

# A Critical Appraisal of Theory of Islamic Financial Regulation

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## Abstract

This critical narrative appraises the Islamic Theory of Financial Regulation by dissertating the elements thereof. It reviews different aspects of regulation and compares them with the objectives of financial market regulation. These elements of regulation surround constructs such as liquidity authority, market failure, monitoring and evaluation, asset safety and market imperfection. Furthermore, a discussion on objectives of financial market regulation towards outreach of benefits derived out of public and private utilities, preservation and maintenance of social values, promotion of Islamic moral values in the market, preservation and enhancement of socio-economic stability, promotion and support of public and private sector is done by keeping in view the elements of Islamic financial regulation theory. A conclusion is drawn at the end with a way forward in this area of research.

**Keywords:** Islamic Theory of Regulation, Central Banking, Financial Market Regulation.

## 1. Introduction

Regulation of financial institutions is not believed to be a novice phenomenon in the history of Islamic civilization. Examples of antediluvian financial regulation are available in institutional forms of Bait-ul-Maal and Al-Hisbah. (Barom, 2013). Various functions such as supervision, pricing, arbitration, anti-monopoly controls, health ascendancies, environmental protection, moral filtering, Shari'ah compliance and quality assurance were achieved during the era of Prophet Muhammad S.A.W. and his righteous caliphates R.A. The Al-Hisbah also had many tools to regulate market such as iqta, ihya, hima, licensing, registration, subsidies, fiscal policy and price control mechanisms (Kahf, 2007). Countries like Pakistan has rejuvenated the concept of Al-Hisbah by having a generic federal Ombudsman institution called Wafaqi Mohtasib and a specific one for banks known as Banking Ombudsman or Banking Mohtasib that particularly deals with the matters of banks.

Having this premise, we proceed to the appraisal of contemporary theories of Islamic financial regulation towards achieving objectives of market regulation. A comprehensive survey on various research data bases was conducted to identify contemporary authors who made attempts in theorizing Islamic financial regulation (discussed in literature). The elements and constructs these authors used in their research studies were further dissertated in detail in close connection to their tendency towards achieving the objectives of regulation. A few definitions of the key terms are given below for acquainting the readers with different constructs that would be used in the study:

### **1.1. Liquidity authority**

“It is the role of an Islamic financial regulatory body that empowers it to supervise liquid solutions and instruments to the financial institutions for investment and meeting the statutory liquidity requirements”.

### **1.2. Market failure**

“Market failure is a term used in financial sector and it represents the situation whereby the financial institutions are not able to meet its liabilities or is unable to perform in an efficient and effective manner for a relatively prolonged period of time. The understanding of market failure in a regulatory perspective is to understand the mandated role of central banks or financial regulatory bodies whereby they have systems and controls in place with early warning signals that demonstrates the overall performance of financial institutions so as to stop market failure from happening or at least minimize its occurrence”.

### **1.3. Monitoring and Evaluation**

“It's the continuous process of keeping an eye on the financial market participants that includes financial institutions, customers and other stakeholders for enabling a financial market to function on smooth basis”.

### **1.4. Asset safety**

“It refers to the phenomenon whereby the assets in which an Islamic financial institution involves is safe in a multi-faceted manner to the extent that stakeholders such as the financial institutions, customers, partners etc. do not make excessive losses”

### **1.5. Market imperfection**

“All kinds of anomalies that result in information asymmetries, moral hazard and adverse selection among the participants of financial market are understood as market imperfection. The role of the Islamic financial regulatory body is to

eliminate market imperfections in all kinds”

### **1.6. Theoretical Underpinnings**

A survey of economic and business management theories informs us that Islamic financial regulation can possibly be analyzed in a multi-faceted manner. For instance, 'systems theory' helps in rationalizing the institutional arrangement of regulatory body as an overarching system of governance supervising and overseeing the operations of IFIs. Similarly, in order to comprehend the institutional roles of regulatory body and the regulated industries play in the market, tenants from 'principle-agent theory' or the 'agency theory' could be used to study different emplacements of regulatory body. Likewise, geographical spread of regulatory functions could also utilize the concepts of 'network theories'. Furthermore, the role, function & service provided by IFIs can be best explored using the constructs of 'contemporary intermediation theories'. However, an indepth study of 'economic theory of regulation' seems to best suit the need of the study, as it aims is to explore the constructs of regulation in an Islamic perspective. It matches the purpose of regulating financial market despite the intent of Islamic regulatory perspective. Despite the differences between Islamic and conventional definition of these regulatory constructs, economic theory of regulation and its later development seems to best describe the available constructs of regulation. Hence, in the later parts of this dissertation, emphasis would be given to it.

## **2. Purpose of the Study**

The purpose of this review is to identify the elements of Islamic financial regulation and discuss them towards achieving objectives of regulating an Islamic financial market.

## **3. Significance of the Study**

The study inductively opens up avenues for discussion and synthesis on the theoretical underpinnings of Islamic financial regulation and purposes behind regulating institutions offering Islamic financial service. The authors believe that regulation is the backbone of market discipline and smooth functioning of intermediators. Regulation should be designed in such a holistic way that it encompasses all the elements related to regulation. Since it is impractical to cover all the elements in one research paper; therefore, the current study focuses on merely the substantial avenues of regulation, as identified in the reviewed literature.

## **4. Research Objectives**

To review selective theoretical and empirical literature of financial regulation to

pertaining to Islamic financial regulation of Pakistan. To explore elements of Islamic financial regulation in a regulatory perspective

## **5. Scope/Limitations of the Study**

The study is institutionally limited to State Bank of Pakistan. Similarly, other theoretical and empirical schools such as public and private interest school and social/political school are not covered in the current study as it doesn't address the objective of the study. The study is taking in to consideration the developments of IF regulation occurred since year 2000.

## **6. Literature Review**

This section explores some of the key constructs in financial regulation in general and Islamic financial regulation in particular. Wherever possible, a visual diagram of constructs has been provided.

Islamic economics in general and Islamic banks in particular is retrospectively considered to be rejuvenated as a consequence of mid-twentieth century Islamic movement in the Asian sub-continent that resulted in the emergence of Pakistan as an Islamic state. The philosophy of Islamic economic system was considered of having distinct elements (different than Capitalism and Socialism), as reflected in the economic writings of Muhammad Ali Jinnah, Moududi and Arab writers such as Syed Qutub etc. (El-gamal, 2013). Islamic economics mainly focused on profit and loss sharing mechanism for all economic activities including banking transactions and was considered as having more stability and equity (Siddiqi, 2006)(Chapra, 2009).

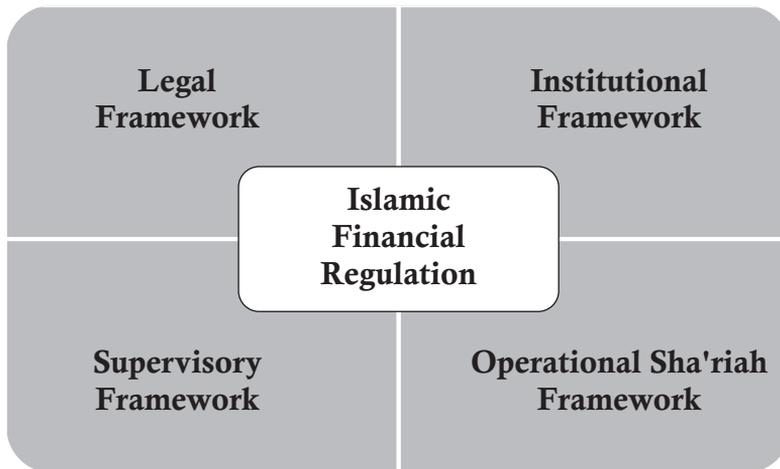
There are very few studies that directly deal with regulating Islamic financial institutions (Kahf, 2007). Regulation of Islamic financial institutions is important because it increases information and understanding of relevant stakeholders and gives rise to transparency. It also enhances the soundness of overall financial system and also ameliorates controls which govern monetary policy (Iqbal, Ahmad, & Khan, 1998). Islamic financial institutions are governed by a twofold regulatory mechanism that comprises both the regulatory and Shari'ah supervisory framework. This is a unique feature that differentiates Islamic banks from their conventional counterparts are of the view that these two dimensional simultaneous regulatory models supervise Islamic banks in two different but mutually inclusive manner in such a way that the Shari'ah supervisory framework deals with the areas pertaining to the Shari'ah compliance such as following the tenants of Islamic sales contracts in substance and form, the documentation incentivizing financial market for increased performance etc.

procedures and order, sharing profits and losses in accordance with the principles of Islamic business etc. The second dimension of regulation deals with the general regulation and supervision namely ensuring transparency, reducing information asymmetry, customer and banker protection, improving economic efficiency and incentivizing financial market for increased performance etc.

It is however important to understand that according to Muslims, Islamic Shari'ah is not silent on general regulation, as one may argue that why there are two regulatory models for Islamic banks. Islamic banks operate in a financial market that is not regulated wholly on the principles of Islamic Shari'ah except for a few countries. Abdallah, Hassan, and McClelland( 2015) suggest that Islamic banks demand Islamic regulation as part of operationalizing banking business; therefore, there are additional regulations for Islamic banks to follow.

Islamic financial regulation could be viewed as a group of activities comprising legal, institutional, supervisory and operational framework as noted by Iqbal et al. (1998) and visualized in the following figure:

**Figure 1: Conceptualizing Islamic Financial Regulation**



Source: Iqbal, Ahmad and Khan (1998)

However, a critical analysis of the same informs that Shari'ah framework does not only entail as a separate regulatory function but also is involved in every segment of the overarching regulation. Holistically, I believe that Shari'ah is the part and parcel of the legal, institutional and supervisory framework, as it is only the Islamic aspect which distinguishes Islamic model of banking regulation from that of conventional

one. Literature also suggests, for instance (Husain, n.d.), that if the underlying frameworks are not based on Islamic principles then the actual potential of Islamic finance may not be reached and a level playing field would not exist for Islamic financial institutions.

'Al-Jarhi(2016) argues that Islamic banks have distinctive features that demand a different attribute of regulations. Since, the current regulatory theory is based and benchmarked on conventional philosophy of regulations. Therefore, these regulations would have to be readjusted for both types of institutions.

## **7. Purpose of Islamic Financial Regulation**

Purpose of regulation is outlined by Kahf (2007) in his seminal paper that outlines a theoretical framework of “Islamic Government and Market Regulation” . He viewed the regulatory process in three different perspectives: Objectives of market regulations in Islam, Criteria for regulating industries and-Tools for regulating Islamic Economic System. He also accepted the fact that in the contemporary empirical literature of Islamic Finance, very less work has been done on the topic of regulation. Kahf (2007) also pinpointed the discourse of instances such as “Needy people asking Prophet Muhammad S.A.W. about money. He gave them as much as he could and also guided them to start a job or business. Similarly, we can see from the life of Prophet Muhammad S.A.W. that as soon as he came out of early childhood, he started dealing in cattle and started international trading.”

Furthermore, “Allah created the earth for the use of mankind and called on all of us to construct it and make the best use of His resources” (11:61, 9:19, 30:9 and 52:4). This is termed “Ilm-al-Imran” that has sociology, economics and political science as its branches. Islamic system, according to Kahf (2007), enables and promotes private sector so that the prosperity could also contribute towards the Islamic redistributive systems such as Zakat and Sadqat etc. Likewise, Islamic economic regulation through government is also responsible for maximizing welfare of the society by ensuring efficient use of public finance in different sectors of the economy.

Other aspects of regulations in Islam, as per Kahf (2007), account for areas such as pricing. He narrates that “People complained to Prophet Muhammad S.A.W. about inflation that arose to a certain level in Madina. He SAW replied that there are forces that determine the prices of commodities according to the will of Allah SWT.

Direct tools of identified above, include both micro and macro tools for market regulation in Islamic historical literature. Pricing allows the regulator to control monopolies and ensure customer's protection. Likewise, registration and licensing allow the regulatory body to know the number of institutions involved under its jurisdiction so that the aggregate picture is clear and adequate policies can be derived. Similarly, at the time of distress, subsidies help the poor consumers of the economy and also support the producers financially. On a macro level, the fiscal and monetary policies help to control the market but both these elements are beyond the scope of this document.

## **8. Method**

It is very important to decide which approach, a research study would undertake because it enables the researcher to take sound decisions about research design which helps in understanding what type of evidence is required and from where? It also helps in understanding how the evidence is interpreted to have good answers to the research questions.

## **9. Research Paradigm**

Worldviews are important inquiry paradigms that not only help the inquirer in deciding what is it he is after but also tell him about what the research boundaries of a research inquiry are? (Guba & Lincoln, 1994).

### **9.1. Ontology**

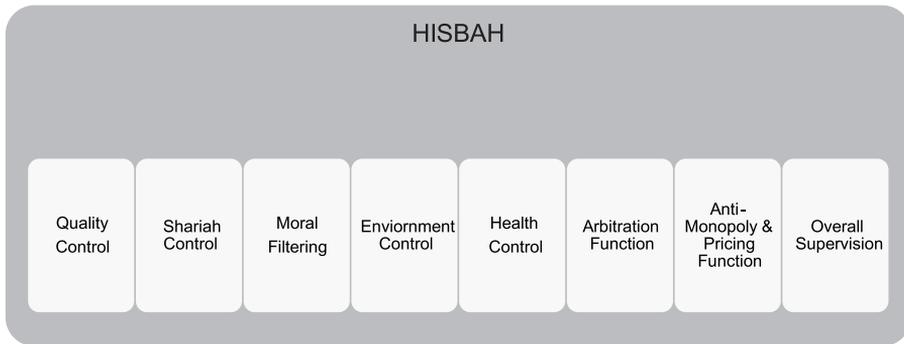
Ontology, as defined by Sage social science dictionary, is “a concept that pertains to the existence of various facets, aspects or views of a society (e.g. social structures, cultural norms & social actors etc.) or relationships among them. Ontological social questions aim to find out answers to the kind of things prevail in a society”. It is “the fundamental nature of reality” (Neuman, 2014, p. 94). Hence, in the current study, reality is assumed to be “relatively constructed” and is “subjective” to the mutual understanding and interpretation of the researcher and the respondents.

### **9.2. Epistemology**

Epistemology means the “philosophical theory of knowledge” as defined by Oxford advanced learners dictionary. Epistemology helps us make sense of the world and comprehend the nature of knowledge (Crotty, 1998). Epistemology of the current study is closer to the “interpretive reality”, commonly used in qualitative research paradigms.

Additionally, price determination can cause injustice to stakeholders; therefore, He S.A.W refused to deal with it.” Based on this premise, many Muslim theorists believe in free-market economies.

**Figure 2: Conceptualizing Islamic Financial Regulation**



Source: Iqbal, Ahmad and Khan (1998)

Hisbah i.e. ombudsmanship is a type of supervision in Islam. It regulates and supervises transactions according to the rules of Shari'ah and gives responsibility to the ombudsman to ensure the transparency of good or bad [i.e. permissible and prohibited] in the market (Kahf, 2007). He further confirms that Islamic history and civilization is witness to Mohtasib (Ombudsman) all over the place from the advent of Islamic till present daybut due to the deterioration in the general belief system of Muslims, their supervision function also faced its repercussions. Kahfian Islamic Economic Model of Market Regulation showing direct tools of market regulation can be visualized as follows:

**Figure 3: Kahfian Direct Tools of Market Regulation**



## 10. Nature and Design of Research Strategy

The study adopts qualitative case study as a research strategy because Islamic finance regulation is a contemporary phenomenon and regulations are carried out in real life context but the boundaries between “regulation and regulator” are not clear and the researcher has no control over both (Yin, 2002).

## 11. Method of Data Collection

The researcher studied secondary sources of data such as relevant research papers accessible to the scholar to enhance the understanding about the case of regulation. Empirical research papers are accessed from various databases such as Ebrary, Science Direct, Springer, Jstor, Elsevier, SSRN, Ethos, Durham E-Thesis and Emerald Insight.

## 12. Findings and Discussion

The study developed the following theoretical model on the basis of the theoretical survey conducted. It comprises various elements and constructs that inform about functions of the Islamic financial regulatory body. The model is outlined below followed by discussion.

Theoretical Framework of Islamic Financial Regulation			
Ensure Sound Regulatory System	Maintain Feasible Competition	Prescribe Strategic Pricing	Offer Performance Improvement Incentives
Maintain Transparency	Keep Market Discipline	Overcome Information Asymmetry	Protect Banks & Customers
ISLAMIC FINANCIAL REGULATORY BODY			
Execute Financial Inspection, Monitoring & Reporting	Ultimate Liquidity Authority	Sustain Resilience	Diminish Market Imperfection
Eliminate Rivalry	Meet Stakeholder Expectations	Proliferate Banks Efficiency	Harmonize Legal Framework & Assure Legitimacy
Administer Corporate Governance	Develop Regulatory Framework & Infrastructure	Assure Shariah Compliance	Build Institutional Capacity

Source: (Abdullah, 2012)""—(Ainley et al., 2007)(Al-Ghoraira, 2010)(Al-Jarhi, 2004)(Al-Jarhi, 2016)(Alwosabi, 2002)(Aris, 2010)(Barclay, 2012)(Chapra M. and Khan, 2000)(Ciancanelli & Reyes-Gonzalez, 2000)(Cihák, Demirgüç-Kunt, Peria, Martínez Soledad, & Mohseni-Cheraghlo, 2012)——(El-Gamal, 2005)(Kahf, 2007)(A. Khan & Shah, 2015)(R. S. Kroszner & Strahan, 2000)(S Archer & Karim, 2007)(Scott, 2005)(Wilson, 2003)(Yan, Hall, & Turner, 2012)

### **12.1. Ensure Sound Regulatory System**

Regulatory body is expected to ensure soundness of financial markets. This is also often termed as the “normative aspects of positive economic regulatory theory (Joskow & Noll, 1981). Soundness of market through regulation is also believed to be a matter of public interest by saving market participants in reducing the information asymmetry. As an outcome, the ultimate concern is to maximize the social benefits of a society (R. S. Kroszner & Strahan, 2000). In Islamic financial market, due to the partnering relationships b/w customers and bankers, the regulation goes beyond the traditional methods and overall soundness and productivity is required for each of the financial solution, a banker is providing and a customer is using. Therefore, regulatory role is more critical to Islamic finance (Zaher & Hassan, 2001). Additional tier for sound regulation also involves soundness of Shari'ah decision making (The Central Bank of Malaysia, 2009).

### **12.2. Maintain Feasible Competition**

One of the basic roles of the regulator is to assure what is feasible for the market or not (R. S. Kroszner & Strahan, 2000). Feasible competition allows the customers to choose from the best available options in the financial market. Regulatory bodies should prudently choose between the competition of conventional and Islamic financial institutions. Moreover, maintaining feasible competition is also dependent on the fact that there is discipline in the financial market. Financial market dealing in Islamic financial solutions, due to intense growth, faces challenges to regulate it” (Bintawim & Saud, 2011).

### **12.3. Prescribe Strategic Pricing**

Ensuring feasible competition and regulating pricing of the financial industry is interrelated. Pricing and asset/liability structure of banks affects its spreads and earnings —(Milanova, 2010). The role of a regulatory body is to analyze and prescribe solutions for risks associated with pricing of products and services (IFSB, 2015). The regulatory body should provide a level playing field keeping in view the experience curve and scale efficiencies of conventional banks to let the Islamic banks achieve the regulatory expectations by suggesting strategic pricing; as a result, enabling the Islamic financial institutions compete with conventional counter parts but also with their peers in Islamic finance market.

### **12.4. Offer Performance Improvement Incentives**

The literature suggests varied results when it comes to the performance of Islamic financial institutions keeping in view the variables, limitations and financial institutions selected.

In some areas such as capital adequacy, most of the Islamic banks perform better than their conventional counterparts whereas in other areas such as liquidity and management efficiency, it needs improvement (Shah, 2015;A. Khan, Tanveer, Shah, & Jamil, 2015;Kader, 1993). However, the regulatory role towards improving the performance of Islamic banks should not only be tackled by lowering certain regulatory thresholds as is evident from implementation of Basel III regulatory framework but also a separate and distinct regulatory framework is needed to augment the overall performance of Islamic financial institutions –(Shamsad& Akhtar, 2007).

### **12.5. Maintain Transparency & Market Discipline**

One of the key objectives of regulating Islamic financial industry is to ensure and maintain transparency. Abdullah and Vicary (2012) suggest that if we have good governance standards in place only, then we would be able to achieve the appropriate level of transparency in the market. Even the third pillar of BCBS also suggests transparency and market discipline. Islamic financial services board (IFSB) has standard number four that deals with market discipline and transparency disclosure requirements for Islamic financial institutions except for takaful companies but the problem is that these standards are discretionary in nature and not mandatory for Islamic banks to follow, that creates challenges in implementation (p. 458).

### **12.6. Overcome Information Asymmetry**

Since, the stakeholders of the financial market are multiple and varied. The prevalence of information asymmetry and its regulation is a continuous process due to the involvement of multiple transactions. The inherent nature of banking companies is different from that of other forms of corporations; therefore, it demands a different set of principles to govern information asymmetry. Ciancanelli and Reyes-Gonzalez (2000)andFaugère (2014) suggest that ruthless compassion is a way out for minimizing information asymmetry from the financial market. Likewise, 'Al-Jarhi (2016) opines moral filtering of potential investors/borrowers dealing with Islamic financial institutions to deal with this challenge.

### **12.7 Protect Banks & Customers**

One of the main roles of regulator is to safeguard and protect customers and bankers under its jurisdiction. Keeping in view the features of Islamic contracts, the regulatory body has to make protection mechanisms for both assets and liabilities of Islamic banks. Moreover, the issue of harmonization and standardization of protection regulation also needs solution, as currently, there is very less uniformity amongst regulators (Mejia, Aljabrin, Awad, Norat, & Song, 2014).

### **12.8. Execute Financial Inspection, Monitoring & Reporting**

Multiple methods of inspection, monitoring and reporting is currently being carried out by the regulator on the Islamic financial institutions. On and Off-site monitoring, surprise visits, regulatory reporting requirements and the like contribute towards this role of regulator. Anything done in conflict to the regulation issued by regulator is treated by negligence of Islamic financial institutions (State Bank of Pakistan, 2012). These roles are also supplemented by external auditors and resident/non-resident Shari'ah scholars.

### **12.9. Ultimate Liquidity Authority**

Liquidity is considered as a challenge in case of Islamic financial market, as there is acute shortage of Shari'ah compliant liquid instruments. However, it is yet to be understood that how an asset based financial system with a mechanism of partnership and agency can be expected to maintain liquidity all the time. There is a need to reconceive the concept of liquidity different than the currently established standards. Regulatory bodies require liquidity disclosures from Islamic banks and also conduct surveillance checks. Authors like 'Al-Jarhi (2016) suggests the central banks/regulatory bodies to also act as ultimate liquidity authority.

### **12.10. Sustain Resilience**

Since the substance and appearance of Islamic finance is different from that of conventional systems; therefore, it is not true that Islamic financial markets are not free from crises. It actually depends of the level of risks, partnerships and investments an Islamic bank makes as well as in the industries/sectors, such endeavors are undertaken (Shamshad Akhtar, 2008). Further analysis is required to study this area of regulation under the evolutionary Islamic finance model.

### **12.11. Diminish Market Imperfection**

Though diminishing complete market imperfection is not possible, as there is always a chance for improvement. However, the regulatory bodies are required to reduce and diminish market imperfections. Disclaimers, alerts, notifications and public awareness programs are initiated to increase market information amongst stakeholders. The inherent nature of imperfection directly affects the overall welfare of stakeholders (Levieuge, Lucotte, & Pradines-Jobet, 2017). Regulators can also opt for special incentive schemes to address the budgetary issues related to market imperfections especially in the time of financial distress (Society, 2016).

### **12.12. Eliminate Rivalry**

Keeping in view the evolving nature of global Islamic financial market, the

condition of rivalry is not similar to that amongst conventional banks. However, in the foreseeable future, it may take some speed. This phenomenon is present in the market in various forms such as intra-inter financial markets, b/w small vs. large banks, b/w banking financial and non-banking financial institutions etc –(R. Kroszner, 1998). Therefore, regulator should holistically address this concern.

### **12.13. Meet Stakeholder Expectations**

In order to mitigate the risks involved in banking operations, regulators should address the stakeholders' interest at large. There are certain non-financial costs involved that indirectly affect financial market. Therefore, these social aspects should also be accounted for(Lui, 2014). Similarly, if all stakeholders work together then the market share of Islamic finance can further be enhanced. It would also reduce the disagreements b/w stakeholders(Arham, 2013).

### **12.14. Proliferate Banks' Efficiency**

Existing literature discusses efficiency of Islamic banks in detail. However, there is further research required on assessing the regulatory efficiency of Islamic financial regulatory body (Yudistira, 2004). Likewise, non-parametric techniques and ratio analysis were found to be the major model for evaluating the financial industry-wide performance whereas different regulatory models for efficiency of banks have also been developed over-time. Furthermore, the work is required to assess the overall efficiency of the regulatory body itself in proliferating efficiency in the Islamic financial markets.

### **12.15. Harmonize Legal Framework & Assure Legitimacy**

AAOIFI and IFSB are playing some role in harmonizing the standards. However, national efforts are required by each regulatory body to make their legal frameworks suitable for Islamic financial institutions. Countries are in the process of the harmonizing their legal systems to adapt Islamic finance. For instance, A. Khan et al. (2015) argue that Malaysia has fully revamped its legal codes, Pakistan has amended many laws, UK has a liberal policy in this regards and is willing to capitalize on Islamic finance but this process is relatively slow and is affected by political change of governments.

### **12.16. Administer Corporate Governance**

Corporate governance in the context of Islamic finance is considered as the two-tiered governance mechanism. Islamic banks are expected to adopt the general principles of governance as required by regulators. Additionally, Islamic banks are expected to adhere to Shar'iah governance guidelines issued by a central or resident

regulator has to still work on, is the interpretive disagreements and their standardizations to govern the Islamic financial institutions.

### **12.17. Develop Regulatory Framework & Infrastructure**

Islamic finance is continuously evolving and so are the needs of the customers; therefore, the regulation to deal with such a market is also expected to evolve in such a prospective and retrospective manner that it can go both ways to facilitate the growth and development of the Islamic financial market. —Zin, Ishak, Kadir, and Latif (2011) argue that despite the growth of the sector, there is still need to enhance the institutional frameworks and infrastructure to address the effectiveness and competitiveness of the system.

### **12.18. Assure Shari'ah Compliance**

The distinctive feature that makes Islamic finance Islamic, is its Shari'ah compliance, without which the essence of it would be lost. Moreover, for some people, Islamic finance may be an alternative method of saving and investment, financial intermediation and profitability but for others, it is a way of life. If the trust of such investors is lost owing to their religiosity or the expectations of those who consider it a mere alternative but resilient financial model are not met, it would be a destructive consequent of the Islamic financial industry. Therefore, all stakeholders need to work together towards assuring compliance to Shar'iah and many just leave it to the Shar'iah scholar and board.

### **12.19. Build Institutional Capacity**

Burhonov (2006) is of the view that in order to make the Islamic finance industry become one of the best administered industries, institutional capacity building is very important. This would allow the industry grow and accomplish competitive edge. Moreover, I believe that if the regulatory bodies build institutional capacities, this would be paid back by reducing the overall cost of regulation. However, a systematic effort is required to carry out this endeavor in true spirit.

## **13. Conclusion**

Islamic financial regulation is composed of many activities that cannot all be accounted for in one draft. However, in this document, some of the elements identified during the literature survey were outlined with some evidence and discussion to the existing literature. Regulation of Islamic markets is not a new phenomenon rather it is being revisited by the re-emergence of Islamic finance. If we study Islamic history and culture, there are some evidences available to some form of regulation being carried out by some form of Institutional arrangement. Of course, if we are talking about an arrangement of financial regulation 1400 years

ago, it would not match today's regulatory bodies. However, there is one important aspect of it and that is the human beings have changed over time but the metaphorical phenomenon of scarcity, borrowing and lending, saving and investment is still the same just as similar to biological needs of the then human beings and the human beings of today. So, there were regulatory bodies as well, called Hisbah. They used to regulate those markets and carried out various functions that we do even today in our regulatory bodies. However, in today's work, the complexity of financial market has increased due to the technological progression and virtual connectivity of the world. Therefore, it is important that the regulatory processes are carried out on continuous basis and instead of having static models of regulation for Islamic finance, there can be more evolving dynamic models of regulation. Further research is required to be conducted on the basis of primary data to account for new and emerging aspects of Islamic finance regulation.

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