38, 49.

³¹⁹ Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking' (2011) 2 *International Journal of Business and Social Sciences* 27.

future price.³²⁰ *Salam* is used particularly to finance the agricultural needs of farmers. In practice, farmers sell their crops before harvest to the purchaser in order to be able to buy the necessary seeds and fertilisers.³²¹ The nature of the *salam* contract is different to other contracts as it is used for perishable goods. According to the *salam* contract, the price should be paid in full when drafting the contract with specifications of the subject matter in terms of quality and quantity. In addition, the exact time and place of delivery of the goods should also be clearly stated in the contract.³²²

Salam is, therefore, an immediate payment for goods of an exact quality and quantity, pending future delivery – a feature that contrasts the *murabaha* contract.³²³ It is an acceptable type of contract under Sharia law as the Prophet (pbuh) allowed Muslims to deal with *salam*. In most cases, a *salam* contract is used in agriculture. For example, a buyer wants to purchase a specific quantity of apples from a farmer through a *salam* transaction. At the present time, the farmer does not have the apples because they are not in season and also does not have the funds to support his farm to grow these apples. Therefore, the buyer provides payment of the specific quantity of apples to the farmer at the time of the contract to receive the apples on a specific date in the future. When the time stated in the contract has arrived, the farmer must deliver the apples in the specific quantity and quality as agreed upon. If the farmer is unable to produce the apples for any reason, he can buy the same quality and quantity of apples from another supplier and deliver them to the purchaser who had pre-paid for them according to the *salam* contract. In a way, a *salam* contract may be riskier because the seller may not be able to deliver the goods to the buyer at the specified time. Therefore, the agreed price of the goods to be sold is usually cheaper than the market price, which compensates for the risk of default.³²⁴

Conditions and Features of *Salam*

- 1- The seller should be paid the full price for the goods at the time of the contract.³²⁵

³²⁰ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 80.

³²¹ Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking' (2011) 2 *International Journal of Business and Social Sciences* 27.

³²² M Iqbal and P Molyneux, *Thirty years of Islamic Banking: History, Performance and Prospects* (1st edn, Palgrave Macmillan 2005) 25.

³²³ Mohammed El Qorchi, 'Islamic Finance Gears Up' (2005) 42 *Finance & Development* 1, 2.

³²⁴ Bashar H Malkawi, 'Financial derivatives between Western Legal Tradition and Islamic Finance: A Comparative Approach' (2011) 26 *Journal of International Banking Law and Regulation* 276, 282.

³²⁵ Anjum Siddiqui, 'Financial Contracts, Risk and Performance of Islamic Banking' (2008) 34 *Managerial Finance* 680, 683.

- 2- The quality and quantity of the goods should be agreed and specified clearly in the contract.
- 3- The time and place of delivery of the goods must be specified and stated clearly in the contract.
- 4- Delivery of money in lieu of goods is not accepted – only the goods that were agreed upon should be delivered to the buyer.³²⁶
- 5- It is possible to take a mortgage and guarantee on a *salam* contract to ensure that the seller fulfils the obligation to deliver the goods on the due date.³²⁷

Applying *Salam* in Islamic Banking

Islamic banks use *salam* as one of the modes of Islamic finance. In this, the bank purchases goods on a *salam* basis, which are cheaper than market price, and then resells them after delivering to its customers or third parties.³²⁸ *Salam* contracts are usually entered into by a bank and a farmer to support the agricultural sector. In other words, the Islamic bank pays the seller of the goods and the seller can eventually use the fund for immediate needs. The seller of the goods also agrees to deliver them to the bank on a specific agreed upon date.³²⁹

2.6.5. *Ijara* Transaction (Leasing)

Ijara is an Islamic finance transaction that can be described as a sale of *manfa'a* (the right to use goods) for a specific period of time, making it similar to a lease in conventional finance. The origin of *ijara* lies in trade transactions, which then became a mode of finance in modern Islamic finance operations. The *ijara* contract is between two parties: the lessor, who is the owner of the asset, and the lessee, who rents the asset for a period of time at a rental price that is agreed upon at the time of contract. The ownership of the asset remains with the lessor who is responsible for the insurance and maintenance of the goods.³³⁰ Therefore, the risk is also borne by the lessor as the owner of the goods. Payment under *ijara* is liable only when the customer is using the asset. If the asset is lost or destroyed, the payment is also terminated.

³²⁶ Bashar H Malkawi, 'Financial derivatives between Western Legal Tradition and Islamic Finance: A Comparative Approach' (2011) 26 *Journal of International Banking Law and Regulation* 276, 282.

³²⁷ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 80.

³²⁸ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 844.

³²⁹ Anjum Siddiqui, 'Financial Contracts, Risk and Performance of Islamic Banking' (2008) 34 *Managerial Finance* 680, 683.

³³⁰ Bruce Hearn, Jennifer Piesse and Roger Strange, 'Islamic Finance and Market Segmentation: Implication for the Cost of Capital' (2012) 21 *International Business Review* 102, 104.

Therefore, as long as the asset exists and is fit for use, the rental continues. If the asset is damaged then the contract is no longer valid.³³¹

Periodically, the lessor can renegotiate the terms of the lease payment at agreed upon intervals. This is to ensure that the rental price remains at the market leasing rate. According to *ijara* transactions, the lessee does not have the option of buying the asset either during or at the end of the rental period. If the lessee does intend to buy the asset at the end of the rental period, they should make another contract called *ijara wa iqtina*.³³²

***Ijara wa Iqtina* (Hire Purchase)**

An Islamic hire purchase contract is similar to the conventional lease purchase agreement. In addition to the regular *ijara* contract, *ijara wa iqtina* includes a promise by the lessor to sell the leased asset to the lessee at the end of the rental period with a predetermined residual value of the asset.³³³ *Ijara wa iqtina* is therefore similar to an *ijara* contract with the only difference being that in this contract, the ownership of the asset transfers to the lessee at the end of the rental period at an agreed price.³³⁴ According to the hire purchase contract, the lessee pays the rental price to the lessor plus a fixed sum of money. At the end of the contract period, the ownership of the leased asset will transfer to the lessee.³³⁵

Conditions and Features of *Ijara*

- 1- There should be a written contract drawn up between the lessor and the lessee. All terms and conditions should be written in detail: lease, rental period, rental price, payment schedule and purpose of using the asset.
- 2- The leased asset should be treated as being held in trust by the lessee.
- 3- The lessor has the right to ask for compensation for any damage caused to the leased asset as a result of negligence on part of the lessee.
- 4- The lessor has the right to cancel the contract if the lessee fails to make a rental payment.³³⁶

³³¹ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 844.

³³² Abbas Mirakhor and Iqbal Zaidi, 'Profit-and-loss sharing contracts in Islamic finance' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (1st edn, Edward Elgar 2007) 52.

³³³ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 82.

³³⁴ Md Abdul Awwal Sarker, 'Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm' (1999) 1 *International Journal of Islamic Financial Services* 1, 7.

³³⁵ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 82.

³³⁶ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 81.

- 5- The ownership and risk of the asset remain with the lessor during the rental period.
- 6- The asset must exist at the time of the contract.
- 7- The period of the rental and the rental price should be clearly stated in the contract.
- 8- The lessor has the right to renegotiate the terms of the lease payment at agreed upon intervals.
- 9- The asset should be useable and fit for purpose.³³⁷
- 10- The asset should exist and be fit for purpose for the rental to be valid; if the asset is destroyed, the contract is rendered invalid.³³⁸

Applying *Ijara* in Islamic Banking

Although *ijara* acts as a mode of trade, it is also used by Islamic banks as a mode of finance.³³⁹ The bank takes on the role of the lessor and the client the lessee. For example, the bank purchases an asset which is rented by the customer for a rental fee. The risks and responsibilities of the asset remain with the bank,³⁴⁰ which retains ownership of the goods and is therefore responsible for the maintenance, monitoring and insurance of the asset under the *ijara* contract.³⁴¹ The client does not have the right to purchase the asset from the bank but another contract can be drawn up if the customer wants to do so; this second contract is called hire purchase. According to a hire purchase contract, the client becomes the owner of the asset at the end of the rental period in accordance to their agreement.³⁴²

2.5.6. *Istisnaa* Transaction (Partnership in Manufacturing)

This contract is between two parties, namely a buyer and a manufacturer. The purpose of this contract is to facilitate the manufacturing or construction of an asset on the request of the buyer. Besides *istisnaa* being a mode of finance by Islamic banks, it also participates in improving the country's economy.³⁴³ According to *istisnaa*, one party buys the materials while the other

³³⁷ Abbas Mirakhor and Iqbal Zaidi, 'Profit-and-loss sharing contracts in Islamic finance' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (1st edn, Edward Elgar 2007) 52.

³³⁸ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 844.

³³⁹ In an *ijara* transaction or contract, the Islamic bank can own the property which is not allowed under conventional banking laws and regulations. Thus, Islamic banks should be exempted from the law that states that banks cannot own properties for the purpose of banking. Therefore, Islamic banking law can allow Islamic banks to hold properties for the purpose of leasing.

³⁴⁰ Mohammed El Qorchi, 'Islamic Finance Gears Up' (2005) 42 *Finance & Development* 1, 2.

³⁴¹ Abdul Rahim Abdul Rahman, 'Islamic Microfinance: A Missing Component in Islamic Banking' (2007) 1 *Kyoto Bulletin of Islamic Area Studies* 38, 49.

³⁴² Abbas Mirakhor and Iqbal Zaidi, 'Profit-and-loss sharing contracts in Islamic finance' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (1st edn, Edward Elgar 2007) 52.

³⁴³ Dr Nagham Husian Nia'ma and Dr Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 12, *Journal of al-Qadisiah for Management and Economic Science* 122, 142 (translated from the original Arabic text by the author).

undertakes the role of manufacturing the goods in accordance to their agreement. Hence, Islamic banks use *istisnaa* for financing constructions and manufacturing projects.³⁴⁴ *Istisnaa* contracts come into existence when a manufacturer builds an asset at the request of a buyer. The contract should contain full details of the agreement between the parties, such as the price of the asset to be manufactured. The purchaser has the right to revoke the contract at the time of delivery if the asset does not conform to the specifications or is incompatible with what had been agreed upon in the contract. The schedule and method of payment in *istisnaa* transactions is flexible; the parties have the right to mutually agree on the payment type. It is not necessary for the price to be paid in advance or at the time of delivery, and it is possible for payment to be made by instalments according to the agreement between the buyer and the manufacturer.³⁴⁵ *Istisnaa* is a suitable contract for supporting new projects that require manufacturing products and supplies.³⁴⁶ In general, *istisnaa* is used for major capital projects or assets, for instance, the acquisition of a ship or aircraft.³⁴⁷

Conditions and Features of *Istisnaa*

- 1- Full payment is not required at the time of the contract.
- 2- The contract can be revoked before the manufacturer assumes the manufacturing role.
- 3- There is flexibility regarding the time of delivery and the payment method.
- 4- Once the manufacturing of the product has started, it cannot be cancelled.³⁴⁸

Applying *Istisnaa* in Islamic Banking

Istisnaa is used by Islamic banks as a mode of finance with three parties: the bank, the client and the manufacturer who is the third party. The nature of this transaction is that the bank will ask the manufacturer to create a defined product for the customer. For the *istisnaa* transaction to be valid, there should be a fixed price for the goods according to the agreement made between the parties. The bank can pay the price in advance or on a deferred basis depending on the contract.³⁴⁹ These modes of finance and products mentioned are the most well-known and offered by Islamic banks today. Whilst the Islamic banking industry is developing through

³⁴⁴ Abbas Mirakhor and Iqbal Zaidi, 'Profit-and-loss sharing contracts in Islamic finance' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (1st edn, Edward Elgar 2007) 52.

³⁴⁵ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 82.

³⁴⁶ Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking' (2011) 2 *International Journal of Business and Social Sciences* 28.

³⁴⁷ Charles Proctor, *The Law and Practice of International Banking* (2nd edn, Oxford University Press 2015) 847.

³⁴⁸ Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (2nd edn, John Wiley & Sons (Asia) 2011) 82.

³⁴⁹ Kelly Holden 'Islamic Finance, "Legal Hypocrisy" Moot Point, Problematic Future Bigger Concern' (2006) 25 *Boston University International Law Journal* 341, 352.

these modes and products, there is still a problem regarding Islamic banking products, for example, the limitations of the products that are used by Islamic banks as modes of finance.³⁵⁰ The prohibition of interest is necessary in Islamic banking products; however, there needs to be a solution to this problem because product limitation leads to client reduction. This issue can be considered as a product gap in Islamic banking which needs to be resolved through innovation. There is a high demand for new products and existing product development. This makes it essential for Islamic banks to start investing in research that focuses on new products as tools for Islamic banking income.³⁵¹

2.7. Global Bodies and Organisations for Promoting the Islamic Banking Industry and Their Forms of Assistance

There are numerous organisations and bodies that have been established in order for the Islamic banking industry to be regulated and supervised more efficiently.³⁵² These organisations assist the Islamic financial sector in different ways, such as by providing training courses, conducting research and creating experts in the Islamic financial field by offering postgraduate courses. In general, each of these organisations promotes the Islamic financial sector through different methods. The following is a description of some of the organisations founded for this purpose.

³⁵⁰ Interview with Abdulla Hama, University lecturer, University of Sulaymaniyah (Erbil, June 2015).

³⁵¹ In fact Islamic banks in Malaysia apply some products that are not used by Middle East countries Islamic banks, such as *bay Inah*.

³⁵² Other international bodies and institutions are:

- The International Islamic Liquidity Management Corporation (IILM): it is an international institution established by central banks, monetary authorities and multilateral organisations to create and issue short-term Sharia-compliant financial instruments to facilitate effective cross-border Islamic liquidity management. By creating more liquid Sharia-compliant financial markets for institutions offering Islamic financial services (IIFS), the IILM aims to enhance cross-border investment flows, international linkages and financial stability. Established on 25 October 2010, the current shareholders are from the central banks and monetary agencies of Indonesia, Kuwait, Luxembourg, Malaysia, Mauritius, Nigeria, Qatar, Turkey, the United Arab Emirates and the Islamic Development Bank.

International Islamic Liquidity Management Corporation, <<http://www.iilm.com/about-iilm/about-us.html>> accessed 25 September 2016.

-The International Islamic Financial Market (IIFM): this is the international Islamic financial services industry's standard setting organization focused on the Islamic capital & money market (ICMM) segment of the industry. Its primary focus lies in the standardization of Islamic financial products, documentation and related processes at the global level.

International Islamic Financial Market, 'Corporate Profile' <<http://www.iifm.net/>> accessed 25 September 2016.

-The Islamic Society for Institutional Economics (I-SIE): it is an academic/research-oriented non-profit body with motivation to promote intellectual and scientific discussions and research on institutions of Islam in the framework of New Institutional Economics.

See: The Islamic Society for Institutional Economics, <<http://www.i-sie.org/>> accessed 17 June 2014.

-The Islamic Banking and Finance Institute Malaysia: it is an industry-owned institute dedicated to producing well-trained personnel and executives with the required talent in the Islamic finance industry.

Islamic Research and Training Institute of Islamic Development Bank³⁵³

The Islamic Development Bank, through its Islamic Research and Training Institute (IRTI),³⁵⁴ provides important assistance to Islamic banking and financial institutions. Multiple services are provided by the IRTI, including research activities, training programmes and information services.³⁵⁵

The IRTI encourages researchers from member and non-member countries to conduct research into issues related to Islamic banking and finance in order to support this field. The organisation has its own publication for issues related to Islamic economic, banking and finance, which is called the IRTI Journal. Furthermore, the organisation offers scholarships to postgraduate students around the world as well as research grants and other research assistance.³⁵⁶

Providing training programmes in Islamic banking and finance is another activity of the IRTI. The organisation provides fee-based training courses to private institutions in cooperation with many international institutions. In addition, the IRTI runs programmes in the form of distance learning and e-learning in order to fill the gap due to the shortage of experts in this field. It aims to educate staff members from Islamic financial institutions in other countries, both members and non-members. Moreover, the IRTI has become a leader in providing information in the field of Islamic economics, banking and finance. It has developed an online system called Islamic Banking and Financial Institutions Information. This can provide information and data to academics, researchers and professionals in order to promote the development of the Islamic financial industry.³⁵⁷

³⁵³ The IRTI was established in 1981 in Saudi Arabia, and it is one of the most important organisations in relation to helping Islamic financial institutions by offering training courses and research programmes.

³⁵⁴ The Islamic Research and Training Institute is one of the most important institutes for promoting and enhancing the Islamic financial industry in the world. It provides Islamic financial institutions with certain kinds of help, such as training courses and research in the Islamic finance field.

See: Islamic Research and Training Institute, 'About IRTI' <<http://www.irti.org/English/AboutIRTI/Pages/default.aspx>> accessed 25 September 2016.

³⁵⁵ Islamic Research and Training Institute, 'About IRTI' <<http://www.irti.org/English/AboutIRTI/Pages/default.aspx>> accessed 25 September 2016.

³⁵⁶ Islamic Research and Training Institute, 'About IRTI' <<http://www.irti.org/English/AboutIRTI/Pages/default.aspx>> accessed 25 September 2016.

³⁵⁷ Islamic Research and Training Institute, 'About IRTI' <<http://www.irti.org/English/AboutIRTI/Pages/default.aspx>> accessed 25 September 2016.

Islamic Corporation for the Development (ICD) of the Private Sector

The ICD³⁵⁸ is a multilateral organisation affiliated with the IDB.³⁵⁹ The organisation's shareholders are the member countries of the IDB and five public financial institutions, including the Saudi Public Investment Fund (SPIF) and Public Organization for Awqaf.³⁶⁰ The ICD was established by the IDB Board of Governors of member countries in 1999 and its headquarters are located in Jeddah. As well as offering a number of products to clients, the ICD provides advisory services to governments and public and private sectors of its member countries, such as business environment assessments. The ICD also provides advisory services for project financing, the restructuring of companies, privatisation, securitisation, Islamic finance and the development of Islamic capital markets. Overall, the ICD has a role in supporting Islamic banking institutions in member countries of the IDB.³⁶¹

Institute of Islamic Banking and Insurance (IIBI)³⁶²

The IIBI is an independent non-profit organisation dedicated solely to education, learning, development and research in the field of Islamic banking and insurance.³⁶³ The main goal of the institute is to create a base of knowledge and understand the principles of Islamic financial services by offering the highest standard of education and learning in the areas of Islamic

³⁵⁸ The Islamic Corporation for the Development of the Private Sector (ICD) is a multilateral organization affiliated with the Islamic Development Bank (IDB). Its authorized capital stands at \$2.0 billion, of which \$1.0 billion is available for subscription. The current subscribed and paid-in capital is \$875 million and \$568 million respectively. Its shareholders consist of the IDB, 51 member countries and five public financial institutions, with headquarters in Jeddah. The ICD was established by the IDB Board of Governors during its 24th annual meeting held in Jeddah in Rajab 1420H (November 1999).

See: Islamic Corporation for the Development of the Private Sector, 'Background' <<http://www.icd-idb.com/irj/portal/anonymous?NavigationTarget=navurl://85a1ba033d81e8e0a1a5e77d882f0924>> accessed 11 November 2015.

³⁵⁹ The Islamic Development Bank is an international financial institution established in pursuance of the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah in December 1973. The Inaugural Meeting of the Board of Governors took place in July 1975, and the bank was formally opened on 20 October 1975. The purpose of the bank is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of Islamic law.

See: IDB, About IDB, 'Establishment' <<http://www.isdb.org/irj/portal/anonymous?NavigationTarget=navurl://24de0d5f10da906da85e96ac356b7af0>> accessed 11 November 2015.

³⁶⁰ Three other institutions are Iran Foreign Investment Co. (IFIC), Bank Keshavarzi-Iran and Bank Melli Iran.

³⁶¹ Islamic Corporation for the Development of the Private Sector, 'About ICD' <http://www.icd-idb.com/irj/portal/anonymous/icd_sitemap_en> accessed 14 November 2015.

³⁶² The Institute of Islamic Banking and Insurance (IIBI) is accredited by the British Accreditation Council (BAC) for Independent Further and Higher Education as an online, distance and blended learning provider. This is the first accreditation that the BAC has awarded to an organisation dedicated solely to Islamic finance education. IIBI, 'Islamic Finance Qualifications' <<http://www.islamic-banking.com/Default.aspx>> accessed 11 November 2015.

³⁶³ The Institute of Islamic Banking and Insurance was established in 1990 in London for the promotion of the Islamic financial industry.

banking and insurance. In addition, it supports research and publications in order to enhance our knowledge of the fields.³⁶⁴

The IIBI also provides training in Islamic banking and Islamic insurance. Furthermore, it works to build human resource skills in the field. The institution has its own monthly publication called *New Horizon* magazine. It also offers distance learning postgraduate diplomas in Islamic banking and Islamic insurance.³⁶⁵

2.8. Conclusion

Islamic banking is an industry that follows Sharia law. Nowadays, Islamic banks are expanding their activities around the world particularly, but not exclusively, in Muslim countries. Islamic banking business is built on Sharia principles that are taken from Sharia sources: the Quran, the Sunnah and the opinions of jurists. The main goal of the Islamic banking industry is to serve society and bring fairness to all. In that context, one of the main principles of Islamic banking is the prohibition of *riba* with the core transaction of these banks focusing on profit and loss sharing. Islamic banks are prohibited from practising all illegal transactions according to Sharia law, for example dealing with alcohol, pork and weapons.

In addition, customers in Islamic banking transactions are partners of the Islamic banks because the bank and the client have an agreement to both share profits and risks. Therefore, in Islamic banking transactions, the client shares the financial risk with the bank, which is its main distinctive feature from conventional banks.

Like the conventional banking sector, the Islamic banking industry needs a special law in order to be regulated in a proper way. The law can be in the form of a specific act or as part of a general banking law. In this regard, some countries, such as Malaysia, have a specific Islamic banking law³⁶⁶ while other countries, such as Turkey, do not have any special laws and regulations for governing Islamic banks.³⁶⁷ In addition to a special Islamic banking law for the regulation of Islamic banks, other related laws should also be amended to increase their suitability in regulating the Islamic banking industry, such as the banking law and the central bank law. However, any rule or law applicable to Islamic banks should consider Sharia

³⁶⁴ IIBI, 'Training' <<http://www.islamic-banking.com/training.aspx>> accessed 1 December 2016.

³⁶⁵ IIBI, 'Training' <<http://www.islamic-banking.com/courses.aspx>> accessed 1 December 2016.

³⁶⁶ IFSA 2013 is a specific law for the regulation of the Islamic financial sector in Malaysia.

³⁶⁷ Interview with Armagan Bayrem, Corporate Banking Director, Al-Baraka Islamic Bank (Erbil, June 2015).

principles. Thus, Islamic banks are governed by two different laws, which are Sharia and positive laws.³⁶⁸

In that context, Islamic banks are regulated and supervised by two bodies: an external and internal body. The external body is usually the central bank but in some countries it may be a specially-authorized body (central Sharia board) which is responsible for supervising the banks' activities and providing assistance to Islamic financial institutions on Sharia-related matters. Hence, the central bank is responsible for protecting the interests of the shareholders and depositors.

On the other hand, in terms of internal supervision, it is the function of the Sharia supervisory board of each Islamic bank to ensure that all the products and activities of the bank are in compliance with Sharia principles. Even though the members of the Sharia supervisory board do not have the authority to interfere in the management of the bank, the decisions made by the board still indirectly affect the management. As such, the Sharia supervisory board is considered the heart of an Islamic bank with its role of controlling the bank's activities. For the Sharia supervisory board to be effective, its members should be experts in all Islamic banking-related matters, such as Sharia, legal and modern economics, and also independent as to not be influenced by the bank.

Concerning the sources of finance, there are several tools that are used by Islamic banks as modes of finance, including *musharaka*, *mudaraba*, *murabaha*, *ijara*, *salam* and *istisnaa*. Although there is a variety of tools and contracts used as modes of finance, they are limited. Therefore, the creation and innovation of new products and modes of finance is necessary in the Islamic banking industry. Nonetheless, the development of existing products will likely have a positive impact on Islamic finance as a whole.

The establishment of the Sharia supervisory board in every Islamic bank may lead to conflicting decisions on the same product. As a result, this will affect customer confidence. Therefore, a central Sharia board for standardising decisions is needed as instituted in Malaysia.³⁶⁹ This council has the final say on internal Sharia supervisory decisions if there is a difference of opinion among Islamic banks. In addition, the central Sharia board also monitors

³⁶⁸ Due to the fact that the Islamic banking industry is part of the financial and banking sectors, it is regulated by laws and rules of these sectors. In addition, Islamic banking laws and rules are also applicable in the Islamic banking industry which is based on Sharia principles.

³⁶⁹ Malaysia has the Shariah Advisory Council (SAC) as part of the BNM for enhancing individual Sharia supervisory boards of the Islamic banks and unifying their decisions.

all Sharia supervisory board operations and movements as a higher watchdog body. Finally, it is worth mentioning that there are several international institutions and organisations that exist to enhance and improve the Islamic financial sector around the world, such as the IRTI and IIBI.

Chapter Three: Islamic Banking System of Iraq: Its Regulation and Operation

3.1. Introduction

The objectives of this chapter are to examine the Islamic banking system of Iraq and explain the role of the CBI in the regulation and supervision of the Iraqi banking system. In addition, the legal and Sharia challenges of the Islamic banking industry of Iraq are also examined in this chapter. In Chapter Two, the Islamic banking system in general has been explained. However, Chapter Three focuses on the current operational procedures of the Iraqi Islamic banking system.³⁷⁰ Thus, Chapter Three will provide the readers with a general overview of the Iraqi banking system together with the weaknesses present in the system. By identifying the faults of the Islamic banking system in Iraq, we are able to understand the challenges and find their solutions as extensively discussed in the following chapters.³⁷¹ Chapter Three will answer research question number [1]: How are Islamic banks governed and regulated in Iraq, and what are the weaknesses in the Iraqi Islamic banking system? In addition, this chapter identifies the parties responsible for these problems and how these issues can be resolved.

Currently, the Iraqi Islamic banking system faces some core problems that impact its operations and practices, such as the lack of a proper legal framework for the Islamic banking industry,³⁷² lack of comprehensive Sharia supervision and shortage of qualified Islamic banking experts. These challenges should be resolved in order to develop an effective Islamic banking system in Iraq. Furthermore, the main issues of the Iraqi Islamic banking system should also be considered. Due to the fact that the current banking system is based on the Western system, the operation of Islamic banks has become unsuccessful. This is because many assistance that are provided to the banking sector are not allowed by Sharia rules, such as receiving aid from the CBI in liquidity crises.³⁷³ Therefore, the Islamic banking industry in Iraq is regulated and governed by a regime that places many legal barriers to Islamic banks, such as accepting assistance from the CBI that includes *riba*. Since Islamic banking transactions are based on

³⁷⁰ It is important to explain and illustrate the state of Islamic banking in Iraq to understand the problems the system is facing.

³⁷¹ See Chapters Four, Five and Six for the challenges that are faced by the Islamic banking system in Iraq.

³⁷² Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 39.

³⁷³ Due to the risk of liquidity crises and not wanting to receive assistance from the CBI as a lender of last resort, Islamic banks avoid entering into long-term transactions.

Sharia rules, Islamic banks are not allowed to deal with *riba* in any of their transactions. As a result, the Islamic banking industry in Iraq faces legal and Sharia problems.

Therefore, it is important to clarify how Islamic banks in Iraq are operating under the current banking and financial systems. Furthermore, if there is no effective Islamic banking legal framework, it is necessary to question how Islamic banks are governed and regulated. These questions are answered in this chapter. Accordingly, the financial and banking systems of Iraq are thoroughly explained with clarifications on the state of Islamic banking in the country.

Therefore, the main points that are included in this chapter are:

- 1- The Iraqi banking system in general.
- 2- The position and operation of the Islamic banks in Iraq.
- 3- The regulation and supervision of the Iraqi Islamic banking industry.
- 4- Core and sub-core challenges of the Iraqi Islamic banking industry.

3.2. The Economic Conditions in Iraq and its Financial Situation

It is important to look at the Iraqi economic and financial situations before examining the banking system in the country because the banking sector is part of the economic system. Iraq is located in the Middle East and holds an important position as one of the region's oil-producing countries.³⁷⁴ It is therefore part of one of the richest regions in the world with its economy being dominated by the public sector.³⁷⁵ In fact, the country has the fifth largest proven crude oil reserve in the world.³⁷⁶ Thus, the country's economy depends on oil production, which represents 90% of foreign exchange earnings.³⁷⁷ In spite of its wealth, the country is presently one of the least banked countries in the world.³⁷⁸

³⁷⁴ Sujata Ashwarya Cheema, 'Investing in Iraq: Prospects and Challenges' (*Middle East Institute*, 20 February 2013) <<http://www.mei.edu/content/investing-iraq-prospects-and-challenges>> accessed 12 November 2015.

³⁷⁵ IMF, Iraq, '2013 Article IV Consultation' (IMF Country Report No 13/217, July 2013) <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 7 October 2016.

³⁷⁶ US Energy Information Administration, Iraq, 'Country Analysis Brief Overview' <<http://www.eia.gov/countries/country-data.cfm?fips=iz>> accessed 14 October 2016.

³⁷⁷ Global Edge, 'Iraq: Economy' <<http://globaledge.msu.edu/countries/iraq/economy>> accessed 9 June 2014.

³⁷⁸ The number of banks in Iraq is at the required level as there are many commercial and Islamic banks. However, the quality of these banks is not on par with those of other countries due to the regulatory and supervisory challenges facing the banking sector in Iraq. Thus, they experience legal and Sharia problems, such as shortage of qualified bankers and managers.

See: V Halama, 'Access to Finance by Micro, Small and Medium Enterprise in Iraq' (USAID, Tijara Provincial Economic Growth Program, 2010) 8.

According to the IMF Staff Report of 2010, credit to the economy as percentage of GDP in Iraq increased from 4% in 2007 to 8.2% in 2009.³⁷⁹ Unfortunately, this level is considered very low according to international standards. The amount taken as deposits by the private sector in 2009, on the other hand, was \$3.9 billion, representing 3.3% of the country's GDP. To increase Iraq's performance to at least the average for lower middle income countries, which is 32.54%, various initiatives need to be in place.³⁸⁰

The banking sector in Iraq is the most important part of the financial system in the country, accounting to more than 77% of the assets as of 2013.³⁸¹ It is dominated by seven big state-owned banks,³⁸² including Rashid Bank, the Trade Bank of Iraq and Rafidain Bank.³⁸³ In contrast, private banks are quite small – many of which have only been recently established.³⁸⁴ There are nine Islamic banks³⁸⁵ with the four largest by capitalisation, which are the Iraq Islamic Bank for Investment & Development, Elaf Islamic Bank, the Kurdistan Islamic Bank for Investment and Finance and the Cihan Bank for Islamic Investment & Finance, being among them.³⁸⁶ Thus, the banking system in Iraq can be considered smaller when compared to other countries in the Middle East and North African (MENA) region.³⁸⁷

The Islamic banking industry in Iraq is weak due to the incomprehensive legal framework in the country. There should be a real attempt by the CBI to support Islamic banks which are currently being treated the same as traditional banks.³⁸⁸ In that context, it is necessary for the Islamic banking industry to be reformed and developed. However, there are reasons for the

³⁷⁹ V Halama, 'Access to Finance by Micro, Small and Medium Enterprise in Iraq' (USAID, Tijara Provincial Economic Growth Program, 2010) 8.

³⁸⁰ V Halama, 'Access to Finance by Micro, Small and Medium Enterprise in Iraq' (USAID, Tijara Provincial Economic Growth Program, 2010) 8.

³⁸¹ IMF, Iraq, '2013 Article IV Consultation' (IMF Country Report No. 13/217, July 2013) <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 20 November 2016.

³⁸² CBI, Iraqi and Foreign Financial Institutions, 'State Banks' <<http://www.cbi.iq/index.php?>> accessed 20 November 2016.

³⁸³ The four smaller government banks are: Real Estate Bank, Agricultural Bank, Industrial Bank, and Iraq Bank.

³⁸⁴ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) xvi.

³⁸⁵ CBI, Iraqi and Foreign Financial Institutions, 'Islamic Banks' <<http://www.cbi.iq/index.php?>> accessed 24 January 2016.

³⁸⁶ Other Islamic banks in Iraq are Al Bilad Islamic Bank for Investment & Finance, Dijla & Furat Bank for Development & Investment, Islamic Regional Cooperation Bank for Development & Investment, Islamic National Bank, Abu Dhabi Islamic Bank, Al-Baraka Turkatilim Bankasi A.S., and International Development Bank for Investment & Islamic Finance.

See: CBI, Iraqi and Foreign Financial Institutions, 'Islamic Banks' <<http://www.cbi.iq/index.php?>> accessed 24 January 2016.

³⁸⁷ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) xvi.

³⁸⁸ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38, 39.

undeveloped financial sector in Iraq, which should be determined. This thesis argues that despite having many resources, especially oil, the country's financial system, particularly Islamic banking, is not developed. The main reason is that the Iraqi government's focus is on the military sector³⁸⁹ because the security situation³⁹⁰ of Iraq is unstable.³⁹¹ Thus, other sectors are given less emphasis including the financial sector. Additional reasons include the lack of a proper legal framework³⁹² and some Sharia issues such as weak Sharia supervisory systems and lack of qualified Sharia experts.³⁹³

Facts and Figures of the Banking Sector in Iraq

The banking sector is the most important part of the financial system in Iraq³⁹⁴ that deals with a significant amount of money.³⁹⁵ This sector is controlled by various banking institutions, including both government and private banks. The total assets of the banking system are worth 329 trillion Iraqi dinars,³⁹⁶ which represents 318% of the country's GDP. There are 51 banks operating in Iraq, including both state-owned and private banks.³⁹⁷ However, the latter outnumber the former by 36 to 10.³⁹⁸ Actually, the number of private banks are at the required level and these banks can provide services to the society.³⁹⁹

Similar to other banks, Iraqi banks offer many services, such as accepting deposits, and trading and issuing industrial and letters of credit.⁴⁰⁰ In recent times, many of the Iraqi banks have been

³⁸⁹ Around one-fourth of the Iraqi budget of 2015 is used for military and security purposes.

See: Hawlati, 'The 2015 Budget is same as 2014 Budget' <hawlati.co/61457/نەڕ شەیفەکان> accessed 20 November 2016 (translated from the original Kurdish by the author).

³⁹⁰ Due to the Iraqi army fighting ISIS, the security situation of Iraq is unstable.

³⁹¹ In 2014, the Iraqi government faced the big challenge of fighting ISIS in the north and northwest of the country where, in fact, this is still continuing in 2016.

³⁹² See Chapter Four of this thesis for more details about this issue.

³⁹³ See Chapter Five of this thesis for more details about this issue.

³⁹⁴ The banking sector accounts for more than 77% of the assets in 2013.

See: IMF, 'Iraq: 2013 Article IV Consultation' (IMF Country Report 13/217, July 2013) <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 20 November 2016.

³⁹⁵ Sahar Nasr and others, 'Iraq - Financial Sector Review' (*World Bank*, 2011) <<https://openknowledge.worldbank.org/bitstream/handle/10986/10869/661050BRI0Quic00Box365730B00PUBLIC0.pdf?sequence=1>> accessed 20 November 2015.

³⁹⁶ Equivalent to around \$282 billion.

³⁹⁷ Sujata Ashwarya Cheema, 'Investing in Iraq: prospects and Challenges' (*Middle East Institute*, 20 February 2013) <<http://www.mei.edu/content/investing-iraq-prospects-and-challenges>> accessed 20 November 2016.

³⁹⁸ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) 9.

³⁹⁹ Despite the fact that private banks outnumber government banks, this sector is dominated by state-owned banks, especially Rashid Bank and Rafidain Bank. These are two of the biggest banks in the country with many branches where most of the population's banking transactions are conducted. In contrast, most of the private banks are smaller. Seven of them have some forms of foreign participation while nine are Islamic banks.

⁴⁰⁰ Trade Bank of Iraq, 'Trade Finance' <<http://www.tbiraq.com/en/products-and-services/trade-finance/>> accessed 12 November 2015.

concentrating on housing project loans, personal loans and car loans,⁴⁰¹ some of which charge interest while others lend on an interest-free basis.⁴⁰²

There are some services that are considered common by banks worldwide but are relatively new in Iraq, such as credit cards.⁴⁰³ The first credit card was launched in the country in late 2005.⁴⁰⁴ Although the banking sector in Iraq has many problems and faces some serious challenges,⁴⁰⁵ there have been attempts to develop the sector and improve it.⁴⁰⁶ However, the Iraqi government supports state-owned banks rather than private banks which may have a negative impact on the financial sector of the country that would consequently affect the country's economy.⁴⁰⁷ Nonetheless, it seems that the number of both Islamic and conventional banks in Iraq are at the required level.⁴⁰⁸ However, the banking sector still suffers from some major challenges.⁴⁰⁹

Iraq Banking Timeline

The banking in Iraq can be divided into two periods: before 2003 and after 2003. The periods are decided based on different political and security situations. Furthermore, the new Banking Law 2004 and CBI Law 2004 were introduced after 2003.

Iraqi Banking Before 2003

Banking in Iraq has a long history. The beginning of the 1930s is generally considered the start of the banking sector in Iraq. The Iraq Currency Board was founded in London to issue notes and maintain reserves for the new Iraqi dinar.⁴¹⁰ In addition, in the mid-1930s, foreign banks

⁴⁰¹ Capital Bank, 'National Bank of Iraq' <<http://www.capitalbank.iq/content/67>> accessed 21 November 2016.

⁴⁰² Usually, Islamic banks give interest-free loans either as a *qard -al hasan* or according to the *murabaha* transaction. In contrast, commercial banks give loans with interest to their customers.

⁴⁰³ Indeed, to date, most Iraqis still do not know about credit cards or, even if they do, they do not use them, despite their worldwide popularity.

⁴⁰⁴ USAID, 'Iraq Competitiveness Analysis' (Izdihar Project, Final Report, May 2006) Chapter Three 48.

⁴⁰⁵ In Iraq, some sectors may be faced with urgent problems. For instance, due to a delay in adopting the Iraqi budget 2014, the manager of the Erbil branch of the Central Bank of Iraq Adham Karim Darwesh said: 'The delay in adopting Iraq's federal budget, in large part, is due to the dispute between Baghdad and the Kurdish Regional Government over oil exports and revenues, which has reduced banking activity in the KRG by up to 25%'.

See: John Lee, '[Budget Delay Hits KRG Banks](#)' (*Iraq Business News*, 28 March 2014) <<http://www.iraq-businessnews.com/tag/banking-finance/>> accessed 21 November 2016.

⁴⁰⁶ The industry has been supported by both local and foreign governments who have helped Iraq to develop. However, private banks including Islamic banks do not gain a lot of assistance. The Iraqi government too differentiates between state-owned banks and private banks with respect of aid.

⁴⁰⁷ The Iraqi government depends on state-owned banks to deal with other government offices and even private companies. In that sense, private banks do not have the same assistance from the government.

⁴⁰⁸ The number of banks in Iraq is sufficient to provide a variety of services to the people.

⁴⁰⁹ One of the challenges of the Iraqi banking sector is the inadequate banking system. In addition, there is a limit to clients in the country who do not use banking services widely as they are not familiar with the services that are provided by these banks. Furthermore, the Iraqi government does not make it easy for people to use and deal with banks, such as online banking and credit cards.

⁴¹⁰ CBI, 'History of the CBI' <<http://www.cbi.iq/index.php?pid=History>> accessed 21 November 2016.

and private Iraqi banks started operations in the country. Thirty years later – in 1964 – the Iraqi government nationalised all banks and insurance companies, including the Rafidain Bank.⁴¹¹ This bank is one of the largest state banks alongside Rashid Bank. Both banks became profitable largely through financing the government's budget deficits during the 1980s. In 1990, this prosperity was needed when UN economic sanctions were imposed on Iraq. From 1990 until the end of the Baath party's authority,⁴¹² the banking system was under the control of the military and the ruling party. In the early 1990s, the Iraqi government opened its banking sector to local private banks in order to support businesses and assist in offsetting the impact of the economic boycott.⁴¹³ During the time of the Gulf War (2002-2003), Iraqi banks were in an especially bad condition.⁴¹⁴ The Ministry of Finance, CBI, Baghdad Stock Exchange and two state-owned banks, Rafidain and Rashid Banks, were completely looted. Even after a year, the banking sector remained in a bad condition with near collapse.⁴¹⁵

Iraqi Banking Since 2003

After the American army came to Iraq in 2003 and the collapse of the Baath party, a new banking system commenced. In the reconstruction of the banking system, the Coalition Provisional Authority (CPA)⁴¹⁶ was confronted with a structure unlike that of neighbouring countries. In contrast to most banks in Gulf Cooperation Council countries, recovering Iraqi banks could not depend on liquidity-driven profits. At that time, the Iraqi interest rate was very high – a rate of 17% was set by the CBI. Credit demand was great and money lending was the main source of banking income. The situation of Islamic banks was even worse than the condition of conventional banks. There was little demand for Islamic banking and there were

⁴¹¹ CBI, 'History of the CBI' <<http://www.cbi.iq/index.php?pid=History>> accessed 21 November 2016.

⁴¹² Its full name is The Arab Socialist Baath Party, which was established in Syria in the 1940s by a small group of French-educated Syrian intellectuals – Michel Aflaq, a Greek Orthodox, and Salah al-Din al-Bitar, a Sunni Muslim. The word Baath means renaissance in Arabic. The party's ideology is pan-Arab, secular nationalism. The Iraqi Baath party was one of the tools by which Saddam Hussein maintained a tight grip on Iraq. See: Tarik Kafala, 'The Iraqi Baath Party' (*BBC News*, 25 March 2003) <http://news.bbc.co.uk/1/hi/world/middle_east/2886733.stm> accessed 21 November 2016.

⁴¹³ This support was offered by the Iraqi government at that time in order to minimise the impact of the economic sanctions on all sectors in the country, especially the banking sector.

⁴¹⁴ Thus, at that time the situation of the Iraqi financial sector was very weak due to the Baath rules, two wars and economic sanctions.

⁴¹⁵ Robert Looney, 'Post-war Iraq's Financial System: Building From Scratch' (2005) XII:1 Middle East Policy 134, 136.

⁴¹⁶ The CPA's authority derived formally from the status of the United States and Great Britain assumed as occupying powers under the laws of armed conflict, as acknowledged in the UN Security Council Resolution 1483 of 22 May 2003. This resolution recognized 'the specific authorities, responsibilities, and obligations under applicable international law of [the United States and United Kingdom] as occupying powers under unified command (the "Authority")'.

See: James Dobbins and others, 'Occupying Iraq: A History of The Coalition Provisional Authority' (RAND 2009) 13.

almost no experts in this type of banking.⁴¹⁷ In fact, there was only one Islamic bank in the country, namely the Iraqi Islamic Bank for Development and Investment.⁴¹⁸

The assets of the banking system in the country in March 2003 stood at approximately \$2 billion, which represented about 8% of the country's GDP. 85 to 90% of this amount was accounted for by the two government banks;⁴¹⁹ Rafidain's assets as of late 2003 were approximately \$1.03 billion,⁴²⁰ and Rashid's assets were about \$750 million⁴²¹ at that time⁴²² Based on these data, it seems that the financial sector, especially Islamic banking, was in a very bad condition during that period. In 2004, the situation changed and there was a slight recovery. New provisions were included in the banking law that were modelled significantly on the Western approach of bank regulation. These provisions granted the CBI full legal and operational authority. Most importantly, the Banking Law 2004 started to provide Iraqi banks with the power and authority that is associated with modern banks operating in today's international financial system.⁴²³

The current state of the Iraqi banking sector is also important. It is not as developed as other countries such as its neighbour Bahrain.⁴²⁴ However, the sector had an important role in supporting the financial and economic sectors of the country.⁴²⁵ Nevertheless, if compared to the Islamic banking industry, conventional banking is actually more developed in Iraq. The reasons are due to the issues that have been mentioned earlier. As all Iraqi government offices

⁴¹⁷ The situation of the Islamic banking industry in Iraq has not changed dramatically since 2003. The Islamic banking industry still has almost all problems it had before 2003, such as a shortage of qualified Islamic banking experts and an ineffective legal framework for the regulation of the industry.

⁴¹⁸ Iraqi Islamic Bank, 'About IIB' <<https://www.iraqiislamicb.com/Page.aspx?id=1#.VkTefVRoiaI>> accessed 20 November 2016.

⁴¹⁹ Robert Looney, 'Post-war Iraq's Financial System: Building From Scratch' (2005) XII:1 Middle East Policy 134, 136.

⁴²⁰ Equivalent to around £636 million.

⁴²¹ Equivalent to around £48 million.

⁴²² David Munro, 'Overview of the Iraqi Banking System: The State-Owned banks' (USAID, 9 November 2013) <http://www.izdihar-iraq.com/resources/bankingconf07/bankconf_pdfs/ref_ses5_munro_overview_iraqi_bankg_soes_032107.pdf> accessed 21 November 2016.

⁴²³ Robert Looney, 'Post-war Iraq's Financial System: Building From Scratch' (2005) XII:1 Middle East Policy 134, 136.

⁴²⁴ See more information on the Bahraini Islamic banking system in other chapters, such as Chapters Four, Five and Six.

⁴²⁵ Suad Abdul Fatah, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science' 1, 16 (translated from the original Arabic text by the author).

are dependent on state-owned banks,⁴²⁶ these banks are promoted and financed through government budget.

In contrast, the situation of Islamic banking did not change remarkably, and is similar to before.⁴²⁷ This is due to the lack of enforcement for this type of system within the Iraqi financial laws.⁴²⁸ The conventional banks, both state-owned and private, have developed in recent years due to the adoption of new laws⁴²⁹ and regulations. However, Islamic banks have not had the support to develop in the same way.⁴³⁰

3.3. Current Situation of the Iraqi Banking Sector

The important role of the banking sector in the daily activities of the Iraqi citizens cannot be denied. Most of the government's financial activities are conducted via conventional banks, especially state-owned banks in Iraq. Islamic banks, as part of the financial sector in the country, have a limited role in promoting Iraq's economic system with the support of the CBI and the Ministry of Finance.⁴³¹ However, the private banks, including Islamic banks, do not receive the same assistance from the government as state-owned banks. The three types of banks operating in the country – government, private and Islamic banks – have their own characteristics.

3.3.1. Government Banks

State-owned banks⁴³² are more organised than private banks due to the special treatment and direct support they receive from the government.⁴³³ Due to this situation, they dominate the government businesses and financial sector.⁴³⁴ Furthermore, the banking sector as a whole is

⁴²⁶ Individuals who work in the public sectors in Iraq receive their salaries from state-owned banks. Therefore, private banks, including Islamic banks, do not have this advantage which leads to a weaker relationship with the public as compared to government banks.

⁴²⁷ The only law in Iraqi Islamic banking is Islamic Banking Law 2015. Other financial laws, such as Banking Law 2004 and the CBI Law 2004, do not refer to Islamic banking.

⁴²⁸ See 3.6.1 and 3.6.2 for more details about Iraqi banking laws.

⁴²⁹ The CBI Law 2004 and the Banking Law 2004.

⁴³⁰ Robert Looney, 'Post-war Iraq's Financial System: Building From Scratch' (2005) XII:1 Middle East Policy 134, 137.

⁴³¹ Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science'1, 17 (translated from the original Arabic text by the author).

⁴³² State-owned banks are run by the government and all employers and staff members who work in these banks are paid by the government on the basis of a monthly salary.

⁴³³ In other words, state-owned banks in Iraq have a proper legal framework, as both the Banking Law 2004 and the CBI Law 2004 were designed for this type of bank. In addition, the Iraqi government and the government offices and departments conduct all their works via state-owned banks.

⁴³⁴ Carlo Sdravovich, 'Iraq: Economic Challenges for the New Government' (*ISPI*, 2014) <<http://www.ispionline.it/en/publicazione/iraq-economic-challenges-new-government-10302>> accessed 21 November 2016.

supported by the World Bank. For example, in 2009, the Iraqi government, with the support of the World Bank, embarked on a two-phase project entitled the Banking Sector Reform Strategy (2008-2012),⁴³⁵ which was extended to 2013.⁴³⁶

There are several government banks operating in Iraq with each of them having their own roles. For example, the Bank of Agriculture supports farmers and the agricultural sector. The Iraqi government, however, relies on the Rafidain Bank and Rashid Bank⁴³⁷ in its businesses and in the country's daily activities.⁴³⁸ Rafidain Bank was founded as a private bank in 1941 and was then nationalised in the 1960s to become the first government bank in Iraq. The Rafidain Bank is the biggest, oldest and most important conventional bank in Iraq.⁴³⁹ As for the Rashid Bank, it was founded much later in 1988 by carving out non-performing assets from Rafidain Bank. It is the second largest government bank and it has 170 local branches.⁴⁴⁰ These two banks were operating at that time on behalf of the government as a foreign borrowing agency; this is the reason for the rapid devaluation of the Iraqi dinar as a result of the second Gulf War that led to very large foreign exchange valuation losses.⁴⁴¹

Both banks account for 62% of the staff members of the banking sector and more than 90% of bank assets. They have many branches inside Iraq; Rafidain has 170 branches⁴⁴² while Rashid Bank has 137. Indeed, they are the only banks that have a nationwide branch system. They are supported by the government more than any other state-owned banks, such as the Bank of Agriculture. Hence, even though depositors do not tend to trust banking institutions in Iraq,⁴⁴³

⁴³⁵ The main aim of the Banking Sector Reform Strategy project is to modernise the banking system in the country. However, due to the shortage of information on the banking sector and the country's unstable political situation, it is difficult to effectively evaluate this sector and its operations. World Bank Iraq Trust Fund, 'Project Summary Sheet' <<http://siteresources.worldbank.org/IRFFI/Resources/BankingAugust2011.pdf>> accessed 21 November 2016.

⁴³⁶ World Bank Iraq Trust Fund, 'Project Summary Sheet' <<http://siteresources.worldbank.org/IRFFI/Resources/BankingAugust2011.pdf>> accessed 19 March 2013.

⁴³⁷ These two banks are considered as the main government bodies for dealing with money in the country.

⁴³⁸ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) 15.

⁴³⁹ CIA, 'Iraq's Banking System' <https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/chap2_annxG.html> accessed 21 November 2016.

⁴⁴⁰ CIA, 'Iraq's Banking System' <https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/chap2_annxG.html> accessed 21 November 2016.

⁴⁴¹ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) 15.

⁴⁴² CIA, 'Iraq's Banking System' <https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/chap2_annxG.html> accessed 12 November 2015.

⁴⁴³ US & Foreign Commercial Service, 'Doing Business in Iraq, Country Commercial guide for U.S. Companies' 51 <http://www.trade.gov/iraq/build/groups/public/@tg_iqtf/documents/webcontent/tg_iqtf_003872.pdf> accessed 12 November 2015.

to a certain extent they believe that these two banks carry a government guarantee, which gives them an advantage in deposit mobilisation.⁴⁴⁴

Due to this support from the Iraqi government, they are both considered as pillars of the financial sector in the country. Almost all government offices deal with these banks, for example, the salaries of civil servants and employees of many private sectors are paid through them and their branches. They are thus links between the government and the public/private companies. It appears that such dominance of the financial sector by these government banks does not give those in the private sector the opportunity to participate broadly in improving the country's economic system.⁴⁴⁵ This thesis argues that the Iraqi government should allow the public to deal with private banks the same way they would deal with state-owned banks.

3.3.2. Private Banks

The number of private banks in Iraq is far greater than that of state-owned banks. There are around 36 private banks in the country, with most of them having been founded in recent years. Even though there are a large number of private banks in the country, the size of these private banks is small and its focus is on trade-related businesses.⁴⁴⁶ At present, Iraq has opened the door for foreign banks to invest in the country and establish financial institutions.⁴⁴⁷ Currently, there are several foreign banks that operate in Iraq, such as HSBC Bank which has a 70% share in the Dar el Salam Bank.⁴⁴⁸

In total, private banks have 383 branches, which is in fact roughly equal to the number of branches by government banks. This shows that the state-owned banks are more active than the private banks.⁴⁴⁹ Private banks are generally disregarded when compared with state-owned banks as government offices, agencies and state-owned companies are not allowed to deal with private banks. There is thus no strong cooperation between the government and private

⁴⁴⁴ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) 15.

⁴⁴⁵ In fact, non-state-owned banks, i.e., private banks, especially Islamic banks, are mostly ignored by the government; they do not receive any financial or other assistance from the government in Iraq.

⁴⁴⁶ IMF, 'Iraq 2013 Article IV Consultation' (IMF Country Report No 13/217, July 2013) <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 12 November 2015.

⁴⁴⁷ Due to the unstable situation in Iraq in the past because of several years of war, foreign investors have, until now, not invested in Iraq widely. They do not provide all types of financial services to their clients.

⁴⁴⁸ In other words, the HSBC Bank in Iraq is working under the Dar el Salam Bank, as approximately $\frac{3}{4}$ of the share is for HSBC. If the bank had worked under the HSBC name, then it could be possible that the bank will have more customers with higher confidence in the system. However, there should be reasons behind working under the Dar el Salam bank with security possibly being one of them.

⁴⁴⁹ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) 20.

banks.⁴⁵⁰ For example, the Iraqi government does not deal with cheques that are drawn by the private banks and all payments to government offices, such as taxes or bills, should be paid through state-owned banks.⁴⁵¹ In this sense, these banks receive both direct and indirect benefits from the government. Therefore, the government should help private banks by, for instance, opening their training courses to staff members from private banks and accepting cheques from these banks the same way it accepts cheques from state-owned banks.⁴⁵²

This disregard for private banks by the Iraqi government together with a lack of assistance⁴⁵³ can be considered a critical issue facing the government. The government should treat private banks the same as government banks.⁴⁵⁴ Furthermore, there should be more cooperation between state-owned and private banks, which would also help improve the country's economic and financial sectors.⁴⁵⁵ Nevertheless, the situation is improving as some of the private banks are now offering loans to people and taking more deposits from clients. Some of these banks provide other services to their customers too, such as real estate and housing project loans. Credit cards are not popular in Iraq; hence, there are only a few private banks, such as Warka Bank, that provide this service or even ATM cards.

In fact, the limited services that are offered by private banks together with the weak relationship between the banks and the people in Iraq have decreased the confidence the people have in these banks. To date, most Iraqis do not have a bank account and do not deposit their money with banks, whether government or private, because of the country's history of instability.⁴⁵⁶

⁴⁵⁰ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 29.

⁴⁵¹ This negatively impacts private banks and their activities causing it to be harder for them to compete with government banks as the latter is heavily supported by the government.

⁴⁵² IMF, 'Iraq 2013 Article IV Consultation' (IMF Country Report No 13/217, July 2013) 19 <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 21 November 2016.

⁴⁵³ Some limited assistance has been given to private banks such as in 2009, the Iraqi Ministry of Finance opened the government LC (Letter of Credit) [A written commitment to pay by an importer's bank to the exporter's bank. an LC guarantees a payment of a specific amount in a specific currency] to businesses by granting private banks permission to issue them for less than \$4 million. However, private banks report that they have yet to receive any LCs of over \$2 million.

US & Foreign Commercial Service, 'Doing Business in Iraq, Country Commercial guide for U.S. Companies' 40 <http://www.trade.gov/iraq/build/groups/public/@tg_iqtf/documents/webcontent/tg_iqtf_003872.pdf> accessed 12 November 2015.

⁴⁵⁴ IMF, 'Iraq 2013 Article IV Consultation' (IMF Country Report No 13/217, July 2013) 19 <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 21 November 2016.

⁴⁵⁵ Sahar Nasr, 'Republic Of Iraq: Financial Sector Review (The World Bank, Middle East and North African Region, 2010) 21.

⁴⁵⁶ Awene, 'Financial Crises, Make Non-Confidence Dipper Between People and the Banks' <<http://www.awene.com/article/2014/11/24/37267>> accessed 21 November 2016 (translated from the original Kurdish by the author).

It is evident that private banks in Iraq do not have branches outside the country despite some foreign banks having branches in Iraq to invest in the financial sector.⁴⁵⁷ This thesis argues that the reason for this is that the size and quality of the private banks in Iraq is not at the required level to allow for investments abroad. Furthermore, the Iraqi government does not permit the private banks to invest overseas. In addition, foreign countries may also have reservations about allowing Iraqi banks to operate in their countries due to their security policies.

3.3.3. Islamic Banks

Islamic banks are part of private banking in Iraq with a strong influence on the financial system in the country.⁴⁵⁸ They are different from government banks and private conventional banks as Islamic banks have an additional supervisory body known as the Sharia supervisory board. Therefore, both the CBI and Sharia supervisory board regulate and supervise these banks.

3.4. Operation of the Islamic Banking Industry in Iraq

Due to the lack of a comprehensive legal and Sharia framework, the position of the Islamic banks in Iraq is not as secure as that of conventional banks. The first Islamic bank, the Iraqi Islamic Bank for Investment and Development, was founded in Iraq in 1993.⁴⁵⁹ Following this, other Islamic banks were established to meet the needs of Muslims by operating in accordance to Sharia principles.⁴⁶⁰

As with Islamic banks in other countries, Islamic banks in Iraq provide many services and use Sharia-compliant modes of finance, such as *mudaraba* and *murabaha*.⁴⁶¹ However, the limited number of experts in Iraq and in the CBI, as well as legal obstacles, are the main challenges that impact the operation of Islamic banks.⁴⁶² For instance, many operations that are practised by Islamic banks around the world are not used in Iraq, such as *salam* and *istisnaa*.⁴⁶³ The

⁴⁵⁷ Al-Baraka Islamic Bank is a branch of the Al-Baraka Islamic bank of Turkey which operates in Iraq.

⁴⁵⁸ Due to the fact that the majority of Iraqis are Muslims, they therefore desire to invest in accordance to Sharia principles with Islamic banks. Hence, if the Islamic banking system is reformed and functioning properly, the people will have increased faith in the banks, allowing them to be a major player in the Iraqi financial sector.

⁴⁵⁹ Iraqi Islamic Bank, 'About us' <<https://www.iraqiislamicb.com/Page.aspx?id=1#.VKTsC1Roial> > accessed 21 November 2016.

⁴⁶⁰ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 37.

⁴⁶¹ See Chapter Two, 2.6, for more details about Islamic banking tools and instruments.

⁴⁶² Sahar Nasr, 'Republic of Iraq: Financial Sector Review' (The World Bank, Middle East and North African Region, 2010) 23-24.

⁴⁶³ Most of the Islamic banks in Iraq do not provide agricultural or industrial loans. Even a *murabaha* transaction, which is one of the transactions that is used widely by Islamic banks in the world, is seldom used in Iraq. There are two reasons for the Islamic banks in Iraq to not provide loans. Firstly, these banks do not trust the situation in Iraq as there were many wars and political problems. Secondly, the loan should be non-interest based as Islamic banks cannot receive interest.

reason behind the disinterest of contracts and transactions with the Iraqi Islamic banks is the lack of confidence between the banks and the clients. In addition, there is a lack of laws that protect both the banks and their clients. In general, it can be observed that the absence of a comprehensive Islamic banking legal framework has impacted the relationship between Islamic banks and their clients.

However, Islamic banks in Iraq play an imperative role in developing the economic growth of the country.⁴⁶⁴ In addition, there is a real desire among depositors and investors to deal with Islamic banks and invest with them in accordance to Sharia rules⁴⁶⁵ given that the majority of Iraqis are Muslims.⁴⁶⁶ However, due to the unsupportive legal system, Islamic banks still have fewer customers than other private banks.⁴⁶⁷ Thus, customers of Islamic banks do not have access to manage their money under the *mudaraba* and *musharaka* transactions. In that context, these customers are unable to deal under certain contracts and transactions with Islamic banks. Nonetheless, Islamic banks and their customers should trust one another. Therefore, introducing a law for the protection of customers and Islamic banks is necessary in Iraq.

3.5. Governing the Islamic Banking Industry in Iraq

The Islamic banking industry in Iraq is governed by the CBI which is the sole regulator and supervisor of the banking sector in the country. In Iraq, all banking institutions are subject to the same rules and regulations.⁴⁶⁸ In addition, the experts of the CBI do not have sufficient knowledge in Islamic banking transactions.⁴⁶⁹ However, it should have adequate numbers of regulators who are knowledgeable in the regulation of both the Islamic and conventional banking sectors.⁴⁷⁰

⁴⁶⁴ Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science 1, 15 (translated from the original Arabic text by the author).

⁴⁶⁵ Interview with Bashir Hadad, Sharia Supervisory Member, Cihan Islamic Bank (Erbil, May 2015).

⁴⁶⁶ The Louis Berger Group, 'State Of Iraq's Microfinance Industry' (USAID, Tijara Provincial Economic Growth Program, 2011) 1, 48.

⁴⁶⁷ Interview with Abdulla Hama, University Lecturer, University of Sulaymaniyah (Erbil, June 2015).

⁴⁶⁸ Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science' 1, 17 (translated from the original Arabic text by the author).

⁴⁶⁹ Lack of a central Sharia board and absence of a special Islamic banking department in the CBI are evidences that Islamic banking industry in Iraq lacks expertise.

⁴⁷⁰ However, the CBI regulators do not have an Islamic banking background. They are only professionals in governing conventional banks.

Currently, the CBI focuses on the conventional banking system, especially after the CBI Law 2004 was introduced. The lack of good governance in the Islamic banking industry in Iraq is a result of having few Islamic banking experts.⁴⁷¹

The Central Bank of Iraq and Its Role of Regulation

The CBI is an independent⁴⁷² regulatory body for financial institutions in Iraq,⁴⁷³ which gives financial activities a high degree of transparency.⁴⁷⁴ It is the CBI's objective to ensure that the domestic price is stable, and to promote and stake out a competitive market-based financial system. In addition, the CBI supports sustainable growth, employment and prosperity in the country.⁴⁷⁵ The authority that has been given to the CBI was invested by law through the CBI Law 2004 that came into effect in March 2004.⁴⁷⁶ The CBI Law 2004 gave the CBI a number of functions, such as to establish, supervise and promote an effective payment system. In addition, it is also responsible for regulating Iraq's monetary policy and exchange rate policy, which are considered the most important elements in the country's economy. Furthermore, this body functions to license and supervise both the state-owned and private banks, according to the licensing instructions of the Banking Law 2004 in Iraq. It is also the CBI's responsibility to be an agent for the government to perform financial operations as necessary and according to the economic situation.⁴⁷⁷

⁴⁷¹ Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

⁴⁷² However, in October 2012 the CBI governor Shabibi was removed from his position and some employees of the CBI were arrested for alleged corruption. This case raised concerns in the international community about the CBI's independence.

See: US Department of State, '2013 Investment Climate Statement – Iraq' <<http://www.state.gov/e/eb/rls/othr/ics/2013/204661.htm>> accessed 9 June 2014.

⁴⁷³ US & Foreign Commercial Service, 'Doing Business in Iraq, Country Commercial guide for U.S. Companies' 5 <http://www.trade.gov/iraq/build/groups/public/@tg_iqtf/documents/webcontent/tg_iqtf_003872.pdf> accessed 9 June 2014.

⁴⁷⁴ Robert Looney, 'Post-war Iraq's Financial System: Building From Scratch' (2005) XII:1 *Middle East Policy* 134, 137.

⁴⁷⁵ Central Bank of Iraq, 'the CBI' <<http://www.cbi.iq/index.php?pid=TheCbi>> accessed 19 March 2013.

⁴⁷⁶ Robert Looney, 'Post-war Iraq's Financial System: Building From Scratch' (2005) XII:1 *Middle East Policy* 134, 137.

⁴⁷⁷ 'The CBI has other following functions:

- 1- To grant loans to government banks on the same terms as private banks.
- 2- To manage the country's gold reserves.
- 3- To issue the currency of Iraq.
- 4- To regulate and supervise the activities of the banks in accordance to the Banking Law.
- 5- To carry out any ancillary tasks or transactions within the framework of Iraqi law.
- 6- To serve as lender of last resort.
- 7- To promulgate rules and regulations under the banking law for the regulation of banks'.

See: Central Bank of Iraq, 'The CBI' <<http://www.cbi.iq/index.php?pid=TheCbi>> accessed 21 November 2016.

It is important to note that overseeing the monetary policy is one of the most important functions of the CBI,⁴⁷⁸ which is independent from the Ministry of Finance. The monetary policy in Iraq is controlled by the CBI in the following ways:

- A) By controlling the amount of currency in circulation;
- B) By establishing the reserve requirement on the banks' deposits;
- C) By setting the rate for deposits, loans and foreign exchange.

In addition, the CBI also provides some training courses and workshops to train commercial bankers; in fact, there is a division within the CBI (the training department), which is responsible for this.⁴⁷⁹

Today, the CBI attempts to comprehensively protect the banking institutions due to the looting and damages faced in the past which cost them significant losses.⁴⁸⁰ Currency protection is one of the main objectives of the CBI with the system currently undertaking a reasonable job of ensuring a stable exchange rate for the Iraqi currency and providing liquidity to Iraqi banks.

How the CBI Deals with Conventional and Islamic Banks

Owing to the fact that the Iraqi banking system is based on interest, the relationship of the CBI towards conventional banks is clear.⁴⁸¹ The CBI and the laws that are enacted for the financial sector are suitable for commercial banks.⁴⁸² Thus, conventional banks do not have any difficulties with the CBI rules and regulations.⁴⁸³

⁴⁷⁸ US Department of State, '2013 Investment Climate Statement – Iraq' <<http://www.state.gov/e/eb/rls/othr/ics/2013/204661.htm>> accessed 12 November 2015.

See also: David Munro, 'Overview of the Iraqi Banking System: The State Owned Banks' (USAID, Izdihar Project, March 2007) 4-5.

⁴⁷⁹ David Munro, 'Overview of the Iraqi Banking System: The State-Owned banks' (USAID, 9 November 2013) <http://www.izdihar-iraq.com/resources/bankingconf07/bankconf_pdfs/ref_ses5_munro_overview_iraqi_bankg_soes_032107.pdf> accessed 21 November 2016.

⁴⁸⁰ The Iraqi war had a negative impact on the banking sector. For example, Rafidain Bank lost an estimated \$300,000,000 to looters with its head office and many branches being completely looted and burned down. Currency losses at Rashid Bank totaled ID 138 billion, equivalent to \$69,000,000.

See: David Munro, 'Overview of the Iraqi Banking System: The State-Owned banks' (USAID, 9 November 2013) <[http://www.izdihar-](http://www.izdihar-iraq.com/resources/bankingconf07/bankconf_pdfs/ref_ses5_munro_overview_iraqi_bankg_soes_032107.pdf)

http://www.izdihar-iraq.com/resources/bankingconf07/bankconf_pdfs/ref_ses5_munro_overview_iraqi_bankg_soes_032107.pdf> accessed 21 November 2016.

⁴⁸¹ Conventional banks do not have any problems in dealing with the CBI because they are interest-based banks. In case of liquidity crises, for example, conventional banks could receive assistance from the CBI without any problems. Thus, the relationship between the CBI and conventional banks is clear as it is based on interest.

⁴⁸² Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

⁴⁸³ In fact, the current regulatory system and the CBI policy supported the development of the conventional banking sector. All financial laws are designed for governing conventional banks and this facilitated the relationship between the CBI and conventional banks.

In contrast, the CBI's relationship with Islamic banks is based on interest which is prohibited by Sharia law. Hence, the lack of a strong, properly prescribed relationship between the CBI and Islamic banks is a problem for Islamic banking institutions today.⁴⁸⁴ This is because Islamic banks are treated the same way as conventional banks by the CBI even though they are different in terms of their nature and practices. The CBI Law 2004 too does not define Islamic banking and does not provide Islamic banks their rights.⁴⁸⁵ Therefore, the relationship between Islamic banks and the CBI is inadequate⁴⁸⁶ because the Islamic banking industry should be dealt with in a different way in accordance to Islamic law.⁴⁸⁷ Hence, reform of the banking system of Iraq would help to achieve this purpose.⁴⁸⁸

3.6. Laws that Regulate and Supervise the Banking Sector in Iraq

Currently there are three main laws that regulate the Iraqi banking sector: the CBI Law 2004⁴⁸⁹, the Banking Law 2004⁴⁹⁰ and the Islamic Banking Law 2015.

The position of the Islamic banking industry in the CBI Law 2004 and the Banking Law 2004 is vague.⁴⁹¹ Therefore, the activities of Islamic banks are regulated under the Islamic Banking Law 2015.⁴⁹² In relation to Sharia supervision which is known as an internal regulatory system or Sharia supervisory regime, similar to most Islamic banks in the world, Islamic banks in Iraq have their own Sharia supervisory boards for monitoring the contracts and activities to ensure they are in compliance with Islamic law.⁴⁹³ However, apart from the Islamic Banking Law 2015, other banking laws and regulations do not deal with Islamic banks in Iraq. This can be considered a gap in the banking laws in Iraq with the CBI being responsible for this problem.

⁴⁸⁴ In an interview with Abdulla Hama, he stated that one of the challenges being faced by Islamic banks in Iraq is the nature of the relationship between the CBI and Islamic banks.

Interview with Abdulla Hama, University lecturer, University of Sulaymaniyah (Erbil, June 2015).

⁴⁸⁵ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

⁴⁸⁶ Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science 1, 17 (translated from the original Arabic text by the author).

⁴⁸⁷ The Louis Berger Group, 'Iraq's Experience with Al-Murabaha Islamic Microfinance' (USAID-Tijara Provincial Economic Growth Program, 2010) 7.

⁴⁸⁸ There needs to be some changes in the financial rules and regulations in Iraq in order to enhance the Islamic banking industry and improve the relationship between the CBI and Islamic banks.

⁴⁸⁹ For details about CBI Law 2004, see Chapter Three, 3.6.1.

⁴⁹⁰ For details about Banking Law 2004, see Chapter Three, 3.6.2.

⁴⁹¹ Khaled Saqqaf, 'Iraq: Changes in the Banking System Needed' (*Islamic Finance News*, February 2014) <<http://islamicfinancenews.com/authors/khaled-saqqaf>> accessed 21 November 2016.

⁴⁹² For details about the Internal Instruction 2006, see Chapter Three, 3.6.3.

⁴⁹³ The Louis Berger Group, 'Iraq's Experience with Al-Murabaha Islamic Microfinance (USAID-Tijara Provincial Economic Growth Program, 2010) 15.

3.6.1. The CBI Law 2004: Its Regulatory Function

The CBI Law 2004 consists of 74 articles which empower the CBI to regulate the entire banking system of the country. The law determines all functions of the CBI on the banking institutions in Iraq. In fact, it is a comprehensive law for regulating the conventional banking system. However, the CBI Law 2004 does not refer to Islamic banking businesses when it defines the term ‘bank’, merely providing a general definition.⁴⁹⁴ Thus, the CBI Law 2004 was enacted as if no Islamic banking industry was in place. The law regulates the CBI’s operations and determines its responsibilities in the banking sector and its relationship with all banking institutions.

By understanding the CBI Law 2004, especially the monetary policy of the CBI as regulated by the law, it is clear that it has little relevance to the Islamic banking industry. Article 29 of the CBI Law 2004 states that:

In order to implement the monetary policy of Iraq, the CBI shall, by regulation, require that banks maintain reserves in the form of cash holdings or deposits with the CBI. Such reserves shall be kept at prescribed minimum levels, calculated as the average of end-of-day reserve levels over such time periods as determined by the CBI and which relate to the size, type or maturity of the banks’ deposits, borrowed funds and such other liabilities as the CBI may designate. Banks shall not be permitted to operate overdrafts on reserve accounts at any time. These required reserve levels shall be the same for all banks for each category of liabilities and may be remunerated.⁴⁹⁵

Article 29 does not differentiate between conventional and Islamic banks; all banks are to be treated in the same way. Therefore, Islamic banks face the major problem of dealing with interest.⁴⁹⁶ Furthermore, as mentioned in this provision, the required reserve levels are the same for all banks.⁴⁹⁷ Thus, Islamic banks are subjected to the same regulations as conventional banks because both of them are governed by the Iraq Banking Law 2004.⁴⁹⁸ The fact is that this policy is designed for the Western banking system and is unsuitable for Islamic banks. The CBI exercises its authority over Islamic banks under laws and regulations designed to control and supervise conventional banks rather than Islamic banks. However, the laws must be implemented on both conventional and Islamic banks.

⁴⁹⁴ Article 1 of the CBI Law 2004 defines a bank as ‘a person holding a license or permit under the Banking Law to engage in banking business and other banking activities’.

⁴⁹⁵ CBI Law 2014, Article 29.

⁴⁹⁶ Saad Abd Muhammad, ‘The Relationship between Central Bank and Islamic Banks’ (2014) 40 Baghdad College for Economic Science 349, 361 (translated from the original Arabic text by the author).

⁴⁹⁷ Islamic banks have a problem with the reserve requirement of the CBI as it earns interest from Islamic banks.

⁴⁹⁸ Mohammad Ahmed Jawad, ‘Finance Committee Report on Banking System Reform Requirements in Iraq’ (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

Another problem with the CBI Law for the Islamic banking industry is the concept of lender of last resort.⁴⁹⁹ It is clear that, in general, the central bank is the lender of last resort in case any banks face liquidity crises. Thus, one of the fund providers is the central bank in the case of an emergency liquidity assistance.⁵⁰⁰ However, the assistance is only provided to banks with liquidity problems and not to insolvent banks.⁵⁰¹ In Iraq, the CBI acts as a lender of last resort when conventional banks or Islamic banks face any liquidity crises. In such a case, the CBI pays on the basis of interest, which is prohibited for Islamic banks.⁵⁰²

According to Article 30 of the CBI Law 2004, the CBI acts as lender of last resort:

In exceptional circumstances, the CBI may, on such terms and conditions as it determines, act as lender of last resort for a bank that is licensed or holds a permit issued by the CBI under the Banking Law. Such support may be provided by granting financial assistance to the bank, or for the bank's benefit, for periods not exceeding three months that may be renewed by the CBI on the basis of a program specifying the measures that the bank concerned will be taking.⁵⁰³

There is no doubt that the CBI provides loans to financial institutions on the basis of interest. Thus, individual banks should repay the interest when returning the money to the CBI. According to Islamic law, it is impermissible for the Islamic banks to pay or charge interest. Therefore, Islamic banks do not benefit from this lender of last resort function by the CBI.⁵⁰⁴ Consequently, it is difficult for Islamic banks to follow the same provisions in the CBI Law 2004. Therefore, Islamic banks should be given special treatments and be exempted from paying and charging interest.

3.6.2. The Banking Law 2004: Its Regulatory Function

The Banking Law 2004 consists of 15 sections and 108 articles. The main aim of this law is to regulate the banking system in Iraq. The Banking Law 2004 has a crucial role in regulating and supervising the Iraqi banking sector. This law determines all licence requirements and conditions for an entity requesting for one in Section 2. Article 4 of the law states that the CBI is the responsible body in Iraq that issues licences to any local or foreign banks:

Establishing a bank in Iraq, including as a majority or wholly-owned subsidiary of a foreign bank or bank holding company, shall require the prior issuance of a banking license by the CBI.

⁴⁹⁹ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 357 (as translated from the original Arabic text by the author).

⁵⁰⁰ Andrew Campbell, 'Insolvent Banks and the Financial Sector Safety Net – Lessons from the Northern Rock Crisis' (2008) 20 Singapore Academy of Law Journal 316, 320.

⁵⁰¹ Andrew Campbell, 'Bank Insolvency and the Problem of Non-Performing Loans' in Paul J Omar (eds), *International Insolvency Law: Themes and Perspectives* (1st edn, Ashgate 2008) 218.

⁵⁰² See Chapter 4, 4.3.2.1, for more details about the role of the CBI as lender of last resort.

⁵⁰³ The CBI Law 2004, Article 30.

⁵⁰⁴ The role of the central bank as a lender of last resort and solutions for this issue will be discussed in detail in Chapter Four of this research.

Establishing a branch or representative office of a foreign bank in Iraq shall require the prior issuance of a permit by the CBI. The subsidiary of foreign owned banks shall be required to have 50 billion dinars of capital. There is no restriction on where that capital is invested.⁵⁰⁵

The main regulatory aim of the Banking Law 2004 is to maintain confidence in the banking system in Iraq. However, there are other regulatory objectives of this law in order to establish a proper banking system in the country. Article 2 states that:

The primary regulatory objective of this Law is to maintain confidence in the banking system. Other regulatory objectives include those of promoting public understanding of the banking system by providing appropriate information, maintaining an appropriate degree of protection for depositors, and helping to reduce financial crime, including fraud, money-laundering and terrorist financing.⁵⁰⁶

It is important to mention that if there is a conflict with another law, the Banking Law 2004 prevails. Article 107 (2) considers its relationship to other laws:

In case of inconsistency with a provision of any other law of Iraq, this Law shall prevail.⁵⁰⁷

The Banking Law 2004 does not have any specific provision for the Islamic banking industry. All provisions are designed for the regulation of conventional banks but applied to all banks.⁵⁰⁸

3.6.3. Islamic Banking Law 2015: Analysing Its Articles

The Islamic Banking Law 2015 is the only law for the regulation of the Islamic banking industry in Iraq. There is no other Islamic financial law for the industry. Similar to the Internal Instruction 2006,⁵⁰⁹ the Islamic Banking Law 2015 does not contain all necessary terms for governing Islamic banks. The first article of the law should be a definition of Islamic banking; however, no such definitions is found in this law.

Article 1 of the Islamic Banking Law 2015 states that Islamic banks are allowed to be established in accordance to the provisions of the Iraqi Companies Law 1997 and General Companies Law 2004 of Iraq. Nonetheless, these laws do not take into account Islamic banking, as they were enacted for non-Islamic financial institutions and enterprises. Therefore, a clear definition of Islamic banks should be established under the Islamic Banking Law 2015.

⁵⁰⁵ The Iraq Banking Law 2004, Article 4(1).

⁵⁰⁶ The Iraq Banking Law 2004, Article 2(1)

⁵⁰⁷ The Iraq Banking Law 2004, Article 107(1) and (2).

⁵⁰⁸ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

⁵⁰⁹ In 2006, the CBI issued an Internal Instruction for managing the Islamic banking industry. However, the Internal Instruction 2006 had incomplete sets of rules for the regulation of Islamic banks.

In this case, the law should have more provisions in order to facilitate Islamic banking institutions.⁵¹⁰

Article 2 of the Islamic Banking Law 2015 states the aims of Islamic banks in Iraq. Thus, Islamic banking services, which are in accordance to Sharia principles, are included in the law. However, the social interest, which is one of the main purposes for establishing Islamic banking, is not stated in the law, such as paying *zakat* to poor people.⁵¹¹ Article 3 of the Islamic Banking Law 2015 states that Islamic banks and their branches, and foreign Islamic banking branches are licensed under the Banking Law 2004 and the CBI Law 2004. Thus, Islamic banks have the same licensing requirements as conventional banks, which is one of the shortcomings of the Islamic Banking Law 2015.⁵¹²

According to Article 4 of the law, Islamic banks should have a minimum capital of ID 250 billion. However, Article 4 (2) states that Islamic banks should keep a specified amount with the CBI as reserve in accordance to the Banking Law 2004. Thus, this thesis argues that the CBI treats Islamic banks the same as conventional banks since both types of banks have to keep a designated amount with the CBI that brings interest (*riba*) to Islamic banks, which is not allowed according to Sharia principles. In that case, the Islamic Banking Law 2015 does not provide solutions for the Islamic banks to avoid dealing with interest because Islamic banks operate under the Banking Law 2004 provisions.

Islamic Banking Services and Operations

Part 4 of the Iraqi Islamic Banking Law 2015, which consists of 12 articles, mentions all services and operations that can be conducted by Islamic banks. For example, Islamic banks are entitled to establish a company for their activities. This author argues that this is the most important aspect that benefits Islamic banks. Thus, Islamic banks can act as a middleman between customers and the company. Article 5 (6) states that Islamic banks can hold, sell, lease and rent moveable and unmovable properties. In fact, this provision is very important

⁵¹⁰ Special principles for licencing Islamic banks should be included in the Islamic Banking Law 2015.

⁵¹¹ One of the main purposes of the Sharia law and the establishment of Islamic banks is to help society and provide assistance to people with low-income statuses. Thus, this purpose can be achieved through the provision of *zakat* and *qard al-hasan* to these people through the Islamic banks. However, these banks in general do not provide *qard al-hasan* to anyone. Therefore, the primary aim that Islamic banks have been established for is not yet achieved.

⁵¹² Both the IFSA 2013 in Malaysia and Volume 2-Islamic Bank in Bahrain include licence requirements and conditions for Islamic banks.

because it has a significant role in facilitating Islamic banking transactions and operations, such as conducting *murabaha*.⁵¹³

On the other hand, Article 6 of the Islamic Banking Law 2015 mentions all prohibited activities by the Islamic banks. These activities are not in compliance with Sharia rules, such as, activities that contain *riba*.

Sharia Supervision of the Islamic Banking Industry

Part 5 of the Iraqi Islamic Banking Law 2015, which consists of 5 articles, mentions all related points about Sharia supervision of the Islamic banks, such as the establishment of the Sharia supervisory board and its functions.

Article 7 (1) (a) of the Islamic Banking Law 2015 states that Islamic banks shall establish a Sharia supervisory board with the approval of the CBI. Part (b) of Article 7 (1), furthermore, states that each board should have a minimum of 3 members with at least 2 of them being experts in Islamic Fiqh and Usul Fiqh, while the other member specializing in the banking, legal and financial areas.⁵¹⁴ The thesis, however, argues that it would be difficult for the members of the Sharia supervisory board to understand one another due to their different knowledge and backgrounds. As for Article 7 (1) (c), it is mentioned that the members of the Sharia supervisory board of the Islamic banks should be appointed by the general assembly of the bank with the approval of the CBI.

In addition, Article 7 (2) of the Islamic Banking Law 2015 states that the members of the Sharia supervisory board have to select one of their members to be the chairman and another to be the executive manager. The Sharia supervisory board of the Islamic banks can also request assistance from other people or bodies.

Article 8 of the Islamic Banking Law 2015 mentions all functions of the Sharia supervisory board, such as monitoring Islamic banking activities and transactions, and preparing reports requested by the general assembly of the bank.⁵¹⁵ Article 9 of the law states that Islamic banks

⁵¹³ Due to the fact that *murabaha* transactions requires two contracts (one contract between the seller and the bank and another between the bank and the buyer), Islamic banks should purchase the goods first and then resell them to their customers. It is a condition for the Islamic banks to hold the goods first and then resell them.

⁵¹⁴ It is worth mentioning that the Internal Instruction 2006 conflicts with the Islamic Banking Law 2015 in determining the number of Sharia supervisory board members. According to the Islamic Banking Law 2015, the minimum number of members is 3 with a maximum of 5 members, while according to the Internal Instruction, the minimum is 5 members with a maximum of 7 members. It is true that the law takes priority over the Internal Instruction but the CBI should rescind the Internal Instruction 2006 or change it to avoid confusions.

⁵¹⁵ One of the functions of the Sharia supervisory board of the Islamic bank is issuing *fatwas*. However, the Islamic Banking Law 2015 does not mention that Sharia board members of an Islamic bank have the power to issue a

cannot terminate the memberships of the Sharia supervisory board members without 2/3 of the bank's administrative council members, without having a reason for termination and with the general assembly approval. Furthermore, Article 10 of the law states that each Islamic bank should establish an internal Sharia auditing unit to audit all transactions that are conducted by the bank.

Some General Rules

Article 11 of the Islamic Banking Law 2015 states that Islamic banks and foreign Islamic banking branches should prepare an annual report on their budget according to the international standards for Islamic finance. Article 13 states that, according to the Islamic Banking Law 2015, Islamic banks should refer to the Iraqi Banking Law 2004, the CBI Law 2004, the Anti-Money Laundering Law 2004, the Companies Law 1997, the General Companies Law 2004 and standards of the AAOIFI, when there is not a specific provision in the Islamic Banking Law 2015.

Article 13 states that Islamic banks and foreign Islamic bank branches are exempted from taxes of buying and selling any properties in all activities. Therefore, Article 13 is very important for Islamic banks. This provision also encourages Islamic banks to have more activities to facilitate their overall operations.

Article 14 states that Islamic banks that were established before the enactment of the Islamic Banking Law 2015 should carry out their professional activities according to the provisions of this new law. Finally, Article 15 of the law states that the CBI can issue instructions for facilitating the implementation of this law. However, this thesis argues that for the CBI to issue instructions and guidelines to facilitate the application of the Islamic Banking Law, it requires the involvement of Islamic banking experts, both Sharia and legal experts.

Main Weaknesses of the Islamic Banking Law 2015

The Islamic Banking Law 2015 does not cover the means to manage and regulate the relationship between the central bank and the Islamic banks⁵¹⁶ nor between conventional and

fatwa because there is a central Sharia board in the CBI which is responsible for dealing with Sharia issues in Islamic banks.

⁵¹⁶ The CBI is the sole regulatory body in the banking industry in Iraq. It is therefore important for the CBI to treat Islamic banks in accordance to the Sharia principles and deal with the Islamic banks not on the interest-based concept.

Islamic banks. Therefore, such issues must be regulated by laws, which are currently not available in addressing these issues and challenges.⁵¹⁷

An additional weakness in the Islamic Banking Law 2015 is that it does not stipulate any supreme Sharia body that should be in charged of the supervision and monitoring of Islamic banks and their Sharia boards, such as the SAC in Malaysia which is the highest Sharia council in that country.⁵¹⁸ Establishing a specific authoritative body for this task is imperative at the present time.

Furthermore, since Islamic banks deal directly with people, there needs to be a mechanism for managing this relationship. Iraqis have bad experiences with banks in general as most of the Iraqi banks faced looting in the past.⁵¹⁹ As a consequence, Iraqis do not trust Islamic banks and tend to avoid dealing with them.⁵²⁰ Therefore, the CBI must act to return public confidence. The relationship between banking institutions and the public could be improved through a law which clearly defines this relationship.⁵²¹ Unfortunately, this is not currently found in the Islamic Banking Law 2015, compounding the lack of confidence in this system.

Moreover, the Islamic Banking Law 2015 does not mention licence requirements for Islamic banks, as licence requirements and conditions are important principles in Islamic banking law. Another critical point is that the Islamic Banking Law 2015 does not mention any punishments for those who breach any law provisions.⁵²²

⁵¹⁷ The relationships between Islamic banks with other financial institutions and bodies should be regulated by laws to determine the mode of interaction and identify their rights and obligations towards each other. Since Islamic banks are forbidden from dealing with interest and interest being a cornerstone in the conventional banking system (of which the central bank is part of), it is difficult for Islamic banks to deal with institutions operating within this other system.

⁵¹⁸ Jasri Jamal, Nor Aziah Mohd and Kamal Halili, 'Alternative Dispute Resolution In Islamic Finance: Recent Development In Malaysia' (2011) 3, *International Journal of Social Sciences and Humanity Studies*, 185.

⁵¹⁹ *Doing Business in Iraq*, Country Commercial guide for U.S. Companies, 'Doing business in Iraq' p 51 <http://www.trade.gov/iraq/build/groups/public/@tg_iqtf/documents/webcontent/tg_iqtf_003872.pdf> accessed 22 November 2016.

⁵²⁰ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank, (Erbil, June 2015).

⁵²¹ Issuing guidelines by the CBI could manage the relationship between Islamic banks and their clients. In addition, the guidelines could also manage and organise the relationship between Islamic banks.

⁵²² In contrast, the Malaysian IFSA 2013 imposes punishments for those who breach any provisions of the act.

3.6.4. Islamic Banking Internal Instruction 2006

In Iraq, besides the Islamic Banking Law 2015, there is also an Internal Instruction 2006 for managing the Islamic banking industry,⁵²³ but with no legal power.⁵²⁴ Furthermore, this Internal Instruction 2006 does not contain all the rules that are necessary for the Islamic banking industry's services; it only covers some basic principles.

Comparison between the Islamic Banking Law 2015 with the Internal Instruction 2006

Looking closely at the Internal Instruction 2006, which was issued by the CBI, and the Islamic Banking Law 2015, one cannot find many differences between them. The Islamic Banking Law 2015 consists of 16 Articles while the Internal Instruction 2006 consists of 13 Articles. Thus, there are many similarities between the Islamic Banking Law 2015 and the Internal Instruction 2006. Many shortcomings which can be found in the Internal Instruction 2006 are replicated in the Islamic Banking Law 2015. For example, neither the Islamic Banking Law 2015 nor the Internal Instruction 2006 defined the term 'Islamic banking'. Furthermore, neither of them determined the qualifications required by the Sharia supervisory board members in detail. Furthermore, both do not specify the Islamic banking licence requirements and conditions. They also do not state the body that has the final verdict in cases relating Sharia matters.

On the other hand, there are some differences between Islamic Banking Law 2015 and Internal Instruction 2006. For example, the Internal Instruction 2006 clearly mentions that conventional banks have the right to provide Islamic banking services by opening an Islamic banking window while the Islamic Banking Law 2015 does not explicitly specify that conventional banks can provide Islamic banking services. Another point is that, in the Islamic Banking Law 2015, Article 5(c) states that, "The members of the Sharia supervisory board of the Islamic bank should be appointed by the general assembly of the bank with the CBI approval" while in the Internal Instruction 2006, this point is not mentioned. Another difference is in Article 5 of the Islamic Banking Law 2015, which states that Islamic banks can hold moveable and unmovable properties, sell them, lease them and rent them.⁵²⁵

Nonetheless, it seems that there is no big difference between the Islamic Banking Law 2015 and the Internal Instruction 2006. Thus, this thesis argues that the Internal Instruction 2006 was reviewed by the CBI and underwent minor alterations before being enacted as a law. More so,

⁵²³ The Internal Instruction 2006 is a guideline issued by the CBI in 2006 for facilitating Islamic banking businesses in Iraq. The Internal Instruction 2006 mentions the basic rules of Islamic banking transactions. Therefore, the instruction cannot be considered a law or regulation.

⁵²⁴ Interview with Bashi Hadad, Sharia Supervisory Member, Cihan Islamic Bank (Erbil. May 2015)

⁵²⁵ Islamic banking Law 2015, Article 5 (6).

it is not rational that a special Islamic banking law for regulating and managing Islamic banking industry consists of only 16 Articles. Therefore, this thesis argues that the Islamic Banking Law 2015 is an incomplete set of rules and regulations, and should be amended in order to be more comprehensive. It is also evident that the CBI does not have sufficient Islamic banking experts and professionals to draft a complete Islamic banking law. However, the CBI could enlist the assistance of Islamic banking regulators from other countries, such as Bahrain. In general, the Islamic Banking Law 2015 is not the best legislation available for the regulation of the Iraqi Islamic banking industry.

Therefore, this thesis argues that amendments to the Banking Law 2004, CBI Law 2004 and the Islamic Banking Law 2015 are necessary. In fact, someone may argue that it is not reasonable to amend the Islamic Banking Law 2015 because the law was only recently enacted. However, this author argues that the Islamic Banking Law 2015 is incomplete and should either be amended or have the CBI issue several guidelines in order to give wider scopes for the Islamic banks to conduct their financial services.

3.7. Ways to Establish an Effective Legal Framework for the Iraqi Islamic Banking Industry

Establishing an effective legal framework for the Iraqi Islamic banking sector is necessary as it would improve this industry. In order to establish this legal framework in Iraq, this thesis argues that there are two main steps that can be pursued. The first step is to introduce a separate Islamic Banking Law⁵²⁶ for the regulation of the industry.⁵²⁷ It should be noted that despite the Islamic Banking Law 2015 being only recently enacted, it seems to have many shortcomings. Thus, an effective and comprehensive set of laws and regulations is necessary. This Islamic banking law can minimise legal problems of Islamic banks and assist them in undergoing faster developments. In this respect, the Islamic Banking Law 2015 should cover the entire Islamic banking system. The law should encompass all requirements for supporting and improving Islamic banking transactions. Furthermore, it must facilitate Islamic banks in conducting their businesses without facing any challenges or obstacles.⁵²⁸ In addition, the law should also

⁵²⁶ The conventional bank, tax and company laws comprise provisions that limit the activities conducted by the Islamic banks within the scope of the Western banking system. Therefore, introducing a separate law for the practice of Islamic banking is necessary.

⁵²⁷ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 47.

⁵²⁸ L Errico and M Farhbaksh 'Islamic banking: Issues in Prudential Regulations and Supervision' (International Monetary Funds, WP/98/30, 1998) 15.

manage the relationship between the CBI with Islamic banking institutions, and also the relationship between individual Islamic banks.

The second step that should be taken is to amend existing laws that have had an impact on the Islamic banking industry,⁵²⁹ such as the CBI Law 2004 and Banking Law 2004. These laws are designed for the regulation of the conventional banking sector rather than the Islamic banking industry. All the provisions of these two laws and also other laws⁵³⁰ are designed primarily for conventional banks and not suitable for Islamic banks. In this regard, there is a need for these laws to be amended in order for the Islamic banking industry to operate effectively.

In addition to those steps, the Iraqi Islamic banking legal framework could be reworked so as to comply with all the international rules that are issued for the regulation and supervision of the Islamic banking sector. For example, the standards that have been issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI),⁵³¹ such as governance and Sharia standards,⁵³² should be followed as adopted in Bahrain.⁵³³ The Islamic Financial Services Board (IFSB)⁵³⁴ is another international body that develops the Islamic banking industry worldwide and acts as a type of Basel Committee for Islamic banks.⁵³⁵ The IFSB promotes the development of a prudent and transparent Islamic financial industry by adopting existing international standards to be consistent with Sharia principles as well as advising about their adoption.⁵³⁶ Thus, all standards and guidelines of these two bodies can be considered as a means of reforming the Islamic banking sector in Iraq.⁵³⁷

Financial Regulators' Duties

The amendment of the current Islamic Banking Law 2015 is the duty of the financial regulators, especially those who work in the CBI. In addition, Islamic banks too have their own roles to play in introducing financial laws and regulations that issue guidelines and instructions for the

⁵²⁹ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 47.

⁵³⁰ Such as the Iraqi Companies Law 1997, the General Companies Law 2004.

⁵³¹ For details about AAOIFI, see Chapter Five, 5.9.1.

⁵³² Adel Mohammed Sarea and Mustafa Mohd Hanefah, 'Adoption of AAOIFI Accounting Standards by Islamic Banks of Bahrain' (2013) 11 *Journal of Financial Reporting and Accounting* 131, 132.

⁵³³ Md Hafijullah, 'Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh' (2013) 1 *International Journal of Social Science Research* 111, 112.

⁵³⁴ For details about IFSB, see Chapter Five of this thesis.

⁵³⁵ Abdul Karim Aldohni, *The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge 2011) 200.

⁵³⁶ Mohammed El Qorchi, 'Islamic Finance Gears Up' (2005) 42 *Finance and Development* 1, 5.

⁵³⁷ All of the steps mentioned are important to be taken by the Iraqi financial regulators and the CBI in order to establish an effective Islamic banking legal framework. Hence, these financial regulators could benefit from local and international Islamic banking professionals and financial regulators to rebuild and reform the Islamic banking system in Iraq.

management of Islamic banking operations.⁵³⁸ Sharing information and taking advantage of the experiences of Islamic banks in other countries will also assist in the success of this legal endeavour.⁵³⁹ A country like Iraq, which has a newly-established Islamic banking industry, requires this form of cooperation more than any other countries.⁵⁴⁰ Bahrain, for instance, can be considered as one of the countries to formulate an advisory relationship with because it assumes an important position in the Gulf region pertaining to Islamic finance.⁵⁴¹ In addition, Bahrain is an Arab country, making communications easier for Iraqi financial regulators. It is also the responsibility of the legislature in Iraq to amend the laws and regulations that relate to the monitoring of the Islamic banking industry. They should review these laws by adding or omitting some provisions in order to be adequate for the Islamic banking industry. For example, the Banking Law 2004 defines a bank in Article 1 as ‘a person holding a license or permit under this Law to engage in banking business and other banking activities’. However, the definition of Islamic bank is different. It seems that instead of stating ‘engage in banking business and other activities,’ it should state ‘engage in business and activities in accordance to Sharia principles.’ Therefore, some laws should be amended to include Islamic banks and ensure they do not conflict with Sharia principles.⁵⁴²

In addition, to establish a strong Islamic banking system, professionals and experts in the field are needed. Unfortunately, the industry in Iraq has the problem of limited human capital.⁵⁴³ Thus, for Iraq, besides a proper legal framework for the regulation of Islamic banks in the country and the amendments of some laws, having a group of qualified experts, who understand the Islamic banking system and transactions well, is a necessity. In addition, establishing an independent body for the supervision and monitoring of Islamic banks in the country is also recommendable to further support these banks as such a body does not exist.⁵⁴⁴

⁵³⁸ For this purpose, international cooperation among Islamic banks is an important element for the success of this type of institution. In any state, local regulators should work closely with regulators abroad and establish strong ties with them.

⁵³⁹ The Monetary and Financial Systems and Middle East and Central Asia Departments ‘Kingdom of Bahrain: Financial System Stability Assessment’ (International Monetary Fund, Report No 6/91, 2006) 13.

⁵⁴⁰ Currently, there is no cooperation among Islamic banks in Iraq and there is no cooperation between Iraqi Islamic banks and other countries’ Islamic banks, as mentioned by interviewee Bashir Hadad.

⁵⁴¹ Gulf Daily News, ‘Bahrain Hub for Islamic Finance’ (21 February 2010) <<http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=271255>> accessed 14 October 2016.

⁵⁴² Mohammad Ahmed Jawad, ‘Finance Committee Report on Banking System Reform Requirements in Iraq’ (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 47.

⁵⁴³ Sahar Nasr, ‘Republic Of Iraq: Financial Sector Review’ (The World Bank, Middle East and North African Region, 2010) 24.

⁵⁴⁴ Mohammad Ahmed Jawad, ‘Finance Committee Report on Banking System Reform Requirements in Iraq’ (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

All these elements and requirements are the responsibility of the financial regulators, particularly the CBI regulators. Hence, these reforms of the Islamic banking system require funds and innovative thinking.⁵⁴⁵ Furthermore, the Islamic banking industry needs human resources as the industry is expanding. Therefore, the establishment of centres and institutions for education and training of Islamic banking experts is crucial in Iraq.⁵⁴⁶ Thus, training of experts may minimise most of the issues faced in Islamic banking.

Sharia Supervisory Boards of Islamic Banks under the Islamic Banking Law 2015

The Sharia board of Islamic banks also has the supervisory task of ensuring that all transactions follow Sharia law.⁵⁴⁷ The Sharia board consists of ‘usually three members minimum’⁵⁴⁸ who have knowledge of Islamic banking. The appointed scholars are required to have knowledge in Sharia, finance and the conventional banking system.⁵⁴⁹ In addition, they have to be qualified to issue fatwas on Islamic banking transactions and new products. In Iraq, every Islamic bank is required to have a Sharia supervisory board. The requirements of Sharia supervisory boards of Islamic bank and its members are specified in Article 7 of the Islamic Banking Law 2015, which states as follows:

- 1- Every Islamic bank shall have its own Sharia supervisory board, which should consist of a minimum of three and a maximum of five members. Half of the members must have experience and knowledge of Islamic principles. The other half should be specialists in banking and finance law.
- 2- The board should choose among themselves one member to be chairman and one to be an executive member. These can receive assistance from anyone else on the board.
- 3- The members of the board should not be managers, high ranking employees, members of the management council or shareholders of the bank.
- 4- The term of the board is three years and it should be re-elected and changed every three years, although renewal for another three years is possible with the agreement of the banking council and the CBI.
- 5- The main function of the Sharia supervisory board is to ensure that all Islamic banking activities and products are compliant with Sharia law principles.
- 6- All board decisions are final and must be acted upon by the bank.⁵⁵⁰

⁵⁴⁵The CBI and the Ministry of Finance could benefit from regional and global Islamic banking experts. In fact, human capital is one of the main elements for developing the Islamic banking industry. If there is resources for creating Islamic banking experts, other issues can be resolved.

⁵⁴⁶ Interview with Abdulla Hama, University lecturer, University of Sulaymaniyah (Erbil, June 2015).

⁵⁴⁷ Yusuf Karbhari, Kamal Naser and Zerrin Sahhin, ‘Problems and Challenges Facing the Islamic Banking System in the West: The Case of the UK’ (2004) 46 Thunderbird International Business Review 521, 523

⁵⁴⁸ Elmelki Anas and Ben Arab Mounira, ‘Ethical Investment and the Social Responsibilities of the Islamic Banks’ (2009) 2 International Business Research 123, 127.

⁵⁴⁹ Hiam Muhammad Abdulqadir Zedanain, ‘Sharia Supervision of Islamic Banks Between Originality and Practice’ (2013) 40 Sharia Science and Law Studies 89, 101 (translated from the original Arabic text by the author).

⁵⁵⁰ CBI Iraqi Islamic Banking Internal Instruction 2006, Article 6 (translated from the original Arabic text by the author).

It is stated in the Islamic Banking Law 2015 that at least three members should be specialists in banking, law and finance. However, this author argues that it would be better if the law required members of the Sharia supervisory boards of Islamic banks to be knowledgeable in Sharia law, Islamic finance, modern finance and the regulation system. Thus, if the members have different professional backgrounds as some have conventional banking backgrounds, a mutual comprehension may be difficult due to clear differences in their expertise. In addition, it will prove difficult for the Iraqi Islamic banks to have three qualified Sharia supervisory members since Iraq has a shortage of Islamic banking experts.

Islamic Windows or Branches of Conventional Banks

Like Bahrain and Malaysia, conventional banks in Iraq are allowed to offer Islamic banking services. According to Article 12 of the Internal Instruction 2006 for Islamic banks in Iraq, conventional banks have the right to open a window or branch to conduct Islamic banking practices. In Malaysia and Bahrain, the Islamic banking legal framework is developed making it easier for both countries to control and regulate the Islamic branch or the window of conventional banks. This thesis argues that it is not so easy to regulate an Islamic banking window or branch in Iraq due to the fact that the current Islamic banking system is incomprehensive.⁵⁵¹ However, the conventional banks should follow the following conditions to run and open the Islamic banking window:

- 1- The Central Bank's approval must be obtained in advance in accordance with the instructions for opening a branch.
- 2- Any capital associated with the window or the branch should be free from interest and the source of the funds must be known. The funds should not be mixed with other banking funds in order to avoid prohibited activities and the charging or paying of interest.
- 3- The branch can practice all Islamic banking activities that are allowed by Sharia law.
- 4- The branch shall have a manager and departments for running the banking business. Staff must be trained and experienced in Islamic finance transactions.⁵⁵²

This author, however, is of the opinion that the current situation of allowing Islamic windows or branches to be opened by conventional banks is not the right decision even with strict rules. This is because firstly, the Islamic banking industry has legal and Sharia issues which would negatively impact the development of the Islamic banks.⁵⁵³

⁵⁵¹ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 355 (translated from the original Arabic text by the author).

⁵⁵² CBI Iraqi Islamic Banking Internal Instruction 2006, Article 12 (translated from the original Arabic text by the author).

⁵⁵³ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 355 (translated from the original Arabic text by the author).

Secondly, since Islamic banks themselves are facing a shortage of experts in the field, it would, in fact, be more difficult for conventional banks to find Islamic banking professionals. However, one may argue that it would be easier for conventional banks to bring in experts from other countries with more available funds. This argument is only reasonable when the security situation of Iraq is safer with foreign experts feeling more comfortable to come to Iraq. However, due to the current unstable situation in Iraq, it is difficult to bring in Islamic banking experts from other countries.

Thirdly, it is difficult for the CBI to have control over Islamic banking windows or branches as there is an insufficient number of experts in the CBI who understand Islamic banking transactions. Moreover, there is no national Sharia board in Iraq.

Fourthly, if conventional banks are allowed to open Islamic branches or windows, this would make it more difficult for Islamic banks to compete with them because conventional banks are larger in size and have more funds. It is also believed that the operation of Islamic banking by conventional banks would boost the Islamic banking industry.⁵⁵⁴ However, this may not be the case in Iraq as people in general do not trust the banking sector, be it conventional or Islamic banking. Therefore, the regulation and supervision of Islamic banks and Islamic windows or branches of conventional banks is complicated under the current conditions of the Iraqi Islamic banking system.⁵⁵⁵

However, in all cases, if conventional banks are allowed to offer Islamic banking services, this should be done by following strict rules. The CBI should, therefore, draft a comprehensive guideline for conventional banks that wish to open an Islamic banking branch as carried out in Malaysia. Certain preconditions and conditions are necessary, such as opening a special division for Islamic banking windows and separate record-keeping of accounts for the branches.⁵⁵⁶ In addition, these windows and branches should also have Sharia supervisory boards and qualified staff members who are proficient in Islamic banking transactions and

⁵⁵⁴ Rania Kamla, 'Critical insights into Contemporary Islamic Accounting' (2009) 20 *Critical Perspectives on Accounting* 921, 925.

⁵⁵⁵ In fact, the CBI does not have the ability to monitor Islamic banking operations due to the limitation of qualified experts. Furthermore, an inadequate Islamic banking legal system makes it difficult for the Islamic banking industry to be regulated.

⁵⁵⁶ M Mansoor Khan and M Ishaq Bhatti, 'Islamic Banking and Finance: on Its Way to Globalization' (2008) 34 *Managerial Finance* 708, 719.

contracts. These preconditions and conditions are important in order to create a conducive environment to conduct Islamic banking activities.⁵⁵⁷

3.8. Core and Sub-Core Challenges Facing Islamic Banks in Iraq

Islamic banking in Iraq dates back to the last century when they were established during one of the most difficult economic periods.⁵⁵⁸ Islamic banking institutions faced many problems at the beginning, some of which still remain unsolved today. Some of these problems are related to financial regulations while others are related to Islamic banking institutions. In this section, some of these issues are addressed.

Core Challenges of the Iraqi Islamic Banking Industry

The current financial framework in Iraq is inadequate for the regulation and supervision of the Islamic banking industry.⁵⁵⁹ Therefore, having a proper legal framework is necessary for effective governance of Islamic banking institutions.

The first core challenge of the Iraqi Islamic banking system is the lack of a comprehensive legal framework. In that context, the Iraqi Islamic Banking Law 2015 is incomplete with many weaknesses such as lack of licencing conditions and requirements. In addition, the current financial laws and regulations, such as the Banking Law 2004, Company Law 2004 and CBI Law 2004 in Iraq, are outdated.⁵⁶⁰ Furthermore, the current Banking Law 2004 in Iraq does not recognise the Islamic banking industry.⁵⁶¹ Thus, this industry faces numerous problems with the current financial laws and regulations.⁵⁶² In addition, the relationship between the CBI and Islamic banks is problematic, as it is based on interest which is impermissible according to Sharia principles.⁵⁶³

⁵⁵⁷ Preconditions could also enhance public confidence in the Islamic banking industry. However, the author believes that under the current system in Iraq, it is difficult to control the Islamic banking windows of conventional banks due to the fact that there is no specific law governing the Islamic banking industry and there is limited expertise in the Islamic banking field.

⁵⁵⁸ Islamic banking began operating in Iraq when the country was under UN economic sanctions.

⁵⁵⁹ Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38.

⁵⁶⁰ In other words, existing financial laws have to be updated in order to cover Islamic banks.

See: Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38, 39.

⁵⁶¹ Mustafa Natiq Salih Matlub, 'Obstacles to Work of the Islamic Banks and Ways of Cures for Development' (2012) *Research and Islamic Studies magazine* 287, 294. (translated from the original Arabic text by the author).

⁵⁶² For details about legal and regulatory issues of the Iraqi Islamic banking system, see Chapter Four of this thesis.

⁵⁶³ For example, in the case of liquidity crises, Islamic banks will ask assistance from the CBI which provides aids based on the interest-based system.

The second core challenge of the Iraqi Islamic banking system is the improper Sharia supervision of Islamic banks.⁵⁶⁴ Ineffective internal supervision and the absence of external Sharia supervision are considered the main challenges in the Islamic banking industry.⁵⁶⁵

The third core challenge is the shortage of human resources,⁵⁶⁶ which negatively impacts the industry.⁵⁶⁷ Therefore, it is clear that adequate human resources is important for efficiently running the Islamic banking industry.⁵⁶⁸

Sub-Core Challenges of the Iraqi Islamic Banking Industry

The lack of cooperation among Islamic banks is one of the issues that has affected the sector. Islamic banks in Iraq do not have a strong relationship and each bank works separately.⁵⁶⁹ These banks can benefit if there is collaboration among them, especially through their Sharia boards. Hence, this new industry requires the cooperation of banks in order to exchange knowledge and experiences to create improvements.

Moreover, the lack of Islamic financial courts is another problem in this sector.⁵⁷⁰ Islamic banks are based on Sharia law and principles; therefore, all Sharia disputes of these banks should be conducted in a special court with special jurists. However, the Islamic banking disputes in Iraq are currently resolved by the civil courts where the jurists commonly do not have Sharia backgrounds to solve these disagreements. Therefore, they may resort to incorrect decisions about Islamic banking cases. In addition, Islamic banks in Iraq have low numbers of clients. Although there are a number of Islamic banks in Iraq, people are unaware of Islamic banking transactions and services.⁵⁷¹ Thus, the connection between the Islamic banks and the people is not strong. As a result, it limits the Islamic banking services because Islamic banks are established to serve the people and society.

⁵⁶⁴ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 361 (translated from the original Arabic text by the author).

⁵⁶⁵ For details about Sharia issues both internal and external, see Chapter Five of this thesis.

⁵⁶⁶ For details about the human resources issue of the Iraqi Islamic banking industry, see Chapter Six of this thesis.

⁵⁶⁷ Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

⁵⁶⁸ These three main issues are focused in this thesis. They will be explained and evaluated in detail in separate chapters later.

⁵⁶⁹ Armagan Bayrem, Corporate Banking Director, Al-baraka Islamic Bank (Erbil, June 2015).

⁵⁷⁰ The issue of the lack of courts is not emphasized in this thesis because currently Iraq has other more important issues of higher priorities. Thus, Islamic banking disputes are not discussed in this research.

⁵⁷¹ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank (Erbil, May 2015).

Iraq, Islamic Banking Institutions and Shortage of Customers

Despite the fact that Islamic bank services are available to the people, a shortage of customers can be observed in these banks. Therefore, this is an important issue that should be examined.⁵⁷²

In order to have more clients and depositors, Islamic banking institutions should have a clear and effective method for promoting public confidence. In Iraq, the reality is, to date, the relationship between Islamic banking institutions and clients has been very weak.⁵⁷³

Therefore, managing the banks' relationships with their customers and with investors who desire to invest with Islamic banking institutions in accordance to Sharia principles is important. The investors want to be assured that their funds are being used correctly. For instance, with an investment account in an Islamic bank, the person who provides funds (*rabul mal*) and the Islamic bank, which invests the funds for ventures (as a *mudarib* according to a *mudaraba* contract), may face some problems in their relationship if these funds are not invested in a Sharia-compliant way. The management of the fund is the bank's responsibility and the fund provider does not have any rights to interfere with its management.⁵⁷⁴ In this case, the provider's capital is at risk to a certain extent because he/she does not have the right to say in what ways the funds should be managed. In this case, a supervisory body is necessary for monitoring all Islamic banking activities and transactions in order to maintain a harmonious and fair relationship among all parties and thus establish more confidence in Islamic banks.⁵⁷⁵

There are some reasons people do not invest or deal with Islamic banks despite wanting to conduct their businesses according to Sharia principles. Firstly, insufficient knowledge about Islamic banks and their products and services is one of the main reasons behind not conducting businesses with these banks.⁵⁷⁶ Secondly, there is a low number of services provided by the

⁵⁷² Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science' 1, 16 (translated from the original Arabic text by the author).

⁵⁷³ There are several obvious reasons behind the limited number of Islamic banking clients and the lack of confidence in Iraq, notably the first and second Gulf Wars. In the second Gulf War, most of the financial institutions were looted.

See: David Munro, 'Overview of the Iraqi Banking System: The State-Owned banks' USAID (9 November 2013) <http://www.izdihar-iraq.com/resources/bankingconf07/bankconf_pdfs/ref_ses5_munro_overview_iraqi_bankg_soes_032107.pdf> accessed 21 November 2016.

⁵⁷⁴ ADCB, 'Almurshid Islamic Finance Guidance' <http://www.adcb.com/arabic/images/New_Mithaq_Eng_tcm10-8830.pdf> accessed 12 November 2015.

⁵⁷⁵ Racha Ghayad, 'Corporate governance and the global performance of Islamic banks' (2008) 24 Humanomics Journal 207, 209.

⁵⁷⁶ Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science' 1, 17 (translated from the original Arabic text by the author).

Islamic banks in Iraq with *murabaha* being the most used service among other transactions.⁵⁷⁷ Thirdly, people do not have confidence in their dealings with banks in general, including Islamic banks, because of past events involving stolen money and looting of banks.⁵⁷⁸ Fourthly, there has been no effective plan by Islamic banks to raise awareness of the services they can offer to the consumer.⁵⁷⁹

In fact, only a few of those who conduct businesses with companies outside the country use the services of banks. Members of the general public, who do not have government jobs, do not use banks and Islamic banks are no exception to this rule. In that sense, Islamic banks do not have effective strategies for providing knowledge to people about Islamic banking practices. Therefore, it is important for the CBI to work in collaboration with Islamic banking institutions to create an awareness programme as has been done in Bahrain.

In Bahrain, the Waqf Fund had set up a public awareness programme on Islamic banking.⁵⁸⁰ A similar programme should be introduced in Iraq since the Islamic banking industry is relatively new with people not fully understanding the operations of these banks and methods of investments.⁵⁸¹ It is therefore necessary for Islamic banks to find a way of recruiting people to explain its operations and nature in order to attract new depositors.⁵⁸² Finally, a general reason people avoid investing with banks, both conventional and Islamic banks, is the previous Iraqi government's strategy of changing the currency⁵⁸³ after occupying Kuwait.⁵⁸⁴

⁵⁷⁷ Interview with Abdulla Hama, University Lecturer, University of Sulaymaniyah (Erbil, June 2015).

⁵⁷⁸ US & Foreign Commercial Service, 'Doing Business in Iraq, Country Commercial guide for U.S. Companies' 51 <http://www.trade.gov/iraq/build/groups/public/@tg_iqtf/documents/webcontent/tg_iqtf_003872.pdf> accessed 21 November 2016.

⁵⁷⁹ Due to no relationships being forged between the Islamic banks in Iraq, no special funds for awareness programmes that provide people with knowledge about Islamic banking transactions and services were allocated.

⁵⁸⁰ State Bank of Pakistan, 'Strategic plan for Islamic banking in Industry Pakistan' <<http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy>> accessed 13 August 2016.

⁵⁸¹ Many people are possibly interested in investing according to Sharia principles via Islamic banking institutions but there is a lack of knowledge about how these banks operate and how consumers can deposit with them.

⁵⁸² Suad Abdul Fatah M B, 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of College of Baghdad for Economic Science' 1, 17 (translated from the original Arabic text by the author).

⁵⁸³ The Iraqi government changed the Iraqi Dinar after the United Nation boycott on Iraq after Iraq occupied Kuwait in 1990.

⁵⁸⁴ Global Security, 'New Iraqi Currency' <<http://www.globalsecurity.org/military/world/iraq/currency-reform.htm>> accessed 21 November 2016.

Impact of the Political/Security Situations and Corruption on the Iraqi Islamic Banking Industry

The political and security situations in Iraq have had a negative impact on all sectors in the country. The financial sector, especially the Islamic banking industry, is no exception.⁵⁸⁵ The country is indeed one of the most unstable states in the world.⁵⁸⁶ It is clear that there is currently a conflict between parties or more specifically between different doctrines and nationalities in Iraq. These conflicts have had significant effects on the Islamic banking industry in the country. Furthermore, people do not trust the current situation to invest or deposit money with these banks, particularly private banks, which include Islamic banks that do not receive financial support from the government. In Iraq, the security and political situations are considered the most serious problem⁵⁸⁷ faced by the financial sector in Iraq, including the Islamic banking industry. In this situation, it is difficult for the Iraqi government to bring staff members from other countries to work in the field of Islamic banking.⁵⁸⁸

Corruption

Corruption has also had a negative impact on the Iraqi Islamic banking industry, which covers almost all sectors in Iraq. If no strict laws and regulations are put in place to control this issue, then the country will collapse. In fact, Iraq is one of the worst offenders of corruption,⁵⁸⁹ which is a status that may lead to the financing of terrorists. This creates a vicious cycle as Islamic banking will be one of the biggest losers because it is not well-established in the country.

Financial Crises

Besides political, security and corruption issues, the financial crises in Iraq and the Kurdistan region have also had an impact on the banking sector in the country. In 2014, the Iraqi government and Kurdistan Regional Government postponed many projects due to the financial crisis. In 2015, there was insufficient money in banks in Kurdistan for the local government to

⁵⁸⁵ Interview with Armagan Bayrem, Corporate Banking Director, Al-Baraka Islamic Bank (Erbil, June 2015).

⁵⁸⁶ Large areas in Iraq have been controlled by ISIS since 2014. However, the Iraqi government in 2016 was able to regain control of some of these areas.

See: Suadad Al-Salhy and Tim Arango, 'Iraq Militants, Pushing South, Aim at Capital' *The New York Times* (11 June 2014) <<http://www.nytimes.com/2014/06/12/world/middleeast/iraq.html>> accessed 21 November 2016.

⁵⁸⁷ Sujata Ashwarya Cheema, 'Investing in Iraq: prospects and Challenges' (*Middle East Institute*, 20 February 2013) <<http://www.mei.edu/content/investing-iraq-prospects-and-challenges>> accessed 21 November 2016.

⁵⁸⁸ Usually, people from other countries avoid working in Iraq as they believe that Iraq is not a safe place. This is an issue that the Iraqi government and especially the CBI should focus on.

⁵⁸⁹ Transparency International, 'Corruption by Country, Iraq' <<http://www.transparency.org/country#IRQ>> accessed 22 November 2016.

pay salaries to government employees. Thus, this issue makes people distrustful of banks and unwilling to deposit with them.⁵⁹⁰ Furthermore, until the end of 2014, the Iraqi budget for the year was not agreed upon by the Iraqi Parliament due to the conflicts between the central government and the Kurdistan Regional Government. In addition, 90% of the Iraqi economy depends on oil; due to a reduction in the exportation of oil because of the fight against Islamic State in Iraq and Syria (ISIS) and the fact that there has been a reduction in the price of oil to around \$46 per barrel (as compared to \$116 in 2013),⁵⁹¹ the Iraqi government faces yet another financial crisis.⁵⁹²

In 2014, three cities in Iraq, which are Anbar, Karbala and Wasit, had declared bankruptcy.⁵⁹³ In general, the reasons for the various financial crises in Iraq and Kurdistan is due to the cost of the war with ISIS, corruption in all sectors in Iraq and problems between the Iraqi government and the Kurdistan Regional Government. These financial problems affect the people and the government. Currently, many people do not have enough income to support their daily lives. Thus, people borrow money from each other which usually leads to social problems because the borrower is unable to pay back the loan. In addition, conventional and Islamic banks do not provide loans to people due to the lack of confidence between the people and the banks.

Hence, all these problems and issues influence the banking sector and make investors and depositors lose confidence in financial institutions in Iraq. It seems that the Iraqi government does not have a plan for resolving issues of corruption, financial crises and political issues which would lead to the worsening of the banking sector. Thus, strict laws and proper independent financial supervision are needed in Iraq.⁵⁹⁴

3.9. Conclusion

This chapter has dealt with the Islamic banking system in Iraq, including some legal and Sharia challenges. It answers research question number [1] of this thesis, i.e., how are Islamic banks governed and regulated in Iraq, and what are the weaknesses in the Iraqi Islamic banking

⁵⁹⁰ Awene, 'Financial Crises, Make Non-Confidence Dipper Between People and the Banks' <<http://www.awene.com/article/2014/11/27/37335>> accessed 21 November 2016 (translated from the original Kurdish text by the author).

⁵⁹¹ The Iraqi economy depends on oil prices. When the oil price is increasing, the Iraqi economy becomes stronger, and when it decreases, it grows weaker.

⁵⁹² Awene, 'Financial Crises, Iraq is about to Insolvency' <<http://www.awene.com/article/2014/11/24/37267>> accessed 21 November 2016 (translated from the original Kurdish by the author).

⁵⁹³ Awene, 'Financial Crises, Iraq is about to Insolvency' <<http://www.awene.com/article/2014/11/24/37267>> accessed 21 November 2016 (translated from the original Kurdish by the author).

⁵⁹⁴ See Chapter Four of this thesis for more details about independent supervisory body.

system? It is clear that Iraq, as one of the richest countries in the Middle East, has a strong economic base as an important oil exporter. Nevertheless, because of the unstable situation in the country in the past, namely the first and the second Gulf Wars, this political background has had a harmful impact on the regulatory system in Iraq. Moreover, the political and security situations of the country have remained unstable.

One of the most important sectors in Iraq is the banking sector yet this has been severely affected. Currently, there is a comprehensive legal framework for conventional banking, which has been able to reorganise this sector to some extent. In contrast, the Islamic banking system still suffers in relation to an ineffective legal system that continues to cause the industry big losses. As a result, the Islamic banking industry remains undeveloped as compared to other countries' Islamic banking industries. In addition, the regulation and supervision of this industry is weak and unsystematic.

The CBI is the sole financial regulatory body in Iraq and regulates both conventional and Islamic banks the same way. In 2006, the CBI issued an Internal Instruction for the regulation of Islamic banking institutions, but this instruction is incomplete and could not replace proper laws. In addition, the Islamic Banking Law 2015 has been recently enacted but it is also incomplete, as the law does not include some important fundamental elements, such as Islamic banking licence conditions and requirements. Hence, the Islamic banking industry still faces a few legal problems. In fact, there are not many differences between the Internal Instruction 2006 and Islamic Banking Law 2015.⁵⁹⁵ In addition, the regulators of the CBI do not have sufficient knowledge of Islamic banking transactions and there is no special departments in the CBI for the monitoring and supervision of Islamic banking activities and products.

Expanding on the Sharia supervision of the Islamic banking industry, the Sharia supervisory board, as part of each Islamic banking institution, is only an internal supervisory body for monitoring and overseeing Islamic banking transactions to ensure that they comply with Sharia principles. There is no doubt that such Sharia boards play a crucial role in the supervision of individual Islamic banking institutions. However, Sharia scholars of the individual Sharia supervisory boards lack knowledge of Islamic banking transactions. In addition, in Iraq, there is no central Sharia board for monitoring Islamic banks and their Sharia boards' decisions.⁵⁹⁶

⁵⁹⁵ The Islamic Banking Law 2015 is similar to the Internal Instruction 2006 which was issued by the CBI. Most of the main principles in regulating the Islamic banking industry are not stated in the Islamic Banking Law 2015.

⁵⁹⁶ See Chapter Five of this thesis for more details about both internal and external Sharia supervision of the Islamic banking industry.

Besides the legal and Sharia problems of the Iraqi Islamic banking system, there is also a shortage of qualified Islamic banking experts who understand the system in both Islamic banks and the CBI. Furthermore, the unclear relationship between the CBI and Islamic banks is also considered a problem for the industry as this relationship is based on interest which is not allowed by Sharia rules.

In addition, Islamic banks are struggling to attract more clients due to the fact that people are unaware of Islamic banking operations and transactions. As a result, Islamic banks have concentrated on *murabaha* transactions more than other modes of finance, such as *musharaka* and *mudaraba*.⁵⁹⁷ Indeed, it is time for financial regulators in Iraq to consider methods of improving and developing the Islamic banking industry in a country in which 99% of the population are Muslims and seek investments which are in accordance to Sharia principles. It is also important to mention that the current political and security situations in Iraq have negative impacts on the banking sector, especially the Islamic banking industry. This reason influences people to deal with banking institutions in the country only under certain circumstances.

Therefore, the establishment of an effective legal framework for the Islamic banking industry in Iraq is necessary. This could be done by revising the Islamic Banking Law 2015 for the regulation of Islamic banks. This law should cover many aspects of the regulatory system and determine the ways in which Islamic banking institutions operate. It should also determine all activities and transactions that are allowed in the operations of Islamic banks. This can be done by establishing an active and suitable Islamic banking regulatory system for the supervision and regulation of this industry. Furthermore, the current laws, such as the Banking Law 2004 and the CBI Law 2004 that have regulatory control over the whole banking sector, including Islamic banks, should be amended.

It is now time for the Islamic banking system in Iraq to have a proper Islamic banking legal framework, and amending the Islamic Banking Law 2015 is an important step for this framework. All the fundamental elements that are necessary for the regulation and supervision of Islamic banking should be covered by this Islamic banking law. For instance, licensing requirements and conditions should be the main purpose of this law. Establishment of an active central Sharia body is also necessary for the regulation and monitoring of Islamic banking

⁵⁹⁷ Interview with Armagan Bayrem, Corporate Banking Director, Al-Baraka Islamic Bank (Erbil, June 2015).

transactions. All Sharia supervisory boards of Islamic banks should also be closely monitored by the central body.

Finally, in order to govern and run the Islamic banking sector in Iraq, there is a need for expertise in the field. More efforts should be made to tackle the shortage of qualified Islamic banking experts,⁵⁹⁸ which would enable this sector to develop. Therefore, all these main challenges need to be resolved. Overall, there is a necessity for reform of the Islamic banking system in Iraq in order to achieve the levels of other countries with more developed Islamic banking industry. Indeed, a general reform that covers all parts of the Islamic banking sector, including legal and Sharia aspects of the system, is essential whilst taking the country's situation into consideration.

⁵⁹⁸ Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

Chapter Four: Legal Challenges of the Islamic Banking System in Iraq

4.1. Introduction

In the previous chapter, the Islamic banking system in Iraq was examined together with the legal and Sharia issues that the banking industry faced. Therefore, the objectives of chapter four are to critically evaluate the legal framework of the Iraqi Islamic banking industry and to analyse the legal issues surrounding Islamic banking in Iraq. Two main issues will be critically evaluated in this chapter: the weak Islamic banking legal framework⁵⁹⁹ and the unsuitable relationship between the CBI and Islamic banks in Iraq.⁶⁰⁰ In order to extensively evaluate the current Iraqi Islamic banking system, it is necessary to understand and critically compare it with the Islamic banking systems found in other countries, such as Malaysia and Bahrain, together with their respective legal frameworks. In addition, this chapter will discuss the actions that should be carried out in order to reform the Iraqi Islamic banking system and propose improvements to the current legal framework.

Therefore, this chapter will deal with the legal issues of the Islamic banking system in Iraq.⁶⁰¹ The lack of an effective Islamic banking law to properly regulate the industry in accordance with the general financial system of Iraq is the first and most important issue⁶⁰² that needs to be addressed and critically evaluated. Furthermore, the role of the CBI in governing the Islamic banking industry is also extensively assessed as its relationship with Islamic banks is problematic because the relationship is based on interest.⁶⁰³ This is because all financial laws and regulations were enacted for the regulation of the conventional banking system rather than for the Islamic banking industry.⁶⁰⁴ Therefore, this chapter will deal with the nature and key characteristics of Islamic banking law, and identify how the Islamic banking industry is regulated and governed. In addition, the role of the central banks in Iraq, Malaysia and Bahrain will be examined, in order to critically evaluate the regulatory role of the CBI. Hence, in order to propose a proper Islamic banking law for Iraq, the Malaysian and Bahraini Islamic banking legal systems will be critically evaluated. This is conducted to establish elements in the foreign

⁵⁹⁹ For details, see 4.3.1. on the incomplete Islamic Banking Law.

⁶⁰⁰ For details, see 4.3.2. on the relationship between the CBI and Islamic banks.

⁶⁰¹ For example, other Iraqi financial laws, such as Banking Law 2004, do not refer to Islamic banks.

⁶⁰² Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

⁶⁰³ These two issues are the main focuses of this chapter. They will first be identified with solutions being later proposed.

⁶⁰⁴ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38.

Islamic banking systems that are essential. The next stage of the research is to assess whether such beneficial elements could be transplanted successfully to the Iraqi Islamic banking legal framework. As a result, after analysing the Islamic banking system and the legal frameworks of other countries, namely Malaysia and Bahrain, it will be easy to identify the elements that should be included in the new Iraqi Islamic banking system. In addition, this is also to find the best mechanisms for the CBI to govern Islamic banking institutions in Iraq.

In that context, this chapter will answer research question number [2] which is: What are the legal shortcomings in Iraq's Islamic banking system, and how should they be resolved in light of other countries' experiences, particularly Malaysia and Bahrain?

Chapter four will focus on the following five issues:

- Legal issues of the Iraqi Islamic banking system.
- Weaknesses of the Iraqi Islamic Banking Law 2015.
- The legal relationship between the CBI and Islamic banks.
- Malaysian and Bahraini Islamic banking legal frameworks.
- Finding solutions for current legal issues of the Iraqi Islamic banking system.

Contemporary Islamic Banking Legal Framework

The contemporary legal system of Islamic banking requires a proper legal framework which consists of Islamic banking law and an effective supervisory body. The Islamic banking industry, similar to other industries, should be regulated and supervised by some laws, such as the Islamic banking law. As with the conventional banking system, the Islamic banking system also requires its own proper regulatory framework, consisting of the laws and rules necessary to govern this industry.⁶⁰⁵ One of the main functions of this regulatory framework is to prevent the industry from breaking the laws that have been enacted.⁶⁰⁶ The law that regulates the Islamic banking industry can be in one of two forms – either part of the general banking law,⁶⁰⁷

⁶⁰⁵ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 355 (translated from the original Arabic text by the author).

⁶⁰⁶ Dr. Md. Abdul Jalil and Muhammad Khalilur Rahman, 'Financial Transactions in Islamic Banking are Viable Alternatives to the Conventional Banking Transactions' (2010) 1 International Journal of Business and Social Science 219, 229.

⁶⁰⁷ In some countries, there are no special legislations on Islamic finance such as, Saudi Arabia. Usually, there are only some Islamic banking provisions under the general banking law.

See: Professor Rodney Wilson, 'Shari'ah Governance for Islamic Financial Institutions' Global Islamic Finance (5 December 2011) <<http://www.global-islamic-finance.com/2011/12/shariah-governance-for-islamic.html>> accessed 12 November 2015.

as provisions or articles,⁶⁰⁸ or as a separate act, such as an Islamic banking act.⁶⁰⁹ The purpose of both forms of law is the same, namely the regulation and management of the Islamic banking industry.⁶¹⁰ However, a separate Islamic banking law is preferred as it is able to better regulate and supervise the industry.⁶¹¹ The law should contain all necessary principles for the regulation of the Islamic banking industry.⁶¹² An Islamic banking law should also take Sharia supervision into consideration, as Sharia is the basis of the Islamic banking system.⁶¹³ Owing to the fact that Islamic banking is part of the general financial system of the country, it is important for the Islamic banking act to adopt many provisions from the financial legal frameworks of other Muslim countries in order to have fair treatment of both conventional and Islamic banks.⁶¹⁴ Because Islamic banking businesses are based on Sharia law, it is obligatory for the Islamic banking act to work in that framework.⁶¹⁵

In addition to an Islamic banking act, there are other general financial laws that should be applicable to Islamic banks. In other words, some provisions are valid to Islamic banks in the same way it affects conventional banks.⁶¹⁶ The laws which might be relevant to the Islamic banking industry, in addition to the Islamic banking act, include a central banking law, anti-

⁶⁰⁸ Turkey does not have a special Islamic Banking Act but there are some provisions for the regulation of Islamic banks under the Commercial Banking Law, as mentioned by Armagan Bayrem, Corporate Banking Director of Al- Baraka Islamic Bank, in an interview with him in June 2015.

⁶⁰⁹ Munawar Iqbal, Ausaf Ahamad and Tariqullah Khan, 'Challenges Facing Islamic Banking' (1998) Islamic Development Banks occasional paper 1, 37 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 12 September 2016.

⁶¹⁰ For example, Act of The Republic of Indonesia No. 21 of 2008 Concerning Sharia (Islamic) Banking and Federal Law No. 6 of 1985 Regarding Islamic Banks.

⁶¹¹ Interview with Bashir Hadad, Sharia supervisory board member, Cihan Islamic Bank, (Erbil, May 2015).

⁶¹² For the Islamic banking law to be complete and effective, it should contain all elements that are necessary for the regulation and supervision of the industry. It is preferred that any laws that are adopted for the regulation and supervision of Islamic banking institutions should be complete and should give a clear definition of an Islamic bank and explain the nature and principles of the Islamic banking system. In addition, it should explain the methods of finance used in the Islamic banking industry and, the most important element, the conditions and requirements of issuing a banking licence.

⁶¹³ Luca Errico and Mitra Farhbaksh, 'Islamic Banking: Issues in Prudential Regulations and Supervision' (1998) International Monetary Fund /98/30, 15 <<http://www.imf.org/external/pubs/ft/wp/wp9830.pdf>> accessed 25 November 2016.

⁶¹⁴ All laws and regulations which are applicable for the Islamic banking industry are under the financial laws. These laws and regulations consist of general banking law, Islamic banking law, insurance law, investment law, company law and central bank law. Islamic banking law should not be conflicting with all these laws which also regulate the Islamic banking industry in some of their provisions. In this case, some laws perhaps require amendments in order to avoid contradictions between these laws and the Islamic banking law.

⁶¹⁵ Islamic banking law should not be conflicting with other financial laws and should follow Sharia principles which is the main foundation of the law.

⁶¹⁶ For example, Islamic banks in Iraq are working under the Iraqi Banking Law 2004 and the CBI Law 2004. Thus, due to the fact that there is no comprehensive Islamic banking laws in Iraq, the provisions of these two laws are applicable to Islamic banks the same way it affects conventional banks. For example, Islamic banks should depend on the CBI in liquidity crises which is based on interest.

money laundering law, banking law and parts of company law which are relevant to banks.⁶¹⁷ Company law deals with all companies that are established including Islamic banks. Therefore, the company law should be applicable to the Islamic banks the same way other companies are affected.

Furthermore, in order to apply these laws and regulations to Islamic banks, there needs to be an authoritative body to regulate and supervise these banks. In most of the countries in the world, central banks have the duty to regulate banking institutions, including Islamic banks. A good example is Jordan which is regulated by the Central Bank of Jordan and Iran with the Central Bank of Iran.⁶¹⁸ However, it should be noted that in some countries, the regulatory and supervisory body is not the central bank, such as is the case of the UK.⁶¹⁹

It is clear that there must be professional or qualified individuals within the central bank who understand Islamic banking transactions.⁶²⁰ Some central banks have established special departments or divisions to monitor Islamic banking institutions such as the Waqf Fund in Bahrain which was established by the CBB,⁶²¹ and the Islamic Banking Department in Pakistan which was established by the State Bank of Pakistan in 2003 to support Islamic banks in Pakistan.⁶²² Furthermore, the central banks should also have stricter monitoring systems for this sector.⁶²³ Hence, with regard to Iraq, there needs to be a special relationship⁶²⁴ created

⁶¹⁷ These laws regulate the financial sector in general, including conventional and Islamic banks, as these laws are designed for governing and protecting the financial sector.

⁶¹⁸ M Umer Chapra and Tariqullah Khan, 'Regulation and Supervision of Islamic Banks' (2000) Islamic Development Bank, Occasional Paper 3, 28.

⁶¹⁹ In the UK, the Prudential Regulation Authority (PRA) has the role of authorizing Islamic banks while the Financial Conduct Authority and the Prudential Regulation Authority regulate all Islamic financial institutions.

⁶²⁰ Munawar Iqbal, Ausaf Ahamad and Tariqullah Khan, 'Challenges Facing Islamic Banking' (1998) Islamic Development Banks occasional paper 1, 36 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 12 September 2016.

⁶²¹ The CBB has established a special fund to finance research, education and training in Islamic finance (the Waqf Fund) and is active in working with the industry and stakeholders in developing industry standards and the standardization of market practices.

Central Bank of Bahrain, 'Islamic Finance' <http://www.cbb.gov.bh/page-p-islamic_finance.htm> accessed 9 September 2016.

⁶²² State Bank of Pakistan, 'Islamic Banking Department' <<http://www.sbp.org.pk/departments/ibd.htm>> accessed 12 November 2015.

⁶²³ To ensure better monitoring of the Islamic banking industry by the central bank, there is a need for experts, who have skills in Islamic banking businesses, or a special Islamic banking department as part of the central bank.

⁶²⁴ In other words, the CBI should consider the case of liquidity crisis in Islamic banks, as Islamic banks cannot deal with interest the same way conventional banks can. This is necessary in order for Islamic banks to avoid dealing with interest. In such cases, the CBI can provide interest-free loan (*Qard al -hasan*) to Islamic banks.

between the CBI and Islamic banks in Iraq, as the CBI is responsible for the regulation of the Islamic banking industry in this country.⁶²⁵

4.2. The Iraqi Banking System

The banking system in any country consists of legislations to regulate the banking sector. In Iraq, similar to Bahrain⁶²⁶ and Malaysia⁶²⁷, there is a certain amount of legislation for the regulation and governing of the Islamic banking industry. The following are the principal acts for the regulation of the general banking sector in Iraq:

The CBI Law 2004⁶²⁸: This law was enacted in March 2004 for the regulation of financial institutions and managing the relationship between the CBI and the financial sector in Iraq.⁶²⁹

Iraq Banking Law 2004⁶³⁰: This law was enforced in 2004 for the regulation of banking activities in the country, in order to determine their responsibilities and to explain how they should organise their activities and deal with clients and depositors.⁶³¹

The Iraqi Islamic Banking Law 2015: This law was enacted in 2015 for the regulation and supervision of the Iraqi Islamic banking industry.⁶³²

Although there is a number of Islamic banks in the country which are operating in accordance with Sharia principles,⁶³³ the aforementioned laws and regulations do not make specific references to Islamic banks. In fact, the only law addressing Islamic banks is the Iraqi Islamic Banking Law 2015.⁶³⁴ Some may argue that these laws do not refer to Islamic banks; however,

⁶²⁵ It is submitted that because the Islamic banking industry is in a nascent state as compared to the conventional banking industry, it should be subject to stricter laws and regulations. That is because this new sector is faced new challenges in practice and also two different laws govern the sector both Sharia and conventional laws.

⁶²⁶ Central Bank of Bahrain, Regulatory Functions, Laws and Regulations ‘CBB Rulebook’ < http://cbb.complinet.com/cbb/microsite/cbb_rulebook.html> accessed 3 November 2016

⁶²⁷ Bank Negara Malaysia, ‘Administered Legislation’ < <http://www.bnm.gov.my/index>> accessed 8 November 2016.

⁶²⁸ The CBI Law 2004 came into force in 1 March 2004 and determines all responsibilities, duties, legal functions and objectives of the CBI.

⁶²⁹ See chapter three, 3.6.1 for more details about CBI Law 2004.

⁶³⁰ According to Article 2 of the Iraqi Banking Law 2004, the primary regulatory objective of this law is to maintain confidence in the banking system. Other regulatory objectives include those of promoting public understanding of the banking system by providing appropriate information, maintaining an appropriate degree of protection for depositors, and helping to reduce financial crime, including fraud, money-laundering and terrorist financing.

⁶³¹ See chapter three, 3.6.2 for more details about Banking Law 2004.

⁶³² See chapter three, 3.6.3 for more details on Islamic Banking Law 2015

⁶³³ CBI, ‘Iraqi and Foreign Financial Institutions’ < <http://www.cbi.iq/index.php?pid=IraqFinancialInst>> accessed 8 November 2016.

⁶³⁴ Jawad (n 604) 38.

these banks are still not exempted from the laws above.⁶³⁵ Due to the fact that Islamic banks are part of the financial sector in the country, the Banking Law 2004 and the CBI Law 2004 encompass Islamic banks in their legislations.⁶³⁶

The conventional banking sector in Iraq is considerably better developed as compared to the Islamic banking system since there are some core laws for the regulation and supervision of the conventional banking sector. In contrast, the Islamic banking system in Iraq is very fragile in terms of both supervision and regulation.⁶³⁷ The first Iraqi Islamic bank was founded in 1993⁶³⁸ with no Islamic banking law yet in place. Therefore, it can be said that the CBI has not been as active in the Islamic banking industry⁶³⁹ as the central banks of other countries are, such as the BNM of Malaysia⁶⁴⁰ and the CBB of Bahrain.⁶⁴¹ There may indeed be some specific, country-related reasons for the undeveloped Islamic banking sector in Iraq, such as the political and security situations of the country that resulted from the two wars that took place - the first Gulf war⁶⁴² and the second Gulf war.⁶⁴³ However, these reasons should not be used as an excuse for an incomplete Islamic banking legal framework in Iraq because, if this argument is true, why was a new conventional banking law introduced earlier in 2004 while

⁶³⁵ Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

⁶³⁶ Currently, Islamic banks in Iraq are governed and regulated by the Islamic Banking Law 2015 and the Islamic banking Internal Instruction 2006 which was issued in 2006 by the CBI for the facilitation of these banks. However, the Islamic Banking Law 2015 and the Internal Instruction 2006, as they currently stand, are an incomplete set of rules or guidelines.

⁶³⁷ In Iraq, the CBI issued an incomplete set of instructions to govern the Islamic banking sector, 13 years after the establishment of the first Islamic bank in the country. Therefore, the regulatory system of the Islamic banking industry is undeveloped as compared to the numbers of the Islamic banks in the country.

⁶³⁸ The Iraqi Islamic Bank for Investment and Development was the first Islamic bank that was established in Iraq. Iraqi Islamic Bank, 'About us' <<http://www.iraqiislamicb.com/IIB%20English/aboutus-eng.html>> accessed 8 November 2016.

⁶³⁹ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

⁶⁴⁰ The Malaysian Government introduced a special Islamic Financial Act which is called Malaysia Islamic Financial Services Act 2013.

⁶⁴¹ The Bahraini government adopted a set of industry-specific regulations in 2001. Issued in 2005, Volume 2 of the CBB Rulebook for regulation Islamic banking industry.

⁶⁴² The war started in 1980 and continued until 1988 between Iraq and Iran, impacting all sectors.

See: Roger Hardy, 'the Iran-Iraq war: 25 years on' BBC News Channel (22 September 2005) <http://news.bbc.co.uk/1/hi/world/middle_east/4260420.stm> accessed 9 November 2016.

⁶⁴³ The Iraqi political and security situation is unstable since, in the past, Iraq had two big wars – the first Gulf war in 1990 and the second Gulf war in 2003. In addition, currently the Iraqi situation is also negatively affected by the existing conflict between races and parties. These events have had serious impacts on the banking sector, including the Islamic banking industry.

CNN, CNN Library September 2013 'Gulf War Fast Facts' <<http://edition.cnn.com/2013/09/15/world/meast/gulf-war-fast-facts/>> accessed 12 November 2015.

the situation remains the same for both conventional and Islamic banks. And why did the Iraqi Banking Law 2004 not refer to the regulation of Islamic banks.⁶⁴⁴

This author opines that the Iraqi banking system, especially the Islamic banking system, is not developed due to a few reasons. Firstly, the previous Iraqi government emphasised on the military sector more than other sectors. Secondly, during the 1990s, Iraq was under economic sanctions where the value of the Iraqi Dinar was very low.⁶⁴⁵ Thus, the financial sector was seriously affected. Thirdly, the absence of Islamic banking legal and Sharia experts in the country was another reason for the lack of progress in the Islamic banking system. Fourthly, the Iraqi government focused more on state-owned banks rather than private banks. Even after 2003 where the new Iraqi government was established, the Islamic banking industry could not be redeveloped due to the political situation.⁶⁴⁶ Furthermore, due to foreign governments that were more concerned with conventional banking, only the conventional banking system was reformed and rebuilt by them rather than reforming the Islamic banking system.

Consequently, all legislations that have been enacted to govern the financial systems in Iraq should be studied and amended. Nevertheless, it is clear that legal issues are the main obstacles hampering the development of Iraq's Islamic banking system. Thus, this author shall now discuss the legal issues.

4.3. Legal Issues of the Iraqi Islamic Banking System

The Islamic banking system in Iraq faces various legal issues which have significant impacts on the Iraqi banking system in general. The first legal issue is a lack of a comprehensive legal framework.⁶⁴⁷ A weakened legal framework of the Islamic banking system includes insufficient laws and regulations for the governing of the Islamic banking industry. In that context, it is important to have an Islamic banking law which is a fundamental element to establishing a proper Islamic banking legal framework. Otherwise, resolving other issues, such as Sharia issues, without resolving legal issues will not improve the state of the Islamic banking industry to eventually allow it to compete with the conventional banking sector.⁶⁴⁸ Thus, a

⁶⁴⁴ Mustafa Natiq Salih Matlub, 'Obstacles to Work of the Islamic Banks and Ways of Cures for Development' (2012) *Research and Islamic Studies magazine* 287, 294. (translated from the original Arabic text by the author).

⁶⁴⁵ 1 US Dollar was equivalent to 9000 Iraqi Dinar; now, however, 1 US Dollar is equivalent to 1250 ID.

⁶⁴⁶ After 2003, the conflict between Sunnah and Shiah in Iraq impacted all sectors.

⁶⁴⁷ Saad Abd Muhammad, 'The Relationship between the Central Bank and Islamic Banks' (2014) 40 *Baghdad College for Economic Science* 349, 355-361 (translated from the original Arabic text by the author).

⁶⁴⁸ In addition, other financial laws such as central bank law and banking law are also not suitable for the regulation of the Islamic banking industry. Consequently, the Islamic banking experts alone cannot assist Islamic banks to develop and improve.

comprehensive Islamic banking law is necessary in order to build an effective Islamic banking system.⁶⁴⁹

A second issue to be considered is the legal relationship between the CBI and Islamic banks, which is problematic.⁶⁵⁰ The CBI and all the rules and regulations that have been enacted for the banking and the financial sectors have been based on the Western model.⁶⁵¹ Thus, they were originally designed for the regulation of conventional banks rather than Islamic banking institutions.⁶⁵² In fact, it has been argued that most of the Islamic banking problems resulted from the Islamic banking system being based on the Western system. This thesis agrees with that notion to a certain degree as it is true that Islamic banking did develop from the conventional system. There is no doubt that starting new things can be difficult when you already have basic principles. Nevertheless, a Western or conventional banking system can facilitate the building of an Islamic banking system, as there are some similarities between these systems. For example, the accounts that are offered by the conventional banks are also offered by the Islamic banks, such as savings account and current account. In addition, both banks provide loans to their customers. Therefore, Islamic banking systems can be built from the foundations of the conventional banking system.

As a final point, the Islamic banking industry does not have the legal support of the CBI⁶⁵³ due to the incomprehensive legal framework.⁶⁵⁴ This is because the central bank deals with interest, which is prohibited by Sharia law for Islamic banks. However, the CBI is the bank of last resort

⁶⁴⁹ Norhasima Yassin, 'Islamic Banking and Finance: Fundamentals and Contemporary Issues' (2007), 252, IRTI, Islamic Development Bank, Edit by Salman Syed Ali and Ausaf Ahmad,

⁶⁵⁰ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 351 (translated from original Arabic text by the author).

⁶⁵¹ The western banking model deals with interest; thus, those rules and regulations that govern the Islamic banking industry are designed for western banking. Another specific practical example is Mudaraba agreement which is similar to a Western-style limited partnership, with one party contributing capital while the other running the business, and profit is distributed based on a negotiated percentage of ownership. In case of a loss, the bank earns no return or a negative return on its investment and the agent receives no compensation for his efforts. In 2009, Mudaraba financing was 5.5% of the total but it accounts for more than 33% in Islamic Finance in Africa. See: Juan-José Durán and María-José García-López, 'The Internationalization of Islamic Banking and Finance: The Co-Evolution of Institutional Changes and Financial Services Integration' (2012) 7 International Journal of Business and Management 49, 56.

⁶⁵² Dr. Nagham Husian Nia'ma and Dr. Raghad Muhammad Najim, 'Islamic Banking and Financial Institutions in the GCC: Reality and Challenges' (2010) 2 Journal of Qadisiah for management and Economic Science 122, 144. (translated from the original Arabic text by the author).

⁶⁵³ Enacting an Islamic Banking Law and establishing a complete Islamic banking legal framework could be considered a legal support for the Islamic banking industry.

⁶⁵⁴ Islamic Bank Bangladesh Limited, 'Issues and problems of Islamic Banking: An Overview on the review of Problems' <http://www.islamibankbd.com/abtIBBL/cis_issues_and_problems_of_islamic_banking.php> accessed 20 November 2016.

when Islamic banks require financial assistance.⁶⁵⁵ As a result, Islamic banks cannot refer to the CBI during liquidity crises⁶⁵⁶ because the CBI provides loans to Islamic and conventional banks on the basis of interest. This is another key issue for the Islamic banking industry in Iraq.⁶⁵⁷ Specific issues that are involved will be extensively discussed in order to evaluate the current legal situation of the Iraqi Islamic banking system to find solutions to reform the sector.⁶⁵⁸ Following the two legal issues of the Iraqi Islamic banking system, a lack of a comprehensive Islamic banking law and relationship between the CBI and Islamic banks will additionally be evaluated.

4.3.1. Incomplete Islamic Banking Law

The banking business is a sensitive sector and it is regulated by a number of legislations. Therefore, banking laws or regulations are necessary for the banking industry in order to protect all parties' interests and promote economic stability.⁶⁵⁹ In addition, there should also be an Islamic banking law for the Islamic banking industry.

The absence of an Islamic banking law is a legal issue for the industry that impacts the banks' development.⁶⁶⁰ In addition, an incomplete or weak Islamic banking law is also problematic as it will slow down the development of Islamic banking. Hence, efforts have been made to control this issue. For example, some countries enacted specific and supportive Islamic banking laws.⁶⁶¹ A good example is Malaysia, where the Islamic Banking Act 1983 and IFSA 2013 were enacted. As an important step, banking laws for the regulation of Islamic banking institutions in Malaysia have significantly supported the development of Islamic banks.⁶⁶²

⁶⁵⁵ Tania Qadir Abdulrahman and Mustaq Mahmud Al-sabaawi, 'Evaluating The Performance Of Islamic Banks By Using Financial Analysis Composite Comparative study of the Iraqi Islamic Bank Performance with the Jordan Islamic Bank for the Period (2000 – 2008)' (2011) 1, *Journal of Kirkuk University For Administrative and Economic Sciences* 152, 161. (translated from the original Arabic text by the author).

⁶⁵⁶ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 357 (translated from the original Arabic by the author).

⁶⁵⁷ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38. .

⁶⁵⁸ See 4.3.2.1. for more details on this issue.

⁶⁵⁹ Abdul Karim Aldohni, *The legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge, London 2011) 122.

⁶⁶⁰ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 39.

⁶⁶¹ The Malaysia IFSA 2013 was introduced for the regulation of the Islamic financial sector including the Islamic banking industry.

⁶⁶² Islamic Research and Training Institute 'Islamic Financial Architecture: Risk Management and Financial Stability' (2005), Islamic development bank, seminar proceedings No. 46, edited by Tariqullah Khan and Dadang Muljawan, 98.

Therefore, an effective Islamic banking law is necessary for the proper regulation of this industry.⁶⁶³ Nonetheless, the lack of an effective Islamic banking law in Iraq is still an issue for the industry. This is mainly due to Iraq's Islamic Banking Law 2015 not being helpful in addressing the Islamic banking industry. Consequently, developing the Islamic banking industry in Iraq requires more initiatives especially in the legal aspect as it is difficult for the Islamic banking system in Iraq to be truly reformed while the Islamic Banking Law 2015 is still being enacted.⁶⁶⁴

The Islamic Banking Law 2015 is an incomplete set of regulation and it does not contain all the fundamental elements for the regulation and supervision of Islamic banks. The law does not include Islamic banking licence requirements, which is a very important part of any Islamic banking law. In addition, the law does not specify the qualifications needed for the staff or scholars who work in Islamic banks. Furthermore, the Islamic Banking Law 2015 does not determine the role of the Iraqi Ministry of Finance towards Islamic banks. Due to the fact that the Ministry of Finance is a body that is involved in the banking sector, it is important to determine its role in regulating the Islamic banking industry. Therefore, the responsibilities and duties of the Ministry of Finance should be clearly specified in the Islamic Banking Law 2015. Moreover, the law does not specify any conditions for foreign Islamic banks to open branches in Iraq. It is necessary for the foreign Islamic banks to know the requirements for practicing Islamic banking in Iraq. Therefore, Islamic Banking Law 2015 must provide the foreign Islamic banks with clearer conditions for opening of Islamic banks in Iraq.

In addition, the law does not state how Islamic banks should prepare their financial statements and whether the banks should even publish their financial statements. The Islamic Banking Law 2015 should clearly include the steps for the Islamic banks to prepare their financial statements at the end of the year. In addition, the contents of the financial statement should be clearly stated in the law. Furthermore, the Islamic Banking Law 2015 does not specify the duties of the auditor and the appointment of the auditor. It is very important for the Islamic banks to know how they appoint the auditor and it is important for the auditor to understand his duties. Thus, the law should specify all the responsibilities related to the auditor. Apart from that, the law does not state the power of the banks to remove their directors or chief executive

⁶⁶³ Munawar Iqbal, Ausaf Ahamad and Tariqullah Khan, 'Challenges Facing Islamic Banking' (1998) *Islamic Development Banks* occasional paper 1, 36 < <http://www.ifisa.co.za/Articles/Islamic%20Banking/Challenges/>> accessed 10 November 2016.

⁶⁶⁴ Due to the current gaps in the Islamic Banking Law 2015, the law could not assist Islamic banks completely.

officers. The Islamic Banking Law 2015 should explicitly mention the reasons and the power of the CBI in removing directors or chief executive officers of any Islamic banks. The law also does not include the positions that are not permitted to be used by any company, such as the name of bank, advisor, banco etc.

Furthermore, the Islamic Banking Law 2015 does not specify the types of punishment for those who break the provisions of the law. It is very important for it to determine the penalty for those who breach the provisions of the Law.⁶⁶⁵ Hence, it should be determined in the law whether the penalty is a fine or imprisonment. Furthermore, the Islamic Banking Law 2015 does not specify the reasons for licence withdrawals from the CBI because it is important for the Islamic banks to be aware of the reasons for the withdrawals. Thus, in this case, Islamic banks can avoid these reasons and these defaults. It seems that the Iraqi Islamic Banking Law 2015 has many deficiencies that make it incomplete and incomprehensive. As a result, the Islamic Banking Law 2015 cannot resolve all Iraqi Islamic banking legal issues. In order to be effective, the law could include all necessary aforementioned fundamental elements. In that case, an active and complete Islamic banking law in Iraq could resolve many issues.⁶⁶⁶

A comprehensive law would be able to manage all transactions and operations conducted by these banks. In addition, it could manage the relationship between the CBI and Islamic banks, and also that between the Islamic banks and other financial institutions.

Elements of an Effective and Supportive Islamic Banking Law

An Islamic banking law should cover all requirements necessary to support and enhance Islamic banking transactions. The nature of the business and all the activities that are practised by the Islamic banks should be stated clearly in the Islamic banking law. The exact entities which can be called Islamic banks should also be explicitly identified in any Islamic banking law⁶⁶⁷ to determine all the activities that are permitted and prohibited by such institutions. The issuance of banking licenses is another important aspect of the Islamic banking law, and therefore all conditions and requirements should be clearly stated in the law for those entities that want to obtain an Islamic banking licence. In general, the law has to regulate Islamic banks and enhance them to develop in accordance with the country's financial and economic systems

⁶⁶⁵ In contrast, the Malaysian IFSA 2013 imposes punishments for those who breach any provisions of the act.

⁶⁶⁶ The law could find solutions for some other issues, such as which bodies have the last word in Islamic banking Sharia issues and the kind of relationship between the CBI and the Islamic banks.

⁶⁶⁷ In other words, the Islamic bank is different from Islamic insurance company. The law can determine which entities can be named Islamic banks. However, in Iraq there is no Islamic insurance company. The only Islamic enterprises that operate in Iraq are Islamic banks.

without facing any unnecessary challenges or obstacles.⁶⁶⁸ Therefore, it is evident that the lack of a dedicated Islamic banking law at present is a serious issue for this industry, and represents a significant obstacle on the path towards developing Islamic banking in Iraq.⁶⁶⁹

Islamic banking law paves the way for the Islamic banks to improve and gives them the opportunity to compete with conventional banks more effectively.⁶⁷⁰ In fact, the lack of an effective Islamic banking law is hindering the development of Islamic banking businesses in Iraq and is creating many obstacles for the industry,⁶⁷¹ which should instead be growing in parallel with global developments. Hence, the enactment of a specific Islamic banking law is needed in Iraq.⁶⁷² In terms of regulation, the law should determine which body is responsible for the regulation and supervision of Islamic banks by explaining the way of how this body regulates the Islamic banking industry and the CBI's role with issuing Islamic banking licenses. The law could give power to the CBI for the regulation of Islamic banks. The Islamic banking law could determine functions and duties of the board of directors. In addition, the proper requirements could also be stated in the law. As for the supervisory aspect, the law should state what the main supervisory body for the Islamic banking industry is.

In addition, the role of the Sharia supervisory boards of Islamic banks should be clearly stated in relation to the supervision of Islamic banks and their activities. Furthermore, the supervisory role of the CBI should also be stated in the law in order to avoid conflicts between the CBI and the internal Sharia boards of the Islamic banks. Thus, the establishment, appointment and duties of the Sharia committee have to be stated under the Islamic banking law. Therefore, all regulatory and supervisory elements of the Islamic banking industry have to be clearly specified in any Islamic banking law.

⁶⁶⁸ Abdul Karim Aldohni, *The legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge, London 2011) 122

⁶⁶⁹ Mustafa Natiq Salih Matlub, 'Obstacles to Work of the Islamic Banks and Ways of Cures for Development' (2012) *Research and Islamic Studies magazine*, 287, 294.

⁶⁷⁰ Islamic banking laws can manage the Sharia supervisory boards of Islamic banks which would lead to better Sharia supervision for these banks. As a result, qualified scholars will be appointed as members of the Sharia supervisory boards which would increase the customers' confidence in the services provided.

⁶⁷¹ Interview with Abdulla Hama, university lecturer, University of Sulaymaniyah, (Erbil, June 2015)

⁶⁷² Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 39.

Current Islamic Banking Rules

Some countries have separate regulations for Islamic banking through laws or acts.⁶⁷³ In certain countries, in addition to having an Islamic banking act, the general banking law also specifically mentions the Islamic banking sector in some parts. This is the case in Malaysia, where section 15 of the Financial Services Act 2013 (FSA) mentions Islamic banking businesses.⁶⁷⁴ For example, section 15 (3) states that:

Without limiting the generality of subsection (2), a licensed bank or licensed investment bank approved under subsection (1) shall, for the purposes of carrying on Islamic banking business— (a) establish and maintain at all times an Islamic banking fund with such minimum amount as may be specified by the Bank to fund the operations of its Islamic banking business; and (b) keep all assets and liabilities of its Islamic banking business separate from its other assets and liabilities in such manner as may be specified by the Bank.⁶⁷⁵

In contrast, the Islamic Banking Law 2015 in Iraq does not regulate Islamic banks effectively. As a result, there is a pressing need to amend some laws in Iraq,⁶⁷⁶ such as the Banking Law 2004 and CBI Law 2004, to address Islamic banks. However, the new Iraqi Islamic Banking Law 2015 should be examined first in the light of other countries' Islamic banking laws in order to identify weaknesses of the law. In addition, following discussions with experts in the fields of Islamic banking, conventional banking and law-making, the law should emulate other laws and regulations that are applicable to the financial and banking systems in Iraq when making provisions for Islamic banking activities. These changes would ease the Islamic banking sector in applying these laws in its situation as an active part of the wider financial sector in Iraq.

Iraq Banking Law

It is well known that Islamic banking transactions are based on Sharia principles, which prohibit dealing with interest, while conventional banks base their dealings with clients, depositors and shareholders on an interest-based system.⁶⁷⁷ This means that the laws that are enacted for governing conventional banks are not applicable for the regulation of Islamic banks.

⁶⁷³ Abbas Hamid al Tamimi and Thaurah Sadq al Hammadi 'Sources and effects of Risk Formulas of Islamic Finance in Islamic Banks' (2014) 20 *The Journal of Administration & Economics* 374, 381. (translated from the original Arabic text by the author).

⁶⁷⁴ Because Islamic banking industry is part of the general finance and banking sector, thus, the laws and regulations that introduced to regulate the sector should refer to Islamic banking industry in their provisions, as can be seen in FSA 2013 and Central Bank Law 2009 of Malaysia.

⁶⁷⁵ FSA 2013, S 15 (3)

⁶⁷⁶ Madhat Kadhim Alquraishi and Misun Abdulaghani Kareem, 'Islamic Banks and the Impact of the world Financial Crisis' (2012) 32 *Iraqi Journal for Economic Sciences* 43, 56.

⁶⁷⁷ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 *IKIM Law Journal* 1.

The Iraqi Banking Law 2004 treats all the banks on the same basis,⁶⁷⁸ i.e. there is no difference between Islamic and conventional banks.⁶⁷⁹ Article 1 of the law gives a definition of a bank as follows: “*bank* means a person holding a licence or permit under this Law to engage in banking business and other banking activities”⁶⁸⁰. Since there is no place for Islamic banks within the Iraqi Banking Law 2004, all Iraqi Islamic banks are subject to this law, regardless of whether it is suitable for them or not.⁶⁸¹

The Iraqi Islamic Banking Law 2015

There were no Islamic banking laws for the regulation of Islamic banks in Iraq until 2015. For the first time in Iraq, the Islamic Banking Law 2015 was enacted by the Iraqi parliament. The law consists of 16 Articles for the regulation of the Islamic banking industry in Iraq. The Islamic Banking Law 2015 came into force when the Islamic banking industry was already regulated by the Internal Instruction 2006 which is just a guideline that was issued by the CBI in 2006. It was expected that the new Islamic banking law could be effective and supportive of Islamic banks. However, the Islamic Banking Law 2015 was introduced in a situation where the Iraqi Islamic banks were facing many legal and Sharia problems together with the law being an incomplete set of regulation. Several shortcomings can be seen in the law.

Nevertheless, the Islamic Banking Law 2015 of Iraq can be considered as an important step to enhancing the Islamic banking industry in the country. However, the law may have some weaknesses. The licensing requirement is the weakest part of the law. It may be argued that all conditions and requirements applicable to Islamic banking licences are stated in the Iraqi Banking Law 2004. This argument is not reasonable as the Banking Law 2004 is enacted for the regulation of conventional banks and only suitable for those banks. In contrast, Islamic banks are based on the religion of Islam. Therefore, it is necessary to have special licencing requirements and conditions, as can be seen in other countries such as Malaysia. Furthermore, it may be possible for Islamic banking institutions to have the same licensing requirements and conditions as conventional banks if the Iraqi Banking Law 2004 specifically mentioned Islamic

⁶⁷⁸ Mohammad Ahmed Jawad, ‘Finance Committee Report on Banking System Reform Requirements in Iraq’ (Iraq report, Iraqi Council of Representatives Finance Committee, 2014) 38, 39.

⁶⁷⁹ There is no distinction made here; the Islamic banking industry is dealt with by the CBI in exactly the same way as the conventional banking sector.

⁶⁸⁰ Iraqi Banking Law 2004, Section 1 General Provisions, Article 1 Definitions

⁶⁸¹ Iraqi Council of Representatives, Mohammad Ahmed Jawad, ‘Finance Committee Report on Banking System Reform Requirements in Iraq’ Iraq report 2014, Council of Representatives Finance Committee 40.

banking businesses. However, this law does not specifically refer to Islamic banking in any of its provisions.⁶⁸²

Therefore, in general, Islamic Banking Law 2015 of Iraq is not comprehensive for the regulation of the Islamic banking industry in the country.⁶⁸³ In fact, this author argues that the reason for the incomplete Islamic Banking Law 2015 is due to insufficient Islamic banking legal and Sharia experts to provide opinions on the law. In addition, the CBI's lack of knowledge of Islamic banking transactions and operations is another reason for the weak Islamic banking law in Iraq.

Various Countries' Experiences in the Regulation of their Islamic Banking Industries

The establishment of the Islamic banking system varies from one country to another. Some countries started adopting Islamic banking in the 1980s, while others started a decade later in the 1990s. For example, Iran has vast experiences in the Islamic banking system. In Iran, the Islamic banking law was passed by the Islamic Majlis of Iran for the regulation of the Islamic banking industry in 1983.⁶⁸⁴ Thus, enacting a specific law for Islamic banking can be a good starting point for this industry to operate. However, for each sector to be evaluated, the challenges and problems that are being faced in this sector should first be identified. In order to investigate and understand the situation of Islamic banking in Iraq, some examples of developed Islamic banking systems in other countries is studied to allow us to determine how the current Iraqi Islamic banking system can be improved and what steps should be taken in order to fully develop this sector in Iraq.

To this end, the Islamic banking systems of Malaysia and Bahrain⁶⁸⁵ will be critically evaluated in terms of how an understanding of their nature and workings could benefit the Iraqi Islamic banking system. Therefore, the author will now critically evaluate these two countries with the objective of demonstrating which elements within their respective systems could be similarly applied to the Iraqi Islamic banking system.

⁶⁸² Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38.

⁶⁸³ See chapter three of this thesis for more details on analysing the Iraqi Islamic Banking Law 2015.

⁶⁸⁴ DR. S. Husain Ashraf, Mr. Ali Alizadeh Giashi, 'Islamic Banking in Iran - Progress and challenges' (2011) 1 Arabian Journal of Business and Management Review 31, 33.

⁶⁸⁵ Both of these countries have advanced Islamic banking systems. Both countries also have special regulations for the governing of their Islamic banking industries.

The Malaysian Experience of Regulating its Islamic Banking System

Malaysia has an advanced Islamic banking system, which is currently regulated by the IFSA 2013 and the FSA 2013. The country's IFSA 2013 is a specific law for the regulation of all Malaysian Islamic financial institutions, including Islamic banks, *takaful* operators, international Islamic banks, while the FSA 2013 governs both conventional and Islamic banks.⁶⁸⁶ In fact, currently the IFSA 2013 is a special legislation that was introduced for regulating the Islamic finance sector. However, before 2013, the Islamic Banking Act 1983 was the act that regulated the Islamic banking industry.⁶⁸⁷ Currently, the IFSA 2013 and FSA 2013 regulate the Islamic banking industry.⁶⁸⁸

In Malaysia, Islamic banks can operate alongside conventional banks without any difficulties. This is due to the fact that in Malaysia, a dual banking system is utilised⁶⁸⁹ and there is a special Islamic financial law for the regulation of the Islamic banking industry alongside banking laws for governing the conventional banking industry. The banking system that is followed in Malaysia is recognised as a special model for the future. It is considered one of the most famous banking models in the world, and, as such, many countries wish to adopt the Malaysian banking system for their financial transactions.⁶⁹⁰ Studying the Malaysian approach in relation to its banking system reveals evidences for the success of this system.⁶⁹¹ Islamic banks in Malaysia are regulated and supervised by the central bank of Malaysia. Hence, the BNM has been given the power by the IFSA 2013 to regulate the country's Islamic financial institutions, including Islamic banks, as referred to in section 7 (1) of the Act:

The Bank shall exercise the powers and perform the functions under this Act in a way which it considers most appropriate for the purpose of meeting the regulatory objectives

⁶⁸⁶ IFSA 2013 is a specific act for regulating Islamic financial institutions, including Islamic banks, while the FSA 2013 regulates both Islamic and conventional institutions. Thus, there are some provisions in the FSA 2013 specific to Islamic financial institutions.

⁶⁸⁷ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 IKIM Law Journal 1.

⁶⁸⁸ The Islamic Banking Act 1983 and the Banking and Financial Institutions Act 1989 regulated the Islamic banking industry before the new IFSA was introduced in July 2013.

See: Norhashimah Mohd. Yasin, 'Islamic Banking In Malaysia: Legal Hiccups and Suggested Remedies' (2001) 9 IIUM Law Journal 1, 4.

⁶⁸⁹ Uzaimah Ibrahim, Aishath Muneeza and Rusni Hassan, 'Conflicts Facing Islamic Banking in Malaysia: Dual Banking System Versus Dual Legal System' (2012) 6 Australian Journal of Basic and Applied Sciences 6, 246.

⁶⁹⁰ For example, Indonesia and Brunei adopted the Malaysian model during the initial stages of developing an Islamic banking system in their respective countries.

See: Professor Sudin Haron, 'Towards Developing A Successful Islamic Financial System: A Lesson From Malaysia' (2004) Creating Dynamic Leaders, Working Paper Series 003, 2.

⁶⁹¹ Hamim S. Ahmad Mokhtar, Naziruddin Abdullah and Syed M. Al-Habshi 'Efficiency of Islamic Banking in Malaysia: A Stochastic Frontier Approach' (2006) 27 Journal of Economic Cooperation 38-39.

of this Act and the Governor shall exercise such powers and perform such functions of the Bank on its behalf⁶⁹²

The Malaysian Islamic Financial Services Act 2013 (IFSA)

Before 2013, the Islamic banking industry in Malaysia was regulated by the Malaysian Islamic Banking Act 1983, which consisted of sixty sections that were divided into eight parts.⁶⁹³ The Islamic banking industry in Malaysia was further supervised by the Central Bank of Malaysia.⁶⁹⁴ The act clearly determined all rights and responsibilities of Islamic banks.⁶⁹⁵ However, in 2013, the Malaysian government introduced a new law for the Islamic banking industry IFSA 2013. Malaysia's new Islamic Financial Services Act 2013 was introduced to provide a stronger legal foundation for the Islamic finance sector and to enhance the sector. The IFSA came into action in July 2013 to replace the Islamic Banking Act 1983 and the Takaful Act 1984. Essentially, the IFSA 2013 gave more authority to the BNM. In addition, the IFSA 2013 can enhance the regulatory and supervisory systems of the Islamic banking industry as it requests Islamic financial institutions to be in compliance with the Sharia principles at all times from the beginning until the end of each transaction and contract. This point is considered one of the strongest points of the act.

The IFSA 2013 defines the Islamic banking in Section 2 of the Act as follows:

Islamic banking business” means the business of— (a) accepting Islamic deposits on current account, deposit account, savings account or other similar accounts, with or without the business of paying or collecting cheques drawn by or paid in by customers; or (b) accepting money under an investment account; and (c) provision of finance;⁶⁹⁶

The objectives of the act is to provide the BNM with greater power to counter future risks of financial instability in the Islamic financial sector, increase consumer protection and promote competition in the broader financial services sector. Thus, the IFSA 2013 provided more power to the BNM to regulate and supervise the Islamic banking and financial institutions as can be seen by Section 7 of the Act:

(1) The Bank shall exercise the powers and perform the functions under this Act in a way which it considers most appropriate for the purpose of meeting the regulatory objectives of this Act and the Governor shall exercise such powers and perform such functions of the Bank on its behalf. (2) The powers and functions of the Bank under this Act are in addition

⁶⁹² IFSA 2013 S 7 (1).

⁶⁹³ Mohamed Ismail b Mohamed Shariff, 'Islamic Banking: How Developed is it in Malaysia today?' (11th Malaysian Law Conference, Kuala Lumpur November 2001).

⁶⁹⁴ The Islamic banking industry is still supervised and regulated by the BNM.

⁶⁹⁵ Ahmad Ibrahim, 'Legal Framework of Islamic Banking' (1997) 1 IKIM Law Journal 1, 2

⁶⁹⁶ IFSA 2013 S 2

to, and not in derogation of, the powers and functions of the Bank under the Central Bank of Malaysia Act 2009.⁶⁹⁷

Furthermore, in part 5 of the IFSA 2013, all Sharia requirements for the Islamic financial institutions have been stated. Thus, in Article 28 of the Act:

(1) An institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with Shariah. (2) For the purposes of this Act, a compliance with any ruling of the Shariah Advisory Council in respect of any particular aim and operation, business, affair or activity shall be deemed to be a compliance with Shariah in respect of that aims and operations, business, affair or activity.⁶⁹⁸

Roles of the BNM under the IFSA 2013

In fact, the IFSA 2013 gave more power to the BNM in relation to Sharia matters. Thus, the BNM with SAC can control Sharia issues of the Islamic financial institutions as it states under section 29 of the Act:

(1) The Bank may, in accordance with the advice or ruling of the Shariah Advisory Council, specify standards—
(a) on Shariah matters in respect of the carrying on of business, affair or activity by an institution which requires the ascertainment of Islamic law by the Shariah Advisory Council; and
(b) to give effect to the advice or rulings of the Shariah Advisory Council.⁶⁹⁹

Therefore, the BNM is given more authority through the IFSA 2013 as compared to the previous Islamic Banking Act 1983. Thus, the IFSA 2013 provides the BNM with a wide range of power to issue standards which are binding upon every director, officer or Sharia committee member of the Islamic financial institutions. Hence, this thesis argues that all Sharia matters of the Islamic financial institutions in Malaysia can only be monitored and supervised by the SAC. In addition, the BNM can monitor the SAC in order to ensure that the BNM rules are followed. In fact, it is not a wise decision to have Sharia matters of the Islamic financial institutions to be supervised by two bodies namely the BNM and the SAC. Hence, as the SAC is the supreme Sharia authority in Malaysia and is specialised in Sharia matters, it is better for it to be the only Sharia supervisory body. In that context, the BNM can regulate all financial institutions and their activities while the SAC can regulate and supervise Islamic financial institutions in issues relating to the Sharia.

⁶⁹⁷ IFSA 2013, S7 (1) and (2).

⁶⁹⁸ IFSA 2013 S28 (1) and (2).

⁶⁹⁹ IFSA 2013 S29 (1) a and b.

Punishments for breaching Provisions of the IFSA 2013

Punishment is one of the most important elements that exist in any law that should be applied properly. In that context, it is noted that the IFSA 2013 provides heavy punishments for those who do not comply with the Islamic financial rules as stated in section 28 (5):

‘Any person who contravenes subsection (1) or (3) commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding eight years or to a fine not exceeding twenty-five million ringgit or to both’.⁷⁰⁰

Furthermore, civil action can be taken against anyone who breaches the provisions of the IFSA 2013 as provided by section 250 of the act:

‘Where it appears to the Bank that there is a reasonable likelihood that any person will contravene or has contravened or will breach or has breached or is likely to fail to comply with or has failed to comply with any— (a) provisions of this Act’ ...
the Bank may institute civil proceedings in the court seeking any order specified under subsection 251(1) against that person whether or not that person has been charged with an offence in respect of the contravention or breach or whether or not a contravention or breach has been proved in a prosecution.’⁷⁰¹

In that regard, this author argues that punishments for those who breach the provisions of the IFSA 2013 is one of the most important points of the act. This strict act can protect the Islamic banking industry from corruption and money laundering.

Role of the Malaysian Minister in the Regulation of Islamic Banks

It is worth mentioning that the minister has its role in licensing Islamic financial institutions. The minister, through the Central Bank, approves, with or without conditions, or rejects applications for licences submitted by Islamic banks in Malaysia, as provided by section 10 (2):

Upon making an assessment under subsection (1) and where the Bank is satisfied that such applicant may be granted a licence, the Bank shall make a recommendation to the Minister to grant a licence under subsection (4) with or without conditions.⁷⁰²

Where the Bank makes a recommendation pursuant to subsection (2), the Minister may grant a licence to the applicant to carry on Islamic banking business, takaful business, international Islamic banking business or international takaful business, with or without conditions.⁷⁰³

⁷⁰⁰ IFSA 2013 S 28 (5).

⁷⁰¹ IFSA 2013 S 250.

⁷⁰² IFSA 2013 S 10 (2).

⁷⁰³ IFSA 2013 S10 (4).

This thesis argues that in a country like Malaysia, it is better for the minister to not have strong authority over the Islamic banking industry due to the fact that the BNM has enough qualified Islamic banking experts. In addition, Malaysia has the SAC which has power over Islamic banks in the country. Hence, if both the minister and the BNM have authorities over Islamic banks, then the process of licensing Islamic banks may take longer and therefore time-consuming.

In general, the IFSA 2013 is a key legal instrument in promoting the Islamic banking industry in Malaysia. The provisions of the IFSA 2013 are organised in a very good way by covering the entire sector and established a clear framework which Islamic banking institutions can develop without any difficulties or problems. In fact, the act is very suitable and clearly provided punishments for those who breach provisions of this act. In addition, the IFSA 2013 facilitates Islamic banking transactions in accordance with today's global financial world.

The Bahraini Experience of Regulating its Islamic Banking System

Bahrain has an advanced Islamic banking system and a long history of regulation of its Islamic banking system. In Bahrain, there is a set of rules and regulations for the Islamic banking industry, which is called 'Volume 2- Islamic Bank'.⁷⁰⁴ This volume consists of several modules that have been enacted for the regulation of the Islamic banking sector in the country. The Bahraini government and the Central Bank of Bahrain (CBB) both play a crucial role in the ongoing development of the country's Islamic banking system. The CBB is the sole regulatory body for the financial sector in Bahrain.⁷⁰⁵

Volume 2- Islamic Bank of the Rulebook in Bahrain

In Bahrain, the CBB issued a rulebook for Islamic banks⁷⁰⁶ to regulate and govern the Islamic banking industry in Bahrain known as 'Volume 2-Islamic Bank'. This volume is in fact one of several volumes⁷⁰⁷ of what is known as the 'Rulebook'.⁷⁰⁸ The 'Volume 2- Islamic Bank' is specific to Islamic banking, while the other volumes were enacted for the regulation of other

⁷⁰⁴ Shamsalden Aziz Salh, 'Impact of the Islamic banking System of Bahrain on the OIC Countries' (2nd Internal Conference on Islamic Economics & Economies of the OIC Countries, Kuala Lumpur January 2013).

⁷⁰⁵ ZulKifli Hasan, 'Regulatory Framework of *Shari'ah* Governance System in Malaysia, GCC Countries and the UK (2010) 3 Kyoto Bulletin of Islamic Area Studies 82, 90.

⁷⁰⁶ Ali Alshamrani, 'A Critical Evaluation of the Regulatory Framework for the Application of Islamic Financial Derivatives in the Kingdom of Saudi Arabia' (2014) 2 Journal of Islamic Banking and Finance 269, 94.

⁷⁰⁷ As a regulatory body, the CBB has issued several volumes for the regulation of financial institutions in the country. Each volume concerns the regulation of a different area of financial services activity.

⁷⁰⁸ 'Volume 2-Islamic Bank' of the Rulebook holds an important position among the CBB's laws and regulations, as it is a special set of rules that concerns the Islamic banking industry.

industries.⁷⁰⁹ This volume covers Islamic banking transactions and consists of prudent conditions and requirements, for example rules on minimum capital and risk management. The ‘Volume 2-Islamic Bank’ contains several modules to guide the government and various organisations of the Islamic banking industry. The Licensing Requirements Module (LR), for example, covers all requirements and conditions necessary for the licensing of Islamic banking institutions, as set up by the CBB. In LR-A.1.1, it is stated that: “The Licensing Requirements Module sets out the Central Bank of Bahrain’s (CBB’s) approach to licensing providers of regulated Islamic banking services in the Kingdom of Bahrain”.⁷¹⁰

Other modules have their individual function and purpose, such as the Auditors and Accounting Standard Module, which presents requirements that have to be met by the Islamic Banks in relation to the appointment of external auditors. In addition, other modules of the ‘Volume 2-Islamic Bank’ address other aspects of the regulation and facilitation of Islamic banking activities. Thus, the purpose of all modules is to ensure that Islamic banks comply with Sharia principles.⁷¹¹

Generally speaking, all modules of the ‘Volume 2-Islamic Bank’ have a role in the regulation and supervision of Islamic banking institutions, but the LR module is key as Islamic banks can only be issued licences in accordance with the conditions contained in this module.⁷¹²

It is worth mentioning that Volume 2 of the Rulebook has a special User’s Guide for guiding Islamic banking institutions in their use and application of ‘Volume 2-Islamic Bank’, together with other useful information. For example, the User’s Guide mentions that Islamic banking licensees, which are members of the Bahrain Stock Exchange, are also subject to the membership and operating rules of that exchange⁷¹³. In sum, any application for an Islamic

⁷⁰⁹ Central Bank of Bahrain, ‘CBB Rulebook’ < http://cbb.complinet.com/cbb/microsite/cbb_rulebook.html > accessed 12 November 2015.

⁷¹⁰ CBB Rulebook, Volume 2-Islamic Banking, Licensing Requirements Module, LR-A.1.1.

⁷¹¹ All activities that are conducted by banks who wish to call themselves Islamic banks should be compliant with Islamic law and free from the paying or charging of any interest, since this is not permitted for Muslims. See: Racha Ghayad, ‘Corporate Governance And The Global Performance Of Islamic Banks’ (2008) 24 *Journal of Humanomics* 207.

⁷¹² The goal of these requirements is to support Islamic banks via the issue of licences and the provision of an appropriate level of protection to the customers of such banks. The issuing of licences to Islamic banks is not easy; the CBB must ensure that the bank implements all the rules and regulations that it imposes.

⁷¹³ CBB Rulebook, Volume 2-Islamic Banking, Users’ Guide, UG-1.1.3.

banking licence should abide by both Volume 2 of the Rulebook and any other applicable law.⁷¹⁴

One of the important points that should be stressed is that the Rulebook is amended quarterly in January, April, July and October. This ongoing amendment makes the Bahraini financial system distinctive. Besides these quarterly amendments, there is also potential for the amendment of all volumes as and when considered necessary. It seems that the CBB monitors the financial system of the country closely and improves the system regularly.⁷¹⁵ Thus, quarterly amendments of the CBB Rulebook Volumes⁷¹⁶ is an example of improvements of the financial system by the CBB.

Malaysian or Bahraini Islamic Banking Regulation

The author will now examine the Islamic banking laws of Malaysia and Bahrain. The laws in these two countries meet the requirements of the industry and enhances the Islamic banking businesses.⁷¹⁷ These laws⁷¹⁸ consist of all necessary elements for the governing and regulating of the Islamic banking industry. Thus, Islamic banking laws in Malaysia and Bahrain are also well structured⁷¹⁹ in order to facilitate the application of their provisions by Islamic banks.

Therefore, it seems highly likely that in Iraq, the CBI and financial regulators would obtain benefits from implementing a similar framework to these countries. In this sense, there is a need for law amendments in Iraq to include Islamic banks, similar to the banking laws in Malaysia.⁷²⁰

Through discussions with experts in Islamic banking and conventional banking, lawmakers should amend the laws applicable to the Islamic financial and banking system in Iraq. Thus, the Iraqi Islamic Banking Law 2015, which is enacted recently, should be amended first

⁷¹⁴ Such as general CBB Law and Company Law which are also applicable for the regulation of the Islamic banking industry because Islamic banks are companies.

⁷¹⁵ CBB Rulebook, Volume 2-Islamic Banking, Users' Guide, UG- 3.1.1.

⁷¹⁶ UG- 3.1.1 states that: "Any changes to the Rulebook are generally made on a quarterly cycle (the only exception being when changes are urgently required), in early January, April, July and October. When changes are made to a Module, the amended Sections are given a new version date, in the bottom right-hand page"

⁷¹⁷ There is no doubt that the existence of such special Islamic banking legislation can enhance the sector and enable it to develop more quickly, and also help the Islamic banking sector to compete with the conventional banking system more effectively.

⁷¹⁸ Malaysia IFSA 2013 and Volume 2 of Islamic Banking in Bahrain.

⁷¹⁹ The structure of the IFSA 2013 and the structure of the Volume 2-Islamic Bank of Bahrain is clear. In other words, these two documents can be followed easily.

⁷²⁰ Central Bank of Malaysia Act 1958 was amended in 2003 to add a new section for the establishment of the SAC in order to be an authoritative body for Islamic financial institutions in Malaysia.

Adawiyah Suhaimi, 'Reference to the Sharia Advisory Council in Islamic Banking and Finance cases: the Effect of the Central bank of Malaysia' < <http://www.academia.edu/1565688/>> accessed 27 January 2014.

because it does not contain all necessary principles for the regulation of the Islamic banking industry. In addition, other financial laws, such as the CBI Law 2004 and Banking Law 2004, should also be amended in Iraq.

Looking at the ‘Volume 2-Islamic Bank’ of Bahrain and IFSA 2013 of Malaysia, the main difference between them is that ‘Volume 2-Islamic Bank’ consists of a number of modules, with each module covering an aspect of the Islamic banking sector. For example, the Licensing Requirements Module addresses licensing of Islamic banks in Bahrain. In contrast, Malaysia’s IFSA is one single document, which contains all relevant elements for regulating all Malaysian Islamic financial institutions, including Islamic banks. Furthermore, the banking regulatory system of Bahrain is somewhat complex due to the fact that it is divided into volumes and it consists of several volumes with each volume having several modules. This structure may not be easy for Islamic banks and their regulators to understand properly. In contrast, the structure of the IFSA 2013 is more easily understood and applied by the regulators on the Islamic banks. Therefore, the Malaysian Islamic banking structure is more suitable for the regulation Islamic banking industry.

In Malaysia, according to the IFSA 2013, the minister⁷²¹ has the role of licensing Islamic banks, while in Bahrain, on the other hand, all Islamic banking licensing processes go through CBB. Thus, the BNM and the minister in Malaysia are responsible for granting licenses to Islamic banks. The minister should approve the licence first while in Bahrain, it is sufficient for the CBB to approve the Islamic banking licence. Section 10 (2) of the IFSA 2013 of Malaysia states that:

(2) Upon making an assessment under subsection (1) and where the Bank is satisfied that such applicant may be granted a licence, the Bank shall make a recommendation to the Minister to grant a licence under subsection (4) with or without conditions.

This author argues that, issuing Islamic banking licenses through both central bank and the minister may make the process longer. Therefore, the way the CBB issues Islamic banking licenses is more preferred.

In Malaysia, the minister and the BNM have the power to cancel the licence as by section 18 (1) of the IFSA2013: ‘The Minister may, on the recommendation of the Bank, revoke the

⁷²¹ “Minister” means the minister for the time being who is in-charged of finance.

licence of a licensed person, and the Bank may revoke the approval of an approved person
.....’

However, in Bahrain, only CBB has the authority to revoke the licenses of Islamic banks as mentioned by LR-3.3.3A of the ‘Volume 2-Islamic Bank’:

‘As provided for under Article 48 (c) of the CBB Law, the CBB may itself move to cancel a license’

Furthermore, in Bahrain, Islamic banks are required to apply AAOIFI standards as stated in the AU-4.1.1 of the ‘Volume 2- Islamic Bank’:

Islamic bank licensees must comply with Financial Accounting Standards (FAS) issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). For products and activities not covered by AAOIFI, International Financial Reporting Standards (IFRS) / International Accounting Standards (IAS) must be followed.

In contrast, in Malaysia, applying the AAOIFI is not compulsory. Thus, Islamic banks in Malaysia are free to apply AAOIFI standards or not.⁷²² This author argues that applying the AAOIFI standards is important. If the standards of the AAOIFI are followed by all Islamic banks in the world, this will help these banks to have unified decisions.

In Malaysia, because applying the AAOIFI is not compulsory, Islamic banks follow the Islamic banking rules of Malaysia. Thus, the members of the Sharia supervisory board of Islamic banks should be qualified in commercial law (*Fiqh Muamalat*) or Islamic jurisprudence (*Fiqh Al - Islami*).⁷²³ However, if members have experiences, then the paper qualifications on the above subjects will not be mandatory.

In contrast, in Bahrain, according to the AAOIFI’s Sharia Standards, the members of the Sharia supervisory boards of Islamic banks should be experts in Islamic commercial jurisprudence and it may include one member with expertise in Islamic finance.⁷²⁴ This author prefers the Bahraini method of one member being an expert in Islamic finance. Because Islamic banking is a part of finance, it is necessary to have one member who has expertise in finance. In general, Bahraini Islamic banks follow all AAOIFI standards and ‘Volume 2-Islamic Bank’. In contrast,

⁷²²Adel Mohammed Sarea and Hj Mustafa Mohd Hanefah, ‘The Need of Accounting Standards for Islamic Financial Institutions’ (2013) 9 International Management Review 50, 58.

⁷²³Mohamed Ben Youssef, ‘Existing Central Shariah Supervisory Models’ (2010) <http://www.academia.edu/4689012/Existing_Central_Shariah_Supervisory_Models> accessed 20 November 2016.

⁷²⁴ the AAOIFI Governance Standard for Islamic Financial Institutions No. 1

Malaysian Islamic banks follow IFSA 2013 and FSA 2013. In addition, Islamic banks in Malaysia follow AAOIFI standards but are not compulsory for them.

Despite the differences between the Malaysian Islamic banking law and the Bahraini banking law, both of them are able to enhance their respective Islamic banking industries. Therefore, the Iraqi Islamic Banking Law 2015 should be amended by taking elements from both the IFSA 2013 of Malaysia and ‘Volume 2-Islamic Bank’ of Bahrain. If the Iraqi Islamic banks apply all standards of the AAOIFI completely, many deficiencies of the Iraqi Islamic Banking Law 2015 will be resolved.

The Role of the CBI in the Regulation of the Islamic Banking Industry

The central bank commonly can be considered the main agent responsible for the regulation and supervision of the banking industry.⁷²⁵ Thus, both Islamic and conventional banks are under the central bank’s control.⁷²⁶ Central banks closely regulate and supervise the banking sector in order to responsibly monitor these institutions.⁷²⁷

The CBI is the only regulatory body for financial institutions in Iraq and is an independent body. The independence of the CBI gives financial activities a high level of transparency and liability.⁷²⁸ According to Article 40 of the CBI Law 2004, the CBI has exclusive authority for the regulation and supervision of the banking sector:

The CBI shall have the exclusive authority to take all such actions as may be necessary: to license, regulate and supervise banks and their subsidiaries as provided for by this Law and in the Banking Law, including the authority to conduct off-site surveillance and on-site examinations of licensees and their subsidiaries in the manner and at the times chosen by the CBI; to require banks and their subsidiaries to provide all such information as the CBI may request regarding the affairs of a bank, its subsidiaries, and their customers; and to take remedial action, as provided in this Law and in the Banking Law, to enforce compliance by licensees and their subsidiaries with such laws and with any regulations, prudential standards, guidelines or directives issued by the CBI in connection with its implementation of such laws. Actions by an entity of the Government other than the CBI to regulate the lending and credit activities of banks are without legal force.⁷²⁹

⁷²⁵ Andrew Campbell, ‘Insolvent Banks and the Financial Sector Safety Net – Lessons from the Northern Rock Crisis’ (2008) 20 Singapore Academy of Law Journal 316, 320.

⁷²⁶ Erlend Walter Nier, ‘Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis’ (2009) *International Monetary Fund WP/09/70*.

⁷²⁷ By effectively monitoring and supervising the banking sector, this can promote a country’s economy and financial sector. Central banks clearly have a central role in the regulation of both conventional and Islamic banking institutions, and as such they usually consist of many experts with sufficient knowledge of the banking sector and financial transactions in general.

⁷²⁸ Robert Looney, ‘Post war Iraq’s Financial System: Building From Scratch’ (2005) XII:1 Middle East Policy 134, 137

⁷²⁹ CBI Law 2004, Article 40.

It is the CBI's objective to achieve and maintain domestic price stability and to promote and stake out a competitive market-based financial system. In addition, the CBI supports sustainable growth, employment and prosperity in the country.⁷³⁰ The undertaking of monetary policy is one of the most crucial functions of the CBI, which is independent from the Finance Ministry. The authority that has been given to the CBI were invested by the law (CBI Law 2004) that came into effect in March 2004.⁷³¹ Since the CBI in Iraq is responsible for governing Islamic banks in addition to conventional banks, it must therefore have a good working relationship with Islamic banks through special mechanisms. Thus, the author argues that this special mechanism can be established via a special unit or division in the CBI as a bridge between the CBI and Islamic banks. In addition, the CBI can have a number of special legal advisors who specialises in Islamic banking and each Islamic bank can have an advisor to supervise the Islamic banking operations. One may argue that it is difficult to have many advisors for this purpose. However, the CBI can also appoint one advisor for two or three Islamic banks. The number of Islamic banks in Iraq is just twelve banks which makes it possible to appoint an advisor to monitor the Islamic banking operations.⁷³² Indeed, the central bank in many countries is responsible for promoting the Islamic banking industry and it is the central bank's role to issue instructions and guidelines for Islamic banking institutions.

In Malaysia, for example, a guideline has been issued on the 1st of April 2005 by the BNM regarding the governance of the Sharia supervisory boards of Islamic financial institutions entitled Guidelines on the Governance of the Sharia Committee for the Islamic Financial Institutions. The guideline has some important functions in the regulation of Sharia boards, such as organising the relationship between Sharia supervisory boards and the Sharia Advisory Council (SAC).⁷³³ The guideline covers all aspects relating to the Sharia boards of Islamic financial institutions, such as membership of the boards, appointments, and qualifications.⁷³⁴ In addition, all duties and responsibilities of the Sharia board are included in the guideline⁷³⁵.

⁷³⁰ CBI, Information About, 'The CBI' < <http://www.cbi.iq/index.php?pid=TheCbi> > accessed 12 November 2016.

⁷³¹ Robert Looney, 'Post war Iraq's Financial System: Building From Scratch' (2005) XII:1 Middle East Policy 134, 137

⁷³² Bashir Hadad, in his interview, mentioned that there is a CBI representative in each bank in Iraq. Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank, (Erbil, May 2015). However, this author argues that this CBI representative is not a specialist in the Islamic banking area. Thus, it is not practical to support and help Islamic banks and he cannot monitor the Sharia supervisory board of the Islamic bank.

⁷³³ Hjh Siti Faridah Abd Jabbar, 'The Governance of Shari'a Advisers of Islamic Financial Institutions: The Practice in Malaysia' (2009) 30 Company Lawyer 312.

⁷³⁴ Applying the guidelines is compulsory for all Islamic financial institutions in Malaysia.

⁷³⁵ Zulkifli Hasan 'The Roles And Responsibilities of The Shariah Committee of Islamic Financial Institutions In Malaysia' (2006) 14 Jurnal Syariah 77, 81.

With regards to the regulation of the Iraqi Islamic banking industry, although the Islamic banking law is necessary,⁷³⁶ there is a need for some guidelines for the Sharia governance of the Islamic banking system. It is the responsibility of the CBI to issue guidelines for managing the Islamic banking-related organs, such as the Sharia supervisory boards.

Hence, the CBI has to use a different method for the regulation of the Islamic banking industry via rules and guidelines.⁷³⁷ As a result, the position and the role of the CBI in governing the Islamic banking sector are vital. The CBI has to work closely with the Islamic banks to overcome the challenges that they face. In this context, it is important to analyse and explain the relationship between the CBI and Islamic banks in order to determine the problems they are facing and explore solutions to these problems.

4.3.2. Relationship between the CBI and Islamic Banks

As the CBI in Iraq is the body responsible for regulating the financial industry in the country,⁷³⁸ any challenges faced by the Islamic banking industry thus automatically becomes the responsibility of the CBI. However, until now, the CBI has been dealing with Islamic banks the same way it deals with conventional banks which is considered as a challenge faced by Islamic banks.⁷³⁹ It is clear that the central bank is a lender of last resort for financial institutions when they are in need of capital.⁷⁴⁰ In this situation, however, the central bank deals with interest, which is a prohibited activity according to Sharia law.⁷⁴¹ This charging of interest would thus prove problematic for any Islamic banks that face liquidity crises and need to go to

⁷³⁶Economic, Islamic Banking, 'Weakness of awareness and lack of special Islamic banking law in Iraq are the serious challenges for Islamic banking in Iraq, September 2011' <http://www.aleqt.com/2011/09/27/article_584288.html> accessed 12 November 2016, (translated from the original Arabic text by the author)

⁷³⁷ Since all laws and regulations that are applicable to the banking sector are finalised by the central bank before being enacted, initiating specific Islamic banking law for Islamic banks in Iraq is the responsibility of the CBI, as the sole authoritative financial regulatory body. Furthermore, issuing guidelines and instructions for the governance of the Islamic banking system is also carried out by the CBI.

⁷³⁸ Robert Looney, 'Post war Iraq's Financial System: Building From Scratch' (2005) XII:1 *Middle East Policy* 134, 137

⁷³⁹ Tania Qadir Abdulrahman and Mustaq Mahmud Al-sabaawi, 'Evaluating The Performance Of Islamic Banks By Using Financial Analysis Composite Comparative study of the Iraqi Islamic Bank Performance with the Jordan Islamic Bank for the Period (2000 – 2008)' (2011) 1, *Journal of Kirkuk University For Administrative and Economic Sciences* 152, 161. (translated from the original Arabic text by the author).

⁷⁴⁰ Erlend Walter Nier, 'Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis' (2009) International Monetary Fund WP/09/70, 11.

⁷⁴¹ This can, therefore, be considered as unfair to Islamic banks that should not be asked to pay or receive interest.

the CBI as a last resort.⁷⁴² Therefore, this inappropriate relationship between the CBI and Islamic banks in Iraq can be considered one of the main legal issues in the current situation.⁷⁴³

As seen above, Islamic banks are not treated accordingly by the CBI when compared to conventional banks. The Islamic banking industry is based on Sharia law, which cannot make transactions that are prohibited by the law.⁷⁴⁴ However, from the viewpoint of interest, the CBI treats Islamic banks the same way as conventional banks.⁷⁴⁵

In that context, legal issues arise from the relationship between the CBI and the Islamic banks as it is a serious one.⁷⁴⁶ Thus, the Sharia principles should be followed in relation to the CBI and Islamic banks. Instead, the CBI should provide Islamic banks with all possible assistance.⁷⁴⁷

The central banks in certain countries with an Islamic banking industry regulate Islamic banks closely via special methods. In Malaysia, for example, the SAC, as a central Sharia board, monitors Islamic banks and their respective Sharia boards, which is a way for the BNM to govern the Islamic banking industry⁷⁴⁸. In Bahrain, there is a National Sharia Board as part of the CBB that is set up in order to assist the CBB. In addition, there are specific rules and regulations of the Islamic banking sector in both Malaysia⁷⁴⁹ and Bahrain.⁷⁵⁰ Therefore, it is noted that Islamic banking in Iraq, under the control of the CBI, is subject to rules and regulations that were designed for conventional banks.⁷⁵¹ In such condition, the Islamic banking industry will face challenges with respect to monetary policy.

⁷⁴² Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40, Baghdad College for Economic Science, 349, 356 (translated from the original Arabic text by the author).

⁷⁴³ Tania Qadir Abdulrahman and Mustaq Mahmud Al-sabaawi, 'Evaluating The Performance Of Islamic Banks By Using Financial Analysis Composite Comparative study of the Iraqi Islamic Bank Performance with the Jordan Islamic Bank for the Period (2000 – 2008)' (2011) 1, journal of kirkuk University For Administrative and Economic Sciences 152, 161. (translated from the original Arabic text by the author).

⁷⁴⁴ Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking' (2011) 2 International Journal of Business and Social Science 166.

⁷⁴⁵ The Iraqi conventional banking system is built on the Western banking system and the laws of this type of banking do not consider Sharia principles, which comes from the Quran and Sunnah as two main sources of reference in Islam.

⁷⁴⁶ Interview with Abdulla Hama, university lecturer, University of Sulaymaniyah, (Erbil, June 2015).

⁷⁴⁷ Mustafa Natiq Salih Matlub, 'Obstacles to Work of the Islamic Banks and Ways of Cures for Development' (2012) Research and Islamic Studies Magazine, 287, 315. (translated from the original Arabic text by the author).

⁷⁴⁸ Adnan Trakic, 'The Supervision of the Islamic Banks: Analytical Analysis with reference to Malaysia', Sharia Law Report, 2011. P IXXXii.

⁷⁴⁹ Abdul Karim Aldohni, *The legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge, London 2011) 18.

⁷⁵⁰ CBB, the Financial Sector, 'Islamic Finance' <http://www.cbb.gov.bh/page-p-islamic_finance.htm> accessed 23 November 2014.

⁷⁵¹ Hashim Omer Hamoudi, 'Towards Activating The Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

4.3.2.1. The Role of the CBI as a Lender of Last Resort

Central banks are responsible for the health of the financial systems in any country. Therefore, central banks, as a lender of last resort, need to respond to any liquidity crises quickly.⁷⁵² In addition, the central bank should have the ability to provide liquidity to the banks that are facing liquidity risks.⁷⁵³ Like conventional banks, Islamic banks can receive assistance from the central bank in liquidity crises. However, Islamic banks cannot deal with interest in situations of liquidity crises because they are unable to pay back this assistance to the central bank with interest. With this regard, it is not rational for Islamic banks to make deposits with the central bank but have to refuse receiving interest,⁷⁵⁴ while conventional banks receive it. Hence, this issue and some other legal issues between the CBI and Islamic banks should be resolved through the adoption of a specific Islamic banking law and amendment of some other laws such as the CBI Law 2004.

Solutions for Liquidity Crises involving Islamic Banks

When the central bank acts as the lender of last resort, for example, a solution has been suggested by some scholars to the problem of Islamic banks facing liquidity crises. Thus, the CBI can follow this suggestion when faced with the crises. M Umer Chapra and Habib Ahmed opine that:

Islamic banks also need some facility akin to the lender of last resort which is available to conventional banks to overcome liquidity crises when they occur suddenly due to unforeseen circumstances. Such a facility is available to Islamic banks at present on the basis of interest and is, therefore, unacceptable because of its incompatibility with the Sharia. Its use exposes Islamic banks to a great deal of criticism. It may be worth considering the creation of a common pool at the central bank to provide mutual accommodation to banks in the case of need. All banks may be required to contribute a certain mutually agree percent of their deposits to this common pool, just as they do in the case of statutory reserve requirements. They would then have the right to borrow interest free from this pool with the condition that the net use of this facility is zero (i.e. drawing is not exceed contributions) over a given period of time. In a crisis situation the central banks may allow a bank to exceed the limit with appropriate penalties, warning, and a suitable corrective programme. This will in a way be a more organised way of replacing the framework for mutual cooperation that prevailed among the *sarraf* during the classical period.⁷⁵⁵

⁷⁵² Ross S. Delston and Andrew Campbell, 'Emergency Liquidity Financing By Central Banks: Systematic Protection or Bank Bailout' in International Monetary Fund (eds), *Current Developments in Monetary and Financial Law* (International Monetary Fund, USA 2005).

⁷⁵³ Andrew Campbell and Rosa Lastra, 'Revisiting the Lender of Last Resort' (2009) 40 *Banking and Finance Law Review* 1, 9.

⁷⁵⁴ Munawar Iqbal, Ausaf Ahamad and Tariquallah Khan, 'Challenges Facing Islamic Banking' (1998) *Islamic Development Banks* occasional paper 1, 38 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 12 September 2016.

⁷⁵⁵ M Umer Chapra and Habib Ahmed, 'Corporate governance in Islamic Financial Institutions' (2002) Paper No. 6, Islamic Development Bank, Islamic research and Training Institute, 84.

However, there are some other suggested solutions for the liquidity shortage being faced by Islamic banks. For resolving the issue of the lender of last resort, Malaysia took two steps: first, issuing non-interest bearing government certificates and second, establishing an Islamic inter-bank market.⁷⁵⁶ Thus, Islamic banks can deal with government certificates in the inter-bank money market in Malaysia. Islamic banks in Malaysia manage their liquidities through buying and selling government certificates.⁷⁵⁷ Hence, the Islamic inter-bank money market can resolve liquidity problems of the Islamic banks to a certain extent. In Bahrain, similar to Malaysia, the Islamic inter-bank money market has its role in resolving liquidity problems on the basis of an Ijara transaction.⁷⁵⁸ Islamic banks in Iraq thus face a problem with the CBI, which itself stems from the fact that the laws and regulations in Iraq are not suitable for the Islamic banking sector.⁷⁵⁹ In addition, the CBI, as a lender of last resort, is dealing with interest.⁷⁶⁰ Therefore, establishing an Islamic inter-bank money market may be a solution for this issue. However, this thesis argues that at present, to create the Islamic inter-bank money market is difficult due to the absence of the fundamental elements of the Islamic banking industry such as insufficient qualified Islamic banking experts.

Therefore, establishing an Islamic banking department and central Sharia board can be the first step to resolve the Islamic banking liquidity issue because the legislation for the banking sector in Iraq has been enacted for the regulation of the conventional banking system rather than the Islamic banking system, in which Islamic banks cannot benefit from this system.⁷⁶¹

Another solution could be that when Islamic banks face a liquidity crisis, the CBI could provide an interest-free loan (*Qard al-hasan*).⁷⁶² Islamic banks in Iraq, in cooperation with the CBI, could apply one of these two solutions for resolving the problem of shortage of liquidity. Due to the fact that creating Islamic inter-bank money market is not possible under the current

⁷⁵⁶ Abdul Karim Aldohni, *The legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge, London 2011) 194.

⁷⁵⁷ Abdul Karim Aldohni, *The legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st edn, Routledge, London 2011) 195.

⁷⁵⁸ Sajjad Zaheer and Moazzam Farooq, 'Liquidity Crisis: Are Islamic Banking Institutions More Resilient?' (The joint RES-SPR Conference on "Macroeconomic Challenges Facing Low-Income Countries, Washington DC, January 2013).

⁷⁵⁹ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 356 (translated from original Arabic text by the author).

⁷⁶⁰ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 356 (translated from original Arabic text by the author).

⁷⁶¹ Mustafa Natiq Salih Matlub, 'Obstacles to Work of the Islamic Banks and Ways of Cures for Development' (2012) *Research and Islamic Studies magazine* 287. (translated from the original Arabic text by the author).

⁷⁶² Ausaf Ahamad 'Instruments of Regulation and Control of Islamic Banks by the Central Banks' (2000) *Islamic Development Banks, Islamic Research and Training Institute* 7, 29.

situation, this thesis agrees to the suggestion of M Umer Chapra and Habib Ahmed in resolving the issue. The common pool which is a mere saving pool that contains all Islamic banks in the country with the supervision of the CBI or the Islamic banking department and central Sharia board of the CBI. Each Islamic bank in Iraq can share and cooperate on the *Wadia* basis.

In fact, the author argues that the idea of the *Qard al-hasan* is the best because it is interest-free and because it is not easy for the Islamic inter-bank money market to be currently established in Iraq. However, it may not be possible for the CBI to provide *Qard al-hasan* to Islamic banks due to the current instability of the country's financial situation and a lack of a comprehensive Islamic banking legal framework.⁷⁶³ Therefore, Islamic banks can create a common pool for resolving the issue of lender of last resort. In fact, the financial problem of the country does not affect the common pool idea because the money that is saved in the pool is not from the government but comes from the Islamic banks. Therefore, the Islamic banks in Iraq can cooperate according to a predetermined agreement.

It is important to mention that the central bank could provide assistance for short periods of time in order to avoid risk of loss for the central bank. Thus, lending for an extended period of time may increase the risk of loss to the central bank which would then lead to a risk of loss to the public. Therefore, lending for an extended period of time is usually a sign that the problems involved are not the illiquidity crises.⁷⁶⁴

4.3.2.2. Strengthen the Relationship between Islamic Banks and the CBI

It seems that the role of the central bank of Iraq in the Islamic banking industry is more problematic when compared to Malaysia and Bahrain because both of these countries have central Sharia bodies in their respective central banks. These bodies⁷⁶⁵ can help central banks in these two countries understand the Islamic banking operations in a better way. Hence, they can advise central banks in related Islamic banking issues. In contrast, similar central Sharia bodies do not currently exist in Iraq. As a result, the CBI must monitor both Islamic banking institutions and conventional banks.

⁷⁶³ Due to the financial crisis, it is not possible for the CBI to provide interest-free loan to the Islamic banks. Therefore, the common pool can be a good option in this stage.

⁷⁶⁴ Andrew Campbell and Rosa Lastra, 'Revisiting the Lender of Last Resort' (2009) 40 Banking and Finance Law Review 1, 15.

⁷⁶⁵ The SAC of the BNM in Malaysia and National Sharia board of CBB in Bahrain act as the central Sharia bodies for respective countries.

For the CBI to have an appropriate relationship with the Islamic banks in the country, a special method is required by establishing an Islamic banking department in the CBI. Therefore, for the CBI to closely govern Islamic banks, there should be an Islamic banking division or department⁷⁶⁶ for the regulation of the Islamic banking industry as it does not exist at the present time.⁷⁶⁷ The department could help the CBI in taking up the responsibility for the regulation and supervision of the Islamic banking industry. Moreover, it can support and promote Islamic banking institutions as they would be able to deal with this department to provide any advice or assistance. Just as there is a training department within the CBI to provide training courses for commercial bankers, there should be a similar department for Islamic banking. Furthermore, this department should have an even wider responsibility than the one for commercial banks. It should be able to give assistance to Islamic banks, such as teaching the bank staff and technically support the Islamic banks.⁷⁶⁸ The department could also provide training courses in Islamic banking transactions and monitor the Islamic banking sector more closely and effectively than the CBI. This special department should be run and governed by legal experts who are specialised in the field of Islamic banking and finance. This solution would strengthen the relationship between the CBI and Islamic banks in a variety of ways, as this relationship is currently far too weak.⁷⁶⁹ Moreover, the special department together with the central Sharia board could assist the CBI in licensing Islamic banks in Iraq.

4.4. Licensing of Islamic Banking Institutions in Iraq

Any enterprise wishing to obtain a licence to operate as an Islamic bank needs to make an application and go through a long process. Issuing a licence is the first and crucial beginning for any Islamic bank applicant before starting its business.⁷⁷⁰ Therefore, providing details on some important conditions and requirements for obtaining a licence is essential. In fact, special Islamic banking legislations should cover all the requirements and elements involved in obtaining a licence.

⁷⁶⁶ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

⁷⁶⁷ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38.

⁷⁶⁸ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank, (Erbil, May 2015).

⁷⁶⁹ In Bahrain, the Waqf Fund is part of the CBB and it has the role of special department for assisting Islamic banks and managing the relationship between the CBB and Islamic banks.

⁷⁷⁰ Luca Errico and Mitra Farhbaksh, 'Islamic Banking: Issues in Prudential Regulations and Supervision' (1998) International Monetary Fund /98/30, 15 <<http://www.imf.org/external/pubs/ft/wp/wp9830.pdf>> accessed 15 November 2016.

Islamic Banking Licensing under the Iraqi Banking System

In Iraq, there is no special part or section about licensing Islamic banks in the Islamic Banking Law 2015. In addition, the Banking Law 2004 licensing requirements do not refer to Islamic banks. In Iraq, in order for the Islamic banks to be licensed, the same rules are applicable for these banks as for conventional banks. In s.2 of the Iraq Banking Law 2004, all related conditions and requirements are mentioned. Section 2 is as follows:

Establishing a bank in Iraq, including a majority or wholly-owned subsidiary of a foreign bank or bank holding company, shall require the prior issuance of a banking licence by the CBI. Establishing a branch or representative office of a foreign bank in Iraq shall require the prior issuance of a permit by the CBI. The subsidiary of foreign owned banks shall be required to have 50 billion dinars⁷⁷¹ of capital. There is no restriction on where that capital is invested.⁷⁷²

Thus, there are no special distinctions made for Islamic banks to apply for a licence from the CBI. Both conventional and Islamic banks fall under s.2 of the Iraq Banking Law 2004.⁷⁷³ Article 3 of the Iraqi Islamic Banking Law 2015 states that Islamic banks are licensed under the Banking Law 2004 and CBI Law 2004.⁷⁷⁴ Thus, there is no special banking conditions and requirements for the licensing of Islamic banks.

Principles of Licensing Islamic Banks

Despite the introduction of the Islamic Banking Law 2015, there are additional elements of Islamic banking that should be included in the law. The licence requirement, for example, must focus on the specific principles necessary for establishing an Islamic bank. The staff who work in these banks and conduct their activities should be informed about by the licence requirements. Currently, the Islamic banking Internal Instruction 2006 of Iraq does not focus at all on the staffing of Islamic banks, yet it is vital for those who hold positions in an Islamic banking institution to have a detailed understanding of Islamic banking transactions and other information related to Islamic banking, such as legislation, modern economics and finance.

Moreover, the Islamic Banking Law 2015 also does not specify requirements for the staff who work in Islamic banks. Therefore, this can be considered a weakness of the Islamic Banking Law 2015. In contrast, in Bahrain, with regards to the Islamic banks' staff, those who run the bank's businesses must be skilled and experts in their job. In other words, those nominated to carry out control functions must satisfy the CBB's approved requirements. As stated in LR-

⁷⁷¹ Equivalent to 26,667,955 Sterling.

⁷⁷² Iraq Banking Law 2004, Section 2 Article 4 Licenses and Permits.

⁷⁷³ Section 2 of the Iraq Banking Law 2003 consists of 13 Articles that concern banking licenses.

⁷⁷⁴ Iraqi Islamic Banking Law 2015, Article 3.

2.4.3, the staff of Islamic bank licensees must have sufficient skills for running the bank's business, as mentioned in LR-2.4.3:

The Islamic bank licensee's staff, taken together, must collectively provide a sufficient range of skills and experience to manage the affairs of the licensee in a sound and prudent manner. Islamic bank licensees must ensure their employees meet any training and competency requirements specified by the CBB.⁷⁷⁵

Therefore, Islamic banks of Bahrain must ensure that their employees are experienced and that they meet the requirements specified by the CBB. In contrast, the Iraqi Islamic Banking Law 2015 does not specify the qualifications necessary for the Islamic banks' staff. It is important for the Iraqi Islamic banks to have qualified staff and employees. In addition, those who work in the Islamic banking field in Iraq should have a clear record.⁷⁷⁶

In countries like Malaysia and Bahrain, the licencing requirements for the Islamic banks are stated in detail in both country's respective laws. In Malaysia, Islamic banking licence requirements are mentioned in the IFSA 2013 while in Bahrain, all requirements are stated in 'Volume 2-Islamic Bank'.

In Malaysia, besides the BNM, the minister also has direct interference in licensing Islamic banks. Thus, both the BNM and the minister are responsible for issuing licenses to Islamic bank applicants. Thus, the process of issuing a licence for an Islamic bank will go through the BNM, which then passes it to the minister with some recommendations. The central bank, then, provides recommendations to the minister on whether to grant or reject the licence either with or without conditions.⁷⁷⁷

In this regard, it can be said that in Iraq, the CBI and the minister are responsible for the challenges that are being faced in the Islamic banking industry. Each of these entities has the obligation to resolve the legal issues that constitute obstacles to the development of the Islamic banking industry in Iraq.⁷⁷⁸ Financial regulators should work together to improve the status of Islamic banking so that that sector can attain equal status to other types of financial institutions in Iraq. Finally, in Iraq, the law needs to be stricter than Malaysia and Bahrain to preserve the customers' interests because of the negative experiences the Iraqis face with the country's

⁷⁷⁵ CBB Rulebook, Volume 2-Islamic Bank, Licensing Requirements Module, LR-2.4.3.

⁷⁷⁶ In other words, staff who work in Islamic banks should not have been involved in any corruption or have any criminal background.

⁷⁷⁷ IFSA 2013 S10 (4).

⁷⁷⁸ The CBI, as a directly responsible body, and the Ministry of Finance, as a second responsible body, should work together to remove or, at least, reduce problems facing Islamic banking in Iraq.

banking sector in the past.⁷⁷⁹ Thus, the absence of a strict legal regulation for the Islamic banking industry is considered as a significant issue in Iraq.⁷⁸⁰ In short, the licence requirements should strive to preserve the balance between the Islamic banks and their clients and investors. In addition, the supervision of the Islamic banking system is also important after the Islamic banks are issued their licence. Therefore, there should be a proper supervisory regime for the monitoring of Islamic banking operations.

4.5. The Supervisory System of the Iraqi Islamic Banking Industry

Another problematic issue of the Islamic banking industry in Iraq is the supervisory system, which is not as strong as it should be.⁷⁸¹ There is no doubt that a strong supervision for the monitoring of any financial system is necessary especially for the Islamic banking system in Iraq. The reason for this is that the Islamic banking system in Iraq is relatively new and it is supervised by two different legal systems, which are Sharia law and positive law.⁷⁸² In addition, the country's political and security situations are still very much fragile and this situation impacts all sectors.⁷⁸³ Iqbal, Ahmad and Khan (1998) claim that:

Supervision of Islamic banks is as important as that of the conventional banks. At present, lack of effective supervisory framework is one of the weaknesses of the prevailing system and deserves serious attention. The roles of both the Shari'ah advisory boards and the Central banks need to be streamlined and strengthened.⁷⁸⁴

In Iraq, the CBI's role is also insufficient in terms of the supervision of the Islamic banking industry as the CBI suffers from a chronic shortage of qualified Islamic banking experts.⁷⁸⁵ There is also no special division or department within the CBI that is responsible in governing

⁷⁷⁹ Due to the fact that the financial institutions and particularly banks faced looting in the past, the Iraqis do not have confidence in the banks and this could be considered a negative experience for them.

⁷⁸⁰ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38.

⁷⁸¹ In other words, due to the fact that the CBI does not have qualified Islamic banking experts, the supervisory system of the Islamic banking industry is weak. In addition, the Sharia supervision of the Islamic banks of Iraq is not as strong as it should be. There is only the individual Sharia supervisory boards for each Islamic banks. In addition, the central bank does not have one. Therefore, the Sharia supervisory board is necessary for better a supervisory system.

⁷⁸² The law that is enacted by Parliament and based on civil or common law.

⁷⁸³ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

⁷⁸⁴ Munawar Iqbal, Ausaf Ahamad and Tariquallah Khan, 'Challenges Facing Islamic Banking' (1998) Islamic Development Banks occasional paper 1, 36 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 12 November 2016.

⁷⁸⁵ Sahar Nasr 'Republic of Iraq: Financial Sector Review' (2010), The World Bank, Middle East and North Africa Region.

and supervising the Islamic banking industry.⁷⁸⁶ Since the Islamic banking system is based on Sharia rules, Islamic banks should be treated differently from the conventional banking sector. Furthermore, Islamic banking needs a strong supervisory system because the Islamic banking industry in Iraq is new and there is no proper legal framework yet for this industry. Therefore, establishing an effective supervisory framework is vital for the Islamic banking industry in Iraq.

4.6. Some Important Elements should be part of the Iraqi Islamic Banking Law 2015

The legal issues of the Islamic banking system in Iraq have been specified. In addition, the Islamic banking legal framework of the country has been critically evaluated. Therefore, the Iraqi Islamic banking law should include several important elements and keys.⁷⁸⁷

Hence, this author opines that the following principles are vital to be considered and included in the new Islamic banking law.

Firstly, the new Islamic banking law should cover all legal and Sharia aspects of the Islamic banking industry. Secondly, since Iraq is still suffering from serious cases of corruption and money-laundering, the Islamic banking law in Iraq should be stricter than in other countries.⁷⁸⁸ Therefore, due to the current fragile situation of the country, such strict rules are necessary.⁷⁸⁹ Thirdly, the relationship between the CBI and Islamic banks should be clarified in the law.⁷⁹⁰

One of the main elements of Islamic banking law is the licence requirements and conditions. Thus, these requirements and conditions should be drawn up by taking into consideration the Iraqi political and security situations. For example, the licence requirements should not allow political parties or high ranking individuals from political parties in Iraq to hold an Islamic bank licence due to the fact that they may use their power for personal benefits. Furthermore, an awareness of issues of corruption, terrorist-financing and money-laundering should also be considered in the proposed Islamic banking law. For example, Islamic banks should be required to clearly declare their sources of capital. In addition, strict punishments can also act as a

⁷⁸⁶ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38.

⁷⁸⁷ The new law should work to actively promote the Islamic banking sector and facilitate it in competing with the conventional banking sector more fairly, particularly since the vast majority (99%) of Iraqis are Muslims.

⁷⁸⁸ Later in this chapter, the corruption and the financial crimes will be explained in detail.

⁷⁸⁹ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 38.

⁷⁹⁰ The CBI law 2004 could also be amended to determine the relationship between the CBI and Islamic banks in the country.

deterrent of money-laundering and terrorist-financing. Hence, there should be strict penalties and punishments for those who break the provisions of this law or other laws.⁷⁹¹ The new Islamic Banking Law 2015 should also determine which bodies have the final say in relation to Islamic banking matters, especially in situations where there is a dispute between Islamic banking institutions or when there are differences of opinion between different Sharia supervisory boards.⁷⁹² In that context, it could be argued that the Iraqi Islamic Banking Law 2015 has many weaknesses and the law should be reviewed.

It can be argued that in Iraq's current situation, the CBI and the Iraqi Islamic banking industry should adopt similar legislation to 'Volume 2-Islamic Bank' of Bahrain or the IFSA 2013 of Malaysia. This thesis argues that establishing Islamic banking regulations that are similar to Malaysia or Bahrain but with some differences is a logical option. For example, the law should apply strong punishments for those who break the law. The reason is that the country's situation is different due to the lack of security and ongoing conflicts between people. In addition, the population and societal structure are also another reason. For example, in Iraq there are three groups of people - Shiah, Sunnah and Kurd.⁷⁹³ Bahrain also consists of Sunnah and Shiah,⁷⁹⁴ but in Iraq there are also Kurds, who live in the Kurdish Region.⁷⁹⁵ Since they practically have a separate territory, it may be difficult to apply Bahraini-style law there. As a result,

⁷⁹¹ In 2011, the central bank of Iraq (CBI) started limiting foreign exchange supply to address concerns related to money-laundering and financing of terrorism. To do so, it enforced existing exchange restrictions and introduced new restrictions.

IMF, Iraq, '2013 Article IV Consultation' IMF Country Report No. 13/217, July 2013, <<http://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>> accessed 6 June 2014,

⁷⁹² The new law does not determine which body has the last say when Islamic banks have problems in Sharia-related matters.

⁷⁹³ CIA, the World Factbook, 'Iraq' < <https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html>> accessed 27 January 2014

⁷⁹⁴ CIA, the World Factbook, 'Bahrain' < <https://www.cia.gov/library/publications/the-world-factbook/geos/ba.html>> accessed 26 January 2014

⁷⁹⁵ In other words, the population structure of Iraq is somehow complex as compared to other countries. In Iraq, there are Shiah and Sunnah as two main branches of Islam. Thus, these two groups should be considered when Sharia law is applied. Furthermore, regarding the nations, there are Arabs and Kurds. However, there is a parliament in Iraq and at the same time, Kurdistan has its own parliament which may not follow the rules and laws enacted in Iraq. In this context, the Islamic banking law should consider all nations and both Shiah and Sunnah doctrines. Until now in Iraq, there are three Waqf Centres: Shiah Waqf centre, Sunnah Waqf centre and Kurd Waqf centre. Thus, Shiahs take fatwa from Shiah Waqf, Sunnahs take fatwa from Sunnah Waqf and Kurds follow Kurd Waqf Fatwa. Any rule and regulation should keep these three groups in its consideration. For example, if the central Sharia board is established in Iraq, it should contain people from these three parties. It is clear that before enacting any law, it should be passed by Parliament. Furthermore, the central Sharia board should contain members from Sunnah, Shiah and Kurd which each of them have its view on any issue especially if the issue is related to religion. Therefore, in Iraq, no one follow others in terms of religion and nations. The best example is the fasting month (Ramadhan), each of these three groups has its own view of determining the first day of Ramadhan. As a result, enacting any Islamic banking law should be through agreements between all groups which may be different from other countries Islamic banking laws as most of the other countries do not have these differences.

amendments of the Islamic Banking Law 2015 is the best solution for resolving the legal issues of the Islamic banking sector in Iraq in the current situation.

4.7. Amendment of Laws Related to Islamic Banking

There are some other laws that are applicable to the Islamic banking industry besides the Islamic Banking Law 2015. These laws should be amended or reviewed in order to become more suitable for the industry.⁷⁹⁶ For instance, the Iraqi Banking Law 2004 was designed for the regulation and governance of conventional banks, but is not appropriate for Islamic banks in its current form. Thus, it needs to be amended,⁷⁹⁷ along with other laws and regulations, such as the CBI Law 2004.⁷⁹⁸ In addition, an effective Islamic banking regulatory framework is necessary in order for the Islamic banking industry to develop in parallel with the conventional banking sector.⁷⁹⁹ In that context, a group of experts who are skilled in the regulation and supervision of Islamic banking is needed in Iraq.⁸⁰⁰

It is worth mentioning here that the regulatory framework for the Islamic banking system should contain organs that can monitor the implementation of these laws and rules. Even if the necessary laws and rules exist and are suitable for the sector, the application of these laws may not be practical in some unstable countries.⁸⁰¹ Therefore, the reforms should cover and seek to oversee the entire Islamic financial system in Iraq.

⁷⁹⁶Madhat Kadhim Alquraishi and Misun Abdulaghani Kareem, 'Islamic Banks and the Impact of the world Financial Crisis' (2012) 32 *Iraqi Journal for Economic Sciences* 43, 56.

⁷⁹⁷ For example, paragraph 2 of Article 33 of the existing Banking Law 2004 must be amended. It states that "Except in connection with the granting of mortgage loans in the conduct of its banking operations, it shall be prohibited for any bank to possess real estate other than the real estate essential to the conduct of its operations and for the housing of its employees and workers. This provision shall not bar the bank from leasing any excess portion of its real estate..." This paragraph is in conflict with Article 5 (6) of the Islamic Banking Law 2015 which allows Islamic banks to conduct some operations that are prohibited by the Article 33 (2) of the Banking Law 2004.

See: Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee 40.

⁷⁹⁸ See chapter three of this research for more details on amendments of the CBI Law 2004 and the Banking Law 2003.

⁷⁹⁹ Norhasima Yassin, 'Islamic Banking and Finance: Fundamentals and Contemporary Issues' (2007), 252, IRTI, Islamic Development Bank, Edit by Salman Syed Ali and Ausaf Ahmad,

⁸⁰⁰ Iraq can depend on local Islamic banking experts if they are available. Due to the fact that Iraq has a shortage of Islamic banking experts, foreigners can be appointed to run Islamic banking businesses. However, in the current situation, it is difficult for foreigners to come to Iraq to serve in the country's Islamic banking industry.

⁸⁰¹ Especially countries that have unstable political and security situations, such as Iraq, Somalia, Afghanistan and Syria.

Challenges of Financial Supervision in Iraq

It is sometimes the case that even when the laws and regulations of one country look very strong in general, there may be gaps found in terms of the regulatory and monitoring systems. Thus, the problem is the supervisory system which is not as effective as it should be. In Iraq, the country's constitution and the laws and regulations that have been enacted for most sectors seem to function perfectly. At the same time, there remain certain problems and issues that are being faced by some sectors, which are often impractical in nature.⁸⁰² In Iraq, because of the political issues and the unstable situation of the country,⁸⁰³ some parties or people are 'above the law'. They break the law and/or bend the law to their benefit with impunity. Indeed, there are punishments for those who break the law, but these do not always apply to powerful people. Therefore, the supervisory system is weak and it has faced problems in bringing powerful parties to justice.

Case of the Elaf Islamic Bank

The best example of weak financial supervision is the case of the Elaf Islamic Bank, which helped Iran while it was under financial sanctions. The following account is from the New York Times:

The little-known bank singled out by the United States, the Elaf Islamic Bank, is only part of a network of financial institutions and oil-smuggling operations that, according to current and former American and Iraqi government officials and experts on the Iraqi banking sector, has provided Iran with a crucial flow of dollars at a time when sanctions are squeezing its economy.⁸⁰⁴

While this was one of the most serious breaches of the law, the Elaf bank did not face any punishments, even though there is legislation against such kinds of crime or corruption. Again, from the New York Times:

Iraqi banking experts said last week that the bank was still allowed to participate in the Iraq Central Bank's daily auction at which commercial banks can sell Iraqi dinars and buy United States dollars. These auctions are a crucial pathway for Iranian access to the international

⁸⁰² In other words, the laws themselves are well-made, but the way in which they are applied is inadequate or unfair.

⁸⁰³ Sujata Ashwarya Cheema, 'Investing in Iraq: prospects and Challenges' Middle East Institute (New Delhi, 20 February 2013) <<http://www.mei.edu/content/investing-iraq-prospects-and-challenges>> accessed 12 November 2015.

⁸⁰⁴ James Risen and Duraid Adnan, 'U.S. Says Iraqis Are Helping Iran to Skirt Sanctions' The New York Times, (Washington, 18 August 2012) < <http://www.nytimes.com/2012/08/19/world/middleeast/us-says-iraqis-are-helping-iran-skirt-sanctions.html>> accessed 12 November 2015.

financial system. Western officials say that Iran seeks to bolster its reserves of dollars to stabilize its exchange rates and pay for imports.⁸⁰⁵

In this kind of situation, it is clear that Iraq needs a special independent supervisory body to monitor the application of the laws and rules. Iraq is still one of the worst countries in terms of corruption, terrorist-financing and money-laundering,⁸⁰⁶ despite having a law called the Anti-Money Laundering and Terrorist Finance Law 2015. The Iraq Banking Law 2004, in Section 1 Article 1, also focuses on this issue:

The primary regulatory objective of this Law is to maintain confidence in the banking system. Other regulatory objectives include those of promoting public understanding of the banking system by providing appropriate information, maintaining an appropriate degree of protection for depositors, and helping to reduce financial crime, including fraud, money-laundering and terrorist financing.⁸⁰⁷

Thus, in theory, the laws in Iraq consider the corruption and financial crimes in the country. However, the problem is not in the current financial laws, such as Banking Law 2004 or Anti-Money Laundering and Terrorist Finance Law 2015. The problem, however, is enforcing these laws. The laws are unfortunately only applied for the underprivileged. Therefore, the financial system in general should be reviewed in order to be applied to everyone.

Problems of the Iraqi Financial Supervisory System

The above case raises the question of why, if there is such a law for protection from wrongdoings and for reducing the level of financial crime, the banking sector in Iraq still faces this kind of problem. It can be argued that the current Iraqi Anti-Money Laundering/Counter Terrorism Financing (AML/CTF) regime is completely ineffective for the current situation in Iraq. Thus, the Iraqi financial regime should be reformed and the anti-money laundering system has to be reviewed in order to meet the Middle East North Africa Financial Action Task Force (MENAFATF) standards.⁸⁰⁸ To control money laundering and corruption in Iraq, this thesis argues that the establishment of an effective supervisory body is necessary in the country. The main purpose of this body is to ensure that laws and regulations are applied to all parties equally.

⁸⁰⁵ James Risen and Duraid Adnan, 'U.S. Says Iraqis Are Helping Iran to Skirt Sanctions' The New York Times, (Washington, 18 August 2012) < <http://www.nytimes.com/2012/08/19/world/middleeast/us-says-iraqis-are-helping-iran-skirt-sanctions.html>> accessed 12 November 2015

⁸⁰⁶ According to the Transparency International, Iraq is one of the top countries in 2015 in corruption which is sixth in the world.

See: The Transparency International, Corruption by Country, 'Iraq' < <http://www.transparency.org/country#IRQ>> accessed 1 September 2016.

⁸⁰⁷ Iraq Banking Law 2004, Section 1, Article 2 (1).

⁸⁰⁸ U.S. Department of State, '2013 Investment Climate Statement – Iraq' <<http://www.state.gov/e/eb/rls/othr/ics/2013/204661.htm>> accessed 9 June 2014.

However, there is a special Rule of Law office⁸⁰⁹ which monitors the enforcement of laws and regulations in Iraq. In addition, the Rule of Law office supports the laws to be applied correctly in Iraq.⁸¹⁰ It seems that the Rule of Law did not achieve the purpose of its establishment as can be seen in the case with Elaf bank.

It is also worth mentioning that the Iraqi parliament consists of several committees, with one of them being the Finance Committee. One of the responsibilities of the Finance Committee is to monitor the banks, country's budget and monetary policy of the Iraqi ministries.⁸¹¹ However, in practice, this committee does not have any role in stopping financial institutions from committing financial crimes with the best evidence being the Elaf Islamic Bank case. The financial services industry still needs to be supervised and monitored more closely and effectively. In this context, the Finance Committee of the Iraqi parliament should have a better role in monitoring the financial sector. Even if the new Islamic banking law focuses on financial crime, such as terrorist finance, corruption and money-laundering, if there is no active body to monitor the enforcement of the law, then the law will not be effective, and will not be able to protect the financial sector from financial crimes.

It seems that the aforementioned case and issue does not in fact result from a lack of laws and regulations, since there are relevant laws and acts in place. Instead, the lack of an effective,

⁸⁰⁹ 'In May 2007, the State Department reorganized the Office of the Rule of Law Coordinator (RoLC) with the U.S. Embassy, Baghdad to consolidate under a single authority, all U.S. Government civilian and law enforcement efforts to support the rule of law in Iraq. The current RoLC is a senior Justice Department official who oversees the work of more than 200 personnel under Chief of Mission authority and serves as the primary advisor to the Ambassador on justice-related issues'.

'The RoLC is responsible for coordinating these efforts with the activities of the United States Forces - Iraq to ensure a unified approach to achieving the goals of the U.S. Mission in Iraq. In addition, the RoLC works closely with members of the Iraqi judiciary and the relevant law enforcement institutions (the Ministry of the Interior and the Ministry of Justice), to ensure collaboration and cooperation in the reconstitution of essential law enforcement and security institutions throughout the Republic of Iraq'.

The United States-Department of Justice, 'Office of the Rule of Law Coordinator' January 2013, <<http://www.justice.gov/archive/iraq/rule-of-law.htm>> accessed 29 January 2014

⁸¹⁰ 'Current Rule of Law priorities include:

- Supporting the security of judicial personnel and courthouses;
- Developing case-management standards that will lead to improved, rapid processing of criminal cases in compliance with Iraqi procedural law;
- Providing adequate resources to bring major cases to completion;
- Institutionalizing the rapid enforcement of civil and criminal judicial orders;
- Developing sufficient Iraqi facilities and personnel, along with appropriate policies and procedures, to detain all pre-trial and post-conviction detainees in compliance with the law and with international human rights standards; and
- Enhancing the courts' system-wide planning capacity and institutional integrity'.

Embassy of the United State, Baghdad-Iraq 'Rule of Law Office' January 2014, <<http://iraq.usembassy.gov/rule-of-law-office.html>> accessed 29 January 2014

⁸¹¹ Parliament of Iraq Internal Rule 2006, Article 93, Specialization's of Finance Committee.

<<http://ar.parliament.iq/LiveWebsites/Arabic/Council-Bylaws.aspx>> accessed 20 November 2016.

supervisory body to oversee the financial sectors is the main reason why these crimes are occurring.

Finally, in one of the most serious corruption cases, the CBI governor was removed from his position in 2012 after he was accused of alleged financial wrongdoings with other bank officials in Iraq.⁸¹² Therefore, there is a real need for an active body to supervise and monitor all financial sectors, including both the Islamic banking and conventional banking sectors. The establishment of such a financial monitoring body is a twin priority, alongside the enactment of a special Islamic banking law. In some countries, there are very strict laws and these laws could prevent the financial sectors from facing cases of money-laundering, such the IFSA 2013 of Malaysia, which mentions punishments for breaking the law. However, the CBI in Iraq itself suffers from financial crimes.⁸¹³

4.8. Conclusion

This chapter dealt with legal issues related to the Islamic banking industry in Iraq. It answered research question number two which is: What are the legal shortcomings in Iraq's Islamic banking system, and how should they be resolved in light of other countries' experiences, particularly Malaysia and Bahrain? With this regard, this chapter has discussed the Islamic banking legal issues in Iraq, finding that the inadequate Islamic banking legal framework is one of the key weaknesses of the industry in Iraq.⁸¹⁴ The Iraqi Islamic Banking Law 2015 lacks many important elements, such as licensing requirements for the Islamic banks. In addition, the Iraqi Islamic Banking Law 2015 does not specify the authoritative supervisory body to monitor Islamic banks. Thus, there are still some challenges for the regulation of Islamic banking in Iraq. The CBI, which is the main regulatory body for the banking system in Iraq, is responsible for this issue.

The Iraqi Islamic Banking Law 2015 should contain all important elements such as licensing requirements and conditions as exemplified through the 'Volume 2-Islamic Bank' of Bahrain and the IFSA 2013 of Malaysia. Furthermore, the Islamic Banking Law 2015 does not define the term 'Islamic banking' and does not determine the Islamic banking staff requirements. In

⁸¹² Reuters, 'Iraq ousts central bank chief over corruption probe' < <http://uk.reuters.com/article/2012/10/16/uk-iraq-centralbank-idUKBRE89F1OU20121016>> accessed 20 November 2016.

⁸¹³ The political and security situations in Iraq is one of the main reasons for corruption and money-laundering in the country. However, the fragile situation should not impact the financial sector and it should not pave the way for law-breaking.

⁸¹⁴ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40, Baghdad College for Economic Science, 349, 355 (translated from the original Arabic text by the author).

addition, the new Islamic banking law does not state which body is the highest Sharia supervisory authority in cases of dispute.⁸¹⁵ Thus, the new Islamic Banking Law 2015 still needs to be amended in order to include all necessary elements for the regulation and supervision of the Islamic banking industry.

Secondly, Iraq's current regulation and supervision framework is also not comprehensive. The laws and regulations that currently apply to the Islamic banking system were originally designed for the conventional financial system.⁸¹⁶ The Iraqi Banking Law 2004 was enacted for the regulation of the conventional banking sector, for which it is suitable for. However, there is no provision for Islamic banks within this law. Furthermore, the CBI has not attempted to differentiate between Islamic banks and conventional banks. In fact, the CBI's rules and regulations narrow the Iraqi Islamic banking scope. In sum, the Iraqi Islamic banking legal framework has not evolved sufficiently to be able to effectively promote Islamic banking institutions. Thus, revising the current banking regulatory framework and banking regime of Iraq is necessary. Moreover, the Islamic banking legal system in Iraq has to manage the industry by considering Sharia principles.

In addition, the relationship between the CBI and Islamic banks is also another problematic issue for the Islamic banking industry in Iraq.⁸¹⁷ It is well known that in liquidity crises, central banks are the lenders of last resort for Islamic banks as well as for conventional banks. In Iraq, in this situation, Islamic banks cannot deal with the CBI because it offers loans on an interest basis only, which is prohibited for Islamic banks. To resolve the issue of lender of last resort when Islamic banks have liquidity crises, the CBI can apply the *Qard al-hasan* principle for example. Therefore, the relationship between Islamic banks and the CBI needs to be improved, and needs to be considered as part of constructing a proper Islamic banking legal framework to support Islamic banks. In this sense, the CBI Law 2004 should be amended in order to change the monetary policy tools in order for it to be compatible with the Islamic banking institutions.

In this chapter, the Islamic banking systems of Malaysia and Bahrain have been critically evaluated. Malaysia has a special legislation for Islamic banks known as the IFSA 2013. This

⁸¹⁵ In Malaysia, the SAC has an important role in the court. The SAC is asked by the court in Sharia matters related to Islamic finance.

⁸¹⁶ Zahraa Ahmad M.T. AL-Noi'mee, 'Islamic Banking: Its development and Roles in The private Banking Industry in Iraq between 1999 -2006' (2009) 16, *Journal of Tikrit for Management and Economic Science* (translated from the original Arabic text by the author).

⁸¹⁷ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 *Baghdad College for Economic Science* 349, 351 (translated from original Arabic text by the author).

act contains all elements that are applicable to the regulation of the Islamic banking industry, such as licensing requirements, Sharia supervision of the Islamic banks and the role of the BNM in the regulation of Islamic banks.⁸¹⁸ Furthermore, Islamic banking supervision is also covered by this act, as the SAC exists as a central Sharia body responsible for the regulation and supervision of the Islamic banks and their Sharia supervisory boards.⁸¹⁹ In Bahrain, there is a special volume of the central bank's Rulebook that addresses the regulation of the Islamic banking industry. This volume, known as 'Volume 2-Islamic Banks', contains special regulations for the governance of the Islamic banking industry in Bahrain and covers most of the necessary elements relating to Islamic banks in the country.

In addition, the BNM in Malaysia and the CBB in Bahrain, as the two central banks, have a strong relationship with the Islamic banks in their respective countries due to the fact that both countries have national Sharia boards in their central banks. Therefore, these national Sharia boards can help the central banks. In short, the Islamic banking legal frameworks are well structured in Bahrain and Malaysia as compared to Iraq in a variety of ways. As a result, Malaysia and Bahrain can be used as good models for the future reform of the Iraqi Islamic banking system.

Finally, given the unstable political and security situations in Iraq, the laws and rules to govern Islamic banks should be very strict. In the past, the financial sector faced significant problems, especially after the second Gulf War. Because of continued financial crimes, such as terrorist-financing and corruption, there must be close monitoring of the application of the law. In addition, an independent supervisory body could be established to supervise all financial sectors, including Islamic banking, in order to ensure that all parties comply with all relevant laws and regulations. Some of the key functions of this body will be to prevent money-laundering and corruption in the financial sector, and thus to restore public trust. In general, the Iraqi Islamic banking legal framework should be reviewed in order to be compatible with the current global Islamic banking system.

⁸¹⁸ In fact, the IFSA 2013 consists of most of the important elements for the regulation of the Islamic financial institutions including Islamic banks in one single document. The act regulates the Islamic banking industry and all Islamic financial institutions in Malaysia.

⁸¹⁹ The Central Banking Act 2009 in Malaysia regulates the relationship between the BNM and Islamic banks, as the act was amended in 2009 because of the establishment of the SAC.

Chapter Five: Sharia Regulation and Supervision of the Iraqi Islamic Banking System

5.1 Introduction

In the previous chapter, the legal issues of the Iraqi Islamic banking system were critically evaluated. However, in this chapter, the Sharia issues of the Iraqi Islamic banking system will be critically evaluated and attempt to answer the research question [3], What are the principal Sharia regulatory and supervisory problems affecting the Iraqi Islamic banking system, and how can they be resolved, by using examples from other countries? The objective of this chapter is to examine the Sharia regulation and supervision of the Islamic banking industry of Iraq, and more specifically, the weaknesses of the external and internal Sharia supervisory systems in the Iraqi Islamic banking industry in order to find the solution to the lack of a central Sharia board and the weakness of the Sharia supervisory boards of Islamic banks.⁸²⁰ The solution can be the establishment of an effective internal and external Sharia supervisory system for the Iraqi Islamic banking industry.⁸²¹ An examination of the Islamic banking system's Sharia regulation and supervision is important due to the fact that this aspect is a fundamental part of its structure. Hence, the Sharia regulation and supervision of the Iraqi Islamic banking industry will be discussed in detail in this chapter.

Studies have shown that the operation of Islamic banking industry in Iraq is limited by the lack of an effective Sharia regulatory and supervisory system⁸²². An ineffective Sharia supervision in Iraqi's Islamic banking industry has negatively impacted the system,⁸²³ as there is no central Sharia board to control and monitor all Islamic banks in the country. In addition, the internal Sharia supervision of the Islamic banks is not effective due to the lack in Sharia scholars.⁸²⁴ Furthermore, most of the Sharia scholars who are current members of the Sharia supervisory boards of the Islamic banks are inadequately qualified.⁸²⁵ The absence of an effective

⁸²⁰ See: Chapter Five 5.4, 5.5, 5.6, and 5.7.

⁸²¹ Sharia regulation and supervision of the Islamic banking system is an important aspect of the Islamic banking industry. Sharia supervision is a distinct point between the conventional and Islamic banking systems. Therefore, Chapter Five concentrates on external and internal Sharia regulation and supervision of the Iraqi Islamic banking industry.

⁸²² Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 361 (translated from the original Arabic text by the author).

⁸²³ Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements for Activating Legitimate External Control in Islamic Banks' (2013) 9 Tikrit Journal for Administration and Economic Science 256, 260 (translated from the original Arabic text by the author).

⁸²⁴ Sahar Nasr 'Republic of Iraq: Financial Sector Review' (2010), The World Bank, Middle East and North Africa Region, 24.

⁸²⁵ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

supervision of Iraqi Islamic banks has created a lack of confidence in depositors, as observed by commentators and studies.⁸²⁶

Effective Sharia supervision is important for Islamic banks not only to ensure that all transactions and contracts are conducted in accordance with Sharia principles⁸²⁷, but also to restore public confidence in the system. Drawing on the Islamic banking systems of Malaysia and Bahrain, this chapter examines the Sharia regulation and supervision that relates to Iraq's Islamic banking system. Though the Islamic banking Sharia supervisory systems of other countries will also be examined, such as Qatar, the UAE, and Kuwait, the principal focus will be on Malaysia and Bahrain with the purpose of proposing an effective Sharia supervisory system for the Iraqi Islamic banking industry. In the concluding part of this chapter, the author will discuss the establishment of a central Sharia board for the Islamic banking system in Iraq. Therefore, this chapter will have as its focus, the following issues:

- External Sharia supervision of the Islamic banking and the importance of the central Sharia board;
- Internal Sharia supervision of Islamic Banking and issues related to the Sharia supervisory boards of Islamic banks in Iraq; and
- The need for a national Sharia board in Iraq's Islamic banking industry.

The Sharia board should deal with the Sharia matters of the Islamic bank.⁸²⁸ The process of reviewing and overseeing Islamic financial institutions is not easy, but individuals who undertake this responsibility require certain qualifications and skills.⁸²⁹

5.2 Sharia Supervision of Islamic Banking

Because Islamic banks carry out their activities under Sharia rules, banks have a specific body and special monitoring mechanism put in place known as Sharia supervision.⁸³⁰ Sharia supervision should give the customer or investor the confidence that the products and services

⁸²⁶ Mohammad Ahmed Jawad, Iraqi Council of Representatives, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq Report 2014, Council of Representatives Finance Committee 38.

⁸²⁷ M Umer Chapra and Habib Ahmed, 'Corporate governance in Islamic Financial Institutions' (2002) Paper No. 6, Islamic Development Bank, Islamic research and Training Institute, 67.

⁸²⁸ Siti Faridah Abdul Jabbar, 'Financial Crimes: Prohibition in Islam and Prevention by the Sharia Supervisory Board of Islamic Financial Institutions' (2010) 17 Journal of Financial Crime 287, 288.

⁸²⁹ Surianom Miskam and Muhammad Amrullah Nasrul, 'Shariah Governance in Islamic Finance: The Effects of the Islamic Financial Services Act 2013' (the World Conference on Integration of Knowledge, Malaysia, November 2013).

⁸³⁰ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386. 388.

being offered by Islamic banks are compliant with the Sharia principles and religion of Islam.⁸³¹ Thus, effective Sharia supervision minimises risks that will impact negatively on the reputation of an Islamic bank. In fact, Sharia risks will cause clients and investors to withdraw their funds from Islamic banks that have ineffective Sharia supervision.

The process of Sharia supervision starts with the verification of the product⁸³², which will then be applied by the Islamic bank. However, the function of Sharia supervision does not simply end after the product has been verified. It should be further monitored even after its launch. Therefore, Sharia supervision should oversee all products and services at all times, from the beginning until the completion of the process, to ensure that they are Sharia compliant. Sharia supervision is conducted by a special body known as the Sharia supervisory board.⁸³³ The role of this unique body is related to the Sharia aspects of the industry and controls Sharia matters according to the Islamic jurisprudence.⁸³⁴

However, the author believes that the unique nature of a Sharia advisory board arises from the fact that it has a sufficient number of qualified scholars who have the right to issue fatwa and are knowledgeable about Islamic banking.⁸³⁵ Otherwise, the Sharia board remains just a name without any real influence of power.

⁸³¹ Due to the fact that most of the Muslims invest with the Islamic banks because of the religion, they want to avoid breaking Sharia rules, particularly in dealing with *riba*. In fact, Muslims believe that dealing with *riba* is a big sin in Islam.

⁸³² Verification of any Islamic banking product needs a fatwa from the Sharia supervisory board in order to be marketed successfully. Therefore, fatwa may be the first step for the product before it is launched and considered as a mode of finance.

⁸³³ Sheila Nu NuHtay, Zafar Abedeen, and Syed Ahmed Salman, 'Towards Standardization of Shari'ah Screening Norms and Practices' (2013) 2 International Journal of Humanities and Social Science Invention 23, 26.

⁸³⁴ Yusuf Karbhari, Kamal Naser, and Zerrin Sahhin, 'Problems and Challenges facing the Islamic Banking System in the West: The Case of the UK' (2004) 46 Thunderbird International Business Review 521, 523.

⁸³⁵ Related knowledge of the Islamic banking system is: Sharia, Islamic finance, modern economics and finance, conventional banking system, and legal aspects of Islamic banking system. It is also important for the scholars to know languages, especially English and Arabic as the two fundamental languages of the Islamic banking field. See: Racha Ghayad, 'Corporate Governance and The Global Performance of Islamic Banks' (2008) 24 Journal of Humanomics 207, 216;

Matthias Casper, 'Sharia Boards and Sharia Compliance in the context of European Corporate Governance' (2012), Preprints and Working Papers of the Center for Religion and Modernity, Westfälische Wilhelms University

5.3 The Nature and Structure of Sharia Supervision within the Islamic Banking System

The existence of Sharia supervision of Islamic banks is one of the most obvious elements that distinguishes Islamic banks from conventional banks.⁸³⁶ In order for it to be effective, both internal and external Sharia levels should be established.⁸³⁷ Furthermore, experts who are qualified in the area of Islamic banking should be appointed as members of the Sharia supervisory board.⁸³⁸

For the Sharia supervisory board at an internal level of an Islamic bank to be effective, it is necessary to have a strong structure and that includes having qualified members. In addition to that, the Sharia supervisory board should also work effectively in monitoring the Islamic bank closely. In this context, members of the Sharia supervisory board should be experts in this discipline. However, it is also allowed to hire and request the assistance of other professionals⁸³⁹ such as legal counsels/lawyers, Muftis⁸⁴⁰, financial experts, economists, as well as accountants from conventional banking systems.⁸⁴¹ Members of a Sharia supervisory board should be respected scholars and well-known and reputable in the society,⁸⁴² as this may restore and increase public confidence in Islamic banks.

In fact, for effective regulation and supervision, Islamic banking institutions should be monitored closely by a central Sharia board that is used in some jurisdictions such as Malaysia and is bestowed with full powers as a Sharia advisory council.⁸⁴³ However, if there is no central Sharia board, the central bank then has to supervise Islamic banks directly, as is the case in Iraq.

⁸³⁶ Yusuf Talal delornzo, 'Shari'ah Supervision in Modern Islamic Finance' Guidance Residential, Modern Finance timeless value <https://www.guidanceresidential.com/blog/wp-content/uploads/2015/05/Shariah_supervision_in_modern_islamic_finance.pdf> accessed 13 November 2015.

⁸³⁷ Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements of Activation the Legitimate External Control in Islamic Banks' (2013) 9 Tikrit Journal for Administration and Economic Science 256, 260 (translated from the original Arabic text by the author).

⁸³⁸ Interview with Hashm Ahmed, university lecturer, Soran University (Soran, May 2015)

⁸³⁹ Ash-Shaikh H. Abdul Nazar, 'Shari'ah Supervision in Islamic Banks and Financial Institutions; 'An Overall Review' 2 May 2008, Ash-Shaikh Nazar, <<http://www.shaikhnazar.net/articles%20english4.htm>> accessed 21 May 2014.

⁸⁴⁰ Muftis is the plural form of Mufti, who is a Sharia scholars qualified to issue fatwa (legal opinion) in Sharia-related matters.

⁸⁴¹ Amir Shahrudin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Jurnal Ekonom 54.

⁸⁴² Racha Ghayad, 'Corporate Governance and the Global Performance of Islamic Banks' (2008) 24 Journal of Humanomics 207, 213.

⁸⁴³ Zulkifli Hasan 'Sharia governance in Islamic Financial Institutions and the Effect of the Central Bank of Malaysia Act, 2009' (2010) 25 Journal of International Banking Law and Regulation 105.

The author argued that establishing a central Sharia board within the CBI is necessary.⁸⁴⁴ A central Sharia board can serve as a medium for capacity building such as organising training courses and workshops for Islamic banking staff.⁸⁴⁵ Thus, a central Sharia board minimises the central bank's burden of monitoring the Islamic banking industry that has a different operation system compared to conventional banking systems.⁸⁴⁶

5.4 Justifications for the Establishment of a Central Sharia Board within the Iraqi Islamic Banking System

The establishment of a national or central Sharia board can help the central bank in Sharia-related matters and help Islamic banks provide Sharia advices in Iraq.⁸⁴⁷ The body can also provide training courses for members of Sharia supervisory boards and scholars who work in Islamic banks.⁸⁴⁸ In addition, the difference in the opinions among Islamic banks in relation to the same products necessitates the need for a central Sharia supervisory board.⁸⁴⁹ In this case, the central Sharia body can standardise Islamic banking products.⁸⁵⁰ For example, if two different Islamic banks have different views on the same product or contract, a central Sharia board can unify their views and determine which view is more compliant with Sharia principles. Thus, the central Sharia board will gather all the decisions of individual Sharia supervisory boards of Islamic banks.⁸⁵¹ The central Sharia board can also have its opinion and

⁸⁴⁴ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank (Erbil, June 2015).

⁸⁴⁵ Abdul Awwal Sarker, 'Regulation and Supervision of Islamic Banks and Financial Institutions: Bangladesh Perspective' (The 3rd International Conference on Islamic Banking and Finance: Risk Management, Regulation, and Supervision, Jakarta, February 2010).

⁸⁴⁶ See 5.4 for details about reasons for establishment central Sharia board.

⁸⁴⁷ In other words, a central Sharia board in Iraq can oversee the activities of Islamic banking industry in Iraq and assist the Sharia supervisory boards of Islamic financial institutions while also providing training courses to the staff of Islamic banks. In addition, the board can advise the CBI on matters related to the Sharia law of Islamic financial institutions.

⁸⁴⁸ Abdul Awwal Sarker, 'Regulation and Supervision of Islamic Banks and Financial Institutions: Bangladesh Perspective' (The 3rd International Conference on Islamic Banking and Finance: Risk Management, Regulation, and Supervision, Jakarta, February 2010).

⁸⁴⁹ Dr. Mahmood Ahmed and Maksuda Khatun, 'The Compliance with Shariah Governance System of AAOIFI: A Study on Islamic Banks Bangladesh' (2013) 9 Journal of Islamic Economics, Banking and Finance 176, 181.

⁸⁵⁰ Elwaleed M. Ahmed, 'Sharia Advisory Board's Vital Role in the Rapid Devolvement of ever complex Islamic Financial Products and Instruments' Sudanese Economist (21 April 2011) <<http://www.sudaneseconomist.com/?p=292>> accessed 13 November 2015.

⁸⁵¹ In other words, the body standardises decisions when there is a different decision based on the different views towards the same product by Sharia boards of Islamic banks in the country or in one Sharia board.

See: Saleh Md. Arman, 'Shariah Compliance Features of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 95.

word in court when there are disputes in a Sharia-related issue such SAC⁸⁵² in Malaysia.⁸⁵³ This body will have the final say in Sharia-related matters within Islamic financial institutions because it is the highest Sharia authority and consists of specialists in the Sharia law.

Furthermore, it is the function of the national Sharia board to supervise individual Sharia supervisory boards of Islamic banks to ensure that they are independent and not influenced by banks that are part of the Islamic banking industry.⁸⁵⁴ Moreover, the central Sharia board helps Islamic banks in Sharia-related issues such as giving advice to Islamic banks and their Sharia boards on request.⁸⁵⁵

A central Sharia board is needed at the levels of both national and international Islamic banking systems.⁸⁵⁶ In order to achieve effective supervision of the Islamic banking industry, there is a need for an effective supervisory framework. Accordingly, the Secretary General of the International Union of Muslim Scholars, Dr. Ali Al-Qaradaghi, expressed his belief that the

⁸⁵² The functions of the Shariah Advisory Council (SAC) of the BNM are listed under Section 52 of the Central Bank of Malaysia Act, 2009 and they include the following:

(a) To ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with Part VII of the Act; (b) to advise the Bank on any Shariah issue relating to Islamic financial business, the activities or transactions of the Bank; (c) to provide advice to any Islamic financial institution or any other person as may be provided under any written law in force in Malaysia; and (d) such other functions as may be determined by the Bank.

See also: Surianom Miskam and Muhammad Amrullah Nasrul, 'Shariah Governance in Islamic Finance: The Effects of the Islamic Financial Services Act 2013' (the World Conference on Integration of Knowledge, Malaysia, November 2013).

⁸⁵³ Salman Lambak and Izah Mohd Tahir, 'Juristic Analysis on the Applications of Common Law in Malaysia Takaful Act 1984 Based on Doctrine al-'Urf' (2013) 9 Asian Social Science 262, 264.

⁸⁵⁴ In Malaysia the BNM stresses that Islamic banks must ensure that shari'ah committees are free from any undue influence that would hamper them from making objective judgements. In relation to this, re-appointment, resignation, and removal of the shari'ah committees cannot be decided at the bank's level. It must be approved by the National Shari'ah Advisory Council (NSAC) formed by the Central Bank of Malaysia (BNM).

See: Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Jurnal Ekonom 53, 54.

However, there is still possibility that the Sharia supervisory board of an Islamic bank can be influenced by an Islamic bank. Therefore, there is a need for greater focus on this issue by the central banks and financial regulators.

⁸⁵⁵ The functions of the Shariah Advisory Council (SAC) of the BNM are listed under Section 52 of the Central Bank of Malaysia Act, 2009, which includes the following:

“(a) To ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with Part VII of the Act; (b) to advise the Bank on any Shariah issues relating to Islamic financial business, the activities or transactions of the Bank; (c) to provide advice to any Islamic financial institution or any other person as may be provided under any written law in force in Malaysia; and (d) such other functions as may be determined by the Bank.”

See: Surianom Miskam and Muhammad Amrullah Nasrul, 'Shariah Governance In Islamic Finance: The Effects of The Islamic Financial Services Act 2013' (the World Conference on Integration of Knowledge, Malaysia, November 2013).

⁸⁵⁶ Elwaleed M. Ahmed, 'Sharia Advisory Board's Vital Role in the Rapid Devolvement of ever complex Islamic Financial Products and Instruments' Sudanese Economist (21 April 2011) <<http://www.sudaneseconomist.com/?p=292>> accessed 13 November 2015.

Higher Sharia supervisory board for Islamic banking is inevitably necessary for the unification of purpose among Islamic banks.⁸⁵⁷

Establishment of the Central Sharia Board in the CBI

The CBI's supervision function of Islamic banks in Iraq can be supportive through the founding of a central Sharia board. In other words, in Iraq, the Sharia supervisory board set up by individual Islamic banks is not effective in supervising Islamic banking transactions. The reason is very clear, as different Sharia supervisory boards may interpret Sharia law in different ways⁸⁵⁸ and this could result not only in the divergence in Islamic banks' operations (no unity of purpose), but also affect the banks' image in the public eye.⁸⁵⁹ Therefore, a central Sharia board is important to resolve Sharia issues and create new Islamic banking products.⁸⁶⁰ Furthermore, customers' trust and confidence in these banks will increase.⁸⁶¹

In addition, a central Sharia board helps regulators within CBI,⁸⁶² as it provides them with information on Islamic banking transactions and helps them understand the nature and practice of Islamic banking institutions.⁸⁶³ Therefore, looking at the Sharia supervisory system of other countries is important to know how those with an advanced Islamic banking system deal with this issue. As a result, it is important to decide which Sharia supervisory system is the best system for Iraq at this point in time.

⁸⁵⁷ Dr. Ali Al-Qaradaghi requires the Qatari Central bank to establish a high Sharia board (Union Sharia board) that consists of the members of all Sharia supervisory boards of Islamic banks in Qatar in order to have one decision. He also said that Sharia supervisory boards of Islamic banks should be formed at the same time. He also argued that there is a necessity to establish a union Sharia board in the world that consists members of all Sharia boards in the world. Furthermore, he is of the opinion that this central board can unify all the decisions of Islamic banking Sharia scholars in the world and all Islamic banks should be bound by its Fatwa and decisions.

See: the International Union of Muslim Scholars, <<http://www.iumsonline.net/ar/Default.asp?ContentID=4896&menu>> accessed 21 May 2014.

⁸⁵⁸ Elwaleed M. Ahmed, 'Sharia Advisory Board's Vital Role in the Rapid Devolvement of ever complex Islamic Financial Products and Instruments' Sudanese Economist (21 April 2011) <<http://www.sudaneseconomist.com/?p=292>> accessed 13 November 2015.

⁸⁵⁹ There is a possibility for different Islamic banks to have different views towards the same product. The variation in service will lead to Islamic banks losing clients, as they believe that these products have problems.

⁸⁶⁰ Saleh Md. Arman, 'Shariah Compliance Features of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 97.

⁸⁶¹ Saleh Md. Arman, 'Shariah Compliance Features of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 94.

⁸⁶² The financial regulators should understand Islamic banking contracts and transactions in order to control the financial and economic system of the country.

⁸⁶³ It is important and necessary for Iraq to have a central Sharia board because it has a shortage of Islamic banking experts and Sharia scholars to run Islamic banking business. A central Sharia board can also be the link between the CBI and Islamic banks, as the CBI does not have sufficient experts and qualified knowledgeable Islamic banking scholars.

5.5 Central Sharia Board of Islamic Banking Industry in Selected Countries

It is vital to look closely at other countries' Islamic banking Sharia supervisory mechanisms with the purpose of evaluating the Sharia supervisory system within Iraq. Therefore, the situations of the Malaysian, Bahraini, and GCC (Gulf Council Cooperation) countries in relation with central Sharia board will be examined below:

Situation in Malaysia

In Malaysia, the SAC, as a central Sharia board of the country, operates as a part of the BNM. Thus, the SAC is the highest Sharia body in the country and it has several authorities that have been given to this board by the Central Bank of Malaysia Act, 2009.⁸⁶⁴ The SAC has the final word if there is a conflict between Islamic banks and it provides assistance to Islamic financial institutions. Thus, the SAC is the sole authoritative body on Sharia issues related to Islamic finance in Malaysia.⁸⁶⁵ In addition, the SAC also advises BNM in Sharia-related issues and provides advice to any Islamic bank or any person as provided for under Section 52 of the Central Bank of Malaysia Act, 2009. Section 52 provides the following:

- (1) The Shariah Advisory Council shall have the following functions:
 - (a) Ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with this Part;
 - (b) Advise the Bank on any Sharia issue relating to Islamic financial business, the activities or transactions of the Bank;
 - (c) Provide advice to any Islamic financial institution or any other person as may be provided under any written law; and
 - (d) Such other functions as may be determined by the Bank.⁸⁶⁶

More importantly, the decisions of the SAC are superior to the decisions of the Sharia supervisory boards of individual Islamic financial institutions (see Section 58 of the Central Bank of Malaysia Act, 2009):

‘Where the ruling given by a Sharia body or committee constituted in Malaysia by an Islamic financial institution is different from the ruling given by the Sharia Advisory Council, the ruling of the Sharia Advisory Council shall prevail’.⁸⁶⁷ Furthermore, the SAC is referred to by the courts for Sharia-related issues and the court shall follow the decision of the SAC. Thus, the

⁸⁶⁴Jasri Jamal, Nor Aziah Mohd, and Kamal Halili, ‘Alternative Dispute Resolution in Islamic Finance: Recent Development in Malaysia’ (2011) 3 *International Journal of Social Sciences and Humanity Studies* 185.

⁸⁶⁵ZulKifli Hasan, ‘Regulatory Framework of *Shari’ah* Governance System in Malaysia, GCC Countries, and the UK’ (2010) 3 *Kyoto Bulletin of Islamic Area Studies* 82, 87.

⁸⁶⁶Central Bank of Malaysia Act, 2009, Part 3 S 52.

⁸⁶⁷ Central Bank of Malaysia Act, 2009, S 58.

position of the SAC is important in the court, as it can be seen in Section 56 of the Central Bank of Malaysia Act, 2009. According to this Section, any case regarding an Islamic financial institution and relating to Sharia issues must take the SAC's publications into consideration or the court may refer the questions to the SAC. This position is clearly set out in Section 56 of the Central Bank of Malaysia Act, 2009, as it is stated:

Where in any proceedings relating to Islamic financial business before any court or arbitrator any question that arises concerning a Sharia matter, the court or the arbitrator, as the case may be, shall:-

- (1) (a) Take into consideration any published rulings of the Shariah Advisory Council; or (b) refer such question to the Shariah Advisory Council for its ruling.
- (2) Any request for advice or a ruling of the Shariah Advisory Council under this Act or any other law shall be submitted to the secretariat.⁸⁶⁸

However, it is not compulsory for the court to follow the decision of the SAC, as Abdul Hamid Mohamed JCA mentioned that the rules of the SAC are not binding on the court and it is optional whether the court wishes to follow it or not.⁸⁶⁹

It seems that the SAC does not have the power that its rules be binding on the court. This thesis argues that if the rules of the SAC are not compulsory for the court to follow, these rules are thus considered as only advices.⁸⁷⁰ In that sense, the members of the SAC will not be encouraged to give their opinions on any cases requested by the court. Therefore, it seems that it is better that the rulings of the SAC be binding on courts when it is requested for its opinions. This thesis further argues that it is really meaningless if the court refers to the SAC for any Sharia issues related to the Islamic banking, but then does not take its word into consideration, as the central Sharia board's decisions are more logical than the court's decisions due to the fact that members of the central Sharia board specialised in the areas of Sharia and Islamic banking. Otherwise, the court should not request the central Sharia board's opinion if the SAC's decisions are not followed by the court.

The role of the SAC cannot be overemphasised, as any rule made by the SAC is binding on the Islamic financial institutions stated in Section 57 of the Central Bank of Malaysia Act, 2009: 'Any ruling made by the Shariah Advisory Council pursuant to a reference made under this

⁸⁶⁸ Central Bank of Malaysia Act, 2009, S 56.

⁸⁶⁹ Hakimah Yaacob, 'The New Central Bank of Malaysia Act, 2009': Enhancing The Integrity and Role of the Shariah Advisory Council (SAC) in Islamic Finance' 2010, Research paper, International Shari'ah Research Academy for Islamic Finance (ISRA), 1, 8.

⁸⁷⁰ Rodney Wilson, 'Islamic Economics and Finance' (2008) 9 World Economics, 177, 179.

Part shall be binding on the Islamic financial institutions under Section 55 and the court or arbitrator making a reference under Section 56'.⁸⁷¹

Situation in Bahrain

In Bahrain, a National Sharia Board of the CBB was established and operated on the level of CBB only. In other words, the function of the National Sharia Board in CBB is limited, as it serves and verifies the Sharia compliance of its own products.⁸⁷² This board does not have any authority over the Islamic banks in Bahrain. However, all Islamic financial institutions in the country are required to establish a Sharia supervisory committee and comply with the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) No. 18 and No. 2. Hence, it seems that the National Sharia board of the CBB is not as powerful and active as the SAC in Malaysia, as its powers are less than the SAC.⁸⁷³ In other words, the National Sharia Board of Bahrain verifies its own products only,⁸⁷⁴ while the SAC of Malaysia monitors all Islamic banks and their Sharia aspects. It can be argued that the Bahraini National Sharia Board is not considered as a central Sharia board.⁸⁷⁵

Some GCC Countries' Situations

The situation of GCC countries is different from Malaysia and Bahrain, as they do not have a specific central board at the level of the central banks. In GCC countries, the central Sharia board does not exist as the same form as Malaysia's,⁸⁷⁶ but each of country has its own form of alternatives to the central Sharia board for resolving Sharia-related matters.⁸⁷⁷

⁸⁷¹Central Bank of Malaysia Act, 2009, Part 3 Section 57.

⁸⁷²Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on Shariah Governance Supervision of Sukuk Defaults' (2012) 8 Journal of Islamic Economics, Banking and Finance 21, 32.

⁸⁷³ZulKifli Hasan, 'Regulatory Framework of *Shari'ah* Governance System in Malaysia, GCC Countries and the UK (2010) 3 Kyoto Bulletin of Islamic Area Studies, 82, 90.

⁸⁷⁴ National Sharia Board of Bahrain does not monitor Islamic banks and standardise their decisions as the SAC of Malaysia does.

⁸⁷⁵ Due to the fact that the National Sharia Board in Bahrain does not have a wide range of responsibilities or does not have power over Islamic banks, it is not considered a central Sharia board. Instead, the Waqf Fund has several functions that help Islamic financial institutions in Bahrain. Thus, the Waqf Fund has wider responsibilities than the National Sharia Board in Bahrain.

⁸⁷⁶ In other words, higher Sharia board in Kuwait is not part of the Central Bank of Kuwait and it is not specialised in Islamic finance. However, the higher central board in Malaysia is part of the BNM and it is specialised in Islamic finance.

⁸⁷⁷ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on Shariah Governance Supervision of Sukuk Defaults' (2012) 8 Journal of Islamic Economics, Banking and Finance 31, 35.

The Situation in Qatar

Self-regulation of Islamic banks occurs in Qatar⁸⁷⁸ and there is no Sharia Advisory board in the central bank of Qatar. However, there is the Supreme Sharia Council attached to the Awqaf Ministry,⁸⁷⁹ where any issues related to Islamic finance can be directed to the Council for clarification. Individual Islamic banks follow the Sharia standards of the AAOIFI⁸⁸⁰. However, the Qatari Central Bank appoints Sharia scholars to solve any problems encountered on a case-by-case basis. Despite that, this mechanism has never been used.⁸⁸¹ It seems that the Supreme Sharia Council is not a specialised council in Islamic banking, as it is part of the Awqaf Ministry. In this case, it will be better if some of the members of the Supreme Sharia Council are experts and specialised in the Islamic banking area.

The Situation in Kuwait

In Kuwait, the situation is slightly different from other countries in relation to a Higher Sharia advisory body. There is no Sharia Advisory Board at the Central Bank of Kuwait, but Article 93 of the Central Bank of Kuwait Law, 1968 provides that every Islamic financial institution in Kuwait should have its own Sharia supervisory board.⁸⁸² In cases of disagreement or dispute between or among members of the Sharia supervisory board pertaining to any Sharia ruling, the Board of Directors of the Islamic financial institution may refer the matter to the Fatwa Board of the Ministry of Awqaf and Islamic Affairs,⁸⁸³ which will be the final authority with regards to any dispute in Islamic finance. It is stated in the Article 93 of the Central Bank of Kuwait Law, 1968 as the following:

Each Islamic bank shall have an independent Shari'ah Supervisory Board, comprised of not less than three members appointed by the bank's General Assembly. The Memorandum of Agreement and Articles of Association of the bank shall specify the establishment of the Board as well as its formulation, powers, and workings.

In case of a conflict of opinions among members of the Shari'ah Supervisory Board concerning a Shari'ah rule, the board of directors of the designated bank may transfer the

⁸⁷⁸ In other words, each Islamic bank in Qatar has its own Sharia supervisory board and there is no central Sharia board in the Central Bank of Qatar.

⁸⁷⁹ Awqaf Ministry is one of the ministries in some Muslim countries. Awqaf Ministry deals with religion affairs in these countries.

⁸⁸⁰ Kabir Hassan and Michael Mahlke, *'Islamic capital markets, Products and strategies'* (1st ed., John Wiley & Sons Ltd, UK, 2011) 324.

⁸⁸¹ Professor Rodney Wilson, 'Shari'ah Governance for Islamic Financial Institutions' *Global Islamic Finance* (5 December 2011) <<http://www.global-islamic-finance.com/2011/12/Shariah-governance-for-islamic.html>> accessed 12 November 2015.

⁸⁸² Azhar Hamid, 'The Shari'ah Supervisory Board' in Karim Ginena and Azhar Hamid (eds), *Foundations of Shari'ha Governance of Islamic Banks* (John Wiley & Son Ltd., 2015).

⁸⁸³ Professor Rodney Wilson, 'Shari'ah Governance for Islamic Financial Institutions' *Global Islamic Finance* (5 December 2011) <<http://www.global-islamic-finance.com/2011/12/Shariah-governance-for-islamic.html>> accessed 12 November 2015.

matter to the Fatwa Board in the Ministry of Awqaf and Islamic Affairs that shall be the final authority on the matter.

The Shari'ah Supervisory Board shall annually submit to the bank's General Assembly a report comprising its opinion on the bank's operations in terms of their compliance with the Islamic Shari'ah principles and any comments it may have in this respect. This report shall be included in the bank's Annual Report.⁸⁸⁴

The advice of the Fatwa Board in the Ministry of Awqaf and Islamic Affairs is binding when the Board arbitrates on disputes between members of the same Sharia supervisory board.⁸⁸⁵ Nevertheless, the act of referring the dispute to the Fatwa Board is not compulsory and the Fatwa Board acts as a higher body for helping the Central Bank of Kuwait.⁸⁸⁶ The author argues that the members of the Fatwa Board in the Ministry of Awqaf and Islamic Affairs are not specialised in Islamic banking and finance matters. It is usually the member of the Fatwa Board who are knowledgeable in the religion of Islam and the Sharia law. Therefore, the decision that is made by the members may not be the right decision. In that regard, the Fatwa Board should consist of members who are experts in Islamic banking, as well as Sharia laws that are related to Islamic banking.

The Situation in the United Arab Emirates (UAE)

In a country like the United Arab Emirates (UAE), there is a special body known as the Higher Sharia Authority (HSA) that deals with Sharia-related issues. In the UAE, the reason for the establishment of the HSA is to supervise Islamic financial institutions.⁸⁸⁷ It is attached to the Ministry of Justice and Islamic Affairs and has the last word on Sharia-related issues. In addition, the HSA is also responsible for Sharia supervision.⁸⁸⁸

According to Article 5 of the UAE Federal law No. 6 of 1985, the HSA should be attached to the Ministry of Justice and Islamic Affairs. Article 5 states as following:

A higher Authority shall be formed by a cabinet decision, incorporating Sharia, legal, and banking personnel to undertake higher supervision over Islamic banks, financial institutions, and investment companies to ensure legitimacy of their transactions according to the provisions of the Islamic Sharia law, and also to offer opinion on matters which these agencies may come across while conducting their activities. The opinion of the said Higher

⁸⁸⁴ Central Bank of Kuwait Law, 1968, Article 93.

⁸⁸⁵ Wafik Graiss and Matteo Pellegrini, 'Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services' (2006), World Bank, WPS4054, 33.

⁸⁸⁶ Zulkifli Hasan, 'Regulatory Framework of *Shari'ah* Governance System in Malaysia, GCC Countries and the UK' (2010) 3 Kyoto Bulletin of Islamic Area Studies 82–115.

⁸⁸⁷ Azhar Hamid, 'The Shari'ah Supervisory Board' in Karim Ginena and Azhar Hamid (eds), *Foundations of Shari'ha Governance of Islamic Banks* (John Wiley & Son Ltd., 2015).

⁸⁸⁸ Wafik Graiss and Matteo Pellegrini, 'Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services' (2006), World Bank, WPS4054, 33.

Authority shall be binding on the said agencies. The Authority shall be attached to the Ministry of Justice and Islamic Affairs.⁸⁸⁹

This Authority has the final word in any Sharia matters in Islamic banking and finance. However, the UAE government also requires the establishment of a Sharia Supervisory Authority at the Islamic financial institutional level.⁸⁹⁰

Selecting a Proper Form of Central Sharia Board for Iraq

According to the above explanations, different states have different forms of Higher Sharia body. For Malaysia and Bahrain, their national Sharia councils are part of the central banks, while in some GCC countries, their higher Sharia council is part of other government offices; for example, the Fatwa Board of the Ministry of Awqaf and Islamic Affairs of Kuwait serves to resolve Sharia matters of Islamic banks.⁸⁹¹

In that context, the thesis argues that the Malaysian form is preferred for Iraq, but with slight changes in the central Sharia board's power over Islamic banks and their Sharia boards in order to give more freedom to the individual Sharia boards of Islamic banks.⁸⁹² In fact, the Malaysian form is preferred because the court can not only refer to the SAC as the highest body in Sharia-related matters and Islamic banking cases in the court, the SAC can also standardise Sharia decisions of the Sharia supervisory boards of Islamic banks when they have different opinions on the same product. Next, the SAC is a bridge between BNM and Islamic banks. It can also help Islamic banks educate and teach scholars and staff about Islamic banks in the Sharia aspect.⁸⁹³

In contrast, the National Sharia Board of Bahrain does not have all these attributes as SAC. For example, the Bahraini National Sharia Board does not standardise decisions of the Sharia supervisory boards of Islamic banks and the courts in Bahrain does not refer to publications

⁸⁸⁹ UAE Federal Law No. 6 of 1985, Article 5, Regulation of Islamic Banks, Financial Institutions and Investment Companies.

⁸⁹⁰ Dubai Islamic Bank, 'Sharia Board' <<http://www.dib.ae/en/about-dib/Sharia-board/>> accessed 13 November 2015.

⁸⁹¹ Professor Rodney Wilson, 'Shari'ah Governance for Islamic Financial Institutions' Global Islamic Finance (5 December 2011) <<http://www.global-islamic-finance.com/2011/12/Shariah-governance-for-islamic.html>> accessed 12 November 2015.

⁸⁹² In an interview with Bashir Hadad, a Sharia supervisory board member of Cihan Islamic Bank in Iraq, he preferred the Bahraini form because Bahrain consists of Sunna and Shia, the two religion branches in Islam, like Iraq. Therefore, he believed that the powerful central Sharia board is not suitable for Iraq. Interview with Bashir Hadad, Sharia supervisory board member, Cihan Islamic Bank, (Erbil, May 2015).

⁸⁹³ However, it should be better in Iraq if each Islamic bank has one Sharia advisor instead having a Sharia supervisory board, and there is a central Sharia board at the CBI level. In this case, the Malaysian model is preferred with some changes.

and decisions of the National Sharia Board. Thus, the National Sharia Board verifies its own products only.⁸⁹⁴ However, it also has to be said that the boards in Qatar, the UAE, and Kuwait also do not have such power as the SAC of Malaysia does.

Therefore, the Malaysian form of the central Sharia board is recommended for Iraq because Islamic banks in the country contain many problems that the central Sharia board should resolve.⁸⁹⁵ For example, the CBI understands Islamic banking transactions through a central Sharia board. In addition, the central Sharia board in Iraq can help educate Islamic banks and their staff by organising training courses and workshops. Furthermore, the central Sharia board of Iraq can issue fatwa that will benefit Islamic banks.

This thesis further argues that it is better for the proposed central Sharia board of Iraq to be part of the CBI⁸⁹⁶ and it can be a bridge between the CBI and Islamic Banks. Regarding the appointment of the members of the central Sharia board, they can be appointed by the Ministry of Finance.⁸⁹⁷ However, the thesis argues that, members of the central Sharia board should be appointed by the CBI due to the fact that the CBI has direct relationship with Islamic banks.

What Does the Central Sharia Board Do?

For the individual Sharia supervisory boards of Islamic banks, it is important to have a backup body to support them. Thus, the establishment of a central Sharia board can function as a backup for the Sharia supervisory boards of the Islamic banks in Iraq. Additionally, the establishment of a research-based centre is important as part of the central Sharia board, with funding from the CBI. This research centre for the central Sharia board can investigate Sharia issues in relation to Islamic banking industry and their Sharia boards. Furthermore, the research centre can be a method for creating new Islamic banking products and the central Sharia board can approve a new product faster when it is created for first time.⁸⁹⁸

Providing assistance to the Sharia supervisory boards of Islamic banks in terms of human resource development is also one of the functions of the central Sharia board. Thus, it can

⁸⁹⁴ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on Shariah Governance Supervision of Sukuk Defaults' (2012) 8 Journal of Islamic Economics, Banking and Finance 21, 32.

⁸⁹⁵ A shortage of Sharia scholars is one of the problems for Islamic banks in Iraq; hence, a central Sharia board can help Islamic banks in this sense, as it can provide them information on transactions and products, while also advise them when it is required.

⁸⁹⁶ In the interview with Bashir Hadad, a Sharia supervisor board member of Cihan Islamic Bank in Iraq, he was also of the opinion that it is better for the central Sharia board to be attached to the CBI. Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank, (Erbil, May 2015).

⁸⁹⁷ Iraj Toutounchi, 'An Analytical Review of Islamic Banking as Practiced In Iran' (1998) IDB, IRTI, 64.

⁸⁹⁸ Interview with Abdulla Hama, a university lecturer, University of Sulaymaniyah, (Erbil, June 2015).

provide training courses to members of the Sharia supervisory boards of Islamic banks.⁸⁹⁹ Often, most of the staff employed or recruited in Islamic banks in Iraq are drawn from conventional banks;⁹⁰⁰ therefore, there is the need for them to be sensitised and educated about Islamic banking transactions and services. Hence, the central Sharia board in conjunction with the CBI can map out a special programme⁹⁰¹ for all Islamic banking staff in Iraq.⁹⁰²

For this purpose, it seems that the central Sharia board should have a special unit (training unit) for the purpose of training staff for Islamic banks, particularly in educating them to understand Sharia aspects and Islamic banking transactions of Islamic banking.⁹⁰³ In addition, the training unit can provide workshops for scholars of the Islamic banking Sharia boards. It is worth mentioning here that in 2010, the IMF⁹⁰⁴ opened a one-week training course for the CBI staff and managers of banks in Iraq through the Lebanon Islamic Bank.⁹⁰⁵ This indicated the need for the creation of a special department by the CBI. Although there should be a strong link between the central Sharia board and the CBI, and the central Sharia board is part of the CBI, it does not mean that the central Sharia board is not independent. However, it is very important for the central Sharia board in particular to be independent.⁹⁰⁶ In addition, the supervisory regime of the Islamic banking industry should also be independent.⁹⁰⁷

Finally, it should be noted that in some countries, the central Sharia body is known as the Sharia advisory council, such as the one in Malaysia. However, in some other countries, it is called

⁸⁹⁹ Abdul Awwal Sarker, 'Regulation and Supervision of Islamic Banks and Financial Institutions: Bangladesh Perspective' (2014) 22 *Thoughts on Economics* 59, 77.

⁹⁰⁰ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 *Sharia Sharia Science and Law studies* 89, 100 (translated from the original Arabic text by the author).

⁹⁰¹ For instance, the central Sharia board can organise a special training course for Sharia scholars and staff of Islamic banks in Iraq every six months in order to update their knowledge on the contemporary issues of Islamic banking systems.

⁹⁰² This board would be part of the CBI and give every possible help to Islamic banks. It can also provide training courses for accountants to teach them how to calculate Zakat. Furthermore, the board can provide courses for staff about modes of finance in Islamic banks, such as Murabaha in order to familiarise them with these services.

⁹⁰³ The central Sharia board can manage opening training courses and workshops for Islamic banking staff with universities and centers inside and outside the country. In this regard, the central Sharia board can provide funds for this purpose.

⁹⁰⁴ The International Monetary Fund (IMF) works to foster global growth and economic stability. It provides policy advice and financing to members in economic difficulties and also works with developing nations to help them achieve macroeconomic stability and reduce poverty.

IMF, 'Overview' <<http://www.imf.org/external/about/overview.htm>> accessed 23 November 2016.

⁹⁰⁵ Mustafa Natiq Salih Matlub, 'Obstacles to Work of the Islamic Banks and Ways of Cures for Development' (2012) *Research and Islamic Studies magazine*, 287, 3116.

⁹⁰⁶ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank (Erbil, May 2015).

⁹⁰⁷ Shamsalden Aziz Salh, 'Sharia Supervision of Islamic Banking Institutions, Challenges and Achievements' (Islamic Banking Finance Conference, Oxford, England May 2013).

the national Sharia board, such as the one in Bahrain.⁹⁰⁸ In fact, all these names are the same in practice, as they have the same function and are established for the same purpose. Therefore, it does not matter how the central Sharia body of the CBI in Iraq is named. It should also be kept in mind that if there is a special division for the Islamic banking industry in the CBI, the author believes that the central Sharia board can be attached to this special department and it may both be better and bring more benefits.⁹⁰⁹

The Structure of the Central Sharia Board

The structure of the central Sharia board can be designed according to the country's Islamic banking situation. Therefore, the central Sharia board suggested by the author for establishment in the CBI can have a special structure.

Hence, this thesis submits that an active central Sharia board of the CBI can contain various numbers of units and each unit can have its special role and duty. Therefore, the central Sharia board can consist of a supervision unit, research unit, fatwa unit, training unit, and consultative unit. Thus, this structure makes the central board more effective and each unit can practice its duties as best as possible. For example, the supervisory unit can supervise Islamic banks' Sharia supervisory boards, as well as their activities to ensure these boards work under the Sharia principles.

However, a research unit should contain academics and strong relationships with universities and institutions for doing research on issues related to Islamic banking. In addition, the researchers in this unit can develop new products or enhance current products used by Islamic banks.⁹¹⁰

As for the fatwa unit, which is one of the most important units, its job is to issue Fatwa on any new product or any uncertain activities. A fatwa unit should make clear Fatwa about contracts

⁹⁰⁸ Similar functions are carried out by the following entities: Central Sharia board, supreme Sharia board, national Sharia board, higher Sharia board, highest Sharia board or Sharia supervisory council.

⁹⁰⁹ If the central Sharia board is attached to an Islamic banking department, the members of these two bodies can then exchange information and help each other in opening training courses for the staff of Islamic financial institutions. It is also for the benefit of the central Sharia board that the Islamic banking department and the CBI work together to reduce costs.

⁹¹⁰ In Iraq, there is no centre or institute that conducts research in the Islamic banking area. Therefore, to develop Islamic banks and the products they offer, there is a necessity for having a research unit.

and products that are ambiguous and identify whether they are allowed under the Sharia principles or not.⁹¹¹

On the other hand, the training unit has a different job compared to a fatwa unit. It is responsible for organising training courses and workshops for the Sharia members of individual Islamic banks' Sharia board or for staff from Islamic banks and central banks to help familiarise them with Islamic banking operations and transactions.⁹¹² However, the main job of a consultative unit is to give advice to the central bank and Islamic banks in Sharia-related issues.⁹¹³ Thus, these units can consist of professionals and experts in the Islamic banking area, as well as other areas that include finance, modern economics, and *fiqh muamalat* (Islamic commercial jurisprudence).

It is worth mentioning here that the Internal Instruction 2006 requested Islamic banks to have an internal Sharia audit department for the purpose of auditing all accounting processes of an Islamic bank. Article 10 of the Internal Instruction 2006 states that: 'each Islamic bank and Islamic window of the conventional bank shall establish an internal Sharia audit department to audit all Islamic banking accounting processes and all reports sent to the CBI'.⁹¹⁴ However, Article 10 does not determine the qualifications of the Sharia audit, as well as the Sharia audit's Sharia roles.⁹¹⁵

Fatwa Function of the Central Sharia Board

Besides the supervisory function of the Sharia supervisory board, the issuance of a Fatwa⁹¹⁶ is another important function of the Sharia supervisory boards of Islamic banks.⁹¹⁷ Nevertheless, issuing a Fatwa is more of the role of the central Sharia board than the individual Sharia

⁹¹¹ In Iraq, there is also no special fatwa council that consists of members who specialise in Islamic finance. Therefore, the establishment of a unit of fatwa as part of the central Sharia board will be able to help Islamic banks and their Sharia supervisory boards in issuing fatwa.

⁹¹² Due to the fact that education centres and training institutes do not exist in Iraq, a special training unit is thus needed to educate and train Islamic banking staff and managers.

⁹¹³ Because Islamic banks in Iraq face problems such as a lack of qualified Sharia scholars for their Sharia supervisory boards, current members of the Sharia boards need to be advised. In that case, a consultative unit that contains qualified scholars can then advise Sharia scholars, managers of Islamic banks, staff, and regulators of the CBI in Sharia-related issues.

⁹¹⁴ Internal Instruction 2006, Article 10 (translated from the original Arabic by the author).

⁹¹⁵ The Internal Instruction 2006 requires Islamic banks and Islamic window of commercial banks to establish a Sharia audit division. However, the responsibility of the Sharia auditor is not related to Sharia matters of the Islamic banking transactions, as can be seen in Article 10 of the Internal Instruction 2006.

⁹¹⁶ Fatwa is a legal opinion of Sharia scholars who are qualified to issue fatwa on a Sharia matter that is not in clear text in the Quran or Ahadith or Ijmaa.

⁹¹⁷ Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements of Activation the Legitimate External Control in Islamic Banks' (2013) 9 Tikrit Journal for Administration and Economic Science 256, 261 (translated from the original Arabic text by the author).

supervisory boards of Islamic financial institutions.⁹¹⁸ It is the function of the central Sharia board to give Fatwa on issues related to Sharia law within Islamic financial institutions.⁹¹⁹ It is clear that Fatwa is one of the most important principles of Sharia law and it is necessary in some financial circumstances.⁹²⁰ This means that the members of the central Sharia body must be persons of great substance in terms of Sharia law and knowledgeable enough to give Fatwa (Mufti).⁹²¹ In addition, any new products or services must be sanctioned by the national Sharia board before being sold by Islamic banks. Fatwa is in accordance with the Islamic doctrines – Quran and Sunnah.⁹²²

However, the central Sharia board may, where necessary, request assistance from others who have knowledge of Islam. There are people who may not be members of the central Sharia board, but are knowledgeable about Sharia. Therefore, they are in the position to give Fatwa. The members of the board could benefit from other Fatwas, such as the Fatwas of International Islamic Fiqh Academy of Jeddah.⁹²³ In this case, one may argue that if there is an international body for issuing Fatwa, there is no need for the central Sharia boards to have a Fatwa unit. This thesis argues that in some cases, due to the different schools of Islamic thoughts, there may be a need for some fatwas to be changed in some countries.⁹²⁴ However, in general, the Fatwa unit

⁹¹⁸ Due to the fact that central Sharia board is higher than individual Sharia supervisory boards of Islamic banks, and to unify the opinion, it should be a function of the central board to issue Fatwa.

⁹¹⁹ A Fatwa is required on matters where there is no clear and straightforward guidance from Quran and Sunnah. Fatwa refers to seeking opinions and rulings by Islamic Scholars on matters where there is ambiguity of whether a certain product or banking activity is in line with Sharia or not. Fatwa resolves controversies and addresses key challenges faced by the Islamic Financial Industry.

Muhammad Shaukat Malik, Ali Malik, and Waqas Mustafa, 'Controversies that Make Islamic Banking Controversial: An Analysis of Issues and Challenges' (2011) 2 American Journal of Social and Management Sciences 41, 42.

⁹²⁰ Islamic financial and economic concepts that are not clearly understood from Quran and Sunnah are better clarified through Fatwa. As Islamic financial products have been developed in the light of the fatwa, it is therefore very important in Islamic banking.

See: Syed Farhan Shah, Muhammad Wajid Raza, and Malik Rizwan Khurshid, 'Islamic Banking Controversies and Challenges' (2012) 3 Interdisciplinary Journal Of Contemporary Research In Business 1018, 1022.

⁹²¹ According to the Oxford Dictionary, Mufti is a Muslim legal expert who is empowered to give rulings on religious matters.

See: Oxford Dictionaries, 'Mufti' <<http://www.oxforddictionaries.com/definition/english/mufti>> accessed 25 November 2016.

⁹²² Bilal Khan and Emir Aly Crowne-Mohammed, 'Islamic Banking and Current Financial Crisis' (2010) 29 Review of Banking and Financial Law 441, 459.

⁹²³ The International Islamic Fiqh Academy is an institute for the advanced study of Islam based in Jeddah, Saudi Arabia <<http://www.fiqhacademy.org.sa/>> accessed 26 November 2016.

⁹²⁴ In fact, fatwa can be changed according to the circumstances. For example, *bai ina* is one of the tools used by Islamic banks in Malaysia according to the fatwa from SAC in Malaysia. However, it is not used in GCC countries, as it is considered illegal under Sharia principles.

Another example is the *Murabaha* transaction, which is used by Islamic banks as one of the most important transactions. In *Murabaha*, there should be two contracts: one between the seller and the Islamic bank, and another between the buyer and the Islamic bank. However, the Al-baraka Islamic Bank of Turkey conducts *Murabaha* transaction through one contract only, which is between the seller and the buyer, and the Al-baraka is just a fund

of the central Sharia board can depend on the fatwa issued by the International Islamic Fiqh Academy when there is a similar fatwa on the same issue.⁹²⁵

Independence of Central Sharia Board

Independence is one of the most important principles of individual Sharia supervisory boards of Islamic banks.⁹²⁶ In addition, independence is vital for a central Sharia board, as it is empowered to make independent decisions on all Sharia-related issues without interference from any individual or government offices.⁹²⁷ Therefore, the central Sharia board should be an independent body and have an effective role in the supervision and regulation of the Islamic financial industry.⁹²⁸ The independence of the central Sharia board is necessary, as it is the highest Sharia body.⁹²⁹ In Malaysia, the independence of the central Sharia board is provided in the Malaysian rules and regulations. It is stated in the Guidelines on the Governance of the Sharia Committee (BNM/DFI/GPS 1) as:

To effectively play its role, the SAC operates as an independent body. An independent SAC with a high level of integrity will command public confidence and thereby will boost the industry to a greater height. There is also a crucial need to define the relationship between the SAC and Shariah bodies which act as Shariah advisers in the industry. Towards this end, the Shariah bodies in the Islamic financial institution need to be rationalised. A Shariah body in the industry, which is to be known as a Shariah Committee, will play a complementary role to the SAC of Bank Negara Malaysia.

Thus, the power to make final decisions over all Islamic banks-related matters allows the central Sharia board to have full and effective roles. It also allows the board to perform its responsibilities to the highest level of quality. The independence of the central Sharia board

provider. However, this form of *Murabaha* is not allowed by almost all Islamic banks under the Sharia rules. Thus, scholars in Turkey issue fatwa on permissibility of this form of *Murabaha*. This point was mentioned by Armagan Bayrem: Interview with Armagan Bayrem, corporate banking director, Al-baraka Islamic Bank (Erbil, June 2015).

⁹²⁵ The Fatwa unit can refer to the fatwa of other Muftis or any fatwa council if they have issued the same fatwa on the same issue.

⁹²⁶ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386.

⁹²⁷ The central Sharia board can be the highest and independent body in terms of regulating and supervising Islamic banking institutions in all matters related to Islamic laws and principles.

⁹²⁸ The SAC of BNM Malaysia has a special role in regulating and supervising Islamic banking institutions and it is a powerful body that resolves disputes among Islamic financial institutions.

See: Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Jurnal Ekonom 53, 56.

⁹²⁹ For example, the National Sharia Council of Indonesia is formed by the Indonesian Council of Ulemas in 1999 and is an independent body duly recognized by the Bank of Indonesia. It is responsible for issuing Shariah rulings on products of Islamic banks. The Bank of Indonesia issues regulations for Islamic banking products based on the fatwa issued by the National Shariah Board.

See: State Bank of Pakistan, 'Strategic plan for Islamic banking in Industry Pakistan', <<http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy>> accessed 25 January 2014.

also increases stakeholders' confidence in Islamic banking institutions⁹³⁰ and it complements the Sharia boards of Islamic financial institutions in the country. As a result, the central Sharia board and Sharia supervisory boards of Islamic banks, as two Sharia supervisor bodies, should be independent and consist of eligible scholars and practitioners.⁹³¹

It seems that independence will make the central Sharia board become dynamic in terms of its role and make its performance effective. Therefore, in Iraq, the financial regulators should emphasize the independence of the central Sharia board and also Islamic banking Sharia supervisory boards as well.

It is worth mentioning here that the independency in general in Iraq is under question due to the fact that there are two religious branches in Iraq, which are the Sunni and the Shia.⁹³² In this situation, it is difficult for a central Sharia board to be independent. Therefore, there is a need for very strict rules and punishment that is difficult to be applied in the current political situation in Iraq.⁹³³

As part of the Sharia supervision of the Islamic banking system, it is essential to explain Sharia supervision in the Islamic banking sector at an internal level, which is the Sharia supervisory boards of Islamic banks. Thus, the following sections deal with the Sharia supervisory board, as well as its roles and functions.

5.6 The Individual Sharia Supervisory Board of Islamic Bank

The internal supervisory body for Islamic banks is the Sharia supervisory board, which comprises of experts or Sharia scholars who are skilful in the Islamic commercial law or Sharia as a general rule. It is the board's responsibility to check and review all products and activities conducted by the Islamic bank to see whether or not they comply with the Islamic law.⁹³⁴ Thus, the Sharia supervisory board looks after the interests of investors and ensures that their

⁹³⁰ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 *Journal of Financial Regulation and Compliance* 386, 89-90.

⁹³¹ Matthias Casper, 'Sharia Boards and Sharia Compliance in the context of European Corporate Governance' (2012), Preprints and Working Papers of the Center for Religion and Modernity, Westfälische Wilhelms University.

⁹³² Because there are two major doctrines in Iraq, the Sunni and the Shia, each of these doctrines have their own followers who attempt to control most of the important government sectors. The Ministry of Finance and the CBI are two important government departments that both sides try to control.

⁹³³ See Chapter Four; in that chapter, the necessity of the establishment of an independent supervisory body is explained to oversee that the laws and rules in Iraq can be applied correctly.

⁹³⁴ Hussain G. Rammal, 'The Importance of Shari'Ah Supervision in Islamic Financial Institutions' (2006) 3 *Corporate Ownership and Control* 1, 2.

contracts with the Islamic bank and their accounts are compliant under the Sharia law. In addition, the board also assists the Islamic banks in operating according to the recent Sharia legal opinion. In that sense, the Sharia supervisory board of the Islamic bank should have links with other Sharia supervisory boards, as well as Sharia advisors of the Islamic banks in the same country and also in the world.

Furthermore, the Sharia supervisory board makes decisions on all services provided by the bank and gives advice to the staff and managers. The Islamic bank should comply with all decisions made by the Sharia supervisory board regarding any transaction applied by the bank. It is better that the scholars appointed as members of the board to be well-known and respected among the people in order to pull in more clients and investors.⁹³⁵

However, the function of the Sharia board does not include the management of the bank's activities or day-to-day business⁹³⁶ and it is strictly forbidden for the Sharia supervisory committee to interfere in the bank's management, as mentioned in the document issued by the FSA on Islamic finance in the UK.⁹³⁷ In general, most Islamic banks have their own Sharia supervisory board.⁹³⁸ However, in some countries there are no Sharia boards for Islamic banks, but there is a high-level body that oversees all banks, such as the case of Iran, whereby the Council of Guardians gives directions on Sharia-related issues to Islamic banks.⁹³⁹

The Sharia supervisory board is unable to give directions to the bank because most of the Sharia board members do not have the necessary experience or skills in the management of banking businesses. Therefore, the role of this board is no more than advisory and supervisory. It is believed that interference by the Sharia advisory board in the bank's business may be considered a breach of the laws and regulations of the central bank.⁹⁴⁰ Therefore, any Islamic

⁹³⁵ Racha Ghayad, 'Corporate Governance and the Global Performance of Islamic Banks' (2008) 24 *Journal of Humanomics* 207, 2015.

⁹³⁶ Shamsalden Aziz Salh, 'Sharia Supervision of Islamic Banking Institutions, Challenges and Achievements' (Islamic Banking Finance Conference, Oxford, England May 2013).

⁹³⁷ The key point from the FSA's perspective is that firms can successfully show that the roles and responsibilities of their Sharia supervisory boards are advisory and that it does not interfere with the management of the firm. See: Michael Ainley 'and others', 'Islamic Finance in the UK: Regulation and Challenges' (November 2007) <http://www.fsa.gov.uk/pubs/other/islamic_finance.pdf> accessed 13 November 2015.

⁹³⁸ Bilal Khan and Emir Aly Crowne-Mohammed, 'Islamic Banking and Current Financial Crisis' (2010) 29 *Review of Banking and Financial Law* 441, 459.

⁹³⁹ M. Umer Chapra and Tariqullah Khan, 'Regulation and Supervision of Islamic Banks' (2000) *Islamic Development Banks* 3, 30-31 < http://www.sbp.org.pk/departments/ibd/Regulation_Supervision.pdf > accessed 26 November 2016.

⁹⁴⁰ Charles Proctor, *The Law and Practice of International Banking* (2nd ed., Oxford University Press, 2015) 875.

Banking Law should clearly state the duties and responsibilities of the Sharia supervisory boards of Islamic banks.⁹⁴¹

Objectives of Sharia Supervision

Sharia supervision plays a significant role in Islamic banking and finance.⁹⁴² Thus, it helps Islamic banks develop faster and, at the same time, is a required element for these banks.⁹⁴³

Sharia supervision is a process followed by the members of the Sharia supervisory boards to ensure that the bank is on the right track.⁹⁴⁴ The importance of Sharia supervision is directly related to shareholder and client confidence in financial institutions.⁹⁴⁵

The three fundamental objectives of Sharia supervision in Islamic financial institutions, which are (i) supervision of financial institution activities, (ii) representing shareholders' interests, and (iii) educating personnel in terms of Sharia rules and principles, are explained and analysed below:

- 1- **Supervision of the Financial Institution Activities:** the role of the Sharia supervision in Islamic banking is to oversee all financial activities of the institution through the Sharia supervisory board. The board supervises the institution to ensure that all contracts and products comply with the Sharia law.⁹⁴⁶ Moreover, it is the Sharia supervisor's responsibility to improve and review all contracts entered by the institution to ensure that they are acceptable under Islamic law.⁹⁴⁷ For instance, when a transaction conducted by the Islamic bank is not compatible with Sharia principles, the Sharia board will then find a solution for this transaction. If there is a possibility of cancelling

⁹⁴¹ In other words, the law (Islamic Banking law) should determine what jobs are allowed to be held by the Sharia board and what jobs are not allowed. Thus, there should be a limitation for the Sharia advisory board in order to protect the law from being breached. All these elements related to the Sharia boards of Islamic banks should be mentioned clearly by the law.

⁹⁴² Yusuf Talal delornzo, 'Shari'ah Supervision in Modern Islamic Finance' Guidance Residential, Modern Finance timeless value <https://www.guidanceresidential.com/blog/wp-content/uploads/2015/05/Shariah_supervision_in_modern_islamic_finance.pdf> accessed 13 November 2015.

⁹⁴³ Financial Islam, 'Sharia Boards' < <http://www.financialislam.com/sharirsquoah-boards.html>> accessed 22 May 2014.

⁹⁴⁴ Ismail Barreh, 'Scholar Shortage Threatens Islamic Financing Industry' Muslim Link (22 January 2013) <<http://www.muslimlink.ca/biz-tech/biz-tech/scholar-shortage-threatens-islamic-financing-industry>> accessed 13 November 2015.

⁹⁴⁵ Yusuf Talal delornzo, 'Shari'ah Supervision in Modern Islamic Finance' Guidance Residential, Modern Finance timeless value <https://www.guidanceresidential.com/blog/wp-content/uploads/2015/05/Shariah_supervision_in_modern_islamic_finance.pdf> accessed 13 November 2015.

⁹⁴⁶ Jean-Yves Moisseron, Bruno-Laurent Moschetto, and Frédéric Teulon, 'Islamic Finance: A Review of the Literature' (2014), Working Paper, IPAG Business School France, 1, 13.

⁹⁴⁷ Mohd Hairul Azrin Haji Besar, Moh dEdi lAbd Sukor, Nuraishah Abdul Muthalib, and Alwin Yogaswara Gunawa, 'The Practice of Shariah Review as Undertaken by Islamic Banking Sector in Malaysia' (2009) 5 International Review of Business Research Papers 294, 295.

the transaction, it will be done so by the Sharia board. However, if there is no possibility of cancelling the transaction or contract, the Sharia supervisory board may have other solutions, such as giving the profit to charity with the *Zakat* that is paid by the Islamic bank every year.

This thesis argues that there should not be the possibility of easily cancelling transactions, as doing so may affect the Islamic bank because it not only costs the institution, but also impacts the reputation of the Sharia board members. Besides that, it affects the reputation of the Islamic bank. Therefore, the board members are required to investigate every single product and transaction accurately before giving their view for application in the Islamic bank.

In addition, the Sharia supervisory board has to also monitor the bank very closely to prevent it from making any transaction without first requesting the board's opinion. In this case, it is the responsibility of the Islamic banks to appoint qualified Sharia scholars for their boards. Furthermore, there should be qualification requirements for the members of the Sharia boards. Thus, in Iraq, the CBI is responsible for considering the Sharia supervisory board's member qualifications.

- 2- **Representing Shareholders' Interests:** Sharia scholars of the Sharia supervisory board represent the shareholders in reviewing the institution's income at the end of each year to ensure the legitimacy of activities performed by the institution.⁹⁴⁸ Thus, in the annual report prepared by the Sharia supervisory board, the board's opinion about all transactions is expressed and this will be published together with the financial statement. It can be said that publishing the annual report is crucial for an Islamic banking institution. Thus, publication of the report is considered a form of transparency that increases public confidence in the bank. The thesis argues that Islamic banks in Iraq can have a similar publication in order to give the people and the public information on the nature and practices of the Islamic banking industry. More specifically, because Islamic banking in Iraq is relatively new, many people still do not have knowledge of these banks.⁹⁴⁹ Besides that, a lack of awareness among them is a common problem at

⁹⁴⁸ Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements of Activation the Legitimate External Control in Islamic Banks' (2013) 9 Tikrit Journal for Administration and Economic Science 256, 259 (translated from the original Arabic text by the author).

⁹⁴⁹ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank (Erbil, May 2015).

the present time.⁹⁵⁰ As the scholars represent the shareholders, the author argues that they should be very strict in reviewing the Islamic banking's income. It is not only because they are trustees, but also because they should have ethical and religious responsibilities.

- 3- **Educating Personnel concerning Sharia Rules and Principles:** It is the duty of the Sharia supervisory board to educate its personnel about Sharia rules and principles related to the Islamic banking transactions and activities so that they understand the purpose and aim of the Islamic financial institution. A Sharia supervisory board should be in the position to answer all management questions and take corrective actions in relation to breaches in the principles of the Sharia law.⁹⁵¹ Finally, the Sharia supervisory board should support stockholder confidence in all the products and activities. It is the responsibility of the board to review and adjudicate the permissibility of all activities.⁹⁵²

5.7 Types and Models of Sharia Supervision of Islamic Banks

The structure and the model of the Sharia supervision of Islamic banks is different from one country to another in accordance with the country's Islamic banking laws and regulations. However, in many countries, the establishment of the Sharia supervisory board for Islamic banks is required by central banks.⁹⁵³ Thus, in almost all countries, each Islamic bank has its own Sharia supervisory board, as required by their local laws,⁹⁵⁴ while in some others, there is only the central Sharia council, such as the one in Iran. However, although every Islamic bank has its own Sharia supervisory board, in some countries there is also a central Sharia board as part of the central bank and one good example is Malaysia.⁹⁵⁵

Since the Islamic banking system of Iraq has Sharia regulatory and supervisory problems, it is crucial to critically look at various models of Islamic banking Sharia supervision structures. In addition, the advantages and disadvantages of each model will be shown to select the best

⁹⁵⁰ Saleh Md. Arman, 'Shariah Compliance Features of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 96.

⁹⁵¹ Shamsalden Aziz Salh, 'Sharia Supervision of Islamic Banking Institutions, Challenges and Achievements' (Islamic Banking Finance Conference, Oxford, England May 2013).

⁹⁵² Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386, 392.

⁹⁵³ In spite of the form or type of the Sharia supervision, it is a necessary part of the Islamic banking system and it is a pre-condition for each Islamic bank to have a Sharia supervisory board.

⁹⁵⁴ Dr. Md. Abdul Jalil and Muhammad Khalilur Rahman, 'Financial Transactions in Islamic Banking are Viable Alternatives to the Conventional Banking Transactions' (2010) 1 International Journal of Business and Social Science 219, 229.

⁹⁵⁵ Frederick V. Perry and Scheherazade S. Rehman, 'Globalization of Islamic Finance: Myth or Reality?' (2011) 1 International Journal of Humanities and Social Science 107, 117.

model for the Islamic banking industry of Iraq with the purpose of establishing a proper Sharia supervisory system.

The following are the main modes of Sharia supervision: External- and Internal-Level Sharia Supervision, Internal Level Sharia Supervision, and External Level Sharia Supervision.

5.7.1 External- and Internal-Level Sharia Supervision

This form of Sharia supervision is one of the strictest Sharia supervisory models of Islamic banking institutions, whereby both levels of the Sharia supervisory boards of the bank and the central Sharia board of the central bank exist. This model is used in Sudan.⁹⁵⁶ In this form, a Islamic financial institution is monitored by two Sharia bodies, one at the micro-level and another at the macro-level. The best example for this type of Sharia supervision is Malaysia, as it has both internal and external Sharia supervisions. Every Islamic bank in Malaysia has its own Sharia supervisory board. At the same time, it also has a central Sharia council known as the SAC as part of the BNM.⁹⁵⁷

In general, the central Sharia board rechecks all products that have already been checked by the Sharia supervisory boards to see if there is a different opinion on the same product from different Sharia supervisory boards. This is to ensure that they are lawful under the Sharia law.⁹⁵⁸

Furthermore, the existence of two Sharia supervisors may reduce the level of mistakes and increase the confidence level of customers towards Islamic banks. Both the individual Sharia supervisory board and the SAC in the BNM can support Islamic financial institutions in relation to Islamic transactions and contracts.

However, this model also has weaknesses in the process of checking the product, which takes more time because two bodies are doing the checking. In addition, it may increase the cost of approving a product or contract. In general, the thesis argues that inspecting a product twice is better than checking once, but takes more time and increases the cost. Nevertheless, increasing the confidence towards Islamic bank leads to the increase in the number of the banks' clients. Furthermore, double-checking the products is more compatible with Sharia law principles and

⁹⁵⁶ Inwon Song and Carel Oosthuizen, 'Islamic Banking Regulation and Supervision: Survey Results and Challenges' (2014) International Monetary Fund, WP/14/220, 16, <<http://www.imf.org/external/pubs/ft/wp/2014/wp14220.pdf>> accessed 9 November 2015.

⁹⁵⁷ Frederick V. Perry and Scheherazade S. Rehman 'Globalization of Islamic Finance: Myth or Reality?' (2011) 1 International Journal of Humanities and Social Science 107, 117.

⁹⁵⁸ Adnan Trakic, 'The Supervision of the Islamic Banks: Analytical Analysis with reference to Malaysia', Sharia Law Report, 2011.

the decisions of the central Sharia board create a standardisation for Islamic banking transactions and products.⁹⁵⁹

This thesis criticises that if there is a Sharia supervisory body at the two levels, internal and external, and the central Sharia supervisory board is very powerful, the Sharia supervisory boards of Islamic banks may then lose their power and the central board may also limit the Sharia supervisory boards' tasks.⁹⁶⁰ Furthermore, with the existence of a central Sharia supervisory body, there is no need for the Sharia supervisory boards of Islamic banks. This is because the central Sharia board's rules are compulsory for Islamic banks and their Sharia boards to follow.⁹⁶¹ In this context, instead of each Islamic bank having its own Sharia supervisory board, it is sufficient for them to have only a Sharia Advisor, while there is a central Sharia supervisory committee in the central bank. Therefore, it can be said that the existence of both Sharia supervisory board of Islamic banks and the central Sharia board of the central bank have both positive and negative effects on the Islamic banking sector, as mentioned earlier. However, in the author's view, this model minimises mistakes in the Sharia board's decisions when it comes to Islamic banking transactions and services.

5.7.2 Internal-Level Sharia Supervision

In the second form of Sharia supervision, there are only Sharia supervisory boards of Islamic banks.⁹⁶² Thus, each Islamic bank has its own Sharia supervisory board at the level of the bank. However, there is no central Sharia supervisory board as the highest Sharia authoritative body in the country.⁹⁶³ This type of supervision may have its advantages and disadvantages. An example of the advantage is that the decision-making process on any new product does not take a long time, as contracts are only verified by the Sharia supervisory board of an Islamic bank. Thus, it takes less time, as the product does not need to be rechecked by a central Sharia board.

⁹⁵⁹ Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 *Jurnal Ekonom* 53, 56.

⁹⁶⁰ Hisam Abdul Nabi, 'Different views on Unify Sharia Supervisory Boards of Banks' (Alemarite Alyum 22 September 2011) <<http://www.emaratalyom.com/business/local/2011-09-22-1.424660>> accessed 13 November 2015 (translated from the original Arabic text by the author).

⁹⁶¹ As in the case of Malaysia and the power of the SAC,

See: Mustafa 'Afifi Bin Ab. Halim, 'Enhancing the effectiveness of legal Infrastructure: A Study on Legal Issues and other challenges of Islamic Banking and Finance in Malaysia' (the 8th International Conference on Islamic Economics and Finance, Qatar, December 2011).

⁹⁶² Frederick V. Perry and Scheherazade S. Rehman, 'Globalization of Islamic Finance: Myth or Reality?' (2011) 1 *International Journal of Humanities and Social Science* 107, 117.

⁹⁶³ At the present time, all six Gulf Cooperation Council countries (GCC) (i.e.: the Kingdom of Saudi Arabia, Kuwait, Bahrain, UAE, Oman, and Qatar) host Islamic financial institutions, but Bahrain is the only GCC country that hosts a centralised national Shari'ah board.

See: Rodney Wilson, 'The development of Islamic finance in the GCC' (2009) *The Centre for the Study of Global Governance*, London School of Economics, 10.

In contrast, there are also disadvantages from this model of Sharia supervision, such as the possibility of different Islamic banks having different interpretations regarding the same product.⁹⁶⁴ In this case, a central Sharia board will be able to standardise the different Sharia supervisory board's decisions on the same product, if the central Sharia board exists.⁹⁶⁵ Moreover, this form is costly, as the bank is required to pay the wage of all the members of the board.⁹⁶⁶ There are many examples of this form of Sharia supervision, one of them Kuwait.⁹⁶⁷ According to the Kuwait Central Banking Law 1968, each Islamic banking institution shall have its own Sharia supervisory board. In other words, in Kuwait, the central Sharia supervisory does not exist.⁹⁶⁸

In fact, this model is also followed by the Islamic banking system of Iraq, as mentioned in the Internal Instruction 2006, for the regulation of the Islamic banking industry in Iraq, whereby each Islamic bank should have its own Sharia supervisory board.⁹⁶⁹

This model of Sharia supervision is a popular method for the Sharia side of Islamic banks. Therefore, the author is of the opinion that it may take less time and cost less than the first method, which both the central Sharia council and Sharia supervisory boards of Islamic financial institutions utilise. However, it is a less strict model, as the Sharia supervisory board of the Islamic bank is the only and last decision-maker about any product and there is no central Sharia board at the central bank level.

5.7.3 External-Level Sharia Supervision

According to this model of Sharia supervision of Islamic financial institutions, the central Sharia board is the only Sharia supervisory body. Thus, the individual Islamic bank does not have a Sharia supervisory board. Instead, the Islamic bank may have a Sharia advisor. In terms of cost and time, this type of Sharia supervision may be better than the other types, as Islamic banks are not required to pay at least three members or more. Furthermore, there is only the

⁹⁶⁴ Nooraslinda Abdul Aris, Rohana Othman, Rafidah Mohd Azli, Mardiyah Sahri, Dzuljastri Abdul Razak, and Zaharuddin Abdul Rahma, 'Islamic Banking Products: Regulations, Issues and Challenges' (2013) 29 *The Journal of Applied Business Research* 1145, 1154.

⁹⁶⁵ Elwaleed M. Ahmed, 'Sharia Advisory Board's Vital Role in the Rapid Devolvement of ever complex Islamic Financial Products and Instruments' *Sudanese Economist* (21 April 2011) <<http://www.sudaneseconomist.com/?p=292>> accessed 26 November 2016.

⁹⁶⁶ M Umer Chapra and Habib Ahmed, 'Corporate governance in Islamic Financial Institutions' (2002) Paper No. 6, Islamic Development Bank, Islamic research and Training Institute, 81.

⁹⁶⁷ Saudi Arabia and Iraq are also another two examples of internal Sharia board supervision.

⁹⁶⁸ See Chapter Five (i.e.: 5.5), Kuwait situation.

⁹⁶⁹ Inwon Song and Carel Oosthuizen, 'Islamic Banking Regulation and Supervision: Survey Results and Challenges' (2014) *International Monetary Fund*, WP/14/220, 16, <<http://www.imf.org/external/pubs/ft/wp/2014/wp14220.pdf>> accessed 26 November 2016.

central Sharia council that makes the decisions about Islamic financial products, and as a result, it does not require a long time because it is easy to standardise the products and transactions of Islamic banking institutions. This is also because one of the main purposes of establishing the national Sharia board is to standardise decisions that are made by individual Sharia boards.⁹⁷⁰

The best example of this model of Sharia supervision is Pakistan, as in this country, there is a Sharia Board that was established as the State Bank of Pakistan (SBP). This board acts as the sole Sharia supervisory body in matters related to Islamic finance. In Pakistan, each Islamic bank is allowed to have one Sharia advisor and this advisor can only serve in one Islamic bank.⁹⁷¹ On the contrary, the configuration of a Sharia board is not mandatory for Islamic banks.⁹⁷² The Sharia advisor of an Islamic financial institution is responsible for vetting all products and transactions of the institution. The main function of the Sharia advisor is to ensure that all transactions of the institution comply with the Sharia rules and principles. In fact, the Sharia board of the State Bank of Pakistan is the highest authoritative body and has the last word on any differences between the Sharia advisor of the Islamic financial institution and the Sharia board of State Bank for any transaction or product.⁹⁷³

This thesis argues that this model of Sharia supervision for an Islamic banking institution may have some advantages, such as finding a solution for the shortage of Sharia experts and scholars. In fact, many countries in the world face a similar problem of a shortage in Sharia experts to work as a member of the Sharia supervisory board of Islamic financial institutions.⁹⁷⁴ Therefore, if one Sharia advisor is sufficient for each Islamic financial institution to monitor the institutions' transactions and its situations, it means that the issue of the shortage of Sharia experts becomes less problematic. Furthermore, the existence of a Sharia advisor may reduce the issue of having different opinions towards different members of the same Sharia supervisory board of an Islamic financial institution. As each member of the board may have his own opinion about the same product, the result leads to a longer time taken to make a

⁹⁷⁰ Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 *Jurnal Ekonom*, 53, 56.

⁹⁷¹ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 *ISRA International Journal of Islamic Finance* 137, 141.

⁹⁷² Omar Mustafa Ansari, 'Roles and Responsibilities of Shariah Advisors in Islamic Banking Institutions' (November-December 2009) 1 *AlHuda Centre of Islamic Banking & Economics, (CIBE)*, <<http://www.alhudacibe.com/AlhudaMagazine/Issue-036/article05.php>> accessed 19 January 2014.

⁹⁷³ State Bank of Pakistan, 'Strategic plan for Islamic banking in Industry Pakistan' <<http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy>> accessed 14 April 2013.

⁹⁷⁴ Muhammad Shaukat Malik, Ali Malik, and Waqas Mustafa, 'Controversies that Make Islamic Banking Controversial: An Analysis of Issues and Challenges' (2011) 2 *American Journal of Social and Management Sciences* 41, 42.

decision on a new product or transaction compared to only one Sharia advisor. However, it is worth mentioning here that usually, large Islamic banks have Sharia boards, while a smaller Islamic bank may rely on a Sharia advisor.⁹⁷⁵

On the other hand, it seems that, besides some advantages of this model of Sharia supervision, there are also some disadvantages, such as the possibility of an improper decision. In the case where an Islamic financial institution has a Sharia supervisory board, which in many cases comprises of three members or more, they have the capacity to make a better decision on any product than the decision made by only one Sharia advisor. It is clear that three people will be able to make a better and more accurate decision than just one. In other words, decision-making by three scholars is more accurate than a single decision.⁹⁷⁶ An additional disadvantage of this model is that it is difficult to find Sharia experts who have the knowledge about Islamic banking business and finance.⁹⁷⁷ As there are three qualified members or more, each of them may be knowledgeable in different areas of the Islamic banking sector. Therefore, in this situation, the Sharia advisor of the Islamic financial institution should depend on other qualified people who have knowledge in other fields of finance and law.

5.8 The Best Model of Sharia Supervision of Islamic Banking for Iraq

Due to the fact that in Iraq, a lack of Islamic banking experts is a big problem,⁹⁷⁸ the existence of external and internal levels may therefore not be appropriate for the current Islamic banking situation in the country. As a result, it is better for Iraq to have a central Sharia board and that all Islamic banks are bound to follow its decisions and instructions.⁹⁷⁹

It is better that this central Sharia board be attached to the CBI⁹⁸⁰ and each Islamic bank has one Sharia advisor instead of the current situation.⁹⁸¹ Thus, the CBI can minimise its problem of Sharia expert shortage until the problem is resolved and sufficient experts in the field have

⁹⁷⁵ Hussain G. Rammal, 'The Importance of Shari'Ah Supervision in Islamic Financial Institutions' (2006) 3 Corporate Ownership and Control 1, 2.

⁹⁷⁶ The Institute of Islamic Banking and Insurance, 'Takaful Islamic Insurance,' Shari'ah Supervisory Board' <http://www.islamic-banking.com/takaful_Shariah_supervisory_board.aspx> accessed 16 January 2014.

⁹⁷⁷ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

⁹⁷⁸ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

⁹⁷⁹ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 101 (translated from the original Arabic text by the author).

⁹⁸⁰ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank (Erbil, May 2015).

⁹⁸¹ In the interview with Bashir Hadad, he mentioned that it is possible for the Sharia supervisory boards of the Islamic banks in Iraq to establish a Sharia supervisory syndicate instead of having a central Sharia board.

been trained. This also means that neither the Bahraini nor the Malaysian system is suitable for Iraq in the current situation, as they have a limited number of qualified Islamic banking experts who are able to run the Islamic banking industry in the country. However, when the Iraqi banking industry has developed and has a sufficient number of Sharia scholars, as well as a number of institutions for creating Islamic banking experts, the Malaysian approach will be preferred with some slight changes in the central Sharia board's power and authority.⁹⁸² For instance, the central Sharia board should give power to Islamic banks regarding internal Sharia matters of the bank. In addition, Sharia supervisory boards are given the rights to hire and contact other Sharia experts who are not working in the Islamic bank and they are allowed to depend on other fatwa that was not issued by the central Sharia board.

The Power of the National Sharia Board

The central Sharia supervisory board, as an external Sharia supervisory council,⁹⁸³ has higher power than that of the Sharia supervisory board.⁹⁸⁴ However, the power of the central Sharia board is different from one state to another. For example, the SAC, which operates the central Sharia board as part of the BNM for the supervision of Islamic banks, has more power than the National Sharia Board of Bahrain.⁹⁸⁵ However, in the case where the central Sharia supervisory council has wider power, the Sharia supervisory boards of Islamic banks cannot have wider freedom in making decisions.⁹⁸⁶

One may argue that in this case, the establishment of Sharia supervisory boards of Islamic banks is not necessary, as there is a central Sharia board that can be the only decision-maker. On the contrary, this thesis argues that an existence of the Sharia supervisory board has its advantages, such as guiding staff who work in Islamic banks and answering their questions on Sharia-related issues. In addition, an internal Sharia supervisory board will be able to closely monitor Islamic banks than a central Sharia board. Furthermore, a central Sharia board can

⁹⁸² For example, the answers that are given to the Islamic banks' request by the SAC should not be binding on the Islamic banks.

⁹⁸³ Munawar Iqbal, Ausaf Ahamad, and Tariqullah Khan, 'Challenges Facing Islamic Banking' (1998) *Islamic Development Banks* occasional paper 1, 37 <http://ierc.sbu.ac.ir/File/Book/Challenges%20Facing%20Islamic%20Banking_46947.pdf> accessed 10 November 2015.

⁹⁸⁴ In other words, the central Sharia council is the highest Sharia regulatory and supervisory body in the country.

⁹⁸⁵ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on *Shariah* Governance Supervision of *Sukuk* Defaults' (2012) 8 *Journal of Islamic Economics, Banking and Finance* 20, 31-32.

⁹⁸⁶ Interview with Abdulla Hama, university lecturer, University of Sulaymaniyah (Erbil, June 2015).

provide assistance to Islamic banks and their Sharia supervisory boards in order to reduce the problems and challenges that they may face.⁹⁸⁷

As a result, this thesis argues that in order to resolve the issue, there should be a fair balance between the responsibilities and duties of the central Sharia board and Sharia supervisory boards of Islamic banks. This can be determined by law or by special guidelines for the Sharia supervision of Islamic banks. However, as a higher Sharia supervisory authority, the central Sharia board is more powerful than the Sharia boards of Islamic banks, which is a conflict. Moreover, the central Sharia board can be a backup for Sharia boards and provide them with assistance when they are in need.⁹⁸⁸

Challenges Faced by Sharia Supervisory Boards of Islamic Banks

The Sharia supervision of the Islamic banking industry is carried out by scholars and experts. Despite its achievements, because it is carried out by humans, the Sharia supervisory board, in some cases, faces challenges and has issues.⁹⁸⁹ It is necessary to clarify the challenges faced by the Sharia supervision of the Islamic banking system in order to find solutions for them. Furthermore, identifying these challenges will help the Iraqi Islamic banking industry and the CBI regulators to resolve them in the future. As a result, establishing a well-structured Sharia supervision for Islamic banking in Iraq can be proposed.

One of the issues of the Sharia supervisory boards of the Islamic banks is that the Islamic banking management may not give sufficient information about a certain transaction to the Sharia supervisory board or may ask the Sharia supervisory board in some way, giving incorrect information about a contract or transaction to the board and resulting in an unlawful decision by the board.⁹⁹⁰ Therefore, in this case, the members of the Sharia boards have to investigate every transaction separately and then monitor the transaction while the Islamic bank apply the transaction. In general, the following are the most common issues of the Sharia supervisory boards of Islamic banks: non-independence, non-confidentiality, incapability of the Sharia scholars, and inconsistency of the Sharia supervisory board:

⁹⁸⁷ Republic of Sudan, Higher Sharia Supervisory Committee of the Banking and Financial Institutions' 'About the Committee' <<http://hssb.gov.sd/page/10>> accessed 10 February 2014.

⁹⁸⁸ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 94 (translated from the original Arabic text by the author).

⁹⁸⁹ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

⁹⁹⁰ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

Lack of Independence

A lack of independence for the Sharia supervisory board is also considered a challenge for the board.⁹⁹¹ The members of the board must be free from any influence by an Islamic bank to avoid an unlawful decision.⁹⁹² Independence is one of most important elements for the members of the Sharia supervisory board.⁹⁹³ In fact, some investors who invest with an Islamic bank act as sleeping partners and they do not have right to interfere in the management of the funds. As a result, they do not have any control over the bank. In this case, the board's independence is necessary and this leads to public confidence in the bank. Hence, the members of the Sharia board should not be controlled by any group or person so that they can perform their duties towards Sharia-related issues of Islamic banks.⁹⁹⁴ In this regard, looking at Malaysia, the BNM emphasises the independence of the Sharia supervisory board. Therefore, resignation and removal or reappointment of a Sharia board member must be approved by the SAC.⁹⁹⁵

However, as long as the members of the board are paid by the Islamic bank, there is a possibility that the institution might influence them.⁹⁹⁶ They should be paid by some other body, which should not be under the bank's control.⁹⁹⁷ It is suggested by a group of scholars in South Africa that Sharia boards should be separate from Islamic banking institutions and not be paid by the institutions in order to avoid conflicts of interest.⁹⁹⁸ Thus, the board can be paid by the general

⁹⁹¹ Shamsalden Aziz Salh, 'Sharia Supervision of Islamic Banking Institutions, Challenges and Achievements' (Islamic Banking Finance Conference, Oxford, England May 2013).

⁹⁹² Hussain G. Rammal, 'The Importance of Shari'Ah Supervision in Islamic Financial Institutions' (2006) 3 Corporate Ownership and Control 1, 3.

⁹⁹³ Yusuf Talal delornzo, 'Shari'ah Supervision in Modern Islamic Finance' Guidance Residential, Modern Finance timeless value <https://www.guidanceresidential.com/blog/wp-content/uploads/2015/05/Shariah_supervision_in_modern_islamic_finance.pdf> accessed 13 November 2015.

⁹⁹⁴ Nawal Kasim, Sheila Nu Htay, and Syed Ahmed Salman, 'Comparative Analysis on AAOIFI, IFSB, and BNM Shari'ah Governance Guidelines' (2013) 4 International Journal of Business and Social Science 220, 225.

⁹⁹⁵ Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Jurnal Ekonom 53, 54.

⁹⁹⁶ Bashar H Malkawi, 'A Bright Future: Towards an Enhanced Shariah Supervision in Islamic Finance, The European Financial Review (2 May 2008) < <http://www.europeanfinancialreview.com/?p=487>> accessed 27 November 2016.

⁹⁹⁷ Qaed Haidar Alwalidi, 'Sharia supervision of Islamic Financial Institutions of Yemen, Reality and Challenges' (Forum, Towards of Activate the Role of the Sharia Supervision of Islamic Financial Institutions in Yemen, April 2013).

⁹⁹⁸ "Traditionally, banks appoint prestigious scholars to their Sharia boards and pay them handsome fees and retainers. This has left the system vulnerable to charges of conflict of interest: the scholars are being paid by the institutions that they are supposed to be impartially supervising. A group of scholars in South Africa, led by Durban-based Ebrahim Desai, a senior figure in the city's Muslim community, proposes that Muslim depositors in each Islamic bank fund a Sharia-compliant body that is created separately from the bank. The body would then hire a Sharia board to supervise the bank. This way, the scholars on the board would not be appointed by or report to the bank's management and would not have a direct financial relationship with the bank."

See: Reuters Dubai, 'Islamic Scholars Propose New Shariah Board Model' al Arabiya News (14 September 2012) <<http://english.alarabiya.net/articles/2012/09/14/237943.html>> accessed 27 November 2016.

assembly of the Islamic bank or an external body, but not the Islamic bank directly to have more freedom.⁹⁹⁹ It is argued that the members of the Sharia supervisory board should be paid by the central bank or central Sharia board instead of Islamic banking institutions.¹⁰⁰⁰ In that regard, the author argues that the central bank or any other external body¹⁰⁰¹ can establish a pool that takes monthly payments from Islamic banks and then pay the members of the Sharia supervisory boards of Islamic banks, therefore disabling Islamic banks from influencing Sharia supervisory members.

On the other hand, Islamic banking experts call for an independent external Sharia supervision and not be a part of the Islamic bank. They believe that such a Sharia body is necessary for the supervision of an Islamic bank and gives more confidence to Islamic banks. Thus, this independent Sharia body should be under an official authority, such as the central bank.¹⁰⁰²

Non-Confidentiality

Non-confidentiality is another challenge faced by the Sharia supervisory boards of Islamic banks.¹⁰⁰³ Because of the lack of qualified Sharia scholars for Islamic banks, one Sharia scholar usually serves on more than one Islamic bank. Thus, a conflict of interest may occur.¹⁰⁰⁴ In this regard, information from one financial institution is used by another because one Sharia member serves on multiple Sharia boards.¹⁰⁰⁵ Therefore, in Malaysia, Sharia scholars cannot serve on more than one board of the same industry.¹⁰⁰⁶ Thus, the Malaysian approach resolves non-confidentiality of the Sharia supervisory board. The thesis argues that the Malaysian approach is a good solution for non-confidentiality of the Sharia supervisory board of Islamic banks. Hence, each Sharia scholar should not be appointed to more than one Sharia supervisory board.

⁹⁹⁹ Qaed Haidar Alwalidi, 'Sharia supervision of Islamic Financial Institutions of Yemen, Reality and Challenges' (Forum, Towards of Activate the Role of the Sharia Supervision of Islamic Financial Institutions in Yemen, April 2013).

¹⁰⁰⁰ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 141.

¹⁰⁰¹ In this case, for example, the central Sharia board, Ministry of Awqaf or Ministry of Finance, could have this role.

¹⁰⁰² Yusuf Al-Ammadi, 'Experts Ask for independency for Sharia supervision from Islamic banks' Alsharq Alawsat, (2 March 2010), <<http://www.aawsat.com/details.asp?section=58&article=559298&issueno=11417#>> accessed 27 November 2016. (translated from the original Arabic text by the author)

¹⁰⁰³ Shamsalden Aziz Salh, 'Sharia Supervision of Islamic Banking Institutions, Challenges and Achievements' (Islamic Banking Finance Conference, Oxford, England May 2013).

¹⁰⁰⁴ Saleh Md. Arman, 'Shariah Compliance Features Of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 93.

¹⁰⁰⁵ Rodney Wilson, 'The development of Islamic finance in the GCC' (2009) The Centre for the Study of Global Governance, London School of Economics, 10.

¹⁰⁰⁶ Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Journal Ekonom 53, 55.

Incapability of the Scholars

The incapability of the scholars is another problem for the board.¹⁰⁰⁷ If the board does not consist of scholars who cover all Islamic banking issues – Sharia, legal, and financial – the board cannot be active and may require the help from others, such as legal and financial experts. Hence, the Sharia boards of Islamic banks should have qualified members who are knowledgeable in all areas related to Islamic banking business.¹⁰⁰⁸ The opening of training courses and education centres for the education of Islamic banking Sharia scholar is therefore a good solution.

Inconsistency of Sharia Supervisory Board

Inconsistency is another issue faced by the Sharia board of the Islamic banks. Because of different interpretations from different scholars, there exists different views of one transaction or service within the same board.¹⁰⁰⁹ Therefore, these different views impact the banking business and to delays in the Sharia board making decisions. In this case, to resolve this issue, the board may request assistance from other scholars, or if the central Sharia board exists, it will have its final word. However, applying the rules and standards issued by the AAOIFI and IFSB by Islamic banks will minimise and maybe resolve the issue of inconsistency.¹⁰¹⁰

5.9 Main International Bodies and Organisations of Sharia Supervision

There is no doubt that Sharia supervision is the backbone of the Islamic financial system.¹⁰¹¹ The Sharia supervision of the Islamic banking should be ruled and managed in a proper way. For this purpose, there are rules and regulations enacted and guidelines have also been issued by related bodies and organisations such as the Sharia standards by the AAOIFI.¹⁰¹² These organisations are internationally-known bodies that work on Sharia supervision of the Islamic

¹⁰⁰⁷ Saleh Md. Arman, 'Shariah Compliance Features Of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 93.

¹⁰⁰⁸ Prof. Dr. Mohamad Akram Laldin, 'Duties and Responsibilities of Shari'ah Boards from a Legal and Regulatory Perspective' September 2012, <<http://www.amanie-icconnect.com/component/k2/item/31-duties-and-responsibilities-of-shari%E2%80%99ah-boards-from-a-legal-and-regulatory-perspective>> accessed 27 November 2016.

¹⁰⁰⁹ Saleh Md. Arman, 'Shariah Compliance Features Of Islamic Financial Institutions and Its Challenges' (2013) 3 Arabian Journal of Business and Management Review (OMAN Chapter) 91, 93.

¹⁰¹⁰ Andreas A. Jobst, 'The Economics of Islamic Finance and Securitization' (2007) IMF Working Paper, WP/07/117, 32.

¹⁰¹¹ Racha Ghayad, 'Corporate Governance and the Global Performance of Islamic Banks' (2008) 24 Journal of Humanomics 207, 214.

¹⁰¹² Accounting and Auditing Organisation for Islamic Financial Institutions, 'Shari'a Standards' <<http://www.aaofii.com/en/standards-and-definitions/shari%E2%80%99a-standards/shari%E2%80%99a-standards.html>> accessed 13 November 2015.

financial sector as one of their main functions. However, there are a number of centres and organisations¹⁰¹³ that have been established for the purpose of managing the Sharia aspects of the Islamic financial institutions. Only two main international bodies that play an important role in the context of Sharia governance of Islamic financial system will be explained. These are the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) and the Islamic Financial services board (IFSB).¹⁰¹⁴

5.9.1 The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

The AAOIFI¹⁰¹⁵ has a significant role in the regulation and supervision of Islamic financial institutions that unite Sharia scholars' opinions on Islamic banking and finance products. Because of the different views from different scholars and the Sharia supervisory boards of Islamic banks, some products and instruments are accepted by certain Islamic banks, while rejected by others. Therefore, the standards set by the AAOIFI can be applied to minimise these contradictory views.¹⁰¹⁶

The organisation has issued a number of standards in the fields of accounting, auditing, ethics, governance, and Sharia. The Sharia standards are a basic element for the Sharia compliance of financial institutions.¹⁰¹⁷ The AAOIFI have issued 45 of them to minimise the Sharia issues of

¹⁰¹³ For instance, Islamic Research and Training Institute (IRTI) and The Islamic Corporation for the Development of the Private Sector (ICD).

¹⁰¹⁴ Kashif Hasan Khan, 'A Critical Review of Shari'ah Supervision on Current Financial Transactions' (13 July 2012) <<http://www.financeokey.com/finance-market/a-critical-review-of-Shariah-supervision-on-current-financial-transactions.html>> accessed 13 November 2015.

¹⁰¹⁵ "The AAOIFI is an Islamic internationally independent non-profit organisation that was founded according to the Agreement of Association signed by the Islamic financial institutions on 26 February 1990 in Algiers. It was finally registered on 27 March 1991 in the State of Bahrain. This organisation arranges accounting, auditing, governance, ethics, and Sharia standards for Islamic financial institutions. Currently, important systems such as the Sharia Advisor and Auditor and the corporate compliance program are presented by the AAOIFI in its efforts to promote the industry's human resources base and governance structures."

As a self-governing international organisation, the AAOIFI is supported by its institutional members. Currently, it has 200 members from over 45 countries (as of 2016), including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industries worldwide. The AAOIFI has obtained assured support for the implementation of its standards, which are now adopted in the Kingdom of Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan, and Syria. The relevant authorities in Australia, Indonesia, Malaysia, Pakistan, the Kingdom of Saudi Arabia, and South Africa have issued guidelines that are based on the AAOIFI's standards and pronouncements."

See: Accounting and Auditing Organisation for Islamic Financial Institutions 'About AAOIFI', <<http://www.aaofi.com/en/about-aaofi/about-aaofi.html>> accessed 20 October 2016.

¹⁰¹⁶ Juan Sole, 'Introducing Islamic Banks into Conventional Banking Systems' (2007) International Monetary Fund WP/07/175, 6.

¹⁰¹⁷ Accounting and Auditing Organisation for Islamic Financial Institutions, 'Standards' <<http://www.aaofi.com/en/standards-and-definitions/shari%E2%80%99a-standards/?page=1>> accessed 13 November 2015.

Islamic financial institutions in the world.¹⁰¹⁸ These standards support the harmonisation of international Islamic finance practices and in turn enhance user confidence in Islamic finance. As a result, the increasing demand for Islamic finance is encouraged. The Sharia standards lead to innovation and creativity in accordance with Sharia principles. The main objective of the Sharia standards is to ensure that all Islamic finance activities are compliant with Islamic law, something which does not apply to the conventional financial system.¹⁰¹⁹ The AAOIFI standards are developed while consulting with some of the most important Sharia experts and Islamic jurists. The organisation offers professional development training programmes in the forms of Certified Sharia Adviser and Auditor, as well as Certified Islamic Professional Accountant, with the vision of improving the industry's human resource base and governance structures.¹⁰²⁰

The Organisation has served the Islamic finance industry for more than two decades to develop a system that complies with Sharia law.¹⁰²¹ Currently, the AAOIFI plays a key role in the international Islamic finance industry because it offers many important activities that complement its core standard-setting function. Contract certification programmes have been developed to promote the application of AAOIFI's standards and the professional development program supports the technical understanding of the standards. Such initiatives give this organisation a good reputation around the world.¹⁰²²

Almost all Islamic banks in the world implement AAOIFI standards, either as a part of regulatory requirements or as internal guidelines, as can be seen in Bahrain. The application of AAOIFI standards is obligatory for Islamic banks.¹⁰²³ Presently, the standards are followed by a majority of Islamic financial institutions in the Middle East, Europe, Africa, Asia Pacific, South Africa, and Central Asia.¹⁰²⁴ It seems to the author that the very existence of the AAOIFI is an important achievement to date in the field of Islamic finance. The AAOIFI standards act as the basis for a productive relationship between Islamic banks throughout the world, which

¹⁰¹⁸ Adel Mohammed Sarea and Mustafa Mohd Hanefah, 'Adoption of AAOIFI accounting standards by Islamic banks of Bahrain' (2013) 11 *Journal of Financial Reporting and Accounting* 131, 132.

¹⁰¹⁹ Central Bank of Bahrain, 'Islamic Finance Review' June 2011, 2.

¹⁰²⁰ Albaraka Bank, Islamic Banking, 'AAOIFI' <http://www.albaraka.co.za/Islamic_Banking/AAOIFI.aspx> accessed 28 November 2016.

¹⁰²¹ Scott R. Anderson, 'Recent Developments Forthcoming Changes in the Shari'ah Compliance Regime for Islamic Finance' (2010) 35 *the Yale Journal of International Law* 237, 240.

¹⁰²² Central Bank of Bahrain, 'Islamic Finance Review', June 2011, 2.

¹⁰²³ Md. Hafij Ullah, 'Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh' (2013) 1 *International Journal of Social Science Research* 111, 112.

¹⁰²⁴ Central Bank of Bahrain, 'Islamic Finance Review', June 2011, 2.

means that this organisation indirectly helps Islamic banks reach their goal of attracting more clients. Implementing AAOIFI standards promotes client confidence towards Islamic banks and boosts funds from public investment.

Assoc. Prof. Dr. Mohamad Akram Laldin, the Executive Director of International Sharia Research Academy for Islamic Finance (ISRA) in Malaysia, stated that:

The AAOIFI Governance Standards for Islamic Financial Institutions (GSIFI) have been issued to manage Sharia supervision of these institutions. The standards play a crucial role in supervising Islamic financial institutions, as it includes some parts. For example, GSIFI 1 is purposing for Sharia supervisory board, while GSIFI 2 is concerned with Sharia review and GSIFI 3 for internal Sharia review and so on. The main purposes of the Governance Standards for Islamic Financial Institutions of AAOIFI are:

- 1- To lay down the key principles and concepts relevant to the governance in Islamic financial institutions (IFIs).
- 2- To assist IFIs as well as their stakeholders to appreciate the respective roles of those charged with governance.
- 3- To establish the foundation upon which the development of future governance or compliance standards will take place.
- 4- To provide the necessary inter-linkages between the various current and future standards applicable to IFIs.¹⁰²⁵

It is noteworthy here that one of the challenges faced by the AAOIFI, however, is a lack of authority to oblige Islamic financial institutions to apply all rules or instructions issued by the organisation. It is therefore not easy for the organisation to ensure that all Islamic financial institutions implement the standards, even though it is desirable for them to do so.¹⁰²⁶ However, governments themselves can require Islamic banks to implement these standards to create better Islamic financial systems for their countries. Nevertheless, it is difficult to unite all governments in forcing their institutions into doing this.

It is noted that the AAOIFI is designed for enhancing Islamic banking institutions in the world and it has several guidelines for the enhancement of Islamic banking systems. Thus, in Bahrain, all Islamic banks are required to apply AAOIFI standards.¹⁰²⁷ In Malaysia, applying AAOIFI standards is not compulsory for Islamic banks, but it is preferable.¹⁰²⁸ Therefore, it is vital to know how Iraqi Islamic banks can take advantage of the AAOIFI and its standards. There is no doubt that there should be a link between the AAOIFI and the Islamic finance sector. Thus,

¹⁰²⁵ Assoc. Prof. Dr. Mohamad Akram Laldin, 'Risk Management in Islamic Finance' ISRA.

¹⁰²⁶ Umer Chapra and Habib Ahmed, 'Corporate Governance in Islamic Financial Institutions' (2002) Islamic Development Bank, Islamic Research and Training Institute, 67.

¹⁰²⁷ Anwar Khalifa Al Sadah, 'Challenges Facing the Islamic Financial Services Industry' (the 8th AAOIFI Annual Conference on Islamic Banking 2006, Manama, June 2006).

¹⁰²⁸ Adel Mohammed Sarea and Hj Mustafa Mohd Hanefah, 'The Need of Accounting Standards for Islamic Financial Institutions' (2013) 9 International Management Review 50, 58.

this link can be the central Sharia body that has yet to exist in Iraq. The establishment of the central Sharia board for Iraq is therefore necessary to act as a bridge between the Islamic banking industry and the AAOIFI and the central Sharia board can help Islamic banks apply the AAOIFI's standards, such as the Sharia standards for Islamic financial institutions. In addition, the CBI can be connected to the AAOIFI via a central Sharia board containing experts in the field.

5.9.2 The Islamic Financial Services Board (IFSB)¹⁰²⁹

The IFSB is an international body that supports the financial services industry and it has functions and aims stated in the Articles of Agreements of the IFSB. The most important functions and objectives of the IFSB are the following:

- 1- To promote the development of a prudent and transparent Islamic financial services industry via adapting existing international standards consistent with *Sharia* principles, and advise them about adoption.
- 2- To provide guidance on the effective supervision and regulation of institutions offering Islamic financial products and to develop for the Islamic financial services industry the criteria for identifying, measuring, managing, and disclosing risks, taking into account international standards for valuation, income, and expense calculation, and disclosure.
- 3- To support member countries of the body that is through cooperation with relevant bodies and organisations that set standards for the stability of the international and financial systems of member countries.
- 4- To improve and manage programmes to develop instruments and procedures for efficient operations and risk management.¹⁰³⁰

In fact, the IFSB is one of the most important global bodies for the supervision of Islamic financial institutions. The Islamic Financial Service Board is located in Malaysia, but its members are from different countries and organisations. It aims to set international regulatory

¹⁰²⁹ A group of central banks from Islamic countries established the Islamic financial services Board (IFSB) in 2002 in Kuala Lumpur.

See: Dahlia El-Hawarya, Wafik Graish, and Zamir Iqbal, 'Diversity in the regulation of Islamic Financial Institutions' (2006) 46 *The Quarterly Review of Economics and Finance* 778, 788.

¹⁰³⁰ Other functions and objectives of the IFSB are:

- 1- "To encourage the members to cooperate among themselves in order to develop and improve the Islamic financial industry.
- 2- To facilitate training and personnel improvement and development skills in the regulation of the Islamic finance industry and related markets.
- 3- To promote the Islamic financial industry by undertaking research and publishing studies and surveys in the Islamic financial field.
- 4- To create a database of Islamic banks and financial institutions and industry experts.
- 5- Any other objectives that the General Assembly of the IFSB may agree to from time to time."

See: Article 4 of the Islamic Financial Services Board, 'Governing Documents' <[http://www.ifsb.org/docs/Articles%20of%20Agreement%20\(Amended%20October%202013\).pdf](http://www.ifsb.org/docs/Articles%20of%20Agreement%20(Amended%20October%202013).pdf)> accessed 13 November 2015.

and supervisory standards for Islamic banking and finance. In some ways, the IFSB is like a Basel Committee for Islamic banks.¹⁰³¹

The body was established in November 2002 to support Islamic banking institutions and it started its operations in early 2003. It is an international standard-setting body of regulatory and supervisory agencies that have a vested interest in ensuring the soundness and stability of the Islamic financial services industry, covering banking, capital markets, and insurance. In advancing this mission, the IFSB promotes the development of a prudent and transparent Islamic financial services industry by adapting existing international standards consistent with Sharia principles and advising them about adoption.¹⁰³² The IFSB provides guiding principles in five sections that cover the general approach to Sharia governance systems, competency, independence, confidentiality, and consistency. Thus, the IFSB guidelines concern all related elements of the Sharia boards of Islamic financial institutions.¹⁰³³

The members of the body are organisations that are experts in financial and banking areas. The IFSB has 190 members, 66 of whom are regulatory and supervisory authorities, eight international inter-governmental organisations, and 116 of them market players, professional firms and industry associations.¹⁰³⁴ Therefore, the role of the IFSB should be appreciated in the governance of Islamic financial institutions, as it was established to help strengthen and harmonise prudential standards for Islamic financial institutions.¹⁰³⁵

As a host country for the IFSB, Malaysia has enacted a law known as the Islamic Financial Services Board Act 2002, which gives the IFSB the immunities and privileges that are usually granted to international organisations and diplomatic missions.¹⁰³⁶

It is very important to mention here that the IFSB assesses Islamic banking and financial institutions that provides guidance for the effective supervision and regulation of Islamic finance institutions. Based on this fact, Islamic banking institutions of Iraq can have the

¹⁰³¹ Abdul Karim Aldohni, *The legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (1st ed., Routledge, London, 2011) 200.

¹⁰³² Mohammed El Qorchi, 'Islamic Finance Gears Up' (2005) 42 *Finance and Development* 1, 5.

¹⁰³³ Nawal Kasim, Sheila Nu Htay, and Syed Ahmed Salman, 'Comparative Analysis on AAOIFI, IFSB, and BNM Shari'ah Governance Guidelines' (2013) 4 *International Journal of Business and Social Science* 220, 224.

¹⁰³⁴ Islamic Financial Services Board: Background, <<http://www.ifsb.org/background.php>> accessed 16 October 2016.

¹⁰³⁵ Islamic Research and Training Institute 'Islamic Financial Architecture: Risk Management and Financial Stability' (2005), Islamic development bank, seminar proceedings No. 46, edited by Tariqullah Khan and Dadang Muljawan, 100.

¹⁰³⁶ Islamic Financial Services Board: Background, < <http://www.ifsb.org/background.php>> accessed 16 November 2016.

opportunity to take advantage of the IFSB. For the purpose of regulation and supervision of the Islamic banking industry, the IFSB encourages Islamic banks to adopt all standards related to the Islamic banking industry. Thus, the Islamic banking industry of Iraq and the CBI can benefit from this organisation through the central Sharia board. The central Sharia board can develop Islamic banking human capital and Sharia experts' skills through relation with the IFSB.

National or International Sharia Board

The national or central Sharia supervisory board is crucial for the Islamic financial sector to achieve a high level of quality.¹⁰³⁷ Some countries such as Malaysia already have central Sharia boards as their highest Sharia supervisory body.¹⁰³⁸ In addition, in some nations there are requests for the establishment of a national Sharia board such as the one in Qatar, as requested by Dr. Ali Qaradaghi, the Secretary General of the International Union of Muslim Scholars.¹⁰³⁹ The Moroccan Central Bank has also planned to establish a central Sharia body in the country to oversee Islamic banks.¹⁰⁴⁰ It seems that a national Sharia board is necessary to be established in order to govern and supervise the Islamic financial industry.

On the other hand, there are also requests for the establishment of a unified or global central Sharia board for the purpose of Islamic financial supervision. Again, Dr Ali Qaradaghi sees that finding and establishing a unified Sharia board at a global level is important.¹⁰⁴¹ In addition, the IDB president, Ahmad Mohamed Ali, called for the establishment of a global Sharia advisory board that can offer greater uniformity for the Islamic financial industry. This global Sharia board could standardise Islamic finance practices at a worldwide level and improve consumer perceptions.¹⁰⁴² In fact, this international Sharia supervisory board is important, as it gathers all specialist scholars and experts in Islamic finance and will be a house for fatwa. In short, a national Sharia board is necessary at the level of the state to oversee the

¹⁰³⁷The International Union of Muslim Scholars, <<http://www.iumsonline.net/ar/Default.asp?ContentID=4896&menu>> accessed 28 November 2016.

¹⁰³⁸ Jasri Jamal, NorAziah Mohd and Kamal Halili, 'Alternative Dispute Resolution in Islamic Finance: Recent Development in Malaysia' (2011) 3 International Journal of Social Sciences and Humanity Studies, 185.

¹⁰³⁹The International Union of Muslim Scholars, <<http://www.iumsonline.net/ar/Default.asp?ContentID=4896&menu>> accessed 28 November 2016.

¹⁰⁴⁰ Al Arabiya News, 'Morocco central bank plans central Shariah board' (15 March 2013) <<http://english.alarabiya.net/en/business/2013/03/15/Morocco-central-bank-plans-central-Sharia-board.html>> accessed 28 November 2016.

¹⁰⁴¹The International Union of Muslim Scholars, <<http://www.iumsonline.net/ar/Default.asp?ContentID=4896&menu>> accessed 28 November 2016.

¹⁰⁴² Al-Zaquan Amer Hamzah and Bernardo Vizcaino, Reuters, 'Islamic finance needs global Sharia board - IDB president' Reuters (16 May 2013) <<http://www.reuters.com/article/2013/05/16/islamic-finance-scholars-idUSL6N0DX1D220130516#EJGD8PU514hYcFBo.97>> accessed 17 October 2016.

Islamic financial sector and an international Sharia board is important at a global level to unify Islamic banking practices and products worldwide.

5.10 Conclusion

Due to the lack of a central Sharia board and weakened individual Sharia supervisory boards of Islamic banks, the Iraqi Islamic banking system are facing Sharia regulation and supervision problems.¹⁰⁴³ For the Islamic banking system to have an effective Sharia supervisory system, it should have two levels of Sharia supervision, external and internal levels. The internal level is practised in most Islamic banking institutions in the world, either by the Sharia supervisory board of Islamic banks such as the GCC countries and Iraq, or by a Sharia advisor such as the one in Pakistan. In contrast, the external level is not practised by all countries. In certain countries, there is a central Sharia body as part of the central bank, while in some others, there is another body that is part of another government office with this responsibility.¹⁰⁴⁴

The Iraqi Islamic banking system, as a new sector in Iraq, faces Sharia regulatory and supervisory problems. The lack of a central Sharia board at the level of the central bank is one of the issues for the Islamic banking system of Iraq. Thus, Sharia boards of Islamic banks are not strong enough to control all Sharia-related matters and monitor Islamic banking transactions as a proper supervisory body. However, each Islamic bank has its own Sharia supervisory board that monitors Islamic banking operations and ensures that all transactions conducted by the bank are compliant with Sharia principles.¹⁰⁴⁵ Due to the fact that the Islamic banking industry of Iraq has a problem in the form of a shortage of experts,¹⁰⁴⁶ it is advisable that Islamic banks in Iraq appoint Sharia advisors. In other words, instead of each Islamic bank having a Sharia supervisory board, each can have one Sharia advisor. Thus, appointing one Sharia advisor can be a good solution, while there is a central Sharia board in the CBI. There is therefore a need for a central Sharia supervisory body like other countries, such as Malaysia and Bahrain. In Malaysia, there is the SAC, which is a high authoritative Sharia body as part of the BNM. This council is considered the final decision-maker and adviser for the Islamic

¹⁰⁴³ Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 361 (translated from the original Arabic text by the author).

¹⁰⁴⁴ See Chapter Five 5.5.

¹⁰⁴⁵ Sawsan Ahmed Saeed and Saba Ahmed Saeed, 'Requirements of Activation the Legitimate External Control in Islamic Banks' (2013) 9 Tikrit Journal for Administration and Economic Science 256, 259 (translated from the original Arabic text by the author).

¹⁰⁴⁶ The issue of the shortage of Islamic banking experts in Iraq will be discussed in Chapter Six of this thesis.

financial institutions in Malaysia. Thus, all Sharia-related issues of the Islamic financial institutions are forwarded to this council when necessary.

In Bahrain, there is a National Sharia Board as part of the CBB, but has less power than the SAC of Malaysia.¹⁰⁴⁷ In contrast, in some countries, there are other bodies that take the role of resolving Sharia issues of the Islamic banks. These bodies act as a central Sharia board with less duty and they are not specialised in Islamic banking. In Qatar, for example, there is a Supreme Sharia Council attached to the Awqaf Ministry, where any issues related to Islamic finance can be directed to the Council for clarification. At the same time, the Central Bank of Qatar appoints Sharia scholars to solve any problems encountered on a case-by-case basis. In fact, every country that has Islamic banks has resolved this issue one way or another. In contrast, the absence of a central Sharia board in Iraq is still an issue and should be resolved to ensure better governance of the Islamic banking sector.

Thus, the establishment of a central Sharia board for Iraq is necessary, as there are benefits attached to such a body. The central Sharia board can standardise Islamic banking products when there are different interpretations by different Sharia supervisory boards of Islamic banks or different opinions between the scholars of one Sharia supervisory board. The central Sharia board can give assistance to Islamic financial institutions when they require help with a Sharia-related issue. It can also organise training courses and workshops for staff of Islamic banks and support them in building a better regulatory system. Furthermore, the central Sharia board can have its say in court in Sharia-related issues should there be a dispute, as can be seen in Malaysia.¹⁰⁴⁸ For these reasons, the establishment of a central Sharia board is important for the Iraqi Islamic banking system as part of the CBI.¹⁰⁴⁹

It is also important that there are guidelines to determine the duties and responsibilities of the central Sharia board.¹⁰⁵⁰ At the same time, the duties of the Islamic banks Sharia supervisory

¹⁰⁴⁷ The function of the National Sharia Board in Bahrain is limited, as it serves the CBB and verifies its own products only.

¹⁰⁴⁸ Section 56 of the Central Bank of Malaysia Act, 2009 states that any ruling made by the Council will be binding on the civil court and the arbitrator, which means that the court and the arbitrator must follow the ruling to arrive at their decision and the ruling shall form part of the judgment of the court in Islamic banking and finance cases.

¹⁰⁴⁹ There is no Sharia court in Iraq for resolving issues between Islamic banks or between Islamic banks and their clients in case of disputes. See:

Saad Abd Muhammad, 'The Relationship between Central Bank and Islamic Banks' (2014) 40 Baghdad College for Economic Science 349, 361 (translated from the original Arabic text by the author).

¹⁰⁵⁰ If the CBI Law 2004 is amended, it might include provisions related to duties and functions of the central Sharia board. Otherwise, there is a need to issue a guideline or instructions to manage the relationship between the central Sharia board and individual Sharia supervisory boards of Islamic banks in Iraq.

boards should also be determined to avoid conflicts between them. However, there may be a negative point in the model when there is central Sharia board and Sharia supervisory board for Islamic banks, such as the increased power of a central Sharia board, which makes the Sharia boards of Islamic banks have less power in return. Therefore, there should be a division of responsibility and duties between the central Sharia body and Sharia supervisory boards of Islamic banks. Each of these boards clearly knows its duties and rights.

In general, the best approach and model of Sharia supervision for the Islamic banking system of Iraq is to have internal and an external levels of the Sharia supervision. Hence, instead of each Islamic bank having its own Sharia supervisory board, it is better that each Islamic bank appoint one advisor. At the same time, there should be a central Sharia board at the CBI. In this case, there should be a very powerful central Sharia board that consists of Sharia experts, Islamic financial experts, economists, and legal practitioners. Thus, these qualified experts and professionals can build proper and strong central Sharia boards in Iraq. In that context, a central Sharia board can cover all Sharia issues of the Iraqi Islamic banking industry.

Finally, it is vital for the Sharia supervisory boards of Islamic banks and the central Sharia board to be independent. Hence, the members of both central and individual Sharia boards should have the freedom to make decisions about any transaction or issues related to Sharia. In this regard, there are organisations and bodies that are established to help and develop Islamic banks and their Sharia supervisory systems, such as AAOIFI and IFSB.¹⁰⁵¹ These international bodies have issued a number of standards and rules that support Islamic banking institutions in the world. Therefore, the proposed central Sharia board and Sharia boards of Islamic banks in Iraq can apply the standards that are issued by these two mentioned bodies. In that sense, Islamic banks in Iraq can apply Sharia standards of the AAOIFI to fill the gap of the Islamic Bank Law 2015 of Iraq and help the Sharia supervisory boards of Islamic banks.

¹⁰⁵¹ Kashif Hasan Khan, 'A Critical Review of Shari'ah Supervision on Current Financial Transactions' (13 July 2012) <<http://www.financeokey.com/finance-market/a-critical-review-of-Shariah-supervision-on-current-financial-transactions.html>> accessed 28 November 2016.

Chapter Six: The Shortage of Islamic Banking Experts within the Iraqi Islamic Banking Industry

6.1. Introduction

In the previous chapter, the Sharia regulations and supervision of the Iraqi Islamic banking system have been critically evaluated. However, the human resource problem of the Islamic banking industry is the focus of chapter six. Thus, in this chapter, the third issue of the Islamic banking system of Iraq will be identified which is a shortage of qualified Islamic banking experts who understand Islamic banking transactions. Hence, chapter six will focus on the limitations of Sharia scholars and this issue will be addressed as well as critically evaluated. For this purpose, the methods utilized by the Islamic banking system of certain countries in dealing with this challenge and minimising the impact of the shortage of Islamic banking experts will be illustrated. Therefore, the approach of Bahrain and Malaysia will be evaluated and criticised to resolve the issue of the shortage of qualified Islamic banking experts in Iraq.¹⁰⁵² Furthermore, some recommendations will be made for resolving the problem using these countries' Islamic banking systems. Therefore, some possible solutions will be described to address the problem such as the establishment of a consulting firm or establishing a special Sharia supervisory board which comprises of Sharia scholars from each Islamic bank. Thus, this chapter addresses research question number [4] which is: What are the human resource issues that negatively impact the Iraqi Islamic banking system, and how can they be resolved as accomplished by other countries' Islamic banking systems?

Therefore, the following main points will be examined in this chapter:

- The shortage of qualified Islamic banking experts in Iraq.
- The problem of the shortage of Sharia scholars in the Islamic banking industry and finding solutions from other countries.
- Qualification and appointment of the Sharia scholars.
- Critical analysis of this issue and proposing solutions for the Iraqi Islamic banking industry.

There is no doubt that the Islamic banking industry needs experts for managing the industry properly in order to be at the required level.¹⁰⁵³ Indeed, Sharia scholars and staff who have legal Sharia knowledge and knowledge in finance and banking systems are necessary for

¹⁰⁵² The Pakistani method will be also evaluated in brief because Pakistan too has a developed Islamic banking system.

¹⁰⁵³ Saeed Al-Muharrami and Daniel C. Hardy, 'Cooperative and Islamic Banks: What can They Learn from Each Other?' (2013) *International Monetary Fund* wp/13/184, 13.

managing the Islamic banking industry.¹⁰⁵⁴ Usually, experts who work in the Islamic banking industry have undergone training courses or have a degree in Islamic banking together with some experience, as required in Malaysia.¹⁰⁵⁵ Even though the problem of the shortage of Islamic banking experts affects many Islamic banks, some countries have enough numbers of Islamic banking experts in their central banks who can cover for the shortage to a certain extent.¹⁰⁵⁶

In Iraq, the shortage of qualified Islamic banking experts is not only a problem at the level of Islamic banking institutions but the CBI itself is faced with this challenge.¹⁰⁵⁷ At least, these other countries have enough Islamic banking experts in their central banks to run the Islamic banking business. A good example is BNM in Malaysia.¹⁰⁵⁸ Hence, the role of the CBI and Islamic banking institutions in Iraq in dealing with this problem will be discussed. Finally, this chapter will put forward some recommendations for the resolution of the shortage of qualified Islamic banking experts in Iraq.

6.2. Islamic Banking Experts in Iraq

In Iraq, the Islamic banking human resource problem has a negative impact on the banking sector in general and on the Islamic banking industry in particular.¹⁰⁵⁹ The shortage of Islamic banking experts is not always due to insufficient numbers of professionals, but also because

¹⁰⁵⁴ In other words, for the optimal regulation and organization of the Islamic banking industry, skilful experts are needed.

¹⁰⁵⁵ Mohamed Ben Youssef, 'Existing Central Shariah Supervisory Models' (2010) <http://www.academia.edu/4689012/Existing_Central_Shariah_Supervisory_Models> accessed 28 October 2016.

¹⁰⁵⁶ Such as Malaysia where there are several universities and some institutions offering a degree in Islamic banking at the graduate and postgraduate level, for example International Islamic University Malaysia.

See: IIUM, 'Institute of Islamic Banking and Finance' <<http://www.iium.edu.my/iiibf>> accessed 28 October 2016.

¹⁰⁵⁷ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

See also: Sahar Nasr 'Republic of Iraq: Financial Sector Review' (2010), The World Bank, Middle East and North Africa Region, 24.

¹⁰⁵⁸ This can be one of the differences between Iraq and other states that have an Islamic banking industry in relation to qualified experts. There are several Sharia experts in the SAC in the central bank in Malaysia. These qualified experts are respected, well-known scholars who have vast experience in banking, finance, economics, law and area of Islamic banking and finance. Dr. Mohd Daud Bakar, Prof. Madya Dr. Mohamad Akram Laldin, Prof. Dr. Engku Rabiah Adawiah Engku Ali and some others are very famous Sharia experts.

Bank Negara Malaysia, 'SAC' <http://www.bnm.gov.my/index.php?ch=en_about&pg=en_thebank&ac=439&lang=en> accessed 13 November 2016.

¹⁰⁵⁹ In other words, the shortage of Islamic banking experts will affect the development of the Islamic banking sector, and thus will affect Iraq's economic development. This is because the Islamic banking industry is an important part of the economic sector.

these professionals are not famous experts.¹⁰⁶⁰ Most Islamic banks wish to appoint well-known professionals on their Sharia supervisory boards. There are a lot of people who are qualified to be Sharia scholars and have been appointed as members of the Sharia supervisory board, but they are not amongst the top-ranking professionals.¹⁰⁶¹ However, the Islamic banks of Iraq are not seeking well-known Sharia scholars, but just require qualified Sharia scholars for their Sharia supervisory boards.

In Iraq, in addition to the shortage of the Sharia scholars, there is also a lack of legal and financial experts in the Islamic banking and financial fields to manage the Islamic banks.¹⁰⁶² Thus, the Iraqi Islamic banking industry has the problem of shortage of expertise in almost all aspects.¹⁰⁶³

The reason for the shortage of Islamic banking experts in Iraq is a lack of trainers and centres for producing experts as well as a lack of training courses in the Islamic banking field.¹⁰⁶⁴ Hence, opening specialist training courses and educating people to become specialists would be beneficial for the development of human resource in the Islamic banking industry.¹⁰⁶⁵

6.3. Lack of Qualified Islamic Banking Sharia Scholars

To enable the Sharia supervisory board to make the right decisions and provide staff with comprehensive advice, it is necessary to appoint in this board scholars who are experts in the Islamic banking business. In addition, these Sharia scholars should be qualified in issuing fatwa, as can be seen in the GCC Sharia supervisory boards.¹⁰⁶⁶ In fact, most of the scholars do not have any formal training in modern finance. Instead they only possess knowledge of Sharia law. Preferably, the scholars who work in Islamic banks have working experience in

¹⁰⁶⁰ There are a number of very famous Sharia scholars in the world and they are appointed to more than one Sharia supervisory board of Islamic banks such as, Sheikh Nizam Mohammed Yacoubi who sits on 85 Sharia boards, and Sheikh Dr Mohammad Ali Elgari who sits on 71 Sharia boards.

See: <<http://www.thenational.ae/business/industry-insights/finance/islamic-finance-industry-needs-more-experts>> accessed 27 December 2015.

¹⁰⁶¹ The National, 'Islamic finance industry needs more experts' <<http://www.thenational.ae/business/industry-insights/finance/islamic-finance-industry-needs-more-experts>> accessed 10 December 2016.

¹⁰⁶² Since the Islamic banking industry is governed by the central bank, legal experts are necessary for dealing with legal documents, laws and rules that are applicable for Islamic banks.

¹⁰⁶³ The Iraqi Islamic banking industry has a shortage of qualified Sharia scholars to be appointed for the Sharia supervisory boards of the Islamic banks. In addition, the Islamic banks in Iraq have a problem of lack of the staff who understand Islamic banking transactions properly.

¹⁰⁶⁴ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May2015).

¹⁰⁶⁵ Norhanim Dewa and Sabarudin Zakaria, 'Training and Development of Human Capital in Islamic banking Industry' (2012) 8 Journal of Islamic Economics, Banking and Finance 95, 97; Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

¹⁰⁶⁶ Rodney Wilson, 'The development of Islamic finance in the GCC' (2009) The Centre for the Study of Global Governance, London School of Economics, 8.

Sharia and Islamic law as well as in financial transactions, to enable better regulation and supervision of Islamic banking institutions.¹⁰⁶⁷ The Islamic banking industry needs more qualified experts because the industry is growing.¹⁰⁶⁸

An interview has been conducted by the New York Times with Sheikh Nizam Yaquby,¹⁰⁶⁹ one of the world's most respected Sharia scholars. He contends that the Islamic financial industry needs a large number of additional Sharia scholars. While there are many highly qualified Sharia scholars who are graduating, there is still not enough of them for the Islamic financial sector. This is because the Islamic financial sector is expanding very fast but the number of qualified experts in the field are not increasing at the required level. Thus, there are 50 to 60 qualified scholars estimated in the world available for running Islamic banks and providing advice to these banks internationally. However, this number is insufficient even for the Middle Eastern Islamic financial institutions, as ten times as many scholars are required for the Middle East alone.¹⁰⁷⁰ Therefore, the Islamic financial industry should invest more effort in resolving the shortage of qualified experts who can understand Islamic financial transactions.¹⁰⁷¹

The situation of the Islamic banking industry is worse in Iraq compared to other countries because the lack of Sharia experts is a problem not only among the Islamic banking institutions, but the CBI also suffers from this problem¹⁰⁷². There are some reasons behind this, for example, the Islamic banking industry is new in Iraq.¹⁰⁷³ In addition, the unstable political situation in

¹⁰⁶⁷ Nizam Yaquby, 'Islamic Finance in View of the Shari'ah' (1999), Proceedings of the Second Harvard University Forum on Islamic Finance: Islamic Finance into the 21st Century, Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University, 159, 161

¹⁰⁶⁸ The number of the Islamic banking experts should be increased side by side with the expanding Islamic banking business in the world.

¹⁰⁶⁹ Yaquby divides his time among several banks. One of them, HSBC, lists advisory roles for him at Abu Dhabi Islamic Bank, BNP Paribas, Dow Jones, Lloyds TSB, Citibank, Standard Chartered and others. Furthermore, he is also a board member of the AAOIFI, one of the world's top Islamic finance standards bodies

¹⁰⁷⁰ Mohammed Abbas, 'Shortage of scholars troubles Islamic banking' (Bahrain, 22 January 2008) <http://www.nytimes.com/2008/01/22/business/worldbusiness/22iht-22bank.4.9412578.html?_r=0> accessed 12 December 2016.

¹⁰⁷¹ In fact, the limitation of qualified Islamic banking experts does not stop continuing Islamic banking business, but it could slow down the development of the industry and as a result, affect country's economic and financial sector. As David Pace, chief finance officer at Unicorn Investment Bank in Bahrain said: "The industry can't wait that long," he said "Two to three years is about enough," he added "The lack of scholars does not mean the industry is paralyzed, but it slows down development" Business,

See: Mohammed Abbas, 'Shortage of scholars troubles Islamic banking' (Bahrain, 22 January 2008) <http://www.nytimes.com/2008/01/22/business/worldbusiness/22iht-22bank.4.9412578.html?_r=0> accessed 12 December 2016.

¹⁰⁷² TK Maloy, 'Islamic Banking in Iraq: A growing Niche' (Marco polis, 29 March 2013) <<http://www.marcopolis.net/islamic-banking-in-iraq-a-growing-niche-2903.htm>> accessed 13 December 2016.

¹⁰⁷³ Interview with Bashir Hadad, Sharia supervisory board member, Cihan Islamic Bank, (Erbil, May 2015).

Iraq¹⁰⁷⁴ also has its impact.¹⁰⁷⁵ Furthermore, there are no special centres or universities offering Islamic banking courses in the country.¹⁰⁷⁶ The thesis argues that these reasons should not be used as an excuse for the shortage of Islamic banking Sharia experts, as there are many methods that can be practiced by the Islamic banks or the CBI in Iraq to produce experts such as sending students to study for degrees in Islamic banking and finance in foreign universities.¹⁰⁷⁷

What are The Necessary Knowledge and Skills for Sharia Scholars?

Currently, Sharia scholars do not have sufficient knowledge in both Sharia and modern economics and finance although these information sets are complementary to each other.¹⁰⁷⁸ Thus, Sharia scholars need to gain knowledge regarding Islamic banking and modern banking systems. However, another possibility would be for the Sharia supervisory board to comprise of religious scholars, economists, bankers, lawyers and finance experts to provide for all areas of Islamic banking.¹⁰⁷⁹ In that regard, this thesis argues that a Sharia supervisory board of an Islamic bank should consist of scholars in such a way that each individual scholar of the board has all the related Islamic banking knowledge, rather than consisting of Sharia scholars where each scholar has different parts of the knowledge required.¹⁰⁸⁰ This is because it may be difficult for the members to understand each other if their areas of knowledge differ and if they have different technical languages.¹⁰⁸¹

This thesis argues that for becoming high qualified scholars in the field of Islamic banking, besides their knowledge of Sharia and modern economics and finance, a very good level of

¹⁰⁷⁴ Due to the unstable political and security situation in Iraq, neither Islamic banking experts nor academics from other countries come to serve in Iraq. Iraq does not have sufficient Sharia scholars who are qualified to be appointed as members of Sharia supervisory boards of Islamic banks. Furthermore, it does not have enough academics to teach Islamic banking courses in universities.

¹⁰⁷⁵ Sujata Ashwarya Cheema, 'Investing in Iraq: prospects and Challenges' Middle East Institute (New Delhi, 20 February 2013) <<http://www.mei.edu/content/investing-iraq-prospects-and-challenges>> accessed 13 December 2016.

¹⁰⁷⁶ Shortage of the academics and the security situation in Iraq are the reasons behind the lack of special departments or centres for education in Islamic banking. Due to the political and security situation, foreign academics do not come to Iraq and teach Islamic banking courses.

¹⁰⁷⁷ Due to the corruption in Iraq, sending student to take courses in Islamic banking may be affected by corruption. For example, students who are not eligible to take these courses may be sent. Thus, the people who are in charge of providing government scholarships may provide these scholarships only for their relatives or for people close to them.

¹⁰⁷⁸ To enable the Sharia scholars to cover and control Islamic banking transactions, contracts and all services, they should have complete knowledge in all areas of Islamic banking industry.

¹⁰⁷⁹ Iraj Toutounchi, 'An Analytical Review of Islamic Banking as Practiced in Iran' (1998) IDB, IRTI, 64.

¹⁰⁸⁰ It is possible for the Sharia supervisory board of the Islamic bank to cover all these specialities. However, the board may lose its speciality as it is the Sharia supervisory board, not any other council. Therefore, it is better for the members of the board to all have the required knowledge at the same time.

¹⁰⁸¹ Fuad Abdullah Al-Omar and Munawar Iqbal, 'Challenges Facing Islamic Banking in the 21st Century' (Proceedings of the Second Harvard University Forum on Islamic Finance: Islamic Finance into the 21st Century Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University. 1999).

proficiency in both English and Arabic is also necessary for the scholars. As for the English language, there are a few countries that have an advanced Islamic banking system where English is spoken such as Malaysia and Pakistan. As a result, most of the books and documents on Islamic banking in these countries are written in English. In addition, the Sharia scholars of Malaysia and Pakistan have high levels of proficiency in English.

This author believes that besides a high level of proficiency in the English language, proficiency in the Arabic language is also necessary as there are many books and texts on Sharia law and Sharia principles which are written in Arabic.¹⁰⁸² However, this thesis further argues that requiring a high level of proficiency in English or Arabic for Sharia scholars would depend on the country in which they are working. For instance, the Sharia supervisory members of the Arabic countries must know the Arabic language, because most of the staff is Arab. Likewise, it is necessary for Sharia scholars working in countries where English is the first language such as the UK to have a high level of proficiency in the English language. In fact, knowing both Arabic and English increases the ability of the scholars to make the right decisions regarding Islamic banking transactions.¹⁰⁸³

6.4. Benefits and Roles of Sharia Scholars

The main role of Sharia scholars in Islamic banks is to deal with Sharia matters such as keeping the bank's practice within the borders of Sharia law.¹⁰⁸⁴ The function of these scholars is limited to Sharia issues under Sharia supervisory boards. However, in an indirect way, the decisions that are made by the Sharia supervisory board affects the institution's management.¹⁰⁸⁵ Sharia supervision is vital in the case of Islamic banking¹⁰⁸⁶ because this type

¹⁰⁸² Ash-Shaikh H. Abdul Nazar, 'Shari'ah Supercision in Islamic Banks and Financial Institutions; An Overall Review' (2 August 2008) <<http://www.shaikhnazar.net/articles%20english4.htm>> accessed 13 November 2015.

¹⁰⁸³ This is because the Sharia supervisory member's language could depend on the country and the language that is used by this country. The members of the Sharia board must know the country's language first, as they may deal with staff and clients who do not know any other languages except the country's official language. Beside the country's official language, the members of the Sharia supervisory board should know English and Arabic for making better decision on any transaction.

¹⁰⁸⁴ Ash-Shaikh H. Abdul Nazar, 'Shari'ah Supercision in Islamic Banks and Financial Institutions; An Overall Review' (2 August 2008) <<http://www.shaikhnazar.net/articles%20english4.htm>> accessed 13 November 2016.

¹⁰⁸⁵ Although the Sharia supervisory board comprises numbers of Sharia scholars, they do not have any power to manage the banks; instead their main role is supervision of the institution and Sharia related matters, in some way they may interfere to bank's management. For example, the decision of the Sharia scholar could change some contracts between the Islamic bank and the clients, if the scholars believe that the contract is not compliant with the Sharia principles. Usually, such cases will happen when the managers of the bank do not have knowledge about one transaction or contract in the Sharia point of view.

¹⁰⁸⁶ State Bank of Pakistan, 'Strategic plan for Islamic banking in Industry Pakistan' <<http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy>> accessed 27 August 2013.

of institution is governed by Islamic law and so it is directly related to people's faith.¹⁰⁸⁷ This supervision is therefore useful first and foremost for the institution, but also for the clients. There are a range of benefits from having Sharia scholars, which include control over the financial institutions, guidance to management, and better governance, as detailed below:

- 1- **Control of Islamic Financial Institutions:** The Sharia scholars control all activities that are practiced by the Islamic institution. All contracts, products and transactions should be approved by the Sharia supervisory board before their release onto the market.¹⁰⁸⁸ The Sharia scholars usually issue an annual Sharia report about all the institution's activities at the end of the year.¹⁰⁸⁹ The report includes their views concerning the Islamic financial institution's activities. The report also evaluates the management's performance and the distribution of the net income return to relevant parties. Furthermore, by functioning as controls, the Sharia scholars will increase public confidence in Islamic banks and promote a level of transparency.¹⁰⁹⁰

Additionally, they also minimise the Sharia risk of the contracts that are conducted by the Islamic bank.¹⁰⁹¹ This thesis argues that because the Sharia supervisory board of the Islamic bank control all activities of the bank, this would result in the members of the boards having a very high level of knowledge in *Fiqh muamalat*¹⁰⁹² and Sharia principles. In addition, the members of the board should work and prepare the annual report free from any influence by the Islamic banking managers and staff.

- 2- **Guidance to The Management:** The Sharia scholars would guide managers through workshops and lectures designed to inform the directors and explain any unclear issues. It is clear that some of the Islamic banking managers come from western banking

¹⁰⁸⁷ The Islamic banking industry is based on the religion of Islam and Sharia principles that relate to Muslim's belief. There are also non-Muslims that deal and invest with Islamic banks but the majority of investors are Muslims. In addition, the religion is the most important reason for the most of the Muslims to invest with Islamic banks.

¹⁰⁸⁸ Fuad Abdullah Al-Omar and Munawar Iqbal, 'Challenges Facing Islamic Banking in the 21st Century' (Proceedings of the Second Harvard University Forum on Islamic Finance: Islamic Finance into the 21st Century Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University. 1999).

¹⁰⁸⁹ The Sharia supervisory board's report of any Islamic bank consists of the opinion of the Sharia scholars of the board on all activities that are provided by the Islamic bank in general. However, if there is any non-compliant Islamic banking transaction for the Islamic bank, it should be stated in the report.

¹⁰⁹⁰ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386.

¹⁰⁹¹ Juan Sole, 'Introducing Islamic Banks into Conventional Banking Systems' (2007) International Monetary Fund 7/175, 4<<http://www.imf.org/external/pubs/ft/wp/2007/wp07175.pdf>> accessed 12 November 2016

¹⁰⁹² *Fiqh mumalat* is an Islamic commercial law that deals with people in relation to buying and selling goods. In the financial system, *Fiqh mumalat* deals with Islamic financial products.

systems, such as in Iraq.¹⁰⁹³ Thus, any new Sharia issue should be explained to the managers by the Sharia scholars.¹⁰⁹⁴ In addition, it is the role of the Sharia scholars of the Supervisory board to guide and clarify the method of paying and calculating Zakat.¹⁰⁹⁵ Due to the Sharia scholars' religious and social position in the society, sometimes they also act to solve legal disputes between the bank and the clients.¹⁰⁹⁶ The author submits that the Sharia scholars are preferred to have teaching experiences to guide the staff and managers of the bank. Furthermore, the scholars should know teaching and education methods in to provide advice to staff and managers.

- 3- **Effective Governance:** For Sharia scholars to have effective governance, they should be independent. The Sharia supervisory board should have complete freedom and its members should not be influenced by any other body regarding their governance function.¹⁰⁹⁷ According to the Accounting and Auditing of Islamic Financial Institutions (AAOIFI) governance standards, Sharia supervision should be discussed solely between the shareholders and the board of Directors, to ensure it is not affected by any other interest. Sharia scholars do not have any executive powers and hence they do not have any ownership of the institution. This independence enhances the stakeholders' confidence in the decisions that are made by the Sharia supervisory board.¹⁰⁹⁸ The thesis argues that the independence of the Sharia members of the boards is not easy to implement in practice while they are being paid by the institution.¹⁰⁹⁹

It appears such that for the Sharia scholars of the Islamic bank to conduct their performance in a better way, the bank should give them assistance and facilitate methods for them to achieve their aims.¹¹⁰⁰ Therefore, the independence of the Islamic banking scholars must be one of the

¹⁰⁹³ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks Between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

¹⁰⁹⁴Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386.

¹⁰⁹⁵Wafik Grais and Matteo Pellegrini, 'Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services: Issues and Options' (2006), World Bank, WPS4054, 4.

¹⁰⁹⁶Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386.

¹⁰⁹⁷ Yusuf Talal delornzo, 'Shari'ah Supervision in Modern Islamic Finance' Guidance Residential, Modern Finance timeless value <https://www.guidanceresidential.com/blog/wp-content/uploads/2015/05/shariah_supervision_in_modern_islamic_finance.pdf> accessed 11 November 2016.

¹⁰⁹⁸Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386.

¹⁰⁹⁹ For details about Sharia scholars' independence, see Chapter Five: Non-independence, P.195.

¹¹⁰⁰ The Islamic bank should not influence scholars to give their opinion and their view in accordance to the Islamic banking interest without concerning Sharia principles. Thus, in order for the Islamic bank to be active, the Sharia law's interest should be above all other interests such as personal interests.

most important basic principles of the Islamic bank.¹¹⁰¹ The Islamic bank also should facilitate the scholars to run training courses and workshops for the staff who work in the bank.¹¹⁰² All staff, especially managers, should receive regular training in order to be familiar with the latest Islamic banking Sharia issues and regulations.¹¹⁰³

In the case of Iraq, the Islamic banks should facilitate Sharia scholars to share their views on transactions that are conducted by the Islamic bank.¹¹⁰⁴ Moreover, the Islamic bank should assist Sharia scholars to educate staff about Islamic banking practices. In addition, the Islamic bank should abide by the decisions of the Sharia scholars.¹¹⁰⁵ It is worth mentioning that apart from the above roles of the Sharia scholars, issuing Fatwa is one of the most important functions of the Sharia scholars.

The Role of the Scholars in Issuing Fatwa (Islamic Legal Opinion)

Fatwa is one of the most important roles Sharia scholars play in some circumstances such as regarding new products.¹¹⁰⁶ In the field of Islamic banking and finance, a fatwa is a religious opinion by a qualified Sharia scholar on the structure of Islamic financial products and transactions.¹¹⁰⁷ Financial fatwas play an integral part in the development of Islamic financial products, as without an explicit authorisation from a Sharia viewpoint, such products cannot be successfully marketed.¹¹⁰⁸

¹¹⁰¹Hussain G. Rammal, 'The Importance of Shari'Ah Supervision in Islamic Financial Institutions' (2006) 3 Corporate Ownership and Control 1, 2.

¹¹⁰²Elwaleed M. Ahmed, 'Sharia Advisory Board's Vital Role In the Rapid Devolvement of ever complex Islamic Financial Products and Instruments' Sudanese Economist (21 April 2011) <<http://www.sudaneseconomist.com/?p=292>> accessed 11 November 2016.

¹¹⁰³ For educating and facilitating the Sharia scholars' duties and jobs, Islamic banks should provide funds for this purpose.

¹¹⁰⁴ Islamic banks should follow all the decisions and advice from the Sharia scholars. Thus, Islamic banks should provide all documents that are necessary for the Sharia scholars to investigate to decide on any transaction.

¹¹⁰⁵ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank, (Erbil, May 2015).

¹¹⁰⁶ In other words, Fatwa is issued by scholars or, better to say, by Sharia supervisor members of the Islamic financial institution and members of the central Sharia board if it is established.

¹¹⁰⁷ Humayon Dar, 'Fatwa and transaction costs in Islamic finance' The Express Tribune (8 September 2013) <<http://tribune.com.pk/story/601629/quest-for-compliance-fatwa-and-transaction-costs-in-islamic-finance/>> accessed 12 November 2016.

¹¹⁰⁸ Humayon Dar, 'Fatwa and transaction costs in Islamic finance' The Express Tribune (8 September 2013) <<http://tribune.com.pk/story/601629/quest-for-compliance-fatwa-and-transaction-costs-in-islamic-finance/>> accessed 11 November 2016.

Hence, it is the Sharia scholar's role to issue fatwa on any new product or service to confirm whether or not the product or service is acceptable under the Sharia law.¹¹⁰⁹ As stated by Rodney Wilson:

The rulings of Sharia scholars are referred to as fatwa, and these are derived through reasoning and attempting to apply fiqh to contemporary economic and financial transactions. This process is referred to as *ijtihad*, and in practice involves reading the contractual documentation governing economic activity and financial transactions and ensuring that it is consistent with the Sharia.¹¹¹⁰

The scholars and Sharia members of the Sharia supervisory board of the Islamic bank should have the following qualifications in order for these members to be qualified to issue fatwa:

- Know the verses of Qur'ān pertaining to the ruling at hand;
- Know the reason behind the verses of Qur'ān related to the ruling – when each was revealed and why;
- Distinguish the supportive and oppositional verses of the Qur'ān;
- Know all the hadith pertaining to the ruling and the soundness of their chain of transmission;
- Be familiar with the legal precedents of the issue before him, including the arguments or consensus reached by earlier scholars; and
- Be well-versed in the syntax, grammar, pronunciation, idioms, special linguistic uses, customs and culture prevalent at the time of the Prophet (s) and succeeding two generations¹¹¹¹

In fact, it is difficult to find scholars who have all these qualifications in order to be qualified to issue fatwa. The thesis argues that for the Sharia scholar to understand the verses of Quran and the reason behind these verses, the scholar has to have perfect command of the Arabic language and its grammar. In addition, the Sharia scholar should have enough knowledge of Islamic history and Islamic culture. Furthermore, the scholar should have sufficient knowledge in *Ahadith*, *qiyas* and *ijmaa*. Thus, finding a Sharia scholar who has all these attributes is very difficult.¹¹¹² Therefore, scholars are allowed to contact other qualified people who are not members of the Sharia board through email or phone to ask their opinion about any new product.¹¹¹³ It is possible for each country to have its own council of fatwa either as part of the

¹¹⁰⁹ Nurhastuty Wardhany and Shaista Arshad, 'The Role of Shariah Board in Islamic Banks: A Case Study of Malaysia, Indonesia and Brunei Darussalam' (2012) ISRA, 2nd ISRA Colloquium, 2.

¹¹¹⁰ Rodney Wilson, 'Islamic Economics and Finance' (2008) 9 World Economics, 177, 178.

¹¹¹¹ Shaykh Muhammad Hisham Kabbani, 'What is Fatwa?' The Islamic Supreme Council of America, <www.islamicsupremecouncil.org/understanding-islam/legal-rulings/44-what-is-a-fatwa.html> accessed 11 November 2016.

¹¹¹² Due to the reason that, there are few numbers of qualified Sharia scholars for issuing fatwa, Islamic banks could take fatwa from other countries fatwa boards or council, such as in Saudi Arabia.

¹¹¹³ Rod Monger and Mufeed Rawashdeh, 'Islamic Finance Enter the Mainstream' (2008) 9 Management Accounting Quarterly 1, 5.

central Sharia board or as part of the central bank.¹¹¹⁴ However, the thesis submits that an international fatwa council should be established because one fatwa council would be able to standardise the fatwa of all Islamic financial institutions in the world.¹¹¹⁵ In addition, all qualified scholars who have the right to issue fatwa can be a member of this international council, which can enhance fatwa.

It should be kept in mind that the fatwa is needed when there is no clear text from the Quran and the Sunna on any issue.¹¹¹⁶ The fatwa board is important for the verification of Islamic banking transactions and services, particularly regarding new products.¹¹¹⁷ The author argues that the fatwa board should have the appropriate power and that their fatwas are binding on all parties. In such cases, the central bank is better suited to have this responsibility.¹¹¹⁸ It is most important to have a council of fatwa as a part of the central bank or as a part of a central Sharia board to bear the responsibility of issuing fatwa on Islamic banking contracts and transactions.¹¹¹⁹ One of the functions of the central Sharia board will be the issuance of fatwa and the avoidance of conflicts between fatwa issued from different Sharia boards of Islamic banks.¹¹²⁰

Issuing of the Fatwa in Islamic Finance in Iraq

In Iraq, Islamic banks have a fatwa problem, as currently there are no modern fatwas.¹¹²¹ Thus, this thesis argues that there is a need for a central Sharia board which consists of some muftis to issue fatwa as well as govern and monitor Islamic financial institutions in Iraq in a better

¹¹¹⁴ In country like Pakistan for example, the Sharia advisory board of the State Bank of Pakistan have the role of issuing fatwa on Islamic banking products. In addition, the SAC in Malaysia have a right to issue fatwa and the courts should abide by these fatwas from the council.

See: Humayon Dar, 'Fatwa and transaction costs in Islamic finance' The Express Tribune (8 September 2013) <<http://tribune.com.pk/story/601629/quest-for-compliance-fatwa-and-transaction-costs-in-islamic-finance/>> accessed 11 November 2016.

¹¹¹⁵ In fact, there is no international fatwa council that all Islamic countries depend on its fatwas. Most of the Sunni people depend on Islamic Fiqh Academy of Jeddah in Kingdom of Saudi Arabia, while Shia people depend on fatwas that are issued by their Imams.

¹¹¹⁶ Humayon Dar, 'Fatwa and transaction costs in Islamic finance' The Express Tribune (8 September 2013) <<http://tribune.com.pk/story/601629/quest-for-compliance-fatwa-and-transaction-costs-in-islamic-finance/>> accessed 11 November 2016.

¹¹¹⁷ In that regard, it is necessary for the Sharia advisory boards of Islamic banks to have scholars that are qualified for issuing fatwa for new products and services provided by Islamic banks.

¹¹¹⁸ Humayon Dar, 'Fatwa and transaction costs in Islamic finance' The Express Tribune (8 September 2013) <<http://tribune.com.pk/story/601629/quest-for-compliance-fatwa-and-transaction-costs-in-islamic-finance/>> accessed 11 November 2016.

¹¹¹⁹ Hisam Abdul Nabi, 'Different views on Unify Sharia Supervisory Boards of Banks' (Alemarite Alyum 22 September 2011) <<http://www.emaratalyom.com/business/local/2011-09-22-1.424660>> accessed 11 November 2016 (translated from the original Arabic text by the author).

¹¹²⁰ Rafisah Mat Radzi and Nurul Aini Muhamed, 'An International Comparative Study on *Shariah* Governance Supervision of *Sukuk* Defaults' (2012) 8:3 *Journal of Islamic Economics, Banking and Finance* 20, 30.

¹¹²¹ Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank, (Erbil, May 2015).

way. In Iraq, the members of the Sharia supervisory boards of Islamic banks do not have an ability to issue fatwa¹¹²² and there is no central Sharia board to be responsible for issuing fatwa. Therefore, as a temporary solution to the lack of issuance of fatwa in Iraq, the author submits that for the time being, Sharia supervisory boards of Iraqi Islamic banks can apply fatwas that are issued by other countries' Fiqh councils, such as the Islamic Fiqh Academy of Jeddah in the Kingdom of Saudi Arabia.¹¹²³ Nevertheless, the author further argues that the Islamic Fiqh Academy Council is not specialized in Islamic finance but the council still issues fatwa on general matters including fatwa in the area of Islamic banking and finance. Therefore, establishing a Fatwa council for Islamic finance is recommended. Such a fatwa council could include specialized Sharia scholars in Islamic banking and finance.¹¹²⁴ In fact, establishing a special fatwa council could enhance Islamic banking even more. The council would consist of Sharia scholars and their role would be to issue fatwa in Islamic banking and finance only. As such, their fatwas would be more reliable as they only focus on Islamic finance.

6.5. Skilful Islamic Banking Staff and Employees

Since Islamic banking business is based on religion and Sharia principles, all services should be conducted in accordance with Sharia law.¹¹²⁵ Therefore, alongside the Sharia scholars of the Islamic banking Sharia supervisory boards which are needed in the industry,¹¹²⁶ the staff of the bank are also required to have knowledge about Islamic banking transactions and services.¹¹²⁷ The employees of Islamic banks should have good knowledge about Sharia principles and also possess deep knowledge regarding banking and economics.¹¹²⁸ Most of the staff of Islamic banks, including even bank managers, do not have sufficient knowledge of Islamic banking

¹¹²² Hashm Ahmed mentioned that some Sharia supervisory boards' members issue fatwa for the Islamic bank's interest which is not a right fatwa. Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

¹¹²³ Bashir Hadad in his interview mentioned that Islamic banks of Iraq can depend on other countries fatwa councils, such as the Fiqh Council of Kuwait. Interview with Bashir Hadad, Sharia supervisory member, Cihan Islamic Bank. (Erbil, May 2015).

¹¹²⁴ In fact, if there is an international Sharia board for Islamic finance, this board can include Sharia scholars who are qualified to issue fatwa in matters relating to Islamic banking.

¹¹²⁵ Albaraka, 'Principles of Islamic Banking' <<http://www.albaraka.com/default.asp?action=article&id=46> > accessed 12 November 2016.

¹¹²⁶ Salman Ali and Faryal Farrukh, 'Islamic Banking: Is the Confidence Level of Being an Islamic Banking Employee Better Than Conventional Banking Employee? An Exploratory Study Regarding Islamic Banking' (2013) 4 Journal of Business Studies Quarterly 27, 39.

¹¹²⁷ Due to the fact that Islamic banking is different from conventional banking, staff who have legal and Sharia experience of Islamic banking are necessary for running the Islamic banking industry.

¹¹²⁸ Yasir Saud Dahlawi, 'Tools for Comprehensively Qualifying the Employees of Islamic Financial Institutions, and the Role of Sharia Boards and Relevant Institutions in Sharia Training' (the 5th conference of the Sharia Boards of Islamic Financial Institutions, the Kingdom of Bahrain, November 2005).

business as they come from conventional backgrounds.¹¹²⁹ Thus, they need to attend training courses and workshops in order to better understand Islamic banking transactions.¹¹³⁰

In fact, there are no unified standards for the Islamic bank's staff. In other words, the knowledge possessed by Islamic banking staff regarding Islamic banking business may differ from person to person. Some of them may be informed on Sharia principles but do not have skills in banking and finance, while some are experts in banking and finance but without the knowledge of Sharia rules. Therefore, unified standards are necessary for selecting qualified staff for Islamic banks. Consequently, Islamic banks can provide their staff with training courses and the Sharia boards can have their role in such processes.¹¹³¹

In that context, the International Islamic Fiqh Academy recommends that Islamic banks provide training program for their staff:

Islamic banks should pay attention to developing competencies of the leadership and employees in the form of professional experience with consciousness of the nature of Islamic banking work and they should provide appropriate training programs in cooperation with the Islamic Research and Training Institute and all other institutions concerned with training in Islamic finance.¹¹³²

This thesis argues that each unit or employee of the Islamic bank has their own jobs which are possibly different from one another. In this regard, Islamic banks should open special training courses and workshops as per the staff's occupation in the bank. Thus, accounting staff should be trained in accounting in relation to the Sharia principles while legal staff should be trained in legal matters relating to the Sharia principles and so on depending on their work and responsibility.¹¹³³ In addition, regarding legal aspects of the industry, there should be legal experts who have knowledge of the financial law and regulatory system. There are Islamic banking legal experts who are knowledgeable in modern finance¹¹³⁴ but the problem is, they

¹¹²⁹ Fuad Abdullah Al-Omar and Munawar Iqbal, 'Challenges Facing Islamic Banking in the 21st Century' (Proceedings of the Second Harvard University Forum on Islamic Finance: Islamic Finance into the 21st Century Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University. 1999).

Also see: Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks Between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

¹¹³⁰ Interview with Armagan Bayrem, corporate banking director, Al-baraka Islamic Bank, (Erbil, June 2015).

¹¹³¹ Salman Ali and Faryal Farrukh, 'Islamic Banking: Is the Confidence Level of Being an Islamic Banking Employee Better Than Conventional Banking Employee? An Exploratory Study Regarding Islamic Banking' (2013) 4 Journal of Business Studies Quarterly 27, 39.

An Exploratory Study Regarding Islamic Banking

¹¹³² the International Islamic Fiqh Academy, Resolution No. 76 (7/8)

¹¹³³ Yasir Saud Dahlawi, 'Tools for Comprehensively Qualifying the Employees of Islamic Financial Institutions, and the Role of Sharia Boards and Relevant Institutions in Sharia Training' (the 5th conference of the Sharia Boards of Islamic Financial Institutions, the Kingdom of Bahrain, November 2005).

¹¹³⁴ Frederick V. Perry and Scheherazade S. Rehman 'Globalization of Islamic Finance: Myth or Reality?' (2011) 1 International Journal of Humanities and Social Science 107, 117.

do not have Sharia knowledge. However, all employees should be trained in Sharia principles related to Islamic finance because they deal with transactions and services based on Sharia rules, which are more important than other skills such as product knowledge.¹¹³⁵

Regarding Bahrain, Islamic banks in Bahrain can benefit from BIBF¹¹³⁶ for training their staff, bankers and managers.¹¹³⁷ On the other hand, in Malaysia, there are some entities which train Islamic banking staff and managers, such as INCEIF,¹¹³⁸ the Malaysian International Islamic Financial Centre (MIFC) and the Sharia Knowledge Centre that exists in most Islamic and commercial banks. These entities are evidences for supporting training courses for the growth of the Islamic finance.¹¹³⁹

Shortage of Staff in Iraqi Islamic Banks

In the case of Iraq, most of the staff and managers that work in Islamic banks have conventional experience and they do not have sufficient skills in Islamic banking transactions.¹¹⁴⁰ On the other hand, most of the legal advisors and staff who work in Islamic banking institutions in Iraq are not knowledgeable about Sharia principles.¹¹⁴¹ In Iraq, there are no standards to determine the required knowledge and skills of the staff and managers of the Islamic banks. Even in the Internal Instruction 2006, there aren't any specific qualifications mentioned for the staff of Islamic bank. Thus, Islamic banks in Iraq depend on the staff of conventional banks. In fact, it is necessary for the Iraqi Islamic bank's staff and managers to have knowledge of the Sharia principles relating to Islamic banking.¹¹⁴² Thus, this thesis argues that the CBI regulators could draw inspiration from other countries which have experience in training and producing

¹¹³⁵ Norhanim Dewa and Sabarudin Zakaria, 'Training and Development of Human Capital in Islamic Banking Industry' (2012) 9 Journal of Islamic Economics, Banking and Finance 95, 100.

¹¹³⁶ For details on BIBF, see 6.7.1 of this chapter.

¹¹³⁷ Bahrain Institute of Banking and Finance, 'Home' <<http://www.bibf.com/home/>> accessed 14 November 2015.

¹¹³⁸ For details on INCEIF, see 6.7.2 of this chapter.

¹¹³⁹ Norhanim Dewa and Sabarudin Zakaria, 'Training and Development of Human Capital in Islamic Banking Industry' (2012) 9 Journal of Islamic Economics, Banking and Finance 95, 105.

¹¹⁴⁰ Hashim Omer Hamoudi, 'Towards Activating the Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260 (translated from the original Arabic text by the author).

¹¹⁴¹ In other words, in Iraq, Islamic banking staff may have knowledge in financial laws and regulations and they have conventional banking understanding but in Sharia rules and principles they do not have even basic knowledge.

¹¹⁴² It is difficult for Iraqi Islamic banks to have such experts with knowledge and experience in legal and Sharia aspects. Therefore, creating legal and Sharia experts in the Islamic banking sector is necessary for developing and enhancing the Islamic banking system in Iraq. As a new player, the Islamic banking industry in Iraq needs human capital in many areas, such as in legal and Sharia aspects.

Islamic banking experts in order to perform better and create more skilful experts.¹¹⁴³ For instance, the Iraqi government could facilitate the private sector to have occasional workshops in order to develop their staff's capacity, such as the two day workshop in the Swedish Embassy in Baghdad.¹¹⁴⁴

In fact, Islamic banks in Iraq are mostly responsible for the lack of qualification among their staff. Islamic banks do not provide sufficient funds for the training of their staff and managers because it may cost them a lot. Thus, this thesis argues that Iraqi Islamic banks could cooperate in bringing Islamic finance trainers from other countries such as Bahrain¹¹⁴⁵ for the education and training of their staff and managers. In this case, the cost could be divided among all Islamic banks which would help to minimise the cost.¹¹⁴⁶

6.6. How Other Countries Are Resolving the Issue of a Shortage of Islamic Banking Experts

Each country has its own way to deal with the problem of the shortage of qualified Islamic banking experts as per the country's situation. In some countries that have a large number of Sharia scholars, the member of one Sharia supervisory board of an Islamic bank cannot serve on another Sharia board in the same industry, the best example is Malaysia.¹¹⁴⁷ In Malaysia, according to the Guidelines on the Governance of Shariah Committee of BNM (BNM/GPS 1), members of the Sharia supervisory boards cannot serve in the SAC or they cannot serve in more than one Sharia supervisory board at the same time.¹¹⁴⁸ It is stated in Article vi (restrictions on Shariah committee):

¹¹⁴³ For the existing experts, the CBI can open training courses and workshops to build better human capital for the Islamic banking industry. The financial regulators in Iraq can take every possible method to find solutions for the issue of the shortage of experts.

¹¹⁴⁴ 'The **Private Sector Development Centre (PSDC)** in Iraq in partnership with **Chamber Trade Sweden** and the support of **The World Bank** and **SIDA** carried out a 2-day workshop at the Swedish Embassy in Baghdad on the 2nd and 3rd of September 2013. Participants included members of the Iraqi private sector and business associations, Iraqi public servants, representatives from leading Chambers of Commerce as well as notable international experts in their respective fields, amongst others'.

See: The Private Sector Development Center, 'The Private Sector Development Center Workshop with the support of The World Bank and SIDA' (29 August 2013) <<http://www.psdc-iraq.org/private-sector-development-center-workshop-support-world-bank-and-sida>> accessed 11 November 2016.

¹¹⁴⁵ Bahrain is preferred because it is an Arab country which has the same language as used in Iraq. In addition, Bahrain has a considerable number of experts because the BIBF is offering courses in Islamic banking.

¹¹⁴⁶ The CBI could also develop the University of Human development (UHD) in Iraq to open a special department for Islamic banking and finance.

¹¹⁴⁷ Amir Shaharuddin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 *Jurnal Ekonom* 53, 55.

¹¹⁴⁸ The Malaysian way does not work for Iraq because Iraq has a lack of Islamic banking Sharia scholars. However, if there are enough numbers of Sharia scholars in one country, then the Malaysian way is the best as it could avoid conflict of interest between Islamic banks.

19. The members of the Shariah Committee are subjected to the following restrictions:
- (a) In line with section 16B(6) of the Central Bank of Malaysia Act 1958, an Islamic financial institution is not allowed to appoint any member of the SAC to serve in its Shariah Committee; and
 - (b) To avoid conflict of interest and for reasons of confidentiality within the industry, an Islamic financial institution shall not appoint any member of a Shariah Committee in another Islamic financial institution of the same industry.¹¹⁴⁹

In Malaysia, there is a restriction preventing members of the Sharia boards from serving in more than one board of the same industry. On the other hand, in some countries it is permitted for members of the Sharia supervisory board to serve on more than one board as a solution to the shortage of Islamic banking experts such as in GCC countries.¹¹⁵⁰ However, in most of the other countries that have Islamic banks, there are no such restrictions except in Pakistan¹¹⁵¹ where it is the same as in Malaysia.¹¹⁵² In Pakistan, the Sharia advisor of one Islamic financial institution cannot serve in other Islamic financial institutions. In that context, some effort for the training and graduating of additional Islamic banking experts have been made by some centres and institutions.¹¹⁵³ Regarding Iraq, it also needs to establish enough training centres to provide training courses for Islamic bankers and Sharia scholars.

However, in Iraq, there are no special methods for producing Islamic banking experts because there are no special Islamic banking centres for teaching and training in Islamic banking. Some Islamic banks in Iraq attempted to fill the gap of limited Sharia experts by appointing some scholars who do not have sufficient knowledge in finance, modern economics, law and banking transactions.¹¹⁵⁴ In fact, they are men of religion (*imam*) who have knowledge only in Sharia

¹¹⁴⁹ Guidelines on the Governance of Shariah Committee of BNM, Article vi.

¹¹⁵⁰ Zulkifli Hasan, 'Regulatory Framework of *Shari'ah* Governance System in Malaysia, GCC Countries and the UK (2010) 3 Kyoto Bulletin of Islamic Area Studies 82–83.

¹¹⁵¹ In Pakistan, each Islamic bank is required to have a Sharia advisor and this advisor can only serve in one Islamic bank

Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 141.

¹¹⁵² Amir Shahrudin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Jurnal Ekonom 53, 55.

¹¹⁵³ According to the interview conducted by the New York Times, the Chartered Institute of Management Accountants that is based in London has said that the "rapid growth of Islamic banking had fuelled a need for both Muslim and non-Muslim financial experts". It is seeking to establish a diploma, and perhaps a master's degree in conjunction with a university.

See: Mohammed Abbas, 'Shortage of scholars troubles Islamic banking' (Bahrain, 22 January 2008) <http://www.nytimes.com/2008/01/22/business/worldbusiness/22iht-22bank.4.9412578.html?_r=0> accessed 11 November 2016.

¹¹⁵⁴ Most of the Sharia boards' members of Islamic banks in Iraq are religious people who come from the mosque. They may have an academic background and certificate but not in finance or banking, instead they have knowledge of Sharia and Islamic studies which is not sufficient for someone to be capable as a Sharia expert to be appointed in Sharia board of Islamic financial institutions.

and Islamic religion¹¹⁵⁵ and they are not qualified to be appointed as members of the Sharia boards.¹¹⁵⁶

Thus, the author argues that appointing *imams* as a member of the Sharia supervisory board for Islamic banks does not develop the industry. Most of the *imams* are not specialists in Islamic banking transactions and contracts. In addition, these people are not qualified to make decisions on any new products because most of the *imams* are not qualified to issue fatwas.

To resolve this problem, it is better to look closely at the Islamic banking system of Bahrain and Malaysia to see how these two countries tackle the shortage of Islamic banking experts. First, the methods in both Malaysia and Bahrain will be evaluated and analysed and then, the Iraqi Islamic banking system will be examined in the context of a lack of Islamic banking experts.

6.6.1. Bahraini Approach

Bahrain has an advanced Islamic banking system.¹¹⁵⁷ It is an international centre of Islamic finance.¹¹⁵⁸ Bahrain's own financial sector is well developed and continues to play an important part in developing the country's economy.¹¹⁵⁹ Bahrain has a strong economic system in the Middle East,¹¹⁶⁰ as shown by the real GDP growth of 4.2% in 2014.¹¹⁶¹ Thus, the percentage of the country's GDP increased from 29 to 52.1 from 2011 to 2015.¹¹⁶² In Bahrain, the Islamic banking system manages to compete equally alongside the conventional banking system, even

¹¹⁵⁵ In Iraq, Islamic banks appoint Imams (men of religion who lead Muslims for pray in mosques) or who have knowledge in Sharia as member of their Sharia supervisory boards. Those Imams do not have experience and knowledge in Islamic banking transactions and services provided by Islamic banks. It seems that Islamic banks try to have Sharia supervisory boards that consist of at least three members to comply with the CBI without concern whether these scholars are qualified or not.

¹¹⁵⁶ Interview with Hashm Ahmed, university lecturer, Soran University, (Soran, May 2015).

¹¹⁵⁷ Bahrain's Islamic banking industry in particular considered as a key player in its financial market. Global Investment House, 2008, Bahrain Islamic Bank: Strong Growth Continues, Global research, 10.

¹¹⁵⁸ The Kingdom of Bahrain started growing as a financial centre in the 1970s, when there was a sharp rise in oil price, and it is now considered as a leader in relation to the Islamic financial industry among Arab countries and the Gulf region. Bahrain has been a pioneer of Islamic finance in the Middle East, and its role in enhancing Islamic finance worldwide cannot be denied. It is one of the most significant countries in the Gulf region, as it has an important role in relation to the region's financial sector.

E S Hersh 'Islamic Finance and International Financial Regulation' (2011) Spring Issue Journal of International Service 58.

¹¹⁵⁹ Bahrain is thus seen as a hub for Islamic banking in the Middle East.

Dr. K A Hussein 'Banking Efficiency in Bahrain: Islamic VS Conventional Banks' (2004), Islamic Development Bank, Research Paper, No. 68, 9.

¹¹⁶⁰ Global Investment House, 2008, Bahrain Islamic Bank: Strong Growth Continues, Global research, 5.

¹¹⁶¹ Kingdom of Bahrain, 'Economic Yearbook 2013' Economic Perspective 19 <<http://www.bahrainedb.com/en/EDBDocuments/Bahrain-Economic-Yearbook.pdf>> accessed 24 October 2016.

¹¹⁶² CBB, Economic Indicator, <<http://www.cbb.gov.bh/assets/E%20I/EI%20Sep2015.pdf>> accessed 25 October 2016.

though the latter is considered as the global banking system and generally is used more widely than Islamic banking, especially in the West and in non-Muslim countries.¹¹⁶³

It could be said that the development of the Bahraini Islamic banking system is due to the fact that Bahrain has a number of qualified Islamic banking experts who can control and manage the industry.¹¹⁶⁴ Bahrain has a special mechanism¹¹⁶⁵ for training and producing Islamic banking experts for governing Islamic banking industry in the country. Each year, multiple students graduate after obtaining a degree in the field of Islamic banking in Bahrain and they work as new knowledgeable staff in Islamic banking.¹¹⁶⁶ In addition, there are some courses and workshops for staff who work in Islamic banks.¹¹⁶⁷ Therefore, the Islamic banking industry in Bahrain attempts to cover for the shortage of qualified experts in the field. Both the Bahrain Institute of Banking and Finance (BIBF) and the Waqf Fund have a crucial role in training and producing Islamic banking experts in Bahrain. The BIBF acts as an education and training centre and the Waqf Fund acts as a sponsor for students to study in the BIBF or other universities to obtain knowledge in Sharia, banking, finance, accounting and business.¹¹⁶⁸

The Role of the Bahrain Institute of Banking and Finance (BIBF)

The BIBF is an institute which was founded in Bahrain in 1981 to support the financial sector of the country.¹¹⁶⁹ As such, the institute provides education and training courses to the financial sector, organisations, and individuals at their request. It also offers an extensive range of internationally and locally recognised professional qualifications.¹¹⁷⁰ One of the most important objectives of this institute is to offer training and education in Islamic banking,

¹¹⁶³Abul Karim Aldohni, 'The Emergence of Islamic banking in the UK: A comparative Study with Muslim Countries' (2008) 22 Arab Law Quarterly 180, 189.

¹¹⁶⁴ In other words, there is no doubt that having this advanced Islamic banking system in Bahrain means that there are numbers of legal and Sharia experts in the Islamic banking industry in the country.

¹¹⁶⁵ Cooperation between the BIBF and the Waqf fund for sponsoring students to obtain a degree in Islamic banking and finance.

Bahrain Institute of Banking and Finance, 'The Waqf Fund continues its Graduate Sponsorship Programme with BIBF in training Bahraini Graduates in Islamic finance' <<http://www.bibf.com/the-waqf-fund-continues-its-graduate-sponsorship-programme-with-bibf-in-training-bahraini-graduates-in-islamic-finance>> accessed 10 November 2016.

¹¹⁶⁶ The number of graduated students in the Islamic banking field cannot be determined per year, because different years may have different numbers of graduation students.

¹¹⁶⁷ Global Islamic Finance Magazine, '[Scholar Development Program Launched by Waqf Fund](http://www.globalislamicfinancemagazine.com/?com=news_list&nid=530)' <http://www.globalislamicfinancemagazine.com/?com=news_list&nid=530> accessed 11 November 2016.

¹¹⁶⁸ First Global Knowledge Centre, weekly Publication, (2012) 53 'Waqf Fund 'Supporting Industry' <<http://www.fgkcentre.com/iGlobalWeb/PDF/iGlobal%20Weekly%20Report%20-%2053.pdf>> accessed 10 November 2016.

¹¹⁶⁹ Bahrain Institute of Banking and Finance, 'What is BIBF' < <http://www.bibf.com/home/index.php/about-bibf/who-we-are/our-organisation>> accessed 14 November 2016.

¹¹⁷⁰ Bahrain Institute of Banking and Finance, 'Home' <<http://www.bibf.com/home/>> accessed 14 November 2015.

insurance, banking, management and leadership, and information technology. The BIBF provides varied programs of short courses on Islamic banking and finance that are appropriate to Islamic institutions, for example, Islamic Structured Finance Securitisation, Risk Management, and Islamic Banking.¹¹⁷¹

The BIBF is well-known not only in Bahrain, but also outside the country as it offers training courses on Islamic banking and finance for other Islamic financial institutions outside the country.¹¹⁷² Such an institute is encouraging the development of the Islamic banking industry in Bahrain and indeed every Islamic bank in one way or another can benefit from the Islamic financial industry in Bahrain via the BIBF.¹¹⁷³

It is important for the BIBF to offer courses in Islamic banking combined with modern economics, finance and the legal side of Islamic banking to create qualified Islamic banking experts.¹¹⁷⁴ As for qualified Islamic banking experts, they should have knowledge in all the areas that are related to Islamic banking transactions and contracts. There is no doubt that every sector has its own legal advisors to deal with legal issues of each sector. In the Islamic banking industry, the people who work as managers or staff in Islamic banks should have knowledge in Sharia, legal, and financial aspects to be qualified Islamic banking experts. In that context, Islamic banks have the problem of finding sufficiently skilled staff who can manage the

¹¹⁷¹ Ricardo Baba, 'Islamic financial centres' in M. Kabir Hassan and Mervyn K. Lewis (eds), *Handbook of Islamic Banking* (1st edition, Edward Elgar, UK 2007) 391.

¹¹⁷² Many bankers and industry employees from neighbouring countries thus come to Bahrain to take short training courses in Islamic banking, with the cooperation of the Waqf Fund. Sometimes, the institution conducts training courses on behalf of other Islamic banks in other countries. For example, in 2004 the institute provided a four-day introductory course in Islamic financial tools for Bosnia International Islamic Bank.

See: Ricardo Baba, 'Islamic financial centres' in M. Kabir Hassan and Mervyn K. Lewis (eds), *Handbook of Islamic Banking* (1st edition, Edward Elgar, UK 2007) 391.

¹¹⁷³ BIBF and the World Bank will sign a memorandum of understanding to foster financial stability in the Middle East through education, training and knowledge exchange activities. BIBF and the World bank will cooperate in contributing to improved financial stability and financial sector development in the Middle East by jointly promoting the identification and dissemination of sound practices in various financial sector topics, including but not limited to prudential regulation and supervision, contingency planning and crisis management, deposit protection, banking sector development, Islamic finance, corporate governance, risk management and anti-money laundering.

See: Bahrain Institute of Banking and Finance, 'World Bank facilitates Board of Directors Workshop on Corporate Governance' <<http://www.bibf.com/world-bank-facilitates-board-of-directors-workshop-on-corporategovernance>> accessed 12 November 2016.

¹¹⁷⁴ Some courses that are provided by the BIBF in 2014 study calendar were: Sharia auditing, introduction to Islamic banking and finance, Islamic mutual funds, Sharia for bankers, conventional and Islamic project finance, Islamic international trade finance and Arbitration and Legal Analysis of Islamic Financial Contracts and some other courses.

See: Bahrain Institute of Banking and Finance, 'Course Calendar 2016, Centre for Islamic Finance' <<http://www.bibf.com>> accessed 26 October 2016.

bank.¹¹⁷⁵ Therefore, the author argues that all courses offered by the BIBF should be complete and include all Islamic banking courses relating to Sharia aspect of the Islamic banking. In addition, all courses relating to the legal aspects of Islamic banking should be also included. It is also important that the courses that are provided by the BIBF to educate Sharia scholars should be different from the courses that are provided to educate other staff of Islamic banks because the Sharia scholars should be experts in the Sharia principles. All issues related to Sharia is the responsibility of the Sharia scholars in the Islamic banks. Therefore, the Sharia courses that are provided for the educating Sharia scholars should be more specific than the Sharia course provided for other staff.

The Role of the Waqf Fund

Establishing the Waqf Fund¹¹⁷⁶ is one of ways by which the CBB has supported Islamic finance and banking. Via the Waqf fund, the CBB funds research, education, and training in the Islamic banking field.¹¹⁷⁷ The main goal of the Waqf Fund is to create experts in the Islamic banking field. The Waqf Fund which operates in association with the BIBF and through the Graduate Sponsorship Program offers education and training courses on Islamic finance in Bahrain. Furthermore, the Waqf Fund provides workshops and further study for students who have graduated from the University of Bahrain and who wish to take additional courses in Islamic finance.¹¹⁷⁸ Scholarships are offered for the best graduates in the finance and banking field from the University of Bahrain.¹¹⁷⁹ This can be considered one of the most important projects by the Waqf Fund.¹¹⁸⁰ It is worth mentioning that in 2014, the Waqf Fund joined hands with

¹¹⁷⁵ Mareyah Mohammad Ahmad ‘Are Islamic banks better immunized than Conventional banks in the current economic crisis?’ (the 10th Global Conference on Business & Economics, Italy, October 2010)

¹¹⁷⁶ The Waqf Fund was established in November 2006 under the auspices of the Central Bank of Bahrain (CBB) in partnership with Islamic Financial Institutions (IFIs) in Bahrain have some important function in Bahrain, such as Graduate Sponsorship Program.

See: CBB, ‘The Waqf Fund’ < <http://www.cbb.gov.bh/page-p-waqaf-fund-page.htm> > accessed 12 November 2016.

¹¹⁷⁷ Bahrain, ‘Economic Development Board’ <<http://www.bahrainedb.com/en/EDBDocuments/Bahrain-Economic-Yearbook.pdf>> accessed 12 November 2016.

¹¹⁷⁸ It is important for the graduate student of the BIBF who has a degree in banking and finance to undergo further study in Islamic banking and finance. Thus, students who take courses in both conventional and Islamic finance could be effective and knowledgeable staff members and scholars with Islamic banks. Further study can be a master or a PhD degree in the field of Islamic banking.

¹¹⁷⁹ Central Bank of Bahrain’s ‘Islamic Finance Review’ July, 2008, 3.

¹¹⁸⁰ The project takes the form of a six-month course, which allows students to combine academic study and practical experience. Each year, approximately 60 students can take advantage of this program, and all costs are paid for by the Waqf Fund. These graduate students will study for an Advanced Diploma in Islamic Finance at the Bahrain Institute for Banking and Finance. This project therefore helps Islamic banking to develop and improve because every year it produces a new group of experts to start working in Islamic financial institutions in the country. The project runs under the supervision of the CBB, with the aim of enabling the country to have sufficient numbers of experts in the Islamic banking industry in the future.

See: Central Bank of Bahrain’s ‘Islamic Finance Review’ July, 2008, 3.

the University of Bahrain to provide financial support to its 4-year first degree in Sharia for Banking and Finance program.¹¹⁸¹

In addition, the Waqf Fund in its 16th board of Trustees meeting on 17 May 2012, decided to support researchers in the Islamic financial field. The Board decided to provide training courses for Islamic banking professionals and Sharia resources in Islamic banking under the Graduate Sponsorship Program, Sharia Review Development Program and Advanced Diploma in Islamic Commercial Jurisprudence Program. Providing sufficient resources and references in the public library of the country is another concern and a decision of the board in the meeting.¹¹⁸² Furthermore, the board decided to provide current books, journals, magazines and online resources on Islamic finance to assist students and researchers who conduct research in this area.¹¹⁸³

It seems that Islamic banking in Bahrain is at an advanced level but there are still attempts to develop human capital in this area. The BIBF and the Waqf Fund work together to support the Islamic banking system in Bahrain. Large numbers of experts have been created each year in Bahrain to serve in the Islamic banking industry in that country. But importantly, the BIBF also opens its door to other countries to participate in its Islamic banking courses. Therefore, those countries that have problems in terms of numbers and quality of Islamic banking experts now have an opportunity to take advantage of this institution. Iraq for example, has a shortage of human capital in the Islamic banking field,¹¹⁸⁴ so it should take advantage of the courses provided by the BIBF in Bahrain.

6.6.2. Malaysian Approach

Malaysia is one of the countries that has large numbers of Islamic banking experts who understand Islamic banking transactions well.¹¹⁸⁵ Therefore, in Malaysia, the shortage of

¹¹⁸¹CBB, 'Waqf Fund Joins Hands with University of Bahrain' <https://www.cbb.gov.bh/page-p-waqf_fund_joins_hands_with_university_of_bahrain.htm> accessed 12 November 2016.

¹¹⁸² Central Bank of Bahrain's 'Islamic Finance Review' June, 2012, 8.

¹¹⁸³ Central Bank of Bahrain's 'Islamic Finance Review' June, 2012, 8.

¹¹⁸⁴ Sahar Nasr 'Republic of Iraq: Financial Sector Review' (2010), The World Bank, Middle East and North Africa Region.

¹¹⁸⁵ For example, there are numbers of qualified and respect Sharia scholars who serve in the SAC of the BNM but they cannot serve in individual Sharia supervisory board of Islamic bank in accordance to the BNM instruction. Currently member of the SAC (from 2013-2016) are:

Dr. Mohd Daud Bakar (Chairman), Prof. Madya Dr. Mohamad Akram Laldin (Deputy Chairman), Yang Amat Arif Tun Abdul Hamid Mohamad' Tan Sri Sheikh Ghazali Abdul Rahman' Y.B. Sahibus Samahah Dato' Haji Hassan Ahmad' Prof. Dr. Engku Rabiah Adawiah Engku Ali' Prof. Dr. Ashraf bin Md. Hashim' Prof. Madya Dr. Rusni binti Hassan

Prof Madya Dr. Asmadi Mohamed Naim' Dr. Shamsiah Mohamad and En. Burhanuddin Lukman.

Islamic banking experts is not a big challenge compared to some other countries such as Iraq.¹¹⁸⁶ Thus, having qualified Islamic banking experts benefits the country's economic system.¹¹⁸⁷

Hence, it is important that Islamic banks have a good relationship with all institutes that produce and educate Islamic experts.¹¹⁸⁸ Furthermore, there should be cooperation between academics and practitioners to train staff of the Islamic banking industry in the best way. In that sense, the University Utara Malaysia has invited representatives¹¹⁸⁹ from both Bank Islam Malaysia Bernhard and Bank Muamalat Malaysia Bernhard to attend academic board's program of the first degree of Islamic banking and finance program of the Faculty of Finance and Banking in University Utara Malaysia.¹¹⁹⁰

In Malaysia, resolving the issue of the shortage of Islamic banking experts is not difficult. There are several universities and centres in Malaysia that can provide courses in Islamic banking and finance. Thus, the BNM or Islamic banks in Malaysia could easily establish formal links with these universities to train their staff. In addition, those universities could create a significant number of Sharia scholars for Islamic banks in each year at both undergraduate and postgraduate levels. That is because there are several universities which provide Bachelor's, Master's and PhD degrees in the Islamic banking field.¹¹⁹¹

See: BNM, 'About the Bank' <<http://www.bnm.gov.my/index.php?ch=7&pg=715&ac=802>> accessed 27 October 2016.

¹¹⁸⁶ The reason that Malaysia has large number of Islamic banking experts is because there are some universities and centres for teaching and educating in areas of Islamic banking and at the same time there are some funding providers for students who study in the Islamic finance field.

For example, for supporting Islamic banking industry, the ISRA provides the Sharia Scholarship Award for 2014 for qualified master and PhD students who pursue study in local or overseas universities.

See: ISRA, 'the Shari'ah Scholarship Award 2014' <<http://www.isra.my/shariah-scholarship-award>> accessed 12 November 2015.

¹¹⁸⁷ Creating numbers of experts has had a positive impact on the Islamic banking industry and on the country's economic system. In addition, Islamic financial institutions can develop very fast as they can benefit from these experts. It seems that Malaysia has ways such as ISRA Sharia scholarship for producing Islamic banking experts.

¹¹⁸⁸ In other words, cooperation between Islamic financial institutions and these universities is necessary for creating more experts and trained employees in the Islamic banking industry. The universities can perform with Islamic banks depending on their needs. If they need human capital in the legal side of the Islamic banking field, they can study in this area, while if they need the financial side they can study in the financial department in these universities.

¹¹⁸⁹ Representatives could be Islamic bank managers, Sharia scholars or any staff, depending on what the Islamic bank needs. The purpose of this cooperation is to have a good relationship between the universities and Islamic banks. Therefore, universities can open training courses for Islamic bank's staff.

¹¹⁹⁰ Professor Sudin Haron 'Towards Developing a Successful Islamic Financial System: A Lesson from Malaysia' (2004), Working Paper Series 003, KLBS Creating Dynamic Leaders, 12.

¹¹⁹¹ Some universities that provide an Islamic banking program in Malaysia are:

- 1- University Utara Malaysia
- 2- University Kuala Lumpur Malaysia
- 3- University Malaya
- 4- University Malaysia Sabah

There is no doubt that each year, many students graduate from the Islamic banking departments of these universities with bachelors, masters and PhDs.¹¹⁹² Therefore, it may be argued that it is relatively easy for Islamic banking institutions to benefit from them as human capital. However, because the recently graduated students do not have sufficient experience in Islamic banking, Islamic banks prefer senior scholars and staff who have practical experience.

The Role of the International Centre for Education in Islamic Finance (INCEIF)¹¹⁹³

Besides the several universities for training and producing experts in the Islamic banking field in Malaysia, there is another important centre which was established specifically for developing human capital in Islamic banking area which is the International Centre for Education in Islamic Finance (INCEIF).¹¹⁹⁴ This centre can help to minimise the problem of a shortage of experts in the Islamic banking industry.¹¹⁹⁵

Currently, the Malaysian government is working to build Malaysia as a centre for Islamic finance in the future. Therefore, one of the steps that has been taken was the establishment of the Malaysian International Islamic Finance Centre (MIFC). It was launched in 2006 to promote Malaysia as a centre for international Islamic finance.¹¹⁹⁶ Furthermore, the establishment of the INCEIF is another attempt by the government to achieve this purpose.¹¹⁹⁷

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- 5- University Technology Mara
 - 6- International Islamic University Malaysia
 - 7- National University of Malaysia

¹¹⁹² This could be a good opportunity for Islamic financial institutions in the country to have sufficient qualified human resources. Those institutions can provide funds for some students or even their employees and scholars to study higher education in Islamic banking field in universities that have Islamic banking courses.

¹¹⁹³ INCEIF was established in Malaysia in 2005 by the BNM, and its main purpose of establishment is to develop human capital to meet the needs of the Islamic finance industry locally and internationally.

See: INCEIF, 'INCEIF's Philosophy' <<http://www.inceif.org/about/philosophy-brand/>> accessed 12 November 2016.

¹¹⁹⁴ As one of the most active universities and specialist centres for producing professional Islamic financiers, INCEIF has a significant role to play in the Islamic financial system. It is a support centre for Islamic financial institutions in the country by generating expertise in the field. INCEIF is considered as a vital centre for enhancing Islamic banking institutions and it creates qualified experts who understand Islamic banking practice.

See: Mohamad Zaid Mohd Zin, Abdul Razak Abdul Kadir, Saurdi Ishak and Mohd Syahiran Abdul Latif 'Growth and Prospect of Islamic Finance in Malaysia' (International Conference on Social Science and Humanity, Singapore, February 2011).

¹¹⁹⁵ Mohamad Zaid Mohd Zin, Abdul Razak Abdul Kadir, Saurdi Ishak and Mohd Syahiran Abdul Latif 'Growth and Prospect of Islamic Finance in Malaysia' (International Conference on Social Science and Humanity, Singapore, February 2011).

¹¹⁹⁶ Malaysia International Islamic Finance Centre, 'About MIFC' <<http://www.mifc.com/index.php?ch=menu>> accessed 21 March 2013.

¹¹⁹⁷ 'INCEIF was established by the BNM to meet the global demand in the Islamic financial industry. The government attempts to develop and enhance the Islamic financial industry through these centres, to meet all requirements and elements to be a hub for international Islamic finance around the globe. INCEIF is the only university in the world that is wholly dedicated to postgraduate studies in Islamic finance. The aim of this centre is to be the knowledge leader in Islamic finance'.

See: INCEIF, 'About us' <<http://www.inceif.org/index.php/inceif-philosophy>> accessed 12 November 2016.

The programs provided by the INCEIF are Master's in Islamic Finance Practice (MIFP), Master's in Islamic Finance (MIF), the PhD in Islamic Finance (PhD) and The Islamic Finance Professional Certificate program. These programs and courses can serve the Islamic financial industry all over the world. People from different countries and backgrounds can attend the INCEIF to be educated in the Islamic financial sector.¹¹⁹⁸ This is because the centre is structured to provide knowledge and information via academic programs and industry service.

Comparison between BIBF and INCEIF

In fact, both the BIBF in Bahrain and INCEIF in Malaysia have a significant role in developing the human resource of Islamic banking and finance in their respective countries. Nevertheless, they are different in some aspects, for example, INCEIF is a special centre for education in Islamic finance while BIBF is not a special institution for Islamic banking and finance. The BIBF has a special centre for Islamic banking only. Another difference is that the INCEIF offers PhD and Master's Degrees only, which are two higher levels of educational degrees. In contrast, the BIBF offers a diploma in Islamic banking, while Master's and PhD degrees are not a focus area of this institute. Another point is that INCEIF concentrates on both the academic and practical aspects of Islamic finance long duration courses, while BIBF focuses on academic programs that provide some short-term training courses and workshops.

Regarding courses and subjects that are taught by these two centres, most of the courses are related to Islamic banking and finance and there are also some legal courses and modern finance subjects. However, INCEIF concentrates less on the Sharia side of Islamic banks, which is the most important information that needs to be known by the Sharia scholars of the Sharia boards of Islamic banks.¹¹⁹⁹ Nonetheless, the centre of Islamic Banking and Finance of the BIBF in the Advanced Diploma in Islamic Commercial Jurisprudence program focuses on more Sharia related subjects.¹²⁰⁰ At the same time, the legal aspects of the Islamic banking industry are not

¹¹⁹⁸ In other words, INCEIF plays an important role in developing the Islamic financial system of Malaysia. It provides an opportunity for local and international students worldwide to do their higher study degree in Islamic finance. The courses are taught by professors and lecturers who have practical and theoretical experience in the Islamic financial area. Through its programs, it can create professionals in the field of Islamic finance for a better regulatory and supervisory system.

¹¹⁹⁹ For example, in the Master of Science in Islamic Finance program in INCEIF, *Usul Fiqh* and *Qawaid Fiqhiyyah*, *Fiqh Muamalat* is taught.

See: INCEIF, Master of Science in Islamic Finance, 'Programme Structure' < <http://www.inceif.org/academic-programmes/master-of-science-in-islamic-finance/programme-structure/> > accessed 12 November 2016.

¹²⁰⁰ Regarding the Centre of Islamic banking of BIBF, these important courses are taught: Advanced Diploma in Islamic Commercial Jurisprudence, of Shariah and Jurisprudential Law (*Usul Al Fiqh*), Principles of Fatwa and Applied Jurisprudence, Islamic Financial Transactions, Fiqh of Zakat and Waqf, Fiqh of Takaful, Shariah Supervision

taught as required knowledge for scholars. However, for the scholars to have wider knowledge about all Islamic banks' contracts and transactions, they should have sufficient legal information. Finally, the courses and programs that are offered by these two centers are very important for the development of human capacity in the Islamic banking field. However, this thesis argues that to prepare qualified Sharia scholars for Sharia boards of Islamic banking, it is necessary to have knowledge in all areas: legal, Sharia, conventional banking, modern finance and Islamic banking practices. In this regard, the courses provided by INCEIF and BFBI still need further development. For example, INCEIF should have more courses on the Sharia aspects of the Islamic finance while BFBI could provide more courses on the legal aspects of the Islamic finance. Thus, all courses relating to Islamic finance should be taught but effort should be concentrated on the Sharia course among other courses.

In addition, it is also noted that both centres do not focus on English and Arabic. Nevertheless, both languages are important for the Sharia scholars to know, especially as most of the texts on Islamic banking and finance are written in these two languages. However, neither INCEIF nor BIBF focuses on Arabic grammar (*Nahu Sarf*)¹²⁰¹ which is necessary for Sharia scholars.¹²⁰² In fact, for the Sharia scholars to understand most of the old Arabic texts, a high level linguistic competence is necessary. Thus, Sharia scholars should have a high level of understanding Arabic texts particularly for those scholars who undertake fatwa issuing responsibilities in the Sharia board.¹²⁰³

In that context, any university or center that will offer Islamic banking courses in Iraq should include subjects and courses in both legal and Sharia aspects of Islamic finance. In addition, Arabic and Arabic grammar should be focused on to create Sharia scholars who can issue fatwas. Furthermore, English also should be studied to enable the scholars to understand documents that are written in English especially in those countries that have advanced Islamic banking systems, such as Malaysia. Therefore, the courses that are provided by INCEIF and BIBF are complementary to each other. Thus, for Iraq to produce qualified Islamic banking experts, most

¹²⁰¹ Nahu Sarf is an Arabic language grammar and it is necessary knowledge for the scholars, especially those who are in the position to issue fatwa.

¹²⁰² Teaching Arabic and Nahu Sarf is necessary for the Sharia scholars to be qualified to issue fatwa. Hence, it seems that the Scholars who graduated from BIBF and INCEIF are not eligible to issue fatwa because both centres do not concentrate on Quran and Ahadith.

¹²⁰³ The old Arabic texts are written in very high level language and these texts are not easy for anyone, even those who know Arabic to understand. Therefore, to understand the exact meaning of the old Arabic texts, especially Ahadith, the scholars need a high level of proficiency in Arabic.

of the courses that are offered by these two centers should be taught by the Islamic banking department.

6.7. Iraq: Human Capital Problem and Possible Solutions

In Iraq, there are insufficient numbers of Sharia scholars to be appointed to the Sharia supervisory boards of all Islamic banks, but the CBI requests that each Islamic bank has its own Sharia supervisory board.¹²⁰⁴ Therefore, the CBI must find a solution for the shortage of qualified Sharia scholars before requiring Islamic banks to appoint at least three Sharia scholars each.

The methods that are used by some of these countries for producing qualified Islamic banking experts can be considered by the CBI for resolving this issue. The CBI can establish a centre just like the BNM established INCEIF for producing Islamic banking experts. Otherwise, the CBI can forge connections with certain universities or centres to cover the shortage of experts in Islamic banks, for example, it can provide funds and request INCEIF to provide online Master's and PhD degrees in Islamic banking to selected students in Iraq.¹²⁰⁵ Furthermore, if requested from the CBI, the BIBF can offer online training courses and workshops to staff who are working in Islamic banking institutions in Iraq.¹²⁰⁶

It is also important to consider the Pakistani model for dealing with the shortage of qualified Islamic banking experts.¹²⁰⁷ In Pakistan, there are some universities and some Madaris (schools) offering Islamic banking programmes.¹²⁰⁸ There are other centres in Pakistan that

¹²⁰⁴ CBI, Iraqi Islamic Banking Instruction, No. 6, 2006, S 6(1) (translated from the original Arabic by the author).

¹²⁰⁵ In this case, the students who are selected for taking the online courses for both master's and PhD degrees should be monitored regularly to ensure that they are following the courses and subjects that are taught online.

¹²⁰⁶ The CBI could require any centre or university that teaches Islamic banks' staff of Iraq to teach these subjects that are necessary to be taught in the online courses for Islamic banking staff or Sharia scholars. CBI could find out the needs of Islamic banks from a human resource aspect and to know the weakness of their Sharia scholars. Therefore, the CBI could determine subjects in the Islamic banking field that are needed to be taught by the BIBF online courses.

¹²⁰⁷ In Pakistan, the Islamic banking sector is developed to some extent. In this country, Islamic banking and the finance industry have experts who can manage the sector. However, the current number of the experts may not be sufficient for the industry. In fact, these numbers of experts could help the Islamic banking sector to improve and develop regularly. Furthermore, Pakistan has a central sharia board which minimises the problem of shortage of Islamic banking experts. The central Sharia board can provide Islamic banking and financial institutions with many facilities, such as opening workshops for staff of Islamic banks and answering questions that are faced by the Sharia advisors of Islamic banks. In general, in Pakistan there are 22 courses in Islamic finance and nine universities offering degree programmes.

See: MIFC, 'Human Capital Development Sustaining the Growth of Islamic Finance' <<http://www.mifc.com/index.php?ch=28&pg=72&ac=56&bb=uploadpdf>> accessed 14 November 2015.

¹²⁰⁸ In Pakistan, some universities and Madaris offer Islamic banking and finance courses and programs. These centres and universities enhance Islamic banks by creating numbers of Islamic banking experts each year. One of the education centres that provide Islamic banking and finance courses is Darul Uloom Korang in Karachi that offers contemporary education in some areas including Islamic banking and finance. The students are specialised

offer Islamic banking courses such as the Al-huda Centre for Islamic Banking and Finance(CIBF)¹²⁰⁹ and International Institutes of Islamic Economics (IIIE)¹²¹⁰. The Iraqi

in Fiqh and they learn good English, principles of Islamic finance and AAOIFI Sharia standards. Presently, in Pakistan, it is the only major source of Sharia supervisory expertise to Islamic banks and financial institutions directly or through its subsidiary 'Centre for Islamic Economics (CIE), also based at Karachi. The AAOIFI Sharia Standards are also taught to the specialised students of Jamia al Rashid, Karachi. The Jamia Ashrafia in Pakistan is another centre for Islamic banking education. The CIE provides courses in various Islamic banking and finance in collaboration with some volunteer CAs and private sector Islamic finance training institutions. There are also some other Madaris and centres or universities that offer courses and lectures in Islamic banking and finance. Almost 100 Madaris in Pakistan provide Takhassus facility in Islamic jurisprudence and/or Ifta'.

See: Mahmmd Ayub, 'Madaris Education and Human Capital Development with Special Reference to Pakistan' (2009) 16 Islamic economic Studies, 1, 9, 19, 11.

In recent years, some efforts of cooperative nature have been made to initiate Islamic economics, finance and banking education in Madaris. The Islamabad based Institute of Policy Studies (IPS) has conducted such programs for teachers and students of Madaris in collaboration with the International Islamic University, Islamabad. They either invite the participants from Madaris and arrange 2-3 week programs at Islamabad or provide resource persons to Madaris in various cities for 1-2 day programs.

See: Mahmmd Ayub, 'Madaris Education and Human Capital Development with Special Reference to Pakistan' (2009) 16 Islamic economic Studies, 1.

¹²⁰⁹ 'Al-huda is an organisation located in Pakistan which works to promote the banking and finance sector in Pakistan and other countries. The organisation consists of seasoned professionals with expertise in various segments of the Islamic financial services industry. It has several departments for enhancing banking and finance centres such as Education and training department and Sharia Department. Al-huda has a few programs in teaching Islamic banking and finance, such as training courses and workshops. Its purpose is to produce Islamic banking experts to govern the Islamic banking industry. The centre has various programs for producing human capital in Islamic banking and finance field and the programme takes 2 to 8 months long. Since its establishment, it has conducted 32 successful campus programs sessions with more than 2000 registered students in the network of Islamic banking and finance, Takaful, Mudaraba and Islamic Microfinance etc. The centre offers a Post Graduate Diploma on Islamic Banking and Finance – 8 Months, Islamic Microfinance Professional – One Month Program, Certified Takaful Manager – One Month Program and Certified Sukuk Professional – One Month Program. Except for some campus programs, Al-huda also has a distance program such as a postgraduate diploma in Islamic banking and finance. Many important Modules are taught by the Centre such as, Introduction to *Riba* and Islamic Economic System, Islamic banking and Finance products, Takaful and risk mitigation Tools in Islam and so on'.

See: AlHuda Centre of Islamic Banking & Economics (CIBE), < <http://www.alhudacibe.com/index.php>> accessed 12 November 2016.

¹²¹⁰ 'As a part of the International Islamic University in Pakistan, the International Institute of Islamic economics (IIIE) is a centre for producing Islamic banking and finance experts. The International Institute of Islamic Economics is a pioneering institution in the Muslim World dedicated for the cause of Islamic Economics. It was established in August 1983 with the primary objective of working towards an Islamic Economic Paradigm and to prepare scholars equipped with appropriately blended knowledge of Shariah injunctions and the mainstream economics. The ultimate objective is Islamization of the economic and financial system of the Muslim societies. The School of Economics is organizing the academic programs of the institute. The faculty is expanding vertically and horizontally. It has been offering the academic programs at Bachelor's (B.Sc- Honours), Master's (M.Sc) and Doctorate (Ph.D.) levels in Economics from the very date of its establishment. Later on, new programs have been added from time to time, like the Post-Graduate Diploma in Islamic Banking & Finance, B.Sc (Hon), M.Sc. and M.Phil in Economics & Finance and Islamic Banking & Finance, M.Phil leading to Ph.D. in Econometrics and Master program in Rural Development. The Institute carries out its academic programs for female students through the Department of Economics in the Women's Campus of the University. There is a well-established Research and Training Division, which is responsible for promoting research in mainstream and Islamic Economics as well as to provide training facilities to the staff who are employed in Academic and Financial institutions, both public and private'

See: International Islamic University Pakistan, 'International Institutes of Islamic economics' <http://www.iiu.edu.pk/index.php?page_id=62> accessed 12 November 2016.

government and the CBI should help universities in Iraq to offer Islamic banking degrees and courses.¹²¹¹

In that regard, the Department of the Science of Finance and Banking in the University of Human Development (UHD)¹²¹² in Iraq can be developed to have a special degree in the Islamic banking area for producing qualified Islamic banking experts and Sharia scholars. This can be done through cooperation between the CBI and the UHD or Islamic banks and the UHD.¹²¹³ In such cases, the UHD can benefit from INCEIF and BFBI and other universities that offer an Islamic banking degree at the Bachelor, Master and PhD degree levels by selecting the courses that have to be taught.¹²¹⁴ Hence, the courses and modules to be taught in UHD would have to include all aspects of Islamic banking, such as legal, Sharia finance, accounting and the conventional banking system.¹²¹⁵

Modules like Introduction to Islamic banking and finance, Islamic commercial law, conventional banking system, Sharia law, *Fiqh Muamalat*, accounting, Arabic and English languages are important subjects that must be studied. Finally, it is worth noting here that there are several other universities, centres and institutes in the world which produce experts in the field of the Islamic banking and finance industry and they could be good templates for Iraq.¹²¹⁶

¹²¹¹ It is important for the Ministry of Higher Education of Iraq to cooperate with the CBI to resolve shortage of Islamic banking experts. The Ministry of Higher Education can point out the modules that are important for students to study to become qualified Islamic banking experts, such as financial law, Islamic banking and finance, accounting, Sharia law, modern finance and the English language.

¹²¹²University of Human Development, 'College of Administration and Economics', <<http://uhd.edu.iq/en/index.php/en/academic/colleges/125-college-of-administration-and-economics>> accessed 12 November 2016.

¹²¹³ However, the CBI has more authority than Islamic banks to request UHD to offer courses in Islamic banking and finance.

¹²¹⁴ Some of the Islamic banking courses that are being taught by the BIBF and INCEIF could be chosen by the UHD to be taught.

¹²¹⁵ The courses and subjects that are taught by the UHD could be determined by the CBI and the Islamic banking experts in Iraq or outside Iraq, such as Bahraini Islamic banking experts.

¹²¹⁶ In Saudi Arabia for example, Imam Muhammad bin Saud Islamic University and King Abdul Aziz University offer Islamic banking degrees. Furthermore, the University of Brunei Darussalam, the Islamic University of Indonesia, and the Islamic University of Bangladesh are also offering degrees in Islamic banking and finance. In the west, there are also some universities offering courses and degrees in Islamic banking such as Durham University, Bangor University, and Surrey University. In France for example Strasbourg University offers a degree in Islamic banking and finance and in the US, Rice University in Texas offers a course in this field.

6.8. Alternative Solutions for the Shortage of Sharia Scholars in Iraq

The shortage of qualified Sharia Scholars is not a problem only in Iraq, but it affects almost all Islamic banks.¹²¹⁷ For example, even though there are approximately 219 Islamic financial institutions in the Gulf countries, at the same time the number of qualified Sharia experts and scholars are limited as there are only 100 Sharia scholars in these countries who are qualified to act as a member of a Sharia supervisory board of Islamic financial institutions.¹²¹⁸ Below are some alternative solutions to address the shortage of qualified Islamic banking experts that can be useful in Iraq:

A- Establishment of Sharia Consulting Firms

Establishing Sharia consulting firms could become a good solution to address the shortage of Islamic banking Sharia scholars for the Islamic banks. To resolve the shortage of Sharia scholars, Sharia consulting firms have been established in some countries and they are recognised by the central banks or Ministries of Finance in these countries, such as in Kuwait, Qatar and Saudi Arabia.¹²¹⁹ The first Sharia consulting firm was founded in Kuwait in 2003 and it is recognised by the Central Bank of Kuwait.¹²²⁰

This approach may be to some extent suitable for Iraq in resolving the shortage of Islamic banking Sharia scholars. It is difficult for an Islamic bank to have at least three scholars as members in a Sharia supervisory board. The CBI could encourage private sectors and facilitate them to establish legal and Sharia consulting firms just like Kuwait and Qatar¹²²¹ to minimise impact of the shortage of qualified Islamic banking Sharia scholars.

However, the author argues that there are possible risks associated with establishing Sharia consulting firms such as a risk of non-confidentiality. The consulting firm would have information about many Islamic banks as well as their products and transactions. Therefore,

¹²¹⁷ Muhammad Shaukat Malik, Ali Malik and Waqas Mustafa, 'Controversies that Make Islamic Banking Controversial: An Analysis of Issues and Challenges' (2011) 2 American Journal of Social and Management Sciences 41, 42.

¹²¹⁸ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386.

¹²¹⁹ Bashir Hadad also mentioned this point in his interview, in which he stated that an establishment of consultant firms for Islamic banking can help Islamic banks in minimizing the limitation of Islamic banking experts. (Erbil, May 2015).

¹²²⁰ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386

¹²²¹ The CBI should help those who want to establish Sharia consulting firms in Iraq. It is also possible for the CBI to establish a Sharia consulting firm to give advice and assistance to the Islamic banks in Sharia related matters.

Islamic banks may avoid requesting assistance from Sharia consulting firms in order to avoid the risk of non-confidentiality.

B- *The Appointment of One Sharia Advisor*

Another alternative solution to address the shortage of qualified Islamic banking experts in Iraq would be for each Islamic bank to have one Sharia advisor and this advisor would then only serve in one Islamic bank.¹²²² The Sharia advisor of the Islamic financial institution is responsible for approving all products and transactions carried out by the institution. The main function of the Sharia advisor would be in ensuring that all transactions of the institution are compliant with the Sharia rules and principles. The Sharia board of the State bank of Pakistan is the highest authoritative body and hence it has the last word on any differences between the Sharia advisor of the Islamic financial institution and the Sharia board of the State Bank on any transaction or product.¹²²³ It is stated in the Instruction for the Sharia Compliance in Islamic banking Institutions of the State Bank of Pakistan (2008):

In case any differences of opinion arise between Shariah Advisor of the IBI and the State Bank's Inspection staff or other SBP departments regarding Islamic Banking practices, State Bank may refer the case to SBP Shariah Board and the decision of SBP Shariah Board, notified by State Bank, shall be final.

Accordingly, in Iraq, instead of having a Sharia supervisory board for each Islamic bank, Islamic banks can appoint a Sharia advisor who is knowledgeable and skilful in governing Islamic banking businesses until the issue can be resolved completely. In addition, there should be a central Sharia body at the level of the central bank. In Pakistan for example, each Islamic financial institution has only one scholar and this scholar is not allowed to serve in more than

¹²²² As can be seen in Pakistan Islamic banking system that each Islamic banking institution is required to work under the guidance of a Sharia advisor. 'To keep this process more objective, broad based and responsive to the market conditions SBP Sharia Board has approved Fit & Proper Criteria for Sharia advisors of IBIs. According to the Fit & Proper Criteria, minimum required Sharia and contemporary educational qualification as well as experience and exposure for becoming a Sharia Advisor has been defined. Moreover, to minimize conflict of interest, it has been specified that a person cannot work as Sharia Advisor for more than one IBI in Pakistan. Further, it has been specified that a Sharia Advisor shall not hold any executive/non-executive position in any other financial institution, except working as Sharia Advisor of Islamic mutual funds of the same IBI. In addition to that Sharia Advisors of IBIs have been barred from having any substantial interest in or becoming employee of some types of organizations like exchange Companies, corporate brokerage houses or stock exchange. These provisions in Fit and Proper Criteria for Sharia Advisors has ensured objectivity in evaluation criteria, minimization of conflicting of interests and induction of new lot of Sharia advisors in the market'. See: State Bank of Pakistan, Islamic Banking Department, 'Pakistan's Islamic Banking Sector review' (2003-2007) <<http://www.sbp.org.pk/ibd/Islamic-Bkg-Review-03-07.pdf>> accessed 12 November 2016.

¹²²³ State Bank of Pakistan, 'Strategic plan for Islamic banking in Industry Pakistan' <<http://ibp.org.pk/pdfs/files/Instructions%20for%20Shariah%20Compliance.pdf>> accessed 13 November 2016.

one financial institution.¹²²⁴ In this regard, there should be a strong connection between the central Sharia board and the Sharia advisers of Islamic banks, and this can be managed and organised by the law. This can be a temporary solution for the Islamic banking sector in Iraq until the CBI can create a sufficient number of scholars and experts for this sector.¹²²⁵ However, there is a possible disadvantage of having just one Sharia advisor in an Islamic bank that is important to be mentioned here that is by having one only Sharia advisor for each Islamic bank there could be negative consequences from the decisions that are made by the advisor. Since the advisor is the only decision maker, there is a possibility for mistakes to happen when making decisions. Therefore, in all cases, the decision made by three members of the Sharia supervisory board is would be more accurate than the decision made by one advisor.

C- The Establishment of the Unified Sharia Board

An establishment of a unified Sharia board which contains several Islamic banking legal and Sharia experts (unified board) could be an alternative solution for the shortage of qualified sharia scholars in Iraqi Islamic banks. This should not be difficult for Islamic banks in Iraq as there are twelve Islamic banks. This unified Sharia board can be a Sharia consultant for all Islamic banks when they have Sharia related problems, or the unified Sharia board can verify all contracts and transactions that are made by Islamic banks.¹²²⁶ The thesis argues that firstly, this option faces conflicts of interest in practice because there are different Sharia scholars from different Islamic banks in the unified Sharia board which create a conflict between the interests of different Islamic banks. Secondly, it is difficult for the unified Sharia board to focus on all Islamic banks and their transactions. In that regard, there will be more gaps in the Sharia aspects of Islamic banks.

On the other hand, there are some advantages to the establishment of a unified Sharia board. Firstly, it would minimise the costs, as the unified Sharia board is paid for by all Islamic banks which is better than each bank paying for their own Sharia supervisory board. Secondly, the unified Sharia board would consist of several scholars and experts leading to a collection of different views and opinions on any product, and subsequently when a decision is made, it will

¹²²⁴Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 141.

¹²²⁵ Appointing one Sharia advisor for each Islamic bank instead of having a Sharia supervisory board which consists of three qualified Sharia scholars is a quick solution for the Iraqi Islamic banking industry at the current situation. However, in this case there should be a central Sharia board in the CBI or an Islamic banking department for supervising Sharia advisors of the Islamic banks.

¹²²⁶ In the interview with Bashir Hadad, he suggested that Islamic banks can establish a syndicate which consists of the Sharia supervisory members from all Islamic banks. The function of this syndicate would be to support Islamic banks and their sharia supervisory boards, (Erbil, May 2015).

be a united decision. Thus, these banks can avoid different opinions on the same product or contract which would increase public confidence. Thirdly, this unified Sharia board can act as a forum for scholars and legal experts to discuss different Islamic banking issues and it may help in creating new products and modes of finance for Islamic banks. Thus, the unified Sharia board may consist of some muftis because fatwa plays an important role in the Islamic financial sector.¹²²⁷ Finally, the CBI should help Islamic banks in Iraq to bring scholars from other countries to serve as members in the Sharia boards of Islamic banks in the country.¹²²⁸

Qualification of the Sharia Supervisory Members

There is no standard Sharia qualification for Sharia supervisory members.¹²²⁹ However, it is preferred for the Sharia supervisory members to be qualified scholars who understand Islamic financial transactions and have knowledge of modern finance in order to deal with the issues facing Islamic banks.¹²³⁰ Though, as a general principle, scholars who serve in Islamic banking institutions should have experience in Islamic finance and Sharia law as can be seen in Islamic Banking of Britain.¹²³¹ The assessment of the scholars or the members of the Sharia board is different from one country to another. In some countries, having previous experience is a prerequisite for joining the Sharia supervisory board of an Islamic bank, while in some other countries having a paper qualification is a further condition, such as in Malaysia. Here the author will examine in detail the required qualifications of the Sharia supervisory members in certain countries.

Qualification of the Sharia Supervisory Members of Malaysian Islamic Banks

In Malaysia, for a Sharia scholar to be appointed as a Sharia committee member, an individual should have at least written qualifications on paper proving that he is qualified to become a Sharia scholar or expert, and also have necessary knowledge or experience in either area of Islamic transaction/ commercial law (*Fiqh Muamalat*) or Islamic jurisprudence (*Fiqh Al -*

¹²²⁷ Humayon Dar, 'Fatwa and transaction costs in Islamic finance' The Express Tribune (8 September 2013) <<http://tribune.com.pk/story/601629/quest-for-compliance-fatwa-and-transaction-costs-in-islamic-finance/>> accessed 13 November 2016.

¹²²⁸ However, in the current situation, as there are security problems in some cities of Iraq, scholars may not respond to such requests.

¹²²⁹ Yusuf Talal delornzo, 'Shari'ah Supervision in Modern Islamic Finance' Guidance Residential, Modern Finance timeless value <https://www.guidanceresidential.com/blog/wp-content/uploads/2015/05/shariah_supervision_in_modern_islamic_finance.pdf> accessed 13 November 2016.

¹²³⁰ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks Between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 101 (translated from the original Arabic text by the author).

¹²³¹ Al Rayan Bank, 'The Sharia Supervisory Committee' < <http://www.islamic-bank.com/useful-info-tools/islamic-finance/>> accessed 15 November 2016.

Islami).¹²³² However, experience is more important in the field; if a member of the Sharia supervisory board has experience there are no obligations to have paper qualification. As stated in the Guidelines on the Governance of Sharia Committee of BNM (BNM/GPS 1:

11. A member of a Shariah Committee shall be an individual. A company, institution or body shall not constitute a Shariah Committee for the purpose of these Guidelines.

12. The proposed member of the Shariah Committee shall at least either have qualification or possess necessary knowledge, expertise or experience in the following areas:

(a) Islamic jurisprudence (*Usul al-Fiqh*); or

(b) Islamic transaction/commercial law (*Fiqh al-Mu'amalat*).

13. It should however be noted that paper qualification on the above subjects will not be mandatory as long as the candidate has the necessary expertise or experience in the above areas.¹²³³

Thus, the Sharia supervisory committee members in Malaysia should have knowledge of Islamic transactions or Islamic jurisprudence. It seems that legal knowledge is not required in Malaysia.¹²³⁴ However, this thesis argues that the Sharia supervisory board member should have at least basic knowledge of the legal aspects of the banking and finance industry. Basic knowledge about the legal aspects of Islamic banking is important for the members of the Sharia board because a part of the Islamic banks is legal as all legal and Sharia instructions are issued by the BNM. In addition, having legal knowledge would help Sharia scholars to protect the Islamic bank from fraud and legal tricks. In general, having legal knowledge can help Sharia scholars have better control of their field and at the same time they should have sufficient knowledge of the entire Islamic banking system.

Qualification of the Sharia Supervisory Members in Bahraini Islamic Banks

In Bahrain, for a Sharia scholar to become a member of the Sharia supervisory board, the scholar should adhere to the Governance Standard of the AAOIFI because it is compulsory for Islamic banks in Bahrain to follow AAOIFI standards.¹²³⁵ These standards stipulate that members of the Sharia board of Islamic financial institutions should be experts in Islamic commercial jurisprudence. The board may include one member who is an expert in Islamic finance rather than jurisprudence. The AAOIFI Governance Standard No.1 states that:

¹²³²Mohamed Ben Youssef, 'Existing Central Shariah Supervisory Models' (2010) <http://www.academia.edu/4689012/Existing_Central_Shariah_Supervisory_Models> accessed November 2016.

¹²³³ the Guidelines on the Governance of Sharia Committee of BNM (BNM/GPS 1

¹²³⁴ In other words, experience or a law degree in Islamic banking or conventional finance is not required for the members of the Sharia committees in Malaysia.

¹²³⁵ Md. Hafij Ullah, 'Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh' (2013) 1 International Journal of Social Science Research 111, 112.

Shari'a Supervisory Board (SSB) Appointed by shareholders at annual meeting include at least 3 members. They experts in Islamic commercial jurisprudence and it may include 1 member with expertise in Islamic finance (rather than jurisprudence)¹²³⁶

Hence, it seems that in Bahrain, possessing an academic degree is not a condition for being a member of the Sharia supervisory board of Islamic financial institutions. Therefore, experience is sufficient for scholars to be appointed as a Sharia supervisory member of the board. This thesis argues that in Bahrain, the Sharia scholars are not required to have knowledge in legal and modern finance. Nevertheless, the Sharia supervisory board is allowed to appoint one member who has experience in Islamic finance. However, it would be preferred for the members of the Sharia supervisory board to have both legal and Sharia experiences as well all Islamic banking related knowledge in order to be qualified and to make the right decisions regarding any Islamic banking transaction.

Qualifications of the Sharia Supervisory Members in Pakistani Islamic Banks

In Pakistan, like in Malaysia, the Sharia advisor of a certain Islamic bank cannot serve in another Islamic bank.¹²³⁷ The Sharia advisor who serves in an Islamic bank should be a qualified person. The qualification of the individual Sharia advisor should be either a degree from any recognized Waffatul Madaris (Darse-e- Nizami)¹²³⁸ with a second-class bachelor's degree in economics or Waffatul Madaris (Darse-e- Nizami) and a specialization in Fiqh (jurisprudence) with sufficient understanding of banking and finance. Alternatively, the candidate should have a postgraduate degree in Islamic jurisprudence, such as an LLM in the Sharia field from a recognised university with exposure to banking and finance. Furthermore, the candidate must have at least 3 years' experience in interpreting Sharia rules or at least five years' experience in research and development in Islamic banking and finance.¹²³⁹

It seems that the requirements for the members of the Sharia supervisory boards of Islamic banks in Pakistan are stricter than Malaysia and Bahrain. In Pakistan, both an academic degree and experience are required for scholars to be appointed as a member of the Sharia supervisory board, while in Malaysia and Bahrain, experience is sufficient for the scholars. This author is of the opinion that the more stringent requirement can be attributed to the political situation in

¹²³⁶ the AAOIFI Governance Standard for Islamic Financial Institutions No. 1

¹²³⁷ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 141.

¹²³⁸ Waffatul Madaris was founded in 1957 in Pakistan and it is a study curriculum used in traditional Islamic institutions known as Dar'ul Ulooms.

¹²³⁹ Muhamad Badri Bin Othman, 'S h a r i a h Governance in Islamic Banking and Finance - A Comparison between Malaysia and Other Selected Countries' (2013) This project paper was written as part of Chartered Islamic Finance Professional (CIFP), INCEIF.

Pakistan which is unstable to a certain extent. The strict rules and requirements can keep Islamic banks under the Sharia rules. Furthermore, there are many schools offering degrees in Islamic banking making it easier for the scholars to obtain an academic degree. On the other hand, in some other countries they may have different qualification requirements for Sharia supervisory members.¹²⁴⁰

Qualification of the Sharia Supervisory Board's Members in Iraq

According to Article 6 (1) of Iraqi's 2006 Internal Instruction, every Islamic bank shall have its own Sharia supervisory board, which should consist of a minimum of three and a maximum of five members. Half of the members must have experience and knowledge of Islamic principles. The other half should consist of specialists in banking and finance law. Thus, in Iraq, an academic degree is not a prerequisite to be a member of the Sharia supervisory boards in Islamic banks.

This author argues that to be a member of the Sharia supervisory board of an Islamic bank, it is better to have both an academic degree as well as relevant experience.¹²⁴¹ The members of the board should be individuals that specialise in Islamic laws of contract and Islamic jurisprudence, in addition to having knowledge of modern business, finance and economics.¹²⁴² Thus, in Iraq, the CBI should clearly specify what qualifications are needed for the Sharia scholars to be appointed as a member of the Sharia supervisory board in an Islamic banking institution. There should be clear requirements made by the CBI for scholars who have taken part in Sharia supervisory boards. However, at this stage, for Iraqi Islamic banks it may be

¹²⁴⁰ 'By way of comparison, in Nigeria, The Central Bank of Nigeria stipulated the qualification of the Sharia advisory board's member for Islamic financial institutions in the Guidelines on Shariah Governance for Non-Interest Financial Institutions. In this Nigerian document, it is stated that: The proposed member of the SAC shall at a minimum, have an academic qualification or possess necessary knowledge, expertise or experience in the sciences of the Shariah with particular specialization in the field of Islamic Transactions/Commercial Jurisprudence (*Fiqh al Mua'amalat*); and it is highly desirable for the member to have:

- skills in the philosophy of Islamic Law (*Usul al Fiqh*),
- good knowledge of written Arabic,
- ability to speak in both Arabic and English, and
- exposure in the areas of business or finance especially Islamic Finance'.

See: The Guidelines On Shariah Governance For Non-Interest Financial Institutions In Nigeria, member of the SAC,

Qualification, <www.cenbank.org/OUT/2011/CIRCULARS/FPR/FINAL%20GUIDELINES%20ON%20SHARIAH%20GOVERNANCE.PDF> accessed 13 November 2016.

¹²⁴¹ In other words, for members of the Sharia supervisory board, besides their experiences, they should have an academic degree in Sharia, the legal field and in Islamic banking and finance in order to be a qualified Sharia scholar. As a common rule, Islamic banking and financial institutions shall be governed by a religious board that acts as an independent Sharia supervisory board which consists of at least three Sharia scholars in almost all Islamic banks.

¹²⁴² 'The Institute of Islamic Banking and Insurance, Takaful Islamic Insurance, Shari'ah Supervisory Board', <http://www.islamic-banking.com/takaful_shariah_supervisory_board.aspx> accessed 13 November 2016.

difficult to find people who have a degree as well as experience in Islamic banking field at the same time to serve as a member of the Sharia supervisory board. Therefore, scholars who have the experience or who have an academic degree in the Islamic finance might be suitable for appointment as a member of the Sharia supervisory board of an Islamic bank in Iraq for the industry at the current situation.¹²⁴³

On the other hand, one may argue that the scholars who serve in Islamic financial institutions should have special qualifications and conditions. It is preferred that the Sharia scholars should have an educational background and a doctoral degree from a recognised university. In addition, they should have at least 10 years of working experience in the relevant areas. Furthermore, a scholar who wants to serve in an Islamic financial institution should have three recommendation letters from three recognised Sharia scholars confirming that the person is eligible to become a Sharia scholar.¹²⁴⁴ However, this thesis argues that it is difficult for Islamic banks to find such Sharia scholars with all these qualities, particularly for Iraqi Islamic banks.

Appointment of the Scholar as a Sharia Board Member

Appointment of the board members is one of the problematic issues which may impact on the independence of the scholars. They should be appointed in such a way that their independence is not in question.¹²⁴⁵ It is an issue within Islamic financial institutions that board members are being appointed by the Islamic bank's management or the shareholders and the board members are being paid by them.¹²⁴⁶

The appointment of Sharia supervisory board members may be different from one country to another. For example, according to the AAOIFI Governance Standard for Islamic Financial institutions, No. 1 "every Islamic financial institution shall have a Sharia supervisory board to be appointed by the shareholders in their annual general meeting upon the recommendation of the board of directors"¹²⁴⁷. Thus, in some countries, members of the Sharia board are appointed

¹²⁴³ During my interview with Bashir Hadad in Erbil (May 2015) the interviewee stated that Islamic banks should appoint scholars for their Sharia boards who have an academic degree and experience. However, this author believes it is very difficult to find such a scholar in Iraq at the current situation. Therefore, a degree holder in Islamic banking or scholars with experience in the Islamic banking field would be suitable to be appointed as a member of the Sharia supervisory board of an Islamic bank.

¹²⁴⁴ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 154-155.

¹²⁴⁵ When the Sharia scholars of the Sharia supervisory board of the Islamic bank are not independent, thus, the decision that made by them on any Islamic banking transaction or product, may not be right decision.

¹²⁴⁶ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 140.

¹²⁴⁷ the AAOIFI Governance Standard for Islamic Financial Institutions (No. 1 sub. 2, 1997)

by the shareholders in order to reflect their commitment towards conduct a Sharia -compliant business.¹²⁴⁸ In Brunei, for example, the Sharia advisory board is appointed by the general assembly of shareholders and recommended during the meeting of the Board of Directors.¹²⁴⁹ In Kuwait, the Sharia board is appointed by the Islamic bank's general assembly.¹²⁵⁰ However, in Malaysia, the Sharia supervisory members are appointed by the board of directors of an Islamic bank by recommendations by its nomination committee. Normally, the appointment is for a renewable term of two years.¹²⁵¹ As for Bahrain, because the Islamic banks adopt all the AAOIFI standards,¹²⁵² Sharia supervisory boards of Islamic banks are appointed by shareholders.¹²⁵³

In the case of Iraq, the Sharia supervisory board of Islamic banks should be appointed by the general assembly of the Islamic bank in accordance with the Iraqi Islamic banking Internal Instruction 2006. Nevertheless, to avoid the influence of Islamic banks on the Sharia supervisory boards, it is better for the members of the Sharia supervisory boards be appointed and paid by the National Sharia Board if such a body exists,¹²⁵⁴ otherwise the central banks should have this responsibility. However, other external bodies can also select the Sharia board, for example it can be appointed by the Ministry of Finance.¹²⁵⁵

This thesis argues that the members of the Sharia supervisory boards of Islamic banks could be appointed by the central Sharia board if there is one existing. Otherwise, they can be appointed by the central bank. In fact, it is preferred for the central Sharia board to determine, appoint and pay members of the Sharia supervisory board for two reasons. Firstly, the central Sharia board is a specialised board in Islamic finance and therefore they know who the best Sharia scholars are. Secondly, appointment and payment of the members of the Sharia supervisory board by the central Sharia board would minimise the impact of the Islamic bank on the

¹²⁴⁸ Samy Nathan Garas and Chris Pierce, 'Shari'a Supervision of Islamic Financial Institutions' (2010) 18 Journal of Financial Regulation and Compliance 386. 3.

¹²⁴⁹ Halil Paino, Anis Barieyah Bahari and Rosliza Abu Bakar, 'Shariah, Social Responsibilities and Corporate Governance of the Islamic Banks in Malaysia' (2011) 23 European Journal of Social Sciences 382, 385.

¹²⁵⁰ Rafisah Mat Radzi and NurulAiniMuhammed, 'An International Comparative Study on *Shariah* Governance Supervision of *Sukuk* Defaults' (2012) 8 Journal of Islamic Economics, Banking and Finance 20, 35.

¹²⁵¹ Amir Shahrudin, 'Shariah Governance of Malaysian Islamic Banking Institutions' (2011) 14 Jurnal Ekonom 54.

¹²⁵² Md. HafijUllah, 'Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh' (2013) 1 International Journal of Social Science Research 111, 112.

¹²⁵³ Wafik Graiss and Matteo Pellegrini, 'Corporate Governance in Institutions Offering Islamic Financial services, Issues and Options' November 2006, WPS 4052, World Bank Policy Research, 19.

¹²⁵⁴ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 141.

¹²⁵⁵ IrajToutouchian, 'An Analytical Review of Islamic Banking as Practiced in Iran' (1998) IDB, IRTI, 64.

members of the Sharia supervisory board, which would in turn preserve the independence of the Sharia scholars.

Senior and Junior Scholars

The numbers of Islamic banking and financial institutions in the world are increasing significantly, while the number of the scholars and experts are not increasing at the same rate.¹²⁵⁶ Thus, there are a limited number of professional scholars in the field of Islamic finance around the world.¹²⁵⁷ Therefore, some top scholars are appointed to more than 50 Sharia boards of Islamic financial institutions¹²⁵⁸ which makes it difficult for them to concentrate on their job or at least do their job properly. There are some senior scholars who have experienced that all Islamic banks in the world hoped to appoint them as a member to their Sharia supervisory boards. These top scholars serve in several Islamic banks at the same time which increases the risk of a conflict of interest.¹²⁵⁹ Hence, these senior scholars dominate the Sharia boards of Islamic financial institutions.¹²⁶⁰

In contrast, junior scholars or recently graduated scholars cannot take a position in any Sharia board as they do not have sufficient professional experience, which is required by almost all Islamic financial institutions. This author argues that not appointing these junior Sharia scholars has two outcomes. Firstly, it is the right of the Islamic financial institution, whose priority is the work, to have scholars who have experience and are famous among the public.

¹²⁵⁶ Prof. Dr. Mohamad Akram Laldin, 'Duties and Responsibilities of Shari'ah Boards from a Legal and Regulatory Perspective' September 2012, <<http://www.amanie-icconnect.com/component/k2/item/31-duties-and-responsibilities-of-shari%E2%80%99ah-boards-from-a-legal-and-regulatory-perspective>> accessed 13 November 2016.

¹²⁵⁷ Muhammad Shaukat Malik, Ali Malik and Waqas Mustafa, 'Controversies that Make Islamic Banking Controversial: An Analysis of Issues and Challenges' (2011) 2 American Journal of Social and Management Sciences 41, 42.

¹²⁵⁸ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137, 141.

¹²⁵⁹ The top 20 scholars serve on 621 boards globally, said Zawya and Funds Work AG, a Dubai-based research company.

See: Dana El Baltaji and Haris Anwar, 'Shariah Scholar on More Than 50 Boards Opposes Limit Plan: Islamic Finance' November 2010, <<http://www.bloomberg.com/news/2010-11-23/shariah-scholar-on-more-than-50-boards-opposes-limit-plan-islamic-finance.html>> accessed 10 November 2016.

¹²⁶⁰ For example, the Bahraini national Sheikh Nizam Yaquby was the most popular Sharia scholar, holding 77 positions (57 in GCC and 20 in international banks) and the Syrian national Abdul Sattar Abu Ghuddah. With a PhD in Islamic Law from Al-Azhar University Cairo, Egypt, he was found to give Sharia advice at 72 positions (54 in GCC and 18 in international banks). Furthermore, Dr. Mohammed Ali Elgari from Saudi Arabia. He did his PhD in economics from the University of California and held a total of 65 positions (50 in GCC and 15 in international banks).

See: Tahreem Noor Khan, 'Enhancing Islamic Financial Brand: Shari'ah Board Theoretical Conceptual Framework' (2015) 3 Journal of Islamic Banking and Finance 62, 64.

See also: The national, 'Islamic Finance Industry Needs More Experts' <<http://www.thenational.ae/business/industry-insights/finance/islamic-finance-industry-needs-more-experts>> accessed 13 November 2016.

Also, if the Islamic financial institution selects one junior scholar who is new in the field and does not have practical experience, the institution would have to establish training courses for him and spend money on this process. The second outcome is, the fresh graduate scholar also has the desire to work in the Islamic banking field and obtain experience. However, there is no space for junior scholars to be appointed as Sharia supervisory members. Therefore, the author further argues that the shortage of Islamic banking experts and scholars is not only because there are insufficient numbers of them but also because there are insufficient qualified and senior experts who have worked in the field for many years.

Some Sharia scholars make large amounts of money per transaction.¹²⁶¹ Thus, top scholars can earn an astronomical income on a per project basis. ‘Scholars can earn up to \$150,000¹²⁶² per project and it can take four to six months for a Sharia-compliant project to be developed’.¹²⁶³ It seems that training and educating fresh scholars is needed by Islamic banks in order to increase the number of scholars.¹²⁶⁴ There is one vital point that should be considered by the Islamic financial institutions which is confidentiality.¹²⁶⁵ In fact, appointing Sharia scholars on more than one Sharia supervisory board will affect Islamic banking confidentiality, as the member accesses a wide range of the bank’s documents.¹²⁶⁶ However, having scholars serve on several Sharia supervisory boards at the same time can help standardize Islamic banking products and transactions¹²⁶⁷ but it also increases risk of conflict¹²⁶⁸ and can cause a lack of confidentiality.¹²⁶⁹ Therefore, this author argues that for a junior scholar to be accepted for appointment as a Sharia board member, they can work for a few years as a volunteer in Islamic financial institutions in order to obtain some experience after graduating or during their studies.

¹²⁶¹ Feisal Khan, *Islamic Banking in Pakistan: Shariah-Compliant Finance and the Quest to Make Pakistan More Islamic* (1st edn, Routledge NY 2015) 113.

¹²⁶² Equivalent to approximately 95000 Sterling.

¹²⁶³ Sayd Farook and Mohammad Omar Farooq, ‘Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance’ (2013) 5 *ISRA International Journal of Islamic Finance* 137, 142.

¹²⁶⁴ Prof. Dr. Mohamad Akram Laldin, ‘Duties and Responsibilities of Shari’ah Boards from a Legal and Regulatory Perspective’ (September 2012) <<http://www.amaniecoe.com/articles/item/duties-and-responsibilities-of-shari-ah-boards-from-a-legal-and-regulatory-perspective>> accessed 13 November 2016.

¹²⁶⁵ See Chapter Six 6.8. A.

¹²⁶⁶ Professor Rodney Wilson, ‘Shari’ah Governance for Islamic Financial Institutions’ *Global Islamic Finance* (5 December 2011) <<http://www.global-islamic-finance.com/2011/12/shariah-governance-for-islamic.html>> accessed 13 November 2016.

¹²⁶⁷ Sayd Farook and Mohammad Omar Farooq, ‘Shariah Governance Expertise and Profession: Educational challenges in Islamic Finance’ (2013) 5 *ISRA International Journal of Islamic Finance* 137, 141.

¹²⁶⁸ Dana El Baltaji and Haris Anwar, ‘Shariah Scholar on More Than 50 Boards Opposes Limit Plan: Islamic Finance’ November 2010, <<http://www.bloomberg.com/news/2010-11-23/shariah-scholar-on-more-than-50-boards-opposes-limit-plan-islamic-finance.html>> accessed 13 November 2016.

¹²⁶⁹ Professor Rodney Wilson, ‘Shari’ah Governance for Islamic Financial Institutions’ *Global Islamic Finance* (5 December 2011) <<http://www.global-islamic-finance.com/2011/12/shariah-governance-for-islamic.html>> accessed 13 November 2016.

6.9. What Does the Iraqi Islamic Banking Industry Need to Do?

To resolve the shortage of Islamic banking experts, it is necessary to know which body or office is responsible and then decide what should be done by this body. In Iraq, the CBI and the Islamic financial institutions are responsible for the issue. The government through the CBI with the assistance of financial regulators and Sharia experts attempts to resolve the issue. In addition, Islamic financial institutions should have their active role in finding the solution for the issue. Therefore, there should be cooperation between the CBI and the Islamic financial institutions. Thus, the role of the CBI and Islamic financial institutions will be explained below:

6.9.1. The Role of the CBI in Resolving the Problem of Shortage of Experts

The CBI has exclusive authority to take any action relating to banking institutions in Iraq under the CBI Law 2004.¹²⁷⁰ Therefore, any challenge faced by any financial institution is responsibility of the CBI first and then the institution. Thus, the lack of qualified Islamic banking experts in Iraq is the responsibility of the CBI first and foremost.¹²⁷¹ The CBI can cooperate with other countries that have successfully dealt with a shortage of Islamic banking experts in their country.¹²⁷² Furthermore, the financial regulators of the CBI can cooperate with Iraqi universities to offer courses in the Islamic banking business.¹²⁷³ They can ask and encourage scholars and academics in Islamic banking to teach in these universities as a first step.

Alternatively, the CBI can provide scholarships to certain students to study abroad in Islamic banking courses. Currently, the Iraqi Government has scholarship programmes to send students outside Iraq to complete their studies.¹²⁷⁴ In this regard, the CBI can attempt to send students

¹²⁷⁰ CBI Law 2004, Article 40, Supervision of Banks

¹²⁷¹ Interview with Bashir Hadad, Sharia supervisory board member, Cihan Islamic Bank, (Erbil, May 2015).

¹²⁷² Financial regulators of the CBI can have a proper plan for resolving the issue of the shortage of Islamic banking experts as they are governing financial sectors in the country and they have authority. The CBI has to benefit from those countries that have advanced Islamic banking systems, such as Malaysia. In this context, a group of the CBI financial regulators can request assistance from Bahrain or Malaysia in relation to Islamic banking experts. They can learn from the BNM and CBB how they dealt with the issue of a shortage of qualified Islamic banking experts.

¹²⁷³ The University of Human Development (UHD), Department of the Science of Finance and Banking is the best example. This department could be developed to include courses in Islamic banking area. However, it is also possible for the CBI to request and help the UHD to open a new department such as Department of Islamic Banking in the UHD.

¹²⁷⁴ "Foreign education became a possibility for local students when the Higher Committee for Education Development in Iraq launched the Iraq Educational Initiative, which was tasked with sending Iraqi students to pursue graduate or undergraduate studies at accredited foreign universities.

The program began in 2009-2010, and functions in partnership with English speaking countries as well as some that teach in English, to send students to a selection of schools that are accredited with the Ministry of Higher Education and appear on UNESCO's list of international universities. In first year, 612 students were sent, and in

abroad to study Islamic banking degrees. At present, it is necessary to invite certain academics for running workshops and training courses for the education of Islamic banking staff because most of the staff have conventional skills rather than Islamic banking knowledge.¹²⁷⁵ Therefore, it is necessary for the Iraqi government to provide funds for achieving this goal of creating Islamic banking experts. This can be conducted by the CBI to achieve the goal of creating qualified Islamic banking experts.

Another responsibility of the CBI is to link Islamic banks in Iraq to Islamic banks outside the country.¹²⁷⁶ There is a need for increased cooperation between countries that have Islamic banking industries. Thus, this can be done by establishing a global Sharia council to include all countries that have an Islamic banking industry.¹²⁷⁷ The CBI should have good connections with other countries to develop its Islamic banking system, especially to develop the human capacity of the industry which currently is a problem.

For this purpose, the Iraqi government through the CBI or Ministry of Finance can request assistance from other countries. In this context, Iraq is a member of certain international organisations related to Islamic countries.¹²⁷⁸ The Iraqi government via these organisations can request assistance from other countries to develop its Islamic banking system. The best and most famous organisation would be the Organisation of Islamic Countries (OIC);¹²⁷⁹ Iraq is a member of this organisation.¹²⁸⁰ The CBI can have an agreement with other members of the

2011, 1,000 scholarships were awarded. The students are mostly pursuing PhD studies, and are primarily pursuing studies in engineering, agriculture, computer science, and hard sciences.

Right now, there is up to \$200 million in scholarships available for studies abroad. For example, the Human Capacity Development Program in Higher Education (HCDP) provides US \$100 million in scholarship support solely for students from Iraq's autonomous Kurdistan region, and to date more than 4,000 Kurdish graduates have been awarded scholarships to study for masters and PhDs in international universities".

See: ICEF Monitor, 'Iraq study programmes and scholarships' <<http://monitor.icef.com/2013/03/200-million-in-international-scholarships-makes-iraq-an-emerging-market/>> accessed 14 November 2016.

¹²⁷⁵ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks Between Originality and Practice' (2013) 40 Sharia Science and Law studies 89, 100 (translated from the original Arabic text by the author).

¹²⁷⁶ The Iraqi government through the CBI can create a bridge between Islamic banking industry in Iraq with other countries Islamic banking sector, especially those countries that have an advanced Islamic banking system, like Malaysia, Bahrain and some other countries.

¹²⁷⁷ The International Union of Muslim Scholars, <<http://www.iumsonline.net/ar/Default.asp?ContentID=4896&menu>> accessed 14 November 2016.

¹²⁷⁸ The famous organisation is OIC which Iraq is a member of this organisation.

¹²⁷⁹ The Organization of Islamic Cooperation (OIC) (formerly Organization of the Islamic Conference) is the second largest inter-governmental organization after the United Nations which has membership of 57 states spread over four continents. The Organization was established upon a decision of the historical summit which took place in Rabat, Kingdom of Morocco on 25 September 1969.

See: Organisation of Islamic Cooperation, 'About OIC' <http://www.oic-oci.org/oicv2/page/?p_id=52&p_ref=26&lan=en> accessed 14 November 2016.

¹²⁸⁰ Organisation of Islamic Cooperation, 'Member States' <<http://www.oic-oci.org/oicv2/states/>> accessed 14 November 2016.

OIC for developing its Islamic banking system, including human capital development. This organization is the collective voice of the Muslim world and aims to safeguard and protect the interests of the Muslim world in the spirit of promoting international peace. Therefore, as a Muslim country, Iraq can make an agreement with countries like Malaysia or Bahrain for training its Islamic banking staff and scholars. In addition, as there are many Arab countries in the OIC, it is easier for Iraq to ask assistance from those countries to open training courses for Islamic banking staff since there would not be a language barrier.

6.9.2. The Role of Islamic Financial Institutions in Resolving the Shortage of Experts

Islamic banking institutions also should have their role to play in resolving the shortage of qualified Islamic banking experts issue in Iraq.¹²⁸¹ There is no doubt that the shortage of qualified Islamic banking experts in Iraq affects Islamic banks and it is a challenge for the Islamic banking industry.¹²⁸² Therefore, Islamic banking institutions should have a plan to tackle the shortage of qualified Sharia scholars who take part in the Sharia supervisory board. In addition, Islamic banks should also have specific programmes for teaching and educating their staff, because some of them may not have a background in Sharia law or Islamic finance.¹²⁸³ To resolve this issue, there should be cooperation between the CBI and Islamic financial institutions in Iraq. On the other hand, there should be cooperation among Islamic financial institutions to find solutions for the shortage of Islamic banking experts.

By cooperating with the CBI, Islamic banks can bring Islamic banking experts from other countries to open training courses and workshops for their staff as an initial solution.¹²⁸⁴ Otherwise, Islamic financial institutions can send a group of people for some training courses in Bahrain which is considered to be a centre for Islamic finance to undergo training courses and bring back some experience regarding the governance of Islamic banking transactions.¹²⁸⁵ Inviting experts from Malaysia or Bahrain can also be a good choice for the current situation

¹²⁸¹ Interview with Bashir Hadad, Sharia supervisory board member, Cihan Islamic Bank, (Erbil, May 2015).

¹²⁸² Hashim Omer Hamoudi, 'Towards Activating the Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

¹²⁸³ Fuad Abdullah Al-Omar and Munawar Iqbal, 'Challenges Facing Islamic Banking in the 21st Century' (Proceedings of the Second Harvard University Forum on Islamic Finance: Islamic Finance into the 21st Century Cambridge, Massachusetts. Center for Middle Eastern Studies, Harvard University. 1999).

¹²⁸⁴ These Islamic banking experts could be academic staff of universities and institutes who teach Islamic banking and related Islamic banking courses. For this purpose, academic staff from BIBF in Bahrain or Institute of Islamic Finance (ETHICA) in UAE are preferred. These two institutes are in Arab (Muslim) countries and share a common language with staff of the Iraqi Islamic banks which is Arabic.

¹²⁸⁵ It is also possible for the Islamic banks in Iraq to provide loans for students to study an Islamic banking degree and then come back to work in the Islamic banks dependent on an agreement between the bank and the students.

until the CBI can produce Islamic banking experts for the industry and find a solution for the issue. However, this author argues that inviting Islamic banking experts from other countries to serve in Iraq is not easy because the political and security situation in Iraq is unstable. Nevertheless, the Kurdistan region is safe to some extent compared to the other parts of Iraq, making it possible to open training courses and workshops for all Islamic banks in Iraq in this region. Thus, the training courses can take place in the Kurdistan region. Furthermore, this thesis argues that Islamic banks in Iraq should provide sufficient funds to develop the skills of its personnel.¹²⁸⁶

6.10. Conclusion

This chapter deals with the problem of the shortage of qualified Islamic banking experts in the Iraqi Islamic banking industry. This chapter answers research question number [4] which is: What are the human resource issues that negatively impact the Iraqi Islamic banking system, and how can they be resolved as accomplished by other countries' Islamic banking systems? In this regard, one of the current challenges of the Iraqi Islamic banking system is the shortage of qualified Islamic banking experts which has a negative impact on the sector.¹²⁸⁷ Thus, the shortage of qualified Islamic banking experts slows down the development of the Islamic banking industry. Having qualified Islamic banking experts can enhance the industry and help it improve and compete with the conventional banking sector. Moreover, the role of the scholars of Sharia supervisory boards of Islamic banks is to supervise and regulate Islamic banks under Sharia law. It is worth mentioning that many Islamic banks have a shortage of qualified Islamic banking experts, but some countries have devised ways to resolve the problem to a certain extent.

Some countries have large numbers of centres or universities for minimising the issue and they have produced many Islamic banking experts, such as INCEIF in Malaysia and BIBF in Bahrain. These two centres have an important role in producing Islamic banking experts in Malaysia and Bahrain. At the same time, they could open training courses for Islamic banking staff in all aspects related to Islamic banking. Thus, legal and Sharia experts can be educated and trained in Malaysia through INCEIF and in Bahrain through BIBF. However, in general, there is a need to develop human capital in Islamic banking all over the world, for both Sharia

¹²⁸⁶ Al- Baraka Islamic Bank in Iraq sent all its staff to Turkey to take some training courses in Islamic banking. Interview with Armagan Bayrem, Corporate banking director, Al-Baraka Islamic Bank, (Erbil, June 2015).

¹²⁸⁷ Hashim Omer Hamoudi, 'Towards Activating the Comprehensive Sharia Audit on The Work of Islamic Banks in Iraq' (2013) 9 Tikrit Journal for Administration and Economic Science 251, 260.

scholars as well as staff and employees of the banks. As for Sharia scholars, they should have comprehensive knowledge regarding Sharia, legal matters, conventional finance and modern economics. Furthermore, the staff of Islamic banks should also have knowledge of Sharia as most of them come from conventional backgrounds.

The appointment of Sharia board members differ from one country to another. In Malaysia, the board members are appointed by the Board of Directors while in Bahrain, they are selected by the shareholders. In contrast, in Iraq, the members of the board are appointed by the General Assembly. However, as the members are paid by the Islamic bank, in all cases the Islamic bank may influence them and thus dilute their independence. Therefore, it is better to be appointed and paid by the central Sharia board or the central bank.¹²⁸⁸

Because the Islamic banking industry is well developed in Bahrain and Malaysia, Islamic banks in these two countries attempt to have well-known experienced scholars for their Sharia supervisory boards. In Bahrain, for example, the Standard Chartered Bahrain (Islamic Banking Account) Sharia supervisory committee is famous because it has the top Sharia scholars in the world.¹²⁸⁹ Similar to Bahrain, in Malaysia, some Islamic banks have the most renowned Sharia scholars for their Sharia committees, for example Bank Islam Malaysia.¹²⁹⁰ Thus, there is none to limited space for young scholars and recent university graduates to be appointed as a member of the board in Islamic banks. On the other hand, as the sector is still new in Iraq and the shortage of Islamic banking experts is a big challenge,¹²⁹¹ the lack of senior scholars in Iraq will remain a certainty for some time to come.

Regarding the experience of the scholars who sit on the Sharia supervisory board, some senior scholars dominate the Sharia boards of many Islamic financial institutions. Thus, the young scholars cannot replace the senior scholars even though there are more junior scholars than

¹²⁸⁸ Appointing and paying Sharia scholars of the Islamic banks by other bodies rather than Islamic banks could increase independence and help the Sharia supervisory board to make right decisions on Islamic banking transactions.

¹²⁸⁹ Members of Sharia committee are: Dr. Abdul Sattar Abu Ghuddah, Sheikh Nizam Yaquby and Dr. Mohamed Ali Elgari.

See: Standard Chartered Bahrain, Islamic Banking, 'Sharia Supervisory Committee' <<https://www.sc.com/bh/islamic-banking/en/>> accessed 14 November 2016.

¹²⁹⁰ Members of the Sharia advisory committee are: Ustaz Dr. Ahmad Shahbari, Dato' Ustaz Mohd Bakir Haji, Assistant Professor Dr. Uzaimah Ibrahim, Ustaz Dr. Muhammad Syafii Antonio, Professor Dr. Ahmad Hidayat Buang and Dr. Yasmin Hanani Mohd. Safian.

See: Islam Bank, 'Sharia Supervisory Council' <<http://www.bankislam.com.my/home/assets/uploads/shariah-supervisory2015.png>> accessed 14 November 2016.

¹²⁹¹ Sahar Nasr 'Republic of Iraq: Financial Sector Review' (2010), The World Bank, Middle East and North Africa Region, 24

seniors. Therefore, the shortage of the Islamic banking scholars is not just due to insufficient scholars in the world but also because there are not enough scholars with sufficient experience.. Nonetheless, there may be more new scholars soon, as every year a large number of them graduate from universities and centers with Islamic banking certificates and degrees.

As for Iraq, Islamic banks have a lack of qualified Sharia scholars as well as a shortage of trained Islamic banking staff. To resolve the shortage of Sharia scholars in the current situation, each Islamic bank could appoint one Sharia advisor who serves in only one bank and in the level of the central bank there should be a central Sharia board. Another possible solution for Iraq is to establish a unified Sharia board that consists of Sharia scholars of all Islamic banks. However, the establishment of a Sharia consultancy firm could also resolve the shortage of Islamic banking Sharia scholars. As for producing qualified staff and employees, Islamic banks should provide funds for the establishment of training courses and workshops in order to provide specialized courses.

In that sense, there is a need for cooperation between Islamic banks and the CBI to resolve the problem of the shortage of Islamic banking experts. Thus, the CBI and Islamic banks in Iraq could provide scholarships for qualified students to take Islamic banking courses in foreign and local universities as to develop the human capital of the Islamic banking industry.

In this regard, the Islamic banks or the CBI can cooperate with the Human Development University (UHD) to teach courses related to Islamic banking and financial systems. The CBI can support this university in educating Islamic banking scholars as well as training staff in the current Islamic banks. In addition, inviting academics to teach in universities in Iraq and to run workshops and training courses for bankers can also be a solution. Another solution for the current situation would be to invite qualified Islamic banking experts to monitor and run Islamic banking transactions in Islamic financial institutions. In short, the regulators of the CBI can benefit from other countries' methods in resolving this issue. They can also establish related centres for the enhancement of Islamic banks similar to the Waqf Fund in Bahrain.

In this case, the CBI can benefit from Malaysia and Bahrain, as the central banks of Malaysia and Bahrain have their vital role in resolving the shortage of Islamic banking experts. In Malaysia for example, the BNM has a role in the establishment of INCEIF, which was a good move done by the BNM in supporting Islamic banks and the development of human capital in

this industry.¹²⁹² In addition, there is a SAC in the BNM which covers all Sharia related matters of Islamic financial institutions.¹²⁹³ In Bahrain, under the auspices of the CBB in partnership with Islamic Financial Institutions, the Waqf Fund was established¹²⁹⁴ to enhance Islamic banks and resolve the shortage of experts in the field of Islamic finance.¹²⁹⁵ Therefore, the CBI can establish a special department similar to the Waqf fund. In addition, the CBI could establish or request the UHD to open an Islamic banking department. The courses that would be offered by the department would include all subjects relating to the Islamic banking system, which would cover both legal and Sharia aspects of the Islamic banking industry.

¹²⁹² INCEIF, 'Bank Negara Malaysia' <<http://www.inceif.org/about/bank-negara-malaysia/>> accessed 14 November 2016.

¹²⁹³ BNM, 'About the Bank' <<http://www.bnm.gov.my/index.php?ch=7&pg=715&ac=802>> accessed 14 December 2016.

¹²⁹⁴ CBB, 'The Waqf Fund' <<http://www.cbb.gov.bh/page-p-waqaf-fund-page.htm>> accessed 14 November 2016.

¹²⁹⁵ Bahrain, Economic Year Book, 'Economic Development Board' <<http://www.bahrainedb.com/en/EDBDocuments/Bahrain-Economic-Yearbook.pdf>> accessed 14 December 2016.

Chapter Seven: Conclusions

7.1. Introduction

During the course of this thesis, the author has critically evaluated the Iraqi Islamic banking system. During this critical evaluation, both legal and Sharia aspects of the Islamic banking industry of Iraq were examined, and the focus of this research is limited to those aspects. Therefore, due to the lack of fundamental and important elements in the Iraqi Islamic banking system such as the lack of comprehensive legal and Sharia framework, matters relating to the courts and dispute resolutions in Islamic banking are not included in this thesis. Accordingly, the thesis analyses the Iraqi Islamic banking system in order to identify the current legal and Sharia deficiencies of the system. For the purposes of this doctoral thesis, the case studies of Malaysia and Bahrain are used because these two countries have significant experience in regulating and governing the Islamic banking industry.¹²⁹⁶

For the purpose of data collection for this thesis, the author depended on both primary and secondary sources such as black letter laws, legal analysis, Sharia analysis and empirical research. The empirical research forms an important part of this thesis, particularly the interviews. The interviews were conducted on the Iraqi Islamic banking system and all the interviews were conducted in Kurdistan. The interviews strengthen the arguments that are provided by this author. In addition, as there is a shortage of literature about the Iraqi Islamic banking system, these interviews can be used as a main source for this thesis. Furthermore, because the interviewees are academic experts and bankers, the author could accept the opinion and views of the practitioners and academics about the Islamic banking system in Iraq.

This thesis answers 4 research questions as a way to explore and identify the main challenges of the Iraqi Islamic banking industry.¹²⁹⁷ Solutions leading to the resolution of these problems has been proposed, using inspiration drawn from the Malaysian and Bahraini Islamic banking systems.¹²⁹⁸

¹²⁹⁶ Malaysia established its Islamic banking system in 1983 and Bahrain established its Islamic banking system in 1979. Both Malaysia and Bahrain have a comprehensive legal and Sharia framework for their Islamic banking industries.

¹²⁹⁷ See Chapter One, 1.3 for the research questions.

¹²⁹⁸ It is worth mentioning that the Islamic banking systems of some other countries, such as Kuwait, Qatar, Pakistan and UAE are referred to in this thesis when related matters are found in their Islamic banking frameworks.

7.2. Summary and Findings

This thesis is divided into seven chapters. The author will now briefly set out the seven chapters and their most salient contents.

7.2.1. Chapter One – Introduction to the Thesis:

Chapter one sets out the background of this doctoral thesis and the research questions. This chapter provides an overview of the current Iraqi Islamic banking system and the problems linked to the legal and Sharia aspects of the Islamic banking industry in Iraq. It discusses the relevant literature and explains the rationale for this doctoral thesis¹²⁹⁹

7.2.2. Chapter Two - Islamic Banking: Its Modern Form

Chapter two provides an overview of the Islamic banking system. The regulation and supervision aspects of the Islamic banking industry are explained further. Most of the important Islamic banking tools and instruments are described and explained in this chapter. The general Islamic banking system is explained in this chapter in order to give the reader an overview of Islamic banking operations and transactions.¹³⁰⁰

7.2.3. Chapter Three - Islamic Banking System of Iraq: Its Regulation and Operation

Chapter three examines the Iraqi Islamic banking system. The main challenges that are faced by the Islamic banking industry in Iraq are identified in this chapter.¹³⁰¹ Hence, chapter three answers research question Number 1.¹³⁰²

The main findings of chapter three are:

- a) The Iraqi Islamic banking industry faces two distinct challenges that are legal and Sharia in nature. Collectively, these challenges impact negatively on the economic system of the country because the Iraqi Islamic banking industry is part of the country's economic system.¹³⁰³
- b) The Iraqi Islamic banking industry is regulated by the Islamic Banking Law of 2015 and is governed by conventional laws (general banking laws) which are unsuitable for Islamic banks. These conventional laws, the Iraqi Banking Law 2004 and the CBI Law 2004 are not entirely

¹²⁹⁹ See Chapter One.

¹³⁰⁰ See Chapter Two on the Islamic banking system in general.

¹³⁰¹ See Chapter Three on the Iraqi Islamic banking system.

¹³⁰² See Chapter One, 1.3.1.

¹³⁰³ See Chapter Three, 3.8 on the challenges of the Iraqi Islamic banking system.

appropriate legislation for the regulation of Islamic banks in Iraq as these laws are designed for regulating the conventional banking sector.¹³⁰⁴

c) The CBI deals with Islamic banks in the same way as conventional banks: The relationship between the CBI and Islamic banks is based on *riba*, which is prohibited by the Sharia law.¹³⁰⁵

d) The Islamic Banking Law 2015 which was enacted at the end of 2015 for the regulation of Islamic banks is incomplete. This law does not include a specific set of rules aimed at the regulation of the Iraqi Islamic banking industry. For instance, the requirements and conditions of licensing for Islamic banks are not included in the Islamic Banking Law 2015.¹³⁰⁶

e) Due to the lack of a central Sharia board and the lack of qualified Islamic banking Sharia scholars and experts, the supervisory system of the Iraqi Islamic banking industry is ineffective.

7.2.4. Chapter Four - Legal Challenges of the Islamic Banking System of Iraq:

Chapter four deals with the legal challenges faced by the Iraqi Islamic banking system. The main legal challenges of the Islamic banking system are identified. The lack of a comprehensive Islamic banking legal framework¹³⁰⁷ and the problematic relationship between the CBI and Islamic banks¹³⁰⁸ are the two main legal challenges currently faced by the Iraqi Islamic banking industry. These challenges are critically evaluated in the light of the Malaysian and Bahraini Islamic banking systems.¹³⁰⁹ Chapter Four answers research question Number 2.¹³¹⁰

The key findings of chapter four are as follows:

a) The Islamic Banking Law 2015 of Iraq is neither complete nor comprehensive due to the lack of many important fundamental elements such as a lack of determining a higher body for resolving Sharia issues, lack of specifying qualifications for the staff of Islamic banks and lack of licencing requirements.

¹³⁰⁴ Mustafa Natiq Salih Matlub, 'Obstacles to the Work of the Islamic Banks and Ways of Curing them for Development' (2012) Research and Islamic Studies Magazine 287, 294 (translated from the original Arabic text by the author).

¹³⁰⁵ Suad Abdul Fatah M B 'The Role of Islamic Banks in Development and Investment: their Role in Iraq' (2010) 24 Journal of the College of Baghdad for Economic Science' 1, 17 (translated from the original Arabic text by the author).

¹³⁰⁶ See Chapter Three 3.6.2 on Internal Instruction 2006.

¹³⁰⁷ Iraqi Council of Representatives, Mohammad Ahmed Jawad, 'Finance Committee Report on Banking System Reform Requirements in Iraq' Iraq report 2014, Council of Representatives Finance Committee, 38.

¹³⁰⁸ See Chapter Four 4.3.2 for the relationship between the CBI and Islamic banks in Iraq.

¹³⁰⁹ See Chapter Four regarding to the legal aspects of the Iraqi Islamic banking system.

¹³¹⁰ See Chapter One, 1.3.2.

b) The current Banking Law 2004 of Iraq does not refer to the Islamic banking industry in its provisions, even though Iraqi Islamic banks are part of the Iraqi banking system.

c) The current Iraqi Islamic banking legal framework should be reformed. Despite its recent adoption, the Islamic Banking Law 2015 that was established for regulating the Islamic banking industry should be amended as the first step. Furthermore, the current Iraqi Banking Law 2004 and the CBI Law 2004 should be amended to include Islamic banks in Iraq.

d) The current Islamic banking legal frameworks of Malaysia and Bahrain can be good templates for Iraq. Malaysia's Islamic Financial Services Act 2013 (IFSA) and Volume 2 - Islamic Banks of Bahrain may significantly assist Iraqi legislators and the CBI financial regulators when it comes to amending the Islamic Banking Law 2015 of Iraq.¹³¹¹

e) The CBI's relationship with Islamic banks is not ideal from the Sharia point of view, because this relationship is based on *riba*. For instance, the CBI as a lender of last resort treats Islamic banks in the same manner as conventional banks in the event of a liquidity crisis when Islamic banks are in need. Thus, the CBI should deal with Islamic banks differently than conventional banks in the case of liquidity crises.¹³¹²

f) Regarding the issue of the liquidity crisis in the Islamic banks, in Malaysia and Bahrain, there is an Islamic inter-bank money market for resolving this issue to some extent. However, it is difficult for Iraq to establish an Islamic inter-bank money market because the Iraqi Islamic banking system lacks certain fundamental elements such as a comprehensive Islamic banking law. In that context, the solution for the Iraqi Islamic banking industry in the event of a liquidity crisis would be interest free loans (*Qard al-hasan*).¹³¹³

It is also one of the best solutions for Iraqi Islamic banks in a liquidity crisis to apply to the common pool, which is a small council containing all Islamic banks in the country under the supervision of the CBI. Islamic banks in Iraq may be required to contribute a certain mutually agreed percentage of their deposits to this common pool. Islamic banks have the right to obtain interest free loans from this common pool in the event of a liquidity crisis.

¹³¹¹ The IFSA 2013 of Malaysia and Volume 2-Islamic Banks of Bahrain are complete laws that include all relevant principles for regulating Islamic banking industries in these two countries. For example, both IFSA 2013 and Volume 2-Islamic Bank include Islamic banking licensing conditions and requirements.

¹³¹² See Chapter Four 4.3.2.1.

¹³¹³, Ausaf Ahamad 'Instruments of Regulation and Control of Islamic Banks by the Central Banks' (2000) Islamic Development Banks, Islamic Research and Training Institute 7, 29.

7.2.5. Chapter Five - Sharia Regulation and Supervision of the Iraqi Islamic Banking System:

Chapter five deals with the Sharia regulation and supervision of the Iraqi Islamic banking system in an attempt to find possible solutions to the current Sharia challenges. In that context, the internal and external Sharia supervisory systems of the Iraqi Islamic banking industry were found to be ineffective.¹³¹⁴ Therefore, chapter five provides an answer to research question Number 3.¹³¹⁵

Thus, the main conclusions of chapter five are:

- a) The Sharia supervision of the Islamic banking industry of Iraq is ineffective because firstly, the internal Sharia supervision which comprises of a Sharia supervisory board within each individual Islamic bank lacks qualified Sharia scholars and secondly, external Sharia supervision of the Islamic banking industry of Iraq does not exist.¹³¹⁶
- b) This chapter emphasises that establishing a central Sharia board as part of the CBI is necessary to enhance the Sharia supervisory system of the Iraqi Islamic banking industry. The central Sharia board is important because of these reasons: (1) It can standardise different decisions of the Sharia supervisory boards of Islamic banks; (2) It can be consulted by the courts in any Sharia matters related to the Islamic banking system; and (3) It can be a link between the CBI and Islamic banks.¹³¹⁷
- c) Chapter five demonstrates that the best Sharia supervisory model would comprise of an individual Sharia supervisory board at the Islamic banking level and a central Sharia board at the central bank level.¹³¹⁸ In this model, each product is checked by both the individual Sharia supervisory board of the Islamic bank as well as the central Sharia board. Therefore, this model minimises mistakes in the Sharia supervisory board's decisions on Islamic banking transactions and products.¹³¹⁹
- d) Chapter five asserts that having both internal and external Sharia supervisory boards for the Iraqi Islamic banking industry is preferable. However, currently Iraq is facing a lack of qualified Sharia scholars, and consequently it is better to have a central Sharia board at the CBI

¹³¹⁴ See Chapter Five on Sharia supervision issues of the Iraqi Islamic banking system.

¹³¹⁵ See Chapter One, 1.3.3.

¹³¹⁶ See Chapter Five 5.3 on the nature and structure of Sharia supervision within the Islamic banking system.

¹³¹⁷ See Chapter Five, 5.4 on justification for the establishment of a central Sharia board.

¹³¹⁸ See Chapter Five, 5.7 as to types and models of Sharia supervision of Islamic Banks.

¹³¹⁹ See Chapter Five, 5.7.1 on external - and internal-level Sharia supervision.

with each Islamic bank having one Sharia advisor. It is also a possibility to establish a unified Sharia supervisory board in Iraq which comprises of Sharia scholars from all Islamic banks in Iraq. Thus, this unified Sharia board can supervise all Islamic banks.

e) Chapter five indicated that there are a number of challenges faced by the Sharia supervisory boards of the Islamic banks which have an impact on the decisions that are made by these boards. Firstly, the lack of independence is a challenge because if the members of the Sharia supervisory board are paid by the Islamic bank, then the decisions that are made by the Sharia board may be affected by the Islamic bank's influence. Secondly, non-confidentiality is an issue for Islamic banks. Due to the shortage of Sharia scholars, one scholar may be appointed to more than one Sharia supervisory board. This will cause a conflict of interest and in fact would impact on the confidentiality of the Islamic bank. Thirdly, the lack of experience among the scholars is another challenge for the Sharia supervisory boards of the Islamic banks. Most scholars do not have sufficient knowledge, particularly with regards to the issuance of fatwas. In addition to that, most Sharia scholars do not have knowledge about modern economics. Fourthly, the inconsistency of the decisions of the Sharia supervisory boards is an additional issue for the sharia supervisory boards of Islamic banks, -since each Sharia supervisory board may have a different opinion on the same product. Thus, this affects the confidence of the public and Islamic banking clients. This may cause concerns among the Islamic bank's customers as they may think that the product is not compatible with Sharia principles.

7.2.6. Chapter Six - Shortage of Islamic Banking Experts within the Iraqi Islamic Banking Industry:

Chapter six shows that Iraqi Islamic banks have a problem with a lack of qualified Islamic banking Sharia scholars, as well as a problem with a lack of expert staff and managers. In Iraq, the CBI and Islamic banks are facing the challenge of a shortage of qualified Islamic banking experts.¹³²⁰ Therefore, Chapter six answers research question Number 4.¹³²¹ Hence, this chapter provides some possible solutions for the shortage of qualified Islamic banking experts in Iraq by looking how other countries have resolved this challenge, namely Malaysia and Bahrain.¹³²² The following conclusions can be drawn from Chapter six:

¹³²⁰ Sahar Nasr 'Republic of Iraq: Financial Sector Review' (2010), The World Bank, Middle East and North Africa Region, 24.

¹³²¹ See Chapter One, 1.3.4.

¹³²² See Chapter Six on human resources of the Islamic banking industry of Iraq.

a) Due to the lack of centres and universities for the training of the Islamic banking experts, Iraqi Islamic banks cannot find enough qualified Islamic banking experts. Thus, most of the staff working in Islamic banks in Iraq come from conventional banks and they do not have sufficient knowledge and experience in Islamic banking transactions and services.¹³²³ In addition, most of the Sharia scholars have limited knowledge of Islamic banking, as well as modern economies and conventional banking. In fact, most of the Sharia scholars in Iraq are men of religion (*imam*) who have knowledge of Sharia matters but they are not specialised in Islamic banking transactions and contracts.

b) Chapter six emphasises that it is the Islamic banks' responsibility to open training courses for their staff to be educated in the Islamic banking business.¹³²⁴ Thus, Iraqi Islamic banks should provide funds for the purpose of training their staff and managers. In that regard, Islamic banks can bring Islamic banking specialists from Bahrain to educate their staff, managers and Sharia scholars.

c) Chapter six examines some of the countries that have advanced Islamic banking systems, to learn how those countries have resolved their shortage of Islamic banking experts. In this regard, Malaysia and Bahrain, as two countries with advanced Islamic banking systems are looked at. Malaysia has resolved the problem to some extent by offering Islamic banking courses in several universities and centres in the country, such as in INCEIF and the International Islamic University Malaysia.

On the other hand, in Bahrain, the BIBF offers courses in Islamic banking. In addition, there is a Waqf Fund that was established by the CBB for supporting the Islamic banking industry and providing training courses for Islamic banking staff.¹³²⁵ In that context, the CBI can derive inspiration from looking at the Malaysian and Bahraini models.

d) The CBI should request and assist universities in Iraq in providing courses and degrees in Islamic banking. For this purpose, the Department of the Science of Finance and Banking in the UHD in Iraq can be developed to offer degrees in the Islamic banking area for training and

¹³²³ Hiam Muhammad Abdulqadir Zedanain, 'Sharia Supervision of Islamic Banks: Between Originality and Practice' (2013) 40 *Sharia Science and Law Studies* 89, 100 (translated from the original Arabic text by the author).

¹³²⁴ Norhanim Dewa and Sabarudin Zakaria, 'Training and Development of Human Capital in Islamic Banking Industry' (2012) 9 *Journal of Islamic Economics, Banking and Finance* 95, 100.

¹³²⁵ See Chapter Six, 6.6 on other countries' methods for resolving the shortage of Islamic banking experts.

producing qualified Islamic banking experts and Sharia scholars. Thus, the CBI shall benefit from the courses and modules that are taught in the BIBF and INCEIF.

e) Chapter six proposes a few other solutions to the shortage of qualified Islamic banking Sharia scholars. Firstly, the establishment of a Sharia Consulting Firm to give advice to Islamic banks on their requests. A second solution could be the appointment of a Sharia Advisor rather than a Sharia Supervisory Board. Each Islamic bank could have one Sharia Advisor instead of a Sharia Supervisory Board which would need three members. In that case, there should be a central Sharia Board at the CBI level. A third solution could be establishing of Unified Sharia Board by all Islamic banks. Thus, Islamic banks could have one unified Sharia Supervisory Board to supervise all the Islamic banks. The members of this unified Sharia Board could include members from all Islamic banks and the board could be paid for by all the Islamic banks.¹³²⁶

Having set out the principal terms and contents of chapters one to six, the author will now deal with how the 4 research questions are answered:

7.3. Answering the Research Questions

7.3.1. Question One

The first question is, “How are Islamic banks governed and regulated in Iraq, and what are the weaknesses in the Iraqi Islamic banking system?”¹³²⁷ To answer this question, the Iraqi Islamic banking system faces both legal and Sharia challenges, which include a lack of a comprehensive Islamic banking legal framework, ineffective Sharia supervision, and a shortage of qualified Islamic banking experts. Therefore, the Islamic banks are governed and supervised by the CBI and regulated by Islamic Banking Law 2015, which is an incomplete set of rules and regulations. Further regulation is provided by the Iraqi Banking Law 2004 and the CBI Law 2004, but these are two pieces of legislation which do not provide specifically for Islamic banking transactions. In addition to these laws, the Internal Instruction 2006 issued by the CBI also guides Islamic banks. The relationship between the CBI and Islamic banks in Iraq is also considered to be a problematic issue. The CBI treats all conventional and Islamic banks on the same basis which is *riba* basis. Therefore, the CBI should deal with Islamic banks

¹³²⁶ See Chapter Six, 6.8 on other possible solutions to the shortage of qualified Islamic banking experts for Iraq.

¹³²⁷ This question was examined in Chapter Three.

according to Sharia principles especially in the situation of a liquidity crisis. In such a situation, the CBI should assist Islamic banks on an interest free basis principle.

7.3.2. Question Two

The second question is, “What are the legal shortcomings in Iraq’s Islamic banking system, and how should they be resolved in light of other countries’ experiences, particularly Malaysia and Bahrain?”¹³²⁸ By way of answer, the Iraqi Islamic banking legal challenges are the lack of an effective legal framework and an inappropriate relationship between the CBI and Islamic banks. The solution to the legal problems is to amend the Islamic Banking Law 2015 of Iraq and to amend the current Iraqi Banking Law 2004 and CBI Law 2004.

Some important provisions should be added to the Islamic Banking Law 2015. For example, some provisions about Islamic banking licence requirements should be added to the law. In addition, the law should clearly specify which body has last word when there is a conflict between an Islamic bank and its clients. The Banking Law 2004 and the CBI Law 2004 should also be amended because these two laws do not refer to Islamic banks. Therefore, some provisions should be added to determine how these laws regulate Islamic banks. The Banking Law 2004 should define the relationship between the CBI and Islamic banks and determine how the CBI regulates and assists Islamic banking industry. Furthermore, the CBI Law 2004 should be amended when the central Sharia board and the Islamic banking department are established in the CBI.

7.3.3. Question Three

The third question is, “What are the principal Sharia regulatory and supervisory problems affecting the Iraqi Islamic banking system, and how can they be resolved, by using examples from other countries?”¹³²⁹ In answer to this, the thesis establishes that the Iraqi Islamic banking system has problems in terms of both internal and external Sharia supervision of the Islamic banking industry. Firstly, the internal Sharia supervision is ineffective because of the lack of qualified Sharia scholars. Secondly, the external Sharia supervision is ineffective because the central Sharia board does not exist. To resolve the problem, the establishment of a central Sharia board is necessary at the CBI level. In addition, the appointment of a Sharia advisor instead of the establishment of a Sharia supervisory board for each Islamic bank is preferred.

¹³²⁸ This question was examined in Chapter Four.

¹³²⁹ This question was examined in Chapter Five.

Accordingly, the Malaysian model which comprises of a central Sharia board in the central bank level with each Islamic bank having its own Sharia supervisory board is the best solution for Iraq. However due to the lack of Sharia scholars in Iraq, all Islamic banks can have only one unified Sharia committee instead of a Sharia supervisory board for each Islamic bank.

7.3.4. Question Four

The fourth question is as follows: “What are the human resource issues that negatively impact the Iraqi Islamic banking system, and how can they be resolved as accomplished by other countries’ Islamic banking systems?”¹³³⁰ This has been answered by pointing out that the Islamic banking industry of Iraq has problems with a lack of qualified Sharia scholars and a shortage of qualified Islamic banking staff and managers. To resolve the issue of a lack of qualified Islamic banking experts in Iraq, the CBI could establish centres and institutes to educate people in the field of Islamic banking. In addition, the Iraqi government could sponsor students to take Islamic banking courses and degrees in foreign universities. Furthermore, Islamic banks could provide training courses for their staff and managers. Bringing in professionals and trainers from other countries like Bahrain can also be a good solution for the shortage of qualified Islamic banking experts in Iraq.

7.4. Recommendations

The author provides various suggestions to reform the Iraqi Islamic banking system. The following are proposed recommendations and suggestions for the CBI, Iraqi financial regulators and the Islamic banks to improve the Islamic banking system of Iraq by addressing the challenges mentioned in this thesis.

Recommendations for the CBI and Financial Regulators

First, the author recommends that the CBI should establish a working group to examine the current conditions of the Islamic banking industry in the Iraq, in order to become more aware of the problems and obstacles faced by this type of bank. The group should consist of legal, financial and Sharia experts. They should study all barriers which hamper the development of the Islamic banking industry. In that regard, the group should visit all Islamic banks in Iraq and consult Sharia scholars and managers of the Islamic banks. In addition, it is also important for this group to talk to some of the Islamic bank’s clients and obtain their opinions regarding services that are provided by these banks.

¹³³⁰ This question was examined in Chapter Six.

Second, the regulators of the CBI should prepare a draft to amend the Islamic Banking Law 2015 of Iraq with regards to the regulation of the Islamic banking industry in Iraq and the amended law should cover the following points:

- i. Licensing requirements and conditions for Islamic banks in Iraq.
- ii. Managing the relationship between the CBI and Islamic banks, and the relationship between the central Sharia board and Sharia supervisory boards of Islamic banks.
- iii. Terrorist finance, corruption and money laundering. (There should be heavy penalties for breaking these provisions.)
- iv. Qualifications required for the Sharia supervisory board members. There should be a clarification of the requirements needed from the scholars who accept positions in Islamic banking institutions or Sharia supervisory boards of Islamic banks.¹³³¹
- v. Determining which law will prevail if there is a conflict between the provisions of the new Islamic Banking Law and other laws that are applicable to Islamic banks, such as the Banking Law 2004.¹³³²
- vi. The independence of the members of the Sharia supervisory boards and central Sharia board.
- vii. Clearly defined and proper requirements needed of the Islamic bank staff.

Banking Law 2004

The author also recommends that the Iraq Banking Law 2004 should be amended, for example Article 33 (2) of the Iraqi Banking Law 2004 should be amended as it is in conflict with Article 5 (6) of the Islamic Banking Law 2015. Article 33 (2) of the Banking Law 2004 states that:

Except in connection with the granting of mortgage loans in the conduct of its banking operations, it shall be prohibited for any bank to possess real estate other than real estate essential to the conduct of its operations and for the housing of its employees and workers. This provision shall not bar the bank from leasing any excess portion of real estate held for the conduct of its operations, provided it obtains the CBI's prior approval. A bank shall dispose of any real estate transferred to it in the course of its banking operations other than mortgage lending as soon as practicable and not later than at a date at which such disposition may occur without incurring a loss and, in any case, within two years of acquiring it at the latest. Upon request by the bank, this period may be extended for two periods of up to two years each by decision of the CBI.¹³³³

¹³³¹ It is also possible for the CBI to issue guidelines for Sharia supervision of Islamic banks and determine all Sharia supervisory members' requirements, such as a qualification of the Sharia scholars and their duties.

¹³³² Other laws that are applicable for Islamic banks would be the Banking Law 2004 and CBI Law 2004.

¹³³³ Iraqi Banking Law 2004, Article 33 (2).

In contrast, Article 5 (6) of the Islamic Banking Law 2015 states that, Islamic banks could hold moveable and immovable properties, sell them, invest them, lease them, and rent them out, etc. However, the Banking Law 2004 under Article 107 (2) states regarding the relationship of the Banking Law 2004 with other provisions of the laws of Iraq: ‘In case of inconsistency with a provision of any other law of Iraq, this Law shall prevail’.¹³³⁴

Hence, the Iraq Banking Law 2004 takes priority over other laws, such as the Islamic Banking Law 2015 and the CBI law 2004, in case of conflict between the provisions of this law with other provisions in other laws.

Therefore, Article 5 (6) of the Islamic Banking Law 2015 will be cancelled by Article 107 of the Banking Law 2004.

Thus, Article 33 (2) of the Iraqi Banking Law 2004 prohibits Islamic banks from conducting some activities that are used by Islamic banks as a mode of finance, such as leasing or *Murabaha*. This Article 33 (2) is contradictive to activities that are allowed by the Sharia law to be conducted by Islamic banks. Therefore, Article 33 (2) should be amended to be suitable for the activities which are practiced by Islamic banks.

In addition, a new Article should be added to the Banking Law 2004 to indicate that conventional banks have the right to offer Islamic banking services if they wish to do so.

Moreover, the Banking Law 2004 should clearly identify which provisions of this law are applicable to Islamic banks and which provisions are not.

The CBI Law 2004

Furthermore, this author also recommends that the CBI Law 2004 should be amended in order to be suitable for regulation of the Islamic banking industry. Thus, the monetary policy tools of the CBI require modification as they are based on interest, which is against Sharia principles. For example, Article 30 of the CBI Law 2004 treats Islamic banks in the same manner as conventional banks in the case of liquidity crises. The CBI assists Islamic banks on the *riba* basis, which is prohibited under Sharia rules. In that regard, Islamic banks cannot receive a loan from the CBI in liquidity crises as the Islamic bank will need pay back the loan with interest. Thus, Article 30 of the CBI Law 2004 should be amended to determine how Islamic banks should be treated when they need liquidity.¹³³⁵ For example, it could be stated in the

¹³³⁴ The Iraq Banking Law 2004, Article 107 (1) and (2).

¹³³⁵ See Chapter Three, 3.6.1.

Article 30 of the CBI Law 2004 that Islamic banks can be exempted being charged interest in case of liquidity crises.

In exceptional circumstances, the CBI may, on such terms and conditions as it determines, act as lender of last resort for a bank that is licensed or holds a permit issued by the CBI under the Banking Law¹³³⁶

Furthermore, it is also necessary for the CBI Law 2004 to be amended when a central Sharia board is established at the CBI level. Thus, a new Article should be added to the CBI Law 2004 to determine the duties and responsibilities of this central Sharia board towards Islamic banks. In addition, the CBI Law 2004 should specify the position of the central Sharia board in the civil courts in case of disputes between Islamic banks and their clients.

Third, the CBI should establish a central Sharia board and a special Islamic banking department. The main function of the central Sharia board would be to deal with Sharia matters of the Islamic banks, such as issues relating to decisions of the individual Sharia supervisory boards of Islamic banks. In addition, the central Sharia board will assist in the Sharia supervision of the Islamic banking industry for example by opening training courses for Sharia scholars. Separately, the main function of the Islamic banking department would be to deal with legal and technical issues of the Islamic banking industry such as dealing with legal documents in the courts in cases of dispute resolution and opening training courses for staff and managers of Islamic banks. In addition, the Islamic banking department can build a link between Islamic banks and CBI regulators to enable the CBI financial regulators to be aware of legal issues of the Islamic banks.

Fourth, the establishment of centres and universities to offer courses about Islamic banking along the lines of those in Malaysia and Bahrain is recommended. Therefore, the CBI and the Ministry of Finance in Iraq could establish a specialist university or centre to enhance Islamic banking human resources. The author also recommends that the CBI or the Ministry of Finance, together with the Iraqi Ministry of Higher Education and Scientific Research should provide scholarships for Iraqi students to study abroad in the field of Islamic banking.

Fifth, this author recommends to the CBI that they should issue special guidelines to facilitate the operation of Islamic banks in the country. In this regard, there should be guidelines to identify the qualifications of the staff and managers who work in Islamic banks. In addition, the guidelines should determine what information should be included in the annual Sharia

¹³³⁶ The CBI Law 2004, Article 30.

supervisory reports. Furthermore, the guidelines should explain how the financial tools and instruments of Islamic banks such as *murabaha*, *musharaka*, *mudaraba* can be applied. Thus, each financial tool should be explained for the Islamic banks to have complete understanding on all transactions. In that context, in Malaysia, there are guidelines on the Governance of Sharia Committee for the Islamic Financial Institutions which was issued in 2005. Hence, the CBI can benefit from Malaysian guidelines by issuing a similar guideline for the Islamic banks in Iraq.

Sixth, the author recommends to the CBI to establish a Sharia research centre similar to International Shari'ah Research Academy (ISRA) in Malaysia for conducting of research on contemporary issues in the Islamic banking industry. Furthermore, this Sharia research center can help Islamic banks in terms of human capital development, such as the opening of training courses for staff of the Islamic banks. In addition, the research centre can create innovative Islamic banking products to encourage development of the Islamic banking system of Iraq.

Recommendations for the Islamic Banks

First, it is necessary to build a more constructive relationship between Islamic banking institutions and their clients. Islamic banks should establish more channels to contact new customers, in order to attract more business and encourage clients to move from the conventional banking system. In this regard, the author suggests that Islamic banks could establish ATMs to make it easier for Islamic bank customers to access their accounts. Furthermore, online and internet banking facilities should also be established by the Islamic banks. In addition, Islamic banks must use various financing tools such as *salam*¹³³⁷ and *istisnaa*¹³³⁸ to connect with their clients; they should not simply rely on *murabaha* only as they are doing currently. They should also attempt to provide agriculture finance and infrastructure finance in order to attract more clients.

Second, this author recommends that Islamic banks should establish awareness via a publicity campaign programme to increase the public's familiarity with Islamic banking services and transactions. Islamic banks should have clear programmes and plans to explain the nature and practice of Islamic banking transactions to the public. In this context, the author recommends that a series of seminars could be conducted and Islamic banks should establish a special group to visit suitable venues and locations to explain Islamic banking transactions and practices. In

¹³³⁷ See Chapter Two, 2.6.4 on *salam* transaction.

¹³³⁸ See Chapter Two, 2.6.6 on *istisnaa* transaction.

addition, television and other media could be used in this campaign as an active method to raise awareness of Islamic banking transactions. In addition, Iraqi Islamic banks can issue a special monthly magazine or journal for publishing their activities for the public. All Islamic banking institutions should cooperate in this endeavour for the benefit of the entire industry. Therefore, Islamic banks should provide funds for this purpose.

This author suggests that the Iraqi Ministry of Finance and the CBI hold an international conference on the Iraqi Islamic banking system as a method of supporting and promoting its Islamic banking system. The participants at the conference could be experts and other knowledgeable people in the area, and their insights and opinions would be helpful for developing the country's Islamic banking regulations and supervision, through systemisation and formalisation of the industry around a proper legal framework.

Lastly, the author suggests that using the name of religious banking or interest free banking in Iraq instead of Islamic banking is preferable because then Islamic banks could attract customers and investors from different religions.¹³³⁹

7.5. Suggestions for Further Research

At the end of this thesis, it should be mentioned that dispute resolution in Islamic banking and finance was not examined in this doctoral thesis. Owing to the lack of special courts for hearing Islamic banking financial cases, disputes arising between an Islamic bank and its clients are referred to the civil courts. Because the judges in the civil courts are not specialised in Sharia law and Islamic banking and finance, the decisions made by these judges may not comply with Sharia rules. Therefore, this author suggests that dispute resolution in Islamic banking and finance in Iraq could be addressed and examined in future research.

¹³³⁹ Even though 99% of the Iraqi people are Muslim, there are some non-Muslims in the country at the same time such as Christians, Yazidis, and Assyrians.

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Interviews

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Interview with Hashm Ahmed, University lecturer, Soran University, (Soran, May 2015).

Interview with Abdulla Hama, university lecturer, University of Sulaymaniyah, (Erbil, June 2015)

Interview with Armagan Bayrem, Corporate banking director, Al-Baraka Islamic Bank, (Erbil, June 2015).

Appendix 1

Interview Letters

24 February 2015



To whom it may concern:

Dear Sir/Madam

Shamsalden Aziz Salh, PhD Candidate - Bangor University, School of Law

The above-named student is undertaking his PhD under my supervision here at Bangor University School of Law, on the Iraqi Islamic banking system. The title of his PhD thesis is '*A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic banking system, using the case studies of Malaysia and Bahrain*'. In order to carry out the empirical component of his doctoral research, the candidate is required to conduct some interviews with academics and specialists in the field of Islamic banking in the region of Kurdistan.

As a part of his research project, I have given him a permission to return to Kurdistan so as to conduct these interviews and collate the information from the interviews.

I would be very grateful if you could assist him, by granting him an interview. As you will appreciate, Mr Aziz Salh's research is cutting edge and will undoubtedly be to the benefit of Iraq.

If further information is required, please do not hesitate to contact me.

Yours faithfully

Dr. Mark Hyland

Lecturer in Law & Solicitor

E: m.hyland@bangor.ac.uk

Ysgol Y Gyfraith
Prifysgol Bangor

School of Law
Bangor University

12 May 2015

Dear Shamsalden

Re: A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain

Thank you for your recent application to the CBLESS Research Ethics Committee.

The committee has considered your application and I am now able to give permission, on behalf of the CBLESS Research Ethics Committee, for the commencement of your research project, subject to the following:

- Electronic data should be securely stored on your University M drive which can be accessed via the Desktop Anywhere facility.
- Data can be securely retained for a period of five years to support the publication of research findings.

I wish you well with your research.

Yours sincerely



Dr. Diane Seddon
Chair, College Ethics Committee

cc – Dr Mark Hyland

PRIFYSGOL BANGOR,
CANOLFAN WEINYDDOL
BANGOR, GWYNEDD,
LL57 2DG

FFÔN: +44 (0) 1248 383231
FFACS: +44 (0) 1248 383228
EBOST: Cbless@bangor.ac.uk

BANGOR UNIVERSITY
ADMINISTRATIVE CENTRE,
BANGOR, GWYNEDD,
LL57 2DG

TEL: +44 (0) 1248 383231
FAX: +44 (0) 1248 383228

EMAIL: Cbless@bangor.ac.uk

YR ATHRO/PROFESSOR PHIL MOLYNEUX BA, Mphil, PhD
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[Insert Date]

Dear Sir

I am writing to invite you to assist with my doctoral research. I am currently working on my doctoral thesis, the title of which is: **“A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain”**.

I would like to interview you on the subject of the Iraqi Islamic Banking system. If you accept my invitation, I can provide you with a list of questions/issues that I intend covering by way of a semi-structured interview with you.

Any information you share would be treated as strictly confidential and stored in secure conditions back in Bangor Law School. Rest assured that you will not be identified in any reports or outputs arising from this work.

It is up to you to decide whether you would like to take part. If you decide that you would like to take part, please complete the consent form and e-mail it to me before the day of the interview. Alternatively, I could collect the completed form from you on the day of the interview.

If you have any questions or would like to know more about this work, please contact me by telephone on 07504337109 or by email (elpe18@bangor.ac.uk). If you have any concerns about

the proposed interviews or systems surrounding said interviews, feel free to contact my doctoral supervisor, Dr. Mark Hyland, at : m.hyland@bangor.ac.uk or, phone: + 44 (0) 1248 – 382585.

Thank you for taking the time to read this letter. I look forward to hearing from you.

Yours faithfully

Shamsalden Aziz Salh

PhD candidate,

School of Law – Bangor University

[Insert date here]

The participant information form

Title of research:

The title of this research is “**A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain**”. The researcher is Shamsalden Aziz Salh, School of Law. The research is a PhD project and it is supervised by Dr. Mark Hyland.

Reason for the research:

Islamic banking system of Iraq is new, and it has several problems some of them legal while others are Sharia problems. It is important to do research in the Islamic banking field in Iraq in order to improve and develop the current system. The academic literature on these issues regarding Iraqi Islamic banking system is scarce. For this reason, it is important to collect data via conducting interviews with some experts in this area. Therefore, the researcher will attempt to do field work and interview some experts in Iraqi Islamic banking industry (Kurdistan Region). Thus, through these interviews the researcher can have wide knowledge on the current Islamic banking system and the challenges that are face this system.

Details of participation:

Regarding the issue of Islamic banking system in Iraq, there is not sufficient research and sources on this topic, hence the need for new data collection. The main method of the fieldwork is conducting interview with academics, experts and Sharia Scholars of Islamic banking industry in Iraq. Several questions have been drafted about familiar cases to participants and those questions are the general framework of the interviews.

How the interviews will be arranged and carried out:

The researcher encloses herewith a Questionnaire and Consent Form. If you decide to participate in the planned interview, you will need to complete the enclosed Consent Form please.

It is envisaged that the interview will take place in the interviewee's place of work.

In a few days from the date appearing on this Participant Information Form, the researcher will phone you to establish whether or not you will participate in the envisaged interview. If you intend participating, then you need to return the completed Consent Form to the researcher before the interview. This can be done by either e-mailing it back to the researcher or by physically handing it to the researcher before the interview commences.

Participants will normally be identified by their names, positions, and institutions. However, Participants' identification details may be fully or partly anonymized if they wish. The interview will be recorded if participants do not object. If they prefer, the researchers will take notes. Participants' information will only be used for this research and related reports and publications. The researcher promises to keep what participant want to be hidden or uncovered and to transfer knowledge and understanding with responsibility and in an honest and cautious way to my research.

Retention and disposal of data relating to the interview

As regards any data or sensitive information obtained at interview, the researcher undertakes to keep it safe on his password-protected laptop/PC or, in the locked Bangor Law School office of his supervisor, Dr. Mark Hyland. The data will only be retained until such time as the researcher is awarded his PhD. The researcher undertakes to destroy the data within a week of being awarded his doctorate.

If you have any queries concerning my doctoral work, any of the documents that I have sent to you or, in fact, the interview process, feel free to contact my supervisor, Dr. Mark Hyland at m.hyland@bangor.ac.uk. Dr. Hyland's direct work telephone number is : + 44 (0)1248 – 38 25 85.

Signature: Shamsalden

Researcher Name: Shamsalden Aziz Salh

Phone: 07504337109

E-mail: elpe18@bangor.ac.uk

Appendix 2
The Transcription of the Interview in the English Language

Questions for the Interview

- 1- What are the principal challenges that faced by the Islamic banking industry in Iraq? Are these challenges legal or related to Sharia issues?
- 2- What is the impact of these issues on Islamic banking in general?
- 3- From your point of view, what are the solutions for these challenges that are faced by the Islamic banking industry in Iraq?
- 4- Is there any cooperation among Islamic banks in Iraq? Or between Islamic banks in Iraq and other countries? If there is such cooperation, to what degree does it occur and, how is it achieved?
- 5- As you know, there is no special Islamic banking Act in Iraq, and there is only a set of Internal Instruction that was issued by the Central Bank of Iraq (CBI) in 2006. What is the impact of the lack of Islamic banking law on Islamic banks in Iraq?
- 6- Do you think that the Internal Instruction is a viable alternative to an Islamic banking law? Or should it be revised/adapted? Or, do you think the adoption of Islamic Banking legislation is necessary?
- 7- From your point of view, which entity (CBI or Islamic Banks) should principally deal with the challenges facing Islamic banks in Iraq? And what should be done?
- 8- To what extent does the lack of qualified Islamic banking experts in Iraq affect Iraqi Islamic banks? And what should be done to create and foster Islamic banking expertise within Iraq?
- 9- Which Islamic transaction is the most commonly used by the Islamic banks in Iraq, for example, *murabaha*, *mudaraba*, *musharaka* and why?
- 10- Do you think that people in Iraq are aware of Islamic banking transactions and operations? What should be done to establish the awareness among people about Islamic banking services?
- 11- What are the responsibilities of the CBI and Islamic banks in terms of reducing the negative impact of (1) the lack of Islamic banking law, (2) the shortage of Islamic banking experts (3) and the lack of central Sharia board?
- 12- From your point of view, is it necessary to establish a national Sharia board in the CBI? And do you think this central Sharia board can help the individual Sharia boards of Islamic banks?
- 13- Is there any special department in the CBI for supervising Islamic banks? If there is, does it need to be adapted so as to meet the challenges as described in this Questionnaire? If

there is not, do you think it is necessary to establish one, and which key powers and competences should it have?

14- To what extent do the political and security situation in Iraq have an impact on the Islamic banking industry? What should be done to reduce this impact?

15- Do you think that the staffs that are working in Islamic banks have sufficient knowledge about Islamic banking operations? If not, what should be done to improve their level of knowledge?

16- Given the challenges currently facing Islamic Banking in Iraq, which countries' regulatory and legislative models constitute a good template for Iraq?

Interview No. 1

The Name: Bashir Hadad

Occupation: Sharia Supervisory Member

Place of Work: Cihan Islamic Bank

Date of the interview: May 2015

Questionnaire compiled by Shamsalden Aziz Salh for the purpose of doctoral research under the supervision of Dr. Mark Hyland at the School of Law in the College of Business, Law, Education and Social Sciences, Bangor University, Gwynedd, Wales, the UK.

Title of PhD Thesis: A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain.

Q1. What are the principal challenges that are faced the Islamic banking industry in Iraq? Are these challenges legal or related to Sharia issues?

A: Because Islamic banking in Iraq is considered new, there are some issues that are faced by this industry, with some of these issues are legal while some others are related to Sharia issue. The most obvious legal issue is the lack of special Islamic banking law and also the lack of any Islamic financial Act in Iraq. Thus, Islamic banks in Iraq are operated depending on their Sharia supervisory bodies as each may follow specific Islamic branch. On the other hand, there is also a Sharia issue for Iraqi Islamic banking industry. For example, some Islamic banks may not follow exactly Islamic principles in order to attract more clients. In other words, some Sharia boards may be flexible while some others are stricter in their decision on any Islamic banking transaction. In addition, some Islamic banks in Iraq may not have a Sharia supervisory board.

Q2. What is the impact of these issues on Islamic banking in general?

A: Certainly, these issues do have their impact on Islamic banking operations in Iraq. If there is no legal framework for the Islamic banking industry as a member of the Sharia board, it is difficult for us to address whether or not a transaction or operation is legal. In addition, the lack of the modern fatwa in Iraq is another issue for the Islamic banking system. We depend on fatwas that are issued by the Fiqih Council of Kuwait, Fiqih Council of Jeddah and Fiqih Council of Muslim Union, as these councils are reliable.

Furthermore, the lack of the modern Ijtihad is another issue for Iraqi Islamic banks and their Sharia boards. Some transactions are operated by Islamic banks in today's life and they are

not mentioned in older sources. These transactions are new so they need new fatwas on the basis of older sources. Therefore, as I mentioned in the beginning of this interview, your research (my thesis) is useful for us as well as for Islamic banks in Iraq.

As a result, these issues have a negative impact on Islamic banking and their Sharia supervisory boards that make difficulties for them. Again, if there is a legal framework for Islamic banking industry in Iraq and also if there are new modern fatwas in the Islamic financial field, our job will be facilitated.

Q3. From your point of view, what are the solutions for these challenges that are faced by the Islamic banking industry in Iraq?

A: In my opinion, it is necessary for the Islamic banking industry in Iraq to have a special Islamic banking Act and an active Sharia supervisory board to supervise and monitor all the transactions and services that are provided by Islamic banks. In order to enact a special Islamic banking Act, the government of Iraq can benefit from local and international financial regulators, as well as from other countries' Islamic Banking Laws.

I suggest that:

1-Sharia supervisory boards of Islamic banks should meet regularly in order to exchange their opinions and have discussion on the new trend in the field and dialog about the current important issue in the Islamic banking area to unify their decisions.

2- or Sharia boards of all Islamic banks can establish a special syndicate under the name of (Sharia supervisory Syndicate) in order to improve and develop their abilities and unify their decisions. Islamic banks should apply all decisions that are decided by the Sharia supervisory boards. Therefore, the Sharia board can ensure the banks are bound to these decisions whenever a case of Sharia non-compliance arises.

3-The Sharia boards should not only provide suggestions on a certain issue as requested by the bank, but they should continually monitor the bank and give a possible recommendation on the Sharia issues. It is also the responsibility of the Sharia board to ensure the banks comply with their decisions or fatwas. In addition, the Sharia supervisory board should submit a report about the identified defaults to the bank management at the end of the year in order for them to review and correct the mistakes.

Question: do you think that the is it better for Sharia board to consist of 4 or 6 members in order to divide the work between them, with half of them monitor the bank and another half of them work as consultants?

A: Yes, this is possible since CBI requests each Islamic bank to have its own sharia board and each board should consist of not less than three members, with the aim to divide the responsibilities among them.

Q4. Is there any cooperation among Islamic banks in Iraq? Or between Islamic banks in Iraq and other countries? If there is such cooperation, to what degree does it occur and, how is it achieved?

A: As I know in general, there is no cooperation among Islamic banks in Iraq and also there is no cooperation between Iraqi Islamic banks with other countries. However, recently, we have participated as one of the Sharia supervisory members of Cihan Islamic Bank in a conference on Sharia committee and Sharia Auditing organized by the CBB in Bahrain. Many Sharia experts from different countries have participated in this conference. We benefited from other people's opinion about Islamic banking that have discussed in the conference.

Motivated the conference, we realize that it is important to have a relationship with other Islamic banks and some companies that provide fatwa and Sharia opinions, such as Shura Company for Sharia consultant. This company has many respected Islamic banking experts in the world and it is located in Kuwait. The company provides fatwa and courses as well as workshops in Islamic banking area.

Hence, it is important and necessary for Iraqi Islamic banks to have the relationship with other Islamic banks outside the country. We suggest Cihan Islamic Bank to hold a conference in Kurdistan Region in order to create the relationship with other Islamic banks in Kurdistan Region. In this context, we can discuss issues relating to Islamic banking industry and exchange opinions. This conference can be a good start for relationship building among Islamic banks in Kurdistan Region. We can exchange Fatwa among different Sharia supervisory boards of Islamic banks and benefit each other in the area of Islamic financial.

Question: why do you not hold the conference for Islamic banks in Iraq, as I also mentioned in my thesis as recommendation for the CBI and financial regulators.

A: In this stage, it is not easy to hold the Islamic banking conference for Islamic banks in Iraq because the political and security situation in Iraq are not stable.

- (But you can invite them to the conference even if you hold it in Kurdistan).

Q5. As you know, there is no special Islamic banking Act in Iraq, and there is only a set of Internal Instruction that was issued by the Central Bank of Iraq (CBI) in 2006. What is the impact of the lack of Islamic banking law on Islamic banks in Iraq?

A: Islamic banking business is a wide area and it has attempted the conventional banks to open a branch for Islamic banking services. Therefore, in my opinion, a special Islamic banking law for regulation of Islamic banking industry in Iraq is necessary.

Q6. Do you think that the Internal Instruction 2006 is a viable alternative to an Islamic banking law? Or should it be revised/adapted? Or, do you think the adoption of Islamic Banking legislation is necessary?

A: It is true that there is a set of Internal Instruction that were issued by the CBI, but these instructions do not have the legal power as an Act. Although Islamic banks are not bound to apply these instructions, they must adopt the law as it has the legal power. Even though the Banking Law 2004 contains some articles of the regulation in Islamic banking industry, I believe that the enactment of the Islamic banking law in Iraq is necessary.

Q7. From your point of view, which entity (CBI or Islamic Banks) should principally deal with the challenges facing Islamic banks in Iraq? And what should be done?

A: CBI, Sharia supervisory boards and clients should be responsible for these challenges that are faced by Islamic banks.

- 1- CBI should be the most responsible for these issues as they are responsible for giving license to Islamic banks. Thus, the license requirements and conditions should be reinforced in order to prevent Islamic banks from breaking the rules that are applicable for them. In fact, CBI should conduct the annual inspection for Islamic bank and have their representatives assigned to every Islamic bank. In this context, CBI can enforce Islamic banks to follow the law.
- 2- The Sharia boards of Islamic banks should also be responsible for these issues facing Islamic banking industry. As a Sharia board member, we have the moral

responsibility and also we are paid by the bank, therefore, it is our duty to work sincerely. In addition, in the Sharia's point of view, members are responsible for any wrong doing that they have done during their service under the Sharia supervisory board in the Day of Judgment. Therefore, I believe that it is better for the members of the Sharia board to be changed for every two or three years.

- (According to the Internal Instruction 2006, the members will be changed for every three years).
- 3- Islamic banking clients should also be responsible because they are the one that deal with Islamic banks when they want their transactions to be interest-free. Thus, if they find out any transaction or service provided by the Islamic bank is unacceptable, they should inform the Sharia board or the Manager of the Islamic bank.

Q8. To what extent does the lack of qualified Islamic banking experts in Iraq affect Iraqi Islamic banks? And what should be done to create and foster Islamic banking expertise within Iraq?

A: Limited qualified Islamic banking experts do have its impact on Islamic banking industry because Islamic banking in Iraq is still considered new. Due to the shortage of experts in the field of Islamic banking, some Iraqi Islamic banks appoint unqualified experts in their Sharia boards. Thus, Islamic banks should appoint qualified people who have a degree in Islamic banking and years of experience in the area. However, such kind of experts is very limited since they may not have wide knowledge in all areas related to Islamic banking. Preferably, Islamic banks should appoint experts who have some knowledge about the banking law, the Islamic banking system, the conventional banking and Sharia as the members of the Sharia boards.

In addition, both CBI and Islamic banks should provide more training courses and workshops for their staff and member of the sharia boards in order to develop their ability. The CBI should enforce Islamic banks to provide such training course for their staff at least once a year

Question: do you think that it is important to offer the Islamic banking courses in college or universities?

A: It is very important to have these Islamic banking courses offered in the college or universities in order to provide more experts and labour force for Islamic banks which are currently having the shortage of experts.

Q9. Which Islamic transaction is most commonly used by the Islamic banks in Iraq, for example, *murabaha*, *mudaraba*, *musharaka* and why?

A: In my view, *murabaha* is the most used transaction among Islamic banks because it is less risky and easier to apply for the bank. In addition, people or clients are familiar with *murabaha* more than other transactions, such as *mudaraba* and *musharaka*. Therefore, Islamic banks avoid other modes of transaction to reduce risk and loss.

Q10. Do you think that people in Iraq are aware of Islamic banking transactions and operations? What should be done to establish the awareness among people about Islamic banking services?

A: In fact, people in general do not have confidence with Islamic banks. However, they desire to invest according to Sharia principles with Islamic banks. Most of the people do not have knowledge about Islamic banking and the types of services that can be provided. To resolve this issue, it is important to explain the basic principle of Islamic banking and the products and services offered to the public via the media, such as TV or newspaper. Besides, Islamic banks can form a team or a group of promoter to visit some places, such as offices, schools or universities in order to explain to the people about what the Islamic banking is and what kinds of services that can be offered by these banks.

Q11. What are the responsibilities of the CBI and Islamic banks in terms of reducing the negative impact of (1) the lack of Islamic banking law, (2) the shortage of Islamic banking experts (3) and the lack of central Sharia board?

A: As I previously mentioned, the CBI and Islamic banks are responsible for these challenges that facing Islamic banks. Enacting a special Islamic banking Act is a solution for the lack of Islamic banking law, which is a responsibility of the CBI initially. Providing training courses and workshops for the staff and Sharia supervisory members are the responsibility of both the CBI and Islamic banks in order to educate them. However, the establishment of the central Sharia board is the responsibility of CBI.

Q12. From your point of view, is it necessary to establish a national Sharia board in the CBI? And do you think this central Sharia board can help the individual Sharia boards of Islamic banks?

A: I think it is necessary to have the national Sharia board in Iraq for monitoring and assisting the Sharia boards of Islamic banks. Another option is, if there is a non-government external Sharia body for monitoring and auditing the Sharia supervisory boards and Islamic banks' operation. This body can give the results to the media to show that to what extent have these banks followed the Sharia principles and laws. For the central Sharia board, it can support Islamic banks and their Sharia supervisory boards. It is important that the central Sharia board should not be too powerful to replace the internal Sharia boards of Islamic banks in making decisions on products or transaction. If it has such power, there is no need for Sharia boards to be established in Islamic banks. To this end, I think it is necessary that each Islamic bank has its own Sharia board. It is also important that the central sharia board should be attached to CBI but not to the Ministry of Finance or Ministry of Awqaf. However, it should also be independent, which means that it should not be fully governed by the CBI. The members of the central Sharia board should comprise of experts from legal, economic, Sharia, finance and banking industries.

Question: do you think that central Sharia board can unify different decision of different Sharia boards?

A: It is possible, but it is somehow difficult in Iraq because there are two major Islamic doctrines, namely (madhhab) *Suni* and *Shii*. Thus, it is not as easy as it is in Malaysia. In Bahrain, the national Sharia board does not have such power because Bahrain also has two Islamic doctrines, which is similar to Iraq. Another benefit of the central Sharia board is that any cases related to Islamic banking will be referred to the court before the Sharia court is established.

Q13. Is there any special department in the CBI for supervising Islamic banks? If there is, does it need to be adapted so as to meet the challenges as described in this Questionnaire. If there is not, do you think it is necessary to establish one, and which key powers and competences should it have?

A: It is important to have a special department in the CBI to assist Islamic banks technically. In addition, Islamic banks should submit a report about their operation and transactions to the

CBI annually. Thus, there should have a special unit in the CBI to audit the report. Furthermore, this department is necessary for supporting Islamic banks.

Q14. To what extent do the political and security situation in Iraq have an impact on the Islamic banking industry? What should be done to reduce this impact?

A: Certainly, the political and security situation in Iraq have a negative impact on all sectors, especially banking sector, as they deal with money. As a part of the banking sectors, Islamic banks are facing an unstable situation in Iraq. Islamic banks should use more secured methods in order to avoid looting or losses in such situation. They should hire more security guards and install more CCTVs. Instead of keeping liquidity in the bank, Islamic banks should keep it in a safer place, such as with CBI.

Q15. Do you think that the staffs that are working in Islamic banks have sufficient knowledge about Islamic banking operations? If not, what should be done to improve their level of knowledge?

A: Most of the staffs who work in Islamic banks are not experts and do not have sufficient knowledge about the Islamic banking operations. Therefore, it is important to provide training courses for those staff in order to create experts in the field.

Q16. Given the challenges that currently facing Islamic Banking in Iraq, which countries' regulatory and legislative models constitute a good template for Iraq?

A: In my opinion, the Islamic banking system of the Gulf Countries could be a good model for Iraq, such as Qatar and Saudi Arabia.

Interview No. 2

The Name: Hashm Ahmed

Occupation: University Lecturer

Place of Work: Soran University

Date of the interview: May 2015

Questionnaire compiled by Shamsalden Aziz Salh for the purpose of doctoral research under the supervision of Dr. Mark Hyland at the School of Law in the College of Business, Law, Education and Social Sciences, Bangor University, Gwynedd, Wales, the UK.

Title of PhD Thesis: A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain.

Q1. What are the principal challenges that are faced by the Islamic banking industry in Iraq? Are these challenges legal or related to Sharia issues?

A: Previously in Iraq, we have the problem about the definition of Islamic banking because we don't have the Islamic banking law. Iraqi Islamic banking industry has both legal and Sharia problems, as Iraq does not have the Islamic banking law. Regarding the Sharia challenges, due to the shortage of experts in the Islamic banking field, some of the operations that are conducted by the Islamic banks maybe not Sharia-compliance.

Q2. What is the impact of these issues on Islamic banking in general?

A: For sure, there are some impacts of these as-mentioned challenges on the Islamic banks. Thus, the lack of the Islamic banking law leaves some gaps on the operations of these banks, such as the contracts that are done between the bank and its clients. For example, when the clients do not perform their duty towards the bank, there is no law in resolving this problem. Another reason is that there is no special supervisory body in the CBI to monitor those Islamic banks. In fact, the Sharia supervisory boards of the Islamic banks are weak.

Q3. From your point of view, what are the solutions for these challenges that are faced by the Islamic banking industry in Iraq?

A: Firstly, there should be a special Islamic banking law for managing the Islamic banking industry. Secondly, the members of the Sharia supervisory board should be professional and knowledgeable, and they should cover all the Sharia aspects of the bank and monitor all contracts that are conducted by the bank.

Q4. Is there any cooperation among Islamic banks in Iraq? Or between Islamic banks in Iraq and other countries? If there is such cooperation, to what degree does it occur and, how is it achieved?

A: Actually, there is no any cooperation among Islamic banks, which is one of the problems of the Iraqi Islamic banks. For example, when any Islamic banks have the liquidity problem, they cannot receive any Qard-hasan from other Islamic banks due to the lack of cooperation. Regarding the relationship with other Islamic banks outside Iraq, Iraqi Islamic banks can benefit from the Fatwa and the *murabaha* contracts that are conducted by those Islamic banks outside Iraq. However, this is not a direct relationship or cooperation, it is indeed an indirect relationship.

Q5. As you know, there is no special Islamic banking Act in Iraq, and there is only a set of Internal Instruction that was issued by the Central Bank of Iraq (CBI) in 2006. What is the impact of the lack of Islamic banking law on Islamic banks in Iraq?

A: The impact of the lack of the Islamic banking Act in Iraq is clearly seen, especially when an issue is aroused between an Islamic bank and its client. Due to the lack of the law, resolving the problem is not easy as both the Islamic bank and the client think they are right on their own stand. For example, if the bank has a problem with a non-Muslim client, such as Christian or Yezidi, these people do not believe in the religion of Islam and therefore, there should be an Islamic banking law to resolve these problems and all parties should be bind by this law.

Q6. Do you think that the Internal Instruction is a viable alternative to an Islamic banking law? Or should it be revised/adapted? Or, do you think the adoption of Islamic Banking legislation is necessary?

A: According to my view, enacting an Islamic banking law is necessary.

Q7. From your point of view, which entity (CBI or Islamic Banks) should principally deal with the challenges facing Islamic banks in Iraq? And what should be done?

A: Firstly, Iraq has many problems that impact the developing Islamic banks in the country. Secondly, the CBI does not concern about Islamic banks in Iraq. The CBI is not paying serious attention in regulating and supervising the Islamic banks, there is only some given

guidelines, which are insufficient, for sure. Thirdly, Islamic banks also should deal with these facing challenges, such as they do not draft any law for regulation of Islamic banks, and it seems that they have benefited from having this challenges. To solve these problems, there should be a strong supervision and establishment of a special Islamic banking department in the CBI.

Q8. To what extent does the lack of qualified Islamic banking experts in Iraq affect Iraqi Islamic banks? And what should be done to create and foster Islamic banking expertise within Iraq?

A: Due to the fact that Islamic banking is new in Iraq, there are limited numbers of Islamic banking experts in Iraq. Those that talk about Islamic banks and consider themselves as experts are not knowledgeable in the field of Islamic banking. For example, the religion men who are called (Imam) lack the knowledge in Islamic banking. For example, I asked one of the Imams about one of the Islamic banking contracts, he did not know the name of this contract. This is a big problem that facing Islamic banks in Iraq today.

Q9. Which Islamic transaction is most commonly used by the Islamic banks in Iraq, for example, *murabaha*, *mudaraba*, *musharaka* and why?

A: Islamic banks do not conduct these contracts and only a few operations are practiced by Islamic banks in Iraq, such as the transfer of money. In some cases, they practice *murabaha*, which is not real *murabaha* in fact, because they bring some special goods, such as car, according to the necessity of the people. In the case of *murabaha*, the client will request the good at first, and then later the bank could buy this special type of goods, which are specified by the specified client. The reason is that there are not experts in the Islamic banking field and people are not adapted to deal with Islamic banks, and even the conventional banks.

Q10. Do you think that people in Iraq are aware of Islamic banking transactions and operations? What should be done to establish the awareness among people about Islamic banking services?

A: In my opinion, religion men (Imam) should be aware of Islamic banking system prior to the public as the public follow these Imam since our society is made up of Muslim in the majority. Secondly, we do not have a proper place, such as university or special Islamic banking department for educating people. In general, communication is playing an important

role in this aspect. However, there are no such knowledgeable experts to educate people about the Islamic banking transactions, such as *mudaraba*, and *murabaha*.

Q11. What are the responsibilities of the CBI and Islamic banks in terms of reducing the negative impact of (1) the lack of Islamic banking law, (2) the shortage of Islamic banking experts (3) and the lack of central Sharia board?

A: Firstly, there should be a special Islamic banking law. Secondly, there also should be a special Sharia department for monitoring Islamic banks because the CBI does not have Sharia experts. This special department should have plans in developing these banks. The Sharia department should monitor Islamic banks and work closely with Islamic banks and help them.

Q12. From your point of view, is it necessary to establish a national Sharia board in the CBI? And do you think this central Sharia board can help the individual Sharia boards of Islamic banks?

A: A National Sharia supervisory board is necessary in the CBI. Some of the Islamic banks appointed members for their Sharia supervisory boards, but unfortunately they do not have sufficient knowledge about the Islamic banking. Therefore, a central Sharia board is necessary to monitor the individual Islamic banking Sharia supervisory board. However, it is found that some members of the Sharia supervisory boards of Islamic banks give fatwa to the Islamic bank's interest, which is not correct indeed. Therefore, the establishment of the central Sharia board in the CBI is needed to control and monitor the Sharia supervisory boards of Islamic banks.

Q13. Is there any special department in the CBI for supervising Islamic banks? If there is, does it need to be adapted so as to meet the challenges as described in this Questionnaire. If there is not, do you think it is necessary to establish one, and which key powers and competences should it have?

A: There is no such special department right now and hence it is important to set up this department, which is different from the central Sharia board, and we could name it as Fatwa committee. It is also important to have a power in issuing fatwa. A member of this committee could also attend any meeting of the Islamic banking Sharia supervisory in order to know about their decisions.

Q14. To what extent does the political and security situation in Iraq have an impact on the Islamic banking industry? What should be done to reduce this impact?

A: The political and security situation in Iraq have impacted all sectors, including both the Islamic and the conventional banks. It is not easy to deal with this situation. However, the Iraqi government could conduct some investment projects through Islamic banks as well as the conventional banks. Thus, the government should deal with Islamic banks and provide them with funds for conducting investment projects in all situations.

Q15. Do you think that the staffs that are working in Islamic banks have sufficient knowledge about Islamic banking operations? If not, what should be done to improve their level of knowledge?

A: Unfortunately, those staffs that work in Islamic banks do not have sufficient knowledge about Islamic banking operations and transactions. There should be Islamic banking departments in universities in Iraq as well as training courses to train the current staff of Islamic banks. In Arabic countries, there are training courses for teaching Islamic banking staff; however, in Iraq, no such kind of training courses about Islamic banking is provided. There should be training courses for six months for example, in the Islamic banking area.

Q16. Given the challenges currently facing Islamic Banking in Iraq, which countries' regulatory and legislative models constitute a good template for Iraq?

A: Each country has its special situation to follow; for example, some contracts may be used in some countries while they are not used in other countries. However, there are some countries that are pioneers in the Islamic banking industry, such as Malaysia and Bahrain. However, Bahrain is the best example for Iraq because it has the similar culture, religion and same language. We could benefit from the Islamic banking system of Bahrain as one of the most developed countries in Islamic banking. In general, Gulf countries are good examples, but Bahrain is the best example for Iraq.

Interview No.3

The Name: Abdulla Hama

Occupation: University Lecturer

Place of Work: University of Sulaymaniyah

Date of the interview: June 2015

Questionnaire compiled by Shamsalden Aziz Salh for the purpose of doctoral research under the supervision of Dr. Mark Hyland at the School of Law in the College of Business, Law, Education and Social Sciences, Bangor University, Gwynedd, Wales, the UK.

Title of PhD Thesis: A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain.

Q1. What are the principal challenges that are faced by the Islamic banking industry in Iraq? Are these challenges legal or related to Sharia issues?

A: Just like other Islamic banks in other countries, I believe the Islamic banks in Iraq also encounter a number of challenges and problems. The primary ones are the legal challenge and the relationship with the central banks. In Iraq, most of the challenges are related to Sharia. In general, the lack of Sharia expert and qualified manpower that are knowledgeable in Sharia are the most serious challenges.

Q2. What is the impact of these issues on Islamic banking in general?

A: In overall, these problems affect their operation, court cases and their performance. An Islamic banking law will facilitate their operation and push the industry to further growth if an advanced legal infrastructure is in place.

Q3. From your point of view, what are the solutions for these challenges that are faced by the Islamic banking industry in Iraq?

A: Considering other Islamic banking law in the countries like Bahrain and Malaysia, the Iraqi government should enact a very supportive and advanced Islamic banking law to facilitate the operation of the industry. This law should be amended according to the industry's needs. Regarding the Sharia issues, they are many viable solutions. Part of the solutions is to establish training centers that can train staffs and produce Sharia experts. This can be done with the help of renowned Islamic banking and finance training centers or even can seek help from the IDB.

Q4. Is there any cooperation among Islamic banks in Iraq? Or between Islamic banks in Iraq and other countries? If there is such cooperation, to what degree does it occur and, how is it achieved?

A: To be honest, I am not aware of such cooperation and I am not sure if it does exist or not. It is good to have such cooperation among Islamic banks in Iraq and even with other IBs in other countries.

Q5. As you know, there is no special Islamic banking Act in Iraq, and there is only a set of Internal Instruction that was issued by the Central Bank of Iraq (CBI) in 2006. What is the impact of the lack of Islamic banking law on Islamic banks in Iraq?

A: It is the law that indicates and decides on so many aspects related to Islamic banking or any other industry. As for Islamic bank, it is the law that decides on the aspects such as bank registration, their rights and obligation, their relationship with the CBI and other authorities, governing law, rights and duties of all the stake holders in a given Islamic bank and so much more. Lack of such a law creates so many obstacles and problems for IBs in practice.

Q6. Do you think that the Internal Instruction is a viable alternative to an Islamic banking law? Or should it be revised/adapted? Or, do you think the adoption of Islamic Banking legislation is necessary?

A: The Internal Instruction is good for guiding Islamic banks to operate in Iraq by providing some guidelines, but it is not as good as well-developed law. An Islamic banking law is indispensable and a draft of the law is already underway to be rectified.

Q7. From your point of view, which entity (CBI or Islamic Banks) should principally deal with the challenges facing Islamic banks in Iraq? And what should be done?

A: Most of the challenges in one way or another are related to the authority. A political will is needed for any central bank or government to try to solve the challenges and problems of Islamic banks. On the other hand, Islamic banks themselves should try to solve problems and deal with challenges that are related to them, such as Sharia experts or qualified staff.

Q8. To what extent does the lack of qualified Islamic banking experts in Iraq affect Iraqi Islamic banks? And what should be done to create and foster Islamic banking expertise within Iraq?

A: Qualified manpower will help the industry to operate soundly and develop accordingly. The lack of qualified manpower will hinder its operation and jeopardize the customers trust. As I mentioned earlier, setting up training centers is a way to deal with this problem.

Q9. Which Islamic transaction is the most commonly used by the Islamic banks in Iraq, for example, *murabaha*, *mudaraba*, *musharaka* and why?

A: Like any other Islamic bank in other countries, *murabaha* is the most common method among other transactions. This is because *murabaha* is almost risk free and the return is guaranteed.

Q10. Do you think that people in Iraq are aware of Islamic banking transactions and operations? What should be done to establish the awareness among people about Islamic banking services?

A: Unfortunately, people are unaware of Islamic banking transactions and have very little knowledge in this regard. This can be due to several reasons. Weak public relation of Islamic banks as they have done very little to spread the awareness among the Iraqi society regarding Islamic banks transactions is one of the reasons. Sharia experts through the media and other forms of publication Islamic banks should try to make the public aware of its transactions.

Q11. What are the responsibilities of the CBI and Islamic banks in terms of reducing the negative impact of (1) the lack of Islamic banking law, (2) the shortage of Islamic banking experts (3) and the lack of central Sharia board?

A: Understanding the needs of Islamic banks by the CBI and being supportive towards providing their needs and facilitating their operations will reduce the impact caused by the lack of an Islamic banking law. IBs themselves should deal with the shortage of Islamic banking experts and one way to do so is to bring trainers from outside to train or educate their internal staff. Regarding the lack of central Sharia board, I don't think it is a big problem for the time being but its existence will help to advance the industry.

Q12. From your point of view, is it necessary to establish a national Sharia board in the CBI? And do you think this central Sharia board can help the individual Sharia boards of Islamic banks?

A: In the long run, the central Sharia board will help to minimize problems, expedite new products approval and limit the difference between Islamic banks operations and some other

Sharia issues. On the other hand, some experts argue that the central Sharia board is not necessary and might limit IBs creativity and freedom.

Q13. Is there any special department in the CBI for supervising Islamic banks? If there is, does it need to be adapted so as to meet the challenges as described in this Questionnaire. If there is not, do you think it is necessary to establish one, and which key powers and competences should it have?

A: As far as I am concerned, no department for overlooking Islamic banks is available at CBI. I believe the establishment of such department is necessary but it should be run by competent the experts that have dual knowledge, both in the mainstream economics and Islamic banking and finance. By this way, the IBs operation in Iraq will be facilitated.

Q14. To what extent does the political and security situation in Iraq have an impact on the Islamic banking industry? What should be done to reduce this impact?

A: The political and security situation has impacts on Islamic banks and the whole industry as well as the countries economics. For sure, it hinders the progress of Islamic banks, push away foreign Islamic banks to operate in Iraq and might affect the political will to making steps towards the progress of Islamic banking due to the religious sects.

Q15. Do you think that the staffs that are working in Islamic banks have sufficient knowledge about Islamic banking operations? If not, what should be done to improve their level of knowledge?

A: I don't think Islamic banks in Iraq have sufficient qualified staffs. Training, as I mentioned earlier, and even online courses in Islamic banking and finance should be arranged to educate their staffs.

Q16. Given the challenges currently facing Islamic Banking in Iraq, which countries' regulatory and legislative models constitute a good template for Iraq?

A: I don't think any country's law can be adapted as it is as every country has some own distinctive features to some extent. However, there are several exemplary countries with good legislations for Islamic banking and finance; these can be helpful in drafting the Islamic banking law in Iraq.

Interview No. 4

The Name: Armagan Bayram

Occupation: Corporate Banking Director

Place of Work: Al-barak Islamic Bank

Date of the interview: June 2015

Questionnaire compiled by Shamsalden Aziz Salh for the purpose of doctoral research under the supervision of Dr. Mark Hyland at the School of Law in the College of Business, Law, Education and Social Sciences, Bangor University, Gwynedd, Wales, the UK.

Title of PhD Thesis: A Critical Evaluation of the Legal and Sharia Aspects of the Iraqi Islamic Banking System, Using the Case Studies of Malaysia and Bahrain.

Q1. What are the principal challenges that are faced by the Islamic banking industry in Iraq? Are these challenges legal or Sharia issues?

A: There are some legal challenges but they are not only specific for Islamic banking system, as well as for all banks and companies. It is true that, there is no Islamic banking law in Iraq, but it is not a big challenge. However, I think it is not the principal legal issue. Regarding the Sharia challenge, it does exist since there are not sufficient experts for Islamic banks. As for the Islamic banking law, I think there should have some provisions for the Islamic banking regulation in Banking Law of Iraq.

Q2. What is the impact of these issues on Islamic banking in general?

A: As I said, there is not difference between Islamic banks and non-Islamic banks or other companies that operate in Iraq. However, the lack of the Islamic banking law is the issue of interest for Islamic banks as there will be no applicable limitation for these banks.

Q: If there is no law, how do Islamic banks solve their problem, if something occur between the bank and its customers?

A: Like the other conventional banks, we solve any problem with our customers. For example, we are the same as the conventional banks in front of the courts. Therefore, all the conventional and Islamic banks are same in the court, and there is no problem for the lack of the Islamic banking law.

Q3. From your point of view, what are the solutions for these challenges that are faced by the Islamic banking industry in Iraq?

A: Since we are working here, we did not face any specific individual challenge for Islamic banks. However, we do have the same problems as the commercial banks, such as capital problems and visa or master card problem because this country is linked with Dubai and we are linked with the Europe office.

Q4. Is there any cooperation among Islamic banks in Iraq? Or between Islamic banks in Iraq and other countries? If there is such cooperation, to what degree does it occur and, how is it achieved?

A: There is no cooperation among Islamic banks inside Iraq, but we, as a Al-baraka Islamic bank, have a link with Islamic banks outside Iraq, especially with Turkish banks as we are one of the members of Turkish Union.

Q5. As you know, there is no special Islamic banking Act in Iraq, and there is only a set of Internal Instruction that was issued by the Central Bank of Iraq (CBI) in 2006. What is the impact of the lack of Islamic banking law on Islamic banks in Iraq?

A: In terms of operation and law, you should not differentiate the Islamic banks from the conventional banks. In turkey, there is no special Islamic banking Law, but there are some paragraphs of the general banking law for Islamic banking industry.

Q6. Do you think that the Internal Instruction is a viable alternative to an Islamic banking law? Or should it be revised/adapted? Or, do you think the adoption of Islamic Banking legislation is necessary?

A: Islamic banking does not need a special law, as 90% of the operation of the Islamic banks is similar to the conventional banks, such as letter of guaranty. Therefore, a new Islamic banking law is not required, but the addition of some provisions into the current banking Law is encouraged.

Q7. From your point of view, which entity (CBI or Islamic banks) should principally deal with the challenges facing Islamic banks in Iraq? And what should be done?

A: in fact, we cannot judge who should be responsible for these challenges that are faced by Islamic banks. The Islamic banks should be linked to the CBI as there should be a special

department for Islamic banks in the CBI or there could be a union (Islamic Banking Union) for Islamic banks and the CBI can be a decision maker.

Q8. To what extent does the lack of qualified Islamic banking experts in Iraq affect Iraqi Islamic banks? And what should be done to create and foster Islamic banking expertise within Iraq?

A: This is the main problem in the banking sector of Iraq and it is not only limited to the Islamic banks. Though there are some Islamic banking experts in Iraq, the amount of experts is not sufficient and similar problem is also faced by the conventional banks. As I previously said, the problem in Iraq is not limited to the Islamic banks but to the banking sector in general. To resolve this issue, we should educate our staff and train them by providing training courses for them. As a Al-baraka Islamic bank, we should offer some courses for our staff inside the bank and some courses outside the bank in Turkey. We should send all our staff to Turkey at least for one month training in Islamic banking system. In addition, we should invite experts from outside to train and educate our staffs every two months, for example, we can invite experts from the law department of Turkey, or from credit department or Sharia department and etc

Q9. Which Islamic transaction is the most commonly used by the Islamic banks in Iraq, for example, *murabaha*, *mudaraba*, *musharaka* and why?

A: *Murbaha* is the mostly used transaction by Islamic banks because it has a shorter transaction time. As for *musharaka*, since it is a long-term and partnership transaction, it may take years for the transaction to be done. However, *murbaha* can be started and completed in a short period. If the transaction takes long time such as two or three years, no one can guarantee what will happen next in this country.

Q10. Do you think that people in Iraq are aware of Islamic banking transactions and operations? What should be done to establish the awareness among people about Islamic banking services?

A: One of the challenges that facing Iraqi Islamic banks is that the people are not used to the banking system, both Islamic and conventional banking. Most of the clients do not aware of the differentiation between the Islamic banking and conventional banking. Another issue is that people are not sure whether or not Islamic banks are bound to the Sharia principles. In

general, people do not have sufficient knowledge about Islamic banks and they are in doubt that whether or not the Islamic banking is real.

In fact, TV or radio programs and conferences can be a good way for informing people about Islamic banks and their services. Therefore, the CBI can use TV or Radio or hold conferences to educate people about Islamic banking

Q11. What are the responsibilities of the CBI and Islamic banks in terms of reducing the negative impact of (1) the lack of Islamic banking law, (2) the shortage of Islamic banking experts (3) and the lack of central Sharia board?

A: For the legal issue, there should be a provision for the Islamic banks in the Banking law, or by establishing a department for Islamic banking in the CBI. For the shortage of experts, we could educate them and provide training courses for them. For example, in our branch, some staffs are new graduates and we offer training courses for them. The CBI could request Islamic banks to provide training courses for their staffs and ask them to educate their staff; this could be done through the law.

Q12. From your point of view, is it necessary to establish a national Sharia board in the CBI? And do you think this central Sharia board can help the individual Sharia boards of Islamic banks?

A: I think it is necessary to establish a central Sharia supervisory board in Iraq. However, in Turkey, we have a higher board or government office in the Ministry of the Religion Affairs, which is not only specialized in Islamic banking but also in Sharia affairs. The higher board cannot cancel any transaction that approved by the Sharia board of the Islamic banks, but they can conclude that this transaction is not Sharia-compliance, which will affect the Islamic banks reputation to some extents.

This higher Sharia board can help Islamic banks in terms of Fatwa, and the higher Sharia board can unify the Sharia supervisory boards' decisions.

Q13. Is there any special department in the CBI for supervising Islamic banks? If there is, does it need to be adapted so as to meet the challenges as described in this Questionnaire. If there is not, do you think it is necessary to establish one, and which key powers and competences should it have?

A: There is no special Islamic banking department in the CBI; therefore, it should be established in the Islamic banks. This department should be established according to the law.

Q14. To what extent does the political and security situation in Iraq have an impact on the Islamic banking industry? What should be done to reduce this impact?

A: The political and security situation impact everybody who lives in Iraq. There is no limitation in the political and security situation and it is not only limited to the Islamic banks, but to all sectors. For example, because of the security situation, the market goes down and hence the customers cannot make payment on time, and also because of the political issue, the employees cannot receive their salary on time and they cannot pay their installments on time.

Q, Then what are the solutions?

A: Though the solution is not in our hand, we can avoid the problems by not providing any new facilities when we think there is an economic crisis caused by the political or security situation.

Q15. Do you think that the staffs that are working in Islamic banks have sufficient knowledge about Islamic banking operations? If not, what should be done to improve their level of knowledge?

A: The staffs that work in Islamic banks do not have sufficient knowledge and experience. To improve their knowledge, they should be educated and well trained by attending the training courses and workshops offered by the banks.

Q16. Given the challenges currently facing Islamic Banking in Iraq, which countries' regulatory and legislative models constitute a good template for Iraq?

A: I don't know about all the countries, but UK and Malaysia are two good examples. I would say Turkey is a good example for the banking system in general, including the Islamic banking. In Turkey, the Islamic banking system is well-regulated. Even though Turkey and Iraq have the similar culture and background, Iraq lags far behind of Turkey in terms of banking system. Therefore, Turkey is a good model for Iraq in terms of banking system in general.