Philosophy of the Fundamentals of Openness to Islamic Finance

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Abstract
Based on the fact that conventional banks are increasingly moving towards adopting Islamic finance tools as a new strategy to enhance their competitiveness, by attracting a large segment of depositors - especially Muslims spread globally - who are looking for financial alternatives that comply with Sharia, and avoid dealing with interest rates; as this shift is a way to attract rigid savings that reject traditional financial systems due to Sharia violations, and a new trend towards diversifying financing tools that achieve good growth rates and a fertile field to invest in. The paper analyzed the philosophy and foundations of the shift towards Islamic banking, focusing on the diversity of its innovative tools and the precise Sharia controls that govern them. The findings revealed that this diversity - supported by strict Shariah regulations - has enabled financial engineers to design flexible financing solutions that meet diverse market needs, making Islamic banking a strategic opportunity to enhance profitability through new investment channels, as well as expand the customer base and enhance confidence in the financial sector. In doing so, the study highlights how Islamic finance forms a bridge between economic efficiency and value commitment, reinforcing its role as a vital component of the global financial system.

Keywords: Islamic finance instruments; openness; islamic banking system; Islamic banks.

Introduction:

The financial arena has witnessed a growing trend in recent years towards openness to operating with Islamic finance instruments. This expansion is attributed to several fundamental factors, foremost among them the diversity that characterizes these instruments, enabling financial institutions to offer innovative solutions that meet the needs of a wide range of clients. Furthermore, Islamic finance instruments have proven their ability to achieve competitive levels of profitability, thereby attracting the attention of investors seeking sustainable and Sharia-compliant growth opportunities. Most importantly, these instruments possess a unique suitability for a broad spectrum of savers and investors, including those who prefer to adhere to Islamic Sharia in their financial dealings, thus opening new horizons for mobilizing capital and promoting financial inclusion.

A growing conviction is emerging among various active banks, both traditional and modern, regarding the possibility of adopting Islamic finance instruments and integrating them into their operations; where some see this trend as an opportunity to expand the customer base and attract new segments of the market seeking Sharia-compliant alternatives; while others consider that diversifying the available financial instruments enhances the bank's flexibility and its ability to manage risks and offer innovative financing solutions. As for the ideal environment for the growth and prosperity of these instruments, most visions agree on the importance of clear and organized legal and regulatory frameworks that support the Islamic banking industry and protect the rights of transactors; in addition, the development of specialized competencies and expertise in the field of Islamic finance, the encouragement of innovation in products and services, and the promotion of awareness and knowledge of these instruments among the public play a pivotal role in creating a nurturing and thriving environment for this sector.

Through this the following problem raises : To what extent has the necessity of adopting a clear philosophy for the fundamentals of openness to operating with Islamic finance instruments become imperative for various financial institutions, given the diversity, profitability, and suitability of these instruments for a wide range of savers and investors?

1- The philosophy of Islamic banking stems

The philosophy of Islamic banking stems from the principles of Islamic Sharia and seeks to achieve comprehensive economic and social justice. This is clearly manifested in its reliance on a diversity of financing instruments that go beyond the traditional concept of usurious lending, including Murabaha, Mudaraba, Musharaka, Ijara, Salam, Istisna'a, and others. This diversity enables Islamic banks to meet the needs of various economic segments and groups and to finance projects with diverse natures and financial structures.

Parallel to the diversity of financing instruments, Islamic banking is keen on directing investments towards diverse fields that contribute to sustainable development and serve the interests of society. These fields include the industrial, commercial, agricultural, services, and real estate sectors, while observing strict Sharia controls that prohibit investment in forbidden activities such as usury, gambling, excessive uncertainty, and the production or promotion of prohibited items. Thus, Islamic banking strives to achieve a balance between realizing legitimate profits and actively contributing to building a strong and robust economy based on ethical foundations and established Islamic values.

1-1- **The concept of conversion to wards an islamic banking system** :

Conversion signifies the move from a state deemed impermissible according to Sharia to one that is permissible. The impermissibility within the conventional system that necessitates this shift lies in engaging in diverse transactions that contravene Sharia principles, with the foremost being the handling of usury [1]. This is pertinent to traditional banking, which conducts various banking transactions inconsistent with the stipulations of Islamic Sharia. The transition involves moving away from conventional banking rooted in the interest rate towards Islamic banking founded on the principle of profit and loss sharing. Furthermore, it entails replacing transactions that violate Sharia with banking practices sanctioned by God, ultimately aiming to achieve fairness among transacting parties in accordance with the objectives of Islamic law

The most important views on the definition of the conversion towards the islamic banking phenomenon can be mentioned as follows[2] :

- The first definition : «the ligitimate origin of the transition is derived from the priciple of repentance and return to god and stop dealing with usury taking and giving, by having a sincere desire to repent through the cessation of banking transactions that conter sharee'ah and replacing them by others that comply with the provisions of islamic sharee'ah ».
- The second definition : «the creation or the conversion of some branches of conventional banks into islamic branches can be considered as a phenomenon of transition from conventional banking to islamic banking ».
- The third definition : « The conversion phenomenon is the branches belonging to traditional banks that perform all banking activities in accordance with the provisions of sharee'ah ».
- The fourth definition : « the existance of regulatory units run by conventional banks specialized in providing financial services ».

As evident, the majority of prior definitions centered on a partial transition, such as the conversion of a conventional bank's branch into an Islamic branch, the establishment of an Islamic window within a conventional bank, or even the transformation of a conventional bank into an Islamic one. Conversely, these definitions overlooked the core objective of conversion, which is the creation of a comprehensive Islamic banking system.

1-2- **Motives for the conversion towards the Islamic Banking[3]** :

Some observers posit that the conversion of several conventional banks to Islamic banks in recent years stems from a desire to repent and abandon financial and banking services that contravene Sharia provisions. This is further driven by an increasing number of customers who recognize the impermissibility of dealing with interest rates and are consequently turning to Islamic banks.

The conversion's reasons have also pure profitable and commercial dimentions due to the remarkable success of islamic banks, such as the high profitibility rates and the returns of financing operations compared to the conventional financing returns, in addition to technical reasons, such as the desire of conventional banks to invest rather than the financial mediation « lending » and « borrowing », and getting specific benefit of so-called «debt trading », while the islamic banking operations extend to direct investment activity for itself or for others, alongside with the financial intermediation i.e they are « comprehensive banks ».

1-3- **Requirements of the conversion towards Islmaic Banking** :

Prior to the bank's conversion, or offering islamic banking products, some requirements should be met before the implementation[4] :

A- The approval of the regulatory bodies (Monetary Agency, Central Bank) ;

B- creating a legitimate body (or a legitimate observer) ;

C- Designing the work systems which include the preparation of:

- documentary courses ;
- forms and documents ;
- legal and legitimate contracts ;
- accounting systems ;
- automated systems.

D- Selecting and preparing human resources ;
E- Setting up an advertising compaign targeting customers of these branches.
The development of human resources is one of the prerequisites for a successful conversion process towards the islamic banking, that is through :
a- selecting leaders with expertise in the conventional banking and preparing them for the islamic banking ;
b- selecting people experienced in the islamic banking field and preparing them for it ;
c- making a plan for training people for the islamic banking that includes the following programs :
1- islamic banking conccepts ;
2- alternative financing formulas to meet customer's needs ;
3- accounting controls and standards for islamic banking operations ;
4- an islamic banking financing method (feasibility study, financial analysis, financing standards, management and collection of non-performing loans)
5- an islamic banking management method ;
6- a ligitimate control and review on islamic banking operations.

2- **The Conversion Sources, Forms and Methods** :
Given the evident expansion of the Islamic finance industry globally, the establishment of financial institutions operating in accordance with Islamic Sharia has manifested in various forms. Some entities have opted to initially introduce an Islamic window within a conventional bank, while others have established Islamic branches. A third group has chosen to create fully integrated Islamic banks, and ultimately, some countries have moved towards the implementation of a comprehensive Islamic banking system.

2-1- **The Conversion Sources** :
By "a source of conversion," we refer to the entity aiming to transform a conventional bank into one operating in line with Islamic principles. This entity can originate from within or outside the bank and may be public (governmental) or private, as detailed below[5] :
a- The conversion decision towards islamic banking could be made by the conventional bank's decision makers.
b- The conversion towards Islamic banking could be initiated by an external private entity interested in acquiring the bank and transforming its operations to align with Islamic principles. Several methods can be employed for this purpose, including:
- An external entity, whose foundational principles emphasize strict adherence to Islamic provisions, acquires a stake in a company by purchasing existing shares and subsequently attempts to amend the company's statutes during the general assembly
- Entering into a partnership without an initial requirement for Sharia compliance, with the understanding that once the partnership attains significant moral and financial standing, the original owners will decide between buying out the new partners and converting the company to operate in accordance with Islamic Sharia.
- Providing financing to companies, some of whose owners desire to operate according to Islamic Sharia, through Islamic financial instruments to eliminate non-compliant activities. This is followed by consolidating control through the purchase of their shares, aiming to influence the majority of owners to agree on converting the company's operations to comply with Islamic Sharia.
c- The state's legal authority decides to implement Islamic provisions and cease any conflicting practices. Consequently, it stops dealing with Riba and other elements that violate Islamic Sharia through conventional banks, and actively works on converting them to operate in accordance with Islamic principles. The experiences of Iran, Pakistan, and Sudan serve as notable examples where state intervention significantly influenced transactions, particularly the interest rate. Another illustration is the recent financial crisis, where Japan and the USA reduced interest rates to zero or near-zero, leading to economic improvement and the commitment of all banks to law application.

2-2- **Forms of conversion** :
The manner of conversion largely hinges on its underlying motives. If the primary driver is repentance to Almighty God and the desire to eradicate Riba, in line with the Prophet's (peace be upon him) saying, "All the usury (riba) of the Ignorance (pre-Islamic) days are abolished, and the first usury I abolish is that of Abbas ibn Abd al-Muttalib, for it is all abolished," then a complete transition towards operating in accordance with Islamic Sharia and ceasing all dealings with usury is necessitated. However, if the motivation behind the conversion is primarily to enhance profitability and expand banking operations, several alternative forms may be adopted, as illustrated below:

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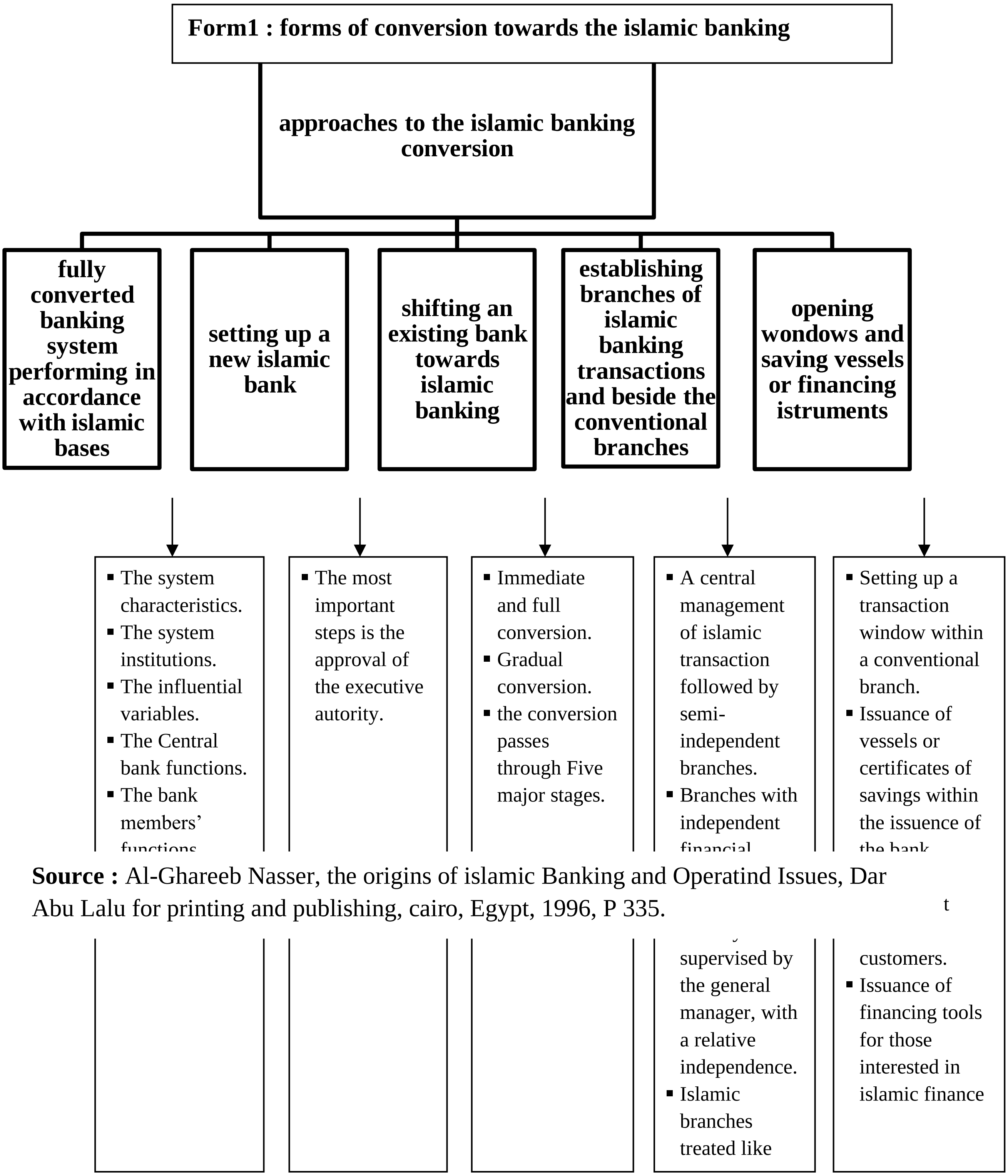

Source : Al-Ghareeb Nasser, the origins of islamic Banking and Operatind Issues, Dar Abu Lalu for printing and publishing, cairo, Egypt, 1996, P 335.

The practice of islamic banking in conventional banks has taken many forms, either by establishing a unit or a departmentdedicated to islamic banking such as what happened in the USA, Germany and Switzerland, or by setting up an islamic banking window like most of Malaysia's banks, or an integrated branche or a branche specialised in islamic banking such as the Egyptian case. Finally, this may take the form of an independent islamic bank owned by the parent bank, such as The Islamic Citybank in Bahrain.

Although these experiences may have their pros, they are not free of cons such as the funds mixing of islamic branches with funds of the parent conventional bank, and that is what the depositors often fear, also the opening of islamic branches by foreign conventional banks may be a tool to attract Muslim clients without a strict committment to islamic banking fundamentals[6].

a- Islamic banking windows and vessels :

Islamic banking windows and vessels refer to the strategy of conventional banks introducing some Islamic banking services to cater to a segment of their clientele seeking Sharia-compliant products. This approach is prevalent in numerous Islamic countries, including Malaysia, Morocco, and Saudi Arabia, as well as in non-Muslim nations such as Great Britain, Switzerland, Germany, and the United States[7].

These windows are straightforward to implement, do not necessitate alterations to the existing banking structure or require specific approvals for their operation, and are often motivated by the desire to capture a portion of the Islamic banking market or to retain customers who prefer to conduct their banking through Islamic saving or financing arrangements. Consequently, this method primarily seeks to accommodate the needs of certain customers who wish to engage with the Islamic banking system without necessarily switching to fully Islamic banks[8].

b- Branches for Islamic Conversion :

The Islamic branch represents a financial entity that is a subsidiary of a conventional bank but operates independently in its activities from the parent bank [9] . It attracts savings, invests them, and provides banking services in accordance with the provisions of Islamic Sharia. Furthermore, it is overseen by a Sharia supervisory board that offers advisory opinions and monitors its operations. Some of the key characteristics of an Islamic branch include[10]:

- The dependence to conventional banks in terms of legal and ownership adaptation, so it appears within the organizational chart of the conventional bank which owns branches operating according to the conventional method
- Branches exercise all banking activities including the granting of good loans.
- The islamic branches's transactions go according to islamic provisions and principles.
- They aim to achieve a numerous purposes which can be summerized as follows :
- • The application of islamic provisions and principles in the banking industry ;
- • Maitain current customers and attract another segment of customers ;
- • The contibution to the economic and social development ;
- • Acquiring expertise in the islamic banking.

Islamic branches within conventional banks face many problems, the most important of which are[11] :

- The lack of interest from the parent bank, and seeing them from the profitability perspective not from the extent of compliance with islamic provisions and rules ;
- The problem of transferring the excess of liquidity from the islamic branch to the conventional parent bank in exchange for interest ;
- The focus on the Murabaha for the purchase order formula, and sometimes it is applied in suspecious ways in terms of ligitimay ;
- Most of the branches' employees in the islamic branches ignore the provisions and principles of sharee'ah.
- The problem of schedueling the late clients' debts by increasing the term for debt increase.

c- Conveting an existing bank into islamic banking :

This is done by one of two ways :

The first method : consists of turning the bank entirely to the islamic banking by replacing transactions that do not comply with the sharee'ah by others complying with it, and quit practicing businesses that are contrary to the sharee'ah, especially dealing with usury. This form is the most credible forms of conversion[12].

The second method : depends on the gradual conversion by shifting the bank's elements from the current conventional position into the islamic banking in stages and within an appropiate period of time[13].

For this purpose, a plan must be developed and supervised by an expert in the islamic finance. This plan should include the following[14] :

- The treatment of shareholders' equity resulted of the difference between benefits and payables seized by the bank before the conversion ;
- The treatment of the interest-bearing loansgranted by the bank before the conversion, and develping the necessary contracts fro their settlement ;
- The treatment of interests deposits recieved by the bankk before the conversion ;
- Training the staff of the bank on the Islamic banking ;
- Setting standards and accounting restrictions, and updating the computer system ;
- Preparing forms of investment formulas and Islamic financing contracts ;
- Preparing madels of investment formulas and islamic financing contracts ;
- The conversion appraoch and the timetable for its implementation.

d- Establishing a new Islamic bank :

The establishment of a new Islamic bank represents the essence of Islamic banking and the most effective form of gradual transition towards it. Creating a new bank allows for the complete control of its foundational elements and components from the outset, ensuring no inherent flaws. If this new bank is established on sound principles that genuinely adhere to Islamic Sharia, it is likely to gain a strong reputation and achieve superior performance.

Despite the establishment of an Islamic bank that engages with the public through Islamic financing and saving arrangements, a challenge persists regarding the Islamic bank's interactions with the Central Bank, particularly concerning the implementation of monetary policy aimed at controlling the money supply within the economy. Consequently, the transition towards a comprehensive Islamic banking system becomes essential for the optimal application of Islamic banking in accordance with Islamic principles.

e- The comprehensive conversion towards islamic banking :

The complete transition to Islamic banking is the ultimate goal, whether achieved through outright conversion or a gradual process. As the Islamic banking system constitutes an integral component of the broader Islamic economic system, it derives its attributes from the latter's characteristics, as well as from the fundamental principles and tenets that govern its inception and operational mechanisms, which are inherently interconnected. Its status as a part does not imply separation from the whole; rather, it signifies its linkage and integration with other facets of the system, such as the financial, production, distribution, and other related systems. Consequently, modifying the existing banking system to operate on an Islamic basis while leaving the rest of the economic system unchanged represents altering a part of the whole while the whole remains intact. If this is not accompanied by a swift transformation across all other components of the economic system, the Islamic banking system will find itself in a position akin to a foreign element within the larger system. While this situation might be preferable to a mixed system, it falls short of achieving the desired objectives of Islamic conversion[15].

Synthesizing the perspectives of contemporary economists on Islamic banking system institutions, we deduce that they encompass a central bank, a number of member banks, and specialized financial institutions focusing on finance and credit. Regarding the conversion process, the most effective approach involves action by the ruling authority. This is achieved by enacting stringent laws across all institutions, including judicial and economic bodies, that prohibit all banking transactions violating Sharia provisions. The initial step should be the cessation of dealing with the interest rate (as evidenced by developed countries reducing interest rates to near zero or even zero to overcome capitalist system crises). Subsequently, a gradual implementation of Islamic banking system mechanisms should follow, tailored to the country's economic circumstances. Ultimately, a comprehensive conversion to the Islamic banking system hinges primarily on political and religious foundations.

Conclusion:

In conclusion, the shift towards adopting Islamic finance instruments represents a fundamental development in the global financial landscape, aiming to transcend the Sharia-compliant restrictions associated with traditional interest-based transactions, which are religiously prohibited. Through this study, we emphasize the pivotal role of supportive legal frameworks and strategic political decisions in facilitating this transformation and openness. Based on the foregoing, the necessity of adopting a clear and integrated academic philosophy for the fundamentals of openness to Islamic finance instruments gains paramount importance for various financial institutions, including those operating in non-Islamic environments.

It must also be emphasized that adopting a systematic vision based on a deep understanding of the principles of Islamic finance and its diverse potential is not limited to meeting the needs of a growing segment of clients seeking Sharia-compliant alternatives, but rather opens broader horizons for enhancing financial inclusion, attracting new investment flows, diversifying funding sources, and strengthening financial stability. Achieving these goals requires the

formulation of clear strategies that include developing robust regulatory and legal infrastructures, investing in building specialized capacities and expertise, and encouraging innovation in Islamic financial products and services.
The adoption of such a clear academic philosophy, based on solid research foundations, will enable financial institutions to move forward confidently towards integrating Islamic finance instruments into their operations, achieving their outlined financial objectives efficiently and effectively, and contributing to the construction of a more inclusive, sustainable, and just global financial system.

Suggestions and Recommendations on How to Adopt a Clear Philosophy for Openness to Operating with Islamic Finance Instruments:

Firstly: At the Level of Financial Institutions:

Conducting In-Depth Studies and Strategic Assessment:
Undertake comprehensive feasibility studies to evaluate the possibility of integrating Islamic finance instruments into current operations or establishing specialized units or branches.
Analyze the target market and determine the potential demand for Islamic financial products and services.
Assess internal resources (human, technical, financial) and identify the necessary requirements for adopting Islamic finance.
Develop a clear strategic vision that defines the expected financial and non-financial objectives of openness to Islamic finance.
Developing a Compatible Regulatory and Governance Structure:
Establish specialized units or departments in Islamic finance that enjoy the necessary independence and flexibility to operate effectively.
Form independent and qualified Sharia supervisory boards to oversee products and operations and ensure their compliance with the principles of Islamic Sharia.
Develop sound governance policies and procedures that ensure transparency and accountability in Islamic financial operations.
Investing in Capacity Building and Staff Qualification:
Launch intensive training programs for employees to enhance their knowledge of the principles and instruments of Islamic finance.
Attract and recruit specialized experts in the field of Islamic finance, law, and Sharia.
Encourage research and development to innovate new and innovative Islamic financial products and services.
Developing Islamic Financial Products and Services:
Offer a diverse range of Islamic financial products and services that meet the needs of various client segments (individuals, companies, institutions).
Focus on developing innovative products that combine Sharia compliance, competitiveness, and profitability.
Ensure transparency and clarity in the structuring and pricing of Islamic financial products and services.
Marketing and Awareness:
Develop effective marketing strategies to introduce clients to Islamic financial products and services and their advantages.
Organize awareness campaigns to increase knowledge and understanding of the principles and importance of Islamic finance.
Build a strong and reliable brand for the unit or branch specializing in Islamic finance.

Secondly: At the Level of Regulatory and Legislative Authorities:

Establishing Clear and Comprehensive Legal and Regulatory Frameworks:
Enact specific laws and regulations governing the work of Islamic financial institutions and clarifying the standards and procedures related to products and services.
Ensure compatibility between local laws and regulations and the fundamental principles of Islamic Sharia.
Provide a flexible regulatory environment that encourages innovation and the development of the Islamic finance industry.
Establishing Specialized Supervisory Bodies:
Establish independent supervisory bodies with the necessary expertise and knowledge to oversee Islamic financial institutions and ensure their compliance with laws, regulations, and Sharia standards.
Develop specific supervisory standards that are appropriate to the nature of risks in Islamic finance.
Enhancing Cooperation and Coordination:
Encourage cooperation between regulatory authorities, financial institutions, and academia to exchange experiences and knowledge in the field of Islamic finance.

Coordinate with international bodies concerned with Islamic finance to adopt best practices and global standards.
Thirdly: At the Level of Scientific and Academic Research:

Encouraging Scientific Research:
Support and encourage specialized academic research and studies in various aspects of Islamic finance.
Develop specialized educational curricula in Islamic finance in universities and institutes.
Spreading Awareness and Knowledge:
Organize conferences, seminars, and workshops to exchange knowledge and experiences in the field of Islamic finance.
Publish specialized books, journals, and scientific articles in Islamic finance.

Fourthly: At the Level of Market Infrastructure:
Developing Islamic Financial Markets:
Establish active secondary markets for trading Islamic financial instruments (such as Sukuk).
Develop Sharia-compliant liquidity management tools.
Providing Support Services:
Encourage the establishment of credit rating agencies specialized in assessing risks in Islamic finance.
Develop specialized legal and Sharia advisory services in the field of Islamic finance.
The integrated and coherent adoption of these suggestions and recommendations will contribute to building a clear and strong philosophy for openness to operating with Islamic finance instruments, ultimately benefiting financial institutions, the economy, and society as a whole.

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