

SPONSORED BY
Cagamas 

ISLAMIC FINANCIAL SYSTEM

Principles & Operations

ISRA الأاديمية العالمية للبحوث الشرعية
International Shari'ah Research Academy for Islamic Finance

ISLAMIC FINANCIAL SYSTEM

Principles & Operations

Published in 2011 by
International Shari'ah Research Academy for Islamic Finance (ISRA)
2nd Floor, Annexe Block,
Menara Tun Razak, Jalan Raja Laut,
50350 Kuala Lumpur, Malaysia.
Tel: +603 2781 4000
Fax: +603 2692 4094
www.isra.my

Printed in Malaysia (CTP – VVP)

4 3 2 1
14 13 12 11

ISBN 978-967-349-127-8

Copy no: 11231434
Initial: NMZ
Date: 13/10/2011
Location: MAIN/PJ/ISTAC/NILAI/K/K2

© International Shari'ah Research Academy for Islamic Finance (ISRA) 2011.

All rights reserved.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, whether electronic, mechanical, photocopying, recording, or otherwise without prior permission of the publisher.

List of Contributors and Reviewers

Editor-In-Chief

Asyraf Wajdi Dusuki, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Project Coordinator

Edib Smolo, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Contributors

Ahamed Kameel Mydin Meera, International Islamic University Malaysia (IIUM), Malaysia

Akhtarzait Abdul Aziz, International Islamic University Malaysia (IIUM), Malaysia

Ashraf Md. Hashim, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Asyraf Wajdi Dusuki, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Azura Othman, PricewaterhouseCoopers Taxation Services, Malaysia.

Edib Smolo, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Engku Rabbiah Adawiah, International Islamic University Malaysia (IIUM), Malaysia

Faizal Ahmad Manjoo, Markfield Institute of Higher Education, UK

Habib Ahmed, Durham University, UK

Hakimah Yaacob, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Hamim Syahrums Ahmad Mokhtar, Central Bank of Malaysia, Malaysia

Madzlan Mohamad Hussain, Zaid Ibrahim & Co., Malaysia

Mansor Ibrahim, Universiti Putra Malaysia (UPM), Malaysia

Mohamad Akram Laldin, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Mohamed Fairooz Abdul Khir, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

Mohammad Kabir Hassan, University of New Orleans, Louisiana, US

Mohammad Nejatullah Siddiqi, Aligarh Muslim University, India

Mohd. Azmi Omar, International Islamic University Malaysia (IIUM), Malaysia

Muhammad Ali Jinnah Ahmad, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia

- Nazrol Kamil Mustaffa Kamil**, International Islamic University Malaysia (IIUM), Malaysia
- Noraini Mohd Ariffin**, International Islamic University Malaysia (IIUM), Malaysia
- Nurdianawati Irwani Abdullah**, International Islamic University Malaysia (IIUM), Malaysia
- Obiyathulla Ismath Bacha**, The International Centre for Education in Islamic Finance (INCEIF), Malaysia
- Saadiah Mohamad**, Universiti Teknologi MARA (UiTM), Malaysia
- Said Bouheraoua**, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia
- Seif Ibrahim Tag el-Din**, Imam University, Riyadh, Saudi Arabia
- Shabana Hasan**, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia
- Shabnam Mokhtar**, SHAPE™ Financial Corporation, Kuwait
- Sherin Kunhibava**, University Malaya (UM), Malaysia
- Siti Salwani**, International Islamic University Malaysia (IIUM), Malaysia
- Staff of the Islamic Technical Unit**, Malaysian Accounting Standards Board, Malaysia
- Wan Norhaziki Wan Abd. Halim**, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia
- Zainal Hasfi Hashim**, Central Bank of Malaysia, Malaysia
- Zulkifli Hasan**, Islamic Science University of Malaysia, Malaysia

Reviewers

- Abbas Mirakhor**, The International Centre for Education in Islamic Finance (INCEIF), Malaysia
- Abdullah Haron**, Islamic Financial Services Board (IFSB), Malaysia
- Ahmad Suhaimi Yahya**, Kuwait Finance House (Malaysia) Berhad, Malaysia
- Ashraf Hashim**, International *Shari'ah* Research Academy for Islamic Finance (ISRA), Malaysia
- Azahari Abdul Kudus**, Kuwait Finance House (Malaysia) Berhad, Malaysia
- Azizi Ali**, Cagamas Berhad, Malaysia
- Azizul Sabri Abdullah**, Central Bank of Malaysia, Malaysia
- Azleena Idris**, Central Bank of Malaysia, Malaysia
- Badlishah Bashah**, Securities Commission (SC), Malaysia
- Badlisyah Abdul Ghani**, CIMB Islamic Bank Berhad, Malaysia
- Ilaina Jamilah Ibrahim**, Cagamas Berhad, Malaysia
- Imran Iqbal**, Saudi Hollandi Bank, Kingdom of Saudi Arabia
- Jasani Abdullah**, Hong Leong Islamic Bank, Malaysia
- Jennifer Chang**, PricewaterhouseCoopers, Malaysia
- Kamaruddin Sharif**, The International Centre for Education in Islamic Finance (INCEIF), Malaysia

Mohd Nasiruddin Mohd Kamaruddin, Standard Chartered Saadiq Berhad, Malaysia

Mustafa Omar Mohammed, International Islamic University Malaysia (IIUM),
Malaysia

Noorul Azmi Mat Dahari, Central Bank of Malaysia, Malaysia

Rodney Wilson, Durham University, UK

Roslan Abdul Razak, Islamic Banking and Finance Institute Malaysia (IBFIM),
Malaysia

Roslan Ahmad, Cagamas Berhad, Malaysia

Rusni Hassan, International Islamic University Malaysia (IIUM), Malaysia

Rustam Mohd Idris, Central Bank of Malaysia, Malaysia

Said Bouheraoua, International *Shari'ah* Research Academy for Islamic Finance (ISRA),
Malaysia

Shamsun Anwar Hussain, CIMB Islamic Bank Berhad, Malaysia

Suhaimi Mohd Yusof, Central Bank of Malaysia, Malaysia

Suzaizi Mohd Morshid, RHB Islamic Bank Berhad, Malaysia

Zabidi Othman, Central Bank of Malaysia, Malaysia

Zurina Shafii, Universiti Sains Islam Malaysia (USIM), Nilai, Malaysia

Contents

List of Contributors **iii**

Foreword **vii**

Preface **xi**

Part 1 Overview of the Islamic Financial System

Chapter 1

Introduction to the Islamic Financial System **3**

Preview **3**

Why Study Islamic Finance? **4**

Shari'ah as the Bedrock of the Islamic Financial System **5**

What Exactly is *Shari'ah*? **6**

Value Proposition of the Islamic Financial System **7**

Functions of the Islamic Financial System **12**

Types of Islamic Financial Markets **14**

Debt and Equity Markets **14**

Money and Capital Market **16**

Islamic Money Markets **17**

Islamic Capital Markets **18**

Primary and Secondary Markets **18**

Organised Exchange and Over-the-Counter Markets **19**

Islamic Financial Intermediaries **20**

Types of Islamic Financial Intermediaries **23**

Requisites of the Islamic Financial System **24**

Strong Risk Management Practice **25**

Effective Regulation of Islamic Financial Institutions **26**

Sound Corporate and *Shari'ah* Governance **27**

A Supportive Legal Framework **28**

Robust Accounting Disclosure and Taxation Regime **29**

Summary **30**

Key Terms and Concepts **31**

Further Readings **31**

Review Questions and Problems **33**

Chapter 2

Overview of Islamic Economics and Financial System **35**

Preview **35**

Islamic Economics **36**

Islamic Worldview **36**

Objectives of an Islamic Economy	38
Why Islamic Economics?	47
The Three Central Economic Problems	47
Economics of <i>Riba</i>	52
Economics of the Financial System	59
The Structure of the Islamic Financial System	61
Islamic Financial Markets	62
Islamic Financial Instruments	67
Summary	70
Key Terms and Concepts	71
Further Readings	71
Review Questions and Problems	72

Chapter 3

Money and Monetary Policy 73

Preview 73

The Concept of Money 74

Introduction 74

Functions of Money 77

Medium of Exchange 77

Unit of Account 77

Store of Value 78

Standard of Deferred Payment 79

Types of Money 79

Commodity Money/Commodity Monetary Standard 80

Metallic Money 81

Fiat Money 83

The Equation of Exchange 89

Time Value of Money 90

Monetary Policy Instruments 92

Required Reserve Ratio 92

Discount Rate 93

Open-market Operations 93

Islamic Monetary Policy Instruments 94

Money Supply Process 94

Simple Monetary Supply Process 94

Modified Money Supply Process 97

Monetary Transmission Mechanism 98

Asset Price Channel — Exchange Rate Effects 99

Asset Price Channel — Equity Prices 100

Credit Channels 100

Profit-and-Loss-Sharing Channel 101

Economic Agents in Monetary Policy 102

Economic Agents and Money Supply Process	102
Fairness in Monetary Policy	103
Issues in the Conduct of Islamic Monetary Policy	104
Summary	106
Key Terms and Concepts	107
Further Readings	108
Review Questions and Problems	108
Chapter 4	
Development of Islamic Financial System 111	
Preview	111
Historical Overview of Islamic Finance	112
Modern Day Islamic Finance	113
Emerging Interest in Islamic Finance in Other Jurisdictions Today	121
International Infrastructure Institutions	122
Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)	123
International Islamic Financial Market (IIFM)	124
General Council for Islamic Banks and Financial Institutions (CIBAFI)	124
Islamic Financial Services Board (IFSB)	125
Islamic International Rating Agency (IIRA)	126
International Islamic Liquidity Management Corporation (IILM)	126
Models of Islamic Finance	127
Market-Driven versus Government Initiatives	127
Full-Fledged versus Dual Banking System	128
Infrastructure for Development	129
Appropriate Regulatory and Supervisory Framework	130
Existence of Strong Corporate Governance	131
Greater Transparency and Disclosure of Information	132
Risk Management Framework	133
Effective and Dynamic <i>Shari'ah</i> Framework	134
Strong and Comprehensive Legal Infrastructure	135
Development of Vibrant Islamic Financial Markets	135
Large Number of Players	136
Wide Range of Financial Products and Instruments	137
Tax Neutrality	137
Blue Print for Islamic Finance	138
Accounting and Auditing Standards for Islamic Financial Institutions	138
Challenges	139
Adoption of a Robust Domestic Islamic Financial System	139
Efficient and Active International Islamic Financial Markets	139
Availability of a Wide Range of Instruments	140
Human Resource Requirements	140

Summary	141
Key Terms and Concepts	142
Further Readings	142
Review Questions and Problems	143

Economics of the Financial System

The Structure of the Islamic Financial

Islamic Financial Markets

Part 2 Shari'ah Framework and Principles for the Islamic Financial System

Chapter 5

Shari'ah Framework for Islamic Finance 147

Preview	147
Definition of Shari'ah	148
Components of Shari'ah	149
Sources of Islamic Law	152
Classification of Sources of Islamic Law	152
Maqasid Al-Shari'ah vis-à-vis Islamic Finance	166
Legal Maxims Pertinent to Islamic Finance	168
Differences (<i>Ikhtilaf</i>) of Opinion Among Scholars	172
Role of <i>Ijtihad</i> and <i>Mujtahid</i> in Islamic Banking and Finance	176
Fundamental Prohibited Elements in Islamic Finance	177
Prohibition of <i>Riba</i>	177
Prohibition of <i>Gharar</i>	181
Prohibition of Gambling (<i>Maysir</i>)	183
Mutuality of Risk-sharing	183
Governance and Transparency	184
Issues and Challenges	185
Summary	187
Key Terms and Concepts	188
Further Readings	188
Review Questions and Problems	189

Chapter 6

Shari'ah Contracts for Islamic Financial Instruments — Part 1 191

Preview	191
Elements of Shari'ah Contracts	192
Form of Contract	192
Subject Matter of the Contract (<i>Mahal Al-'Aqd</i>)	195
Contracting Parties (<i>Al-'Aqidan</i>)	198
Classification of Shari'ah Contracts	201
Exchange-based Contracts (<i>'Uqud Al-Mu'awadat</i>)	201
Charity-based Contracts (<i>'Uqud Al-Tabarru'at</i>)	201

Waiving Contracts (' <i>Uqud Al-Isqatat</i>)	202
Partnership Contracts (' <i>Uqud Al-Ishtirak</i>)	202
Concept of Exchange-based Contracts	202
<i>Bay' Al-Murabahah</i> (Mark-up Sale)	202
<i>Bay' Al-Istisna'</i> (Manufacturing Sale)	207
<i>Bay' Al-Salam</i> (Forward Sale)	210
<i>Bay' Al-Dayn</i> (Sale of Debt)	214
<i>Bay' Al-Sarf</i> (Sale of Currency)	217
<i>Bay' Al-'Inah</i> (Sell and Buy-Back)	220
<i>Bay' Al-Tawarruq</i> (Monetisation/Cash Financing/ Cash Procurement)	226
<i>Ijarah</i> (Lease)	232
Summary	240
Key Terms and Concepts	240
Further Readings	241
Review Questions and Problems	241

Chapter 7

Shari'ah Contracts for Islamic Financial Instruments — Part 2 243

Preview	243
Partnership Contracts in Islamic Finance	244
<i>Musharakah</i>	244
<i>Mudarabah</i>	249
Security Contracts	255
<i>Kafalah</i> (Guarantee)	255
<i>Rahn</i>	259
Charitable Contracts	264
<i>Hibah</i>	264
<i>Wadi'ah</i> (Deposits)	269
Agency Contract: <i>Wakalah</i>	272
Definition of <i>Wakalah</i>	272
Legality of <i>Wakalah</i>	272
Basic Rules and Conditions of a <i>Wakalah</i> Contract	273
Types of <i>Wakalah</i> Contract	274
Supporting Contracts	277
<i>Hiwalah</i>	277
<i>Muqasah</i> (Set-off)	281
<i>Ibra'</i>	283
<i>Wa'd</i> and Problems	287
Summary	291
Key Terms and Concepts	292
Further Readings	292
Review Questions and Problems	294

Part 3 Islamic Financial Markets

Chapter 8

Islamic Banking Operations and Instruments 297

Preview 297

Introduction 298

Role of Islamic Bank as an Efficient Financial Intermediary 299

Balance Sheet of an Islamic Bank 300

Sources of Funds 302

Savings Deposit 302

Current Deposit 303

Term Deposit 303

Investment Deposit 304

Underlying Contracts for Savings and Current Deposit 304

Uses of Funds 314

Islamic Retail Financing 315

Corporate Financing 330

Working Capital Financing 333

Islamic Trade Financing Instruments and Practices 335

Islamic Letter of Credit 335

Islamic Trust Receipt 338

Islamic Accepted Bills 340

Islamic Bank Guarantee 343

Islamic Shipping Guarantee 347

Summary 351

Key Terms and Concepts 351

Further Readings 352

Review Questions and Problems 352

Chapter 9

Islamic Money Market 353

Preview 353

Introduction 354

Money Market Participants 354

Money Market Instruments 355

Preview Treasury Bills 355

Elements Repurchase Agreements (REPOs) 356

Negotiable Certificates of Deposit (CDs) 356

Commercial Papers (CPs) 356

Banker's Acceptances (BAs) 357

Functions of Money Market 357

The Need for Islamic Money Market 358

Differences between Islamic and Conventional Money Markets 359

Components of the Islamic Money Market	360
Islamic Interbank Market	361
Trading of Islamic Money Market Instruments	371
Government Investment Issues (GIs)	372
Malaysian Islamic Treasury Bills (MITBs)	373
Bank Negara Monetary Notes (BNMNs)	374
<i>Sukuk</i> Bank Negara Malaysia <i>Ijarah</i> (SBNMI)	377
Islamic Negotiable Instruments (INIs)	377
Negotiable Islamic Debt Certificates (NIDCs)	377
Islamic Negotiable Instruments of Deposit (INIDs)	381
Islamic Accepted Bills (IABs)	381
Sell and Buy-Back Agreement (SBBA)	383
Cagamas <i>Sukuk</i>	384
Islamic Corporate <i>Sukuk</i>	386
Summary	387
Key Terms and Concepts	387
Further Readings	387
Review Questions and Problems	388

Chapter 10

Sukuk Market 389

Preview 389

Shari'ah Framework for Islamic Securities 390

 Definition of *Sukuk* 390

 Origin of *Sukuk* 392

 Role of *Shari'ah* Framework in *Sukuk* Structuring 395

Sukuk Structures 398

 Sale-Based *Sukuk* 402

 Lease-Based *Sukuk* 419

 Equity-Based *Sukuk* 424

Issues, Opportunities and Challenges in the *Sukuk* Market 437

Sukuk – Debt or Equity 437

Sukuk Trading 438

Sukuk Pricing 440

Sukuk Default 443

Summary 446

Key Terms and Concepts 447

Further Readings 447

Review Questions and Problems 449

Chapter 11

Islamic Equity Market 451

Preview 451

The Characteristics of Islamic Equity	452
<i>Shari'ah</i> Permissibility of Modern Day Corporations	454
<i>Shari'ah</i> Permissibility of Secondary Market Trading	454
Approach 1: Shares as Reflecting Partnership Interest	455
Approach 2: Shares as Ownership of Enterprise	456
Equity Valuation	457
Supply, Demand and Price of Equity	458
Models of Pricing and Equity Valuation	460
Understanding and Measuring Risks	464
Islamic Equity Market Instruments	466
Shares or Stocks	466
Preference Shares	467
Stock Index Futures	467
Short-selling	468
Unit Trusts or Mutual Funds	469
Islamic Real Estate Investment Trusts (REITs)	471
Islamic Exchange Traded Funds (ETFs)	478
<i>Shari'ah</i> -Screening of Shares	481
Sector Screening	481
Financial Screening	483
Dividend Purification	483
Issues in <i>Shari'ah</i> Stock Screening	485
Islamic Equity Market Index	487
Issues, Opportunities and Challenges	489
Speculation in Equity Markets	489
Summary	494
Key Terms and Concepts	494
Further Readings	495
Review Questions and Problems	496

Chapter 12

Takaful 499

Preview 499 Participants 354

Section 1: Insurance and Risk Management 500

Concept of Insurance 500

Why Conventional Insurance is Not Accepted by *Shari'ah* 502

Islamic Alternative to Insurance — *Takaful* 504

Historical Development of *Takaful* 505

Shari'ah and Regulatory Framework for *Takaful* 508

Section 2: Operational Framework of *Takaful* 510

Classification of *Takaful* Operations 512

Underlying Contracts in *Takaful* 513

Models of <i>Takaful</i>	516
<i>Takaful</i> Stakeholders	524
Section 3: Issues, Opportunities, and Challenges	534
<i>Shari'ah</i> Issues in <i>Takaful</i>	534
The Way Forward	543
Summary	545
Key Terms and Concepts	545
Further Readings	546
Review Questions and Problems	548

Part 4 Risk Management Principles and Mechanisms for the Islamic Financial System

Chapter 13

Principles and Best Practices of Risk Management 551

Preview 551

Introduction to Risk and Uncertainty 552

Islamic Perspective on Risk Management 555

Types of Risk Exposures 556

 Risks Faced by Financial Institutions 557

Unique Characteristics of Risks in Islamic Finance 559

 Nature of Risks Faced by Islamic Financial Institutions (IFIs) 559

 Risks in Islamic Modes of Financing 564

IFSB Guidelines on Risk Management for IFIs 571

 Comprehensive Risk Management and Reporting Process 571

 Managing Specific Risks 575

Issues, Opportunities, and Challenges 578

 Infrastructure and Risks 578

Summary 583

Key Terms and Concepts 583

Further Readings 584

Review Questions and Problems 585

Appendix: IFSB Guiding Principles of Risk Management 586

Chapter 14

Risk Management Tools and Mechanisms 589

Preview 589

Introduction 590

The Basics: Defining Derivatives 590

Foreign Exchange Basics (Nominal Versus Real Exchange Rate) 593

 Further What is an Exchange Rate? 593

 Review Exchange Rate Risk 595

Nominal versus Real Exchange Rates	598
Forwards, Futures, Options, and Swaps from the Islamic Perspective	600
Islamic Forex Derivative Instruments	604
Islamic Promissory Forward Contracts	605
Islamic Forex Swap	606
Islamic Cross Currency Swap	606
Islamic Profit Rate Swap	608
Islamic Options	609
Islamic-Structured Products	610
Pricing of Islamic Derivatives and Islamic-Structured Products	614
Valuing a Basic <i>Sukuk Ijarah</i>	615
Valuing the Embedded Call Option	617
Valuing <i>Wa'd</i> -Based Currency Swaps	618
Issues, Opportunities and Challenges	620
Summary	625
Key Terms and Concepts	625
Further Readings	625
Review Questions and Problems	626

Part 5 Regulation, Supervision and Governance of the Islamic Financial System

Chapter 15

Regulations and Supervision of Islamic Financial Institutions 631

Preview	631
Overview of the Regulations of Islamic Finance Institutions	632
Rationale for Regulations of Islamic Finance	634
Arguments For	634
Protecting the Interest of Depositors and Investment Account Holders (IAHs) of IFIs	635
Ensuring Compliance with <i>Shari'ah</i>	636
Supporting the Integration of IFIs in the International Financial System	636
Arguments Against	638
The Unique Characteristics of the Regulation of Islamic Finance	638
Islamic Banking	638
Islamic Capital Markets	639
Rationale for Capital Regulation	641
Capital Adequacy Framework for IFIs	642
Regulatory and Supervisory Authorities for Islamic Finance	643
Malaysia's Experience	644
Securities Commission's Role	650
Malaysia's Experience on Securities Commission	651

Experience in Other Jurisdictions	653
International Standard-Setting Organisations	664
Other Infrastructure Institutions	668
Deposit Insurance	671
Issues, Opportunities and Challenges	673
Opportunities	673
Challenges	674
Summary	677
Key Terms and Concepts	678
Further Readings	678
Review Questions and Problems	679

Chapter 16

Corporate and Shari'ah Governance in Islamic Financial Institutions 681

Preview	681
Corporate Governance	682
Conceptual Definition of Corporate Governance from the Islamic Perspective	682
Role of Corporate Governance in Islamic Financial Institutions (IFIs)	684
The Development of Corporate Governance in IFIs	685
Foundational Dimension of Corporate Governance	685
Corporate Governance Framework in IFIs	690
Corporate Social Responsibility in IFIs	694
Corporate Governance Issues	697
Shari'ah Governance	701
Conceptual Framework of Shari'ah Governance System	701
Functions of a Shari'ah Governance System	704
Institutionalisation of Shari'ah Board	705
Role of a Shari'ah Board	707
International Standard-Setting Agencies	709
Shari'ah Governance Process	714
Shari'ah Governance Issues	720
Independence of Shari'ah Board	720
Competency and Conflict of Interest	721
Disclosure, Transparency and Consistency	723
Legal Status of the Shari'ah Pronouncement	724
Summary	728
Key Terms and Concepts	728
Further Readings	729
Review Questions and Problems	733

Chapter 17 **Legal Framework for Islamic Finance** 735

Preview **735**

Conceptual Meaning of Legal Framework **736**

Legal Systems in which Islamic Finance Operates **737**

Civil Law Systems **738**

Common Law Systems **738**

Shari'ah (Islamic Law) Systems **740**

The Spread of Different Legal Systems **741**

"Legal Framework" for Islamic Finance **743**

Existing Islamic Finance Legal Frameworks Across the Globe **746**

Approaches Towards the Legal Framework for Islamic Finance **747**

Rationale and Justification for Different Approaches **748**

Ensuring a Coherent Interaction between Different Sets of Laws **749**

Legal Issues and Challenges in Islamic Finance **751**

The Enforceability of Contract **751**

Support of the Legislative, Executive and Judiciary **753**

Status and Enforceability of *Shari'ah* Pronouncements **756**

Governing Laws and Jurisdiction of Choice **760**

Laws Supporting Reciprocal Enforcement of Judgement **761**

Common Clauses in Financial Contracts **767**

Indemnities **767**

Warranties **767**

Rental Period and Term **768**

Rent Calculation **768**

Compensation and Liquidated Damages **768**

Set-off and Netting **769**

Events of Default **769**

Insurance and Maintenance **769**

Total Loss **770**

Summary **773**

Key Terms and Concepts **773**

Further Readings **774**

Review Questions and Problems **775**

Chapter 18

Accounting, Auditing and Taxation of Islamic Financial Institutions 777

Preview **777**

Part A : Accounting **778**

Introduction **778**

Islamic Accounting **778**

Accounting Standard-Setters **780**

Objectives and Concepts of Financial Reporting	781
Accounting Recognition	786
Accounting Measurement	786
Accounting Disclosure and Presentation	788
Accounting Treatment of Islamic Financial Transactions	789
Part B : Auditing in IFIs	809
Financial Statements and Audit	809
Part C : Taxation in IFIs	815
Tax and Islamic Finance	815
Tax Issues in Islamic Finance	816
Issues, Opportunities and Challenges	827
Summary	829
Key Terms and Concepts	829
Further Readings	830
Review Questions and Problems	832

Part 6 Moving Forward — Opportunities, Issues and Challenges

Chapter 19

Challenges and Opportunities 835

Preview 835

Islamic Finance in Light of the 2007-2009 Global Financial Crisis 836

Challenges Facing Islamic Finance 837

 Islamic Finance : Between Ideals and Reality 838

Shari'ah Governance 842

 Standardisation 843

Developing a Comprehensive and Robust Islamic Financial System 844

 Debt vs Equity 845

A Way Forward 854

 Need For a New Approach 855

 Going Beyond *Shari'ah*-Compliance 855

Summary 857

Key Terms and Concepts 858

Further Readings 858

Review Questions and Problems 860

Biographies of Contributors 861

Glossary of Terms 871

References 879

Index 905

Takaful

shattering, leaving these unfort
commonly asked question is: ho

Preview

This chapter exposes students to the principles and practical framework of *takaful* as one of the important components of the Islamic financial market. As one of the risk mitigation tools, *takaful* complements its counterparts, namely the Islamic banking market, Islamic capital market and Islamic money market. Indeed, mitigation and prudent management of risks are integral parts of Islam in order to achieve justice in the system which is in line with the objectives of *Shari'ah* (*maqasid al-shari'ah*).

To date, the *takaful* market is considered as one of the fastest growing services industries, although it needs to work on further improvements in areas such as accounting, regulation, jurisprudence and operation. Nevertheless, due to its growing demand, the *takaful* industry seems to have a bright future awaiting it. This chapter covers the basic conceptual framework of *takaful*, its evolution, models and regulatory framework affecting its proper functioning.



The conventional insurance contract is basically constructed between the insured and the insurance company. *Takaful* differs from conventional insurance in the sense that the *takaful* operator is not the insurer insuring the participants. *Takaful* participants mutually insure one another while the *takaful* operator simply functions as the administrator and manager of the *takaful* fund.

Learning Outcomes

At the end of the course, you should be able to:

- Discuss the general *Shari'ah* principles which govern the operationalisation of *takaful* and *re-takaful*.
- Discuss the underlying theories and the conceptual framework related to the *takaful* and *re-takaful* system.
- Explain the operational mechanisms of contemporary *takaful* and *re-takaful* products.
- Analyse issues arising from *takaful* and *re-takaful* operations including *takaful* fund management, legal aspects and regulatory perspectives.