

# Overview of Islamic Economic System in *Shariah* law

This slide covers the overview of the economic system based on guidelines given in the *Shariah* law. It consists of a series of bullet points under four main sections: **What is Islamic Economics?**, **Principles of Islamic Economics**, **Components of Islamic Financial System**, and **Practices of Islamic Finance**.

## Chapter 3: Institutions and Markets in Islamic Finance

Islamic economic system involves organizations, institutions, and social values that govern the production, exchange & consumption of goods and services.

Exploring the Structure, Components, and Framework of Islamic Financial Systems

Islamic economics is different from other economic systems like capitalism, communism, socialism, and mixed economies.



Conventional economy is categorized by borrowing to finance some current purchases, while the Islamic economy disallows interest.

Material gain is encouraged for Muslims, but it should be obtained in a respectful way that considers the well-being of others and promotes a happiness for their families.

This slide is 100% accurate. All the laws needs and practices are changing all the time.

# Outline

1 Islamic Financial System



2 Islamic Financial Institutions



3 Infrastructure Institutions



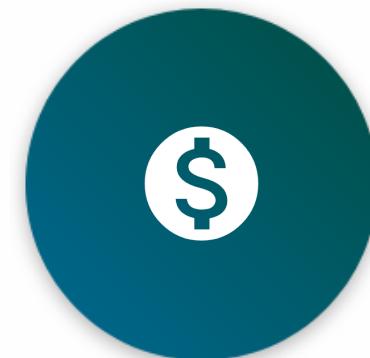
4 Other International Bodies



5 Islamic Financial Markets



6 Shariah Governance



Institutions & Markets in Islamic Finance

# Islamic Financial System

## i Introduction

- ✓ Shares **similarities** with conventional financial system structure
- ✓ Comprises **financial institutions** and **markets**

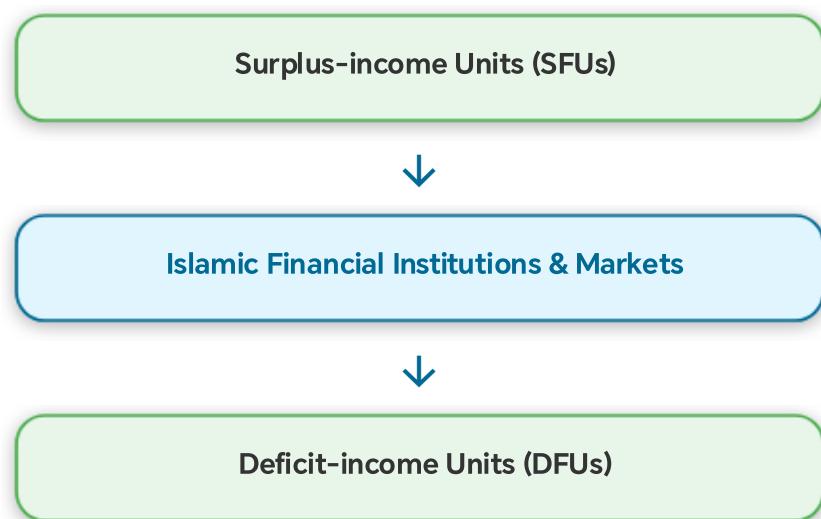
## iii Components

- grid Islamic banks
- shield Islamic insurance (takaful) companies
- square Islamic mutual funds
- arrow Other finance companies

## ↔ Function

- down Channeling funds from **SFUs** to **DFUs**
- people Units: business firms, government, households, foreigners

### Islamic Financial System Flow



# Modern Day Islamic Banking Categories

## Co-existing with Interest-based Banks

### 1 Single Islamic Bank

Example: Al-Hilal Islamic Bank in **Kazakhstan**

### 2 Multiple Islamic Banks

Egypt    Qatar    Bahrain    Bangladesh

### 3 Islamic Windows

Conventional banks providing Islamic financing

Malaysia    Qatar    Egypt    Saudi Arabia

## All-embracing Islamic Banking System

### Countries with Full Islamic Banking

Sudan    Iran

Entire banking system based on Shari'ah

### Iran's Islamic Banking History

Nationalized all banks after the Islamic Revolution in **1979**

### Malaysian IFS Components

Islamic Banking Institutions

Islamic Money Market

Islamic Capital Market

Takaful Industry

Non-Banking Institutions

# Islamic Financial Institutions

## Types of Institutions



## Takaful Operation



## Development of Islamic Banks in Malaysia



Established after Islamic Banking Act  
Listed on Kuala Lumpur Stock Exchange



Commenced operations



Incorporated  
Became full-fledged Islamic Bank after acquiring Asian Finance Bank

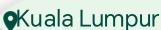
# Infrastructure Institutions Supporting IFS in Global Development



## IFSB

Established: 2002

- ✓ International standard-setting body for Islamic financial services
- ✓ Promotes soundness and stability of Islamic finance industry
- ✓ Issues standards on Risk Management, Capital Adequacy, Corporate Governance



## IIFM

Founded by central banks

- ✓ Focuses on **Islamic capital & money market** (ICMM) segment
- ✓ Standardizes Islamic financial **products, documentation, and processes**
- ✓ Founded by Bank Negara Malaysia and Islamic Development Bank



## IILM

Established: 2010

- ✓ Creates and issues **short-term Shari'ah-compliant** financial instruments
- ✓ Facilitates effective **cross-border Islamic liquidity management**



## AAOIFI

Established: 1990

- ✓ Non-profit body preparing **accounting, auditing, governance, ethics** standards
- ✓ Ensures transactions **adhere to Shari'ah principles**
- ✓ Develops Shari'ah standards for Islamic financial institutions

# Other International Bodies Supporting Islamic Finance



## Islamic Development Bank (IDB)

Established: 1973

Fosters **economic development** and **social progress** in member countries in accordance with Shari'ah principles

56 Member Countries

Equity Participation

Project Loans

Foreign Trade Promotion



## Education and Training Institutes



### INCEIF

Postgraduate study in Islamic Finance (CIFP, Masters, PhD)



### IBFIM

Training, professional development, Shari'ah Advisory & Audit



## Islamic International Rating Agency (IIRA)

Established: 2005

Develops methodologies for **issue/issuer ratings** and provides comprehensive rating services for IFIs

Credit Ratings

Sovereign Ratings

Corporate Governance Ratings

Shari'ah Quality Ratings

# Islamic Financial Markets

## Islamic Interbank Money Market (IIMM)

introduced by BNM as a **short-term intermediary** providing investment outlets based on Shari'ah principles

## Key Instruments

### MII / MID



Mudharabah Interbank Investment/Deposit

Profit sharing

### Wadiah Acceptance



BNM accepts surplus funds under Al-Wadiah

Hibah (gift)

### GII



Government Investment Issue

Non-interest bearing

### SBNMI



Sukuk Bank Negara Ijarah

Al-Ijarah (sale and lease back)

2006

### INID



Islamic Negotiable Instruments of Deposit

Mudharabah contract

### NIDC



Negotiable Islamic Debt Certificate

Bai Bithaman Ajil

Bay Ad-Dayn

## Islamic Money Market Flow

### Surplus Banks



### Investment Outlets

# Islamic Capital Markets

ICM runs as a **parallel market** to conventional capital market, free from **riba, maisir, and gharar**

## Components

 Islamic Equity Market

 Islamic Mutual/Unit Trust Market

 Sukuk/Islamic Bond Market

 Shariah Compliant Derivatives

 Islamic Structured Products

 Islamic Stockbroking

## Regulatory Framework

-  Regulated by **Securities Commission (SC)**
-  SC's **Shari'ah Advisory Council (SAC)** advises on ICM matters
-  Ensures compliance with Shari'ah principles

## Fundamental Basis: Islamic Contracts

 Bai' Bithaman Ajil

 Murabahah

 Mudharabah

 Musyarakah

 Ijarah

# Islamic Equity Market Screening

## 🔍 SAC Screening Approach

- ▣ **Quantitative** approach: Measures financial ratios and prohibited activities
- ▢ **Qualitative** approach: Considers public perception, company image, 'uruf (custom), and maslahah (benefit)

## 5% Benchmark

Activities must contribute less than 5% of TO and PBT



Conventional Banking

Gambling

Liquor

Non-Halal Food

20% Benchmark

## 📊 Financial Ratio Benchmarks

**33%**

Cash/Total Assets

Excluding Islamic cash

**33%**

Debt/Total Assets

Excluding Islamic financing/sukuk

## 👤 Qualitative Analysis

- ▢ **Public perception** of the company
- ▣ **Company image** and branding
- ▢ **'Uruf** (custom) and practices
- ▢ **Maslahah** (benefit to the Ummah)

## ⚠ Non-Compliant Investment Guidance

# Shariah Governance

## Overview

- 👤 **Shari'ah board** is an independent body entrusted with directing, reviewing, and supervising IFI activities
- ⚙️ Ensures **compliance** with Shari'ah principles
- 📄 Issues **legal rulings** (fatwas) on Islamic financial matters



## BNM Shariah Advisory Council

Established: 1997

- ⭐ **Highest Shari'ah authority** in Islamic finance in Malaysia
- ↗ Status reinforced by Central Bank of Malaysia Act 2009



## Securities Commission SAC

Established under SC Act 1993

- ⌚ Ensures ICM operations **do not contradict** Shari'ah
- 💡 Advises SC on **market development**
- ✓ Classifies **Shari'ah-compliant securities**

## Shariah Governance Structure

👤 **Shariah Board**



⌚ **Supervision & Review**



# Malaysia International Financial Centre (MIFC)

## MIFC Initiative



Collaborative effort by regulators to **bridge and strengthen** international Islamic financial markets

Launched: 2006

## Focus Areas



Sukuk Origination



Islamic Fund & Wealth Management



International Takaful



Human Capital Development

## Key Incentives



International Islamic Banking (IIB) Licenses



International Takaful Operator (ITO) Licenses

## Strategic Benefits



Global hub for Islamic finance



Facilitates **cross-border** Islamic financial activities



Comprehensive **regulatory framework** aligned with international standards



Access to **skilled professionals** and Islamic finance expertise