

CHAPTER 14

Law and Legislation

Introduction

Islamic finance is a particularly dynamic industry, and one that confirms the ancient observation about “change” being the only constant. In mixed measure, change is both desirable and anathema. Change is anticipated, even sought, in the context of commerce and finance as it presents new opportunities for those who are alert and prepared, including practitioners of Islamic finance. At the same time, change in a system defined at base by divinely revealed admonitions and principles, such as the Shari’a, is to be considered with the greatest of caution. Change entails uncertainty and thus increased risk. In the context of Islamic finance, the increased risks transcend mere monetary considerations: they extend to the essence of observance and religious obligation.

To compound matters, change—seemingly such a simple concept—is exceptionally difficult to define. A quick look at any unabridged dictionary confirms the complexities. Change is one of the longest definitions in most dictionaries. The conceptual distinctions between the 38 definitions of change in a highly respected unabridged dictionary are subtle, but of significant impact when one is considering change in legal thought relating to the Shari’a as sacred law that is applicable to the quite earthly endeavor of finance. Consider this dictionary’s primary definition: “to make the form, nature, content, future course, etc., of (something) different from what it is now or from what it would be if left alone” (they actually use “etc.” in the definition; most unusual). Other concepts include transformation, conversion, substitution, exchange, reciprocity, removal and replacement, alteration, modification, amendment, mutation, becoming, passing, progression, supplanting, trading, and divisions of money, among others. And the discussion has not yet gotten to consideration of the cause of change or its inevitability or controllability. Consider, for example, the observation of Heracli-

tus: “you could not step twice into the same river; for other waters are ever flowing onto you.”

This chapter focuses on change in the law and is divided into two parts. Part 1 takes a micro insight, discussing the resultant changes of Islamic legal thinking following the issuance of the Dow Jones Fatwa in 1998. Effects of this fatwa on the industry were subtle, but profound. Part 2 takes a more macro look, providing insights into changes of state law in GCC countries and Malaysia to accommodate Islamic finance.

Part 1: Change in Islamic Financial Markets and its Jurisprudence.

This part focuses on change in Islamic finance and change in law (“legal change”) from a jurisprudential vantage.. The “law” is the Shari’a as applicable to commerce and finance, especially Islamic finance. The methodology is to take an individual fatwa and the principles that were institutionalized in that fatwa and examine how those principles have been applied in Islamic finance over a specified period (1998-2014). The subject of the examination is the Dow Jones fatwa pertaining to its initial index of Shari’a-compliant equity securities (and, by direct implication, to the permissibility of investment in equity securities). Its official designation is The Dow Jones Islamic Market Index: Statement by the Shari’a Supervisory Board (DJIMI Fatwa), which is undated, but was issued in 1998 to Dow Jones & Company, Inc. in connection with the establishment of the Dow Jones Islamic Market Index (DJIMI). The relevant principles pertain to “permissible variance” or “permissible impurity” and “purification” as matters of Shari’a interpretation and application. The concepts of

interpretation and application necessitate consideration of “interpretive modalities” or methodologies. For example, are they Shafi? At least one prominent scholar posits that they are and equates Shafism with the jurisprudential theories labelled “legal formalism” or “classical legal theory” or “classical orthodoxy” in which formal logical conceptions are predominant. Six induced sequelae or type-groupings of change are discussed. Consideration of interpretive modalities necessitates consideration of the roles and processes by which Shari’a principles are given effect in Islamic finance, and of those who interpret and apply the Shari’a: the jurists (muftis), sitting individually and on supervisory boards.

The challenges of change, and the context in which change occurs, are (by definition) important. The challenge facing the Islamic finance industry, particularly the Shari’a scholars, in these formative years has been, and remains, how to develop Islamic finance:

- given the parameters and constraints established by the Quran, the sunna, ijma, qiyas, istihsan and istislah, among other interpretive tools, and the interpretive modalities that are employed in defining and implementing Shari’a principles;
- in light of the diversity of orientations, opinions and madhahib of the Shari’a scholars that influence, and arguably define much of, the developmental process; and
- in the context of, and in competition with, dominant economic, financial and legal systems that are (i) interest-based, (ii) have no understanding of, take no cognizance of, and are sometimes hostile to, the Shari’a, (iii) are pervasive and well-established, and (iv) are supported by a vast legal, regulatory and institutional infrastructure and broad transactional base.

DJIMI Fatwa

The DJIMI Fatwa is well-known to Islamic finance practitioners.¹ It is one of the critical factors in the development of contemporary Islamic finance. It established two levels of equity investment screens to determine permissibility under the Shari’a. The first level is comprised of two branches: first, is the instrument under consideration permissible; and second, does the entity issuing that instrument engage in impermissible business activities.

Certain instruments are impermissible, primarily those stipulating a predetermined rate of return and an absence of profit and loss sharing, but also those providing for preferential returns. The permissible variance principle is first seen in the second branch of level one pertaining to the well-known and non-exclusive list of impermissible business activities. The DJIMI Fatwa test is whether the “primary” or “basic” business activities of the issuing entity are impermissible, rather than whether the issuing entity engages in any impermissible business activity. The types of issues addressed relate to issuers that engage in multiple business activities, some of which are permissible and some of which are impermissible. This permissible variance principle has been the impetus for significant change in both Islamic finance and its jurisprudence.

If those screens are passed, the level two inquiries focus on three financial screens. The DJIMI Fatwa permits the investment if:

- total interest-bearing debt (long and short term) to market capitalization of the issuer is less than 33%;
- the issuer’s accounts receivable do not exceed 45% (subsequently amended to 33%) of its market capitalization; and
- cash (including cash equivalents) plus interest-bearing securities owned or held by the issuer do not exceed 33% of its market capitalization.

In each case in which market capitalization is used as a term of a calculation, a 12-month (subsequently amended to a 24-month) trailing average is adopted to address volatility issues. The financial screens are based upon balance sheet information, which was the information that was available at the time (1993-1998). They use balance sheet information as surrogates for the estimation of an operating statement concept (impermissible interest income). The financial screens have also been the source of significant change in both Islamic finance and its jurisprudence.

In addition to the various screens, the DJIMI Fatwa established principles relating to disposition of instruments that fall out of compliance at some time after the acquisition of the instrument. A primary reason for mandatory disposition is failure to meet all of the screen requirements on an on-going basis. There are also discretionary disposition circumstances, including bankruptcy and insolvency events, mergers and management buy-outs.

And, critically, it mandates on-going reevaluation of the screens themselves: if more precise or accurate screens become available, they must be adopted. Thus, the concept and dynamic of mandatory on-going legal change has been intentionally introduced into the interpretive paradigm, whatever modality might be employed.

Sequelae

The DJIMI Fatwa principles have given rise to a wide range of changes in Islamic finance and its jurisprudence. Six such sequelae or groupings of changes are considered here, together with one other area in which permissible variance is pervasive.

First Sequelae

The first sequelae involves two sets of changes. First, modifications were made to the balance sheet tests of the DJIMI Fatwa itself. The accounts receivable to market capitalization test threshold was changed from 45% to 33%. Next, the balance sheet tests, while preserved, were modified in the 2004 standard of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) which addresses principles to be incorporated into screens for the acquisition of, investments in and trading of equities (standard 21, the “AAOIFI Equity Standard”). The AAOIFI Equity Standard adopted some of the DJIMI Fatwa framework (e.g., impermissible business activities) and the use of testing based upon

¹ For a deeper and more comprehensive insight into the change in Islamic finance legal thinking, please see Michael McMillen’s monograph *Islamic Finance and the Shariah: The Dow Jones Fatwa and Permissible Variance as Studies in Letheanism and Legal Change* (2013). This book discusses a range of matters pertaining to interpretive modalities, criticisms of the Islamic finance industry and its interpretive processes, and the sequelae of the DJIMI Fatwa as a case study in legal change within the field of jurisprudence generally.

balance sheet information. It made a slight modification to the total debt to market capitalization test, using a 30% threshold figure. It dispensed with the accounts receivable test. And in place of the cash, cash equivalents and interest-bearing investments test, it substituted a conceptually similar, but less comprehensive, test of total deposits paying interest to market capitalization test (with a 30% threshold). Of course, not all interest yielding investments are deposits. It also does not use trailing average or other levelizers for market capitalization calculations. And, in a somewhat confusing requirement fraught with difficult implications, market capitalization determinations are based upon "the last budget or verified financial position" of the issuer.

Second Sequelae

The second sequelae involves a more pronounced change: a move away from the DJIMI Fatwa standards rather than a variation on those standards. In the period between issuance of the DJIMI Fatwa and 2003, operating statement information became widely available and accessible to large segments of the markets. This enabled investors to move away from the methodology based upon estimates of interest income based upon balance sheet surrogates to direct use of relatively precise (or more accurate) operating statement information that is self-adjusting as to applicable interest rates. The early operating statement tests retained much of the DJIMI Fatwa format, including the level one instrument and business activities tests. But they modified both the numerator and the denominator of the financial screens so as to use the operating statement information on interest (and other impermissible income) relative to some measure of revenue (gross revenue or an adjusted revenue figure). These tests are usually significantly

more accurate. They still overstate impermissible interest income, however. For example, under GAAP or IAS accounting rules profit on a compliant ijara is still stated as interest income on operating statements.

Third Sequelae

The third sequelae involves bifurcated financing structures (such as the ijara structure) that incorporate both a Shari'a-compliant investment and an interest-based financing in a single integrated construct. See Figure 1, which illustrates both a real estate example and an operating company example. These structures were developed simultaneously with consideration and issuance of the DJIMI Fatwa and are not direct induced sequelae of that fatwa. However, their acceptance became essentially universal after the institutionalization of the DJIMI Fatwa principles. Bifurcated structures were critical to the development of Islamic finance as a global industry. They allowed Shari'a-compliant financing (and investment) in jurisdictions across the world. Most jurisdictions do not take cognizance of the Shari'a as a matter of secular law (it is not the law of a nation within the applicable international convention) and most jurisdictions do not have Islamic banks: interest-based banking dominates. To achieve global penetration and success, Shari'a-compliant transactions must be consummated and enforced in these jurisdictions. Jurisdictions that do not take cognizance of the Shari'a are referred to as "Purely Secular Jurisdictions". In these transactions, a Shari'a compliant investor purchases a commercial property in a Purely Secular Jurisdiction for investment purposes. Banks within the Purely Secular Jurisdiction provide the acquisition financing, which, of course, is interest-based financing. The bank financing arrangements are shown to the left of the dotted line in Figure 1. All

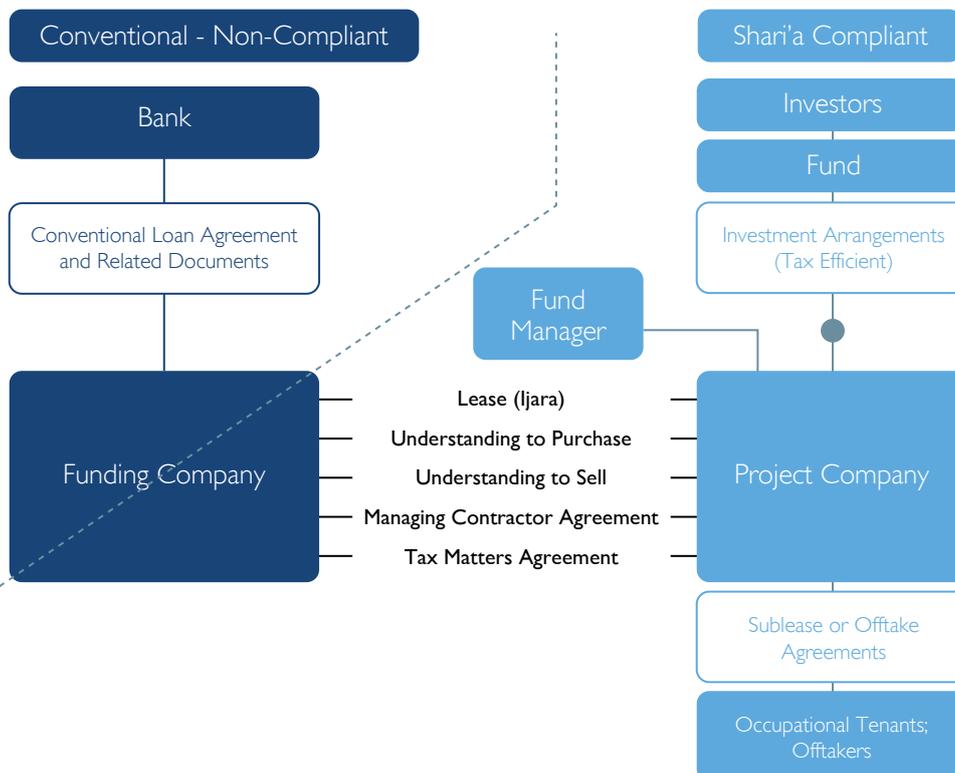


Figure 1: Bifurcated Financial Structures

of the activities and documentation to the right of that dotted line are Shari'a compliant.

Fourth Sequelae

The permissible business activities tests of the DJIMI Fatwa in the non-equity context are the subject of the fourth sequelae. The real estate transaction illustrated in Figure 1 provides two illustrative examples. For discussion, the focus in this grouping is on (a) non-compliant business activities conducted at the property by an Occupational Tenant and (b) compliant business activities conducted at the property by an Occupational Tenant where that Occupational Tenant, as a larger entity (including its corporate group) conducts non-compliant activities at other properties.

In many circumstances, the non-compliant activity has been found permissible if the activity is relatively insignificant relative to the entirety of the activities conducted at the property and if the income from that non-compliant activity can be purified. Take, for example, a multi-tenant property where all but one of the tenants conduct compliant activities and one tenant, say a group of automatic teller machines owned and operated by an interest-based bank, conducts non-compliant activities (cash deposits and withdrawals through the machines). In this case, Shari'a scholars have generally permitted the acquisition of the building and the on-going presence of the violative activity (the machines). But this is a factual determination. Does commercial lending take place at the property? That would mitigate against acceptance of the arrangements. Is it a relatively small portion of the total property, in terms of square footage and rental income? That would induce acceptance of the tenant. Purification may be on a relative square footage basis, a relative rental income basis or some other similar set of criteria.

The second factual example in this fourth sequelae is not as clearly resolvable, and Shari'a scholars differ in their positions. An example might be the check-clearing operations of an interest-based bank. Some scholars consider the primary business of the bank, and determine the acquisition of the property to be impermissible so long as the check-clearing operations are a significant portion of the property's total rental income. Other scholars look at the precise activity (check clearing) and, that being a permissible activity on a stand-alone basis; they allow the acquisition and the presence of that tenant and those activities. Again, however, these are factually sensitive determinations involving considerable jurisprudential discretion and judgment.

Fifth Sequelae

The real estate example depicted in the Figure also provides an example for the fifth sequelae. This involves permissible variance principles not set forth in the DJIMI Fatwa. One example relates to the Sublease from the Shari'a-complaint building owner to any particular tenant having to be itself Shari'a compliant. Most Subleases of this type are not compliant, due primarily to market customs and practices, including the prevalence of triple-net leasing in which the Occupational Tenant is responsible for all expenses, including structural maintenance, but also including late payment and default interest pro-

visions. Here again, permissible variance concepts are creatively implemented so as to facilitate the development and growth of Islamic finance. Taking the easiest issue first, late payment and default interest are frequently permitted in order to incentivize timely payment, but any interest proceeds are purified through charitable donations. As to other matters, Shari'a boards frequently require reasonable efforts to modify the Subleases before the acquisition and then more definitive efforts to modify those Subleases upon their renewal after the acquisition. This has greatly facilitated the growth of international Islamic finance and, in its details, is another example of contemporary legal change.

The second example in this fifth grouping is the "single Islamic tranche" that is so frequently used in project and infrastructure financings. Two structures predominate in single Islamic tranche financings, one using an ijara and the other using a murabaha, in each case in tandem with an interest-bearing loan financing. The interest-based financing is necessary due to the prevalence of conventional banks in the global system, the enormous capital requirements of these transactions, and the needs of financiers for adequate risk diversification through involvement of multiple financiers. These transactions give rise to a host of Shari'a issues, including issues pertaining to uses of finance proceeds and the allocation of proceeds to distinct asset groups (one pertaining to the Shari'a-compliant financing and one to the interest-based financing), allocation of assets to the distinct financings for collateral security purposes, decision-making as between the two groups of financiers, initiation and control of remedies, allocation of enforcement proceeds, and numerous bankruptcy and insolvency matters. Permissible variance accommodations are pervasive in these structures, and their use facilitates infrastructure development throughout the Islamic world.

Sixth Sequelae

The final sequelae deals with a range of purification issues. Some are relatively straight-forward, such as those arising in private equity transactions in which a Shari'a-compliant investor takes a controlling interest in a company that has a relatively limited amount of impermissible income. A controlling interest allows for a rather complete and transparent information base, thereby ensuring the ability to purify with accuracy. Non-controlling positions, such as those taken by way of the purchase of equities present more difficult situations, despite satisfaction of the DJIMI Fatwa (or other) screens. In these circumstances, dividends and distributions from the issuer will contain some proportionate amount of impermissible income. It is often difficult to even estimate the proportion with any degree of accuracy. Management of the issuer will likely be unaware of the presence of non-controlling Shari'a-compliant investors, and will likely not provide any information as to the proportion of a dividend or distribution that is attributable to impermissible income (in fact, it will likely not even consider calculating any such figures). In such a situation, estimates will have to be made from available financial information using a combination of balance sheet and operating statement information.

Of course, in practice matters are significantly more complex than is indicated by these simple examples. As an example, consider a private equity controlling interest of an entity that, at the time of acquisition, has massive interest-bearing indebtedness (i.e., well in excess of a financial screen threshold). May this acquisition proceed? Some scholars prohibit the acquisition. Others allow it if there is a strong commitment to refinancing all of the outstanding interest-bearing debt on a rigid timetable and to otherwise operating the entity in a fully-compliant manner. But the questions are many. What is the evidence of the commitment to convert to full compliance and what degree of certainty exists that the conversion will be consummated? What is an acceptable timetable? May the proceeds of a Shari'a-compliant refinancing be used to satisfy interest payments on the outstanding interest-based financing? The case studies in this grouping also illustrate how Islamic finance has changed, and is changing, almost daily. And they demonstrate how law, the Shari'a in its application, is changing incrementally.

Permissible Variance Considerations

The final category of permissible variance considerations relates to the often used, frequently abused, and continually criticized murabaha transaction in its financing iteration. These are often referred to, particularly by critics, as "commodity murabaha" transactions. That is unfortunate. There are many true murabaha transactions in which the commodity substrate is desired for its intrinsic worth. Thus, legitimate traders frequently use murabaha arrangements to purchase a wide range of commodities and other assets for compliant trading purposes or as raw materials for incorporation in Shari'a-compliant products. These might be referred to as "True Murabaha Transactions." The focus, particularly of critics, is on financing transactions that make use of commodity murabaha transactions solely for the purpose of generating a debt obligation and in which the commodity (often platinum or palm oil) is a vector for the purpose of that debt generation. Here, the intrinsic nature of the commodity is irrelevant. One might call these "Vector Murabaha Transactions." Essentially all of the Vector Murabaha Transactions are currently permissible, but with reluctance and with the admonition that other arrangements should be preferred. The logic is that there are no reasonable alternatives at present. And not all scholars agree that the Vector Murabaha Transactions are actually violative of Shari'a precepts or examples of permissible variance: consider the regional variations around the world.

Conclusion

The DJIMI Fatwa is clearly one of the most monumental fatawa in the short history of modern Islamic finance. This fatwa has done a great service to the development and growth of Islamic finance and is an extraordinary example of legal change. As with any such exercise of judgment and discretion, the fatwa and its applications are not without controversy. That is as it should be: the debate is healthy and constructive.

As an example of legal change from a jurisprudential vantage, the determinations of the jurists and

the transactional implementation of those decisions are worthy of intensive and objective study. These are unique opportunities for the application of both anecdotal and empirical techniques. And the results will redound to the benefit of both academia and the Islamic finance industry. Undertaking these sorts of studies will require more stringent definition of the objectives of the Islamic finance industry, particularly in terms of its aspirations in respect of social justice, social policy, public welfare, fairness, equity, ethics, morality and similar conceptions. The Islamic finance industry, rather broadly, proclaims some or all of these as aspirations—even justifications—for the existence of Islamic finance and its relevance for both Muslims and non-Muslims. Yet there is little rigorous work in defining these objectives, as they relate to Islamic finance, with rigor. The time seems appropriate for that definitional effort.

From another vantage, the DJIMI Fatwa and the application of the permissive variance principles institutionalized in that fatwa have been critically instrumental in enhancing the globalization of Islamic finance, in large part through integration of Islamic finance with the broader global financial system. And that integration to be a long-term necessity if Islamic finance is to continue to grow, develop and provide its benefits to the world. The processes of change illustrated by the DJIMI Fatwa and its sequelae should be encouraged, but implemented in accordance with paradigms that ensure vigilance and considered examination of the appropriateness of the variances. Those variances can and should be reduced, to some extent, as the industry grows and refines itself, and as it competes more effectively with other so-called "conventional" systems. How that is achieved requires creative and cooperative collaboration within the Islamic finance industry and between the Islamic finance industry and the broader interest-based finance community. The time also seems ripe for solidifying that cooperative endeavor.

Part 2: Legal Changes to Accommodate the Unique Aspects of Islamic Financial Products.

Islamic finance cannot exist, much less thrive, without an enabling and accommodative legal framework. Shari'a compliant financial products and services are based on Shari'a contracts and principles which are not easily accommodated by, and at times directly contradict, existing legal systems be they the common or civil law. In the last few years, countries new to Islamic finance such as Japan, Kazakhstan, Tajikistan, Hong Kong and Australia have initiated the requisite measures in their legal system to introduce Islamic financial services in their jurisdictions.

These legal changes are needed to:

- Enable the establishment of Islamic finance institutions (IFI) and the issuance of Islamic instruments;
- Regulate Shari'a supervision of IFI and products;

- Implement a tax regime placing Islamic banking and finance (IBF) on a level playing field with conventional finance, which does not penalize consumers of IBF services;
- Ensure the enforceability of Islamic financial contracts;
- Introduce appropriate dispute resolution mechanisms for IBF disputes;
- Create a harmonised interface between Shari'a principles which form the backbone and *raison d'être* of the industry, with the existing legal framework.

Nations which had made headway in this regard such as Malaysia and some countries in the GCC continue to strengthen their legal framework for Islamic finance to ensure the sustainability and competitiveness of Islamic financial services as a business.

Developing a sound and effective legal framework for Islamic finance is a key priority area for regulators as it provides greater certainty and builds public confidence in the system as a whole. Such a framework defines and enforces end-to-end Shari'a compliance in IBF through legal provisions that regulate the conduct and governance of Islamic financial institutions. It recognizes the distinctive elements of Islamic financial products and identifies risks and challenges associated with the different Islamic contractual arrangements and instruments, for the appropriate regulatory treatment of Islamic financial transactions.

There is also a need for court recognition and acceptance of Islamic contracts within the common and civil law systems, with a consistent approach of interpreting the rights of the contracting parties based on Shari'a principles. This will provide certainty and predictability to Islamic financial transactions which are becoming increasingly complex and innovative. It will also facilitate the evolution of legal frameworks that are facilitative of cross-border transactions, as Islamic financial activities continue to venture beyond domestic borders.

Awareness of the importance of alternative dispute resolution mechanisms to facilitate resolution of Islamic financial disputes has increased as witnessed by the decisions issued by the English and Malaysian courts. Laws and regulations for Islamic finance need to accommodate existing rules and Shari'a principles; similarly financing contracts drafted by lawyers need to comply with the applicable local law and Shari'a principles. The court cases show the limitations that national secular courts have in resolving Islamic financial disputes, and that the acceptability and recognition of Shari'a principles underpinning Islamic financing transactions in those courts remain vague and uncertain. Arbitration and mediation or reconciliation are methods which are recognized by Islamic law and have the advantage in terms of cost, speed, flexibility in procedure and involvement of authoritative Shari'a experts as arbitrator or part of an arbitration panel.

The Islamic Financial Services Board (IFSB) and AAOIFI are two international organizations whose prudential and Shari'a standards have been used as benchmarks by regulators and market players. The Islamic Financial Services Board (IFSB), based in Kuala Lumpur, has intro-

duced prudential standards for the Islamic financial services industry - in all key areas of capital adequacy, risk management, corporate governance and Shari'a governance. Their implementation would in turn promote more consistent regulatory and supervisory frameworks across borders. AAOIFI's accounting, Shari'a, auditing and governance standards, as well as their codes of ethics for IFI employees, are similarly adopted or influence the regulations in many countries.

In what follows, we provide an update on developments in the GCC countries and Malaysia as the regulators continue to build upon their existing legal framework for Islamic finance and take into account global developments, international standards and best practices.

Qatar

The four principal Islamic banks in the region, namely the Qatar Islamic Bank (QIB), Masraf Al Rayan, Qatar International Islamic Bank (QIIB), and Barwa Bank represent the core of the Islamic finance sector in Qatar. In 2011, the Central Bank of Qatar issued a directive prohibiting conventional banks from offering Islamic financial products and services via its Islamic windows. Although critics may contend that this measure would effectively restrict the proliferation of IBF in the region and also render it an exclusive industry; the trade-off here is arguably manifested in the fact that this regulation retains the purity of Shari'a compliant funds. The ring-fencing of conventional finance nullifies the prospect of non-Shari'a assets to contribute to fully Shari'a-compliant funds. This is perceived as a measure which would augment the autonomy and sustainability of the IBF industry vis-a-vis its secular alternative.

Further developments are noted with the launch of the Al Rayan Islamic Index by the Qatar Exchange (QE) in January 2013. The index is based on Shari'a-compliant stocks of a specified free-float size and liquidity listed on the QE. The index is total return based, meaning the dividends are reinvested in the index and has been calculated back to January 2007.

Saudi Arabia

While Islamic project and syndicated financing dates back to the early 1990s, Islamic finance took off in Saudi Arabia in the mid-2000s. The catalysts for this development included:

- The fatwa issued in 2005 in Saudi Arabia in relation to Shari'a compliant investments in the Saudi equities market. The fatwa requires that not only must activities of the company be permissible, those activities must also be financed in a predominantly Shari'a-compliant manner.
- Requirement that entities taking feedstock allocations in Saudi Arabia must offer shares to the public.
- The rapid gain in retail market share of Al Rajhi Bank. As a result, Saudi banks became more focused on Shari'a-compliant financing, as were sponsors and borrowers. Between 2005 and 2008 there was a

large shift in the Saudi finance market towards Islamic-compliant structures.

Fueled by steeply rising oil prices, the Saudi project finance market experienced an unrivalled period of growth during this time. The Islamic project financing market grew with it. Since the fully Shari'a-compliant Al Waha Petrochemicals project in 2006, all significant Saudi project financings have included an Islamic tranche.

Saudi Arabia may be an Islamic finance powerhouse, but it does not have specific legislation governing its IBF industry and the existing legal framework does not distinguish between IBF and conventional banking. Articles 1 and 7 of the Basic Law of Rule or Nizam Asasiy state that the Qur'an and Sunnah of the Prophet form the Constitution of Saudi Arabia and all state powers originate from those sources which shall reign supreme over any other law. The use of interest is prohibited but interest-based transactions are practiced in Saudi Arabia, whereby the term "commissions" is used instead of "interest".

The Saudi Arabian Monetary Agency (SAMA), the regulatory agency which oversees banking and finance in Saudi Arabia supervises and regulates Shari'a-compliant activities in accordance with the same practices applied to conventional commercial banking businesses. Hence, standards of capital adequacy, liquidity and other supervisory and monitoring requirements apply to Shari'a-compliant institutions and banks. The Banking Control Law is a uniform law which governs conventional banking and IBF alike. In Articles 8 and 9 this law provides for credit facilities and the granting of loans, but is silent on the question of interest-bearing transactions. Saudi Arabia's Shari'a regulatory framework remains an ambiguous one and the IBF industry engages in self-regulation. SAMA has ruled out the adoption of a Malaysian-style dual-banking model.

In 1987 SAMA established the Committee for the Settlement of Banking disputes (CBSD) designed for the resolution of disputes concerning banking and financial matters, which previously fell within the purview of the Shari'a courts being the 'competent court holding original jurisdiction power'. Therefore, although IFIs are governed by completely different principles, they must arbitrate their disputes in the same forum as their conventional counterparts. Where the CBSD fails to reach a satisfactory settlement between the parties, the dispute is to be referred to the Shari'a courts which in general strictly enforces Islamic law. There is no specifically set up a tribunal for IFIs or other IBF related disputes.

Recently, in a significant legal development, the kingdom enacted a major reform of its finance laws by introducing a system for the provision of mortgages and other financing arrangements by financial companies. These laws, referred to as the Real Estate and Financing Laws, were enacted by royal decrees in July 2012, published in the Official Gazette in August 2012 and are now in force. They are expected to increase access to finance options for home ownership, ensure that the interests of both financiers and borrowers are protected and further the development of secured and/or structured financings in the secondary market. The laws establishes nationwide standards for mortgage issuance that are

compatible with Islamic law, codify Shari'a principles in relation to mortgages and are expected to further spur the progress of Islamic finance there.

The five laws are the long awaited Mortgage Law, Enforcement Law, the Real Estate Financing Regulations, the Finance Licensing Regulations and the Finance Companies Control Regulations. The five laws between them set out regulations governing the registration and enforcement of mortgages and the establishment of finance companies and their activities.

- The Real Estate Finance Law provides for the authorisation and licensing of banks and finance companies to enter the real estate finance market, for the dissemination of information within the market, and for enhancing liquidity with measures to promote a secondary market (both through mortgage refinance companies and securitisation) and new methods for government financial support.
- The Finance Companies Control Law provides a framework for Shari'a compliant finance companies to enter the market alongside banks as providers of finance for real estate and other assets, including alternative forms of finance such as lease finance and micro finance. The royal decree passing the law also provides for the establishment of a new committee (the Committee for the Resolution of Financing Violations and Disputes) to hear disputes under the Finance Companies Control Law and the Financing Lease Law (excluding real estate ownership and securities disputes).
- The Registered Real Estate Mortgage Law, the main focus of attention in the media, provides a new framework for security over real estate, including, for the first time, provision for second ranking mortgages.
- The Finance Lease Law codifies the rules surrounding finance leasing (including of real estate) as an alternative product to secured debt.
- The Enforcement (Execution) Law provides for a new cadre of dedicated enforcement judges and defines categories of "enforcement instrument" in a way which potentially broadens the kind of enforcement actions which can be brought.

Separately, there is an amendment to the Capital Market Law to facilitate the licensing and regulation of special purpose vehicles by the Capital Market Authority, paving the way for their use as securitisation vehicles (and possibly for other uses).

A key provision states that financing arrangements (be it real estate related or otherwise) need to be undertaken in a Shari'a-compliant manner. The laws require upfront disclosure by parties and protect both parties' interests – building upon the very premise of Shari'a principles. All five laws take into consideration the fairness of transactions.

The real estate and financing laws will revolutionise the real estate and financing market in the country and, although this may take some time, provide clarity on the process

to be followed in order for financiers to obtain recourse to the assets. Specifically, the laws are trying to ensure that both parties to a financing transaction are of 'clean hands'. Financiers need to be qualified, honest and operate in an equitable manner; and borrowers need to have a credit rating and adhere to the agreed commercial terms.

The laws appear to deal with the concerns that have plagued real estate and financing laws for over a decade. Also they attempt to ensure that the mistakes that occurred in other jurisdictions that resulted in the global financial crisis do not occur in the kingdom (noting that the kingdom was fairly sheltered from the effects of the global financial crisis). Specifically, finance activities must not prejudice the safety of the financial system and fairness of transactions. To address this, the Finance Companies Law requires Finance Companies (defined therein) to diversify their risk, with limitations being imposed on the amounts a financier can lend to a borrower or its related entities. Details are expected to be forthcoming in the implementing regulations.

Bahrain

The BMA, in consultation with the industry, had developed a framework known as the Prudential Information and Regulation for Islamic Banks (PIRI) which takes the standards developed by AAOIFI into consideration. The PIRI framework covers five important aspects which reflect the Basel Committee guidelines. Specifically:

- Capital adequacy, for both credit and market risk;
- Asset quality including monetary large exposures and related party exposures;
- Regulatory treatment of investment accounts both restricted and unrestricted both on and off balance sheet;
- Prudential requirements concerning liquidity management on balance sheets;
- Separated funds related to restricted investment accounts analysis of earnings quality.

In 2006, BMA introduced the Trust Law which provides comprehensive guidance and lays down rules relating to the creation and administration of financial trusts. The law is aimed at providing a firm legal foundation for trust business and enable the Bahrain-based wealth management industry to develop and extend more innovative products and solutions. It was also expected to enhance the development of investment products, both conventional and Islamic, that could be offered using the trust mechanism, such as real estate investment trusts (REITS) and private pension schemes.

CBB's comprehensive rulebooks contain comprehensive regulations for all financial activity including Islamic banking. There are only two additional specific requirements for Islamic banks:

- Each Islamic bank must have an independent Shari'a supervisory committee; and

- Islamic banks should adopt the AAOIFI standards for their financial reporting.

Bahrain plays host to a number of organizations central to the development of Islamic finance, including the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Liquidity Management Centre (LMC) which aims to facilitate the placing of surplus funds of Islamic financial institutions in profitable traded instruments, the International Islamic Financial Market (IIFM), the Islamic International Rating Agency (IIRA) and the Shari'a Review Bureau.

In contrast to other GCC states, Bahrain has kept its market open to foreign banks, while, for example, Saudi Arabia and Kuwait have licensed only majority-locally-owned institutions. As a result, Bahrain has the most Islamic banks in the GCC, with 24 Islamic banks and 11 takaful companies. With most of these institutions serving the region as opposed to the local market, it has continued to be dependent on Saudi Arabian business.

A significant development in the region is BMA's innovation of IBF products which perform similar liquidity functions as conventional products. These innovations manifest themselves in the form of the salam sukuk. This short-term sukuk instrument closely resembles a forward contract. It is essentially a transaction of sale between two parties involving the purchase of an underlying asset. The price is determined and fully paid at the time the contract is agreed. The seller agrees to provide the asset in the agreed quantity and quality to the purchaser, at an agreed future date. Since this transaction requires a full prepayment, it is clearly beneficial to the seller if the contract price is under pitched vis-à-vis the prevailing market price. The difference between the lower sale price and the spot price is the compensation by the seller for the privilege of receiving an advance payment.

The establishment of the Bahrain Institute of Banking and Finance in 1981 with a dedicated Islamic training department has created a resource for nurturing IBF. Additionally, CBB has also recently established a special fund to finance research, education and training in Islamic finance (the Waqf Fund).

Oman

The Islamic Banking Regulatory Framework (IBRF), issued in December 2012, represents a significant step towards building IBF in the Sultanate of Oman. The IBRF is a 500-page document which sets out the regulations that will govern Oman's financial sector and is set to open the door for both conventional and Islamic banks to market Shari'a-compliant products. In a statement accompanying the regulations, the Central Bank of Oman (CBO) described the IBRF as "a detailed and comprehensive document covering all aspects of Islamic banking".

While conventional lenders will be allowed to conduct Islamic banking operations, the IBRF requires them to open separate branches for the two different services and make clear the sources of their funds and what they are used for. The requirement for individual branches for both conventional and Islamic operations respectively

will impose additional costs on banks seeking to operate in both segments, although the strict reporting requirements should limit any concerns regarding crossover of funds from non-accepted sources.

The regulations do not put in place a centralised body to supervise and vet Islamic products, allowing each bank to have its own Shari'a board to oversee products. A board is required to have a minimum of three scholars – each with a proven knowledge of legal and financial matters and a minimum of 10 years of experience. All such scholars will be subject to performance assessments throughout their terms and will be limited to serving two consecutive three-year terms. These requirements are tighter than many applied in other Gulf countries. For instance, the restriction on board members working for two competing IFIs.

Another area where the regulations are more stringent than those in other markets is tawarruq or commodity murabaha: the buying of an item or product from a bank through a deferred payment arrangement by a person or entity, who then sells the item to a third party for cash. The IBRF rules out this instrument, saying, "Commodity murabaha or tawarruq, by whatever name called, is not allowed for the licensees in the sultanate as a general rule". Tawarruq has come under criticism by some scholars for not being fully compliant with Islamic financial requirements.

Oman's banking sector has long been awaiting the CBO's regulatory framework, after Sultan Qaboos bin Said Al Said issued a decree in May 2011 authorising the establishment of Islamic banking. Currently, seven conventional lenders – Ahli Bank, Bank Dhofar, Bank Muscat, Bank Sohar, the National Bank of Oman, the National Bank of Abu Dhabi and the Oman Arab Bank – are planning to offer services in the Shari'a-compliant segment, along with the two dedicated Islamic banks Bank Nizwa and Al Izz Islamic Bank. Oman already has a competitive banking sector and the opening of the Islamic segment of the market will only serve to make it more so. The success of the two dedicated Shari'a-compliant banks, and that of the segment as a whole, will likely depend on how well new products are promoted and services are provided.

In the sphere of capital markets, Oman's Capital Market Authority (CMA) has received two requests for issuing sukuk. The CMA has released draft sukuk regulations and the proposed amendments to the Capital Market Law related to this issue.

A new index for Oman's stock exchange is expected to provide a boost to the Sultanate's nascent Islamic financial services sector and lead the way for additional Shari'a-compliant products. In June 2013, the Muscat Securities Market (MSM) announced that it was close to launching a new index, one for listed companies that operate according to the Shari'a principles as set down by AAOIFI. To be known as the MSM Sharia Index, the benchmark will contain 31 listings. Industrial firms will be the best represented, with 18 companies, followed by 10 from the services sector and three from the financial industry.

The United Arab Emirates

There are two different jurisdictions in the UAE. The onshore jurisdiction relates to residents and local companies, which included retail banks, insurance companies, securities and investment firms, etc. These onshore financial institutions are subject to the central bank's legislation and overall supervision, and provide services to individual clients, local companies as well as free zone establishments that allow 100% shareholding by foreigners.

The other jurisdiction in the UAE is Dubai International Financial Centre (DIFC), an offshore financial free zone having a separate legislative environment with its own regulator, the Dubai Financial Services Authority (DFSA), courts and administrative office. Although it is a free zone identical to other free zones in the UAE, its highly regulated environment distinguishes it from the other free zones in the UAE and makes it one of the world's top ranking financial centres.

Since both jurisdictions vary in terms of allowed activities and scope of business, the legal framework for Islamic financial institutions differs. However, the differences are not significant. Both jurisdictions require IFIs to set up Shari'a systems and controls to ensure operations and activities are conducted in accordance with Shari'a, but neither the UAE nor the DIFC have a centralized Shari'a board.

Federal Law No. 6 of 1985 Regarding Islamic Banks, Financial Institutions, and Investment Companies allows the creation of Islamic banks. The Articles and Memorandum of Association of Islamic banks, financial institutions and investment must provide for the establishment of a Shari'a committee of not less than 3 persons who will ensure the adherence by such companies to Shari'a principles in their operations and contracts. The appointment of the relevant Shari'a committee within each of these companies is subject to the approval of a supervisory Shari'a committee within the Ministry of Islamic Affairs. The UAE Federal Law No. 5 of 1985 Concerning Civil Transactions (the 'Civil Code') was issued with the aim of achieving compliance with the Shari'a and regulates the main types of Islamic contracts such as mudaraba, musharaka, murabaha, ijara, salam, etc.

Insofar as the DFSA is concerned, the DIFC Law No. 13 of 2004 creates a regulatory framework for the conduct of Islamic financial business in or from the DIFC.

The UAE has promoted itself as the hub of IBF in the region, and established the Dubai Global Sukuk Centre and the Dubai Centre for Islamic Banking. However, it has been argued that the UAE is not equipped with an adequate regulatory and dispute-resolution framework to sustain itself as a global centre of Islamic finance. The Governor of the Central Bank has indicated that the UAE plans to develop an independent authority which will supervise the country's IBF industry, backed by specific legislation over the next two years.

In 2013 the UAE Securities and Commodities Authority (SCA) issued draft regulations dealing with the separate treatment of sukuk and conventional bonds. The

regulations are intended to encourage the growth of the domestic credit market and the sale of sukuk in the UAE. In October of the same year, Dubai announced its ambition and roadmap to transform itself into the global capital for Islamic economy. Its initiatives include establishing Dubai as the hub for sukuks and all Islamic financial services, and drawing up a legal framework with legislative and regulatory bodies for the Islamic market.

In relation to dispute resolution, the emergence of the International Islamic Centre for Reconciliation and Arbitration (IICRA) in Dubai is conspicuous. IICRA is an international, independent and non-profit organization with published rules and procedures for reconciliation and arbitration. The centre offers facilities to settle financial and commercial disputes that arise between financial or business institutions that choose to apply the provisions of Islamic law and Shari'a principles in resolving disputes arising between these institutions and their clients or other parties.

Kuwait

This success of IBF in Kuwait may be attributed to a number of factors. Most importantly, Kuwait adopted legislation and regulation which provided a competitive environment. It encouraged financial institutions, particularly Islamic banks, to develop their strategies and improve their performance, services and products to meet present and future requirements, as well as pay more attention to modern methods of banking and financial activity. In addition, the Central Bank of Kuwait (CBK) plays an integral role in controlling and supervising the institutions and activities of this industry.

The CBK has taken interest in the regulation of Islamic financing activities since the early 90s, following the establishment of a number of investment companies operating in accordance with the provisions of the Shari'a. Kuwait Finance House (KFH) was already operating in the market; however, it wasn't supervised by the CBK. In light of the increasing demand for products and services of Islamic banks, the need for the completion of banking legislation became quite urgent. Hence, law No.32/1968 concerning currency, CBK and banking regulation was amended by the issuance of law No.30/2003 which addressed Islamic banks.

Key points of this law are:

- 1- Regulate Islamic banks activities on sound basis taking into consideration the nature of their activities, and provision of necessary legal instruments for the oversight of banks.
- 2- Perform Islamic banking activities through independent legal and financial entities. Those activities are not permitted through windows or branches at conventional banks, avoiding money mixing.
- 3- Conventional banks are permitted to convert to Islamic banking activities by following the terms and conditions set by the CBK. Two conventional banks have completely converted to Islamic banking activities as per the CBK's terms and conditions.
- 4- Legal supervision is, basically, the responsibility of the

legal supervisory authority of each bank.

CBK's responsibility is to ensure banks' commitment to submit all policies and products to the legal supervisory authority, and confirm banks adherence with issued decisions and fatawa, through onsite inspections, in addition to the auditor role in this regard. A major development in the legislative structure was the issuance of law No.7/2010 regarding the establishment of the Capital Market Authority (CMA), and regulating securities' activity. It aimed at developing conventional and Islamic instruments and institutions, and regulating Kuwait's capital market in accordance with the international standards applied under the supervision of CMA.

In view of the new regulatory framework, conventional and Islamic investment funds and companies are now supervised by the CMA. The CBK's supervisory role regarding those companies is limited to their financing activities. New corporate legislation has been issued to replace the law issued in 1968 allowing companies to issue financial instruments in accordance with Shari'a principles, and establishment of new companies with a specific purpose. The new regulations are expected to lead to positive developments in the capital market of Kuwait and lead to the enhancement of instruments and performance of its conventional and Islamic institutions.

The supervisory framework designed by the CBK for Islamic banks took in consideration the applied international standards of banking activity. The amended standard of Basel II regarding capital adequacy became effective for Islamic banks as of June 2009. The said standard aims at urging Islamic banks to adopt the best practices related to various risks management and control. This standard also considers the general basis of Basel II amending the frame of capital adequacy in a way that doesn't contradict Islamic banks' activities, taking into account risk weights in the items concerning those banks, in accordance with the standards and guidelines issued by the IFSB.

Malaysia

A major catalyst for the progression Malaysia has experienced in the IBF sector is its consistency in developing a legal framework which enables IBF, incorporates international standards and keeps abreast with the ever expanding horizons of the industry. Malaysia is an acknowledged frontrunner in building an appropriate supervisory and regulatory framework for IBF.

The Islamic Banking Act 1983 and the Takaful Act 1984 had pragmatically dealt with legal and regulatory impediments to the growth and sustainability of the industry through the requisite legal measures. Its tax neutrality policy, which overcame the issue of dual taxation in IBF transactions, created a precedent which was emulated in other jurisdictions. Related amendments to laws concerning income tax, stamp duty and real property gains tax as well as incentives have led to the remarkable progress IBF has made in Malaysia.

Pursuant to challenges to the validity of a popular Islamic home financing product, a provision was included in the Central Bank Act 2009 to require the court and

arbitrators to take into consideration published rulings of the Shariah Advisory Council (SAC) of the central bank, Bank Negara Malaysia (BNM), or refer to it when a question arises concerning a Shari'a matter during proceedings relating to Islamic financial business. Rulings made pursuant to a reference made to the BNM SAC shall be binding on the court or arbitrator. This legal measure was undertaken to minimize the Shari'a uncertainty brought about by court cases and ensure enforceability of Islamic financing transactions, and restore the shaken confidence in the industry.

On 30 June 2013, sweeping new laws for the financial sector came into force in Malaysia. The Financial Services Act 2013 (FSA) and its Islamic counterpart, the Islamic Financial Services Act 2013 (IFSA), were introduced to promote financial stability by fostering, amongst others, the safety and soundness of financial institutions, the integrity of the money market and foreign exchange market, business conduct of financial institutions, and consumer protection. In line with the Financial Sector Blueprint 2011 and new international standards, BNM now has power to dictate what is appropriate for an institution and its holding company in respect of its:

- Capital Requirements
- Corporate Governance;
- Consumer Protection;
- Shareholding; and
- Intervention.

The Acts may be described as a step-jump in the regulation of the financial system in Malaysia, as it marks a gradual shift away from the laissez-faire and self-regulatory approach of the previous regime towards one of increased regulation and corporate accountability.

The provisions of the Acts on the key areas, i.e. corporate governance, prudential requirements, transparency of operations, consumer protection and BNM powers to intervene to ensure compliance in these aspects, are largely identical. However, the IFSA has an additional principal regulatory objective in addition to financial stability, and that is to promote compliance with the Shari'a.

The IFSA is an omnibus legislation that repealed the Islamic Banking Act 1983 and the Takaful Act 1984, and introduced significant new provisions for the Islamic finance industry, regulating Islamic financial institutions, the Islamic money market, the Islamic foreign exchange market, Islamic payment systems and instruments, and financial holding companies. In addition, the Minister, with the recommendation of BNM may prescribe a business or activity or a person who engages in Islamic financial intermediation and therefore bring them within the purview of the IFSA.

The main distinction between the FSA and the IFSA lies in the IFSA's extensive requirements on Shari'a governance and ensuring Shari'a compliance in its Part IV: Shari'a Requirements. As explained in its Financial Stability and Payment Systems Report 2012, BNM intends the IFSA to strengthen the foundations for end-to-end Shari'a governance and compliance, support the effective application of Islamic contracts in the offering of Islamic financial products and services from entering into a con-

tract to the resolution of a failed Islamic financial institution, and align legal and regulatory principles with Shari'a precepts and promote greater legal and operational certainty. In this regard, the IFSA significantly reflects the recommendations of international Shari'a, prudential and governance standards for Islamic finance. The FSA requires conventional institutions with Islamic operations and windows to comply with the requirements for Shari'a compliance laid out in Part IV of the IFSA.

The IFSA requires Islamic financial institutions to ensure that their aims, operations, business, affairs and activities are in compliance with Shari'a at all times. Specifically, the IFSA:

- entrenches the role of BNM as Shari'a regulator;
- embeds Shari'a principles and BNM Shari'a Advisory Council rulings;
- strengthens Shari'a governance and compliance requirements;
- statutorily enforces management of Shari'a non-compliance risk, and makes it an offence for IFIs to carry on Shari'a non-compliant activities;
- imposes heavy penalties for offences and breaches in relation to Shari'a matters;
- gives BNM wide powers to assess, intervene, direct and penalize IFIs in relation to offences and breach of IFSA provisions.

Under the IFSA, IFIs are to ensure that it complies with BNM standards and internal policies to ensure Shari'a compliance. Breach of Shari'a BNM standards and failure to report non-compliance could result in a stringent penalty for an institution or individuals involved, i.e. up to MYR8 million, up to 8 years imprisonment, or both. Directors are to give due regard to the decisions of the Shari'a Committee on any Shari'a issue relating to the carrying on of the business, affairs and activities of the institution. The board of directors of an institution shall have regard to the interests of, as the case may be, depositors, investment account holders and takaful participants of the institution.

Section 35 states that an institution and any director, officer or controller of such institution shall:

- (a) provide any document or information within its or his knowledge, or capable of being obtained by it or him, which the Shari'a committee may require; and
- (b) ensure that such document or information provided under paragraph (a) is accurate, complete, not false or misleading in any material particular; to enable the Shari'a committee to carry out its duties or perform its functions under this Act.

To enable an objective and transparent assessment of the Shari'a compliance of IFIs, the IFSA provides that BNM could require IFIs to appoint an external auditor to conduct an audit on the Shari'a compliance of its operations. In addition, BNM itself may appoint an auditor to conduct such an audit if the institution fails to do so,

in addition to the person appointed by the institution and under any other circumstances as the BNM deems appropriate for the purposes of compliance with the Shari'a by the institution.

In another development, measures are currently underway to liberalise the legal profession in Malaysia to enable the presence of international law firms with expertise in Islamic finance.

In relation to harmonizing the legal framework which is based on the common law with Shari'a principles for Islamic finance, the Islamic Finance Law Harmonisation Committee in Malaysia was established under the auspices of BNM in 2010. The Committee seeks to inter alia:

- position Malaysia as the reference law for international Islamic finance transactions;
- achieve certainty and enforceability in the Malaysian law in regard to Islamic finance contracts;
- for Malaysian laws to be the law of choice and Malaysian dispute resolution institutions as the forum for settlement of disputes for international cross border transactions as part of creating a conducive legal system for the IBF industry.

The Committee in its report enumerates the issues which warrant amendment, research or attention. The initiatives of the Committee include the following:

1. The proposal for legal recognition of Shari'a permissibility of imposing late payment charge on judgement debts in Islamic financial cases. This proposal has been incorporated into law by way of Order 42 Rule 12A of the Rules of Court 2012.

2. Deliberating proposals to amend relevant laws that protect a financial institution's rights to realise its security involving reservation lands.

3. Deliberating proposals to recognise Islamic finance transactions under the National Land Code 1965.

4. Deliberating proposals to facilitate the use of collateralised commodity murabaha in short-term Islamic financial market instruments and clarifying the requirements for registration of collaterals under the Companies Act 1965.

5. The Kuala Lumpur Regional Centre for Arbitration (KLRCA) has strived to promote arbitration for Islamic finance disputes since its introduction of specific rules in 1997. In 2012, KLRCA launched an adapted set of its arbitration rules for Islamic arbitration. The new rules are referred to as the i-Arbitration Rules and allow the resolution of disputes arising from any contract that contains Shari'a issues (the "i" prefix being a well-recognised indication of Shari'a compliance). The aim behind the Rules is to provide arbitration that is suitable for international commercial transactions premised on Islamic principles, which Rules will be recognised and enforced internationally.

The KLRCA Islamic Model Arbitration Clause provides that "[A]ny dispute, controversy or claim arising out of a commercial agreement which is based on a Shari'a

principle or the breach, termination or invalidity thereof shall be settled by arbitration in accordance with the KLRCA i-Arbitration Rules. Awards under the i-Arbitration Rules will be enforceable in the 146 countries that are signatories to the New York Convention". The new rules are expected to increase the scope for cross-border Shari'a based commercial transactions and respond to the increasing number of Islamic finance parties relying on arbitration to resolve their disputes.

The Rules were amended in 2013, and some important amendments are on the following:

- An amendment pertaining to the referral to a Shari'a expert which offers a method of obtaining the correct and most appropriate authority for any Shari'a issues that may arise. This broadens the procedure to accommodate international parties by the removal of any reference to a particular jurisdiction (previously the Shari'a Advisory Councils of BNM or that of the Securities Commission of Malaysia).
- Optional mechanism in a Shari'a related dispute which enables the tribunal to award compensation to parties for the late payment of an award. This mechanism allows parties to receive full compensation in line with Shari'a principles.
- Emergency arbitrator provisions. The emergency arbitrator provision provides an option for parties to apply where they require urgent interim relief, increasing party autonomy, providing certainty and minimizing judicial intervention. Parties are now able to obtain the full breadth of commercial remedies within the auspices of their KLRCA administered arbitration proceedings.
- The power or jurisdiction for arbitrators to grant pre-award interest has also been included. Furthermore, new provisions have been added regarding consolidation of proceedings and concurrent hearings to ensure consistency with international trends. The KLRCA has also sought to enhance its confidentiality rules restraining the cases where the matter can be disclosed.
- Confidentiality requirements have been strengthened in order to enhance the privacy of any proceedings. The only exclusion becomes where the matter falls under public domain or the disclosure is necessitated by legal requirement.
- The schedule of fees and administrative costs has been revised maintaining the KLRCA's cost advantage over other institutions. Apportionment of fees and costs relative to parties' claim and counterclaim respectively promotes fairness and equitability within the arbitration procedure. When the Director of the KLRCA has fixed separate advance preliminary deposits on costs, each of the parties shall pay the advance preliminary deposit corresponding to its claim.