

# Chapter 1:

# Introduction to Islamic Finance



# Outline

- Philosophy of Islamic finance.
- Principles of Islamic economics.
- Principles of Islamic finance.
- Shari'ah framework for Islamic finance.
- Fundamental prohibited elements in Islamic finance.
- Differences between Islamic finance and conventional finance.
- Development of Islamic finance in Malaysia.
- Islamic finance today.





# PHILOSOPHY OF ISLAMIC FINANCE

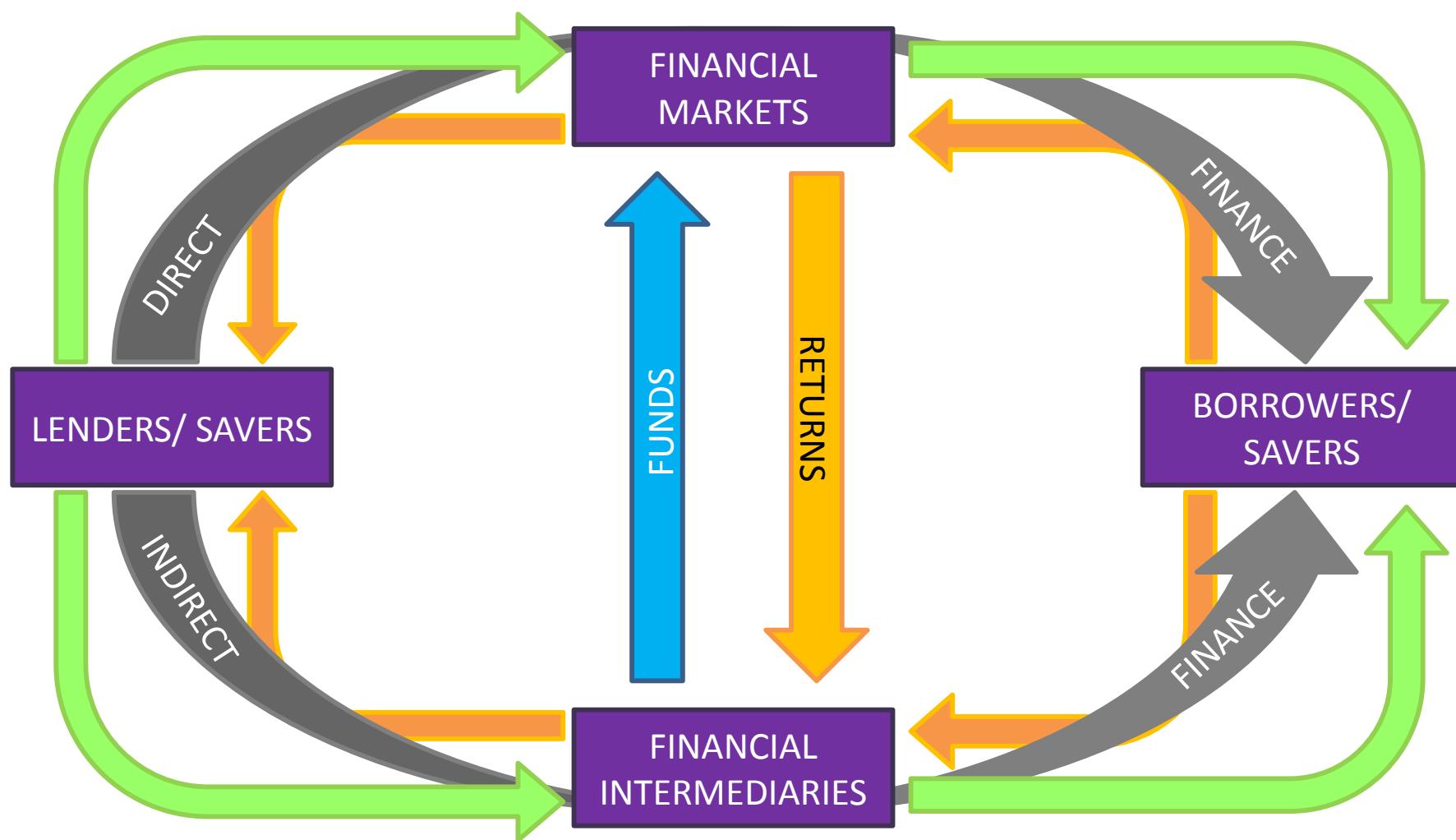
# What is Finance?



It is all about money.

It concerns resource allocation, management, acquisition and investment.

# Flow of Funds through the Financial System



# Conventional Financial System

Value Neutral  
System

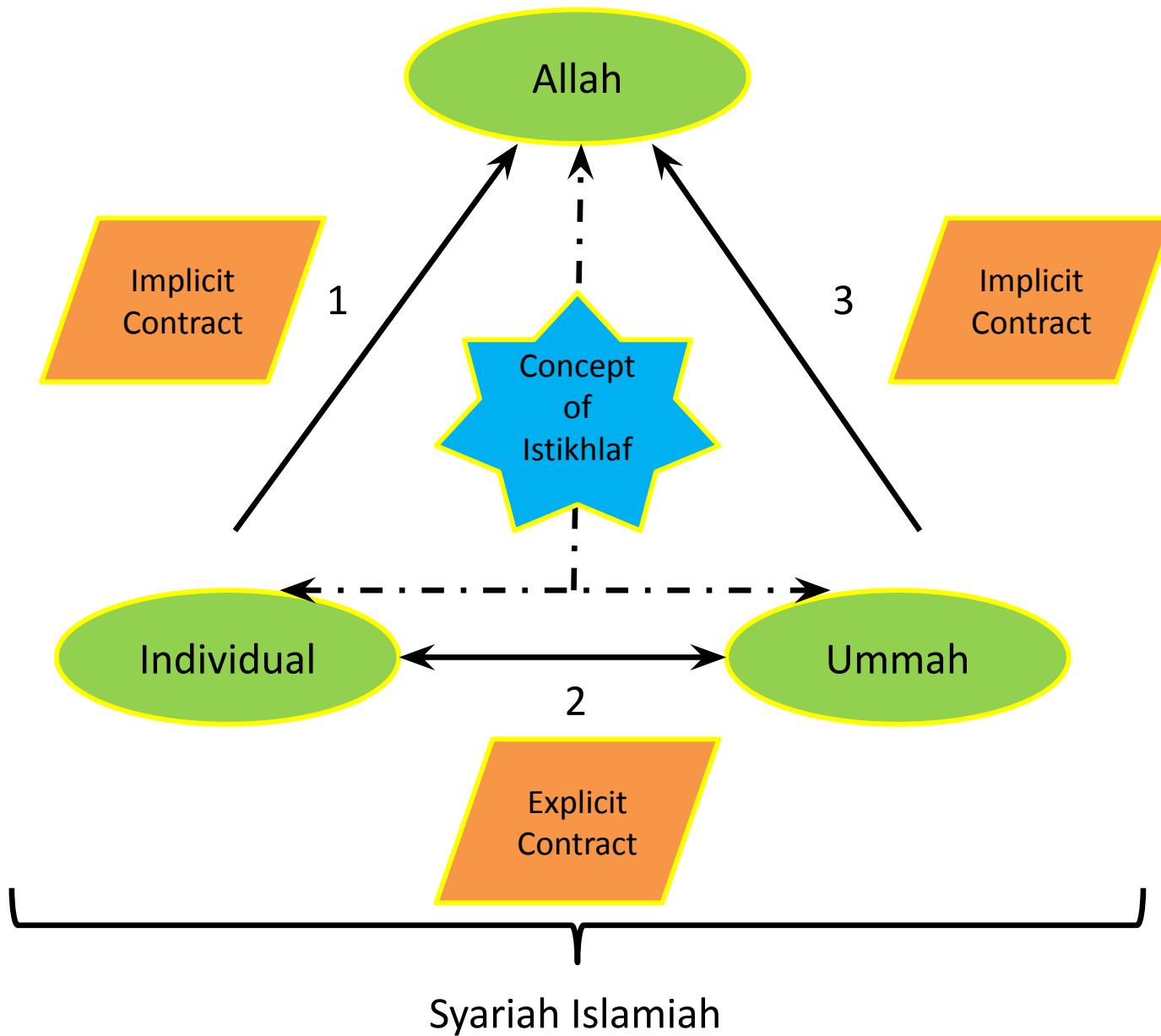
Relies on the assumption that human beings are rational in decision making.

Doctrine of Self Interest

By satisfying individual self-interest, one will, in general contribute to the economic development of the society as a whole.



# The Islamic Worldview



# Istikhlaf

- This principle implies that man is not the absolute owner of the resources, but rather he is entrusted with them and may utilize them only for the betterment of mankind.
- Therefore, man is accountable to Allah swt for his conduct on earth.



The concept of trust, in Islam, is linked with responsibility, implying that wealth that is entrusted upon a human being is indeed a responsibility that he will be accounted for in the Hereafter.

# What is Islamic Finance?

## Islam

Characteristics are based upon certain principles underlined by Shari'ah.

## Finance

Comprises of Islamic financial markets and institutions that deal with resource allocation, management, acquisition and investment. Also involved with risk transformation and management.



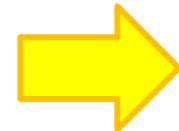
Provision of financial services on a basis that is compliant with the principles and rules of Islamic commercial jurisprudence (Fiqh al-Mua'malat), a branch of Islamic Shari'ah jurisprudence.



As a Muslim, every transactions must be  
Shari'ah compliant!

# Islamic Finance

Shari'ah



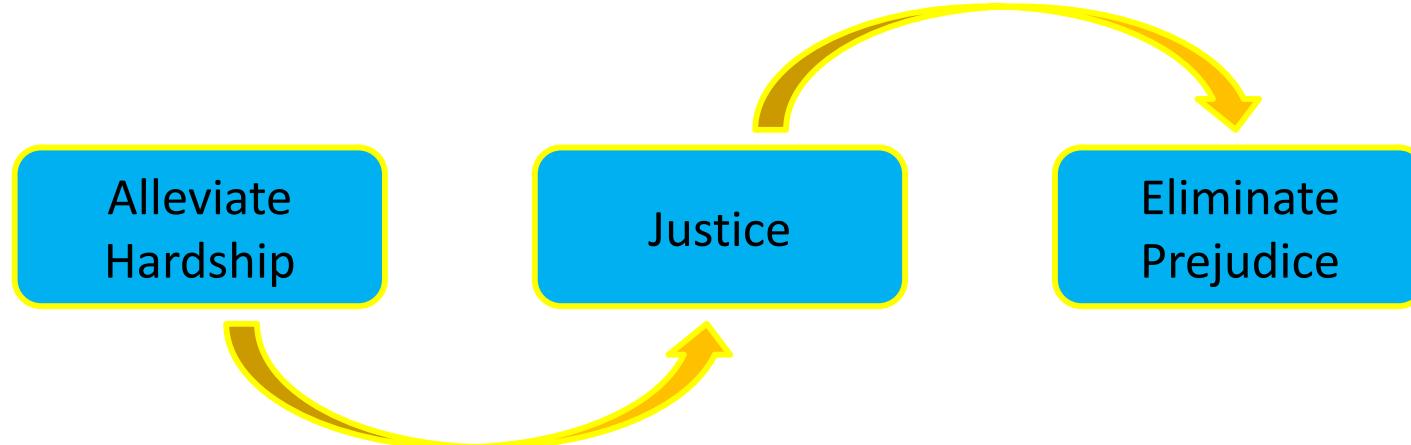
Relationship with the Almighty Allah  
(swt) – *hablu minallah*

All aspects of human life – *hablu minannas*

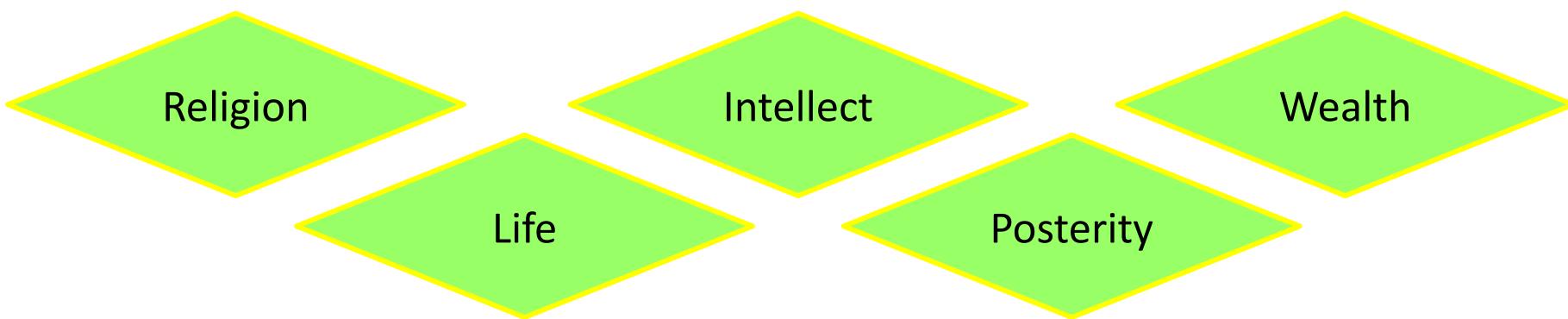


نِعْمَلَاعِلَّةً مُحْرِّرٌ لَا كَانَ لِسَرَاً أَمْوَالُ

“And We have sent you (O Muhammad) not but a mercy to the whole universe”  
(Al-Ambiya:107)



### Maqasid al-Shari'ah (The Objectives of Shari'ah)



Preservation and Promotion

Islamic economics is based on a paradigm which is not secularist and value-neutral. It treats all human beings as vicegerents of God and brothers unto each other. All resources at the disposal of human beings are trust and must be used for the well-being of all in conformity with the values provided by the *Shari'ah*. However, well-being in Islam is not a function of just material possessions and unlimited consumption. It is rather a function of the balanced satisfaction of both the material and the spiritual needs of the human personality. This can be done by actualizing the *maqasid al-shari'ah* (goals of *Shari'ah*).  
– Muhammad Umar Chapra (1998)

# PRINCIPLES OF ISLAMIC ECONOMICS



# Islamic Economic System

Falāḥ is the Arabic word for success, happiness and well-being. In Islamic context, according to the Qur'an, actions such as conforming to Allah's commands, establishing the Zakat, not taking intoxicants and not gambling will all lead to it.

Tawhid (Arabic: تَوْهِيد, tawḥīd, meaning "unification or oneness of God as per Islam. Arabic: الله Allāh; also romanized as Tawheed, Tawhid, , Tauheed or Tevhid ) is the indivisible oneness concept of monotheism in Islam. Tawhid is the religion's central and single most important concept, upon which a Muslim's entire religious adherence rests.

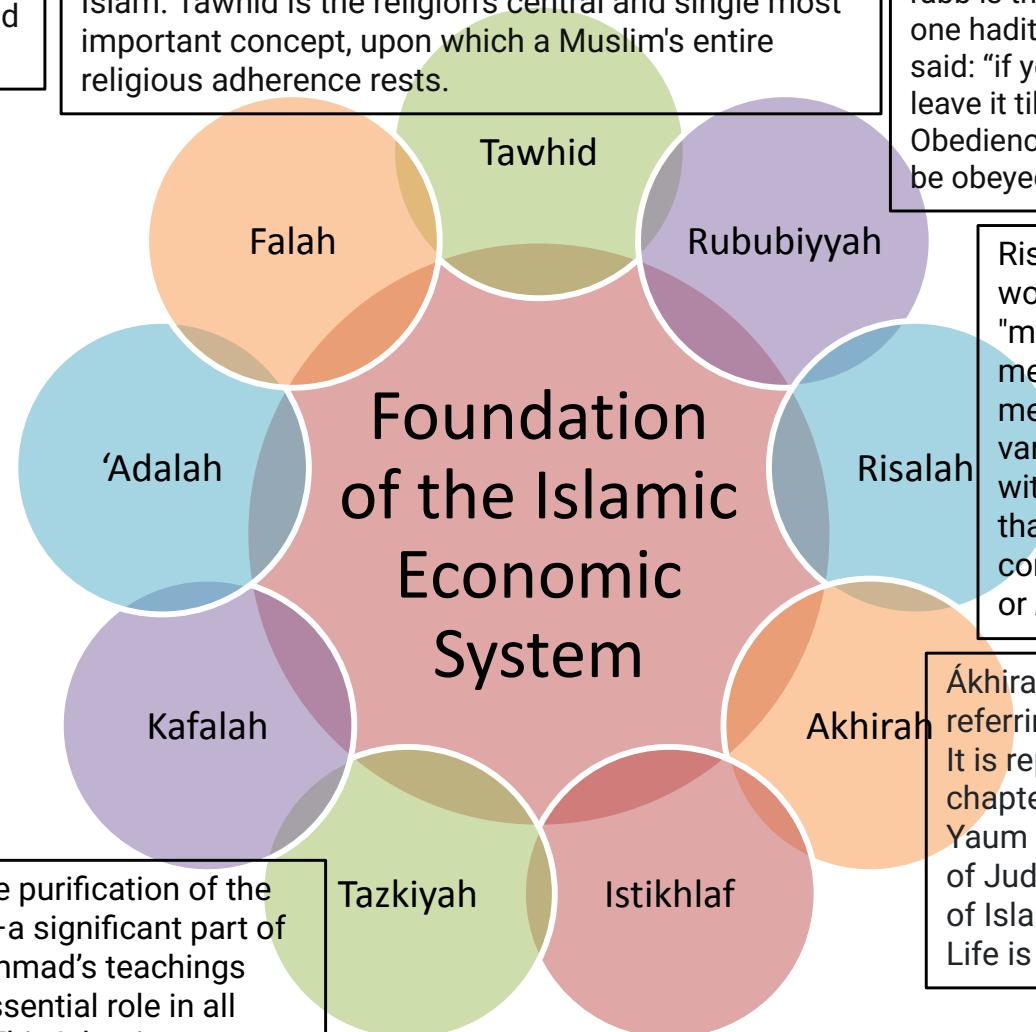
Rububiyyah is from rabb (رب) which has three linguistic meanings: Owner: The rabb is the true and complete owner. In one hadith, the Prophet (صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ) said: "if you find a camel in the desert, leave it till it meets its rabb (owner)". Obedience: The rabb is the one who is to be obeyed.

Adalah عدالة means justice and denotes the Justice of God. It is among the five Shia Principles of the Religion. Shia Muslims believe that there is intrinsic good or evil in things, and that God commands them to do the good things and shun the evil.

Kafalah means guarantee. It is defined as a contract which combines one's liability with another person's liability. It is a contractual guarantee given by the guarantor to assume the responsibilities and obligations of the party being guaranteed on any claims arising.

Al Tazkiyah—the purification of the heart and soul—a significant part of Prophet Muhammad's teachings and plays an essential role in all people's lives. This Islamic fundamental cultivates people's consciousness and character, spirituality, and morality.

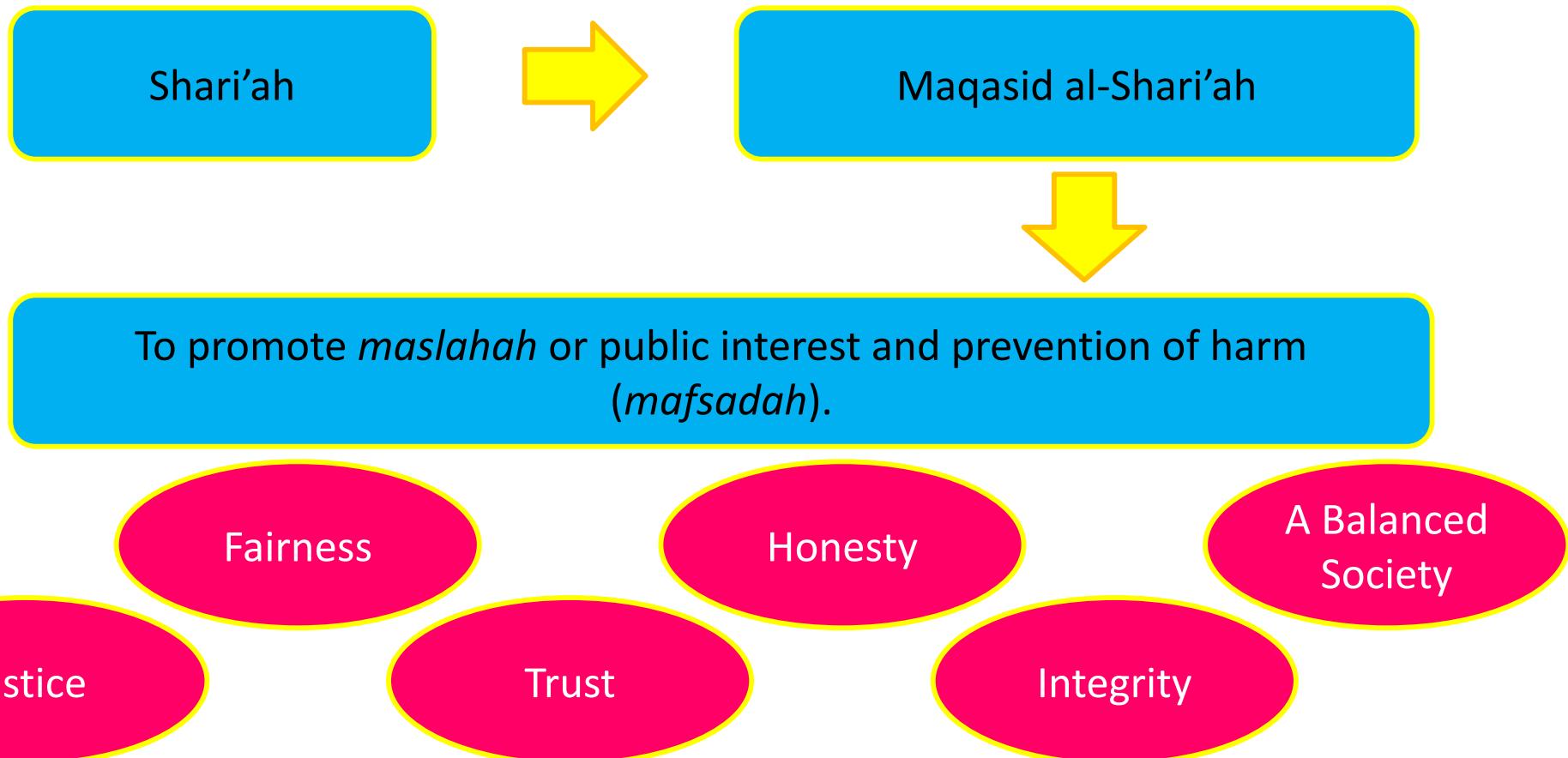
## Foundation of the Islamic Economic System



Risala (رسالة) risalah, is the Arabic word for "Information" or "message". Ar-Risala (الرسالة) is "the message." Prophethood or messengership and represents the various ways Allah communicates with humanity. Muslims believe that messages from Allah are communicated through prophets , or nubuwwah.

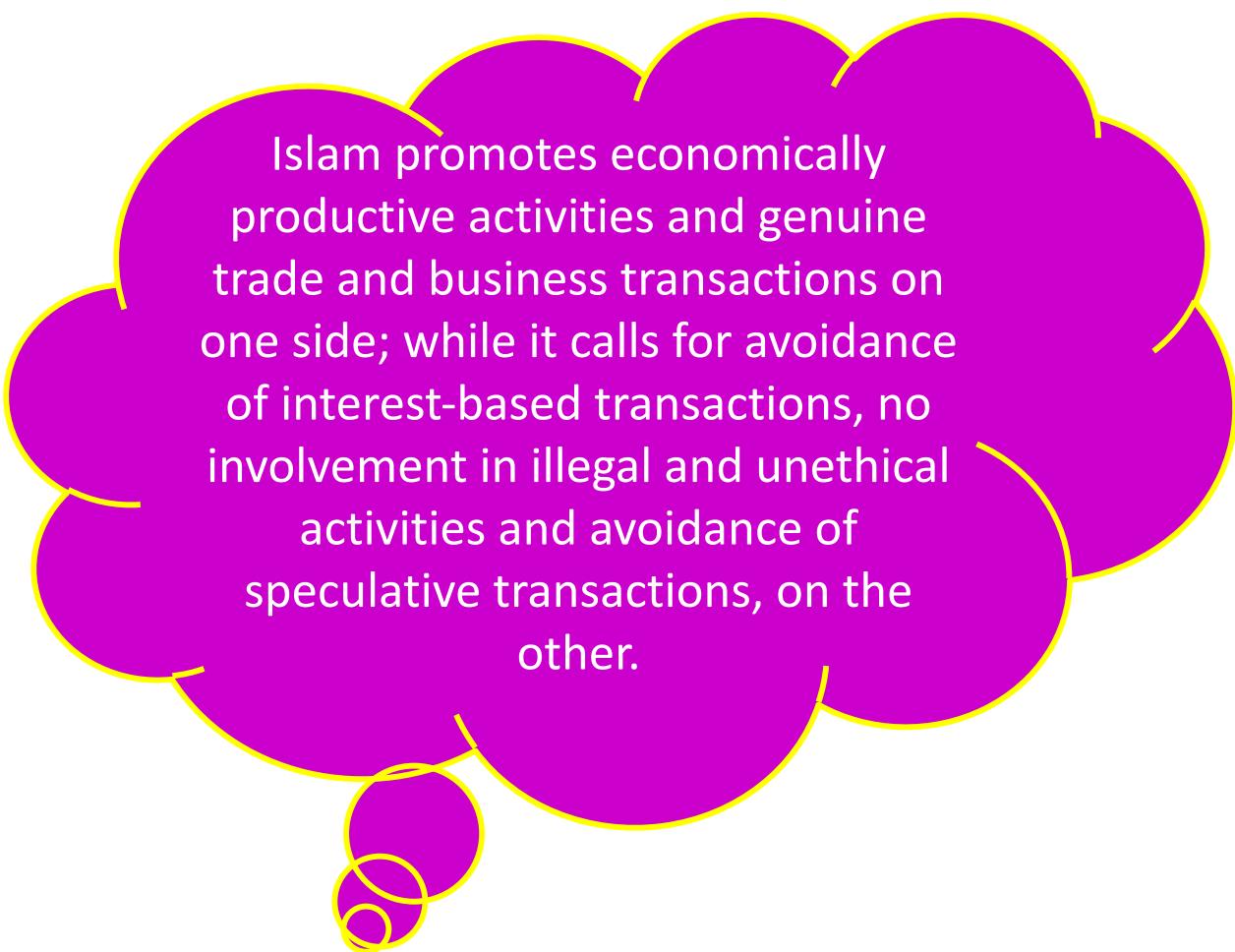
Ákhirah/Akhira is an Islamic term referring to the after life. It is repeatedly referenced in chapters of the Qur'an concerning Yaum al Qiyamah, the Islamic Day of Judgment, an important part of Islamic eschatology. Life is temporary on the earth.

# Islamic Economics



Ethical and Moral Framework of the Shari'ah

The principles of *halal* (permissible) and *haram* (prohibited) provide a sort of moral filter for actions taken by every individual in the society and form a legal framework for Islamic finance.



Islam promotes economically productive activities and genuine trade and business transactions on one side; while it calls for avoidance of interest-based transactions, no involvement in illegal and unethical activities and avoidance of speculative transactions, on the other.

# PRINCIPLES OF ISLAMIC FINANCE

# VALIDITY versus PERMISSIBILITY

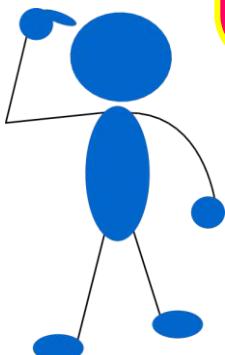
## Validity

- is based on the FORM of the contract.
- A valid contract is not necessarily permissible.

## Permissibility

- is based on the SUBSTANCE of the contract and the INTENTION of the contractors.

A financial contract must be both *halal* (permissible) and *sah* (valid)



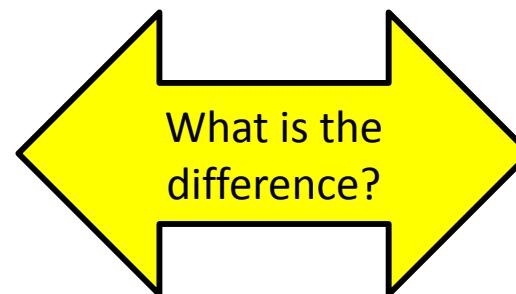
# How to Make Money in Islam?

وَاحْلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا  
“Allah permits trading but prohibits Riba” (2:275)

قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا  
“They said that indeed trading is just like riba” (2:275)



No Counter – Value



With Counter – Value ('Iwad)



Effort (Al-Kasb)



Risk (Al-Ghurm)

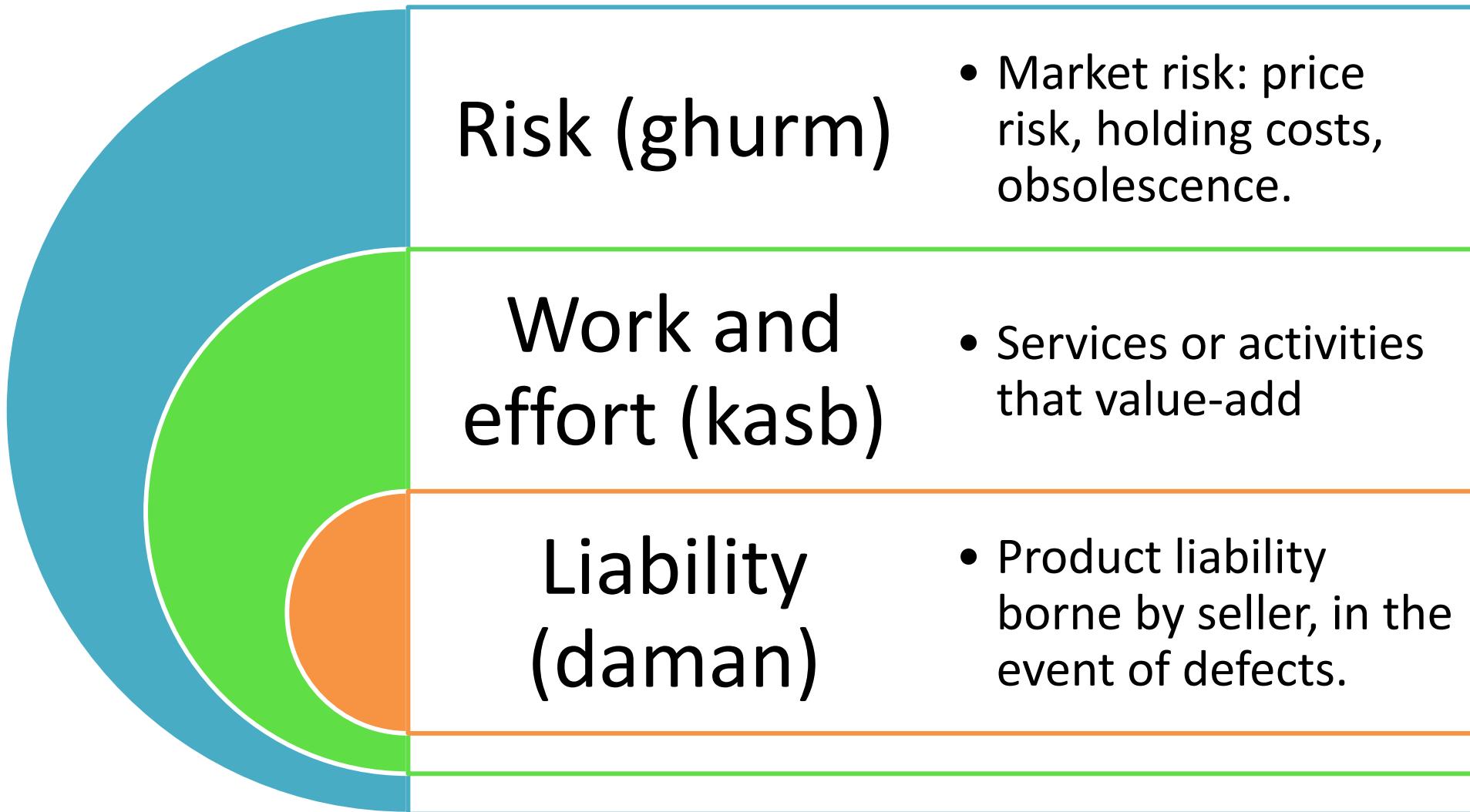


Liability (Al-Dhaman)

# The concept of ‘iwad

- Islam prohibits riba but permits sale (bay’)
  - The element of ‘iwad (equal countervalue) in sale promotes a sense of equity and justice in the economic transaction, differentiating it from riba.
- The Shari’ah requires all legitimate exchange to contain ‘iwad.
  - “Every increase, which is without ‘iwad or equal countervalue, is riba” – Ibn al-‘Arabi

# Components of 'iwad



# Examples of Valid Countervalue ('iwad)

Risk " <i>ghurmi</i> " of trade or ownership " <i>daman milkiyah</i> "	Effort " <i>ikhtiyar</i> " expended or expertise rendered	Liability in the event of product defect
<ul style="list-style-type: none"><li>• TV manufacturer undertakes the risk that he might produce TVs that customers do not like and do not end up buying.</li><li>• TV retailer faces the risk of unfavorable market price movements – he might have to sell his products in stock at a price which is lower than the cost or accepts inventory buildup which would eventually be costly.</li></ul>	<ul style="list-style-type: none"><li>• TV manufacturer adds value to the raw materials that make up a television set by contributing the effort in putting the TV set together as well as providing the expertise on how to put a TV set together.</li></ul>	<ul style="list-style-type: none"><li>• When the TV retailer sells a TV set, he provides a product warranty against defects.</li><li>• In the event that a particular TV set is defective, the TV retailer will assume liability and bear some costs.</li></ul>

# Is there ‘iwad’ in conventional banking?

Risk	Effort	Liability
<ul style="list-style-type: none"><li>• Argument: Banks face risk of default on repayment (credit risk).</li><li>• Counter-argument: Credit risk is not inherent in the contract itself. Risk of default is present in all contracts.</li><li>• In the event of defaults, the bank has recourse (collateral, punitive measures by authorities).</li><li>• Contrast with market risk associated with trading.<ul style="list-style-type: none"><li>• Risk is inherent in trading activity itself.</li><li>• If downside risk materializes (i.e. cannot sell goods at profit) trader has no contractual or systemic recourse.</li></ul></li></ul>	<ul style="list-style-type: none"><li>• Argument: Bank expends effort to act as financial intermediary, evidenced by its costs of operation (wages, overheads). The bank charges for, and earns profit from, bringing together deficit and surplus units. The bank is merely providing a service.</li><li>• Counter-argument: Bank’s efforts do not add value to the product itself</li><li>• Effort cannot validate an underlying transaction/ activity which is prohibited (i.e. gambling).<ul style="list-style-type: none"><li>• At most, the bank can justify fee-based revenue but not interest-based revenue.</li><li>• If the bank is charging for the service of matching deficit and surplus units, its return should not be a function of the amount of financing.</li></ul></li><li>• The bank does not act as agents for both deficit and surplus units but contracts separately with them.</li></ul>	<ul style="list-style-type: none"><li>• The product in a conventional loan contract is money.</li><li>• Physical defects in currency do not permanently diminish its value as legal tender.<ul style="list-style-type: none"><li>• E.g. a torn or badly-soiled note can be exchanged at the central bank.</li></ul></li><li>• Therefore, product liability is not relevant.</li></ul>





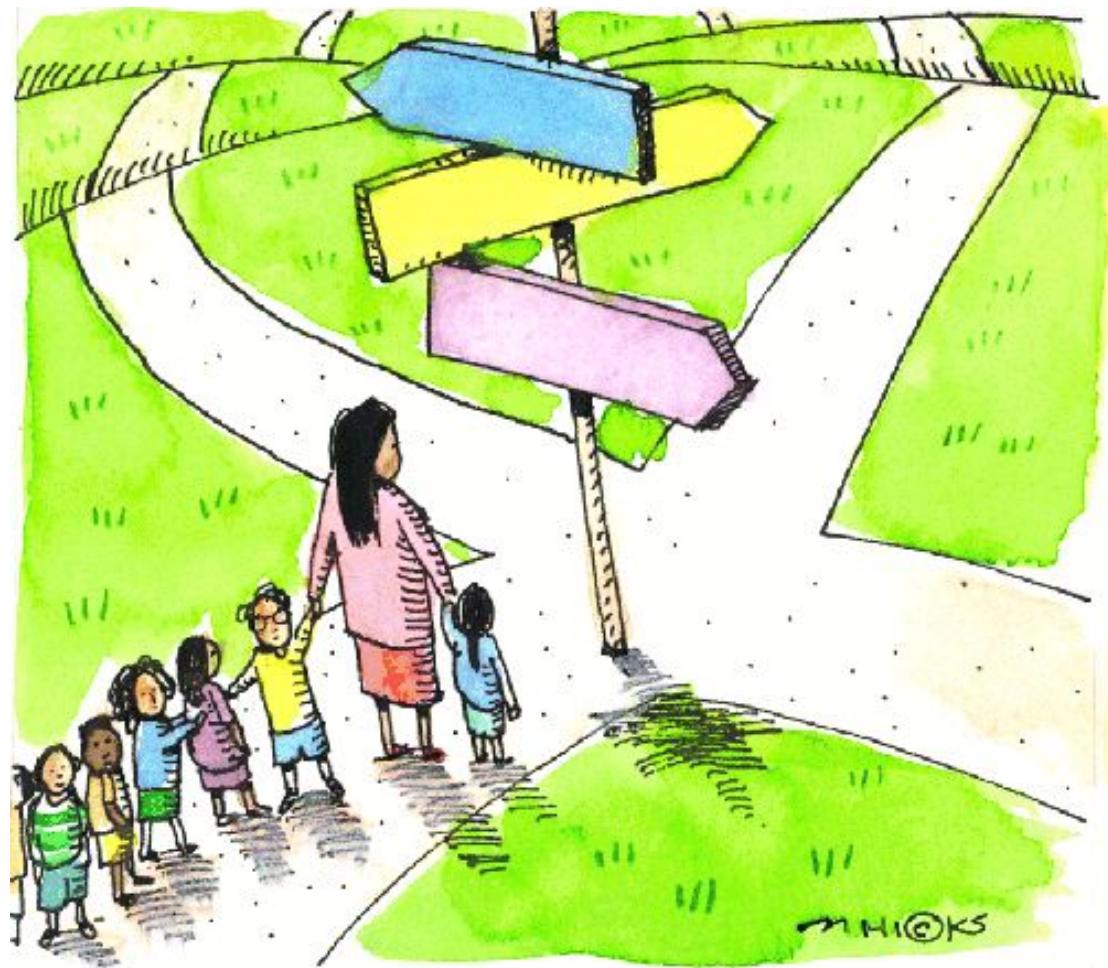
# **SHARI'AH FRAMEWORK FOR ISLAMIC FINANCE**

# Shari'ah

Literally means 'path to watering place'.

Technical meaning: Path to tread for guidance in this world.

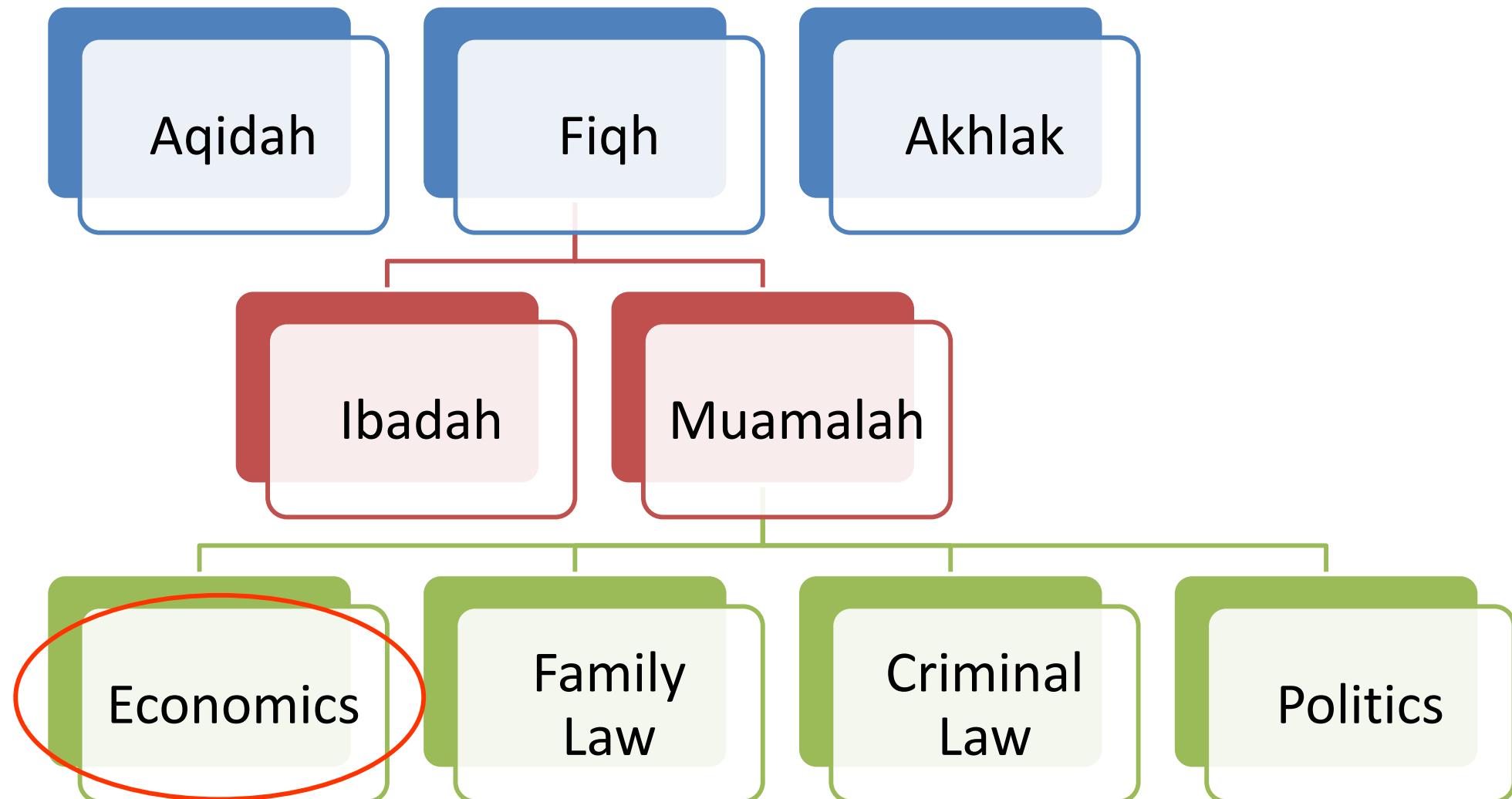
Commands, prohibitions, values prescribed by Allah for His slaves either through Al-Quran or As-Sunnah (a divinely guided lifestyle and whatever that was reported about what the Prophet Muhammad (pbuh) said, did, or gave his tacit approval)



# What is Shariah?

- Normally, the Sharī'ah is described as 'Islamic Law'. But the boundaries of Sharī'ah extend beyond the limited horizons of law (Sardar 2003).
- According to one observer, the Sharī'ah is the "epitome of Islamic thought, the most typical manifestation of the Islamic way of life, the core and kernel of Islam itself" (See in Schact (1964)).

# Islam & Components of Shariah



Issues in  
Islamic banking and finance

# Sources of Islamic Finance

- Fiqh – understanding the laws relating to human deeds derived from Al-Qur'an and Sunnah.
- Divisions of Fiqh:
  - Ibadat (rituals)
  - Munakahat (marriage or family laws)
  - Muamalat (commercial transactions)
  - Jinayat (offences, crimes and punishments)
- Muamalat:
  - Literally = to interact - interactions or transactions
  - Commercial transactions are concluded through contracts which are permitted by the Shari'ah as evidenced by the Qur'an, the Sunnah and other sources of Islamic law.

# Sources of Shari'ah

Primary  
Sources

- The Holy Qur'an
- Sunnah (Prophetic tradition)

Secondary  
Sources

- Ijma' (consensus of opinion)
- Qiyas (Analogical deductions)
- Istihsan (equity in Islamic law)
- Masalih Mursalah (consideration of public interest)
- Istishaab (presumption of continuity)
- Sadd al-dzara'i (blocking the means)
- 'Urf (custom)

# Understanding the Objectives of Shariah?

- Need to understand Maqasid al-Shariah.

ضر لاأ ئفلاخ سانلا موقي يكلا ٿر خلاؤ ايندلا ي ف دابعلا ئ حلصه قيقحت  
ن م مع متجملا علاخاو مهندع راضملا ع فدو مهـ ع فانملا بـ لـ جـ بـ كـ لـ ذـ وـ  
دـ سـ اـ فـ مـ لـ

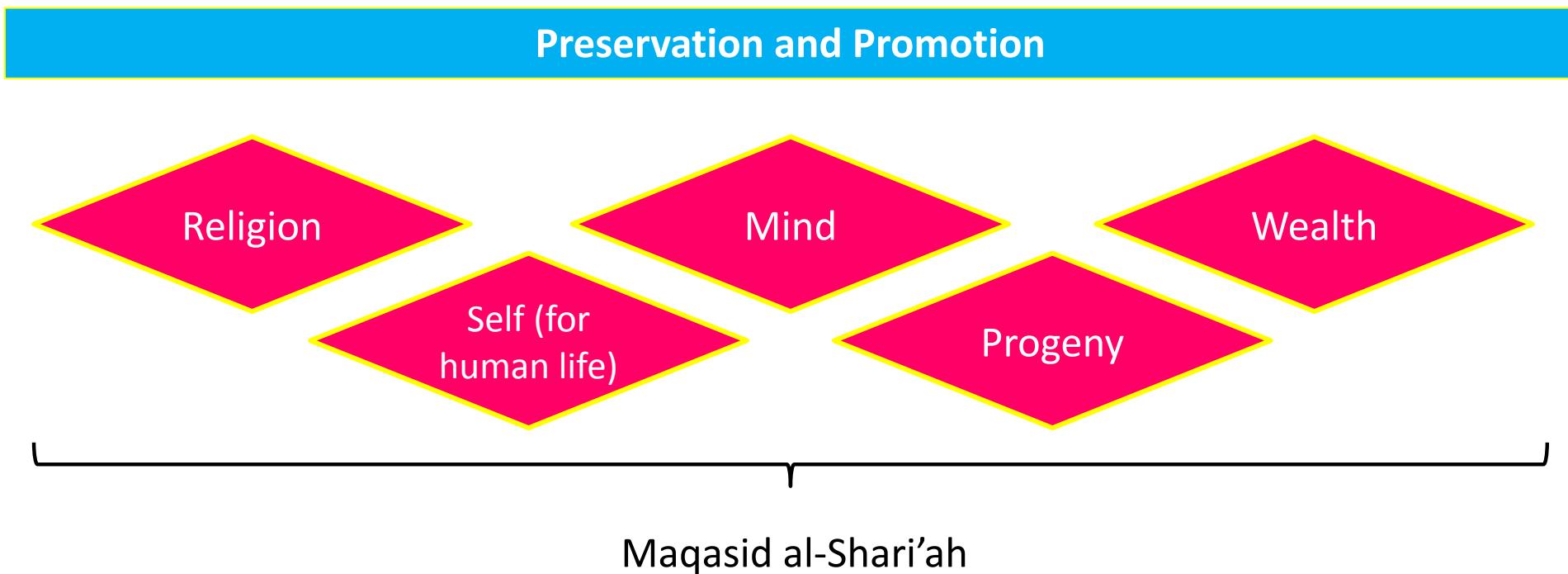
- “The realization of *maslahah* or interest of human being in this world and the hereafter in order to manifest the vicegerency role; and this can be done through the acquisition of benefits towards them and avoiding harms upon them and cleansing the society from evils” (refer to Abdul Azeez Al-Khayat, *Maqasid al-Shariah wa Usul al-Fiqh*)

# What is Maqasid As-Syariah?

- It outlines the objectives and wisdom (hikmah) as prescribed by Shariah (Allah & His Prophet s.a.w.) in all its rulings to protect and preserve the benefits and interests (*maslahah*) of society.
- What is *Maslahah*?
  - is the benefits or interests which are deemed necessary from Syariah perspectives to protect and preserve the five darurah. (Al-Mansul, Fakhruddin Ar-Razi, p.24)

# Necessities (*darruriyyat*)

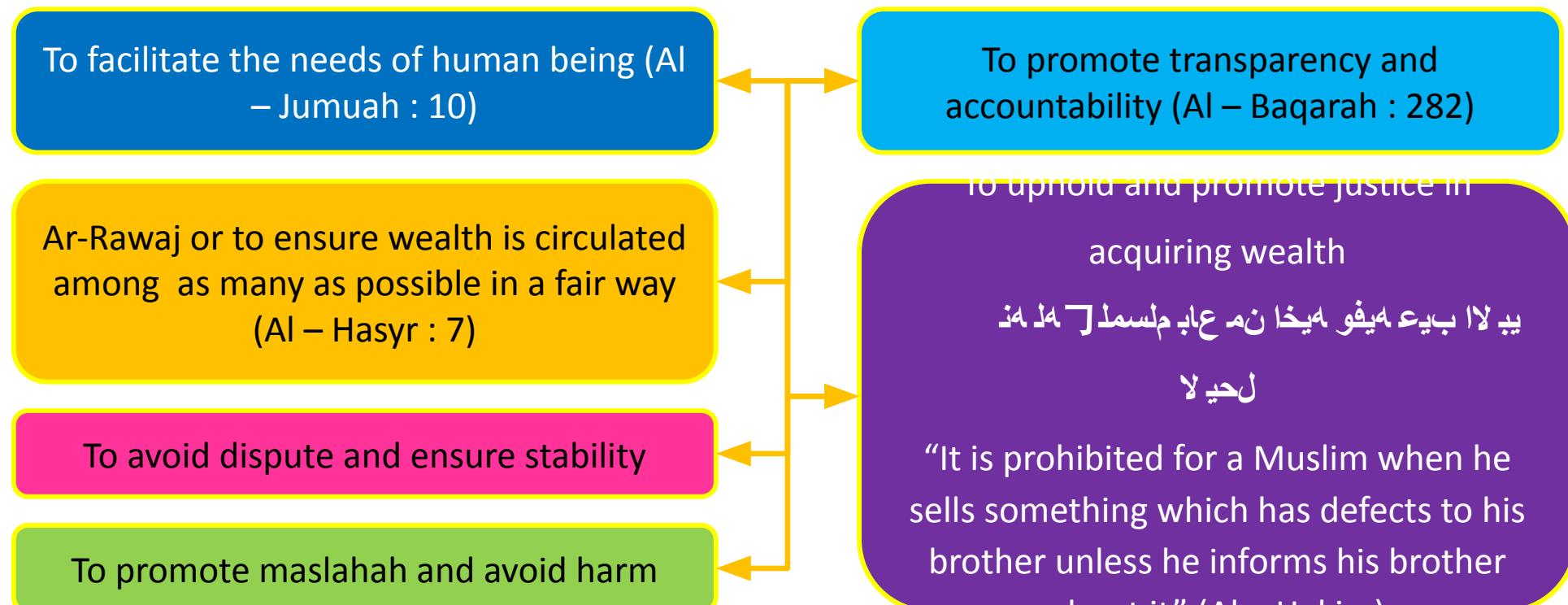
- The minimal requirements of human livelihood.



# Maqasid as-Syariah in Financial Transactions

يَنْعَمِلُ إِلَى تَافِلَاتٍ لَمَاعِلًا يَفْلِصلَا

“The origin of Muamalat matters is by understanding its underlying wisdom”



# Characteristics of Shariah-compliant Banking and Financial System

Free from *Riba*

Free from *Ihtikar* (hoarding)

Free from *Qimar* or *Maysir* (Gambling)

Free from *jahl mufdi ila al-niza* (lack of information leading to dispute)

Free from *Najsh* (Raising prices by making false bids) - *nay' muzayadah* is allowed

Free from *Gharar Fahish*

Free from *Ikrah* (coercion)

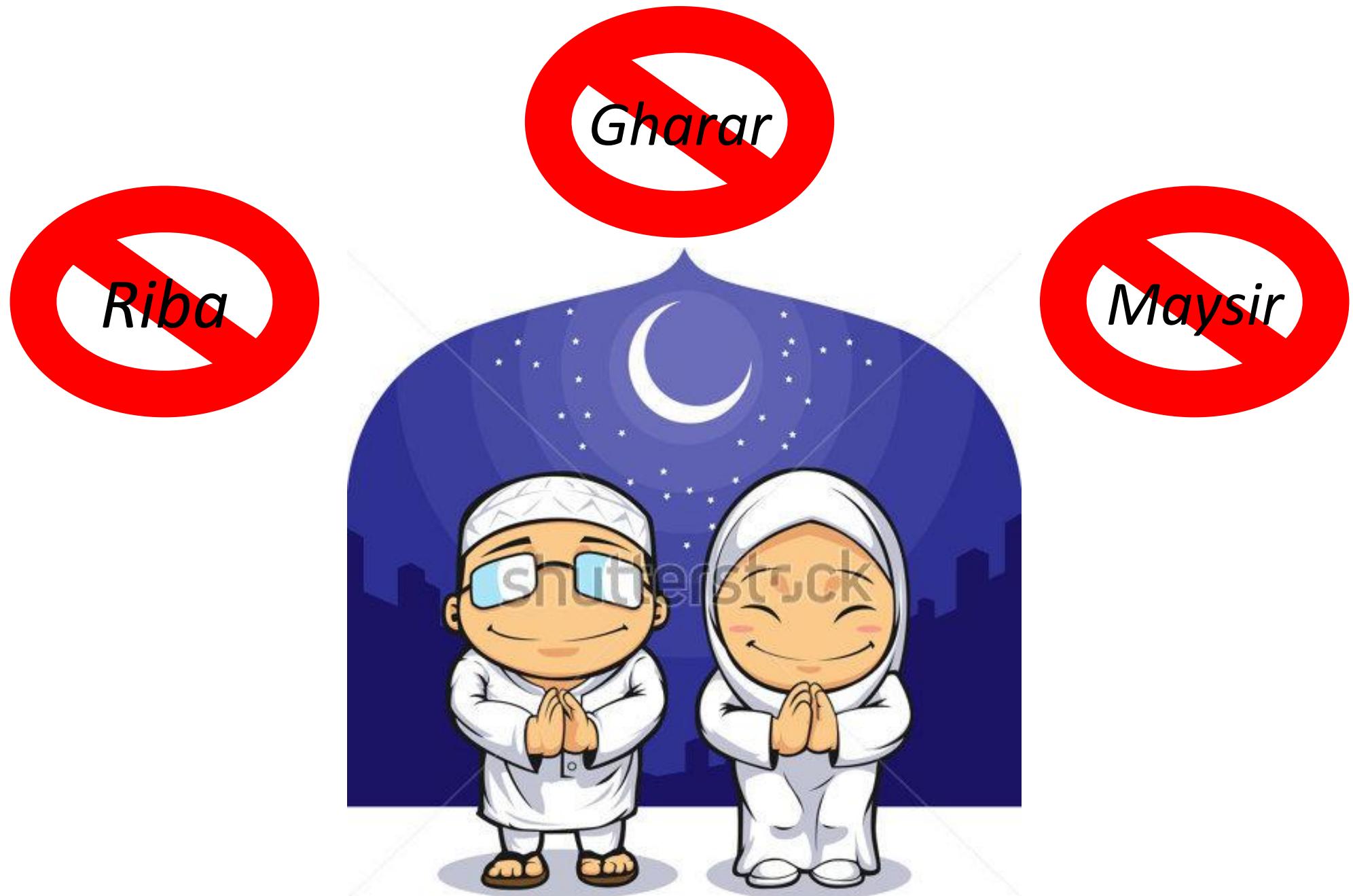
Free from element of exploitation of needs (*bay' al-mudtarr* - بيع المضار)

Constructed upon the principle of brotherhood and cooperation

A system grounded on moral and ethical framework of Shariah

# FUNDAMENTAL PROHIBITED ELEMENTS IN ISLAMIC FINANCE





Islam promotes maslahah by protecting the interests and benefits of all parties involved in the market.

# Why is Interest prohibited?

- Charging of interest, is unjust to both the lender and the borrower.
- It is an injustice to the borrowers as they have to repay their debts irrespective of their financial situation and the outcome of their business venture.
- In cases when the return on investments is much higher than the interest rate charged, interest-based contracts are similarly unjust to the lenders who cannot enjoy the fruits of higher earnings.
- E.g. **Savings accounts in banks** vs **banks returns and profit.**

# What is Riba?

Interest is prohibited not only because money must remain a medium of exchange to facilitate trade but also because money is not a leasable asset. It must be consumed in the process of being utilized in production or consumption.



# Meaning of Riba

- Literally means excess, increase, expansion, growth.
- In Shariah:
  - Hanafi's School: A surplus of commodity or an excess in return without counter value.
  - Riba is a predetermined excess or surplus over and above the loan received by the creditor conditionally in relation to a specified time period.

Referring to Fiqh Al-Islami Wa Adillatuh by Wahba Al-Zuhaily

# The Prohibition of Riba

يَأَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنْتُمْ مُّؤْمِنِينَ  
فَإِن لَّمْ تَفْعَلُوا فَأَذْنُوْا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ وَإِن تُبْتُمْ فَلَكُمْ رُءُوسُ  
أَمْوَالِكُمْ لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ

٢٧٨

٢٧٩

O you who believe, fear Allah and give up what remains [due to you] of interest, if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger. But if you repent, you may have your principal [*without interest*] – [thus] you do no wrong, nor are you wronged.

(Al-Baqarah: 278-279)

# Prophet s.a.w. also condemns Riba

"Avoid the **seven grave sins**". The companions asked: "And what are they, O Messenger of Allah? He said: "They are: associating others with Allah, engaging in magic, killing a forbidden human soul without a legal right, devouring *riba*, devouring the wealth of an orphan, escaping on a day of religious battle, and defamation of unsuspecting believing married women.

The Prophet s.a.w. condemns those who take *riba*, give *riba*, witness to *riba* (*transaction*) and the writer of the *riba transaction*.

أَخْبَرَنَا الرَّبِيعُ بْنُ سُلَيْمَانَ، قَالَ حَدَّثَنَا ابْنُ وَهْبٍ، عَنْ سُلَيْمَانَ بْنِ بَلَالٍ، عَنْ ثَوْرِ بْنِ زَيْدٍ، عَنْ أَبِي الْغَيْثِ، عَنْ أَبِي هُرَيْرَةَ أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَ " اجْتَنِبُوا السَّبْعَ الْمُوبِقَاتِ ". قِيلَ يَا رَسُولَ اللَّهِ مَا هِيَ قَالَ " الشَّرْكُ بِاللَّهِ وَالشُّحُّ وَقَتْلُ النَّفْسِ الَّتِي حَرَمَ اللَّهُ إِلَّا بِالْحَقِّ وَأَكْلُ الرِّبَا وَأَكْلُ مَالِ الْبَيْتِ وَالتَّوْلِي يَوْمَ الزَّحْفِ وَقَذْفُ الْمُحْسَنَاتِ الْغَافِلَاتِ الْمُؤْمِنَاتِ ".

حَدَّثَنَا قُتَيْبَةُ، حَدَّثَنَا أَبُو عَوَانَةَ، عَنْ سِيمَاكِ بْنِ حَرْبٍ، عَنْ عَبْدِ الرَّحْمَنِ بْنِ عَبْدِ اللَّهِ بْنِ مَسْعُودٍ، عَنْ ابْنِ مَسْعُودٍ، قَالَ لَعَنَ رَسُولِ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ آكِلِ الرِّبَا وَمُوْكِلَهُ وَشَاهِدَيْهِ وَكَاتِبَهُ . قَالَ وَفِي الْبَابِ عَنْ عُمَرَ وَعَلِيٍّ وَجَابِرٍ وَأَبِي جُحَيْفَةَ . قَالَ أَبُو عِيسَى حَدِيثُ عَبْدِ اللَّهِ حَدِيثُ حَسَنٌ صَحِيحٌ .

"There are 73 different types of *riba*, the least of which is equivalent to bedding one's mother, and the worst of which is equivalent to destroying the honor of a Muslim".  
(Narrated by Ibn Majah and Al-Hakim).

# Prohibition of Riba

Riba corrupts society  
(Surah ar-Rum: 37-41).

Riba is unjust (Surah  
al-Baqarah: 279).

Riba implies improper  
appropriation of  
others' property  
(Surah an-Nisa':  
160-161).

Riba demeans and  
diminishes human  
personality (Surah  
al-Baqarah: 275).

Riba's ultimate effect  
is negative growth  
(Surah al-Baqarah:  
276).



# Ribawi Materials

## RIBAWI MATERIALS

Ribawi materials are divided into two bases and under each basis are the different kinds as follows:

BASIS (MEDIA OF EXCHANGE)	BASIS (FOODSTUFFS)
<ul style="list-style-type: none"><li>• Gold</li><li>• Silver</li><li>• RM</li><li>• USD</li></ul>	<ul style="list-style-type: none"><li>• Grains – rice, wheat, corn</li><li>• Meats – beef, mutton, chicken</li><li>• Vegetables – tomatoes, bean</li><li>• Fruits – apples, oranges</li><li>• Salts – salt, sugar, condiments</li></ul>

# *Rules of Exchange of Ribawi Materials*

Exchanges	Rules
<p>1. Ribawi materials of the same kind of the same basis. (5 grams of 916 gold for 5 grams of 750 gold; 10 grams of Basmathi rice for 10 grams of A1 rice)</p>	<p><b>1. Materials must be of the same weight, measurement or number of units.</b></p> <p><b>2. Payment must be on cash terms.</b></p>
<p>2. Ribawi materials of different kinds of the same basis. (5 grams of gold for RM200; RM3,800 for USD1,000; 10 kgs of rice for 15 kgs of wheat; 1 tonne of palm oil for 2 tonnes of sugar.)</p>	<p>1. Difference in weights, measurements or number of units allowed,</p> <p><b>2. Payment must still be on cash terms.</b></p>

## *Rules of Exchange of Ribawi Materials, cont.*

Exchanges	Rules
3. Ribawi materials of different kinds of different bases. (10 kgs of dates for 1 gm of gold; 30 kgs of wheat for USD10; 1 tonne of palm oil for RM1,500)	- No rules are imposed. (Difference in weights, measurements or number of units allowed.)

# Categories of Riba

## Loan Riba or Riba Qard/Duyun

- Also known as Riba al-Quran because it is prohibited by the Quran.
- Applies to loan or to any debt regardless of the cause of that debt be it because of a loan contract or because of any transaction like a price that has not been paid yet by the buyer in a sale contract
- It has two types:
  - Riba' al-qard (imposed from the beginning)
  - Riba' jahiliyyah (only imposed after default)

## Sales Riba or Riba al-Buyun

- Also known as Riba as-Sunnah because it is prohibited by the Sunnah.
- Applies to sale transactions in certain commodities
- It has two types:
  - Riba al nasi'ah (delay in paying or delivery of one or the two sold items); and
  - Riba al fadl (exchanging one ribawi commodity for the same commodity but unequal in amount).

# Riba al bay'

The basis for the prohibition of riba in the exchange of commodities is the famous hadith of the Prophet on six commodities:

*"Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt – like for like, equal for equal, and hand-to-hand (spot); if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand or a spot transaction."*

# Example of Riba transactions from the hadith

“Paying in advance for the offspring of the offspring of a pregnant animal (Habal al Habalah) is Riba.”

Once Bilal brought Barni (i.e. a kind of dates to the Prophet and the Prophet asked him, “From where have you brought these?” Bilal replied, “I had some inferior types of dates and exchanged two Sas of it for one Sa of Barni dates in order to give it to the Prophet; to eat.” Thereupon the Prophet said, “Beware! Beware! This is definitely Riba (usury)! This is definitely Riba (usury)! Don’t do so, but if you want to buy (a superior kind of dates) sell the inferior dates for money and then buy the superior kind of dates with that money.”

أَخْبَرَنَا يَحْيَى بْنُ حَكِيمٍ، قَالَ حَدَّثَنَا مُحَمَّدُ بْنُ جَعْفَرٍ، قَالَ حَدَّثَنَا شُعْبَةُ، عَنْ أَيُوبَ، عَنْ سَعِيدِ بْنِ جُبَيْرٍ، عَنْ ابْنِ عَبَّاسٍ، عَنِ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَ "السَّلَفُ فِي حَبَلِ الْحَبَلَةِ رِبَا" .

حَدَّثَنَا إِسْحَاقُ، حَدَّثَنَا يَحْيَى بْنُ صَالِحٍ، حَدَّثَنَا مُعاوِيَةُ - هُوَ ابْنُ سَلَامٍ - عَنْ يَحْيَى، قَالَ سَمِعْتُ عُقْبَةَ بْنَ عَبْدِ الْعَافِرِ، أَنَّهُ سَمِعَ أَبَا سَعِيدِ الْخُدْرِيَّ - رَضِيَ اللَّهُ عَنْهُ - قَالَ جَاءَ بِلَالٌ إِلَى النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ بِتَمْرٍ بَرْزَنِيٌّ فَقَالَ لَهُ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ "مِنْ أَيْنَ هَذَا". قَالَ بِلَالٌ كَانَ عِنْدَنَا تَمْرٌ رَدِيٌّ، فَبَعْثَ مِنْهُ صَاعِينِ بِصَاعٍ، لِنُطْعِمَ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ فَقَالَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ عِنْدَ ذَلِكَ "أَوْهُ أَوْهُ عَيْنُ الرِّبَا عَيْنُ الرِّبَا، لَا تَفْعَلْ، وَلَكِنْ إِذَا أَرَدْتَ أَنْ تَشْتَرِي فَبِعِ التَّمْرَ بِبَيْعٍ آخَرَ ثُمَّ اشْتَرِهِ".

# Misconceptions about Riba



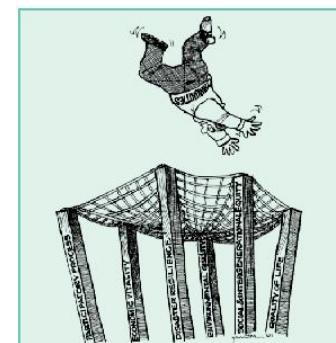
Bank Interest is NOT RIBA because NOT EXCESSIVE

INTEREST should be ALLOWED because of inflation



RIBA is not relevant to commercial loans

Interest-based commercial transactions is NOT RIBA because it's newly invented



RIBA should be allowed under *Dharurah*

# Interest-based commercial transactions is NOT RIBA because it's newly invented

## Argument

- The prohibition of riba was revealed in the last days of the life of the Prophet s.a.w.
- The Prophet did not have the opportunity to elaborate the interpretation and definition of riba
- Such ambiguity in the meaning of riba falls under area of *Mutashabihaat*, thus its prohibition cannot be extended to modern day banking

## Addressing the Misconceptions

- The fact that the Prophet included the prohibition of riba in his last sermon does not mean that the prohibition was only introduced at that time
  - Given that his last sermon was attended by most of his followers, perhaps he felt necessary to reiterate the prohibition of riba
- Other prohibitions (e.g. pork, liquor, gambling, adultery) were also not given elaborate definitions.
- *Mutashabihaat* refers to verses in the Qur'an, the correct meaning of which is not known to anybody for sure, e.g. some words used in the beginning of some surahs, "Alif Lam Mim" or references made to the "hand of Allah" in 57:29. Ignorance of correct meaning does not affect the lives of Muslims because no precept of Shari'ah is revealed through them.
- However, riba relates to prevalent economic and social practice

It is not imaginable that Allah the All-Merciful would wage war against a practice, the correct nature of which is not known to anybody

# Bank Interest is NOT RIBA because NOT EXCESSIVE

## Argument

- Al-'Imran (3:130) – “ O those who believe do not eat up riba doubled and redoubled”
- If rate of interest is not excessive (e.g. doubled) then it does not constitute riba and therefore not prohibited

## Addressing the Misconceptions

- Verses of the Qur'an on the same subject matter must be studied in relation to each other.
  - Al-Baqarah (2:278) – “O those who believe fear Allah and give up whatever remains of riba, if you are believers”.
  - Every amount, regardless of magnitude, over and above principal is riba
- The Qur'an is a book of guidance, not originally a book of statutes and legal text.
  - Embodies many expressions having persuasive value. E.g. “Do not sell My verses for a little price” (al – Baqarah 2:41) – does not imply that one can sell verses for a high price
  - Other e.g. “Do not kill your children for fear of poverty” (al-Isra 17:31) does not imply that killing our children for other reasons is halal
- The expression “doubled” only meant to emphasized added severity of the sin due to its excessiveness

# RIBA should be allowed under Dharurah

## Argument

- Doctrine of Necessity – under *dharurah* circumstances, the haram is permissible.
- E.g. It is permissible to consume pork to save one's life from dying of hunger.

## Addressing the Misconceptions

- Is the “necessity” real or exaggerated by imaginary apprehensions?
- Can the necessity be met with by any other permissible means?
- At the individual (debtor) level
  - Is the purpose of the riba-based loan to protect an absolute necessity?
  - Have all other permissible alternatives been exhausted?
- At the institutional level
  - Removal of riba from the economy does not imply that financial institutions will have to give charitable (interest-free) loans
- While giving a benevolent loan is highly recommended, the taking of a loan is discouraged and limited to cases of absolute necessity
  - Islam provides means of financial intermediation in the form of profit and loss sharing

The role of loan-giving and taking in Islam must be understood

# RIBA is not relevant to commercial loans

- Argument
  - The common practice of riba during the time of its prohibition was the charging of interest on consumption loans taken by poor people to finance their basic needs.
  - This form of exploitation is not present in production loans whereby in many cases, the debtor is economically well-off.
    - Loans taken by rich businessmen are used to generate profit
  - The basic cause of the prohibition of riba, zulm (injustice), is absent.

# Addressing the Misconceptions

**To say that commercial or productive loans were not in existence then is not accurate.**

- There are evidences to substantiate that the practice of interest-based production loans dated back to much earlier times.
  - As early as 2000 B.C. in Babylon; 500 B.C. in Greece; During the time of Byzantine emperor Justinian (527-565 A.D.); and
  - A number of hadith reporting on the practice of riba-based commercial loans
- Nature of Qur'anic prohibition
  - includes all forms of riba regardless of whether or not prevalent at time of its revelation.
  - E.g. prohibition of liquor and gambling

**Validity of a transaction is not based on the financial status of a party.**

- Intrinsic nature of transaction itself should determine its validity
- Similarly for prohibited transactions
  - E.g. Gambling and bribery are prohibited for both the rich and poor
- Consumption loans  taken by the poor, Production loans  taken by the rich – an erroneous presumption.
  - Consumption of luxurious objects
  - Financing of business by poor entrepreneur

# Addressing the Misconceptions

## Need to differentiate *illat* and *hikmat*

- Application of law depends on *illat* and not *hikmat*
  - Can one consume alcohol if he claims that it does not promote hatred and prevent him from remembering Allah?
  - E.g. does it make it legal for a motorist to run the red light if he is reasonably sure that there is no risk of accident?
- The *illat* of a law is always determinable by hard and fast definition that leaves little room for dispute.
  - *Zulm* (injustice) is relative, ambiguous and subject to manipulation
- Possible rationale for making application of law based on *illat* and not *hikmat*
  - For e.g. why does Islam provide a long list of prohibitions and commands instead of issuing one single command to avoid *zulm*?
  - Human reason, despite its wide capabilities, cannot claim to have unlimited power to reach the absolute truth
  - Reason often confused with desires, leading to disguised justice
  - Thus humans need guidance of divine revelations

*Illat* – Basic feature of the transaction

*Hikmat* – Wisdom or rationale behind the rule or prohibition

# INTEREST Should be Allowed because of Inflation

## Argument

- Interest represents compensation for the erosion of the value of money (due to inflation) during the period of borrowing.
- Loans should be indexed so that there is no injustice to the creditor.

## Addressing the Misconceptions

- Rates of interest are not based on rates of inflation, although there may be correlations.
- Indexation of loans is problematic due to the lack of precise measures of inflation.
  - Indices are, at best, aggregated generalizations about price levels
  - The effects of inflation differ from individual to individual
- If surplus on loan amount is only attributable to actual value loss due to inflation, there will be no commercial incentives to banks
- Interest is one of the causes of inflation
  - Using interest to remedy inflation which is a consequence of interest-based lending in the first place
  - A better solution is not to charge interest to begin with

- For Muslims, the prohibition of riba as evidenced in the Qur'an and Sunnah should be sufficient.
- However we can attempt to articulate some rationale or reasons for its prohibition to better appreciate the wisdom behind the injunction.
- In the next slides are some of the possible rationale for the prohibition of riba

# Rationale for the Prohibition of Riba

## **Element of injustice in financing productive activities**

- An interest-based production loan constitutes a contract with unequal counter values –certainty of interest obligation vs. uncertainty of business outcome
- Injustice to debtor – obligated to pay interest even if business venture results in no profit or loss
- Injustice to creditor –in the event of substantial profits, creditor receives a return disproportionate to amount of generated profits

## **Element of exploitation in financing consumption**

- Riba assumes money as a commodity, one which the rich has in abundance
- The rich is able to generate more wealth without exerting much effort or contributing to productive activity

# Rationale for the Prohibition of Riba

## Riba inconsistent with Islam's perspective on debt

- In Islam, incurring debt is discouraged
  - The Prophet s.a.w. refused to offer salat-ul janazah of a person who died indebted
  - Borrowing money should be limited to cases of dire need
- On the other hand, permitting riba enables lending to become a viable business
  - Banks are motivated to lend as much as possible
  - Banks exploit man's inherent greed to spend beyond their means by offering credit
  - Given that spending on credit is a product of human greed, it will result in negative repercussions
  - □ The outcome is the proliferation of a "credit society"

## Negative effects of a “credit society”

- Easy availability of credit cultivates a materialistic society
  - People have to work harder in order to repay bank debt
  - The banks in essence exercise “control” over economic agents, people become “enslaved” to the banks
- The quest for economic development clouds good moral judgment and the Islamic value system
  - Unethical business practices
  - Degradation of the natural environment
  - Less emphasis on the institution of family leads to social ills e.g. longer working hours, multiple jobs, forced female and teenage labour
  - □ Essentially, Muslims forget their roles as ‘abd & khilafah
- Social relations amongst the people are negatively affected
  - Members of society should help each other in times of need
  - Riba entails taking advantage of a man's inferior economic position
  - Riba breeds hatred, jealousy & ill-will towards the rich

# Rationale for the Prohibition of Riba

## Negative effects on production

- Impediment to healthy growth of the economy
  - Riba-based lending is security oriented rather than growth oriented
  - Lending is confined to established businesses with known creditworthiness and adequate security (collateral)
  - Potential entrepreneurs without security to pledge are denied credit
- Inefficient allocation of resources
  - Bank interest return does not vary with actual profits, no incentive to give priority to ventures with highest profit potential
  - Lending based on creditworthiness, not profitability
- Discourages Innovation
  - Interest obligation act as disincentive for experimenting with new, unproven methods of production, especially for small-scale enterprises and agriculture
- Leveraged financing favours large-scale businesses
  - Domination of big businesses over smaller entrepreneurs will curtail competition and in turn will affect product variety and innovation
- Anti-productive
  - Inflexibility in a loss situation leads to bankruptcies – loss of productive potential and unemployment
- Funding not channeled to deserving economic agents
  - Utility of certain projects is with reference to criteria other than profitability
  - E.g. projects that benefit the public, poverty alleviation
- Financing of luxurious or wasteful consumption and/or production

# Rationale for the Prohibition of Riba

## Negative effects on distribution

- Because the primary basis of interest-based lending is creditworthiness, there will be disproportionate supply of credit to the already affluent segments of population
- Wealth inequality (in terms of purchasing power) is widened
  - The rich become richer, and the poor become poorer

## Transfer of real assets to the lenders

- Most debt financing requires some form of collateralization in the form of real assets (real estate, equipment & machinery)
- Given that with the current monetary system, bank debt is un-repayable in aggregate, loan defaults are inevitable
- Interest-based lending will, by design, lead to transfer of real assets from the borrower to the lender, in the long run
- Wealth inequality (in real terms) becomes prevalent

# Rationale for the Prohibition of Riba

## Domination of large enterprises leads to demise of smaller economic units

- Lacking collateral and established economic standing, poorer segments of the economy are at an economic disadvantage when competing for credit to finance economic activities
- As a result, wealth and income disparities worsens

أَخْبَرَنَا قُتَيْبَةُ، قَالَ حَدَّثَنَا أَبْنُ أَبِي عَدِيٍّ، عَنْ دَاؤَدْ بْنِ أَبِي هِنْدٍ،  
عَنْ سَعِيدِ بْنِ أَبِي خَيْرَةَ، عَنِ الْحَسَنِ، عَنْ أَبِي هُرَيْرَةَ، قَالَ  
قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ "يَأْتِي عَلَى النَّاسِ زَمَانٌ  
يَأْكُلُونَ الرِّبَا فَمَنْ لَمْ يَأْكُلْهُ أَصَابَهُ مِنْ غُبَارٍ".

It was narrated that Abu Hurairah said:  
**“The Messenger of Allah said: There will come a time when there will be no one left who does not consume Riba, and whoever does not consume it will nevertheless be affected by residue.”**

# What is Gharar?

## Meaning

- Literally:
  - Deceit, fraud, uncertainty, danger, peril, or hazard that might lead to destruction or loss
- Technically:
  - Uncertainty and/or ignorance of one/both parties in a contract over the substance or attributes of the object of sale, or doubt over its existence and availability at the time of contract

So, some stuff happened,  
and some people were like,  
whatever, and stuff, and  
some other people were there,  
and so, like, no one was hurt,  
fortunately.



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[www.CartoonStock.com](http://www.CartoonStock.com) **the vague**

## Types of Gharar

Gharar Yasir  
(minor gharar)

Gharar Fahish  
(major gharar, cannot be avoided)

Contracts involve minor gharar are permissible and valid

Uncertainty is so great that it becomes unacceptable

Related to some factors:  
Buyer and seller | Asset | Price | Contract

# Prohibition of Gharar

## Prohibition of gharar

- Indirect references made in the Qur'an
- Conclusively prohibited by the Sunnah of the Prophet s.a.w.

## Classical examples of gharar sale

- Sale of fish still in the sea
- Sale of birds in the air
- Sale of unborn animals

All jurists agree that gharar should be avoided in commercial exchange contracts

# Rationale for Gharar Prohibition

- To ensure full consent and satisfaction of the parties in a contract.
- Without full consent, a contract may not be valid.
- Full consent can only be achieved through certainty, full knowledge, full disclosure and transparency.

Gharar in commercial contracts may lead to injustice, exploitation and/or enmity among contracting parties.

# The prohibition of gharar

## Gharar elements in sale contracts

- Non-possession of object i.e. selling item owned but stolen
- Conditional sales, insertion of extraneous stipulations that introduce uncertainty i.e. will sell if snow falls

## Exceptions

- The uncertainty is slight or trivial (gharar yasir)
- Contract is unilateral or charitable (al tabarru'at) such as gift or bequest
- There is a public need for the transaction or contract (consideration of maslahah) i.e. bay' al salam, istisna'

# Risk (Ghurm) and Gharar

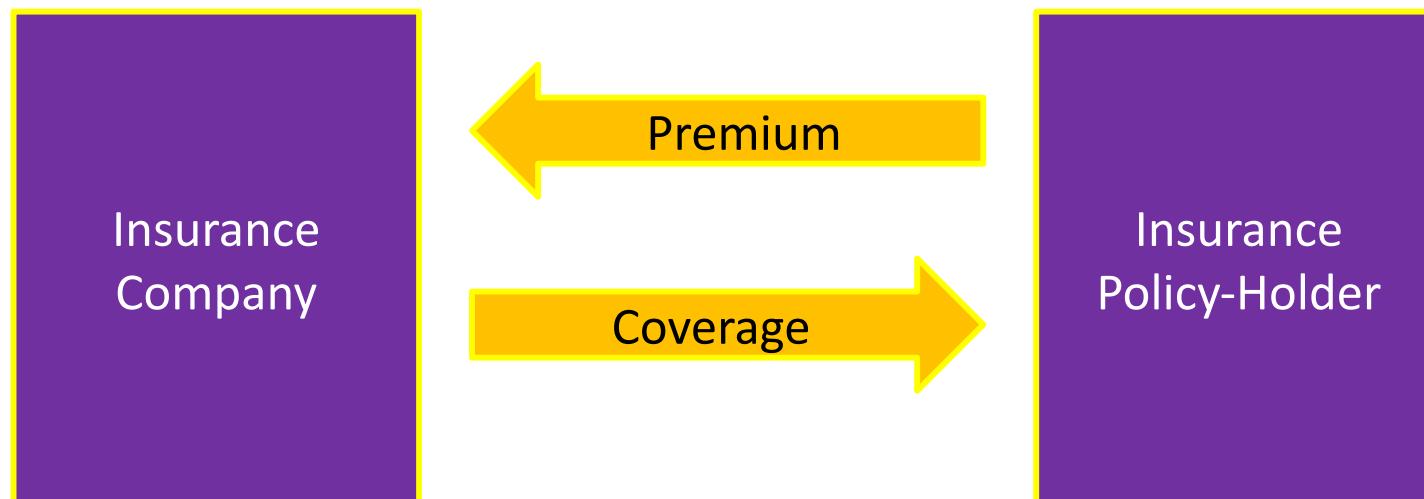
	Risk (Ghurm)	Gharar
Permissibility in Islam	Allowed in Islam, as per Islamic legal maxim – Al ghurmu bil ghunmi (no risk no gain)	Hadith – gharar sales prohibited (e.g. selling fish in the sea, birds in the sky)
Characteristic	Inherent in productive economic activities	Unnecessary, avoidable, intentionally created
Common day Example	Risks of trading, doing business, making investments	Not stipulating price or product specification in a sales contract
Effects	Encourage entrepreneurial spirit and Productivity	Exploitation for self interest, can lead to harm and injustice

# Gharar in Modern day Financial Transactions

- Financing documentation must feature sufficient details, terms and conditions so as to avoid gharar.
- Conventional insurance is deemed as not Shari'ah compliant because it entails gharar.
- Conventional insurance contract is aleatory (outcome affected by chance) in nature.

# Gharar in Modern day Financial Transactions

- There is uncertainty (gharar) of what the insurance policy-holder is “buying” or paying for
  - If no loss occurs – Policy-holder receives nothing
  - If loss occurs – Policy-holder gets compensation in varying amounts



# Gharar in Modern day Financial Transactions

- The Islamic alternative to conventional insurance is takaful.



Manages the fund for a fee or a share in profits on investment.

Takaful Fund



Takaful Participants



Contribute via unilateral contract (tabarru'at)

# Gharar in Modern day Financial Transactions

- Takaful participants contribute to takaful fund based on the concept of mutual assistance.
- The contribution is done via reciprocal/mutual donation (*tabarru'at*) and does not represent a commercial “sale of coverage”.
- Gharar is tolerated in such a charitable unilateral contract.

# Gambling (Maysir)

- Gambling or maysir or also known as qimar, is defined as **any activity** which involves betting **whereby the winner will take the entire bet and the loser will lose his bet.**
- It means games of pure chance where any party might gain at the expense of the loss of the other party.



# Prohibition of Gambling

- The Quran had explicitly condemned and prohibited gambling.

“O believers, wine and gambling (maysir), idols and divination by arrows are but abominations devised by the Satan, avoid them so that you may prosper. Indeed Satan seeks to stir up enmity and hatred among you by means of wine and gambling and to keep you away from remembrance of Allah swt and from your prayers.”

Surah al-Maidah, verses 90-91.

This verse explains the reason for the prohibition of gambling as it invokes enmity in society and distracts believers from worshipping Allah swt.

# The Distinction for the Prohibition Of Gambling in the Financial Market



The betting is done on the basis of other people's wealth. The terms of betting are so designed that losses are distributed over other wealth owners but those making the bet share only the gains.



Because speculation resembles gambling, it increases volatility in financial markets, making life difficult for those engaged in the production of real goods and services.

**Gambling does not create wealth;  
it only redistributes what already exists.**



# **DIFFERENCES BETWEEN ISLAMIC FINANCE AND CONVENTIONAL FINANCE**

- Contrary to conventional economics, Islamic economics and finance must **observe the teachings of Shari'ah**.
- Thus, IFIs are **not allowed to finance any project which conflicts with the moral values of Islam** such as production of alcohol, tobacco, pornography and casino businesses, due to their detrimental effects on society while prohibiting usury (*riba*), excessive ambiguity (*gharar*), and gambling (*maysir*).
- Charging interest, as practised by the conventional financial system, is also unjust to both the lender and the borrower.
- Islam promotes economically productive activities and genuine trade and business transactions.

In the Islamic financial system, money is not a commodity as is the case with the conventional financial system.

- The Islamic financial system promotes the principles of brotherhood and co-operation through partnership, equity-based financing and risk-sharing.
- As a result, the provider of funds (investor) and user of funds (entrepreneur) are expected to help each other, co-operate and mutually share both benefits & shortcomings of the business venture.
- Islamic finance is community-oriented and entrepreneur-friendly, emphasizing on productivity and physical expansion of economic production and services.
- It shifts from the practice of focusing on financial collateral or financial worth of the borrower to the entrepreneur's trustworthiness and project viability and usefulness.

# Key Differences between Conventional and Islamic Finance

Conventional Finance	Islamic Finance
Man-made principles	Principles prescribed by Islamic law
Does not need an asset to be purchased for transaction to happen	Promotes purchase of an asset to generate an income or a return
Charging of interest permitted	Prohibits charging of interest
Structures do not need to be approved for compliance	Structures approved by Shari'ah Advisory Committee or Shari'ah Supervisory or Board of Compliance
Prohibited activities depends on each bank's frameworks	Financing of certain activities such as gambling is not permitted

# Difference between Islamic Financing and Conventional Loan

Items	Conventional Banking	Islamic Banking	Commentary
Banking Relationship	Loan arrangement and services	Financing arrangement based on Partnership, Profit-sharing, Trading, Buying-and-selling, Agency relationship, Commodity sale and services	IB relationship is based on actual economic transaction which must be effected. And where applicable must involve a real asset and ownership.
Contractual terms	Borrower and lender	Partners, Fund Provider and Entrepreneur, Buyer and Seller, Principal and Agent, Supplier and Buyer, Service Provider	Under IB, each relationship is tied to specific contractual obligations where the roles and responsibilities of each party to the transaction is clearly defined and agreed up-front.
Governing Authority	Bank Negara Malaysia	Bank Negara Malaysia and Shariah Committee	A Bank's Shariah Committee may override a BNM instruction if it deems non-compliant or for differing views/ interpretation.
Determinant of Returns	Contractual obligation on the loan amount	Reliant on the activities done to justify earning the returns on the transaction.	In IB, an economic action is crucial to formalize the agreement to pay the Bank a return on their capital, efforts, or assets. E.g. a processing fee for IB requires the Bank to show proof of the processing actions required to justify charging a fee to customers. Otherwise, this will be considered "back-door riba".
Bank Rate Calculation	Monthly/daily rest interest calculations based on floating/ fixed rate loan	Monthly or daily rest profit calculations based on floating or fixed rate financing.	IB are on par with conventional loan at the same bank rate strategy, but must not be deemed excessive.



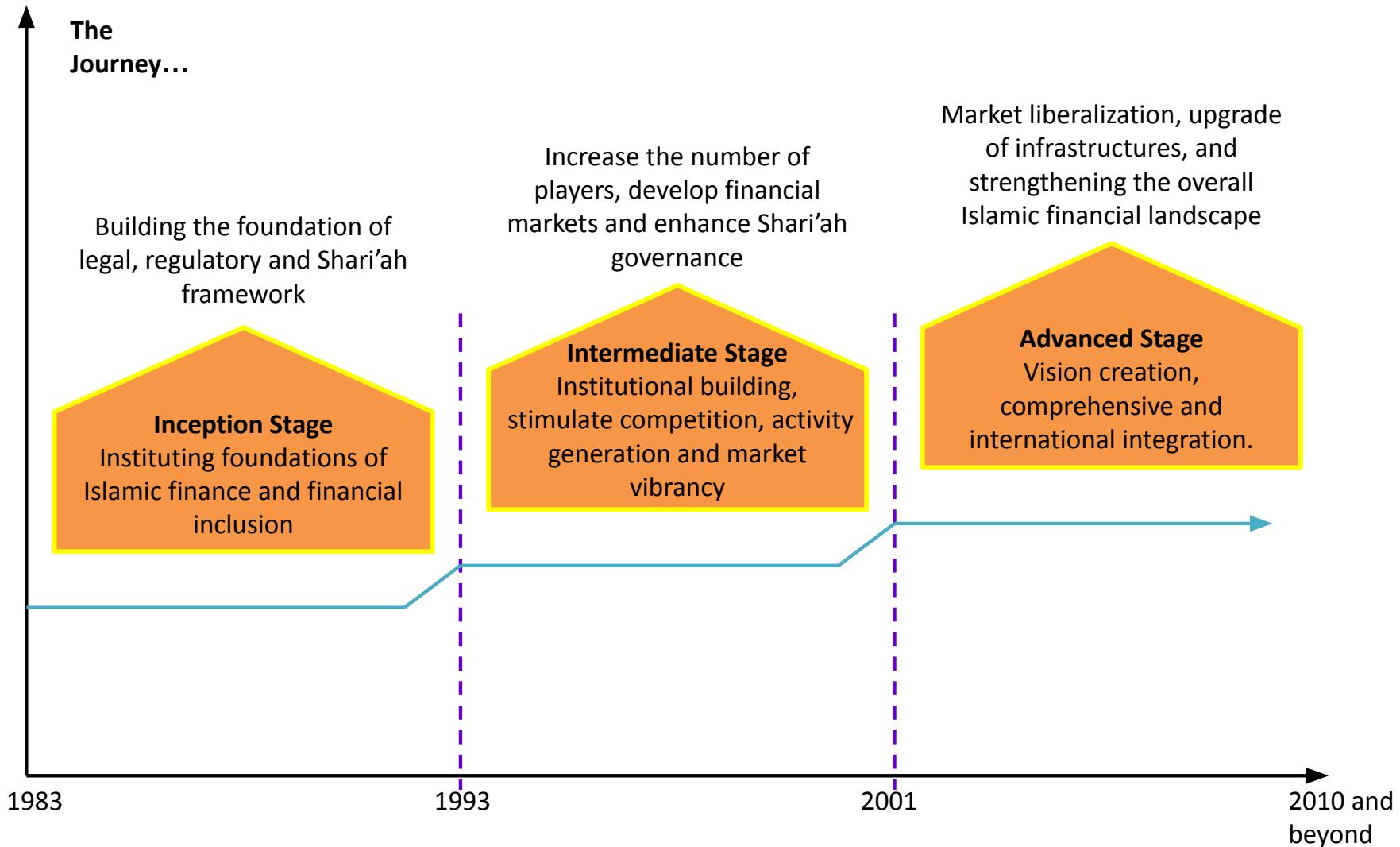
# DEVELOPMENT OF ISLAMIC FINANCE IN MALAYSIA

# Journey of Islamic Finance

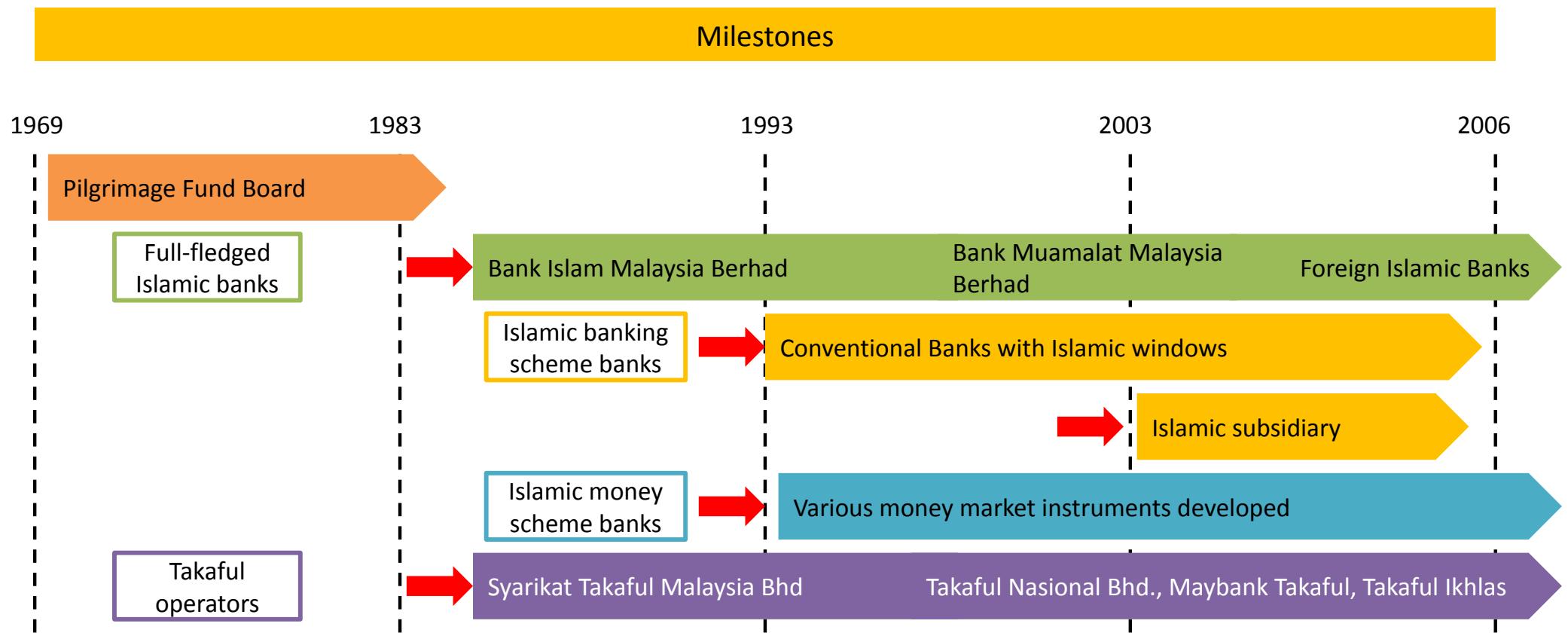
1960s	1970s	1980s	1990s	Contemporary
<b>1963</b> <ul style="list-style-type: none"> <li>Mit Ghamr Local Savings Bank, Egypt</li> <li>Lembaga Tabung Haji, Malaysia</li> </ul>	<b>1971</b> <ul style="list-style-type: none"> <li>Nasser Social Bank, Egypt</li> </ul> <b>1975</b> <ul style="list-style-type: none"> <li>Islamic Development Bank, Jeddah</li> <li>Dubai Islamic Bank, Dubai</li> </ul> <b>1977</b> <ul style="list-style-type: none"> <li>Faisal Islamic Bank, Sudan</li> </ul> <b>1979</b> <ul style="list-style-type: none"> <li>Bahrain Islamic Bank, Bahrain</li> </ul>	<b>1982</b> <ul style="list-style-type: none"> <li>Al-Baraka</li> </ul> <b>1983</b> <ul style="list-style-type: none"> <li>Bank Islam Malaysia Berhad</li> <li>Islamic Bank, Bangladesh</li> <li>Qatar Islamic Bank</li> </ul> <b>1984</b> <ul style="list-style-type: none"> <li>Dar al-Maal Islamic Trust, Geneva</li> </ul> <b>1989</b> <ul style="list-style-type: none"> <li>ANZ Global Islamic Finance, UK</li> </ul>	<b>1991</b> <ul style="list-style-type: none"> <li>Accounting &amp; Auditing Organization for Islamic Financial Institutions, Bahrain</li> </ul> <b>1993</b> <ul style="list-style-type: none"> <li>Islamic Bank of Brunei</li> </ul> <b>1994</b> <ul style="list-style-type: none"> <li>Islamic Inter-banks Money Market, Malaysia</li> </ul> <b>1999</b> <ul style="list-style-type: none"> <li>Bank Muamalat Malaysia Berhad</li> </ul>	<b>2002</b> <ul style="list-style-type: none"> <li>International Islamic Financial Market, Bahrain</li> <li>Islamic Financial Services Board, Kuala Lumpur</li> </ul> <b>2006</b> <ul style="list-style-type: none"> <li>International Centre for Education in Islamic Finance (INCEIF)</li> </ul> <b>2010</b> <ul style="list-style-type: none"> <li>International Islamic Liquidity Management Corporation (IILM)</li> </ul>



# Malaysia's Pragmatic and Gradual Development Approach in Building its Islamic Financial System



# Stages of Development of Islamic Finance in Malaysia



... achieved significant milestones in building a comprehensive and integrated Islamic financial system with diversity of players...

# Implementation of Islamic Finance in Malaysia

1970s – 1980s  
Establishment of  
Islamic Banking and  
Islamic Windows

1980s – 1990s  
Establishment of  
Takaful Institutions

1990s – 2000s  
The emergence of  
Islamic capital market  
instruments

## Phase 1

Establishment of  
Islamic financial  
institutions:

- Tabung Haji
- Bank Islam Malaysia Berhad
- Syarikat Takaful Malaysia Berhad

## Phase 2

Conventional banks  
were allowed to offer  
Islamic financial  
products and services  
under Islamic Banking  
Scheme:

- Interest-free Banking Scheme

## Phase 3

Conventional banks  
were allowed to set  
up Islamic  
subsidiaries:

- Interest-free Banking Scheme

## Phase 4

International  
integration of the  
domestic Islamic  
banking system:

- KFH
- Al-Rajhi
- AFB

Evolution of Islamic financial services industry

# Malaysian Islamic Financial System

## Governance

### Legal & Regulatory

- IFSA 2013
- FSA 2013

### Shariah Advisory Council

- Central Banking Act

### Dispute Resolution

- Judicial system: dedicated high court
- KL Regional Centre for Arbitration
- Financial Mediation Bureau

## Diversified Players

### Banking

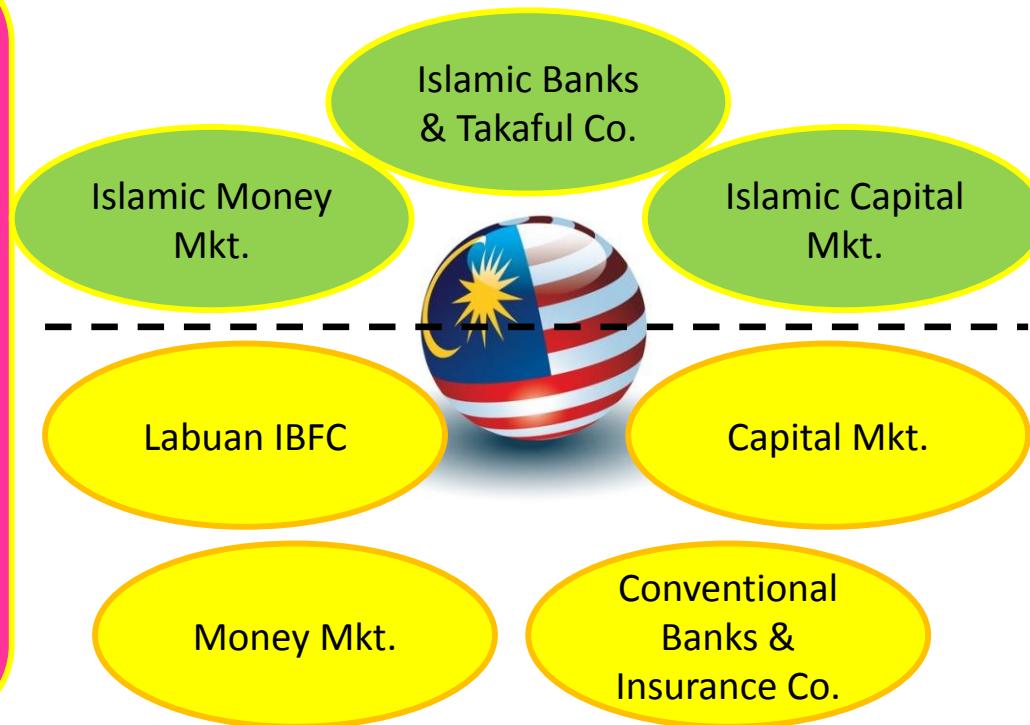
- 16 Islamic banks
- 12 Islamic windows

### Takaful

- 15 Takaful operators
- 3 Retakaful operators

### Fund Management

- 23 Islamic fund mgrs.
- 34 Islamic fund mgmt. windows



## Professional Service

- More than 100 firms offering Islamic financial & related services:
  - Shariah advisory
  - Legal
  - Rating agencies
  - Accounting & Audit

## Financial Markets

- Capital Market
- Money Market
- Foreign Exchange Market
- Commodity Market
- Bursa Suq Al-Sila

## Infrastructure

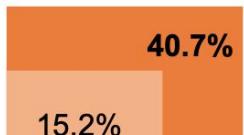
- Pmt., clearing & settlement, custodian
- Principal Dealers
- Listing on Bursa with authorized exchange status
- Technology solutions
- Commodity Trading Platforms

# Islamic finance: An integral component of Malaysian financial system and economy

20%

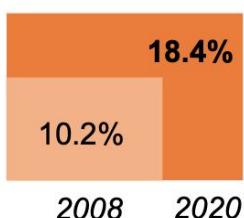
Market share  
of total global  
Islamic financial  
assets as at 2019

## Steady growth in banking and takaful



### Islamic banking

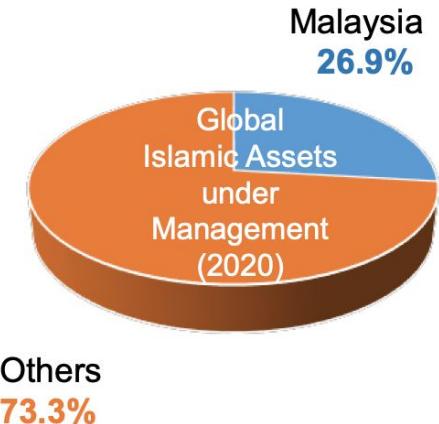
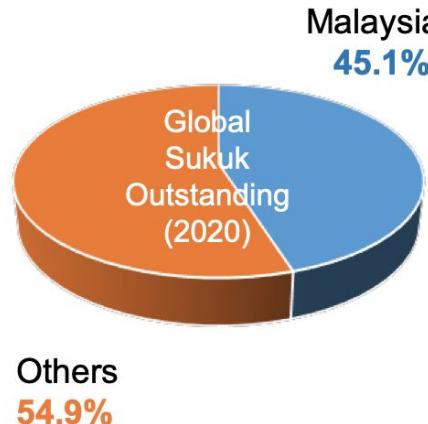
Market share of Islamic banking sector by total financing\*



### Takaful

Market share of takaful sector by total net contributions

## Key driver in global sukuk & Islamic funds



## Key milestones encapsulating the industry's vision to be more impact-driven

### Value-based Intermediation (VBI)



- Aims to deliver the intended outcomes of Shariah through practices, conduct, offerings that generate positive and sustainable impact to the economy, community and environment.
- The Islamic banking industry intermediated approximately RM155.6 billion\* in VBI-related or aligned initiatives. Examples of impact created include:

Nearly 35,000 families now own affordable houses through more than RM20 billion financing

More than 100,000 SMEs & micro-SMEs supported with over RM40 billion financing

More than 4500 renewable energy & green projects financed via more than RM8.8 billion financing

### Optimising Social Finance



Infusion of social finance in Islamic financial services to mobilise capital towards building social resilience e.g.

**iTEKAD:** A blended finance programme that leverages social finance as an instrument to upskill and empower B40 entrepreneurs to generate sustainable income.

**myWakaf:** An online fundraising platform by six Malaysian Islamic banks which allows for cash waqf contribution via built-in payment gateway.

### Supporting Halal Industry

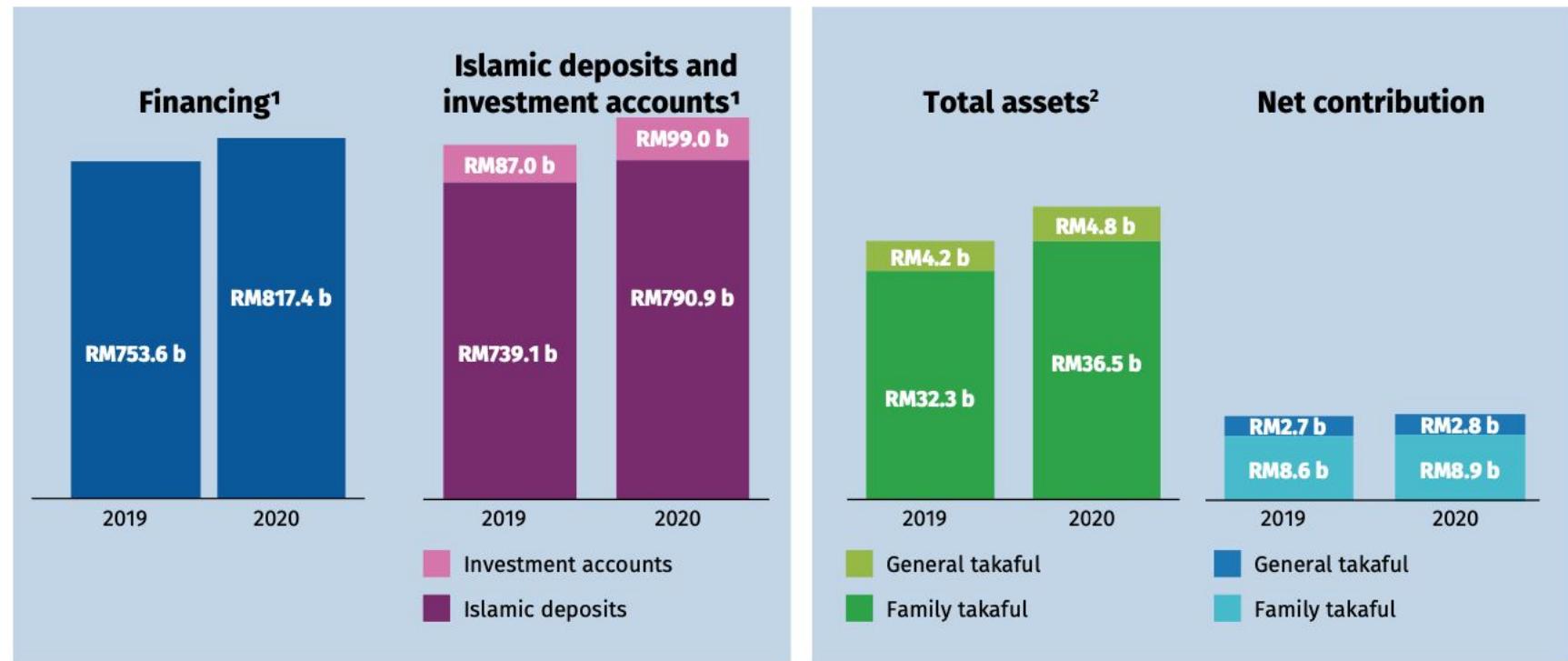
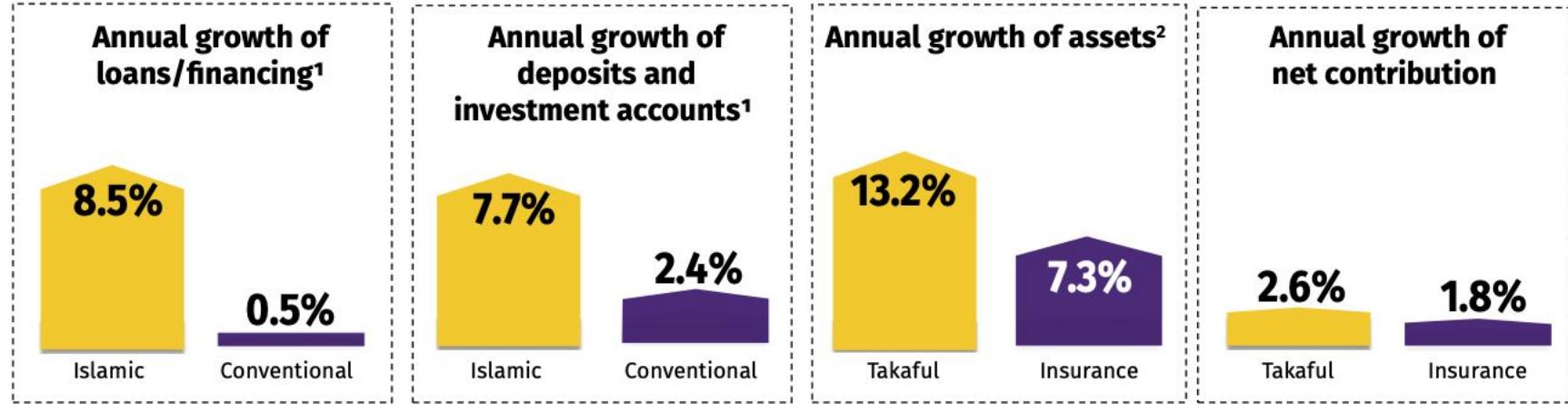


- Widen offerings beyond Shariah financing to support growth of halal industry by providing end-to-end facilitation such as
  - Business advisory including halal certification consultation
  - Business matching leveraging on financial institutions' regional or global networks
- Continued engagements with halal companies to increase take up of Islamic finance products

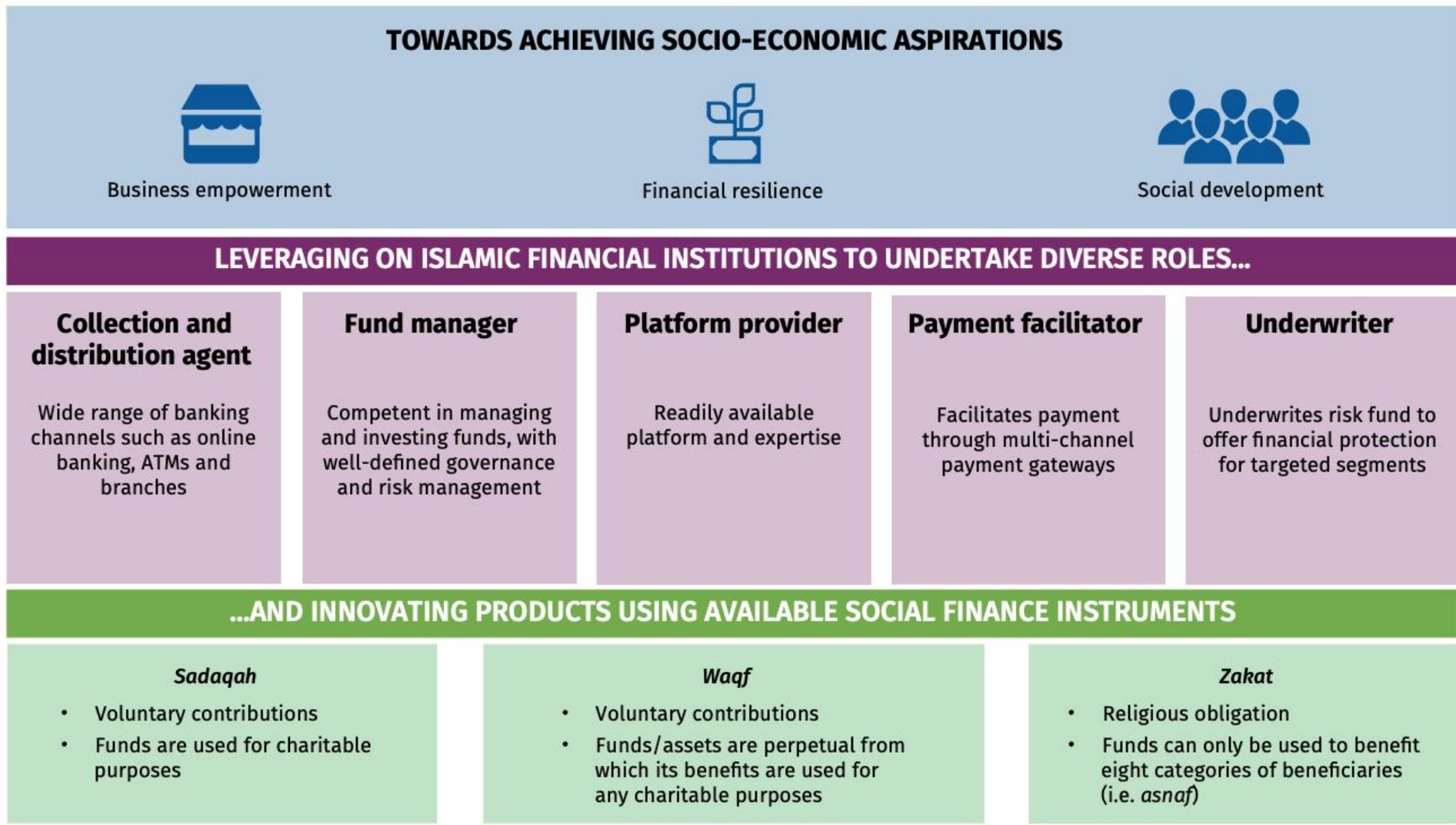
\*Source: VBI Preview Report 2017 – 2020

For more information on VBI, visit [www.aibim.com/value-based-intermediation](http://www.aibim.com/value-based-intermediation).

Diagram 1: Growth of Islamic banking and takaful in 2020

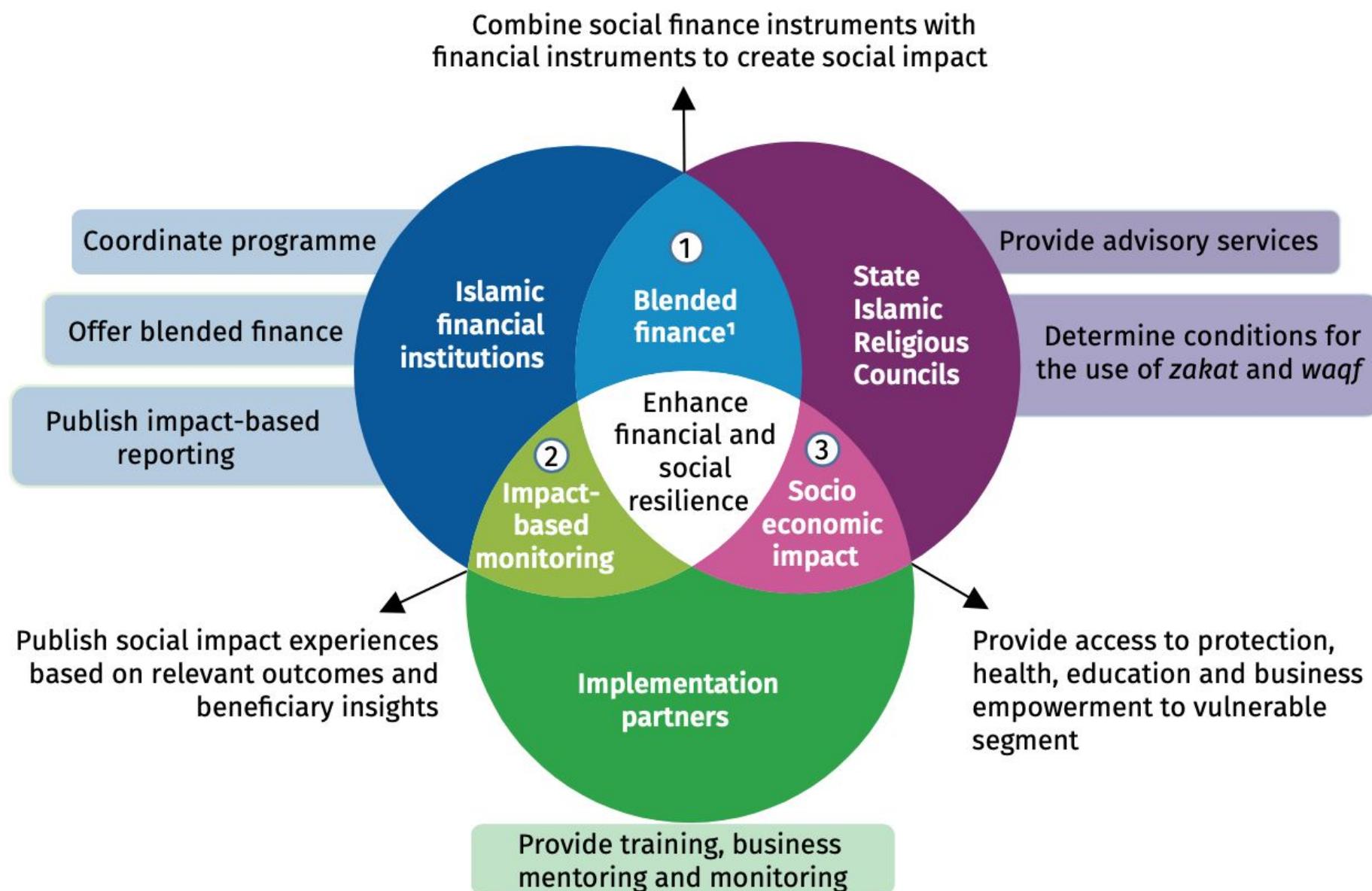


**Diagram 4: Financial intermediation using social finance instruments**



Source: Bank Negara Malaysia Annual Report 2020

Diagram 5: Integration of social finance and roles of key stakeholders



Notes:

<sup>1</sup> Blended finance refers to the strategic use of development finance for the mobilisation of additional finance including philanthropic funds towards sustainable development. Sourced from OECD (2018), Making Blended Finance Work for the Sustainable Development Goals

# Wakaf Development

Diagram 6: Existing myWakaf projects nationwide

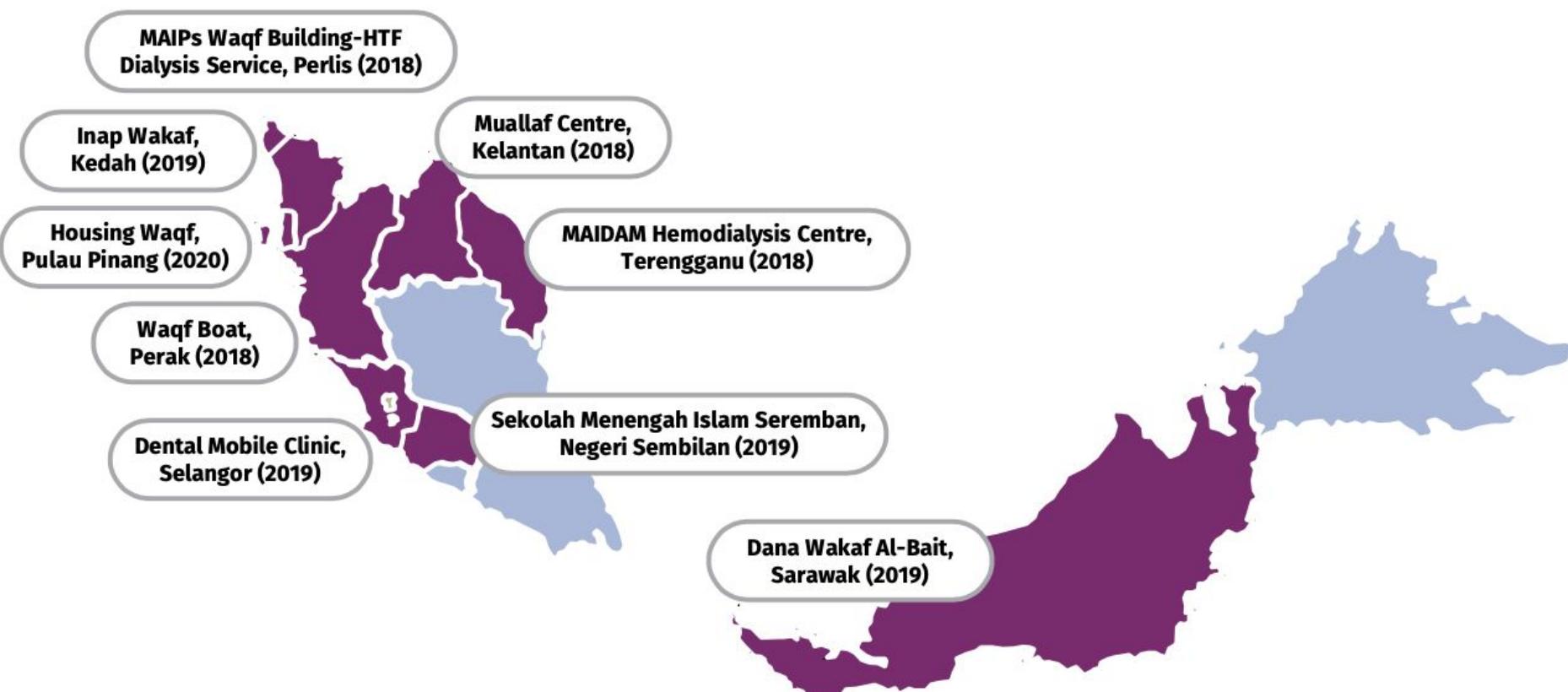
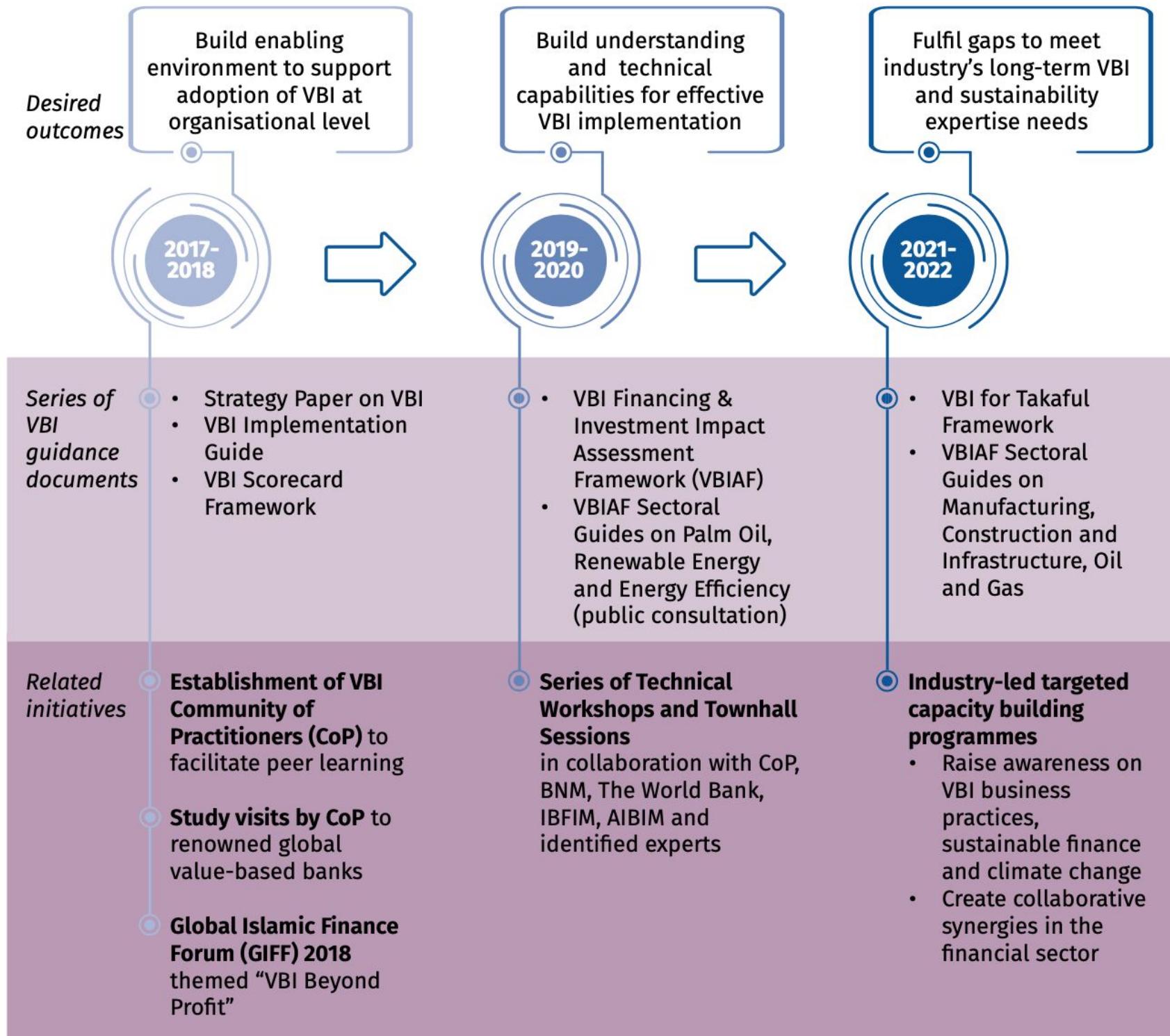


Diagram 10: Concerted efforts on capacity building in catalysing VBI adoption across banking and takaful sectors





In 2021, we will continue to develop a progressive and inclusive Islamic financial system. We will sharpen our focus across three major areas, namely, social resilience, climate resilience and business empowerment. This will entail further diversification in Shariah-compliant financial solutions to address market gaps, and innovative approaches in meeting the evolving needs of the society and economy. These developments, together with the value-based focus of the industry, will contribute towards further strengthening the Islamic financial sector and enhancing its contribution to Malaysia's socio-economic growth and development.

Opportunities, Issues & Challenges to sustain development in global financial system.

## ISLAMIC FINANCE TODAY

# The Current Scenario

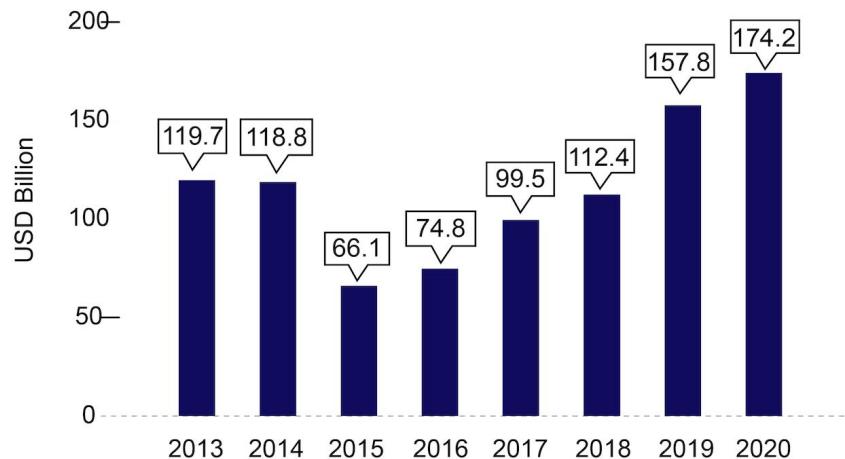
- The global Islamic finance market is growing moderately, because of the strong investments in the Halal Sectors, infrastructure, and Sukuk bonds, especially through electronic modes in all products and services.
- The factors driving the growth of the market are directing investment toward the tremendous growth opportunities in the promising Islamic sectors.
- The industry's total worth, according to key industry stakeholder organizations, across its three main sectors (banking, capital markets, and TAKĀFUL), was estimated to be USD 2.05 trillion in 2017, marking an 8.3% growth in assets in USD terms, and reversing the preceding two years of assets' growth stagnation (2017: USD 1.89 trillion vs. 2016: USD 1.88 trillion).

# Sukuk

Global SUKUK outstanding surged by a record 25.6% to close at USD 399.9 billion as at end 2017 [2016: USD 318.5 billion], as per industry sources, on the back of strong sovereign and multilateral issuances in key Islamic Finance markets to support respective budgetary expenditures. This included debut entries into the sovereign SUKUK market by Saudi Arabia and Nigeria, as well as the pan-African multilateral development finance institution, Africa Finance Corporation.

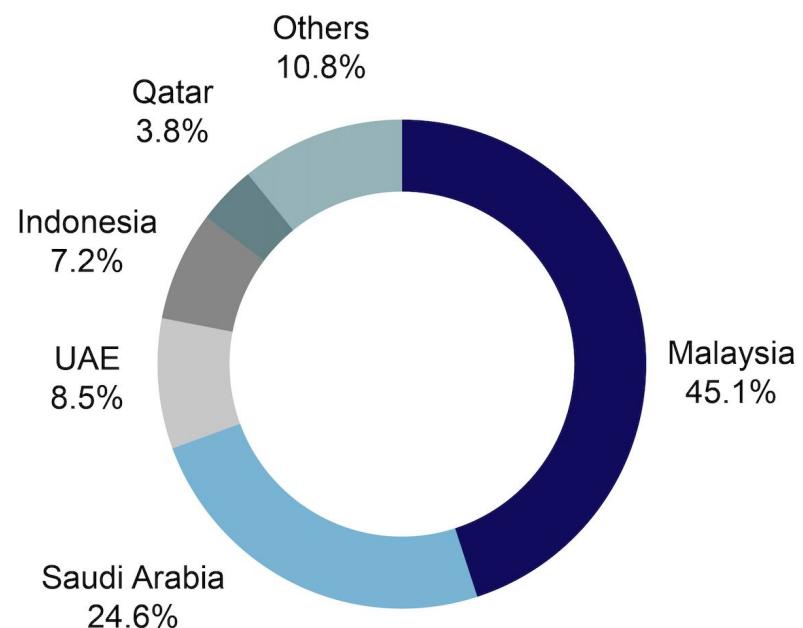
Source: Global Islamic Finance Market 2019

**Global Sukuk Issuance  
as at end 2020**



Source : MIFC estimates

**Global Sukuk Outstanding by Domicile  
as at end 2020**



Source : MIFC estimates

# Key Market Trends

## Islamic Banking is the Largest Segment

- Islamic banking is the largest sector in the Islamic finance industry, contributing to 71%, or USD 1.72 trillion, of the industry's assets. The sector is supported by an array of commercial, wholesale, and other types of banks. Yet commercial banking remains the main contributor to the sector's growth. There were 505 Islamic banks in 2017, including 207 Islamic Banking windows. However, the number of players is not necessarily indicative of the size of the industry, in terms of assets. Islamic finance's second-largest market, Saudi Arabia, has 16 Islamic banks, including windows, which is less than the smaller markets of Malaysia and the United Arab Emirates.
- With the rapidly growing popularity of mobile banking, particularly among younger people, according to PwC's 2018 Digital Banking Consumer Survey, a growing number of digital-only, or 'disruptor banks' with no physical branches, have emerged. Islamic banks are also catching up on this trend, with the launch of digital-only subsidiaries, such as Gulf International Bank's Meem in Bahrain and Saudi Arabia, and Albaraka Türk's insha in Germany and other European countries with large Muslim communities.
- Islamic banking is commonly seen to have two advantages over conventional banking. The first is a perception that Islamic banks are bound to a higher moral standard. They will not take on irresponsible amounts of risk or pay outsize bonuses to their top bankers. The second is that earnings come from identifiable assets, not opaque combinations of derivatives and securities. Because Islamic banks cannot make money through interest, they rely on ties to tangible assets, such as real estate and equity, charging 'rent' instead of interest.

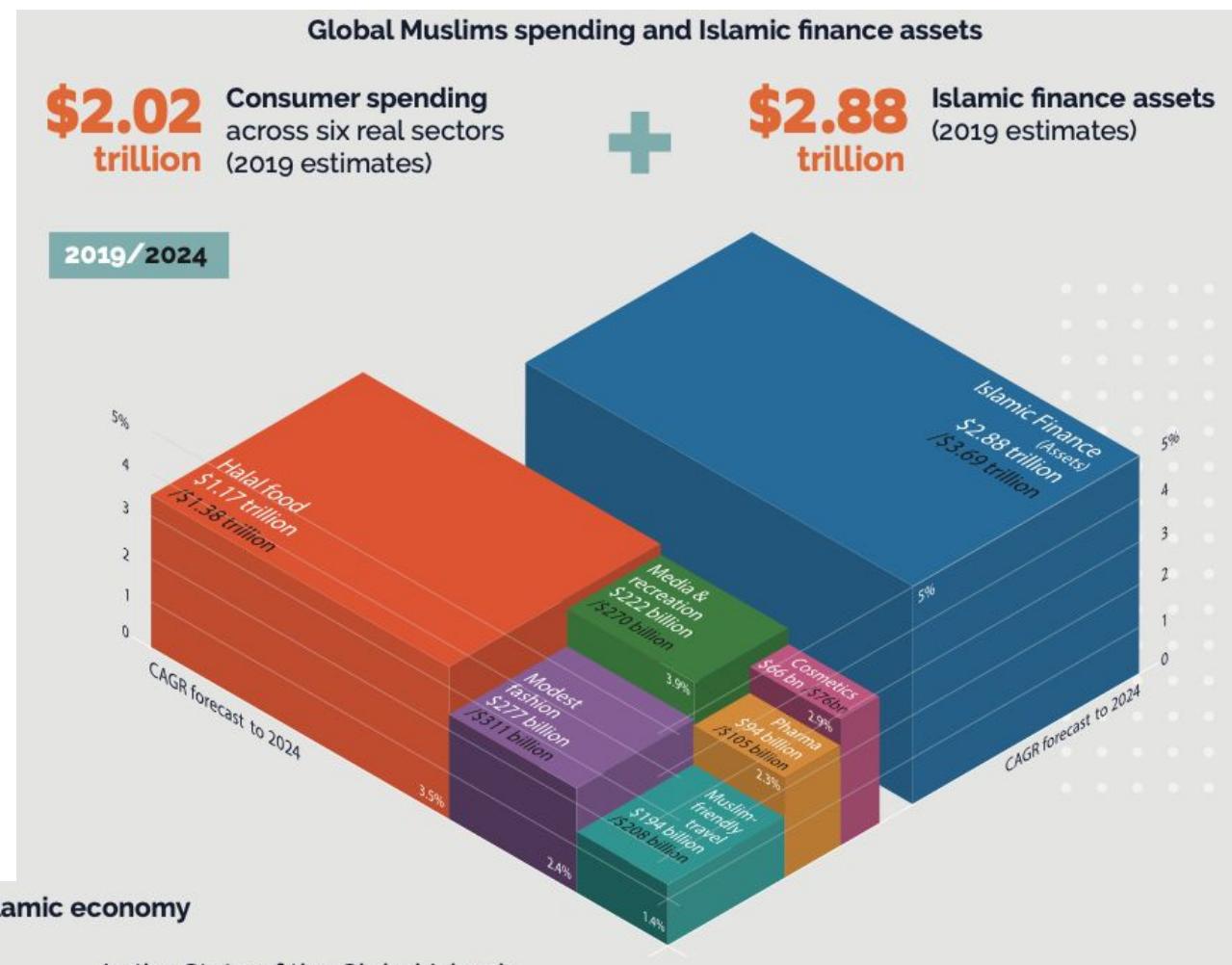
## GCC Regional Overview

- Shariah-compliant assets represent a significant portion of total banking assets of the GCC. While in the Middle East & North African (MENA) region, Islamic Banking assets represent 14% of total banking assets. In the GCC, the market share of Islamic banking crossed the 25% threshold, which suggests that Islamic banks have become systemically important in these countries.
- GCC Islamic banking assets reached USD 490 billion by the end of June 2013, with Saudi Arabia dominating the region with a 49% share, followed by the United Arab Emirates (19%), Kuwait (16%), Qatar (11%), and Bahrain (5%). This segment is still nascent in Oman (Islamic Financial Services Board (IFSB), (2015)). Islamic banking has acquired systemic proportions in Kuwait, Saudi Arabia, and the United Arab Emirates, in line with IFSB's definition of systemic, at least 15% of banking system assets. Retail Islamic banking in Bahrain has reached systemic proportions with a 27% asset share in retail banking, and a 13% asset share in total retail and wholesale banking. Oman's entry in Islamic Banking was in late 2012.

# Competitive Landscape

- The global Islamic finance market is fragmented with a large number of players trying to grab a significant chunk of the developing market.
- In some regions, like Asia and Africa, it is moderately growing with the presence of a large number of local players and some major players.
- However, GCC is a highly competitive market, with the presence of large number of international players.
- Bank Al-Rajhi, Dubai Islamic Bank, and Kuwait House Finance, are among the major players present in the region.

# Opportunities



## Impact of Covid-19 to Islamic economy



The global Muslims spending in 2020 is projected to decrease by 8% due to Covid-19 impact. All Islamic economy sectors except for travel industry are expected to rebound to pre-pandemic level by the end of 2021.

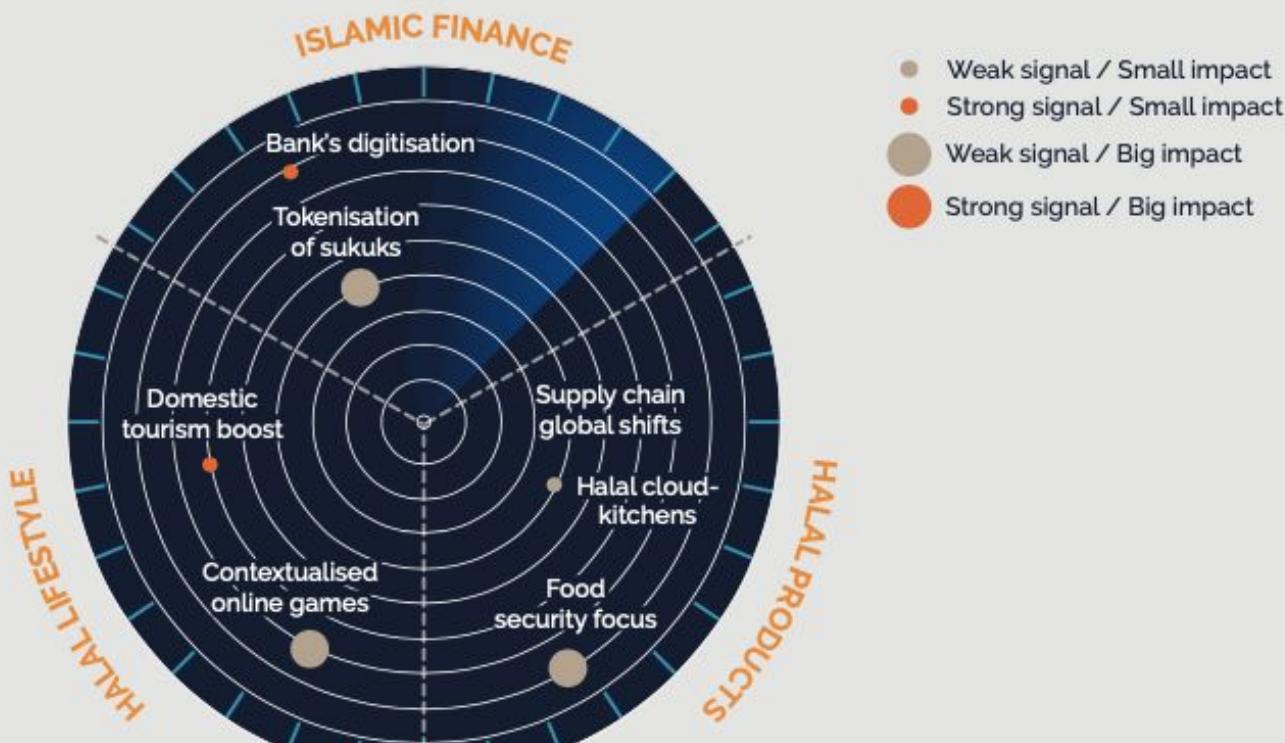


In the State of the Global Islamic Economy Report 2020/21, Muslims spending is forecasted to reach USD2.4 trillion by 2024 at a 5-year Cumulative Annual Growth Rate (CAGR) of 3.1%.

# Opportunities

## Signals of Opportunities

Amidst the pandemic, multiple signals of opportunities are emerging:



# Glossary

<i>Gharar</i>	<ul style="list-style-type: none"><li>•An unknown fact or condition.</li><li>•An element which must be avoided in Islamic banking dealings as excessive gharar may make the contract null and void.</li></ul>
<i>Riba'</i>	<ul style="list-style-type: none"><li>•The amount paid or received over and above the principal in a loan contract.</li></ul>
<i>Shariah</i>	<ul style="list-style-type: none"><li>•The Islamic law which came from various sources – the Quran, the Hadith, the Sunnah, ijma' (views collectively agreed by Muslim scholars), qiyas (analogy) and ijtihad (personal reasoning) of the Muslim jurists.</li></ul>



End of Chapter 1

**ANY QUESTIONS**