SHARIAH-COMPLIANT FINANCE: AN ANALYSIS OF THE ISLAMIC FINANCIAL SERVICES INDUSTRY

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ABSTRACT
A study on the Islamic financial services industry is a comprehensive analysis of the financial sector that operates in accordance with Islamic principles, also known as Shariah-compliant finance. Shariah is Islamic law and code of conduct derived from the divine principles mentioned in primary sources of Islam i.e., Quran and Sunnah. Islamic finance is guided by the principles of Islamic law (Shariah), which prohibit activities such as charging or paying interest (usury) and engaging in speculative transactions. Instead, Islamic finance promotes ethical and equitable financial practices. This research highlights the substantial growth and financial soundness of the Islamic financial services industry, and it suggests a positive outlook for the sector's future. Islamic finance has gained momentum globally, attracting both Islamic and non-Islamic investors who are interested in ethical and Shariah-compliant financial solutions.

Keywords: *Shariah, Shariah compliant, Islamic finance, Islamic Finance Service Industry.*

1. ISLAMIC FINANCE
Islamic finance currently generates more than USD 3 trillion in revenue and is one of the international finance sectors with the quickest growth rates. Over 75 nations around the world currently practice Islamic banking and finance, including many in Europe, North America, South-East Asia, and Africa.
Islamic finance is governed by 'Shariah' (Islamic Law), which is a derived version of the Islamic principles obtained from the fundamental sources of Islam, namely the Holy Quran (the holy book) and the Sunnah (the sayings and traditions of the Prophet Muhammad [Peace be upon Him]).
Islamic finance refers to a financial system that follows Islamic law (Shariah) and is guided by Islamic economics. In particular, usury, the collection and payment of interest, or riba, are forbidden by Islamic law. Islamic law forbids investing in companies that are deemed to be unlawful, or haraam (such as those that sell pork or alcohol, or those that create pornographic or gossip publications that go against Islamic principles). Islamic finance is more than just an interest-free financial system; it also includes other important principles that promote entrepreneurship, risk-taking, transparency, the preservation of property rights, and ethical values such as justice, fair dealing and fair pricing, mutual cooperation, and respect for the other contracting parties.

Shariah: Islamic law and code of conduct derived from the divine principles mentioned in primary sources of Islam i.e., Quran and Sunnah.

Shariah compliant: A financial product/service/activity complies with the principles of Shariah (Islamic Law).

2. ISLAMIC FINANCE PRINCIPLES
Islamic finance operates according to the following tenets:

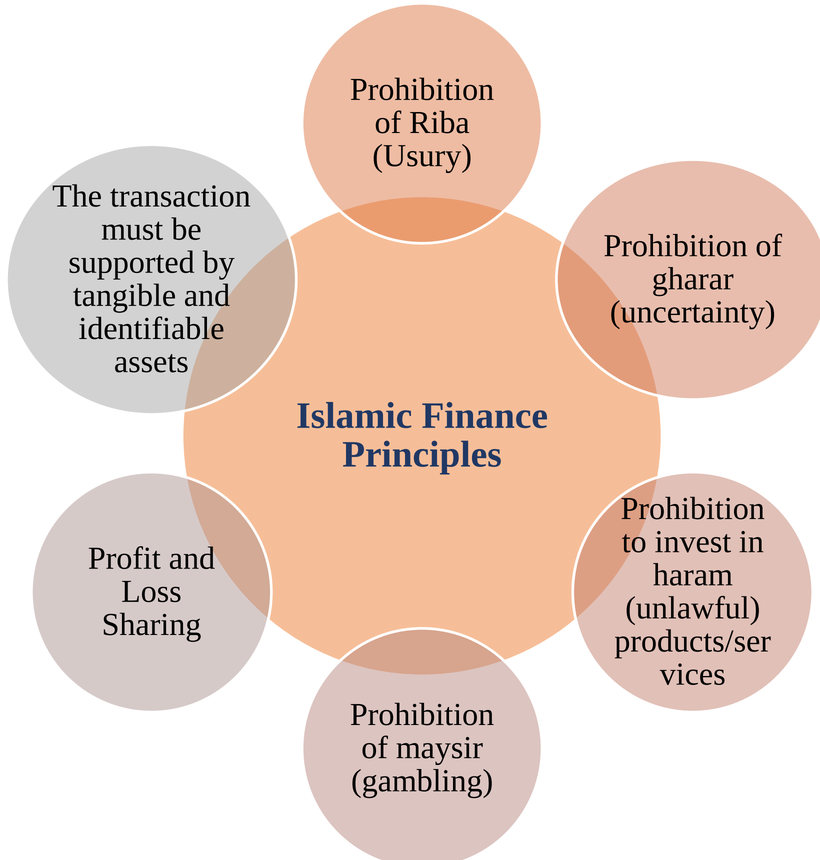


Figure No.1: Islamic Finance Principles

2.1 Prohibition of Riba (Usury)

Riba, which means "**excess**" in Arabic, refers to any gain or surplus that one party in a transaction makes at the expense of the other party.

The Holy **Qur'an** states in the verses that trade is legal but that riba, or usury, is unlawful.

Interests are not the only thing that are forbidden in Islamic finance; any over and above the actual principal lent, scheduled payments. This rule's justification is that any growth or interest that is not motivated by effort or risk sharing is to be seen as inappropriate. The only loan deemed to be compliant with the precepts of the Shariah is the Qard al Hassan ("interest free loan"), as any potential direct, indirect, or connected gains in the hands of the lender are likewise prohibited.

2.2 Prohibition of gharar (uncertainty)

Gharar refers to uncertainty, ambiguity, and buyer deceit. In Islamic finance, there should be no excessive speculation or uncertainty in any transaction. Contracts must be written as precisely as possible to avoid any ambiguity regarding the quality, quantity, or presence of its subject matter.

2.3 Prohibition of maysir (gambling)

It describes any activity where two participants are at risk of losing money and the gain of one means the loss of the other. Gambling is forbidden in Islam because it diverts attention away from productive efforts and generates wealth effortlessly.

2.4 Prohibition to invest in haram (unlawful) products/services

Investment initiatives that violate moral principles are prohibited and considered as haram. Investment in enterprises dealing with goods and activities including alcoholic and non-permissible foods such as pork, pornography, prostitution and other immoral entertainment, traditional financial institutions.

2.5 Profit and Loss Sharing

One of the main tenets of Islamic finance is that partners should split profits and losses based on their respective contributions to the venture. There will be no assurance regarding the rate of returns that the individual will act as a partner and not a lender. Islamic Finance encourages capital providers to become partners and share the benefits and risks involved with a business rather than acting as interest-charging lenders. The guiding principle that results from this is to attempt to ensure that investment benefits the entire community by discouraging simple lending of money for interest without incurring any risk.

2.6 The transaction must be supported by tangible and identifiable assets

Transactions must be supported by tangible, identifiable assets. In the Islamic financial realm, money is simply seen as a tool for determining the worth of something. Making money out of money is therefore unacceptable. Consequently, in Islamic Finance is not considered a true form of finance because money itself has no intrinsic value. All transactions must be based on tangible, measurable assets such as property, merchandise, real estate, land, etc.

3. COMPONENTS OF ISLAMIC FINANCIAL SERVICE INDUSTRY

The IFSI has subsectors that are comparable to those in the traditional system. These include, among others:

- Islamic banking industry
- Islamic capital markets including asset management industry
- Islamic insurance known as takaful
- Islamic nonbank financial services such as leasing, microfinance, etc.
- Islamic money market

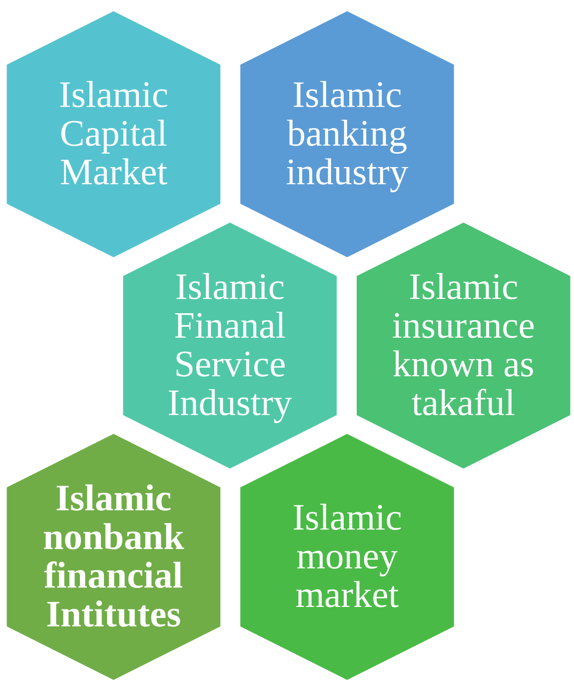


Figure No. 2: Components of Islamic Financial Service Industry

3.1 Islamic banking

In Islamic banking funds are mobilised through noninterest-bearing deposits and investment deposits based on "profit-sharing and loss-bearing" contracts (usually mudarabah, and, on some occasion, wakala contracts), and directing these money to financing permitted (in accordance with Shariah) economic activity by numerous Islamic financing agreements (usually murabahah, ijarah and musharakah contracts). Utilizing investment deposits This incorporates the features of traditional bank deposits investments in mutual funds (where the money is protected) and a potential loss of principal) raises particular challenges in the risk IIFS management and supervision.

3.2 Islamic insurance - Takaful:
In accordance with Shariah guidelines, mutual insurance is known as takaful, which is an Arabic word that means "guaranteeing each other." Islamic insurance, also referred to as takaful, typically combines commercial and mutual insurance arrangements. Participants (policy holders) in a group decide to cooperate with one another in opposition to a specific loss, and make a monetary contribution to this end, it contributes in part to a common fund. Takaful manager enters into an agreement known as a mudarabah with policyholders to invest the finances and a contract (wakala) with an agency to underwrite the risks associated with it.

3.3 Islamic nonbank financial organizations
Islamic nonbank financial organizations often offer specialized financing, such as Islamic microfinance or ijarah, using funds raised through profit-sharing arrangements (for instance, mudarabah businesses within Pakistan)

3.4 Islamic money markets:
Islamic money markets are those that trade Shariah-compliant, short-term instruments that can be used by central banks and IIFS to manage liquidity. Such
Markets are undeveloped or almost non-existent as a result of limited supply of suitable short-term, Shariah-compliant instruments, as well as the flaws in the supporting system. The majority of instruments used for short-term transactions among IIFS or between IIFS and traditional banks either Deposits made in mudarabah or murabahah in some exchange-traded product (such as aluminium). They are not exchangeable instruments, and possibly have high market or return rates risks.

3.5 Islamic capital markets
The Islamic Capital Market (ICM) is an essential element of the Islamic finance one that complements Islamic banking and Islamic insurance. Islamic capital markets are made up of long-term securities that are compliant with Shariah, as well as the related markets and market intermediaries., The organizational structure of Islamic Capital Market is very similar to that of conventional markets. The ICM operates as a parallel market for capital seekers and suppliers to the traditional capital market. The development of this market has been accelerated in recent years, and it has played a vital role in bolstering the established traditional capital market. In an increasingly complex and volatile global financial and economic environment, the development of this sector on a worldwide scale is vital. (Alam, N., et al., B. 2018)

4. ISLAMIC FINANCIAL SERVICE INDUSTRY GLOBALLY:

TABLE 1.1 Breakdown of the Global IFSI by Sector and Region (USD billion) (2021)

Region	Islamic Banking Assets	*Ṣukūk* Outstanding	Islamic Funds Assets	*Takāful* Contributions	Total	Share (%)
Gulf Cooperation Council (GCC)	1,212.5	332.3	46.0	12.7	1,603.5	52.4
South-East Asia (SEA)	287.5	390.3	37.5	4.7	720.0	23.5
Middle East & South Asia (MESA)	477.1	26.9	22.0	5.6	531.6	17.4
Africa	58.2	1.8	4.0	0.6	64.6	2.1
Others	68.8	24.4	45.1	0.7	139.0	4.5
Total	2,104.1	775.7	154.6	24.3	3,058.7	100.0
Share (%)	68.7	25.4	5.1	0.8	100	

Source: IFSB IFSI Stability Report 2022

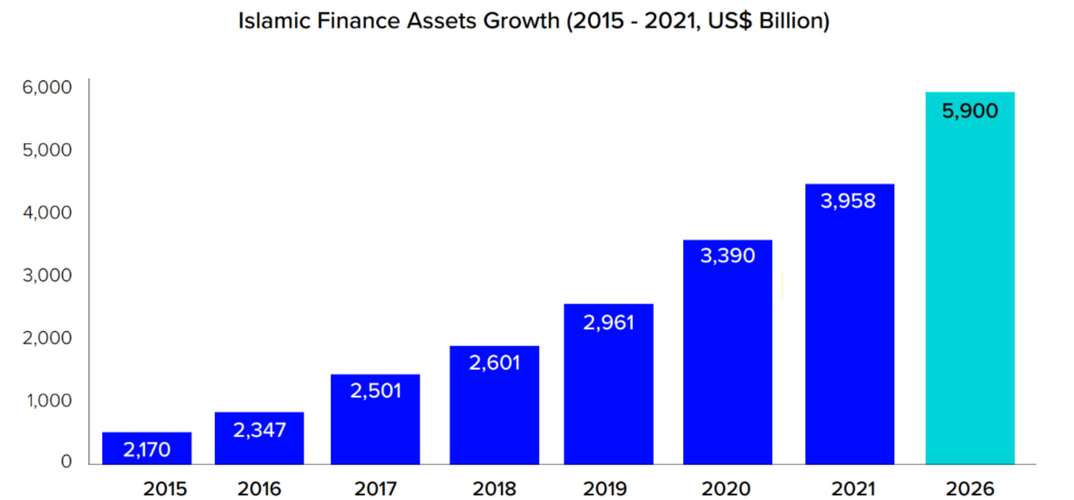
Source: Islamic Financial Services Industry Development Ten-year Framework and Strategies: A FINAL REVIEW

Above table demonstrates that the IFSI had a value of USD 3.06 trillion in 20212 as opposed to USD 1.87 trillion in 2014. Based on a variety of financial soundness indexes, the performance of the IFSI's major segments has generally exceeded worldwide regulatory criteria since the MTR. This performance was also superior to that of the traditional financial services industry in several developed financial markets. This is true despite the fact that the global financial system has faced several obstacles, breakthroughs, and improvements since the MTR (mid-term review). The COVID-19 epidemic, internal civil unrest, geopolitical conflicts, trade wars, economic sanctions, financial constriction owing to inflation, climate change concerns, technical and digital revolution, advancements in crypto assets, etc. are notable examples of these.

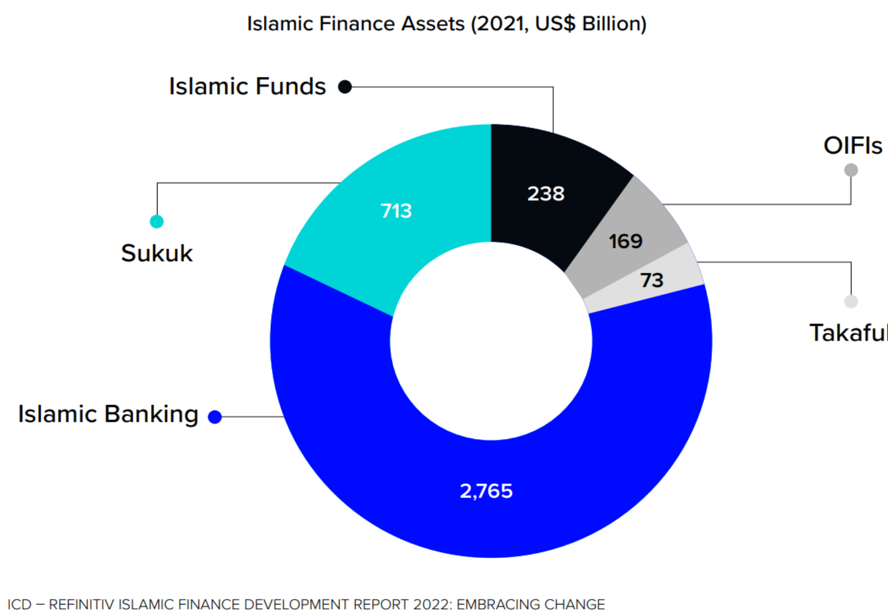
4.1 Islamic Finance Growth:

As per ICD – Refinitiv Islamic finance development report 2022: embracing change,

The main news for the Islamic finance sector in 2021 was its robust growth of 17% to reach assets worth US$4 trillion. Strong growth was seen in all areas, which we believe is evidence of the the ability of the industry to recover from large-scale uncertainties in 2020. Islamic or Muslim-majority nations no longer have exclusive access to Islamic finance. Countries like the UK have participated in all industries for decades, and in 2021 they will continue to benefit the global business.



Source: ICD – REFINITIV ISLAMIC FINANCE DEVELOPMENT REPORT 2022: EMBRACING CHANGE



Source: ICD – REFINITIV ISLAMIC FINANCE DEVELOPMENT REPORT 2022: EMBRACING CHANGE

The global Islamic banking business remained resilient in 2020, the first year of the pandemic, with total asset size increasing by 14%, but it was the following year when growth of 17% outperformed pre-Covid levels, boosting assets to US$4 trillion.

4.1.1 Islamic bankings

Which accounts for 70% of all assets in the Islamic finance sector. Globally, the Islamic banking industry increased by 17% to US$2.8 trillion in year 2021. **Sukuk**, the second-largest sector by assets, increased by 14% in 2021, reaching an outstanding value of US$713 billion. The total amount of new issuance increased by 9% to a record $202.1 billion. In 2021, the issuance of ESG sukuk hit a new high of US$5.3 billion, and they still hold a dominant position in that market.

4.1.2 Islamic funds

The third-largest industry, with exceptional growth of 34% to assets under management of US$238 billion in 2021. Even still, this industry is less universal than banking and sukuk, with just three nations—Iran, Saudi Arabia, and Malaysia—representing a significant 81% of all global Islamic finance.

4.1.3 Other Islamic financial institutions (OIFIs)

Such as brokers and traders, leasing and microfinance organizations, investment firms, and financial technology companies grown by 5% to assets worth US$169 billion.

4.1.4 Takaful

Takaful is the smallest sector of the Islamic financial industry, accounting for US$73 billion in 2021 after a 17% increase.
IFDI (Islamic Finance Development Indicator) forecasts that the global Islamic finance sector would increase from US$4 trillion in 2021 to US$5.9 trillion in 2026, mostly due to the growth of its two largest divisions, Islamic banks and sukuk. Source:(ICD – Refinitiv Islamic Finance Development Report 2022: Embracing Change)

5. CONCLUSION:

This research analysed the Islamic financial service Industry- the financial sector that operates in accordance with Islamic principles, also known as Shariah-compliant finance. The IFSI has subsectors that are comparable to those in the traditional system. These include, among others: Islamic banking industry, Islamic capital markets including asset management industry, Islamic insurance known as takaful, Islamic nonbank financial services such as leasing, microfinance, etc., Islamic money market. The IFSI had a value of USD 3.06 trillion in 2021 as opposed to USD 1.87 trillion in 2014. Based on a variety of financial soundness indexes, the performance of the IFSI's major segments has generally exceeded worldwide regulatory criteria since the MTR (mid-term review). The Islamic finance sector in 2021 was its robust growth of 17% to reach assets worth US$4 trillion. Strong growth was seen in all areas, which we believe is evidence of the ability of the industry to recover from large-scale uncertainties in 2020. IFDI (Islamic Finance Development Indicator) forecasts that the global Islamic finance sector would increase from US$4 trillion in 2021 to US$5.9 trillion in 2026.

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