



Islamic Financial Institutions from the Perspective of Islamic Economics

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Abstract:

The accelerating development of the global financial sector has contributed to the widespread adoption of conventional financial institutions, which have attracted capital owners through diverse investment services.

However, their reliance on interest-based transactions poses ethical and religious dilemmas for Muslim investors. This concern has motivated Islamic economists to formulate Shariah-compliant financial alternatives that align with Islamic legal and ethical principles. As a result, the concept of Islamic financial institutions has emerged, offering investment mechanisms grounded in the objectives of Islamic law.

This paper explores the notion of Islamic financial institutions within the framework of Islamic economics. It aims to clarify key concepts related to their structure, operational models, and governance systems, all shaped by their adherence to Shariah rulings and Maqasid (higher objectives).

Additionally, the study highlights the main categories of Islamic financial institutions and delineates the unique characteristics that distinguish each type within the broader financial ecosystem.

Keywords: Islamic Financial Institutions; Islamic Economy; Shariah-compliant Finance; Ethical Investment.

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1. Introduction

The rapid developments witnessed in the financial sector, characterized by accelerated activities and the expansion of conventional financial institutions—widely accepted in many countries due to the investment services they offer to capital holders—have posed significant ethical dilemmas for numerous Muslims. These dilemmas arise primarily from the interest-based mechanisms imposed by such institutions, contravening Islamic principles on usury (Riba). Consequently, scholars specializing in Islamic economics have been prompted to explore alternative institutions that comply with Sharia law, capable of competing with conventional entities while providing ethically sound investment avenues for Muslim investors. From this imperative emerged the concept of Islamic financial institutions. This research paper aims to comprehensively elucidate the essence and practical implications of this concept within the context of Islamic economics.

Moreover, Islamic financial institutions exhibit diversity regarding their functional nature, operational mechanisms, and inherent characteristics. Recognizing this complexity, this research is entitled: "Islamic Financial Institutions from the Perspective of Islamic Economics." The primary objective of this study is to articulate and analyze fundamental concepts related to Islamic financial institutions, delineating their operational frameworks and regulatory systems as aligned with their strategic objectives, most notably adherence to Sharia principles and objectives. Additionally, the paper outlines the primary classifications of these institutions and the distinctive features of each category.

1.1. Research Problem:

The research problem is articulated as follows:

What constitutes the concept of Islamic financial institutions within the framework of contemporary Islamic economics?

This central research problem branches into a series of related questions that this study endeavors to address, summarized as follows:

- What precisely are Islamic financial institutions?
- How do Islamic financial institutions differ fundamentally from conventional financial institutions?
- What are the various types of Islamic financial institutions, and what distinguishing characteristics define each type?

1.2. Significance of the Research Topic:

The significance of this research is distinctly evident in the following aspects:

- ❖ The prominent global position occupied by Islamic financial institutions within the contemporary Islamic banking landscape, as these institutions have emerged as essential hubs, viable avenues, and authoritative references for numerous investors worldwide.
- ❖ The increasing competitiveness demonstrated by Islamic financial institutions vis-à-vis their conventional counterparts, reflecting their growing ability to effectively compete within global financial markets.
- ❖ Addressing such topics contributes meaningfully to the expansion and diversification of Islamic banking practices in Algeria, thereby facilitating exposure to, and engagement with, a broader range of Islamic financial institutions.

1.3. Research Objectives:

- * To examine the impact of Islamic financial institutions on capital allocation and overall economic activity at both regional and global levels.
- * To identify the primary obstacles hindering the proper implementation of Islamic financial institutions, particularly those operating in environments that do not adequately accommodate the distinctive nature of Islamic banking practices, and subsequently propose potential solutions to address these obstacles.

1.4. Rationale for Selecting the Topic:

Several significant considerations have motivated the selection of this particular research topic, among which the most prominent include:

- The noticeable scarcity of scholarly research and academic studies that rigorously investigate the operational characteristics of Islamic financial institutions and comprehensively address their practical applications.
- The challenges encountered by Islamic financial institutions, particularly those operating within environments that do not sufficiently recognize or accommodate the distinctive operational requirements inherent to these institutions.
- The Algerian legislature's recent adoption and integration of Islamic banking practices within the country's financial institutions, reflecting a progressive openness toward Islamic finance.

1.5. Research Methodology:

In pursuit of comprehensively addressing the multifaceted dimensions of the subject, the following methodological approaches have been meticulously adopted:

– **Comparative Approach:**

This approach involves an analytical exploration of the distinctive characteristics and regulatory frameworks governing conventional financial institutions, juxtaposed with those of Islamic financial institutions. Such comparison facilitates an in-depth observation and analysis of similarities, divergences, and the nuanced attributes unique to each institutional model.

– **Descriptive Approach:**

This approach emphasizes the systematic collection and meticulous documentation of pertinent data relating to both conventional and Islamic financial institutions, enabling a thorough and accurate depiction of their operational realities and institutional frameworks.

1.6. Research Plan:

In order to comprehensively address the dimensions of this research, the study has been systematically organized into four main sections, structured as follows:

1. Introduction – Comprising the following main components: background, research problem, significance of the topic, research objectives, rationale for topic selection, and research methodology.
2. Conceptualizing Islamic Financial Institutions within the Framework of Islamic Economics.
3. Types and Characteristics of Islamic Financial Institutions in Islamic Economic Thought.
4. Conclusion, Summarizing the principal findings and insights derived from the study.

2. Overview of Islamic Financial Institutions in Islamic Economics

Among the most prominent reasons that prompted scholars of Islamic economics to contemplate legitimate alternatives capable of competing with conventional financial institutions—and serving as channels for the investment of Muslim wealth within the framework of Shariah principles and rulings—is the significant evolution in the global financial landscape. This evolution has led to the rapid expansion and increasing influence of conventional financial institutions, which have gained widespread acceptance across most countries due to the diverse investment services they offer to capital holders. This constitutes the first reason. The second reason lies in the ethical and religious dilemma faced by many Muslims, who find themselves constrained when dealing with such institutions due to the interest-based transactions they impose,

which contravene the prohibitions of Riba (usury) in Islamic law. It is within this context that the concept of Islamic financial institutions emerged. The present discussion seeks to examine the essence and definition of this concept within the broader framework of Islamic economics.

2.1. Defining the Scope of the Term “Financial Institutions:

2.1.1. Definition of the Term “Institution”:

2.1.1.1. Lexical Definition of the Institution:

The term institution is derived from the Arabic verb “assasa”, which signifies the act of founding or establishing. The noun “asās” denotes the foundation or origin of a structure and the beginning of anything. The passive participle “Mu’assas” refers to something that has been established. For instance, it is said in Arabic, “He established a house,” meaning he demarcated its boundaries and laid its structural foundations.

This usage finds its resonance in the Qur’anic verse:

“Is the man who lays the foundations of his sanctum on his allegiance to God ...”
[Al-Tawbah: 109] ¹.

2.1.1.2. Terminological Definition of the Institution:

There exists a multiplicity of definitions for the term institution in technical discourse, a variance attributable to several factors, such as the nature of the activity, ownership of capital, legal framework, and institutional size. The dimension of particular relevance to our discussion is the nature of the institution’s activity.

From this perspective, institutions are generally categorized into four principal types:

- Industrial Institutions
- Commercial Institutions
- Agricultural Institutions
- Service Institutions

Broadly defined, an institution can be understood through the following conceptualizations:

¹ - See: Al-Jawhari, Al-Sihāh: Tāj al-Lughā wa Ṣiḥāḥ al-‘Arabiyyah (The Crown of Language and the Sound Lexicon of Arabic), 3/903; Al-Azhari, Tahdhīb al-Lughā (The Refinement of Language), 13/96; Ibn Manẓūr, Lisān al-‘Arab (The Tongue of the Arabs), 6/6; Aḥmad Mukhtār ‘Umar, Mu‘jam al-Lughā al-‘Arabiyya al-Mu‘āṣira (Dictionary of Contemporary Arabic Language), 1/91.

1. **A dynamic group composed of interacting individuals unified by a collective goal,** which varies according to their respective specializations.
2. “An economically autonomous organizational structure, operating within a defined legal and social framework, whose objective is to integrate the factors of production for the purpose of producing or exchanging goods and services with other economic agents, or both (production and exchange), with the aim of achieving an optimal outcome under economic conditions that differ depending on spatial, temporal, and activity-specific variables.”¹
3. “The rational coordination of the activities of a group of individuals toward the attainment of shared implicit goals, realized through the division of labor and systematic task allocation.”²

Upon examining these definitions, it becomes evident that the concept of an institution fundamentally hinges upon several core elements, which constitute its foundational pillars. These include: organizational structure, legal framework, specialization, human resources, and clearly articulated objectives.

2.1.2. The Definition of Wealth (Māl):

2.1.2.1. Lexical Definition of Wealth (Māl):

The term *māl* is derived from the trilateral Arabic root *māla*, which conveys the sense of possession or increase. It is said: “*Māla al-rajul* – the man’s wealth increased.”³ Likewise, “*tamawwalahu fulān mālan*” refers to a person acquiring property or wealth for personal use. In customary usage, that which is *tamawwalu*—i.e., capable of being acquired and possessed—is recognized as *Māl* (Wealth)⁴. Hence, in its original usage, the term referred specifically to tangible items owned, particularly gold and silver. However, over time, it has come to denote all objects that may be possessed and held as property⁵.

2.1.2.2. Technical (Juristic) Definition of Wealth (Māl):

Islamic jurists have developed various nuanced definitions of wealth, each reflecting the principles and methodology of their respective legal schools. Below are selected definitions from the four principal Sunni schools of thought:

▪ **The Ḥanafī Definition:**

According to the Ḥanafī school, wealth encompasses “everything that a person can own, such as dirhams, dinars, gold, silver, wheat, bread, animals, clothing, weapons, and the like.”⁶

¹ - Muḥammad Ismā‘īl Bilāl, *Principles of Management: Between Theory and Practice*, pp. 297–305.

² - Faculty of Economic, Social and Legal Sciences, Department of Organization and Enterprises, Course Outline: Organization and Enterprise, p. 5.

³ - See: Al-Azhari, *Tahdhib al-Lugha* (Refinement of the Language), 15/285.

⁴ - Al-Fayoumi, *Al-Misbah al-Munir* (The Radiant Lamp), 2/586.

⁵ - See: Ibn Manzur, *Lisan al-‘Arab* (The Tongue of the Arabs), 11/636.

This definition is characterized by its functional approach, emphasizing the attribute of ownership rather than strict permissibility. The Ḥanafīs thus adopt a broad and inclusive conception of wealth, extending beyond currency to anything that yields utility (*manfaʿa*) and elicits human desire to possess. Consequently, the Ḥanafī framework allows for the categorization of wealth into *muqawwam* (permissibly utilized wealth) and *ghayr muqawwam* (impermissibly utilized wealth), a distinction arising precisely from their non-restrictive stance on lawful utility.

▪ **The Mālikī Definition:**

The Mālikī jurists define wealth as “anything that is customarily considered property and may lawfully be compensated for.”¹

Here, the notion of wealth is restricted by the criterion of lawful exchangeability (*ʿiwaḍ*). Ibn al-ʿArabī elaborates that wealth encompasses “all that people desire and which is deemed legally and customarily suitable for benefit. If the Sharīʿah prohibits its use, then human desire is of no consequence, and no utility can be derived from it—such as wine or swine.”²

This articulation places Sharīʿah-compliance at the heart of the definition: even if an item is theoretically useful, its prohibition nullifies its classification as wealth.

▪ **The Shāfiʿī Definition:**

In the Shāfiʿī tradition, wealth is defined as “anything that may lawfully be sold and from which benefit may be derived—whether immediate or deferred.”³

This definition aligns closely with that of the Mālikīs but introduces an important nuance: the notion of deferred benefit. Thus, items such as debts, forward-sale goods (*Salam*), or made-to-order goods (*Istisnāʿ*)—despite their future utility—are recognized as wealth. The Shāfiʿīs emphasize the permissibility of benefit, whether present or future, as a central condition for wealth classification.

▪ **The Ḥanbalī Definition:**

According to the Ḥanbalīs, wealth is “that which possesses a permissible benefit not confined to necessity.”⁴

This definition mirrors that of the Mālikīs and Shāfiʿīs in requiring lawful utility. However, the Ḥanbalīs add a critical condition: the benefit must be inherently lawful,

⁶ - Al-ʿAynī, Badr al-Dīn. *Al-Bināyah Sharḥ al-Hidāyah*, 3/366.

¹ - al-Qāḍī ʿAbd al-Wahhāb. *al-Ishrāf ʿalā Nukat Masāʾil al-Khilāf*, 2/947.

² - Ibn al-ʿArabī. *Aḥkām al-Qurʾān*, 2/107.

³ - Zakariyyā al-Anṣārī. *Asnā al-Maṭālib fī Sharḥ Rawḍ al-Ṭālib*, 2/9.

⁴ - ʿAbd al-Raḥmān al-Maqdisī. *al-Sharḥ al-Kabīr ʿalā Matn al-Muqniʿ*, 4/7.

not merely tolerated due to necessity. Thus, items whose use is permissible only in dire circumstances—such as carrion consumed during famine or alcohol used to clear a blocked throat—are excluded from the category of wealth.

➤ **Synthesis of Juristic Definitions:**

From these varying definitions, a unifying pattern emerges. The Ḥanafīs refrain from stipulating permissibility as a precondition for wealth, allowing for a broader conceptualization that includes impermissible but potentially valuable items. This has led them to differentiate between *māl* (wealth) in general and *māl mutaqaawwam* (legally permissible wealth).

As stated in Ibn ‘Ābidīn’s *Ḥāshiyah*, “Wealth is broader than that which is customarily valued (*mutamawwalu*); wealth encompasses whatever can be stored—even if impermissible, such as wine—whereas *mutaqaawwam* is that which can be stored and is legally permissible. Thus, wine is wealth, but not *mutaqaawwam*.”¹

In contrast, the majority of jurists (Mālikīs, Shāfi‘īs, and Ḥanbalīs) require that wealth be both beneficial and permissible—whether immediately or eventually—and they exclude items permitted only by necessity.

▪ **The Economic Definition of Wealth:**

Economists define wealth as “any quantity—whether small or large—of possessions that may be owned or valued, typically referring to currency in the form of gold, silver, or their modern equivalents.”²

This definition resonates with the Ḥanafī stance in that it does not condition the permissibility of benefit. Thus, from an economic standpoint, legality is not a prerequisite for something to be deemed wealth.

➤ **Contemporary Application in Islamic Economics:**

In modern Islamic economic discourse, the term “wealth” encompasses a wide array of financial instruments and tangible assets—including securities, shares, bonds, digital currencies, and real estate. Given the increasing diversity of wealth forms, a rigid definition becomes impractical. Nevertheless, a general framework may be proposed based on two central criteria: **Sharī‘ah legality** and **legal recognizability**. Accordingly, wealth in Islamic economics can be defined as:

¹ - Ibn ‘Ābidīn. *Radd al-Muḥtār ‘alā al-Durr al-Mukhtār*, 4/501.

² - Muḥammad ‘Amārah. *Dictionary of Economic Terminology in Islamic Civilization*, p. 503.

“Anything that may be possessed, lawfully owned, benefited from, compensated for, and transacted.”

This definition comprises several key qualifiers:

- **“May be possessed”**: This excludes intangible elements that cannot be appropriated—despite potential utility—such as air, sunlight, or moonlight. The manner of possession varies with the asset class: tangible assets are physically possessed, whereas intangible or digital assets (e.g., cryptocurrencies) may be possessed virtually.
- **“Lawfully owned”**: This criterion excludes all assets whose ownership is prohibited under Islamic law, such as wine, musical instruments used for illicit purposes, or misappropriated funds.
- **“Benefited from”**: This condition excludes items from which benefit is only permissible under duress.
- **“Compensated for and transacted”**: This excludes assets or services that may not be lawfully sold or exchanged, such as waqf (endowment) benefits, public utilities, or private non-transferable property.

2.2. Defining Islamic Financial Institutions as a Descriptive Compound:

Before elucidating the concept of Islamic financial institutions, it is imperative to first clarify the notion of financial institutions in general. Financial institutions are commonly defined as:

"Any financial intermediary or other institution that is licensed to engage in commercial activities and is subject to regulation or supervision as a financial institution under the laws of the jurisdiction in which it operates."¹

The definition of Islamic financial institutions has been subject to various interpretations in the literature, with the most prominent summarized as follows:

- *"Islamic financial institutions are entities that mobilize financial resources from individuals within society and allocate them efficiently in ways that maximize and grow these resources, within the established framework of Islamic Sharia principles, aiming to serve the Muslim community and contribute to the development of its economy."²
- * "They comprise all Islamic companies and financial institutions operating in the realms of finance and economics, whether in the form of banks, investment firms, financing companies, leasing entities, or insurance providers."³

From these definitions, a comprehensive definition of Islamic financial institutions may be synthesized as follows:

"Any legal entity possessing a physical presence and juridical personality, which engages in the mobilization, saving, investment, or insurance of client funds in

¹ - Chapter 11: Financial Services, Article 11.1: Definitions, Page 1.

² - Abdelkarim Kandouz, Financial Engineering: Between Theory and Practice, p. 116.

³ - Mohammed Walidi and Adi Firas, The Role of Islamic Financial Institutions in Supporting Investment, p. 261.

accordance with the rulings and principles of Islamic Sharia, through various permissible forms and instruments."

Breaking down this definition:

- The phrase **"any legal entity possessing a physical presence"** implies that such an institution must have a tangible, physical establishment and be legally recognized.
- The phrase **"possessing a juridical personality"** affirms that an institution cannot be considered as such unless it is legally acknowledged; its corporate personality derives legitimacy from the law governing its operations.
- The phrase **"engages in the mobilization, saving, investment, or insurance of client funds"** delineates the core functions and services of Islamic financial institutions, which may vary depending on their specialization and the manner in which they utilize and manage funds.
- The phrase **"in accordance with the rulings and principles of Islamic Sharia"** underscores the fundamental distinction between Islamic financial institutions and their conventional counterparts. Islamic institutions are governed by a framework rooted in the objectives and overarching values of Sharia, which regulate their operations and ensure conformity to Islamic ethical and legal norms.

3. Types and Characteristics of Islamic Financial Institutions in the Islamic Economic System

Islamic financial institutions vary in nature according to their functions, operational mechanisms, and inherent characteristics. In this section, we endeavor to provide a concise overview of the most significant types of these institutions.

3.1. The Islamic Banking System:

3.1.1. The Islamic Central Bank:

The Islamic Central Bank is regarded as the foundational institution within the Islamic banking system. It is an independent governmental entity that performs all banking functions on behalf of the state. Additionally, it exercises monetary oversight over the policies of domestic banks and financial institutions. Its Islamic character imposes upon it the responsibility of fulfilling both the economic and social objectives of the Islamic economic framework, particularly within the domains of monetary policy and banking operations ¹.

Among the most salient features that an Islamic Central Bank must possess to effectively carry out its designated roles and responsibilities are the following:

❖ **Monetary Sovereignty:**

The Islamic Central Bank must constitute the sole monetary authority within the Islamic banking and monetary system. No other institution should compete with it

¹ - Mohammad Umar Chapra, Towards a Just Monetary System: A Study of Money, Banking, and Monetary Policy in the Light of Islamic Teachings, p. 196.

in performing its core functions, in accordance with the principle of unified leadership in monetary governance.

❖ **Public Ownership and Issuance of Legal Tender:**

The bank must be a public institution wholly owned by the state. This endows it with the exclusive right to issue legal tender within the country. Islamic jurisprudence unanimously upholds the necessity of state monopoly over currency issuance due to its critical economic importance ¹.

❖ **Central Coordination Role:**

It must serve as the principal institution within the Islamic monetary and banking framework, acting as a unifying body for Islamic banks. It coordinates their efforts and regulates the relationships between them and other Islamic financial institutions².

❖ **Operational Independence:**

The Islamic Central Bank must enjoy a high degree of autonomy, ensuring its ability to function impartially. This independence is essential for enabling the bank to maintain macroeconomic stability and to act in the national economic interest without external interference.

3.1.2. Islamic Banks:

Formulating a comprehensive and precise definition of Islamic banks presents a significant challenge. Numerous works have proposed various definitions, each emphasizing different aspects of these institutions. However, a common thread among these definitions is the focus on the specific functions Islamic financial institutions perform. Among the most prominent definitions are the following:

- “A financial banking institution that collects funds and employs them within the framework of Islamic Sharia, in a manner that serves the construction of an Islamic solidarity-based society, achieves distributive justice, and channels financial resources along the Islamic path.” ³
- “A banking institution whose primary objective is to mobilize funds and savings from individuals who refrain from engaging in interest-based (usurious)

¹ - Souleiman Nacer, *The Relationship Between Islamic Banks and Central Banks in Light of International Developments*, p. 354.

² - Chafia Ketaf and Dhahbia Latrech, *Theoretical Framework of Islamic Financial System Institutions* (Article), p. 165.

³ - Saifan Hussein Saeed and Abdullah Khalid Amin, *Islamic Banking Operations – Modern Accounting Methods*, p. 28.

transactions, and to invest these resources across various sectors of economic activity. It also aims to provide a broad range of banking services to clients in accordance with Islamic law, thereby supporting the economic and social development goals of the society.”¹

- “A monetary and financial institution that seeks to attract monetary resources from individuals within society and to invest them effectively, ensuring their growth and optimization within the stable framework of Islamic Sharia. This is done in service of the peoples of the Ummah and in pursuit of the development of their economies².”

An analysis of the above definitions—presented selectively rather than exhaustively—reveals a set of shared attributes that collectively represent the general characteristics of Islamic banks. The most salient among these are:

- Reliance on Islamic jurisprudential principles in the conduct of financial transactions, which fundamentally distinguishes them from conventional banks, particularly through the absolute prohibition of interest (Riba).
- The identification of Islamic banks as monetary and financial institutions with a purely economic character, whose objective is to achieve profitability in accordance with the overarching principles of Sharia, utilizing legitimate (Sharia-compliant) modes of financing and investment.
- Clarification of their primary role, which is to contribute actively to the economic and social development of their clients and the broader community.

3.2. Islamic Investment Funds:

3.2.1. Definition of Investment Funds:

An investment fund may be defined as a financial vehicle designed to pool individual savings and channel them into securities through an entity specialized in portfolio management—something that individuals often cannot achieve independently. These funds represent a modern financial mechanism for capital management tailored to the preferences, service needs, and risk appetites of investors. They provide collective benefits unattainable by investors acting alone, thereby yielding returns for the bank or financial institution that establishes the fund, for the individual savers, and for the national economy at large.

¹ - Abdel-Naeem Mohamed Mubarak and Mahmoud Younis, *Economics of Money, Banking, and International Trade*, p. 173.

² - Mohsen Ahmed Al-Khodairi, *Islamic Banks*, p. 17.

Moreover, investment funds serve as a conduit for financing economic activities by linking national savings with capital markets in a manner that ensures investor protection. They are specifically structured to serve a distinct category of investors—particularly small-scale savers—by offering them a vehicle for diversified investment that would otherwise be inaccessible without the presence of a large-scale financial portfolio ¹.

3.2.2. Types of Investment Funds:

Investment funds are generally classified into two main categories: ²

– Open-End (Mutual) Investment Funds:

These are entities that pool capital from numerous investors and invest it in a variety of financial instruments including stocks, bonds, short-term money market instruments, or a combination thereof. These funds operate as open-ended registered investment companies overseen by securities regulatory authorities. Each mutual fund represents a proportional ownership stake for the investor ³.

– Closed-End Investment Funds:

These funds issue a fixed number of shares that are typically listed and traded on stock exchanges or over-the-counter markets. They raise capital by issuing a predetermined quantity of equity or debt securities, and then invest in a diversified portfolio of domestic and international assets, including common stocks, preferred shares, high-yield bonds, corporate bonds, and other financial instruments ⁴.

3.2.3. Islamic Economic Definition of Islamic Investment Funds:

Islamic economists have offered multiple definitions of Islamic investment funds which, although varied in their wording, converge on a shared core concept: the collective pooling of participants' capital for the purpose of investing in specific areas, with the resulting profits distributed among them according to predetermined principles.

Among these definitions are:

- “A joint investment vehicle comprising a group of investors who contribute their surplus capital for the purpose of generating Halal (permissible) profits, in conformity with the principles of Islamic Shariah. Participants are entitled to

¹ - Abdel-Ghaffar Hanafi, Investment Strategy in the Stock Exchange, p. 45.

² - Essam Ahmed Al-Bahji, The Legal Encyclopedia of the Stock Exchange in Arab Legislations, p. 858.

³ - U.S. Securities and Exchange Commission Office of Investor Education and Advocacy, MUTUAL FUNDS and ETFS, A Guide for Investors, p4.

⁴ - Investment Company Institute, a guide to Closed-End Funds, p2.

receive certificates or units that attest to their participation and entitle them to a share of the profits proportionate to their actual contribution. These certificates may take the form of units, shares, or other documented claims.”¹

- “An Islamic financial institution that aggregates investors' funds in the form of investment units or sukuk, delegating the management of these assets to professionals with expertise in Shariah-compliant investments. Returns are distributed according to pre-agreed terms, and all transactions are governed by the rulings and principles of Islamic jurisprudence, along with applicable governmental regulations, statutory directives, and internal policies.”²

These funds must satisfy two essential conditions to acquire their Islamic legal character:

- **Shariah-Compliant Investments:** The funds must be invested exclusively in ventures or instruments deemed permissible under Islamic law.
- **Profit-Based Returns:** The returns distributed must reflect a genuine share in the profit, linked proportionally to the fund's actual earnings on its nominal capital. Consequently, neither the principal nor the rate of return can be guaranteed. Subscribers to such funds must therefore enter with full awareness that returns are contingent upon the actual profits or losses incurred by the fund. In the event that the fund achieves substantial profits, the return on the investor's subscription will correspondingly increase. Conversely, if the fund incurs losses, these must be borne by the investors as well—except in cases where the loss stems from negligence or misconduct, in which case the fund's management bears liability for compensation³.

3.2.4. Key Features of Islamic Investment Funds:

The principal distinguishing features of Islamic investment funds may be summarized as follows⁴:

- ❖ Their investment activities are directed exclusively toward ventures that are fully compliant with Islamic legal principles.
- ❖ Their financial instruments are also aligned with the tenets of Shariah.

¹ - Taqi Usmani, Principle Of Shari'ah Governing Islamic Investment Fund , p1.

² - Hussein Shahatah. A Proposed Framework for Enhancing Shariah and Financial Supervision over Islamic Investment Funds. p. 09.

³ - Muchelule Yusuf Wanjala, Shaban Juma Chibololo, Hassan Yusuf Akasi, Omar.R. Omukaba: ISLAMIC INVESTMENT FUNDS, p 21.

⁴ - Abdul Majid Al-Salāhīn. Islamic Investment Funds: Their Concept, Characteristics, and Legal Rulings (An Intervention). p. 4.

- ❖ They are subject to continuous oversight by Shariah supervisory boards or Fatwa and Shariah compliance committees, which ensure that all operations adhere strictly to Islamic norms.

3.2.5. Objectives of Islamic Investment Funds:

Drawing from the definitions above, the core objectives of Islamic investment funds can be summarized as follows:

- The aggregation of investor funds in the form of investment units or Islamic financial instruments (e.g., sukuk).
- The deployment of these funds in accordance with suitable Islamic investment contracts or modalities.
- The distribution of net returns among the investors in accordance with pre-agreed terms.
- The unwavering commitment of the fund's management to the Shariah-compliant handling of all investment activities.

3.3. Islamic Financial Markets:

Islamic financial markets represent a highly significant platform for Muslim investors, serving as the primary conduit through which savers and investors engage in the exchange of Shariah-compliant financial assets across varying time horizons. These interactions are facilitated through mechanisms and methodologies that strictly adhere to the principles and injunctions of Islamic jurisprudence (Shariah), ensuring that all transactions are devoid of any elements that might compromise their legal and ethical integrity from an Islamic standpoint.

Fundamentally, Islamic financial markets function as a mechanism for mobilizing surplus capital from entities possessing excess financial resources (investors), and channeling it toward those experiencing financial shortfalls (savers), by means of issuing and trading specific Shariah-compliant financial instruments—with the assistance of qualified intermediaries. Crucially, these operations must be structured in a manner that eliminates prohibited elements such as Gharar (excessive uncertainty), Jahalah (ambiguity), Ihtikar (monopolistic practices), and other corruptive elements that invalidate financial transactions under Islamic law.

There is no doubt that such markets—through instruments such as Sukuk (Islamic bonds), various categories of Shariah-compliant equities, and innovative financial products including Islamic derivatives (e.g., Islamic options, futures, and forward contracts, whether currently available or under future development)—will significantly contribute to the qualitative advancement of Islamic banking and finance. Furthermore, they play a pivotal role in fostering genuine economic and social

development, particularly within Muslim-majority countries, by prioritizing real, asset-based investment as opposed to speculative or illusory financial activity ¹.

Although investment in Islamic financial markets is, in principle, permissible within the framework of Islamic law, Shariah imposes a distinct set of criteria and regulatory standards that differentiate these markets from their conventional counterparts. These criteria include, but are not limited to, the following:

- The operations and exchanges within these markets must fully conform to the foundational principles of Islamic commercial jurisprudence. In the case of equities and debt instruments, for instance, it is impermissible to own or trade in shares of companies that are directly or indirectly involved in interest-based (Riba) transactions. This includes institutions such as conventional banks, insurance companies, and financing or leasing firms that operate on an interest-bearing model. These entities fall under a categorical prohibition due to their fundamental incompatibility with Islamic financial ethics.
- Issuing companies must explicitly declare that their commercial activities and corporate governance structures are firmly rooted in Islamic principles. Moreover, they must affirm that they do not engage in any of the following impermissible activities:
 - Gambling or games of chance
 - Trading without the actual delivery of goods or services
 - Engaging in fictitious bidding or artificial price inflation
 - Involvement with conventional banking institutions
 - Participation in traditional (interest-based) leasing enterprises
 - Speculative risk trading characterized by Gharar or gambling elements, including conventional insurance
 - The production, distribution, trading, or provision of goods or services that are prohibited due to their intrinsic nature or content
 - Conducting transactions involving bribery or corrupt practices ².

3.4. Takaful Insurance Companies:

3.4.1. Definition of Takaful Insurance:

A number of contemporary scholars have proposed various definitions of Takaful insurance, as it constitutes a relatively recent concept within Islamic jurisprudence. Among the prominent definitions are the following:

- Takaful is a mechanism of compensation for losses that may befall any participant, through collective contributions made in monetary form, from which indemnity is

¹ - See: Shafia Ketaf and Dahabiya Latrash, Op. cit., p. 165; Ben Ali Belaazouz and Abdelkarim Kandouz, The Islamic Financial Market: The Malaysian Experience and the Potential for Its Application (An Intervention), p 265.

² - Alam, M.M., Akbar, C.S., Shahriar, S.M., and Elahi, M.M. 2017. The Islamic Shariah Principles for Investment in Stock Market, Qualitative Research in Financial Markets, p 135.

disbursed to any member who suffers a covered loss. Alternatively, it may be defined as a mutual insurance contract in which each participant commits to contributing a sum of money by way of donation (Tabarru') in order to indemnify any fellow member who sustains a specified loss ¹.

- It is a cooperative arrangement among a group of individuals, referred to as "the participants' pool," who are exposed to certain defined risks. They mutually agree, on a charitable basis, to mitigate the consequences of such risks through compensating any member who suffers harm due to those risks. Each participant undertakes to pay a specified amount, commonly referred to as a "contribution" or "premium," as outlined in the insurance certificate or participation agreement ².

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines takaful as follows:

"An agreement among individuals exposed to particular risks to avert the consequences of such risks by paying contributions on the basis of a commitment to donation. This results in the formation of a Takaful Fund, which is treated as a legal entity with independent financial liability. Compensation for damages incurred by any participant due to insured risks is paid out from this fund, in accordance with its governing rules and documentation. The fund is managed either by a body elected from among the policyholders, or by a joint-stock company acting as a paid operator responsible for administering the insurance operations and investing the fund's assets ³."

From the definitions provided, it may be concluded that Islamic insurance (takaful) is founded upon the following core principles: organized administration of operations; mutual consent among participants; compensation based on voluntary contribution; and the presence of a clearly defined insurable risk.

Takaful, therefore, stands in fundamental contrast to conventional insurance, which is essentially a profit-driven contract characterized by financial compensation irrespective of the principles underlying the insurance itself. It is governed by the jurisprudence of commutative contracts, where elements of Gharar (excessive uncertainty) are typically present and problematic.

¹ - Ahmed Mohammed Sabbagh, ISLAMIC TAKAFUL INSURANCE From Jurisprudents to Applications, p13.

² - Kotb, Abdel-Raouf. The Experience of Islamic Insurance: Summary of Sessions and Discussions (Intervention). p. 03.

³ - Accounting and Auditing Organization for Islamic Financial Institutions. Shari'ah Standards, p. 685.

3.4.2. Definition of Takaful Insurance Companies

Takaful insurance companies have been defined in several scholarly and institutional contexts. The principal definitions include:

- ❖ A company established by shareholders for the purpose of conducting insurance and investment activities in accordance with Islamic Shariah. Its primary function is to provide coverage for the risks specified in the insurance certificates issued to participants, while investing the surplus of participants' funds either for a profit share or for a management fee ¹.
- ❖ An entity responsible for managing risks and investment operations on behalf of the takaful fund, under the supervision and guidance of a Shariah supervisory board, in return for a known fee or a share of the realized profits ².

Such companies undertake the administration of takaful operations, including underwriting and management, on behalf of the participants, who due to their large number are unable to administer the process themselves. The takaful operator concludes contracts with policyholders, collects contributions, compensates eligible claims according to pre-established criteria, and carries out all requisite activities pertaining to the insurance process. The company functions as an agent on behalf of the policyholders and is compensated by a predetermined fee ³.

Based on the above, takaful insurance companies may be defined as:

"Entities that function in parallel to conventional insurance companies, but are founded on the principles of mutual assistance (Ta'awun) and donation (Tabarru'), undertaking all aspects of insurance operations and investment management in accordance with the tenets of Islamic law. These companies are managed by the founding shareholders in the interest of the participants (i.e., the risk-sharing members)."

3.4.3. Core Principles of Takaful (Islamic) Insurance Companies

The Accounting and Auditing Organization for Islamic Financial Institutions has articulated a set of fundamental principles that govern Islamic insurance. These principles are required to be explicitly reflected in the company's charter, internal

¹ - Al-Nashmi, Ajeel Jasim. Commitment to Benevolence, Profit Distribution, and Loss Bearing in Cooperative Insurance (Intervention), p. 03.

² - Tobias Frenz, Younes Souall, Takaful & Retakaful -advanced principles and practices-, p 127.

³ - Ahmed Mohammed Sabbagh, ISLAMIC TAKAFUL INSURANCE From Jurisprudents to Applications, p27.

regulations, and official documentation. They include, but are not limited to, the following ¹:

- Full adherence to the provisions of Islamic Shariah in all business and investment activities, with an explicit prohibition on insuring prohibited (Haram) objects or unlawful purposes.
- Commitment to the principle of donation (Tabarru'), whereby the participant donates his contribution and its returns to the takaful fund for the purpose of providing compensation. The participant may also be required to cover potential deficits in accordance with the approved bylaws.
- Establishment of two distinct accounts: one for the company's own assets and liabilities, and another for the policyholders' fund, representing the rights and obligations of the participants.
- The company acts as an agent in managing the insurance account and as a Mudarib (investment manager) or agent in investing the fund's assets.
- The insurance account must bear all entitlements and liabilities arising from insurance operations and the proceeds of investments made from the fund.
- Surplus management policies must be clearly defined in the bylaws, including acceptable uses such as building reserves, reducing contributions, donating to charitable causes, or distributing (partially or wholly) to participants. The operator is not entitled to any portion of the surplus.
- Upon liquidation of the company, all allocations and accumulated surpluses must be disbursed for charitable or public benefit purposes.
- Preference should be given to enabling policyholders to participate in overseeing insurance operations through legally recognized mechanisms that guarantee their rights and protect their interests, such as representation on the board of directors.
- A Shariah Supervisory Board must be appointed, whose rulings are binding on the company, along with an internal department dedicated to Shariah audit and compliance.

3.5. Islamic Investment Companies:

Islamic investment companies represent one of the most pivotal institutions within the financial system, as Islamic investment constitutes an integral component of a comprehensive economic framework governed by well-established principles, stringent regulations, and diverse operational mechanisms, all derived from the tenets of Islamic law (Shari'ah).

¹ - Accounting and Auditing Organization for Islamic Financial Institutions. Ibid., p. 687.

Before delving into the specific concept of Islamic investment companies, it is essential to first outline the general definition of financial investment companies. These have been characterized through various definitions, the most notable of which are as follows:

- * "A financial institution organized in the form of a joint-stock company that acts as an intermediary between savers and industrial or commercial ventures. It seeks to construct and manage a portfolio of financial securities in accordance with the principle of risk diversification. ¹"
- * "Joint-stock companies engaged in financial and investment activities, with a minimum capital requirement, established through a founding contract. They possess legal personality and an independent financial liability, enabling them to carry out their principal — though not exclusive — activity of forming and managing portfolios of financial securities. They bear the risks associated with such activity in accordance with the legal frameworks and boundaries set forth. ²"

In light of the foregoing, Islamic investment companies may be defined as: Joint-stock companies whose primary function is to attract investors' capital and allocate it into financial portfolios and investment funds in strict compliance with the rulings and ethical parameters of Islamic jurisprudence. The returns on these investments are distributed in proportion to the investors' respective shares. Accordingly, these companies may be described as:

"Entities that receive funds from investors of various categories in order to invest them in structured collections (Funds) of Shari'ah-compliant financial instruments tailored to each investor category. The investor's entitlement is determined by the number of shares held in the relevant fund, without conferring ownership rights over any specific security within the fund. Instead, the investor holds a proportional share of the portfolio as a whole, and in return, is issued shares or certificates that attest to this ownership. ³"

4. CONCLUSION

By the bounty and grace of Allah, we have successfully completed the present research paper entitled "Islamic Financial Institutions from the Perspective of Islamic Economics". This study examined the concept of Islamic financial institutions and the

¹ - Ali Fawzi Ibrahim Al-Mousawi, *The Legal Framework for the Management of Securities Portfolios*, p. 128.

² - Siham Suwadi Tu'mah Al-Taie, *The Legal Framework of Financial Investment Companies: A Comparative Study*, p. 26.

³ - Munir Ibrahim Hindi, *Investment Funds in the Service of Small and Large Savers*, p. 95.

distinctive features that set them apart from their counterparts in the conventional economic system.

At the conclusion of this research, a set of findings has been recorded, followed by recommendations which, in our view, may contribute to furthering the development and refinement of this field.

Research Findings

This study has yielded the following principal findings:

- Within the framework of Islamic economics, wealth assumes diverse and evolving forms in contemporary times—ranging from financial and commercial papers, shares, and bonds to digital currencies and real estate, among others.
- A comprehensive definition of Islamic financial institutions can be articulated as follows:
 “Any physical or legal entity possessing juridical personality that engages in the employment, saving, investment, or insurance of clients’ funds in accordance with the principles and rulings of Islamic Shariah, utilizing various permissible contractual forms and financial structures.”
- Islamic financial institutions manifest in various forms depending on the nature of their functions, operational mechanisms, and institutional characteristics. Nevertheless, they all converge upon a fundamental principle—adherence to the rulings and objectives of Islamic law, while avoiding practices such as usury (Riba), excessive uncertainty (Gharar), and gambling (Maysir).

Research Recommendations

This study puts forth the following recommendations:

- There is a pressing need to establish a unified Shariah reference framework under which all Islamic financial products and institutions may operate. Such a framework should be appropriately tailored to accommodate the specific nature and requirements of each type of Islamic financial institution and should, when necessary, serve as a binding authority.
- Stakeholders should endeavor to benefit, to the greatest extent possible, from the guidelines and standards issued by leading bodies that support Islamic financial institutions—such as those promulgated by the Accounting and Auditing Organization for Islamic Financial Institutions, along with other relevant councils and authorities.
- It is imperative to ensure the optimal education and training of personnel and executives working within Islamic financial institutions—particularly those

operating within legal environments that do not fully recognize or accommodate the distinctiveness of Islamic banking practices.

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