

RIAYAH CONSULTANCY

Introduction to Islamic Finance

CONTRACT



This Agreement contain the entire agreement of the parties with respect to the
of this Agreement, All parties shall act to complete
supersede all prior negotiations, agreements and
agrees to indemnify and hold harmless the contract
of the liability or potential liability of the contract
the work described within a rea
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against lo



WHICH ONE IS HALAL?

Common Arguments/Misconceptions

“Islamic finance looks the same as conventional finance”

- Halal meat and not halal meat may look exactly the same
- But one is permissible while the other is not



WHICH ONE IS HALAL?



Introduction to Islamic Finance

Islamic finance refers to a financial system that operates in accordance with Shariah. It offers banking, investment, insurance (Takaful), and capital market products that comply with Islamic ethical principles and the guidance of Shariah scholars.

Definition of Shariah

Literal Meaning

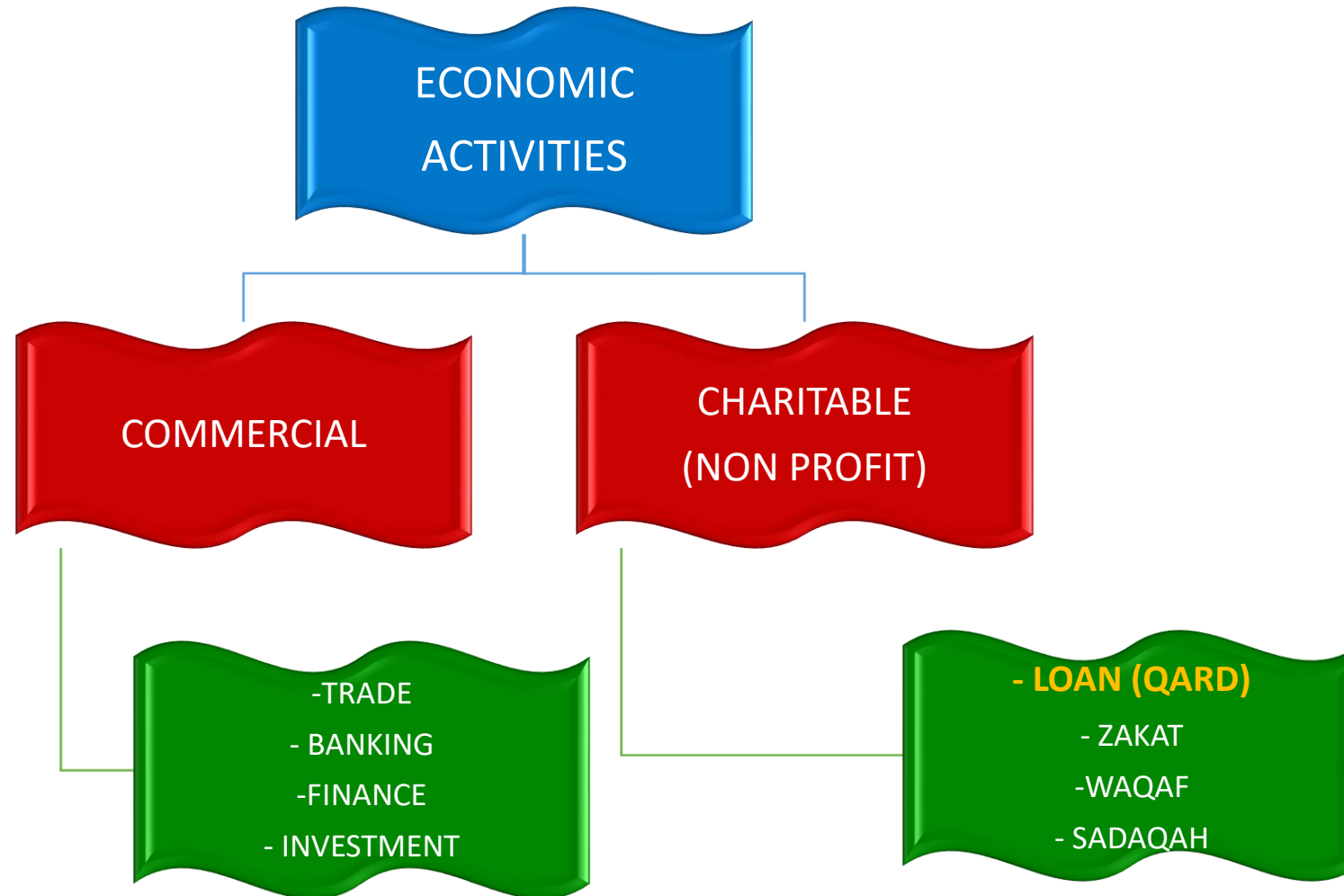
The path leading to the watering place or plain way



Technical Meaning

Shariah guides the responsibilities to society, religious beliefs, as well as commercial interactions.

COMPONENTS OF SHARIAH (cont'd)



Alleviate Hardship

Eliminate Prejudice

Justice



The Objectives of Shariah

Religion

Life

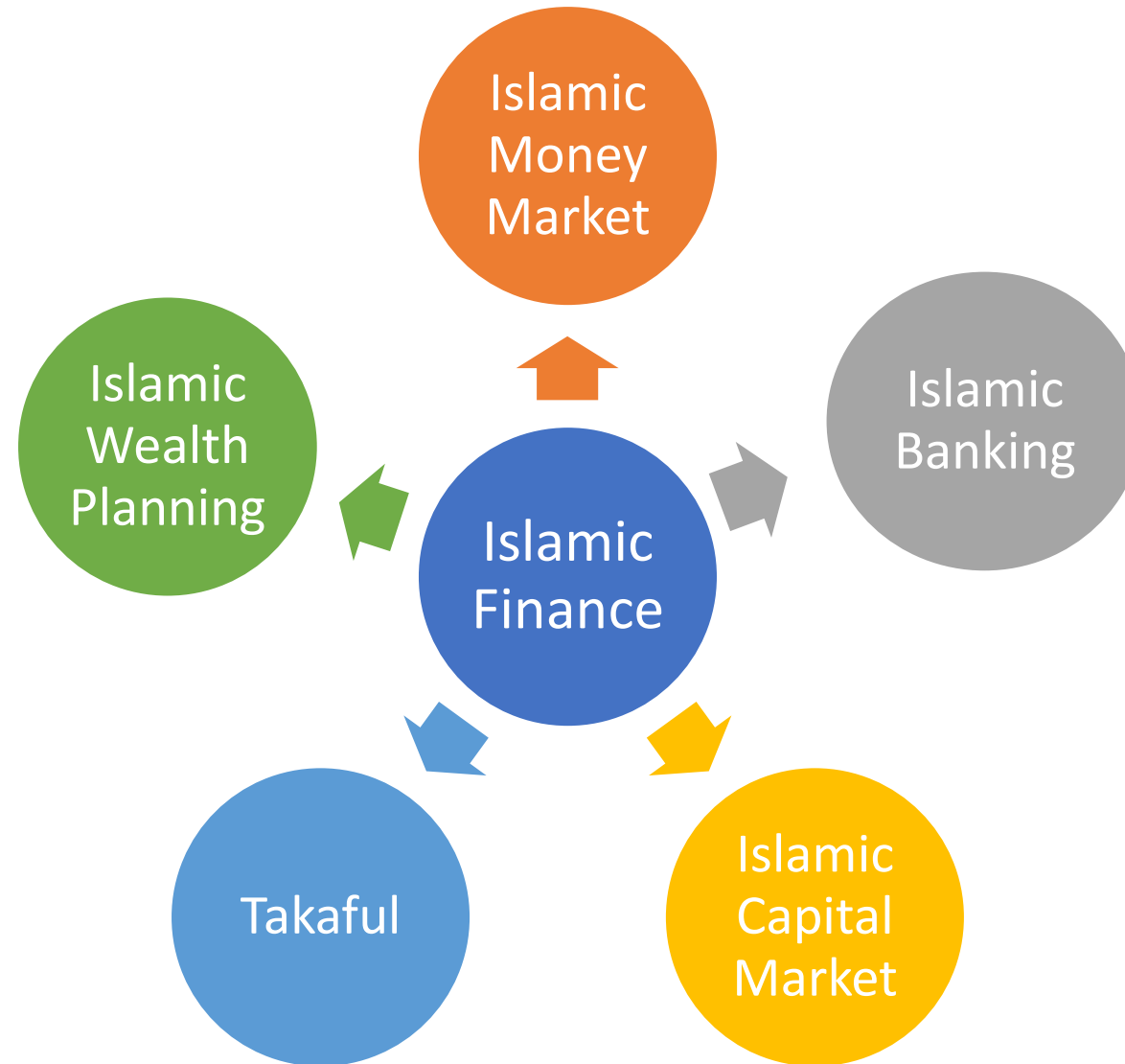
Intellect

Posterity

Wealth

Preservation and Promotion

Components of Islamic Finance



Operating structures of Islamic Finance

Types of entity

1 Fully Fledged

2 Subsidiary

3 Window Model

4 Branch Model

Rebirth of Islamic Economics

1950s–1980s



The rise of modern Islamic finance in the 1970s created momentum for Shariah-compliant alternatives to savings, insurance, and pensions.

01

1963: First Modern Institution

Mit Ghamr Bank established in Egypt as first Islamic savings institution.

02

1975: IDB Founded

Islamic Development Bank established, strengthening Islamic finance infrastructure.

03

1979–1985: Rapid Growth

Islamic banking expanded across GCC and Malaysia, triggering research into retirement planning.

First Generation Islamic Pensions

1990s Initiatives



Malaysia – Global Pioneer

- EPF allowed Islamic investment windows
- State-backed Shariah-compliant retirement savings
- Private Islamic pension funds emerged under Takaful operators



Middle East Developments

- GCC countries strengthened public pension schemes with Islamic elements
- Takaful retirement products appeared in Bahrain, Kuwait, Saudi Arabia



Academic Research

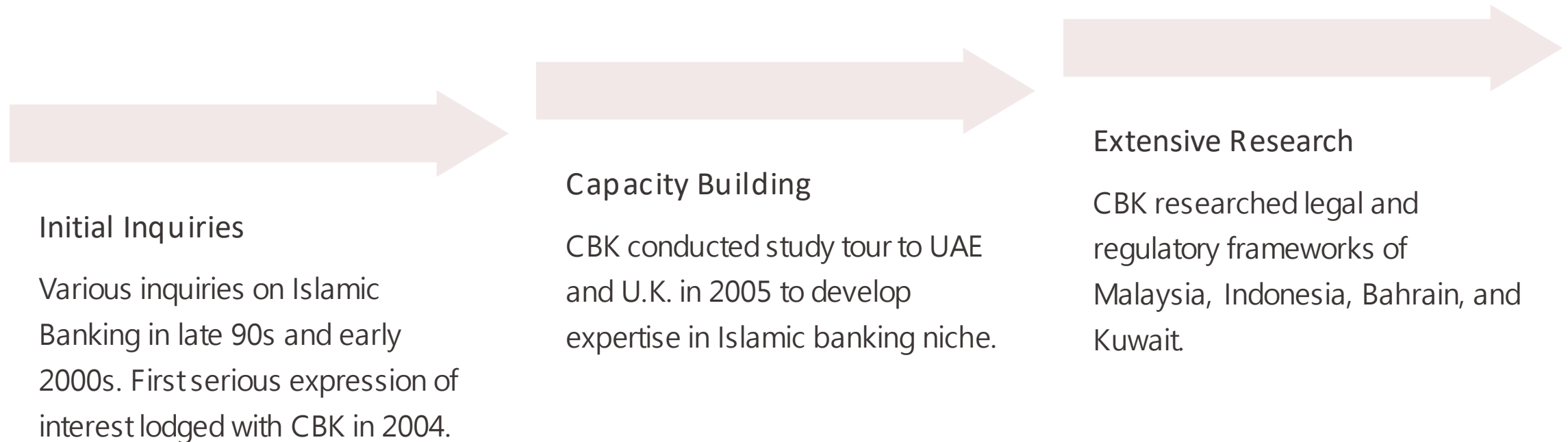
- Shariah scholars debated Wakālah, Mudārabah, Takaful, Waqf models
- AAOIFI standards foundations laid for pension investments

Kenya's Islamic Finance Journey



Kenya: Early Exploration Phase

Late 1990s – 2005



Kenya's Policy Framework

Three Policy Options Considered

- 1 Regulate Islamic Banks within existing legal framework
- 2 Amend existing framework to accommodate Islamic Banks
- 3 Enact separate Islamic Banking Act

Final Decision

After careful consideration and need for level playing field, CBK recommended regulating Islamic banking within existing framework. Policy approved by Treasury in late 2005.



Kenya's Position

Islamic Banks not separately defined in Banking Act. All banks can offer Shariah-compliant products subject to statutory requirements.



Private Schemes Emerging

Shariah-compliant pension schemes through Takaful operators and pension administrators.



Growing Demand

Increasing interest from Muslim civil servants, NGOs, and private companies across Africa.

Regulatory Support & Standardization

Regulatory frameworks now incorporate Islamic pension provisions through multiple channels:



AAOIFI Standards

Investment and governance guidelines for Islamic financial institutions.



IFSB Guidelines

International standards for Islamic financial services regulation.



National Regulators

Pension regulators enabling Shariah-compliant investment windows.



Sukuk Markets

Growth improving long-term investment opportunities for Islamic pensions.



AAOIFI Standards: Ensuring Shariah-Compliant Pension Funds

Rigorous governance, ethical investment screening, and transparent financial reporting to build trust and global acceptance



Establishes Robust Governance Frameworks To Ensure Shariah Compliance And Ethical Oversight



Implements Strict Investment Screening To Exclude Interest (riba), Excessive Uncertainty (gharar), And Prohibited Industries



Mandates Transparent And Standardized Financial Reporting Aligned With Islamic Principles

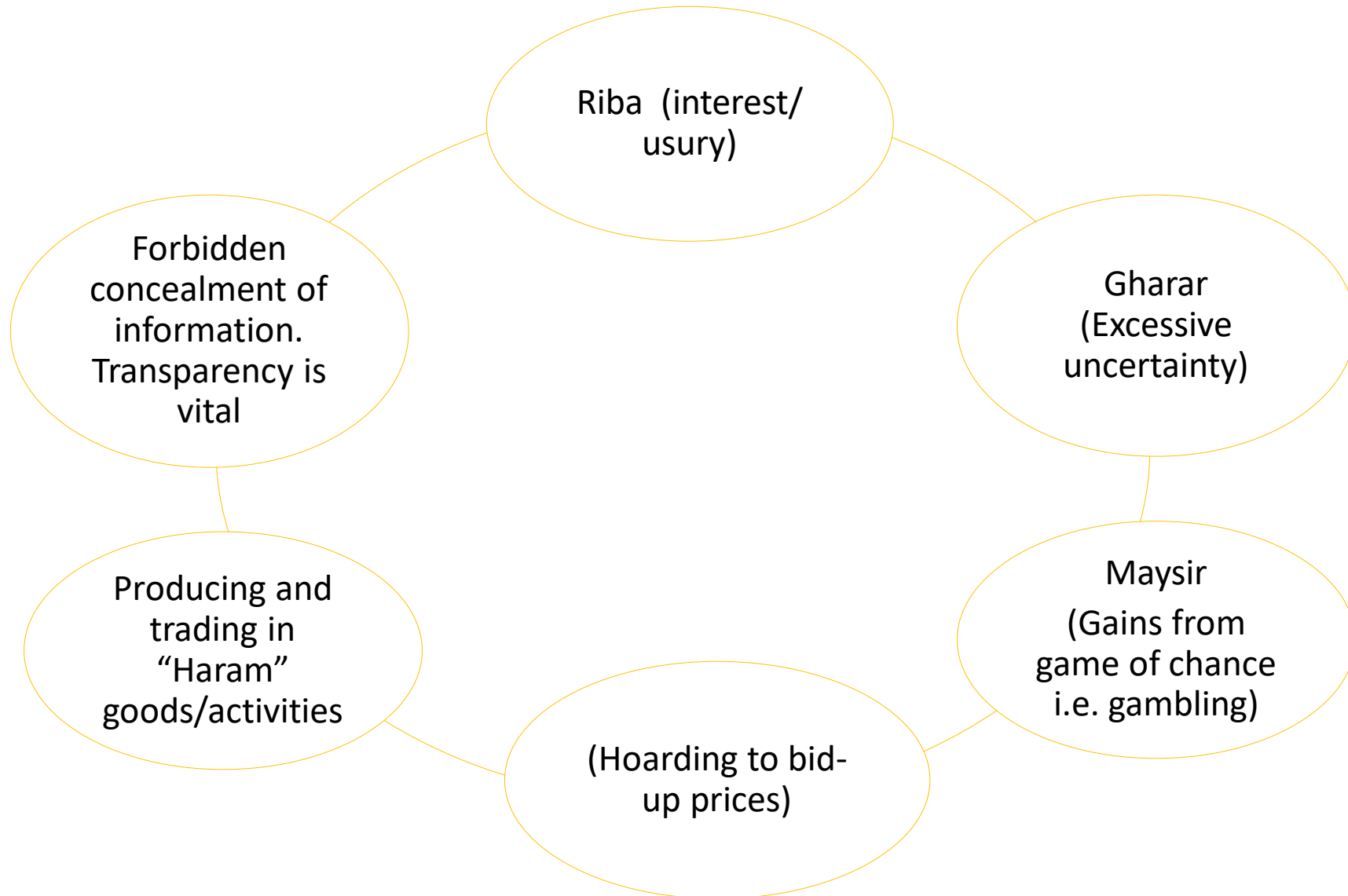


Promotes Ethical Compliance To Maintain Investor Confidence And Uphold Shariah Integrity

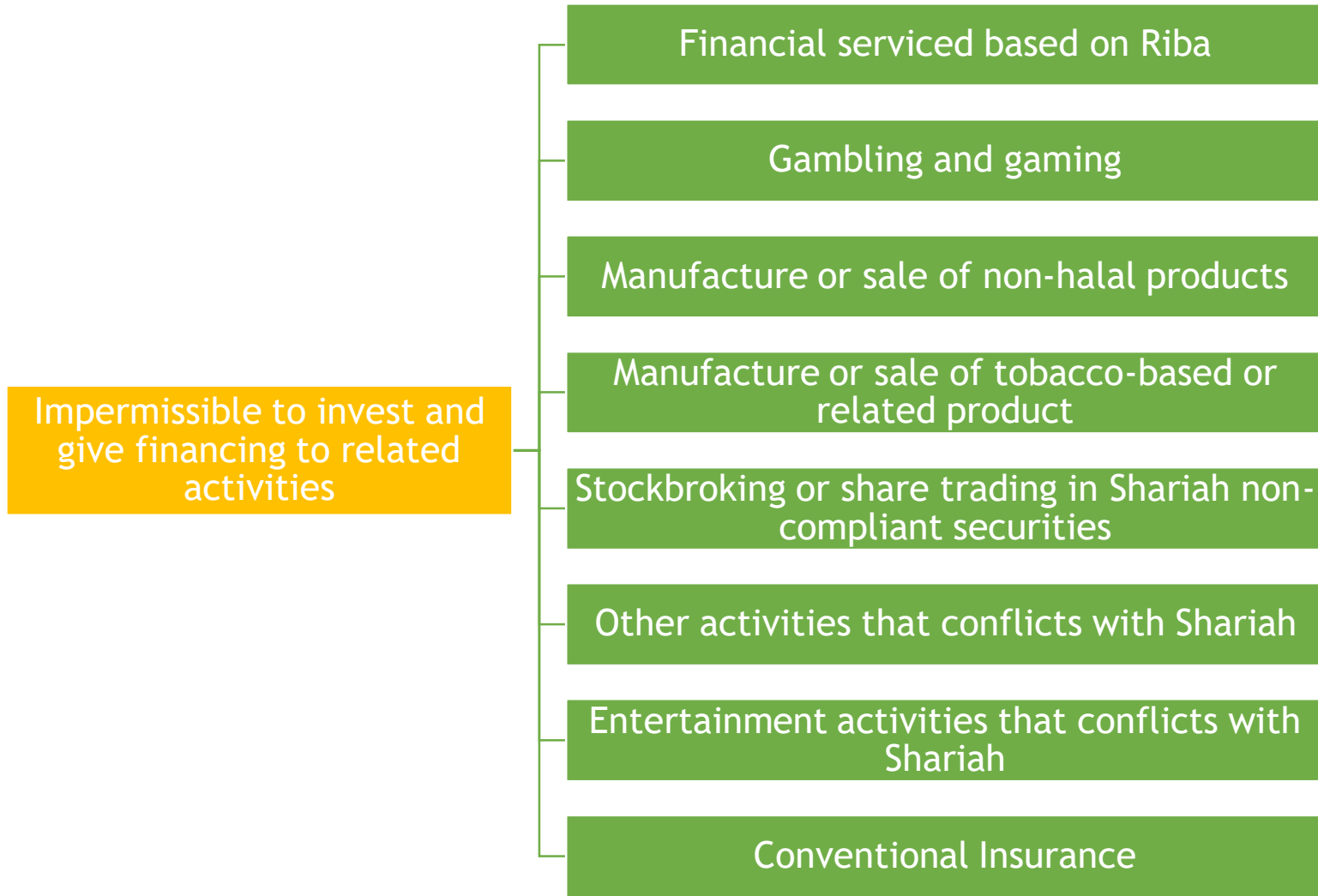


Fosters Risk Reduction And Wider Acceptance Of Islamic Pension Funds In Global Financial Markets

WHAT ARE THE ELEMENTS NOT APPROVED UNDER ISLAM?



NON HALAL (NON PERMISSIBLE) ACTIVITIES



Prohibition of Gambling

Gambling, known as *Qimar* in Arabic, refers to the easy acquisition of wealth by chance, whether or not it deprives another's rights. It means any game of chance in which one person gains at the cost of others.



SMS Contests

Prize competitions using text messages



Prize-Winning Tickets

Lottery-style prize draws



Horse Racing

Betting on race outcomes



Lottery

Chance-based monetary prizes



Crossword Puzzles

Prize-based competitions



Football Betting

Sports wagering activities

Four Essential Ingredients of Gambling

For a transaction to be classified as gambling under Shariah, it must contain all four of these critical elements:

01

Multiple Parties

The transaction involves two or more individuals or entities participating in the exchange.

02

Wealth at Stake

To gain someone else's wealth, a participant places his own wealth at risk—either by actually transferring it or by promising to pay it later.

03

Uncertain Future Event

Gaining another person's wealth is contingent upon an uncertain event in the future, where both the possibility of it occurring and not occurring are present.

04

Complete Loss or Gain

The wealth at stake is either lost completely without anything in return (resulting in total loss), or it brings wealth from another person without giving anything back (causing the other party to suffer complete loss).



Impermissible Income

Islamic financial institutions must carefully manage any income that does not comply with Shariah principles. The following guidelines govern the treatment of impermissible income:

No Ownership Rights

Impermissible income is not an object of ownership of the takaful operator and does not confer any ownership rights on the institution.

Dedicated Account

The impermissible income shall be placed in a dedicated account and shall not be commingled with the funds of the Islamic financial institution.

Obligation to Dispose

The financial institution is under strict obligation to dispose of any impermissible income that accrues to it through charitable giving or other approved methods.

What is Riba?

Riba refers to any predetermined, guaranteed increase over the principal amount of a loan, or any unjust excess in an exchange of similar commodities.

In Shariah, Riba is strictly prohibited because it leads to unfair advantage, exploitation, and economic injustice.

Riba al-Nasī'ah

Interest charged due to deferred payment or time

Riba al-Faḍl

Excess in exchange of similar commodities

Interest on Loans

This is the most common form of Riba today and forms the basis of modern banking interest, credit cards, and conventional financial contracts.

Loan with Interest

A loan is given and interest is charged on the principal amount

Delayed Payment Penalty

Lender increases the loan amount if the debtor delays payment

Time-Based Charges

Fixed or variable interest imposed due to passage of time



Unjust Excess in Exchange



Occurs When:

Exchanging similar commodities with unequal amounts

This ensures fairness in commodity trading and prevents exploitation in transactions involving similar goods.

Ethical Reasons for Prohibition



Prevents Exploitation

Protects borrowers from being taken advantage of by lenders



Protects the Poor

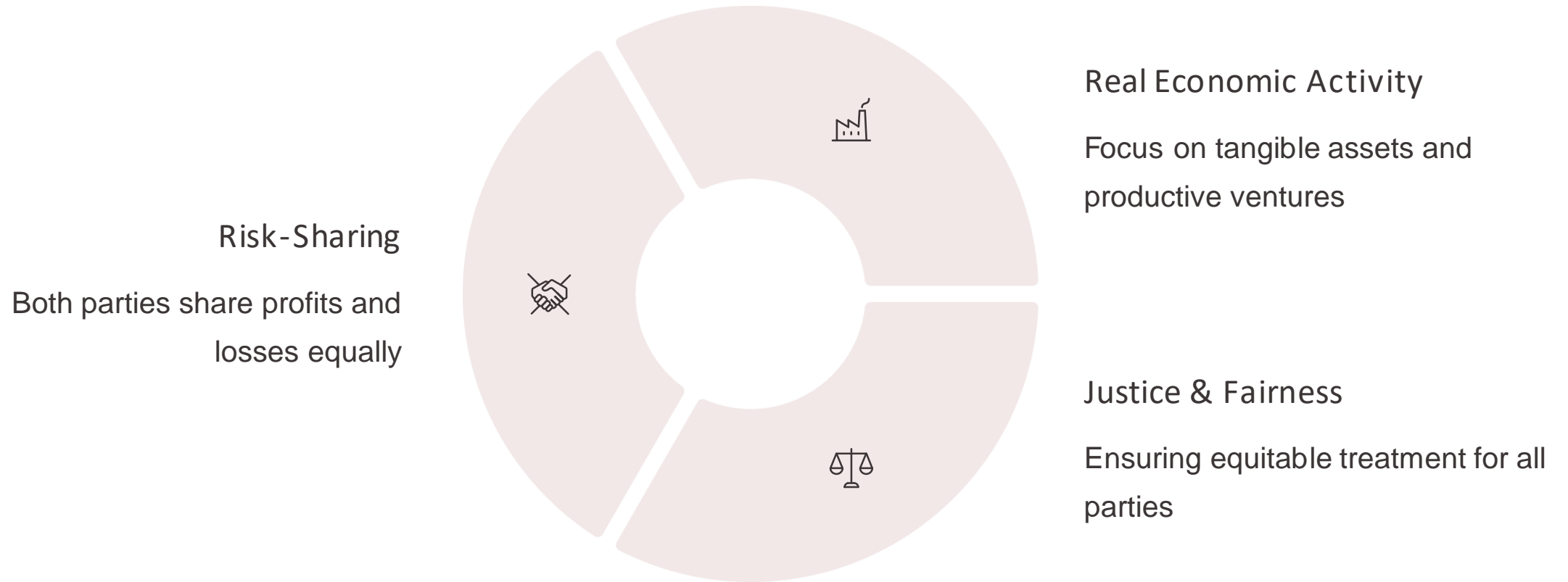
Safeguards vulnerable populations from predatory lending practices



Encourages Fairness

Promotes mutual benefit and equitable transactions

Shariah Compliant Alternative Approach



Riba vs. Trade



Trade is Permitted

- Involves risk
- Involves assets, labor, and value creation
- Profit earned through effort



Riba is Prohibited

- Earns money from money
- No value is created
- Risk transferred entirely to borrower



Uncertainty?



Excessive Uncertainty

Ambiguity or deception in contracts that could lead to dispute or exploitation



Unclear Terms

When subject matter, price, delivery, or obligations are not fully defined



Undermines Justice

Prohibited because it compromises transparency, fairness, and justice in transactions

What is Gharar?

Uncertain Outcome

Parties don't know the exact result of the transaction

Unclear Value

The value being exchanged is ambiguous or undefined

Unknown Timing

Delivery or payment schedule lacks clarity

Undefined Asset

The underlying asset is not clearly specified

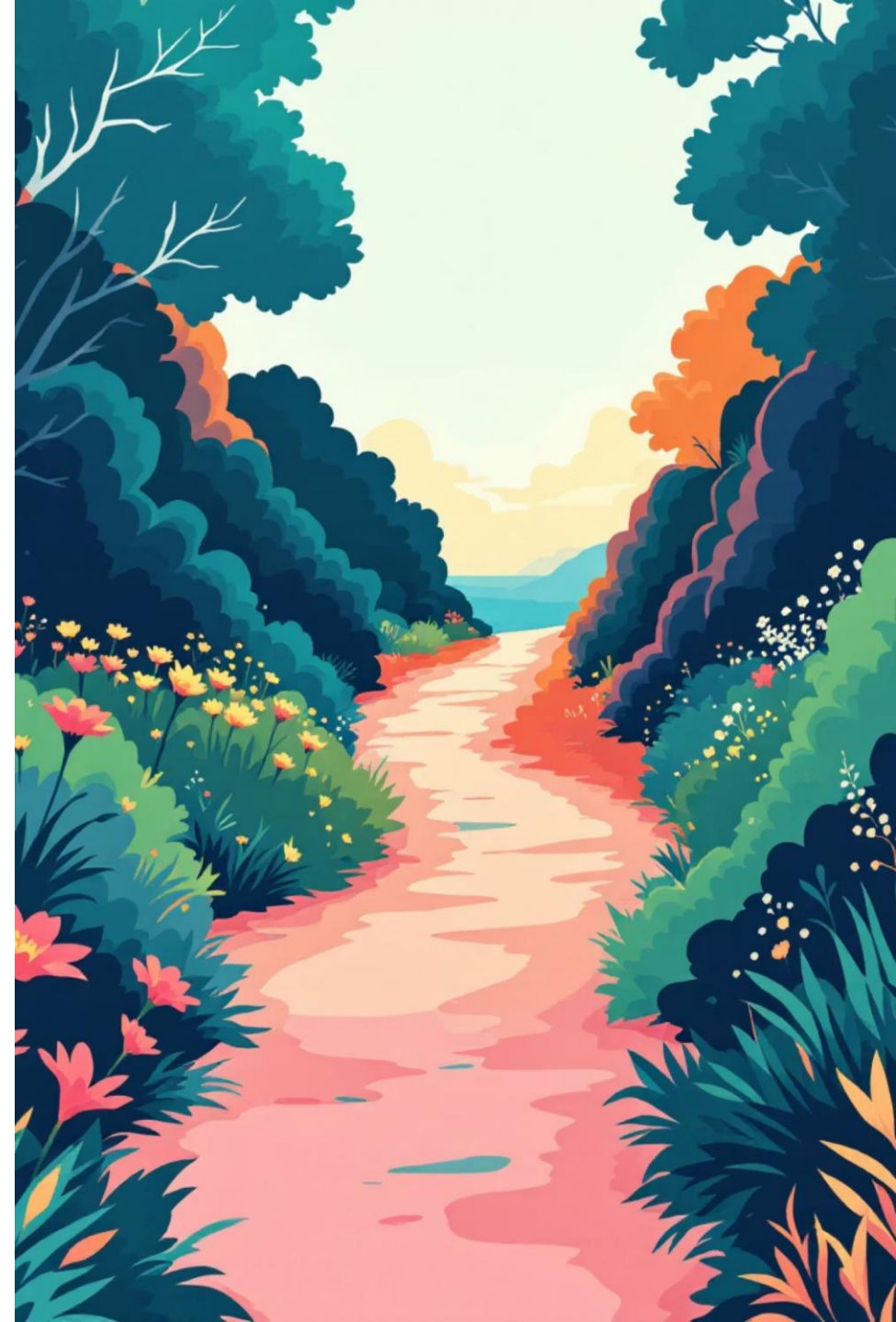
Two Categories of Uncertainty

Major Gharar

Prohibited and invalidates contracts

Minor Gharar

Tolerated as unavoidable uncertainty



Acceptable Minor Uncertainty

Lifespan Uncertainty
Not knowing how long a member will live
in retirement



Market Movements
Market fluctuations affecting fund value



Timing Variations
Contribution timing due to payroll
changes



Performance Variance
Returns from approved Shariah
instruments



This is **Gharar Yasir** (minor uncertainty) and is permitted because it's unavoidable, doesn't undermine the contract, and occurs after clear terms are agreed upon.

Structural Gharar: Ambiguous Scheme Rules

Ambiguous Benefit Formulas

Unclear calculation methods for retirement benefits

Undefined Vesting Conditions

No clarity on when members gain full benefit rights

Vague Payout Triggers

Unclear circumstances for benefit distribution

Excessive Discretion

Example: "The scheme may pay a benefit as trustees deem appropriate" = prohibited uncertainty



Investment-Related Gharar

Pension contributions invested in uncertain or speculative instruments expose members to unclear risk, uncertain returns, and undefined underlying assets—constituting major uncertainty.



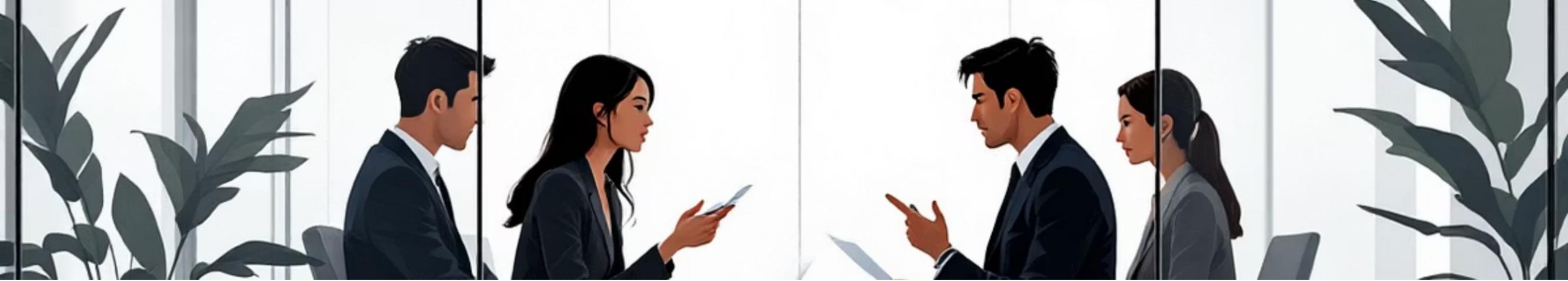
Prohibited Instruments

- Derivatives without tangible assets
- Short-selling
- Complex structured notes



Shariah-Compliant Alternatives

- Sukuk (Islamic bonds)
- Screened equities
- Real Estate Investment Trusts
- Asset-backed securities



Operational & Protection Uncertainty

Operational Uncertainty

Violates the principle of al-bayān (clarity):

- Members don't understand benefit calculations
- Unclear communication
- Investment policy changes not disclosed
- No transparency on Shariah screening
- No disclosure of purification amounts

Death/Disability Benefits

Conventional insurance introduces:

- Uncertainty in payout
- Uncertainty in surplus distribution
- Uncertainty in risk-sharing

Solution: Takaful must replace conventional covers in Shariah pension schemes.

Practical Examples: Gharar vs. Shariah-Compliant Solutions

Area	Example of Gharar	Shariah Concern	Compliant Alternative
Contributions	Unknown or adjustable without consent	Ambiguity in contract	Fixed % + member approval
Benefits	"Depends on trustee discretion"	Excessive discretion	Clear formula in rules
Investments	Crypto, derivatives, short-selling	Unclear underlying asset	Sukuk, screened equities, REITs
Protection	Conventional insurance	Uncertain payout terms	Takaful coverage
Communication	No clarity on fees, purification	Hidden Gharar	Full disclosure via IPS
Service Fees	Variable, undefined fees	Uncertain consideration	Clear Wakalah fee structure

Conventional vs. Shariah Schemes

Aspect	Conventional	Shariah-Compliant
Return Generation	Interest-bearing & equity	Shariah equities, Sukuk, real assets only
Protection	Conventional insurance	Takaful
Governance	Normal board oversight	SAC + Shariah audit + governance framework
Investment Screens	No ethical screens	Sector & financial ratio screens
Member Assurance	No religious filter	Faith-aligned & ethical compliance
Reporting	Financial statement only	Shariah audit + purification report

Effective Investment Strategies for Shariah Pension Funds

Balancing ethical compliance, risk management,



Employ Strict Screening To Exclude Interest-bearing And Prohibited Assets



Focus On Equity Investments Via Islamic Indices To Ensure Shariah Adherence



Allocate Capital To Sukuk (Islamic Bonds) Offering Ethical Fixed-income Alternatives



Diversify Portfolio With Alternative Assets Such As Real Estate And Commodities



Balance Risk And Return While Aligning With Ethical And Depositor Goals

Emerging Trends Accelerating Islamic Pension Growth

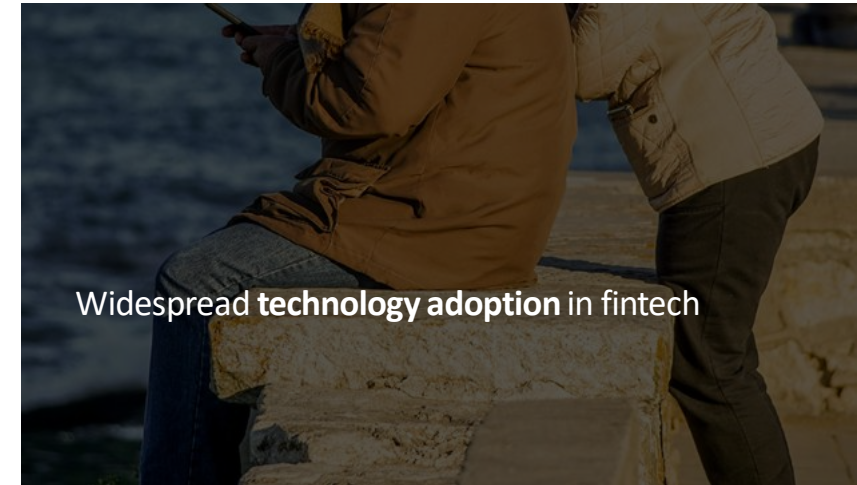
Key forces shaping a dynamic, customer-centric Shariah pension landscape



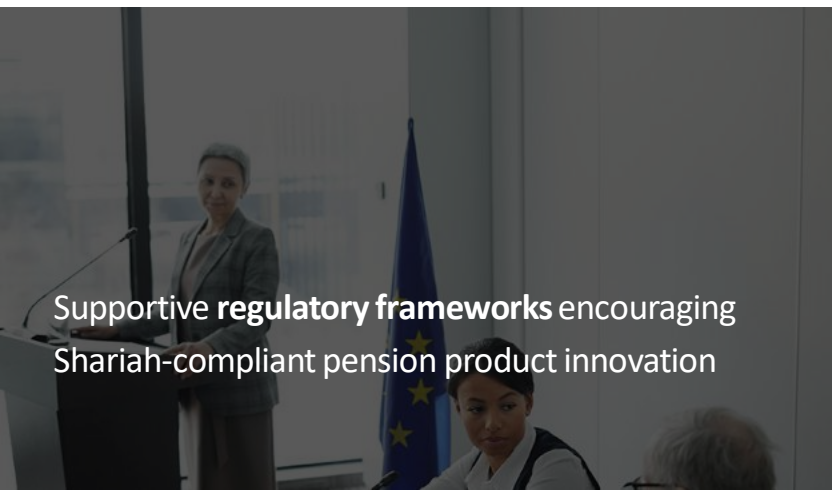
Rapid growth of global **Muslim demographics**



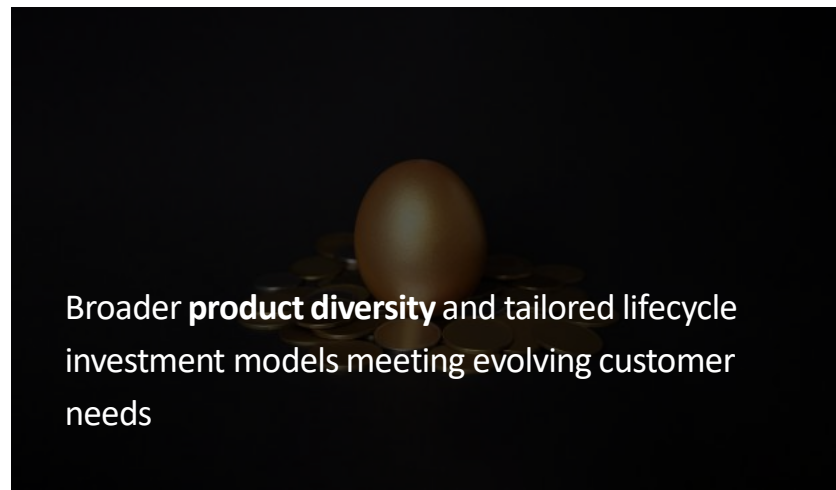
Increasing **financial literacy** fostering informed



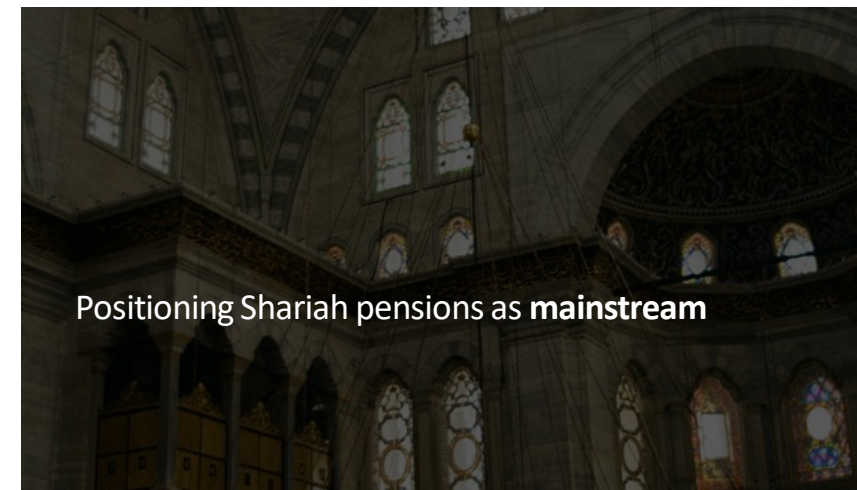
Widespread **technology adoption** in fintech



Supportive **regulatory frameworks** encouraging
Shariah-compliant pension product innovation



Broader **product diversity** and tailored lifecycle
investment models meeting evolving customer
needs



Positioning Shariah pensions as **mainstream**

Role of Islamic finance in achieving national development goals



Challenges in introducing Islamic finance in Africa



Lack of awareness among the stakeholders



Lack of governments' vision and political will to see the value of introducing Islamic finance in the financial system



Inadequacy of the legal, taxation, regulatory, and supervisory frameworks to accommodate the unique requirements of Islamic Financials Services Providers (IFSPs)



Absence of Shariah compliant instruments to be used by the financial regulators to duly protect the clients of IFSPs in cases of insolvency/liquidation



Limited Islamic finance capabilities of human resources among the policy makers, regulators and market players



Awareness issues and misconceptions about Islamic finance among the public including Muslims and non-Muslims

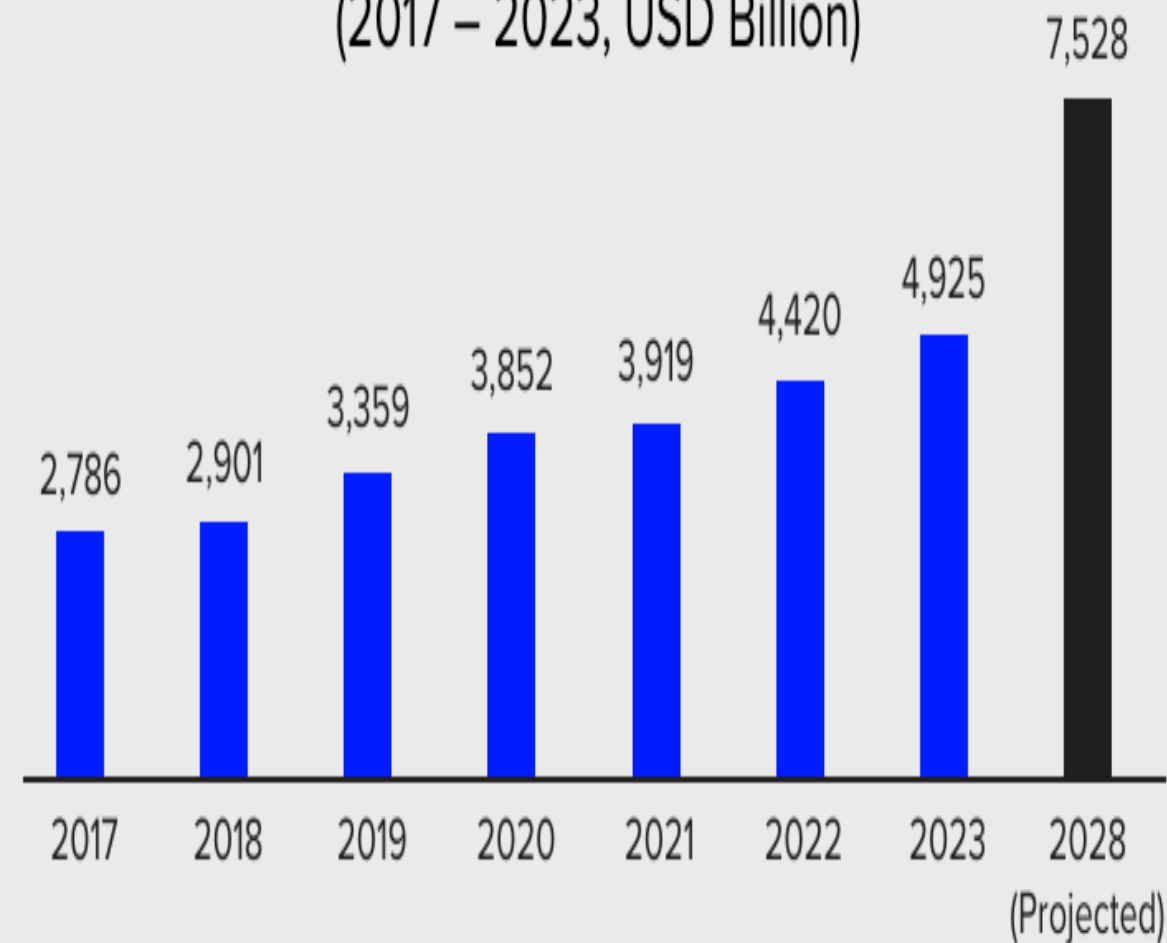


Absence of enabling legal and taxation frameworks for issuance of Sukuk

Islamic Finance Industry in 2023

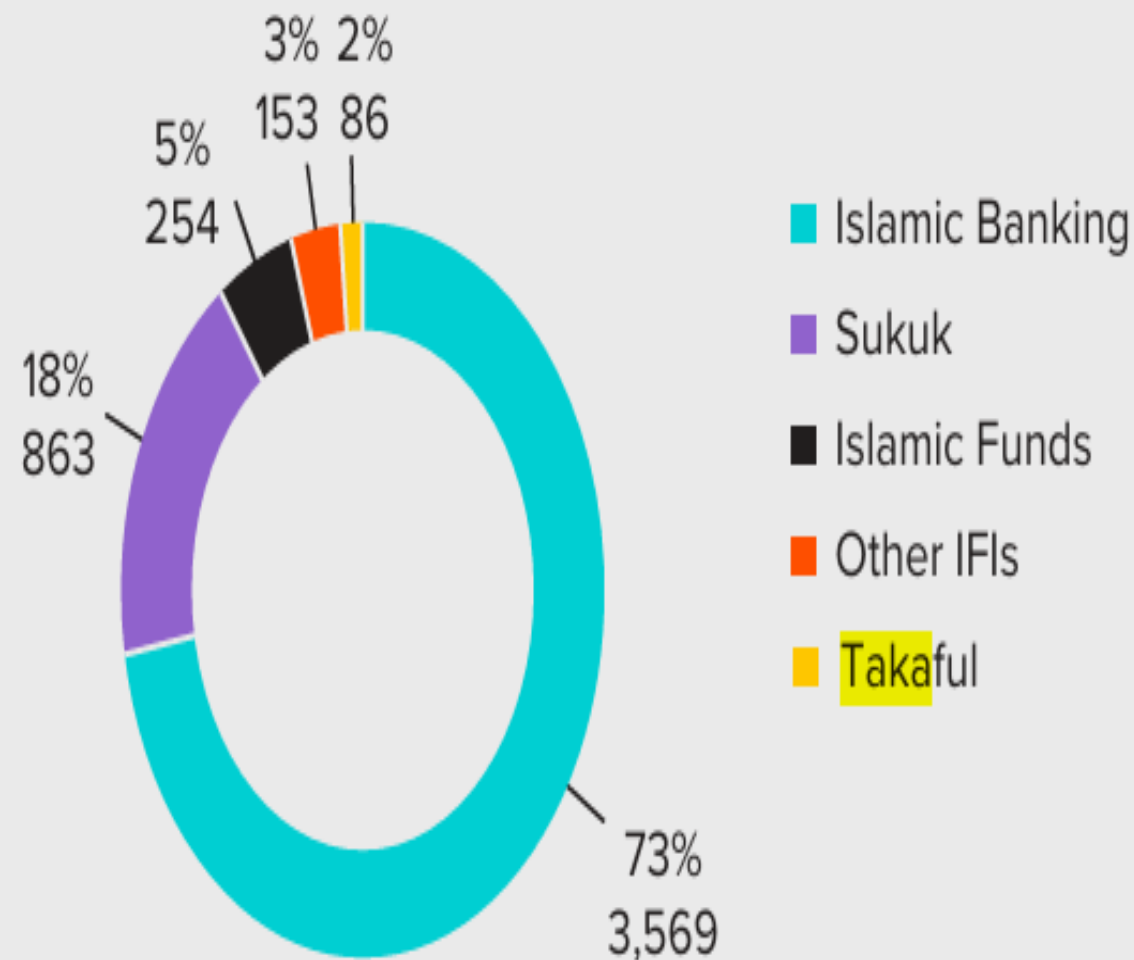
Islamic Finance Assets Growth

(2017 – 2023, USD Billion)



Islamic Finance Assets by Sector and Asset Class

(USD Billion, 2023)



Islamic Finance Industry and its Supporting Ecosystem in 2023

Financial Performance



Total Islamic Finance Assets
US\$4.9 Trillion



YoY Growth of IF Assets
11%



Islamic Financial Institutions
1,981

Governance



Countries with at Least One Type
of Islamic Finance Regulation
57



Countries with
FinTech Sandbox
72



Number of Countries with
Centralised Shariah Committee
23



Average Disclosure Index by
Public Islamic Banks
69%



Scholars Representing
Shariah Boards
1,512

Sustainability



Total Value of ESG Sukuk
Outstanding (USD Billion)
35.9



Total Value of ESG Islamic Funds
Outstanding (USD Billion)
8.0



Number of Countries with
Sustainability Guidelines
50



Average Sustainability Reporting
Index by Public Islamic Banks
48%



Total CSR Funds
Disbursed (USD Billion)
1.3

Awareness



Number of Islamic Finance
In-Person Events
531



Islamic Finance
Virtual Events
387



Number of Islamic
Finance News
10,534



Islamic Finance
Education Providers
1,007

Knowledge



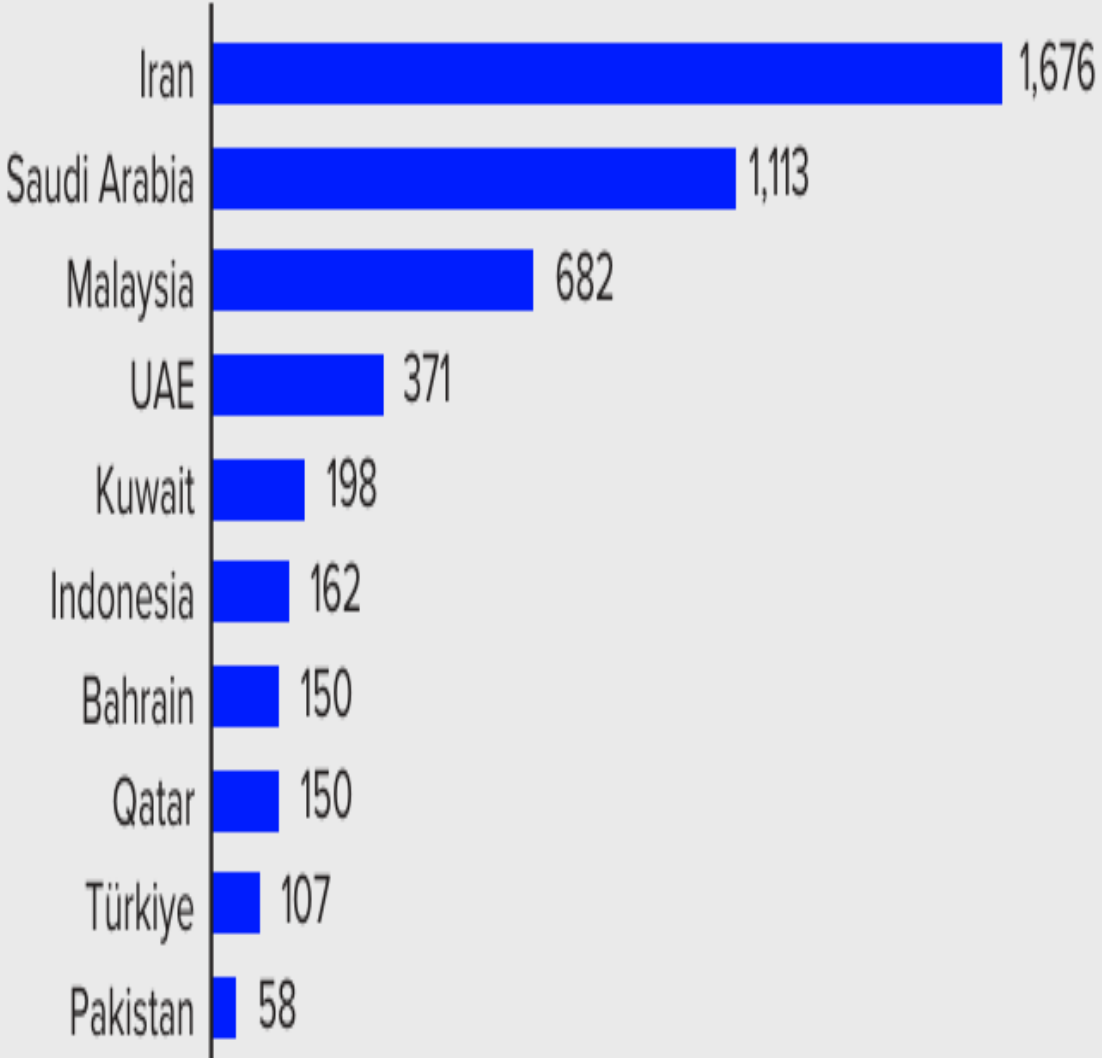
Islamic Finance Research
Papers Produced
5,162



Islamic Finance
Journals
347

Islamic Finance Assets by Top Countries and Regions

(USD Billion, 2023)



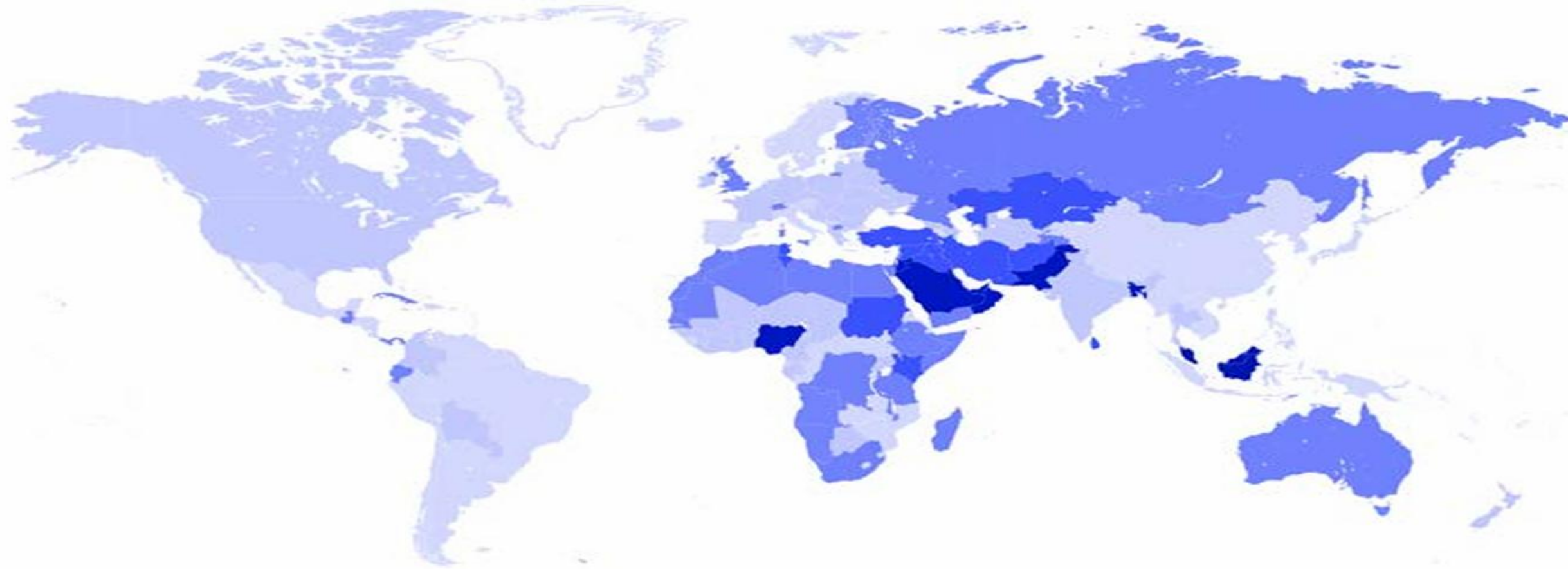
Most Developed Countries in Islamic Finance

According to IFDI 2024



Islamic Finance Development Indicator 2022

Most Developed Countries In Islamic Finance



Low IFDI Value  High IFDI Value

■ Top five countries

1

Malaysia

2

Saudi Arabia

3

Indonesia

4

Bahrain

5

Kuwait

Country	Rank	Sustainability Score
Indonesia	1	195
Malaysia	2	147
Saudi Arabia	3	75
Pakistan	4	52
Bahrain	5	49

The Knowledge indicator is a weighted index of education and research which are the main building blocks for any knowledge-based industry.

Top Countries by Sub-Indicator

	Education	Research
Rank	Average - 8	Average - 6
1	Indonesia 200	Malaysia 200
2	Malaysia 93	Indonesia 190
3	Bahrain 71	Saudi Arabia 81
4	Jordan 71	Pakistan 49
5	Saudi Arabia 68	Brunei 33
Metrics Used	Number of Islamic finance course and degree providers	Number of research papers produced and <i>number of Islamic finance journals</i>

Country	Rank	Sustainability Score
Malaysia	1	172
Kuwait	2	157
Saudi Arabia	3	143
UAE	4	116
Bahrain	5	112

The Awareness Indicator is a weighted index of Islamic finance market awareness that assess two components: events and news.

Top Countries by Sub-Indicator

	Events	News
Rank	Average - 6	Average - 18
1	Malaysia 144	Malaysia, Kuwait, Saudi Arabia, UAE, Bahrain, Qatar 200
2	Kuwait 113	
3	Saudi Arabia 86	
4	Brunei 58	
5	Indonesia 43	
Metrics Used	Number of seminars, conferences and online events	Number of exclusive and regional news

Country	Rank	Governance Score
Malaysia	1	94
Oman	2	89
Bahrain	3	86
Pakistan	4	75
Kuwait	5	75

The Governance indicator is a weighted index of standards of good practice with regard to regulations, corporate governance and Shariah governance.

Top Countries by Sub-Indicator

	Regulations	Shariah Governance	Corporate Governance
Rank	Average - 24	Average - 14	Average - 10
1	Malaysia, Pakistan, Indonesia, Oman, UAE, Bahrain, Brunei, Nigeria, Kazakhstan 100	Kuwait 120	Singapore 157
2		Malaysia 104	South Africa 106
3		Bahrain 98	Oman 103
4		Sudan 94	Maldives 90
5		Bangladesh 93	Sri Lanka 82
Metrics Used	Regulations on Islamic banking, specific accounting, Shariah governance, takaful, sukuk, Islamic funds, <i>FinTech sandbox</i>	Presence of Centralised Shariah committee, number of scholars with at least one board membership, number of scholars with more than five board memberships (counts as negative), number of institutions with three Shariah scholars or more	Disclosure index score, number of independent directors, other corporate governance items (independent chairperson of the board, non-executive chairs of audit and risk management committees)

Takaful



Takaful Assets in 2021

US\$ 73 Billion



Growth of Takaful Assets in 2021

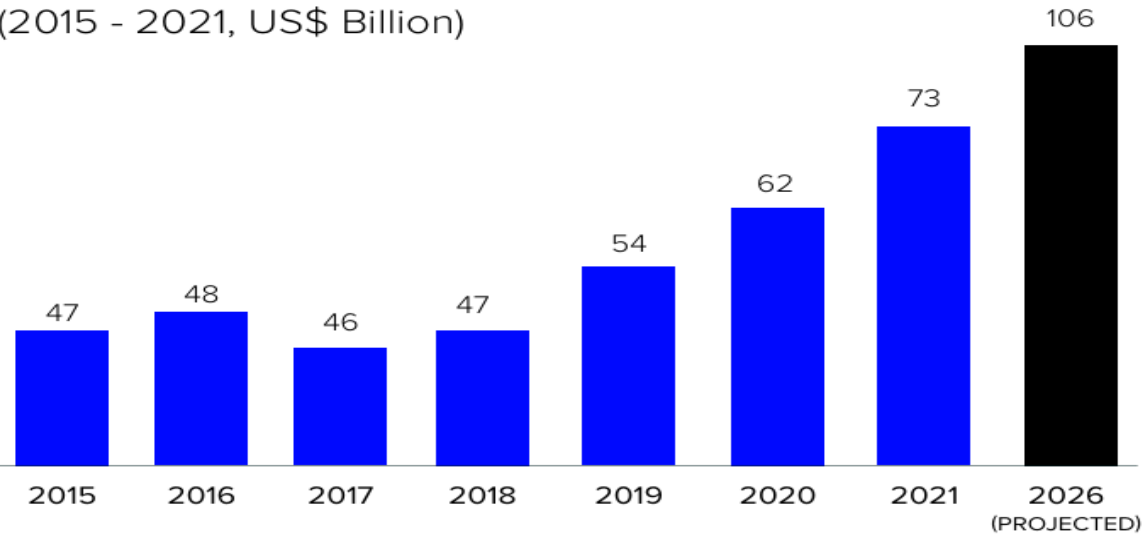
17%



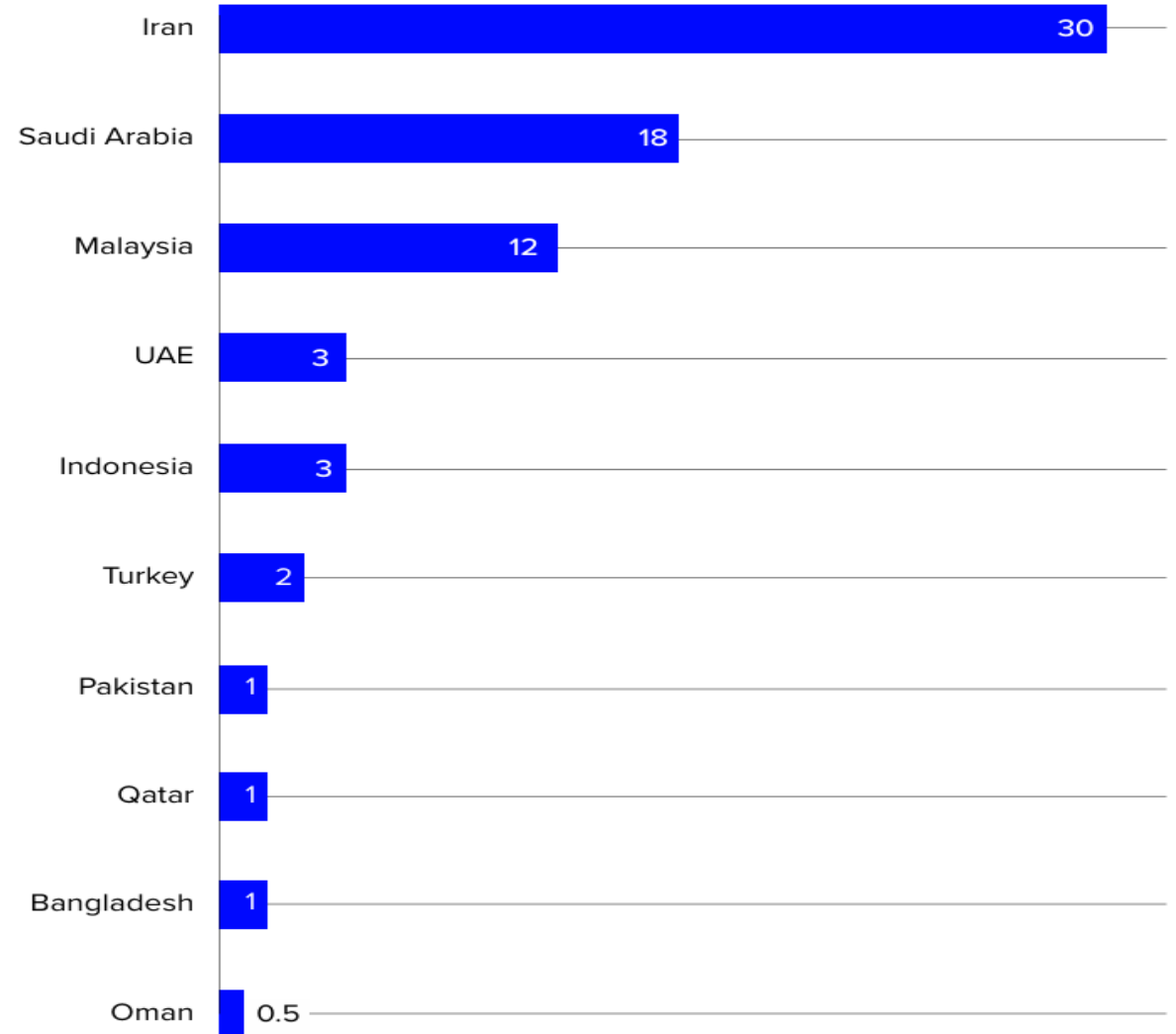
Takaful Operators

335

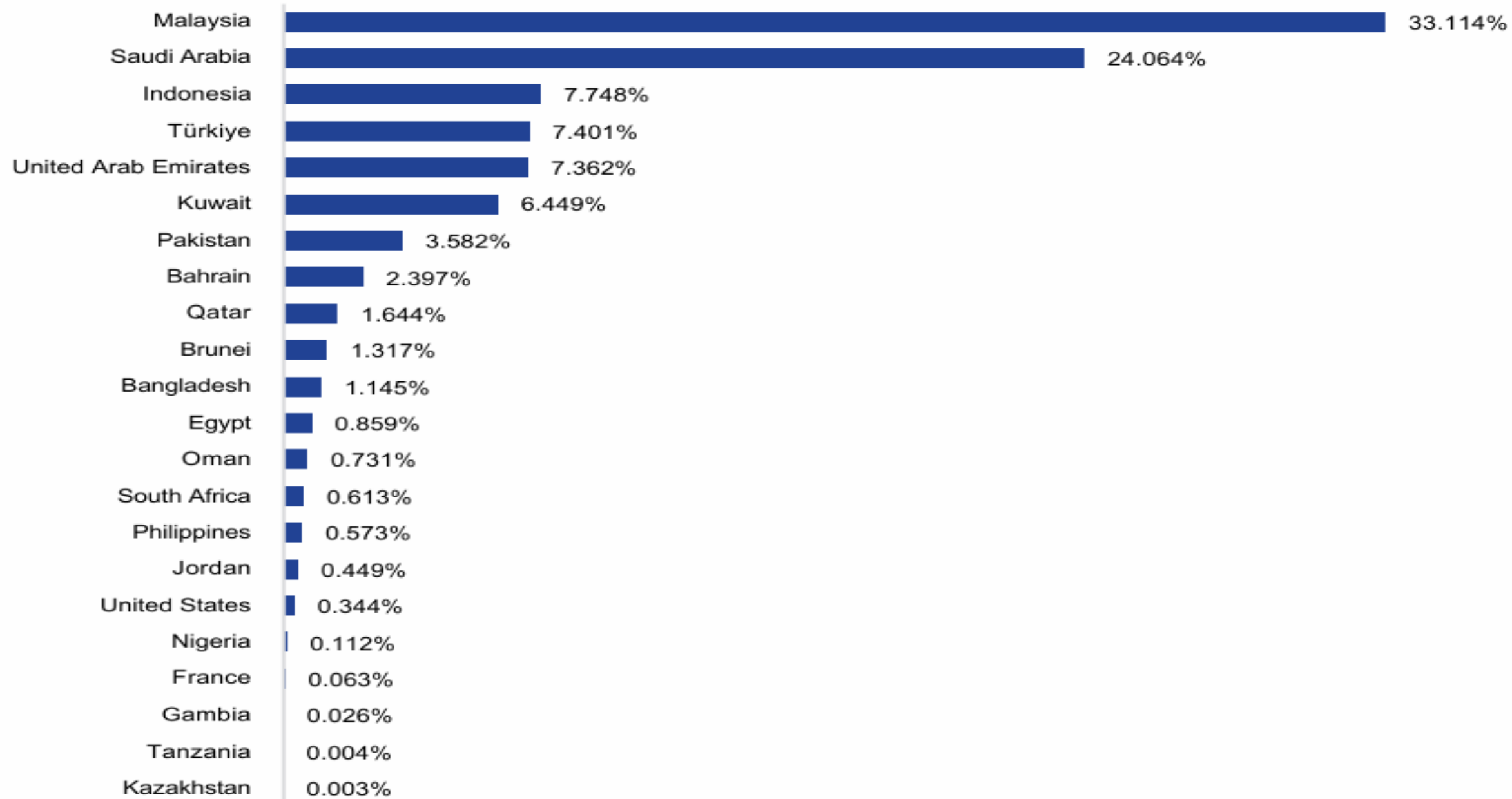
Takaful Assets Growth
(2015 - 2021, US\$ Billion)



Top Countries by Takaful Assets
(2021, US\$ Billion)

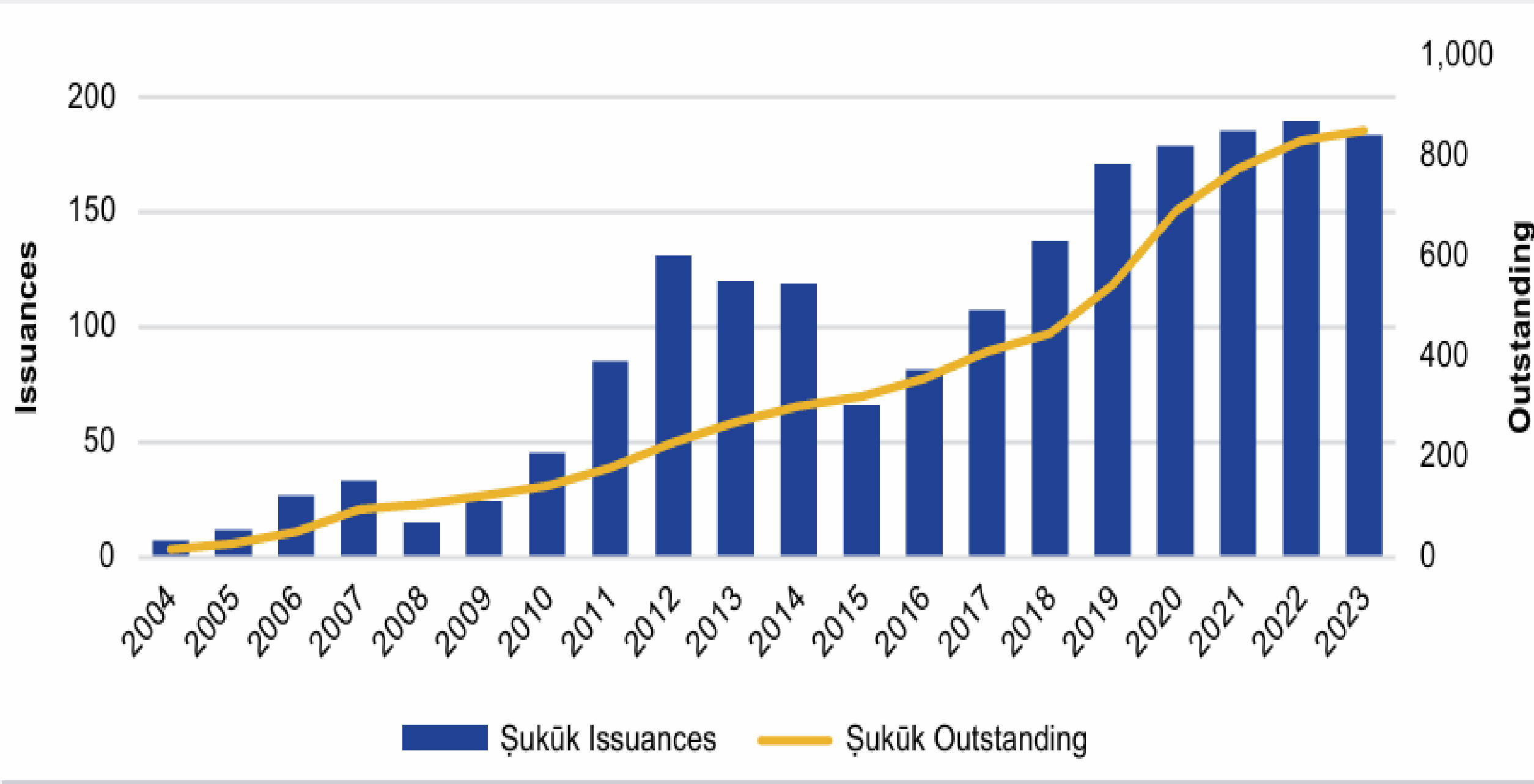


Total Share of Şukūk Issuances by Domicile (2023)



Source: IFSB estimates based on data from Refinitiv and Regulatory Authorities (excluding multinationals)

Global Şukūk Issuances and Şukūk Outstanding Trends (2004-2023) USD billions



Source: IFSB estimates based on data from Refinitiv and regulators (excluding Iran due to data limitations)

THE END

