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## Some Thoughts from Legal Academia on Reappraising the Islamic Financial Industry after the Downturn

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## Centre of Islamic and Middle Eastern Law (CIMEL)

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<b>Title</b>	Some Thoughts from Legal Academia on Reappraising the Islamic Financial Industry after the Downturn
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#### ABSTRACT

IF has reached a new stage in its development, a new level of maturity. At such a point, it is worthwhile to step back and consider issues which need attention for progress to the next stage. A silver lining to the cloud of the financial crisis is that it has given us the opportunity, and a powerful impetus, to spend some time and effort on this stock-taking, on the 'reappraisal' of the workshop title.

This paper contains a modest contribution to this exercise, a somewhat ragbag collection of thoughts derived from personal experience and reflection. It is consciously and intentionally legal and academic. It deals with the following topics:

- the skills gap and bandwagoning;
- law as a specialist area of IF; and
- some possible solutions.

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## I. THE SKILLS GAP AND BANDWAGONING

The great enhancement in the profile of IF, largely attributable to its resilience in the financial crisis and the success of the sukuk market,<sup>2</sup> has many positive aspects. The expansion of the field and a greater awareness of its benefits are to be welcomed, as is the recent increase in the depth and range in the available literature. However, for various reasons, some of which are explored below, there are also significant disadvantages.

One such disadvantage is the commonly acknowledged problem of the skills gap. There is a dearth of suitably qualified people in the industry. Less discussed is one of the causes - a lack of good courses and suitably qualified teachers, combined with deficiencies in the knowledge base.

A related issue is bandwagoning. A large number of newcomers are coming into IF because of its popularity and the opportunities afforded by the skills gap. One potential problem with bandwagoning is the possibility that a significant number of those newcomers are the wrong people and the wrong institutions coming into the field for the wrong reasons. Another potential problem is that bandwagoning does not solve the skills gap, in the short to medium term it compounds it. In the absence of enough capacity to educate and train the newcomers adequately, their presence makes matters worse by increasing the number of people in the industry with low skill levels, until enough of the newcomers have acquired sufficient expertise in the School of Hard Knocks.

Without conducting a psychologically-based enquiry, one cannot be absolutely sure why people and institutions enter IF. Undoubtedly, many are motivated by genuine religious devotion. On the other hand, some seem primarily interested in some combination of financial gain, academic recognition and career advancement. They are 'less interested in the ethical than the financial rewards'.<sup>3</sup> It will be interesting to hear from practitioner colleagues as to whether they have noticed a change here between the bandwagoning period and that immediately preceding it, both as regards institutions and individuals.

On the academic and pedagogic side, in the past few years we have seen a huge increase in interest, teaching/training activity and publications. A quick Google search reveals numerous training courses offered by a range of institutions. Several universities offer courses in IF.

The quality of some courses is undoubtedly high. We are all aware, for example, of the reputation of Durham's School of Government and International Affairs. My colleagues in the SOAS Department of Finance and Management Studies run an IF course, and our School of Law has a Masters course in the Law of Islamic Finance.<sup>4</sup> The quality of some training programmes seems sound. The instructors have

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<sup>2</sup> Its recent difficulties are, it is submitted, no more than inevitable teething troubles. Evidence for this point of view can be found in the recent sukuk issuance figures.

<sup>3</sup> Foster, NHD (2010) 'Making People Behave Properly in Islamic Finance: Some General Thoughts' SOAS Law of Islamic Finance Working Papers Series No 2, p9.

<sup>4</sup> All legal aspects of IF. See the more extensive definition in section 3(D).

considerable IF experience and a thorough knowledge of the subject. I am, however, unconvinced about the quality of some others. The teachers are no doubt very able in their own fields, but they have little IF experience.

These trends also cause concern about the quality of the literature produced. On the positive side, in addition to the well known and admired work of the ‘old hands’, some scholars newer to the field are producing stimulating, and often critical, articles and books. There are many more useful textbooks and technical manuals than in the past. Some of the courses mentioned above have good material. However, the bandwagoning effect has already added to the too large amount of existing less rigorous work, which suffers from, inter alia, superficiality in treatment of the material, historical revisionism in the cause of marketing the industry, some outright mistakes, poor bibliographical work and so on.

As far as the students are concerned, we see a similar pattern. Many are very able. However, some are clearly less so. For example, on the PhD level, in addition to some interesting and promising proposals, I also regularly receive some which are of less than satisfactory, or low (on occasion very low), quality. Of greater concern, perhaps, is the fact that even the sound proposals nearly all relate to technical or topical issues. There is, of course, nothing wrong in a potential student wishing to study such a subject, but I strongly suspect that such a person’s motive for doing a PhD is often simply pecuniary, the thinking being: ‘practical PhD = good job’.<sup>5</sup> Various consequences follow. The growing pool of PhD theses will not increase the sum total of IF expertise in more general topics such as the history of commercial and financial law, its applicability in the classical era and the determination of *maqasid*, so we risk remaining ignorant about these vital areas. Few successful students will join the academic community, so there will still be relatively few researchers and teachers to extend the boundaries of knowledge and fill the skills gap.

## II. LAW AS A SPECIALIST AREA OF IF

### A. The Need for Formal Specialisation

A skills gap and bandwagoning are characteristic of a rapidly expanding field which has some way to go before it is fully mature. Another such characteristic is a lack of specialisation. This is inevitable in the early stages of the development of an activity, which is necessarily developed by a small group of people (the founders) who have to do everything. As the activity matures, specialisation develops in practice. In order to progress further, more formal specialisation is needed.

IF, and in particular its legal aspects, constitute an example of this phenomenon. Specialisation inevitably takes place in practice, of course, but there is no formal division between IF’s major constituent parts, the economic, the financial and the legal. The appearance, although not the reality, is that we all study all of IF, not pieces of it, regardless of whether we are economists, financial experts or lawyers. The peculiarity of IF non-specialisation becomes apparent when one considers some

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<sup>5</sup> This attitude creates another problem, because a ‘practical’ PhD, ie one focussed on technical matters with nothing to say about broader issues, is a contradiction in terms. I have never received a proposal for practical work appropriate to a PhD thesis, ie empirical work set in the context of broader issues.

similar fields, each of which has its own specialist legal subject. Commerce has Commercial Law, international trade has International Trade Law, international finance has the Law of International Finance. But there is no specialist legal subject related to IF, no Law of Islamic Finance. This is what IF needs, a formal categorisation of the Law of Islamic Finance as an area of study, separate from the economic and financial aspects of IF on the one hand and from other areas of law on the other.

The point was brought home when I was steering the SOAS School of Law course through the approval process. The question was raised of overlap with the IF course in the Department of Finance and Management Studies. Such a question would be unthinkable in, say, conventional international finance, where the divide between finance and law is very clear.

Indeed, the need for specialisation is arguably greater in IF than in other fields, because the skill base required is so much wider. The ideal specialist in the Law of Islamic Finance needs competence in the English and Arabic languages, a knowledge of the foundations of the sharia as well as its financial aspects, combined with expertise in English financial law and practice. This is a very tall order indeed.

## **B. The Place of Law in IF**

Formal legal specialisation in IF raises some specific issues. Law has, in one sense, pride of place, for of course IF is founded on a legal idea – compliance with the sharia - but in another sense it occupies a subaltern position which, inter alia, does not seem to merit a specialisation of its own. That position may well derive from the initial conditions in which IF was developed. Its numerically few founders, people such as Abu al-A'la al-Mawdudi, Hassan al-Banna and Sayyid Qutb, took an economic, or ‘socio-economic’, approach which influenced IF’s form and dominant attitudes within it.<sup>6</sup> There was a dearth of specialist legal expertise. Contrary to what is often said, there was no financial system, or financial law to serve it, of a sophistication equivalent to the Western financial system even of the 19<sup>th</sup> century, let alone the 21<sup>st</sup>. And from the middle of the 19<sup>th</sup> century what commercial law did exist was progressively eliminated.<sup>7</sup> To put it another way, IF came out of Islamic Economics.<sup>8</sup>

As for law, as just stated it is clearly fundamental, for IF is based on compliance with the sharia. The sharia scholars have a central role in the industry. And ‘most of today’s IFIs fall under [what Hegazy calls] the legalistic approach’,<sup>9</sup> that of people such as Muhammad Baqir as-Sadr and Sami Homoud. It would seem, then, that law has its acknowledged place in the IF scheme of things. However, this is not the whole picture, for law is seen in a fairly restricted light. It is used as an instrument, a tool for

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<sup>6</sup> Hegazy, WS (2007) ‘Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism’ (7) *Chicago Journal of International Law* 581, p582.

<sup>7</sup> With the exception of Saudi Arabia and the amended version of Hanafi law codified into the Majalla.

<sup>8</sup> Later on, as IF became an (albeit fledgling) industry, the voices of its practitioners started to be heard and financial specialists started to study IF.

<sup>9</sup> Hegazy ‘Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism’, p 582. Presumably the author is using the word ‘legalistic’ in the sense of ‘based on transactions which comply with the sharia’, in which case the statement is correct and does not conflict with the point made in the text.

the achievement of specified ends, a fact closely related to the form/function criticism and the debate concerning *maqasid* and *qawa'id*.

### C. The Need for Legal Specialisation in IF

Law's position means, inter alia, that outside the area of product development and transaction approval reserved for the narrow circle of eminent sharia scholars, the Law of Islamic Finance is fair game for anyone interested in the subject. A great deal of the 'legal' literature is written by non-lawyers, people whose training is in economics/finance. This is curious and, as far as I know, unique to IF. Works on other legal subjects are not authored by lay people, by specialists in the underlying activity rather than legal specialists in the related field of law.<sup>10</sup> Books on the Law of International Finance are not produced by bankers, but by financial lawyers.

To date, the lack of legal specialisation in IF has not been a major problem. Some lower quality material is seen in lower level publications. Sharia scholars make a significant contribution. The high-level work produced by present colleagues is rigorous and professional. One need only mention such scholars as Mahmoud El-Gamal and Rodney Wilson, to name but two, to realise that expertise in the legal side is certainly not the exclusive reserve of the legally trained.<sup>11</sup> But as bandwagoning brings in less knowledgeable, and perhaps some less scrupulous people, our current acceptance of the practice of lay legal authorship becomes dangerous, for law is a field which is especially prone to dabbling. To the unwise (bandwagoning?) non-lawyer, its difficulty is not apparent, it seems to be just words and rules. Experienced commercial lawyers are familiar with the problem of a certain type of client who, impatient with what as he sees as the silliness, and the undoubted expense, of his legal advisor, tries his hand at the technicalities of contract drafting and negotiation, with unfortunate, sometimes catastrophic results. Examples of such consequences can be seen in another field, the English law of succession, in which several rules were established in cases which arose from testators writing their own wills. So as IF grows in popularity, poor quality work may well increase. Formal specialisation is one means of combating this phenomenon.

Less easy to spot, and therefore more insidious, are the disadvantages which stem from a lack of a broad and deep knowledge of law generally among non-lawyers, however expert they might be in the specialist legal aspects of IF. It is extremely difficult, if not impossible, to be an excellent economist and at the same time have a good knowledge of subjects such as legal theory and comparative law – it is hard enough for a legal academic. With some very honourable exceptions, most treatments of the Law of Islamic Finance remain technical, with little theorisation or consideration of broader issues, an essential step in further development of the field. For example, the classification of AAOIFI 'sharia standards' inherent in their name is generally accepted, whereas to a lawyer, they are easily identifiable as model legislation such as that produced by UNCTAD or the EBRD.<sup>12</sup> Another example is

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<sup>10</sup> 'Lay' is used here in the strict sense of 'without formal legal training'.

<sup>11</sup> The advantages of specialisation can be seen in the work of, for example, Frank Vogel and Samuel Hayes (Vogel, FE; and Hayes, SL (1998) *Islamic Law and Finance: Religion, Risk and Return* Kluwer Law International).

<sup>12</sup> Georges Affaki, a lawyer, refers to the AAOIFI standards as the 'codification of sharia financial rules' (my translation): Affaki, G (2008) 'L'accueil de la finance islamique en droit français' in

the lack of insights in the extant literature from the legal academic disciplines of comparative legal studies and legal history.

Another example is the backwards development of the adapted form of the sharia used in IF. The general law is, of course, used as the foundation, but by far the bulk of work has been on the development of the superstructure, the specialist law. So we have detailed, technical works on sukuk,<sup>13</sup> but no general work on commercial law, and only a very few monographs on contract.<sup>14</sup> There are very few academic journals and many of those that do exist are difficult to find and access, for they are not in the 'information loop' of the major publishers and on-line databases. Bibliographic information is also, therefore, difficult to find. No journals specialise in the Law of Islamic Finance.

Contrast this situation with English law. There is a plethora of books on contract on all levels, from simple introductions to weighty, regularly updated reference works and highly specialist treatises, along with excellent textbooks on commercial and financial law. There is a range of specialist journals addressed to various audiences, all of which are solidly established in the information loop.

#### **D. An Example: Some Analytical Tools Deriving from Legal Specialisation**

A minor, but illustrative, example of the sort of benefit which can come from legal specialisation is the development of some taxonomic analytical tools for dealing with issues arising from the interaction of the sharia with secular legal systems.

Such interaction has come to the fore in the last few years as a result of IF's expansion and growing maturity. Unless and until an alternative method is found, the sharia needs 'vehicular' legal systems such as Bahraini, English and Malaysian law to implement it, to put it into positive law effect.<sup>15</sup> This interaction increases exponentially the already considerable amount of expertise required for the study of the Law of Islamic Finance. Not only does one need a broad and deep knowledge of the sharia, but also of the vehicular system, as well as of comparative law for the study of the interaction between them, legal history for the study of the Law of Islamic Finance as a legal system in development, and so on. Indeed, the ideal methodology is collaborative, with contributions from more than one legal specialist. By happy coincidence it has recently been possible to develop some analytical tools which seem useful in the study of such interactions. The supervision of two PhD

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Laramée, J-P (ed) *La finance islamique à la française: un moteur pour l'économie; une alternative éthique*, p 156. The fact that this model legislation is called 'standards' may be an indication of the economic bias in IF mentioned above. Or it may just be that the use of the word 'law' or 'legislation' would be too controversial in view of the principle that Allah is the only legislator.

<sup>13</sup> Eg Adam, NJ; and Thomas, A (2004) *Islamic Bonds: Your Guide to Issuing, Structuring and Investing in Sukuk* Euromoney.

<sup>14</sup> Vogel, FE (2006) 'The Contract Law of Islam and of the Arab Middle East' *International Encyclopedia of Comparative Law* Vol VII, Ch 7; Rayner, SE (1991) *The Theory of Contracts in Islamic Law* Graham & Trotman; Hassan, H (2011) *Contracts in Islamic Law* IB Tauris.

<sup>15</sup> Two broad aspects of such an interaction can be identified, implementation (eg the enactment of the Takaful Act 1984 (Malaysia)) and regulation. The latter has become increasingly important as IF has come to the attention of regulators in vehicular/hosts systems.



students has allowed the further development of an earlier thought.<sup>16</sup> One study concerns the interaction of the sharia with English law in general and with reference to financial regulation. The other concerns the interaction of the sharia with Malaysian law in the area of takaful.<sup>17</sup>

The earlier thought was that the legal elements of IF demonstrated the characteristics of a legal system: legislation, precedent and doctrine, somewhat hidden in the form of 'institutional creation of "standards", the collecting of *fatwas*, [other standardising forces], including such processes as the consensus of scholars, standard documentation, and the search for guiding principle'.<sup>18</sup> As in other legal systems, such characteristics are designed to create 'creating certainty and uniformity in legal rules'.<sup>19</sup> The result of the recent work is the present (still evolving) categorisation:

*Financial Sharia* (FS): the sharia as adapted for the needs of IF;

*Law of Islamic Finance* (LIF): all law relevant to IF, including the FS and all relevant aspects of municipal legal systems,<sup>20</sup> international law and regulation;

*Local Financial Sharia*: variants of the FS, eg Malaysian and Middle Eastern;

*Municipal Law of Islamic Finance* (MLIF): local FS as used in a given municipal system, plus all other legal aspects of that municipal system relevant for IF as practiced in that jurisdiction.

*Municipal IF Enactment*: a municipal enactment (primary or secondary legislation) enacting MLIF in a given jurisdiction, eg the Takaful Act 1984 (Malaysia).

Such a taxonomic framework allows a clearer view of the relevant issues, as well as a means by which one can manipulate the concepts. Taking the example of takaful in Malaysia, this taxonomy has already proved very helpful, for one can consider the situation in terms of a local variant of the Financial Sharia interacting with municipal law via a Municipal LIF Enactment to create a Malaysian Municipal Law of Islamic Finance.

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<sup>16</sup> See Foster, NHD (2007) 'Islamic Finance Law as an Emergent Legal System' (21) *Arab Law Quarterly* 170, especially pp 186-188.

<sup>17</sup> England: Jonathan G Ercanbrack; Malaysia: Radin Ariff Taquiddin Radin Amir. I am grateful to both Jonathan and Rad for their patience and to Rad for his contribution to the amendment of the initial taxonomy by practical application to the Malaysian takaful case.

<sup>18</sup> *Ibid*, p 186.

<sup>19</sup> *Ibid*, p 186.

<sup>20</sup> 'Municipal' is the English law technical term for what is often called 'national' law. 'National' is incorrect because it does not take account of the fact that in many instances a nation-state is made up of more than one 'law district', or 'jurisdiction'. For example, there is no national contract law in the United Kingdom, only the contract law of England and Wales, the contract law of Northern Ireland and the contract law of Scotland.

### III. SOME POSSIBLE SOLUTIONS? AN INSTITUTE OF ISLAMIC FINANCE?

The problems referred to above are complex and challenging, and they will not be easily or quickly solved. On the positive side, though, colleagues at the workshop and elsewhere are already working on some of them. For instance, the suggestion to create a specialist journal in the Law of Islamic Finance is very much to be welcomed. Colleagues may be interested in the LIF bibliographic website which Professor Shaheen Sardar Ali and I plan to set up. If it is technically possible, the website will contain a bibliography which colleagues can consult, download, and supplement, from all over the world.

More generally, the skills gap will start to close as people acquire knowledge and expertise in IFs and educational/training institutions. Major publishers are already much more interested in IF than before, and this will assist in the production and dissemination of more IF publications. However, it is important that this process be, to the extent possible, directed in the right direction, that of very high quality.

One aspect of this quest for quality is specialisation. I have argued the case above for legal specialisation, but economics, financial and IF practitioner colleagues may well consider that it is desirable in their fields as well. If this occurs, we will need to beware of the disadvantages of specialisation such as too much narrowness and lack of communication and collaboration.

Another aspect of the quest for quality is institutional. Bodies such as the Harvard Islamic Finance Project and Durham's School of Government & International Affairs already play a pivotal role in this regard. A useful addition to these bodies would be an Islamic Finance Institute, based in London, a natural location given the City of London's prominence in the IF industry. With representatives from all branches of IF, such an institute could, inter alia:

- run courses at various levels;
- establish and maintain a specialist library;
- help assist in raising publication quality by pre- and post-publication review;
- run specialist journals, including that relating to LIF;
- if affiliated to a university, house PhD and postdoctoral study, and direct that study by grants in specified areas; and
- run a translation project.

The establishment of such an institute would require major inputs of time, effort and money, but could provide significant long-term benefit to the industry.

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