

ISLAMIC BANK RISK MANAGEMENT PROBLEMS AND SOLUTIONS IN UZBEKISTAN

Iskandarov Abdullojon Rustam O'G'Li

Master's student of the Banking and Finance Academy of the Republic of Uzbekistan

Abstract: this article investigates the multifaceted risk management challenges confronting Islamic banking in Uzbekistan as the country transitions from pilot initiatives to full-scale implementation following the landmark Islamic banking law enacted in early 2026. By analyzing recent regulatory advancements, including the Central Bank's IFSB membership, AAOIFI alignment initiatives, and the planned national rollout beginning in 2027, the study highlights critical vulnerabilities in Shariah governance, liquidity provisioning for asset-backed products, operational transitions within Islamic windows, and human capital readiness amid rapid sector expansion. Ultimately, it proposes a forward-looking framework of adaptive supervisory tools, digital risk analytics, and targeted capacity-building partnerships to foster resilient, Shariah-compliant growth that enhances financial inclusion and positions Uzbekistan as a emerging hub for Islamic finance in Central Asia.

Keywords: Islamic banking Uzbekistan, Shariah governance risk, regulatory transition 2026, liquidity management challenges, operational risk in Islamic windows, human capital development, fintech-enabled risk monitoring, sukuk market potential, Central Bank roadmap 2030, AAOIFI IFSB harmonization, sustainable Islamic finance, civil law adaptation.

The global Islamic finance industry continues to demonstrate remarkable resilience, with assets surpassing USD 6 trillion by the end of 2024 and sustained expansion projected through 2026 despite geopolitical uncertainties and tightening monetary conditions. In this context Uzbekistan has emerged as one of the most dynamic new entrants in the sector, having secured full legislative approval for a dedicated Islamic banking framework in February 2026 after intensive preparatory work throughout 2025. This development builds directly upon the Central Bank's accession to the Islamic Financial Services Board in late 2024 and its formal application for AAOIFI membership, signaling a strategic commitment to international best practices. At the same time the forthcoming launch of Islamic services in at least one commercial bank by 2027 and expansion to three institutions by 2030 introduces unprecedented complexity for risk oversight. Policymakers and practitioners must therefore address unique structural vulnerabilities that arise when embedding profit-and-loss sharing mechanisms within a predominantly conventional civil-law banking environment.

Recent analyses underscore that effective risk management will determine whether Uzbekistan's Islamic banking experiment succeeds in mobilizing previously untapped domestic savings and attracting substantial foreign direct investment from Gulf and Southeast Asian partners. The absence of mature secondary markets for Shariah-compliant instruments, combined with limited expertise in asset valuation and contract enforcement, heightens exposure to liquidity and operational disruptions during the initial rollout phase. Moreover the planned coexistence of Islamic windows within conventional banks creates hybrid governance challenges that demand sophisticated separation of funds and risk silos. Without robust mitigation strategies these transitional frictions could undermine depositor confidence and slow the sector's contribution to broader financial inclusion objectives.

Consequently a comprehensive examination of both challenges and practical solutions has become essential for supporting evidence-based policymaking at this pivotal juncture.

The present study aims to fill this analytical gap by providing a detailed assessment of risk management impediments and corresponding remedies tailored to Uzbekistan's post-2026 regulatory reality. Employing a qualitative approach grounded in official Central Bank documents, IFSB stability reports, and comparative case studies from other civil-law jurisdictions, the research systematically dissects Shariah compliance, liquidity, operational, and emerging climate-related risks. Its primary contribution lies in articulating an integrated supervisory architecture that aligns international standards with local institutional capacities while anticipating the 2030 expansion targets. By doing so the article offers actionable insights for regulators, financial institutions, and international development partners seeking to ensure that Uzbekistan's Islamic banking sector develops on a sound and sustainable foundation.

Uzbekistan's recent legislative breakthrough in Islamic banking reflects a deliberate policy shift toward diversifying financial services and deepening capital market integration. The 2026 law introduces separate licensing provisions for fully fledged Islamic banks alongside permissive Islamic windows in existing institutions, thereby creating a dual-track architecture that balances innovation with prudential caution. This framework necessitates immediate attention to risk governance because conventional supervisory tools were never designed to accommodate profit-sharing or asset-backed structures. Early implementation experiences from similar hybrid models elsewhere reveal that inadequate segregation of Islamic and conventional balance sheets can propagate contagion risks across the broader banking system. Therefore establishing dedicated risk committees within each participating institution represents a foundational requirement for the 2027 launch.

A particularly pressing concern involves the independence and operational effectiveness of Shariah supervisory boards under the new law. Although the Central Bank plans to create a national Shariah Advisory Council, questions remain regarding its authority to enforce binding rulings across both windows and standalone entities. In the absence of clear enforcement mechanisms subtle divergences in fatwa interpretation could erode market confidence and invite regulatory arbitrage. Comparative evidence from jurisdictions that successfully harmonized multiple Shariah opinions demonstrates the value of mandatory pre-approval protocols for all product structures. Uzbekistan's regulators would therefore benefit from adopting similar standardized review processes before any window becomes operational. Such measures would substantially reduce Shariah non-compliance exposure during the critical scaling phase through 2030.

Liquidity risk assumes heightened significance in Uzbekistan's Islamic banking context because of the heavy reliance on real-asset financing and the still-nascent state of local sukuk markets. Conventional liquidity coverage ratios cannot be applied directly to profit-sharing deposits that lack fixed-return guarantees, forcing institutions to develop alternative stress-testing methodologies. The Central Bank's forthcoming roadmap must therefore incorporate dedicated Islamic liquidity facilities backed by high-quality sovereign sukuk once issuance commences. Without these instruments participating banks may face acute mismatches between long-term ijara portfolios and short-term withdrawal demands from investment account holders. Proactive calibration of liquidity buffers calibrated to local economic cycles will prove essential for maintaining systemic stability.

Operational risks multiply during the transition period when staff must simultaneously manage conventional and Islamic portfolios within the same institution. Training programs announced in partnership with INCEIF represent a positive step yet require supplementation with scenario-based simulations that replicate real-time Shariah compliance failures. Documentation workflows for murabaha and musharaka contracts demand entirely new digital templates to prevent errors that could later trigger costly restructuring. Furthermore internal audit functions must be restructured to include specialized Shariah auditors capable of verifying both financial and religious compliance. These operational enhancements will determine whether Islamic windows achieve seamless integration or instead become sources of reputational vulnerability.

Human capital constraints constitute perhaps the most binding limitation on rapid sector development. Despite the Central Bank's project office and planned certification pathways the pool of qualified Shariah scholars and risk managers familiar with Uzbekistan's civil code remains extremely small. Recruitment from established markets such as Turkey and Malaysia offers only a temporary bridge because cultural and legal nuances require localized expertise. Long-term solutions must therefore emphasize university-level curriculum reform and mandatory continuing professional development for existing bankers. Without accelerated talent pipelines the ambitious target of ten Islamic banks by 2030 risks being undermined by governance weaknesses rather than market demand shortfalls.

Fintech integration presents both opportunities and novel risks for Uzbekistan's emerging Islamic banking ecosystem. The country's existing blockchain and cryptocurrency regulatory sandbox provides a ready foundation for deploying smart-contract versions of mudaraba and wakala agreements. However such innovations introduce cyber-security and smart-contract audit risks that traditional supervisory frameworks are ill-equipped to address. Collaboration with regional fintech hubs could accelerate the development of Shariah-compliant regtech solutions capable of real-time compliance monitoring. At the same time regulators must establish clear guidelines on data privacy and algorithmic transparency to prevent technology-driven Shariah breaches. A balanced approach to digital transformation will enable Uzbekistan to leapfrog legacy systems while safeguarding financial integrity.

Climate and environmental risks are gaining prominence within global Islamic finance discourse and Uzbekistan's agricultural and energy sectors make this dimension especially relevant. Green sukuk structures could channel financing toward sustainable irrigation and renewable projects yet require sophisticated environmental risk assessment capabilities currently absent in local institutions. The Central Bank's roadmap should therefore incorporate mandatory climate stress testing for all Islamic financing above certain thresholds. International technical assistance from IsDB and IFSB working groups on sustainable finance would accelerate capacity building in this area. Integrating ESG considerations into core risk management will not only mitigate physical and transition risks but also enhance the sector's appeal to ethical investors from the Gulf Cooperation Council.

Comparative analysis with Turkey's recent Islamic finance expansion offers instructive parallels for Uzbekistan. Turkish authorities successfully navigated civil-law adaptation by creating dedicated Islamic banking subsidiaries rather than windows, thereby achieving clearer risk ring-fencing. Uzbekistan could adapt this model selectively for larger state-owned banks while retaining windows for smaller institutions seeking gradual entry. Pakistan's experience with centralized Shariah boards also merits examination particularly its mechanisms for resolving interpretive disputes across

institutions. Selective adoption of these proven practices would allow Uzbekistan to avoid common pitfalls observed in other frontier markets.

The planned 2030 expansion trajectory demands proactive macroprudential oversight to prevent excessive concentration in real-estate or commodity-linked financing. Diversification mandates embedded within licensing conditions could encourage broader sectoral coverage including manufacturing and export-oriented SMEs. At the same time the deposit insurance scheme must be extended to profit-sharing investment accounts on a risk-adjusted basis to maintain competitive parity with conventional deposits. These complementary measures would reinforce overall financial stability while supporting the government's financial inclusion objectives.

Supervisory technology platforms represent another critical enabler for effective risk oversight in the new environment. The Central Bank should prioritize development of a unified Islamic finance reporting dashboard that aggregates data across windows and full banks in real time. Artificial intelligence-driven anomaly detection could flag potential Shariah deviations or liquidity breaches before they escalate. Initial investment in such infrastructure although substantial would yield long-term dividends in supervisory efficiency and crisis preparedness. Regional cooperation within the IFSB framework could facilitate cost-sharing and knowledge transfer for these digital initiatives.

Corporate governance arrangements must evolve to reflect the dual fiduciary responsibilities inherent in Islamic banking. Boards of directors require specialized committees that jointly oversee financial performance and Shariah adherence with clearly defined escalation protocols to the national advisory council. Independent non-executive directors with Islamic finance expertise should be mandated for all licensed entities to strengthen oversight. These governance enhancements would align decision-making processes more closely with the ethical foundations of the industry and reduce agency problems that frequently arise in profit-sharing arrangements.

Tax neutrality provisions within the 2026 law constitute a significant enabler yet their practical implementation will require careful calibration to avoid unintended risk concentrations. Double taxation risks on murabaha mark-ups or musharaka profit distributions must be eliminated through precise amendments to the Tax Code. At the same time regulators should monitor whether tax incentives inadvertently encourage excessive leverage in certain asset classes. Continuous dialogue between the Central Bank, Ministry of Finance, and industry participants will be necessary to maintain an optimal balance between competitiveness and prudential soundness.

Public awareness campaigns will play a decisive role in shaping depositor behavior and managing reputational risks during the initial rollout. Many potential customers still harbor misconceptions regarding the risk-return profile of Islamic accounts compared with conventional deposits. Targeted educational programs delivered through mosques, universities, and digital channels could clarify the equity-based nature of investment accounts and associated risk-sharing principles. Transparent communication of historical performance data from pilot projects would further build confidence. Effective awareness initiatives would reduce the likelihood of sudden withdrawal pressures triggered by market volatility or isolated compliance incidents.

International partnerships offer valuable avenues for accelerating risk management capabilities. The memorandum of understanding with INCEIF provides a platform for curriculum development and executive training programs tailored to Uzbek conditions. Similarly technical cooperation with the Islamic Development Bank could facilitate pilot testing of standardized risk-weighting methodologies

for local asset classes. These collaborative efforts would compress the learning curve and help Uzbekistan avoid costly trial-and-error experiences observed in other emerging markets. Strategic engagement with global standard-setters will also enhance the country's credibility with international investors.

The interaction between conventional and Islamic segments within hybrid institutions deserves particular regulatory attention. Firewalls separating capital, liquidity, and operational resources must be robust enough to prevent spillover effects while remaining operationally efficient. Regular joint stress tests involving both segments would reveal hidden interdependencies and inform contingency planning. Over time the Central Bank may consider requiring separate capital adequacy calculations for Islamic windows to reflect their distinct risk profiles more accurately. Such graduated supervisory measures would support orderly growth without imposing prohibitive compliance costs on smaller banks.

Emerging risks associated with cross-border Islamic transactions warrant inclusion in the national supervisory agenda. As Uzbek Islamic banks begin attracting deposits or investment from Gulf investors currency mismatch and correspondent banking risks will intensify. Developing Shariah-compliant hedging alternatives that comply with both local regulations and international standards represents a complex but necessary undertaking. Participation in regional liquidity management facilities such as those coordinated by the International Islamic Liquidity Management Corporation could provide a partial solution. Forward-looking regulatory preparedness in this domain will safeguard against external shocks.

Performance measurement frameworks for Islamic banks must transcend conventional return-on-equity metrics to incorporate risk-sharing and social impact indicators. The Central Bank should pilot a balanced scorecard approach that evaluates not only financial soundness but also adherence to maqasid al-Shariah principles. Disclosure requirements for such metrics would enable market discipline to complement regulatory oversight. Over time standardized reporting would facilitate benchmarking across institutions and support evidence-based policy adjustments.

The role of microfinance institutions in extending Islamic finance to rural and underserved segments introduces additional risk layers related to small-ticket financing and limited collateral options. Specialized regulatory sandboxes could allow testing of group-based musharaka and qard hasan models under controlled conditions. Lessons learned from these experiments would inform scaled rollout while containing potential losses. Integration of micro-Islamic finance within the broader risk management framework would enhance overall financial inclusion without compromising systemic stability.

Finally continuous monitoring of global Islamic finance developments remains essential for maintaining Uzbekistan's regulatory agility. The IFSB Stability Report 2025 highlights evolving challenges around hybrid capital instruments and fintech-driven disintermediation that could soon affect local institutions. Regular gap analyses comparing domestic standards against updated international guidance will help preempt regulatory lag. Institutionalizing such forward-looking reviews within the Central Bank's Islamic finance project office would embed adaptability into the supervisory culture from the outset.

Conclusion

The enactment of Uzbekistan's Islamic banking law in 2026 marks a historic milestone that opens substantial opportunities for financial diversification and inclusive growth. However the transition phase through 2030 will test the country's ability to design and implement risk management systems capable of addressing novel Shariah, liquidity, and operational challenges within a hybrid regulatory environment. Success will hinge on proactive collaboration between the Central Bank, financial institutions, and international partners to build institutional capacity and technological infrastructure before full-scale expansion.

Four principal conclusions emerge from the analysis. First, Shariah governance arrangements must achieve genuine operational independence to preserve market confidence during the critical launch period. Second, liquidity risk frameworks require bespoke instruments and stress-testing methodologies that account for the unique characteristics of profit-sharing deposits and asset-backed financing. Third, human capital development through sustained educational partnerships represents the foundational prerequisite for sustainable sector growth. Fourth, digital risk monitoring platforms combined with adaptive prudential standards will enable Uzbekistan to leapfrog traditional development stages and establish a resilient Islamic banking ecosystem aligned with international best practices.

Recommendations

1. Establish a dedicated Islamic Finance Risk Laboratory within the Central Bank by mid-2026 to conduct joint stress tests with participating banks and develop Uzbekistan-specific liquidity and Shariah risk models ahead of the 2027 launch.
2. Mandate compulsory certification programs in partnership with INCEIF for all Shariah board members and senior risk officers, targeting full coverage across pilot institutions before any Islamic window commences operations.
3. Introduce mandatory climate-risk disclosure requirements for all Islamic financing facilities exceeding USD 5 million, integrated into the supervisory reporting dashboard to align with global sustainable finance trends.
4. Develop and pilot a unified digital compliance platform using blockchain for contract verification and real-time Shariah monitoring, with mandatory adoption by all licensed entities by the end of 2028 to support the 2030 expansion targets.

References

1. Central Bank of Uzbekistan. (2026). Roadmap for Islamic finance development 2026-2030. Tashkent: CBU.
2. Islamic Financial Services Board. (2025). Islamic financial services industry stability report 2025. Kuala Lumpur: IFSB.
3. Umarov, S., & Tlemsani, I. (2026). Implementing Islamic banking in Uzbekistan. *Journal of Islamic Banking and Finance*, 43(1), 45-67.
4. Asadov, A. (2024). Empirical analysis of demand for sukuk in Uzbekistan. *Economies*, 12(8), Article 220. <https://doi.org/10.3390/economies12080220>
5. Botirova, H. O. (2025). Current trends and regulatory innovations in Uzbekistan's Islamic finance sector. *European Journal of Economics, Finance and Business Development*, 3(2), 112-130.
6. Khan, T., & Ahmed, H. (2025). Risk management practices in emerging Islamic banking markets. *Journal of Islamic Finance*, 14(1), 78-95.

7. Accounting and Auditing Organization for Islamic Financial Institutions. (2025). Shari'ah standards update 2025. Manama: AAOIFI.
8. Islamic Development Bank Group. (2025). Annual report on Islamic finance in Central Asia. Jeddah: IsDB.
9. LSEG & IsDBI. (2025). Islamic finance development report 2025. London: London Stock Exchange Group.
10. Turdaliev, S. (2026). Uzbekistan's strategy for Islamic banking integration. Central Bank of Uzbekistan Bulletin, 12(1), 3-18.