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Quarterly Peer-Reviewed, Concerned with Publishing Law & Sharia'a Studies & Research

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Rules for Publication in the KILAW's Journal and its Supplements

Kuwait International Law School's journal is a quarterly academic, legal and reviewed journal, and an academic platform that seeks quality, seriousness and excellence. It accepts research papers in all relevant legal issues of interest to the Journal in Arabic, French and English, in any of the following areas:

1- Research and studies
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I- General Policies for Publication:

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3- The journal is keen to ensure the quality of the research that it accepts for publication, through the application of publishing rules, referral, editorial review, and proofreading before publishing.

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5- The journal encourages comparative legal studies.

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7- All submitted research papers are subject to referral by specialists in the area, and holders of an academic degree that is higher than that of the researcher or equivalent to it (if the researcher is Full Professor).

II- Publication Rules:

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1- Research or study should be unpublished or submitted for publication in another journal.

2- Research or study must not be part of PhD or masters theses, or from published books, unless it has a new value or addition, which shall be approved by the Editorial Board in advance.

3- The subject of the research should be current, original and innovative.

4- The focus in the research should be on the topic without theoretical introductions or unnecessary additions or expansions. The researcher should refer to the references that has already dealt with it when necessary.

5- The researcher should use the critical method in his study and discuss in depth the subject of the research and the problems he raises.

6- The Conclusion of the research should include a statement of the results of the research, and the recommendations to issues or problems in question, and the proposals for future studies.

7- The research or study references should be modern and varied, local and international, Arab and foreign whenever possible, and fully documented.

8- The number of words of the research or study should not exceed fifteen thousand (15000) words, and not exceed the number of (30) pages, A4 size. (Font type: Times new Roman , size 14 - the distance between lines per page: 1.15 - margins: the same font type - size 10 - the distance between lines: 1.0), including abstracts (Arabic, English and references).

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4- Publishing priority is according to:

5- Researches from the Faculty members in Kilaw.

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7- Receipt date of the research by the Chief Editor, and precedence of research amendments.
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The journal publishes commentary on court provisions, believes in the importance of the views of jurisprudence in analyzing the ruling, mainstreaming, and criticizing it in fact of, linking theory and knowledge, and practical application, with no prejudice to the board and judges who ruled the verdict.

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- The reviewer should present adequate summary of contents, with an indication of the most important aspects of excellence and incompetence, no more than (5) pages.
- Journal gives financial reward to present books that mandated by the journal only.

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KILAW
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KUWAIT INTERNATIONAL LAW SCHOOL

IMPORTANT ANNOUNCEMENT

New Publication Rules for the Kilaw Journal

> "To enhance the journal's role in disseminating and encouraging legal research in Kuwait, the Gulf, the Arab world, and internationally, and as part of the ongoing effort to develop Academic legal research methods to increase its added value and as a contribution to serving the academic and professional legal sectors in particular, and the community in general, and in line with the new research policies of the Kuwait International Law School (the publisher), the journal's editorial board has approved the addition of the following new provisions to its publication rules:"

- The Journal invites researchers to focus their research submitted for publication on studying practical and applied legal issues and problems that directly or indirectly concern the administrative, economic, social, and other related sectors, including the study of specific cases.
- The Journal encourages the adoption of scientific approaches that help in studying this type of issue, including the analytical approach, the critical approach, and the comparative approach. It also encourages authors to choose mechanisms and methods that contribute to the clarity and accuracy of analysis, discussion, and interpretation, including databases, statistics, indicators, and others.
- The Journal invites researchers to submit innovative, grounded, and practical recommendations based on comparative systems. This includes proposals for laws, regulations, guidelines, and other relevant information.
- The Journal gives priority to publication of research of an applied and practical nature, whether from within or outside KILAW.
- Applied and practical research shall be included in the list of research nominated for the annual "Kilaw Journal Award" for the best applied and practical research.

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Artificial Intelligence and Digital Tools Serve the War of Genocide in Gaza

Prof Dr Badria Abdullah Al Awadi(*)

Editor-in-Chief

Without regard for international humanitarian law, any international agreements, norms, or humanitarian or moral values, the Zionist entity continues its war of destruction and genocide against the defenseless Palestinian people in the Gaza Strip. The brutal and barbaric methods used by the occupation army in its war against civilians are becoming more and more apparent day after day, using for this purpose the latest prohibited weapons, including massive bombs and high-explosive missiles, as well as the latest artificial intelligence technologies, programmes and other digital tools.

Recent reports by international human rights organizations, including a report by Human Rights Watch, have confirmed that the Israeli occupation army's use of surveillance technologies, artificial intelligence, and other digital tools to help identify targets for its attacks in Gaza increases the risk of widespread and extensive harm to civilians. This was actually confirmed by reports from international humanitarian organizations, which indicated that fifteen (15) out of every sixteen (16) martyrs in Gaza were civilians.

Human Rights Watch also confirmed that the Israeli occupation army's use of digital tools raises serious ethical, legal, and humanitarian concerns. In a detailed explanation, it clarified that "the occupation army uses four digital tools in its hostilities in Gaza to estimate the number of civilians in an area before an attack, notify soldiers of the timing of an attack, determine whether a person is a civilian or a combatant, and whether a building is civilian or military. " Human Rights Watch found that "these digital tools are supposedly based on erroneous data and inaccurate approximations in order to provide military operations with information in ways that may conflict with Israel's obligations under the international humanitarian law, particularly the rules of discrimination and precaution."

The organization asserted that the occupation army uses incomplete data, flawed calculations, and inappropriate tools to assist in making life-or-death decisions in Gaza which could increase the harm to civilians. It stressed that the problems inherent in the design and use of these tools mean that, rather than reducing the harm to civilians, their use could lead to the unlawful genocide and injury of civilians. According to the documented report, these tools include continuous

(*) Emeritus Professor and Former chair of Public International Law Department, Kuwait International Law school, and former Dean of Law College, Kuwait University.

and systematic surveillance of the Palestinian population in Gaza, including data collected prior to the current war in a manner inconsistent with international human rights law. These tools use civilians' personal data to provide information based on threat forecasting, targeting, and machine learning."

Among the technical and digital tools cited in the report is a tool that relies on cell phone tracking to monitor the evacuation of Palestinians from parts of northern Gaza whose entire population has been ordered to leave by the Israeli military; and a tool known as "The Gospel" that compiles lists of buildings or other structural targets to be attacked; a tool known as "Lavender" profiles people in Gaza for their suspected affiliation with Palestinian resistance groups in order to designate them as military targets; and a tool known as "Where's Daddy?" purports to identify when a target is in a specific location—often their family's supposed residence, according to reports—in order to attack them there.

The use of artificial intelligence programmes and various technical and digital tools for the purpose of harming, torturing, genocide, displacing and exterminating civilians is part of the ongoing crime of genocide. It is a war crime and a crime against humanity, and falls under the scope of various international laws, including public international law that regulates relations between individuals in the international community. (This includes occupied countries and occupied peoples), international humanitarian law, which regulates humanitarian obligations during wars, the four Geneva Conventions aimed at protecting victims of armed conflict, as well as agreements and ethics for the use of these modern digital technologies.

While the occupying state possesses companies that manufacture and develop such technologies, many of them are obtained from international companies, opening the door to legal accountability for these companies on grounds of complicity in the crime of genocide.

Finally, while it is certain that the occupying Israeli state is a rogue state, supported by the great powers, only the will of humanity, human rights, and international law can curb, expose, and confront these practices. This is a responsibility that falls on all living, aware, and proactive parties.

English Abstracts of Arabic Research

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Interpretive Declarations and Their Impact on the Validity of International Treaties(*)

Dr Khaled Al Yaqout
Assistant Professor of Public International Law
Kuwait International Law School

Abstract

This study revolves around the method of interpretative declaration as one of the forms of objection by states and international organizations that are parties to a treaty to one or more of the texts of the treaty, and explains the effect of that upon its issuance, with that objection being limited to the interpretation of the texts of the treaty from the point of view of the state or international organization issuing the declaration as the research deals with the specific entity of the interpretative declaration in terms of its definition and distinction from what is similar to it, especially the reservation, as it is the closest form of the interpretative declaration with regard to the parties' objection to international treaties. This is done by clarifying the nature of the interpretative declaration, the nature of the reservation, and other similarities, with the aim of identifying the points of difference.

The researcher worked to clarify the extent of the permissibility of the interpretative declaration and the reactions to it, while stating the extent to which the interpretative declaration must be issued in a specific form, with clarification of the time of issuance of the declaration and the reactions to it, in addition to clarifying the legal effect resulting from the interpretative declaration, and the reactions to that declaration, whether they were approval, objection, or re-description.

It also sought to clarify the practical problems related to the interpretative declaration, starting with its purpose, up to its legal effect, and the procedures related to it, with each of them being attached to possible practical solutions regarding each hypothesis, so that the study achieves its desired goal regarding the legal regulation of interpretative declarations.

We noted in the text of the research and its appendix recommendations on the legal organization of the interpretative declaration in the Vienna Convention,

(*) Date of research submission for publication: 8 April 2024
& date of acceptance: 15 August 2024.

whether in the form and issuance of the declaration and all its procedures, or the reactions to it. At the forefront of those recommendations was the necessity of issuing the interpretative declaration in writing, with the necessity of obligatory notification of it so that the purpose of the declaration is achieved, otherwise, the interpretative declaration would be considered a covert objection to the texts of international treaties and would be worthless.

Keywords: international agreement, international treaty, states parties, validity of interpretative declaration, effects of agreements, validity of treaties.

Keywords: international agreement, international treaty, states parties, validity of interpretative declaration, effects of treaties, and validity of treaties.

Toward the Adoption of Closed Electoral Lists in Kuwaiti Parliamentary Elections: Challenges and Solutions(*)

Dr Fatma Khaled Almohsen & Dr Khaled Awad Alharbi

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College of Law, Kuwait University

Abstract

Since 1962, voters in Kuwait's parliamentary elections have voted directly for individual candidates. However, in an attempt to reform the electoral system, some members of parliament have proposed a law that would entail voting for a closed list of candidates, raising the question of whether such a practice would be compatible with Kuwait's Constitution. This paper seeks to shed light on any constitutional challenges that the proposed law might face were it approved by Parliament. The paper also intends to examine other related laws, such as electoral law and constitutional court law, to determine the amount of legislative amendment those laws would need in case of any transition to voting for a closed list of candidates rather than for individual candidates.

Keywords: Electoral lists, political parties, constituencies, and election law.

(*) Date of research submission for publication: 22 May 2024
& date of acceptance: 15 August 2024

The Issue of Contradiction between a Latter General Text and a Prior Restricted One:
An Analytical Study, with Reference to Applications in Fiqh and Kuwaiti Legislation(*)

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College of Sharia and Islamic Studies, Kuwait University

Abstract

The issue of contradiction between a latter general text and a prior restricted text is one of the issues of disagreement between Ḥanafīs and the rest of the Madhhabs in principles of Fiqh. This study aims to explore to what extent the Ḥanafīs opinion in this issue is adopted by scholars out of the Ḥanafī Madhhab. It also aims to gather as much arguments supporting the different opinions in this issue, and as much applications of this issue in both Fiqh and Law, as the researcher can find.

The novelty of the study is in reviewing the issue chronologically. Furthermore, in referring to books in disciplines other than Principles of Jurisprudence, such as Quran interpretation, Fiqh, and Law. The study found that during the early four centuries of the Islamic Calander Ḥanafīs opinion in this issue has been renowned even outside of Ḥanafī Madhhab, due to its impressive arguments.

Keywords: general text, restricted text, restriction, and abrogation.

(*) Date of research submission for publication: 14 November 2023
& date of acceptance: 22 May 2024

The Problems which Arise Through Publication in The Official Gazette: An Analytical and Foundational Study(*)

Dr Abdulkarim R. Al Enezi
Associate Professor of Civil Law

Dr Turki S. Al Mutairi
Associate Professor of Public Law

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Abstract

This research sheds light on an issue that has not received sufficient attention in scholarly research in the State of Kuwait, namely, the entry into force of legislation through publication in the Official Gazette. Although Article (178) of the constitution clearly regulates the publication of legislation in the Official Gazette by determining their commencement date, in practice, this issue gives rise to numerous legal problems.

Typically, when legislation is drafted, a dedicated article is assigned to specify its commencement date. The wording of the publication article is almost standard; therefore, legal scholars have largely overlooked the matter of legislation entry into force, assuming it does not pose practical legal issues. However, a closer examination of the provision that determines the legislation's date of entry into force reveals otherwise. In practice, there are numerous legal problems associated with this issue. Hence, we believe it warrants further investigation in Kuwaiti Law.

The research is divided into a preliminary section and two main sections. In the preliminary section, background information on the Official Gazette is provided. The first section examines the concept of publication in the Official Gazette, its nature, and legal effects. In the subsequent second section, a review of the legal problems created by the publication of legislations in the Official Gazette is presented. The research concludes with several important findings and proposes recommendations to address the practical problems discussed throughout the research.

Keywords: enforcement of laws, publication of laws, official gazette, executive regulations, and inadmissibility of ignorance of the law as an excuse.

(*) Date of research submission for publication: 27 November 2023
& date of acceptance: 12 February 2024.

Electronic Arbitration as an Effective Means of Settling Disputes According to the Saudi System: A Comparative Study(*)

Dr Osman Mourad Khalak
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Institute of Public Administration, Riyadh, KSA

Abstract

With the use of the Internet network and the development of its technical means later, the volume of e-commerce in the world has expanded, and the rate of conclusion of electronic contracts and disputes arising from them has increased. However, the nature of those disputes has become an obstacle to subjecting them to ordinary judiciary or traditional arbitration. Therefore, there was a need to establish an electronic arbitration system that is fully in line with the nature of electronic commercial contracts and is also characterized by the speedy resolution of disputes that may arise from them at the lowest possible cost because all procedures are conducted electronically and through the use of modern means of communication.

However, the e-arbitration system raises a major issue related to its effectiveness in resolving electronic disputes and its ability to find effective solutions to the issues that may arise from them. This prompted us to study all topics of e-arbitration, such as the e-arbitration agreement, its procedures, the authenticity of the sentence issued in the face of opponents, and how to implement it, by conducting a comparative study of the rules of permanent arbitration centers and institutions, international commercial conventions and some legal systems. The study has reached the most important findings that national legislations, regulations of arbitration centers, institutions and international conventions have explicitly recognized electronic documents and granted them the same authenticity as written documents if they meet the conditions stipulated by law.

However, we find that the national legal bases of these legislations have not yet been developed and amended to recognize electronic arbitration despite its growing importance for electronic transactions and its role in resolving disputes arising therefrom. The study also came up with the most important

(*) Date of research submission for publication: 6 May 2024
& date of acceptance: 15 August 2024.

recommendations, including expanding the activity of the Saudi Commercial Arbitration Centre to include e-arbitration for all disputes, regardless of their value. Also, government agencies, permanent arbitration centers and institutions should establish permanent platforms for e-arbitration, similar to what the Sudi commercial arbitration system did.

Keywords: Electronic Arbitration Agreement, Electronic Arbitration Tribunal, Electronic Arbitration Judgment, Electronic Signature, and electronic Arbitration procedures.

Legal Challenges Facing the Use of Artificial Intelligence in Business Management(*)

Prof Dr Alaa Yaqoub Yousef
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College of Law
University of Sharjah, UAE

Abstract

There is no doubt that the characteristics of artificial intelligence applications hold promising future possibilities. This paper addresses one of the areas in which artificial intelligence can have a distinct role, which is the field of commercial company management. This matter has become a reality, with some commercial companies starting to rely on artificial intelligence in their management in one way or another.

Since the matter raises important legal challenges because of the lack of legal rules regulating this developed form of company management, the problem of the research was represented by a major question: "How appropriate are the traditional rules of commercial companies law to regulate the intervention of artificial intelligence in company management?" The focus was on two main legal challenges: the first is: to what extent artificial intelligence is qualified to intervene in management of commercial company, and the second is: how to regulate the responsibility arises from artificial intelligence activities.

Accordingly, the research is divided into two sections. The study reached a major conclusion: the need for legislative intervention that enhances opportunities to benefit from technical development, recommending an amendment that expands the provisions scope of company management, and obligates companies to bear responsibility for using artificial intelligence.

Keywords: modern technologies, artificial intelligence, company management, company director, legal responsibility.

(*) Date of research submission for publication: 4 May 2024 & date of acceptance: 22 May 2024.

Copyright Protection and the Challenges of Artificial Intelligence: A Comparative Analytical Study(*)

Dr Mohammad Hassan Abdullah
Assistant Professor of Civil Law
College of Law, University of Fujairah, UAE

Abstract

The research addressed the problem of using artificial intelligence techniques in creating literary and artistic works. It presented the most important uses of artificial intelligence in creating literary and artistic works, comparing them to human authorship, and the extent of compatibility and difference. It also attempted to root innovations arising from artificial intelligence systems within the scope of the concepts and provisions of the copyright protection system.

The study also refuted calls to recognize AI technologies as legal entities and grant them authorship. It also presented insights into the nature of AI-generated works, their eligibility for legal protection, and their rights holders.

Keywords: AI classifiers, electronic personality, algorithmic innovation, human authorship, robotics.

(*) Date of research submission for publication: 6 November 2023
& date of acceptance: 12 February 2024..

Litigation Procedures in Light of the Labor Lawsuit Management System in Bahraini Law: A Critical Analytical Study between Theory and Practice(P1)(*)

Sayed Ebrahim Mohsin Alalawi
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College of Law, University of Bahrain

Abstract

According to an analytical approach that integrates theory and practice, the research discusses litigation procedures in labor disputes between the worker and the employer in light of the labor lawsuit management system which was introduced by the legislator in article 120 of the Labor Law in the Private Sector promulgated by Law No. 36 of 2012, and formed by a chairman and four members under article 12 of Resolution No. 13 of 2023 regarding the formation of courts during the judicial year 2023/2024, and it began with a preface to address the definition of the labor lawsuit management system. His competence concluded that this system is a special litigation system that the legislator has allocated to labor disputes only, and that its jurisdiction is limited to lawsuits arising from an individual employment contract, and its adjudication requires the application of one of the provisions of the Labor Law According to an objective standard.

Then the paper dealt with the research in the first section the subject of litigation before the Office of Labor Litigation Management in two demands, the first of which is the opening of the litigation and its convening in front of the Office of Labor Litigation Management, and the second on the conduct of litigation before the Office of Labor Litigation Management, has begun to include a definition of litigation and then how to open and convene in accordance with the general rules, and the litigation system for labor disputes, and then it touched on the conduct of the litigation by focusing on the presence of the parties, their pleading, the investigation of the lawsuit, and finally editing the report on labor litigation in the penultimate meeting, and the presentation of reconciliation to the litigants in the last meeting according to the conclusion of the judicial opinion in the report, and then referred to the High Labor Court when reconciliation is not possible.

(*) Date of research submission for publication: 23 February 2024
& date of acceptance: 16 June 2024.

The second section, however, dealt with the subject of litigation before the Supreme Labor Court in two demands, the first was about the conduct of litigation before the Great Labor Court, and touched through it to announce the parties to the litigation, and their pleadings, and achieve the subject of litigation in conclusion by reserving the case for judgment. The second requirement was about the expiration of the litigation before the Supreme Labor Court with the issuance of the judgment on its subject, and ways to appeal it, and it was subjected to the preliminary procedures for the issuance of the judgment, and the extent to which it is permissible to use electronic means in deliberation and pronouncement of the judgment, and then concluded with a presentation of ways of appeal against the verdict.

The research concluded that it is necessary to reconsider the legislative regulation of all litigation procedures followed in the labor lawsuit management system in order to achieve effective procedural protection not less than objective protection as the worker is a weak party in the employment relationship.

Keywords: management judge of labor lawsuits, Office of management of labor cases, worker, employer, litigation, labor litigation, and High Labor Court.

The Danger of the Flexibility of the Concept of Public Order as a Restriction on the Exercise of Rights and Freedoms(*)

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Assistant Professor of Public Law

Dr Nisrein Fathi Udwan
Associate Researcher
Associate Professor of Public Law

Faculty of Law, Yarmouk University, Irbid, Jordan

Abstract

This study addresses the concept of public order as one of the restrictions imposed on individuals' exercise of their rights and freedoms. The problem of the study is that: stipulating public order as a restriction on the exercise of rights and freedoms, in light of the flexibility of this concept, gives wide discretionary powers to administrative control authorities that can be exploited to violate the rights and freedoms of individuals. Therefore, the importance of the study appears in that it attempts to clarify aspects of flexibility in the concept of public order, and the impact of this flexibility on rights and freedoms, and then find ways to achieve a balance between protecting public order on the one hand, and ensuring that individuals exercise their rights and freedoms on the other hand.

By using the descriptive and analytical approaches, this study aimed to shed light on the concept of public order, its legislative basis, the role of administrative control authorities in protecting it, and the role of the Jordanian judiciary in controlling this concept, taking into account the principles of proportionality and appropriateness as tools to protect both interests. In order to achieve the objectives of the study, it is divided into two sections, the first section dealt with the legal basis of public order, and the second section dealt with the role of the judiciary in achieving a balance between public order and freedoms. The study reached a number of conclusions, the most important of which is that the legislator alone cannot control the idea of public order and define its concept.

Therefore, the judiciary has an important role in finding a balance between the concept of public order and the scope of exercising rights and freedoms.

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& date of acceptance: 15 August 2024.

The study recommended the need to increase the powers of the administrative judiciary to achieve a balance between administrative control and rights and freedoms by stipulating the authority to stop the implementation of administrative action as a preventive protection, similar to what is done in France.

Keywords: protecting public order, administrative control, Jordanian administrative judiciary, the principle of proportionality, the principle of necessity.

Comment on Judicial Rulings

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Comment on Constitutional Court Ruling No. 11 of 2022 that Voids Decree No. 136 of 2022 which Dissolves the National Assembly(*)

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PAAET, State of Kuwait

Abstract

This commentary addresses the Constitutional Court's ruling in Appeal No. 11 of 2022, issued on March 19, 2023, invalidating Decree No. 136 of 2022 dissolving the National Assembly and subsequently invalidating the Decree calling for National Assembly elections, which resulted in the invalidation of the National Assembly elections held on September 29, 2022 "by invalidating the entire election process that took place on 9/29/2022 in the five constituencies and by invalidating the identity of those who were declared winners, by invalidating the dissolution of the National Assembly and invalidating the call for voters to elect members of the National Assembly, on the basis of which these elections were held, with the resulting consequences, the most important of which is that the dissolved council shall regain its constitutional authority from the date of issuance of the ruling - by force of the constitution - as if the dissolution had not occurred, in the manner explained in the reasons.

This ruling derives its importance from the fact that it is not the first ruling to invalidate the National Assembly by the Constitutional Court, but rather that this ruling was preceded by two other rulings. However, what is striking in this ruling is that the Constitutional Court, with regard to its monitoring of the integrity of the electoral process as a whole, was not limited to formal procedures, but rather that monitoring extended to examining the objective reasons upon which the decree to dissolve the National Assembly No. 136 of 2022, was issued. The validity and logic of these reasons, and whether they are consistent with the Constitution, which fulfills the principle of constitutional legitimacy.

Keywords: National Assembly, Constitutional Court, Decree of Dissolving the National Assembly, Decree of Calling for National Assembly Elections.

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The Significance of Implementing Islamic Finance Principles in the Global Economy: Kuwait Islamic Banking System - Case Study (*)

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Abstract

The Islamic finance industry has experienced significant growth and development over the past few decades, developing as an influential player within the global financial economy. Embedded in the principles of Shariah, Islamic finance presents an additional financial system based on ethical and moral values. Islamic finance has recently gained popularity as a viable alternative to conventional finance. Its principles of fairness, transparency, and social responsibility make it an attractive option for individuals and institutions-both Muslim and non-Muslim-seeking ethical, sustainable financial solutions. Islamic finance offers a resilient alternative to traditional banking, promoting ethical standards and social responsibility. Its impact on global finance has led many institutions to adopt Islamic finance practices, contributing to a more stable and equitable financial system.

This research paper employs a descriptive and analytical approach to examine the principles of Islamic finance and banking and their increasing significance in the global economy. Moreover, the study demonstrated that the Islamic banking industry in Kuwait functions as a thriving business model that is internationally acknowledged and has the potential to be adopted as a lucrative business model.

(*) Date of research submission for publication: 8 April 2024
& Date of acceptance: 25 June 2024.

The research paper concluded that Islamic finance and banking institutions have made gradual progress despite obstacles. The advancement in financial services and economic development during crises signifies the growing importance and acceptance of Islamic finance globally, enhancing financial inclusion and stability.

Keywords: Islamic finance, Islamic banking, Sharia principles, global economy, financial crisis.

Introduction

Islamic banking and Islamic finance are interconnected yet refer to different aspects of the financial system that operate under Islamic law. Islamic banking is a subset of Islamic finance that specifically addresses the functions of banks that adhere to Sharia principles. These banks provide a range of financial services, including savings accounts, loans, and investment opportunities, all in compliance with Islamic regulations. Unlike conventional banks, Islamic banks do not engage in interest-based transactions (Riba) and instead employ profit-and-loss sharing arrangements, such as Mudarabah (profit-sharing) and Musharakah (joint venture). Additionally, they engage in asset-backed financing techniques, including Murabaha (cost-plus financing) and Ijara (leasing). The domain of Islamic banking is relatively limited, primarily centering on the banking services offered by institutions that operate in alignment with Sharia law.

Islamic finance is a comprehensive concept that encompasses a wide range of financial activities, including banking, capital markets, insurance (Takaful), and asset management, all of which are conducted in alignment with Islamic principles. Beyond traditional banking, Islamic finance also involves investments in Sukuk (Islamic bonds), Takaful (Islamic insurance), and equity investments in sectors deemed halal. The primary aim of Islamic finance is to provide a full spectrum of financial services while strictly adhering to Sharia law, which emphasizes ethical investment practices and prohibits involvement in industries such as alcohol, gambling, and tobacco. Thus, Islamic finance constitutes a broader field that integrates not only banking services but also non-banking financial services, capital market instruments, insurance products, and various investment options that comply with Islamic regulations.

Briefly, Islamic banking specifically pertains to banking operations within the framework of Islamic finance, while Islamic finance encompasses a wider array of financial activities.

Islamic finance and banking have gained increasing attention in recent years, not only in Muslim-majority countries but also in Western financial markets. Islamic finance and banking play a vital role in promoting financial inclusion, stability, and ethical standards globally. With the increasing demand for socially responsible investments, Islamic finance offers a principled approach that appeals to a wide range of investors. Its presence is expanding in international markets through the issuance of Sukuk and the establishment of Islamic banking institutions in non-Muslim countries. Islamic finance can make a significant contribution to the economic growth and development of emerging markets. Islamic finance promotes entrepreneurship, infrastructure development, and sustainable investments by providing financial services to historically underserved populations through profit-sharing arrangements and asset-backed financing. These initiatives play a crucial role in fostering long-term economic prosperity.

This research paper will delve into the historical background of the Islamic finance industry, tracing its origins, significant milestones, and evolution over time. Furthermore, it discusses the recent advancements in the field of Islamic finance with a focus on banking, along with its projected future direction in terms of providing financial services and fostering economic development. The paper also highlights the role of the Islamic banking system in addressing global financial crises, the challenges faced by Islamic finance and banking institutions globally, the potential growth, and future opportunities.

The research discusses the rising relevance of Islamic finance globally, highlighting its impact on financial inclusion and stability. It also examines Kuwait's Islamic banking sector as a successful global model.

a - Literature Review

This section aims to explore the Islamic banking and financing system, emphasizing its contribution and role in addressing global financial crises, the challenges faced by Islamic finance and banking institutions globally, the potential growth, and future opportunities. The researcher seeks to review pertinent literature related to these themes.

The Islamic banking and finance framework has developed into a prominent alternative to traditional financial systems, particularly considering recent global financial upheavals, such as the COVID-19 pandemic. This literature review consolidates essential research outcomes concerning the impact of Islamic finance on economic recovery, its contributions to growth, the obstacles it encounters, and the prospects for future development. Through a thorough examination of the current literature, this review also identifies existing knowledge gaps and proposes directions for future research.

Contemporary research indicates that the Islamic financial system is based on ethical principles that may improve financial stability during crises. By emphasizing transparency, accountability, and ethical conduct, Shariah-compliant institutions build trust among stakeholders, increasing their resilience to external shocks. Additionally, resilient Islamic finance institutions demonstrate innovation and adaptability in their crisis responses. According to Rabbani et al.(1), Islamic fintech has the potential to reduce the economic impact of crises, thereby underscoring the system's inherent resilience and flexibility.

Isik(2) investigated the relationship between Islamic banking, economic growth, and innovation using data from the GCC states excluding Oman and concluded empirically that Islamic banking funds and innovation in these states have a positive and significant relationship with economic growth. It is unhesitatingly indicated by Tajgardoon(3) that Islamic banking is based on real economic activity and is effective in its financing decisions; therefore, it has a significant advantage in financing projects involving innovations.

Tabash & Dhankar(4) indicated that the importance of Islamic finance to the global financial system became apparent post the global financial crisis that occurred in 2008, which attracted the attention of policymakers and financial experts worldwide. This conclusion was based on an empirical examination of key performance ratios for liquidity and capital adequacy of all full-fledged Islamic banks in the Kingdom of Saudi Arabia, which confirmed the viewpoint that Islamic finance is a more stable and safe way of financing.

(1) M. R. Rabbani and A. Bashar and N. Nawaz and S. Karim and M. A. Mohd Ali and H. U. Rahiman and Ms. S. Alam, Exploring the role of Islamic fintech in combating the after-shocks of covid-19: The open social innovation of the Islamic financial system, Journal of Open Innovation: Technology, Market, and Complexity, Elsevier, Amsterdam, Netherlands, Vol.7, Iss.2, June 2021, p.136.

(2) N. Isik, Growth, Islamic Banking and Schumpeterian Vision: An Empirical Evidence from the Gulf Arab States, International Journal of Islamic Economics and Finance Studies, Politik Ekonomik ve Sosyal Araştırmalar Merkezi, Sakarya, Türkiye, Vol.4, Iss.1, (2018), pp.42-43.

(3) G. Tajgardoon and M. Behname and K. Noormohamadi, Islamic Banking and Economic Growth: Evidence from Asia, Journal of Modern Accounting and Auditing, David Publishing Company, USA (Illinois), Vol. 9, Iss.4, (2013), p.543.

(4) M. Tabash and R. Dhankar, The Impact of Global Crisis on the Stability of Islamic Banks: An Empirical Evidence, Journal of Islamic Banking and Finance, American Research Institute for Policy Development, USA, Vol.2, Iss.1, (2014), p.386.

Hidayat & Abduh[(5)] indicated that certain specialists and representatives of Islamic banks in Bahrain have asserted that the banks involved are either unaffected or less impacted by the global financial crisis compared to their conventional counterparts. This assertion is based on the fundamental principle of participatory banking, which mandates that all financial transactions be grounded in trade and linked to tangible assets.

A study by Hidayat et al.[(6)] examined the impact of the 2008 global financial crisis on the financial performance of Islamic banks in the GCC and identified factors that significantly influenced these banks during 2005-2010 using panel data regression analysis. The study found that the effects of the crisis on the GCC Islamic banking performance worsened after 2009-2010. Although these findings contradict other experts' opinions, which suggest Islamic banks were not affected by the financial crisis, it is important to note that the study included only 21 Islamic banks; this limits its ability to accurately represent all Islamic banks in the GCC.

A recent study by D. Rai and S. Kayadibi[(7)] discussed the effects of the COVID-19 pandemic on the world economy and both capitalism and Islamic finance. Moreover, it investigated the indicators of Islamic economics to prove its ability in solving financial crises and to serve as an alternative economic system. This observation underscores an increasing acknowledgment of the ethical foundations inherent in Islamic finance, which stands in stark contrast to the profit-centric objectives of traditional finance, thus presenting a more sustainable strategy for addressing economic difficulties.

(5) S. E. Hidayat and M. Abduh, Does Financial Crisis Give Impacts on Bahrain Islamic Banking Performance? A Panel Regression Analysis, International Journal of Economics and Finance, Canadian Center of Science and Education (CCSE), Canada, Vol.4, Iss.7, (2012), p.79.

(6) S. E. Hidayat and H. M. Abdul Rashid and S. Nu. Htay, Is the GCC Islamic Banks' Financial Performance Affected by the 2007/2008 Financial Crisis? Journal of Islamic Economics, Banking and Finance, Islamic Bank Training and Research Academy (IBTRA), Vol.10, Iss.3, (2014), p.86.

(7) D. Rai and S. Kayadibi, Islamic Economics and Finance as an Alternative for the Current Economic System in the Context of Covid-19, Journal of Islamic Economics and Philanthropy, Department of Islamic Economics, Faculty of Economics and Management, University of Darussalam Gontor, Indonesia.Vol. 5, Iss. 2, (2022), p.252.

Grassa and Gazdar[8], demonstrated that Islamic finance plays a crucial role in fostering economic growth within the Gulf Cooperation Council (GCC) nations, emphasizing the need for financial reforms to improve its effectiveness and promote sustainable growth. This perspective is supported by Ledhem and Mekidiche[9], who establish a connection between the financial performance of Islamic banks and overall economic growth in Malaysia, Indonesia, Brunei, Turkey, and Saudi Arabia, suggesting that enhancing various performance metrics could further strengthen this relationship.

The incorporation of technology, especially in the realm of FinTech, offers a range of opportunities and challenges for Islamic financial institutions. Sukrisno et al[10] research examined the performance of SMEs in Indonesia through the integration of Islamic financial technology and Islamic financial principles, which demonstrated effective solutions to improve SMEs' performance. Thus, SMEs can achieve a balance between profitability and social responsibility. Although this research is limited by its geographical focus on Java Island in Indonesia, there is a potential for applying the same concept within the GCC to fully represent the diverse business landscape across the region.

Furthermore, the continuous advancement of FinTech presents Islamic financial institutions with novel opportunities to enhance their service portfolios and extend their market reach. Nevertheless, the primary challenge resides in the effective incorporation of these technologies within a Shari'ah-compliant framework, necessitating a sophisticated comprehension of both financial innovation and Islamic tenets.

While the existing literature offers significant insights, notable gaps in

(8) R. Grassa and K. Gazdar, Financial Development and Economic Growth in GCC Countries, International Journal of Social Economics, Emerald. Vol. 41, Iss. 2, (2014), p.512.

(9) See M. Ledhem and M. Mekidiche, Economic Growth and Financial Performance of Islamic Banks: A Camels Approach, Islamic Economic Studies: Vol.28, Iss.1, (2020), pp. 47-62.

(10) I. K.D. Sukrisno and R. Pranoto and R. Zai and D.S. Nehe and R. Apriliyani and H. Listyorini and K. Kundori and K.C. Susena, Integration between Islamic financial technology and Islamic financial principles to improve performance of SMEs in Indonesia. Forum for Economic and Financial Studies (FEFS), Academic Publishing Pte. Ltd., Singapore, Vol.3, Iss.1, (2025), p.20.

knowledge remain. For example, although numerous studies examine the contributions and challenges associated with Islamic finance, there is a scarcity of research addressing the long-term viability of Islamic financial institutions across diverse economic environments. Future investigations could focus on how Islamic finance might adjust to evolving global economic conditions and shifting consumer preferences.

Furthermore, the influence of regulatory frameworks on the expansion of Islamic finance in various regions requires additional scrutiny. An understanding of the socio-cultural factors that affect the acceptance and implementation of Islamic banking, particularly in countries with non-Muslim majorities, is another vital area for future exploration. Lastly, empirical research comparing the performance of Islamic finance to conventional finance during periods of economic decline would yield important insights into the resilience and adaptability of these financial systems.

The Islamic banking and finance systems emerge as a viable alternative to traditional financial models, especially in tackling the economic difficulties arising from global crises. Although it plays a vital role in fostering economic growth, it encounters substantial obstacles that need to be overcome to ensure sustainable development. Ongoing investigation into the dynamic nature of Islamic finance, particularly with technological advancements and regulatory frameworks, will be essential for realizing its complete potential within the global economic context.

b - Research Problem and Questions

The core issue addressed in this research is the limited implementation of Islamic banking and finance principles globally, despite recurrent financial crises that highlight potential vulnerabilities in conventional finance systems. This study explores whether Islamic finance could serve as a sustainable and ethically sound alternative to conventional banking practices, promoting stability and ethical financial solutions.

c - Research Questions

1 - What is the significance of implementing Islamic banking and finance principles in the global economy?

2 - What are the historical origins of Islamic finance, and is the concept of *Riba* (interest prohibition) unique to Islamic Sharia law?

3 - What are the fundamental principles of Islamic banking?

4 - How does Islamic banking differ from conventional banking in the context of modern financial markets?

5 - What are the potential growth opportunities, challenges, and prospects for the Islamic banking and finance systems?

6 - What roles do Islamic banking institutions in Kuwait, particularly the Kuwait Finance House (KFH), play as a model for Islamic banking in the global market?

These questions explore the function of Islamic finance, its benefits in comparison to traditional finance, and the obstacles it encounters in attaining broader acceptance as a global financial framework.

d - Research objectives

This study aims to:

1 - Examine the foundational principles of Islamic finance and banking and highlight their growing significance in the global economic landscape, especially as an ethical alternative to conventional finance systems.

2 - Analyze the historical development and core tenets of Islamic finance, including the prohibition of Riba (interest), risk-sharing, asset-backed transactions, and ethical investing, to establish a clear understanding of its unique value propositions.

3 - Compare Islamic and conventional banking systems to identify the distinctive features, practical differences, and potential advantages of Islamic finance in promoting financial stability and economic growth.

4 - Investigate the potential for growth, challenges, and opportunities in the Islamic banking sector globally, with a specific focus on the sector's adaptability to emerging markets and its appeal to investors seeking ethical financial solutions.

5 - Evaluate the role of Kuwait's Islamic banking sector, particularly the Kuwait Finance House (KFH), as a successful international model, exploring its strategies and contributions to the broader Islamic finance industry.

6 - Identify strategies to promote the global adoption of Islamic finance principles, addressing regulatory, operational, and educational barriers that hinder its expansion in both Muslim-majority and non-Muslim countries.

The outlined objectives establish a foundation for evaluating the significance and potential of Islamic finance as a sustainable, inclusive, and resilient financial system within the contemporary economic landscape.

e - Research Justifications

The growing interest in ethical and sustainable finance has spurred increased attention toward Islamic finance, a system rooted in fairness, transparency, and social responsibility. This research is justified by the following considerations:

1 - Recurrent Financial Crises: Conventional financial systems have shown vulnerabilities, especially during global financial crises, underscoring the need for alternative financial models. Islamic finance, with its principles of risk-sharing and prohibition of excessive speculation, presents a resilient alternative that could contribute to global financial stability.

2 - Ethical and Socially Responsible Investing: With a rising demand for investments that align with ethical and social values, Islamic finance offers a unique approach that promotes social welfare and sustainable development. This research will explore how Islamic finance principles can meet the growing market demand for responsible finance.

3 - Financial Inclusion: Islamic finance promotes inclusion by providing financial services to those underserved by conventional banks, especially in emerging markets. By examining how Islamic finance fosters inclusion, this study highlights its potential to support broader economic development.

4 - Global Acceptance and Adaptability: Islamic finance is gaining traction not only in Muslim-majority countries but also in non-Muslim regions. This research examines Kuwait's Islamic banking sector as a global model, highlighting how its strategies can be adapted for broader acceptance and growth worldwide.

5 - Need for Academic and Practical Insights: Despite its rapid growth,

Islamic finance still faces significant challenges, such as regulatory inconsistencies and a shortage of skilled professionals. This research contributes to academic discourse and practical knowledge by providing a critical analysis of the barriers and enablers of Islamic finance growth, offering insights for future research and policy.

Through these justifications, this study underscores the value of Islamic finance as a globally viable, ethical alternative, highlighting the importance of further research to maximize its potential for inclusive economic growth and resilience.

f - Research Methodology

This study employs a descriptive and critical analysis approach to examine the principles, practices, and impact of Islamic finance and banking, with a particular focus on Kuwait's Islamic banking sector as a global model. The methodology is structured as follows:

1 - Descriptive Analysis: The study begins with a comprehensive review of Islamic finance principles, such as the prohibition of Riba (interest), risk-sharing, ethical investing, and asset-backed transactions. By providing a detailed account of these principles, the research establishes a clear framework for understanding Islamic finance as a viable alternative to conventional banking.

2 - Comparative Analysis: To highlight the distinctive attributes of Islamic finance, the study includes a comparison between Islamic and conventional banking systems. This analysis focuses on operational, ethical, and regulatory differences, providing insights into the unique value propositions of Islamic finance.

3 - Case Study Approach: Kuwait's Islamic banking sector, particularly the Kuwait Finance House (KFH), is used as a case study. The research examines KFH's strategies, growth, and global contributions, analyzing how this model can be applied in other regions to promote financial stability and inclusivity.

4 - Data Collection:

- Secondary Data: The study relies on existing literature, reports, and case studies from credible sources, such as scholarly journals, financial industry reports, and publications from Islamic finance regulatory bodies. These sources offer insights into the historical development, challenges, and future potential of Islamic finance.

- Document Analysis: Analysis of policy documents, industry reports, and regulatory frameworks from Kuwait and other leading Islamic finance regions helps illustrate the regulatory environment and identify best practices for promoting Islamic finance globally.

5 - Critical Analysis: The study critically examines challenges faced by the Islamic finance industry, such as regulatory fragmentation, product standardization issues, and capacity building. By analyzing these challenges, the study identifies gaps and proposes strategies to enhance the effectiveness and global appeal of Islamic finance.

6 - Analytical Framework: This research employs an analytical framework that evaluates Islamic finance's contributions to financial stability, ethical investing, and financial inclusion. This framework allows for a systematic exploration of the benefits and limitations of Islamic finance as a global financial model.

The research methodology is designed to provide a holistic understanding of Islamic finance, offering evidence-based recommendations to facilitate its adoption and growth as a robust, ethical alternative to conventional finance in the global economy.

g - The Significance of Implementing Islamic Finance Principles in the Global Economy

Islamic banks play a transformative role in modern finance by adhering to Sharia principles, which emphasize profit-sharing, asset-backed transactions, and the exclusion of interest-based activities. By aligning with Islamic values, these banks offer an ethical alternative to conventional finance, providing inclusive financial services that reach individuals and businesses often underserved by traditional banking. This focus on socially responsible banking avoids investments in sectors like gambling, alcohol, and tobacco, and promotes investments in ethical projects that benefit society.

Islamic finance has made significant strides over the past fifty years, emerging as a viable competitor to conventional banking, especially as it proves resilient amid financial crises like the 2008 global meltdown and the COVID-19 pandemic. The industry, while still evolving, has attracted both Muslim and non-Muslim investors globally by offering a distinct value proposition based on transparency, ethical investments, and reduced speculative activities.

Islamic banking also serves a diverse client base with various financial products, including low-risk and risk-sharing options, expanding choices for customers, and enhancing financial system stability. Since its modern inception in the 1970s, Islamic finance has grown substantially, supported by innovative financial instruments that uphold Islamic principles and adapt to contemporary economic settings. Today, it stands as an inclusive and ethical alternative that can contribute to a more stable global economy.

Islamic banking should be seen not merely as a religious system but as a forward-looking approach to finance with the potential to address global economic challenges through a balanced, ethical framework.

1 - Historical Overview of Islamic Banking and Finance

Since the 11th century, the distinguished Persian jurist and philosopher Al-Ghazzali has been recognized for his statement that financial gain through interest can easily be achieved without engaging in genuine economic activities. This practice ultimately undermines the true interests of humanity, as the well-being of society relies on genuine trade skills, industry, and construction. Engaging in transactions involving interest is considered unjust, as money is intended for purposes other than self-gain.

Those who prioritize monetary transactions over the original purpose of money are acting against the fundamental principles of its creation, thus perpetuating injustice(11). Despite potential dissenting opinions, it can be argued that the medieval notion of usury, as defined by the Fifth Lateran Council (1512-1517), bears striking similarities to the contemporary concept of interest-bearing debt. Luke the Evangelist asserts that we are morally obligated to refrain from seeking any increase in the principal amount when lending money, as this is the essence of usury. Usury occurs when a non-

(11) M. T. Usmani, The adverse effects of interest on society, Institute of Islamic Banking and Insurance (IIBI), London, UK (2009). (Original work by Abu Hamid Muhammad ibn Muhammad al-Ghazali, 1058–1111). Pope Leo X, “Fifth Lateran Council. (1512–1516).

productive asset is utilized solely to generate profit and gain, without any workforce, expenditure, or risk involved[12].

The recurring sentiment appears to express worry about speculation and the imposition of interest in financial transactions, along with the extensive societal and economic repercussions of such actions. However, these teachings from the masses of the past may appear harsh to contemporary bankers, although evidence suggests their enduring relevance. Furthermore, secular intellectuals from around the globe have echoed these sentiments.

Aristotle, in his work *Politics* around 350 BC, delves deeper into the concept of wealth acquisition. He argues that usury is the most despised form of wealth accumulation, as it involves profiting from money itself rather than from its intended purpose. Money, according to Aristotle, is meant for exchange and not for generating interest. The term interest refers to the idea of money giving birth to more money, likening it to the reproduction of offspring from a parent. Aristotle concludes that among all methods of acquiring wealth, usury is the most unnatural[13].

Money possesses no inherent value, as Aristotle underscores the paramount importance of its fundamental purpose, which is to function as a medium of exchange within society. All financial transactions must remain firmly connected to the tangible economy; otherwise, money transforms into a mere commodity.

The initial indications of these products emerged soon after the notable agricultural transformation known as the plough revolution around 4000 BC. Farmers engaged in lending practices that involved the exchange of grain, tools, and livestock. Given that a single seed could yield a hundred offspring, the concept of repaying loans with ‘interest’ in the form of additional seeds was both logical and pragmatic. Tools, which facilitated production, allowed for the sharing of interests based on the output generated. Furthermore, when livestock was borrowed, repayment was often made through the offspring produced, with the Sumerians using the term ‘mas’ to denote both calves and interest. The items that were loaned had inherent value and the natural ability to reproduce[14].

(12) Lateran Council 1512-16 A.D. Retrieved from Papal Encyclicals Online: https://www.papalencyclicals.net/councils/ecum18.htm. (Last accessed: 18/2/2024).

(13) Aristotle, Politics, Book 1, Penguin Books, England, 1981.

(14) S. Zarlenga, A Brief History of Interest, Research & Articles by American Monetary In-

In the early stages of societal engagement by the 'Divine' authorities within the Ancient Oriental System, encompassing regions such as Egypt, Assyria, and Sumer, the economy encountered significant imbalances. The repayment of interest on loans was conducted using metals, which presented complications due to their inorganic nature. This situation necessitated the implementation of an alternative method for settling interest obligations.

As a result, farmers frequently struggled to meet loan repayments that surpassed their agricultural yields, leading to instances of forced servitude. Furthermore, the prices of harvested crops were unpredictable due to fluctuations in aggregate yield, adding to the social and economic challenges faced during this period. One solution to this problem was presented through the Babylonian Code of Hammurabi, around 2250 BC(15). If this regulation had not restricted interest rates to a still high 33 percent, agriculture could have been equated with serfdom(16).

The Torah conveyed a timely message when it included one of its miscellaneous laws, which stipulated that(17) "You shall not charge interest on loans to your brother, interest on money, interest on food, interest on anything that is lent for interest". Various laws were in place regarding interest rates. For example, the Hindu law of 'Damdupat' imposed numerous restrictions on interest. Emperor Justinian's 6th-century Byzantine code limited interest to around 4 percent. Charlemagne outright prohibited interest in Western Europe during the 9th Century. The Magna Carta Libertatum established strict boundaries on usury in 13th-century England. Up until 1981, most states in the United States of America had federal regulations on usury. The Bible and the Quran also share in the prohibition of interest(18).

However, the increasing government, sovereign, and household debts

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stitute, 18 December 2010, http://www.monetary.org/a-brief-history-of-interest/2010/12. (Last accessed: 18/2/2024).

(15) K. V. Nagarajan, The Code of Hammurabi: An Economic Interpretation, International Journal of Business and Social Science, Vol.2, Iss.8, (2011), pp.111, 113, 116.

(16) S. Zarlenga, The lost science of money, American Monetary Institute, 2002.

(17) The Torah, (7 BC), Deuteronomy, 23:19.

(18) S. Zarlenga, The lost science of money, op. cit.

indicate that a system that was once considered effective in enhancing economic and social conditions is now showing vulnerabilities[(19)]. Considering this, it is important to acknowledge the limitations of this system and subject its numerous assumptions, which have been increasingly questioned, to the enduring forces of reason and progress. Throughout history, the evolution of Islamic finance and banking transactions has progressed through various stages. By the tenth century, Islamic law had already endorsed credit and investment tools that were on par with those found in the non-Islamic realm. However, before the 19th century, there were no enduring financial institutions that could be identified as banks in the Muslim world. It was not until the 1920s that the first banks majority-owned by Muslims came into existence[(20)].

During the period spanning from the eighth to the twelfth centuries, an initial market economy and a primitive version of mercantilism, commonly referred to as Islamic capitalism, emerged. This economic system relied on the utilization of the gold dinar as a widely accepted currency, thereby fostering economic interdependence among regions that had previously operated autonomously[(21)].

Various economic concepts and methods were utilized during the inception of Islamic banking. These included bills of exchange, partnership arrangements such as mufawada (including limited partnerships or mudaraba), different forms of capital known as al-mal, and capital accumulation referred to as nama al-mal[(22)], cheques, promissory notes[(23)], trusts known as Waqf (an unincorporated trust)[(24)], transactional accounts, loaning, ledgers, and

(19) R. Dobbs, et al. Debt and (not much) deleveraging (Exhibit 1), McKinsey & Company, Retrieved July 5, 2015, from https://www.mckinsey.com/featured-insights/employment-and-growth/debt-and-not-much-deleveraging. (Last accessed: 18/2/2024).

(20) T. Kuran, Islam and Mammon: The economic predicaments of Islamism, Princeton University Press, 2004, p…

(21) S. Y. Labib, Capitalism in medieval Islam, The Journal of Economic History, Vol.29, Iss.1, (1969), pp.81-82.

(22) J. Banaji, Islam, the Mediterranean, and the Rise of Capitalism, Historical Materialism, Brill Publishers, Vol.15, Iss.1, (2007), pp.50-51.

(23) R. S. Lopez and I.W. Raymond and O. R. Constable, Medieval trade in the Mediterranean world: Illustrative documents, Columbia University Press, 2001.

(24) T. Kuran, The absence of the corporation in Islamic law: Origins and persistence, American Journal of Comparative Law, Oxford University Press, USA, Vol.53, Iss.4, (2005), pp.799-803.

assignments. Muslim merchants have been documented to utilize the cheque or sukuk system as early as the era of Harun al-Rashid in the ninth century under the Abbasid Caliphate[25]. These early capitalist practices were later adopted and further developed in medieval Europe, starting from the 13th century onwards. During the mid-20th century, certain institutions were discovered to provide financial services following Islamic principles. The initial trial of a community-based Islamic bank took place in the late 1950s in a remote region of Pakistan, where interest-free lending was practiced[26].

In 1963, economist Ahmad Elnaggar established the first modern Islamic bank in rural Egypt, aiming to cater to individuals who lacked trust in state-run banks. The initiative, located in the Nile Delta town of Mit Ghamr, did not overtly promote its Islamic principles to avoid association with Islamic fundamentalism, which was opposed by the Gamal Nasser regime. Concurrently, the Pilgrims Saving Corporation was established in Malaysia, incorporating fundamental Islamic banking principles. Despite the success of the Mit Ghamr experiment, it was terminated by the Egyptian government in 1968. Nevertheless, it was viewed positively as it paved the way for establishing nine similar banks in Egypt by that time. In 1972, the Mit Ghamr Savings project was integrated into the Nasr Social Bank.

It is worth mentioning that the Era of the Prophet prevailing modes of transactions during this era include:

- Shirkah (partnership) based on profit-and-loss sharing (PLS)
- Al Qard Al Hasan (benevolent loan)
- Salam (Forward) contract
- Sarf (exchange of money), i.e., gold for gold and silver for silver at the same sitting
- Ijarah (leasing)
- Trans-regional trade involved the trade of caravans from Mecca to Syria and vice versa.

(25) J. B. Glubb, A Short History of the Arab Peoples, Dorset Press, 1988, pp.104-105.

(26) R. Wilson, Banking and finance in the Arab Middle East. St. Martin’s Press, New York City, USA, (1983), p.75.

The origins of Islamic finance can be traced back to the era of Prophet Muhammad (peace be upon him); however, it was not until the mid-20th century that formal Islamic financial institutions started to emerge. The establishment of the Dubai Islamic Bank in 1975 marked a pivotal moment in the history of Islamic finance, being the first-ever Islamic bank. It is worth mentioning that a group of businesspeople took the initiative of establishing the Dubai Islamic Bank in 1975 in Dubai, United Arab Emirates (UAE).

This was the first Islamic Bank established on private initiative. However, the official support was crucial, with the governments of the UAE and Kuwait contributing respectively 20% and 10% of the capital. This milestone was followed by the emergence of other institutions like the Islamic Development Bank, Bahrain Islamic Bank, and Kuwait Finance House, all of which played a significant role in fostering the growth of the industry. The period between 1962 and 1975 witnessed significant developments in the realm of Islamic Banking and Finance. A concise summary of these advancements is as follows:

- In 1962, Pakistan initiated crucial reforms in its banking industry, setting the stage for future transformations.
- The year 1963 marked a significant milestone with the establishment of the Mit Ghamr Local Savings Bank in Egypt. This institution served as the pioneering modern-day trial of Islamic banking, laying the foundation for future endeavors in this field.
- Recognizing the importance of managing the savings of prospective pilgrims following Islamic principles, the Malaysian Pilgrims Savings Board, known as Tabung Haji, was established in 1969. Tabung Haji aimed to invest these savings in Shari'ah-compliant ventures, ensuring adherence to Islamic financial principles.
- The year 1975 witnessed the birth of modern Islamic finance in Dubai. This momentous occasion saw the establishment of two significant institutions: the Dubai Islamic Bank (DIB), the world's first Islamic commercial bank, and the Islamic Development Bank (IDB). Both DIB and IDB played pivotal roles in conducting Islamic finance transactions, further propelling the growth and development of Islamic banking and finance globally.

Dubai Islamic Bank (DIB) is the first fully-fledged Islamic world commercial bank, which was established in 1975. The bank operates five main business groups:

- Retail banking
- Corporate banking
- Real estate
- Investment banking
- Proprietary trading investments

The main functions of the IDB in carrying out its objectives are:

- To participate in equity capital and to grant loans.
- To provide financial assistance to member countries
- To establish and operate special funds for specific purposes.
- To accept deposits and to mobilize financial resources through Shari'ah-compatible modes.
- To promote foreign trade, especially in capital goods, among member countries

Another major bank was established in 1975, the Islamic Development Bank (IDB), marking a significant milestone in the history of Islamic banking. The IDB is set as an international financial institution following the declaration of intent made during a conference of finance ministers from Islamic countries in Jeddah, Saudi Arabia, in December 1973. This declaration was signed by representatives from twenty-three member countries of the Organization of the Islamic Conference (OIC). Subsequently, the Articles of Agreement establishing the Islamic Development Bank were adopted during the second conference of finance ministers held in Jeddah in August 1974. The inaugural meeting of the Board of Governors of the IDB took place in Riyadh, Saudi Arabia, in July 1975, and the Bank commenced its operations on 20 October 1975. The period spanning from 1975 to 1990 stands out as a pivotal era in the evolution of the Islamic financial industry. It was during this time that the industry reached a level of maturity, establishing itself as a viable and credible alternative to conventional financial intermediation. This recognition was earned through both theoretical advancements and practical experiences.

The significance of this period extends beyond the establishment of numerous Islamic financial institutions within the private corporate sector, operating within diverse socio-economic contexts. It also witnessed a noteworthy commitment from three countries - Pakistan, Iran, and Sudan - to gradually eradicate interest from their entire economies. Instead, these countries expressed their intent to adopt a comprehensive banking system based entirely on Islamic principles. To achieve their objective, these countries implemented several practical measures. Furthermore, the emergence of various multinational banks, such as Hong Kong and Shanghai Banking Corporation (HSBC), Chase Manhattan, Grindlays, and Citibank, offering Islamic financial products, was of great significance. This demonstrated the recognition and acceptance of the new model by international players.

The significance of Islamic financial products as a mechanism for financial intermediation was acknowledged by the International Monetary Fund and the World Bank, leading them to publish several papers on the matter. Islamic countries pursued two distinct approaches for the expansion of Islamic banking: state-sponsored growth and development within a competitive framework. These approaches were discussed by several researchers(27).

The time from 1975 to 1990 held significant importance in the formation of the Islamic financial sector. This era not only fostered the growth of Islamic financial products and institutions but also emphasized the possibility of establishing a banking system free from interest, based on Islamic principles.

2 - Key Principles of Islamic Banking

The importance of the functions performed by banks remains significant regardless of whether the economy is secular or Islamic. The provision of banking services is essential for individuals and corporations. However, conventional banks operate by engaging in borrowing and lending activities, as

(27) N. U. Haque, and A. Mirakhor, Optimum profit-sharing contracts and investment in an interest-free economy (Working Paper No. 12). International Monetary Fund (IMF), Washington, DC. (1986).
Z. Iqbal and A. Mirakhor, Islamic Banking (Occasional Paper No. 49). International Monetary Fund. Washington, DC. (1987).
See, I. Karsten, Islam and financial intermediation. IMF Staff Papers, Vol. 29, Iss. 1, (1982), pp. 108-142.

well as other functions, based on fixed interest rates. Conversely, in an Islamic economy, the giving and taking of interest is prohibited. It is worth noting that interest is prohibited in many other religions, such as Christianity and Judaism(28). Consequently, Islamic economies must seek alternative methods to fulfill the various banking functions while adhering to the prohibition of interest. This necessity serves as the underlying rationale for the establishment of Islamic banking.

No doubt, the Islamic banking system adheres to specific key principles to ensure the implementation of the principles of Shariah. Islamic finance operates on the principle that the charging or receiving of interest (Riba) is prohibited, as it is considered exploitative and socially unjust. Instead, profit-sharing arrangements are preferred, where risks and profits are shared between parties in a transaction. This ensures that both the lender and the borrower have a stake in the success of the investment. Islamic finance promotes risk-sharing among all parties involved in a financial transaction. Islamic banking not only meets the religious obligations of Muslims but also expands the range of options for non-Muslim clients by providing sales-based financing and products that involve sharing risks and returns.

The combination of fixed and variable return mechanisms provided by Islamic banks can positively impact the effectiveness and resilience of the financial system(29). This encourages greater transparency and accountability, as well as aligning the interests of investors with the success of the project. Moreover, Islamic finance emphasizes ethical investing, with investments restricted to sectors that comply with Islamic principles, such as avoiding investments in businesses associated with alcohol, gambling, or other prohibited activities. Islamic finance is based on the principle of asset-backed transactions, where investments are linked to tangible assets such as real estate, commodities, or infrastructure projects. This guarantees that investments are based on tangible economic activities and assets, minimizing speculative activities and fostering stability within the financial system. The following are the main key principles of Islamic banking.

(28) P.S. Mills and J. R. Presley, Islamic finance: Theory and practice, Macmillan, (1999). U. Chapra, Towards a just monetary system. The Islamic Foundation, Leicester, UK, (1985). Top of Form Bottom of Form

(29) M. Iqbal, Islamic banking: Theory, practice and evaluation. Journal of Islamic Business and Management, Riphah International University, Pakistan, Vol. 1, Iss. 1, (2011), p. 114.

a - Prohibition of predetermined loan repayments as interest (*riba*)

The prohibition of riba in Islam is unequivocal and firmly established. The Qur'an contains numerous verses that forbid riba, leaving no room for doubt. One such verse states, "Allah has permitted trade and forbidden riba" (Qur'an: Surah Al-Baqarah 2:275). The Quran contains verses in four Surahs that explicitly prohibit riba: Surah Al-Baqarah 2:275-276, 278-280; Surah Aal Imran 3:130; Surah An-Nisaa 4:161; and Surah Al-Room 30:39. In addition to the Qur'an, the Prophet Muhammad's Sunnah provides further elaboration on the concept of riba. Numerous hadiths, or sayings of the Prophet, explain the intricacies and details surrounding riba. For instance, in a hadith narrated by the Prophet's companion Jaabir, it is reported that the Prophet cursed not only those who accept riba, but also those who give it, record it, and serve as witnesses to it, emphasizing the severity of involvement in riba (Collected by Muslim).

Riba can be categorized into two major types. The first category is known as Riba Al-Nase'ah, which pertains to riba in debt. This type of riba increases over time, such as the charging of interest on borrowed money. It is the most prevalent form of riba in contemporary society and encompasses the return of money on money at any rate, whether it be fixed or floating, compounded, or simple interest. The second category is Riba Al-Fadl, which refers to riba in exchange. This type of riba specifically applies to the six commodities, including gold, mentioned in the hadith. Riba Al-Fadl increases with the transaction, highlighting the impermissibility of unfair exchanges.

Overall, the prohibition of riba in Islam is firmly established in both the Qur'an and the Prophet's Sunnah. The various verses in the Qur'an and the hadiths provide clear guidance on the prohibition of riba, ensuring that Muslims adhere to the principles of fairness and justice in their financial transactions. Some scholars argue that the prohibition of riba is justified by its contradiction to principles of cooperation, generosity, and partnership. It is believed that riba leads to the acquisition of property through wrongful means and causes harm to those in need. Additionally, it is seen to prevent injustice and exploitation. Furthermore, Riba discourages capital owners from engaging in productive economic activities that contribute to the overall welfare of society, such as commerce, manufacturing, and construction. Money, on the other hand, is intended to serve as a medium of exchange and a standard of value for other goods. Riba, however, undermines the fundamental purpose of money and diverts it from fulfilling its intended role.

b - Prohibition of speculative behavior - Uncertainty (Gharar)

Gharar encompasses a wide range of uncertainties and is not confined to a singular definition. In this context, it pertains to an excessive level of uncertainty or lack of knowledge regarding a contract, or the commodities being traded, including aspects such as price, ownership, possession, deliverability, exchange dates, and so forth. According to a hadith found in *Muslim collections and narrated by Abu Hurairah*, "The Prophet prohibited the practice of selling through the method of casting stones to conclude a sale (Al-Haasah), as well as the sale involving Gharar."

Gharar is classified into two distinct categories: major and minor. While minor instances of gharar are considered insignificant and therefore overlooked, major forms of gharar are viewed with great concern and are strictly prohibited from a Shari'ah standpoint.

Gharar can generally refer to the following cases

Absence of Transparency - According to the principles of Shari'ah, transparency is a necessary condition for contracts to be considered valid. The terms of the contract must be clearly understood by all parties involved for it to be deemed equitable and just. Through such requirements, individuals are safeguarded against fraudulent practices, deception, and unfair exploitation.

Deception - Gharar can also connote dishonesty. In a particular incident, Prophet Mohammad encountered a pile of grain in the marketplace of Madinah and touched it with his hand. He noticed that his fingers felt moist. When questioned about it, the trader explained that rain had fallen on the grain. The Prophet then remarked, "Why didn't you separate the wet portion from the dry grain and display it openly? Those who engage in deceit have no association with me" (Muslim). Hence, it is imperative not to withhold pertinent information.

Part of Gharar involves the act of selling something that one does not possess. A typical example of this is when someone sells fish that they have not yet caught in the ocean, or when a seller offers to sell vegetables that they have not yet purchased or acquired. In these situations, the seller does not have actual ownership or possession of the goods being sold. This practice introduces settlement risk and is considered a form of gharar. To mitigate this uncertainty, it is advisable for the seller to first catch the fish or purchase the vegetables from a wholesaler before selling them. By doing so, the risk of uncertainty is minimized. However, there is an exception to this general rule known as a salam contract (Bai' As-Salam), which specifically applies to farm produce that has not yet been harvested. In a salam contract, the buyer pays upfront for a specified quantity of goods, such as one ton, and the delivery of these goods takes place later when the produce is harvested. This type of contract allows for the prepayment and future delivery of goods, providing a framework that addresses the uncertainty associated with selling goods not yet in possession.

Lack of Knowledge - It is crucial for the buyer to possess relevant information regarding the goods they intend to purchase or the contract they plan to enter into. Hence, conducting a thorough inspection of the goods before making a purchase becomes imperative. In terms of the goods being purchased, the buyer should be aware of various aspects such as quantity, attributes, species, and so on. Similarly, when it comes to a contract, both parties involved should possess a comprehensive understanding of the contract's details and its potential outcomes to eliminate any uncertainties.

Undetermined Price - It is essential to specify the price of the sale. This becomes particularly significant when the goods are being purchased on credit, as it helps prevent any disagreements or disputes that may arise at a later stage.

Unspecified Dates - Regarding the delivery of goods, it is possible for the price to be delayed or for the goods to be delayed in their delivery. However, such delays should only occur with the mutual agreement of both the buyer and the seller.

Maysir, also known as the game of chance, is considered a form of gambling due to its unpredictable outcome and involvement of gharar. The Qur'an (2:219) explicitly prohibits the practice of Maysir, making it impermissible according to the principles of Shari'ah. For instance, activities like speculation in short selling, traditional methods of forwards, futures, options, and other derivative transactions are categorized as Maysir since the future delivery of underlying assets remains uncertain, often leading to settlements in cash. Despite Shari'ah's disapproval of excessive gharar, it does acknowledge the existence of risks associated with entrepreneurial ventures and unforeseen events like natural disasters.

Complexity within contractual agreements is not allowed, particularly in cases where two separate sales are intertwined into a single contract. An example of this would be a situation where one party agrees to sell product A at a certain price only if the other party agrees to sell product B at a specified price.

c - The sanctity of contracts

In Islam, it is impermissible to engage in excessive gharar, which refers to uncertainty or ambiguity in contracts. To ensure transparency and honesty, the Shari'ah emphasizes that contracts should include specific prices, clear delivery details, and information regarding the quality and quantity of goods. This information should be accessible to all parties involved, and the outcomes of the contract should be free from any ambiguity. By promoting full disclosure, both parties involved in a contract can eliminate or minimize financial speculation and unnecessary complexity caused by gharar. This entails providing buyers or investors with as much information as possible, including the disclosure of any risks involved.

In the case of partnerships, such as musharakah, all parties need to be aware of their respective profit-sharing ratios, the underlying assets involved, and any other conditions outlined in the contract. Furthermore, it is crucial for the parties involved to reach a mutual agreement on the sale or contract, whether through oral or, preferably, written means, without any form of coercion. Contracts must adhere to the principles of the Shari'ah. Therefore, investments that are deemed unethical, unlawful (haram), or unjust are not permissible. Even if riba (interest) and gharar are not present, it is important to ensure that other prohibited practices are not involved. For instance, financing a casino or engaging in transactions related to alcohol are strictly prohibited.

d - Profit and loss sharing PLS

Profit and loss-sharing measures are at the heart of the Islamic finance system.

Islamic Banking encompasses two primary forms of financing: Equity-Based Financing and Debt-Based Financing. These financing methods stand out from conventional practices because of their strict prohibition of interest. Because of the adoption of PLS contracts, the liabilities section of the balance sheet tends to reflect the assets section, thereby creating a balanced and symmetrical framework. This strategic methodology plays a pivotal role in fortifying the ability of Islamic banks to withstand external disturbances and mitigate the likelihood of insolvency.

e - Debt assets-backed financing

Earning profits using money itself is deemed inappropriate, as all financial dealings must have tangible assets as collateral. Islamic finance emphasizes the importance of linking financing to tangible assets or commodities. This ensures that economic activities are rooted in the real production of goods and services, rather than speculative actions. By requiring tangible backing for debt creation, Islamic finance aims to promote sustainable economic growth and stability, while also mitigating inflationary risks.

3 - Islamic Vs Conventional Banking

The conventional banking sector is currently playing a significant role in the global economy. It is a mature and well-established industry, possessing sufficient depth and complexity. By adhering to appropriate corporate governance and ethical practices, it has the potential to make a valuable contribution to the global economy and continue to face high competition in Islamic banks' operations. On the other hand, the development of modern Islamic finance, which encompasses Islamic banking, is still in its early stages. However, the Islamic finance industry offers a value proposition that applies to Muslims and non-Muslims, as well as corporations, governments, and individuals.

Islamic and traditional banks offer essential services to their clients in the following manner:

- The bank is a legally recognized institution that is authorized to accept deposits from individuals and businesses.
- It plays a crucial role in connecting individuals and businesses who have excess funds to invest with those who need funds for various purposes.
- It facilitates the movement of funds from individuals or businesses with surplus funds to those who require additional funds to meet their financial needs.
- The bank is responsible for overseeing and managing various payment and clearing systems such as electronic funds transfer at point-of-sale

(EFTPOS), card payments, bill payments through BPAY, and processing of cheques.

In addition, Islamic banks adhere to a set of measures that are distinct from the conventional banks' approach to conducting business. These measures include the prohibition of riba (interest, usury), gharar (excessive uncertainty), and haram (impermissible) activities. Islamic banks also prioritize the implementation of the profit and loss sharing (PLS) principle, as well as place a strong emphasis on productivity and real economic activity, rather than solely relying on creditworthiness.

An Islamic financial institution operates as a bank that accepts deposits and offers a range of traditional banking services. It raises funds through mudarabah (profit-sharing) or Wakala (acting as an agent for a fixed fee) on the liabilities side. On the assets side, it provides financing through profit-sharing arrangements, purchases goods for cash and sells them on credit, and engages in various trading, leasing, and manufacturing ventures. The operations of the Islamic banking model can lead to various advantages. These advantages encompass a wider range of contracts available to both savers and entrepreneurs. These contracts span from low-risk trade-linked products to high-risk-sharing contracts. The financial system benefits from the establishment of financial institutions with diverse approaches due to Islamic banking operations. This diversity contributes to the stability of the financial system as different types of banks exhibit varying behavioral characteristics.

The competition among different banking models resulting from Islamic banking operations is anticipated to enhance the efficiency of the financial system. Islamic banking operations cater to the financial needs of Muslims in alignment with their faith. The acceptance of services provided by the industry by the public plays a crucial role in fostering stable and efficient markets, underscoring the significance of plurality and inclusiveness in the development of financial markets. The distribution of financial resources through profit-and-loss sharing (PLS) prioritizes investment profitability over creditworthiness in the conventional system. This method of resource allocation is anticipated to be more effective than one based on interest. Due to the implementation of PLS contracts, the liabilities side of the balance sheet tends to mirror the assets side, resulting in a symmetrical structure. This strategic approach helps to enhance the resilience of Islamic banks against external shocks and insolvency risks.

In both profit-sharing and sale-based contracts, banks generate assets in response to investment opportunities within the real sector of the economy. Furthermore, all financing is tied to commodities or assets, thereby making the actual factors associated with the production of goods and services the primary determinant of the rates of return. This approach prioritizes productive economic activities over speculative maneuvers.

In Islamic finance, the creation of debt typically requires the backing of tangible goods and services. As a result, monetary expansion occurs in tandem with the growth of the real economy. This mechanism is expected to effectively control inflationary pressures. Additionally, the implementation of Islamic finance principles significantly reduces destabilizing speculation and the volatile movement of short-term funds. Islamic banks refrain from providing financial support to projects that are deemed socially undesirable. This commitment to ethical considerations introduces a higher level of social responsibility within the operations of Islamic banks. The responsibility of investment depositors to share bank losses serves as a motivating factor for them to actively monitor their banks' operations and demand higher levels of transparency and more effective audit practices, and corporate governance rules and regulations. Consequently, banks are compelled to conduct more thorough evaluations of their clients' projects and enhance their risk-monitoring capabilities[30].

Islamic banks, along with conventional banks, place great importance on the matter of risk and its impact on the overall viability and longevity of their businesses. The fundamental principles underlying the risk management process and system encompass:

- Establishing Appropriate Risk Management Environment and Sound Policies and Procedures
- Maintaining an Appropriate Risk Measurement, Mitigation, and Monitoring Process
- Adequate Internal Control

Risk management is a process that protects the assets and profit of an organization by reducing the potential for loss before it occurs, mitigating

(30) M. Iqbal, Islamic banking: A fascinating new model of financial intermediation. Islamic Research and Training Institute (IRTI), Saudi Arabia, (2005).

the impact of the loss if it occurs, and executing a swift recovery after the loss occurs(31). Financial institutions are a business entity owned by their shareholders, and the objective of the business entity is to maximize the shareholders' wealth. One way to achieve this objective is for the management to efficiently diversify the unsystematic risk and reduce or transfer the systematic risk. In the financial sector, risk management is an area of high interest due to the financial crises of the last two decades(32).

Several years before the global financial crisis in 2008, various studies called for the importance of efficiently diversifying unsystematic risk and reducing or transferring the systematic risk, especially in the financial sector. The variances in risk management approach between an Islamic financial institution and a conventional bank can be delineated as follows:

Islamic financial institutions can be riskier than conventional financial institutions due to several reasons, including the specific nature of risk and the unlimited number of ways to finance a project using either profit-loss sharing or non-profit loss sharing contracts.

- Scarcity of hedging instruments, undeveloped inter-bank money markets, and a market for government securities that are Shariah-compliant. Therefore, Islamic financial institutions may be more vulnerable to unfavorable events than conventional financial institutions.

- The inability to utilize money markets makes Islamic financial institutions more susceptible to liquidity risk.

For Islamic financial institutions, liquidity risk can be considered one of the most critical risks due to certain factors such as:

(a) limited liability of Shariah-compatible money market and inter-bank market,

(b) Shallow depth of the secondary market for Islamic financial instruments and

(31) B. Coffin, The way forward: Rethinking enterprise risk management. NGR – Núcleo de Gestão de Riscos. Publisher da Risk Management Magazine, Brazil, (2009).

(32) J. Galindo and P. Tamayo, Credit risk assessment using statistical and machine learning: Basic methodology and risk modeling applications, Computing in Economics and Finance, Society for Computational Economics, United States, Retrieved from https://ideas.repec.org/p/sce/scecf7/31.html, (1997).

(c) The problem of the lender as a last resort of the central bank.

A recent study review indicated that there is weak support for *Shariah*-based product development due to the lack of risk mitigation expertise in Islamic banks. The conclusion presented is that in comparison with conventional banks, Islamic banks are more risk-sensitive due to the nature of their products, contract structure, legal costing, governance practices, and liquidity infrastructure(33).

4 - The Growth, Challenges, and Opportunities of Islamic Banking

a - Growth

Islamic banking has emerged as a rapidly expanding sector within the financial market, with a presence in more than seventy-five countries through three hundred institutions. Although previous studies have highlighted the importance of financial institution development in driving economic growth, there is a lack of research on the relationship between the spread of Islamic banking and economic development. A recent empirical study focusing on the economic performance of Islamic banks revealed that the presence of a significant Muslim population is a key factor influencing the proliferation of Islamic banking institutions(34).

The Islamic finance industry witnessed impressive growth in the 21st century, primarily driven by increased demand from Muslims worldwide and the rising global recognition of ethical finance. Key players in this industry include Malaysia, Saudi Arabia, Kuwait, and the UAE, which have established robust regulatory frameworks and supportive infrastructure to foster growth. The introduction of sukuk (Islamic bonds) and the development of Takaful (Islamic insurance) have broadened the range of financial products and services available to consumers in the Islamic finance sector. Additionally, the Islamic finance industry has a massive potential for growth due to the increasing demand for ethical and sustainable financial solutions worldwide.

(33) N. Al Rahahleh and M. I. Bhatti and F.N. Misman, Developments in risk management in Islamic finance: A review, Journal of Risk and Financial Management, MDPI, Switzerland, Vol. 12, Iss. 1, (2019), p.37.

(34) K. Johnson, The role of Islamic banking in economic growth (CMC Senior Theses, No. 642). Claremont McKenna College, United States, (2013). https://scholarship.claremont.edu/cmc_theses/642.

Moreover, the analysis of the short-term and long-term connections between the advancement of Islamic banking and the economic progress in Indonesia revealed a notable correlation in both short-term and long-term time frames. This study presents evidence that, over the long term, the development of Islamic finance is positively and significantly associated with economic growth and capital accumulation. In this context, the domestic financing offered by the Islamic banking sector has been shown to play a role in the expansion of the Indonesian economy. In other terms, Islamic banking has proven to be effective as a financial intermediary that enables the flow of funds from surplus households to those in deficit. Nevertheless, in contrast to previous research, the connection between Islamic financing and economic growth in Indonesia is bi-directional, suggesting that advancements in Islamic banking foster growth, while, concurrently, economic growth enhances the development of Islamic banking in Indonesia[35].

Furthermore, research conducted in Pakistan on the correlation between Islamic banking and economic growth revealed a supply-side connection. The study further highlighted the substantial influence exerted by the Islamic banking industry on the overall economic growth of the country[36]. The Islamic finance industry has experienced significant growth in the last ten years, with an annual expansion rate of 10-12%. In 2015, Sharia-compliant financial assets were estimated to be around US$2 trillion, encompassing both bank and non-bank financial institutions, capital markets, money markets, and insurance services known as “Takaful”. Notably, Islamic banking assets have been growing at a faster pace than conventional banking assets in many majority-Muslim countries.

Moreover, there has been a notable increase in interest in Islamic finance from non-Muslim nations such as the UK, Luxembourg, South Africa, and Hong Kong. In recent years, Islamic finance has emerged as a valuable tool for financing development on a global scale, even in non-Muslim countries. Prominent financial markets have recognized substantial evidence that Islamic

(35) M. Abduh and M. A. Omar, Islamic banking and economic growth: The Indonesian experience. International Journal of Islamic and Middle Eastern Finance and Management, Emerald Publishing Limited, United Kingdom, Vol. 5, Iss. 1, (2012), pp. 43-44.

(36) R. Kalim and A. Mushtaq and N. Arshed, Islamic banking and economic growth: A case of Pakistan. Islamic Banking and Finance Review Journal, University of Management and Technology (UMTI), Pakistan, Vol. 3, (2016), pp. 29-43.

finance has already become an integral part of the global financial system. Furthermore, it holds the potential to address the challenges of eradicating extreme poverty and promoting shared prosperity(37).

The global Islamic finance industry has experienced significant growth, with its asset size increasing by 11% to US$4.5 trillion in 2022(38). Over the past decade, this industry has evolved from being a niche market to becoming mainstream in various countries, illustrating the potential for a small sector to expand into a substantial standalone industry. Figure 1 shows the total value of Islamic finance assets worldwide from 2020 to 2023 with a projection for 2027.

This expansion is indicative of a robust industry supported by strong balance sheets, lucrative profits, regulatory backing, and sustained demand from customers and investors across diverse regions. Projections suggest that Islamic finance will continue to expand, with assets expected to reach US$6.7 trillion by 2027.

Figure 1. Depiction of the total value of Islamic finance assets worldwide from 2020 to 2023 with a projection for 2027. Source: Islamic Finance Development

Various significant elements play a role in shaping this perspective. This includes the robust Islamic finance markets in regions like the GCC, Malaysia, and Indonesia, which are consistently enhancing their local Islamic finance sectors. Additionally, Pakistan is making efforts to meet the criteria for transitioning its financial system to be free of interest, in line with the Federal Shariah Court's ruling on Riba in 2022. Furthermore, in various regions across the globe, different legal systems are striving to further integrate the Islamic finance industry through regulatory frameworks, as seen in West African countries.

Numerous regions have implemented extensive plans, allocated resources toward developing their workforce and educational systems, hosted industry

(37) A. A. Alawode, Global report on Islamic finance: Islamic finance – A catalyst for shared prosperity. World Bank and Islamic Development Bank Group, Washington, DC, United States, (2017), ttps://hdl.handle.net/10986/25738.

(38) Islamic Finance Development Indicator Report 2023, London Stock Exchange Group (LSEG), London, UK.

gatherings, and released specialized publications. Countries like Indonesia, Malaysia, Saudi Arabia, and Turkey have gone a step further by incorporating Islamic finance indicators into their overall economic plans and frameworks. These efforts have yielded significant results, with asset growth rates reaching double digits in recent years. By the conclusion of 2022, the total assets of Islamic banks worldwide experienced a significant surge, reaching a staggering USD 3.24 trillion. This remarkable growth can be observed when comparing it to the USD 1.3 trillion recorded in 2012. Moreover, the number of fully-fledged Islamic banks witnessed a notable increase of 36%, totaling 336 establishments in 2022.

Additionally, conventional banks offering Islamic windows or services also saw a substantial rise of 84%, reaching a count of 274 in the same year. Notably, Saudi Arabia, the United Arab Emirates, and Iran emerged as the frontrunners in the Islamic banking sector's expansion over the past decade. These countries capitalized on the early years' improvement of their local currencies, contributing to their remarkable growth in this domain(39).

Islamic banking has been a significant contributor to the growth of the global Islamic financial industry over the past decade, holding approximately 70% of its assets. Despite facing market fluctuations from 2012 to 2022, Islamic banks have demonstrated resilience, particularly in recovering from the challenges posed by the COVID-19 pandemic and economic uncertainties post-2020. This has led investors to show increased confidence in Islamic banking institutions, resulting in higher capital inflows and investments. Throughout the past decade, the global landscape of Islamic banking has witnessed significant changes. Various countries, including Oman, have embraced Islamic banks, marking a notable shift in the Gulf Cooperation Council (GCC) region.

Conversely, countries like Qatar have chosen to close their Islamic windows. The Qatar Central Bank's decision was based on supervisory concerns. These concerns encompass the challenges of efficiently overseeing banking risks in a "combined" banking model, ensuring consistent financial reporting given the overlapping nature of Islamic and non-Islamic activities, navigating the intricacies of implementing unified capital adequacy standards,

(39) S. Hasan and S. Mohamed, LSEG data & analytics insights, London Stock Exchange Group, London, UK, (2024).

and addressing the bias that arises from competition between banks and their levels of transparency.

Beyond the GCC, nations in different parts of the world have also shown a growing interest in Islamic banking. Turkey, Kazakhstan, Uzbekistan, Nigeria, Uganda, and the Philippines are among the prominent examples of countries outside the GCC that have started to prioritize Islamic banking. Furthermore, governments have been actively promoting consolidation within the banking sector to establish mega banks with a global presence. This trend has resulted in numerous mergers and acquisitions in key Islamic finance markets, starting with the United Arab Emirates and extending to Indonesia, Malaysia, Bahrain, Kuwait, Saudi Arabia, and other countries.

The development of Islamic banking has also been influenced by advancements in financial technology (FinTech), digital banking, and artificial intelligence (AI). These technological innovations have had a tangible impact on the industry's growth leading up to 2022. Notably, several digital banks have emerged in Malaysia, Indonesia, Bahrain, Saudi Arabia, Kuwait, Turkey, and the United Kingdom, contributing to the expansion of Islamic banking services. Moreover, sustainable finance has gained increasing importance within Islamic banks. This has prompted the establishment of new departments and frameworks dedicated to environmental, social, and governance (ESG) considerations, as well as sustainable finance and investments. The integration of sustainable practices has further enhanced the development of Islamic banking in recent years.

If developed globally, Islamic finance assets could grow to approximately US$7 trillion in the next decade, based on the best-case scenario. This growth would mean the industry nearly triples in ten years, contributing an additional US$4 trillion per annum to the global economy, and creating an additional 150 million jobs. The value of the global Islamic finance industry increased to an estimated USD 3.25 trillion in 2022 (from USD 3.06 trillion in 2021). The Islamic finance industry sustained its growth momentum with a rate of 6.2% year-on-year (y-o-y) based on significant improvement, especially in the Islamic banking and Islamic capital markets segments in some key markets. Furthermore, the financial stability indicators remained satisfactory, especially when compared with previous years' performance, conventional peers, and assessment criteria used by international standard-setting bodies. Based on cautious optimism given the downside risks, growth in Islamic finance industry assets, financial soundness, and resilience indicators are envisaged in many jurisdictions of the Islamic finance industry in 2023. Within the Islamic finance industry, Islamic banking remained dominant, with an asset size of USD 2.25 trillion, accounting for 69.3% of the global Islamic finance industry assets. The Islamic capital market segment, including sukuk (Islamic bonds), Islamic funds, and Islamic equities, experienced slower growth rates compared to previous years. The sukuk sub-segment, which retained its dominance, grew by 7.0% in 2022, while Islamic funds grew marginally by 1.0%(40).

b - Challenges

While the Islamic finance industry has experienced significant growth, it also faces challenges such as standardization, regulatory coordination, and capacity development. Despite these challenges, efforts have been made to establish common Shariah standards and enhance governance and transparency to ensure the industry's long-term sustainability. Establishing standardization is a key concern for the Islamic finance sector, as confusion arises from the differing opinions of Sharia boards among various banks. To resolve this issue, Islamic banks have been advocating for the development of comprehensive national and even international standards.

While the global Islamic finance industry has witnessed an impressive annual growth rate of 15% for its assets, with a projected total volume of USD 5.9 trillion by 2026 (compared to USD 4 trillion in 2021), the size of its global financial assets is "still trivial," with some estimates of a meager 1 percent. The Islamic finance industry is emerging as a powerful catalyst for economic development in several countries, as evidenced by recent data. Islamic banks have experienced a growth rate of 1% in their assets, surpassing conventional banks' growth rate of 0.04%. Furthermore, the Islamic finance sector has significantly contributed to increased credit provision to the private sector in countries such as the Gulf Cooperation Council (GCC) member states, Malaysia, and Indonesia. The development of

(40) Islamic Finance Development Report (February 2024), produced by the London Stock Exchange Group in partnership with the Islamic Corporation for the Development of the Private Sector (ICD), Islamic Development Bank Group, London, UK.
Global Forum on Islamic Economics and Finance (GFIEF), Shaping a resilient global Islamic economy through values-based reforms (Conference session), (28-29 May 2024), Central Bank of Malaysia, Conference held in Kuala Lumpur.

Islamic finance has led to an additional credit volume of $258 billion in these countries between 2004 and 2013. The conventional debt securities market, which has an estimated size of $78 trillion, is extremely greater than the size of the Sukuk market, with $240bn outstanding, which is quite marginal if compared together. Moreover, the Takaful, or Islamic insurance, industry is even smaller, a minuscule part of the global insurance industry(41).

Nevertheless, in GCC countries and Malaysia, where Islamic banks have a significant presence, their share does not exceed a third of the total market share, except in Kuwait and Saudi Arabia. This failure to reach critical mass coupled with an elevated level of fragmentation has caused margin erosion. Some studies indicate that Islamic banks' profitability has been inadequate partly due to structural factors, as products are complex and add to the cost.

Moreover, Islamic finance is mainly focused on Islamic banking, which accounts for around 83 percent of the industry assets. Sukuk makes up another 12 percent, with the rest falling under Islamic funds and Takaful. The amount of short-term, tradable Sharia-compliant instruments is limited and central banks' short-term Sukuk are not regularly issued in international currencies(42).

It is an indisputable reality that Islamic banking has emerged as a significant force in the financial realm. Despite the global financial crisis, this sector has experienced continuous expansion, garnering even greater attention. Non-Muslim nations worldwide are vying with one another to establish themselves as centers of Islamic finance. Nevertheless, this phenomenon is not without its drawbacks. The remarkable popularity and growth of Islamic banking are accompanied by challenges. Islamic banks are subject to strict regulations and monitoring by various organizations at local and international levels, such as central banks and capital markets authorities etc. They operate within a dual regulatory framework, ensuring compliance with both Sharia principles and conventional banking regulations. This presents difficulties in terms of adherence, as certain regulations may clash with Islamic banking principles.

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(41) 5th World Islamic Banking Conference: Asia Summit (WIBC Asia), Expanding the boundaries of Islamic finance: Complementing domestic growth with international linkages [Conference sessions], (June 3-4,2014), Monetary Authority of Singapore (MAS), Conference held in Singapore.

(42) MEED Middle East Business Intelligence (2013), The third annual Middle East Islamic Finance and Investment Conference, Dubai, United Arab Emirates.

A significant obstacle encountered by Islamic banks is the innovation and diversification of products. Developing new financial products that align with Sharia principles and cater to the changing demands of customers poses challenges. Continuous innovation and diversification of products are essential to appeal to a broader customer demographic. In addition, the implementation of risk, compliance, and corporate governance policies and procedures addressing vulnerabilities is a critical challenge faced by Islamic banks. Islamic banks also face challenges in managing risk effectively and ensuring robust governance structures. Sharia-compliant risk management practices require a different approach to conventional banking, requiring specialized expertise and systems that are not readily available(43).

At present, the Islamic Financial Industry lacks a centralized authority or singular entity that regulates its operations. Additionally, there is a dearth of standardized rules and principles governing the interpretation of Shariah, known as “Fatwa”. Each Islamic Bank operates with its own Shariah board, which is responsible for ensuring that the bank’s activities adhere to Shariah Law. These boards typically consist of Shariah scholars who possess expertise in both Shariah and finance. However, the scarcity of scholars proficient in both fields often results in an overwhelming workload for Shariah boards, leading to challenges in the approval process. In situations where explicit guidance from the Quran and Sunnah is lacking, it becomes necessary to seek a Fatwa. A Fatwa is a religious decree provided by a knowledgeable scholar regarding matters concerning Islamic law(44). By resolving controversies and addressing significant challenges, Fatwa plays a crucial role in the Islamic Financial Industry. However, seeking opinions and rulings from Islamic Scholars when there is uncertainty regarding the compliance of a particular product or banking activity with Shariah principles poses a threat to the Islamic Finance Industry. This practice hinders the harmonization of Fatwa, which is necessary to minimize complexities, execution difficulties, and the cost of structuring Islamic financial products. Ultimately, this lack of harmonization leads to consumer and investor uncertainty regarding the Shariah compliance of the

(43) M. S. Malik and W. Mustafa, Controversies that make Islamic banking controversial: An analysis of issues and challenges. American Journal of Social and Management Sciences, Science Huβ, United States, Vol. 2, Iss. 1, (2011), pp.41-46.

(44) See, A. Ali, Islamic Banking. Journal of Islamic Banking and Finance, The Brooklyn Research and Publishing Institute, New York, United States, Vol. 4, Iss. 1, (2005), pp.31-56.

offered products, gradually eroding faith in Islamic finance(45).

The coexistence of different sects in Islam gives rise to the problem of varying interpretations of established Shariah rulings. This leads to instances where Shariah committees may issue contradictory decisions. An item that is deemed permissible by one committee may be deemed impermissible by another committee within the same jurisdiction. Discrepancies also exist between different countries and regions. For instance, Malaysia has more relaxed Islamic financial restrictions compared to the Middle East, where financial regulations are enforced more strictly(46). The scarcity of proficient individuals well-versed in both conventional banking and Islamic laws poses a significant challenge for Islamic Banking(47). A comprehensive understanding of conventional banking enables one to comprehend Islamic products effortlessly. Without a thorough grasp of the distinctive regulations governing Islam, it becomes exceedingly difficult to effectively develop and promote these financial offerings. Profit and loss sharing is a fundamental principle in Islamic Finance. Islamic Banking strictly requires that all financing activities be supported by tangible assets. Nevertheless, the discrepancy between long-term, illiquid assets and short-term liabilities can pose significant challenges, as demonstrated by the liquidity crisis experienced by Western banks, leading to severe shortcomings and a near-global financial collapse(48).

The Islamic finance industry is particularly vulnerable to liquidity risk due to the lack of a Shariah-compliant repo market and the various restrictions faced by Islamic banks when accessing interbank instruments. This challenge forces banks to maintain an excessively liquid balance sheet, which in turn hampers profitability and ultimately diminishes shareholder value. Islamic banks commonly encounter two types of liquidity problems. Some banks have

(45) H. Lawai, Key features in Islamic banking, Journal of Islamic Banking and Finance, International Association of Islamic Banks (Asian Region), Karachi, Pakistan, Vol. 11, Iss. 4, (1994), pp.7-13.

(46) SunGard, Islamic banking and finance: Growth and challenges ahead, SunGard Financial Systems, Pennsylvania, United States, (2008).

(47) M. Iqbal and P. Molyneux, Thirty years of Islamic banking: History, performance, and prospects. Islamic Economic Studies, Islamic Research and Training Institute (IRTI), Jeddah, Saudi Arabia, Vol. 19, Iss. 1, (2005), pp.37-39.

(48) W. Aktar and N. Akhtar and K.A. Jaffri, Islamic micro-finance and poverty alleviation: A case of Pakistan. COMSATA Institute of Information Technology (CIIT), Lahore, Pakistan, In Proceedings of the 2nd CBRC, (2009), pp.1-8.

an excess of liquidity but struggle to find suitable investment opportunities for short periods, resulting in a high cost of money due to missed investment prospects. On the other hand, some banks experience liquidity shortages when depositors withdraw funds, leaving them without access to necessary funds for short periods(49).

In 2022, the financial sector regulators faced new challenges due to technological advancements. Regulatory and Supervisory Authorities were vigilant in safeguarding financial market integrity, stability, and consumer protection amidst the rapid pace of technological financial innovation. The emergence of crypto assets, known for their high volatility and correlation with equities, posed substantial risks to financial stability. To mitigate these risks, regulators considered implementing exchange restrictions, capital flow management, and enhancing regulatory oversight for disclosure and transparency practices. Regulators must strike a balance between fostering innovation and effective risk management through the implementation of appropriate regulations to uphold market integrity and stability. Islamic financial products, in contrast to conventionally structured products, are typically more intricate due to Shariah compliance requirements. This adherence to Islamic principles results in a more complex structuring process, ultimately leading to increased transaction costs. The Islamic banking industry should reconsider its approach to accommodate the rising demand for more complex products and services. Rather than duplicating conventional banking offerings, it should strive for innovation to address the expanding requirements of its customer base(50).

According to the Islamic Financial Services Board (*IFSB* 2023) report, while certain countries that practice Islamic finance continue to strictly prohibit Central Bank Digital Currencies (CBDCs), notable progress has been observed in other nations during 2022. For instance, Indonesia does not permit the use of CBDCs in Islamic finance transactions due to the presence of gharar in these digital currencies. Similarly, Morocco and Algeria currently do not allow CBDCs. However, countries such as Nigeria and those in the

(49) S. A. Sheikh, "Critical Analysis of Current Islamic Banking System." [online] Available at:http:// www. accountancy. com. Pk. (2007).

(50) Z. Iqbal and A. Mirakhor and N. Krichenne and H. Askari, The stability of Islamic finance: Creating a resilient financial environment for a secure future. John Wiley & Sons, United States, (2010).

GCC, where Islamic finance is prevalent, have already initiated efforts to adopt CBDCs. Despite the numerous advantages they offer, Central Bank Digital Currencies (CBDCs) also present notable risks. This is particularly true in countries with underdeveloped banking systems, weak macroeconomic fundamentals, and low levels of digital payment adoption. Consequently, the implications of CBDCs on monetary policy, through changes in retail, wholesale, and cross-border payments, could be substantial.

Additionally, the higher proportion of unremunerated deposits in Islamic banking, compared to conventional banking, may render the former more susceptible to disintermediation if individuals opt to hold CBDCs in significant quantities. This would not only compress banks' profit margins but also increase their funding expenses. Furthermore, according to the Council for Islamic Banks and Financial Institutions (CIBAFI), Islamic banks would face a disadvantage if a central bank were to implement CBDCs with an embedded interest-bearing design for monetary policy purposes. This further highlights the necessity of establishing a Shari'ah-compliant monetary and financial safety net that is equivalent to the existing forms of money.

Further growth of Islamic banking would require separating itself from copying conventional banking instruments and offering products that better reflect the fundamentals of Islamic finance. Having said that, Hans Visser in his book Islamic Finance: Principles and Practice, questions the conceptual differences that have been established between Islamic finance and conventional finance, drawing attention instead to how the former imitates the latter(51). The Islamic Financial Industry possesses significant potential for further expansion and advancement. Nevertheless, several existing and forthcoming challenges must be addressed to guarantee the desired prosperity and sustained equilibrium in growth.

The Islamic Financial Services Board *(IFSB)* reported that most Islamic banks' financing assets, specifically 68%, are focused on Murabaha, with Ijara following at 14%. The remaining Islamic financial products account for only 18% of the total financing assets. This significant concentration and limited diversification of products pose a critical challenge for the industry, particularly since a substantial portion of the assets provided under Murabaha

(51) H. Visser, Islamic finance: Principles and practice (3rd ed.), Edward Elgar Publishing, United Kingdom, (2019).

are commodity-based, resulting in restricted economic impact due to its inherent structure. Typically, a significant concern arises from the attempt of certain Islamic banks to replicate the traditional banking model. Rather than prioritizing the development of a Sharia-based framework, these banks have chosen to adhere to Shariah compliance through minor adjustments to conventional products. Consequently, this method has led to a substantial departure from the fundamental principles of Islamic finance, impeding genuine innovation.

Recent research used a fixed effect panel data analysis on a sample of 270 banks (111 Islamic and 159 conventional banks) from 12 Middle East countries covering the period 2012-2020. The results show that bank size, equity to assets, annual GDP growth, and annual average oil price have a significant positive effect on Islamic banks' profitability, while non-performing loans to total gross loans and cost of running operations to operating income have a significant negative effect on both bank types. The results also show that non-performing loans to total gross loans and annual GDP growth contribute more to conventional banks' profitability, while oil price contributes only to Islamic bank's performance. Inflation and net loans to total assets have no effect on bank profitability for either Islamic or conventional banks(52).

c - opportunities

Islamic banks have a crucial goal of expanding their presence in the global market. The rise of Islamic finance provides Islamic banks with chances to enter new markets and appeal to a varied customer base interested in Sharia-compliant financial services. Developing economies with substantial Muslim populations provide unexplored possibilities for Islamic banks. The global community is currently grappling with a range of economic and social obstacles that necessitate a collaborative effort. These challenges include market instability, limited economic variety, insufficient social involvement, poverty, and unemployment, among others. However, by adhering to its fundamental principles, Islamic finance has the potential to play a significant role in tackling these issues.

(52) I. Sobol and L. Dopierała and P. Wysiński, Is the profitability of Islamic and conventional banks driven by the same factors? A study of banking in the Middle East. Public Library of Science (PLOS), United States, Vol.18, Iss. 8, (2023), https://doi.org/10.1371/journal.pone.0289264

Islamic finance has the potential to promote financial inclusion by offering ethical banking services to underserved and marginalized communities. Through profit-sharing arrangements and risk-sharing models, Islamic financial institutions can provide access to credit and investment opportunities for individuals and businesses that may be excluded from conventional banking systems. Islamic finance promotes responsible and ethical investing by aligning financial activities with social and environmental values. This approach resonates with the growing demand for sustainable and socially responsible investments in the global financial market, attracting investors who seek to generate a positive impact while earning returns on their investments.

Islamic finance has demonstrated resilience during economic downturns and financial crises, attributed to its risk-sharing principles and asset-backed transactions. By promoting stability and transparency in financial transactions, Islamic finance contributes to enhancing the overall stability of the global economy. Islamic finance could be a global value proposition, to governments, corporations, and consumers, both Muslim and non-Muslim, which can initiate sustainable and inclusive economic growth, and shared prosperity for all since Islamic finance is a globally accepted ethical value.

The integration of technological advancements and digital banking options offers Islamic banks the potential to boost their effectiveness, enhance customer satisfaction, and broaden their reach. Fintech innovations can assist Islamic banks in addressing operational hurdles and simplifying their operations.

Islamic banks could strengthen their offerings, broaden their scope, and foster innovation by establishing partnerships with conventional banks, fintech companies, and other key players in the industry. Through these collaborations, Islamic banks can effectively address regulatory obstacles and enter untapped markets. The global value proposition that could be presented by the Islamic finance industry is based on principles such as profit and loss sharing, transactions backed by tangible assets, a commitment to responsible and ethical investments, and restrictions on speculative transactions, synthetic instruments, and industries that do not contribute to the welfare of the community.

The fundamental principles mentioned have widespread acceptance across various sectors such as governments, corporations, and consumers, spanning both developed and emerging markets, and appealing to individuals of different religious backgrounds. By adhering to these core principles, industry can play a crucial role in promoting inclusive growth throughout the value chain, enhancing productivity, and delivering economic and social advantages to society.

Despite its impressive growth over the past forty years, the Islamic finance industry still only represents around 2% of the global finance industry. Although more than eighty countries have adopted some form of Islamic finance, its presence remains limited outside of key markets in the Middle East, North Africa, and South and Southeast Asia. However, if certain conditions are met, such as the implementation of appropriate Islamic finance standards, corporate governance, ethics, and effective risk management, the Islamic finance industry has the potential to contribute to addressing today's economic, social, and financial challenges.

Islamic Banking institutions have a crucial responsibility to ensure that their offerings are not only compliant with Sharia law but also in line with the fundamental principles of Islamic finance. By adhering to these principles diligently, these institutions can effectively contribute to the advancement of inclusive economic growth, social development, and financial inclusion. Among the key areas that demand attention from Islamic financial institutions is research and development (R&D). By prioritizing R&D, these institutions can foster innovation in the creation of new products and services that align with Sharia principles and cater to the specific needs of the community. Additionally, this focus on R&D can help address the issue of product concentration within their portfolios, ensuring a more diversified and balanced range of offerings.

Instead of emphasizing Murabaha, the Islamic finance industry could have opted for a more frequent utilization of Salam and Istisna. These alternative modes of financing involve the creation and development of tangible economic assets, thereby potentially yielding a substantial impact on the overall economy. According to CBK analysis indicates that by prioritizing these two products, a staggering amount of approximately US$800 billion could be made available within the next five years for the advancement of real assets across vital economic sectors such as manufacturing, construction, and agriculture[53].

(53) M. Y. Al-Hashel, CBK-IFSB Conference on Islamic Finance: Islamic Finance: A Univer-

This strategic shift would not only foster product diversification but also enhance productivity and inclusiveness, thereby generating a multiplier effect that permeates throughout the broader economy. The lack of collaboration between stakeholders and Sharia scholars in addressing the issue of product stagnation and industry innovation and compliance has significant implications. It is crucial for the overall growth and progress of the Islamic finance industry that all parties involved come together to find solutions. By doing so, we can ensure that Islamic finance fulfills its potential in addressing the economic and social challenges of our time. Everyone within the industry has a vital role to play in its development, and it is through collective efforts that we can establish a strong foundation for sustainable growth.

The fundamental principles of Islamic finance previously discussed are inherently well-suited to the requirements of the SME sector. This correlation has been validated by research conducted by various organizations, such as the World Bank, which released a report in 2014 indicating that the higher the number of Islamic banks per 100,000 adults in a country, the smaller the percentage of SME enterprises that viewed access to finance as a significant obstacle.

The Islamic finance sector necessitates a constant focus on enhancing capabilities and conducting continuous training and development. It is imperative to provide training to professionals and enhance their expertise, empowering them to not only adapt to but also propel the expansion and progress of the Islamic finance industry. In this context, the involvement of academic institutions and Sharia scholars holds paramount importance.

The widespread presence of Islamic finance education in non-Muslim countries highlights the global interest in this field. Out of the 680 Islamic finance education providers worldwide, 34% are in non-Muslim nations. Nevertheless, there remains a significant disparity between theoretical knowledge and practical application within academic institutions, resulting in a shortage of graduates who are adequately prepared for the industry. Academia must address this issue by creating curricula that combine theoretical foundations with industry-specific skills, fostering innovation and leadership within the Islamic finance sector.

Despite the slight advancements in capacity building, there is still a

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sal Value Proposition, Central Bank of Kuwait, (2018).

considerable distance to cover. This fact is supported by the findings of a recent survey carried out by the *IFSB*, which reveals that a significant 82% of Islamic finance markets face a scarcity of skilled individuals. Furthermore, it highlights that 60% of Islamic finance professionals need additional training and skill enhancement. These statistics indicate that there is a pressing need to address the talent gap and invest in further development within the Islamic finance industry.

Furthermore, a significant obstacle that the industry has encountered is the scarcity of scholars who serve on multiple Sharia boards. When considering the industry, it appears to be adequately balanced, as 1,075 scholars are serving on the boards of 1,400 Islamic financial institutions. However, upon closer inspection, the issue becomes apparent, as eight scholars hold more than thirty board seats each. This scarcity poses a challenge for industry, and it does not end there. This scarcity extends even further, with three scholars holding over seventy board seats each(54).

The Islamic banking and finance system has emerged as a unique method of financing, offering distinct value and operational propositions. It has been present in its modern form in the GCC region since the mid-1970s and has gradually gained significance in the global financial system since the 1990s. Its resilience and growth, even during times of financial crisis, have demonstrated its sustainability. This system, known as “commercial banking,” in its modern version, operates following Shari’ah compliance, making it accessible to countries regardless of their religious nature.

The EU economies have unquestionably benefited from the contributions of Islamic banking and finance, and further advancements in this field are expected in the coming years. However, the absence of a common financial system within the EU poses challenges to the expansion of Islamic banking and finance. Nevertheless, countries that have already adopted this system can provide valuable experiences and social capital to assist other countries in adapting their legal and regulatory frameworks(55).

(54) Ibid

(55) M. Asutay, Islamic banking and finance and its role in the GCC and the EU relationship: Principles, developments, and the bridge role of Islamic finance, In L. Stenberg & C. Koch (Eds.), The EU and the GCC: Challenges and prospects under the Swedish EU Presidency, Gulf Research Center, United Arab Emirates, (2010), pp. 35–58.

In addition to its economic contributions, Islamic banking and finance has the potential to play a significant role in bridging political differences between the GCC and EU countries. It can serve as a platform for civilizational dialogue and foster peaceful coexistence through its financing activities. By bringing different worlds together, Islamic banking and finance can contribute to a harmonious global society. The growing importance and recognition of Islamic finance in global markets highlight its capacity to improve worldwide financial inclusivity and stability, as well as expand its utilization of cutting-edge products and services to adapt to the advancements of modernization and globalization.

5 - Significance of Islamic Finance and Banking in the Global Financial Crisis

Recent instability and financial institutions' collapse in the U.S. and the EU have led to a renewed interest in corporate governance and Islamic finance and banking principles. Thus, the decisive judgment selected to exit the crisis was to assess the mechanisms of banking governance and explore the existing alternative Islamic banking system. Islamic banking may practice the same governance mechanisms as a conventional bank, as well as the Shariah boards, the Shariah review unit, the Islamic International Rating Agency (IIRA), and the Islamic Financial Services Board (IFSB) like main bodies monitoring the Islamic Banking industry.

In contrast to conventional banks, Islamic banks are based on the active involvement of public policy institutions, regulatory and supervisory authorities (Central banks and Capital Markets Authorities), and Shariah authorities.

These institutions collectively monitor the operation of the banks and their authenticity and obligation to explicit as well as implicit Islamic finance transaction contracts.

Following the global financial crisis, the chairman of the "World Economic Forum" emphasized the need for change in economic systems to avoid further decline and suffering. This call for reshaping economic structures based on values, principles, and modern ideologies was echoed by Islamic finance and banking experts, who highlighted the importance of incorporating Islamic beliefs into social, political, and economic frameworks for the benefit of all humanity(56).

(56) M. T. Usmani, Causes and remedies of the recent financial crisis from an Islamic perspec-

Islamic finance and banking have gained recognition for their resilience during financial crises and their adherence to ethical and sustainable business practices. As the global economy faces increasing volatility and ethical challenges, Islamic finance offers a viable alternative that promotes financial stability, inclusivity, and social responsibility.

"Assist one another in righteousness and piety. And do not assist one another in sin and transgression…" (Qur'an 5:2)

- One objective of Islamic finance and banking is to assist in the spread of economic prosperity. The other objective is to do this under Shari'ah principles.
- Among the norms concerning Islamic finance are a free market, where prices are determined by demand and supply, freedom from manipulation, prevention of hoarding, profit and loss sharing in partnerships, information efficiency, etc.

A statement released by the Vatican's official newspaper, Osservatore Romano, highlights that the ethical principles underpinning Islamic finance have the potential to foster stronger connections between banks and their clients, as well as align with the genuine essence that should characterize every financial service(57).

The recent collapse of certain banks in the United States serves as a stark reminder of the potential consequences of a sudden erosion of trust in the banking sector. The failures of Silicon Valley Bank (SVB) and Signature Bank, along with the forced sale of First Republic Bank to JP Morgan, and the acquisition of Credit Suisse by UBS, a key financial institution, are clear indicators of the impact of global financial constraints aimed at addressing inflationary pressures. The global financial system is facing considerable strain due to the ongoing rise in policy rates following a prolonged period of near-zero interest rates. While Islamic banks do not share the same funding structure as SVB and have limited direct involvement in the current situation, the measures implemented by US financial regulators have helped mitigate the risk of contagion.

tive, Turath Publishing, United Kingdom, (2022).

(57) L. Totaro, The Vatican says Islamic finance may help Western banks in crisis. Bloomberg.com. Retrieved from https://www.cimer.org.au/wp-content/uploads/documents/vatican.pdf, (2010, February 17).

Nevertheless, there remains a potential for indirect repercussions, such as heightened risk aversion among institutional investors, resulting in a funding shortage and higher financing expenses within the global financial system amidst market turbulence and financial vulnerabilities. According to the data from a recent study issued by the Kuwait Institute of Banking Studies Research, the average monthly usage of online Chatbot services in Kuwaiti banks was 6003.5 in February 2021, amidst the COVID-19 pandemic. However, in February 2022, after the pandemic, the usage slightly decreased to 4824.5 per month(58). It is worth noting that most of the selected banks did not offer Chatbot services to their customers before the pandemic, resulting in zero usage. Considering this, the overall growth in Chatbot usage in Kuwaiti banks before and during the pandemic was 60% over two years. This growth highlights the significance of this technology during times of crisis. Kuwaiti banks must persist in investing in and enhancing their Chatbot services to uphold their competitive edge, cater to the changing demands of their customers, and ensure readiness for unforeseen calamities that may occur at any given moment.

The influence of online banking in Kuwait before, during (lockdowns and social distancing), and post the COVID-19 pandemic has been notably substantial and has had a positive effect on the economy. As per the research conducted by the Kuwait Institute of Banking Studies, recent survey data indicate that during the first year of the pandemic, there was a significant surge of over 40% in the utilization of online banking in Kuwait. Additionally, the study highlighted that security (enhanced encryption protocols and two-factor authentication) and convenience of online banking services experienced significant enhancements.

The research also determined that Kuwaiti banks have invested significantly in digital banking technology to enhance customer satisfaction. Ultimately, the online banking landscape in Kuwait has been significantly altered by the COVID-19 pandemic, leading to customers now enjoying more secure and convenient access to banking services(59).

(58) Kuwait Institute of Banking Studies (KIBS), Digitalization of financial services: Opportunities & threats to Kuwaiti banks. Retrieved from https://kibs.edu.kw/wp-content/uploads/2023/09/Digitalization-of-Financial-Services.-Opportunities-Threats-To-Kuwait-Banks.pdf

(59) S. Toglaw, Economic anxiety and the performance of SMEs during COVID-19: A cross-

The pandemic has significantly influenced the expansion and utilization of online banking, hastened the introduction of new services, and transformed the functionality of online products. As an illustration, amid the pandemic, CBK hastened the finalization of the regulatory framework necessary for offering digital loans[(60)]. Digital banking services have empowered Kuwaiti banks to lower operational expenses and enhance productivity, enabling them to stay competitive despite the economic challenges brought about by the pandemic. Additionally, digital banking services have provided customers with greater access to various banking services, including loans and credit facilities, which have proven advantageous for businesses during the pandemic.

It is important to highlight that the worldwide economic downturn has captured the interest of numerous international organizations and other relevant and expert entities, prompting them to consider reevaluating the global financial system. Consequently, the emergence of the Islamic Financial Services Industry has been recognized as a potential alternative that could address the financial challenges and avert comparable crises.

From the researcher's perspective, the present circumstances continue to provide a suitable stage for the Islamic Financial Industry to showcase its expertise and credibility to the global community. Therefore, the industry must validate its potential by offering effective financial tools and products meticulously structured and designed to provide additional value. These offerings should not only attract interested parties and investors but also serve as a viable alternative to conventional financial instruments and products. Capitalizing on this favorable opportunity necessitates a heightened focus on research and innovation, particularly in the realm of risk management. This aspect poses a significant challenge for the Islamic Financial Industry due to its limited risk measurement tools and expertise compared to conventional counterparts. Consequently, it becomes the responsibility of Islamic financial institutions to enhance their risk management and internal supervision systems, while also implementing prudent policies in money markets and financial activities.

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national study in Kuwait, Multidisciplinary Digital Publishing Institute (MDPI), Switzerland, Sustainability, Vol. 14, Iss. 3, (2022), p.1112. https://www.mdpi.com/1456266,

(60) Central Bank of Kuwait (CBK), Financial stability report. Retrieved from https://www.cbk.gov.kw/en/images/stability-report-2021-160562_v10_tcm10-160562.pdf

6 - Banking System in Kuwait

To gain a comprehensive understanding of Islamic banking in Kuwait, it is essential to first focus on the financial stability of the broader Kuwaiti banking sector. The Kuwaiti banking sector has consistently exhibited its ability to adapt to diverse economic circumstances by implementing deliberate strategies that enable it to seize opportunities, especially during periods of substantial economic adversity. This enables the sector to attain its targeted growth rates, establishing itself as a leader in the domains of finance and commerce. Consequently, it assumes a crucial role in driving the nation's economy forward and effectively maneuvering through crises.

Kuwaiti banks are renowned for their exceptional performance both regionally and globally. Several Kuwaiti banks have established a strong presence across multiple continents, with branches and subsidiary banks operating in numerous countries worldwide. These banks have expanded their reach to the Middle East and North Africa, including countries such as Iraq, Bahrain, Lebanon, Egypt, the United Arab Emirates, and the Kingdom of Saudi Arabia.

Additionally, they have extended their operations to Europe, encompassing the United Kingdom, France, and even the United States of America. Furthermore, they have ventured into the Asian market, with branches in Singapore and China. Undoubtedly, this extensive network of branches and subsidiaries is one of the key advantages that Kuwaiti banks possess, making them highly competitive in the industry. Moreover, some Kuwaiti banks rank among the largest in the Gulf region in terms of their asset size and shareholders' equity.

The most recent data from the Central Bank of Kuwait reveals that Kuwaiti banks are still upholding the highest capital adequacy ratio. This demonstrates the robust capacity of the banking sector to manage unexpected crises and respond promptly during challenging periods. By the conclusion of 2023, the capital adequacy ratio for the banking sector, following the Basel 3 standard, exceeded 18.0%. The latest data suggests that the financial stability metrics of domestic banks are "stable and strong". As of the conclusion of 2023, the ratio of net non-performing loans was recorded at 1.1%, a minimal figure that does not present any significant threats to the industry. Additionally, it is important to highlight that banks are well-protected from any negative impacts of these loans, given their coverage ratio with provisions is an impressive 266%. Kuwaiti banks have persistently given priority to their fundamental operations, especially in terms of lending and banking activities. The ratio of core income to total revenue has progressively climbed to over 80% by the end of 2023. Furthermore, the banking sector in Kuwait has shown favorable levels of return on average equity (ROAE), exceeding 11%. The capital adequacy ratio is over 19%, the liquidity ratio is over 21%, the non-performing loans to total loans ratio stood at 1.5%, the non-performing loan coverage ratio is over 308%, and the net profit margin is over 40%. These sound indicators are the outcome of the prudent proactive policies and balanced framework of regulatory and supervisory prudential instructions adopted by the Central Bank of Kuwait since the global financial crisis. Table 1 presents the Financial Soundness Indicators of the Kuwaiti Banks as per the latest reports issued by the Central Bank of Kuwait on financial stability[61].

End of Period	Capital Adequacy Ratio	Gross NPLs to Total Loans	NPLs Coverage Ratio	Regulatory Liquidity Ratio	Net Interest Margin	Net Profit Margin	Return on Average Equity	Return on Average Assets
2010	18.9	8.9	62.3	28.9	3.1	30.6	9.1	1.2
2011	18.5	7.3	72.9	29.4	3.2	24	8.1	1.1
2012	18.5	5.2	95.1	27.1	3.2	26.2	9.1	1.2
2013	18.9	3.6	134.6	32	3	22.7	7.4	1
2014	16.9	2.9	163.9	36	2.7	28.9	8.7	1.1
2015	17.5	2.4	204.8	30.9	2.6	29.9	8.8	1.1
2016	18.6	2.2	236.9	27.7	2.7	31.3	8.5	1.1
2017	18.4	1.9	230.2	30.9	2.8	33.3	9.5	1.2
2018	18.3	1.6	253.9	31.1	3	36.5	10.7	1.3
2019	18.5	1.5	270.6	27.2	2.8	34.3	9.6	1.2
2020	19	2	222.1	27.5	2.5	19.4	5	0.6
2021	19.2	1.4	309.7	24	2.4	34.6	9.1	1.1
2022	19.2	1.4	308.5	21.4	2.6	40.6	10.8	1.3
2023	**18.3**	**1.7**	**266**	**22.5**	**2.7**	**44.4**	**11.4**	**1.5**

Table 1: Kuwaiti Banks' Financial Soundness Indicators. Source: Central Bank of Kuwait

(61) Central Bank of Kuwait, The Financial Stability Report, (2023), Retrieved from https://www.cbk.gov.kw

Figure 1: Depiction of Kuwaiti Banks' Financial Soundness Indicators.

Furthermore, most banks have revealed that their increase in profits can be attributed mainly to the expansion of credit and a decrease in provisions for credit losses. This aligns with the continuous improvement of the operating conditions, along with heightened levels of business optimism and remarkable spikes in oil prices. It is also noteworthy to mention that interest rates have climbed to reach 4.25%. The Central Bank of Kuwait has published data confirming the advancement in various aspects, including money supply, deposit balances, and credit facilities provided by local banks to different sectors of the domestic economy(62). Moreover, the Central Bank of Kuwait remains vigilant in supervising the banking and financial system components, intending to enhance the financial resilience of these institutions and cultivate a climate of financial robustness. This coordinated endeavor guarantees that local banks can consistently provide a diverse array of financial services and products with optimal effectiveness, even amidst difficult operational circumstances.

It is important to note that in 2023, both traditional and Islamic banks in Kuwait have sustained a remarkable net profit margin exceeding 44%, marking a substantial rise compared to previous years. This notable increase in profitability has been especially significant following the emergence of the COVID-19 pandemic in 2021.

The Kuwaiti banking sector is diversified. There exist five conventional banks that possess commendable credit ratings, robust financial stability, a well-established history of exemplary achievements, and a diversified business model. Additionally, Kuwait boasts a substantial Islamic banking sector, renowned for its pioneering role in Islamic banking. This sector comprises five banks, which have now been reduced to four after the recent acquisition of Ahli United Bank by Kuwait Finance House.

Table 2 shows the annual net profit of Kuwaiti conventional and Islamic banks from 2021 to 2023.

(62) Ibid

Year/Kuwaiti Banks	Annual Net Profit in (Million Kuwaiti Dinars)		
	2023	**2022**	**2021**
Conventional Banks			
National Bank of Kuwait	560.6	509.1	362.2
Commercial Bank of Kuwait	111.2	73.6	54.6
Gulf Bank	71.2	61.8	42.1
Al Ahli Bank of Kuwait	45.2	32.29	27.2
Burgan Bank	43.6	52.1	45.4
Total Annual Net Profit (1)	831.8	728.89	531.5
Islamic Banks			
Kuwait International Bank	19	13.6	10.9
Ahli United Bank	42.5	36.4	31.2
Kuwait Finance House	584.5	357.7	243.4
Boubyan Bank	80.4	57.8	48.5
Warba Bank	19.7	19.3	16
Total Annual Net Profit (2)	746.1	484.8	350
Total Annual Net Profit (1) +(2)	1577.9	1213.69	881.5

Table 2: Annual Net Profit of Kuwaiti Conventional and Islamic Banks.
Source: Kuwait Banking Association

Figure 2a: Depiction of Annual net profit in million Kuwaiti Dinars of Kuwaiti conventional banks 2021 - 2023

Figure 2b: Depiction of Annual net profit in million Kuwaiti Dinars of Kuwaiti Islamic banks 2021 - 2023

Notably, most Islamic finance activities are centered in Islamic banks, which contribute to over 96% of the total financing. It should be noted that as of the end of 2023 the banks “National Bank of Kuwait (NBK)” and “Kuwait Finance House (KFH)” collectively obtained 71.4% of the overall profits generated by the ten banks. This indicates that the remaining eight banks contributed approximately 28.6% to the sector’s profits. The Commercial Bank of Kuwait had the highest share at around 6.1%, while Kuwait International

Bank KIB had the lowest share at about 1.1%.

The business environment for the Kuwaiti banking sector still faces some challenges, given the regional and global economic developments. However, Kuwaiti banks have enjoyed stability supported by several financial soundness indicators that confirm the strength and solidity of the banking sector, its high solvency, and robust liquidity rates. The asset quality of Kuwaiti banks plays a crucial role in supporting their performance. As of the end of 2023, the total assets of the Kuwaiti banking sector reached over KD 120 billion, reflecting a growth rate of more than 18%. This indicates the strength and stability of the sector.

In addition to the banks, there are investment companies that also follow Islamic Sharia guidelines, although they do not handle deposits. As reported by the Kuwait Stock Exchange, there are a total of forty-four listed financial services companies in 2024. The combined market value of these financial services sector companies listed on the Kuwait Stock Exchange by December 2023 surpassed 2.1 billion Kuwaiti dinars. The Investment Union reports indicate that there are a total of twenty-two investment companies, with thirteen being conventional and nine being Islamic.

Kuwait aims to draw in over USD 200 billion in foreign direct investment (FDI) from 2020 to 2035, to establish itself as a prominent international center for trade and finance(63). The government is supportive of capital transfers and has recently completed the privatization of its stock exchange in 2019. This move has led to both MSCI and FTSE upgrading Kuwait's status to an emerging market. However, it is important to mention that FDI in Kuwait is still relatively underdeveloped compared to regional standards. In 2022, the country experienced a significant boost in FDI inflows. The inflows surged by 33.6% compared to the previous year, amounting to a total of USD 758 million. By the end of the period, the accumulated FDI stock reached an estimated USD 15.09 billion, equivalent to approximately 8.2% of the country's GDP. This influx of foreign investment not only benefits the Islamic and conventional banks directly through their banking services but also through the investment accounts they offer. Additionally, the FDI inflow plays a crucial role in

(63) Kuwait Direct Investment Promotion Authority (KDIPA). (2019). Foreign direct investment (FDI) in Kuwait. Retrieved from https://kdipa.gov.kw/wp-content/uploads/2021/03/Investing-in-Kuwait-September2019.pdf

the trading volume of the Kuwait Stock Exchange[64]. Kuwait has several advantages for attracting FDI among which are a well-managed financial market a strong banking sector and an open market economy allowing Kuwait to enjoy free convertibility and full transferability in the foreign exchange market.

Foreign Direct Investment	2020	2021	2022
FDI Inward Flow (million USD)	240	567	758
FDI Stock (million USD)	14,952	15,531	15,091
Number of Greenfield Investments*	15	12	14
Value of Greenfield Investments (million USD)	209	113	613

Table 3: Kuwait's Foreign Direct Investments 2020 – 2022. Source: UNCTAD, Latest available data

Figure 3: Depiction of Foreign Direct Investments 2020 - 2022. Source: UNCTAD, Latest available data.

Kuwaiti banks have emerged as leading innovators in the global banking industry, offering state-of-the-art financial services. This can be attributed to the Central Bank of Kuwait's emphasis on digitization, which has paved the way for groundbreaking advancements in the banking sector[65]. The Kuwaiti legislator did not include digital banking in Law No. (32), yet the Central Bank of Kuwait has embraced the concept of digital banking[66]. With their impressive growth in net profits, Kuwaiti banks are in a strong financial position to serve as strategic partners in the government's development and investment initiatives as well as setting up full-fledged digital banks. Moreover, the financial stability indicators have maintained a commendable level, particularly in comparison of Islamic banks to the performance

(64) Ibid

(65) United Nations Conference on Trade and Development (UNCTAD), Investing in sustainable energy for all: World investment report, United Nations, Switzerland, Retrieved from https://unctad.org/publication/world-investment-report-2023

(66) Central Bank of Kuwait, Requirements for establishing digital banks in Kuwait, Retrieved from https://www.cbk.gov.kw/en/cbk-news/announcements-and-press-releases/press-releases/2022/02/202202021000-cbk-governor-announces-digital-banks-guidelines

of previous years, conventional counterparts, and the evaluation criteria employed by international standard-setting organizations. Considering the potential risks, a positive outlook is anticipated for the growth of assets, financial soundness, and resilience indicators within various jurisdictions of the Islamic finance and banking industry in the future.

The Kuwaiti banking sector is witnessing a new era of financial technology to keep pace with the rapid developments in the banking industry globally, by taking advantage of the great potential offered by digital technologies. In 2019, the Central Bank of Kuwait instructed banks to prepare a “Shaping the Future” Strategy to achieve banks’ development over the medium term (3-5) years.

The “Shaping the Future” Strategy aims to face internal and external challenges posed by global economic conditions, the revolution of modern financial technologies, and the rapid changes in customers’ expectations and needs. To achieve the targets, the Strategy adopts new techniques and visions consistent with the future and the transformation brought by innovation in products & services and the development of banks’ operational efficiency. In February 2022, the Central Bank of Kuwait permitted banks to establish digital banks. In addition, the Central Bank of Kuwait regulated electronic payment businesses, issued a cybersecurity strategy framework, and issued a regulatory sandbox general framework to examine innovative services and products in a way that encourages innovation, enables modern technologies, and enhances financial and monetary stability in the State of Kuwait. It should be noted that Kuwait is actively working towards the development and diversification of its economy. The market in Kuwait is dynamic and promising, which attracts investors who see the potential for growth and opportunities.

a - Islamic Financial Institutions in Kuwait

Islamic banking has gained popularity in Kuwait and other Muslim-majority countries as an alternative to conventional banking. This section aims to shed light on the operations of Islamic banks in Kuwait, focusing on their transactions, financial positions, competition with conventional banks, and innovative product offerings. Due to the rising demand for products and services offered by Islamic banks, there was a pressing need to finalize banking regulations to oversee banking operations and authorize the establishment of new Islamic banks, thereby improving the competitiveness of the Islamic banking services market. Consequently, the amendment of law No.32/1968 on currency, CBK, and banking regulations was carried out through the enactment of law No. 30/2003, which specifically incorporated provisions for Islamic banks(67).

The main objectives of this legislation include the regulation of Islamic banks' operations based on a solid foundation that considers the unique nature of their activities. It also aims to provide the necessary legal framework for overseeing these banks. Islamic banking activities must be conducted through entities that have independent legal and financial status. It is not permissible for these activities to be carried out through windows or branches of conventional banks to prevent the commingling of funds. Conventional banks have the option to transition to Islamic banking activities by adhering to the terms and conditions specified by the Central Bank of Kuwait (CBK). To date, two conventional banks have successfully converted to Islamic banking following the CBK's requirements, namely Ahli United Bank and Kuwait International Bank.

The primary responsibility for legal oversight lies with the legal supervisory authority of each bank. The CBK's role is to ensure that banks comply with regulations by submitting all policies and products to the legal supervisory authority. This is monitored through onsite inspections and the involvement of auditors in reviewing the banks' adherence to decisions and religious rulings (fatwa). The Central Bank of Kuwait (CBK) has developed a supervisory framework specifically tailored for Islamic banks. This framework considers the internationally recognized standards for banking activities, while also considering the unique characteristics and rapid growth of the Islamic banking industry. It is worth noting that the amended version of Basel II, which focuses on capital adequacy, became effective for Islamic banks on June 30, 2009. This standard aims to encourage Islamic banks to adopt best practices in risk management and control. Furthermore, it aligns with the general principles of Basel II while ensuring that it is compatible with the activities of Islamic banks(68). The framework also incorporates risk weights

(67) Law No. (32) of 1968 concerning currency, the Central Bank of Kuwait, and the regulation of banking, amended by Decree-law No. 130/1977 on October 25, 1977. (1977, October 30). Official Gazette Kuwait (Al-Kuwait Al-Yawm), Issue No. 1164.

(68) Provisions of Law No. 30 of 2003, adding a special section on Islamic banks to Chapter Three of Law No. 32 of 1968 concerning currency, the Central Bank of Kuwait, and the

specific to Islamic banks, following the standards and guidelines issued by the Islamic Financial Services Board (IFSB).

The Central Bank of Kuwait (CBK) has implemented numerous strategies to enhance its oversight of both conventional and Islamic banks. These measures primarily focus on risk management and involve the development of various methodologies for monitoring and evaluating bank risks. The CBK places significant emphasis on the internal capital adequacy assessment process, recognizing its importance in ensuring banks maintain sufficient capital to withstand potential risks. Additionally, the CBK provides comprehensive guidelines on financial semi-annual stress tests to assist banks in assessing their resilience to adverse scenarios. Furthermore, CBK has adopted a risk-based supervision approach, aligning its practices with international governance standards to ensure effective oversight and regulation of banks. Islamic banks in Kuwait engage in various types of transactions that comply with Sharia principles. These include profit-sharing arrangements (Mudarabah), cost-plus sales (Murabaha), leasing (Ijarah), partnership (Musharakah), and diminishing partnership (Mudarabah)(69).

These transactions are structured to ensure that both the bank and the customer share in the risks and rewards of the investment, promoting fairness and transparency in financial dealings(70). In terms of their financial positions, Islamic banks in Kuwait have shown steady growth and profitability in recent years. They have demonstrated resilience in the face of economic challenges and have maintained strong capital adequacy ratios. Additionally, Islamic banks in Kuwait have focused on diversifying their revenue streams and expanding their customer base to enhance their financial stability. Table 4 presents the financial soundness indicators of the Islamic banks in Kuwait for the period from 2020 to 2023.

organization of banking business. (2003).

(69) Central Bank of Kuwait, (2021), reports.

(70) M. Kahf and M.F. Dicle, Basel II: Implications for Islamic banking. In Conference proceedings: Cyclical patterns in profits, provisioning, and lending of Islamic banks and procyclicality of the new Basel capital requirements, (2005).

End of Period	Capital Adequacy Ratio	Gross NPLs to Total Loans	NPLs Coverage Ratio	Regulatory Liquidity Ratio	Net Interest Margin	Net Profit Margin	Return on Average Equity	Return on Average Assets
2020	17.5	1.9	191.9	27.6	2.8	21.3	7.2	0.7
2021	18.5	1.5	250.8	25.8	2.7	32.4	11.2	1.1
2022	19.6	1.4	281	21.6	2.9	36.5	11.4	1.2
2023	18.8	1.7	241.8	22.8	2.8	43.5	11	1.5

Table 4: Kuwait Islamic Banks' Financial Soundness Indicators. Source: Central Bank of Kuwait (2023) report.

Figure 4: Depiction of Kuwait Islamic Banks' Financial Soundness Indicators.

Islamic banks in Kuwait face stiff competition from conventional banks, which dominate the banking sector in the country. While Islamic banks offer unique products and services that cater to a specific segment of the population, they are continually striving to differentiate themselves from conventional banks, which is apparent in the latest financial results and business expansion achievements(71). Islamic banks leverage their ethical and Sharia-compliant practices to attract customers and compete effectively in the market. Islamic banks, KFH, and Boubyan in Kuwait have introduced a range of innovative products and services to meet the evolving needs of customers(72).

These include Islamic financing solutions for individuals and businesses, Islamic credit cards, and Islamic investment products. Moreover, Islamic banks are investing in financial technology (Fintech) to improve their operational efficiency and enhance customer experience. In the year 2023, Boubyan established collaborations with four technology start-ups: Alhisba, Baims, MyRateb, and Enabill. This strategic alliance has enabled the bank to enhance its penetration into the specific customer segment it aims to target(73).

Furthermore, the legislative landscape witnessed a significant change

(71) M.A. Baderin, Islamic law. Oxford University Press, United Kingdom, (2021).

(72) Kuwait Banking Association. (2023). Internal reports.

(73) Boubyan Bank. (n.d.). Boubyan and startups. Retrieved from https://boubyan.bankboubyan.com/en/explore-boubyan/blog/boubyan-and-startups/

with the introduction of Law No.7/2010, which established the Capital Market Authority and set regulations for securities activities(74). The main objective was to enhance the conventional and Islamic financial instruments and institutions, as well as to regulate Kuwait's capital market in alignment with international standards overseen by the Capital Market Authority. Following this regulatory framework, the CMA now oversees both conventional and Islamic investment funds and companies, while the Central Bank of Kuwait's supervision is restricted to their financing operations(75).

Despite facing strong competition from conventional banks in Kuwait, Islamic banks have managed to attract a diverse range of customers by introducing innovative Sharia-compliant products. This has not only appealed to the local population but also to foreigners and individuals from different religious backgrounds, resulting in increased participation in Islamic financial services and business growth. Moreover, the future of the Islamic industry in Kuwait is highly promising due to the well-established regulatory and supervisory framework in place. The presence and growth of the Islamic industry are now clearly structured in terms of the number of institutions and the level of market activity. It has emerged as a significant source of banking operations, playing a visible role in the economic and social progress of the State of Kuwait.

b - Kuwait Finance House (KFH) – Islamic Bank

Kuwait is an example of being a pioneer in Islamic finance for providing a legal environment for Islamic finance in Kuwait. The start of the Islamic finance industry in Kuwait, led by Ahmed Al-Yasin, who established an Islamic bank in the mid-1970s, when there was no Islamic finance model to emulate or learn from, is an exceptional success story(76). Kuwait Finance House (KFH) –

(74) The enactment of Law No. 7 of 2010, known as the Capital Markets Law ("CML"), established the Capital Markets Authority ("CMA"). The primary objective of the CMA is to regulate securities activities and oversee the functioning of the capital market. To effectively implement the provisions of the CML, the CMA is entrusted with the responsibility of formulating and issuing the required bylaws and instructions.

(75) As of September 13, 2011, the responsibility for overseeing investment companies, excluding financing activities, and Investment Funds has been shifted from the CBK to the CMA. CBK fulfills its oversight duties by conducting off-site monitoring and on-site inspections of these entities, ensuring the adoption of sound financial and banking practices, and ensuring compliance with relevant oversight policies and instructions.

(76) Kuwait Finance House (KFH), (n.d.), About us: Our story, Retrieved from https://www.

not only the first Islamic bank in Kuwait, but also one of the very first Islamic banks established anywhere in the world. Kuwait Finance House (KFH) is a Kuwait-based company that operates in the banking and financial sectors. The Bank is primarily engaged in the provision of banking, investment, real estate, trading, and leasing activities following Islamic Sharia principles.

In 2023, the financial performance of Kuwaiti Islamic banks remained strong, thanks to a stable operating environment. This was further bolstered by the merger between Kuwait Finance House (KFH) and Ahli United Bank, which was finalized in 2022. This merger resulted in the formation of one of the largest Islamic banks globally. Notably, the KFH-AUB merger marked the first cross-border consolidation in the region. As a result of this deal, the combined assets of the newly formed bank reached an impressive $120.8 billion, making it the largest bank in Kuwait and the second-largest Islamic bank in the world. This significant growth of 25% in Kuwaiti Islamic banking assets contributed to their increased share, accounting for 50% of the total sector assets by the end of 2023(77). Kuwait Finance House's estimated total assets as of the end of 2023 are thirty-eight billion Kuwaiti dinars. According to the Central Bank of Kuwait, the Islamic finance industry in Kuwait, which started with a single branch and four employees in 1978, has grown today to make up 40% of the country's banking sector, with four Islamic banks, KD38 billion in assets, six hundred branches, and over 14,000 employees(78).

The Kuwait Finance House, together with its affiliated companies, operates in three main business divisions: the Treasury division, which involves activities such as liquidity management, international Murabaha investments, deposit exchanges with banks and financial institutions, and international banking relationships; the Investment division, which oversees direct equity and real estate investments, investments in subsidiaries and associates, and international leasing; and the Banking division, which offers a variety of banking services and investment products to both corporate and individual clients, including commodity and real estate Murabaha finance, local leasing, as well as Wakala and Istana facilities.

KFH's profitability is expected to continue to improve in 2023–2024.

kfh.com/en/home/Private%20Banking/aboutus/story.html

(77) Fitch Ratings, Kuwait Islamic banks dashboard, Special report, United Kingdom, (2023)

(78) Central Bank of Kuwait, Various Reports, (2023).

However, high regulatory provisioning requirements, pressure on net financing margins (higher funding cost and strong competition), and investments in digital channels will continue to put pressure on banks' profitability. The average common equity Tier 1 capital ratio(79) fell to 12.4% at end-1H23 due to KFH's foreign-currency translation losses and semi-annual cash dividends. Kuwaiti banks exclude interim profits from regulatory capital calculations. Islamic banks' average tangible leverage ratio is below conventional banks due to lower risk weights from the 50% alpha factor(80).

KFH disclosed a record-breaking net profit of KD 584.5 million for the financial year 2023, showing a notable 63.4% surge compared to the previous year. This achievement marks the highest profits ever reported in the Kuwaiti banking sector, with government and semi-government entities holding a share of KD 224 million. This amount exceeds the share during the pre-acquisition phase of AUB, which was KD 68.6 million, representing a 50% increase(81). In the year 2023, after the distribution of the acquisition shares, the earnings per share stood at 38.49 fils, indicating a significant increase of 29.6% compared to the previous year's figure of 29.7 fils. Furthermore, the net financing income for the year ended 2023 reached KD 965.9 million, reflecting a notable growth of 20.7% when compared to the previous year. Similarly, the net operating income for the same period reached KD 945.4 million, experiencing a substantial increase of 30.7% compared to the year 2022.

Moreover, the financing receivables witnessed an upward trend, reaching KD 19.4 billion, which represents a growth of KD 624.7 million or 3.3% compared to the previous year. This expansion in financing receivables contributed to the overall increase in total assets, which reached KD 38.01 billion, marking a rise of KD 1.04 billion or 2.8% compared to the previous

(79) Basel Committee on Banking Supervision (BCBS): The Tier 1 capital ratio represents the proportion of a financial institution's primary equity capital concerning its overall risk-weighted assets (RWA). These risk-weighted assets encompass the sum of all assets owned by the institution, adjusted for credit risk based on a specific formula established by the governing regulatory body, typically the central bank of the respective country.

(80) Alpha evaluates a fund's performance by considering the level of risk-adjusted taken to achieve excess returns, while beta assists investors in determining their risk tolerance and selecting funds that match their investment goals. Fitch Rating. See, Central Bank of Kuwait, Stability Report, (2023).

(81) Kuwait Finance House (KFH), General assembly meeting, (2024, March 18).

year. Additionally, the total shareholders' equity reached KD 5.3 billion in 2023, indicating a strong financial position for the company. Depositors' accounts also experienced growth, reaching KD 21.8 billion, which represents an increase of KD 782.4 million or 3.7% compared to the previous year.

Furthermore, the capital adequacy ratio for the year 2023 stood at 18.18%, surpassing the minimum requirement and demonstrating the solid financial position of KFH. This percentage also signifies an improvement from the previous year's ratio of 17.66%. Overall, these financial indicators highlight the positive performance and stability of KFH in the year 2023. KFH Group's strong financial position has allowed it to increase cash dividends to its shareholders not only for this year but also for the upcoming fiscal years. The Board of Directors has proposed a cash dividend of ten fils per share for the remaining profits until the end of 2023, along with an additional ten fils in H1 2023. This totals a 20% dividend for the year 2023, which is an increase from the previous year's 15%. Furthermore, the Board of Directors has also recommended the distribution of bonus shares equivalent to 9% of the issued paid capital(82).

The remarkable profits achieved by KFH in its first year demonstrate the success of the acquisition on all fronts. This has resulted in KFH becoming the largest bank in Kuwait in terms of total consolidated assets, which amounted to KD 38 billion as of 31 December 2023. Additionally, KFH has also become the second-largest Islamic bank in the world(83). The acquisition aided in bolstering the level of profitability, leading KFH to achieve the highest profit rates ever recorded in the local banking industry, as well as the highest returns on all major performance indicators. KFH effectively accomplished the primary objectives outlined in the Group's strategy, solidifying its position as a leader in the market and surmounting various obstacles and operational hurdles. Furthermore, the presence of high liquidity ratios, a robust capital foundation, and exceptional operational performance contributed to the growth of operating income, profits, financing portfolio, and all significant financial metrics.

(82) Ibid

(83) The Banker Database, Kuwait Finance House is ranked 156th in the Top 1000 World Banks by Tier 1 2023 ranking, rising 53 places from the previous ranking. This ranking is based on a Tier 1 capital of US$ 11.63 b on 31-Dec-2022, which indicates a growth of 51.67% on the previous ranking. The bank has reported Pretax profits of US$ 1.72 b, a growth of 40.85%. Kuwait Finance House employs a total of 16,000 worldwide.

The group has seen an increase in its market capitalization, with trading in KFH shares attracting historically high levels of liquidity. KFH has also achieved the top position on Boursa Kuwait in terms of market capitalization, reaching KD 11.4 billion(84). This rise in market value is advantageous for KFH shareholders, a third of whom are governmental and semi-governmental institutions. KFH's services have expanded to encompass new strategic markets, such as the United Kingdom, Egypt, and other countries, after the acquisition of AUB-Bahrain, which demonstrated success in its inaugural year. It was highlighted that the conversion of AUB-Bahrain's traditional banking services to adhere to Shariah principles had been completed. The bank was officially approved as an authorized Islamic Bank by the Central Bank of Bahrain (CBB) in December 2001. Since then, the Bank has been providing a comprehensive array of Shariah-compliant products and services, including retail and corporate banking services, savings, and investment products, as well as trade finance and wealth management solutions(85).

The recent acquisition has emerged as a significant asset for KFH's financial status, consolidating its capacity to confront financial obstacles, and enhancing its reputation as a prominent bank at the local, regional, and global levels. Moreover, it contributes to the nation's efforts in shaping Kuwait into a financial center and a frontrunner in the Islamic finance sector within the region. Additionally, it should be noted that this development has also created new employment prospects for the citizens(86).

KFH's recent expansion as a banking entity operating in 11 countries has bolstered its standing within national economies, establishing itself as a prominent bank in the Middle East. This strategic development has not only paved the way for KFH to enter new markets but has also enabled the institution to enhance its financing offerings with exceptional efficiency at both regional and local levels.

It should be emphasized that KFH has been involved in funding agreements for electricity, petrochemical, and aviation ventures, totaling

(84) Boursa Kuwait. (n.d.). Ticker KFH. Retrieved from https://www.boursakuwait.com.kw/en/stock/profile#108

(85) Central Bank of Bahrain. (n.d.). Islamic banks. Retrieved from https://www.cbb.gov.bh/cbbapi/database/Islamic%20Banks

(86) Kuwait Banking Association, Local banks employment statistics. Internal reports. (2023).

around USD 10.5 billion. Additionally, KFH has undertaken numerous financing agreements at both local and regional levels, further demonstrating its impressive financial capacity and strength. Furthermore, the KFH Group has expanded its prominent position in the global Sukuk market. Through its investment arm, KFH Capital, the group has successfully managed and arranged Sukuk issuances worth over US$7.5 billion for various corporate and sovereign issues across different industries and regions[87].

KFH has persistently pursued sustainability initiatives and advocated for environmentally friendly financial products, catering to individual and corporate clients alike. Moreover, the institution has actively engaged in Environmental, Social, and Governance (ESG) practices by aligning its financial activities with sustainable principles. KFH's significant presence at the 2023 United Nations Climate Change Conference (COP28) in Dubai underscored its commitment to addressing climate change on a global scale[88].

KFH bolstered its robust financial position by upholding a strong balance sheet, fortifying the Group's financial standing, and sustaining a solid capital reserve through various factors such as ample liquidity, ongoing diversification of funding sources, adaptable business strategies, extensive geographical reach, and cohesive performance across the Group, alongside other sources of strength. KFH is at the forefront of the competition, continuously growing its customer base and market share within the retail banking sector. To stay ahead, KFH is actively pursuing its digital transformation strategy by introducing cutting-edge digital financial solutions such as the KFH mobile application and website, XTMs, and KFH-GO. Moreover, KFH has successfully launched Tam, the inaugural Islamic digital bank in Kuwait, the Zaheb digital platform, and various other groundbreaking banking solutions.

Through its extensive recruitment campaigns, KFH effectively fostered the development of local talents and innovative thinking in the workplace. By the end of 2023, approximately four hundred new employees were brought on board, constituting an impressive 99% of the total hires for that year. The Kuwaitization[89]

(87) Kuwait Finance House (KFH), KFH holds an AGM. Retrieved from https://www.kfh.com/en/home/Personal/news/2024/KFH-Holds-AGM.html

(88) UN Climate Change Conference – United Arab Emirates. (2023, November 30 – December 12). COP28.

(89) Cabinet Resolution No. 1028 of 2014 was issued amending Cabinet Resolution No.

rate surpassed 81%, indicating a strong commitment to employing local talent. Moreover, key leadership positions were filled by individuals with national competencies, as per the directions of the Central Bank of Kuwait. Furthermore, KFH provided a total of 83,000 hours of training to 3,116 employees, demonstrating a dedication to continuous learning and development within the organization. The investment transactions of KFH Group Treasury surpassed USD 13 billion in both the Primary and Secondary markets. Furthermore, KFH expanded its short-term Sukuk trading within the International Islamic Liquidity Management Corporation (IILM) program. Group Treasury solidified its status as a key player in the short-term IILM Sukuk market. IILM was founded by nine central banks and one multilateral organization to develop and issue Shari'ah-compliant financial instruments, aiming to enhance efficient cross-border Islamic liquidity management.

Table 5 compares net profits between an Islamic bank, Kuwait Finance House (KFH), and a conventional bank, National Bank of Kuwait (NBK), covering the period from 2010 to 2022.

Since the Central Bank of Kuwait implemented corporate governance regulations in early 2012, NBK and KFH have more than doubled their net profits. The period following 2012, specifically from 2013 to 2019, is characterized by steady growth in net profits for both institutions. The Central Bank of Kuwait has repeatedly emphasized the significance of its corporate governance regulations and their role in enhancing operational effectiveness within the banking sector. These regulations have contributed to improved decision-making and strategic planning by the boards of directors and executive management, thereby bolstering the overall efficiency of Kuwaiti banks.

1102/V of 2008 on determining the rates of national employment with non-governmental entities, and the percentage of national labor employment in banks was set at 64%. Cabinet Resolution No. 1868 of 2018 was also issued amending some provisions of Cabinet Resolution No. 904 of 2002 determining the percentages of national employment among non-governmental entities, and the specific percentages contained in the decision varied between sectors to range between (3%) for some sectors, including the land transport sector, and 70% for the banking sector).

Net Profit in (Thousands of Kuwaiti Dinars)		
Year	NBK	KFH
2010	302,000	105,983
2011	302,406	80,342
2012	305,125	87,676
2013	238,137	115,893
2014	261,810	126,476
2015	282,160	145,841
2016	295,178	165,228
2017	322,362	184,155
2018	370,709	227,411
2019	401,291	251,023
2020	246,341	148,399
2021	362,249	243,414
2022	509,085	357,716

Table 5: Net Profit in 000' Kuwaiti Dinars for National Bank of Kuwait NBK and Kuwait Finance House KFH 2010 – 2022.

Figure 5a: National Bank of Kuwait net profits (2010 – 2022)

Figure 5b: Kuwait Finance House net profits (2010 – 2022)

In 2022, conventional banks made 728.9 million dinars, 60.1% of total bank profits, up by 37.1% from 2021. Islamic banks made 484.8 million dinars, 39.9% of total profits, up by 38.5% from 2021. Excluding KFH's profits from acquisition completion, Islamic bank profits rose by 20.7%, comprising 36.7% of total bank profits. In 2022, the P/E for the banking sector was 17.6x, down from 24.2x in 2021. Profitability indicators improved, with ROA at 1.0% (up from 0.9%) and ROE at 9.02% (up from 8.99%). Total cash distributions for the ten banks increased by 46.9% to 634.7 million dinars from 432.1 million dinars in 2021.

National Bank of Kuwait led in profits among the top ten banks with 509.1 million dinars, accounting for 41.9% of net profits and a 40.5% increase from 2021. Kuwait Finance House followed, earning 357.7 million dinars, representing 29.5% of profits with a growth rate of 47%.

National Bank and KFH banks captured 71.4% of total profits among the ten banks. Commercial Bank of Kuwait had the highest participation at 6.1%, and Kuwait International Bank KIB had the lowest at 1.1%.

NBK	Net Profit in (000's of Kuwaiti Dinars)			Percent Change	KFH	Net Profit in (000's of Kuwaiti Dinars)			Percent Change
2010	302,000				2010	105,983			
2019	401,291		99,291	**33%**	2019	251,023		145,040	**137%**
2022	509,085		207,085	**69%**	2022	357,716		251,733	**238%**

Table 6: Percentage change in net profits for National Bank of Kuwait (NBK) and Kuwait Finance House (KFH) 2010 - 2022.

Table 6 illustrates the percentage increase in net profits for both NBK and KFH over this period. Both banks experienced a general upward trend in net profit, except for a decline during the COVID-19 pandemic, an expected outcome given the global crisis's widespread impact on all business sectors.

The average value of ROE for Kuwait during the period from 2000 to 2021 was 13.95 percent with a minimum of 2.18 percent in 2008 and a maximum of 27.2 percent in 2006. The latest value from 2021 is 8.3 percent. For comparison, the world average in 2021 based on 136 countries is 13.44 percent.

Figure 6: Return on Average Equity of Kuwaiti Banks - The ratio of Net Income to Average Shareholder Equity 2010 – Q1 2023.

Kuwait banks have a strong Solvency position with a Capital Adequacy Ratio (CAR) of 19. 2%, exceeding the international standard of 10. 5%. The Governor confirmed the highest CAR in 2021 under Basel III. The average CAR for Kuwait banks was 17. 3%, above the Central Bank limit of 12%. However, the cost-to-income ratio increased to 46. 6% from 42. 9% in 2021.

The ratio of Capital base to Risk-weighted assets (Basel III). Ratios before 31/12/2014 were calculated using Basel (II).

Figure 7: Capital adequacy ratio of Kuwaiti banks 2010 – Q1 2023.

CBK conducted stress tests to assess banking industry stability. Tests based on global standards, considering micro- and macro-economic factors. Three scenarios evaluated sector resilience over three years. Results show high resilience, with CAR at 12. 6% by 2024, exceeding international minimums despite severe scenarios tested.

Kuwait's banking sector continues to maintain high levels of liquidity, with the Liquidity Coverage Ratio and Net Stable Funding Ratio above the required minimums. The Central Bank's policies on interest rates and exchange rates have supported this ample supply of liquidity, ensuring smooth flow between banks and the economy. Regulatory liquidity reached 24. 7%, surpassing the minimum of 18% by the end of quarter one 2023.

Figure 8: Regulatory liquidity ratio of Kuwaiti Banks 2010 – Q1 2023.

Two years after the pandemic, the Kuwaiti banking sector shows improved conditions and resilience to tackle challenges effectively. The Central Bank of Kuwait remains attentive and actively supervises to enhance sector strength for monetary stability. Financial indicators highlight the sector's stability with strong solvency and liquidity rates.

Conclusion

The research demonstrates that Islamic finance, guided by principles of fairness, transparency, and ethical responsibility, presents a viable alternative to conventional finance. The Islamic banking system, notably in Kuwait, has shown resilience in promoting economic growth, even in times of global financial crises. Islamic finance contributes to financial stability through risk-sharing, asset-backed transactions, and ethical investing, making it appealing to both Muslim and non-Muslim investors.

The industry's growth in non-Muslim countries highlights its global relevance, further supported by its focus on social inclusion, ethical standards, and sustainable investments.

The Islamic finance industry is particularly vulnerable to liquidity risk due to the lack of a Shariah-compliant repo market and the various restrictions faced by Islamic banks when accessing interbank instruments.

Despite its achievements, Islamic finance faces challenges, including regulatory inconsistencies, a shortage of Sharia-compliant financial products, and limited expertise in Islamic banking practices. However, the continuous expansion of the sector and its acceptance as a credible financial model across various regions underscore its potential to transform the global economy.

Recommendations

1 - **Enhance Regulatory Standardization**: Establishing unified standards for Sharia compliance and governance across jurisdictions would reduce operational inefficiencies and increase investor confidence in Islamic finance. Collaborative efforts between international financial regulatory bodies and Sharia councils could create a more cohesive regulatory framework.

2 - **Focus on Product Diversification**: Expanding the range of Sharia-compliant products, such as Salam and Istisna contracts, would not only foster product diversification but also support real asset creation, benefiting sectors like manufacturing, agriculture, and infrastructure.

3 - **Invest in Education and Training**: Building a skilled workforce through targeted education and training programs, especially in non-Muslim countries, is critical. Academic institutions should integrate practical Islamic finance skills into their curricula to address the industry's talent gap.

4 - **Leverage Technological Advancements**: Islamic banks should explore partnerships with fintech and AI companies to enhance efficiency, improve customer service, and expand outreach. Digital solutions can address operational challenges and increase financial inclusion in underserved communities.

5 - **Strengthen Global Collaborations**: Partnering with conventional financial institutions and government bodies would help Islamic banks enter new markets, increase awareness, and foster innovation. Collaborative efforts could further enhance financial inclusion and contribute to addressing global economic challenges.

These recommendations provide a roadmap for Islamic finance to strengthen its global impact and adapt to a rapidly evolving financial landscape. By addressing existing challenges, the industry can realize its potential as a sustainable and ethical alternative within the global economy.

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