THE MİNİSTRY OF EDUCATİON OF THE REPUBLİC OF AZERBAİJAN

AZERBAIJAN STATE UNIVERCITY of ECONOMICS

INTERNATIONAL GRADUATE AND DOCTORATE CENTER

MASTER DISSERTATION

ON THE TOPIC

“THE ROLE OF ISLAMIC BANKING IN ECONOMIC DEVELOPMENT ”

ORUJLU NURLAN VAHID

BAKU – 2019

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MASTER DISSERTATION

ON THE TOPIC

"THE ROLE OF ISLAMIC BANKING IN ECONOMIC DEVELOPMENT"

Code and name of Programme: 060403 – "Finance"

Specialisation: "Financial Management"

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XÜLASƏ

Mövzunun aktuallığı: Son illər İslam maliyyə və bankçılıq sistemi yalnız müsəlmanlar yaşayan ölkələrdə deyil, hətta qeyri-müsəlmanlar yaşayan ölkələrdə də geniş yayılmağa başlamışdır. Belə ki, əmanətçilərdən əldə olunmuş vəsaitlərin faiz olmadan maliyyə ehtiyacı olan sahibkarlara ödənilməsi insanlarda böyük marağa səbəb olmuşdur. Ənənəvi bank sistemindən fərqli xüsusiyyətləri onun qlobal böhranlar dövründə belə inkişafına şərait yaratmışdır. Onun təklif etdiyi məhsullar sahibkarlığın və ölkənin iqtisadi inkişafında mühüm rolu ilə digər bankçılıq sistemindən fərqlənərək əhəmiyyət kəsb etmiş, bu məqsədlədə qərb ölkələri kommersiya banklarında bu məhsulların bir qismini təklif etməyə başlamışdır.

Tədqiqatın məqsəd və vəzifələri: Bu bank sisteminin İqtisadi İnkişafda rolunun göstərilməsi və bu bank sisteminin ölkəmizdə tətbiqinin yenidən təşkili üzrə təkliflər vermək bu tədqiqatın başlıca məqsədlərindən biridir.

İstifadə olunmuş tədqiqat metodları: Tədqiqatın aparılmasında ən başlıca statistik metodlardan, əvvəlki illərdə tədqiqat aparmış tədqiqatçı və elm adamlarının həyata keçirdiyi sorğu və müşahidə metodlarının nəticələrindən istifadə olunmuşdur.

Tədqiqatın informasiya bazası: Bu sahə üzrə çap olunmuş kitablar, internet resursları və audit hesabatları bu dissertasıyanın əsas başlıca məlumat bazası hesab olunur.

Tədqiqatın məhdudiyyətləri: İslam Bankçılıq sisteminin hal-hazırda ölkəmizdə fəaliyyət göstərməməsi məhdudiyyətlərdən biridir ki, bu da öz növbəsində bu sahə üzrə məlumat əldə etmək də tədqiqatçılara çətinliklər yaradır.

Tədqiqatın elmi-praktiki əhəmiyyəti: Ölkəmizdə indiki zamanda bu maliyyə sisteminin tətbiq olunmadığını, bu sistemə uyğun zəruri informasiya və məlumatların olmadığını nəzərə alarsaq, bu tədqiqat bu sahə üzrə informasıya əldə etmək istəyənlərə ilkin kitab rolunu oynayır.

Dissertasiya işinin strukturu və həcmi: Dissertasiya işi üç əsas fəslindən və giriş, xülasə, mənbə və cədvəl və qrafiklərin siyahısı adlı əlavə hissələrdən ibarətdir.

Açar sözlər: Islam Maliyyəsi, İslam Bankçılığı, Təkafül.

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INTRODUCTION

We need to explore existing financial and banking systems to ensure sustainability of economic development that has been observed in recent years in the world and to achieve possible economic development. Islamic religion, which is considered to be the most outstanding achievement of world culture and the most striking example of spiritual moral values, is also a very consistent tool for the study of human sciences. One of the earliest calls of Islam was to invite people to think, to get rid of ignorance. The outlook on reason, science and thought, and the lifestyle of this world outlook can be a protection against human distractions and a healthy lifestyle.

When we look at history, we will see how important our religion is to science and enlightenment. Fast growth in Europe after XII century in trade, and from XIX century to industry has accelerated the development of banking and banking institutions. As a result of economic and trade relations of Islamic countries with these countries, banking activity spread to the Islamic world. However, interest rates were not paid in these banks because interest in Islam was considered haraam. In addition to such banking, ie interest-free, interest-free transactions, the Islamic bank, which conducts other transactions legally deemed to be Islamic, has begun to be investigated by Muslim economists as to what dimensions and boundaries they can work on, if they are established, rules of conduct and laws and normative legal acts have been prepared. Throughout history, people have sought new solutions and have developed different theories to solve their problems. The inadequacy of existing organizations to address the problems faced by them is inevitable. The immediate adoption of an important part of the current economic problems, as pointed out above, by the existing bank and lending system, makes it evident that alternative solutions in this area are inevitable. Although different economic development models are applied in Muslim countries, a single economic system that never works on Islamic principles will fail to achieve a high score if no single Islamic ideology is taken into account. However, the general principles of the Islamic economy and the fact that it is based on economic development will shape a single Islamic development model.

The fundamentals of the Islamic economy model are based on the rules formed by the living standards of Muslim societies and the principles and methods they have adopted and implemented in the economic field. Without knowing the fundamentals of Islam's economic model, it will not be possible to get a full understanding of Islamic banking and to obtain the expected benefit from the system.

Material resources for the emergence of Islamic banks have created an oil crisis of 1973, when the sharp rise in oil prices resulted in the flow of oil from oil to the countries of the Near East, which in turn enabled the Islamic banks to create a large savings pool. Over the last ten years, the growth rate of Islamic banks' assets has been about 10-15% per year, and it is assumed that this trend will be maintained in the future. However, the application of Islamic banking in the traditional financial system is being studied in many countries, including Azerbaijan.

The introduction of the Islamic banking system in the Azerbaijani financial market is a subject of public debate in conducting large-scale and substantial market changes in all economic institutions in Azerbaijan, in particular.

Implementation of the Islamic banking model in Azerbaijan can lead to attracting cheap and long-term funding sources and can help to increase return on investment. Moreover, the introduction of the Islamic banking model in Azerbaijan may turn the country into a financial center of the Islamic world.

Study of Islamic financial institutions is a fairly relevant topic in the world of economic literature, and is of practical interest to economic agents in our country and abroad.

In the first chapter of the dissertation, preliminary information on Islamic finance has been provided and the products and services offered by Islamic banks have been discussed. This section outlines the main features that distinguish Islamic banking from other traditional banking systems and provide information on the advantages of these features to this system. In this section, it is possible to find out the development of Islamic finance assets for many years.

The second chapter deals with the major types of Islamic finance, especially Islamic banks. Brief and detailed information on its governance principles was provided. The last part of this chapter provides information on banks in the world, especially in western countries, the list and assets of these banks.

The last chapter outlines the research results of the role of Islamic banks in economic development. In recent years, information on key countries developed by this banking system has been noted. Also, in the last part of this chapter, information about Islamic windows that once functioned in Azerbaijan was given, their initial activities and challenges. Information on investment made by banks in the Gulf countries has been given to Azerbaijan and a brief note on some of their projects has been provided. The list of banks in which Islamic finance is applied in Azerbaijan and the reasons for the cancellation of this system are shown.

Finally, the results of the research have been shown and certain proposals have been made for the application in Azerbaijan.

Background of the research

First I would like to start with general information about background of my thesis. As the name suggests, this dissertation is related to Islamic Banking and explores its role in economic development. We all know that banking system is one of the major parts in World Economy. This banking system works with interest since the foundation. People who live in Muslim countries don’t like the interest because the interest is forbidden by Sharia law. For this reason, Conventional banks don’t work in Muslim countries. This process has led to the introduction of a new banking system which controlled by Islamic rules in Muslim countries. Currently, these banks are very developed and spread all over the world. Following the general information, there will be notes on countries where Islamic banking has spread. It will be great deal of information about UK which has the most Islamic banking in the West. Additionally, readers will be informed about the assets, operations and management system of this system.

Purpose of the research

The purpose of the diploma study is to study the various issues. The essence, history of development, classification and ways of development of Islamic banking are discussed here. The functions, duties and operations of Islamic banking are studied in detail. The role of Islamic banks in monetary policy, the role of the banking system, the impact on the financial markets and in general its role in the development of the economy.

Objective of the research is obtaining, analyzing and comparing economic data concerning Islamic banking and its influence to Economic development.

Theoretical knowledge of the research is based on the findings of previous researchers, both local and foreign. In addition, statistical diagrams, annual reports and comparative tables were used. Both quantitative and qualitative methods were used in dissertation. The figures and diagrams mentioned in the annual financial statements were used for comparing.

The main database of the research is the statistical data, statements, book of researchers, scientists who have researched in recent years.

There are some **limitations in the conduct of the research**, most of which are that the financial and banking system is not currently practiced in our country. However, in our country, there are many qualified specialists in this financial system.

As a result of the research, the role of Islamic banking in economic development is determined. Suggestions for the implementation of this system in Azerbaijan are given.

The scientifically practical significance of the results is that after reading this research, the reader will be informed about the basic concepts of this financial system, its principles of operation, and its essential features. At the same time, in our country, this banking system is not taught in our universities, and this dissertation will be the primary book for students and young people wishing to learn about this bank system.

Scope of the thesis

The dissertation consists of three main chapters: in addition, there are additional sections called summary, source, results and table of graphs and graphics.

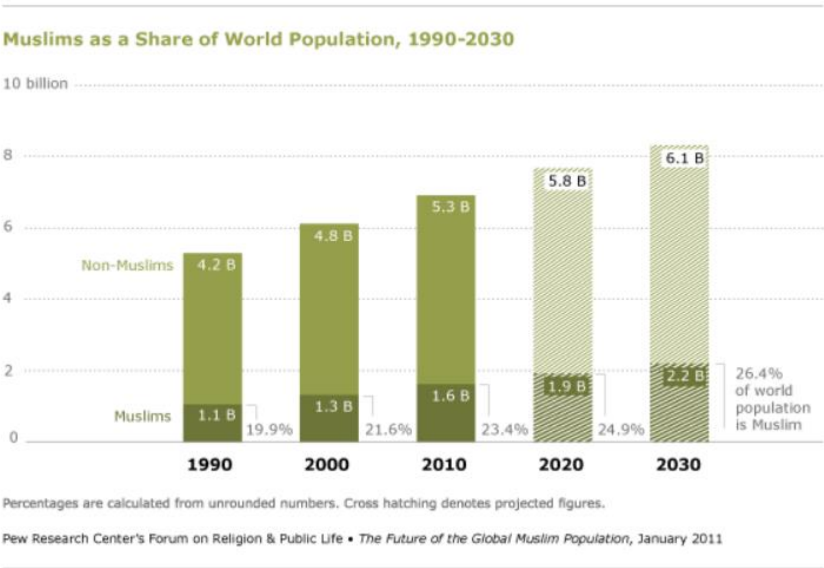
CHAPTER 1.THE SALIENT FEATURES OF ISLAMIC FINANCE

1.1 THE MEANING OF ISLAMIC FINANCE

Even though its name is related to Islam, Islamic finance is not a religious product. Its working principles and rules of governance are mostly dated to 1400 years ago. It's specific past features have now been further developed for today. Now it is more modern and innovative. Although the purpose of both systems, both conventional finance and Islamic finance is to make economic benefits, but each of them have different characteristics.

In addition, it has several types of financial products that meet the requirements of Muslim and non-Muslim population. As we all know, the key elements of conventional finance are interest and risk, which is forbidden by Islam law. Therefore, finance that meets the Islamic rules has been created. According to statistics, a quarter of the world's population is Muslim. (See chart 1)

Chart 1 Muslims as a share of World Population



Source: https://www.pewresearch.org

Most of these people live in Asia and Africa. However, this financial system is now used in many countries around the world. Even in countries where the Muslims are less than non-Muslims. The reason for this is that it is liked by most people in the world for its features which belong to it. Risk and interest limit the development of many entrepreneurs in the world. However, they are forbidden in Islamic finance. This feature of Muslim finance supports new small and medium entrepreneurs who enter the market.

It is based on Islam and its principles and values are derived from the Holy Quran and the Prophet Muhammad. Islamic laws begin with the writing of the Quran and regulate many transactions, marriages, divorce, trade and other processes.

This financial system as other processes we have mentioned above is governed by Sharia rules. Unlike other systems, this financial system may make appropriate investments in accordance with Sharia rules. It is the one of the unique features distinguish it from traditional finance.

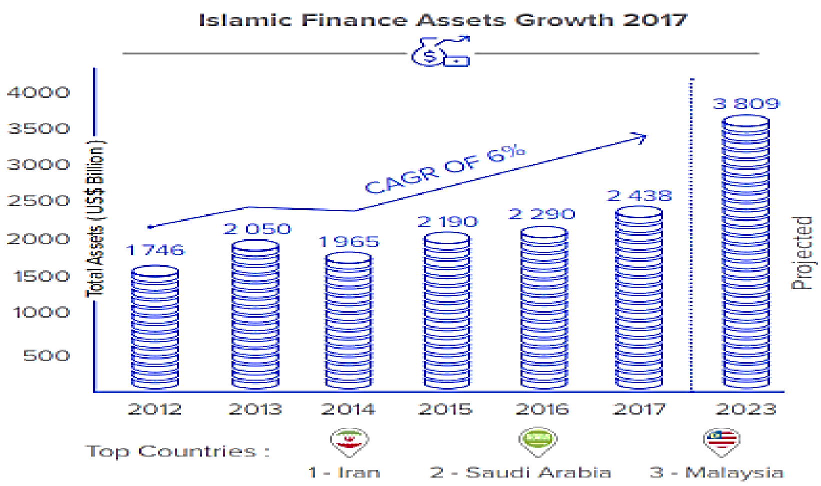
The Islamic economy and banking have gained noticeable growth since the 1970s and now there is a steady development dynamics in this area. In this finance system, not only Islamic Finance Institutes, but also its contracting partners, which have a specific place in the market, are closely involved. In addition, many Muslim countries are transforming their economic and financial institutions fully into Islamic finance principles. Now some CIS countries are also interested in projects implemented in Islamic finance business. Currently, more than 80% of Islamic financial institutions fall to the Persian Gulf countries, more than 42% of their financial funds are in the Persian Gulf, South and Southeast Asia is concentrated.

Islamic finance has had an important place in economy in the past as well as now. Especially, in the last four decades, it has grown substantially. Despite the increasing influence of the financial crisis in America and the West, the financial institutions of this system and banking are rapidly evolving. It should be noted that in recent days, the Vatican's official newspaper also said that the only way out of this crisis was Islamic banking. The main reason why it has achieved great success in 2008 is that the commitments in the American and Western banks are tough and not serious. While the development of banks in American and Western banks is based on credit interest rates, the banking sector is being developed in Islamic banking, not by these interest rates, but by investing. One reason for its success in 2008 was that there was no interest on mortgage loans. The main reason for the financial crisis in the United States was that people were not able to pay the interest rates on mortgages. This ultimately led to a $1.7 trillion loan repayment.

In recent years, its' assets have risen by 15%, and in recent years, when many banks have suffered their profits during the 2008 financial crisis in the United States, Islamic banks were profitable.

As I have mentioned above Islamic finance and banking have been linked to Islam. However, formal Islamic Finance has taken place in the 20th century. But currently, Islamic finance has grown by 15-20 percent and assets of the total Islamic finance institutions exceed $2 trillion in 2017. And these assets are expected to reach $3.8 trillion in 2023. (See chart 2)

Chart 2 Islamic Finance Assets Growth 2017 (IFDI 2018)



Source: Islamic Finance Development Report 2018

As it can be seen from the chart 1.1, these three countries (Iran, Saudi Arabia and Malaysia) are the main ones according to the volume of assets. As a result of this development, many countries began to use Islamic finance. Especially in UK, government began to investigate and use some products and services of Islamic Finance.

The main components of Islamic Banking

This finance combines all aspects of finance that do not contradict Sharia rules. Commonly, Conventional finance and banking basically based on collecting deposits from the population and lending to the population. For these reasons, banker and customer relationships remain the same as the debtor and lender. And these transactions carried out with interest unlike Islamic Banks. As we know, interest is considered haram according to Sharia laws. Therefore, interest-charging transactions were forbidden in Muslim countries. In contrast to other financial systems, Islamic finance is a trust among Muslims. Muslims believe that Sharia will regulate their operations and maintain Islamic compliance. Such as, the timely repayment of these debts, tolerance towards each other, compliance with contract, honesty in all statements and guarantees etc.

It is forbidden to make interest in Islamic banking, to make products forbidden, and to serve the service sectors (such as gambling, tobacco and alcoholic beverages). Such as insurance (uncertainty in insurance) and capital markets (interest arising in conventional bonds and securities). Conventional bondholders are paid both interest and principal amounts. It is unclear whether the insured will pay the amount of insurance at the event. But it is also likely that there will be no accident in the future and it is also uncertainty which is also known as Gharar in Sharia. In addition, conventional finance carried out the purchase and sale of products which contrary to Sharia law. These may be gambling, unhealthy foods or non-Halal foods, animals such as pork, alcoholic beverages, pornography and entertainment. The essence, function, and turnover of money are extremely flexible and serious in the Islamic economy. For centuries, Muslim countries, based on prohibition of money laundering and money-laundering, have not been able to effectively use the mechanism of its effective use.

The Islamic banking system definitely implements interest-free loans for the implementation of one or another project. At the same time, it participates in profits derived from foreign trade operations. Both interest-free loans and interest-earnings are determined at the end of transactions. As a rule, banks finance more trade-related import-export transactions. Here, the share of earnings by participating in the operation appears to be a profit, not as interest. The difference between the Islamic banking classic banking system is related to the fact that it shares the profit earned at the end of the transactions. Thus, it can completely move away from the predetermined interest rate, interest, and usury.

Interest (Riba) – IB is the most developed branch of Islamic finance. This is a remarkable banking system with different characteristics than other banking systems. One of these differences is the fact that ordinary banking takes an additional interest or usury to make money from money. It is known as riba in Muslim countries and has been forbidden from the beginning by Sharia.

When it is impossible to earn money from money, conventional banks adding interest for make profit. And this is contrary to Islamic banking. Therefore, Islamic banking was first applied to trading, leasing and some investments. Because interest is forbidden, Lenders and Borrowers in Islamic banking are not doing it for interest. But subsequent lender-borrower relationships are regulated a number of relevant agreements.

Below are some examples of these relationships. Especially, there are several examples for relationship between user and supplier in Islamic banking.

In Islamic banking these relationships between the bank and suppliers may be agent and principal, depositor and borrower, investor and entrepreneur. The relationship between the bank and the user may be the buyer and the seller, the investor and the seller, the lessor and the lessee.

Below you can find contractual relationships between the parties within Islamic banking. The differences are shown in the following table. (See table 1.1)

Takaful – also called Islamic Insurance

According to Sharia rules, the insurer is not allowed to pay compensation to the insured. This is because the amount of compensation is uncertain. It creates uncertainty, which is also called Gharar. And this is forbidden according to Islamic Law. Conventional insurance companies are built for profits only and their interest is only earnings.

Table 1 Contractual relationships both conventional banks and Islamic banks

Differences relationship between individuals of this banking system and the traditional banking system

Conventional Banking system	In IB
Cooperation to maximize profits	Cooperation for investment and business development
Ordinary debtor and lender	Non-interest debt relationship
leasehold and lender relationships for profit	for business development
interest and profit	Leaseholder and lessee

Source: Islamic Banking, 2015.

Types of insurance:

1- Social Insurance: An insurance system established by collecting mandatory social insurance fees collected by the state to prevent citizens from exposing them to aging, illness, natural disasters, and so on.

2- Mutual insurance (membership) insurance: An insurer's type of insurance is a shareholder's share of the insurance company's interest in reimbursement of risks that can be attributed to a portion of the insurance premium that they are paid to, and the other part to the investment. Islamic insurance, today called Takaful, is based on this system and the insurance premium and revenue earnings in this insurance system are directed exclusively to halal areas.

3- Paid individual insurance: The insurance company undertakes to pay certain risks for a certain period for payment of a certain insurance premium.

The essence of Takaful

The word "takaful" is derived from the Arabic word ("كفل" - khafala), means to provide, to help someone (to be surprised) or to care for someone.

The unequivocal system is a system of relationships established for financial risk based on common responsibility, fraternity, solidarity, mutual cooperation and assistance. An alternative to traditional insurance, this system is based on the "Trust" and "Mutual Assistance" principle. Discretion - this is one of the benefits if the Foundation (Participants Fund or Fund) is ready to provide financial support to malicious events that may occur by other parties on a mutual basis and on a voluntary basis. (R.Fatullayev., 2018).

Contradictory elements of traditional insurance to Islam

• *Gharar* – also known as Uncertainty

When translated from the Arabic language, it is clear that it does not know what's going to happen in the future, but it takes into account some operations. This is a direct risk, which is prohibited in our religion;

Our Prophet (saas) has a hadith narrated concerning Abu Huraira's prohibition of the 'judgment' transactions;

Sharia prohibits the sale of commerce over uncertainty, the sale of any uncertain thing, the possibility of existence, security, risk, etc.

• *Meysir (Gumar / Gambling)*

In the 90th verse of Surat al-Ma'ida Sura, "Meysir", that is, any form of gambling is forbidden. In the verse, the word "gamble" is expressed in Arabic as "meysir". The word "gambling" in Shari'ah is a transaction that can be spent on a person's money or other valuable things, and may lose all of his earnings. It is also gambling to enter into any competition with the risk of losing money by paying a certain amount, regardless of "person's participation fee" or "ticket price". From the point of view of trade insurance, the terms of the insurance agreement are determined separately by one person and loss of the other party. Sharia scholars consider gambling as a sign.

• *Riba*

"Riba" means the Arabic word for "increase, expand," in Arabic.

In the commercial insurance, the riba element is mainly driven in two ways:

Investing insurance reserves into demand-based assets and co-operating with such insured income;

An insured's certain amount of money is to ensure compensation in excess of the amount paid in case of an insurance event without any labor, risk, or extra costs paying the insurance premium. Such a guarantee has been deemed to be a riba, which is a key element agreed upon in dealings with commercial insurance, which is caused by Islamic scholars. (R.Atakishiyev., 2019).

• *Risk transfer*

Commercial risk management is based on the risk transfer principle of risk management. Thus, by paying a certain insurance fee, the person transfers the risk of material damage to the insurance company and, in the event, the damage is compensated by the company as far as the loss is concerned. In other words, by charging a certain amount without any guarantee of return, the insurer can buy "convenience." This is the most important reason not to consider this type of insurance with the proof of Sharia as halal.

According to Sharia, it is not permissible for the risk to be transferred to someone else, but only within the framework of mutual agreement. This principle is only answered in the Takaful. Therefore, there is no risk of transmission in the financial system that meets all the conditions of religion. Thus, after the parties undertake their obligations, the risks that may occur for any bad event are mutually shared. It even has a risk of investing in some trading and investment transactions. And this process does not deter them from operating. Under these circumstances, the parties feel more insured and do their operations. In the table below, the difference between this insurance and ordinary insurance can be clearly understood.

Table 2 Comparison of Commercial insurance with Takaful

Indicator	Commercial insurance	Takaful
Organizational principle	Profit for shareholders	Mutual benefit for participants
Base (basic) principle	Transfer risk (transfer)	Risk sharing
The key factor to consider	Profit maximization	Convenient and spiritual satisfaction
Laws	Traditional legislation	Sharia + Traditional legislation
Ownership	Owners are shareholders	Participants are owners
Management status	Managed by the company's management	Operated by operators
The form of the contract	Insurance contract	Treaty based on Islamic treaties or Taber'ru'ya (contribution) Mudarba contract
Investments	Interest-based	Interest-free based
Profit	Benefit of the insurance company	Proportional allocation to participants

Source: https://www.comparehero.com

Models of Takaful:

Wakalah – When applying this model, the operator receives a pre-agreed fee. The fee received by the unrestricted operator is determined by the Fund's management and investment in its behalf on behalf of the participants, as a pre-agreed portion of the contributions of the participants in the fund (traditional insurance "insurance premiums").

The operator does not have a share of the fund's residuals as well as in the distribution of investment income, nor does it participate in losses of the fund or investment losses. However, if the funds of the surplus funds are insufficient to cover the losses of the participants, the operator's fund should provide interest-free debt ("cash"), which will be repaid in the future if there are remnants of the fund.

Under this model, the operator earns a profit, though less than the transaction costs.

Question: Does the Operator do not take any risks formally, and in some cases does it not try to get rid of the risks properly?

Answer: The use of an incentive scheme for adequate risk management, as well as the obligation to provide "cash" to the Fund for a reasonable risk assessment and, in many cases, to manage the Fund's risks, eliminates the mentioned problem.

Mudharabah – Operator's fee is paid in advance by proportionate sharing of the balance between the operator and the participant, provided that funds are available to the surplus fund.

This model involves the distribution of profit, not between the individual participants, but also between the operator and the participant.

The operator will have a pre-agreed proportion of the remainder of the surplus fund as well as the investment income.

When concluding contract based on this model, the intent of the participant in written form is usually expressed as follows: "Any residual balance and (or) investment income in the surplus fund belongs to me in proportion to the amount of assistance I have paid with the deduction in% of the operator".

As with the mortgage model, where there is a deficit of funds in the fund, it is the operator's obligation to pay interest-free debt, called the cash. When applying this model, the operator only benefits if its operating costs are less than the total balance of the surplus fund and investment income. Therefore, the main concern of the operator is the efficient management of the fund, as well as the proper assessment of the risks.

Hybrid – It is implemented jointly by both models mentioned above.

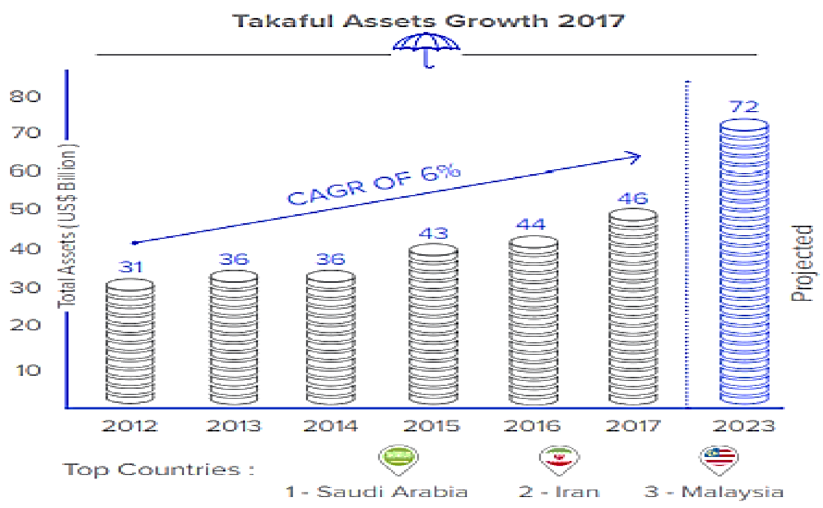
The operator also receives a pre-agreed portion of the benefits of the participants in the fund and at the same time they share in the Fund's investment income.

Many regulators and international organizations (eg, the Islamic Financial Institutions Accounting and Auditing Organization) recommend the use of a mixed-copy model, as it combines the advantages of both models.

If the application of the Mudharabah model in investment transactions hinders problems that may arise in relationships (as a participant) - agent (as part of a single carrier operator), the application of the validity model will provide the necessary funds to cover administrative costs for risk assessment.

We can see the change in the growth of Takaful assets in the chart below. (See chart 3). It is forecasted that these assets will reach 72 billion USD by 2023.

Chart 3 Takaful Assets Growth



Source: Islamic Finance Development Report 2018

Sukuk – Islamic Bonds

Sukuk is the Arabic name of the financial certificate and is defined as an interest-free bond. However, fixed yields which are based on interest are not allowed in Islam. Therefore, sukuk is the securities that comply with the principles of Islamic law, which prohibits the payment of interest or interest charges. They are categorized as secondary market traded in economic resources. This bond is generally defined as (interest-free) bonds in accordance with Islamic principles. Sukuk demonstrates the right to take advantage of it in its easiest shape. The right-claim in Sukuk is not only the right to cash flow, but also the right to property and this feature distinguishes it from other bonds. While traditional bonds consist of securities carrying interest, they are primarily equity certificates composed of asset basket property rights. Sukuk was first used by Muslims in the past as a paper showing financial obligations arising from trading and other activities. Today's sukuk is different from the sukuk used in the past.

Sukuk and Bonds

Bond is a debt liability contract that makes the issuer pay the interest and the principal to the buyer on certain dates. On the other hand, sukuk buyer is entitled to full savings in the related asset. As a result, the sukuk buyer is given the right to buy sukuk assets as well as the revenue from sukuk assets. Another distinguishing feature of Sukuk is that it shows the debts to the recipient of the certificate.

Benefits and Features

- Sukuk is an interest-free stock market item which yields set or varying yields in the medium or long term.
- Evaluation by international rating agencies is used as a guide by investors for making risk / return analysis of sukuk.
- It offers a constant revenue stream during the investment period with its simple and effective payment. It also is a liquid instrument and traded in the secondary sector.

Types of Sukuk

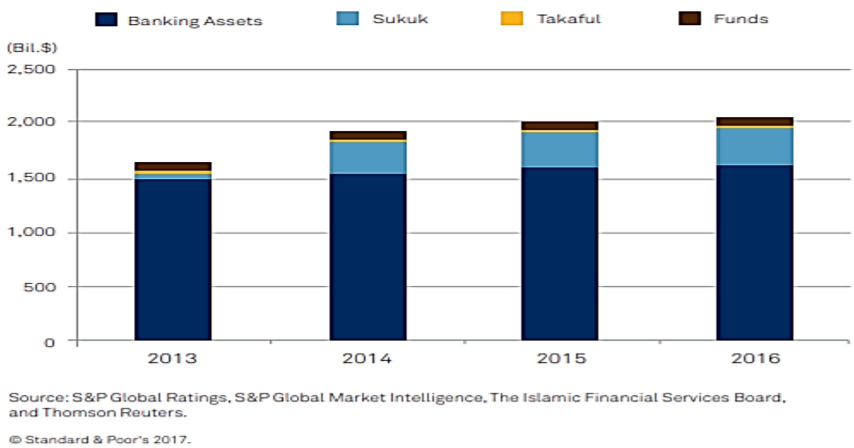
There are 8 kinds of sukuks widely used in the international sukuk market. Sukuk varies according to how the job is done. These:

- **Mudaraba** | Labor-Capital Partnership | (Trust Financing)
- **Musharaka** | (Profit-Loss Partnership) (Partnership Financing)

- **Murabaha** | Cost + Profit Margin Sales | (Mark-up Trading)
- **Ijara** | Rent Financing | (Leasing)
- **Qard al-Hasan** | Loan without interest |
- **Salam** | Forward Term Purchase | (Future Sale)
- **Istisna** | Order-Based Purchase
- **Takaful** | Insurance (Insurance)

Statistical data, reports show that sukuk is in the second place after the banking system in this financial field. The following graphics are given to compare the quantitative aspects of this information. By doing so, we can clearly see the share of sukuk in this financial system for several years. It is planned that the volume of these bonds will increase in the future and will cover the higher part of this system. The primary reason is that some non-Muslim nations are interested in this bond.

Chart 4 Assets of the Islamic global financial industry (2013-2016)



Source: S&P Global Ratings, S&P Global Market Intelligence

1.2 ISLAMIC BANKING PRODUCTS AND SERVICES

Muslim Banking is based on three principles:

1. Mudarabah

2. Musharakah

3. Murabaha

These concepts are taken as the scale for regulating the business of banks, which is basically legal. As all economic activities are regulated by the legal norms of Islam, the banking system is subject to such norms as well. Because the banking activity has to do with loans and should clearly reflect the interest rate in its business.

Mudarabah – one of the major regulatory arrangements considered to be the most important of these regulations. It is the type of contract between the parties: the investor and the managing partner that is offering knowledge and skills. According to this type of arrangement, the person who provides the capital is called **rabal-maal** (investor) and the labor which is called **mudarib**, which provides its knowledge and skills. They invest activities in what they have already been predetermined by them and then distribute their income which is gained together from their investments. These activities, even if they existed before the Islamic period, are considered to be in line with Sharia rules. There are currently two types of agreements for Mudarabah:

Restricted – The investor (rabal-maal) determines his/her business area where he/she will invest.

Unrestricted – But in this type, the investor invests in a business that is suggested by the managing partner (mudarib).

The principal peculiarities of the agreement are as follows:

• Shareholder's profit / loss with the investor, his / her work, skills and experience;

• The uncertainty of the profits / losses of the parties and the distribution of profit / loss between the parties at a predetermined rate;

• Damage to belong to the investor;

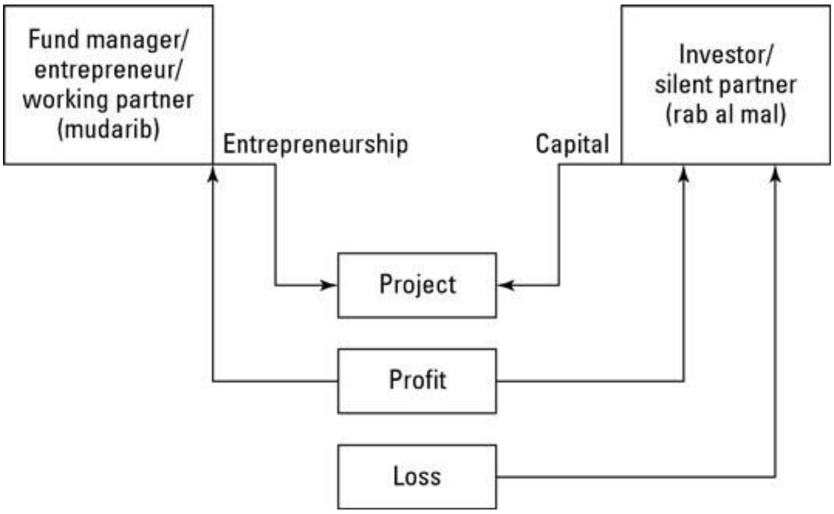
• Management by the investor;

• The investor has only the authority to inspect;

• Investments should be gold, silver, and money.

The Revenue from this transaction is allocated at a predetermined pace between the sides. Income sharing rates are specified in advance and must be specified in the contract. In addition, revenue sharing should be banned until all costs are met. Let's look at the diagram for more information: (See scheme 1)

Scheme 1 Scheme of a Mudarabah transaction



Source: https://en.wikipedia.org/wiki/Profit_and_loss_sharing

Musharakah –The second important principle of the Islamic banking business is Musharakah. Musharakah is the Arabic word which means sharing. The Bank is expected to cooperate with a partner in the implementation of any project. Both parties are participating as a shareholder. As seen under the title, the sides share gain and loss among themselves in this agreement. It helps entrepreneurs who want to develop, but they haven't enough capital. They come to an agreement and decide working together as partners. This agreement allows both parties to share their risks and revenues. Sometimes there is no capital need for any of these cooperatives. Such as several services (maintenance, accounting, advertising services etc.). In such circumstances, the partner will be able to gradually acquire the bank's assets and will be reimbursed on the basis of a contract for general benefit, not a share-based investment.

In the business areas where the capital is required, the capital allocated by the parties may not be equal. But cash is preferred as investment capital in these processes. If the money is invested in different currencies are converted into the same currency currently used. Profit and loss are allocated at the contract's predetermined prices. Otherwise, division shall be considered unfair and this is to contrary Sharia laws.

Sometimes this contract is confused with the mudarabah. However, they have different features that make it easy to distinguish them. Such as:

Unlike musharakah, in mudarabah all required capital is invested by only one party which is called rabal-maal. The other group (mudarib) only offers leadership abilities with its workers to handle this company. As we know, in musharakah each parties of this joint partnership must involve their capital to the business. Additionally, they have several differentiate features which I tried to write some of them in below.

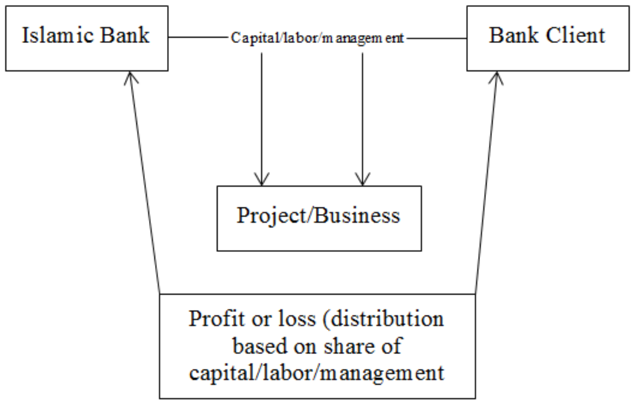
- The capital in musharakah comes from all members of the business, but mudarabah capital only comes from rabal-maal.
- All members can participate in the management of the business in musharakah. However, in mudarabah only mudarib can participate in the management of business. Rabal-maal hasn't right to participate in the management of business.
- Unlike mudarabah, in musharakah all members share the loss. However, in mudarabah because of sole investment only one member (rabal-maal) suffers from the loss.

For more illustration about musharakah contract see scheme 2.

Murabaha (also known as cost plus financing) – It is the most frequently used agreement in Islamic Finance. This is a kind of contract of exchange that profit and cost was predetermined by the parties before sale and purchase operations. In this contract, the bank purchases something by the consumer's request. The bank informs the customer about the cost that has been incurred to the asset by the bank and mark-up which is the bank adding in order to benefit from it. Bank is considered as the actual owner of the asset before selling it to the client. The consumer makes a payment within a certain period. Once the payments are completed, all rights of the asset are transferred to the consumer. Consumers mostly use this Islamic finance agreement to buy the vehicle and other assets.

Some experts argue that this agreement is contrary to Islamic terms because it does not share the risk. But experts also state that this agreement or contract contains up to 80 percent of the Islamic finance volume.

Scheme 2 Diagram of Musharakah transaction



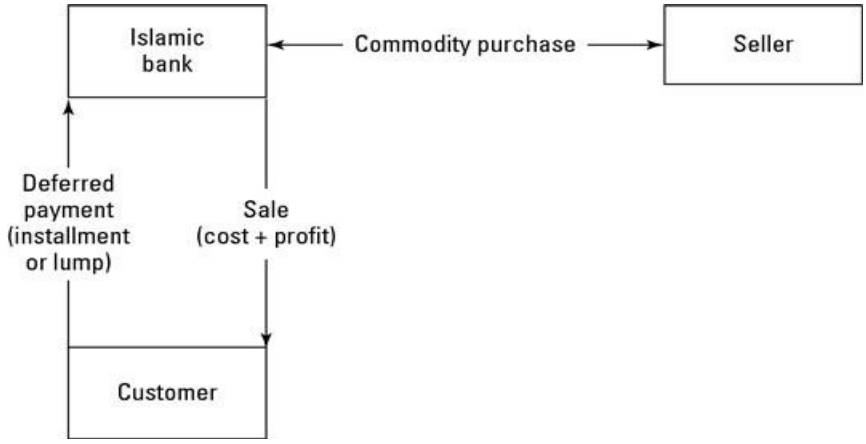
Source: https://en.wikipedia.org/wiki/Profit_and_loss_sharing

Illustration 1 – Murabaha

For instance, the constructor wants to purchase £50000 worth of raw materials, but he/she doesn't have enough money. The constructor agrees with the bank and signs a contract which is called Murabaha to buy raw materials at cost plus mark-up £10000.

The bank purchases and transfers these materials to the consumer. Then the constructor owes £60000 to the bank. Both sides are aware of the profit and value of the goods. There is no uncertainty that is contrary to Sharia law. (See scheme 3)

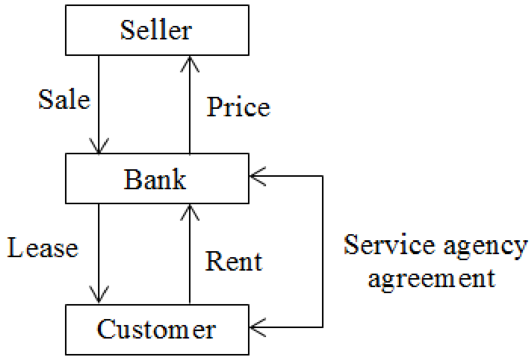
Scheme 3 Scheme of a Murabaha transaction



Source: https://www.dummies.com

Ijarah (leasing contract) – This contract is very similar to the lease agreement known to us. This contract is a signed agreement between the lessee and the lessor in order to pay the fixed rent for using the lessor's property or assets. With this contract, the user can benefit from the asset or property without purchasing it. Both parties benefit from this Ijarah. So that, the lessee benefits it without purchasing, the lessor benefits its fixed rent and has the residual value of the asset after the lease expires. These lease contracts are both long and short-term. Because of the payment between the parties, people confuse it with the sales operations. However, unlike the sales during the leasing process the lessor remain is an owner of the property. (See scheme 4)

Scheme 4 Scheme of Ijarah transaction



Source: https://www.researchgate.net

Salam (also known as forward contract) – Salam is the advance payment for the purchase agreement agreed between the seller and the client. According to this agreement, the buyer does the advance payment to the seller for the products. When the seller is ready for sale, he / she will offer any product to the customer.

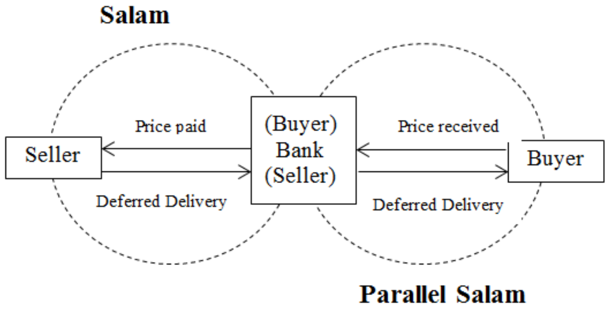
The products must be delivered time that is predetermined between the parties. In addition, the quality and quantity of goods to be provided before the advance payment is specified.

Salam can also be accepted as a debt. It is the supplier's obligation to supply the products to the customer. There are currently two known types of Salam contract:

Ordinary Salam –contract between the two parties: purchaser and vendor

Parallel Salam – this agreement comprises of two autonomous contracts. The bank is both a client and a vendor in these agreements.

Scheme 5 Scheme of Salam transactions



Source: https://www.slideshare.net

Istisna (manufacture contract): This type of contract is similar to Salam contract. But it has some distinctive features from Salam. It is basically an agreement on the manufacturing of the new something. In addition, this contract is also used in construction. According to the contract, one of the parties undertakes that the project be built on a timely basis at the predetermined fixed amount. If the terms of the contract are not met, the buyer may claim his/her rights. In some cases, the manufacturer can't finish the project and therefore can't deliver it on time. This deal facilitates payment terms between producers and consumers. Unlike salam contracts, this agreement don't require advance payment and don't prohibit partial payments. Both parties may offer their own payment terms. As above mentioned, Istisna is used mostly in construction and trade financing.

Through this financial instrument, construction has been done in many parts of the world.

As we know, uncertainty is forbidden in Islam. Therefore, people using this contract should provide detailed information about the product or construction to be manufactured. There are two types of Istisna contracts, as in Salam: Ordinary istisna and parallel istisna.

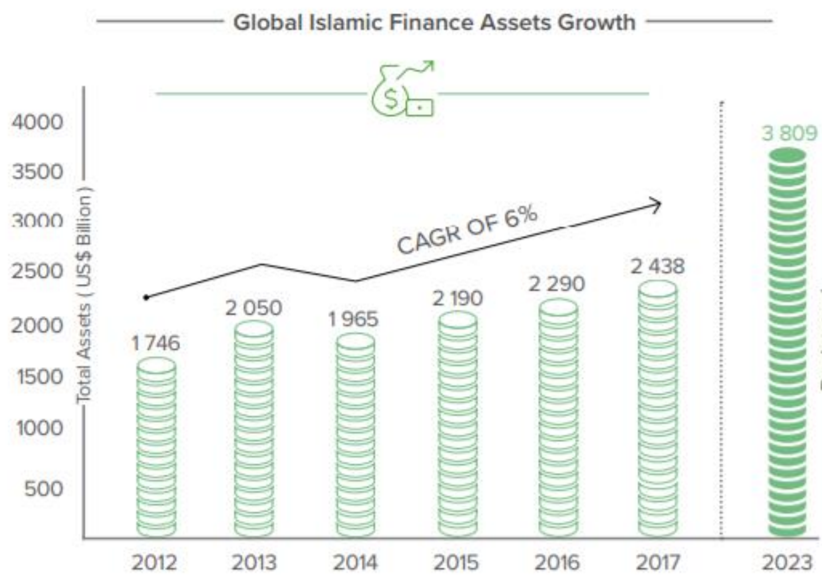
This section may have given you more information about the products that were previously known to us. Most of these products are now being used in many nations around the globe. Some of these have also been implemented to undertakings with Islamic windows working in our nation at one moment. However, for some reasons, some of these reasons will be explained more clearly in the last chapter of the dissertation and have ceased to exist for them. But small and medium-sized entrepreneurs who start new activities need the use of these products. Therefore, this finance scheme and financial goods are anticipated to be practically implemented in almost all nations of the globe in the coming years. The growth of users over the years is one of the main evidence of this.

CHAPTER 2.CONTEMPORARY TRENDS OF THE ISLAMIC BANKING

A amount of studies relying on statistics from 56 nations indicate that, with the Budget Annual Growth Rate (CAGR) since 2012, Islamic Financial Industry has risen from 6 percent to $ 2.4 trillion in 2017. (See chart 5)

While the Islamic Financial Industry is distributed all over the globe, most Muslim countries, particularly Middle East, South Asia, Iran, Malaysia, and Saudi Arabia, stay the most significant Islamic finance sectors. In addition, Nigeria, Cyprus and Australia are growing dramatically. In this reason, several researchers think about that Islamic Finance became indisputable reality nowadays. Many accounts and statistical information indicate that while the world population fell to 2 percent of the International Economic Crisis, Islamic Finance was less influenced by the crisis and even increased. More details on this impact are provided in more detail in future sections.

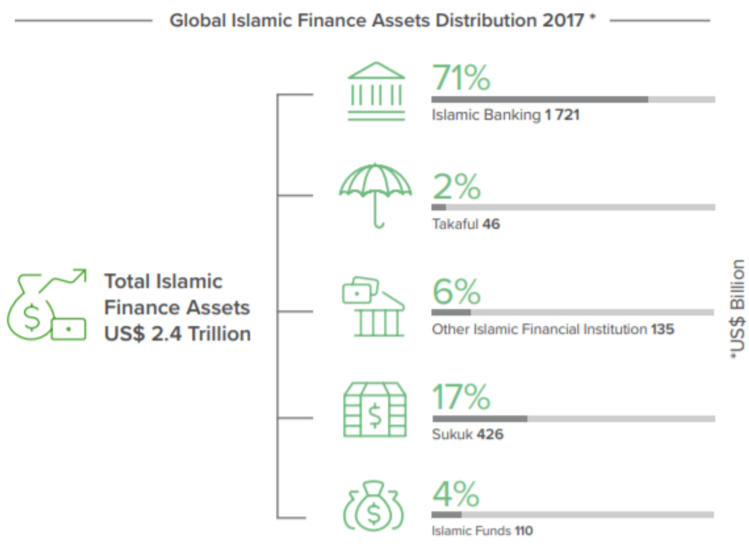
Chart 5 Growth of Global Islamic Assets 2017



Source: Islamic Finance Development Report 2018

In addition, a clearer understanding of the development and distribution of assets can be found in the chart. The chart demonstrates obviously that 71% of the finance scheme is the basis of this economic scheme.

Chart 6 Total assets of Islamic Finance 2017



Source: Islamic Finance Development Report 2018

As shown in the notes, Islamic Banking performs a significant part as seen from the allocation of Islamic property. This finance scheme includes about 71 percent of its economic structure. The reason for the selection of the subject matter was also this.

2.1 ISLAMIC BANKING SECTOR AS A DOMINANT COMPONENT OF THE ISLAMIC FINANCE INDUSTRY

Islamic Banks have the most important place in the Islamic Financial System. The notion of Islamic Finance is sometimes grasped by the notion of Islamic faith, although this is not the correct strategy. Islamic Finance assets are adequate to warrant a worldwide scale of $ 1.3 trillion, about which more than $ 1 trillion is immediately and indirectly linked to Islamic Banking. As you can see, figures make initial impressions about the importance of the subject.

This paragraph first clarifies what this bank is, its principles, key features, and how it works. In addition, this feature shows the peculiarities of the other banking system that some of these peculiarities increase the interest of Muslims in this bank. The following parts will provide comprehensive data on the tools and their practical elements of Islamic Banking. The Muslim Banking will discuss distinct characteristics of traditional bank accounts. The short history of Islam Banking will be reviewed.

The first banking services were offered in religious buildings, and religious officials were also the first bankers in a sense. It is seen that people are handing over to their temporal and temporal temples to protect their possessions from the talent, plunder and theft. In this way, temples collecting assets have lent the seeds and other inputs to the needy and regained harvest time. In this sense, the oldest bank structure known as "The Red Temple" appeared in Mesopotamia near the city of Uruk. The Red Temple priests are well aware of the fact that they hold accounts of entrusted wealth and help the needy people.

The most important purpose of establishing banks is the spread of various types of gold and silver in Europe and the difficulties in determining their values, negatively affecting international trade and the regulation of international payments.

At the end of the last century, in 1899, Mufti of Egypt, Mohammed Abdo, for the first time gave a fatwa about the collection of money in banks and the share of profit from it. But in Muslim countries, this charge has not been widely accepted.

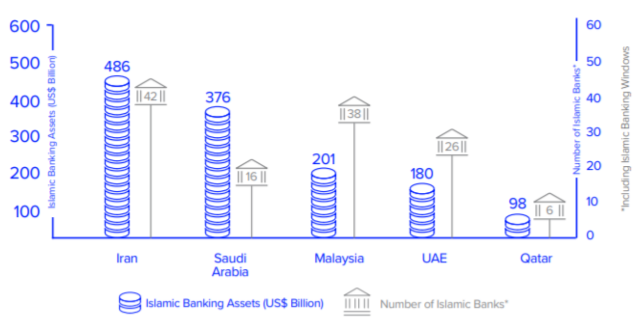
The Islamic Development Bank, which is the basis of these banks, was opened only at the initiative of Jeddah King Abdulaziz in 1975 and covered the essence of the financial lending process for Muslims. His subsequent activities had a serious impact on the formation of financial and credit relations, as well as economic integration, especially between the member countries of the Organization of the Islamic Conference. True, Nasir's Social Bank, founded a year ago in 1974 and operating in Egypt, has been pushing for Islamic-oriented lending.

However, the IDB has expanded its influence both in Muslim and non-Muslim countries with its activities.

After the primary experiment in the Mid Ghamr (the village of Egypt) in 1963 Islamic Banking is growing rapidly round the world and become the dominant part of the Islamic Industry. Its banking section has become systemically necessary in a very dozen countries in a large choice of regions. Islamic law-compliant finance is expected to proceed to evolve in reaction to financial development and processes in nations with huge and comparatively unbacked Muslim communities. It's additionally fueled by the massive savings accumulated by several oil-exporting countries especially Gulf countries that are seeking to speculate in financial products that are in accordance with Sharia.

This is why Islamic banks operate in the Muslim globe at times in over 60 countries, most of them in the Middle East at intervals. Similarly, Islamic banks have recently opened up in the US and hence most of Europe's nations. Belgium and Luxembourg introduced an Islamic Finance Diploma in Europe, and Germany launched its first Muslim bank, KT Bank. At present, there are 505 total Muslim banks (commercial, wholesale and different forms of banks) in the world and its assets has reached \$1.72 trillion banking assets (Participation banks contributing seventy-one percentage of the Muslim Finance Industry's assets). These banking assets are 6% of the assets of the whole world banks. Asian countries Iran, Saudi Arabia and Malaysia are three high nations with Participation banking assets.

Chart 7 Global Shariah Banking Assets Shares



Source: 2018 Islamic Financial Development Report

The global Islamic financing structure and the increase in asset volume have been facilitated by the emergence of some supporting institutions. Some of these organizations strive to improve the system's legitimacy and efficiency by raising consciousness of Islamic finance, offering data about its workings, solving sectoral problems and managing R&D operations, and creating global norms and auditing processes. Azerbaijan is also in contact with these institutions, which serve internationally, both through membership and joint work / projects. The most important general information about these institutions is presented in the headings below.

Islamic Development Bank

IDB is the biggest bank in this section. This bank is an international organization that plays a guiding role for all Shariah banks. At the same time, Muslim countries have Islamic banking, which has a large turnover in Qatar and Indonesia. In 1983, it was allowed to open the first Islamic bank in Turkey. Berhad Bank in Malaysia is now the fourth largest Islamic finance bank in the world. Islamic banking's fundamental concept is focused on the concept of allocation of revenue and expense, not interest payment, in compliance with Sharia regulations. The Islamic Development Bank (IDB), an international financial institution, was established by the Islamic Conference Organization on 7 December 1973. It should be noted that the 38th meeting of the Organization's Council of Foreign Ministers held in Astana on 28-30 June 2011, by decision of the participants, the Organization of the Islamic Conference Organization for Islamic Cooperation (short name ECO). Signed at the Conference of Islamic Country Finance Ministers in Jeddah by the 7th member countries (Saudi Arabia, Kuwait, Libya, Turkey, UAE, Egypt and the last one, Iran). The Bank has started its activities on October 20, 1975. The Bank provides financial assistance to Islamic countries. The expansion of trade relations among the member states of the Organization of Islamic Conference is among the strategic goals of the bank and ensures financial opportunities for this. Its center located in Jeddah that is the city of Saudi Arabia.

Chairman of the Bank and Chairman of the Board of Directors is Z.A. Dr. Ahmed Mohammad Ali. He was chosen by voting among member nations on the appointment of the latest chairman at the 35th Annual Meeting of the Board of Directors of the Islamic Development Bank (current ECO) conducted in Baku on June 23-24. The Azerbaijani party is depicted by Economic Development Minister Shahin Mustafayev, and the option is Finance Minister Samir Sharifov.

The Islamic Development Bank has an observer status at the UN General Assembly. The International Islamic Trade Finance Corporation, which is its body, has been operating in the field of Trade Loans since 2005.

The bank's currency is a dinar. The Bank's capital is collected at the expense of Member States. The equity of the Bank is 30 billion Islamic dinars. The Bank's authorized capital is 15 billion Islamic dinars. The Bank's approved equity is laid at SDR 2 billion. It should be observed that this amount was paid in full by a bank affiliate and the Islamic Conference participating nations. The Muslim Dinar, the bank's payment unit, is equivalent to SDR 1.

Sharia Council in Islamic Banks

Islamic banks must determine whether their transactions are in sharia, and must conduct only Sharia-compliant activities. To this end, Islamic banks have a special structure - Sharia Board. There are highly qualified Islamic scholars and experts in this area. Banks receive permission from the Sharia Board for the new product they want to submit to each new project or market, whether they are in line with the project or product. Apparently, such a structure is not observed in traditional banking. The number of Shariah experts is so small that they are sometimes represented on the Sharia Council of 10 to 15 Islamic Financial Institutions. According to unofficial data, Nizami Yacoubi, a Shariah expert, is represented on more than 80 Sharia Councils. However, since 2007, Malaysia has permitted Shariah experts to represent only one Shariah council in Islamic banking, Islamic insurance and Islamic Capital Markets. It should also be observed that the

Sharia Council system is established not only in Islamic banks, but also in other Islamic Finance Organizations.

SESRIC-Statistical, Economic and Social Research and Training Center for Islamic Countries

In 1978, a few branches of the organization were opened by a resolution adopted at the 8th Foreign Ministers meeting of the Organization of the Islamic Conference. The purpose of the establishment is to compile, organize, and present socio-economic statistical information about member states; to initiate and develop technical and economic cooperation among Member States; to organize seminars and training programs on the issues that Member States need.

AAOIFI- The Accounting and Auditing Organization for Islamic Financial Institutions

Established in Bahrain in 1991, the Islamic Finance Institutions Accounting and Auditing Organization (AAOIFI) is an global non-profit organisation that develops accounting, auditing, governance, morality and sharia norms for Islamic finance organizations and the industry. The purpose of AAOIFI is to establish accounting and audit provisions regarding Islamic finance institutions. To this end, it prepares and publishes a number of accounting and auditing standards for Islamic finance institutions. It also organizes various seminars, publishes periodicals, and conducts various studies. An autonomous organisation, AAOIFI, is backed in 45 nations by 200 distinct organizations, including key banks and numerous Islamic finance organisations.

IFSB- The Islamic Financial Services Board

Islamic principles determine the basic movement area of participation banks that are held in their branches by banks which offer a traditional banking service and also make a name for themselves with interest-free banking practice around the world. In accordance with the standards drawn by religion, it has become a necessity to comply with the standards determined by the Islamic Financial

Institutions and the Islamic Financial Services Board. Because the primary appeal of these companies is to conduct banking operations on the grounds of Islamic values. Acting in accordance with the issues determined by the boundaries of religion will be inevitable when there is uncertainty about the increase in the volume of banking business.

One of the institutions issuing standards for Islamic finance institutions is the Islamic Financial Services Board. Starting its operations in Malaysia in 2003, the Islamic Financial Services Board publishes worldwide fair norms and guiding values to enhance and promote the sustainability and complexity of the Islamic finance industry. IFSB also conducts several research studies, organizing meetings, seminars and conferences to address industry-related issues.

IIRA-The International Islamic Rating Agency

The International Islamic Rating Agency, something that launched its activities in Bahrain in 2005, is the only organization providing a wide variety of banking and equity markets in Islamic nations. The grading method includes an analytical amount of knowledge and a complete range of investment markets, particularly Islamic financial tools. The IIRA also recognizes its ratings by means of various regulatory authorities. Bahrain is recognized by the Central Bank as an external credit rating agency. The IIRA is supported by various international institutions, leading banks, various financial and rating agencies.

IRTI-Islamic Research and Training Institution

Established in Saudi Arabia in 1981, IRTI is component of the Islamic Development Bank, which is dedicated to encouraging a vibrant and extensive Islamic finance industry to assist member countries grow economically. It is aimed to educate human resources who know and apply the Islamic financial system. Consulting services are available to assist in the development of new Islamic finance instruments and the elimination of existing problems in the implementation of existing instruments. On the other side, IRTI publishes the journal "Islamic Economic Studies," which involves elevated scholarly expectations research.

IILM-International Islamic Liquidity Management Corporation

IILM was created in 2010 collectively by key banks / money officials and Islamic Development Bank in nine nations, such as Malaysia, Turkey, the United Arab Emirates, Malaysia, Qatar, Kuwait, Nigeria, Luxembourg and Indonesia. IILM seeks to provide various Islamic liquidity instruments to enable cross-border liquidity management among Islamic economic services suppliers.

Islamic Banking vs Conventional Banking: Islamic banks' rivalry to traditional banks is an issue that can be assessed after over 10% of the sector's share. There is a long distance to which Islamic banks have to overcome. However, the policy of sustainable and sustainable development should be preferred rather than a fast and aggressive development policy. The introduction of new participants in the market should be encouraged, and the Islamic banks should be provided to the larger masses.

Islamic banks differ according to their company values from classical banks. They carry out transactions without interest and are actively involved in the implementation of the tasks facing the Islamic economy. Nearly 150 economic organizations operate in the globe with predominance of Islamic principles.

The growing reach of Muslim Finance promises a number of possible benefits. For example, it is often asserted that Islamic banking is less prone to crises by its nature, as its risk-sharing role decreases leverage and adds to stronger risk leadership from both economic organizations and their customers. It is also argued that Islamic finance is more stable than conventional finance, because: (1) Shariah finance includes prohibiting speculation; (2) funding is asset-based and thus fully secured; and (3) it is based on strong ethical precepts. In addition, Islamic financial institutions (IFIs) are considered to be a good platform for expanding access to financial affordability, including access to finance for SMEs, thereby supporting growth and economic development.

Islamic Banking offers its services that lead to socio-economic devolopment of a society,country,region,continent and the world.

- Islamic banking is focused on Sharia values and these values are the main criteria for its management. In Islamic Banking profit and loss are shared between the partners at predetermined rates.
- Likewise, Islamic banks also target to maximize profit and decrease loss.
- Islamic banks promote the growth of entrepreneurship in many company fields. Such as offering equity, interest-free credits, etc.
- In Muslim banking, depositors are not guaranteed that they gain profit from their deposit in bank or their investment. Even they can loss their capital.
- Unlike conventional banks, in Islamic banks the relationships of partners is more close. They work together as a buyer and seller, investor and manager. However in conventional bank this relationship is a debitor and creditor. It shows that this bank only work in order to make a profit. This example is the main distinction feartures of Islamic banks from conventional banks. I tried to more information about the features of conventional banking in below.

Conventional banking serve economic development without preserving the social contribution and base for individual growth, and not for community development. With the exception of Islamic banks, standard banks are focused on completely human-made characteristics and there are no values linked to Islam faith or any other cultures.

In this banking system, depositors are guarenteed that they gain additional amount (interest) for their deposit in bank. This amount / interest is decided before they create payment. This interest level differs from bank to bank.

Conventional banking system also aims to maximize earning. This feature is the similar features of Islamic and conventional banking.

The main earning is the interest of this banking system. However, isterest is forbidden in muslim finance by Sharia.

As above mentioned, the realitionship of bank with its client is a debitor and creditor.

Challenges in Islamic Finance: Islamic finance, however, also faces a amount of difficulties like conventional finance. For instance, despite the efforts of the developers of Islamic finance standards, in many countries the industry is governed by a regulatory and supervisory framework developed for conventional finance. Therefore, it does not fully take into account the special nature of Islamic finance. This industry is still mostly nascent, it lacks economies of scale and it works in an environment where legal and tax rules, financial infrastructure and access to the central bank's financial security and liquidity networks are either not available or, if they exist, not used properly and taking into account the features of Islamic finance.

Because of instability, Islamic inventory exchanges endured from political uncertainty, slow development, reduced petroleum prices, and unstable product prices in 2015 and much of 2016. U.S. election findings, however, resulted to an rise in Nov and Dec, Islamic shares and set revenue resources benefited from excellent Islamic inventory indicators and improved sukuk returns. The favorable outcomes of Islamic investment funds are primarily linked to rising petroleum rates at the top(end) of the year. "While the yield in 2016 was positive, the sustainability of Islamic funds cannot be taken for granted, as most of them have no scale: 73% of Islamic funds have less than $25 million AuM (assets under management), while the average amount of conventional funds is $394 million AuM (assets under management)." (Islamic Finance Development Report,. 2018). Thus, the sukuk market has diminished the decline and increased its volume by 6% by the end of 2016 to $318.5 billion (While this figure was $300.3 billion in 2015). (See table 3). Developing and energy-exporting countries stimulated the increase of funds, including sukuk issuers, produced by Jordan and Togo in 2016, and this sector has increased its market share in the IFSI by 16.8%. This increase also occurred at the Takaful market, so that the Takaful market rose by 13.1% to 25.1 billion US dollars by the end of 2015 and amounted to 1.3% of the IFSI. International bond bonds risen by 2.65% in worldwide economies at the beginning of 2015 and in the first quarter of 2016, while worldwide insurance premiums rose by 3.8% at the same moment.

Table 3 Breakdown of IFSI by Sector and by Region (USD billion, 2016)

Region	Islamic Banking	*Şukūk* Outstanding	Islamic Funds Assets	*Takāful* Contributions	Total
Asia	218.6	182.7	19.8	4.4	425.5
GCC	650.8	115.2	23.4	11.7	801.1
MENA (ex-GCC)	540.5	16.6	0.2	8.4	565.7
Africa (ex-North Africa)	26.6	1.9	1.5	0.6	30.6
Others	56.9	2.1	11.2	--	70.2
Total	1,493.40	318.5	56.1	25.1	1,893.10

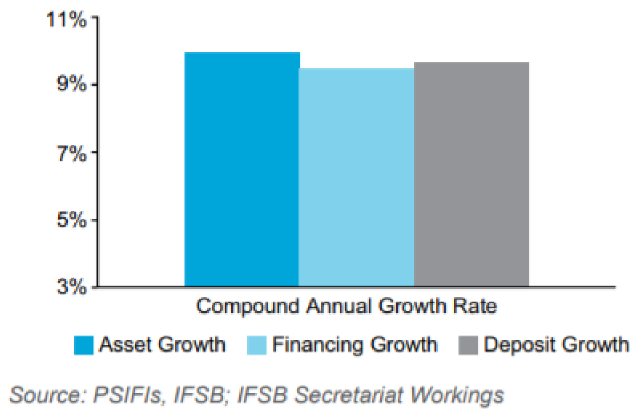
** Data for şukūk outstanding and Islamic funds is for full-year 2016; data for Islamic banking is for the six months ended June 2016 (1H2016); data for takāful is as at end-2015.*

Source: Islamic Financial Services Board (IFSB) Secretariat Workings

Source: Islamic Financial Services Board (IFSB) Secretariat Workings

In the second quarter of 2016, global Islamic Bank assets decreased by 0.2 percent. Nevertheless, between the last quarter of 2013 and the second quarter of 2016, IB assets expanded at a CAGR of 9.9 percent across fourteen countries. (See chart 9)

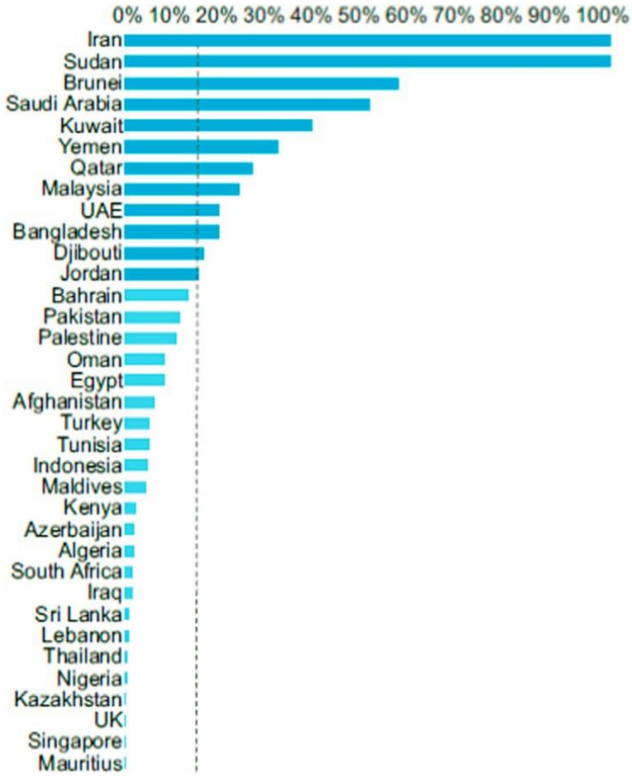
Chart 8 CAGR of Islamic Banking Statistics 4Q2013-2Q2016



Source: PSIFIs, IFSB; IFSB Secretariat Workings

Specifically, IB has been over traditional banking the past ten years. As I mentioned at the beginning of the chapter, Muslim Banking rapidly increased and increased its share of assets in ten countries by 22.5%. Among these 10 countries, Iran and Sudan are the full-fledged Islamic financial sector. While Islamic Banking assets constitute a small proportion of global banking assets, they were less exposed to the toxic assets than traditional banks during the recent global financial crisis. But Islamic banking has also been affected by the real estate slump that is considered a secondary impact.

Chart 9 Islamic Banking Share in Total Banking Assets by Jurisdiction



Source: PSIFIs, IFSB; IFSB Secretariat Workings

Rapid development of interest-free loans in both Muslim and non-Muslim nations has resulted in a multitude of issues. Examples of these issues are the following:

- **Legal Regulations**

One of the beginning issues is legal rules for interest-based banking and trading in nations where interest-free companies represent Islamic Financial services. Several companies conducting interest-free operations do not permit some fundamental operations like Musaraka, Mudaraba and others. In other words, we can conclude that these accounts are run in compliance with Islamic regulations but are opposite to the legal structures of the nations they are formed in.

Lack of qualified specialists

Employees operating in Islamic banks in interest-free terms should have distinct abilities and expertise than traditional bank staff. For these reasons, Islamic banks' employees are different from the employees of other banks. So banks want their employees to work in those banks for a long time. Universities in many countries offer a variety of training and seminars to study Islamic finance. For example, a diploma of Chartered Institute of Management Accountant for Shariah Finance.

- **This system is relatively new to others**

While interest-free loans on the one side contributed to the growth of businessmen and customers, on the other side interest-free was triggered by employers ' absence of interest and lower interest in this scheme. But we hope that these problems will be solved in the future and the system will grow all over the world.

- **Lack of institutions and organizations supporting**

One of the problems identified by researchers is the support of Islamic banking by very few organizations and institutions. As we know, any system needs support from other organizations to build a major banking system and succeed in the future. In the future, there is a need for support from organizations with knowledgeable professionals to grow volume and achieve new success.

- **Income loss problem as one of these problems**

Islamic banks do not calculate extra interest prices for clients who are unable to settle their loans in moment, unlike traditional banking. This is also one of other traditional banks ' distinct characteristics. Attempt to cover the existing losses by other ways.

However, Islamic banks do not earn extra interest on early credit repayments, which is a move made by the Islamic banking scheme to create a more customer-friendly scheme. Researchers note that Islamic jurisprudents say that the additional charges received for delays are not interests and are the compensation that the borrower pays to the lender. In some cases the borrower is deceived and this process is prohibited in Islam religion.

Islamic banks take some steps to help their clients recover credit repayments. Unlike traditional banks, for example, IB banks give a monetary credit refund that they obtain a credit. This prevents the growth of loan debt volumes during global crises. Other traditional banks merely take their interest into account, however, and apply greater interest prices for overdue loans.

It is believed that some of these problems are related to the structure of financial institutions.

We can see below some of these problems:

Lack of Financial instrument: Unlike other banks, there are fewer financial instruments available in these banks because interest rates are not applied. Nowadays, the standard finance scheme uses more than 1000 economic tools to gain cash from debt. In order to increase the possible financial instruments in IB certain steps should be taken by organizations.

Do not meet urgent needs: Debt-bearing banks have the ability to satisfy their future instant expenses. But banks that do not apply interest and distribute profits and losses are difficult in such cases. And this problem is considered their main problem.

Non-financing of long-term projects: Experts believe that long-term initiatives are less lucrative and in short-term Islamic Finance trade they favor murabaha. Because this procedure is regarded to be less dangerous and can be regulated in the brief run by the scheme.

It does not participate in public funding: The primary reason is that it is mainly in interest-bearing economic tools that public finance is included.

Money can’t enter the market: Muslim companies are still struggling to access economies where interest is implemented and others using economic tools to purchase and sell. As a result, they were unable to obtain a number of opportunities in this market.

Difficulties with balances analysis of assets and liabilities

Compete with traditional banks: Interest-free banks, like other banks, are opening fresh offices to better serve customers. Even some traditional banks on such Islamic banks have started to open offices. These affiliates have already become an adversary of interest-bearing banks.

2.2 ISLAMIC BANKING IN ALL OVER THE WORLD

Islamic Finance issue has given rise to extensive discussion around the globe, particularly as the Islamic Bank has not suffered from the worldwide economic recession of 2008. These debates have grown so much that the word Islamic Finance is almost a mystery for anybody today. Today, some of the world's largest financial institutions and banks offer Islamic Finance services in some way, while some non-Islamic countries, including Great Britain, Luxembourg and Singapore, also officially provide Islamic Finance services in their countries. The leading universities in the world are establishing faculties on Islamic Finance and are trained undergraduate, graduate and even doctoral degrees. In non-Islamic countries special teams are created for this market research and trends in the market are regularly studied. The world's famous financial news agencies are creating separate sections on Islamic Finance at least on their website. Experts of the International Monetary Fund (IMF) issue and publish Islamic Finance research and analytical publications and distribute it to the world through their website. We can further extend the list, especially if we include statistical indicators on Islamic Finance at the global level. However, as the previous paragraphs on statistical figures and reports are provided in sufficient detail, the figures in this paragraph will not be affected by the market.

The importance of Islamic finance in the world is increasing. Not only in Islamic countries, but also in European countries with a Muslim population, this system is developing on the line of interest. In addition, the fresh orientation of a variety of business banks operating in Western manufacturing nations was to provide financial and investment facilities to their country's Muslim customers in complete accordance with Islamic customs and Islamic economic theory values. One of the most effective methods for adapting Islamic banks to credit markets in Western countries was their operational activity as a building society, which primarily provided debt to their Muslim customers to borrow residential properties and other real estate in those countries. For instance, this type of operational operation has been extremely efficient in North American (Michigan and Ontario) companies, which are specialized in their clients ' tiny commercial funding and are a major Islamic financial organization, Ferst Ras Fainenshn Service.

In general, "mudaraba" and "musharaka" acts in the name of Islamic banking in Europe are used under the name "Commenda" and "Societa". Mudaraba was one of the most important principles among the Italians, then the Spanish. The method of Mudaraba's partnership has been transformed to Europe by the name "Commenda" since X century. It has resulted to the creation of sympathetic communities and profit groups as the Islamic financial organization after the Renaissance and Reformist Movement.

It is a evidence of resemblance and closeness to the Islamic Bank, which still retains its significance in English banking and is based in part on income allocation (Investment Trust). Islamic banking has achieved excellent achievement in many nations of the globe and well-known gigantic companies have unique offices in many non-Muslim nations to serve customers in compliance with Islamic legislation. Banks operating under Islamic principles are classified as follows:

1) **Muslim countries:** Egypt, Saudi Arabia, the United Arab Emirates, the Republic of Indonesia, the Republic of Turkey, the Islamic Republic of Iran, Kuwait, Malaysia, Azerbaijan and others.

2) **non-Muslim countries:** Great Britain, the Philippines, Denmark, the United States, Canada, Australia, Germany, Switzerland and so on.

Egypt: As an interest-free financial institution, "interest-free banking" was first introduced in the Mit Gamr settlement in the Egyptian Arab Republic. Egypt has a special place in the development of Islamic banking. As a result of the work done by Sanhuri in Egypt, interest-free banking and traditional banking are accompanied by a percentage allowing only one percentage to be exceeded. Interest-free banking, which is an alternative to traditional commercial interest banking, plays an important role in Egypt's financial system. The Egyptian Feysal Bank founded in 1977 with Egypt-Saudi Arabia and in the following years, the International Investment Bank, which is entirely Egyptian, is the two largest interest-free banks that play an important role in the Egyptian banking system. These banks concentrate on 17% of total savings.

Kuwait and other Gulf countries: The United Arab Emirates Commercial Law imposes some restrictions on the interest rate. In the United Arab Emirates, interest is paid to avoid a certain percentage of trade debt, but non-commercial debt is also considered a criminal offense under the Criminal Code. Similarly, the amendment to the Kuwait Constitution was amended in the 1980 Trade Code. These changes are generally considered to be illegal in Kuwait, where interest rates can be charged for trading operations, as interest in transit transactions, as in the United Arab Emirates. Founded in 1987, the Kuwait Finance House was the world's largest non-interest-bearing financial institution with a budget of $4 billion before the 1991 Gulf War, but the war hit him hard. Kuwait, which operates other interest-free financial institutions, has become one of the most developed countries in the region with interest-free banking. On the other hand, the United Arab Emirates does not have a bank that does interest-free banking outside the Dubai

Bank. In Qatar, only Qatar Islamic Bank is conducting interest-free banking operations.

Malaysia: A secular country with a majority of its population includes Malaysia, an interest-free banking system with an interest-free banking system along with its interest-based banking system. The Central Bank of Malaysia has been able to be more effective than the simple interest-free banking system established in Iran and Pakistan by developing the low-cost structure of the financial system. Banks working in the country without interest-bearing system are subject to separate laws and regulations. Islamic controlling regulation: liquidity, reserve ratio, trading payment systems, and second-order bank remittances. A central board was established to ensure compliance with all Islamic banking laws. Under the Islamic Banking Act of 1983, the Central Bank of Malaysia was authorized to license and supervise interest-free banks. Investment certificates and securities, which are not interest bearing, were started on the basis of the State Investment Law adopted in the same year. State Investment Certificates are defined as interest-free cash assets.

When looking at the history of interest-free financial institutions in Malaysia, it can be seen that the bank was first created in 1983 by the Bank of Islam Malaysia Berhad. It has shown a significant growth in a short time. In order to maintain the long-term existence of interest-free banking, more companies, more customers, and interest-free money markets should reach targets. In this regard, Malaysia in 1994 promoted the formation of a market for interest-free banking under the name "Islamic Interbank Money Market". In 1999, the Bank launched its second non-interest-bearing bank, Muamalat Malasyia Berhad. Following the establishment of this bank, steps were taken between the commercial banks in the country and the sharing and sale of products and services between interest-free banks. As a result, there are currently two banks in Malaysia, whereas interest-free banking products are provided by commercial banks and other financial institutions.

Turkey: The Turkish government, which was among the founding members of the Islamic Development Bank (ICD) in 1975, has become one of the largest partners in this organization, increasing its shareholding in 1984 and acquiring permanent members of the ISE Board.

Thus, Turkey will be able to increase its activity within the Islamic Development Bank, one of the world's leading financial institutions, which plays a major role in implementing economic cooperation programs, promoting foreign trade, supporting infrastructure investments, promoting the private sector and developing various financial techniques. At the same time, the State Industrial Investment Bank (DESİAB), established in 1975 to provide services to small and medium-sized enterprises who want to evaluate their deposits in a non-interest-free system, continues to work in this field until 1978.

With the Decree No 83/7506 dated December 16, 1983, the foundation of the Affiliated Banks was established and under this decree, it was called the "Special Financial Institution". In those years, the emergence of a new system that can assess the savings of the conservative layer, which is far from interest, has emerged under the influence of the liberalization of the Turkish economy. For the first time in 1985, Faisal Financial Organization Inc. started its operations with Albaraka Turk Private Financial Institution, later in 1989, the Kuwait Turkish Foundations Financial Organization, in 1991, Anadolu Finansal Kuruluşu A.Ş, , İhlas Finans Kuruluşu A.Ş. in 1995, and finally the Asian Financial Organization Inc. in 1996. Thus, the main enterprises of interest-free banking system in Turkey were formed. The first three of them were based on foreign capital, and later they were completely marketed with local capital.

A decision was made to amend the Banking Law No. 4491 of December 17, 1999, to strengthen the lower legal framework of participating banks, which came into effect on December 19, 1999. It was emphasized that these institutions are an integral and integral part of the Turkish financial system.

England: In England, under the name of AUB-UK Housing since 1997, non-interest murals and lease-based loans are offered. However, the exchange of this product in these financial methods has resulted in double taxation in the use of interest-free housing loans in the UK. The Central Bank of England eliminated the double taxation in interest-free housing loans in 2004 with its agreements. Reducing the gap between traditional products and traditional banking products has led to great interest in the UK's major commercial banks in this area. In 2003, the Central Bank established a working committee headed by Barclays Bank's former CEO Andrew Buxton on interest-free housing finance (mortgages). It is composed of representatives of some banks, such as the Ministry of Finance, Financial Services Management, Credit Providers, Ahli United Bank, HSBC and Barclays as well as with the Islamic Commission of England and representatives of Islamic society. There is not yet a single bank in the UK that can offer products that are completely independent and in compliance with religious conditions. At the same time, there are serious developments in this area. Islamic Bank of Britain has been operating since the beginning of 2002, with the name "Islamic House of Britain" and the first interest-free bank in the UK. Under the guidance of the Islamic Bank of Britain, Article 14 of the Expenditure Tax of the Corporate Tax Law No 5422 consists of the "Laws of the Private Financial Institutions".

Luxembourg: Luxemburg Islamic Banking System (Luxembourg Islamic Banking System International Holding SA) was founded in Luxembourg in 1978 as holding $3,624,800 and was not interested in direct funding as a holding company, and in general, Vadez and Liechtenstein financial institutions. Basically, the Arab Investment Company (Arinco Investment Investments Co.), which owns 55%, is an institution that evaluates 48 hours of non-term loans with an investment opportunity of up to 5 years in all currencies.

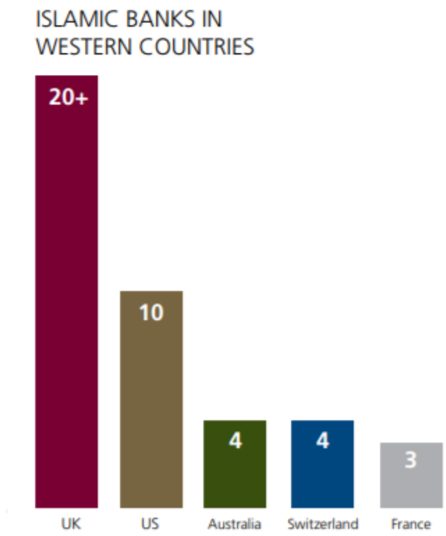
Established in Luxemburg and based on interest-free banking principle, this is the first bank to work on interest-free basis.

Germany: In addition to investing in treasury profits, investments in the Gulf countries have been invested in the United States as well as the "Non-Interest Bearing" In Germany, Dresdner Bank and Deutsche Bank also have interest-free working funds. These funds also have equity investments.

Many Islamic banks, including non-Muslim, including Western countries, were able to compete successfully with the local financial institutions of foreign countries that accept them at local credit markets; today these banks operate in Australia, India, Great Britain, the USA, Thailand, Denmark and some other countries. The research shows that there are several countries that fully and partially implement Islamic finance and their banking system. In recent years, the number of these countries has exceeded 60. However, only thirds of these countries are fully operational under the Sharia law. These countries are Iran, Pakistan and Sudan. But in other countries is carrying out Islamic Banking together with Conventional banking at the same time. As we have already seen in the previous sections, Islamic banking is rapidly developing and continuing to open their new branches in various countries. In many countries, even in non-Muslim countries, the opening of these banks is offered by experts. After starting this thesis, I was delighted to learn that these banks are in developed countries like America, Australia and the UK.

According to various reports, Islamic banking currently operates with 505 banks in 69 countries around the world. Several European countries recently joined the list of these countries. Our neighboring country, Turkey, has a great potential for the development of Islamic banking, and some researchers think that Turkey is the first one in Europe. But IB in Turkey is a very small part of total banking (appr. 3% of total banking). Researchers consider England to be the second largest Islamic financial institution in Europe. For this reason, this part of the research will be dedicated to United Kingdom. The more additional information of the number of Islamic banks in western countries, the diagram was added to below.

Chart 10 Islamic Banks in Western Countries



Source: https://assets.publishing.service.gov.uk

As above mentioned many large banks in the world have special departments to serve clients in accordance with Islamic rules. The following are examples of these banks: Commerzbank, Deutsche Bank, Europe Arab Bank Plc, Bank Britain etc.

2.3 ISLAMIC BANKING IN THE UNITED KINGDOM

The UK is the first western state to officially authorize the activities of Islamic Finance Institutions in the country. More than two million Muslims live here. Nevertheless, in the UK, non-Muslims use Islamic Financial Institutions' services as well. According to the City UK Islamic Finance 2012 report, Britain is the ninth country in the world in terms of total assets of Islamic Finance assets.

Although United Kingdom is not a Muslim country, it supports Islamic Finance Industry more than 30 years and just continues to support. Because they understand that Islamic finance supports economic development and really contributes to the prosperity of individuals. It is also helps to investors to invest their money in more accurate investment. The existence of such reliable system in modern time caused great interest of investors who want to invest their money.

This process makes it an opportunity learning Shariah law for those who invest in Muslim Banking. There are well-known experts who know both Islamic Finance and Conventional Finance in the UK to advise these investors. Products offered by Islamic Finance are considered by them (experts) good for both Muslims and non-Muslims. Even so, the United Kingdom offered applying Islamic Finance to several countries.

HISTORY OF ISLAMIC FINANCE IN UNITED KINGDOM

Islamic Finance came to Britain in the 1980s with the Murabaha operation for the first time. Following the expansion of these operations, Al Baraka International is the first Islamic bank in the UK was established in 1982. In the early 2000s, interest in Islamic finance increased sharply in the UK and a new development program was developed in order to develop these services. Additionally, UK has changed tax and some legislation to expand Islamic finance industry in own country. The Financial Institutions have implemented some reforms to ensure more comfortable operation. These include the removal of double taxation against Islamic mortgage in 2003 and the inclusion of tax-deductible in interest expense as interest payments.

After these changes the traditional banks and Islamic banks had the same right. As a result of these changes, the amount of tax charged to Islamic banks has been balanced with other banks. Over the years, Islamic finance has been developed in the UK to serve more than 2.5 million Muslims who live in the UK. And over the years, all products and services of Islamic Finance have been offered to the population. Currently, there are 5 banks operating in the UK with a fully Sharia rules and more than 20 institutions which offering Islamic Finance services. Five Islamic Banks in the United Kingdom were established in 2004 and 2008. The remaining 17 banks are Islamic Finance, creating the Islamic Window (Table 2). Among them is HSBC Amanah, whose assets ($16.7 billion) make up 88% of UK total assets.

Table 4.a list of banks providing Islamic Finance services in the UK

Full Islamic Banks	Islamic windows
Bank of London and the Middle East	ABC International Bank
European Islamic Investment Bank	Ahli United Bank
Gatehouse Bank	Bank of Ireland
Islamic Bank of Britain	Barclays
QIB UK	BNP Paribas
	Bristol & West
	City Group
	Deutsche Bank
	Europe Arab Bank
	HSBC Amanah
	IBJ International London
	J.Aron & Co
	Lloyds Banking Group
	Royal Bank of Scotland
	Standard Chartered
	UBS
	United National Bank

Source: https://assets.publishing.service.gov.uk

• The British Islamic Bank (IBA) has 5 branches and approximately 50,000 customers. The main shareholders of the Bank are the International Islamic Bank of Qatar.

• Another Islamic Bank, The Bank of London and The Middle East (BLME), offers Islamic Finance services in treasury and asset management.

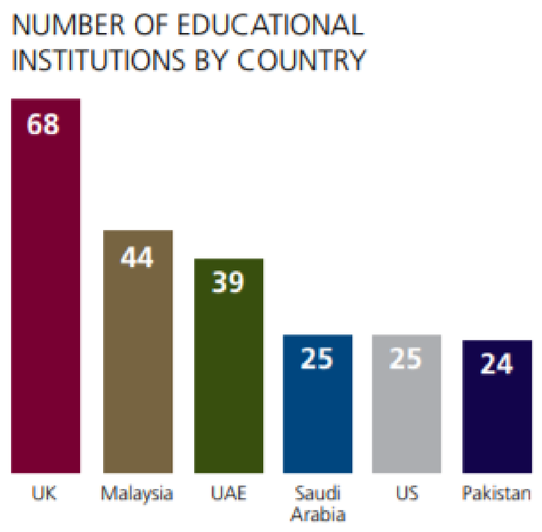
• Gatehouse Bank is an investment bank operating in the fields of capital markets, real estate markets and advisory services.

UK began to prepare qualified personnel for to serve the growing industry. For this purpose, several organizations and institutions which offer training and seminars to the employees have been opened in the UK.

UK is in the first place among the world countries by the number of organizations offering Islamic finance education (Chart 11)

At least 10 universities and business schools (such as Aston, Cass, Durham, Reading) and four professional institutions offer Islamic Finance education. There are some examples of these universities in the below. (see Table 5)

Chart 11 Number of educational institutions



Source: https://assets.publishing.service.gov.uk

People who work in the Islamic banking system can educate from these qualification institutions. Also in our country many employees are student of these associations. In our country the most popular is the CIMA.

Table 5 a list of Universities and Professions Institutions teach Islamic Finance in the UK

Universities and Business Schools	Professional Institutions
Aston Business School	Chartered Institute of Management Accountants
Bangor Business School	Chartered Institute for Securities and Investment
Cass Business School	Association of International Accountants
Dundee University	Institute of Islamic Banking and Insurance
Durham University and Business School	
Durham University	
ICMA Centre Henley University of Reading	
Glam University	
London School of Business and Finance	
Newcastle Business School	
Salford Business School	

Source: https://assets.publishing.service.gov.uk

Presently, UK is at the center of the countries which offering Islamic Finance products, due to the abundance and accessibility of qualified staff. The latest ICD

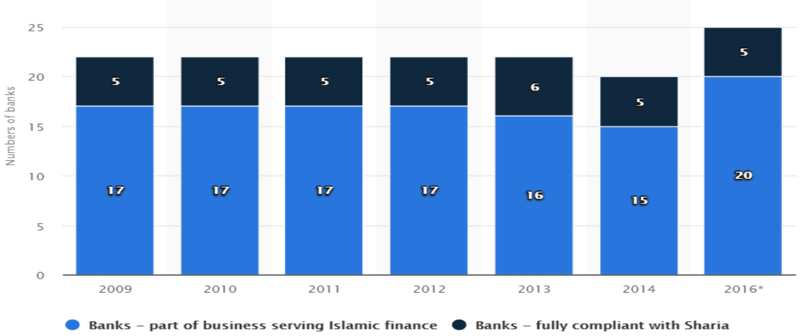
Thomson report shows that the UK's index value for Islamic Finance is 16.2 and this value is considerably higher than that of other non-Muslim countries. This index value is about 10.3 for other non-Muslim countries. As I noted above, there are currently five banks operating with fully Sharia rules in the UK. This data once again proves that it is the leader among the western countries in IF. At the end of 2014, the value of these banks' assets exceeded $3 billion. In addition to these banks, there are traditional banks in the UK offering a range of Islamic products. Totally, about more than 20 banks offer Islamic products and services. (Chart 12) The Bank offers Islamic Finance services, of which 5 are fully Islamized banks. This is the best indicator among western states.

With a large number of IB, United Kingdom significantly differs from western countries. Even twice higher than American IB. Reports show that the value of the assets of Islamic finance institutions in the UK has risen sharply and reached $4.5 billion at the end of 2014.

The London Stock Exchange listed 37 insurance lists totaling $20 billion. Suction emissions have been delved since the expiry of 6 years. Taking these into account, 43 cigars emitted $24 billion.

In the 21st century the first Islamic bank of UK, the Islamic Bank of Britain was opened in 2004.It was followed by the European Investment Bank in 2005. But this bank's activity was approved only one year later (2006). And the next following bank was Bank of London and Middle East that was founded in 2006.

Chart 12 Number of banks offering Islamic financial services in UK from 2009-2016



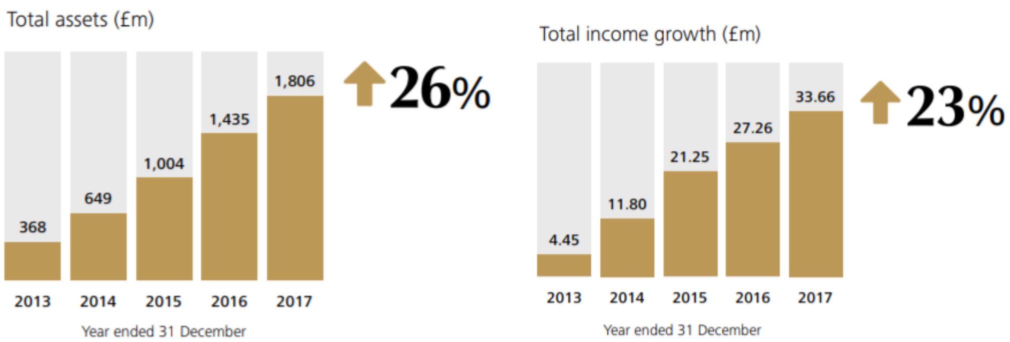
Source: https://assets.publishing.service.gov.uk

AL RAYAN BANK PLC (ALSO KNOWN AS ISLAMIC BANK OF BRITAIN)

After a long period of time only in smaller parts of Islamic Finance products had offered by UK banks, the FSA allowed the opening of the first full-fledged Islamic bank in a non-Muslim country in 2004. The new application of these services generated a variety of questions in people who did not know about Islamic Finance and it took a year to answer these questions. Understanding of the differences between traditional banks and understanding the concepts such as the distribution of profits and losses by Islamic banks have become a bit tricky for people. Over time, people's interest in Islamic finance began to increase and The FSA has agreed to open other banks and provide other services. As the Islamic banking has developed in the UK, this bank has sharply developed.

Reports show that the bank's assets have increased by 26% to 1.81 billion from 2016 to 2017. In the same year, the bank's revenues from Islamic finance products rose by 23% to 33 billion GBP.

Chart 13 Financial performance of IBB



Source: Financial Statement Report of Al Rayan Bank 2017

The main purpose of Islamic banks in the UK is to expand their activities in the coming years. In addition, improve customer service and lowering the cost per capita income.

In addition, the main goals strategies of IBB for the coming years are:

- Staying in number 1 on Islamic banks in Europe
- Develop risk management
- Continuing with the main place in the UK as Islamic Banking
- Enhance assets and at the same time serve customers better

BANK OF LONDON AND MIDDLE EAST

Bank of London was originally established in 2006 and started operating in 2007 with the permission of the FSA. Bank of London is also governed entirely by the Sharia laws. The bank offers products and services within the framework of Sharia norms. The strategy of this bank is carried out in main 3 directions-Commercial Finance, Wealth Management and Treasury. The bank's revenues reached 3.5 million GBP in 2017 however this figure is a 21 million GBP loss in 2016. The total assets have dropped by a smaller percentage and amounted to 1.025 billion GBP in 2017.

CHAPTER 3.THE ROLE OF ISLAMIC BANKING IN ECONOMIC DEVELOPMENT

The main objective of this paragraph is to show the role of the Islamic Financial System in economic development and to discuss the possibilities of implementing the system in Azerbaijan.

The Islamic Financial System is developing with rates that are not analogous to 15-20% despite the global financial crisis. At present, more than 500 financial institutions operate on the Islamic principles and the total amount of assets managed by Islamic Finance Principles has exceeded $1 trillion on a global scale. Some economists have linked the dynamic growth of the Islamic Finance System to cash flows to the Arab countries as a result of high oil prices. I think this idea is only partly true and not full.

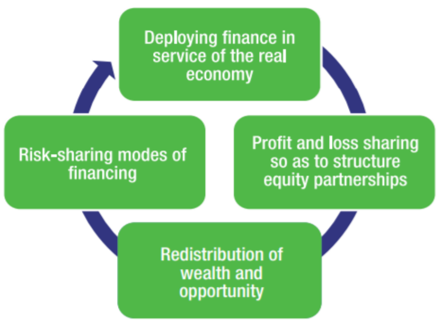
The dynamic development of the Islamic Financial System is linked to the growing religious devoutness of Muslims who can’t or will not benefit from the services of traditional banks. This factor and the anti-crisis duration of the Islamic Financial Institutions have further accelerated the tendency of traditional banks to establish branches, divisions that operate in accordance with the Sharia principles. This, in its turn, played a role of global propaganda for Islamic Finance. These institutions have not been exposed to the impact of the crisis because the specificity of the Islamic Bank's activities has been isolated from the traditional financial system. Therefore, the Islamic Financial System is already a global tendency and it would be wrong to avoid this globalization. But along with all this, there are great barriers to the path of globalization of the Islamic Financial System.

3.1 THE ROLE OF THE ISLAMIC FINANCIAL SECTOR IN ACHIEVING ECONOMIC DEVELOPMENT

In Islamic banking, savings are involved in trade and industrial activities and receive a production factor. In this way, the added value is generated and the amount of savings increases. Savings outside the economy are a loss for both the country and the depositors. Moreover, the outside collection of money does not correspond to the principles of Islamic economics. Return to equity means an increase in national income, and this growth promotes the welfare of the community.

Valuation of deposits outside the real economy, such as promissory notes, stock exchanges and interest rates can prevent the entrepreneur from producing and working as he entrains savvy businessmen. In times of crisis, industrial organizations are gaining higher interest rates by earning a large portion of their income through interest. The economy, which is not based on production, is built on debt and a small minority lives in prosperity, while large masses are forced to fight poverty. Particularly high share of public institutions, where extravagant wasting is widespread, shrinks resource potential of the producer and the employer. The state's borrowing requirement is, as a matter of principle, beyond the interest of Islamic banks. Islamic banks are constantly reducing the destructive power of crises as they are constantly financing real economy, production, and trade. Even in times of crisis, it continues to help its customers. They do not value their funds in any other area. Therefore, it continues to use funds from its customers during crisis times (perhaps at times when companies have the most demand for the source).In addition to the features we have mentioned above, some features of Islamic finance are those that give rise to economic development. These features are clearly illustrated in the following scheme.

Scheme 6 Main features of Islamic Finance which contribute to the economic development



Source:United Nations ESCAP

HOW ISLAMIC BANKING AND ISLAMIC FINANCE SERVICES CAN PROVIDE ECONOMIC DEVELOPMENT?

Implementing Islamic Finance services can increase domestic investment. It is known that Muslim practitioners practicing Islam in their lives do not use traditional banks services. As a result, the pillow economy deprives the economy of additional investment opportunities. In order to ensure that these savings are pulled out of the pillows and flowing into the economy, mechanisms that do not contradict people's beliefs are required. It is also widely practiced by the application of Islamic Financial Services.

The application of the Islamic mortgage can solve the problem of the homeowner's homeless part of a religious one. This, in turn, can ease the state's homeless social program.

Islamic Banks can also invest in nonprofit social projects, as these cases are widely observed in international Islamic banking practice. In most of these banks, even in almost all of them, charity funds are established. Voluntary contributions, including zakat payments, are collected in these funds. Collected funds are spent for charitable purposes. All of these can play a role in resolving social problems of the population and raising the welfare.

As can be seen, Islamic Banking and Finance can not only develop the financial sector, but also the development of the real sector. Naturally, all the above mentioned issues are possible when the Islamic Finance System is fully implemented and the government obtains full legal support (legislative base, tax regime, accounting directives, etc.).

Deposits in Islamic Banking depend on income generated by the bank's assets. This addiction enhances the effectiveness and robustness of both the bank and the financial system. The interest-based financial system generates debt that can’t be repaid and makes rich people even wealthy, while poorer people are poorer. Hence, the Islamic Finance System is also beneficial for preventing the deepening of social stratification.

Islamic banking can be more advantageous than the prerequisite of microeconomics. So, interest should be paid both in good times and in bad times. But dividends can be reduced at bad times. The advantage of the Islamic Finance, which forbids interest from the root, is also evident here. That is, Islamic Finance admits that bad times, crises can take time and, in bad times, the company is less damaged than traditional competitors by reducing dividends, and guarantees that there is no problem with the problem of "paying interest in such a difficult situation" as in its traditional competitors. This proves that the Islamic Financial System and Islamic Finance Institutions are more resistant to systemic financial crises. And this is not just a theory, but an axiom that has proven itself during the recent financial crisis. It is very interesting that sometimes some corporations, banks, investment funds, etc., have recently tended to resolve debt problems, especially at the expense of the debt crisis. This is called the Ponzi scheme in finance. How effective is debt repayment and how long can this process to continue? How long can this approach last? In short, it would be appropriate to emphasize an important point. So it is completely wrong to think that the Islamic Financial System is a riskless and non-crisis system. Crisis can also occur in the Islamic Financial System. However, unlike the traditional financial system, crises in the Islamic Financial System relate to the real sector. Islamic Financial Institutions are exposed to more business risks than financial risks due to zero leverage. Therefore, the realities of the Islamic Financial Institutions are beginning to come as a result of the crisis of the real economy. However, it should be emphasized that, unlike the traditional financial system, Islamic Financial Institutions are not systematic financial crises.

The above principle also applies to the macro level. That is, when countries borrow it, they must pay when the time has come. If the repayment coincides with the bad times of the state, then some countries of the European Union may fall into disadvantages. Of course, it can be argued that the European Union can help save these states. Even if we accept that, no one can predict that these states will come to better positions.

As mentioned above, Islamic financing can also be considered a means to meet the financial needs of people who do not use their traditional financial system for religious reasons. While there are more than 1.7 billion Muslims in the world, only 15 percent of them use banks. But with the application of some of these financial systems in accordance with the Sharia rules, the use of banking system by Muslims can be expanded, which in turn leads to the development of the real economy. The following table shows the percentage of Muslims who consumers of the banks in some Muslim countries.

Table 6 Consumers of the banks in some Muslim countries

Country	Adults with account at formal financial institutions (%)	Adults with no accounts due to religious reasons (%)
Afghanistan	9.0	33.6
Bahrain	64.5	0.0
Bangladesh	39.6	4.5
Djibouti	12.3	22.8
Egypt	9.7	2.9
Indonesia	19.6	1.5
Kuwait	86.8	2.6
Malaysia	66.2	0.1
Nigeria	29.7	3.9
Pakistan	10.3	7.2
Qatar	65.9	11.6
Saudi Arabia	46.4	24.1
Tunisia	32.2	26.8
Turkey	57.3	7.9
UAE	59.7	2.3

Source: World Bank Global Findex (2011), Gallup Poll, ISRA

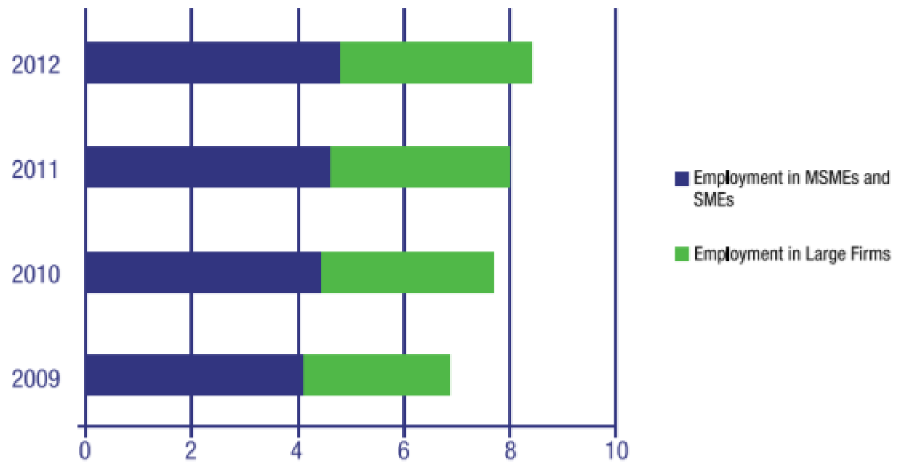
Source: World Bank Global Findex

Some Shariah-compatible socioeconomic financial instruments influence the real economic development

Positive economic growth is linked with the goal of enhancing financial inclusion. Hence, in line with the main aims of Islam, socioeconomic tools which have generally been known as critical in achieving financial inclusion, is one of the main instruments in the Islamic financial system that should be given extra consideration. These financial instruments include financial instruments that support the development of small and medium-sized businesses and provide financial flows. In addition to these social and financial instruments, the Islamic finance system has zakat and waqf financial instruments, which in its turn supports financial development. Small and medium-sized entrepreneurship, as well as micro-small entrepreneurship, which have evolved through these financial instruments, have led to economic development. To illustrate this topic, let's look at the model of Malaysia. The development of micro entrepreneurship and small and medium entrepreneurship in Malaysia is an important factor in the socioeconomic development of this country. In 2012, large companies employed 3.7 million workers in Malaysia, whereas small micro entrepreneurs and small and medium-sized enterprises increased this figure to 4.7 million. It comes from the financial support of Islamic finance to small entrepreneurs. They can develop their businesses with financial support and hire new employees. This process, in turn, leads to a decline in the country's unemployment rate. (See chart 14)

In Indonesia, where Islamic finance is supporting small-scale entrepreneurship and micro-small entrepreneurship, this type of entrepreneurship is also the basis of the country's economy, and almost all of its population is involved in this field of entrepreneurship.

Chart 14 Employment in MSMEs & SMEs and Large Companies (million)



Source:Malaysia Islamic Finance Report 2015

3.2 ISLAMİC CAPİTAL MARKET TRENDS AND DEVELOPMENT

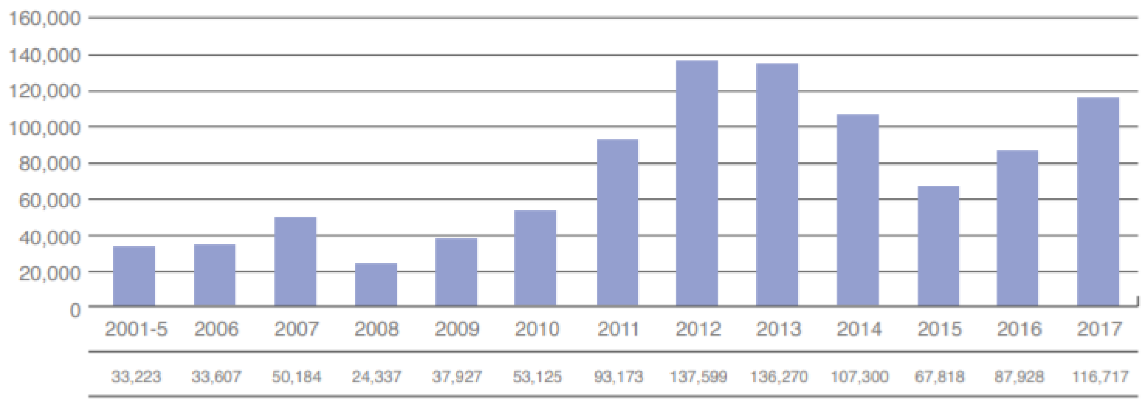
As a matter of fact, the Islamic capital market is a market where financial individuals and financial organizations are trading their financial securities. As in the traditional capital market, financial institutions and institutions sell their stocks in these markets to increase their financial assets in the Islamic capital market. And as we know, these markets are also composed of two parts, primary and secondary market. As with other Islamic finance activities, all transactions, purchases and sales carried out within this market must comply with Sharia rules. And only financial securities can be bought and sold according to the Sharia requirements.

The conformity of this capital market to Sharia regulates the functionality and usefulness of this market and makes it different from the usual capital market.

Sukuk Market: Many statistical indicators, including researchers, show that the Sukuk emission raises the dynamics of the Islamic capital market and is the basis of this market's Islamic capital market. Even some international financial companies have started sukuk emission to increase their investment. We can show examples of several financial centers such as London, Hong Kong and others. For the issue, Hong Kong has several times succeeded in promoting the sukuk market in 2014, 2015 and 2017 to further strengthen its location as a global financial center. One of the other reasons for this is that Sukuk is one of the key tools for the development of the infrastructure of the states and the elimination of the budget deficit, and for this purpose the development of this market is of great interest in these countries. For example, we can use the sukuk market to eliminate oil deficits in oil-producing countries like ours. Currently, the Gulf countries use this method. Sukuk can be both short-term and short-term, so in some countries short-term liquidity is used for liquidity purposes. In addition, the alternative sukuk is used as an alternative debt instrument. Gulf countries, especially Saudi Arabia, have begun to develop other areas in order to reduce oil dependence in the future, which has led to the rise in sukuk market demand and the development of the market.

Some organizations we have briefly described in the second chapter of the dissertation have also played an important role in building and promoting the sukuk market structure. Islamic Economic Development Bank, International Islamic Liquidity Management and World Bank are examples of these organizations. The main purpose of which is to develop the Islamic finance industry in the world, the Economic Development Bank plays an important role in suitability of the Suuk market and the innovative development of its structure. The international Islamic liquidity management organization, established to manage the liquidity of the Islamic financial market, carries out short-term sukuk emission. This also helps to increase liquidity. This organization has issued 3 billion sukuk in 2017.

Chart 15 Total Global Sukuk Issuances (Jan 2001 - Dec 2017)



Source: IIFM Sukuk Database

In addition to the listed financial institutions, there are some management entities that have set some standards for managing this market. However, these failures have little success in terms of law. Because, as we know, the main problem is generally hindered by the spread of Islamic finance is the legislative problem. So it needs more effort to legally renew these standards and suit the strings. The relatively inexpensive standards of sukuk regulation in the market lead to a decrease in its value. This in turn causes the interest in other simple bonds. But as a result of standardization, the transparency of the sukuk market will increase, and in this case, the trust and interest will grow. Therefore, standardization is considered one of the key processes. I will try to provide some basic standard-setting organizations and information about the most basic AAOIFI.

AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions)

While studying the Islamic Finance System, organizations that set standards for Islamic Finance Institutes should not be forgotten. One of these organizations is the AAOIFI for the Organization of Islamic Finance Institutions, although it has not yet been adopted unanimously by all Islamic countries. AAOIFI (Islamic Financial Institutions) is a nonprofit international Islamic organization that prepares accounting, auditing, ethical and charismatic standards and codes for Islamic Finance Institutes and the Islamic Finance sector. AAOIFI also offers internationally recognized qualifications in the field of Islamic Finance to strengthen the field of human resources. AAOIFI was established on February 26, 1990 and was registered in Bahrain in 1991. As an independent international organization, AAOIFI is supported by 200 members from 45 countries. Most of these members are central banks, Islamic Finance Institutes, and other institutions in the field of Islamic Finance. AAOIFI standards have been adopted by Bahrain, Qatar, Dubai International Financial Center, Jordan and Sudan. These standards are compulsory in Bahrain and Qatar. Australia, Indonesia, Malaysia, Pakistan, Saudi Arabia and South Africa have prepared technical guidelines based on AAOIFI standards. However, it should be noted that these countries have not yet fully adopted AAOIFI standards.

The objectives of AAOIFI are as follows:

a) Identifying accounting and auditing standards suitable for Islamic Finance Institutions

b) Spreading of these standards through seminars, trainings, periodic reports

c) Setting standards

d) Review and improve existing standards

3.3 ECONOMİC PROSPECTS OF ISLAMİC BANKİNG İN AZERBAİJAN REPUBLİC

This paragraph will first provide information on Islamic Financial Services and organizations offering these services in Azerbaijan. Then, the main obstacles facing this field will be listed in Azerbaijan and proposals will be made regarding the application and development of the area.

At present, there are no banks operating on the principles of Islamic banking only in Azerbaijan, and once again we note that Azerbaijan's banking legislation does not allow it. It can be operated only in the form of an Islamic Window or Department at any bank, provided that exceptions can be applied to several Islamic banking products that are not contrary to the country's banking legislation.

Recently, International Bank, Amrah Bank, Unibank, Turanbank and other banks in Azerbaijan have shown interest in providing Islamic Finance Services at a certain level and have done certain work for this purpose.

I. The Kauther Bank, the first Islamic Bank in Azerbaijan, failed to meet its minimal requirements for its charter capital, and was revoked by the Central Bank.

II. The International Bank of Azerbaijan has also established a division of the Islamic Bank (division), which has been operating since 2013. After opening an Islamic window within this bank, $500 million was invested in Azerbaijan at the initiative of this department.

III. Nikoil Bank received interest-free deposits and provided Islamic finance services and was one of the first pioneers in the field. These deposits were also used only in foreign exchange markets.

IV. Also, the first Islamic investment company (Caspian International Investment Company) and the first leasing company (Ansar Leasing) operated.

INTERNATIONAL BANK OF AZERBAIJAN

International Bank of Azerbaijan, one of the most highly regarded banks in Azerbaijan, has actively cooperated with Islamic banks of Gulf countries. In 2011, the International Bank adopted the relevant concept on the application of Islamic banking products and services. Also, within the framework of Islamic finance the Islamic banking department of IBA was opened in 2012 year. With the opening of this window, the International Bank has attracted more than 500 million US dollar funds from the financial institutions of Gulf countries. At the time, it became known that within the framework of the concept, proposals were made to start work and make appropriate changes to the legislation under existing legislation. Even bank employees have made some suggestions about changing the legislation. However, due to the fact that the legislation on Islamic Banking has not been compliant with the legislation of our country, the bank has stopped its activity in this direction in the 2015 year.

ANSAR LEASİNG

Azerbaijan Leasing Company LLC was established by the Islamic Corporation for the Development of Private Sector and was officially registered on December 12, 2008. The company's charter capital, ANSAR LEASING, is about 5000000 manats. The entity is mainly engaged in providing financial leasing services. The organization, which rules the Sharia rules, intends to have a leading position in Azerbaijan's leasing market in a short period. Acting on the Shari'ah rules helps protect the interests of the clients and gain their sympathy. The Islamic Corporation for the Development of the Private Sector has a 100% interest in the Azerbaijani Leasing Company (Ansar Leasing).

CASPIAN INTERNATIONAL INVESTMENT COMPANY

The Caspian International Investment Company (IFC) was established in March 2008 by the Azerbaijani Investment Company and the Islamic Corporation for the Development of the Private Sector. Once, the charter capital of the IBRD amounted to AZN 2,954,200. The Caspian International Investment Company has the right to invest in non-oil sector enterprises of Azerbaijan's economy, except for companies that violate Sharia's principles (production of alcoholic beverages, pork products, etc.), as well as banks and insurance companies providing traditional financing and insurance services. The criteria for selecting investment facilities were:

- Project commercial efficiency
- Competitive and mainly export-oriented or import-substituting products (goods and services)
- Responsibility for carrying out or carrying out accounting in accordance with International Financial Reporting Standards
- An audit of financial statements by an independent auditor

Investment procedure:

- Submission of Investment Proposal to the Company or the Company's Initiation
- Investment evaluation
- Adoption of the investment decision by the Investment Committee
- Signing of the investment contract and the fact that the investor is a shareholder of any investment entity acquired in the capital
- Company's involvement in the investment project and monitoring
- Analysis of financial and economic activity reports and information obtained on request

The company's share in the capital of any investment entity has been between US $1 million and US $15 million.

AMRAHBANK

Sale of 49% of Amrahbank's shares in the International Investment Bank (BPB), a strategic investor in Bahrain, is marked as an important milestone in the history of the Bank. The International Investment Bank, which is considered to be a worldwide reputable organization, has played a great role in improving corporate governance in Amrahbank, and has shared its knowledge and experience in risk management and other areas. This strategic partnership has created ample opportunities for Amrahbank to build close relationships with various leading financial institutions. Amrahbank carried out leasing operations with Turkapital, a division of Kuwait Finance House Group. Amrahbank has obtained credit lines from the Islamic Corporation for Trade Finance, a subsidiary of the IDB, to finance the activities of small and medium enterprises.

MAIN OBSTACLES FACING ISLAMIC FINANCIAL INSTITUTIONS IN AZERBAIJAN

Generally, there are certain obstacles and at the same time prospects for the implementation of this type of banking and generally Islamic Financial Services in Azerbaijan. In my opinion, the biggest obstacles and shortcomings facing this field in Azerbaijan are:

Current law of the Republic of Azerbaijan related to banks. Under this law, banks can not engage in commercial activity, so it is impossible to apply the most commonly used Murabaha financing method and other transactions in Islamic Banking practice. At the same time, the law prohibits banks from investing in other companies, except banks, leasing and insurance companies. This makes it impossible for Musharakah and Mudarabah to be used. All these points are reflected in Article 33 of the Banking Law of Azerbaijan.

- The lack of people who practice their beliefs in practice at the moment. This fact may limit the opportunities for broader market access to Islamic Banking.
- There are very few experts in Islamic finance in Azerbaijan. There is a serious staff shortage in this area. Islamic Finance and Banking in universities are almost untrained.

CONCLUSIONS AND SUGGESTIONS

Some countries have misconceptions about Islam religion. It has long been ahead of time and is still going on. In some countries of the world, Islam is labeled as a terrorist and is presented as a source of radical behavior, and in some countries it is referred to as the cause of negligence. Despite all these unfair claims, it seems that the Islamic Financial System, established on the basis of Islam, which is the cause of this backwardness and radicalism, is at least a scientific reality. In my view, the Islamic Finance System has become one of the most important economic theories of the modern era, and practically it will not be possible to study and educate economics in the future regardless of the future success or failure of Islamic Finance Institutes and the Islamic Finance sector. Especially after the most acute financial crisis in the 21st century, the Islamic Financial Institutions' surprise resistance to the crisis will provide the Islamic Finance System as one of the major theories of modern economics. Nowadays, the UK's famous universities study what economics science with the Islamic Finance System, and have even established separate faculties and specialties in this area. It can be predicted that this approach will continue in the future and will be geographically expanded. However, the practical successes of the Islamic Finance Institutions and their self-justification during the crisis give the impression that the Islamic Financial System and Islamic Finance services are not just theories. The specificity of the Islamic Finance System ensured the Islamic Financial Institutions from the global financial crisis. As a result, the defenders of the Islamic Financial System now say that this system deserves to be the only global system. Of course, although they are right in their claims, they are well aware that it is impossible or unrealistic to do so. First of all, the market of the Islamic Financial System is not so great. Only 15 percent of the world's Muslims use Islamic Financial Services, according to statistical magazines. Moreover, Islamic Finance assets make up only 1 percent of the global financial system. Instead, it is possible to apply the Islamic Finance System in one or another way in all countries of the world and more real. Current trends in the global economic and financial system also confirm this idea. The dynamic growth rates of the Islamic Financial System and its separate segments make it hard to think seriously about how states can benefit from this. In the states where Muslims live, this is shaped by a market demand. Despite all these positive tendencies, the Islamic Financial System should learn serious lessons from the crisis. In any case, the Islamic Finance System could protect itself from the global financial crisis, even if it was not practiced in the best way possible, as in the theory. Because this system was superior even in this case. The closer the theory of Islamic Finance to practice, the more important it will be for the real economy and its continuing existence. This will further enhance the stability of the system and further expand its geography.

SUGGESTIONS FOR THE DEVELOPMENT METHODS OF THE ISLAMIC BANKING SYSTEM IN AZERBAIJAN

I think that the following measures should be taken to implement and develop this field in Azerbaijan:

• A separate law on Islamic Banks should be adopted or certain amendments to existing law should be made.

• Experience of the countries in which the Islamic Finance System is applied should be studied and the best suited model should be chosen for Azerbaijan taking into account its specificity. For this purpose, a special group of specialists should be established within the Central Bank and Financial Market Supervisory Authority of Azerbaijan Republic.

• Islamic Finance courses should be included in the curriculum of universities and separate Islamic Finance specialties should be established.

• Islamic banks should be seriously investigated from the point of view of the current tax regime and tax privileges should be applied to Islamic banks in the years to come.

• Specific Accounting Directives for Islamic Banks should be prepared.

• Public awareness campaigns on the Islamic Finance System should be conducted on a large scale.

Given the fact that both citizens and banks have practical skills and practice in traditional form partial payments in Azerbaijan, then, first of all, it would be appropriate for the Azerbaijani market to apply the Murabaha and Ijara Financing Methods.

This field has recently been developed at an excellent pace of 15-20% per year. Especially during the crisis, this type of banks has proved to be very stable. It is very important that Islamic banks serve the real sector, not just financial sector, as traditional banks. Therefore, in such non-Islamic countries (England, USA, Singapore, France, etc.), such banks are appreciated and created. It would be expedient to apply Islamic Banking and other Islamic finance services in Azerbaijan, taking into account both the development of the field and the potential increase in the portfolios, the individuals, as well as the citizens who have not used traditional bank services in their lives.

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