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Research Article

# LEGAL CHALLENGES HINDERING THE DEVELOPMENT OF ISLAMIC FINANCE IN UZBEKISTAN

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**Summary:** 1. Introduction. – 2. Literature Review: Islamic Finance in Uzbekistan. – 3. Methodology and Data. – 4. Findings: Legal Challenges of Islamic Finance in Uzbekistan. – 5. Conclusion and Recommendations.

**Keywords:** *Islamic finance, Uzbekistan, Legal matters, Regulatory framework, Finance industry.*

## ABSTRACT

***Background:*** *Recently, the Uzbek government expressed interest in introducing Islamic financial services. Nevertheless, the creation of the legal framework for the smooth operation of Islamic financial institutions is dragging. This work attempts to identify legal hurdles preventing the*

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*penetration of the Islamic finance industry in Uzbekistan, and formulates vital policy recommendations to lead the development of a regulatory framework for the industry.*

***Methods:*** *A library research method and legal analysis is employed by going through diverse legal matters. For that purpose, we studied a range of legal documents varying from banking and capital market legislation to some newly introduced laws. Additionally, issues of Islamic finance in the tax law and the civil code of the nation are scrutinized.*

***Results and Conclusions:*** *The finding of the paper shows that some legal barriers exist that hinder the complete implementation of the Islamic finance industry in the country. They are not only in one area of national legislation but also exist in various parts of the legal system. Accordingly, it is recommended that the Uzbek government develop a sound legal and regulatory framework to provide a favourable environment for the activities of Islamic finance institutions. The general conclusion of the research resolves that, even if the process of developing an Islamic finance legal framework may start gradually, it should be holistic to be fully effective.*

## 1 INTRODUCTION

Uzbekistan is the most populated country in the Central Asian region, with a permanent population exceeding 36 million as of January 1, 2023.[3] Estimates state that most of the country's population is Muslim, varying from 88 to 96 percent.[4] Despite having the largest Muslim population in the region, Uzbekistan began its efforts to introduce Islamic banking and finance into the country much later than other Central Asian countries. This could be explained as a result of the former Soviet Union's legacy and a cautious approach to the reforms implemented by the previous leadership of the country.[5] Until 2016, it was difficult, almost impossible, to conduct any economic or financial projects that bore the title "Islamic." After the election of Mr Shavkat Mirziyoyev as the President of the Republic of Uzbekistan in 2016, reforms began in all aspects of the country, including in the economic sphere.

At the end of 2020, in his Presidential address to the Parliament of the Republic of Uzbekistan, Mr Shavkat Mirziyoyev admitted that the time had come to create a legal base for introducing Islamic financial services. He revealed the political will of the government to introduce Islamic finance and banking institutions in the country.[6]

The country's citizens are also interested in using Islamic finance services. A survey was conducted on introducing Islamic finance in Uzbekistan and showed that the main reasons for the non-use of bank loans by individuals and businesses were religious beliefs, high-interest rates, and the complexity of lending procedures at banks. In this survey, 61% of legal entities and 75% of individual respondents expressed their will and expectations of the operation of

3 Statistics Agency, 'Permanent Population' (Statistics Agency Under the President of the Republic of Uzbekistan, 2023) <https://stat.uz/en/58-useful-information/5903-permanent-%E2%80%8Epopulation> accessed 31 March 2023.

4 United States Department of State, '2021 Report on International Religious Freedom: Uzbekistan' (US Department of State, 2 June 2022) <https://www.state.gov/reports/2021-report-on-international-religious-freedom/uzbekistan> accessed 31 March 2023.

5 Muzaffar Ahunov, 'Financial Inclusion, Regulation, and Literacy in Uzbekistan' (2018) 858 ADB Working Papers, doi:10.1007/978-1-349-67278-3_116.

6 Shavkat Mirziyoyev, 'President Shavkat Mirziyoyev's Address to the Oliy Majlis' (President of the Republic of Uzbekistan, 29 December 2020) <https://president.uz/en/lists/view/4057> accessed 31 March 2023.

Islamic financial institutions in the country.[7] Thus, the survey results show a high demand for Islamic financial products and services in Uzbekistan, and the country has enormous potential for developing Islamic finance and banking. Nevertheless, some serious legal challenges prevent its development of Islamic finance.

Therefore, this work attempts to identify legal hurdles that prevent the emergence of the Islamic finance industry in Uzbekistan. The studied legal issues range from capital market legislation to banking rules, and from the newly introduced law on non-banking institutions to insurance regulations. In addition, we also delve into tax regulation and discuss some changes required in the Civil Code. As a result, we formulate important policy recommendations to improve the chances of introducing a regulatory framework for the industry. The general conclusion of the research is that, even if the process of developing an Islamic finance legal framework may start gradually, it should be holistic to be fully effective.

The structure for the rest of the paper is as follows: Section 2 provides a brief literature review on Islamic finance development in Uzbekistan. Section 3 discusses the methodology and data used in the study. The findings of the study related to legal issues hindering the progress of Islamic finance in the country are presented in the fourth section. The final section concludes the paper, provides relevant policy recommendations, and briefly highlights its limitations and avenues for future research.

## 2 LITERATURE REVIEW: ISLAMIC FINANCE IN UZBEKISTAN

Islamic finance started developing in the Commonwealth of Independent States (CIS) after 1991 when the Soviet Union broke down. The Central Asian (CA) region and the state of Azerbaijan, in the Caucasus region, are considered republics with a majority Muslim population. To develop Islamic finance infrastructure and secure financial aid from the largest Islamic financial institution, these states started joining the Islamic Development Bank (IsDB) group. Azerbaijan was the first to join in 1992, followed by Kyrgyzstan, Turkmenistan, Kazakhstan, and Tajikistan, each one year after another from 1993 to 1996. Uzbekistan was the last to join IsDB in 2003. The regional office of IsDB was established in Almaty, Kazakhstan, which rapidly promoted the Islamic finance industry's development in the region.[8]

The CA region can be considered the epicentre of Islamic financial growth in the CIS. The Muslim countries in the CA region lie in the middle of the historic silk route that connected Central Asia with major economies across the world as the central vein of trade for silk, agriculture, spices, and minerals. Central Asian countries border with Russia and China, giving their markets a potential of 1.6 billion customers, a similar number to the combined population of the 57 Organization of Islamic Cooperation (OIC) member nations, currently standing at 1.8 billion.[9]

7 Jakhongir Imamnazarov, 'Landscaping Analysis of Islamic Finance Instruments in Uzbekistan' (UNDP Uzbekistan, 17 June 2020) <https://www.undp.org/uzbekistan/publications/landscaping-analysis-islamic-finance-instruments-uzbekistan> accessed 31 March 2023.

8 GN Khaki and Bilal Ahmad Malik, 'Islamic Banking and Finance in Post-Soviet Central Asia with Special Reference to Kazakhstan' (2014) 4(2) International Journal of Excellence in Islamic Banking and Finance 1, doi:10.12816/0010779.

9 Join Madina Kalimullina, Sheikh Bilal Khan and Khondamir Nusratkhujaev, 'Islamic Finance: The CIS Region Opportunity' (Islamic Markets, 4 November 2020) <https://app.islamicmarkets.com/tv/islamic-finance-the-cis-region-opportunity> accessed 31 March 2023.

After the establishment of the IsDB regional office in Almaty, Islamic banking and finance activities increased in the region. Government bodies started adjusting regulations, investors opened Islamic banks, leasing, and takaful companies. States looked into the matter of sovereign Sukuk (Islamic bonds) to open new opportunities. Responding to the growing customer need for Islamic finance products, the governments of countries including Azerbaijan, Kazakhstan, Kyrgyzstan, and Tajikistan introduced some notable changes to their respective state legislation. Furthermore, IsDB and its group members, such as the International Islamic Trade Finance Corporation (ITFC) and the Islamic Corporation for the Development of the Private Sector (ICD), supported the new industry in the region.[10]

The last member of the IsDB among the Central Asian countries is Uzbekistan. It acceded to IsDB in 2003 and became the 55th member with a subscribed capital of 13.4 million ID, accounting for a 0.03% share in the total capital of the Islamic Development Bank. As compared to its neighbours, Uzbekistan is seen as the farthest from the Islamic finance industry despite its 36 million Muslim-dominated population. The country has received around 2.5 billion USD in financing since it acceded to the IsDB. To date, there have been 103 projects implemented countrywide, out of which 49 are complete, whilst 54 are ongoing. The majority of the financing received channelled to the fields of education, health, agriculture, electric development, and construction.[11]

Altogether, since 2005 till today during its 18 years of history in Islamic finance, Uzbekistan became a member of all suborganisations of the IsDB, including the Islamic Corporation for the Development of Private Sector (ICD), International Islamic Trade Finance Corporation (ITFC), Islamic Solidarity Fund for Development (ISFD), and Islamic Corporation for Insurance of Investment and Export Credit (ICIEC). The country has utilised some Shariah-compliant financing received from IsDB through some commercial banks during its membership in the organisation. In 2011, the first Islamic leasing company, Taiba Leasing, was established in Uzbekistan with sole ownership of ICD and contributed a capital of 5 million USD, which started its operation in 2011.[12]

Internally, the growth trajectory of Islamic finance was slow until 2017, which sparked more interest by the elected president of the country in 2016, Shavkat Mirziyoyev, who pushed for the introduction of Islamic finance in the country's financial system. Thereafter, some attempts were made to establish a legal and financial infrastructure to allow the operationalisation of Islamic banking and finance, though unfortunately, it produced worse results than expected. Even if the country still lacks legal foundations for the establishment of Islamic financial institutions, there are numerous initiatives and attempts of establishing Islamic banking in some of the commercial banks, takaful companies, and Islamic trade financing companies.[13]

10 Bilal Ahmad Malik, 'Halal Banking in Post-Soviet Central Asia: Antecedents and Consequences' (2015) 2 Marketing and Branding Research 28, doi:10.19237/MBR.2015.01.03.

11 Khusan Khasanov, 'Prospects for the Development of Islamic Finance in the Republic of Uzbekistan: Presentation' (Round Table Meeting on Prospects of Development of Islamic Finance in Uzbekistan, International Islamic Academy of Uzbekistan, Tashkent, 11 September 2019) doi:10.13140/RG.2.2.16580.58247.

12 Alam Asadov and Khurshid Gazikhanov, 'Ijarah's Prospects in Central Asian: An Example of Uzbekistan' (2015) 11(2) Journal of Islamic Economics, Banking and Finance 63, doi:10.12816/0024915.

13 Imamnazarov (n 7); Moody's Investors Service, 'Banks – Uzbekistan: Islamic Finance Windows Would be Credit Positive for Uzbek Banks' (Islamic Finance News (IFN), 10 December 2020) <https://www.islamicfinancenews.com/islamic-finance-windows-would-be-credit-positive-for-uzbek-banks.html> accessed 31 March 2023; Hondamir Nusrathujaev, 'Opportunities and expectations for Islamic finance in Uzbekistan' (Islamic Finance News (IFN), 22 December 2020) <https://www.islamicfinancenews.com/opportunities-and-expectations-for-islamic-finance-in-uzbekistan.html> accessed 31 March 2023; Hondamir Nusrathujaev, 'Apex Takaful seizes opportunity in Takaful market of Uzbekistan' (Islamic

As a first attempt to legalise Islamic finance activities, at the end of 2019, the Capital Markets Development Agency (CMDA) of the Republic of Uzbekistan presented the Capital Market Development Strategy for 2020–2025. In the same strategy, CMDA's director, A. Nazarov, announced that by mid-2020, the country would start issuing Islamic bonds (Sukuk) with the technical assistance of the IsDB. After over 30 years of its independence, Uzbekistan still lacks an established capital market, a vital part of any country's financial system. The volume of securities freely traded on the Tashkent Stock Exchange was equivalent to 0.4% of the country's GDP as of late 2019. CMDA had an ambitious goal to increase the volume of the stock exchange indicator to 10% of GDP within 5 years. Despite conventional stocks and bonds being actively traded in the country, there is no legislation regulating the issuance and trading of Sukuk in Uzbekistan. To support the first and following issuance of Sukuk, a legal act on Islamic bonds was supposed to be adopted.[14] However, the legal action has not passed as of 2023, and CMDA was abolished. Its powers, rights, obligations, and property were transferred to the Ministry of Finance of Uzbekistan.[15]

Other sectors of the Islamic finance industry, such as Islamic banking, Islamic insurance (takaful), Islamic leasing (Ijarah), Islamic microfinance, Islamic fund management, and others, also need to further develop in Uzbekistan. Even with the introduction of some, they are still in a nascent stage in the country. To date, Islamic finance was implemented by the public financial institutions in Uzbekistan through financing lines offered by the IsDB and its subsidiary companies, such as the Islamic Corporation for the Development of Private Sector (ICD) and the International Islamic Trade Finance Corporation (ITFC). In parallel with its loan portfolio extended to the government initiatives, over 2.5 billion USD as per the latest figures, it has also offered over 30 million USD financing lines under the Murabaha contract to private banks, such as Aloqabank, Asia Alliance Bank, and Turonbank. Other banks, i.e., Kapitalbank, O'zsanoatqurilishbank, Trastbank, and Asia Alliance Bank have enjoyed financing from the International Islamic Trade Finance Corporation (ITFC), totalling 32 million USD. Furthermore, private sector clients and SMEs in Uzbekistan have received trade finance and development support under trade finance facilities for 17 lines, totalling 166 million USD since the country joined the ITFC in 2019.[16]

On the other side of the spectrum when supporting society's Islamic finance needs, private sector initiatives have displayed considerable results. Nowadays, despite the regulatory challenges in place, multiple firms are operating in Uzbekistan within the legal boundaries of conventional finance. One of these firms, the pioneer in the country, is the ICD-backed Islamic leasing company, Taiba Leasing LLC, which first joined Uzbekistan's financial market in 2011. As one of 130 leasing companies operating in the country, it has operated in Tashkent city since its beginning. It is then followed by the Iman Group of Companies, which joined the market in 2019 and has been distinctly recognised by both the regional and international

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Finance News (IFN), 20 April 2021) <https://www.islamicfinancenews.com/apex-takaful-seizes-opportunity-in-takaful-market-of-uzbekistan.html> accessed 31 March 2023.

14 Bekzod Shavkatovich Usmonov, 'Uzbekistan's Capital Market: New Rules and Development Strategy' (2020) 1 O'zbekiston iqtisodiy axborotnomasi <https://evu.uz/intervyu/uzbekistan-s-capital-market-new-rules-and-development-strategy.html> accessed 31 March 2023.

15 'Capital Market Development Agency is abolished in Uzbekistan' UzDaily.uz (UzDaily, 3 April 2021) <https://uzdaily.uz/en/post/64603> accessed 31 March 2022.

16 'ITFC extends US$ 15 Million Line of Trade Financing Facility to Invest Finance Bank' (International Islamic Trade Finance Corporation (ITFC), 26 January 2022) <https://www.itfc-idb.org/news-events/news/itfc-extends-us$-15-million-line-of-trade-financing-facility-to-invest-finance-bank> accessed 31 March 2023.

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viewers as a successful Islamic fintech company that freely operates in Uzbekistan despite the legal constraints.[17]

The third player in the market is Alif Shop in Uzbekistan, with its operations dedicated to the financing technologies sector. Serving as a shopping platform, it deals with several suppliers in the technology sector and presents its products on its platform (Alif Tech, no date). Between 2017-2020, two more firms joined the untapped Islamic insurance sector, namely Uzaro Yordam and Apex Takaful. Both, located in the capital city, offer general and family takaful to their clients. Notably, Uzaro Yordam was the first firm in the Islamic finance industry to establish itself and fill a genuine need to support over-exhausted businesses and households suffering from the nonexistence of Shariah-compliant insurance coverage and unfair premium packages. It is a non-profit organisation meant to provide cooperative mutual insurance services that are Shariah-compliant. Following, Apex Takaful became the second of the two to enter the market and obtained its Shariah compliance license from the Al-Huda Islamic economics centre.[18]

Next, in 2020, came the establishment of Oqil Himoya, the Islamic house and auto financing company as a part of Uzaro Invest Group. This firm has provided Islamic investment opportunities in the field of house and vehicle financing. It also offers a wonderful opportunity for the households to satisfy their need for houses and vehicles financed in Shariah-compliant forms, acting as a gateway for the local investors who wish to invest in Shariah-compliant projects. Most recently, in January of 2023, Trastbank, a local commercial bank, launched Trast Muamalat. Trast Muamalat is subsidiary offering Murabaha and Ijarah-based leasing products (IFN 2023). In recent years, from 2019-2023, an increase in momentum of Islamic finance development in the history of Uzbekistan has been experienced. The President issued an order to develop a draft resolution on Islamic finance introduction into the economy on the 19th of December of 2020; this was the first time in its history that Uzbekistan's public witnessed the President stressing the urgency of implementing Islamic finance publicly at a top-level event. This action was subsequently followed by Senate endorsement of the Law on "On Non-Banking Credit Organizations and Microfinance Activities " in April 2022.[19]

Along with the achievements highlighted above, there remain several other critical challenges holding various levels of priority. First, the list starts with regulatory challenges. During seven years of reforms started by the new government, led by President Shavkat Mirziyoyev, Islamic finance was only included formally in only one legislation, the Law "On Non-Banking Credit Organisations and Microfinance Activities. " Even in that law, only non-banking financial institutions were permitted to engage in Islamic finance activities aligned with internationally-accepted standards and defined by the Central Bank of Uzbekistan (CBU).[20] Yet no such classification or definition of Islamic banking and finance products has been provided by the CBU as today.

From a general review of the literature on the development of Islamic finance in Uzbekistan, it can be understood that the country lacks a legal framework for the smooth operation of

17 Murod Khusanov, 'Uzbekistan Opens for Islamic Finance' (Islamic Finance News (IFN), 16 December 2022) <https://www.islamicfinancenews.com/uzbekistan-opens-for-islamic-finance.html> accessed 31 March 2023.

18 Nusrathujaev (2021, n 13); 'About Society' (UZARO Yordam, 2023) <https://yordam.uzaro.uz/About> accessed 31 March 2023.

19 'The Law "On Non-Banking Credit Organizations and Microfinance Activities" was approved' (The Central Bank of the Republic of Uzbekistan, 17 March 2022) <https://cbu.uz/en/press_center/news/614570/> accessed 31 March 2023.

20 Law of the Republic of Uzbekistan No ZRU-765 'About Non-Banking Credit Organizations and Microfinance Activities' of 20 April 2022 <https://lex.uz/uz/docs/5972411> accessed 31 March 2023.

the Islamic finance industry. As Sharipov and Yuldashev state, "Any transactions performed based on or using Islamic finance principles shall be subject to conventional laws of Uzbekistan.[21] Islamic finance or Islamic banking and similar practices have not yet been afforded a specific treatment or legislative framework in Uzbekistan." Even if there is the first law "On Non-Banking Credit Organisations and Microfinance Activities, " it is still not operational since directives for the operation of Islamic financial institutions are not yet defined by the Central Bank of Uzbekistan. Therefore, the main legal challenges facing the Islamic finance industry should be investigated in Uzbekistan's case.

## 3 METHODOLOGY AND DATA

The applied methodology in the study is a combination of systematic library research and content analysis of the current legal infrastructure in Uzbekistan. Firstly, previous studies in the matter were systematically reviewed and their conclusions summarised. Thereafter, an analysis of content in various legal documents pertaining to the activities of Islamic finance institutions was undertaken. Accordingly, different legal matters, varying from capital market legislation, insurance regulations, banking rules, as well as the newly introduced law on non-banking institutions, were scrutinised. We also delved into issues of taxation and evaluated the nation's Civil Code. When analysing issues pertaining to Islamic finance institutions or products, relevant articles or sections of law or regulatory documents were highlighted. Finally, changes necessary to accommodate the smooth operation of the Islamic finance industry are suggested.

The relevant financing documents from Uzbekistan's finance industry were utilised to collect data for this study. This information was sorted and organised concurring with the studied issues in Islamic finance. Next, the issues were compared to the theories of Islamic finance and the opinions of scholars. Whenever available, data was obtained directly from the official legal portal of the government of the Republic of Uzbekistan, which is Lex.uz. Alternatively, if an official translation was not available on the government's legal portal, an unofficial translation was taken from other websites, such as www.cis-legislation.com, which provides reliable information about legislation of Commonwealth of Independent States (CIS) members. Alternatively, a local language version of the document was taken from the regulation portals of the government of Uzbekistan, such as Lex.uz or Regulation.gov.uz. In addition, wherever applicable, regulations of neighbouring countries were taken from their respective official sources, such as the website adilet.zan.kz for Regulatory Legal Acts of the Republic of Kazakhstan.

Furthermore, official statements of the representatives of the government of Uzbekistan were pulled from the respective official websites, such as one regarding The Central Bank of the Republic of Uzbekistan at Cbu.uz, or the official government news agency, Uzbekistan National News Agency at Uza.uz. Nevertheless, if such statements or information regarding Islamic finance in the country could not be found in those sources, popular local news media, such as Kun.uz, Daryo.uz, or UzDaily.uz, or international news agencies, such as Islamic Finance News (IFN) were utilised. Relevant statistics of secondary data were brought in either from the State Statistics Committee of Uzbekistan or the Islamic Development Bank (IsDB) or its subsidiaries, such as the International Islamic Trade Finance Corporation (ITFC). Other reliable sources of data and information are also referenced wherever necessary.

21 Atabek Sharipov and Nodir Yuldashev, 'Islamic Finance and Markets in Uzbekistan' (Lexology, 1 October 2019) <https://www.lexology.com/library/detail.aspx?g=9aaf1dd8-417e-408c-ba8f-79e069edf65c> accessed 31 March 2023.

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## 4 FINDINGS: LEGAL CHALLENGES OF ISLAMIC FINANCE IN UZBEKISTAN

After the Uzbekistan leadership's commitment to introduce Islamic financial services, activities to create the legal base for the operation of Islamic financial institutions have begun. The government chose to start implementing Islamic finance through Islamic microfinance services, as mentioned earlier. The law of Uzbekistan "On Non-Banking Credit Organisations and Microfinance Activities" went into effect on April 20, 2022.[22] According to the law, microfinance organisations have the right to provide Islamic finance services. The law defines Islamic finance services as financial services which are provided within the procedure developed by the Central Bank of Uzbekistan, following the rules of international organisations which establish standards for the implementation of Islamic finance.

The law emphasises that the governing rules and principles of Islamic financing shall be that of AAOIFI-established standards as well as the Prudential Standards set forth by the IFSB. According to the content of the law, it will provide regulatory support for non-banking institutions and microfinance firms willing to offer Islamic financing lines. This move is the first of its kind, demonstrated by the Legislative body, Oliy Majlis (Parliament), to cover Islamic finance operations under the country's regulations. However, it has drawn certain criticism and disappointment from the experts in this field.

Following a thorough analysis of the law's content, it is worth noting that the comments given by the professionals are objectively formed, because the law only allows microfinance institutions and non-banking credit organisations to offer Islamic finance products, leaving out Takaful, Islamic banking, and Islamic capital markets disciplines, which are the cornerstones of Islamic finance. Furthermore, these services should be rendered strictly under the Procedure for Providing Islamic Finance Services, which should be developed and adopted by the Central Bank of Uzbekistan. This means that it may take another several months, if not years, before this law can be wholly implemented. Although the law has been in effect for over a year, the procedure for providing Islamic finance services has not yet been established. We agree with Sekoni that Islamic and conventional banking systems and products are not the same, and they should have separate legal frameworks.[23] The activities of Islamic microfinance institutions in Uzbekistan should also be regulated by a separate law rather than the law "On Non-Banking Credit Organisations and Microfinance Activities."

It is a fair assumption that the government of Uzbekistan is trying to regulate Islamic finance services out of its current banking system. The share of non-bank credit institutions in the financial market of Uzbekistan makes up less than 1% of the whole. The government of Uzbekistan aimed to increase the share of non-bank credit institutions in the total volume of crediting from 0.35% to 4% by 2025.[24] However, even 4% is a small fraction of the entire finance industry.

22 Law No ZRU-765 (n 20).

23 Abiola Sekoni, 'Legal and Regulatory Issues and Challenges Inhibiting Globalization of Islamic Banking System' (2015) 62332 MPRA Paper <https://mpra.ub.uni-muenchen.de/id/eprint/62332> accessed 19 August 2023 .

24 Decree of the President of the Republic of Uzbekistan No UP-5992 'On the Strategy of Reforming of Bank System of the Republic of Uzbekistan for 2020–2025' of 12 May 2020 <https://lex.uz/ru/docs/4811025> accessed 30 April 2023.

Ahunov also highlights a key role played by commercial banks in Uzbekistan, since the country's financial system is bank-based.[25] Therefore, there is little to no role played by the other types of financial intermediaries that operate in its financial market, including non-deposit-taking microfinance institutions. The same picture can be seen on an international scale where Islamic microfinance makes up a small portion of the financial services provided. It is reported that only 255 Islamic microfinance institutions operated worldwide in 2015, with a total outstanding loan portfolio amounting to 628 million USD.[26] Attempting to regulate Islamic finance services using non-bank credit institutions may be understood as an overly cautious approach to introducing Islamic finance in the Uzbekistan.

Despite the absence of appropriate legal conditions, Uzbekistan's commercial banks began to establish Islamic windows which would provide a limited number of Islamic finance services. Several commercial banks signed a memorandum of understanding with the Islamic Development Bank on introducing Islamic windows. The hope is that the opening of Islamic windows would be an initial step in further establishing fully-fledged Islamic banks.[27]

Efforts to introduce Islamic securities in the financial market of the country have also started. The Capital Market Development Agency of Uzbekistan (CMDA) offered the draft of a Presidential Decree of the Republic of Uzbekistan, "On measures of introducing securities based on Islamic principles," for public discussion at the portal of public discussions of drafts of legal acts, found at regulation.gov.uz, which envisaged rules for issuance and circulation of sukuk.[28] Unfortunately, this normative act has not been adopted. Also, the governing body that drafted this act, CMDA, was liquidated and all its powers were vested in the Ministry of Finance of Uzbekistan (now merged with the Ministry of Economy to form the Ministry of Economy and Finance).[29] Thus, a legal framework was created for regulating the emission and circulation of sukuk in economically-healthy ways.

Another important aspect of Islamic capital markets is the existence of Islamic equity markets through Shariah stock indexes and screening methods employed in the development of such indexes. Unfortunately, Uzbekistan does not have an active equity market, let alone a Shariah index or regulations specifying its screening. Nevertheless, solely setting up a Shariah index without enforcing some disclosure requirements is not enough. A study of some jurisdictions with advanced Islamic equity markets, such as Malaysia, Saudi Arabia, and the United Kingdom, revealed that a lack of Islamic disclosures related to the main activity of the companies screened for a Shariah index adds difficulty for Shariah scholars who perform the screening.[30]

The slow process of developing a legal framework could be explained by a cautious approach implemented by government officials. The chair of the board of the Central Bank of Uzbekistan revealed the position of the Central Bank concerning the introduction of Islamic finance in the country and acknowledged that microfinance organisations shall have the right to con-

25 Ahunov (n 5).

26 Asian Development Bank and The Islamic Financial Services Board, Islamic Finance for Asia: Development, Prospects, and Inclusive Growth (ADB-IFSB 2015) 15.

27 Nusrathujaev (2020, n 13).

28 Draft Decree of the President of the Republic of Uzbekistan ID-23150 'On Measures for the Introduction of Securities Based on the Principles of Islamic Finance' of October 2020 <https://regulation.gov.uz/uz/document/23150> accessed 31 March 2023 .

29 Decree of the President of the Republic of Uzbekistan No UP-6207 'On Measures for Further Development of the Capital Market' of 13 April 2021 <https://lex.uz/ru/docs/5371091> accessed 31 March 2023 .

30 Anna Azmi, Normawati Non and Norazlin Ab Aziz, 'Challenges to Shariah Equity Screening, from Shariah Scholars' Perspective' (2017) 10(2) International Journal of Islamic and Middle Eastern Finance and Management 229, doi:10.1108/IMEFM-11-2016-0165.

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duct operations on Islamic finance principles. After, he also stated that Islamic windows will open within conventional banks to provide such services. The chairman of the Central Bank admitted that introducing Islamic finance in the country is a complex and delicate process.[31]

Another public official, former deputy minister of the Ministry of Economic Development and Reduction of Poverty, Ilhom Norkulov, explained that the reason behind the slow process of introduction of Islamic finance in Uzbekistan is the low level of the population's financial literacy. He stated that the public's awareness of Islamic finance principles is lacking.[32] Even if he is partially correct, it can be noted that such a level of Islamic finance awareness has not prevented neighbouring countries from introducing Islamic finance in their jurisdictions. For example, neighbouring country Kazakhstan adopted sound legislation to regulate Islamic finance and banking. By doing so, its government planned to make the country an Islamic finance hub of the Central Asian region in 2020. However, it did not reap the expected results as one cannot observe the rapid growth of Islamic finance in Kazakhstan. Specialists list the factors, such as low financial literacy and poor awareness of the population and businesses about Islamic finance services, which restrain the development of Islamic finance in Kazakhstan.[33] The lack of specialists in the Islamic finance sector is also considered a challenge that hinders the development of Islamic finance in the country. Despite all these difficulties, Kazakhstan's government is still ambitiously pursuing its goal of establishing the country as the Islamic finance leader of the region and has developed the Islamic Finance Master Plan for 2020-2025. According to the Master Plan, the country's Islamic banking assets are set to increase from the prior 1% to the new 3% of GDP by 2025.[34]

The efforts to introduce Islamic finance in Uzbekistan through non-bank credit institutions and to establish Islamic windows of conventional banks create a sceptical view about the future of Islamic financial services and products in the country. One reason is that the Civil Code of Uzbekistan does not contain provisions on types of Islamic finance service contracts. Problems with the taxation of financial services could be another issue for the further development of the sector. As it will be explained later, certain taxes would be applicable on Islamic finance products, making their application costly and inefficient.

The primary barrier to conducting Islamic finance operations by commercial banks is the presence of a ban for banks engaging in production and trade activities. Article 7 of the Law of Uzbekistan on Banks and Banking Activities prohibits commercial banks from engaging in production, trade, and insurance activities.[35] As Islamic banks base their activities on their direct involvement with trade and business, this ban is considered the main obstacle to conducting the activities of Islamic banks. Commercial banks that want to offer Islamic finance products through Islamic windows also complain about these issues. Abrorov and Imamnazarov specify that commercial banks that participated in their survey on issues of Islamic

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31 '"We are Working on Opening an Islamic Window in Banks" – CB Chairman' (Kun.uz, 21 October 2021) <https://kun.uz/en/news/2021/10/22/we-are-working-to-open-an-islamic-window-in-banks-cb-chairman > accessed 31 March 2023 .

32 'It Was Explained Why Islamic Financing Was Not Fully Implemented in Uzbekistan' (Daryo, 2 September 2021) <https://daryo.uz/k/2021/09/02/ozbekistonda-islomiy-moliyalashtirish-nega-toliq-amalga-oshirilmaganiga-izoh-berildi> accessed 31 March 2023 .

33 Maiya Arzayeva and Assel Dochshanova, Problems of Development of Islamic Financing in Kazakhstan: Financial and Legal Aspects' (2016) 9(S1) Indian Journal of Science and Technology 1, doi:10.17485/ijst/2016/v9is1/99524.

34 Muhammad Rafiq, 'Islamic Finance Market in Kazakhstan Opens New Investment Opportunities' Astana Times (Astana, 17 August 2023) <https://astanatimes.com/2023/08/islamic-finance-market-in-kazakhstan-opens-new-investment-opportunities/> accessed 19 August 2023.

35 Law of the Republic of Uzbekistan No 216-I 'On Banks and Banking Activities' of 25 April 1996 <https://lex.uz/en/docs/4404890> accessed 31 March 2023 .

banking identified the nonconformity of banking and tax legislation as a main impediment to the introduction of Islamic finance in Uzbekistan.[36] Unless this barrier is removed or Islamic banks are given special treatment and permitted to conduct trade activities, the introduction of Islamic banking is impossible in the country. For example, Kazakhstan's banking law set a special rule concerning the activities of Islamic banks, allowing them to finance production and trade activities by contributions done directly in the charter capital of legal entities or under partnership terms.[37]

Provisions of the current tax legislation of the Republic of Uzbekistan are also another obstacle to the introduction and further development of Islamic financial products in the country. Tax legislation makes financial operations of conventional financial institutions exempt from Value-Added Tax (VAT).[38] At the same time, some transactions that involve Islamic finance operations, especially Murabaha operations, could face double taxation. In Uzbekistan, VAT is charged for the sale of goods and services, which are considered taxable under the Tax Code. In Murabaha operations, initially, a bank purchases the goods and later sells them to the customer. Under current tax law, both transactions shall be subject to VAT, which will raise the price of the financial service for the customer. To avoid this double taxation, Murabaha operations should be recognised as financial operations, and corresponding amendments should be implemented into the tax legislation.

According to Article 244 of the Tax Code of the Republic of Uzbekistan, transactions with securities (shares, bonds, and other securities) are exempt from payment of VAT.[39] It is worth mentioning that tax legislation refers to securities such as shares, bonds, promissory notes, depositary receipts, certificates of deposit, forward, future, and option contracts, and other securities recognised as such per the laws or pertinent laws of another country. However, since sukuk is not yet recognised as a security by the local legislation, the above-mentioned tax incentives do not apply to transactions involving sukuk certificates. Thus, VAT will create another burden for the development of Islamic capital markets. It is necessary to make amendments to the legislation to treat sukuk similarly to conventional bonds under tax codes.

Regarding insurance regulation, Uzbekistan's rules are strict. The Law on Insurance Activities is the main law regulating the insurance industry in Uzbekistan. Even if the general principles of insurance are not vastly different from the takaful system, nevertheless, there are subtle differences in certain aspects. In this regard, Sharipov and Yuldashev specify that the principal difference is that, while insurance is considered a commercial activity and shareholders are primary beneficiaries of the company's profits under Uzbekistan law, under takaful principles, insurance is not considered a commercial activity and shareholders of the company do not directly benefit from underwriting surplus.[40]

Furthermore, there is clear insurer-insured relation between two parties as specified in the law, which is prohibited in takaful since participants contribute donations to a common fund and are considered mutual beneficiaries of the fund. Specifically, in Article 14 on Rights and Obligations of the Insurer of the Law, it is clearly stated that the insurer should "upon the oc-

36 Sirojiddin Abrorov and Jahongir Imamnazarov, 'Islamic Finance: New Opportunities for Uzbekistan' (2021) 4 Iqtisodiyot va ta'lim 146, doi:10.55439/ECED/vol_iss4/a148 .

37 Law of the Republic of Kazakhstan No 2444 'On Banks and Banking Activities in the Republic of Kazakhstan' of 31 August 1995 <https://adilet.zan.kz/eng/docs/Z950002444_> accessed 31 March 2023 .

38 Tax Code of the Republic of Uzbekistan No ZRU-136 of 25 December 2007 (new edition 2019) <https://lex.uz/en/docs/5535180> accessed 31 March 2023 .

39 ibid, art 244 .

40 Sharipov and Yuldashev (n 21).

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currence of an insured event, make all necessary calculations and payments of the insurance indemnity (insurance benefit) within the terms provided for by the legislation or the insurance (reinsurance) contract."[41] However, in takaful, the takaful operator acts as an agent of the takaful participants and is not solely responsible for the payment of the claims. There exist other discrepancies which make the operation of takaful companies difficult in these countries unless certain leeway is provided in its regulation. Therefore, as admitted by industry experts, current takaful companies operating in the country use some existing loopholes in the system, rather than the specific regulatory exception, to provide takaful services.[42]

Regarding the importance of the legal framework for the takaful industry, a recent study by Amuda and Alabdulrahman that explores the policy and reinforcement of the Islamic insurance framework in Saudi Arabia can provide some insights. The study finds that consumers consider takaful as policyholder-oriented when compared to conventional insurance as shareholder-oriented. It also reveals that the statement of the policy period and the nature of the Islamic insurance contract are important to reinforce takaful products' Shariah compliance. Finally, takaful participants should receive a share of the income generated from the investment of takaful funds in addition to the underwriting surplus as provided in the Shariah principles of the takaful model.[43] The proposed perfect application of the takaful model would only be applicable if a country has a legal framework allowing for the application of principles of Islamic insurance.

The smooth operation of Islamic finance institutions in the country requires making corresponding amendments to the banking, insurance, civil, and tax legislations. During its annual meeting held in Tashkent on September 3-4, 2021, the Islamic Development Bank signed a grant agreement worth 265,000 USD with the Republic of Uzbekistan to provide technical assistance for the establishment of an Islamic banking and finance legal framework. The main objective of the agreement was to develop the requisite regulatory, supervisory, and Shariah guidelines, establishing awareness and capacity building for Islamic banking in Uzbekistan. It is hoped that attracting technical assistance from Islamic Development Bank will give additional impetus for accelerating the development of the legal and regulatory framework for the operation of Islamic finance institutions in Uzbekistan.

## 5 CONCLUSION AND RECOMMENDATIONS

This work analysed some of the legal impediments which exist in Uzbekistan that prevent the proper development of the Islamic finance industry in the country. The analysis shows that legal barriers hindering the complete implementation of the nascent new industry are not only in one area of national legislation but exist in various parts of the legal system. In general, it is observed that Uzbekistan's government is working to draft new regulations related to various stakeholders of Islamic banking and finance. Nevertheless, the drafting of such legal and regulatory acts is conducted by different government agencies, and it is difficult to garner coordination among these agencies. The absence of a national roadmap and a unique

41 Law of the Republic of Uzbekistan No ZRU-730 'On Insurance Activities' of 23 November 2021 <https://lex.uz/en/docs/6124730> accessed 31 March 2023 .

42 Nusrathujaev (2021, n 13).

43 Yusuff Jelili Amuda and Sarah Alabdulrahman, 'Reinforcing Policy and Legal Framework for Islamic Insurance in Islamic Finance: Towards Achieving Saudi Arabia Vision 2030' (2023) International Journal of Law and Management, doi:10.1108/IJLMA-03-2023-0045.

strategy that depicts the plan of development of a legal framework for the operation of Islamic finance institutions makes the smooth development of the Islamic finance industry difficult.

Considering the legal impediments and difficulties in the process of introducing Islamic finance in Uzbekistan, we provide some important recommendations. They are as follows:

1. Accordingly, to coordinate the activities of government agencies, the government should identify directions of the reform and adopt the "Concept of Introducing Islamic Finance Services in Uzbekistan." The Concept must identify perspectives and strict directions for introducing Islamic finance in the country. It should also delegate powers and responsibilities of state agencies to regulate Islamic finance and determine the legal and regulatory acts which need to be developed. Furthermore, since it is an important and time-consuming task, a separate agency or state department should be formed to implement the "Concept of Introducing Islamic Finance Services in Uzbekistan." In this phase, technical and consultative assistance from international organisations, such as the Islamic Development Bank or Islamic Financial Services Board, and some leading consulting organisations should be requested.

2. Within the scope of the "Concept of Introducing Islamic Finance Services in Uzbekistan," the government of Uzbekistan can adopt one of two methods to approach the problem. It can either adopt a single legislative act which regulates the operation of Islamic finance in general, or it can pass several legal acts which coordinate each specific field of the industry. In the second scenario, legal acts for each sector, such as Islamic banking, Islamic insurance (takaful), and Islamic capital markets, should be drafted and adopted. The latter approach may be easier and faster to implement since the development of a comprehensive regulation for the entire Islamic finance industry could become a challenging and lengthy process.

3. At the same time, to bring the adopted special legal acts related to Islamic banking and finance in conformity with the current legislation of the country, amendments to the current civil, tax, banking, and other legislations should be adopted. As indicated earlier, each piece of legislation has some elements that contradict legal conditions for the smooth operation of Islamic finance and the introduction of some of its products. Only once those impediments are removed or amended can the industry smoothly operate in the country.

4. Learning from the example of its neighbours, Uzbekistan should ensure adequate awareness of Islamic finance among the public and the availability of a sufficient number of specialists once the Islamic finance legal framework is ready. Thus, training specialists in the field of Islamic finance should be one of the main priorities for introducing Islamic finance and banking in Uzbekistan. Preparing high-quality textbooks and manuals in Islamic finance should be the main concern in training within this field. Similarly, raising the awareness of the public about Islamic finance should promote quicker acceptance of the industry by ordinary citizens once introduced in the country. Thus, various means of knowledge dissemination through public talks, seminars, conferences, articles, and programs in various media outlets can help rapidly raise the population's awareness of Islamic finance.

5. Promoting research in the field of Islamic finance and banking shall be a priority. As noted above in the literature review section, research in the field of Islamic banking and finance legislation is scarce in the country. Researchers at universities and scientific-research institutions should be encouraged to conduct research in the field of Islamic finance and banking law.

Thus, following those recommendations, the government of Uzbekistan can adopt one of two methods to approach the problem. It can either adopt a single legislative act to regulate the operation of Islamic finance in general, or it can pass several legal acts to coordinate each specific field of the industry. Irrespective of which path it takes, the development of a sound legal and regulatory framework shall create a favourable environment for the activities of Islamic finance institutions. This could bring not only an increase of investment flow from other Muslim countries, but also bring about local investment potential not revealed due to people's avoidance of conventional financial products.

Former Deputy Chairman of the Senate of Uzbekistan, Mr Sodiq Safoyev, acknowledged that the people of Uzbekistan have approximately 10 billion USD which are stored out of the banking system, and these funds can be utilised more beneficially.[44] Most people do not deposit their money into banks or do not take out bank loans due to fear of getting involved in *riba* (usury) that exists in the conventional financial system. Hence, introduction of the Islamic financial institutions in the country could draw local investments into these institutions and make effective use of financial resources, which are typically kept idle, to benefit the economy at large.

It is strongly believed that further development and flourishing of Islamic financial instructions in Uzbekistan shall positively influence the country's image within the Islamic world. To do so, the country's government should start making necessary changes in the legislative system and remove legal impediments that prevent the proper introduction and development of the Islamic finance industry. For this movement, it should adopt a national Concept of Introducing Islamic Finance Services. Even if the process of developing an Islamic finance legal framework may start gradually, the framework should be holistic in nature to be fully effective in its operation. Another point which should be considered for the effective operation of the Islamic finance industry is assuring the adoption of standard Islamic finance regulations on par with other jurisdictions already holding advanced Islamic finance industries. As some studies have shown, the harmonisation of regulations with other Muslim countries only promoted the development of the Islamic banking and finance industry in the country.[45]

There are also some limitations of the current study due to its limited scope. Since its findings are based on secondary data and a review of relevant literature, the scope of the research is general in nature. As it does not use primary data obtained from relevant stakeholders of Islamic finance in Uzbekistan, its findings are broad in perspective. This, in turn, proved a new avenue for future research where more narrow studies can be undertaken within a specific sector of the Islamic finance industry in Uzbekistan. As such, those studies can investigate areas including legal difficulties faced by certain segments, such as Islamic banking, Islamic insurance (takaful), or Islamic capital market, by collecting primary data from relevant stakeholders through surveys or interviews.

44 '"Public has 10 billion dollars" – Sodiq Safoyev Suggested Beneficial Use of Idle Savings' (Kun.uz, 25 February 2021) <https://kun.uz/uz/news/2021/02/25/aholida-10-milliard-dollar-bor-sodiq-safoyev-bosh-mablagdan-foydalanish-zarurligini-aytdi> accessed 31 March 2023 .

45 Shafiqul Hassan, 'An Empirical Investigation of Regulatory Framework for Islamic Banking System in Saudi Arabia' (2019) 7(3) International Journal of Innovation, Creativity and Change 129; Shafiqul Hassan, 'Analysis of Standard Regulatory Framework for the Islamic Banking System in Muslim Countries: A Comparative Analysis between Bangladesh, Malaysia and Saudi Arabia' (2019) 7(3) International Journal of Innovation, Creativity and Change 143.

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