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THE RISE OF ISLAMIC FINANCE IN THE CEMAC ZONE

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Islamic finance is part of the Islamic economy (or "Islamic economic doctrine"), an economic doctrine that is distinguished by its own value system, in the same way as capitalism, communism and socialism. The value system of Islamic finance, for example, is based on the need to avoid what is prohibited, on a balance between self-interest and public interest, and on the values of fairness, transparency and sincerity. These values are of paramount importance and must be reflected in actions and transactions, making Islamic finance, above all, an ethical finance[1].

Islamic finance, which is open to all faiths, refers to all financial services and products implemented in accordance with the principles of *Sharia law*[2], the main source of which is the Koran[3] and the *Sunna*[4]. According to the doctrine, there are five (05) cardinal principles of Islamic finance, including three (03) prohibitions and two (02) obligations:

- Prohibition of interest and usury: in Islamic finance, these two notions refer equally to the same concept, that of *riba*;
- Prohibition of uncertainty (*gharar*) and speculation: transactions whose counter value is not accurately known, those involving excessive risk or those whose outcome depends essentially on chance are prohibited (gambling, traditional insurance contracts, etc.);
- Prohibition on investing in illegal (*haram)* activities: these include the alcohol and tobacco industries, the pork industry, armament, pornography, gambling, etc.;
- Obligation to share profits and losses: known as the "Three Ps Principle", it implies a perpetual quest for fairness in business. No single party can assume all the risk associated with a transaction;
- Requirement to be backed by a tangible asset: all transactions must be backed by real, exchangeable assets. This principle, combined with the prohibition of uncertainty, means that derivatives, for example, are prohibited.

Generally speaking, Islamic financial institutions have a *Sharia Board*, a committee of religious advisers who give their opinion on the acceptability of new financial instruments and who carry out audits to ensure that the activities carried out and the products offered comply with the above-mentioned principles.

Over the past two decades, Islamic finance has experienced one of the most interesting developments in the history of the global financial system, to the extent that the market for institutions specializing in Islamic finance, once confined to the Muslim world, is now expanding at the international level.

[1] W. Mzid, La finance islamique: principes fondamentaux et apports potentiels dans le financement de la croissance et du développement.
[2] Islamic law.
[3] The Muslim holy book.
[4] The collection of the sayings of the Prophet Mohamed.

It is in this respect that the African financial system, largely dominated by traditional or conventional banks, is gradually expanding thanks to innovations such as mobile banking, but also thanks to the new tools of Islamic finance, which is a real alternative for economic operators wishing to diversify their sources of financing.

Islamic finance also offers a range of financial products that are fair and equitable, and therefore better suited to a local population whose investment capacity does not yet allow them to bear the risks inherent in conventional financing, especially in a continent where the rate of bank penetration is still low. In addition to contributing to financial inclusion, Islamic finance can also be a factor in sustainable development, insofar as it encourages investment in sectors deemed licit by Islam, and promotes a better distribution of wealth through more responsible risk management.

Nevertheless, as Bandar Mohamed Hajjar, Former President of the Islamic Development Bank (IDB) Group, pointed out, "*Islamic finance needs a regulatory framework that is conducive to its development [...]*"[5].

With this in mind, the IDB has developed partnerships with various institutions, in particular the BCEAO[6], to which it has offered Islamic finance training programs, and which now has a significant lead over the BEAC[7]. The clear difference in the number of *sukuks*[8] issued in each of the sub-regions is a perfect illustration of this. Imbued by the boom in this activity in the UEMOA zone[9], some institutions in the CEMAC[10] zone have embarked on Islamic finance, thereby inspiring the legislator, as in the past with electronic money, to establish a legal framework a posteriori for its sub-region.

Thus, while the establishment of Islamic finance in the CEMAC region deserves to be analyzed in terms of the regulatory framework put in place by the legislator and the objectives of such an initiative, it would be inappropriate not to consider the scope of the implementation of Islamic finance, which is based on the challenges to be met and the prospects.

I. The introduction of Islamic finance in the CEMAC zone

A. Regulatory framework

Islamic finance in the CEMAC zone is governed by three (03) main regulations (hereinafter the "**Regulations**"): Regulation No. 04/22/CEMAC/UMAC/COBAC of 9 November 2022 relating to the conditions of exercise and control of the activity of Islamic finance within the CEMAC (the "**CEMAC Regulation on Islamic Finance**"), Regulation No. 01/22/CEMAC/UMAC/CM/COSUMAF of 21 July 2022 on the organization and operation of the Central African financial market (the "**COSUMAF Financial Market Regulation**"), and the recent COSUMAF General Regulation of 23 May 2023 (the "**COSUMAF General Regulation**").

[5] A. Oury Diallo, Bandar Mohamed Hajjar: « *La finance islamique a besoin d'un cadre propice à son développement* », Jeune Afrique, Dakar, 2018.
[6] Central Bank of West African States.
[7] Bank of Central African States.
[8] Islamic equivalent of bonds.
[9] West African Economic and Monetary Union.
[10] Economic and Monetary Community of Central Africa.

In this respect, the Regulations (1) provide a framework for the organization and operation of Islamic financial institutions, (2) define Islamic finance products and services and (3) establish an Islamic window within FOGADAC[11].

1. **Organization and operation of Islamic financial institutions**

According to Article 3 of the CEMAC Regulation on Islamic Finance, "*Islamic finance activity means all products, services, transactions and commercial, financial and investment operations marketed or carried out on a regular basis by a reporting institution, based on the following principles: prohibition of uncertainty and speculation, prohibition of investment in illicit activities, backing by tangible assets, sharing of profits and losses*". It therefore appears that the CEMAC legislator has merely defined the concept of Islamic finance as it is perceived in various other jurisdictions around the world.

Nevertheless, it should be noted that it has not refrained from entrusting the exclusive exercise of this activity to credit or microfinance institutions, as specified in Article 1(8) and reiterated in Article 2(2), which may exercise it on an exclusive or partial basis[12].

In the first case, the legislator requires prior authorization from the National Monetary Authority[13] for the institution and its managers and auditors[14], issued after the COBAC has given its assent[15], whereas the partial exercise of an Islamic finance activity by a reporting institution is carried out by means of a dedicated structure: the Islamic window. The opening of the latter "*is subject to the prior authorization by the COBAC*" under the conditions and according to the procedures laid down by COBAC regulations. However, we are entitled to question the real effectiveness of this mechanism.

Islamic windows within conventional banks could conflict with non-compliant operations conducted by the same institutions. This raises the question of the purity of funding sources and the risk of mixing compliant and non-compliant transactions.

By allowing both credit and microfinance institutions to carry out Islamic finance activities, the legislator is encouraging a diversity of players in the market. This could potentially stimulate competition and offer consumers greater choice in terms of *Sharia-compliant* financial services.

Also, opening up the Islamic finance business to microfinance institutions could help promote financial inclusion, by giving access to *Sharia-compliant* products and services to populations that may not be served by large financial institutions.

On the other hand, some might criticize this choice by questioning whether credit and microfinance institutions have the expertise to provide Islamic finance products and services appropriately. Islamic finance is complex and requires a thorough understanding of *Sharia* principles to avoid non-compliant practices.

[11] Deposit Guarantee Fund of Central Africa.
[12] Article 7 of the CEMAC Regulation on Islamic Finance.
[13] This is the Minister responsible for currency and credit in the country where the company is based.
[14] The conditions and procedures for obtaining such authorization are set out in Regulation No. 02/15/CEMAC/UMAC/COBAC amending and supplementing certain conditions relating to the exercise of the banking profession within the CEMAC and its subsequent texts for credit institutions and Regulation No. 01/17/CEMAC/UMAC/COBAC relating to the exercise of supervision of microfinance activity in CEMAC and its subsequent texts applicable to microfinance institutions.
[15] Banking Commission for Central Africa.

In an attempt to answer this question, the CEMAC Regulation on Islamic Finance requires Islamic financial institutions to set up a compliance committee responsible for ruling on the legality of Islamic finance transactions. The conditions of organization and operation of the compliance committee are set by COBAC regulation. The opinion of the compliance committee on the exercise of an Islamic finance activity is given in the form of a certificate of compliance for operations, the form and conditions of issue of which are set by COBAC regulation.

2. Islamic finance products and services

In any event, the CEMAC Regulation on Islamic Finance authorizes several Islamic finance products and services. In particular, they distinguish between products and services based on the transfer of ownership (*mourabaha*, *moussawama, ijara*, *salam* and *istisnaa*), and products and services based on the sharing of profits and losses (*moudaraba* and *moucharaka*). The content of each product is developed in Article 4 of the CEMAC Regulation on Islamic Finance. In addition, the said regulation provides for the possibility for reporting institutions to collect funds from their customers through Islamic demand deposits and Islamic investment accounts.

The marketing of these Islamic finance products will undoubtedly present a challenge in terms of interpretation for the competent courts in the OHADA zone, in the event of disputes. For example, the principle of loss sharing in certain Islamic finance products may present a contradiction with the traditional notion of limited liability in company law. This contradiction arises from the fundamental differences between these two approaches as regards the allocation of risks and liabilities between the contracting parties.

In Islamic finance, profit and loss sharing products, such as *Mudaraba* and *Musharaka*, are based on the concept of cooperation and equitable sharing of risks and returns between the parties. When losses occur in a transaction, all participants, including the financial institution, can assume a proportionate share of those losses. This approach stems from the ethical principles of the *Sharia*, which emphasize solidarity and collective responsibility.

On the other hand, the concept of limited liability in civil law implies that partners or parties to a business (particularly limited companies such as public limited companies) are only liable for losses up to the amount of their initial contribution or commitment. This means that their personal liability is limited and does not extend beyond their initial investment in the business.

The contradiction between these two approaches lies in the fact that the profit and loss sharing products of Islamic finance imply shared and extended liability for losses, whereas limited liability limits the liability of the parties to their financial contributions. This contradiction can be seen as a challenge in legal systems where these two approaches coexist, as it can lead to divergent interpretations of contractual obligations and liabilities.

Moreover, the products and activities listed above are not the only ones that may fall within the scope of Islamic finance. In fact, according to Article 6 of the COSUMAF Financial Market Regulation, Islamic finance is authorized to issue *sukuks* and similar financial securities within the meaning of the said Regulation. *Sukuks* are Islamic financial instruments which represent a share of ownership in an underlying asset or project. They therefore give their holders claim rights to the income generated by the underlying asset or project, as well as rights to participate in profits and losses.

The conditions of issue, technical characteristics and rights conferred by *sukuks* are set out in the COSUMAF Instruction[16].

3. FOGADAC's Islamic window

Finally, the CEMAC Regulation on Islamic Finance creates a compartment dedicated to Islamic finance within FOGADAC, which is the fund responsible for compensating savers in the event of unavailability of their deposits with financial institutions in CEMAC and for providing assistance to institutions carrying out Islamic finance activities whose situation gives rise to fears of total or partial unavailability of deposits or repayable funds[17].

COBAC and the Central Bank continue to act as regulators for Islamic financial institutions in the CEMAC zone, exercising their functions in the same way as for credit institutions or traditional microfinance institutions.

The CEMAC Regulation on Islamic Finance sets out the terms and conditions for the funding, management and operation of the sub-fund dedicated to Islamic finance.

The Regulation provides in particular that the compartment dedicated to Islamic finance is funded by a specific contribution levied on deposits collected by financial institutions involved in Islamic finance that the compartment dedicated to Islamic finance is managed by a specific committee made up of representatives of the financial institutions concerned, the COBAC and FOGADAC, and that the compartment dedicated to Islamic finance operates under the same conditions and limits as the general compartment of FOGADAC.

B. Objectives

The definition of the regulatory contours of Islamic finance in the CEMAC zone is motivated by the pursuit of several objectives, namely (1) the harmonization of the legal framework, (2) the securitization of activities, and (3) the promotion of Islamic finance in the sub-region.

1. Harmonization of the legal framework

The regulation of Islamic finance in the CEMAC zone aims to establish common rules applicable to financial institutions carrying out Islamic finance activities in this zone, whether they are institutions exclusively dedicated to this activity or institutions that open an “Islamic window” within their conventional activity.

This framework is of vital importance as it also aims to ensure compliance with the principles of Islamic finance, given that the authorization of credit and microfinance institutions to carry out Islamic finance activities could potentially create situations of unfair competition if some players do not properly comply with *Sharia* principles, while others do.

2. Making business safer

The CEMAC Regulation on Islamic Finance aims to ensure that Islamic finance operations comply with international standards and *Sharia* principles.

[16] Article 186 of the COSUMAF General Regulation.
[17] Article 16 of the CEMAC Regulation on Islamic Finance.

In particular, the Regulation requires the financial institutions concerned to set up a compliance committee responsible for ruling on the legality of Islamic finance transactions[18]. It also provides for the creation of a compartment dedicated to Islamic finance within FOGADAC, in order to protect savers in the event of their deposits becoming unavailable[19].

3. Promoting Islamic finance

The above-mentioned harmonization facilitates the movement of capital and investments between different countries, thereby contributing to the growth and stability of the international financial system.

II. The scope of the implementation of Islamic finance in the CEMAC zone

A. Challenges to effective implementation

To be effective and efficient, the implementation of Islamic finance in the sub-region faces several challenges.

1. The challenge of adapting tax and accounting law to the specific nature of Islamic finance transactions

The aim is not only to ensure that Islamic financial transactions comply with national and international tax and accounting standards, but also to recognize the special features of these transactions compared with conventional transactions.

To meet this challenge, it is necessary to develop a tax and accounting framework adapted to Islamic finance in the CEMAC zone. In particular, it is necessary to harmonize the tax rules applicable to Islamic financial products and services within member countries, in order to avoid double taxation or distortions of competition. It is also necessary to adapt accounting standards to the specificities of Islamic financial operations, taking into account the recommendations of international bodies such as the Islamic Accounting Standards Board (organ of the AAOIFI[20]). Finally, there is a need to build the capacity of players in the sector, both in terms of technical skills and knowledge of *Sharia* principles.

These transactions often involve successive transfers of ownership or income splitting, which may result in double taxation or non-recognition of costs and assets. It is therefore important to harmonize and clarify the tax and accounting rules applicable to Islamic finance in the region, taking into account international standards and *Sharia* principles.

[18] Article 13 of the CEMAC Regulation on Islamic Finance.
[19] Article 16 of the CEMAC Regulation on Islamic Finance.
[20] Accounting and Auditing Organization for Islamic Financial Institutions. It is the organization in charge of developing and publishing standards in various areas such as auditing, corporate governance, accounting, codes of conduct and compliance with the Sharia principles.

2. The challenge of training of market players and raising their awareness of Islamic finance

The aim is to enhance the skills and knowledge of financial institutions, regulators, auditors, lawyers, academics, the media and the general public about the concepts, products, risks and opportunities of Islamic finance.

As well as offering customers a varied range of products tailored to their needs and expectations, it is also crucial to stand out from the competition with conventional finance.

There is also a need to raise awareness and educate potential customers about the benefits and features of Islamic finance, as well as to strengthen cooperation and coordination between the various stakeholders, including regulators, financial institutions, standardization bodies and certification bodies.

3. The challenge of diversification and innovation

The aim is to meet the varied and growing needs of potential customers, whether individuals, businesses, local authorities or governments. It is also about developing instruments tailored to the financing of strategic sectors for the region's development, such as agriculture, energy, infrastructure and digital technology.

Furthermore, in order to foster regional cooperation and integration through Islamic finance, it is important to create synergies between market players.

The challenge of diversifying and innovating Islamic finance products and services in the CEMAC zone is therefore of paramount importance. The aim is not only to offer customers a varied range of products tailored to their needs and expectations, but also to stand out from the competition with conventional finance. To meet this challenge, we need to develop innovative products and services that exploit the potential offered by new technologies, particularly digital technologies. These innovations can enhance the efficiency, transparency and traceability of Islamic financial transactions.

B. Prospects for the implementation of Islamic finance in the CEMAC zone

The effective implementation of the CEMAC Regulation on Islamic Finance opens up promising prospects for the development of the financial sector and the sub-regional economy.

1. Promising financial inclusion

Financial inclusion can be defined as the provision of basic, low-cost financial and banking services specifically for people who are poor and/or in financial difficulty, and therefore excludes traditional services. Islamic finance offers financial products and services that respect *Sharia* principles as outlined above. These products and services can meet the needs and expectations of customers seeking access to financial services in line with their religious or ethical beliefs.

Moreover, Islamic finance in the CEMAC zone can also contribute to the financial inclusion of poor, rural or informal populations, who are often excluded from the conventional banking system. For example, Islamic microcredit can enable micro-entrepreneurs to access finance without having to pay interest that is often prohibitive.

In addition, Islamic finance can encourage the financing of productive sectors, such as agriculture or SMEs, by linking the financing to a real asset and sharing the risks with the beneficiaries.

2. **Greater financial stability**

The introduction of FOGADAC's Islamic window makes it easier to compensate savers if their deposits become unavailable in the context of Islamic finance.

Islamic finance can strengthen financial stability in the CEMAC zone by diversifying sources of financing and reducing systemic risks. Based on the link between finance and the real economy, it limits recourse to excessive debt and speculation. In addition, Islamic finance promotes risk sharing between stakeholders. Finally, Islamic finance incorporates ethical and social principles, which strengthens the confidence of economic agents and the social responsibility of financial institutions.

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