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## I. Introduction

The Islamic financial system generally refers to financial market transactions, operations and services that comply with Islamic rules, principles and code of practices. These principles and rules entail some types of activities, risks or rewards to be either prohibited or promoted. Islamic laws and rules are also known as Sharia' that includes faith, economic, social, political and cultural facets.

Islamic finance started in the 7th century, when the Quran prohibited interest (riba) and encouraged profit-and-loss sharing agreements. Modern Islamic finance started in early 1960s in Egypt with the establishment of the Mit-Ghamr Islamic Saving Associations (MGISA) in addition to the Malaysian Hajj Fund via Pilgrims Fund Corporation. This Hajj fund enabled Malaysian Muslims to save gradually and invest in Sharia compliant instruments for the purpose of funding their Hajj expenses. In the 1970s and 1980s, modern Islamic financed developed and many Islamic banks started rising in Muslim countries and especially GCC countries.

In Lebanon, the law # 575 issued in 2004, allowed the establishment of Islamic banks in Lebanon that shall be governed and regulated by all legal and regulatory provisions in force in Lebanon, particularly those related directly or indirectly to banks, including the Code of Land Trade, the Code of Money and Credit, and the Banking Secrecy Law. Usually, in Islamic banks, there is a Sharia Committee that supervises the bank's operations and products and gives its legal opinion (fatwa).

## II. Basic Principles of Islamic Finance

As per Sharia, it is forbidden to make money from money, and wealth can only be generated from legitimate trade and investment in assets, i.e. in order to be Sharia compliant, money must be used in a productive way. Moreover, it prohibits some elements of commercial transactions such as interest (riba), gharar (uncertainty of price and quality of good), maisir (gambling), non-halal products (alcohol, pork, etc.) in addition to immoral activities.

Three main principles regulate Islamic Finance:

1. <u>Principle of Ownership</u>

   The core components of this principle are:

   - The seller must own the asset they are selling.
   - The right to profit from an asset comes with the responsibility of taking the risk of ownership.
   - Transactions are linked to real economy instead of speculative markets, since they are based on actual assets owned.

2. <u>Principle of Equity</u>

   This principle is mainly based on three bases:

   - Protecting the weaker party in financial transaction mainly through prohibiting interest or “riba” which means “high interest” in Arabic. It refers to growing wealth without engaging in a productive activity.
   - Prevention of extreme uncertainty or “gharar”. In a transaction, both parties have to disclose all needed information before involving in a contract so as to reduce information asymmetry.
   - Wealth distribution through payment of 2.5% of wealth (zakat) by people who meet a specific minimum levels of income and capital to aid the less prosperous and promote social unity.

3. <u>Principle of Participation</u>

   As per a key Sharia’ ruling, reward or profit derives from risk taking. In more details, profits or returns should be earned from risk-taking transactions and not with the passage of time. As such, investment returns should be based on performance and productivity of the project, thus linking financial activities and real activities.

It is interesting to note that, Islamic banks were not directly affected by the 2008 financial crisis, since its regulations prohibit them from engaging in extremely risky subprime assets. Additionally, the principle of risk sharing restricts engaging in highly leveraged assets and short selling.

## III. Islamic Finance Products:

Modern Islamic financial products are formed by either modifying and removing any prohibited elements that do not comply with Sharia' principles in existing conventional products, or originating new products and services that employ the application of several Sharia' principles.

We will briefly discuss some of the Islamic finance products that are widely used.

❖ <u>Murabaha</u>

It was one of the most used Islamic financial products and represents about 80% of Islamic transactions and mainly in trade and asset financing. It refers to a contract of exchange transaction between the financial institution and the client. In details, the financial institution purchases the goods as per client's request and the latter makes deferred payments to cover the cost of the good in addition to the pre-agreed upon profit margin. In this case, the transaction does not violate the principle of ownership. In such transaction, the seller is responsible for the delivery of any defective good.

❖ <u>Commodity Murabaha "Tawarrok"</u>

This is a kind of Murabaha that is used in interbank financing and liquidity management in addition to international trade in cases where Murabaha is not applicable. This is a multi-step transaction and occurs as follows:

Step 1: The client requests from the Islamic Bank (IB) to buy him commodities (usually metal and specifically Palladium as its price is not volatile).

Step 2: The Islamic bank, through a broker X, buys the commodities at a spot price P and sells them to the client at a price P + Margin (being a pre-determined profit between the IB and the client).

Step 3: The client then requests from the Islamic Bank to sell his commodities.

Step4: The IB simultaneously agrees with broker Y to sell him their commodities at the same price P.

Step 5: The Islamic bank put the proceeds of the sales of the commodity in the client's account.

Step 6: The client repays the Islamic bank the amount P + Margin as per agreed terms.

It is to be noted that the commodities transactions are done simultaneously (buying and selling of commodities) to protect both parties (IB and client) from price variation. In addition, both parties do not physically receive or deliver the commodities.

Moreover, a revolving Murabaha transaction could also be done. Here, the agreement between the buyer and the seller to enter into consecutive Murabaha contracts of the same amount and each for the same period of time. This product is used by BLOM Development Bank to finance its clients' purchase of assets (cars, houses, etc.) on a medium and long term basis.

- <u>Sukuk</u>

This financing product is similar to bond in a conventional bank but is asset backed. It represents a proportionate ownership in an asset, where the Sukuk holder (Investor) will only be exposed to the credit risk of the Islamic bank. For a determent period of time, the Sukuk holder will get a regular stream of income (cash flows from the asset) with a final bullet payment at the maturity.

It is to be noted that there are different types of Sukuk, but this is not in the scope of this spotlight.

- <u>Mudaraba</u>

Mudaraba is similar to the idea of Special Purpose Vehicle (SPV) in conventional banking. In such transaction, two parties are involved. The financer (Rab Al Mal) provides the funding and the other party (mudarib) provides the management expertise and effort for the purpose of generating profits. As for the management, the financer cannot participate in management. Profits are shared as per initial agreement. In case of loss, the financer will bear the loss unless the loss resulted from mudarib's imprudence, misbehavior, or breach of contract terms.

❖ <u>Musharaka</u>

It is a partnership for a limited interval between two or more parties. The partners provide capital to finance an asset or a project and profits are distributed as initial agreement while losses are split in proportion to investment contribution.

This type of Islamic financing is considered the purest as it complies with the principles of risk sharing and engaging in productive activities.

❖ <u>Ijara</u>

Ijara is the Arabic term of leasing. It is simply a lease contract where the leaser (who should own the asset) leases the asset to the lessee. In this transaction, the leaser is responsible for the maintenance of the asset unless the damage resulted from the misuse of the lessee. At the end of the period, the asset is returned to the leaser unless there is an agreement to sell the residual asset to the lessee at the pre-determined price.

❖ <u>Salam:</u>

It is a form of forward contract where there is an agreement to deliver the goods at a future date in exchange for a pre-determined price paid at the spot. This kind of financing is appropriate in agriculture.

It is very important that the price paid initially; otherwise, it will be against Sharia' since it will be a debt-against-debt sale.

❖ <u>Istisnaa':</u>

This type of financing is applicable for manufacturing companies. In this type of financing, the price of the good is fixed and the good specifications are agreed upon between both parties. The Istisnaa transaction can be cancelled before the manufacturer starts manufacturing. After that, the contract cannot be cancelled unilaterally.

❖ <u>Qard Al Hassan:</u>

This type of financing, as its name reveals, is done for a humanitarian purpose without interest. It can be used to finance individuals in need and also for financing social and economic development projects. In this case, the Islamic bank can charge the client some fees to cover administrative cost.

❖ Takaful Insurance:

This Islamic product is similar to the idea of conventional insurance. However, there are few main differences. First, in Takaful insurance, it is based on cooperation, solidarity, and shared risk; as for conventional insurance, the risk is transferred from the insured to the insurer. Second, fund belongs to the participants while in conventional insurance, fund is owned by the insurance company. Lastly, surplus is distributed to the participants and not retained by the insurance company.

## IV. Islamic Banks in Lebanon and Worldwide

In Lebanon, before the economic and financial crisis that blew in October 2019, there were five Islamic banks: BLOM Development Bank, Lebanese Islamic Bank, Arab Finance House (AFH), Al Baraka Bank, and Al Bilad Islamic Bank. However, after the crisis, most of these banks are not fully active today except for BLOM Development Bank. Total assets and equity of BLOM Development Bank as of 31/12/2024 recorded USD 152 million and USD 20.7 million respectively.

Islamic banks in Lebanon are facing several challenges that are hindering its growth. First, the financial and economic crisis that affected all banks, conventional and Islamic. As such, public trust in the whole banking system is lost since depositors are not able to reach their deposits. Second, the low Islamic finance literacy in Lebanon and physical distance to branches that affect the Islamic banks' potential customer base. Third, there is a fierce competition with conventional banks that dominated the banking sector for decades compared to Islamic banking that started in Lebanon in 2004. Lastly, liquidity management is challenging due to the absence of Sharia' compliant high quality liquidity assets as the Islamic securities market in Lebanon is narrow.

*Top 10 Islamic Banks by Total Assets*

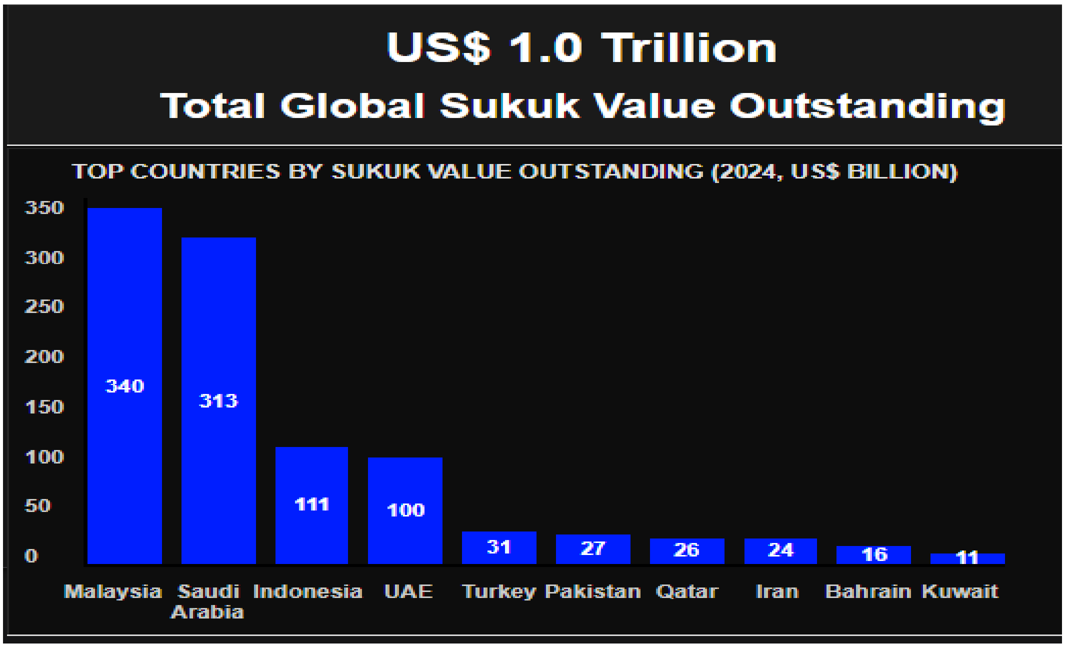
As for Islamic banks worldwide, below are the top 10 banks in 2024 as per total assets.

| Name of the Institution | Country | Total Assets (USD Million) |
|---|---|---|
| Bank Mellat | Iran | 407,640 |
| Bank Saderat Iran | Iran | 277,977 |
| Al Rajhi Bank | Kingdom of Saudi Arabia | 259,352 |
| Bank Tejarat | Iran | 257,507 |
| Pasargad Bank | Iran | 221,447 |
| Saudi National Bank | Kingdom of Saudi Arabia | 194,402 |
| Bank Keshavarzi | Iran | 143,694 |
| Parsian Bank | Iran | 122,853 |
| Kuwait Finance House | Kuwait | 119,163 |
| Dubai Islamic Bank | United Arab Emirates | 93,854 |

*Source: LSEG*

The above top 10 Islamic banks' total assets ($2.1 trillion) represents around 49% of Islamic Banks' total assets ($4.3 trillion).

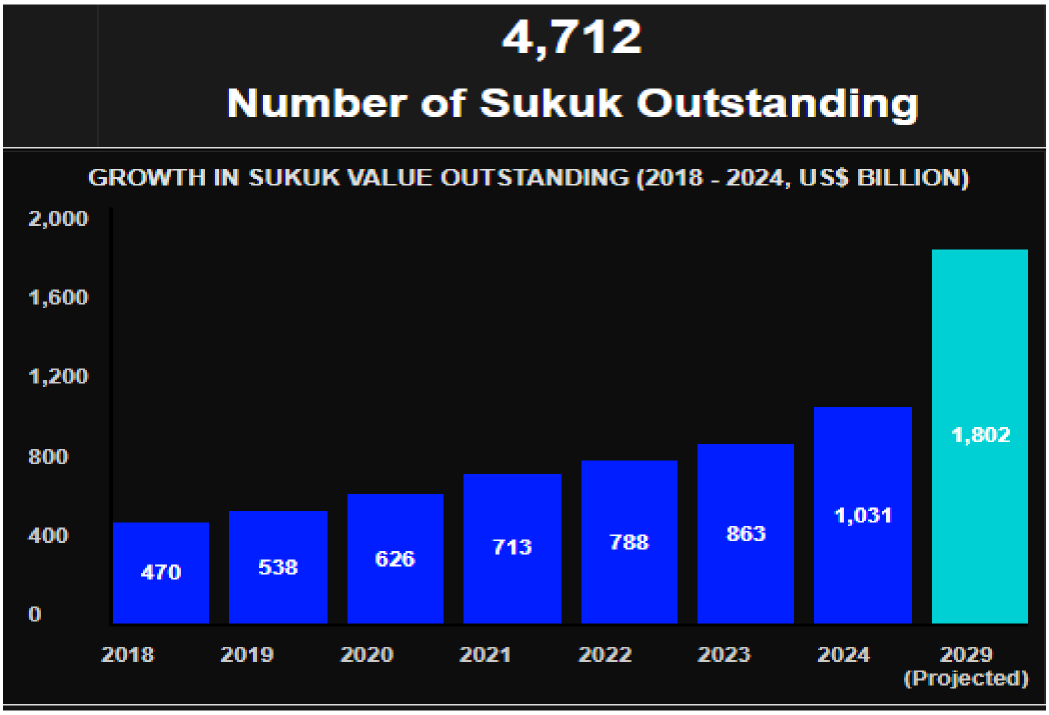
*Top 10 Countries by Outstanding Value of Issued Sukuk*




*Source: LSEG*

Around two-third of total global Sukuk outstanding are issued in Malaysia and Saudi Arabia alone.

*Growth in Sukuk Value Outstanding (2018 – 2024)*




*Source: LSEG*

From the graph above, we find that the outstanding value of Sukuk is increasing annually since 2018 by at least 10% annually.

It is interesting to note that Islamic finance is developing in several non-Islamic countries such as United Kingdom, Luxemburg, and South Africa to name a few.

Islamic finance development in United Kingdom (UK) is an interesting case. UK plays a significant role in Islamic Finance. The key listing site of dollar-denominated Sukuk issuances is the London Stock Exchange (LSE), especially green and sustainable ones. Additionally, London Metal Exchange plays a vital role in Commodity Murabaha liquidity management through purchases and sales of Palladium and other metals. In addition, UK's government is working on Sharia' compliant student loans, and if implemented, it will be one of the first countries to offer such a service.

South Africa is another interesting case. Despite the fact that the majority of South African population are non-Muslims (Muslim population is less than 5%), it was the first Sub-Saharan African Country to position itself as a possible hub for Islamic banking in the region.

## V. Global Islamic Finance Development Indicator[1]:

Global Islamic Finance Development Indicator (IFDI) is a composite weighted index that measures the overall development of Islamic finance industry across variety of sub sectors. It also allows comparison in advancement between countries and regions. The components of IFDI are Financial Performance, Governance, Sustainability, Knowledge, and Awareness and each includes sub-components. Governance recorded the highest average score globally, mainly due to the presence of strict regulatory frameworks.

1. Financial Performance Indicator:

   *Sub Indicator 1: Islamic Financial Institutions*

   Underlying Metrics: Assets, Number of full-fledged institutions and windows, Number of Listed Institutions

   *Sub Indicator 2: Sukuk*

   Underlying Metrics: Number of Sukuk Issued and Outstanding, Value of Sukuk Issued and Outstanding, and Number of Listed Sukuk

   *Sub Indicator 3: Islamic Funds*

   Underlying Metrics: Number of Islamic Funds, Net Asset Value of Islamic Funds, Number of Islamic Funds Launched, and Number of Islamic Asset Managers

   Top five performing countries in financial performance indicator were Malaysia (144), Saudi Arabia (136), Iran (119), United Arabs Emirates (88), and Indonesia (59).

[1] LSEG and ICD (2025) “ICD – LSEG Islamic Finance Development Report 2025: 50 Years of Exponential Growth”, LSEG.

2. Governance Indicator:

*Sub-Indicator 1: Regulations*

Underlying Metrics: Islamic Banking, Accounting & Auditing, Sharia' Governance, Takaful & Retakaful, Sukuk, Islamic Funds, and Fintech Sandbox

*Sub-Indicator 2: Other Governance*

Underlying Metrics: Centralized Sharia' Committee, Number of Scholars with Sharia' Supervisory Board (SSB) membership, Number of Scholars with more than five SSB memberships, Number of IFIs with three SSB memberships or more, and Disclosure Index Score

The top five performing countries in governance indicator were Malaysia (98), United Arab Emirates (85), Bahrain (84), Bangladesh (80), and Kuwait (79).

3. Sustainability Indicator:

Underlying Metrics: Disclosed Funds Distributed to Charity, Zakat and Qard Al Hassan, Number of ESG Sukuk Outstanding, Value of ESG Sukuk Outstanding, Number of ESG Islamic Funds Outstanding, Value of ESG Islamic Funds Outstanding, Sustainability Guidelines, and Sustainability Reporting Index

The top five performing countries for the sustainability indicator were Malaysia (155), Saudi Arabia (111), United Arab Emirates (56), Jordan (41), and Indonesia (32).

4. Knowledge Indicator:

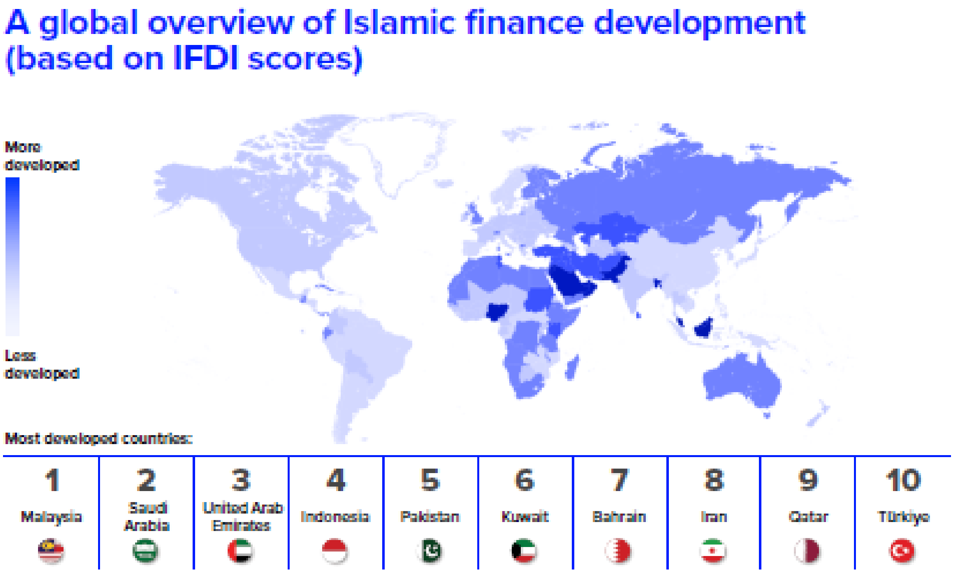
Underlying Metrics: Number of Institutions Offering Training Courses in Islamic Finance, Number of Institutions Offering Degrees in Islamic Finance, Number of Published Research Papers on Islamic Finance, and Number of Islamic Finance Journals

The top five performing countries for the knowledge indicator were Indonesia (200), Malaysia (101), Pakistan (88), United Arab Emirates (50), Saudi Arabia (48).

5. Awareness Indicator:

Underlying Metrics: Number of In-Person Events, Number of Online Events, Number of Islamic Finance News

The top five performing countries for the awareness indicator were Malaysia, Pakistan, United Arab Emirates, Saudi Arabia (200), Kuwait (195), Bahrain (173), Qatar (69), and Indonesia (49).




Source: LSEG

## Top IFDI countries and global average score for 2025

| Ranking | Country | IFDI Score | Financial performance | Governance | Sustainability | Knowledge | Awareness |
|---|---|---|---|---|---|---|---|
| 1 | Malaysia | 135 | 144 | 98 | 155 | 101 | 200 |
| 2 | Saudi Arabia | 114 | 136 | 73 | 111 | 48 | 200 |
| 3 | United Arab Emirates | 92 | 88 | 85 | 56 | 50 | 200 |
| 4 | Indonesia | 75 | 59 | 76 | 32 | 200 | 49 |
| 5 | Pakistan | 72 | 40 | 78 | 24 | 88 | 200 |
| 6 | Kuwait | 67 | 47 | 79 | 29 | 17 | 195 |
| 7 | Bahrain | 66 | 47 | 84 | 30 | 22 | 173 |
| 8 | Iran | 64 | 119 | 55 | - | 21 | 6 |
| 9 | Qatar | 40 | 31 | 64 | 27 | 8 | 69 |
| 10 | Türkiye | 39 | 33 | 65 | 26 | 41 | 15 |
| 11 | Bangladesh | 38 | 31 | 80 | 17 | 13 | 19 |
| 12 | Oman | 34 | 17 | 75 | 23 | 15 | 37 |
| 13 | Brunei Darussalam | 31 | 9 | 72 | 14 | 22 | 44 |
| 14 | Iraq | 30 | 31 | 59 | 1 | 4 | 20 |
| 15 | Jordan | 29 | 16 | 51 | 41 | 28 | 14 |
| **Global average** | | **11** | **8** | **20** | **8** | **6** | **11** |

*The scores are rounded up, except for 200, which is the maximum attainable score

Source: LSEG

## VI. Financial Performance:

Islamic finance assets witnessed a huge growth in the last 7 years as total Islamic finance assets increased from around $2.5 trillion up to around $6 trillion. The figure is forecasted to reach around $9.7 trillion in 2029.

## VII. Islamic Finance Accounting Standards & Regulations:

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established in Bahrain in 1991. AAOIFI is the leading international non-profit organization primarily responsible for development and issuance of standards for the global Islamic finance industry. It has issued a total of 100 standards in the areas of Sharia', accounting, auditing, ethics and governance for international Islamic finance. It is supported by a number of institutional members, including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries. Its standards are currently followed by all the leading Islamic financial institutions across the world and have introduced a progressive degree of harmonization of international Islamic finance practices.

Later on, in 2002, the Islamic Financial Services Board (IFSB) was established in Malaysia for issuing supervisory and regulatory standards and guidelines. In 2010, the International Islamic Liquidity Management Corporation (IILM) was established in Malaysia for issuing short-term Sharia' compliant financial instruments to ease cross-border Islamic liquidity management.

## VIII. Conclusion:

As such, awareness of Islamic finance worldwide is growing substantially as total assets increased from $2.5 trillion in 2018 to $6 trillion in 2024 and is expected to reach around $10 trillion in 2029. Islamic banking assets represents the majority of Islamic finance assets recording $4.3 trillion (72%), followed by Sukuk of $1 trillion (17%), Islamic fund of $308 billion in addition to other assets. As for Takaful insurance, it is still uncommon as it represents only 2% of total Islamic finance assets ($136 billion).

Despite the global growth in Islamic finance, the prospect of Islamic finance in Lebanon is still stagnant. Several challenges are facing this sector that should be solved in order to develop the Islamic finance sector. First, regaining public trust that might take ample time after the current banking system difficulties. Second, there is a lack of awareness about Islamic finance by the public. Third, there are some regulatory gaps, as the regulations that are currently regulating Islamic banks are primarily designed for conventional banks.

In order to develop Islamic finance sector, several steps could be taken. First, seminars and presentations should be done to increase the awareness in Islamic finance. Second, there should be some expansion in offered Islamic finance products and instruments besides Murabaha, such as Sukuk, Takaful insurance and Islamic funds. Regulatory authorities could help in such expansion through putting rules that support these Islamic finance instruments and products and ensure stability.

For your Queries:

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