



**LEGAL ACCOMMODATION OF ISLAMIC
BANKING IN BOSNIA AND HERZEGOVINA: A
COMPARATIVE APPRAISAL IN THE EUROPEAN
CONTEXT**

BY

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the degree of Doctor of Philosophy in Laws**

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ABSTRACT

The Islamic banking industry in Bosnia and Herzegovina (B&H) is part of the banking sector which has tremendous potential. In order for the industry to be able to prosper in the future, it needs to have an adequate legal framework within which it will operate and by which it will be duly protected. Furthermore, the legal framework for the Islamic banking industry in B&H needs to be devised in the European context since Bosnia is a potential candidate for European Union (EU) membership. The Islamic banking industry in B&H does not have an adequate legal framework, and the only existing Islamic bank in the country operates within the conventional banking framework. In addition, the dispute settlement mechanism for Islamic banking cases is not adequate since the cases are being heard before the civil court judges who do not consider the underlying Islamic nature of the transactions and who lack sufficient knowledge about Islamic banking. The existing Law on Banks of the Federation of Bosnia and Herzegovina (FB&H) limits the application of some very significant Islamic banking products which are normally used by Islamic banks around the world. In the past, there was an attempt to amend the Law on Banks of the FB&H but the amendment has not passed into law. This research offers constructive suggestions for the creation of an adequate legal framework for the Islamic banking industry which would be effectively protected by an adequate dispute settlement mechanism. In order to offer practical solutions for the establishment of the legal framework for the Islamic banking industry in B&H, the researcher has studied the obstacles that the industry, and the amendment of the Law on Banks of the FB&H, are facing in B&H. In that regard, an in-depth analysis of the official letters exchanged by the influential officials locally and internationally about the passing of the amendment to the Law on Banks of the FB&H has been done. Furthermore, this is a comparative research whereby the experience of two countries, the UK and Malaysia, in devising an adequate legal framework for the Islamic banking industry has been analyzed with the intent of applying the relevant experience in the context of B&H. The adequate legal framework for Islamic banking in B&H needs to be in line with three sets of laws, namely, local banking laws i.e. the Law on Banks of the FB&H, EU Directives and policies, and *Shari'ah*. The adequate dispute settlement mechanism for Islamic banking cases in B&H would mean the upholding of the underlying *Shari'ah* principles of the transactions by the civil court judges or the establishment of a commercial tribunal which would specifically deal with Islamic banking disputes. This research is a contribution towards further development of the Islamic banking industry in B&H specifically, and in the EU in general.

خلاصة البحث

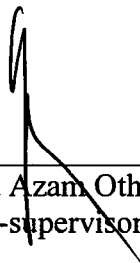
تعتبر المصرفية الإسلامية في البوسنة والمهرسك جزءاً من القطاع المصرفي الذي يزخر بالإمكانات الواعدة. ويتوجب على هذه المصرفية الإسلامية، لضمان ازدهارها المستقبلي، أن تمتلك إطاراً قانونياً مناسباً لتعمل ضمنه وتحت حمايته. كما ينبغي أن يكون هذا الإطار مصاغاً ضمن السياق الأوروبي لأن البوسنة مرشحة لعضوية الاتحاد الأوروبي، وأن يتسق مع القوانين المصرفية المحلية وضوابط وتوجيهات الاتحاد الأوروبي والشريعة الإسلامية. ولا يوجد لدى المصرفية الإسلامية في البوسنة أي إطار قانوني مناسب إذ يعمل المصرف الإسلامي الوحيد ضمن القوانين الناظمة لعمل البنوك التقليدية، كما لا يوجد أي آلية لحل نزاعات القضايا المتعلقة بالمصارف الإسلامية فيتم تسويتها أمام المحاكم المدنية التي قد لا يمتلك قضاتها المعرفة اللازمة بالمصرفية الإسلامية أو لا ينظرون فيها للجانب الإسلامي للتعاملات المصرفية. إن قانون المصارف البوسني الراهن يحد من استخدام العديد من المنتجات المصرفية الإسلامية التي تستخدمها المصارف الإسلامية حول العالم، وقد جرت محاولات لتعديل هذا القانون ولكنها لم تدخل حيز التنفيذ إلى الآن. لذلك يقدم هذا البحث اقتراحات بناءً لإيجاد إطار قانوني مناسب لعمل المصارف الإسلامية وحمايتها ضمن آلية تسوية نزاعات ملائمة. ولتوفير حلول عملية لعملية بناء إطار قانوني للمصرفية الإسلامية في البوسنة، فقد درس الباحث الصعوبات التي تواجه هذا القطاع وتواجه تعديل قانون المصارف البوسني. كما قام الباحث بتحليل عميق للرسائل الرسمية المتبادلة بين المسؤولين التنفيذيين محلياً ودولياً حول تعديل قانون المصارف هذا، وبدراسة مقارنة لتجربة ماليزيا والمملكة المتحدة في صياغة أطر قانونية للمصرفية الإسلامية بغرض تطبيق ثمار هاتين التجربتين في السياق البوسني. لا بد للإطار القانوني للمصرفية الإسلامية في البوسنة أن يتسق مع ثلاثة نظم قانونية هي القانون البوسني المحلي وضوابط وتوجيهات الاتحاد الأوروبي والشريعة. إن آلية تسوية النزاعات لقضايا المصرفية الإسلامية في البوسنة تعني احترام المحاكم المدنية لمبادئ الشريعة المصرفية أو تأسيس محاكم اقتصادية للتعامل مع هذه القضايا. إن هذا البحث إضافة هامة لتطوير المصرفية الإسلامية في البوسنة خصوصاً وفي الاتحاد الأوروبي عموماً نظراً لعضوية البوسنة المحتملة في هذا الاتحاد.

APPROVAL PAGE

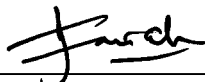
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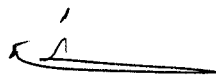


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DECLARATION

I hereby declare that this thesis is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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Signature.....

Date.....23.07.2012

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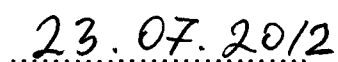
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All praise be to Allah, the Most Compassionate and the Most Merciful; for He is the Best of planners. For without His permission and His guidance, any human is helpless. Hence, I pray to the Almighty that all the efforts devoted for the completion of this thesis; all its future gains to the society at large and all the unrelenting support from the good people and organization out there; for it to be regarded as '*Ibādah* and may all be rewarded with *Jannah*.

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Merger Treaty 1967

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Treaty of Paris 1951

Treaty on European Union 2006

Vienna Convention on Law of Treaties 1969

UK Statutes

Consumer Credit Act 1974

Finance Act 2003

Finance Act 2005

Financial Services and Market Act 2000

Malaysian Statutes

Banking and Financial Institutions Act 1989

Central Bank of Malaysia Act 2009

Civil Law Act 1956

Companies Act 1956
Contract Act 1950
Federal Constitution of Malaysia
Government Investment Act 1983
International Financial Services Board Act 2002
Islamic Banking Act 1983
National Land Code

LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AIBIM	Association of Islamic Banking Institutions Malaysia
B&H	Bosnia and Herzegovina
BAFIA	Banking and Financial Institutions Act 1989
BBA	<i>Bay' Bithaman Ajil</i>
BBI	Bosna Bank International
BCBS	Basel Committee on Banking Supervision
BIMB	Bank Islam Malaysia Berhad
BLME	Bank of London and Middle East
CBBH	Central Bank of Bosnia and Herzegovina
CBMA	Central Bank of Malaysia Act 2009
EC	European Communities
ECB	European Central Bank
EEC	European Economic Community
EIIB	European Investment Islamic Bank
EMI	European Monetary Institute
EMS	Economic Monetary System
EMU	Economic and Monetary Union
EP	European Parliament
ESCB	European System of Central Banks
ESDP	European Security and Defense Police
ESUA	Exchange in Satisfaction and User Agreements
ETFs	Exchange Traded Funds
ETQ	Education, Training and Qualifications
EU	European Union
EUPM	European Union Police Mission
FB&H	Federation of Bosnia and Herzegovina
FMB	Financial Mediation Bureau
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
FSMP	Financial Sector Master Plan
GCC	Gulf Cooperation Council
IBA	Islamic Banking Act 1983
IBB	Islamic Bank of Britain
ICJ	International Court of Justice
ICTY	International Criminal Tribunal for Former Yugoslavia
IFEG	Islamic Finance Experts' Group
IFQ	Islamic Financial Qualification
IFSB	Islamic Financial Services Board
IFSL	International Financial Services London
IICG	Islamic Investment Company of the Gulf
IIMM	Islamic Interbank Money Market
IIFM	International Islamic Financial Market

IMF	International Monetary Fund
IPA	Instrument for Pre-accession Assistance
KLRCA	Kuala Lumpur Regional Centre for Arbitration
MENA	Middle East and North Africa
MIFC	Malaysian International Financial Centre
NPL	Non Performing Loans
OIC	Organization of Islamic Conference
RPM	Reform Process Monitoring
RS	Republic of Srpska
SAA	Stabilization and Association Agreement
SAB	<i>Shari'ah</i> Advisory Board
SAC	<i>Shari'ah</i> Advisory Council
SAP	Stabilization and Association Process
SDLT	Stamp Duty Land Tax
SIB	Securities and Investments Board
UK	United Kingdom
UKTI	UK Trade & Investment
VAT	Value Added Tax
VCLT	Vienna Convention on Law of Treaties 1969
ZAVNOBIH	National Anti-Fascist Council of the Peoples' Liberation of Bosnia and Herzegovina
10 MP	10 th Malaysian Plan

TRANSLITERATION TABLE

Table 1: Consonants

ء	ب	خ	kh	ش	Sh	غ	gh	ن	n
ب	B	د	d	ص	ṣ	ف	f	هـ	h
ت	T	ذ	dh	ـ	ḍ	ق	q	و	w
ث	Th	ـ	r	ط	ṭ	ك	k	ي	y
ج	J	ز	z	ظ	ẓ	ل	l		
ح	h	س	s	ع	ʿ	م	m		

Table 2: Vocalisation Signs

Short Vowels		Long Vowels	
ـ	a	ا + ـ	ā
ـ	i	ي + ـ	ī
ـ	u	و + ـ	ū

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION AND BACKGROUND OF THE STUDY

Bosnia and Herzegovina (B&H) is a country situated in South East Europe in the Western part of the Balkan Peninsula. B&H covers an area of 51.209 km² and its capital city is Sarajevo. The estimated population of B&H, as of 2011 is 4.712.135.¹ The population of B&H is comprised of three major ethnic groups or constituent peoples, namely, Bosniak 48%, Serb 37.1%, and Croat 14.3%. Other minorities are present as well and they altogether comprise 0.6% of the total population of B&H.² Bosniaks who are predominantly Muslim represent the majority of the population of B&H, while the remaining part of population are Serbs who are normally Orthodox Christians, Croats who are mostly Catholic Christians, and minority groups including Jews and Bosnian Roma.

The official independence day of B&H is 1st March 1992 and on that day the B&H officially separated from the Yugoslav Federation. Unfortunately, the cost that it had to pay to get its independence was enormously high. B&H was subjected to terrible aggression from 1992 to 1995. Thousands of people were killed and tortured. Most of the victims were Bosnian Muslims, but other religious groups were targeted as well. The aggression on B&H was driven by hatred towards different ethnic and religious groups. Some of the aggressors have been arrested and prosecuted by the International Criminal Tribunal; some are currently undergoing trial, while some are

¹ See the Thematic Bulletin entitled “*Demography*” published by the Agency for Statistics of Bosnia and Herzegovina, November 2010, Sarajevo.

² This data has been retrieved from the official website of the Central Intelligence Agency (CIA) – The World Fact-Book at <https://www.cia.gov/library/publications/the-world-factbook/geos/bk.html>. Retrieved March 14, 2011.

still fugitives. The aggression was put to an end by the signing of the Dayton Peace Accord in 1995 and this International treaty is also the basis of the Constitution of B&H because the Constitution of B&H makes up Annex 4 of the Dayton Peace Accord. Administratively, B&H has been divided into two main entities, namely Federation of Bosnia and Herzegovina (FB&H) and Republika Srpska (RS). There is also a third component, called District Brcko, which does not belong to any entities and has its own autonomy within the B&H. FB&H consists of 10 cantons consisting of 79 municipalities. RS does not have cantons and it consists of 62 municipalities. The administrative division of B&H is demonstrated in figure 1.1 below.

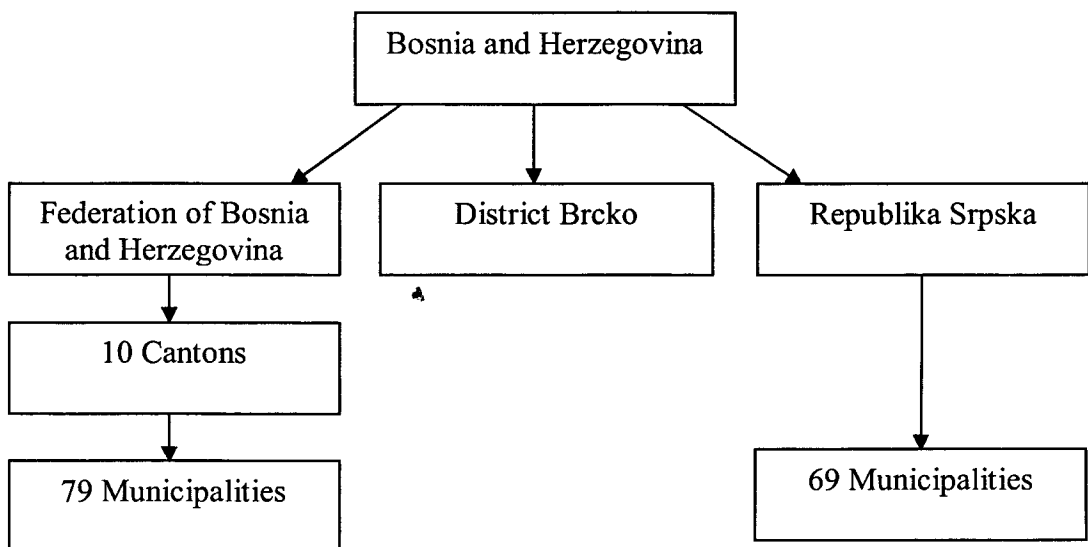


Figure 1.1: Administrative Division of Bosnia and Herzegovina³

Administratively, B&H is a very complex country which needs revision of its administrative structure. This revision is only possible if certain constitutional changes

³ The administrative division of B&H is very complex and is based on the Constitution of B&H. The only way to change the existing structure is through Constitutional reforms. The Constitution of B&H is the highest legal act in the country and it has been adopted as Annex 4 of the Dayton Peace Accord which was essential for ensuring peace in the country. Nevertheless, that Constitution is not really adequate in the current context and the complex administrative structure propounded by it should be reformed. See also Julie Kim, "Bosnia: Overview of Issues Ten Years after Dayton", CRS Report for Congress, Order Code RS 22324, Congressional Research Services, The Library of Congress, November 14, 2005.

are done.⁴ The legal infrastructure in B&H is rather unique due to the division of the country into two major entities. The highest legal Act in B&H is the Constitution of B&H outlining the basic administrative structure of the country. B&H is a Civil Law country governed by written legal acts or statutes. Unlike the Common Law tradition which is familiar with the “doctrine of judicial precedence”, the Civil Law countries, including B&H, do not follow this doctrine. In other words, the cases decided by the courts do not have binding effect on the judges of the lower courts. The main sources of law are various national and entity based Statutes or Codes which have a binding effect on the court.

The structure of the judiciary in B&H follows the administrative division into two Entities and a District Brcko.⁵ Thus, at the Entity level, there are different courts operating in the FB&H and RS, although from the practical point of view their operation and jurisdiction almost completely mirror each other. In FB&H, the lower courts are the Municipal Courts (28 in the FB&H) which have jurisdiction over the less serious matters.⁶ In the RS, the lower courts are called Basic Courts (19 in the RS) and their jurisdiction is the same as the Municipal Courts in the FB&H. In the FB&H, at the cantonal level there are 10 Cantonal Courts whose main jurisdiction is to hear more serious matters and appeals from the municipal courts, while in RS those types of courts are called District Courts (5 in the RS). The highest appellate court in the

⁴ For more information about the necessary constitutional reforms and the efforts directed towards those reforms see Sofia Sebastian, “*Leaving Dayton Behind: Constitutional Reform in Bosnia and Herzegovina*”, 46 Working Paper, Fondacion Para Las Relaciones Internacionales y el Dialogo Exterior (FRIDE), November 2007. Furthermore, the complexity of the circumstances surrounding the constitutional reforms in B&H and the role of the United States and the European Union in mediating the reforms has been discussed by Florian Bieber, “*Constitutional Reform in Bosnia and Herzegovina: Preparing for EU Accession*”, Policy Brief, European Policy Centre, April 2010.

⁵ See L.A. Barria and S.D. Roper, “*Judicial Capacity Building in Bosnia and Herzegovina: Understanding Legal Reform Beyond the Completion Strategy of the ICTY*”, Human Rights Review, DOI 10.1007/s 12142-007-0052-0, Springer Science + Media Business B.V. 2007.

⁶ For information about the general overview of the judicial system of B&H see the Judicial Portal of B&H at <http://www.pravosudje.ba/>.

FB&H is the Supreme Court of the FB&H which hears appeals from the Cantonal Courts and resolves disputes over jurisdictional matters between the Cantonal and Municipal courts which have not been expressly stated by the law.⁷ The parallel court in the RS is the Supreme Court of the RS.⁸ All the Statutes and regulations must be consistent with the Constitution. Any inconsistency with the constitution will be referred to the Constitutional Court of the FB&H,⁹ which has exclusive jurisdiction to decide on the inconsistency of the laws with the Constitution. In this manner, human rights and the basic democratic values of the state are preserved and guaranteed. In the RS there is the same type of court called the Constitutional Court of the RS.¹⁰ In the RS there are also Commercial Courts (5 in the RS) and one Higher Commercial Court.¹¹ The autonomous District of Brcko has only two types of court, one Basic Court and one Appellate Court.

At the state level, there is the Constitutional Court and the State Court of B&H. The Constitutional Court is entrusted with the duty of upholding and protecting the Constitution of B&H.¹² On the other hand, the State Court, or the Court of B&H, has been established primarily to protect matters that under the Constitution of B&H fall under the jurisdiction of the Court of B&H such as; terrorism, war crimes, human

⁷ For further information about the Supreme Court of the FB&H see its official website at <http://www.vsfbih.ba/index.php?lokacija=strane&otac=&id=2>.

⁸ For further information about the Supreme Court of the RS see its official website at <http://www.vrhovnisudrs.com/>.

⁹ For further information about the Constitutional Court of the FB&H see its official website at <http://www.ustavnisudfbih.ba/bos/index.html>.

¹⁰ For further information about the Constitutional Court of the RS see its official website at <http://www.ustavnisud.org/Default.aspx?lang=bos>.

¹¹ The Commercial Courts in RS commenced operation on May 1, 2010 and one of the main reasons for their establishment is to clear the backlog of cases and release the money that used to be frozen due to the judicial process into the economy. For further information see the news article entitled "*U Republici Srpskoj velika ocekivanja od privrednih sudova*" [In Republika Srpska huge expectations from the Commercial Courts], April 10, 2010, Beta. Retrieved March 16, 2011 http://www.pravobih.com/index.php?option=com_content&view=article&id=105:u-republici-srpskoj-velika-oekivanja-od-privrednih-sudova&catid=1:nove-vijesti&Itemid=53.

¹² For further information about the Constitutional Court of B&H see its official website at <http://www.ccbh.ba/eng/>.