

# COMPARATIVE ANALYSIS OF ISLAMIC COMMERCIAL LAWS AND MODERN BANKING LAW TRENDS

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## ABSTRACT

This article presents a critical examination of Islamic commercial laws as compared to modern banking rules. The analysis underscores the impact of Islamic banking, its revival, and how its globalization has changed the way of banking in different eras. This article analyses the core concept, meaning, origin and background of Islamic banking laws and focuses on the main principles of Islamic contracts that guide the agreement between parties and ensure smooth functioning of businesses. The overall argument of this article is to reinforce the need and significance of Islamic commercial law as a tool to encourage faithful business conducted in a way which benefits all parties to a contract. By comparing both models of Islamic and conventional banking transactions, this article argues that Shari’ah not only aligns with modern business practices, but also encourages fairness, transparency and accountability. Applications of Islamic commercial law ensure ethical conduct in trading and contemporary banking transactions, the products of which provide real life case studies of fair, transparent and accountable banking.

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## I. INTRODUCTION

International business conditions are filled with unpleasant ethical dilemmas and threats which undermine loyalty, integrity and trust in transactions and commercial activities. The primary focus of the research here is to address the issue of unethical business practices and the significant need of a robust ethical framework to mitigate this issue. The chief question of this article is how the implementation of Islamic transaction laws can encourage ethical, fair and faithful modern business practices.

The common understanding of Islamic (Shari'ah) law covers all aspects of human life from a basic code of conduct to economic and commercial transactions and financing in economics (*fiqh-maumalat*). Islamic laws ensure principles of justice, fairness and equality.<sup>1</sup> The principal goal of Islamic financing is to promote the fair and equitable distribution of wealth, resources, and assumption of risk (*gharar*) in uncertain transactions. Islamic financing rules also prohibit interest-based transactions (*riba*), as they are seen as exploitative, discriminatory and hampering the ease of doing business. Islamic banking is about a sharing arrangement of profits and losses which makes a society socially responsible and ethical. Whilst prior studies have placed much emphasis on applications and principles of Shari'ah finance, there is a literary gap that needs to be addressed to foster ethical parts of Islamic laws governing business activities.<sup>2</sup> This article guides the gap that is needed to be filled by examining the practicality and comprehensiveness of Shari'ah principles. Although previous works have focused on Islamic finance aspects of Shari'ah compliance, there is a determinant need of larger exploration of its ethical approaches for conducting business.<sup>3</sup>

The major objectives of this article are to compare the foundational elements of Shari'ah laws of business and banking with modern commercial laws, its ethics and practical implications. This research paper uses both primary and secondary Islamic texts to provide a nuanced understanding of the outcomes of an Islamic banking system. Such an understanding forms the basis for recommendations and directions for businesses. This ultimately supports the paper's overall argument that adopting such recommendations would promote ethical and trustworthy business practices.<sup>4</sup>

It is worth noting that Shari'ah banking and finance has being encouraged in recent years as many Muslims have tried to avoid *riba* based transactions in their business and give charity (*zakat*), which is considered to be one of the most

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1. MUHAMMAD NEJATULLAH SIDDIQI, ISSUES IN ISLAMIC BANKING: SELECTED PAPERS (1983).

2. MUNAWAR IQBAL & PHILIP MOLYNEUX, THIRTY YEARS OF ISLAMIC BANKING: HISTORY, PERFORMANCE, AND PROSPECTS (2005).

3. Zulkifli Hasan, *Corporate Governance: Western and Islamic Perspectives*, 5 INT'L. REV. OF BUS. RSCH. PAPERS 277 (1964).

4. Mohammad Nejatullah Siddiqi, *Islamic Banking and Finance in Theory and Practice: A Survey of State of the Art*, 13 ISLAMIC ECON. STUD. 2 (2006).

essential parts of Islamic law. The main aim of Islamic finance is to create transparency, shared ventures, risk division and ethical investing. However, Muslims are not alone in considering interest free trade and finance; non-Muslims have also shown a keen interest in Islamic financing. In the past few years, many foreign banks such as SCB (Standard Chartered Banks), Citibank and HSBC, which operate in European and West Asian countries, have introduced interest-free windows, which is quite remarkable. In India, RBI is considering taking in interest-free windows, even though it will take time for the implementation of Islamic finance and banking in full capacity. In late 2008, RBI Governor Raghuram Rajan, then chairman of the High Level Committee on Financial Sector Reforms, urged the need for the implementation of Islamic banking in India.<sup>5</sup>

This paper is structured as follows: Part II of the article deals with the conceptual understandings of Islamic Banking and its background in detail. Part III of the study examines the comparison between Islamic banking and conventional banking system trends by highlighting the convergence and divergences between the two. Part IV evaluates the existing challenges and hindrances in applying Shari'ah banking systems globally. Part V provides an analysis of real case studies of Islamic commercial laws. Finally, this article concludes with future directions and recommendations, reinforcing the importance of Shari'ah commercial laws for promoting ethical business conduct.

## II. RE-EVALUATION OF THE FEATURES AND OBJECTIVES OF ISLAMIC BANKING

*Allah says: "Deal not unjustly, and you shall not be dealt unjustly"*<sup>6</sup>

Islamic Commercial laws (*fiqh-al-maumalat*) provide a comprehensive understanding of ethical and legal guidance for trade conduct with adherence to Shari'ah principles.

The foundations of Islamic banking and financing are based on the rules and guidance of the Holy Qur'an and Sunnat (sayings and doings of Prophet Mohammad (PBUH)), consensus among scholars (*ijma*), and analogical interpretations and reasoning (*qiyas*).<sup>7</sup> The fundamental rules that govern Islamic banking are the sharing of gains and loss and the prohibition of any kind of interest in the payment (*riba*), risk sharing (*gharar*), and gambling (*maysir*). The five main pillars of Islamic banking and finance are equal risk sharing (*mudarabah*),

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5. *No Deadline for Introduction of Sharia Banking in India: RBI*, THE ECON. TIMES (Apr. 9, 2017), <https://economictimes.indiatimes.com/industry/banking/finance/banking/no-deadline-for-introduction-of-sharia-banking-in-india-rbi/articleshow/58089521.cms?from=mdr> >

6. *Al Qur'an*, Surah Al'- Baqarah [The Cow], 2:279.

7. FUAD AL-OMAR & MOHAMMED ABDELHAQ, ISLAMIC BANKING: THEORY, PRACTICE, AND CHALLENGES (1996).

joint ventures (*musharaka*), preserving in safety (*wadiah*), fixed percentage that is cost-plus (*murabah*) and lease (*ijarah*).<sup>8</sup>

The employees of Islamic banks must comply with the Shari'ah laws and are trusted not to deviate from the teachings of Qur'an. When it is necessary to seek guidance, the employees reach out to scholars (*ulemas*). Some commercial banks also offer "Islamic windows" that are strictly based on Shari'ah rules.<sup>9</sup> Islamic banks profit through equity participation, which requires the borrower to give a portion of their profits earned through the shares they hold in their business.

Salient features of Islamic Banking are analyzed as followed:

#### A. Prohibition of Interest

Under Islamic laws, there is a prohibition against taking and giving interest (*riba*), which is the guaranteed amount on loaned money which is charged on the same. Islamically this is considered to be exploitative and unjustifiable. The principle of forbidden interest is based on the idea that wealth cannot be concentrated in the hands of a few at the expense of others. Thus, it is mandatory that anyone who enters a trade agreement must share the risk both ways (i.e. profit and loss equally).<sup>10</sup> Many Qur'an verses explicitly mention the prohibition of interest.<sup>11</sup> Most notably, in Surah Al-Baqarah, it is mentioned that "Those who devour interest do not stand except as one stands whom Satan by his touch has driven to madness . . . Allah has forbidden taking and giving of *riba* and allowed trade."<sup>12</sup> The verse mentioned here differentiates between legal and illegal trade and forbidden interest-based transactions.

The explicit prohibition of interest is deeply rooted in the Qur'an and Hadith, which informs the basis of the Islamic banking system and is one principal way in which this system differs from conventional banking systems. The rationale for this approach lies in protecting notions of fairness and justice, along with promoting equitable distribution of wealth and resources so that no one can take advantage of the poor, who may not be able to escape the never-ending cycle of debt caused by the exploitative practice of charging interest.

Interest (*riba*) is defined as a predetermined guaranteed amount on debts or deposits at the expense of other human beings which is unjust and discriminatory. Islam also promotes social justice and entrepreneurship and ensures

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8. MAHMOUD A. EL-GAMAL, *ISLAMIC FINANCE: LAW, ECONOMICS, AND PRACTICE* (2006).

9. Farid Sobhani & Maleha Murtaz, *Critical Analysis of the Role, Challenges, and Shariah Compliance of Islamic Windows by Conventional Banks in Bangladesh*, 10(2) INT'L J. ECON. AND MGMT. 385 (2016).

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10. IQBAL & MOLYNEUX, *supra* note 2.

11. *Al Qur'an*, *supra* note 6, at 2:275-79.

12. *Al Qur'an*, *supra* note 6.

that both parties work in consensus as both have an equal interest in the overall outcome of the business project.

### B. Risk-Sharing

Risk-sharing of both profits and losses is also one of the essential parts of Islamic commercial laws. This reflects the embedded principles of justice, equity, fairness and commitment to the common good. Such an approach is a far divergence from conventional banking which wholly transfers the risk into the hands of the borrower. The idea of risk-sharing is deeply rooted in Islamic laws.

Shari'ah principles encourage risk-sharing model ventures which promotes equal sharing in gains and losses among business partners (*madarib*). This type of balanced risk sharing between the parties removes uncertainty. This principle is attached in several financial instruments to ensure that the parties share the uncertainties together in good and bad times. This approach is aligned with the ethical values and socio-economic stability emphasized under Shari'ah laws. Moreover, excessive uncertainty (*gharar*) involved in a transaction, which encompasses broader financial systems, is also prohibited.

Further, avoidance of speculation and highly risky commercial transactions encourages investment in a more productive manner that gives rise to economic stability and development of the country. As a proper and more resilient financial model, Islamic banking reduces the probabilities of excessive leverage and loans in times of financial crises as well.<sup>13</sup>

### C. Transparency and Fairness

Another main feature of Islamic law is to ensure transparency and fairness in conducting business. As such, the terms of a contract must be clearly, unequivocally and mutually agreed upon by everyone that has entered into the contract. Another aspect which must be present in the agreement is a full disclosure of risks and the avoidance of any hateful practices such as fraud, coercion and misrepresentation.<sup>14</sup> High uncertainty (*gharar*) is prohibited and so is speculation.<sup>15</sup> Contracts must be unambiguous to ensure justice and fairness.<sup>16</sup> The teachings of the Qur'an and the Hadith emphasize loyalty, integrity, honesty, safety and protection for all of the parties involved in a commercial transaction.

Islamic laws mandate the prerequisite condition that all contractual terms should be clearly disclosed and understood by the parties before the transaction takes place; this is the transparency rule which is known as the *Bay' al-Wafa'*.

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13. ABBAS MIRAKHOR & HOSSEIN ASKARI, ISLAM AND THE PATH TO HUMAN AND ECONOMIC DEVELOPMENT 84 (2010).

14. M. KABIR HASSAN & MERVYN K. LEWIS, HANDBOOK OF ISLAMIC BANKING (2007).

15. Noor Mohammed, *Principles of Islamic Contract Law*, 6(1) J.L. AND RELIGION 115, 120-21 (1988).

15.

16. SIDDIQI, *supra* note 1.

There must be no concealment of the facts and no ambiguity. Further, Islamic commercial law reinforces the need for transparency as the transaction is considered void if it consists of any high uncertainty (*gharar*) or any kind of deception or dishonesty.

For instance, in a contract between a seller and a buyer, the seller has to disclose all information related to the goods to the buyer to avoid any potential misunderstandings or disputes, whether it be the subject matter of the sale, the delivery date or its price. The principle of transparency is intended to protect the rights of the contracting parties and to build trust, confidence and assurance.

Further, the idea of fairness is one of the main requirements of any kind of commercial or financial agreement in Islam, requiring that every agreement must be free from exploitation and discrimination in any form. There are multiple Qur'anic verse to support this view, including: "do not wrong others, and you will not be wronged" and "not to consume one another's wealth unjustly."<sup>17</sup> In addition, fairness is achieved through the prohibition of interest (*riba*), which forbids the lender to earn unjustly at the expense of a borrower by prohibiting the concept of unjust enrichment and injustice (*zulm*). Moreover, there is a notion that a party entering into a contract must have full knowledge of its conditions because sharing principles prohibits ignorance (*jahalah*) by requiring full disclosure and awareness among parties. An agreement is only enforceable under Islamic law when the parties are ready and willing to agree to all the terms of the contract with free consent. This gives the power to bargain equally and freely while ensuring that the transaction is done fairly without any exploitation of vulnerable parties.

These principles offer a model of Islamic banking including ethical, just and responsible practices that align with the needs of modern business ventures.

The idea of fairness can be duly implemented and conceptualized differently in different banking systems by carping and analyzing these approaches substantively to the present literature, drawing special attention to the inconsistencies and filling the gaps. The principles of Shari'ah assure fairness and just behavior in all commercial transactions such as the prohibition of speculation (*maysir*), excessive uncertainty (*gharar*), and interest (*riba*), all of which rightly align with the values and objectives of "distributive fairness." The doctrine is that the parties in a contract can neither be discriminated against, nor can they exploit others while engaged in a financial transaction. Theoretically, the Islamic products of finance like profit-sharing contracts (*Murabaha*) and partnership ventures (*musharakah*) are devised in a such a way as to ensure that principles of fairness cannot be ignored.

In practice, however, there are imbalances which are evidence to the contrary. Critics argue that *Murabaha* contracts are used to replace conventional

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17. *Al Qur'an*, *supra* note 6, at 2:279.

loans, showing that the Shari'ah principles have somehow diverged from their main purposes and raising questions about the principle of fairness.<sup>18</sup> Another discrepancy is that *Murabaha* contracts transfer almost all risk towards the customer, which conflicts with the risk-sharing doctrine. So, there is a problem of implementing the principle of fairness encouraged under Islamic banking falling short in modern-day banking, notwithstanding different meanings, justifications and terminologies.

While modern banking claims to be fair by aiming to protect consumer rights derived from its regulatory framework in the form of, for example, the Equal Credit Opportunity Act (ECOA) in the U.S. and the EU's MiFID II, which aim to ensure equality, fairness and transparency, many studies have shown the existence of discriminatory practices, such as the redlining despite legal protections as witnessed in the financial crisis of 2008.<sup>19</sup> Thus, the principle of fairness is compromised many times because of market dynamics, informational dissimilarities and the pursuit of profit. This compromise creates issues in reducing risk and promoting stability, which is otherwise possible because of the principle of fairness's flexible nature. Another issue is liquidated challenges, which restricts access to the conventional banking's lending system and its debt-based model. For instance, many institutions rely on *Murabaha* contracts to limit risk distribution, and its asymmetrical information and profit-driven goals creates marketplace tensions which compromise fairness. This paper shows and prefers a hybrid model as well as novel framework that would work well with ethical, social and economic goals of fairness.<sup>20</sup>

Further, there are inconsistencies when applying theories of Islamic banking into practice due to the complexity of Islamic banking. For instance, in reverse *murabaha* (*tawarruq*), there is a high level of obscuring key information which can lead to confusion among customers. The varying jurisdictions and lack of uniformity in the system can lead to divulgence of standards in the market. Thus, this can defeat the very idea of Shari'ah principles and instead create a mere replica of conventional banking in the name of Islamic banking by ignoring the ultimate goal of achieving transparency and focusing only on gains. On the other hand, conventional banking is more procedural in nature by simply applying complex laws with technical terminology, causing misunderstandings among consumers. These are the fundamental weaknesses of both systems. There has to be a genuine goal of clarity and understanding of the main problem. The way to solve these issues is to create necessary awareness to

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18. LINDA ALLEN & ANTHONY SAUNDERS, CREDIT RISK MEASUREMENT :NEW APPROACHES TO VALUE AT RISK AND OTHER PARADIGMS 86-90 (2004).

19. European Commission, *Markets in Financial Instruments Directive MiFID II*, Off. J. of the Eur. Union (2014).

20. Zaki Ahmad et al., *A Comparative Analysis of Shariah Governance Framework of Islamic Bank in Malaysia and Pakistan*, 3(1) J. ISLAMIC FIN. 1 (2023).

encourage transparency among people by legislating a uniform and standardized statute into both systems and proper scrutiny of non-compliance. These steps can allow an alignment with the values of ensuring transparency and fairness.

#### D. Encouraging Ethical Practices

Islamic commercial law is known for promoting ethical practices which align with the objectives of Shari'ah (*Maqasid-al Shari'ah*). Ethical practices are drawn from the Qur'an and Hadith. Forbidden practices such as gambling (*maysir*) are considered to be harmful activities to society, as it includes gaining wealth through "probabilities"—rather than engaging in productive efforts based on real economic activities—along with facilitating hoarding, which results in an artificial scarcity of supplied goods.<sup>21</sup>

Compliance with Shari'ah principles and knowledge of permissible and prohibited (*halal* or *haram*) shapes the central idea of ethical practices in finance; this is the understanding that prohibited activities such as gambling, pork and illicit activities are not only morally wrong but also socially wrong and degrade society's welfare. Parties are expected to act in bona fide manner and through trust (*Amanah*) which are considered to be important aspects of Islamic finance. Public interest (*Maslahah*) doctrine supports transactions and investments that are beneficial to the common good and contribute to the economic development of the country. In addition, Islamic commercial law not only prioritizes gaining profit but also promotes making a good social impact through the concept of mutual assistance (*takaful*) to support equal distribution of wealth.

Meanwhile, when it comes to implementation of the theory into practice, both systems of banking, modern and Islamic, face inconsistencies. However, the idea of this paper is not to compare both systems but to create new insights that would create a better improvised operationalized systems by filling the gaps between their ideals and promoting ethical notions into application. Western banking relies on corporate governance and statutory frameworks, while Shari'ah banking works on deeply rooted principles of Islam to encourage ethical practices, despite challenges to turn theory into practice. The *murabaha* contracts have been criticized for mimicking conventional banking (interest-based loans), thereby diverging from its ethical foundations and risk-sharing notion that emphasize profits rather than loss-profit sharing ratio. Meanwhile, modern conventional banking laws such as USA's Sarbanes-Oxley Act<sup>22</sup> and England's Bribery Act<sup>23</sup> promote ethical business practices by imposing heavy fines on non-compliance. However, many times these fines are improperly implemented. The focus on imposing penalties, as opposed to underlying integrity, leads to

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21. UMER CHAPRA, *ISLAM AND THE ECONOMIC CHALLENGE* (1992).

22. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

23. Bribery Act 2010, c. 23 (UK).

these inconsistencies in the West. This analysis shows that weakness exist within both systems.

Islamic commercial laws can introduce new Islamic financial products that not only provide a unified regulatory framework but also focuses on its ethical foundations in a genuine way while adhering to Shari'ah principles covering Islamic aspects of promoting welfare and discarding economic inequalities. Conventional banking can adopt the ethical foundation of Shari'ah laws of transaction by effectively incorporating the same in corporate governance and business decision making and strategies.

#### E. Social Harmony and Welfare

Social harmony and societal welfare of are fundamental objectives of Islamic commercial and finance laws which aims to establish broader principles of fairness, justice and equality. These ensure that the parties to the business serve societal development and are socially responsible for economic development. Social harmony and welfare aligns with principles espoused by the Qur'an and the Sunnah. Many verses of the Qur'an promote ethical practices through teaching loyalty and honesty in business dealings, stating, "Give full measure and weight, and do not deprive of what is rightfully theirs."<sup>24</sup>

Another essential concept is the principle of excellence and benevolence (*ihsan*) which states that Muslims should go beyond their legal duties and to work with generosity to establish equality and a just society by involving in the common good and to create a balance between social responsibility and economic growth. This crucial aspect of Islamic commercial laws is to support society by almsgiving mechanisms way of giving charity through (*zakat*) which is one of the Five Pillars of Islam, and by creating endowments (*waqf*) to promote social welfare and harmony.<sup>25</sup>

The concept of social harmony and welfare related *laissez-faire* is considered important in both modern and Islamic banking systems to promote long term societal goals. Their approaches are somewhat the same, but they achieve their objectives in different ways. *Maqasid al-Shari'ah* (public interest) is deeply enshrined under Shari'ah laws which provides protection of religion, innovations, life, offsprings and of wealth. Financial inclusion of giving alms (*sadaqah*) is mandatory on every individual based on how much he earns. However, modern Islamic banking provides limitations to implement the same. For instance, Islamic banking mandates giving of charity through *zakat*, but the frequency of donations is very low compared to their financial well-being. This is evident in profit aiming products such as *murabaha* and *ijarah*. On the other hand, conventional banking addresses the needs of societies through a framework

24. *Al Qur'an, supra* note 6, at 11:85.

25. ABDULLAH SAEED, ISLAMIC BANKING AND INTEREST: A STUDY OF THE PROHIBITION OF RIBA AND ITS CONTEMPORARY INTERPRETATION (1996).

called Corporate Social Responsibility (CSR), which provides mandatory provisions for certain companies having certain turnover to contribute to the overall development of the country, environmental sustainability programs and initiatives. In addition to that, ethical practice models of banking such as credit unions as well as community banks majorly focus on supporting local businesses and underdeveloped communities like United States's Community Reinvestment Community (USCRU). These institutions are there to meet the needs of low-income communities and to meet their credit expectations. However, they are not very effective as the motive is to generate profit, thereby diverging from its stated purpose of social welfare. Oftentimes CSR programs improvise with the needs of the day. Meanwhile they also serve more to public relations rather than on actual commitments to societal benefit. Often times banks engage in CSR activities while simultaneously engaging in disgraceful activities such as predatory lending or investing in harmful businesses that degrade the environment. These trends underscore the limitations of both the systems of banking which leads to social disparities.

When analyzing substantially, both Islamic and Western banking systems equally recognize the need for societal welfare, but these ideals lack proper implementation. There is a requirement of implementing financial products in Islamic finance laws that forthright relates to societal needs like introducing affordable housing and educational loans without charging any interest thereon, and activities that directly impact medical and sustainable development. Intensifying social financial bonds (*sukuk*), which planned to fund the projects have ulterior motives of contributing social welfare and ethical needs of the society at large.<sup>26</sup> For Western banking it is essential to move beyond CSR compliance-driven activities to a more integral approach that sees social welfare as a key to benefit business, including decision making on standards of business to promote national welfare.

### III. EVALUATION OF ISLAMIC BANKING — EARLY FOUNDATIONS TO MODERN REVIVAL

#### A. Early Foundations (7th Century CE)

The evolution of Islamic banking can be traced back to when the Qur'an was revealed to the Prophet Mohammed (PBUH). The Holy City of Mecca had been an international trading center since the pre-Islamic period, and trade was regarded as the main occupation of the people of Mecca. In running their businesses, these traders needed financing to have surplus funds; the businessmen would advance their capital and share their profits equally. Even Prophet

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26. Hanan Al Madani et al., *The Role of Sukuk in Achieving Sustainable Development: Evidence from the Islamic Development Bank*, 15(4) BANKS AND BANK SYS. 36 (2020)

(PBUH) was a tradesman before his prophethood; his teachings were based on fairness and transparency in financial transactions.<sup>27</sup> Trade practices in this period laid the main framework which has evolved into Islamic banking as we know it today. The legal and ethical values are derived from the Qur'an and the Sunnah, prohibiting exploitative practices such as gambling (*maysir*) and interest (*riba*). Varied historical records suggest that partnership contracts (*mudarabah*), also known as *Qirad* early in the seventh century, were a form of profit-sharing model whereby one party provided the capital and the other would provide labor and other expertise with profits to be shared on a pre-determined agreement. This early model was mostly practiced in the early 7th century Middle East while adhering to the sharing rules of promoting justice fairness and ethical practices.

There was another key practice of safekeeping (*Wadi'ah*), under which a person would trust their valued goods to the most trustworthy individual for safe keeping without any expectations of gaining any consideration. This practice later got its shape as a deposit service for those who wanted to keep a trust or create savings for investing in business ventures. In this, the principal amount is guaranteed in the hands of an individual aligning with notion of trust (*Amanah*) which indicates practicing an ethical grasp of someone's wealth. These early practices provide the groundwork for major concepts of social harmony, justice, fairness and trustworthiness.

#### B. Caliphate Era (7th-13th Century CE)

The Caliphate era extended from 7th to 13th centuries and is of greater importance in the historical development of Islamic commercial laws. In the course of this period, there was a need to harmonize the Islamic values and principles governing economics and finance. There was significant development in the regulatory frameworks through the introduction of administrative authorities, organizations and institutions that became modern Islamic banking law.

Early finance laws were developed in the reign of the Rashidun and Umayyad dynasties and prospered in the vast territories. There were massive and large trade networks that expanded from Spain in the West to the Indian sub-continent in East. These trade routes not only flourished between the regions but also diversified exchanges of knowledge and traditions. The Abbasid period saw more reformation by introducing the concepts of risk sharing (*mudarabah*) and partnership ventures (*musharakah*) which were formulated in these periods.

Another major development was the organization of the House of wealth and treasures (*Bayt al-Mal*), which had the important function of almsgiving in the form of *zakat* and *Sadaqah*. Due to its impact on those in need, the House of wealth and treasures is considered to be one of the key institutions in promoting

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27. MUSLIM IBN-AL HAJJAJ, *Kitab al-Buyu (The Book of Transactions)*, in SAHIH MUSLIM, Book 10, Hadith 3663.

welfare. This treasury influenced state affairs and managed public finance and other expenses incurred in war times. Management of state affairs through the House of wealth prospered under this period, promoting social justice, coherence and economic stability in the nation.

Furthermore, the Caliphate era witnessed the establishment of Islamic bond (*sakk*) as a financial instrument similar to today's promissory notes and checks and balances. Merchants transferred the funds and debts over a vast distance without the urge to carry loads of cash while traveling.

### C. Medieval Era

#### 1. Islamic Jurisprudence (13–18 Century CE)

This era marked the development of Islamic Jurisprudence (*fiqh*) and the adaptation of Islamic legal traditions. Sociological and political changes in the region posed challenges regarding the establishment of Islamic commercial laws with sociological and political changes in the region.

Classical Islamic jurisprudence on commercial and banking laws was codified in legal texts in the medieval period. Eminent scholars like Ibn Khaldun and Al-Mawardi contributed towards the development of the same. The major focus was adherence to Sharia principles for doing trade.<sup>28</sup> *Madhabs*, different schools of Islamic thought, were consolidated in 13th century into the following schools: *Hanafi*, *Maliki*, *Shafi'i*, and *Hanbali*. These *madhabs* hold a major position in legal Sunni tradition. Legal opinions and interpretations (*taqlid*) during this period saw a greater impact by the eminent Scholars. However, this refining of legal provisions of Islamic legal texts was not enough to completely address legal innovations. Scholars interpret this emerging problem through way of reasoning and analogy (*ijtihad*) especially in the domain where fresh interpretations are needed. Similar practices occurred in other sects. Shia Muslims's adoption of twelver Shi'ism in *Safavid* Persia depended on the crucial role played by Shi'a clerics in shaping religious and legal dynamics. Likewise, *Ursuli* Jurisprudence emphasized the reliance on jurists (*mujtahids*) and the role of reasoning in the interpretations of Shari'ah.

In a diverse country like India with multiple religious and ethnic communities, Shari'ah jurisprudence had to contend with the same. The Mughal Empire sought to comply with Hindu customs and other local traditions in addition to Shari'ah. Thus, in Medieval India, the nation had adopted a blend of secular terms. But still, the *Hanafi* School was considered to be the primary source of Islamic law in India.

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28. IBN KHALDUN, MUQADDIMAH: AN INTRODUCTION TO HISTORY (NJ Dawood ed., Franz Rosenthal trans., Princeton University Press 1967); ABUL HASAN ALI IBN MUHAMMAD MAWARDI, AL-AHKAM AL-SULTANNIYA: THE LAWS OF ISLAMIC GOVERNANCE (Wafaa H Wahba trans., Ta Ha Publishers 1996).

The 18th century saw a decline when, amidst growing corruption and mischief in Islamic governance, Islamic reform movements led to a return of the fundamentals of Islam, a revival of *ijtihad* and rejection of *taqlid*.

## 2. Great Ottoman Empire (14th- 20th Century CE)

Stretching over 600 years, the Ottoman Empire had a very large and complex administrative system running across parts of modern day Europe, Asia and Africa. Shari'ah law was applied in the region. *Qanun*, or laws adopted by the state legislatures, had addressed the pragmatic requirements of multi-religious and multi-ethnic people. Thus, there was a synchronicity of Islamic laws and *qanun* introduced by the Sultan to cover subjects going beyond personal laws such as taxation, land laws, trade and public order. The highest religious authority having office (*Sheikh al-Islam*) was responsible for issuing legal interpretations (*fatwas*) that provide acceptance of religious legitimacy to the orders and decrees of the Sultan. The office also had jurisdiction to appoint judges (*qadis*) for the administration of the courts. This coexistence of Shari'ah laws with *qanun* were maintained throughout the empire for administrative flexibility.

Across the territory, *Hanafi* school of jurisprudence was adopted vastly and provided a coherent legal code of conduct with flexibility for interpretation and opinions (*ra'y*). This school of thought was significant in the regions of Balkans, Anatolia and Arabia in cases of commercial, personal and criminal laws. However, the empire also allowed multiplicity of legal traditions where different school of jurisprudence were recognized.

The judiciary in the Ottoman empire planned to include both frameworks of state laws and Islamic laws presided by the *qadis* who specialized in the integration of applying laws in the context. *Muftis* supported the *qadis* who issued *fatwas* on complex disputes in areas of Cairo, Istanbul and Damascus. Their workings often give valuable insights of the practical applications in daily life.

In the 19th century, when the empire faced internal decline and external pressures from Europe, many important reforms were undertaken such as the Tanzimat reforms in the late 18th century, marking a shift towards codification and globalization influenced by western traditions. Based on *Hanafi* school of thought, the code of Micelle was introduced and codified Islamic civil law. The reform saw the enabling of secular courts that operated side by side with Shari'ah courts.

In this glorified era, institutional banking systems were also introduced aligning with core principles of Islamic jurisprudence. The Ottomans placed emphasis on endowments (*waqfs*) for their commercial conducts. Also, the business networking was enlarged in this period, which fostered economic growth in the nation. Therefore, legal dualism and pluralism expressed the empire's role to establish Islamic identity with secular laws.

#### D. Modern Revival (20th Century CE)

The revival was largely honed by the growth of conventional banking systems which were extensively against the principles of Islamic commercial laws. Since, the medieval era (1,000–1,500 AD), businessmen from the Middle East had engaged with Europeans in commercial activities. Interestingly, Arabs extensively carried on business in Spain, in particular. When Europeans introduced their own banking systems in Asian countries, many of the banks were interest bearing. The main focus of the scholars, jurists, economists and policy makers was to encourage the progress of the Islamic banking systems. There was an enlargement of Islamic banking products that would line up with economic ethics of Islam in the modern world.

The contemporary world saw the introduction of Islamic economic thought as a different discipline in the 20th century. Many great scholars emerged in this period such as Muhammad Baqir al-Sadr and Sayyid Abul Al'a Maududi, both of whom recommended an Islamic based financial system, rejecting rejected ideas of socialism and capitalism. They also advocated for the need to apply Shari'ah laws to commercial transactions by prohibiting interest (*riba*), to promote risk-sharing among partners and the significance of ethical and socially responsible transactions, savings and investments.

Despite the constant focus of various scholars to promote the Islamic system of finance, the European system of banking become more well known than the Islamic banking system. As countries became free of colonialism, small local business owners had no option but to comply with these conventional banks.

While some professionals introduced interest free banking windows, there was a need for the resurgence of Islamic banking to operate in greater numbers. The return of Islamic banking saw many important changes with the development and expansion of Islamic banking institutions. From its moderate beginnings in the 1960s, Islamic banking has grown into an international industry having almost trillions of dollars in assets.

#### IV. DEVELOPMENT AND GROWTH OF MODERN ISLAMIC BANKING

The first ever Islamic banking project was initiated in 1963 in Mit Ghamr, Egypt, and allowed depositors to get small loans for carrying cooperative programmers. The Mit Ghamr banking establishment was closed in 1967 due to political situations in the country, however, it got a deal of only approving forty percent business loans to the applicants and economically in good times the default ratio was said to be zero.<sup>29</sup> Later, the Nasser Social Bank, a profit-sharing cooperation, was incorporated by Ahmad El Najjar, the founder of the Mit Ghamr project.

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29. Vraj Parikh et al., *A Comparative Study of Islamic Banking Services Using CAMELS Analysis in Indonesia*, 9 INT'L J. OF RSCH. THOUGHTS 5341 (2021).

Importantly, the first international conference on Islamic Economics was held to introduce the ideas and benefits of Islamic finance and a semi-inter-governmental bank laid its foundations in 1975. In 1974, the first Islamic bank, known as “The Islamic Development Bank,” was established by the Organization of Islamic Countries (OIC).

The Dubai Islamic Bank operated in the same year along with countries that accepted the Islamic banking laws in Sudan (Faisal Islamic Bank of Sudan), Bahrain (1977), Egypt and Kuwait. More than fifty Islamic banks were established after 1975 that followed Shari’ah compliance. To a lesser extent, the governments of Iran and Pakistan had also introduced Islamic banking systems in their countries.<sup>30</sup>

The growth in regulatory framework of Islamic commercial banking networks had developed through organizations such as the Accounting and Auditing Organization for Islamic Finance Institution (AAOIFI) and boards such as the Islamic Financial Service Board (IFSB) had formulated guidelines to ensure their workings would be Shari’ah compliant. These managements work in fields like risk management, corporate governance, accounting, financing and auditing while having stability and credibility adhering to Islamic commercial laws.

Globally speaking, the market expansion of Islamic banking is greatly influenced by Islamic finance in Muslim minority countries, for instance, across Europe, Asia and America.<sup>31</sup> Muslim majority nations such as Bahrain, UAE, Malaysia and Indonesia have become a hub for Shari’ah banking and finance attracting international investors also.<sup>32</sup>

## V. ISLAMIC BANKING PRODUCTS

Under the Islamic point of view, there are two major types of Shari’ah compliant contracts and three supporting categories of Islamic financial contracts. The two major contract types include equity-type and price mark-up contracts, while the three supporting contracts are *wakalah* (principal-agent), *kafalah* (surety) and *musawamah* (general sale of goods) contracts.

### A. Equity Type Contracts

Equity-type contracts can either *mudarabaha* or *musharakah* contracts.

#### 1. *Mudarabaha* (Trust -Financing)

In this, the capital is provided by the bank while the other party carries their business. The profit levied on the business is shared by the bank and the other

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30. *The Establishment of National Interest Free Banking Systems in Iran, Sudan and Pakistan*, ISLAMIC FIN. FOUND., <https://tokenizer.ca/insights/i/interest/> (last visited Aug. 6, 2024).

31. *Id.*

32. IBRAHIM WARDE, ISLAMIC FINANCE IN GLOBAL ECONOMY (2nd ed. 2010).

party in a prior accepted ratio. However, if there is any loss, unless there is negligence or any kind of violation of the agreed terms of the contract, the bank has to bear the loss and the bank passes off this loss to the depositors. The investor (*rab-ul-mal*) can also give a loan to other working partners (*mudarib*) for investing in business, but the investor cannot participate in business activities and the profit sharing is pre-determined by the parties.

*Mudarabaha* is based on the model of a profit-sharing arrangement whereby one party provides the capital and the other party provides labor and expertise. The *mudarib* is responsible for managing the investment, acting in a bona fide and just manner, and working with due diligence while the funds are collected or given by the *rab-al-mal*. The profit is divided among them on a pre-determined basis while the risk of loss is only incurred by the investor as their work is only confined to the capital, aligning with the principles of Shari'ah laws.

Compliance with the Islamic commercial laws requires clear documentation. The contract must provide all the necessary details such as the amount of capital provided, the nature and scope of the transaction, and pre-agreed profit and losses ratio. Both parties have to agree with the terms and conditions of the contract to ensure transparency in the transaction. All potential conflicts of interest must be clearly disclosed to the investor, the contract must contain the procedure for resolving any disputes, and all parties' rights and duties should be defined and enforceable. In this way, this type of contract ensures ethical and equitable trade practices.

## 2. *Musharakah* (Joint Venture)

*Musharakah* is related to the joint venture, enterprise and partnership to form a kind of contract where the partner (*mudarib*) of the business shares the losses and profits which have to be distributed by a pre-agreement when entering into the contract. The purchase of any asset can be done in installments also without any interest. These types of contracts see two or more parties contribute to a trade or investment and share the risks based on a pre-agreed ratio avoiding interest-based transactions unlike conventional banking systems. All partners to the contract have to contribute to the capital of the business either through cash, expertise or any other contribution contingent with the terms of contract. This form of contract enables the profit equally among partners and losses to be shared in accordance with the contribution of the partner so that no one takes advantage of the other's contribution. This shows fairness and accountability toward each partner. In this way, the members are rewarded based on their contributions and level of involvement and share risk and expertise, which is considered to be the rightful manner according to Islam.

The permissibility of these type of contracts depends on various judgment-based conditions according to Shari'ah jurisprudence. All contributions

related to capital should be rightly defined and every partner should have knowledge of all the contingencies at hand. The ratio related to profit sharing and loss should also be pre-agreed by the parties depending on the contributions of each partner.

The functional and operative part of the *Musharakah* is governed by the delineation of management roles as per Islamic laws. Partners can work on their roles or delegate the same to one or more partners. In situations where one person takes on a directorial role, many receive an extra share of remuneration for their management performance. There must be a supervisory board having expertise in Islamic laws to review the contracts and ensure Shari'ah compliance. These contracts give greater insight to the ethics and risk alignments that differ them from conventional contracts encouraging social justice, equality in wealth distribution and welfare.

## B. Price Mark Up Contracts

Also known as debt contracts, in Price Mark Up Contracts the bank finances the purchase of assets in an agreed exchange of negotiated prices.

These contracts are sub divided into *Murabaha*, *ijarah*, *istisnah* and *salam* contracts.

### 1. *Murabaha* (Cost-Plus Profit)

In *murabaha* contracts, the most widely used form of Price Mark Up Contracts, there are two parties to the contract: a seller and a buyer. The seller is said to disclose the price of the goods. The parties must agree with the cost of goods and the profit margin in the sale. It is the form of cost-plus profit arrangement whereby a banking institution buys an asset, sells the same to the consumer to gain profit and both parties have agreed upon the negotiated price, cost and margin of the asset. This model is both interest-free and based on profit sharing as proscribed by Islamic laws. The bank acts as a seller by selling the purchased asset to the customer, who can either pay a lump sum amount or pay in installments depending on his agreed terms.

This contract model, in which the bank acts as a seller (rather than as a lender) and buys assets or goods identified by the customer on their behalf, is widely used. When the bank then receives ownership, it sells the assets or goods back to that customer at an extra price and both of them agree on the same ratio. The buyer repays the bank either directly or in installments. This type of contract is commonly used in purchasing vehicles, real estate and finance trading. It typically concerns the sale of tangible assets or goods, rather than monetary loans free from interest, unlike convention banking.

*Murabaha* is generally an uncomplicated and flexible, short- or medium-term arrangement that needs clarity in pricing ratio. Both parties have knowledge of all the terms and conditions, decreasing high uncertainty (*gharar*)

in transaction. The seller first assumes its full ownership and bears all the risk before reselling it to the customer. This shows actual ethical trade while adhering to Shari'ah principles.

## 2. *Ijarah* (Lease)

*Ijarah* is a lease financing whereby the owner of any product or asset transfers the right to use and enjoy the product or service for a certain agreed time. It is a leasing contract in which a party (buyer) leases an asset or product such as vehicles, property or machinery. The scope of leasing can be extended to corporate equipment leasing and for real estate at a rental price without any excessive uncertainty, interest and only on permissible goods. It is an actual trade practice which is an asset-backed transaction.

The ownership rests with the lessor but he has to transfer the possession to the lessee for utilizing the goods at a specified price and for a limited time period agreed upon by them. Apart from leasing, the idea of *ijarah* extends to long-term financing. The contract aligns with the Islamic principles by ensuring that the full ownership can only be obtained through fulfilling all the duties. The rules align with principles of Islam and ensure transparency to make sure that each and every clause of the contract must be agreed upon along with the rental price, duration and other requirements. The contract also specifies the conditions regarding return of the asset in situations such as when lessee damages the asset by behaving negligently or not proper using, they have the liability of compensation for such damages.

## 3. *Istisna* (Manufacture Commission)

*Istisna* is said to be the contract between manufacturers and the buyers, in which the buyer asks the manufacturer to make a product at specified rates. In these types of contracts, one party undertakes to construct or produce something for the other party at an agreed price mentioned in the agreement upon the completion of the same. Unlike other contracts of Islamic jurisprudence, under *Istisna*, the asset or product is not available or not in existence at the time of contract. These contracts are widely used for the development of infrastructure and construction. After the buyer asks the seller to produce a product according to a fixed price and future date of execution, the seller is responsible for handling the project and producing the product. Payment can be done in advance, in installments or after completion of the task, which shows flexibility and assurance.

The financial institution can act as a mediator by arranging the contract requirements and conditions ensuring compliance with Shari'ah. *Istisna* contracts play a key role in managing the real-world economic infrastructure through an agreement without depending on interest-based conventional banking and promotes ethical practice as well as shared risk among the parties. Another interesting aspect is that it requires the seller to bear all risks related to the raw

materials and employ labor until the asset is ready. The buyer can also reject the asset if there is any specification that does not satisfy the agreed terms regarding quality of the asset. This shows responsibility and actual economic effort of the manufacturer to follow all the agreed conditions otherwise he will be liable to pay the damages to the buyer. However, the contractor can delegate its authority for the production of any part to a third party which also shows flexibility.

#### 4. *Salam* (Advance Sale Transaction/ Agreement to Sell)

A *Salam* is a sale transaction whereby a seller has agreed to supply goods to the buyer for a future date at specified prices and the buyer must give an advance payment to the seller. The main aim is to meet the needs of small farmers for agriculture so that farmers can invest in fertilizers, seeds, machineries and other required materials. The delivery of the product is deferred to a future date, provided that the buyer pays the necessary amount for the creation of the product or at the given capital. This contract provides a mechanism to take a security of the good which is helpful if there is any flux in market in the future.

The main functionality of the *Salam* is to facilitate smooth operation of trade and give liquidity to the sellers so that the purchaser can lock in prices for future receiving. It is free from interest as well as speculation and is backed up by actual assets. It differs from other contracts of Islamic commercial laws by acquiring assets or producing products at a future delivery by the seller for up front capital along with requiring that payment has to be made duly and not partly. The buyer has the right to reject the goods if there is any defect in quality or any ambiguity in the delivery by the seller. In this scenario, the seller would be liable to pay compensation due to any negligence on his part. This shows that there should be fair dealing and that the risk is shared suitably among the parties.

#### C. *Wakalah* (Principal-Agent Contract)

*Wakalah* are agency contracts in which a person appoints an agent to perform certain duties or tasks on behalf of his principal on agreed contractual terms. As such, there are two parties in *wakalah*: an agent and a principal. The principal can appoint an agent to act on his behalf to perform any specific task or transactions. The agent can work on certain tasks within the scope of the contractual arrangement at a specified fee. The contract is mostly utilized in investments, insurance, and advisory bodies and the principal can delegate its authority to the agent while being compliant with Shari'ah principles.

*Wakalah* agreements should contain specific duties, obligations, rights, services and roles of the agent while complying with the instructions and directions given by his principal. The overall mechanism of these contracts ensures fairness, mutual consent and transparency. This contract shows loyalty and ethical standards as the main aim of Islamic commercial laws.

Further, the agent is assumed to work with due diligence and in good faith and to ensure that his acts are in the best interest of the principal. Any negligence, fraud or misrepresentation could result in legal and financial intricacies.

#### D. *Kafalah* (Surety Contract)

*Kafalah* is a contract in which a third-party becomes “surety” that provides assurance for the payment of a loan on behalf a person who has given a debt. It is merely a pledge in which a third party becomes a guarantor (*kafeel*). This suretyship agreement is when one party assumes the role of the other party if the principal failed to pay the debt or any duty. A guarantor acts as a moral assurance which encourages trust and transactions by mitigating risks. These contracts support loans, performance bonds, trade credits and other transactions.

The *Kafeel* accepts the guarantee to cover all obligations of the principal if the principal defaults in payment. *Kafalah* is unconditional and irrevocable to ensure that principal’s worthiness and reliability should be assured.

The primary function of *kafalah* is to provide safety for transactions by transferring the risk of any default from the principal to the guarantor. This shows mutual cooperation in trade practices. The agreement is procedurally structured to ensure compliance with Islamic principles. The guarantee is a form of support and not to gain any profit expectations to the guarantor.

#### E. *Musawamah* (General Sale of Goods)

*Musawamah* is a sale of goods contract in which the seller is not required to disclose the price the goods sold to the buyer. Both parties negotiate the prices involved in the sale while not disclosing the exact markup information related to the goods. The *Musawamah* is much different from *Murabaha* which necessitates prior agreement of prices. These contracts are based on trust and transparency and provide flexibility in pricing ratios. However, prices can be altered by bargaining while maintaining fair competition in markets. *Musawamah* encourages that trade should be conducted ethically while complying with Shari’ah.

Further, the parties to the contract should align with mutual consent agreeing on all the terms and conditions of the sale. Not disclosing the prices does not mean that price is unfair or exploitative because it still has to be just, reasonable and a true valuation. If the terms of the contract are not met then the aggrieved party can file a suit or seek redress by mediation. The main purpose of *Musawamah* is to promote justice, fairness and ethical trade practices.

## VI. CHALLENGES AND OPPORTUNITIES FOR ISLAMIC BANKING

The key difference between Islamic and conventional banking is that the Islamic banking prohibits usury and speculation in any form such as gambling (*maisir*). Another important difference is the prohibition of interest in any form

on debts (*riba*). Lastly, any kind of investment on prohibited (*haram*) commercial practices such as alcohol, gambling and pork is regarded as prohibitory activities and thus, not allowed.

In some ways, Islamic banking is more convenient as compared to conventional banking. Islamic banking is more people-friendly in the sense that it focuses more on taking smaller loans rather than imposing large debts to the people. Risk is shared equally and easily and profit is shared, whereas conventional banking is driven through profits and interest (*riba*), resulting in a practice which profits from the borrower regardless of their ultimate success or failure. These differences between Islamic and conventional banking systems create multiple challenges as well as opportunities for Islamic banking.

#### A. Challenges Posed to Islamic Banking

##### 1. Lack of Legal and Regulatory Framework

One of the most major challenges to Islamic banking is the lack of uniform rules and a regulatory framework. Many countries have different opinions on implementing Shari'ah principles which leads to an imbalance in trade requirements. For example, Malaysia has a comprehensive regulatory framework while Pakistan faces challenges in applying Shari'ah laws of finance with their existing laws.<sup>33</sup> Uniformity in the statutory framework creates problems in effective implementation and adaptations in global financial system. Standardized jurisdiction of the Islamic interpretations of rules across the world, just like conventional banking, is required. In Saudi Arabia, there is a strict operation of *Hanbali* jurisprudence while in Malaysia there is a flexibility in the regulatory framework. The worldwide inadequacies in implementation leads to inefficient and uneven trade practices. Many countries, like those in South Asia and Africa, still have outdated regulatory frameworks which shows a lack of adaptation and competitiveness causing developing countries to struggle with absent regulations.

Another important challenge is the lack of mechanisms for the enforcement of Shari'ah laws. This is a problem because if any dispute arises out of Islamic contracts, those should be dealt with under Islamic principles and in Shari'ah supervisory tribunals. But in most situations the cases are dealt with under secular law and in secular courts, which may not result in compliance with Shari'ah. For example, in the United Kingdom, which has a large Muslim population, cases related to Islamic finance are handled within England's common law. This leads to major inconsistencies in interpretation of enforcement mechanisms.

International standards also pose a challenge in accepting Shari'ah laws. Various administrative bodies such as the Basel Committee and the Financial Stability Board set a uniform standard on an international level which is

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33. *Id.* at 3.

only confined to conventional banking. This complicates the adaptation of Shari'ah laws.

## 2. Merging with Conventional Commercial Laws

One of the key proposals suggests that the present banking system should align itself with Shari'ah laws as a dual banking system. For example, in England there is a regulatory guideline issued and set by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (ARA), which Shari'ah compliant banks could align with.<sup>34</sup> Operation of Shari'ah laws alongside conventional banking occurs in countries such as UAE and Malaysia, which both have dual banking systems.

However, combining Shari'ah commercial laws with modern banking laws comes with challenges, which can lead to higher operational costs and complexities. This raises questions regarding legal consideration and coexistence.

## 3. Consolidated Approach

One of the biggest concerns is the interpretation of Shari'ah commercial laws to be universally applicable. Varying opinions and points of view pose problems leading to inefficiency and unified Shari'ah-compliant business conducts. This can be seen in the Islamic bond (*sukuk*) issuance, where misinterpretations and varied jurisdictions create concerns and different structures on the permissibility of the same.

## 4. Lack of Awareness and Education

Another challenge to Islamic banking is the lack of knowledge and awareness among consumers and business owners about Islamic principles. This can hinder opportunities in adaptation of Islamic finance and services. There is a severe scarcity of well-versed scholars in the discipline to navigate the problems of development in Islamic finance and the present academics legal experts as well as training infrastructure. For instance, most of the countries provide courses that focus on conventional banking but do not cover aspects of Shari'ah laws. This knowledge gap gives rise to complexities and limits the scope of legal and financial practitioners to develop innovative solutions.

## B. Opportunities for Islamic Banking

### 1. Growth in Demands for Ethical Markets

Islamic finance's emphasis on transparency, fairness, truthfulness and ethical practices aligns with today's market demands of ethical and socially responsible business ventures. This can attract a broader base of investors. One

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34. *What is Islamic Finance?*, BANK OF ENGLAND (NOV. 15, 2024), <https://www.bankofengland.co.uk/explainers/what-is-islamic-finance>.

instance can be seen in the United Arab Emirates, where many non-Muslim investors have been attracted to Islamic commercial investments due to their ethical practices.<sup>35</sup>

## 2. Financial Inclusion Promotion

Countries like Bangladesh have finally implemented schemes whereby financial assistance is provided to marginalized communities, reducing poverty to some extent.<sup>36</sup> This can be applied in Muslim majority countries, where there is an existing alignment with Islamic financial and banking principles, by introducing Shari'ah compliant financing for financial services to low wages workers and for small businesses.

## 3. Innovations

Innovated products in financing such as insurance (*takaful*), mutual funds and bonds (*sukuk*) would develop the needs of the finance demand today. Green *Sukuk* has been promoted as a means of adapting environmentally sustainable practices that can contribute to challenges prevalent nowadays. Practices like renewable energy and sustainable development emphasizes ethical investment and social practices and encourages environmental responsibility. Countries like Malaysia and Indonesia have pioneered the issuance of Green *Sukuk*, driving funding for many green projects. For example, Indonesia issued its first Islamic bond focusing on the reduction of greenhouse gas emissions in 2018.<sup>37</sup>

## 4. Collaboration Internationally

Collaboration between countries can affect the Islamic principles effectively globally as seen in Malaysia and the UAE. Harmonization of standards can enhance the international reach and facilitate cross-border transaction and investments.

# VII. THE IMPACT AND FUTURE DIRECTIONS

## A. Impact of Islamic Banking

The points have been discussed below (via case studies):

Assets have grown substantially, reaching as much as \$2.4 trillion. Additionally, the demands of Shari'ah compliant financial services have increased due to its ethical benefits and stability in business conduct. The Gulf Cooperation

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35. *Id.* at 9.

36. *Social Safety Nets in Bangladesh Help Reduce Poverty and Improve Human Capital*, WORLD BANK GROUP (Apr. 29, 2019), <https://www.worldbank.org/en/news/feature/2019/04/29/social-safety-nets-in-bangladesh-help-reduce-poverty-and-improve-human-capital>.

37. Mira Minkara & Olive Munene, *Islamic Finance: An Untapped Resource for Climate Funding*, CONVERGE (Feb. 27, 2024), <https://www.convergence.finance/news/6myTSgAFhYrJCS0haBWade/view?utm.com>.

Council (GCC) countries such as Indonesia and Malaysia have seen growth. For instance, in Malaysia about 30 percent of the assets are Shari'ah based.<sup>38</sup>

Islamic bonds (*sukuk*) emerged to be efficient assets for raising capital throughout the world. For the first time, the United Kingdom issued a £200 million bond as *sukuk* as a non-Muslim country.<sup>39</sup>

Promoting harmony facilitates good economic ties between Muslim-majority and non-Muslim countries. The Islamic Development Bank (IsDB) has played a crucial role in financing infrastructure projects in countries which they are members of. One such involvement is the project of Trans-Saharan Road in Africa, which has had a significant regional impact.<sup>40</sup>

Apart from these, Islamic finance has contributed to the countries that are in financial need of Shari'ah compliance and especially to those who are underserved by conventional banking. In Pakistan, Akhuwat foundation, a micro finance institution, has offered assistance to people that are on low salary promoting sense of entrepreneurship.

The major principle of Shari'ah banking laws is the risk-sharing principle, which has shown remarkable stability and resilience in comparison to conventional banking trends. During the 2008 global finance crisis, Islamic banks were less affected by avoiding speculation and risky or unethical practices.<sup>41</sup>

Islamic banking promotes sustainable and eco and socio friendly practices by prohibiting harmful practices such as alcohol, gambling and tobacco, making it a more ethical and socially beneficial system of finance. One great example is the innovation of Green *Sukuk* in 2017 to increase funding into more environmentally friendly business activities.

Commercial laws in Islam incorporate mandatory giving of charity (*zakat*), creation of *Waqf* boards and wealth redistribution mechanisms to alleviate poverty and support society's welfare while prohibiting inequalities in the interest of overall socio-economic development.

## B. Future Directions and Recommendations

The future of Islamic Banking holds great value and upcoming opportunities to expand internationally through standardization of the system as differences in opinions would create confusion and imbalance in market penetration and inconsistencies in the minds of investors. This can be solved by providing a unified banking network framework through administrative bodies

38. Bank Negara Malay., Annual Report 2022 (2023), [https://www.bnm.gov.my/documents/20124/10150308/ar2022\\_en\\_book.pdf](https://www.bnm.gov.my/documents/20124/10150308/ar2022_en_book.pdf).

39. HM Treasury, *Government Issues First Islamic Bond*, GOV.UK ( June 25, 2014), <https://www.gov.uk/government/news/government-issues-first-islamic-bond>

40. Yousuf Adil, *Financial Statement of the Year Ended June 30, 2022*, AKHUWAT (last visited Feb. 16, 2025), <https://akhuwat.org.pk/wp-content/uploads/2022/11/AIMreport21-22.pdf>

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of nations worldwide. There is also a lack of awareness and understanding of Islamic finance which may incur difficulties. Raising awareness through campaigns, programs and inclusion of Islamic finance in academics might increase interest and yield a greater potential to its application in broader ways.

There is a significant need of continuous innovation in Islamic financial products which may lead to more enthusiasm in youths and investors to promote ethical and sustainable practices. Finally, advancement of Shari'ah compliant technologies like Artificial Intelligence, block chain and fin tech solutions, such as in Dubai Fin tech, may lead to the enhancement and revolutionization of Islamic banking and finance.

The implementation of these recommendations would create opportunities and help with the world's need of risk management in corporate governance and ethical conduct in conducting business while strengthening the aim for stable economic development and equal distribution of wealth.

#### VIII. CONCLUSION

Islamic finance is guided by the principles of risk sharing, transparency and fairness which promotes ethical investment; a goal which has gained traction globally. This paper has underscored these different aspects of Islamic finance.

Fundamental principles on which Islamic finance is based includes the prohibition of interest (*riba*), the importance of risk-sharing and discouragement of high uncertainty (*gharar*), and supports ethical asset backed financing. These primary principles ensure equality and require that business conduct shall align with Islamic values that preach fairness and justice.

Islamic commercial laws provide diversity by providing interest free insurance (*takaful*) and issuance of Islamic bonds (*sukuk*) that cater to today's market needs. Integration with global markets by enhancing cross-border participation in trade has attracted many non-Muslim countries also. Establishment of financial hubs has increased the value and increased the demands of Islamic financial products.

Despite its growth, there are various challenges that are in significant need of solving including unified regulatory and legal frameworks, raising awareness and knowledge among stakeholders and technological development. Innovations, creating market awareness and harmonizing regulatory stable frameworks would enhance the global opportunities and expand Shari'ah compliance on a global scale.

The findings of this research paper underscores the significant role of Islamic finance promoting ethical and fair sustainable practices. Adhering to this paper's suggestions would prioritize a socio-economic, just system and the integration of the risk-sharing principle with conventional banking laws, highlighting its potential to contribute to the significant needs of global markets.