On the regulation of the intersection between religion and the provision of financial services: Conversations with market actors within the global Islamic financial services sector

1. Introduction

The growth of the Islamic financial system has been one of its hallmarks and its market capitalisation currently stands at $2.05trillion dollars (IFSB, 2018). With this growth the Islamic financial system has had to contend with the challenges of expansion, more specifically, the increasing criticisms of the regulatory framework (Khan, 2010a and 2010b). This is further exacerbated by the development of the Islamic financial system into more mainstream financial markets (see Abedifar *et al.*, 2015 for a succinct comparison of Islamic and conventional finance) and the emphasis on advancing the regulatory standards to accommodate this situation (Fang & Foucart, 2013). Additionally, the unique characteristics of Islamic finance – no interest (*riba*), prevention of uncertainty (*gharar*) and gambling (*maysir*) and the insistence of 'real' transactions (El-Gamal, 2005) - also generate concerns for development of the regulatory framework (El-Hawary *et al.*, 2007; Kayed & Hassan, 2011) and the overall growth of the Islamic financial system (El-Hawary *et al.*, 2007).

The academic discussions on Islamic financial regulatory development centres on differences in regulatory standards, which stem from the fragmentation of the global Islamic financial system – major hubs in Malaysia, the Middle East and the UK in the West (Pollard & Samers, 2013). These differences in regulatory standards also include Shariah-based or Shariah-compliant regulatory standards and have raised concerns that the lack of regulatory uniformity across the Islamic financial system could hamper overall growth and development (Apaydin, 2018). Whilst the literature has provided substantial insights into the conceptual and descriptive ideas of Islamic financial regulation, there remains gaps within the underlying knowledge.

Firstly, whilst there is acknowledgement for the deficiencies within the regulatory framework that governs the various Islamic financial hubs, there is limited exploration of what this means to market participants (Sarea & Hanefah, 2013). Much of this research is descriptive in nature and does not address, directly, regulation at both institutional and systemic level *vis-à-vis* the stakeholders of the Islamic financial system. Secondly, the literature provides numerous recommendations towards addressing the issues of regulation (Farook & Farooq, 2013), but there is little empirical evidence in support of these recommendations and as such there is little verification of the implementation of these recommendations and their respective impacts. Given this, we are beginning to observe academic research into regulation within the Islamic financial system (Aribi *et al.*, 2014; Fang & Foucart, 2013). More recently, notable empirical research by Apaydin (2018) offers a detailed insight into the Islamic financial regulatory characteristics of two of the largest Islamic financial hubs – Malaysia and the UAE – and provides a salient comparative narrative of the regulatory challenges using interviews with market participants. We aim to contribute to this growing body of qualitative empirical studies of Islamic financial regulation.

The purpose of our study is to address these gaps in the literature via an exploration of market participant perspectives on these stylised theoretical debates on the development (or lack thereof) of Shariah financial regulation. Using an exploratory qualitative methodology, we are able to synthesize theoretical literature and market participant perspectives, thus creating an empirical framework for evaluating Islamic financial regulation. Our study and its findings provide key contributions to the existing academic literature on two fronts. Firstly, our conceptual framework provides a comprehensive collective view of the extant academic knowledge on Islamic financial regulation and governance. Secondly, our established empirical framework explores how the types, processes and dimensions of Shariah financial regulation is developed and understood. This enhances the academic and practical knowledge on the core focuses in the development and creation of sustainable Islamic financial regulation. Our contributions build on the empirical findings of papers such as Apaydin (2018) on issues such regulatory harmonisation and Islamic central banking facilities. Our findings show that while there is consensus in appreciating the quality and quantity of regulatory development, the market perspective is not for complete harmonisation of regulatory standards but rather, an adequate regulatory foundation to foster financial innovation and to ensure a degree of uniform protection for market participants within the varying Islamic financial hubs. The findings from this latter perspective also highlight the inherent difficulties with the establishment of these foundational regulatory requirements due to the dualistic nature of the spectrum of the Islamic financial market participants - the needs of the Islamic financial market and the conventional financial market participant. Our results enhance the extent understanding of the focuses in developing sustainable regulation within the Islamic financial system thus fostering the overarching theological and social aim of Islam – maqasid al-Shariah.

The paper is set out as follows. We establish our thematic framework in section two via an extensive review of the extant academic literature on Islamic financial regulation. Section three and four, provides a description of the adopted qualitative methodology and data analysis processes. In sections five and six, we present our findings and discussions from the interview analysis. We conclude with section seven and highlight our contributions, limitations of study and proposals of avenues of further research.

2. Theoretical Underpinnings of Islamic Financial Regulation

The literature addresses the notion of regulation in Islamic finance from two perspectives – institutional and industry (systemic). At an institutional level, the job of assessing the validity of Shariah-based and Shariah-compliant financial products is the responsibility of in-house religious advisors, collectively known as the Shariah-supervisory Board (Bassens *et al.,* 2009 and 2011). The composition of these SSBs consists of a mix of religious scholars and financial practitioners whose job is to debate both the religious and financial underpinnings of new services and/or products (Al Mannai & Ahmed, 2018). The composition and operation of these SSBs raises several issues of a regulatory nature 1) independence 2) disclosure 3) confidentiality 4) competence and 5) consistency (IFSB, 2009).

Firstly, the issues of independence of SSBs have been given a more colloquial nomenclature in the form of 'Fatwa-shopping' or 'Fatwa repositioning', whereby financial institutions seek out specific Shariah scholars based upon their 'leniency' in interpreting Shariah (Azmat *et al.,* 2014; Oseni *et al.*, 2016, Ullah *et al.*, 2018). El-Gamal (2005) noted the increasing frequency of similar Islamic scholars on different SSBs and questioned the validity of these judgements based on robustness of Shariah-interpretation. Moreover using agency theory as a lens, El-Gamal (2005) suggested that if Shariah scholars were hired upon a reputation for being lenient, this created fundamental issues with the quality of the religious judgements and the resulting financial products and services. This situation is not aided by the inherent opaqueness of IFIs and there is a lack of disclosure of SSB composition and the Shariah decision-making process (Bhatti & Bhatti, 2010, Platonova *et al.*, 2016). The implications of both recruiting specific scholars and a lack of transparency is a further detriment to market participant confidence (Khan, 2007; Safieddine, 2009; Riaz *et al.*, 2017). Secondly, having similar religious scholars on the SSBs of different Islamic financial institutions (IFIs) raises concerns about the confidentiality of these religious judgements with discussions focusing on intellectual property rights and conflicts of interests (Al Mannai & Ahmed, 2018). Thirdly, there have also been calls for the development of an environment that bolsters the development of human capital (Hamza, 2013; Mejía *et al.*, 2014; Nawaz, 2017). Recent studies, Farook and Farooq (2013) and Najeeb and Ibrahim (2014), advocate the development of a central accreditation process for new Shariah scholars and auditors. Potentially, establishing a much wider base of knowledge and human capital would invariably alleviate market stresses on the small pool of existing Shariah scholars as well as address the conflict of interest from having similar SSB members on the SSBs of varying IFIs. The final concern about SSBs relates to the level of consistency of religious decisions given the differences in Shariah interpretation of the various schools of Islamic thought (Ullah, 2016). Consistency in this context includes both consistency of Shariah judgements and consistency in adoption of Shariah rules and regulation. Whilst there are core commonalities in religious ideology between the various schools of Islamic thought, religious decisions are determined by the interpretation of an individual (or group) of scholar(s) within SSBs. Given the, potentially, subtle but nuanced differences in interpretation of the various schools of Islamic thought there is the potential for diverse judgements on similar issues (Apaydin, 2018).

Next, we examine systemic Islamic financial regulation. It is possible for Islamic finance to exist in three core systemic frameworks:

i) Wholly Islamic financial systems or Shariah-based financial systems (e.g. Iran)
ii) Parallel financial systems offering Islamic and conventional finance (e.g. Malaysia and Saudi Arabia)
iii) Shariah-compliant financial systems, which are conventional financial systems that provide Islamic financial products and services via a Shariah screening process, also known as Shariah-windows (e.g. U.K.)

Shariah-based financial systems adopt a system of regulation whereby the laws and principles of Islam are applied in their strictest form without exception and flexibility (Derigs & Marzban, 2008; Asutay, 2012). Both parallel and Shariah-compliant financial systems more commonly adopt a less strict mode of religious financial regulation by filtering out Islamic financial products and services through a set of Shariah rules with religious exceptions. Furthermore, these different systemic frameworks are fragmented along geographical lines (Bassens *et al.,* 2009 and 2011; Pollard & Samers, 2013, Apaydin, 2018), borne out of variances in the interpretation of fundamental Islam (see Khuri 2006 for an overview of core Islamic schools of thought). Apaydin (2018) conceptualised the regulatory differences under a political framework and within the study distinctly highlighted the varying levels of regulatory autonomy borne from sovereign historical legacies. This issue can also be sub-divided into i) Shariah-based and ii) Shariah-compliant diversity. Examining Shariah-based diversity, there is the degree of difference in religious interpretation across the schools of Islamic thought (Khuri, 2006). For example, the dominant Shia and Sunni sects who possess nuanced interpretations of Islamic law. Additionally, the Sunni school of thought can be divided into four groups with their own nuances in interpretation. The outcome of this diversity in Shariah interpretation is an increased potential for the development of market inefficiencies such as incompatibility of financial instruments across markets even though they yield the same payoffs (Zakariyah, 2012). Azmat *et al.* (2014) have shown that inconsistencies in screening processes hamper the structuring process of Islamic financial instruments. On the other hand, there are also variances in the Shariah-compliant screening process adopted by conventional financial institutions seeking to offer Islamic financial services and products (Ho, 2015; Ashraf & Khawaja, 2016) provide a succinct collection of the details of the Shariah-screening criteria adopted by major conventional equity exchanges and illustrate distinct differences in the Shariah-compliant screening criteria. In terms of design of the regulatory framework, this highlights one of the core issues, in that having both Shariah-based and Shariah-compliant interpretations of Islam, this creates duality within Islamic financial regulation and what is Shariah-compliant may not necessarily be accepted within Shariah-based systems and vice versa (Khatakay & Nisar, 2007; Khan, 2010a and 2010b).

Another dimension of this argument of systemic Islamic financial regulation relates to the underdeveloped nature of the Islamic financial system from a core financial perspective (recent guideline literature from the IFSB indicates that these regulatory issues are being considered – see IFSB 10 and 14). This lack of or slow development has resulted in numerous deficiencies in terms of – 1) banking regulation, 2) market liquidity and 3) the establishment of a central bank (CB) and/or lender of last resort (LOLR) (Dar & Azami 2010; Song & Oosthuizen, 2014; Hassan *et al.*, 2019).

First, from a banking regulation and capital adequacy perspective, IFIs are characteristically less liquid that their conventional financial counterparts (Ariss & Sarieddine, 2007; Daher, 2015) thus placing increased emphasis on capital management. Additionally, there remains difficulties in assessing and measuring the types of risks faced by IFIs (Msatfa, 2012, Zins & Weill, 2017; Ahmed & Farooq, 2018; Warninda *et al.*, 2019). Whilst the Islamic financial system has implemented the principles established in Basel I, II and III (see IFSB standard 15) to ensure IFI robustness, the academic literature is critical of the legal protection afforded to market participants. The studies (Muneeza & Hassan, 2014; Oseni, 2015; Oseni & Hassan,

2015) have suggested a need to streamline the legal protection afforded to market participants in both Shariah-based and Shariah-compliant markets. Mejía *et al.,* (2014) provides a succinct review of the adaptability of conventional legal systems in Shariah-compliant financial systems in accommodating IFI requirements and further studies (Monger & Raswashdeh, 2008; Oseni, 2013; Sarea & Hanefah, 2013) have highlighted the continual development of these processes via the two main Islamic financial bodies – AAOIFI and IFSB.

Secondly, given these developments in banking regulation, there is room for the advancement of financial products and services to address any issues of liquidity in the Islamic market (Volk & Pudelko, 2010; Hassan *et al.*, 2019). Studies, such as Ahmed and Hassan (2007), into the liquidity of the Islamic financial markets are inconclusive and much of the literature focuses on specific Islamic financial systems rather than the industry as a whole. Any developments on establishing a uniform Islamic regulatory foundation, it is argued, will greatly aid financial innovation, in turn addressing the liquidity within the Islamic financial markets (Abdul-Rahman *et al.,* 2014; Daher *et al.,* 2015). The suggestion here is that the illiquidity of the Islamic financial markets due to difficulties with financial innovation is an outcome of a lack of regulatory uniformity (Zakariyah, 2015).

Finally, studies such as Hassan *et al.* (2013) suggests that a LOLR will aid the development of a uniform regulatory standard and address the issues of liquidity across the Islamic financial systems. The lack of a formal framework and developed culture for risk management has meant that there is increased importance placed upon establishing a LOLR (see Grais & Rajhi, 2014) for an overview on the likelihood of systemic risks). Hassan *et al.* (2013) provide an overview of the financing practices of Islamic banks in host countries that further contributes towards the arguments in favour of global Islamic financial regulation and the requirement for a LOLR. Given the indication for the need for a LOLR, however, there is a lack of discourse about whom should undertake this role. Solé (2007) suggests that this role should be undertaken by a sovereign central bank whilst Siddiqui (2008) puts forward a central regulatory body within this role of LOLR but also highlights that this could lead to questions about a conflict of interests. Additionally, Chattha and Halim (2014) provide a salient theological discussion on the inception and viability of an Islamic LOLR and it is possible to draw inference from conventional finance for a model of a centralised LOLR – the European Central Bank (ECB) (Obstfeld, 2009).

Given the conceptual insights established within the existing literature, there persists a need for research exploring the extent to which these issues raised actually impact market participants within the Islamic financial system. Figure 1 below provides a visualisation of this conceptual framework of Islamic financial regulation and for a breakdown of the core thematic issues, see also Table 1 in Appendix A. It is the aim of this study to depart from the extant conceptual studies to highlight the situation 'on the ground'. The proceeding section provides an explanation of the underlying methods applied in addressing the research questions.

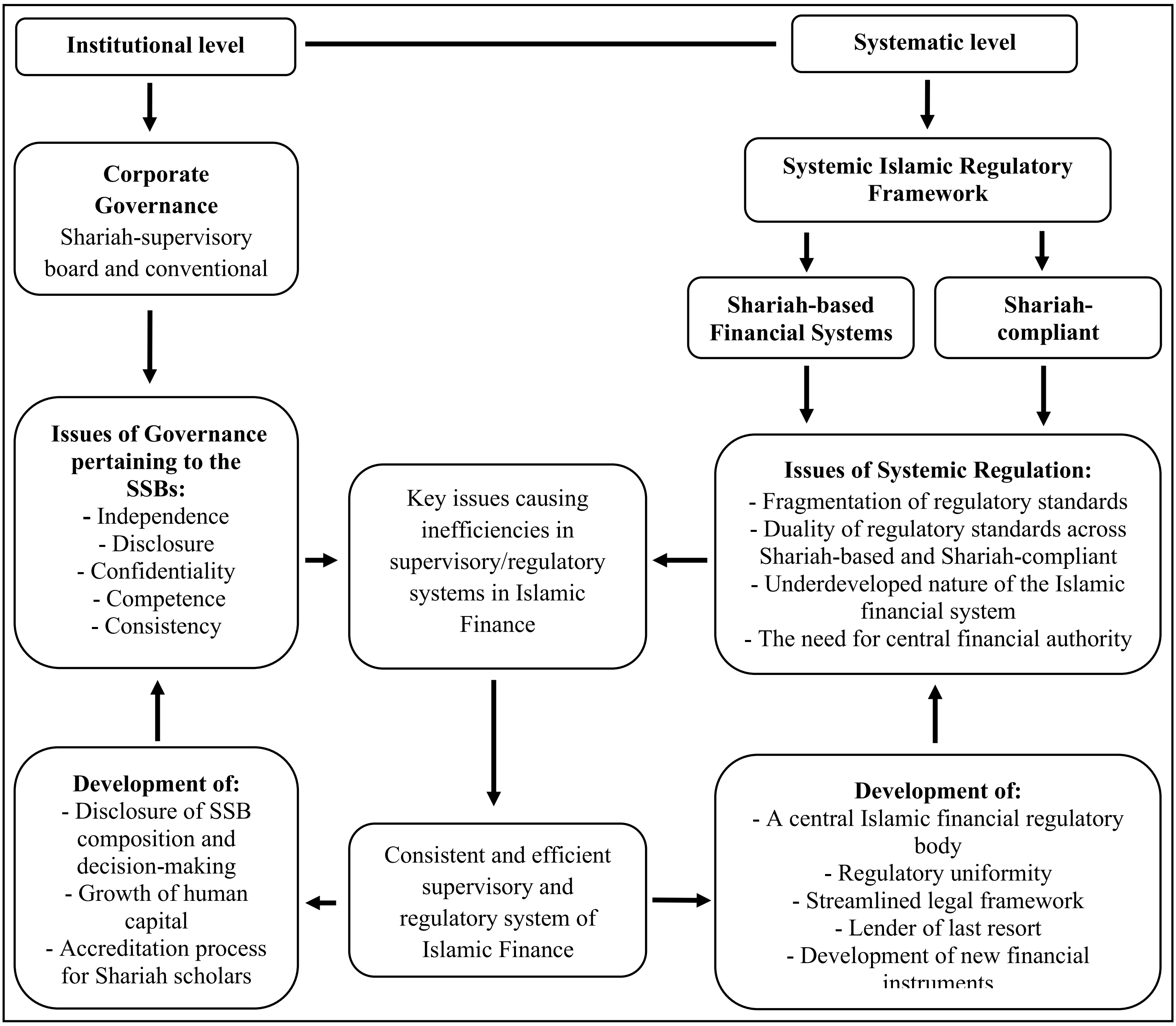

Figure 1: Conceptual Framework for Islamic Financial Regulation

3. Methods

This study adopts a qualitative research approach to achieve deeper insights from market participants on issues of Islamic financial regulation. It would be pertinent to explore if the issues of regulation is, hitherto, as much of a hindrance to the operations of the Islamic financial system as posited within the existing literature. This would enable a reconciliation of market perspectives and theoretical literature on regulation in Islamic finance (Cresswell, 2018).

Using an interview-based approach, this study will adopt a framework-synthesis methodology by designing a framework for analysis of existing literature and which is explored via a method of quote-analysis with procedures drawn from Barnett-Page and Thomas (2009) and Miles *et al.* (2014). Whilst, framework synthesis deviates from the conventional qualitative research approaches in being more deductive, the development of *a priori* framework from the literature provides robustness to the interviews themes and its analysis. The framework derived from the existing literature is divided into several core themes, which form the basis of our interview questions and subsequent analysis.

Semi-structured interviews (Horton *et al.,* 2007) were with individuals who possess extensive academic and/or practical knowledge in the subject matter. The interviews are conducted via telephone or in person, based on interviewee availability, and last no more than sixty minutes. Candidates are identified via numerous media sources, including journal authorships, institutional profiles (both academic and professional) and conference proceedings. Sample size is driven by data saturation of views, which is described in the proceeding section. To reduce interviewer bias, pilots were undertaken with the purpose of refining interviewing technique, questioning sequence and question coverage.

3.1. Sampling and Data Collection

This study adopted a purposive sampling approach using the snowballing technique to select participants who possess the relevant knowledge and capacity to enhance the theory development. The number of participants selected for this study was driven by the concept of data saturation (Glaser and Strauss, 1967) whereby an interviewer continues to interview relevant cases until no new information arises. As such, there was no predefined number of participants for the study until saturation.

Candidates were assigned into one of three groups – 'Academic', 'Academic-practitioner' and 'Practitioner' (see Table 1 below). Perspectives from both academics and professionals would provide a richer view on the subject area. We justify the addition of academics as recent research (see Francis *et al.,* 2015; McLean & Pontiff, 2016) has highlighted the influence of academia on the financial system and hence are unable to discount the views of academics from the sample. In order to ensure psychological homogeneity across the academic or practitioner groups, we have employed the use of a bridging group – 'Academic-practitioner' (Robinson, 2014). Interview candidate profiles are given in Table 2, Appendix B, and are relatively diverse across the core Islamic financial hubs. In order to ensure relevance of perspectives in relation to the subject of study, selection criteria were established for each of the interview groups (see Table 1 below). This has yielded interviews with practitioners who hold substantial positions within core regulatory bodies such as the IFSB and AAOIFI, along with highly published academics within the field of Islamic banking and finance.

Classification	Definition	Selection criteria
Academic	Significant involvement in the academic field of Islamic banking and finance	Based upon number of publications and conferences attended
Academic-Practitioner	Significant involvement in the academic and practical fields of Islamic banking and finance	Based upon a combination of number of publications and industry consultations
Practitioner	Professional involvement in the field of Islamic banking and finance	Substantial position within an Islamic financial institution, e.g. CEO, treasurer, compliance-manager, regulators

Table 1: Definition of Interviewee Groupings

The procedure for establishing saturation requires continual review once interviews have been conducted and we have adapted the methodology developed in Francis *et al.* (2010) given below:

i. Initial three interviews for reference group – one candidate from each interviewee group.

ii. Another three interviews added – once again one candidate from each of the interview groups. Three 'new' interviews evaluated against core themes.
iii. This will continue to happen until interview analysis demonstrates that there are no changes to reference to core nodal themes, i.e. saturation

There is no consensus in terms of establishing a sample size stopping point for data saturation. The academic literature is relatively inconclusive on saturation points with average interview samples ranging from six to fifty candidates (see Mason (2010) for an overview of sample size and saturation). Given the processes identified above a total of fourteen interviews were conducted with a good spread of quality candidates – four academics, four academic-practitioners and six practitioners. The additional participants in the practitioner groups were the final two "confirmatory" interviews to further validate the concept of saturation. Saturation was reached after no new information emerged from the 11th to the 14th participants (Guest *et al.,* 2006; Mason, 2010; Rtchie *et al.*, 2013). The following section explains the data analysis processes for this study.

4. Data Analysis

The interviews were transcribed and reviewed independently by the authors to reaffirm contextualisation of issues for consistency and reliability. Transcripts were sent back to the respective interviewees to certify that their views were adequately captured in the transcription process and any discrepancies were adjusted

The study utilised a 'quote-research' method of analysis established in Miles *et al.* (2014). Both, the procedures from framework synthesis and quote-research alleviate the concerns about quote-analysis as a single platform for qualitative exploration. The process-based method to bolster the 'quote-analysis' used is detailed below:

i) Data Reduction: development of underlying qualitative themes - see Figure 1 & Table 1 (Erlandson *et al.* 1993; Miles *et al.* 2014)
ii) Data display – we then sought meaning amongst collected interviews. Once interviews were transcribed, themes across each interview were classed into their respective nodes.

iii) Conclusion – we compared, contrasted and triangulated the collected interviews and initial underlying themes and linked them to the overall aim of the study.

To strengthen validity of the quote-analysis, protocols adopted for this study required independent coding of the interview transcripts into the thematic nodes. A consensus-based approach was adopted whereby commonalities across the independent quote coding exercises were compiled to form the core findings of this study (Maxwell, 1992 and Seale, 1999). This consensus-based approach was also used to further validate saturation of views across the interview sample. The subsequent section details the core findings from the quote-analysis.

5. Findings

In this section, we highlight the core findings from the interviews. The section is organised in light of our theoretical framework – institutional and systematic regulation respectively and to provide context, core themes are accompanied by quotes from the interviews.

5.1. Institutional regulation - Shariah-supervisory Boards

The perspectives from the interviews on SSBs are substantially polarised from the literature. Two core common themes existed across the interviews – SSB composition and decision-making. Firstly, interviewees highlighted that the concerns about SSB composition are rapidly diminishing across the global Islamic financial system. As Islamic finance has developed and grown, the base of human capital has been expanding and this has led to the continual diminishment of issues such as composition of SSBs and the consistency of their decision-making. Fundamentally, the rapidly expanding base of Shariah-scholars and industry expertise has greatly addressed the many issues of institutional regulation and governance and should continue to be an area of focus going forward.

> "…It is a double digit annual growth and it is very difficult and very hard for the industry to manage this growth by providing the resources that will be required including human and financial resources… this is something that you cannot develop overnight…" – ***practitioner 1***

Secondly, our findings highlight that interviewees questioned the notion of transparency within the context of SSB decision-making. Whilst the literature indicates a desire for greater transparency concerning decision-making processes, our findings suggested a contrarian view of this in that there is first a need to define transparency. This notion of 'complete transparency' as suggested within the literature is relatively idealistic and the interviewees highlighted a need for a realistic perspective on transparency. The interviewees indicated that conventional financial institutions and systems possessed a certain degree of opaqueness themselves and that this was predominately borne out of competitive market conditions.

> "…they put broad details of what goes on but they don't put details of the structures they are recommending to individual clients as that would be a breach of confidentiality… So, like any banking contract, it is not in the public domain…" – ***academic 3***

> "…Islamic banks have regulatory obligations in terms of monetary reporting so they have this sort of obligation and the extra obligation from a Sharia compliance perspective that they have to report…" ***– academic-practitioner 2***

This finding does raise several questions about the coverage of existing research on the concept of transparency within SSBs. In the following sections we progress on to our findings about interview precepts on systemic Islamic financial regulation

5.2. Systemic regulation

5.2.1. Islamic Finance as an Alternative

Participants from all three interviewee groups were quick to illustrate that the adoption of a religion-financial framework would result in increased risk for the Islamic financial system. The views of the interviewees add to the existing literature by indicating that individuals transitioning or engaging in Islamic finance from conventional financial systems have to understand the differing structures of certain types of financial products as well as financial risks.

> "…it's a lack of understanding of the principles and a perception that it's essentially a religious practice and if it's seen on that basis, they probably feel that it is not accessible to non-Muslim users …" ***– academic 4***

"…Islamic finance has got its own particular risk. Obviously, there is potentially more market risk for the Islamic financing facilities than there is conventional banking because Islamic banks can invest directly and take on ownership risk."
– academic-practitioner 4

"…this is an alternative financial system and you have to understand the nature of risk involved in this so do not think that it is completely risk free, do not think that it is immune to any shock or any hazard." ***– practitioner 1***

In addition to this precept, there was little to no capture of the issues of being viewed as an alternative financial system as suggested within the theoretical literature. Facets such as the level of consumer protection did not seem to feature within the interviewee precepts. Interviewee concerns were predominately about ensuring that new market entrants understand the fundamental differences between Islamic and conventional finance, we progress on to present the findings on uniformity, which, if not address could potentially result in a relatively nebulous interpretation of Islamic financial principles.

5.2.2. Fundamental Regulatory Framework

The context of uniformity splices arguments relating to the homogeneity of Shariah-compliant criteria and the standardisation of Islamic financial systems. Examining the interview transcripts in relation to homogeneity, there is little reference by interview candidates on this issue. Concerning standardisation, the interview findings largely confirmed the theoretical literature in indicating that this had to be one of the core focuses of the Islamic financial system going forward. The arguments presented by the interviewees were very similar to that of the theoretical literature in highlighting that the nuanced regional interpretations of Shariah created barriers towards harmonisation. Additionally, these differences further exacerbated problems of market development in terms of breath – financial innovation – and depth – the number of cross-market participants. The interviews indicated that there is a need to develop a salient fundamental regulatory framework that governs the global Islamic financial system.

"… you have differences on what is allowed in some markets and what isn't. You have conflict between the various schools of interpretation. If you don't have harmonisation, you don't have products that can be traded between markets, there's a lack of liquidity, so keeping things opaque and having separate rooms, separate schools and separate interpretation is not going to lead to a deep market" – ***academic 4***

"…the inconsistency could lead to complications in implementation and a disadvantage to the Financial Institution in cases of legal dispute…" – ***practitioner 2***

"…there is no uniformity between those hubs, every bank is different at the operational level…there will be a problem with the compliance, there will be a problem because there is a lot of rules and regulations that are different…" – ***practitioner 3***

An interesting facet of the findings from this dimension of the interviews related to the degree of uniformity. To the best of our knowledge, the degree of uniformity has not been addressed within the academic literature and these findings potentially extend the theoretical literature. Whilst there are calls for further development of a fundamental regulatory framework, the interviewees indicated that complete harmonisation was an impossible prospect. The interviews also highlight that market participants are relatively favourable of the efforts of current regulatory bodies such as AAOIFI and the IFSB in continually streamlining the fundamental regulatory framework of the Islamic financial system. It should be noted as well that there is little criticism of central regulatory bodies and the interviewees acknowledged the continual contributions of these bodies towards the development of the Islamic financial system. Essentially, there is acceptance for the benefits of a unified, fundamental regulatory framework but there were no clear advocates to complete uniformity.

"…but you don't want (complete) standardisation because that will obviously preclude innovation – putting everything in sort of a strait jacket, then there is not much scope for devising new methods of doing things…" – **a*cademic-practitioner 3***

"…most successful global brands have adopted the approach of customizing to local scenarios such as HSBC with the slogan "The world's local bank"…" – ***practitioner 5***

These suggestions of complete uniformity stifling product design and financial innovation lead on to the next theme that evaluates the market participants' view on the development of new instruments within the Islamic financial system.

5.2.3. Financial Innovation

Concerning the development of new instruments, our findings largely confirm and extend the academic literature. The interviewees highlighted the mimicry by Islamic financial instruments of their conventional counterparts as source of substantial concern. Fundamentally, the arguments put forward emphasised that continual mimicry of conventional financial instruments could lead to a loss of credibility for the Islamic financial system. There is a need for further development of financial instruments under a Shariah-framework and potentially meeting the requirements of market participants within the industry. There is substantial room for financial innovation along this front.

> "…look this is just too complex. I can't see who's doing what and I don't see where the risk is really held from and so I'm not putting my clients money into it...*" – **academic 1***

> "…Islamic banks tried develop a market tool with the BBA (British Bankers Association) - Islamic LIBOR…it's very premature but you'll find contributors are very low and you will find the same people who contribute to Islamic LIBOR are benchmarking according to conventional LIBOR which is a contradiction…"
> ***– academic-practitioner 1***

> "…there is a strong tendency of mimicking conventional products to make them Shariah-compliant and to make them Islamic…very risky process because first of all it kills the objectivity of Islamic finance so it is not really an alternative. It is just a dressing up of something else…" ***– practitioner 1***

The findings extend the existing academic-based as this is not entirely captured within the literature, where the arguments relate predominately to the development Islamic financial innovation in general, *inter alia*, the need for a LOLR.

5.2.4. Central Banking

There are two core findings from the interviews in relation to the LOLR. Firstly, the interviews confirm the academic literature in that there is desire for the Islamic financial system to establish some form of central banking entity within the industry. The arguments put forward reiterate once again the nuances of regional interpretation of Shariah but further these discussions in relation to the concepts of central banks. Fundamentally, there is a need review the role of an Islamic central bank in the context these regional differences in interpretation. If there is a desire to establish some form of fundamental regulatory framework where an Islamic central bank can exist, then there is a need to think about how this Islamic central bank can, potentially, afford pastoral guidance on Shariah whilst at the same time fulfil its role as central financial entity within the financial system.

> "...we definitely need a lender of last resort but this is where the central banks have to be considered and they have to start moving towards a position where they will be able to act as the lender of last resort for Islamic institutions in an Islamic way" ***– practitioner 1***

> "…I think it's very difficult to think about Islamic central banks in the abstract without thinking about which territories and legal contexts they're actually going to be plot down in and how they've always got this issue of adapting to what rules are already in place … " ***– academic 2***

More interestingly, the interviewees suggest two potential frameworks for the accommodation of this central bank and LOLR – a mega Islamic bank and sovereign central banks. The suggestion put forward from the interviews was that sovereign central banks would be the best positioned to fulfil this role for the Islamic financial system. Essentially, sovereign central banks would have to evolve their roles, marginally, to accommodate the Islamic financial system. Alternatively, the mega Islamic bank framework would see an additional layer to the financial hierarchy in having a supra-entity oversee conventional central banks and maintain the religious integrity of the Islamic financial system. Both suggestion would involve conventional financial markets and sovereign central banks making provisions to provide macro-prudential regulation, establish and maintain market liquidity in-line with Shariah financial rules.

> "…I mean central banks do but the lender of last resort is lending to a system, it's the banking system as a whole. If there's a generalised systemic run, okay I mean and if there's a run it seems to me that, you know, Islamic banks could fail their customers…" – ***academic 4***

> "…well I think we need a mega Islamic bank. It's either through the Islamic Development Bank (IDB) or through any other shareholding structure, we need a mega Islamic bank that oversees the whole industry and we need to try to achieve this sort of regional standardisation." – ***academic-practitioner 1***

> "…The Malaysian central bank – Bank Negara Malaysia provides a viable outlet for funds for Islamic financial institutions. If I am not mistaken in the UK, with HSBC's Islamic banking branch and Lloyds Islamic finance branch they have the Bank of England as a lender of last resort and in terms of regulation they are still governed by UK law." – ***practitioner 4***

This section of the study presented our core findings from the interview analysis with relation to the established thematic framework presented in Section 2. Figure 2 below provides a further visualisation of the framework deigned from our empirical findings (see Table 1 Appendix I for a summative of empirical findings):

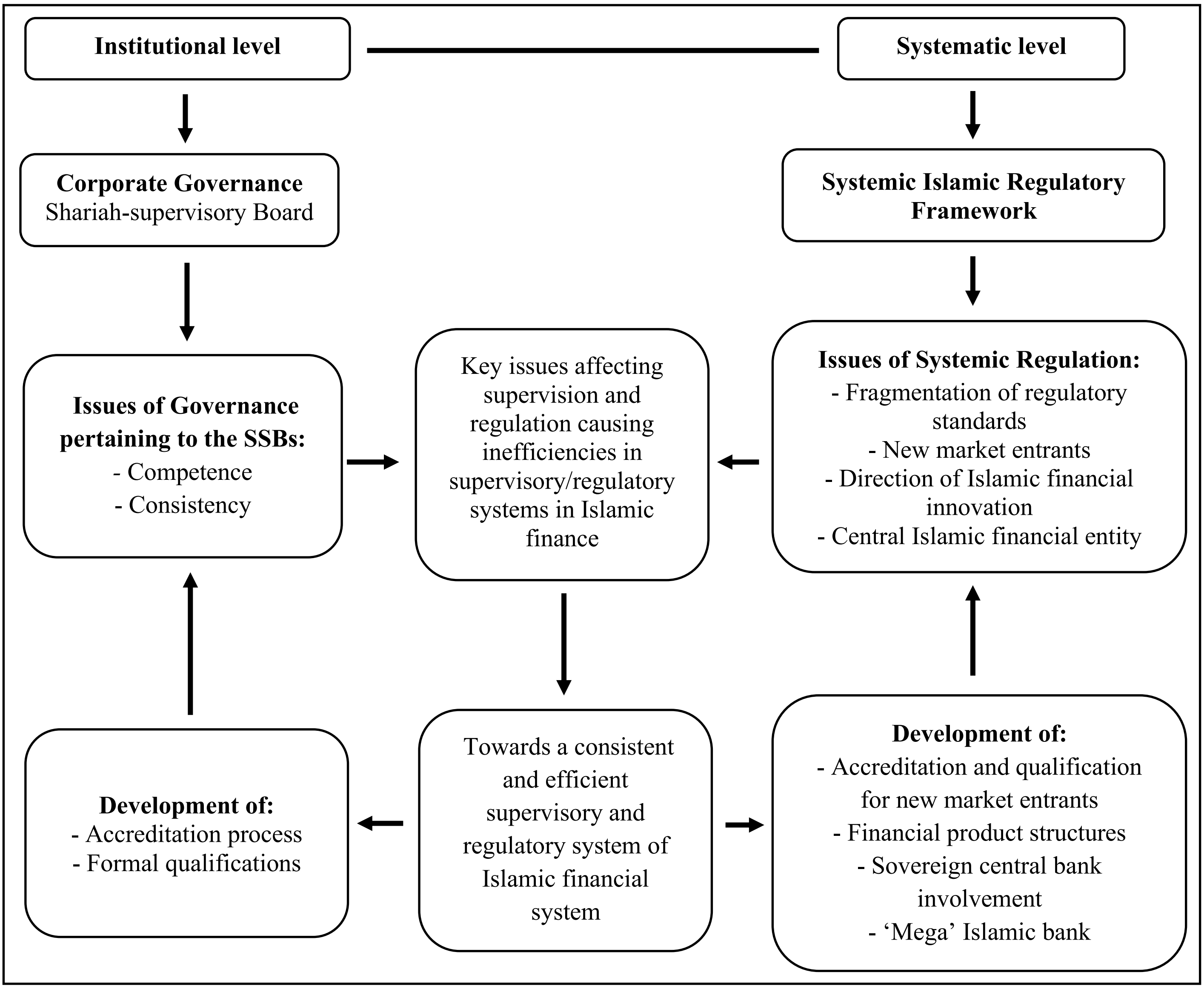

Figure 2: Framework from Empirical Findings

6. Discussions

The growth of Islamic finance within the modern economic spectrum has resulted in numerous developments within the base of academic knowledge about Islamic financial regulation. In this section, we reconcile and synthesize the theoretical narratives from the literature and our findings using the developed conceptual framework.

Similar to the structure of our theoretical framework we begin our discussions with institutional regulation. Issues of institutional regulation within the Islamic financial system centre on the SSB. The academic literature on SSBs highlight five core areas for consideration – independence (Azmat *et al.*, 2014; Oseni *et al.*, 2016), composition (Al Mannai & Ahmed, 2018), competence (Farook & Farooq, 2013; Najeeb & Ibrahim, 2014), confidentiality (Bhatti & Bhatti, 2010; Platonova *et al.*, 2016) and consistency (Ullah, 2016). Of these five characteristics, our findings indicate that only the competence and consistency of SSBs are core concerns and complete transparency is impossible to realise. On the issue of competence, there is very much a consensus on the further development of human capital within the Islamic financial system. Very much in line with Farrok and Farooq (2013), the market participants view the creation of accredited qualification by both AAOIFI and the IFBS relatively favourably in bolstering the expertise of human capital within the Islamic financial system. These arguments for the continual development of formal qualification extends into the consistency argument. Logically, the formal education and accreditation process provides a consistent minimum knowledge base from which, IFIs are able to draw and build expertise vis-à-vis allowing, in turn, for consistency and competence across Islamic decision-making. Moreover, on the degree of transparency of SSB decision-making, the bifurcation of views between academic literature (Platonova *et al.*, 2016; Grassa *et al.*, 2018) and market participants on the degree of transparency presents an interesting discussion point. Whilst the academic literature suggests greater transparency, the counter argument from market participants is that there is the need to define transparency, i.e. degree of transparency as compared to which other financial system. We can draw inspiration from the conventional financial literature in this regard as studies such as Merton (1990 and 1995) indicated that conventional financial systems possess a level of opaqueness as well and as such places complete transparency as an ideological precept that is, potentially, unattainable. These discussions of SSBs have implications at both the institutional and systemic Islamic financial regulation level.

We next explore the themes on systemic regulation. Firstly, concerning Islamic finance as an alternative to conventional finance our findings confirm the existing literature in indicating that as Islamic finance grows into traditional financial markets, there is the need for market participants to understand the fundamental changes that arise from combining religious and financial principles. Both the literature (El-Gamal, 2005; Oseni & Hassan, 2015) and the interviews highlight this as one of the largest risks facing the Islamic financial system. On this front, the arguments about the development of an accreditation process of formal education in Islamic banking and finance could also pertinent. Any accreditation process of provision of formal education will, similar to aiding SSB competence, also aid general market participant competence, especially new market entrants. This development of base knowledge in turn fosters the development of systemic Islamic financial regulation.

Secondly, we observe some consensus between the academic literature and interviewees on the lack of uniformity of the current Islamic regulatory framework and how this is damaging the development of Islamic finance going forward. Both literature (Ho, 2015; Zakariyah, 2015; Ashraf & Khawaja, 2016) and the interview findings indicate the there is a need for the development of a fundamental regulatory framework across the global Islamic financial system. The nuances of the regional interpretation of fundamental Shariah create a financial system with barriers, which can limit development and growth (Apaydin, 2018). These barriers could invariably result in the diminishment of a 'deep' and 'wide' financial system, which could deteriorate financial innovation and market development in terms of elements such as liquidity management. Given that the majority of Islamic financial transactions have to exist in the real economy this lack of a fundamental regulatory framework could be catastrophic. However, the calls for uniformity from an interview perspective are limited to a base regulatory framework and stop short of desiring complete harmonisation of regulation. Once again, it is possible to draw parallels between the Islamic financial system and conventional finance in that there exist differences in regulatory standards within conventional finance as well. Potentially, central regulatory bodies such as AAOIFI and the IFSB have to establish regulatory balance between regulatory guidance and stifling totalitarian control (Apaydin, 2018). Nevertheless, whilst our findings suggests that complete harmonisation and uniformity is impossible and, to a certain extent, undesired, there are conscious steps being taken by the Islamic financial system to continually develop and improve the fundamental base of Islamic financial regulation.

Thirdly, in relation to the concerns about the current direction of Islamic financial innovation, the literature articulates a desire for an established framework for financial innovation (Delorenzo & McMillen, 2007) whilst, the market perspectives suggest the structure of these new Islamic financial instruments is a more relevant issue. Linking into the harmonisation argument above, studies such as Sarea & Hanefah (2013), Oseni (2013) and Farook and Farooq (2013) suggest that an amalgamation of Islamic and conventional financial practices would allow for not only the creation of a fundamental regulatory framework but also expansion into conventional financial markets. It is possible to discuss the differences between literature and market participants' precepts from both a theological and economic perspective. From a theological perspective, mimicry of conventional financial instruments by Islamic financial innovation calls into question the religious legitimacy of Shariah finance. A view, which is strongly held by the interviewees. From an economic perspective, mimicking conventional financial instruments creates an unfavorable competitive environment for IFIs and conventional financial entities. Given that Islamic finance has to contend with additional religious or Shariah risk this has to be priced into any Islamic financial instrument, making it more expensive than its conventional counterparts. Conceptualizing this from an economic perspective, the additional risk premium could price Islamic financial instruments out of the conventional market.

Finally, the calls for a central banking entity within Islamic finance have been conceptualised within the academic literature and recently, the direction of thematic research has moved towards examining sovereign legal and financial systems to determine if sovereign conventional financial entities were able to fulfil this role. Building on the work of Solé (2007), recent studies such as Muneeza and Hassan (2014) and Oseni (2015) have suggested that modern legal systems are sufficiently flexible to accommodate Shariah from a financial perspective. The suggestion is that sovereign central banks could and should undertake this role as central banking entity in support of the various Islamic financial hubs. Large financial hubs ranging from Hong Kong, Singapore, the United Kingdom and America have all seen substantial growth in the legal infrastructure and initiatives to support and adopt Islamic finance as a viable complementary and alternative financial system. Our interview findings provide support for this conceptual proposal with market participants suggesting that this could be one possible framework towards achieving central banking for Islamic finance. However, a major concern from market participants about this suggestion on the development of sovereign central banks would relate to the underlying 'Shariah-ness' of sovereign central banks. Chattha and Halim (2014) provide some theological support for such a structure but highlight that this approach is sub-optimal from a Shariah perspective in that any emergency funding would not be Shariah-compliant but acceptable to prevent further market instability.

From our interviews, the suggestion is that the creation of a 'mega' entity would help alleviate this 'lesser of two evil approach' with a proposed structure akin to that of the ECB. Under this structure the LOLR responsibilities (and hence decision-making) lie with the mega 'Islamic Central Bank' (ICB), who then instructs individual sovereign central banks to provide liquidity. Moreover, this liquidity provision can be structured similarly to that of the ECB's emergency liquidity assistance (ELA), via the use of repurchase orders (repos) requiring the need for collateral backed lending, which, can be argued, are closer to Shariah principles (Garcia-de-Andoain *et al.*, 2016). Whilst, the structure of the ECB can be seen as a "successful" method of harmonizing markets and the ELA does meet the fundamental principles of a LOLR, there is persistent concern about how this central entity will deal with divergent religious ideology.

7. Conclusions

Using an exploratory qualitative methodology, this study aimed to shed further light on the regulation of the Islamic financial system. Via the establishment of a thematic framework from existing literature and subsequent interview analysis, our findings illustrate that there are divergences between existing academic knowledge and that of market participants. At an institutional level, our interview analysis highlight that SSB issues are diminishing. The overwhelming sentiment is that the continual growth of human capital and the development of market expertise is having substantial positive impacts on the regulation of SSBs. From a systemic regulatory perspective, there is substantially more capture of issues. There is congruence, with literature, from market participants on issues such as financial innovation, uniformity and an Islamic central bank. Summarily, market participants identified that i) complete uniformity of regulatory standards was not expected and that this could, potentially serve to subvert financial innovation ii) there is a distinct need for an Islamic central bank with two proposed model arising from the interviews – a 'mega' Islamic bank or adapting sovereign central banks to accommodate this role.

7.1. Contributions

We contribute to the academic literature in the following ways. This study extends the literature on Shariah governance and regulation using a qualitative approach to capture information from market participant perspectives on stylised theoretical debates of Shariah financial regulation. Our study differs from the existing literature by posing these stylised arguments to market participants in order to evaluate actual perceptions of these theoretical issues. This study, thus, bridges the gap in the academic literature through the exploration of how the specific types, processes and dimensions of Shariah regulation are developed and understood. We develop an extensive conceptual framework, which provides a comprehensive collective view of the extant academic knowledge on regulation and governance in Islamic finance. Furthermore, we extend the conceptual framework using the primary data to develop a comprehensive empirical model, which integrates market participant precepts on the academic literature. The novelty of these findings lies in the divergence between the market participant's views and the theoretical literature. This paper thus enhances our understanding of what Shariah-based regulations should focus on to develop sustainable regulation in the Islamic financial system. The empirical model in this study can be applied to both developed and developing economies, as a basis for understanding governance and regulations in Islamic finance, but such applications should take into consideration the different Shariah principles, culture and economy of the research context.

We can divide the implications for practice into two levels – institutional regulation via SSBs and systemic regulation of the Islamic financial system. Firstly, at institutional level, our study illustrates that the issues pertaining to SSBs are quickly diminishing. We should caution against suggesting that the regulation of SSBs is no longer an issue for consideration but rather use the findings from this study as a barometer for the impact of current institutional regulatory policies on addressing perceived issues with SSBs. Secondly, in terms of systemic Islamic financial regulation, it is evident that the divergences in Shariah financial standards across the Islamic financial markets cause substantial concern. Whilst, complete harmonisation is not expected, there is an increased need to establish a more succinct framework of regulation. From this study, the core area of focus is the consideration for a LOLR.

7.2. Limitations and Further studies

There is subjectivity with establishing a saturation point for interview analysis and we have endeavoured to define a robust structural process to minimize this subjectivity. This study developed and suggested both a conceptual and an empirical model using a qualitative approach; future studies could test the model in multiple economies, quantitively, to improve generalisation.

In terms of further studies, firstly, SSBs are still relatively understudied within the Shariah financial literature and there is need for further exploration of their decision-making processes. The combination of religious and financial frameworks could create a situation where SSBs could be quasi self-regulating. That SSBs are governed by religion would suggest that failure to adhere to Shariah would result in catastrophic theological consequences and the utility from decision-making could be better conceptualised. Secondly, there is a decline in the academic literature on Islamic financial innovation. It is felt that further research is required into determining the extent that Islamic financial instruments mimic their conventional counterparts and to discover the reasons behind this direction of financial innovation. Finally, the academic literature on Islamic central banks is scarce and our study puts forward several questions that present scope for further study. Our findings allow us to pose questions such as 'would sovereign central banks have to provide for Shariah-compliant lending to Islamic banks?' and 'would this source of finance for Islamic banks be similar to their conventional counterparts?' Additionally, the model of a 'mega' Islamic bank illustrates an interesting proposition from a structural perspective. Questions such as 'would a central entity whose financial responsibility transcends geographical boundaries be ideal in harmonizing a divergent Islamic financial system?', 'would the reach of such an entity extend to conventional banks providing Shariah-compliant financial services?' and 'would this then result in a dual regulatory system for banks providing such services?'

In conclusion, we set out to explore market participants' perspectives on issues of Islamic financial regulation. Our findings have shown that there are distinct differences between market participants' perspectives and the thematic literature on Islamic financial regulation on issues such as uniformity and Islamic central banks. Thus, our study contributes to the literature through the creation of both a thematic and empirical framework that allows for a better understanding of financial regulation in Islamic finance.

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Appendix A

Regulatory Factor	Core Literature	Thematic Framework	Empirical Findings
Shariah-supervisory Boards	• El-Gamal (2005) • Azmat et al. (2014) • Oseni et al. (2016) • Al Mannai and Ahmed (2018)	- Head hunting of specific Shariah scholars on the basis of leniency of decision - Shariah scholars on the Shariah-supervisory boards of different institutions and resulting conflicts	- Shariah-headhunting and similar scholars on different boards are rapidly diminishing as the Islamic financial system grows
	• Hamza (2013) • Mejía et al., 2014 • Ullah (2016) • Nawaz, 2017	- Consistency of Shariah-financial decisions	- Issues of consistency are diminishing with the creation of accreditation process and formal qualifications for Islamic finance
	• Khan (2007) • Safieddine (2009) • Bhatti and Bhatti (2010) • Platonova et al. (2016) • Riaz et al. (2017) • Grassa et al. (2018)	- Disclosure as to the composition of Shariah-supervisory boards - Disclosure of the details of Shariah financial decision making	- Complete transparency is not possible
Fundamental Regulatory Framework	• Khatkhatay and Nisar (2007) • Ho. (2015) • Ashraf and Khawaja (2016) • Ullah (2016)	- Uniformity of the Shariah-compliant screening processes across conventional financial systems	- Divergent Shariah-compliant criteria was not raised within the interviews
	• Delorenzo and McMillen (2007) • Bassens et al. (2009 & 2011) • Pollard and Samers (2013) • Apaydin (2018)	- Regional differences in interpretation of fundamental Islamic law creates varying standards for Islamic financial regulation	- Harmonisation of the global Islamic financial hubs. - No absolute standardisation as this could preclude innovation
	• Sarea and Hanefah (2013) • Oseni (2013) • Oseni and Hassan (2015) • Farook and Farooq (2013) • Najeeb and Ibrahim (2014) • Song and Oosthuizen (2014) • Mejía et al. (2014)	- Development of central bodies who undertake the 'standardisation' of IFIs - Role of AAOIFI and IFSB - Creation of an evaluation system that allows for a uniform evaluation of IFIs	- Appreciation for the contributions of AAOIFI and the IFSB. - Accreditation process and formal education help with development of human capital allowing for further harmonisation.

Islamic Finance as an Alternative	• Ariss and Sarieddine (2007) • Monger and Rawashdeh (2008) • Wilson (2008) • Fang and Foucart (2013) • Azmat et al. (2014) • Muneeza and Hassan (2014) • Oseni (2015) • Nawaz (2017) • Daher (2015)	- Islamic finance as an alternative financial system	- The growth of Islamic finance into more conventional markets - Need for individuals switching from conventional to Islamic finance to understand the unique characteristics of Shariah
Central Banking	• Ahmed and Hassan (2007) • Solé (2007) • Siddiqui (2008) • Dar and Azami (2010) • Msatfa (2012) • Hassan et al. (2013) • Chattha and Halim (2014) • Zins and Weill (2017)	- Need for an Islamic central bank	- Conventional central banks establishing Shariah-compliant financial facilities. - Creating a “mega” Islamic central bank overseeing the Islamic financial system
Financial Innovation	• Delorenzo and McMillen (2007) • Zakariyah (2012) • Abdul Rahman et al. (2014) • Rahman et al. (2014) • Daher et al. (2015)	- Regulatory standards to establish greater development of the depth and breadth of Islamic financial markets	- There is scope for financial innovation - Desire for Islamic financial instruments, which do not recreate conventional financial products.

Table 1: Summative of Thematic Framework and Empirical Findings

Appendix B

INTERVIEWEE	GROUP DESIGNATION	POSITION AND EXPERTISE	INSTITUTION TYPE	LOCATION
1	Academic 1	Professor (Economics)	University	UK
2	Academic 2	Professor (Economics)	University	UK
3	Academic 3	Senior Lecturer (Ethical Investments)	University	UK
4	Academic 4	Lecturer (Accounting Standards)	University	UK
5	Academic-Practitioner 1	Treasurer and PhD candidate	Islamic Bank and University	MENA & UK
6	Academic-Practitioner 2	Shariah Scholar and PhD candidate	Islamic Bank and University	MENA & UK
7	Academic-Practitioner 3	Professor (Banking and Finance) and Industry Consultant	University, IFSB and central bank	UK, Malaysia and MENA
8	Academic-Practitioner 4	Professor (Economics) and Industry Consultant	University and central Bank	UK and Pakistan
9	Practitioner 1	Managing Director and Industry Consultant	Islamic financial consultancy and AAOIFI	MENA
10	Practitioner 2	Deputy Managing Director	Islamic Bank	Malaysia
11	Practitioner 3	Senior Manager (Governance and Ethics)	Central bank	MENA
12	Practitioner 4	Senior Manager (Equity Investments)	Islamic Bank	Malaysia
13	Practitioner 5	Senior Manager (Personal Wealth)	Islamic Bank	Malaysia
14	Practitioner 6	Senior Manager (Retail Banking)	Islamic Bank	Malaysia

Table 2: Summative profiles of interview candidates