LEGAL CHALLENGES IN ESTABLISHING THE ISLAMIC CAPITAL MARKET IN UZBEKISTAN

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ABSTRACT

Purpose — This study aims to examine the possibility of introducing the Islamic capital market (ICM) in Uzbekistan and to investigate the legal challenges inhibiting the process. Consequently, important policy recommendations are proposed.

Design/Methodology/Approach — It employed library research, scrutinised legal documents, and conducted interviews related to the ICM in Uzbekistan. The analysis involved both primary data from a series of interviews, and secondary data from available literature and the country's financial legislation.

Findings — The research findings show that despite the existence of a large demand for ICM products in Uzbekistan, its capital market is not ready for the introduction of the industry products at the current stage. Thus, several legal reforms and changes to current financial regulations are necessary for the industry to be introduced and flourish in the country.

Originality/Value — Unlike some previous studies, this article specifically examines the legal barriers faced by the ICM industry in Uzbekistan, shows some of its implications, and provides relevant policy recommendations.

Practical Implications — Following the recommendations of this paper, the government of Uzbekistan can make necessary legal reforms that would increase investment flow into the economy from both its own people and foreign investors.

Research Limitations/Implications — Due to the confined scope of the study, its findings are limited to legal issues relating to the ICM in Uzbekistan. Hence, the findings of the paper cannot be generalised to other countries or other sectors of the Islamic finance industry in the country.

Keywords — Financial regulation, Islamic capital market (ICM), Islamic finance products, Legal issues, Uzbekistan

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INTRODUCTION

Uzbekistan is a Central Asian country that is home to over 36 million people (Statistics Agency of Uzbekistan, 2023). The population of the country is predominantly Muslim, with estimates ranging from 85 to 96 per cent, making it the largest Muslim nation in the Commonwealth of Independent States (CIS) (United States Department of State, 2021). In spite of its large Muslim population and over 30 years of independence, Uzbekistan only recently began introducing Islamic financial services for its people. This delay in introducing Islamic finance is attributed to the previous leadership's cautious approach to reforms, a vestige of its Soviet legacy (Ahunov, 2018).

However, when the new government took power in 2016, reforms were initiated across various sectors, including financial services. In May 2018, a proposal for a Presidential Decree on 'Measures for Organizing Islamic Banking and Finance Infrastructure in the Republic of Uzbekistan' was posted on the government portal for public discussion (Kun.uz, 2018). However, the proposal was removed after a few weeks without a new proposal or a decree based on the original one being passed, indicating the government's hesitancy about fully adopting an Islamic financial system.

Similar initiatives ensued in the following years, with top government officials expressing the political will to establish a legal framework for introducing Islamic financial services. The last and most promising of those is the Presidential decree on measures to implement the tasks set in the open dialogue with entrepreneurs in September 2023. One of the tasks was to develop a proposal for an Islamic finance law by December 2023 (Republic of Uzbekistan, 2023).

However, some facts indicate the presence of significant unsatisfied demand for Islamic financial services in Uzbekistan and, in turn, hint at great potential for developing the industry in the country. A Findex survey conducted in Uzbekistan in 2014 showed that one of the two main reasons for individuals not taking loans from conventional banks was their religious beliefs. Furthermore, a 2020 survey conducted in collaboration with the United Nations Development Program (UNDP) revealed that 75 per cent of individuals and 61 per cent of businesses were willing to use services provided by Islamic financial institutions (IFIs) if they were offered in Uzbekistan (Ahunov, 2018; Imamnazarov, 2020).

One area of Islamic finance where Uzbekistan could start is the offering of Islamic capital market (ICM) products. Some of its Central Asian neighbours and other members of the CIS have experimented with providing a legal basis for the issuance of Islamic investment securities such as *ṣukūk* and Islamic mortgage certificates, as well as launching Islamic investment indexes (Anadolu Agency, 2021; Nagimova, 2021). It is plausible that Uzbekistan could adopt similar practices to promote the Islamic finance industry within the country. Therefore, the current study aims to analyse the feasibility of implementing an ICM in Uzbekistan, identify barriers to its introduction, and provide policy recommendations to overcome these obstacles. The following three main research questions are considered:

1. What is the level of awareness of the ICM and demand for its products in Uzbekistan?
2. What are the legal barriers preventing the introduction and development of the ICM in Uzbekistan?

3. How can the experience of the neighbouring countries and other countries with developed ICMs benefit Uzbekistan?

The remainder of the paper proceeds as follows. The next section provides an overview of the development of Islamic finance and capital markets in Central Asia and Uzbekistan. Then, the research methodology and data used in the analysis are discussed. The following section analyses the demand for the ICM based on the results of interviews with experts and assesses the compatibility of capital market regulations in Uzbekistan with the requirements of the ICM while also benchmarking them with ICM regulations of other countries. Finally, the last section summarises the paper and provides key policy recommendations.

LITERATURE REVIEW

Development of Islamic Finance and Capital Markets in Central Asia and Uzbekistan

The ICM has been introduced and is developing in many Muslim-majority and minority countries across Asia, Europe, Africa and North America. Even countries with a Muslim-minority population, such as the United States, the United Kingdom and Luxembourg, have thriving ICMs with well-known Islamic funds and Islamic indexes such as the Dow Jones Islamic and FTSE Shariah indexes. However, some of Central Asia's Muslim-majority countries such as Uzbekistan are lagging in ICM development.

Islamic banking and finance made inroads into Central Asia when those countries gained independence following the collapse of the Soviet Union in 1991. In the early years of their independence, the Central Asian countries joined the Islamic Development Bank (IsDB)—the largest and most specialised IFI under the Organisation of Islamic Cooperation (OIC)—which provided them with financing and assistance for the development of Islamic finance infrastructure. In 1993, Kyrgyzstan was the first of the Central Asian countries to join the IsDB, and the other three Central Asian countries, namely Kazakhstan, Tajikistan and Turkmenistan, followed its lead by joining the organisation between 1994 and 1996. Uzbekistan joined the IsDB in 2003, making it the last Central Asian country to do so. The Islamic finance industry started developing more rapidly in the region following the establishment of the IsDB regional office in 1997 in Almaty, Kazakhstan (Malik, 2015).

Subsequently, new legislation was passed and changes to financial regulations were adopted by the regional governments to accommodate the smooth operation of IFIs such as Islamic banks, *takāful* (Islamic insurance) and leasing companies and to permit the issuance of Islamic investment securities such as *ṣukūk* (Malik, 2015). Those changes to accommodate the Islamic finance industry were most visible in Kazakhstan and Kyrgyzstan, and partially in Tajikistan. The remaining two Central Asian countries, Uzbekistan and Turkmenistan, were relatively slow in introducing elements of the Islamic finance industry. Nevertheless, all five of the newly independent states of Central Asia were benefiting from financial assistance provided by the IsDB and its group member organisations.

Uzbekistan has received financing of around USD2.5 billion from the IsDB since 2005. The Sharīʿah-compliant financing received from the organization was channelled to the country's economy through some commercial bank credit lines provided to large enterprises or

was provided directly to some government projects. Most of the financing was directed to educational, health, agricultural, utilities and construction sectors of Uzbekistan's economy (Khasanov, 2019).

Nonetheless, no significant progress in Islamic finance development was witnessed in the country. Just one private Islamic leasing company was established by the Islamic Corporation for the Development of the Private Sector (ICD) in 2011 (Asadov & Gazikhanov, 2015). It was only after the new government came to power in 2016 that some new sparks of hope appeared for the introduction of Islamic finance. Despite some initiatives by the new government and some private initiatives resulting in the establishment of some IFIs (such as *takāful* and *ijārah* companies and Islamic microfinance institutions), the country still lacks formal legislation allowing for the smooth operation of IFIs in the country (Moody's Investors Service, 2020; Nusrathujaev, 2021).

Regarding ICM developments, Uzbekistan is far behind its neighbours. So far there was only one official initiative to legalise ICM activities in the country in 2019. Then, the Capital Markets Development Agency (CMDA) of the Republic of Uzbekistan proposed a strategy for the development of the capital market in the country for 2020–2025. As part of this strategy, it was proposed that *ṣukūk* be issued by mid-2020 with the technical support of the IsDB. Accordingly, a legal act to support such *ṣukūk* issuance was supposed to have been passed by the government of Uzbekistan in 2020 (Nagimova, 2021). However, as of 2023, no *ṣukūk* had been issued and no such legislation had been adopted.

On the other hand, ICM developments are quite noticeable in neighbouring Central Asian countries and the Russian Federation. Kazakhstan is considered the regional leader in the development of the ICM. The Islamic finance law of Kazakhstan was adopted in 2009, and some amendments were made in 2011 to allow for *ṣukūk* issuances. In 2012, the government of Kazakhstan placed its first sovereign *ṣukūk* issued by the Development Bank of Kazakhstan (Dawn, 2012). The five-year *ṣukūk* worth MYR240 million (USD75 million) was facilitated by Malaysian Islamic banks. Furthermore, in 2020, a USD500 million *ṣukūk* issued by the Qatar International Islamic Bank was jointly placed on the Astana International Exchange (AIX) and the London Stock Exchange (LSE), marking the debut of a foreign entity in Kazakh stock exchanges (Nagimova, 2021).

In another Central Asian country, Kyrgyzstan, amendments allowing the issuance of Islamic securities were incorporated into the law 'On the Securities Market' in 2016. The envisioned objective of the amendments was to pave the way for the introduction of *ṣukūk* into the country's capital markets. Consequently, the State Mortgage Company of Kyrgyzstan introduced a new 2020-2025 programme in 2019 which allowed for the issuance of new financial instruments called Islamic securities and housing certificates and allowed for the raising of up to 1.25 billion Kyrgyz Som (Nagimova, 2021). More recently, the Hong Kong-based Intercascade Group placed the first private issuance of *muḍārabah ṣukūk* to qualified institutional investors, worth 750 million Kyrgyz Som (USD8.55 million), in April 2023. This was a landmark issuance of Islamic securities in Kyrgyzstan that was overseen by Interstate Securities as the lead manager of the transaction and financial advisor (IFN, 2023).

Even the Russian Federation, having only a Muslim-minority population, has made some progress in terms of ICM activities. In 2017, the special purpose vehicle (SPV) Sukuk Invest

LLC tried out the first technical *ṣukūk* issuance with a symbolic amount equivalent to USD15,700. The trial was successful, which proved the potential of *ṣukūk* issuances in Russia (Nagimova, 2021). Furthermore, on 14 October 2021, the Moscow Exchange launched Russia's first Islamic equity index. The exchange undertook the initiative jointly with Sberbank, and it resulted in the initiation of two Islamic indexes, the MOEX Shariah Index (MXSHAR) and the MOEX Shariah Total Return Index (MXSHARTR). The Sharīʿah supervisory board responsible for the Sharīʿah screening of securities included in the indexes was formed by Sberbank's UAE-based investment subsidiary, Sberinvest Middle East Limited (Anadolu Agency, 2021).

Table 1 summarises the above initiatives related to the ICM.

Table 1: ICM Initiatives in CIS Countries

Country	ICM Initiatives
Kazakhstan	• Islamic finance law was passed in 2009 and amended in 2011 to allow for *ṣukūk* issuances • The first sovereign *ṣukūk* issued by the Development Bank of Kazakhstan in 2012 • The first foreign *ṣukūk* placement on the Astana International Exchange (AIX) in 2020
Kyrgyzstan	• Amendments made to the law 'On the Securities Market' in 2016 • The State Mortgage Company programme for 2020–2025 allowed for the issuance of Islamic securities and housing certificates • Private issuance of *muḍārabah ṣukūk* by Intercascade Group in 2023
Russian Federation	• The first technical *ṣukūk* issuance by SPV Sukuk Invest LLC in 2017 • Two Islamic indexes initiated by the Moscow Exchange and Sberbank in 2021

Source: Authors' own

Although a number of ICM initiatives took place in some Central Asian countries and the Russian Federation, the same has not been observed in the case of Uzbekistan. Moreover, there are not many studies scrutinising the potential of ICM development or analysing the legal aspects of introducing ICM products in the country. There are only a few studies analysing the legal approaches to the introduction of Islamic investment funds (Jumagulov, 2023), the feasibility study of green *ṣukūk* issuances (UNDP, 2021), the importance of sovereign retail *ṣukūk* (Holboboyev & El Amri, 2022) and some other general studies related to Islamic finance in Uzbekistan. Therefore, this paper attempts to analyse this issue and examine the reasons hindering the introduction of ICM products in Uzbekistan. By addressing the research questions stipulated under the introduction of this paper, this study aims to fill in the identified research gap in the literature.

METHODOLOGY AND DATA

This study assesses the current condition of the capital market in Uzbekistan and examines the legal barriers to the introduction of ICM products in the country by employing both primary and secondary data. Primary data were collected by conducting interviews with experts familiar with Islamic finance and Uzbekistan's capital markets. More specifically, six experts with various backgrounds coming from academia, financial consulting, financial practice and management of international financial organisations were selected to learn their opinions on the possibility of introducing the ICM in Uzbekistan. Three of the interviewees reside in the country, while the other three live abroad. The interviewees were asked eight questions related to the level of

capital market and Islamic finance development, as well as the prospects and obstacles relating to ICM development.

In addition to primary data, secondary data were collected and organised related to legal issues surrounding the ICM in Uzbekistan. The secondary data were compiled by collecting relevant legal documents from Uzbekistan's financial sector, specifically the capital market industry. Furthermore, some practices of neighbouring countries and some countries with developed ICMs were scrutinised to investigate the specifications of the regulatory environment required for the introduction of ICM products.

Thus, the study employed qualitative methodologies, which consisted of a combination of analytical assessments of data obtained from the conducted interviews and examination of legal documents connected with the introduction of the ICM in Uzbekistan. It employed a structured interview method, followed by deductive analysis. The interviewees were asked at least two questions related to the first research question, aiming to get indicative answers to the second research question related to the legal barriers preventing the introduction and development of the ICM. Furthermore, the interviewees were asked to suggest the best model to be applied in introducing the ICM industry in the country, which helped answer the last research question.

For the legal scrutiny, secondary data were used; presidential decrees, decree proposals, laws and financial regulations about the capital market in Uzbekistan were examined. Other legal documents that could potentially affect the operation of the ICM in the country were also analysed. These legal and regulatory documents were studied to assess their compatibility with the requirements of the ICM. Subsequently, these issues were aligned with the theory and opinions of Islamic finance scholars found in the literature and the practices of other countries to provide recommendations for enabling the introduction of the industry in Uzbekistan.

FINDINGS AND DISCUSSION

Financial Literacy, Awareness of Islamic Finance and Demand for the ICM in Uzbekistan

In September 2021, the IsDB held its annual meeting in Tashkent, the capital of Uzbekistan, marking the official welcome of Islamic finance in the country. During the meeting, some government officials of Uzbekistan were questioned by a number of event participants as to why Islamic finance had not been officially introduced in the country. One official attributed the delay in the introduction of Islamic finance to the people's lack of confidence in the banking system in general and their low level of Islamic finance literacy (Kun.uz, 2021). Another Uzbek official gave a similar answer to a similar question: lack of trust in the banking system and the need for time to develop such trust and enhance people's familiarity with Islamic banking among the public before the country is able to introduce Islamic financial services (Depozit.uz, 2021). Nevertheless, what both officials seemed to have overlooked is the lack of financial inclusion caused by the dearth of Islamic financial services in the country. As some panellists emphasised, Muslims desire Islamic financial services as a matter of faith, not because they mistrust traditional banks, especially in Muslim-majority countries such as Uzbekistan. Therefore, it is imperative to consider this issue on a broader scale, providing all segments of the population with financial services that align with their faith (Depozit.uz, 2021).

Against this background, it is intriguing to explore the general knowledge of the people in Uzbekistan about capital markets and Islamic finance products. The goal is to ascertain whether the level of public awareness about Islamic finance and capital markets significantly impacts their demand for ICM products. According to the 2014 S&P Global Financial Literacy Survey, Uzbekistan ranks amongst the CIS countries with the lowest level of financial literacy (Klapper *et al.*, 2016). The survey found that only 21 per cent of the adult population was financially literate in 2014, a figure much lower than that of some other Muslim-majority CIS countries, such as Kazakhstan and Azerbaijan, which had financial literacy rates of 40 per cent and 36 per cent, respectively, among their adult populations (Klapper *et al.*, 2016). This could be attributed to an extended period in Uzbekistan during which there was no national strategy to promote financial literacy. Only recently has the government of Uzbekistan begun initiating financial literacy programmes (Morgan *et al.*, 2018).

Furthermore, Uzbekistan adopted the National Financial Inclusion Strategy for 2021–2023 (NFIS) in June 2021. The central bank developed it to promote financial literacy, financial consumer protection, basic and digital financial services, and access to finance for micro, small and medium-sized enterprises (MSMEs). It received the technical support of international organisations, namely the World Bank and the International Finance Corporation, and was funded by the Financial Sector Reform and Strengthening Initiative (FIRST) (UzDaily, 2021; Babasyan *et al.*, 2023).

Despite these recent programmes and strategies aimed at improving financial literacy, elevating the populace's financial literacy level in a short period is challenging. A positive development in this regard is the recent surge in the number of trainings and materials providing information on capital markets and Islamic finance in the Uzbek language. Nevertheless, it is suspected that the general public's knowledge and awareness of these topics remain superficial in Uzbekistan, and the interviewees' responses in this study confirm this doubt. Specifically, one of the interviewed experts stated: 'There is high demand for Islamic finance products in Uzbekistan, but I think it is important to improve the financial literacy of Uzbek people first. It is not just financial literacy but also Islamic financial literacy.' As a solution, he suggests implementing an Islamic financial system gradually in the country by introducing some elements of it at a time.

When it comes to the capital markets in general, one of the interviewees indicated that the capital market of Uzbekistan has undergone great changes in recent years as new investment opportunities have opened up in the country. People's interest in the stock market and investment has been increasing substantially. However, the same cannot be said for the ICM, as such financial products are not available in Uzbekistan yet. Thus, it can be inferred that as Islamic finance products become available in a country, the general public's awareness of Islamic finance will also improve. This contradicts the argument of some government officials who state that the general public is not ready for the introduction of Islamic finance due to their low level of financial literacy.

When asked whether they believed the population of Uzbekistan is ready to embrace Islamic finance, five out of the six interviewed experts stated that it is, while only one suggested that improving financial literacy on Islamic finance could enhance the adoption of Islamic financial services by the people. However, he did not imply this as a prerequisite for the

establishment of Islamic finance in Uzbekistan. Instead, the expert proposed a gradual introduction of the industry's services to enhance people's awareness about Islamic finance in the process.

All the interviewees responded positively to an inquiry about the prospects for the development of the ICM in Uzbekistan and its comparison with other CIS countries. Their conclusions were primarily justified by the relative size and devotion of the Muslim population in Uzbekistan. Another justification was the unsatisfied demand for alternative investment and financing opportunities that the ICM could offer for both individuals and businesses. At present, mainly conventional banking services are available for both investors and borrowers, which leaves many unsatisfied due to the aspect of Sharīʿah non-compliance on the one hand, and relatively high costs on the other.

Development of Capital Market Regulations in Uzbekistan

In 1992, the Uzbekistan Parliament adopted the Law on Exchanges and Exchange Activities to regulate commodity exchanges, currency exchanges, stock exchanges and exchanges dealing with intellectual property, among others (Republic of Uzbekistan, 1992). This law stipulated that stock exchanges and commodity exchange divisions dealing with stocks would be regulated by specific laws. This special legislation came in the form of the Law on Securities and Stock Exchanges, adopted on 2 September 1993. This law established the rules for capital market regulation and laid the foundations for its development in Uzbekistan. Further key regulations were the Law of the Republic of Uzbekistan 'On the Mechanism of Functioning of the Securities Market' (25 April 1996) and the Law 'On Joint-Stock Companies and Protection of the Rights of Shareholders' (26 April 1996).

Despite these efforts, the domestic capital market remained underdeveloped and did not play a significant role in mobilising financial resources in Uzbekistan. This can be partly attributed to the inefficiency of the existing capital market legal framework, which does not align with international standards or practices (UNDP, 2021). According to a press release by the Capital Market Development Agency (CMDA), which regulated the securities market in Uzbekistan until April 2021, the volume of transactions in financial securities has been low in the national stock exchange. The market capitalisation of listed companies was a mere 5.3 per cent of gross domestic product (GDP). In contrast, the market capitalisation of listed domestic companies in neighbouring Kazakhstan and the Russian Federation accounted for 21.7 per cent and 34.8 per cent of GDP, respectively (Dettoni, 2019).

The current capital market infrastructure of Uzbekistan is overly complex, with the roles of different regulators often overlapping. Article 55 of the law 'On the Securities Market' (2015) vaguely states that 'The authorized state body for regulating the securities market is determined by the President of the Republic of Uzbekistan'. Since the adoption of this law in 2015, several state agencies have been appointed as the securities market regulator in Uzbekistan. Initially, the Centre for Coordination and Development of the Securities Market under the State Competition Committee of the Republic of Uzbekistan was designated as the regulator. In January 2019, the CMDA was established by presidential decree, replacing the Centre for Coordination and Development of the Securities Market and assuming all its functions. However, the CMDA only functioned for two years; in April 2021, all of its functions and powers as the securities market

regulator were transferred to the Capital Market Development Department of the Ministry of Finance (Republic of Uzbekistan, 2021b). As of 2 September 2023, this authority to regulate the capital market was transferred again to the National Agency of Prospective Projects (NAPP) under the President of Uzbekistan (Gazeta.uz, 2023).

The Central Bank of the Republic of Uzbekistan also has regulatory power in the sphere of the capital market. The Central Bank serves as the fiscal agent of the government in the case of state bond placements issued by the Ministry of Economy and Finance and other state agencies. It advises the Ministry of Economy and Finance on matters concerning the schedule and volume of state bond issuances and state debt payments, considering their potential impact on the liquidity of the banking system and monetary policy priorities (Republic of Uzbekistan, 2015). The Central Bank adopts rules on the placement and circulation of depositary certificates and bills of exchange in conjunction with the authorised state body for the securities market (currently the NAPP).

The Agency for State Assets Management of Uzbekistan also has the power to organise the issuance and circulation of bonds and shares of enterprises with state participation (Republic of Uzbekistan, 2019a). Having multiple regulatory bodies overseeing the capital market in Uzbekistan further complicates the regulatory landscape. Therefore, establishing a capital market regulator that operates independently from other state agencies is a critical issue.

The International Organization of Securities Commissions (IOSCO) sets global standards for the securities sector. One of IOSCO's principles regarding securities regulators stipulates that regulators should be accountable and operationally independent (OICV–IOSCO, 2017). According to an assessment by the European Bank for Reconstruction and Development (EBRD), Uzbek securities legislation does not require the securities market regulator to be independent (OECD, 2013).

This finding is not particularly surprising given that, unlike in many developed countries, the independence of state regulators is not a stipulated requirement in the securities market legislation in Uzbekistan. This is according to a 2007 assessment of the securities market regulator conducted by the EBRD (OECD, 2013).

Based on the analysis of legal documents and expert feedback, establishing a single entity to oversee capital markets, similar to the Securities and Exchange Commission of the United States, the Securities Commission of Malaysia, or the Capital Market Authority of Saudi Arabia, would be beneficial for standardising the securities market in Uzbekistan. Such a central authority would facilitate the introduction of new capital market products. If the responsible agency were granted a sufficient level of independence, it could make more proactive decisions, contributing to the overall development of the country's capital markets, which is one of the attributes found for countries that issue *ṣukūk* (Boujlil *et al.*, 2020).

When it comes to the level of capital market development in Uzbekistan, all of the interviewees believed that it is underdeveloped. They cited several reasons, including low investment engagement, limited competition, a weak connection between the economy and financial markets, inadequate protection of investors' rights, and underdeveloped stock exchange infrastructure. They also highlighted the lack of a long-term capital market development programme, which has made both foreign and local investors hesitant to enter the capital market of Uzbekistan.

However, the government recently adopted the Capital Market Development Program (CMDP) for 2021–2023 (Republic of Uzbekistan, 2021b). The CMDP acknowledged the main problems facing the country's capital market, such as the extremely low volume of securities freely traded on the exchanges (only 0.4 per cent of Uzbekistan's GDP). This was attributed to the lack of a strategic planning system for capital market development and the existence of an overwhelming number of legal acts, most of which are outdated and do not meet modern standards for capital markets (Republic of Uzbekistan, 2021b).

The CMDP aims to deepen reforms in the capital market with the expectation of increasing the total volume of publicly traded securities to 5 per cent of the country's GDP by the end of 2023. The current securities legislation still lacks provisions assuring the independence of the regulator. However, the CMDP envisions that its primary objective under the direction of 'improving the legal regulation and oversight of the capital market' is to create an effective legal framework by developing the law 'On the Securities Market'. This law should be drafted based on the principles laid down by IOSCO and should ensure the real independence of the capital market regulator (Republic of Uzbekistan, 2021b).

Compatibility of Uzbekistan's Current Capital Market Regulations with ICM Requirements

In January 2019, the CMDA was established, with one of its objectives being to attract foreign investment to Uzbekistan. To draw Islamic finance funds as a source of investment, the CMDA developed a draft of the Presidential Decree of the Republic of Uzbekistan 'On Measures of Introducing Securities Based on Islamic Principles' in 2020. This draft act proposed rules and regulations that would enable the issuance and circulation of *ṣukūk* in the country. The CMDA was designated as the authorised agency responsible for the regulation of issuance, placement and circulation of *ṣukūk* under Islamic finance principles.

The CMDA aimed to introduce *ṣukūk* by attracting technical assistance and financial support from the IsDB. Regrettably, the draft act was not adopted. The CMDA was instead dissolved, and all its powers were transferred to a department of the Ministry of Finance (now the Ministry of Economy and Finance) (Republic of Uzbekistan, 2021b).

Unfortunately, to this date, the matter of legislation on the issuance and circulation of *ṣukūk* has been left ambiguous in Uzbekistan. Several provisions relating to the rights and obligations for the issuance of *ṣukūk* in Uzbekistan, which were previously assigned to the CMDA, were incorporated into the Presidential Resolution 'On Measures for Further Improvement of the Capital Market Regulatory System'. The resolution was issued and the Capital Market Development Program (CMDP) was adopted on 13 April 2021 (Republic of Uzbekistan, 2021b). The CMDP aims to experimentally issue *ṣukūk* by applying foreign legislation until appropriate capital market regulation is developed in Uzbekistan. The CMDP also empowered the corresponding state authorities to develop a draft law on the capital market to unify legal acts in the field of securities market regulation based on international best practices.

However, opinions gathered from interviews suggest that the current legal infrastructure of the capital market in Uzbekistan does not comply with ICM requirements. Nonetheless, the country can begin by preparing a legislative framework to accommodate the issuance and trading

of *ṣukūk*, for which draft work has already begun. Uzbekistan could follow the United Kingdom's (UK) example in terms of its legislative approach. Rather than drafting new legislation for Islamic finance, the UK chose to adjust existing laws and rules regulating traditional financial instruments. Regulatory changes were made to oversee minor formalities used in Islamic finance instead of introducing separate legislation regulating Islamic finance products (Dewar & Hussain, 2021).

However, another obstacle in Uzbekistan's legislation might hinder the recognition of *ṣukūk* as a security in the country. Article 96 of the Civil Code of the Republic of Uzbekistan (Part One) classifies and restricts financial securities to those recognised by legislation as commercial paper and securities (Republic of Uzbekistan, 1995). Securities legislation classifies only company shares, promissory notes, treasury bills, depositary receipts, certificates of deposit, bonds and options as securities (Republic of Uzbekistan, 2015). Therefore, to classify *ṣukūk* as a security, the current legislation would need to be amended. Alternatively, at least for the pilot issuance of *ṣukūk*, the draft act that defines *ṣukūk* as a security and regulates its pilot issuance should be adopted.

The Islamic Financial Services Board (IFSB) suggests that to promote the formation of a resilient and deep ICM in a jurisdiction, legal and regulatory barriers must be eliminated by introducing laws and regulations that cater to the special requirements of ICM products. This can facilitate the development of Islamic securitisation and the creation of new financial instruments that are Sharīʿah compliant (IFSB, 2022). In line with the IFSB's suggestion, Uzbekistan could also follow Russia's example by forming a Sharīʿah-compliant Islamic investment index and establishing a Sharīʿah board and screening methods for analysing stocks and other securities to be included in the index. Particularly, the development of capital markets, including Islamic ones, is crucial.

The original proposal of the Presidential Decree 'On Measures for the Introduction of Securities Based on the Principles of Islamic Finance' suggested many steps that would have facilitated the introduction of *ṣukūk* into Uzbekistan's capital market—an instrument deemed highly important for the development of ICMs (Hassan *et al.*, 2022). Important recommendations included providing tax exemptions related to the issuance of *ṣukūk*, such as exemptions from profit, property, land, sales and value-added taxes during financial transactions for both involved parties and the transactions of the SPV formed specifically for the issuance of *ṣukūk* (The Republic of Uzbekistan, 2020). At the moment, Uzbekistan's Tax Code in Article 244 exempts transactions in financial securities from paying value-added tax (VAT) (Republic of Uzbekistan, 2019b). However, this tax incentive would only apply to transactions with *ṣukūk* certificates if *ṣukūk* is recognised as a security in the legislation, without which VAT on such transactions becomes another burden for the issuance of *ṣukūk* in the country.

With no formal regulation governing Islamic finance activities in Uzbekistan, there are no set rules regarding the Sharīʿah advisory board that would confirm the Sharīʿah compliance of *ṣukūk* issuances. The proposed decree 'On Measures for the Introduction of Securities Based on the Principles of Islamic Finance' touched upon this matter. Surprisingly, it suggested the designation of the Committee of Religious Affairs (CRA) under the Cabinet of Ministers of Uzbekistan as the responsible body for certifying the conformity of the issuance, placement and

circulation of *ṣukūk* certificates with Islamic finance principles, thus making it the Sharīʿah advisor for the issuance and oversight of *ṣukūk*.

However, the CRA is a special government agency that implements state policies in the religious sphere in Uzbekistan, which is not limited to Islam. It lacks the adequate expertise and staff to serve as a Sharīʿah advisor for matters concerning Islamic financial transactions (Republic of Uzbekistan, 2021a). Instead, the Muslim Board of Uzbekistan (MBU)—a governing body of Muslim organisations coordinating the activities of Islamic organisations and educational establishments—would be a more appropriate organisation (Muslim Board of Uzbekistan, n.d.; CRA, 2020). Therefore, the MBU could be initially assigned to provide guidance on Sharīʿah matters or recommend candidates as potential advisors for the Sharīʿah board of the entity issuing *ṣukūk*.

A Sharīʿah council or Sharīʿah advisor should be an independent body and must adopt its decisions according to Islamic principles independently. For instance, the capital market legislation of Kyrgyzstan indicates that the Sharīʿah council is an independent body confirming the compliance of the issuance, circulation and redemption of Islamic securities with Islamic finance principles. The council is formed by the requirements of regulatory legal acts of the Government of the Kyrgyz Republic (The Kyrgyz Republic, 2009).

Nonetheless, once Islamic finance makes significant inroads into the country, the regulator may consider the formation of separate Sharīʿah advisory committees responsible for the ICM and IFIs, as seen in countries such as Malaysia. In the case of Malaysia, the Shariah Advisory Committee (SAC) under Bank Negara Malaysia, the Malaysian central bank, supervises the Sharīʿah compliance aspects of deposit-taking institutions, while the Securities Commission Malaysia, a governmental body for the supervision of capital markets, has a separate SAC to oversee the Sharīʿah compliance of Islamic securities. In the Malaysian 'Guidelines on Islamic Capital Market Products and Services', the role of the Sharīʿah advisor includes, among other things, advising on all aspects of ICM products and services. These include ensuring that documentation, structuring, features and investment instruments, are in accordance with Sharīʿah requirements. It, moreover, makes sure that the applicable Sharīʿah rulings, principles and concepts as approved by the SAC are complied with, and applies *ijtihād* (intellectual reasoning) to ensure all aspects of the ICM products and services comply with Sharīʿah (Securities Commission Malaysia, 2022).

As Uzbekistan moves towards adopting Islamic financial market legislation, it can incorporate successful practices of other Muslim countries such as Malaysia, Saudi Arabia, the United Arab Emirates (UAE), Kazakhstan, Bangladesh and Indonesia as recommended by the experts interviewed in this study. These countries' diverse experiences in issuing sovereign, corporate and retail *ṣukūk*, and in developing Islamic funds and indexes, can provide valuable insights for Uzbekistan. For instance, the success of Indonesia with the issuance of retail sovereign *ṣukūk* with a low denomination can also be replicated in Uzbekistan (Danila *et al.*, 2023).

Nonetheless, most experts who took part in the interviews proposed adopting the Malaysian model of ICM regulation. Malaysia, an undisputed leader in the sector, has enacted three Capital Market Masterplans from 2001 until the present. The latest Masterplan 3 (2021–2025) sets comprehensive objectives for sustainability, efficiency and diversification. Securities

Commission Malaysia (2023) issued the 'Maqasid Al-Shariah Guidance for Islamic Capital Market Malaysia', which emphasises the *maqāṣid al-Sharīʿah* (objectives of Islamic law) principles such as justice, benevolence, transparency, flexibility, fiduciary, accessibility and accountability.

Other two Muslim-majority countries that were proposed as role models for Uzbekistan are the UAE and Saudi Arabia. The UAE has longstanding experience in this arena, while Saudi Arabia, despite its recent entrance into it, has quickly become a competitor to Malaysia in *ṣukūk* issuances, thanks to its ambitious strategies. Moreover, some Western countries, such as Luxembourg and the United States, have shown considerable success in issuing *ṣukūk* and developing ICMs, even though other sectors of Islamic finance have not been as prominent in these nations. For instance, in terms of assets managed by Islamic funds, the United States and Luxembourg rank fifth and sixth globally, with USD7 billion and USD4 billion in assets, respectively. Additionally, Luxembourg hosts 145 operating Islamic funds (ICD-Refinitiv, 2022). This observation suggests that all branches of Islamic finance do not need to be fully operational within a country for it to cultivate a thriving ICM industry.

Overall, the lessons and experiences that can be gained from the introduction of an ICM in Uzbekistan are invaluable. Particularly, the experience can be enhanced by experimenting with the issuance of *ṣukūk*, establishing Islamic indexes, and permitting the operation of Islamic funds as some of its neighbours have done. Of greater significance, with minor modifications to the existing financial legislation, Sharīʿah-compliant securities such as *ṣukūk* and shares of Islamic mutual funds could be issued in the country. Such experience can provide the Uzbek government with the necessary exposure and knowledge required for drafting legislation for the full adoption of the Islamic finance industry in the country.

Table 2 summarises the legal challenges facing ICM products in Uzbekistan that are discussed above and provides some of this study's proposed solutions and country practices as a reference.

Table 2: Legal Challenges and Proposed Solutions for the ICM in Uzbekistan

Legal Challenge	Proposed Solution	Reference Practices
Transactions with Islamic financial products are subject to taxation, which could impose an extra burden on the issuance of *ṣukūk* and other securities.	Adjust tax legislation or introduce a separate law to avoid double taxation of Islamic finance transactions.	▪ 2009 Islamic finance law of Kazakhstan allowed for tax exemption of Islamic financial transactions. ▪ Amendments made to the law 'On the Securities Market' of Kyrgyzstan in 2016 allowed for tax exemption of Islamic securities. ▪ Malaysia adjusted laws that govern taxation to accommodate for the smooth operation of Islamic financial transactions: changes made in the Stamp Duty Act 1949, the Real Property Gains Tax Act, 1976, and the Income Tax Act 1967.

Legal Challenge	Proposed Solution	Reference Practices
Frequent changing of the principal capital market regulator and several state authorities having the power to regulate capital markets.	To establish a single independent state agency to regulate the capital markets by enacting it in the country's legislation.	▪ Establishment of the Securities Commission Malaysia by the Securities Commission Malaysia Act 1993. ▪ Securities and Exchange Commission of the United States, which was created under the Securities Exchange Act of 1934.
The legal infrastructure of the capital market in Uzbekistan does not comply with the ICM requirements.	To create a legal framework for the ICM by adopting a special law or adjusting existing laws and financial regulations controlling traditional financial instruments to accommodate the issuance and trading of Islamic securities.	▪ Experience of the UK in adjusting existing laws and rules regulating traditional financial instruments to regulate the ICM. ▪ Passing of 2009 Islamic finance law of Kazakhstan. ▪ Amendments made to the law 'On the Securities Market' of Kyrgyzstan in 2016.
Absence of a special Sharīʿah board that confirms the Sharīʿah compliance of the issuance, circulation, and redemption of Islamic securities.	To establish an independent Sharīʿah board within the capital market regulator.	▪ Amendments to the Securities Law of Kyrgyzstan 2016 provide for the establishment of an independent Shariah Council. ▪ The establishment of an independent Shariah Advisory Council (SAC) within the Securities Commission Malaysia.

Source: Authors' own

CONCLUSION

There is a common assumption that the development of an ICM requires the mandatory presence of other IFIs offering their services and products. However, according to Muneeza (2018), who studied ICM development in Maldives, this assumption does not apply universally. Her analysis showed that an ICM was successfully established in Maldives when only one Islamic bank and one *takāful* company were operating. This indicates that if political will and supporting regulations are in place, the ICM can be established in a country such as Uzbekistan with a relatively nascent and underdeveloped Islamic finance infrastructure.

This study explores the opportunity for introducing the ICM in Uzbekistan and examines the legal hindrances that can prevent its implementation. Accordingly, the researchers conducted interviews with Islamic finance and capital market experts to learn their opinions regarding the awareness of the general public about ICM products, the existence of demand for such products amongst the general public, and possible legal challenges that the ICM can face if it is introduced in Uzbekistan. The majority of the experts interviewed affirmed the presence of a large untapped demand for ICM products and a promising potential for the industry's development despite people's relatively low literacy regarding Islamic finance. Based on this study's analysis of Uzbekistan's capital market regulations and experts' feedback, it can be concluded that the current level of capital market development in Uzbekistan is significantly below its full potential and that the current legal and regulatory infrastructure is not conducive to the integration of the ICM.

To improve the operations of the capital markets and to make them suitable for introducing and expanding the ICM, it is recommended that the relevant parties undertake some essential legal and practical measures. These include the following:

- Introducing adjustments in relevant financial regulations to promote the development of the ICM and independence of its regulator.
- Establishing conducive legal infrastructure for the smooth operation of the ICM industry.
- Adopting best practices from successful reforms of neighbouring countries or other countries with developed ICMs.

Based on the researchers' assessment and recommendations of interviewed experts, Malaysia is the best model to be emulated in developing an ICM framework based on its current legislation, implementation of the capital market masterplan, and Sharīʿah guidelines as compared to other jurisdictions. Uzbekistan could learn from the Malaysian experience in ICM development to establish a viable and competitive ICM industry for the benefit of its Muslim-majority population.

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DECLARATION

Credit Authorship Contribution Statement

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- Ikhtiyorjon Turaboev: Investigation, Writing original draft, Methodology, Formal analysis, Resources.
- Mohd Zakhiri Md. Nor: Formal analysis, Resources, Writing, Review & editing, Visualization.

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Data will be made available on request from the corresponding author.

Appendix

None