SME FINANCE (SMEF) WORKING GROUP

ISLAMIC FINANCE AND FINANCIAL INCLUSION: AFI MEMBERS' PERSPECTIVES

SURVEY REPORT

CONTENTS

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This survey report is a product of the SME Finance Working Group (SMEFWG) and its members, led by the Islamic Finance and Financial Inclusion subgroup.

Contributors:

AFI members: Phumzile Nhleko-Mtetwa (Central for Financial Inclusion, Ministry of Finance Eswatini), Ibrahim Shaugee and Aishath Asna Hamdi (Maldives Monetary Authority), Noel P. Tienaela and the FSS-IBSG Unit (Bangko Sentral ng Pilipinas), Ahmed Hessein and Ahmed Badawy (Central Bank of Egypt), Shahanaj Pervin (Bangladesh Bank), Saba Assaf (Palestine Monetary Authority), Ligia Marcela Herrera (Comisión Nacional de Bancos y Seguros), Dania Melissa López Vásquez (BCR El Salvador), and Banji Milambo (Bank of Zambia).

From the AFI Management Unit: Nik Kamarun (Senior Policy Manager, SME Finance), Kennedy Baboloki Kwati (AFI Intern), and Lucy Wanjiku Kabethi (Policy Analyst, Gender Inclusive Finance).

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EXECUTIVE SUMMARY

This survey report provides the presence of Islamic finance in various member countries, the importance placed on Islamic finance as a complement to conventional finance, the challenges faced in formulating strategies, and the regulatory frameworks governing Islamic finance.

The survey received responses from 33 countries (**List of countries in Annex 11**) across the AFI network, and the findings reveal that Islamic finance has gained traction in the financial sector, with a number of countries incorporating Islamic finance into their national financial inclusion strategies. However, the survey further did not include the takaful sector in its scope.

Islamic finance has highlighted its potential in addressing the challenge of financial inclusion advocates through risk-sharing contracts and wealth redistribution mechanisms, highlight its role in promoting economic justice and social participation, allowing for more equitable sharing of prosperity.[1] The majority of AFI survey respondents recognize the medium-to-high importance of Islamic finance in advancing financial inclusion, indicating positive sentiment towards its potential impact.

Islamic finance products available in member countries include equity-based products such as mudarabah and musharakah, fee-based such as wadiah, leases (ijarah), cost-plus (murabaha), sukuk (Islamic bonds), takaful (Islamic insurance), and social products (including waqf, zakat, and sadaqah) which contribute to financial inclusivity, risk-sharing, and the promotion of social welfare in accordance with Islamic principles.[2]

49%

While 49 percent of respondents reported having at least one Islamic finance product in their organization or country, there is still room for increased adoption and utilization of these products.

The findings highlight the diversity and complexity of approaches to Islamic finance within member countries, influenced by factors such as well-established conventional financial systems, lack of awareness and understanding, and implementation challenges. Further awareness, capacity building, research, and knowledge sharing are needed to fully evaluate the potential role of Islamic finance for inclusive financial systems.

Overall, this report serves as a consolidated resource that provides a comprehensive overview of the state of policy frameworks, laws, and regulations related to Islamic finance within the respondent member countries. It informs policy initiatives and promotes collaboration among member countries to further advance financial inclusion through Islamic finance.

[1] Maghrebi, N., Mirakhor, A. 2015. Risk Sharing and Shared Prosperity in Islamic Finance. Islamic Economic Studies, 23(2), 85–115. Islamic Research and Training Institute : Islamic Development Bank. Available at: https://doi.org/10.12816/0015021

[2] Musaffa Academy. 2021. 4 Islamic Finance Products and Why Are They Important? 18 September. New York. Musaffa Academy. Available at: https://academy.musaffa.com/4-islamic-finance-products-and-why-are-they- important/

INTRODUCTION

Financial inclusion plays a vital role in fostering economic growth and reducing poverty by ensuring that individuals and businesses have access to quality financial services.

Recent estimates by the Islamic Development Bank reveal that, on average, around nine percent of the population in 35 selected Muslim-majority countries voluntarily exclude themselves from the formal financial sector due to religious considerations.[3] In this context, Islamic finance has emerged as a potential tool for promoting financial inclusion, offering alternative financial management mechanisms rooted in Islamic principles. Islamic finance provides financial instruments and services designed to comply with Shariah principles, which prohibit interest (riba) and promote ethical and socially responsible practices.[4] Islamic Finance follows ethical and socially responsible investment principles, avoiding investments in sectors such as alcohol, gambling, and tobacco. This aligns with the values of many women who prefer investments that have a positive impact on society and the environment.

Over the past decade, Islamic finance has emerged as a powerful tool for financing development on a global scale, extending its reach beyond Muslim-majority countries to non-Muslim nations as well to operate alongside the conventional finance platform. Countries such as the UK, Luxembourg, South Africa, and Hong Kong have witnessed a growing demand for Islamic finance products, recognizing their economic value.[5] In countries with small Muslim populations, conventional banks often establish Islamic banking (IB) windows to cater to the needs of Muslim customers and offer Sharia- compliant financial products and services. This approach allows conventional banks to tap into the growing demand for Islamic finance while enhancing financial inclusion in markets where standalone Islamic banks may not be viable.[6] The IB window is one of the feasible ways of providing Islamic bank services that enhance financial inclusion.

6.2%

According to the 2023 Islamic Financial Services Industry Stability Report published by the Islamic Financial Services Board's, the "value of the global Islamic financial services industry (IFSI) that is composed of Islamic banking, Islamic capital markets and takaful sectors, increased to an estimated USD3.25 trillion in 2022, sustaining an annual growth rate of 6.2% based on significant improvement in Islamic banking and Islamic capital key market segments in some key markets.[7]

The range of Islamic finance products varies across different market segments. However, the closest to financial inclusion is via NBFIs, Islamic microfinance and Islamic social finance. Islamic microfinance addresses the financing gap and adheres to the Islamic social principle of caring for the less fortunate backed by the power of microfinance's to provide financial access to the those in low- income groups. Islamic microfinance serves as a powerfull tool for advancing financial inclusion by providing accessible, ethical, and socially responsible financial services to underserved populations. By aligning with Islamic principles and values, Islamic microfinance promotes inclusive economic development, empowerment, and social cohesion, thereby contributing to the broader goals of financial inclusion. Islamic finance institutions often offer microfinance and microenterprise programs that specifically target women, enabling then to access small loans which they can use to start or expand their own businesses and generate income. As a result, AFI SME Finance Working Group (SMEFWG) recognized the significance of Islamic finance in advancing financial inclusion and has undertaken a survey to assess the current landscape of Islamic finance and shed light on the policy frameworks, laws, and regulations pertaining to Islamic finance within the member countries.

[3] World Bank, Islamic Development Group. 2017. Global Report on Islamic Finance: Islamic Finance - A Catalyst for Shared Prosperity? Washington, DC: World Bank. Available at: https://openknowledge.worldbank.org/entities/publication/fb5e614a-2a30-5f5c-a94e-91fbd5ae902c

[4] Hussain, M. Shahmoradi, A. Turk, R. 2015. An Overview of Islamic Finance. IMF Working Paper Monetary Fund WP/15/120. Washington D.C. International Monetary Fund. Available at: https://www.imf.org/external/pubs/ft/wp/2015/wp15120.pdf

[5] World Bank. 2015. Islamic Finance. Washington D.C. World Bank. Available at: https://www.worldbank.org/en/topic/financialsector/brief/islamic-finance

[6] Song, Inwon. Oosthuizen, C. 2014. Monetary and Capital Markets Department Islamic Banking Regulation and Supervision: Survey Results and Challenges. IMF Working Paper WP/14/220. December. Washington D.C. International Monetary Fund. Available at: https://www.imf.org/external/pubs/ft/wp/2014/wp14220.pdf

[7] Islamic Financial Services Board. 2023. *Islamic Financial Services Industry Stability Report: Navigation a Challenging Global Financial Condition*. Kuala Lumpur. Available at: https://www.ifsb.org/wp- content/uploads/2023/10/Islamic-Financial-Services-Industry-Stability-Report-2023_En.pdf

OBJECTIVES

The primary objective of this survey report is to map and identify the stages of Islamic finance use, capture different perspectives, and gain insights into the application of Islamic finance products, regulatory measures, and supervisory frameworks.

Exploring the prevalence of Islamic finance mechanisms within member countries allows AFI to understand how these mechanisms are being utilized to promote financial inclusion. By exploring how Islamic finance complements conventional finance and contributes to mitigating financial exclusion, this survey aims to inform policy initiatives and promote collaboration among member countries.

This report provides valuable insights into the current landscape of Islamic finance, including the presence of national financial inclusion strategies (NFIS) incorporating Islamic finance, the importance placed on Islamic finance as complementary to conventional finance, the challenges faced by financial regulators in formulating strategies, and the regulatory frameworks which are in place to govern Islamic finance. The report also highlights how Islamic finance:

- ✓ promotes financial stability
- ✓ allows for risk-sharing
- ✓ contributes to equitable wealth distribution
- ✓ fosters economic justice
- ✓ encourages productive investments
- ✓ contributes to sustainable economic growth

METHODOLOGY

The survey was designed to gather insights from member institutions of the SME Finance Working Group (SMEFWG), which spans diverse jurisdictions.

A total of 33 different member countries[8] responded to the survey, representing a valuable pool of knowledge. The methodology employed in this survey involved the distribution of a well- structured questionnaire containing 10 key questions related to Islamic finance. These included:

- the presence of Islamic finance in member countries and its inclusion in NFIS
- the importance of Islamic finance in complementing the conventional finance ecosystem
- the organization's view on Islamic finance as a tool for enhancing financial inclusion; the possibility of strategy or policy conflicts
- the range of Islamic finance products available and any existing laws or regulations governing Islamic finance
- the supervisory role of central banks or ministries of finance
- any recent regulations or policies impacting the Islamic financial services industry
- the main challenges faced in formulating a strategy for financial inclusion through Islamic finance.

Through these questions, the survey aimed to capture a comprehensive picture of the current state, perspectives, and challenges surrounding Islamic finance within member countries. The survey was deployed using SurveyMonkey,[9] ensuring convenient access and ease of response for the participating institutions. The survey findings were supplemented with secondary research to enhance the insights obtained from the primary research. Throughout the report, the insights from desk research are incorporated to reinforce key findings and conclusions drawn from the survey results. This combined approach offers a well-rounded understanding of the subject matter and strengthens the overall analysis presented in the report.

[8] The member countries which responded to the survey are: Armenia, Bangladesh, Cambodia, Costa Rica, Dominican Republic, Ecuador, Egypt, El Salvador, Eswatini, Fiji, Ghana, Honduras, Kenya, Lesotho, Malaysia, Maldives, Mongolia, Mozambique, Namibia, Nepal, Nigeria, Palestine, Rwanda, São Tomé e Príncipe, Senegal, Seychelles, Solomon Islands, Sudan, Tanzania, Zambia, Zimbabwe

[9] Survey Monkey. Available at: http://www.surveymonkey.com

Rudolf Ernst/iStock

DEMOGRAPHIC ANALYSIS AND NATIONAL FINANCIAL REGULATORS

The survey saw varying responses by regions summarized in Table 1 below.

TABLE 1. PROPOSED BASELINE FINTECH TAXONOMY

REGION	RESPONDENTS (BY COUNTRY)	# OF COUNTRIES	PERCENTAGE RESPONSE
LATIN AMERICA & THE CARIBBEAN	Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Solomon Islands (6)	11	55%
SOUTH ASIA	Bangladesh, Maldives, Nepal (3)	6	50%
SUB-SAHARAN AFRICA	Eswatini, Ghana, Kenya, Lesotho, Mozambique, Namibia, Nigeria, Rwanda, São Tomé e Príncipe, Senegal, Seychelles, Tanzania, Zambia, Zimbabwe (14)	29	48%
EAST & SOUTHEAST ASIA	Cambodia, Malaysia, the Philippines (3)	5	60%
ARAB REGION	Egypt, Sudan, Palestine (3)	8	38%
EASTERN EUROPE AND CENTRAL ASIA	Armenia, Mongolia (2)	6	33%
PACIFIC	Fiji (1)	7	14%

It is worth noting that some countries namely, Eswatini, Malaysia, Nigeria, Seychelles and Zambia provided multiple responses to the survey. This can be attributed to various factors such as participants representing different national institutes like central banks or ministries of finance, or the presence of both primary and alternate members from the same institution. These multiple responses from a single country provide a more comprehensive perspective on the status and approach of Islamic finance and financial inclusion within these specific jurisdictions. It allows for a deeper analysis of the diverse viewpoints and practices within the country, offering valuable insights into the implementation and impact of Islamic finance across different institutions and stakeholders. For national-level analysis, only one response from each country was used.

For general analysis which does not utilize country-level insights, all responses received were used. Variations in responses were further investigated through secondary research, contributing to a more robust understanding of the subject matter in the survey report.

The majority of survey respondents were affiliated with financial regulators in the respective country, either a ministry of finance or a central bank, reflecting the significant role these institutions play in shaping financial policies and regulations within their respective countries. However, it is important to note that a portion of the respondent institutions are not explicitly referred to as a central bank or ministry of finance. While equivalent in their regulatory functions, these institutions use different nomenclature in member countries.

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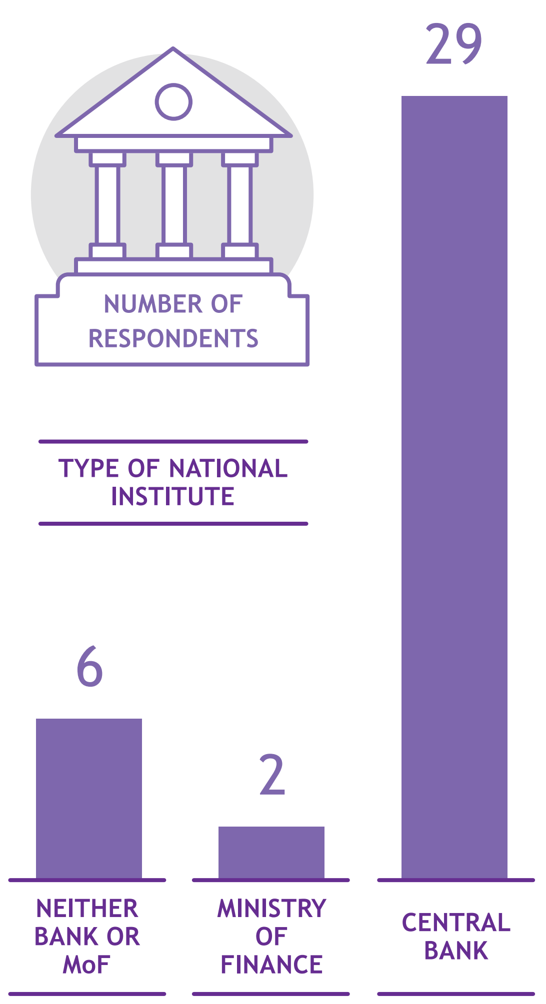
FIGURE 1 THE COMPOSITION OF RESPONDENT INSTITUTIONS IN MEMBER COUNTRIES



For instance, the survey received responses from the Financial Regulatory Commission of Mongolia, which plays a crucial role in overseeing and regulating non-banking financial activities in the country.[10] In Kenya, the respondent was the savings and credit cooperative organization (SACCO) Society Regulatory Authority (SASRA), an institution responsible for regulating and supervising SACCOs.[11] In Honduras, the respondent was the Comisión Nacional de Bancos y Seguros, which serves as the regulatory body for the entire financial system, insurance, pensions, and other institutions that carry out activities of remittances and credit, among others.[12] For these countries, the member institutions may not bear the name of a central bank, but the scope of their regulatory oversight made their insights valuable to the subject matter.

Similarly, other countries such as Ecuador, the Dominican Republic, and Costa Rica had financial institution superintendencies as respondents. These superintendencies hold the responsibility of supervising and regulating various financial sectors within their respective jurisdictions. The participation of these different types of institutions underscores the inclusive nature of the survey, encompassing a broad range of institutions that are integral to shaping policies and practices governing the financial landscape in the different member countries.

[10] Financial Regulatory Commission of Mongolia. 2023. *Ensuring the Stability and Integrity of Mongolia' s Financial Markets.* Ulaanbaatar. Financial Regulatory Commission. Available at: http://www.frc.mn/resource/frc/Document/2023/04/25/8v70eewsu149ggad/Financial%20Regulatory%20Commission%20of%20Mongolia.pdf

[11] Sacco Societies Regulatory Authority (SASRA). 2023. SACCO Societies Regulatory Authority (SASRA) - Securing Sacco Funds. Nairobi. SASRA. Available at: https://www.sasra.go.ke/

[12] Comisión Nacional de Bancos y Seguros. 2022. Comisión Nacional de Bancos Y Seguros. Accessed 20 February 2024. Available at: https://www.cnbs.gob.hn/

SURVEY FINDINGS FIVE SECTIONS

The survey addressed several questions which will be analyzed and contextualized across the following five sections:

1
National Financial Inclusion Strategy and Islamic Finance

2
Importance of Islamic Finance for Financial Inclusion

3
Islamic Finance Products and Regulations in Member States

4
Structures for Supervision and Regulation of Islamic Finance

5
Challenges in including IF in National Financial Inclusion Strategy

1 NATIONAL FINANCIAL INCLUSION STRATEGY AND ISLAMIC FINANCE

The NFIS is one of the hallmarks of AFI's partnership with member countries. For over a decade, a vast majority of AFI's members have been developing and implementing NFIS to promote financial inclusion in their countries[13].

The strategy has had significant impact in advancing financial inclusion for populations segments such as youth, women, forcibly displaced persons (FDPs), and for programs to do with green initiatives etc. As a comprehensive framework designed to promote inclusive financial services, the NFIS serves as a primary reference point for incorporating Islamic finance initiatives.

Members of the AFI SMEFWG indicate diverse approaches regarding the integration of Islamic finance into their respective NFIS. Out of the 31 countries that responded, a significant number of countries (18) have an existing NFIS, but Islamic finance is not currently part of their strategy. This suggests a potential opportunity for these countries to explore the inclusion of Islamic finance as a means to enhance their financial inclusion efforts.

Additionally, four countries have both a NFIS and explicitly include Islamic finance as part of their strategy. These are Malaysia, Nigeria, Philippines, and Palestine. These countries showcase a proactive approach to harnessing the potential of Islamic finance in promoting financial inclusion. Meanwhile, in the Maldives and Sudan, which are both in the process of developing their NFIS, Islamic finance features as an integral component. This reflects a growing recognition of Islamic finance as a valuable tool for achieving financial inclusion objectives.

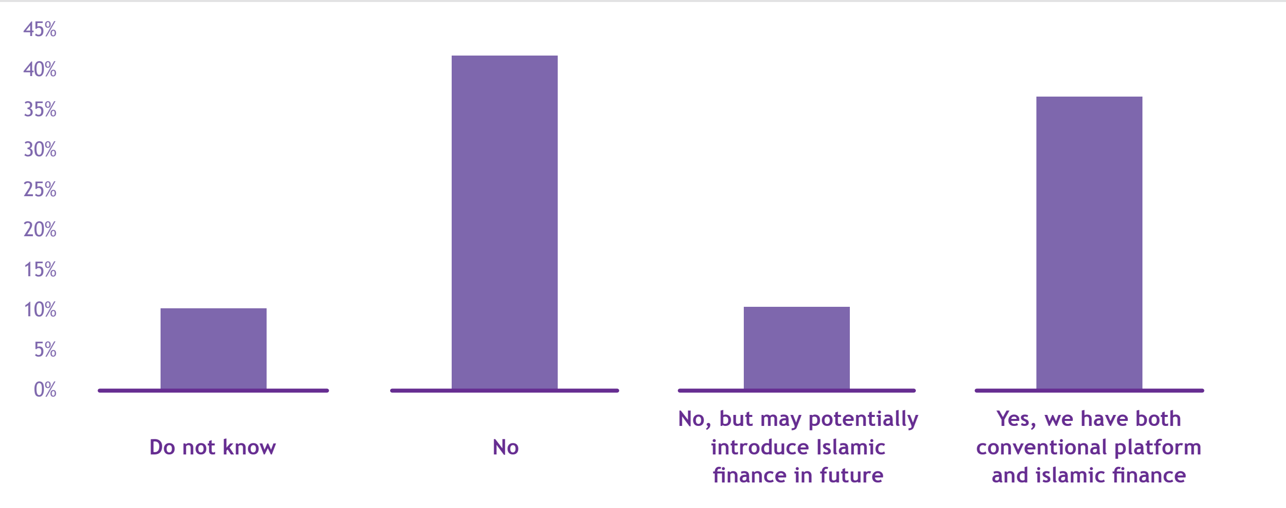
It is worth noting that five countries (Costa Rica, Ecuador, Ghana, Lesotho, Seychelles) indicated the absence of an NFIS, and two countries (Honduras and Namibia) provided alternative responses. Honduras will begin preparations for the development of the NFIS, and Namibia already has another mechanism, the Financial Sector Strategy, which includes the goal of financial inclusion and outlines various strategies to achieve it. These findings highlight the need for further exploration and engagement to understand the specific contexts and considerations that inform the inclusion or exclusion of Islamic finance in countries' NFIS.

FIGURE 2. PRESENCE OF NFIS AND INCLUSION OF ISLAMIC FINANCE AS PART OF THE STRATEGY

[13] Financial Inclusion Strategy (FIS) Peer Learning Group. 2020. *Policy Model for National Financial Inclusion Strategy.* Kuala Lumpur. Alliance for Financial Inclusion. Available at: https://www.afi- global.org/sites/default/files/publications/2020-09/AFI_NFIS_PM_AW2_digital.pdf

This is particularly important because with regard to the presence of Islamic finance in the national financial landscape, there is a notable proportion (35 percent on the graph below) of working group members that has already incorporated Islamic finance alongside conventional platforms. This is despite the lack of policy inclusion of Islamic finance in the NFIS. While a significant portion of respondents indicated the absence of Islamic finance in their national finance systems, 11 percent of the responses indicated the potential future introduction of Islamic finance, thereby highlighting a willingness to explore its integration. These findings underscore the importance of promoting further awareness and understanding of Islamic finance to enable informed decision-making regarding its inclusion or exclusion in national financial systems, including in policy documents like the NFIS.

FIGURE 3. ISLAMIC FINANCE AS PART OF THE NATIONAL FINANCE LANDSCAPE



SUDAN

Sudan is currently in the process of developing its NFIS, and Islamic finance will be an integral part of the strategy. Sudan presents a unique landscape with a fully Islamic banking system that embraces the tenets of Shariah in its financial sector. This aligns well with the preferences of its predominantly Muslim population, as approximately 98% of Sudan's population adheres to the Islamic faith and exhibits a strong inclination towards engaging with Islamic financial institutions.

Notably, Sudan has witnessed the establishment of one bank and one microfinance institution (MFI) built upon the principles of Waqf. These institutions serve as exemplars of sustainable and socially responsible financial entities, promoting the welfare of the community through their operations.

Some of the Islamic finance products available in Sudan include profit- and loss-sharing schemes such as musharaka and mudaraba. In musharaka, the financier provides equity financing to a project while in mudaraba, the financier provides all the funds for an entrepreneurial activity while expecting the client to provide managerial expertise.Salam financing is also available, which essentially provides advance payment against future delivery.

Sources: Central Bank of Sudan. Islamic Banking in Sudan Ebrahim, Shahid. 2011. Islamic Banking in Sudan. SSRN Electronic Journal. Available at: https://www.researchgate.net/publication/228202433_Islamic_Banking_in_Sudan

2

IMPORTANCE OF ISLAMIC FINANCE FOR FINANCIAL INCLUSION

Islamic finance plays a crucial role in addressing the challenge of financial inclusion through two distinct avenues.

Firstly, it promotes risk-sharing contracts, offering a viable alternative to conventional debt-based financing.[14] This approach not only enhances financial inclusion but also contributes to the development of a robust and sustainable economy. Secondly, Islamic finance incorporates specific instruments for wealth redistribution within society,[15] further reinforcing its potential impact on inclusivity and poverty eradication (SDG 1: No Poverty).[16] The synergy between risk-sharing financing and redistributive instruments provides a comprehensive framework to foster financial inclusion, eradicate poverty, and cultivate a thriving economy.

Additionally, during the 2008 global financial crisis, Islamic financial institutions were relatively untouched, protected by their fundamental operating principles of risk-sharing and the avoidance of leverage and speculative financial products.[17]

Interestingly, the sentiment towards Islamic finance's significance in advancing financial inclusion is widely shared among AFI members.

89%

The majority of survey respondents – 89 percent – acknowledged the medium to high importance of Islamic finance in contributing to financial inclusion goals.

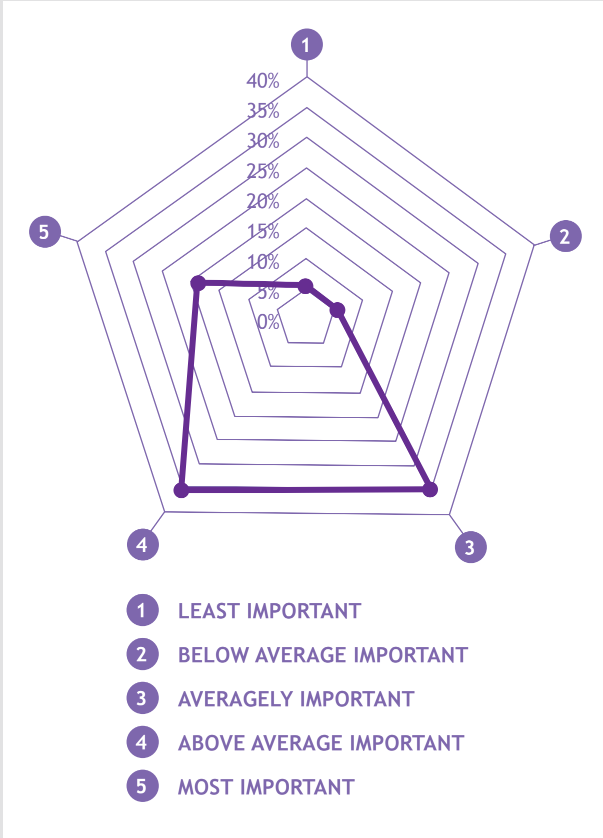
[14] Al Rahahleh, N., M. Ishaq Bhatti. Faridah Najuna Misman. 2019. Developments in Risk Management in Islamic Finance: A Review. Journal of Risk and Financial Management 12, no. 1: 37. Available at: https://doi.org/10.3390/jrfm12010037

[15] Securities Commission of Malaysia and World Bank Group. 2020. Islamic Finance A Catalyst for Financial Inclusion. Kuala Lumpur. Securities Commission of Malaysia. Available at: https://www.sc.com.my/api/documentms/download.ashx?id=824aa54c-ed70-4e56-a43e-ea629c8e5b6b

[16] United Nations Development Programme. N.d. What are the Sustainable Development Goals? Available at: https://www.undp.org/sustainable-development-goals?gad_source=1&gclid=CjwKCAiAuNGuBhAkEiwAGId4asXXcFo7lUY A9zpHOIoVBBfOljViA5bBSM30GobF5L49239 iEOwJnxoCzzgQAvD_BwE

[17] World Bank. 2015. Islamic Finance. Washington D.C. World Bank. Available at: https://www.worldbank.org/en/topic/financialsector/brief/islamic-finance

FIGURE 4. RELATIVE IMPORTANCE OF ISLAMIC FINANCE FOR FINANCIAL INCLUSION



Source: AFI Survey: Islamic Finance and Financial Inclusion

These findings suggest a positive recognition of the role Islamic finance can play in addressing financial inclusion challenges, and highlight the need for further exploration and integration of Islamic finance mechanisms into national strategies and policies for inclusive financial systems.

While some view Islamic finance as a crucial tool for expanding access to formal financial services, aligning with religious and cultural beliefs, and providing alternative financing options, there are also instances where Islamic finance is not currently part of the financial landscape or not widely recognized as a tool for enhancing financial inclusion. Some of these sentiments are expressed in the survey findings.

The varying levels of conviction among member countries regarding the importance of Islamic finance, however, can be attributed to several factors. Firstly, some countries may have well-established conventional financial systems that have been ingrained within their economies for decades, making it challenging to embrace and integrate Islamic finance seamlessly. For example, in Costa Rica "it is not part of the financial landscape and we do not view it as a tool for enhancing financial inclusion".[18]

Secondly, there may be a lack of understanding of the principles and benefits of Islamic finance among policymakers and financial institutions in certain countries. This knowledge gap can hinder the ability to fully appreciate the potential impact of Islamic finance on financial inclusion. "It is relatively a new concept which needs more research and awareness to evaluate its impact on Fiji's financial ecosystem. It is however acknowledged that developing these products can lead to the availability of a wide range of alternatives for financial consumers to choose and use."[19]

Additionally, concerns about the religious connection, complexity and implementation challenges associated with Islamic financial instruments and regulations may also contribute to the skepticism observed in some member countries. Awareness, research, and knowledge sharing are highlighted as important factors in effectively evaluating the potential role of Islamic finance for inclusive financial systems.

[18] Alliance for Financial Inclusion (AFI) Member Interview, 2023.

[19] Alliance for Financial Inclusion (AFI) Member Interview, 2023.

MALAYSIA

Malaysia has emerged as a prominent global player in the field of Islamic finance, recognizing its significance in promoting financial inclusion. Since its inception in the 1980s, Islamic finance has played a pivotal role in Malaysia's financial system, serving as a catalyst to enhance inclusivity from both faith-based and commercial perspectives.

A key component of the Malaysian Islamic Finance ecosystem is the Islamic Financial Services Act 2013 (IFSA), a Malaysian law that was enacted to provide for the regulation and supervision of Islamic financial institutions, payment systems, and other relevant entities, as well as the oversight of the Islamic money market and Islamic foreign exchange market to promote financial stability and compliance with Shariah principles.

One of the key contributions of Islamic finance in Malaysia is its ability to complement commercial financing by introducing new sources of funding and emphasizing value- based financing. Through Islamic Social Finance, which encompasses various instruments such as Zakat (mandatory alms-giving), sadaqah (voluntary charity), and waqf (endowment), Malaysia has been able to mobilize funds for socially responsible initiatives. These initiatives address the needs of marginalized communities, promote economic empowerment, and provide financial support to those who may otherwise be excluded from conventional financial processes.

Malaysia's commitment to financial inclusion through Islamic finance extends beyond faith-based considerations. The adoption of Islamic financial principles has opened up avenues for individuals and businesses to access ethical and inclusive financial services. Islamic finance products such as Islamic banking, takaful (Islamic insurance), and Islamic capital market instruments have provided alternative options for individuals and businesses to participate in the financial system. By adhering to Shariah principles, these products ensure transparency, fairness, and ethical conduct, aligning with the values of a diverse Malaysian society.

Sources: Bank Negara Malaysia. 2013. Financial Services Act 2013 and Islamic Financial Services Act 2013 Come Into Force. 1 July. Kuala Lumpur. Bank Negara Malaysia. Available at: https://www.bnm.gov.my/-/financial-services-act-2013-and- islamic-financial-services-act-2013-come-into-force and World Bank Group. 2021. Malaysia - Islamic Finance and Financial Inclusion. Washington D.C. World Bank Group. Available at: https://www.worldbank.org/en/country/malaysia/publication/malaysia-islamic-finance-and-financial-inclusion

3
ISLAMIC FINANCE PRODUCTS

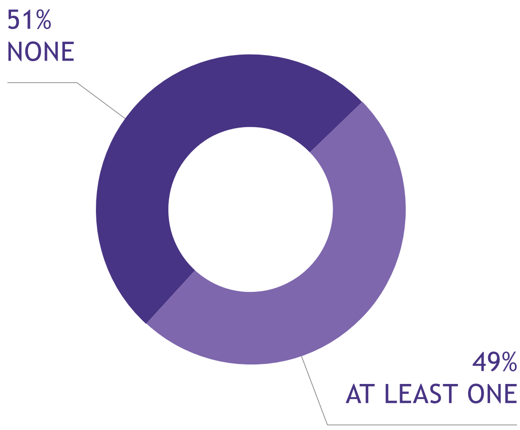
The range of Islamic finance products varies across different markets. In this section, we explore the diverse landscape of Islamic finance products and their prevalence among the member countries surveyed.

There are several key Islamic finance products, including Islamic banking, Islamic capital market instruments (such as sukuk), Islamic microfinance institutions, Islamic insurance (takaful), Islamic hire-purchase (Al-Ijarah Thumma Al-Bai'), Islamic FinTech, and Islamic social finance (such as Zakat, sadaqah, and waqaf).[20] By examining the prevalence and distribution of these products, we gain valuable insights into the development and adoption of Islamic finance within the surveyed jurisdictions.

In the survey, respondents were asked about their organization or country's usage of specific Islamic finance products. The survey aimed to explore the adoption and prevalence of these products in member countries. The identified Islamic finance products encompassed a range of offerings, including Islamic banking, Islamic microfinance, Islamic insurance (takaful), sukuk (Islamic bonds), and Islamic investment funds.

The findings from the survey revealed that 49 percent (Figure 5) of the respondents reported having at least one Islamic finance product in their country, indicating a significant level of adoption. However, it is notable that 51 percent of the respondents indicated that they did not have any of these Islamic finance products in their financial landscape. These results highlight the diversity in the adoption and utilization of Islamic finance products across member countries, suggesting varying levels of awareness, implementation, and integration of Islamic finance within national financial systems.

FIGURE 5. AVAILABILITY OF ISLAMIC FINANCE PRODUCTS IN MEMBER COUNTRIES



The distribution of different Islamic finance products among member countries offers valuable insights into the landscape of Islamic finance adoption.

78%

The survey findings reveal that Islamic banking is the most prevalent Islamic finance product, with 78 percent of the respondents who have Islamic finance products indicating its presence in their organization or country.

This signifies the widespread acceptance and utilization of Islamic banking as a core component of Islamic finance systems. There are different forms of transitioning to an Islamic bank. One way is through the establishment of an Islamic window, which is a separate unit within a conventional bank that offers Shariah-compliant financial products and services. Another way is through the establishment of a full-fledged Islamic subsidiary, which is a separate legal entity that operates as an Islamic bank and is wholly owned by the parent conventional bank.[21] A full-fledged Islamic bank, on the other hand, is a standalone bank that operates entirely on Islamic principles and offers only Shariah-compliant financial products and services. The transition from an Islamic window or subsidiary

[20] Asutay, M. Al-Zu'bi. Z. Hendranastiti, N. D. Özdemir, M. & Mbacke, L. 2021. The Role of Islamic Finance in Supporting Microenterprises and SMEs against COVID-19. Ankara. The Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation (COMCEC) Available at: https://www.comcec.org/wp-content/uploads/2021/11/1-2-The-Role-of-Islamic-Finance-in-Supporting-MSMEs-against-COVID-19.pdf

[21] Salami, Oladipupo Luqman, and Adewale Abideen Adeyemi. 2017. Malaysian Islamic Banks' Efficiency: An Intra-Bank Comparative Analysis of Islamic Windows and Full-Fledged Subsidiaries. International Journal of Business and Society 16 (1). Available at: https://doi.org/10.33736/ijbs.551.2015

to a full-fledged Islamic bank involves obtaining the necessary regulatory approvals and licenses, as well as meeting the requirements for capital, governance, risk management, and Shariah compliance.[22]

50%

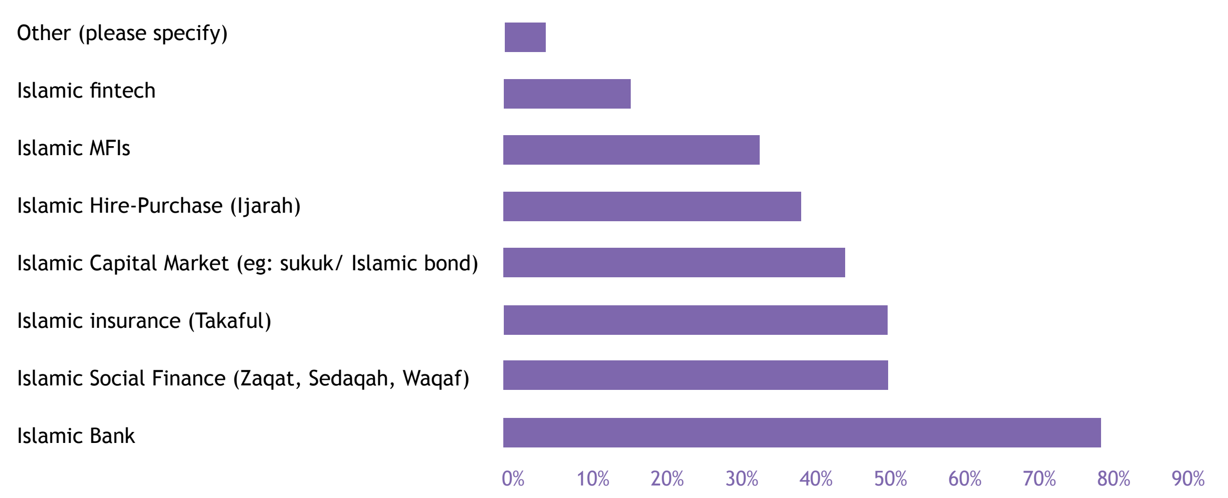
Islamic insurance, also known as takaful, follows closely with 50 percent of the respondents reporting its usage, highlighting the significance of ethical and cooperative insurance practices in Islamic finance.

Other notable Islamic finance products include the Islamic Capital Market, with 44 percent of respondents incorporating instruments such as sukuk (Islamic bonds) and Islamic microfinance institutions, (MFIs), which were reported by 33 percent of the respondents. Islamic hire purchase, known as Al-Ijarah Thumma Al- Bai, was utilized by 39 percent of the respondents, indicating the popularity of Shariah-compliant financing options for asset acquisition. As Islamic Finance promotes asset- backed financing, women have an increased opportunity to own tangible assets which allows them to build wealth and accumulate assets in their own names, increasing their financial independence and security. Islamic FinTech, a relatively newer domain within Islamic finance, garnered a response rate of 17 percent, showcasing the potential for technology-driven solutions within the Islamic finance sector. In Bangladesh for instance, FinTech companies are offering various Shariah-compliant products and services such as payment services, crowdfunding, peer-to-peer (P2P) lending and gold savings plans.

Additionally, Islamic Social Finance, encompassing practices such as sadaqah, Zakat, and waqf, was reported by 50 percent of the respondents. These forms of Islamic Social Finance play a crucial role in providing social safety nets and supporting charitable initiatives, showcasing the broader societal impact of Islamic finance.

[22] Bank Negara Malaysia. CP06 Malaysian Economy -The Islamic Finance. Kuala Lumpur. BNM. Available at: https://www.bnm.gov.my/documents/20124/830659/cp06.pdf

FIGURE 6. DISTRIBUTION OF AVAILABLE ISLAMIC FINANCIAL PRODUCTS IN MEMBER COUNTRIES



PHILIPPINES

Philippines, a non-Muslim majority country, has advanced the adoption of Islamic finance-friendly products in the country. The Bangko Sentral ng Pilipinas (BSP) supports the development of Islamic banking and finance in the country, consistent with the goal of financial inclusion of all Filipinos. According to the Philippines central bank “Islamic banking and finance serves everyone — granting Muslims much-needed access to financial services and providing non-Muslims with alternative banking and finance options.”

By applying the same regulations to conventional and Islamic banks — with supplemental guidelines for the unique features of Islamic banking — the BSP enables a level playing field that allows Islamic banks to thrive and serve all Filipinos. It is worthy to note that the regulations and framework issued by the BSP are complemented by regulations issued by the Bureau of Internal Revenue (BIR) and the Insurance Commission (IC) which provide for: (i) tax neutrality between Islamic and equivalent conventional banking transactions, and (ii) baseline regulations on takaful undertakings, which jumpstart the growth of the Philippine Islamic capital market and takaful, and make the Philippines ready for the entry of Islamic finance players and investors. These issuances were facilitated under the whole-of-government approach of promoting Islamic finance under the Islamic Finance Coordination Forum that also paved for the establishment of a Shari’ah Supervisory Board in the Bangsamoro Autonomous Region in Muslim Mindanao. These were backed by an issuance from the Department of Justice (DOJ) affirming that the Republic of the Philippines can validly execute sukuk under existing laws which is a significant development for the Philippine Islamic capital market as the country is now finalizing preparations for a maiden sovereign sukuk issuance. It also provided for the signing of the implementing rules and regulations of R.A. No. 11840 or An Act Amending RA No. 3591, otherwise known as the Philippine Deposit Insurance Corporation (PDIC) Charter. The PDIC Charter of 30 September 2022 authorizes PDIC to cover deposits in Islamic banks and establish a separate insurance fund and insurance arrangement (given the peculiarities of Islamic banking), and extend financial assistance to Islamic banks.

Additionally, ASA Philippines, an MFI, provides Shariah- compliant microfinance services. ASA Philippines recognizes the potential and importance of Islamic finance principles in addressing the financial needs of various communities. By providing Shariah-compliant microfinance services, ASA Philippines aims to cater to the financial requirements of individuals and businesses who prefer Islamic financial products and services. This initiative promotes financial inclusion and offers an alternative avenue for those seeking ethical and Shariah-compliant financial solutions in the Philippines.

The Philippines has a long and impressive history of integrating Islamic finance into their financial ecosystem.

Sources and further reading:

Bangko Sentral ng Pilipinas (BSP). N.d. Islamic Banking: Promoting an Inclusive and Participative Banking Community for Every Filipino. Manila. BSP. Accessed 20 February 2024. Available at: https://www.bsp.gov.ph/Pages/FinancialStability/Islamic%20Banking/Islamic_Banking.aspx

ASA Philippines. N.d. History of Islamic Financing Program. Pasig City. ASA Philippines. Available at: https://asaphil.org/history-of-islamic-financing-program/

Islamic Banking: Promoting an Inclusive and Participative Banking Community for Every Filipino. https://asaphil.org/reports/history-of-islamic-financing-program.aspx

iTEKAD: EMPOWERING LOW-INCOME ENTREPRENEURS

iTEKAD is an umbrella programme that has been established by Bank Negara Malaysia, with the aim of assisting low-income microentrepreneurs to strengthen their financial management and business acumen towards generating sustainable income. Each iTEKAD programme combines the provision of business assets funded by social finance instruments (e.g. donations, social impact investment, zakat and cash waqf) with microfinance, supplemented with structured financial and business training.

iTEKAD MAIN COMPONENTS

- seed capital
- microfinancing
- structured training

COLLABORATIVE NETWORK

- 11 financial institutions
- More than 40 implementer agencies (government agencies, training centers, NGOs, Islamic State Councils and statutory bodies)

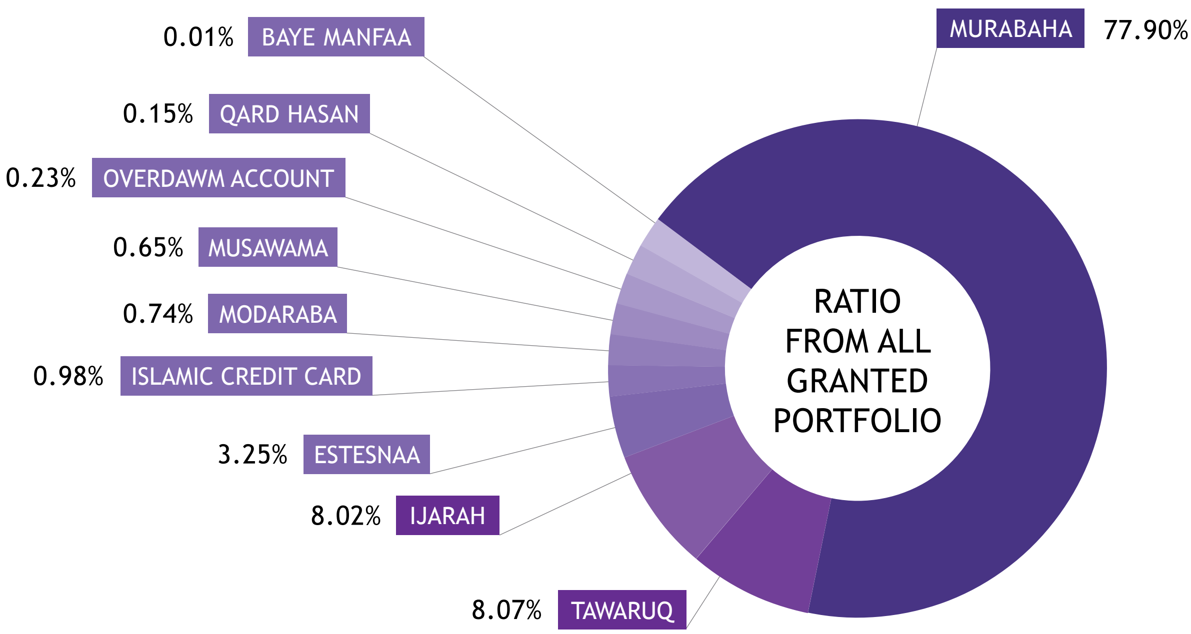
iTEKAD UPDATES

- 3,389 participants
- 14 states
- MYR9.8million social finance fund
- MYR8.5million fund disbursed

Source: Bank Negara Malaysia

PALESTINE

In Palestine, there are three Islamic banks; the Palestinian Islamic Bank, the Arab Islamic Bank, and more recently, the Al-Safa Bank since 2016. These banks grant various Islamic facilities. Below is the ratio of these facilities from all granted Islamic portfolio.



Islamic banks play a significant role in providing financial support to various sectors, including micro, small, and medium-sized enterprises (MSMEs). One notable initiative in this regard is the Istidama Fund, established by the Palestine Monetary Authority (PMA) with the aim of supporting MSMEs, particularly in response to the challenges posed by the COVID-19 pandemic. The Istidama Fund offers soft loans to MSMEs with zero or low- interest rates of three percent, and a repayment period of 36 months. It also emphasizes promoting women's access to financing, recognizing the importance of empowering women entrepreneurs. Islamic banks (in addition to conventional banks) are actively involved in facilitating the disbursement of these loans, thereby contributing to the growth and resilience of the MSME sector in Palestine.

Islamic Banks in Palestine are also confronted by various challenges including:

- the absence of branches of Islamic banks outside Palestine
- the complicated requirements regarding the collaterals and guarantees in the case of Islamic financing
- the unstable political conditions, repeated financial crises, weak economic investment, and the lack of identification papers in real estate

Sources and further reading:

Palestine Islamic Bank. N.d. Estidama Programs. Accessed on 20 February 2024. Available at: https://www.islamicbank.ps/en/business/finance/SustainabilityFund

4 STRUCTURES FOR SUPERVISION AND REGULATION OF ISLAMIC FINANCE

The effective supervision of Islamic finance is crucial for maintaining the integrity and stability of the industry.

With its unique principles and practices rooted in Shariah law, Islamic finance requires specialized oversight mechanisms to ensure compliance and adherence to ethical standards.[23] One of these specialized oversight mechanisms is the Shariah Committee. The Shariah Committee is a group of experts which advises the Board, Management, and subsidiaries of an Islamic bank on Shariah matters.[24] The committee is responsible for ensuring compliance with Shariah principles in the bank's day-to-day business and operations. The committee plays both supervisory and advisory roles, including reviewing transactions, certifying financial products, reviewing contracts and agreements, and providing compliance rulings on new products. The Shariah Advisory Council has the authority to ascertain Islamic law for Islamic banking business and other businesses based on Shariah principles.

Supervision and regulation on the other hand encompasses various aspects, including national regulatory frameworks, monitoring of financial institutions, and enforcement of rules and regulations. It plays a vital role in safeguarding the interests of stakeholders, promoting transparency, and fostering trust in the Islamic financial system. This section explores the structures and approaches employed by member countries in supervising Islamic finance, providing valuable insights into the diverse landscape of regulatory frameworks and oversight models.

Based on the survey responses, it is evident that there is a diverse range of approaches in supervising Islamic finance among the member countries. Among the respondents, 17 countries indicated that their central bank or ministry of finance directly held the responsibility for supervising Islamic finance. Additionally, four countries mentioned that their central bank or finance ministry have the authority to delegate supervision to other institutions, highlighting a collaborative approach to oversight.

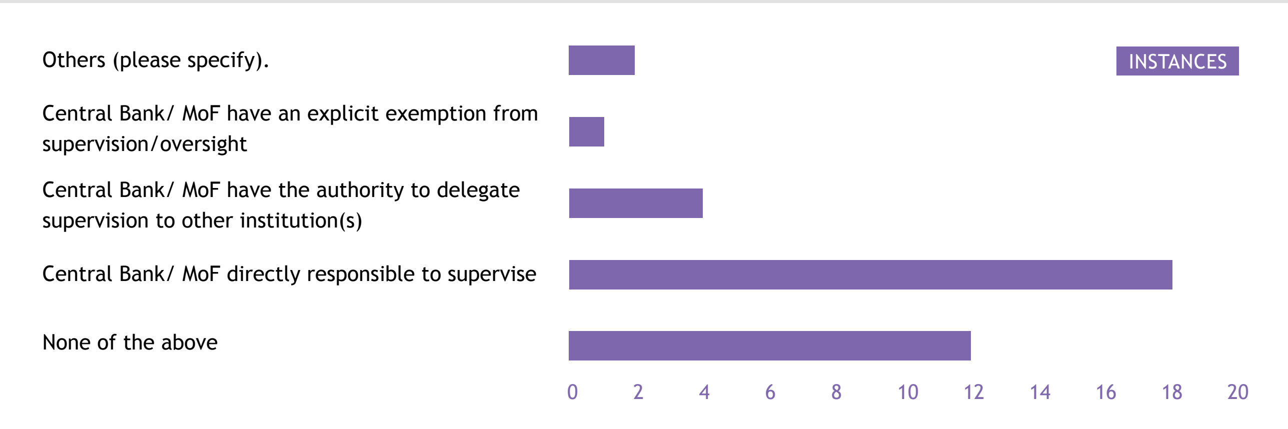
Notably, in the cases of Eswatini and Nigeria, both the central bank and the ministry of finance are directly responsible for supervising Islamic finance, and can delegate supervision to other institutions, indicating a shared responsibility.

In contrast, Zimbabwe reported an explicit exemption from supervision or oversight by their central bank or ministry of finance, while two countries have unique

[23] Hayat, U. Malik, A. 2014. Islamic Finance: Ethics, Concepts, Practice. Charlottesville. CFA Institute Research Foundation. Available at: https://www.cfainstitute.org/-/media/documents/book/rf-lit-review/2014/rflr-v9-n3-1-pdf.ashx

[24] Bank Muamalat. N.d. Duties and Responsibilities of the Shariah Committee. Kuala Lumpur. Bank Muamalat. Available at: https://www.muamalat.com.my/downloads/corporate-overview/Duties-and-Responsibilities-of- the-Shariah-Committee.pdf

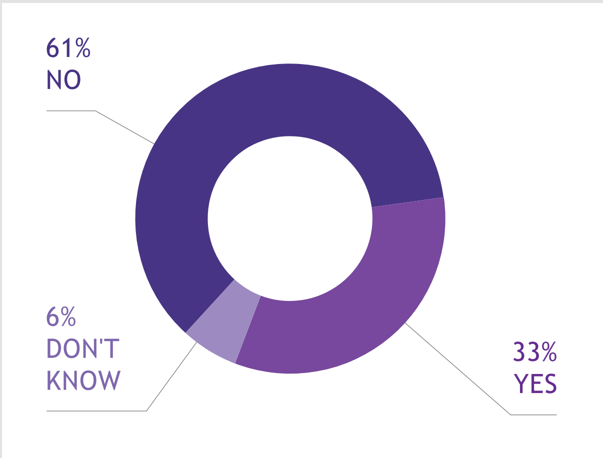
FIGURE 7. HOW INSTITUTIONS PARTICIPATE IN THE SUPERVISION OF ISLAMIC FINANCE



arrangements for supervising Islamic finance. In Honduras, the Comisión Nacional de Bancos y Seguros (CNBS) is the organization that exercises - by constitutional mandate - the supervision, vigilance and control of the supervised institutions (banks, finance companies, pension institutes, insurance companies, etc.) Meanwhile, in Kenya, the SASRA's supervision mandate extends to the SACCOS rolling out Islamic finance products, but not to the entire banking ecosystem.

The varied supervisory approaches highlight the importance of a tailored regulatory framework and institutional arrangements that align with the specific needs and circumstances of each country. Effective supervision is crucial for ensuring the integrity, stability, and compliance of Islamic finance activities, while also promoting transparency and consumer protection within the sector.[25]

FIGURE 8. EXISTENCE OF LAWS, REGULATIONS, AND FRAMEWORKS FOR ISLAMIC FINANCE



Among the respondents, 11 countries (Zambia, Malaysia, Senegal, Nigeria, Ghana, Seychelles, Maldives, Dominican Republic, Bangladesh, Sudan and Philippines) reported having laws, regulations, or frameworks in place for Islamic finance, indicating a supportive legal environment.

The specific measures vary across countries and encompass various aspects of Islamic finance. For instance, some countries have enacted dedicated legislation; Malaysia has the Islamic Financial Services Act 2013, the Bank of Zambia has the (Islamic Finance) Guidelines of 2014 while Senegal has laws and guidelines which allow for the operations of Islamic banks.[26] In Nigeria, Non-Interest Financial Institutions (NIFI) and Non-Interest Guidelines for development finance frameworks govern different segments of Islamic finance, including non-interest banking, sukuk, takaful, and non- interest pension accounts.

In some cases, existing banking regulations have provisions that accommodate Islamic finance activities. For example, the law regulating the banking sector in Ghana includes provisions that allow institutions to practice profit- and loss- sharing and to refrain from interest-based services. Additionally, amendments have been made to sector-specific laws, like microfinance regulations in Senegal, to permit Islamic financial activities.

Seychelles mentioned that it is currently in the process of developing a national strategy which includes guidelines for Islamic finance, indicating a growing interest in integrating Islamic finance principles into their financial systems. In the Maldives, 85-87 percent of the adult population have access to finance in the form of bank accounts. Approximately 10 percent chose to opt out of having a bank account and out of that, only one percent cites religious belief as the reason.[27] Islamic finance offers an alternative framework that aligns with Islamic principles and caters to the needs of individuals who seek financial services in accordance with their religious convictions. The presence of laws, regulations, and frameworks specific to Islamic finance reflects the efforts made by these countries to provide a conducive environment for Islamic financial activities and foster the growth of this sector within their respective jurisdictions.

Among the surveyed countries, only a few reported having recently established new regulations or policies related to financial inclusion that directly or indirectly impacted the Islamic financial services industry in their jurisdictions. Bangladesh, for instance, mentioned that

[25] Islamic Financial Services Board. 2019. Technical Note on Financial Inclusion and Islamic Finance. December. Kuala Lumpur. IFSB; Islamic Financial Services Board. Available at: https://www.ifsb.org/download.php?id=5519&lang=English&pg=/index.php

[26] Republic of Zambia. 2014. Bank of Zambia - Islamic Finance Guidelines. Government Gazette No.6351. Republic of Zambia. Available at: https://www.boz.zm/53_IslamicFinanceGuidelines.pdf

[27] Maldives Monetary Authority. 2022. National Financial Inclusion Survey 2022. Male. Maldives Monetary Authority. Available at: http://www.mma.gov.mv/documents/National%20Financial%20Inclusion%20Survey/2022/NFI-Survey-2022.pdf and World Bank Group. 2018. Financial Inclusion in the Maldives Findex Survey 2018. Washington D.C. Available at: https://documents1.worldbank.org/curated/en/570891571303596376/pdf/Financial-Inclusion-in- the-Maldives-Findex-2018-Survey.pdf

the central bank has introduced a pre-finance facility for Islamic banks and financial institutions. The aim is to facilitate easier credit flow from the central bank. This measure seeks to support the Islamic finance sector by ensuring adequate access to financing.

Although the Dominican Republic does not have a legal framework pertaining to Islamic finance, limitations were set on the commissions and interests charged by credit card products, and clarifications provided regarding acceptable practices regulated by the authorities. Malaysia reported developing the Digital Insurance and Takaful Operator framework, highlighting efforts to promote digital innovation and technology adoption within the Islamic insurance sector.

Nigeria implemented the National Financial Inclusion Strategy (3.0), which emphasized non-interest finance as a focal product for reaching the excluded population. Additionally, guidelines were established on access to Central Bank of Nigeria for development finance interventions, further reinforcing the support for non-interest finance. Sudan introduced a new act to permit conventional banks to operate in the country, indicating a broader financial landscape that encompasses both conventional and Islamic banking systems. While most countries did not indicate any recent regulatory changes impacting Islamic finance, it is important to note that the development of new regulations and policies in the future can have a significant influence on the growth and expansion of Islamic financial services within these jurisdictions.

BANGLADESH

Bangladesh has an NFIS for the period of 2021- 2026, aims at offering affordable, quality, easy access with sustainable manner financial services. This includes the utilization of Islamic window and finance to the financial landscape.

GOVERNANCE AND SUPERVISION
The Shariah Council of Bangladesh for Islamic Financial Services (SCBIFS) is an independent body responsible for ensuring the compliance of Islamic financial products and services with the principles of Shariah law in Bangladesh. The council was established in 2010 under the Bangladesh Bank (Islamic Banking and Takaful) Regulations, 2009.

The SCBIFS is composed of prominent Islamic scholars and experts in the fields of Islamic finance, law, and economics. Its primary objective is to provide guidance and advice to Islamic financial institutions operating in Bangladesh on matters related to Shariah compliance.

The council's functions include:

- reviewing and approving the Shariah compliance of financial products and services offered by Islamic financial institutions in Bangladesh;

  providing guidance and advice to Islamic financial institutions on Shariah matters, including product development and structuring
- conducting research on Islamic finance and its application in the context of Bangladesh
- developing Shariah standards for Islamic financial institutions in Bangladesh
- educating the public on the principles of Shariah-compliant finance.

The SCBIFS plays an important role in ensuring the growth and development of Islamic finance in Bangladesh. Its oversight helps to maintain the integrity of the industry and increase confidence among investors and consumers.

Sources: Alliance for Financial Inclusion (AFI) and Bangladesh Bank (BB). 2018. Bangladesh: Bringing the Light into the Blind Spot. Member Series: Financial Inclusion Journey. Kuala Lumpur. AFI. Available at: https://www.afi-global.org/wp- content/uploads/publications/2018- 08/AFI_MS_Bangladesh_AW_digital.pdf#:~:text=building%20on%20emerging%20opportunities%20and%20the%20shared%20 vision,across%20policymakers%2C%20regulators%2C%20service%20providers%20and%20other%20stakeholders.
Ministry of Finance, Government of the People's Republic of Bangladesh and Bangladesh Bank. 2022. Bangladesh's 2021- 2026 National Financial Inclusion Strategy. Dhaka. Ministry of Finance, Bangladesh. Available at: https://www.afi- global.org/publications/bangladeshs-2021-2026-national-financial-inclusion-strategy/

MOROCCO

The legal framework for the establishment of Islamic Banks labeled participative banks in Morocco is set out in the Law No. 103.12 relating to credit institutions and similar bodies, which was enacted into the official gazette on January 22, 2015, including dedicated chapter on participation banks.

This law presents the activities of participative banks or windows and the legislative framework that defines their scope of application, compliance instances, and other various dispositions.

The Law has been seen as a major step forward in the development of participative finance in Morocco and has helped to establish a clear legal and regulatory framework for the operation of participative banks in the country. It has also helped to promote the diversification of the financial sector in Morocco.

Since its introduction, the participative banking sector in Morocco has grown rapidly, with several banks launching Sharia-compliant products and services. Below are some key points of this landscape:

- As of early 2022, there were five participative banks operating in Morocco, namely, Al Akhdar Bank, Bank Al-Yousr, Bank Atmwel Wa Al-Inma, Bank Assafa, and Umnia Bank and three participation windows namely Dar Al Amane, Arreda and Najma. Since April 2019, Central Bank of Morocco allowed the Central Guarantee Fund through its dedicated window called "Da3ama Tamwil" to provide Participation Guarantee products to participation banks and Windows, which will mitigate counterpart risk and boost funding activities of participative banks.
- In November 2022, there were 187 Sharia-compliant agencies (an increase of 8.1 percent annually).
- In November 2022, there were 182.060 accounts (an increase of 22.2 percent annually).
- The deposits in November 2022 were at MAD8,661,360,000 (USD834.6 million, an increase of 23.8 percent annually), including 2.272.328.000 MAD of Investment deposit.
- Outstanding amount of participative financing stood at November 2022: MAD 23.198.871.000 which include 23.106.791. MAD of Mourabaha financing (an increase of 22.8 percent annually) and 92.080.000 MAD of Salam financing (an increase of 396 percent annually).

Source: Bank Al Bank Al-Maghrib

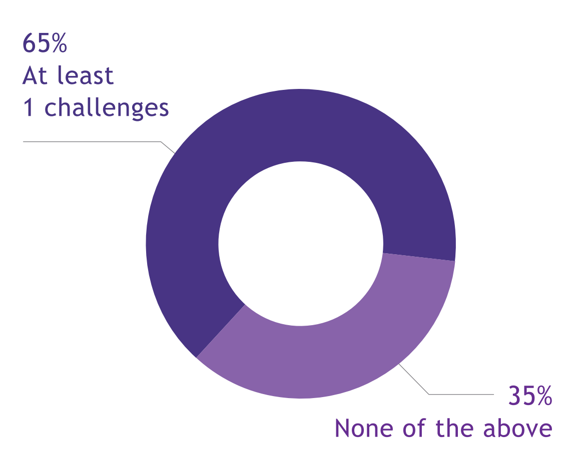
5 CHALLENGES IN INCLUDING ISLAMIC FINANCE IN NATIONAL FINANCIAL INCLUSION STRATEGIES

The data provided offers insights into the main challenges faced by organizations in formulating a strategy for financial inclusion through Islamic finance.

Out of the 36 organizations surveyed, 35 percent or 13 organizations did not identify any of the listed challenges. This indicates that a significant portion of the organizations either have already established strategies or have not encountered notable obstacles in their financial inclusion plans through Islamic finance.

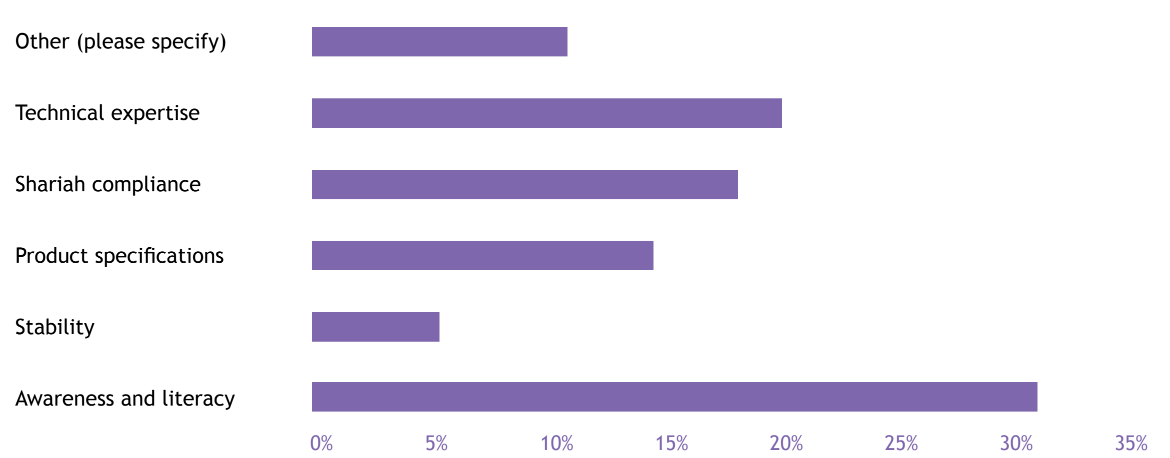
Among the organizations that did face challenges, the highest percentage (31 percent) identified "Awareness and literacy" as a significant hurdle. This suggests that improving awareness about Islamic finance principles and enhancing financial literacy among the target population are crucial for promoting its adoption and fostering financial inclusion.

FIGURE 9. CHALLENGES IN FORMULATING A NATIONAL FINANCIAL INCLUSION STRATEGY THAT INCLUDES ISLAMIC FINANCE AND STRATEGY



Other challenges mentioned include stability (five percent), product specifications (15 percent), Shariah compliance (18 percent), and technical expertise (20 percent). These challenges reflect the complexity involved in implementing Islamic finance, including the need for stable financial systems, tailored product offerings that meet the requirements of the market, adherence to Shariah principles, and specialized knowledge and skills in Islamic finance.

FIGURE 10. TYPES OF CHALLENGES IN FORMULATING A FINANCIAL INCLUSION STRATEGY THAT INCLUDES ISLAMIC FINANCE AND STRATEGY



In addition to the challenges mentioned in the survey, respondents highlighted several other obstacles in formulating a strategy for financial inclusion through Islamic finance. These include the lack of awareness and knowledge about Islamic financing in certain countries, the need for feasibility assessments and buy-in from government and other stakeholders, the recognition that financial inclusion is applicable to both conventional and Islamic financial institutions, temporary halts in establishing Islamic banking policies and infrastructure, the relevance of challenges to specific organizations, the high cost of Islamic financial services and the lack of information. These factors contribute to the complexity and varied nature of challenges faced in promoting financial inclusion through Islamic finance.

Overall, the data underscores the significance of addressing challenges related to awareness, literacy, stability, product specifications, Shariah compliance, and technical expertise to effectively formulate strategies for financial inclusion through Islamic finance. It highlights the diverse range of hurdles organizations may encounter and the need for targeted approaches to overcome these challenges and drive financial inclusion.

DOMINICAN REPUBLIC

In the context of the Dominican Republic, the possibility of implementing Islamic finance for financial inclusion needs to be carefully evaluated considering the primary mission and objectives of the country's institutions. While the country has an NFIS involving various public and private sector institutions, the strategy currently does not include the implementation of Islamic finance. This decision is driven by the need to address risk factors, establish necessary actions, and encourage inclusion in the financial system in the short and medium term.

The Dominican Republic's current plan for enhancing financial inclusion focuses on several key areas. These include raising user awareness, implementing technology solutions, expanding financial services to underserved regions, and providing incentives for sectors such as small and medium-sized enterprises (SMEs). Given the specific context of the country, the implementation of Islamic finance at this stage may present challenges that could hinder progress in addressing other factors with a more significant impact locally.

One of the concerns highlighted is the potential impact on profitability and risk. Implementing Islamic finance without adequately mitigating risks and addressing existing challenges could potentially limit profits and introduce higher risks to the financial system. Therefore, the decision to prioritize other factors and strategies that enhance financial inclusion aligns with the objectives of stability and gradual progress in expanding access to financial services for all segments of the population.

While the Dominican Republic acknowledges the potential benefits of Islamic finance, it is currently focusing on a comprehensive approach to financial inclusion that encompasses various measures. By addressing factors such as user awareness, technological advancements, and incentivizing sectors like SMEs, the country aims to establish a strong foundation for financial inclusion. As the financial landscape evolves and risk factors are mitigated, the Dominican Republic will revisit the possibility of integrating Islamic finance into the broader strategy for financial inclusion, ensuring a balanced approach that aligns with the country's primary mission and objectives.

Source: Superintendencia de Bancos de República Dominicana

POLICY OPTIONS TO BE CONSIDERED TO ADVANCE ISLAMIC FINANCE AND FINANCIAL INCLUSION

Based on the findings and insights gathered through the survey report on Islamic finance, below are the policy options that AFI member institutions may consider to advance Islamic finance in their jurisdictions according to their priorities

1 ENHANCE ISLAMIC FINANCE AWARENESS

Promote awareness and understanding of Islamic finance and its economic value to enable informed decision-making regarding its inclusion in national financial systems, including in policy documents like the NFIS. Launch targeted financial literacy programs that focus on Islamic Finance principles, products, and services. Islamic Finance prioritizes financial literacy and education, which helps women increase their understanding of financial concepts. These programs should be designed to educate individuals, especially those in underserved and marginalized communities, about the benefits, opportunities and value-add offered by Islamic Finance.

2 STRENGTHEN REGULATORY FRAMEWORKS

- Engage with AFI member states to understand the specific contexts and considerations that inform the inclusion of Islamic finance in NFIS.
- Develop comprehensive and clear policy models and regulatory frameworks that specifically address Islamic Finance, taking into consideration the unique characteristics and principles of Islamic financial products and services. This will provide a solid foundation for the understanding, growth and regulation of Islamic Finance and ensure consumer protection.
- In dual banking systems where a jurisdiction has both significant Islamic banking and conventional banking sectors, a dual assessment should be performed for the Islamic banking and conventional banking sectors be able to assess the relevant linkages and their implications for financial stability based on Core Principles for Islamic Finance Regulation (CPIFR) and Basel Committee on Banking Supervision (BCP) assessment methodology.
- Central banks should make provisions so that the liquidity facilities for Islamic banks are Shariah-compliant. These institutions can then that consider aligning this specialty to the role of lender of last resort or emergency lending arrangements.[28]

[28] Song, In W. and Carel Oosthuizen. 2014. Islamic Banking Regulation and Supervision: Survey Results and Challenges. IMF Working Papers 2014, 220 (2014) A001. Accessed 20 February 2024. Available at: https://doi.org/10.5089/9781498380928.001.A001

3 FACILITATE COLLABORATION AND KNOWLEDGE-SHARING

- Provide avenues and opportunities for member states to engage and learn from each other and to engage experts in the field to address the lack of technical expertise cited in the report.
- Establish platforms and networks that facilitate collaboration and knowledge-sharing among stakeholders in the Islamic Finance industry, such as financial institutions, regulators, academics, and industry experts. This will encourage the exchange of best practices, innovation, and research in Islamic Finance.

4 SUPPORT THE DEVELOPMENT OF INNOVATIVE ISLAMIC FINANCIAL PRODUCTS AND SERVICES

- Support the development of Islamic microfinance institutions (MFIs) that provide microcredit, savings, and insurance services based on Islamic principles. These institutions can play a crucial role in promoting financial inclusion and addressing the financing needs of marginalized individuals and communities.
- Promote the growth and success of Islamic FinTech services and products by creating a conducive environment be created by the implementation of supportive policies and regulations. This can include measures such as providing regulatory clarity and guidance, establishing a level playing field for Islamic FinTech companies, and promoting innovation and competition in the market[29].
- Regulators in countries with advanced Islamic finance services can add additional products to current offerings and increase consumer awareness. For countries which do not have Islamic finance services, they can start with a unit in conventional banks that is dedicated to Islamic finance offerings. From there, they can track the uptake and performance of these services before building them into free-standing services.

[29] Fintech News Malaysia. 2023. Funding Societies Rolls Out Islamic Financing Products For Malaysian MSMEs. 30 May. Fintech News Malaysia. Available at: https://fintechnews.my/36057/islamic-fintech/funding-societies- rolls-out-islamic-financing-products-for-malaysian-msmes/

5 FOSTER COLLABORATION BETWEEN ISLAMIC AND CONVENTIONAL FINANCIAL SECTORS

- Encourage collaboration and cooperation between Islamic and conventional financial institutions to leverage their respective strengths and expertise. This can involve joint ventures, partnerships, and knowledge-sharing initiatives that promote the integration of Islamic Finance within the broader financial ecosystem for operation as dual platforms.

- Promote the development of Islamic windows or dedicated divisions within conventional financial institutions, enabling them to offer Islamic financial products and services alongside their conventional offerings. This will provide customers with a wider range of options and contribute to the growth and accessibility of Islamic finance.

6 ENRICH RISK MANAGEMENT AND SUPERVISION

- Strengthen risk management practices and supervision frameworks for Islamic financial institutions to ensure their stability and resilience. This includes implementing robust risk assessment methodologies, enhancing corporate governance frameworks, and conducting regular audits and inspections[30].

- Provide capacity building and training programs for regulators and supervisors to enhance their understanding of Islamic Finance and enable them to effectively oversee and regulate Islamic financial institutions[31]. This will ensure a level playing field and maintain trust and confidence in the Islamic Finance industry. Models like the Financial Regulators Training Initiative can be implemented[32].

- In addition, there should be capacity building and the development of certification programs for the staff of banks and non-bank financial institutions (NBFIs) to enhance their understanding of Islamic finance principles, mechanisms, and products.

- Provide capacity building programs to market and industry players to encourage them to participate in the development and expansion of the Islamic banking and finance industry.

7 SUPPORT RESEARCH AND DEVELOPMENT

- Allocate resources for research and development initiatives that focus on exploring new avenues and opportunities in Islamic finance, such as Islamic FinTech, green and sustainable finance, and Islamic social finance. This will foster innovation and create a conducive environment for the growth and evolution of Islamic finance.

- Encourage collaboration between academia and industry in conducting research on Islamic Finance, promoting interdisciplinary studies, and translating research findings into practical applications and policy recommendations.

[30] Mohd Ariffin, Noraini. 2022. Shariah Risk Management Practices in Malaysian Islamic Banks. International Journal of Economics, Management and Accounting 30 (1):101-23. https://journals.iium.edu.my/enmjournal/index.php/enmj/article/view/924.

[31] Toronto Centre. 2020. The Covid-19 Pandemic: Supervisory Implications and Priorities for Islamic Banking. 30 May. Toronto Centre. Available at: https://www.torontocentre.org/index.php?option=com_content&view=article&id=103&Itemid=99#_ftnref1

[32] Asian Development Bank (ADB). 2017. Capacity Building Support for Asia-Pacifc Economic Cooperation Financial Regulators Training Initiative. Sovereign Project 51336-001. Metro Manila. Asian Development Bank. Available at: https://www.adb.org/projects/51336-001/main

LIMITATIONS

While the survey report on Islamic Finance provides valuable insights and information, it is important to acknowledge the limitations of the study. These limitations include:

- **SAMPLE SIZE AND REPRESENTATIVNESS**
  The survey was conducted among a specific group of respondents within the AFI member countries. The sample size might not be fully representative of the entire population involved in Islamic Finance. The findings and conclusions drawn from the survey should be interpreted within the context of this limited sample.

- **SELF-REPORTED DATA**
  The survey relied on self-reported data provided by the respondents. There is a possibility of response bias, as respondents may have provided answers that aligned with a specific perception. This could impact the accuracy and reliability of the findings.

- **SCOPE AND DEPTH**
  The survey report provides a comprehensive overview of Islamic Finance, but it may not cover every aspect or subsector within the field. Certain areas or specific topics may have received less attention or may not have been included in the survey, leading to potential gaps in the analysis.

- **RESPONSE RATE**
  The survey's response rate, although high, varied across different regions and groups. This could introduce potential biases and impact the generalizability of the findings.

It is important to consider these limitations when interpreting the results of this survey report and to exercise caution in generalizing the findings beyond the scope of the study. Further research and analysis are recommended to validate and expand upon any specific findings of critical importance presented in this report.

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ANNEX I: LIST OF COUNTRIES AND MEMBER INSTITUTIONS PARTICIPATED IN THE SURVEY

NO.	COUNTRY	INSTITUTION
1.	ARMENIA	Central Bank of Armenia
2.	BANGLADESH	Bangladesh Bank
3.	CAMBODIA	National bank of Cambodia
4.	COSTA RICA	SUGEF
5.	DOMINICAN REPUBLIC	Superintendencia de Bancos de República Dominicana
6.	ECUADOR	SEPS
7.	EGYPT	Central Bank of Egypt
8.	EL SALVADOR	Central Reserve Bank of El Salvador
9.	ESWATINI	Ministry of Finance Eswatini
10.	ESWATINI	Central Bank of Eswatini
11.	FIJI	Reserve Bank of Fiji
12.	GHANA	Bank of Ghana
13.	HONDURAS	Comisión Nacional de Bancos y Seguros
14.	KENYA	SASRA
15.	LESOTHO	Central Bank of Lesotho
16.	MALAYSIA	Bank Negara Malaysia
17.	MALDIVES	Maldives Monetary Authority
18.	MONGOLIA	Financial Regulatory Commission of Mongolia
19.	MOZAMBIQUE	Banco de Moçambique
20.	NAMIBIA	Bank of Namibia
21.	NEPAL	Nepal Rastra Bank
22.	NIGERIA	Central Bank of Nigeria
23.	PALESTINE	Palestine Monetary Authority
24.	RWANDA	National bank of Rwanda
25.	SÃO TOMÉ E PRÍNCIPE	Banco Central de SãoTomé e Príncipe
26.	SENEGAL	Banque Centrale des États de l'Afrique de l'Ouest (BCEAO)
27.	SEYCHELLES	Central Bank of Seychelles
28.	SOLOMON ISLANDS	Central Bank of Solomon Islands
29.	SUDAN	Central bank of Sudan
30.	TANZANIA	Executive Director, Digital Financial Services Group, State Bank of Pakistan
31.	ZAMBIA	Ministry of Finance and National Planning
32.	ZAMBIA	Bank of Zambia
33.	ZIMBABWE	Reserve Bank of Zimbabwe

ANNEX II: SAMPLE OF SURVEY QUESTIONNAIRE : ISLAMIC FINANCE AND FINANCIAL INCLUSION

FINANCIAL INCLUSION AND ISLAMIC FINANCE
Survey Questionnaire

A. National Financial Inclusion Strategy and Islamic Finance

Q1. Does your country have a national financial inclusion strategy (NFIS)? Is Islamic finance part of the strategy?

☐ Yes, we have a NFIS and Islamic Finance is part of the strategy
☐ Yes, we have a NFIS but Islamic finance is NOT part of the strategy
☐ We are currently developing our NFIS and Islamic Finance is part of the strategy
☐ We are currently developing the NFIS but Islamic Finance is NOT part of the strategy
☐ No, we do not have a NFIS
☐ Other (please specify):

Q2. Is Islamic finance a part of the financial landscape in your country?

☐ Yes, we have both conventional platform and islamic finance
☐ No
☐ No, but may potentially introduce Islamic finance in future
☐ Do not know

B. Member perception of Islamic Finance

Q3. In your opinion, how important is Islamic finance in complementing the conventional finance ecosystem for financial inclusion? Please rate on a scale of 1 to 5, with 5 meaning 'most important' and 1 meaning 'least important'.

1 = least important	2	3	4	5 = most important

Q4. How does your organization/country view 'Islamic Finance' as a tool for enhancing financial inclusion? Please explain briefly. (eg: Islamic Social Finance (zaqf, sedaqah, waqf) opens more options for inclusion and financing?)

Q5. Do you think there is a possibility of strategy/policy conflict between implementing Islamic finance for financial inclusion and the objectives of your organization's primary mission / vision / objectives? (e.g. enhancing financial inclusion through Islamic finance may be prone to higher risk thus affecting stability)?

☐ *Do not know*
☐ No
☐ Yes. Please indicate areas, and policy measures to mitigate the impact.

C. Islamic Finance Products and Services

Q6. What are the Islamic finance products available in your jurisdiction?
☐ Islamic Bank
☐ Islamic Capital Market (eg: sukuk/ Islamic bond)
☐ Islamic MFIs
☐ Islamic insurance (Takaful)
☐ Islamic Hire-Purchase (Ijarah)
☐ Islamic fintech
☐ Islamic Social Finance (Zaqat, Sedaqah, Waqaf)
☐ Other (please specify):
☐ *None of the above*

D. Regulation and Supervision

Q7. Are there any laws / regulations / framework on any of the Islamic Finance in your country?
☐ Yes
☐ No
☐ Do not know

Please describe (eg: Islamic finance leverage on the conventional framework).

Q8. How would your organization participate in supervising the Islamic Finance? [Please tick the appropriate box]
☐ Central Bank/ MoF directly responsible to supervise
☐ Central Bank/ MoF have the authority to delegate supervision to other institution(s)
☐ Central Bank/ MoF have an explicit exemption from supervision/oversight (e.g. only registers and regulates)
☐ Others (please specify):
☐ *None of the above*

Q9. Has your organization recently established any new regulation or policy related to financial inclusion that has directly or indirectly impacted Islamic Financial Services Industry in your jurisdiction?
☐ *Do not know*
☐ No
☐ Yes. Please describe.

Q10. What are the main challenges faced by your organization in formulating a strategy for financial inclusion through Islamic finance? You may pick more than one answer.
☐ Awareness and literacy

☐ Stability
☐ Product specifications
☐ Shariah compliance
☐ Technical expertise
☐ Other (please specify):
☐ *None of the above*

COMMONLY USED TERMS

AFI (Alliance for Financial Inclusion)	An international organization that promotes financial inclusion policies and initiatives among its member countries.
FinTech	Financial technology, and also organizations that provide financial technology products and services.
ISLAMIC FINANCE	A financial system that operates in accordance with Islamic principles, which prohibit the charging or paying of interest (riba) and promote risk-sharing and ethical investment.
KNOWLEDGE DATABASE	A repository or collection of organized information and resources on a particular subject. The survey report on Islamic Finance will form part of a knowledge database on this topic, which will be accessible to AFI and its member countries for future reference.
KNOWLEDGE PRODUCT	A tangible output or resource that disseminates information, insights, or findings on a specific subject. The survey report on Islamic Finance serves as a knowledge product that contributes to the understanding of Islamic Finance within the AFI network.
MSME (Micro, Small and Medium-Sized Enterprises)	Businesses that have a limited number of employees and/or assets. They play a crucial role in economic development and employment generation.
P2P	Peer-to-Peer platform
REPRESENTATIVENESS	The degree to which the sample accurately reflects the characteristics and diversity of the population under study. A representative sample ensures that the findings can be generalized to the larger population.
RESPONDENTS	The individuals or organizations who participated in the survey and provided responses to the questionnaire.
RESPONSE BIAS	The tendency of respondents to answer questions in a certain way that may not reflect their true beliefs or behaviors. Response bias can introduce inaccuracies or distortions in the data collected.
SAMPLE SIZE	The number of respondents included in the survey. It represents a subset of the entire AFI SMEFWG membership and is used to draw conclusions about the larger group.
SELF-REPORTED DATA	Information provided by respondents about their own experiences, opinions, or behaviors. In the context of the survey, self-reported data refers to the responses provided by member institutions regarding their practices and perceptions related to Islamic Finance.
SURVEY	A research method used to collect data and gather information from a specific group of individuals or organizations. The survey conducted for this report involved structured questionnaires to gather insights on Islamic Finance practices in different AFI member states and institutions.
WORKING GROUPS	An AFI operational structure under which representatives of member institutions collaborate on a specific topic to achieve a common goal. In this context, the SME Finance Working Group (SMEFWG) focuses on issues related to SME financing and the Islamic Finance and Financial Inclusion sub- group focuses on issues within the framework of Islamic Finance.

ABBREVIATIONS

AFI	Alliance for Financial Inclusion
CNBS	Comisión Nacional de Bancos y Seguros (Honduras)
FI	Financial Inclusion
FinTech	Financial technology or an organization providing financial technology
IB	Islamic Bank
IF	Islamic Finance
MFIs	Microfinance Institutions
MoF	Ministry of Finance
MSMEs	Micro, Small and Medium Enterprises
NBFIs	Non-Bank Financial Institutions
NIFI	Non-Interest Financial Institutions
NFIS	National Financial Inclusion Strategy or Strategies
P2P	Peer-to-Peer
PMA	Palestine Monetary Authority
SACCO	Savings and Credit Cooperative Organization
SASRA	SACCO Society Regulatory Authority
SCBIFS	Shariah Council of Bangladesh for Islamic Financial Services
SME	Small and Medium Enterprises
SMEFWG	Small Medium Enterprises Finance Working Group
TAKAFUL	Islamic Insurance

Alliance for Financial Inclusion
AFI, Sasana Kijang, 2, Jalan Dato' Onn, 50480 Kuala Lumpur, Malaysia
t +60 3 2776 9000 **e** info@afi-global.org **www.afi-global.org**
Alliance for Financial Inclusion AFI.History @NewsAFI @afinetwork