

## Finding the Right Regulatory Path for Islamic Banking

**Authors :** Meysam Saidi

**Abstract :** While the specific externalities and required regulatory measures in relation to Islamic banking are fairly uncertain, the business is growing across the world. Unofficial data indicate that the Islamic Finance market is growing with annual rate of 15% and it has reached 1.3 \$ trillion size. This trend is associated with inherent systematic connection of Islamic financial institutions to other entities and different sectors of economies. Islamic banking has been subject of market development policies in major economies, most notably the UK. This trend highlights the need for identification of distinct risk features of Islamic banking and crafting customized regulatory measures. So far there has not been a significant systemic crisis in this market which can be attributed to its distinct nature. However, the significant growth and spread of its products worldwide necessitate an in depth study of its nature for customized congruent regulatory measures. In the post financial crisis era some market analysis and reports suggested that the Islamic banks fairly weathered the crisis. As far as heavily blamed conventional financial products such as subprime mortgage backed securities and speculative credit default swaps were concerned the immunity claim can be considered true, as Islamic financial institutions were not directly exposed to such products. Nevertheless, similar to the experience of the conventional banking industry, it can be only a matter of time for Islamic banks to face failures that can be specific to the nature of their business. Using the experience of conventional banking regulations and identifying those peculiarities of Islamic banking that need customized regulatory approach can aid to prevent major failures. Frank Knight has stated that "We perceive the world before we react to it, and we react not to what we perceive, but always to what we infer". The debate over congruent Islamic banking regulations might not be an exception to Frank Knight's statement but I will try to base my discussion on concrete evidences. This paper first analyzes both theoretical and actual features of Islamic banking in order to ascertain to its peculiarities in terms of market stability and other externalities. Next, the paper discusses distinct features of Islamic financial transactions and banking which might require customized regulatory measures. Finally, the paper explores how a more transparent path for the Islamic banking regulations can be drawn.

**Keywords :** Islamic banking, regulation, risks, capital requirements, customer protection, financial stability

**Conference Title :** ICIBFI 2014 : International Conference on Islamic Banking, Finance and Investment

**Conference Location :** Vancouver, Canada

**Conference Dates :** August 07-08, 2014