

Introduction to Islamic Finance

Chapter 1

Philosophy of Islamic Finance

Islamic Worldview

Relationship between **Allah**, the **Individual**, and the **Ummah** (community)

Based on **Implicit Contract** and **Explicit Contract**

Concept of Istikhlaf (Vicegerency)

Man is **not the absolute owner** of resources

Entrusted with resources for **betterment of mankind**

Accountable to Allah (swt) for conduct on earth

Trust is linked with **responsibility**

Conventional Financial System

Value Neutral System

Assumes humans are **rational** in decision making

Based on **Doctrine of Self Interest**

Key Differences

Conventional

- Self-interest focus
- Resource ownership
- Value-neutral

Islamic

- Community benefit
- Resource stewardship
- Value-based

Principles of Islamic Economics

Paradigm & Role

- Not secularist and value-neutral
- Humans as **vicegerents of God**
- All humans are **brothers** unto each other

Resource Usage & Well-being

- Resources are a **trust**
- Must be used for **well-being of all**
- Conforming to **Shari'ah values**
- Balanced satisfaction of **material and spiritual needs**

Foundations of the Economic System

Tawhid

Indivisible oneness of monotheism

Rububiyyah

Ownership and obedience

Risalah

Prophethood and divine communication

Akhirah

Afterlife and temporary nature of earth

Istikhlaf

Vicegerency and trusteeship

Tazkiyah

Purification of heart and soul

Kafalah

Guarantee and shared liability

Adalah

Justice and fairness

Principles of Islamic Finance

Definition & Scope

- Financial services compliant with **Islamic commercial jurisprudence**
- Branch of Islamic **Shari'ah**
- Comprises Islamic financial markets and institutions

Trade vs Riba

- "Allah permits **trading** but prohibits **Riba**" (2:275)
- Trade involves **risk**, **effort**, and **liability**
 - Riba involves **predetermined excess** without counter-value

Core Promotions & Avoidances

Promotes:

- Economically productive activities
- Genuine trade/business transactions

Avoids:

- Interest-based activities
- Illegal/unethical activities
- Speculative transactions

Concept of Iwad (Equal Counter-Value)

- Element of '**iwad**' in sale promotes **equity and justice**
- Distinguishes legitimate exchange from **riba**
- Every legitimate exchange must contain '**iwad**'

Risk (Ghurm)

Effort (Kasb)

Liability

Validity vs Permissibility

Shariah Framework for Islamic Finance

Definition of Shariah

- Literally: '**path to watering place**'
- Path to tread for **guidance in this world**
- Commands, prohibitions, and values prescribed by Allah
- Epitome of Islamic thought and core of Islam

Sources of Shariah

Primary Sources

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

Secondary Sources

- Ijma' (consensus)
- Qiyas (analogical deduction)
- Istihsan (equity)
- Masalih Mursalah (public interest)

Components of Shariah

- **Aqidah**: Islamic creed and beliefs
- **Fiqh**: Understanding of laws relating to human deeds
- **Akhlaq**: Moral ethics and character

Divisions of Fiqh:

- **Ibadat**: Rituals

Maqasid al-Shariah Objectives

- Realization of **maslahah** (human interest)
- Manifesting **vicegerency role**
- Acquiring benefits and avoiding harms

Religion

Life

Fundamental Prohibited Elements in Islamic Finance

Riba (Interest)

Definition

Predetermined **excess** over and above the loan received, conditionally related to a specified time period, and **without counter value**

Prohibition Rationale

Explicitly prohibited in **Qur'an** (Al-Baqarah: 278-279)

Creates **injustice** to borrower and lender

Two categories: **Riba al-Qard** (loans) and **Riba al-Buyun** (sales)

Gharar (Ambiguity)

Definition

Uncertainty and/or ignorance of one/both parties over the substance or attributes of the object of sale, or doubt over its **existence/availability**

Prohibition Rationale

Prohibited by the **Sunnah** of the Prophet

Ensures **full consent** and satisfaction

Prevents **injustice** and exploitation

Types: **Gharar Yasir** (minor) and **Gharar Fahish** (major)

Maysir (Gambling)

Definition

Activity involving **betting** where winner takes entire bet and loser loses; games of **pure chance** where one party gains at expense of another

Prohibition Rationale

Explicitly condemned in **Qur'an** (al-Maidah: 90-91)

Stirs up **enmity** and **hatred**

Distracts from **remembrance of Allah**

Does not create wealth but relies on others' wealth

Differences between Islamic Finance and Conventional Finance



Conventional Finance

Regulatory Basis

Uses **man-made principles**

Asset Requirement

No asset requirement

Charging Return

Permits charging **interest**

Governance

Standard regulatory approval

Relationship

Based on **loan arrangements** (borrower/lender)

Determinant of Returns

Based on **contractual obligation** on loan amount

Ethos

Focus on **profit maximization**



Islamic Finance

Regulatory Basis

Uses principles prescribed by **Islamic law (Shari'ah)**

Asset Requirement

Promotes **purchase of an asset** to generate income

Charging Return

Prohibits charging interest

Governance

Requires **Shari'ah Advisory Committee** approval

Relationship

Based on **Partnership, Profit-sharing, Trading**

Determinant of Returns

Reliant on **actual economic activities**

Ethos

Promotes **brotherhood, cooperation, risk-sharing**

Development of Islamic Finance in Malaysia

⌚ Early Timeline Milestones

1963

Lembaga Tabung Haji established

1983

Bank Islam Malaysia Berhad (BIMB)

1994

Islamic Inter-banks Money Market (IIMM)

1999

Bank Muamalat Malaysia Berhad (BMMB)

2002

Islamic Financial Services Board (IFSB)

2006

INCEIF established

❖ Implementation Phases

Phase 1

Establishment of Islamic financial institutions

Phase 2

Conventional banks offered Islamic Banking services

Phase 3

Conventional banks set up Islamic subsidiaries

Phase 4

International integration of the domestic system

🏗 Infrastructure

Islamic Finance Today

↗ Current Scenario

- Global Islamic finance market **growing moderately**
- Driven by strong investments in **Halal sectors**
- Focus on **infrastructure** and **Sukuk bonds**

Market Size

\$2.05T

Total worth of Islamic finance industry in 2017

8.3%

Annual growth in assets

71%

Contribution of Islamic banking to industry assets

↗ Key Market Trends

▢ Digital Adoption

Islamic banks launching
digital-only subsidiaries

▢ Perceived Advantages

Bound to **higher moral standards** and
asset-based approach

▢ Global Issuance

Global SUKUK outstanding
surged **25.6%** to \$399.9B

▢ Regional Significance

GCC market share crossed
25% threshold



Conclusion

Key Takeaways

- 💡 Islamic finance based on **Shari'ah principles** with focus on **justice, equity, and risk-sharing**
- 🚫 Prohibits **Riba** (interest), **Gharar** (uncertainty), and **Maysir** (gambling)
- ➡️ Fundamentally different from conventional finance in **asset-backing** and **risk-sharing**
- ⌚ Malaysia has been a **pioneer** in developing comprehensive Islamic finance ecosystem
- ↗️ Global Islamic finance market valued at **\$2.05 trillion** with steady growth

Significance & Future

- 💡 Offers **ethical alternative** to conventional financial systems
- 🤝 Promotes **social responsibility** and **economic justice**
- 🌐 Expanding beyond Muslim-majority countries to **global markets**
- 💻 **Digital transformation** creating new opportunities and challenges

Future Focus Areas



Social
Resilience



Climate
Resilience



Business
Empowerment