

The reality of Islamic financial institutions



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Abstract:

Through this research paper, we tried to enumerate all Islamic financial institutions and bodies that frame and support the Islamic financial industry, and it became clear to us that they came to meet all the needs of the banking and money sector in terms of mediation, fatwa, guidance, research, oversight innovation, governance, strategy, planning, etc., waiting for the emergence of other bodies and institutions in the future to keep pace with Its development in light of the era of financial technology, digitization and artificial intelligence.

They also stated that Islamic financial institutions have proven that they represent a qualitative addition to the banking and financial sector, and that they really constitute an increase in the financial strength of this sector and support its economic and financial strength.

key words: Islamic financial institutions; Islamic banks; Islamic financial industry; Islamic finance, Islamic finance bodies.

Introduction:

Islamic financial institutions have achieved great successes at both regional and international levels, especially after the global financial crisis (the subprime mortgage crisis) in 2008, despite their relatively recent experience compared to their conventional counterparts.

The first thing that comes to mind when hearing the term "Islamic financial institutions" is Islamic banks. This is justifiable, as Islamic banks are the most widespread and visible institutions compliant with Sharia (Islamic law). However, Islamic finance institutions are numerous and varied. In addition to Islamic banks, there are other Islamic financial markets such as the Sukuk (Islamic bonds) market, Takaful (Islamic cooperative insurance) companies, Islamic investment funds, Islamic microfinance institutions, and others. This study will explain and analyze the most important Islamic finance institutions.

Research Problem: based on the above, the research problem can be formulated with the following question: To what extent is Islamic finance relied upon internationally as an alternative to traditional finance?

To simplify the problem and fully address the subject, we pose the following sub-questions:

- What is the global reality of Islamic finance?
- What are the financial and banking institutions that constitute the structure of the Islamic financial industry?

Hypotheses: To answer the research problem and the posed questions, we have formulated the following hypotheses:

- Islamic banks and financial institutions are no longer a phenomenon that can be ignored in Islamic countries; rather, they will continue to grow and advance, surpassing conventional banking.
- Ensuring a promising future for Islamic finance and enhancing its global position in financial markets depends on the rapid growth witnessed.

Research Significance: The significance of this research stems from the current importance of Islamic financial institutions, which have attracted considerable attention in the field of finance. The research also highlights the current global standing of Islamic financial institutions in financial markets.

Objectives :The research aims to achieve the following objectives:

- To highlight the great importance that the Islamic financial industry has gained in recent times. The Islamic financial industry has become a reality in economic life, and Islamic finance is gaining increasing recognition and interest in the global financial industry.
- This study aims to clarify the extent to which Islamic financial institutions have spread globally, becoming a reality that has imposed itself in the global economic arena, with the goal of improving the credibility of Islamic banking and the finance industry.

Research Methodology: The descriptive-analytical method was used to define and classify these institutions, followed by studying their current reality.

THE FIRST TOPIC: Introduction to Islamic Financial Institutions

Islamic financial institutions represent a vital component of the modern financial system, operating in accordance with the principles and objectives of Islamic law (Sharia). They have emerged as credible alternatives to conventional institutions, offering financial products and services that avoid interest (riba), excessive uncertainty (gharar), and unethical investment practices. These institutions play a crucial role in mobilizing resources, promoting social justice, and supporting economic development through Sharia-compliant modes of financing and investment.

First requirement: Concept of Islamic Financial Institutions

The concept of Islamic financial institutions is rooted in the fundamental principles of Islamic economics, which emphasize justice, equity, and the prohibition of interest (*riba*). These institutions represent an alternative model to the conventional financial system, offering products and services that comply with the ethical and legal framework of Islamic law (*Sharia*). Their operations are guided by the principles of risk-sharing, asset-backing, and the promotion of social welfare, ensuring that financial activities contribute to both economic growth and moral integrity. By integrating financial objectives with religious and social values, Islamic financial institutions aim to achieve comprehensive development that aligns with the broader goals of Sharia, including fairness, transparency, and the equitable distribution of wealth.

First section: definitions

Definition of Financial Institutions: Financial institutions are defined as business entities whose assets primarily consist of financial assets, or liabilities and receivables owed by others, such as stocks, bonds, loans, rather than physical assets like buildings, equipment, and raw materials, as is the case in business enterprises. They provide loans to customers or purchase and invest in securities (offered in the financial market) (عبد الغفار و قرياقصة، 2003، صفحة 207).

Definition of Islamic Financial Institutions: Islamic financial institutions are cooperative and integrated economic entities that conduct their financing, investment, and administrative activities in accordance with the principles and objectives of Islamic law (*Sharia*), with the aim of achieving Islamic, economic, and social goals..

Key points highlighted by the definition:

- **Economic Nature:** Islamic financial institutions are engaged in financing and investment activities with the primary objective of achieving profitability while maintaining ethical standards consistent with Islamic principles.
- **Cooperation and Solidarity:** These institutions operate within a framework of mutual cooperation and solidarity, aiming to realize shared goals that contribute to the stability and growth of the Islamic financial system.
- **Commitment to Sharia:** Their operations are strictly governed by the principles of Islamic law (*Sharia*) and are monitored by specialized Sharia supervisory boards to ensure full compliance with religious and ethical guidelines.
- **Diverse Objectives:** Beyond profit generation, these institutions pursue a combination of religious, social, and economic Objectives, thereby promoting social justice, equitable distribution of wealth, and sustainable economic development.

Second section: Characteristics of Islamic Financial Institutions:

- Prohibition of interest (riba): They do not engage in interest-based transactions.
- Compliance with Islamic law: Avoiding all activities considered unlawful under Sharia.
- Avoidance of uncertainty (gharar): They refrain from transactions that involve excessive risk or uncertainty.
- Profit and loss sharing principle: Profit is earned only when there is a willingness to bear potential losses.
- Principle of "Al-Kharaj bi Al-Daman": Whoever bears the risk is entitled to the return.
- Zakat (charitable contribution): A portion of the institution's wealth is allocated for zakat recipients.
- Sharia supervision: These institutions are subject to Sharia oversight to ensure compliance.
- Social solidarity: This is reflected in practices like interest-free loans (qard hasan), zakat, and donations.
- Linking economic development with social development: Aiming for sustainable development through profitable projects that benefit society.

Second requirement: Objectives of Islamic Financial Institutions:

Islamic financial institutions seek to achieve a range of religious, economic, and developmental objectives, which can be briefly summarized as follows:

➤ Religious Objectives:

- Effectively applying Islamic law in the economic domain.
- Promoting and developing Islamic economics globally.
- Enhancing Islamic banking operations and improving financial products.
- Addressing internal and external challenges facing Islamic financial markets.

➤ Economic Objectives:

- Attracting savings and financing various economic sectors in a lawful, profit-generating manner.
- Contributing to economic stability and solving economic problems.
- Supporting national economies, achieving sustainable economic growth.

➤ Developmental Objectives:

- Economic Development: Investing in productive projects, increasing productivity, and expanding the economic structure.
- Social Development: Reducing unemployment, providing job opportunities, and promoting income distribution equity through financing productive and

consumption activities via Islamic contracts, which helps create jobs and reduce poverty.

- Categories of Islamic Financial Institution

THE SECOND TOPIC: Types of Islamic Financial Institutions

Islamic financial institutions can be classified into several main types according to the nature of their operations and objectives.

First requirement: Islamic Banking Institutions.

Islamic banking institutions represent the central component of the Islamic financial system, serving as intermediaries that mobilize funds and provide financing in full compliance with the principles of Islamic law (Sharia). Unlike conventional banks that rely on interest-based transactions, Islamic banks operate on the basis of risk-sharing, asset-backed financing, and ethical investment. Their activities are guided by contracts such as *mudarabah* (profit-sharing), *musharakah* (partnership), *murabaha* (cost-plus sale), *ijarah* (leasing), and *istisna'a* (manufacturing contract). These institutions aim not only to achieve profitability but also to promote social justice, economic development, and equitable wealth distribution. Through their adherence to Sharia principles, Islamic banking institutions play a crucial role in fostering financial inclusion and supporting sustainable economic growth within the Islamic financial framework.

First section: banks

Islamic Banks: These institutions collect funds from savers and invest them in projects following the principles of profit and loss sharing (*mudaraba*), ensuring that all operations comply with Islamic law (القري، 2004، صفحة 9).

Islamic Central Bank: The Islamic central bank can be defined as follows: It is a government institution that stands at the top of the entire banking system, covering both the monetary and financial markets. It is also referred to as the "bank of banks" and the "government bank." The central bank's primary role is to monitor and control the money supply and oversee general credit policies (الموساوي، 1993، صفحة 244).

The Islamic central bank is an independent governmental institution responsible for achieving the economic and social objectives of the Islamic economy in the monetary field. Like traditional central banks, it is responsible for issuing currency and, in coordination with the government, ensuring the stability of the currency both domestically and internationally. It acts as the government's bank, the bank of commercial banks, and manages clearing arrangements, check settlements, and transfers. It also serves as the lender of last resort and guides, regulates, and supervises Islamic commercial banks, specialized financial institutions, non-banking institutions, deposit insurance bodies, and investment account auditors, without infringing significantly on the independence of these institutions. Unlike traditional central banks, it bears the responsibility of preventing the concentration of wealth and power in the hands of the elite through financial institutions.

Some countries in the Islamic world have fully Islamized their banking systems, so that transactions between banks and individuals, as well as between banks and the central bank, all adhere to Islamic law. Three countries stand out in this regard:

Islamic Republic of Iran: The islamization of the banking system coincided with the Islamic Revolution in 1979. Interest was abolished on all banking operations, both borrowing and lending, and the banking system was transformed to a profit-sharing system under the supervision of the central bank in 1983.

Pakistan: The country laid out plans to eliminate interest and replace it with an Islamic banking system, adopting a gradual approach to implementation. The official announcement for the full transition to an Islamic banking system was made in 1985, overseen by the Pakistani Islamic Thought Council (خلف و الناعس، 2019، صفحة 17).

Sudan: A decision to convert the Sudanese banking system to an Islamic system was issued in 1984. However, the decision remained largely symbolic until 1989, when the government pushed for a deeper implementation of the Islamic banking system.

Second section: Non-Banking Islamic Financial Institutions.

The Financial Stability Board defines non-banking financial institutions as comprising all financial institutions that are neither central banks nor commercial banks nor public financial institutions.

Definition of Non-Banking Islamic Financial Institutions: These are institutions that carry out their financial, investment, and administrative activities using non-banking methods within the framework of Islamic law. This category includes:

a. Islamic Investment Funds.

Islamic financial institutions mobilize savings from the public through standardized investment certificates or bonds, which are entrusted to a third party for management and investment in securities and other permissible sectors on behalf of the savers. The primary objective is to achieve the highest possible profit with minimal risk, in accordance with the agreed-upon terms and Islamic principles. Investment companies issue their capital to the public and manage these funds to generate returns. However, Islamic investment funds differ from conventional funds in both the methods of resource mobilization and the nature of their investments, as they operate strictly in compliance with Islamic law (Sharia).

b. Takaful Institutions (Islamic Insurance).

This type of financing is one of the most distinctive sources of funding in Islam, focusing on cooperative and mutual financing to ensure that individuals live with dignity.

Zakat Fund: Zakat is defined as "the giving of a specified portion of a specific type of wealth when it reaches a certain threshold, under the condition that one has full ownership of it for a full year." (شبير، 1994، صفحة 28) The Zakat fund plays a significant role in mitigating economic fluctuations by controlling the collection,

allocation, and utilization of zakat funds. It also has an investment role, investing part of its assets in productive projects, providing a continuous income source for beneficiaries, increasing consumer spending, and ultimately boosting economic growth and reducing unemployment.

Islamic Insurance Companies (Takaful and Cooperative Insurance): Islamic insurance companies emerged after the issuance of collective fatwas endorsing cooperative insurance as an alternative to commercial insurance. The function of these companies is to manage the funds, not to provide guarantees as in commercial insurance. Takaful companies design insurance portfolios, collect premiums based on actuarial calculations, and manage the pooled funds for the benefit of participants.

Waqf Institutions (Endowments): Waqf is defined as "the holding of an asset and donating its benefits." (الخياط، 1986، صفحة 183) Waqf institutions have legal status, independent finances, and the goal of maintaining, growing, and disbursing the returns from endowments in line with Islamic law. The diverse and lasting benefits of waqf contribute significantly to both economic and social development. While primarily social in nature, waqf institutions also have an economic role, funding projects that benefit society. Despite being profit-seeking, waqf institutions are considered cooperative financial sources due to their unique funding origins and their significant role in social development.

Endowment institutions' involvement in the financial system is reflected in their dealings with financial institutions (banks, stock exchanges) and the establishment of financial waqf institutions, such as endowment funds and endowment companies

C. Islamic Financial Markets.

The financial market is one of the key financial intermediaries in modern economies. This system provides investors with security, liquidity, profitability, and a balance between these goals, which is the aspiration of any investor. For this reason, Islamic economics researchers have paid attention to this market by developing tools compatible with Islamic law (Sharia), allowing Muslim participants to benefit from its advantages and characteristics instead of being deprived of them.

Islamic Financial Market Instruments:

The financial securities traded in the Islamic financial market are: shares, Benefit instruments (Sukuk Al-Ijarah), Partnership instruments (Sukuk Al-Musharaka; Sukuk Al-Mudaraba), and sales instruments, which are: Murabaha Sukuks, Salam Sukuks, and Istisna Sukuks, Sales instruments, which include Murabaha Sukuk, Salam Sukuk, and Istisna Sukuk

Second requirement: Supporting and Supervisory Bodies in the Islamic Financial Sector

The Islamic financial sector operates within a comprehensive framework that extends beyond financial institutions themselves. Its soundness and credibility depend largely on the presence of supporting and supervisory bodies that ensure compliance with Sharia principles, promote transparency, and uphold global best practices. These bodies play a fundamental role in regulating, standardizing, and guiding the operations of Islamic financial institutions, thereby enhancing their stability and trustworthiness. They include both international and national organizations responsible for setting accounting, auditing, and governance standards, as well as Sharia supervisory councils that oversee the conformity of financial activities with Islamic law. Collectively, these institutions form the backbone of the Islamic financial infrastructure and contribute to its sustainable growth and global recognition.

First section: Supporting Bodies.

These are entities that support Islamic financial institutions, enabling them to fully carry out their financial and banking activities

Deposit Insurance Body: This can be a mutual or cooperative insurance company to secure deposits from risks. It is an independent, non-profit body guaranteed by the government and supervised by the central bank, funded by commercial (Islamic) banks. (قندوز، 2008، صفحة 111)

Investment Review Body: This governmental authority, established in a manner analogous to the Deposit Insurance Corporation, is mandated to audit and supervise the accounts of investors and financial intermediaries that have obtained funds either directly or through commercial banks and non-banking financial institutions. Its primary function is to ensure transparency, accountability, and compliance with regulatory standards, thereby safeguarding the stability of financial institutions and protecting the interests of depositors, account holders, and shareholders.

Sharia Supervisory Body: According to the auditing standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), this independent body consists of jurists specializing in Islamic commercial law. One member may be a non-jurist with expertise in Islamic financial institutions. The body is tasked with guiding the activities of Islamic financial institutions, and its rulings are binding. It comprises no fewer than three members and may seek the assistance of specialists in business administration, economics, law, or accounting.

Sharia boards and their supervisory roles are the backbone of Islamic financial institutions. They play a vital supervisory role, and most laws related to Islamic financial institutions mandate the presence of a Sharia body to approve their transactions, even though these laws do not detail the work of the body or committee. The institution's operations must adhere to Islamic principles and rules, which necessitates the establishment of an independent Sharia body to provide fatwas and oversight. Some Islamic banks and financial institutions have also started appointing Sharia monitors, acting as liaisons between executive management and the Sharia

Supervisory Body, overseeing daily operations, and ensuring that the institution's (activities comply with Islamic law.

Second section: Supporting Infrastructure Institutions for Islamic Financial Institutions.

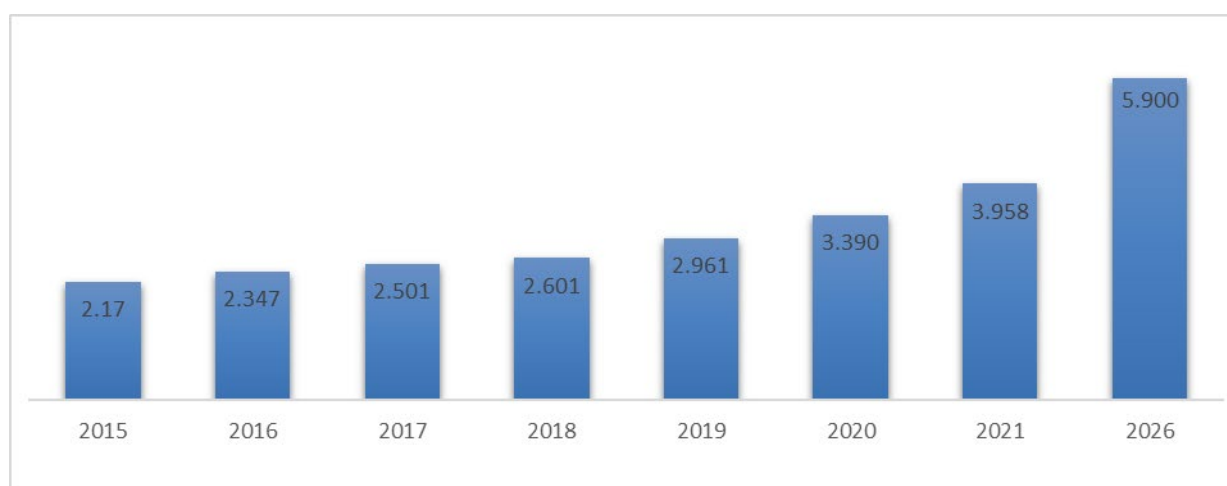
In recent years, Islamic finance has witnessed the establishment of several international supporting institutions, reflecting the global nature of this industry. The most notable of these are:

- Islamic Development Bank (IDB)
- Organization for Islamic Financial Institutions (AAOIFI)
- Islamic Financial Services Board (IFSB)
- International Islamic Financial Market (IIFM)
- General Council of Islamic Banks and Financial Institutions (CIBAFI)
- Liquidity Management Center (LMC)
- Islamic international rating agency (IIRA)
- International Islamic Centre for Reconciliation and Arbitration - IICRA

3. The Spread of Islamic Financial Institutions Worldwide:

Islamic financial institutions, in all their forms, are spread across the globe and have become an undeniable reality. The demand for the financial services provided by these institutions continues to rise. We will attempt, through the following, to demonstrate this:

- Fig.1. Growth of Islamic finance assets from 2015 to 2021 Billion dollars \$



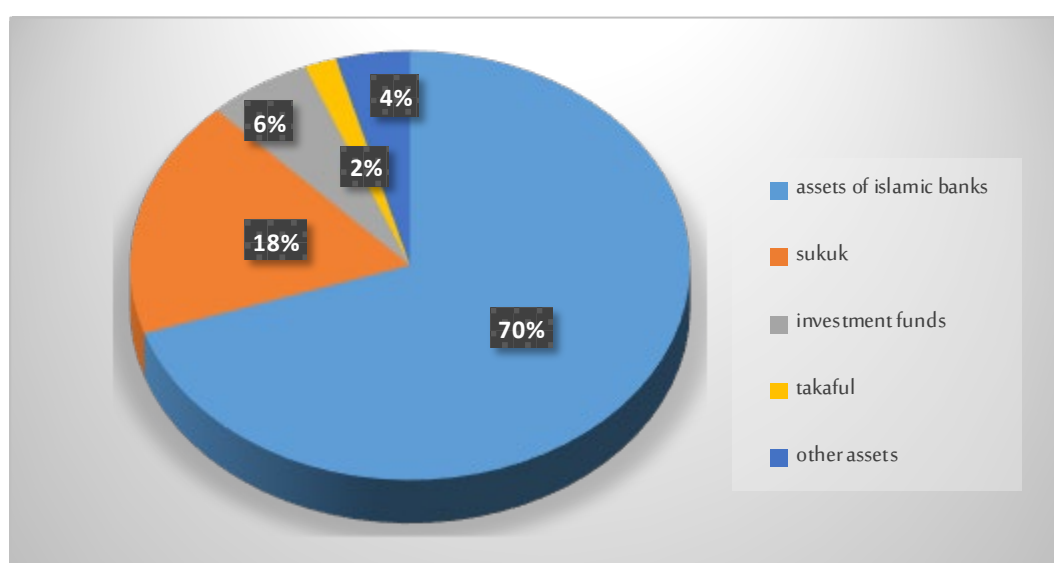
Source: Islamic finance reports, ICD – REFINITIV ISLAMIC FINANCE DEVELOPMENT REPORT2022 ,EMBRACING CHANGE, IFDI, <https://www.zawya.com/en/primarykeyword/ISLAMIC%20FINANCE%20REPORTS>, consult

17/01/2023 à 9h 59.

We can observe from the figure above that the assets of Islamic financial institutions have been increasing from 2015 to 2021, with the total value of global Islamic finance assets reaching \$3.985 trillion. This figure is expected to rise further by 2026.

The previous data includes more than 1,600 Islamic financial institutions, encompassing Islamic banks, Takaful, Sukuk, and Islamic funds, along with Islamic financial technologies. These assets are distributed across the sectors as illustrated in the following figure:

- Fig. 2: Islamic finance assets 2021 (million dollars \$)



Source: Prepared by a researcher based on Islamic finance reports, ICD – REFINITIV ISLAMIC FINANCE DEVELOPMENT REPORT ,EMBRACING CHANGE, IFDI 2022 ,P24-50.

Table 1. Distribution of Islamic Finance Assets across Islamic Financial Institutions

Years	Sukuk	Islamic Banking Principles	investment funds	Takaful	Other assets
2015	306	1.603	71	47	143
2016	349	1.707	99	48	143
2017	420	1.768	123	46	145
2018	470	1.819	114	47	152
2019	539	2.069	146	54	154
2020	626	2.364	178	62	160
2021	713	2.765	238	73	169
2026 expected	1.138	4.025	416	106	214

Source: : Prepared by the researcher based on islamic finance reports, ICD – REFINITIV ISLAMIC FINANCE DEVELOPMENT REPORT, EMBRACING CHANGE, IFDI 2022, P24-50.

According to the 10th edition of the Islamic Finance Development Report for 2022, provided by the Islamic Corporation for the Development of the Private Sector (ICD), the Islamic Development Bank (IsDB), and Refinitiv, the world's largest financial markets data and infrastructure provider:

- **Islamic Banking Sector:** Islamic banking is the largest sector in the Islamic finance industry, holding 70% of the total Islamic finance assets. The global Islamic banking sector grew by 17% to reach \$2.8 trillion in 2021, with growth expected to reach \$4 trillion by 2026. Three main drivers of this growth include government support for sectors affected by the pandemic, operational efficiencies through branchless banking and fintech partnerships, and a continuing rise in demand for Islamic banking services.

- **Sukuk (Islamic Bonds):** Sukuk is the second-largest sector in terms of assets, increasing by 14% in 2021 to \$713 billion in outstanding sukuk, with new issuances growing by 9% to \$202.1 billion, a record high. This sector is expected to continue growing, reaching \$2 trillion by 2026.

- **Islamic Funds:** As the third-largest sector by assets, Islamic funds grew significantly by 34% to \$238 billion in 2021. However, this sector is less widespread compared to banking and sukuk, with 81% of global Islamic funds located in just three countries: Iran, Saudi Arabia, and Malaysia.

- **Other Islamic Financial Institutions:** This includes fintech firms, investment companies, financing companies, leasing, microfinance, brokers, and traders. This sector also experienced growth in 2021, increasing by 5% to \$169 billion in assets. The fastest growth was recorded in Kazakhstan (44%), Egypt (38%), and the Maldives (31%). Fintech is a major focus, especially in Saudi Arabia, which plans to nearly triple its fintech companies from 82 to 230 by 2025.

- **Takaful (Islamic Insurance):** Takaful is the smallest sector in Islamic finance, accounting for \$73 billion in 2021, or 17%. This sector is undergoing consolidation in the GCC countries to simplify and reduce costs, with significant regulatory changes expected in Southeast Asia, particularly Indonesia and Malaysia, and the potential for new entrants in the Philippines.

Conclusion:

- **Islamic Finance:** Islamic finance is a key component of the Islamic economy, comprising Islamic banking institutions, non-banking entities (such as takaful companies, Islamic investment funds, and Islamic capital markets), and non-profit organizations like zakat and waqf institutions. It includes products and contracts that provide capital or physical assets according to Islamic law, particularly in financial transactions.
- **Integration of Islamic Financial Institutions:** The integration of Islamic financial institutions and bodies represents a scientific development that aligns with their role and the future needs of the Islamic banking and financial industry.
- **History and Evolution:** Islamic financial institutions began with Islamic banking in the 1970s, followed by non-banking financial institutions (Islamic insurance) in the late 1970s. Supporting infrastructure institutions were established, including the Islamic Development Bank in 1975, the Accounting and Auditing Organization for Islamic Financial Institutions in 1991, the Islamic International Rating Agency in 2000, the General Council for Islamic Banks and Financial Institutions in 2001, the Liquidity Management Center in 2002, and the International Islamic Centre for Reconciliation and Arbitration in 2005. Islamic financial institutions have since expanded across Arab, Islamic, and Western countries.
- **Growth and Infrastructure:** According to the 10th edition of the Islamic Finance Development Report, Islamic banks and financial institutions have become a global reality, with continuous growth expected until 2026. This growth is supported by Islamic financial institutions providing the necessary infrastructure.

We aimed to account for most Islamic financial institutions that constitute the Islamic finance industry, anticipating the emergence of new entities and institutions in the future that will accompany and keep pace with the development of Islamic finance in the era of financial technology, digitization, and artificial intelligence

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