

## The Malta case: distributed ledger technologies (dlts) and Islamic commercial law in the European union. A European controversy.

## El caso de Malta: nuevas tecnologías distribuidas y el derecho comercial islámico. Una controversia europea.

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**Abstract:** The Shari'a Law has a comprehensive vision of all human activities, including commerce. The peculiarities of the commercial legal system that derives from the legal principles of Shari'a emanates from the concepts of forbidden or Haram and permissible or Halal. These principles are applied today to breakthrough commercial developments such as the Blockchain/Digital Ledger Technologies. On the other hand, there is a growing debate about the possibility of the application of Shari'a Law in the Member States of the European Union, either for social reasons or for commercial reasons. The controversy and opportunities created in the smallest State of the Union, Malta, serves as a sample.

**Keywords:** Law, Shari'a, Commerce, Blockchain, Digital Ledger Technologies, Malta.

**Resumen:** La Ley islámica o Shari'a tiene una visión total de las actividades humanas, incluyendo las comerciales. Las peculiaridades del sistema legal comercial que se deriva de los principios legales de la Shari'a emana de los conceptos prohibido o Haram y permitido o Halal. Estos principios se aplican hoy en día a novedades como el Blockchain/Digital Ledger Technologies. Por otro lado, hay un debate cada vez mayor sobre la posibilidad de la aplicación de la ley Shari'a en los Estados Miembros de la Unión Europea, ya sea por motivos sociales o de interés comercial. La controversia creada en el Estado más pequeño de la Unión, Malta, sirve como muestra.

**Palabras clave:** Ley, Comercio, Shari'a, Blockchain, Malta.

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## **1. INTRODUCTION TO THE SHARI‘A LAW COMMERCIAL PRINCIPLES: HALAL, HARAM, CERTIFICATIONS ISSUES, BLOCKS CHAIN AND SHARI‘A LAW.**

The Shari‘a Law has a comprehensive vision of all human activities, including commerce. The peculiarities of the commercial legal system that derives from the legal principles of Shari‘a emanates from the concepts of forbidden or Haram and permissible or Halal. These principles are applied today to breakthrough commercial developments such as the Blockchain. On the other hand, there is a growing debate about the possibility of the application of Shari‘a Law in the Member States of the European Union, either for social reasons or for commercial reasons. The controversy created in the smallest State of the Union, Malta, serves as a sample.

### **1.1 Commercial possibilities and applications of the Shari‘a Law**

### **1.2. Pockets of law controversy: Towards a dual legal principle?**

The Baron Rowan Williams, at the time being the Archbishop of Canterbury, delivered a lecture at the Royal Courts of Justice on the 7<sup>th</sup> February 2008, on a series of public discussions on the nature of Islam in English Law. It was a lecture based on whether or not the British Legal System should allow Courts following the principles of religious laws such as the Islamic Shari‘a Law to decide in matters related to family law (Williams. 2008). The issue raised a general social polemic, with general media such as The Guardian or the BBC showing a wave of articles and opinions about the matter. Great Britain is a secular country with a sizeable Muslim population in excess of three million people according to the (British) Office for National Statistics (Various. 2018). In view of such reality the Baron Rowan Williams in his lecture “*sought carefully to explore the limits of a unitary and secular legal system in the presence of an increasingly plural (including religiously plural) society and to see how such a unitary system might be able to accommodate religious claim*” (AOC, 2013 ). The concept of other legal forms having a saying of our reality was outed with a considerable controversy about it (Sánchez-Bayón, 2012 & 2016).

### 1.3. The Shari‘a Law and the new commercial realities: the Blockchain/Digital Ledger Technologies example

In order to better understand the potential reach of the commercial Islamic reality it would be necessary to note a simple fact: According to Thomson Reuters' projections, Islamic finance assets are projected to grow to \$3.2 trillion by 2020 (Arabianbusiness. 2018).

New commercial and financial realities are coming into the light (Sánchez-Bayón, 2017 & 2019). A finest example would be the Digital Ledger Technologies, also popularly known as the Blockchain. For the purpose of this paper we will be referring to the Digital Ledger Technologies as there is mainly a misconception in thinking one and the other are the same. The Blockchain in one of the forms of the Digital Ledger Technologies “*The most important difference to remember is that blockchain is just one type of distributed ledger. Although blockchain is a sequence of blocks, distributed ledgers do not require such a chain. Furthermore, distributed ledgers do not need proof of work and offer – theoretically – better scaling options*” (Tradeix. 2019/)

A Ledger is “*a book containing accounts to which debits and credits are posted from books of original entry*” (Merriam-Webster. 2019 ). All kinds of commercial information can be contained in Ledger. A distributed ledger refers to the ways these Ledger recordings are kept. It is a P2P (*Peer-to-Peer*) technology how these recordings are kept. The *Peer-to-Peer* or *P2P* is a network in which computers share data directly with each other without the need of a central server. Any changes to the ledger are reflected in all the P2P copies in minutes, or in some cases, seconds. The records that are preserved can be of financial, legal, physical or electronic nature.

Algorithms enable the creation of distributed ledgers as they provide an effective way to organize the records or the information. Encryption scrambles the records to make them unreadable by anyone other than those with the keys to decode them. Encryption allows a security layer to the system and the records are protected by hashing/encryption means. This way to keep and certify commercial data is a disruptive innovation with the potential to transform the delivery of commercial services and to boost commercial productivity through a wide range of applications. Ledgers have been essential to commerce since the beginning of recorded History and they can be used to record assets such as money and property among others. As the British Government Office for Science points out: “*They have moved*

*from being recorded on clay tablets to papyrus, vellum and paper. However, in all this time the only notable innovation has been computerisation, which initially was simply a transfer from paper to bytes. Now, for the first-time algorithms enable the collaborative creation of digital distributed ledgers with properties and capabilities that go far beyond traditional paper-based ledgers”* (Various. 2016).

In commerce the Digital Ledger Technologies will bring protecting critical infrastructure against cyberattacks, reducing operational costs, offer better transparency, traceability and better financial inclusion, better ways to know how money is used and spent .They will be creating opportunities for economic growth, bolstering SMEs and increasing employment and reducing tax fraud (Various. 2016. “Distributed Ledger Technology: beyond block chain” The British Government Office for Science ). However, they are currently mainly known by the Bitcoin and fellow P2P cash cryptocurrencies phenomenon.

The Shari‘a Law is of comprehensive nature and as M. Zahraa defines it: *“Islamic Law, in its simplest definition, is the Corpus of rules and principles derived from the Quran and Sunnah and aimed to regulating the spiritual as well as temporal of Muslims in their relationship with God, with each other and with non-Muslims. Amongst the main characteristics of Islamic Law are its divine source, comprehensive nature and flexibility”* (Zahraa. 2000). Therefore, the limits of the Shari‘a Law also include temporal, thus commercial matters. And the Digital Ledger Technologies and the cryptocurrencies are not strangers to this fact.

A basic concept that one would need to address when referring to the Shari‘a Law is the concept of *Halal* and the opposite concept of *Haram*. According to the Halal Research Council *“halal is an Arabic word meaning lawful. It refers to the things, actions and processes permitted by Islamic Shari‘a Law without punishment imposed on the doer. It is usually used to describe something that a Muslim is permitted to engage in. The opposite of halal is haram, which in Arabic is used for unlawful or prohibited”* (Halalrc. 2019).

Main principles of Islamic finance include: The prohibition of taking or receiving interest. Also, Capital must have a social and ethical purpose beyond pure, unfettered return. In Shari‘a Law, Investments in businesses dealing with alcohol, gambling, drugs or anything else that the Shari‘a considers unlawful are deemed undesirable and prohibited (*Haram*). There is also a prohibition on transactions involving *Maysir* (speculation

or gambling) and a prohibition on *Gharar*, or uncertainty about the subject-matter and terms of contracts – this includes a prohibition on selling something that one does not own (Elasrag. 2019).

Several authors have considered if such new technologies as the DLTs are thus *Halal* or *Haram*. This has been quite a debate specially regarding the cryptocurrencies in the surge of their popularity three years ago. The strict Shari‘a Law rules where money is concerned have been interpreted to support both parties’ arguments. The Muslim faith prohibits practices like lending for profit on interest, in addition to currencies that are not backed by anything of tangible value: “*Money can be everything which is used as a medium of exchange - whether it is gold, silver, flower petals, skin, paper, etc. - if it is generally accepted among the people (Al-Mausuah, Al-Fiqhiyah, Al-Kuwaitiyah)... Shari‘a emphasizes to treat money just for its basic purpose (i.e. as medium of exchange and measure of value)*” (Abu-Bakar. 2018)

The concept was mainly raised regarding the restricting Bitcoin and other cryptocurrencies vision of the DLTs. In such a view, Islamic Scholars have recently deemed the Bitcoin to be Halal: “*In Germany, Bitcoin is recognized as a legal currency and therefore qualifies as Islamic money in Germany. In countries such as the US, Bitcoin lacks official legal monetary status but is accepted for payment at a variety of merchants, and therefore qualifies as Islamic customary money*” (Abu-Bakar. 2018).

Other popular forms of DLTs such as digital assets, digital identity, notary services, compliance and audit, taxation, voting, record management, smart contracts, supply chains for the *Halal* food, cosmetics, hospitality and drugs industries (Drescher. 2017) are also subject to controversy. Likewise, several Financial Islamic concepts are able to enjoy the characteristics of the DLTs. Notably, we may mention the possibility of the collection of the charitable *Zakat*, that has been institutionalized in many Muslim countries. The beneficiaries of *Zakat* consist of eight categories including poor and needy. “*The amount of Zakat is calculated at 2.5% of liquid assets held for at least a full year: gold, silver, cash, savings, investments, rent income, business merchandise or profits, shares, securities, and bonds all qualify as part of the calculation. Since cryptocurrency like Bitcoin qualifies as a liquid asset, Muslim Blockchain made the process trackable, auditable, and immutable, all of which are essential qualities of any successful charitable raise*”. Another charitable institution, the *Waqf*, is also

compared with the concept of Blockchain as it is gifts that are immutable and aren't owned by a particular entity. The closer Western equivalent would be that of the Trust, but in Allah's name. As in the Trust the right to specify the conditions for the *Waqf* can be specified, and the asset or properties cannot be sold, distributed, traded or inherited. A *Waqf* Chain allows participants to create project proposals to develop the endowment of properties. Other Islamic institution that may be subjected to the advantages of the DLTs is the *Takaful* (Islamic Insurance): By moving insurance claims onto an immutable blockchain ledger can help eliminate common sources of fraud in the insurance industry. The *Sukuk* or Islamic Bonds can also be DLTed as a smart *Sukuk* uses Ethereum blockchain smart contracts in order to strengthen the efficiency and make it a globally acceptable *Sukuk* (Elasrag, 2019).

These possibilities show the potential for a fringe Shari'a financial law and how this is being implemented on a practical basis in Western positive law countries such as an EU Member State: Malta.

## **2. EU MEMBER STATE'S CASE: THE REPUBLIC OF MALTA DLT'S ENVIRONMENT AND THE SHARI'A LAW.**

Malta has been a Member State of the European Union since the 1<sup>st</sup> of May of 2004 (12003T/PRO/03. *Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded - Protocol No 3 on the sovereign base areas of the United Kingdom of Great Britain and Northern Ireland in Cyprus* . Official Journal L 236, 23/09/2003 P. 0940 – 944). Furthermore, Malta is a Schengen Treaty signatory and it has been accepted in the euro since 2004 and fully adopted it in 2008 (Europa.eu. 2008). The most important sectors of Malta's economy in 2016 were wholesale and retail trade, transport, accommodation and food services (20.9 %), public administration, defence, education, human health and social work activities (17.7 %) and Professional, scientific and technical activities; administrative and support service activities (12.7 %) (Europa.eu. 2008).

Malta and the DLTs and the cryptocurrencies: Malta is one of the countries spearheading the DLTs as it has recently, July 2018, passed

advanced legislation on the subject. These acts are: The Malta Digital Innovation Authority Act or MDIA, the Innovative Technologies Arrangements and Services Act or ITAS and the Virtual Financial Assets Act or VFA. They are collectively known as the Digital Innovation Framework. The Malta legislation already considers four categories of DLT Assets: Electronic money, financial instruments, virtual tokens and virtual financial assets. The movement pro DLTs is not only supported by this sophisticated legislation but also by social organizations such as BitMalta, the Malta Blockchain Organization, the Blockchain Research Group of the University of Malta, the Malta Information Technology Agency or MITA or the YouStart IT Accelerator platform (Falzon and Valenzis. 2019).

Regarding the Shari'a Law, the Malta Islamic Finance Association (MIFA) has been recently backed by the Maltese Government (The Independent Malta. 2018). The President of the MIFA, Sheik Bilal Kahn also commented that in the view of Malta being a pioneer in economic innovation so as to Malta developing into an Islamic Finance hub (erremme.com.2018) calling also Malta the Blockchain Island.

Furthermore in October 2018 at the Delta summit, Alberto G. Brugnoli, founder and managing partner of ASSAIF (*Associane per le Sviluppo di Strinenti Alternativi e di Innovazione Finanziaria*) (ASSAIF.2019) lectured in a panel at the Delta Summit 2018 talking about Islamic finance and fintechs. At the panel entitled "*Islamic Finance and Blockchain*" it was announced that a committee is already evaluating various Islamic finance products that can be made accessible through blockchain technology and regulated under Maltese Law (Timesofmalta.2018). The project is being developed by the Malta Islamic Finance Association (MIFA) and ASSAIF Italia who envisage the reduction in costs for subscribing to the various financing contracts such as *Murabaha* ("*Murabaha* is a form of sale where the cost of the goods to be sold as well as the profit on the sale is known to both parties"), *Mudarabah* ("The term refers to a form of business contract in which one party brings capital and the other personal effort.") and *Musharakah* ("*Musharakah* is a joint enterprise or partnership structure in Islamic finance in which partners share in the profits and losses of an enterprise.") using DLTs.

Another interesting project around DLTs and Shari'a Law taking place in Malta is the *Huulk Project* by OneGram: a crypto exchange that is Shari'a compliant. This crypto exchange is headed to Malta and is

currently on the lookout for the necessary licenses to fully operate. This platform plans to secure more partnerships across Europe according to their CEO, Ibrahim Mohammed.

These projects are just relevant simples of the thriving activity taking place in Malta around the concept of Shari‘a Law and DLTs.

### 3. CONCLUSIONS

The Shari‘a Law has a vocation for a comprehensive reach of reality, including the latest financial ones. There is a growing influence of the Muslim culture and the point of view of the interconnected cultural, ethical and legal values of the Shari‘a Law are a force to be taken into account not only in Islamic countries but also in Western societies with Legal systems based on the Positive Law.

The situation allows for new technologies such as the DLTs to be considered *Halal* or permissible under the Shari‘a compliant finances and it has the potential to become an accepted element in international financial transactions. These new financial and commercial technologies will target the issues of inefficiency, security and lack of transparency as to tremendously improve the different financial issues covered by the Shari‘a Law in terms of how funds are managed and distributed.

The moral and ethical aspects of the Islamic Law offer an additional chance to an understanding of business and finance that spreads beyond the Arab and/or Islamic world and that will have a profound impact on the financial reality needed to sustain economic and social progress.

Malta seems to be finding the right balance between new technologies and old legal realities as the Shari‘a Law. Bearing in mind what the DLTs are particularly good at Malta is creating a Halal blockchain environment that is attracting relevant players of this technologies and encouraging the creation of a new playground. This is creating an environment biased to avoiding committing fraud and bolstering efficiency and trackability in Halal blockchains that are providing clear advantages for manufacturers, brand owners, retailers, logistics service providers, distributors, fintechs, insurtechs and Halal certification bodies. All of this is happening in the European Union, leading once more innovating and creative solutions for the Law and the Commerce.

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