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Islamic Finance Instruments and Systematic Risks: A Call for Financial Framework Reform

İslami Finans Araçları ve Sistematik Riskler: Finansal Çerçeve Reformu için Bir Çağrı

Abstract
This manuscript examines the contemporary practices in Islamic finance and the associated systematic risks. It critiques the current instruments of Islamic finance and the conventional financial framework within which Islamic banks function, highlighting their suboptimal nature. The discussion extends to the challenges of tenor and currency mismatches and their influence on systematic risk, as observed in the deposit banking model concerning asset-liability management. The study advocates for a direct connection between resource mobilization and lending activities, aiming to counteract the trend of Islamic finance converging with conventional finance and to prevent the recurrent financial crises attributed to the disparities between resource mobilization and bank lending. The arguments rest on the premise that the profit-loss sharing principle in Islamic finance is designed not to absolve borrowers of their obligations. Rather, it ensures that investors, as opposed to the general public, share in both the profits and the risks. Furthermore, the manuscript suggests the potential development of Shari'ah compliant capital market alternatives within an appropriate financial framework, which is currently absent. Additionally, it addresses the Shari'ah compliance concerns associated with sukuk, specifically the issues surrounding the sale and lease-back-based (bai' al-'inah) and commodity murabaha (organized tavarruq) transactions. This paper anticipates several outcomes from the proposed measures. These include establishing a fair risk-sharing system aligned with Islamic finance principles, enhancing resistance to speculative bubbles by mitigating systemic risks in the current structure, and contributing economically to society through genuine financing models.

JEL Classification: E5, G2
Keywords: Deposit banking, Bai'al-'inah, Commodity murabaha, Tavarruq, Resource mobilization, Liquidity management

Öz
Bu makale, İslami finansın çağdaş uygulamalarını ve bunlarla ilişkili sistematik riskleri incelemektedir. İslami finansın mevcut araçlarını ve İslami bankaların faaliyet gösterdiği geleneksel finansal çerçeveyi eleştirerek, bunların optimal olmayan doğasını vurgulamaktadır. Tartışma, varlık-yükümlülük yönetimi ile ilgili olarak mevduat bankacılığı modelinde gözlemlenen vade ve döviz cinsi uyumsuzluklarının sistematik risk üzerindeki etkilerini de kapsamaktadır. Çalışma, kaynak mobilizasyonu ve kredi verme faaliyetleri arasında doğrudan bir bağlantı kurulmasını savunarak, İslami finansın geleneksel finansa benzeşme eğilimini engellemeyi ve kaynak mobilizasyonu ile banka kredilendirmesi arasındaki uyumsuzluklardan kaynaklanan finansal krizleri önleyici tedbir önerileri sunmaktadır. Sunulan çerçeve, İslami finanstaki kâr-zarar paylaşım ilkesinin kredi alanları yükümlülüklerinden kurtarmak için tasarlanmadığı öncülüne dayanmaktadır. Tam tersine, bu ilke, kâr ve riskin genel halk yerine yatırımcılar tarafından paylaşılmasını öngörmektedir. Ayrıca, makale, şu anda mevcut olmayan uygun bir finansal çerçeve içinde İslami finans prensiplerine uyumlu sermaye piyasası alternatiflerinin geliştirilmesini önermektedir. Ayrıca, sukuk ile ilgili İslami finans prensiplerine uyumluluk endişelerini, özellikle sat-geri kirala (bey'u'l-'îne) ve emtia murabahası (organize teverruk) işlemleri etrafındaki sorunları ele almaktadır. Bu çalışmadaki çağrının beklenen bazı sonuçları olacaktır. İslami finasın ilkelerine uyumlu adil bir risk paylaşım sistemi, mevcut yapıdaki sistemik risklerin azaltılıp spekülatif balonlara karşı güçlü mukavemet, gerçek finansman modelleri ile toplum yararına ekonomik katkı bunlardan bazılarıdır.

JEL Sınıflandırması: E5, G2
Anahtar Kelimeler: Mevduat bankacılığı, Bey'u'l-'îne, Emtia murabaha, Teverruk, Kaynak mobilizasyonu, Likidite yönetimi

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Introduction

Islam prescribes a nuanced set of guidelines for economic activities, akin to its moral directives for human behavior. It does not propose finance as either a malevolent force or a panacea for prosperity. Instead, Islamic doctrine suggests that finance can serve as either, depending on the implementation of checks and balances, or 'taqwa'—the formal term for ethical restraint in Islam (Gundogdu, 2019). For example, a household lacks a refrigerator. The absence of proper food storage leads to more waste than the cost of financing a refrigerator purchase. Islamic finance offers a solution through murabaha financing for such necessities, allowing banks to profit while contributing to societal welfare. However, after a murabaha sale, the resulting debt is not tradable in secondary markets. Banks are also restricted from accruing late payment fees as profit in the event of payment delays. While they may impose such charges to deter borrower exploitation and encourage timely repayment, these fees should not be recognized as profit on the banks' income statements (Gundogdu, 2016). The same issue arises for Islamic capital market instruments. Saad et al. (2016) delineate three methods for structuring sukuk: asset acquisition, bai' al-'inah transactions, and organized tawarruq in the form of commodity murabaha. According to Shari'ah rules, murabaha sukuk should not be traded on the secondary market due to the prohibition of trading in debt. However, the permissibility of bai' al-'inah and commodity murabaha (organized tawarruq) for structuring sukuk itself is a more formidable consideration than tradability.

Islamic prohibition of accruing late payment charges ensures that banks do not engage in reckless lending practices or inflate their markup rates by statistically incorporating default risks. Moreover, unlike justified by Abdul Ghafar, I. and Karmila Hanim, K. (2010), Islamic banks are barred from selling distressed debt to asset management firms to improve their financial statements. Abdul Ghafar, I. and Karmila Hanim, K. (2010) explores how risk management mechanisms, specifically debt selling, impact the value of Islamic banks. By maximizing the sale of murabaha on housing debt, Islamic banks can mitigate risk from interest rate fluctuations. They developed a theoretical model to optimize the banks' value through housing debt financing, aligning assets and liabilities. Their findings suggest that debt selling enhances earnings and addresses asset-liability mismatches. When market interest rates rise, base financing rates and mark-ups in Islamic banks increase, as these rates influence profits. Engaging in debt selling to reduce risk exposure can amplify earnings, overall bank value and manage asset-liability mismatch. Adopting such practice of conventional banks is a means to address flow of deposit collecting business model. Islamic financial principles are designed to prevent moral hazard for both lenders and borrowers, ensuring that finance serves the greater good. While finance is necessary for progress, Islamic principles guard against exploitation by either party. This balance is why Islam endorses ethical financing but strictly prohibits *riba, gharar*, and *maysir*.

In the context of CAPEX financing for assets such as machinery, Islamic finance advocates the use of the ijara contract. Ijara has served as a fundamental contract in

Islamic law for centuries. It has been adapted to offer financing and benefits through various fiqh solutions. Despite the existence of different forms of ijara, it is significant to note that the ijara contract has historically been utilized to provide financing (Yilmaz, 2023). Given the necessity for a longer tenor, this contract enables banks to continuously accrue profit for the duration of the borrower's asset utilization. Moreover, the bank's ownership of the asset renders ijara contracts favorable for the secondary market, thereby facilitating capital markets (Cakmak, 2024). However, this raises the issue of moral hazard. Banks amalgamate syndicated loans and deposits for such financing activities. Yet, in the event of a bank's insolvency, syndicated lenders and depositors may be precluded from accessing these ijara assets if they have been transacted in the secondary market (Gundogdu, 2019). This predicament suggests that developing equitable and Shari'ah-compliant capital markets is unattainable within the prevailing deposit banking business model.

Islamic banks can be considered within the same framework as conventional banks in the current structure. They are similar to conventional banks in terms of resource mobilization and lending. Consequently, Islamic banks may face the same systematic risks and financial stability issues. For instance, the factors that led to the 2008 crisis could have also caused significant shocks to Islamic banks. Global financing, the credit boom, the housing price bubble, shadow banking, securitization, expansive monetary policy, low interest rates, and leverage are some of the factors that impacted Islamic banks in their relationship with central banks. This is not only due to their relationship with central banks but also because they share the same systematic risks and financial stability concerns.

Islamic finance introduces two additional lending contracts: istisna' and salam. Istisna' is particularly suited for greenfield projects, such as establishing a production facility or infrastructure development, which entail extensive civil work necessitating cash payments to contractors upon achieving milestones. Clearly, such assets cannot be financed through murabaha or ijara, but rather through istisna' (Diallo and Gundogdu, 2021). It can be asserted that the istisna' contract method held significant promise for Islamic banks towards the end of the 20th century. Given that Rajhi Bank is a major Islamic bank in Saudi Arabia and continues its active banking services in many countries, the development of istisna' can be examined through the decisions of the Rajhi Bank Shari'ah Board. Numerous examples of this can be found in the Shari'ah Board's decisions. For instance, the istisna' contract was applied in a project to construct a building on land owned by a company, in an aircraft manufacturing contract, in the construction of a shopping center building, and in providing housing for university academics (Qarārāt al-Rājiḥī, 2010). However, over time, the resemblance of Islamic banks to conventional banking, both in terms of legislation and products, has begun to diminish the significance and applicability of some of the unique contracts of Islamic finance.

Similarly, in agricultural financing, beyond the provision of inputs, there are ancillary civil works required for land leveling and water supply systems, which also demand

cash payments to service providers. For these purposes, Islamic finance recommends the salam contract (Muhammad and Chong, 2007). The limited number of references to salam in the decisions of the Shari'ah Board of Rajhi Bank may suggest that Islamic banks have not extensively utilized this contract from the outset. However, it is noteworthy that this contract is mentioned, particularly in the decisions from the early period (Qarārāt al-Rājiḥī, 2010).

Regrettably, the industry has begun to increasingly rely on Service ijara contracts for immediate cash payments for civil works, rather than fostering the development of istisna' and salam practices. It should be noted that Service ijara is deemed an impermissible practice for financing civil works within the Islamic jurisprudence due to the prohibition of selling what one does not own (Diallo and Gundogdu, 2021). Under this product, an Islamic banking customer applies to an Islamic bank for financing a predetermined service from a supplier. The bank, upon accepting the financing request, purchases the predetermined service directly from the service provider and appoints the customer as an agent. The Islamic bank then provides the predetermined service at the agreed time in accordance with the customer's request. Ultimately, the customer pays the Islamic bank a predetermined fee for the service provided (Mohamed et al., 2024). Today, Service ijara has become a significant instrument for Islamic banks in many countries, including United Arab Emirates, Malaysia, Oman, Bahrain, Maldives, Bangladesh, Nigeria, and Tanzania (Mohamed et al., 2024). This product provides financing in numerous other areas such as health, travel, marriage, and religious pilgrimages like Hajj and Umrah ((Mohamed et al., 2024).

It is evident that Islamic finance encompasses essential contracts to support economic activities. Among these, the murabaha contract stands out as a dominant lending arrangement. Considering that Islamic finance mirrors the real economy, where approximately 90% of household and corporate activities involve short-term trade finance, murabaha serves as a crucial mechanism (Gundogdu, 2016). Additionally, contracts such as ijara, istisna', and salam address other financial needs (Watkins, J.S., 2020). Criticisms leveled against Islamic finance in relation to these contracts lack a solid basis. In reality, Islamic finance offers a robust framework with ample contracts to facilitate economic activities, obviating the need for creative solutions that could jeopardize the economy. Risk management practices in the field of Islamic banking, along with regulatory arrangements related to the deposit-collecting banking model, have led to a convergence with the conventional banking system.

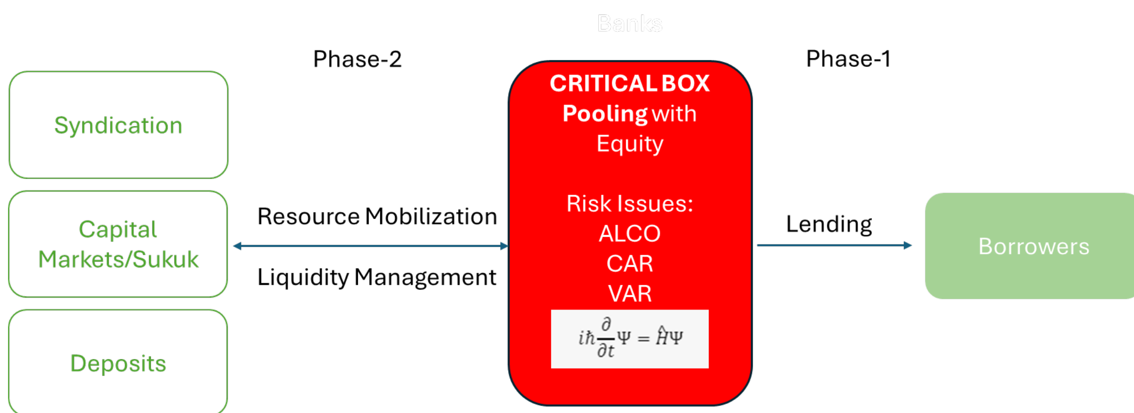
All these traditional financial contracts impose debt obligations on borrowers. However, the financial system should strive for fairness. The question of whether profit-loss-sharing is relevant during the lending phase in Islamic finance warrants consideration. Those who benefit from financing facilities should also shoulder the associated responsibilities. What remains unfair is the enrichment of certain individuals through leveraging and bank bailouts when systemic risks arise within the current financial architecture. Rather than imposing the burden on the general public, it is more appropriate for those who have leveraged from and invested in

banks to bear the consequences in the event of bank failures. The main objective of this paper is to propose structural reforms that align Islamic finance practices with the fundamental principles of Shari'ah. These reforms aim to promote risk sharing, enhance social impact, and prevent systemic risks. In the subsequent section, the Islamic finance perspective on profit-loss-sharing is refined.

1. Existing Financial Framework

Within the existing financial framework, banks engage in lending, money creation, and resource mobilization to facilitate further lending and, consequently, expand the money supply (Banke and Yitayaw, 2022). As depicted in Graph 1, banks mobilize resources from depositors, other financial institutions, and capital markets. However, significant mismatches arise, particularly concerning currency and tenor, between Phase 1 (lending) and Phase 2 (resource mobilization). To address these mismatches, banks employ intricate risk management tools and mathematical formulas. Notably, the formula within the Critical Box draws inspiration from quantum physics—it is the Schrödinger equation. The formulas and structures used by banks to manage this critical box are even more intricate than quantum physics. The current financial structure relies on resource pooling. It is important to note that the mismatches between resource mobilization and lending can lead to vulnerabilities, financial instability, and unfair risk sharing. Reforming both stages is crucial for reducing risks and ensuring fairer risk sharing. Consequently, improving financial stability becomes possible.

Graph 1. Financial Framework



Source: The Authors

The incongruities between resource mobilization and lending, alongside deficiencies in asset and liability management, are emblematic of financial crises and contribute to persistent recurrence of financial crisis. This is attributable to the reliance on formulas and structures such as the Asset-Liability Committee (ALCO), Value-at-Risk (VaR), and Capital Adequacy Ratio (CAR), which banks employ for risk management. These mechanisms operate based on assumptions and historical data

that are susceptible to invalidation by unpredictable, high-impact 'black swan' events. According to Kayhan (2023), the global financial crisis of 2008 intensified the debate on Value at Risk (VaR) models, with widespread criticism regarding their inadequacy. However, with the introduction of new market risk standards by the Basel Committee in January 2016—initially planned for implementation in 2019, then postponed to early 2022, and subsequently to 2023—the VaR measurement model was replaced by the Expected Shortfall (ES) model. Despite these developments, Kayhan noted that VaR has significant limitations. Nevertheless, VaR continued to be used persistently (Kayhan, 2023). Traditionally, Islamic banks have engaged in a banking business model centered on deposit collection, thereby subjecting themselves to risks analogous to those faced by conventional banking institutions (Hassan and Mollah, 20018). It can be argued that there are two primary reasons for this phenomenon. The first reason is the transfer of management policies and managerial practices from conventional banking to Islamic banking. The second reason is the similar regulations and legislations to which both Islamic banking and conventional banks are subject (Gundogdu, 2019).

Islamic banks engage in resource mobilization similar to conventional banks. This practice emerged at the outset the establishment of Islamic banks, primarily due to the limited availability of Information and Communication Technology (ICT) during that period. As in conventional finance, lending and resource mobilization are not directly intertwined. Consequently, a complex interplay of activities occurs within this financial framework. To address the challenges posed by mismatches between Phase 1 (lending) and Phase 2 (resource mobilization), Islamic banks found it necessary to adopt resource mobilization and risk management practices akin to those of conventional banks. Over time, this convergence has led to the financialization of assets within the Islamic banking system.

In recent years, risk management practices have increasingly been incorporated into the regulatory framework of Islamic banking. For instance, the Central Bank of Bahrain's regulatory volume on Islamic banking includes a dedicated chapter on the credit risk associated with Islamic banking products. Similarly, in the United Arab Emirates, the Standardized Risk Management Requirements for Islamic Banks have been integrated into the legislation. Additionally, the Standard Re Liquidity Directive for Islamic Banks in the UAE outlines principles related to the liquidity management of Islamic banks. This standard, issued by the Central Bank, provides guidance on the Shari'ah-compliant management of liquidity risks, addressing both qualitative and quantitative requirements, as well as reporting obligations. While risks such as credit risk, market risk, and capital risk are discussed in detail, a significant section is devoted to the risk of Shari'ah non-compliance (CBUAE 2022). A similar situation exists in Kuwait. For Islamic banks in Kuwait, the instructions issued by the Central Bank are of considerable importance. The Central Bank has issued directives on various topics, including the risk system center, electronic payment funds, sustainable development, and sustainable finance, demonstrating its influence on Islamic banking comparable to that on conventional banking. The critical point here is that central banks exert as much influence on Islamic banking as they do on

conventional banking, directly applying the management practices and legislation of conventional banking to Islamic banks.[1]

The primary purpose of both bonds and sukuk is to finance projects, and they are securities that can be bought and sold. Both instruments can be utilized to manage cash flow and finance various objectives. However, there are theoretical differences between sukuk and bonds. The return on investment for sukuk is based on the income generated from the performance of the underlying asset, whereas the return on investment for bonds is fixed as interest and does not depend on any underlying asset. In sukuk, the investor receives a return on ownership rather than interest. Additionally, sukuk represent the sale of assets in theory, whereas bonds represent the sale of debt (Abalkhil, 2018). Many of the financial instruments currently presented as sukuk are, in fact, securitized bonds. Hence, a persistent shortage of assets to meet demand has prompted industry-wide discussions. It is because focus is not on genuine economic transactions but financialization of existing assets unlike Islamic finance promotes. The phrase 'Where are the assets? We do not have enough assets resonates throughout the Islamic finance sector. Lahsasna, Kabir Hassan, and Ahmad (2018) proposed forward lease sukuk as a highly viable and dynamic Shari'ah-compliant instrument for the Islamic capital markets. Forward lease sukuk aims to raise funds based on non-existent assets, whose subject matter does not yet exist at the time of issuance. They explore the key features of forward lease sukuk and highlights its essential role in project construction and manufacturing within the growing field of Islamic finance. Gundogdu (2019) posit that assets should be generated through istisna' contracts for infrastructure development and project finance by banks. Following asset creation, ijara-based sukuk should be introduced in capital markets. Banks should bear the risk associated with asset production to prevent adverse consequences in capital markets in the event of asset deficiencies. This proposal assigns a pivotal role to Islamic banks in underpinning capital markets and contributing to society by fulfilling a critical function of asset creation. Despite the proposed alternatives, several Islamic finance institutions have turned to non-compliant financial products, including:

- Bai' al-'inah based sukuk (sale and lease-back): Originally from the conventional banking system, this practice has spread from bank sukuk to company sukuk.
- Commodity murabaha syndications and sukuk: Initially associated with bank syndications/sukuk, this approach has extended to lending to companies and households, also often underpinning so-called Islamic hedging instruments.
- Bai' al-dayn: Involving debt trading, receivable discounting, and factoring.

Abalkhil (2018) stated that sukuk, as it is known today, was redefined as *mugarasa* bonds during the fourth session of the Islamic Fiqh Academy in 1988. In 1990, Malaysia issued sukuk, followed by Bahrain in 2001, and the Islamic Development Bank and Qatar issued millions of dollars' worth of sukuk in 2003 (Abalkhil, 2018). This development in the sukuk market extended to the fatwa dimension with the publication of the sukuk standard by AAOIFI in 2004. Before discussing the fatwa

dimension, it is important to note that sukuk plays a crucial role in liquidity management for Islamic financial institutions and banks. Sukuk can be viewed as a key instrument in the context of liquidity. Consequently, sukuk issuance has become a significant objective in Islamic banking. Sukuk provides an effective method for liquidity management; institutions with excess liquidity can purchase these instruments, and when liquidity decreases, sukuk can be sold in the secondary market (Abalkhil, 2018). [2]

Within the realm of Islamic finance, tensions have arisen among academicians and Shari'ah scholars. On one side, some scholars have embraced the maslahah approach as a means to foster industry growth. Mubarak and Osmani (2010), citing Dusuki and Abozaid, argue that attention should be paid to *Maqasid al-Shari'ah* in the creation of financial products. Otherwise, Islamic banks will not differ from conventional ones. Conversely, some academicians advocate for constructive criticism and emphasize the importance of exploring alternative perspectives. It is imperative to recognize that specific financial instruments have engendered considerable debate. Nonetheless, industry bodies responsible for setting industry standards have promulgated guidelines and some Shari'ah Boards have issued fatwas endorsing these instruments. Notwithstanding these developments, it is noteworthy that the entities formulating industry standards are constituted by members of the banking sector, and the remuneration of Shari'ah Board members is furnished by the banks themselves. These circumstances have precipitated deliberations within the Islamic Fiqh Academy. The Academy has unequivocally classified such cases as instances of Shari'ah circumvention and deceit (Gundogdu, 2019). Regrettably, market-driven dynamics have even allowed non-compliant practices from Phase-2 to infiltrate Phase-1. For instance:

- Commodity murabaha for household and corporate lending: Originally designed for inter-bank liquidity management, commodity murabaha has become a prevalent practice in household and corporate lending for Islamic banks. Contrary to its name, a commodity murabaha transaction is not a murabaha transaction but rather an impermissible organized tavarruq.
- Bai' al-'inah sukuk (sale and lease-back) for corporate lending: Despite its non-compliance with Islamic principles, bai' al-'inah sukuk has gained traction as a financing tool for companies.
- Qard al-hasan imitating conventional overdraft facilities: Islamic banks have increasingly adopted qard al-hasan to mimic conventional overdraft facilities.

The reliance on these practices reflects the industry's struggle to strike a balance between growth and adherence to Shari'ah principles. Unfortunately, this approach has delayed the development of genuinely Shari'ah-compliant alternatives (Gundogdu, 2018). Consequently, Islamic finance has become embedded in the conventional system, diverging from its original principles. Presently, the prevailing practice of Islamic finance perpetuates an inequitable economic and financial system. A minority enjoys the benefits, while the broader public bears the repercussions when risks escalate beyond manageable levels within the existing framework. The pooling of resources for lending remains a shared critical flaw in

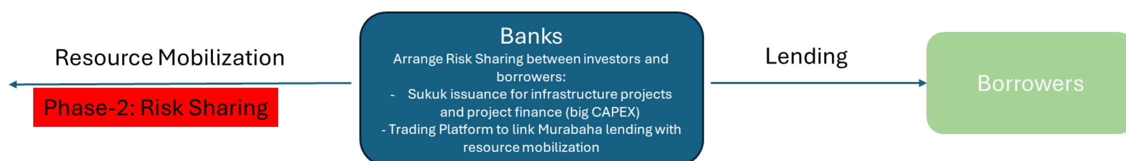
both conventional and Islamic finance. To address the existing challenges, structural reforms are essential. These reforms should aim to realign Islamic finance with its fundamental principles and promote the broader public interest. In the following section, specific adjustments and proposed immediate actions are outlined to unlock the full potential of Islamic finance.

2. Novel Islamic Financial Architecture

While the issue of Central Bank intervention and the monetary system lies outside the scope of this paper, a more significant flaw warrants attention. The creation of money based on debt contracts is incompatible with Islamic principles. According to Islamic perspective, money should originate from the collective efforts of people—rewarding their productive work. As long as individuals can produce goods and services demanded by others, they, rather than central banks, should be creating money (Gundogdu, 2019). Consequently, in an Islamic economic and financial system, Central Banks should play no role with their as-is business model, while banks and organized exchanges are expected to serve as pivotal institutions for the prosperity of society.

In the present day, Information and Communication Technology (ICT) capabilities allow to design a business model that effectively addresses the requirements of Islamic finance. Rather than solely focusing on deposit collection, Islamic banks can gradually transition toward linking people's savings with lending opportunities through investment accounts. The ideal model would resemble crowdfunding, although this transition should occur incrementally. Banks can mobilize resources for lending opportunities via investment accounts, allowing individuals to choose from a list of lending options while sharing the associated risks. In this context, banks play a crucial role by providing due diligence, risk assessment, categorization of offers, and legal arrangements, including security packages and documentation. Furthermore, it is advisable to discontinue sukuk issuance for companies as an alternative to traditional lending contracts, given their frequent use for window dressing and other purposes (Gundogdu, 2019). Instead, sukuk should be exclusively issued for infrastructure projects and large-scale project finance.

Graph 2. Profit-Loss Sharing



Source: The Authors

Graph 2 illustrates the critical connection between Phase 2 (resource mobilization) and Phase 1 (lending). By establishing this link, a profit-loss sharing mechanism can be ensured. Importantly, individuals who are not directly involved in these transactions would be shielded from liability for any erroneous investment decisions made by banks and investors. This alignment promotes transparency, accountability, and equitable risk distribution within the financial system.

Table 1. To-dos and Not-to-dos for Phase 1 and Phase 2

Phase 2	Phase 1
Not-to-dos	***Not-to-dos***
- Commodity murabaha syndication - Sukuk (Bai' al-'inah and commodity murabaha based) - Bai' al-dayn	- Commodity murabaha: Non-compliant - Bai' al-dayn - Sukuk - Musharaka - Mudaraba
To-dos	***To-dos***
- 2-Step Murabaha - Mudaraba - Musharaka - Sukuk (not based on bai' al-'inah and commodity murabaha)	- Murabaha - Ijara - Salam for agricultural finance - Istisna' for project finance and infrastructure development

Source: The Authors

Upon reviewing Table 1, it becomes evident that not only Shari'ah non-compliant products but also mudaraba, musharaka, and sukuk should be excluded from Phase 1 (lending to companies and households). These contracts primarily serve as resource mobilization mechanisms rather than lending contracts. To ensure alignment with Islamic principles, it is advisable to restrict the use of standard Islamic lending contracts for Phase 1, such as murabaha and ijara. The profit-loss sharing principle of Islamic finance is not intended to relieve borrowers of their responsibilities. Instead, it ensures that investors, rather than the general public, share both the profits and the risks. By appropriately linking resource mobilization and lending contracts (as outlined in the provided to-dos within Table 1), we can mitigate systematic risks for the industry and countries. To further elaborate on Table 1, Phase 2, i.e. sukuk based on commodity murabaha, bai' al-dayn and bai' al-'inah should not be employed in resource mobilization/liquidity management. Instead, the proper methods for Phase 2 are 2-step murabaha, mudaraba, musharaka and Shari'ah-compliant sukuk different from the ones above. These methods will contribute to fair risk sharing and play an effective role in mitigating systematic risks. Because they are based on actual Islamic financial contracts. Similarly, in Phase 1, in addition to the three methods mentioned above, mudaraba and musharaka are not appropriate. Instead, murabaha, ijara, salam and istisna' are proposed as methods of social welfare and actual financing. In fact, this can be interpreted as the purpose of Islamic banks when they first emerged. As a matter of fact, it is seen in some of the first Islamic banks' Shari'ah board decisions that such decisions were taken first. The improvement of the profit-loss sharing mechanism and the adoption of platforms such as crowdfunding can enable a direct link

between resource mobilization and lending. This could lead to a more shared and participatory financial ecosystem with fairer risk-sharing.

Indeed, the focus on murabaha holds merit, especially given that approximately 90% of business and lending activities are short-term trade-related. This alignment with real economic transactions underscores the practical relevance of murabaha within Islamic finance. While sukuk play a role, emphasizing murabaha as a cornerstone can enhance the system's effectiveness (Gundogdu, 2016).

To establish a seamless linkage between resource mobilization and lending, concerted efforts are necessary. The key lies in avoiding pooling and directly connecting these components. An organized exchange can play a pivotal role in facilitating resource mobilization through instruments like sukuk (for project finance), mudaraba, musharaka, and 2-Step murabaha (Gundogdu, 2016). By leveraging the existing capabilities of organized exchanges, we can effectively match resource mobilization contracts within Islamic finance to corresponding lending contracts, ensuring a more efficient and transparent system.

Conclusion

Islamic banks predominantly follow a deposit-collecting business model, primarily due to the limited capabilities of information and communication technologies during the outset of the establishment of Islamic banks. However, with the advancements in technology and the development of well-organized exchanges equipped with robust clearing house mechanisms, there is an opportunity for transformation. By shifting the business model and adhering to Shari'ah compliance, Islamic finance holds promise as a potential solution to address global dissatisfaction with the conventional finance industry.

In conclusion, the transformation of Islamic finance necessitates structural changes that align with its core principles. By linking resource mobilization and lending without pooling, a more transparent and equitable system can be created. The focus on murabaha, as a reflection of real economic transactions, holds promise. Additionally, leveraging organized exchanges to match resource mobilization contracts with lending contracts can enhance the industry's effectiveness. Ultimately, these steps can harness the potential of Islamic finance for the benefit of society at large. This evidence supports the assertion that central banks, with their current business model, have no place within an Islamic economic and financial framework. Indeed, central banks have imposed agendas that have led to the convergence of Islamic banking with conventional banking practices. Instead, organized exchanges and crowdfunding banks, serving as intermediaries, are poised to assume a pivotal role.

Notes

[1] Although there are separate instructions sent by Central Banks to Islamic banks, it should be noted that they are still subject to the same legislation in some aspects and are part of this management system. However, in terms of Shari'ah governance, Islamic banks are subject to a separate department. This is the case with legislation such as Central Bank laws or risk management instructions in some GCC member countries, but this issue is beyond the scope of this paper and will be discussed in detail in a separate study.

[2] It should be noted that only asset-backed sukuk are tradable in the secondary market.

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