Professional Certificate in Islamic Funds and Asset Management

Ethics and Governance in Islamic Finance

Islamic finance is a system of finance that is consistent with the principles of Islamic law, also known as Shariah law. At its core, Islamic finance is based on the idea of risk-sharing and the prohibition of riba (interest), gharar (uncertainty), and maysir (gambling). In order to ensure that financial practices are in line with these principles, Islamic finance relies on a number of key terms and concepts. In this explanation, we will explore some of the most important terms and vocabulary related to ethics and governance in Islamic finance.

1. Shariah Supervisory Board (SSB): The SSB is a committee of Shariah scholars who are responsible for ensuring that the operations and activities of an Islamic financial institution are in compliance with Shariah law. The SSB reviews the institution's products, services, and policies to ensure that they are in line with Islamic principles.
2. Zakat: Zakat is a form of alms-giving that is one of the five pillars of Islam. It is a mandatory charity that is required of all Muslims who meet certain criteria, such as owning a certain amount of wealth. In Islamic finance, zakat is often used as a tool for poverty alleviation and social welfare.
3. Mudarabah: Mudarabah is a profit-sharing agreement between two parties, where one party provides the capital and the other party provides the labor or expertise. The profits are then divided between the two parties according to a pre-determined ratio, while any losses are borne solely by the provider of the capital.
4. Wadiah: Wadiah is a safekeeping agreement where one party (the depositor) entrusts their property to another party (the bank) for safekeeping. The bank is responsible for safeguarding the property and returning it to the depositor upon request.
5. Murabahah: Murabahah is a cost-plus-profit agreement where the seller discloses the cost of the goods to the buyer and adds a profit margin to it. The buyer then pays the seller the total amount in installments.
6. Musharakah: Musharakah is a partnership agreement where two or more parties contribute capital to a joint venture and share in the profits and losses according to a pre-determined ratio.
7. Ijara: Ijara is a leasing agreement where the owner of an asset (the lessor) leases it to another party (the lessee) for a fixed period of time in exchange for a rental fee.
8. Takaful: Takaful is an Islamic insurance system where participants contribute to a pool of funds that is used to pay for the losses of other participants. Takaful is based on the principles of mutual assistance and cooperation.
9. Sukuk: Sukuk are Islamic bonds that represent ownership in an asset or pool of assets. Sukuk are structured in such a way that they comply with Islamic principles, such as the prohibition of interest.
10. Shariah Audit: A Shariah audit is an examination of an Islamic financial institution's operations and activities to ensure that they are in compliance with Shariah law. The audit is conducted by a team of Shariah scholars and auditors who review the institution's financial statements, contracts, and other relevant documents.
11. Ethics: Ethics in Islamic finance refers to the moral principles that govern the behavior of individuals and institutions in the industry. These principles include honesty, transparency, fairness, and social responsibility.
12. Governance: Governance in Islamic finance refers to the systems and processes that ensure that Islamic

financial institutions are managed in a responsible and accountable manner. This includes issues such as corporate governance, risk management, and internal controls.
13. Riba: Riba is the Arabic word for interest, and it is strictly prohibited in Islamic finance. This means that Islamic financial institutions are not allowed to charge interest on loans or investments.
14. Gharar: Gharar is the Arabic word for uncertainty, and it is also prohibited in Islamic finance. This means that Islamic financial transactions must be based on clear and transparent terms and conditions.
15. Maysir: Maysir is the Arabic word for gambling, and it is also prohibited in Islamic finance. This means that Islamic financial transactions must not be based on speculation or uncertainty.

Challenges in Ethics and Governance in Islamic Finance:

One of the main challenges in ethics and governance in Islamic finance is the lack of standardization and consistency in the application of Islamic principles. This is due to the fact that Islamic finance is governed by a complex set of rules and regulations that can vary from country to country. As a result, it can be difficult for Islamic financial institutions to ensure that their operations and activities are in compliance with Shariah law.

Another challenge is the lack of awareness and understanding of Islamic finance among the general public. Many people are not familiar with the principles of Islamic finance and may not understand how it differs from conventional finance. This can make it difficult for Islamic financial institutions to attract new customers and to build trust and confidence in the industry.

Additionally, Islamic financial institutions may face challenges in terms of risk management and internal controls. This is because Islamic finance is based on the principle of risk-sharing, which can make it more difficult to manage risks compared to conventional finance.

Examples and Practical Applications:

An example of how the principles of Islamic finance can be applied in practice is the use of mudarabah contracts in venture capital financing. In this case, the venture capitalist provides the capital and the entrepreneur provides the labor or expertise. The profits are then divided between the two parties according to a pre-determined ratio, while any losses are borne solely by the venture capitalist.

Another example is the use of ijara contracts in leasing. In this case, the owner of an asset (the lessor) leases it to another party (the lessee) for a fixed period of time in exchange for a rental fee. This allows the lessee to use the asset without having to purchase it outright, while the lessor generates a steady stream of income.

In terms of ethics and governance, an example of a best practice is the establishment of a Shariah Supervisory Board (SSB) in Islamic financial institutions. The SSB is responsible for ensuring that the institution's operations and activities are in compliance with Shariah law. This helps to build trust and confidence in the institution and in the industry as a whole.

Conclusion:

In conclusion, Islamic finance is a system of finance that is based on the principles of Islamic law, also known as Shariah law. Key terms and concepts related to ethics and governance in Islamic finance include Shariah Supervisory Board (SSB), Zakat, Mudarabah, Wadiah, Murabahah, Musharakah, Ijara, Takaful, Sukuk, Shariah Audit, Ethics, Governance, Riba, Gharar, and Maysir. Challenges in ethics and governance in Islamic finance include the lack of standardization and consistency in the application of Islamic principles, the lack of awareness and understanding of Islamic finance among the general public, and the lack of risk management and internal controls. Examples of practical applications of Islamic finance include the use of mudarabah contracts in venture capital financing and the use of ijara contracts in leasing. Best practices in terms of ethics and governance include the establishment of a Shariah Supervisory Board (SSB) in Islamic financial institutions.