University of Jijel

Departement of Economic Sciences

Module : English for Specific Purposes ***Teacher :Manel.A***

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Islamic Finance

Islamic finance is a financial system that operates in accordance with Islamic law (Sharia). It prohibits interest (riba), emphasizes risk-sharing, and promotes ethical and asset-backed financing. Unlike conventional finance, which is largely debt-driven and interest-based, Islamic finance fosters equity-based transactions and ethical investments that align with Islamic principles. Over the past few decades, Islamic finance has gained significant traction, with institutions and regulatory frameworks emerging to cater to the growing demand for Sharia-compliant financial products.

The common practices of Islamic finance and banking came into existence along with the foundation of Islam. However, the establishment of formal Islamic finance occurred only in the 20^{th} century. Nowadays, the Islamic finance sector grows at 15%-25% per year, while Islamic financial institutions oversee over $2 trillion..

- **Principles of Islamic Finance**

Islamic finance strictly complies with Sharia law. Contemporary Islamic finance is based on a number of prohibitions that are not always illegal in the countries where Islamic financial institutions are operating:

1. Prohibition of Interest (Riba)

Islam considers lending with interest payments as an exploitative practice that favors the lender at the expense of the borrower. According to Sharia law, interest is usury (*riba*), which is strictly prohibited.

2. Investing in businesses involved in prohibited activities

Some activities, such as producing and selling alcohol or pork, are prohibited in Islam. The activities are considered *haram* or forbidden. Therefore, investing in such activities is likewise forbidden.

3. Speculation (*maisir*)

Sharia strictly prohibits any form of speculation or gambling, which is called *maisir*. Thus, Islamic financial institutions cannot be involved in contracts where the ownership of goods depends on an uncertain event in the future.

4. Uncertainty and risk (*gharar)*

The rules of Islamic finance ban participation in contracts with excessive risk and/or uncertainty. The term *gharar* measures the legitimacy of risk or uncertainty in investments. *Gharar* is observed with derivative contracts and short-selling, which are forbidden in Islamic finance.

In addition to the above prohibitions, Islamic finance is based on two other crucial principles:

- **Asset-Backed Transactions:** Each transaction must be related to a real underlying economic transaction, i.e. financial activities must be backed by tangible assets or services, preventing speculative investments and ensuring economic stability.

- **Profit/loss sharing:** Parties entering into the contracts in Islamic finance share profit/loss and risks associated with the transaction. No one can benefit from the transaction more than the other party.

Some Basic Features Of Islamic Finance

Important differences exist between conventional and Islamic finance. Islamic finance must follow certain "Shari'ah" legal standards, hence it is often called "Shari'ah compliant". The general principles of Islamic finance are: the prohibition of collection and payment of interest; the encouragement of investment in real economic activities or trading in goods and services for profit; sharing rewards and risks between parties involved; the avoidance of profiting from trading in financial assets or "using money to make money"; the discouragement of excessive uncertainty, which may prohibit the use of many types of financial derivatives; and the prohibition on the financing for certain activities that are forbidden by Islam, such as alcohol or drugs. In addition to commercially driven activity, Islamic principles also emphasize the importance of charitable giving, whether through the mandatory welfare due (or *Zakah*) or voluntary charity (*Sadaqah*). Both forms of giving can (but do not have to) be implemented through a type of endowment trust known as a *Waqf.*

To adhere to these principles and to simultaneously accommodate the financing of economic activity, Islamic financial corporations have developed various financing arrangements that are mapped to more generic financial. These financing arrangements are often based on trading models or profit and loss sharing models involving underlying real non-financial assets. Economic ownership of any non-financial assets and changes in economic ownership are fundamental to the compilation of the macro-economic statistics. The recording may be reflected on the balance sheet of the Islamic financial institution when the (legal) ownership is acquired but can change rapidly afterwards by allocating the non-financial assets to the users of such assets.

In addition, Shari'ah-compliant activities should be segregated from non-compliant activities and funds (i.e., not following Shari'ah principles). This gives rise to some specific treatments. First, the financial statements of Islamic windows of conventional financial institutions are separated from their regular financial activities. Further, off-balance sheet restricted investment accounts of banks and other depository corporations which comply with Islamic finance accounting standards are to be classified as separate institutional units.

❖ ***Text Based Activities***

Exrtcise 01 : Comprehension Questions

1. What are the core principles of Islamic finance, and how do they differentiate it from conventional finance?
2. Why is speculation (maisir) prohibited in Islamic finance?
3. Explain how Islamic financial institutions manage risk in accordance with Sharia law.

Exercise 03: Determine whether the following statements are true or false, and provide a brief explanation for your answer.

- Islamic finance permits the use of financial derivatives as long as they are asset-backed.
- Islamic financial institutions can invest in businesses selling alcohol as long as it is profitable.
- The principles of Islamic finance emphasize profit-sharing rather than fixed interest payments.
- Sharia-compliant financial transactions must always involve tangible assets or services.
- Zakah and Sadaqah are both forms of voluntary charity in Islamic finance.financial systems.

Exercise 2: Complete the following sentences using the correct academic term related to financial inclusion:

1. he prohibition of __________ ensures that financial activities are not based on excessive uncertainty.
2. Unlike conventional banks, Islamic banks use __________ instead of charging interest on loans.
3. The ethical aspect of Islamic finance prohibits investments in __________, such as alcohol and gambling industries.
4. __________ is a profit-sharing model in which one party provides capital while the other manages the business.
5. In Islamic finance, transactions must be __________, meaning they must be backed by real economic assets.

Exercise 03: **Match the following terms with their correct definitions**

a) Riba
b) Maisir
c) Gharar
d) Mudarabah
e) Ijara

1. A type of leasing agreement in Islamic finance.
2. The prohibition of excessive uncertainty in financial contracts.
3. The practice of lending money with interest, considered usury.
4. A profit-sharing agreement where one party provides capital and the other offers expertise.
5. The prohibition of speculative transactions or gambling.