

المؤتمر العالمي العشرون لعلماء الشريعة في المالية الإسلامية

ISSF 2025

20TH INTERNATIONAL SHARIAH SCHOLARS FORUM
IN ISLAMIC FINANCE

HYATT REGENCY TASHKENT, UZBEKISTAN

16-18 SEPTEMBER 2025 | 22-24 RABI' AL-AWWAL 1447H

المدخل إلى المصرفية الإسلامية: التقدم نحو نظام مالي مستدام

**THE INTRODUCTION OF ISLAMIC BANKING:
ADVANCING TOWARDS A SUSTAINABLE FINANCIAL SYSTEM**

MASTERCLASS

Principles and Contracts of Islamic Financial Transactions

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**ISLAMIC BANKING MODELS (FULL-FLEDGED,
SUBSIDIARY, AND WINDOW):
SHARIAH AND REGULATORY IMPLICATIONS**

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Table of Content



Foundations & Objectives

Exploring the core principles of Shariah compliance and the rationale behind diverse Islamic banking models.



The Three Models

Analysing the structures, operations, and market positioning of Full-Fledged, Subsidiary, and Window Islamic banking models.



Shariah Governance Frameworks

Critically evaluating the efficacy and challenges of Shariah compliance frameworks across various models, highlighting their practical implications.



Regulatory Frameworks

Examining the necessary supervisory adjustments and regulatory innovations required to ensure stability and integrity within the evolving Islamic finance landscape.



Conclusion & The Path Forward

Summarising key takeaways, offering actionable recommendations, and outlining future directions for sustainable Islamic finance.



Conceptual Foundation: Why Different Models

The Strategic Imperative for Multiple Models

The adoption of different models is not arbitrary but a strategic response to market realities and developmental phases.



Objective: Islamic Finance

Facilitating ethical and Sharia-compliant financial services as alternatives in response to market demands.



Market Entry Strategy

A pragmatic, phased approach allows the institutions and the market to develop knowledge and demand.



Regulatory Accommodation

Allows regulators to build capacity and frameworks within existing systems, minimising initial systemic shock.

"...Allah intends for you ease and does not intend for you hardship..." (Surah Al-Baqarah, 2:185).



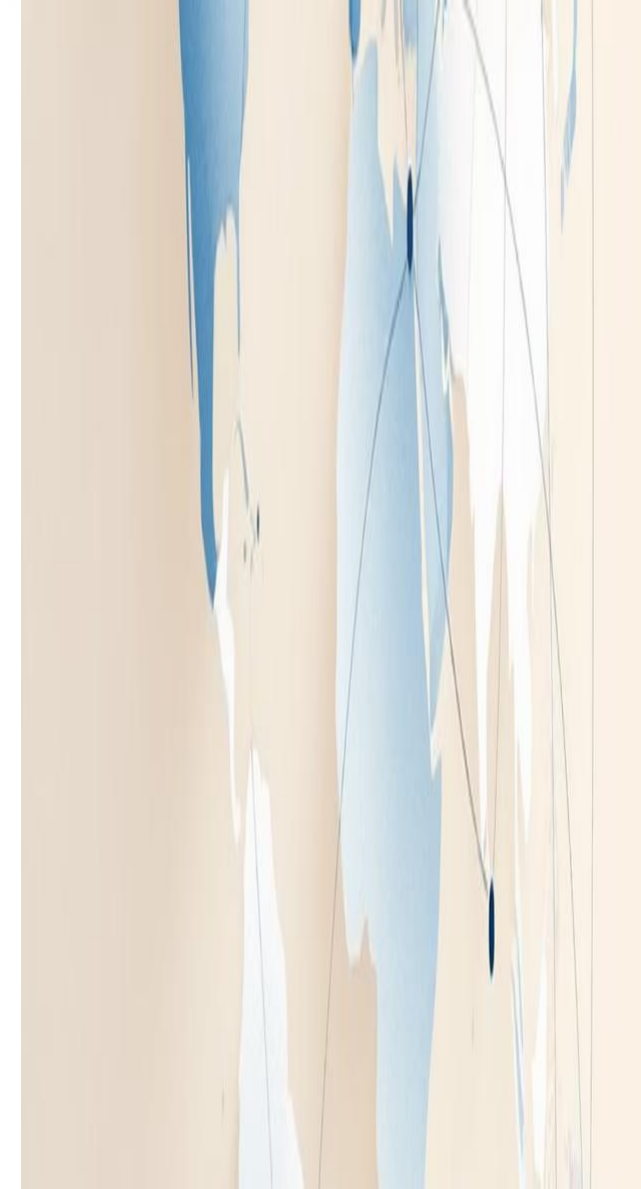
Economic Viability

Tests market depth and profitability before committing significant capital for a full-fledged bank.



Strategic Objective

Deciding between servicing a niche segment or driving a system-wide transformation of the financial landscape.



Core Principle: The Primacy of Shariah Compliance

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The Non-Negotiable Foundation

The raison d'être of Islamic finance is its unwavering commitment to compliance to Shariah principles, which form an entire ecosystem, not just a set of product rules.



Prohibition of Riba

The unequivocal prohibition of interest. All transactions must be asset-backed or service-based.

"...But Allah has permitted trade and has forbidden interest..." (Surah Al-Baqarah, 2:275).



Avoidance of Gharar

Prohibition of excessive uncertainty, ambiguity, and speculative risk in contracts.



Prohibition of Maysir

Prohibition of gambling and games of chance, ensuring wealth generation is through legitimate trade and effort.



Linkage to Real Assets

Finance must be connected to real economic activity, promoting tangible asset creation and risk-sharing.

The Ultimate Goal: Maqasid al-Shariah

The entire architecture aims to preserve faith, life, intellect, progeny, and wealth, thereby achieving justice and social welfare.



The First Model: Full-Fledged Islamic Bank

A standalone financial institution, operating exclusively on Islamic principles with its own license, capital, and segregated balance sheet.

- **Structural Purity**

No commingling with conventional finance.

- **Brand Identity**

Clearly and unambiguously Islamic.

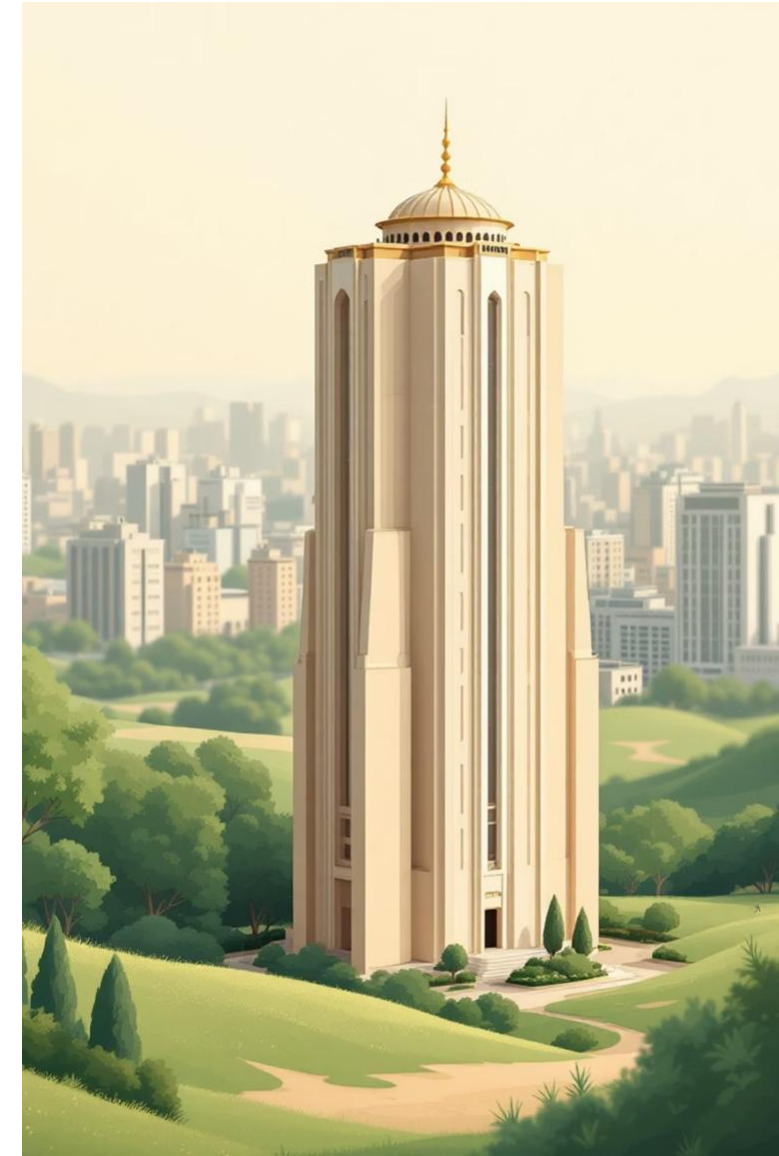
- **Holistic Ecosystem**

All operations, from IT to HR, are built on Shariah compliance from the ground up.

"Leave that which makes you doubt for that which does not make you doubt."

(Jami` at-Tirmidhi)

This model offers the least doubt regarding its operations, setting the benchmark for the industry's purest form.



Full-Fledged Model: The Shariah Governance Structure

The standalone nature of this model allows for the most robust and integrated Shariah governance framework, ensuring uncompromised adherence to Islamic principles.

1

Independent Shariah Supervisory Board (SSB)

A dedicated, independent board of Shariah scholars responsible for the supervision, approval, and certification of all products and activities.

"The Shariah Supervisory Board must be appointed by the shareholders... and must be independent."

AAOIFI Governance Standard No. 1 and IFSB-10 Guiding Principles on Shariah Governance

2

Comprehensive Shariah Compliance Manual

A foundational document dictating all operations, from contract design to ethical investment policies, ensuring institutional-wide adherence.

Internal Shariah Compliance Unit and Secretariat of the SSB.

IFSB-10 (Guiding Principles on Shariah Governance Systems)

3

Dedicated Internal Shariah Review (ISR) & Audit Unit

A separate internal department that continuously audits operations to ensure ongoing compliance with SSB rulings and guidelines.

Defines the role and independence of the Internal Shariah Review.

AAOIFI Governance Standard No. 3

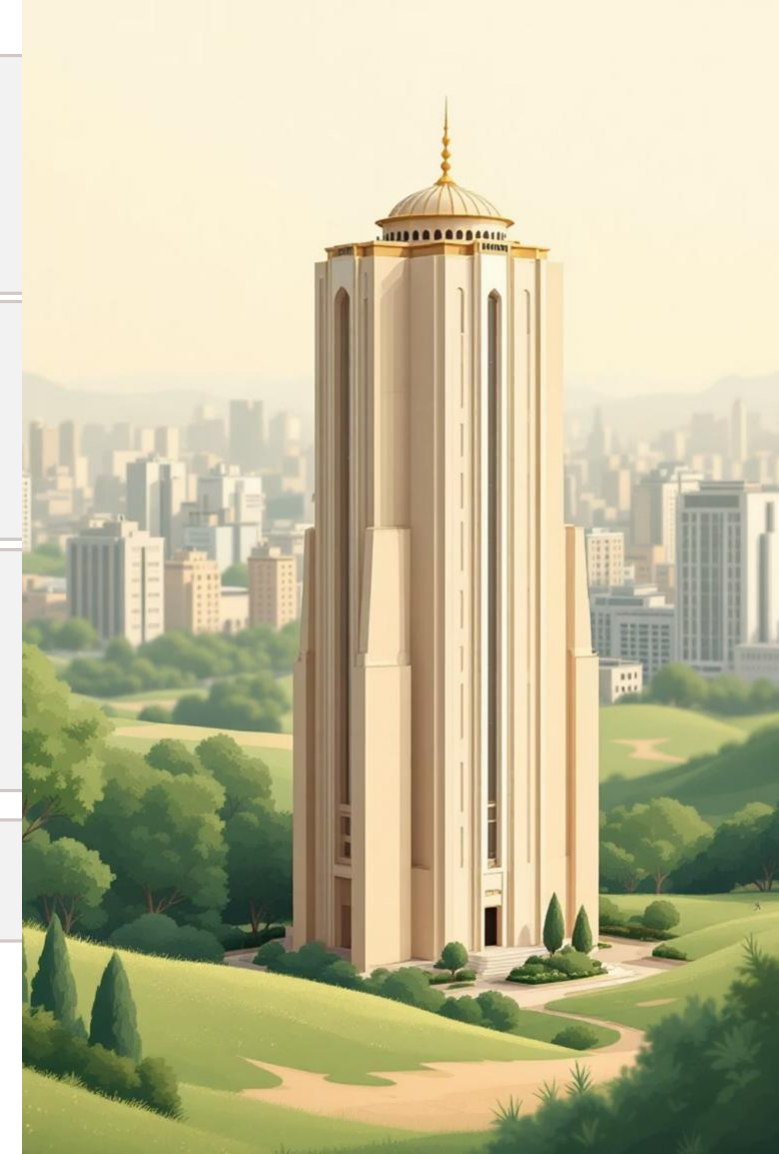
4

Direct Accountability

Management is directly accountable to the SSB and the Board of Directors for Shariah compliance, embedding it as a strategic priority.

"O you who have believed, fulfill [all] contracts..." (Surah Al-Ma'idah, 5:1)

This model is optimally structured to fulfill the sacred contract of trust (Amanah) with all its stakeholders, reflecting the highest level of adherence, and is the most prevalent in the Global IFSI



Full-Fledged Model: Regulatory Considerations



Establishing a full-fledged Islamic bank within a conventional regulatory system requires specific adaptations to ensure a level playing field and financial stability.

Dedicated Legal Framework

Requires either a dedicated Islamic Banking Act (Malaysia) or a comprehensive chapter in the existing banking law (Nigeria –BOFIA 2020) to address unique contractual nature and specificities of Islamic finance principles and practice - addressed by IFSB-17 Core Principles for Islamic Finance Regulation (Banking Segment)

Capital Adequacy (Basel vs. IFSB)

Risk-weighting for Profit-Sharing Investment Accounts (PSIAs) follow IFSB standards (e.g., IFSB-15) to correctly reflect the risk profiles of assets.

"Provides specific guidelines for calculating capital adequacy ratios for IIFS." IFSB-27 (Revised Capital Adequacy Standard for Banking)

Liquidity Management

The critical need for Shariah-compliant liquidity instruments (e.g., Sukuk) and a developed Islamic interbank market to manage short-term funding needs and invest surplus funds –

"Outlines principles for managing liquidity risk in institutions offering Islamic financial services." IFSB-12 (Guiding Principles on Liquidity Risk Management)

Transparent Profit Distribution

Regulations must mandate clear and transparent mechanisms for calculating and distributing profits to depositors to avoid misconduct, ensure good market practice and build trust.



The Hybrid Approach: Islamic Banking Subsidiary



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This model represents a strategic compromise, allowing conventional financial institutions to enter the Islamic finance market through a dedicated, albeit connected, entity.

Definition of Islamic Subsidiary

A separately incorporated legal entity, owned by a conventional parent holding company, with its own capital and banking licence, operating under Islamic principles.

Strategic Balance

Leverages the brand, capital, and infrastructure of the parent bank while maintaining a crucial degree of operational and Shariah-compliance independence.

Structural Separation

Operates with a segregated balance sheet, a key differentiator from the Islamic Window model, providing greater transparency and autonomy.

This approach aims to achieve market penetration and Shariah compliance without requiring a complete overhaul of the parent company's operations.

Subsidiary Model: Shariah Governance Complexities



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This model introduces unique complexities that must be actively managed to preserve Shariah integrity, given its connection to a conventional parent.

Risk of Reputational Contagion

Perception challenges arise: can an entity owned by a conventional bank be truly pure? Negative actions by the parent can directly impact the subsidiary's brand and public trust.

Principle of Hilah (Legal Stratagem): Scholars caution against structures that may technically comply but violate the spirit of the law. The ownership link requires constant vigilance.

Operational Diligence : Firewalls

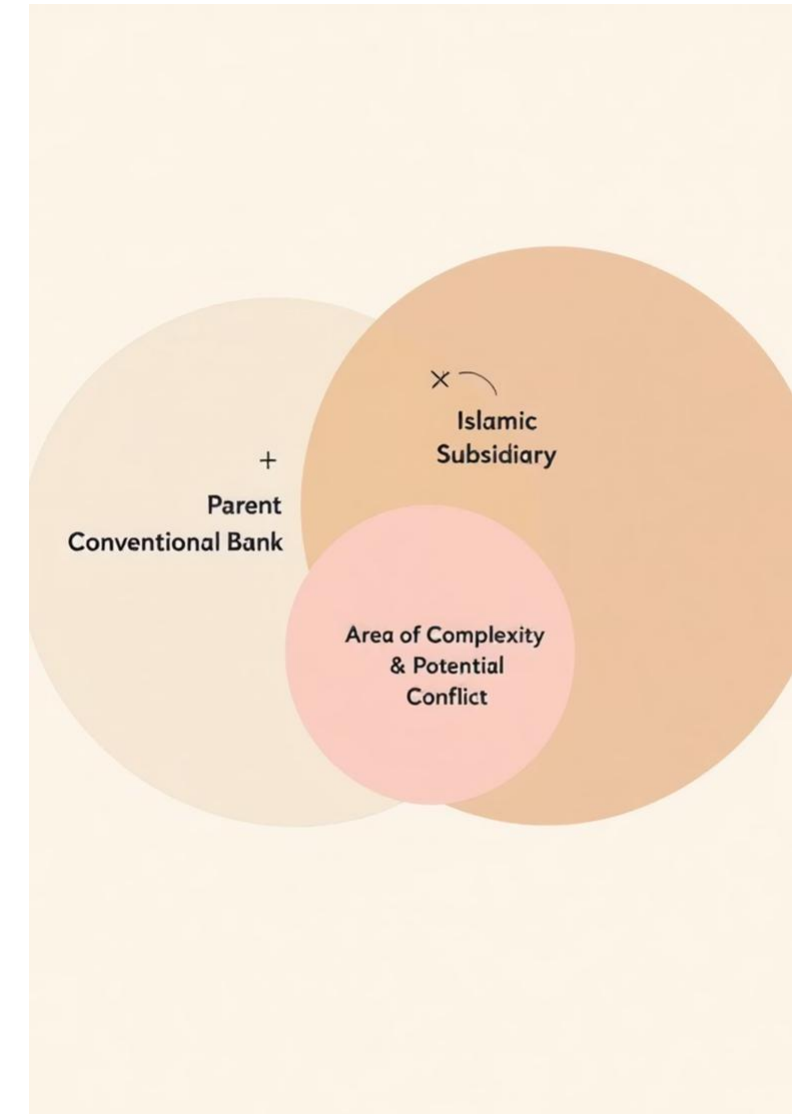
Strict separation of funds, IT systems, and marketing is crucial to prevent commingling. Shared services (e.g., HR, IT) require stringent Shariah controls to avoid ambiguity (shubuhah).

"Leave that which makes you doubt for that which does not make you doubt." Al Tirmidhi.



Independence of the Subsidiary's SSB

Critical Issue: Who appoints and compensates the subsidiary's Shariah Supervisory Board (SSB)? If it's the parent's board, it can create a conflict of interest, challenging the SSB's independence – addressed by relevant AAOIFI and IFSB Shariah Governance Standards



Subsidiary Model: Regulatory Perimeter

Regulating the Subsidiary: Ring-Fencing and Supervision

Regulators must define clear boundaries to protect the subsidiary and the broader financial system from potential risks associated with its conventional parent.

Ring-Fencing Regulations

Explicit rules are needed to legally and operationally isolate the subsidiary's assets and liabilities from those of the parent company. This is crucial for depositor protection and maintaining the subsidiary's Shariah integrity.

Consolidated vs. Solo Supervision

Regulators must be proficient in both approaches:

- **Solo Supervision:** Assesses the subsidiary's financial strength in isolation.
- **Consolidated Supervision:** Evaluates the entire banking group's financial health, including the parent.

"Core Principle 11: Requires supervisors to understand the structure of financial groups and apply solo and consolidated supervision."

IFSB-17 (Core Principles for Islamic Finance Regulation Banking Segment)

Exposure Limits & Arm's Length Transactions

Strict limits must be imposed on transactions (e.g., lending, exposures) between the Islamic subsidiary and its conventional parent. All such transactions must be conducted at market rates to prevent cross-subsidization or potential exploitation.

"Related party transactions must be conducted at arm's length and be subject to robust oversight."

Typical Central Bank Regulations



The Option of Islamic Window Operation



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This model serves as a practical entry point for conventional financial institutions wishing to tap into the Islamic finance market without establishing a separate legal entity.

Definition of Islamic Window

A dedicated division or unit within an existing conventional bank that offers Shariah-compliant financial products and services alongside its traditional offerings.

Low-Barrier Entry

This is often the most accessible and cost-effective entry model, leveraging the parent bank's existing infrastructure, capital, and operational licences.

Branding & Perception

Operates under the established brand of the conventional parent, which can provide credibility but may also raise questions about Shariah purity amongst discerning customers.

Operational Reality

Due to shared resources and systems, this model presents the highest risk of commingling (ikhtilat) of funds and operations, demanding stringent internal controls and oversight.

Many contemporary scholars permit the Window model as a necessary means (wasila) to introduce Islamic finance in a new market, provided stringent conditions are met to avoid clear prohibitions. This is based on the Islamic legal maxim: **"A matter is judged by its objectives and intentions"** and the permissibility of entering into Mudarabah and Musharakah contracts between Muslims and non-Muslims provided the management is done in line with Shariah principles.

Window Model: The Shariah Compliance Quagmire

Islamic Windows: Navigating a Compliance Labyrinth

This model presents the most significant practical challenges to achieving pure Shariah compliance, demanding rigorous oversight and an unwavering commitment to Islamic principles.



Highest Risk of Commingling

The greatest challenge is ensuring the absolute separation of funds—from the pool of deposits to the allocation of assets. Co-mingling of funds renders the entire operation non-compliant.

"And do not consume one another's wealth unjustly or send it [in bribery] to the rulers in order that [they might aid] you [to] consume a portion of the wealth of the people in sin, while you know [it is unlawful]." Surah Al-Baqarah, 2:188

This Quranic principle highlights how commingling unjustly jeopardizes wealth and violates the spirit of fairness in transactions.

Operational Firewalls

The necessity for theoretical and practical firewalls between conventional and Islamic operations is absolute. However, this is often difficult to enforce in practice across shared IT, treasury, and staff functions, leading to potential breaches.

SSB Authority & Oversight

The bank's Shariah Supervisory Board (SSB) is crucial for overseeing the Window's activities. However, its authority can be challenged by a management structure primarily focused on conventional profitability, requiring meticulous implementation of its fatwas.

IFSB-10 highlights that in a Window operation, the Shariah governance system must have "clear lines of responsibility and accountability" and mechanisms to prevent commingling.

Window Model II: Product Offering Window

A Window Without Ring-Fencing of Assets

Asset-Side Window mentioned by IFSB standards 10, 16, 17 etc. Mentioned in the CBN Guidelines as one of the institutions recognized as NIFIs

Central Banks Offering Islamic Banking Products

In many jurisdictions with Islamic Banking practice, the Regulatory and Supervisory Authorities (RSAs) offer Shari'ah compliant liquidity management instruments and lender of last resort facilities (SLOLR).

These Central Banks are in reality windows offering Islamic finance products.

Development Finance Institutions

These institutions include:

- Export and Import Banks
- Banks of Industry
- Banks of Agriculture
- Development Banks
- Secondary Mortgage Banks

These are also product offering windows when they offer Islamic banking products.

Common Features of Product Offering Windows

- Not deposit taking institutions as such no need for fund segregation
- Require Shari'ah Governance framework to offer Shari'ah compliant products, thus existence of Shari'ah Advisory Councils in the apex banks and Shari'ah Boards in the development finance institutions.



Window Model: The Regulatory Tightrope

Regulating Windows

Regulators often employ a phased approach for Islamic Window operations, commencing with guiding principles that incrementally evolve into more robust and stringent regulatory frameworks.



Governance by Directive

In some jurisdictions, Windows are often governed by a central bank circular or directive, rather than comprehensive legislation. This outlines the minimum operational requirements and lays the groundwork for future regulatory enhancement. While in others the same guidelines are issued for full-fledged as well as Windows



Fund Segregation & Profit Calculation

Regulations must explicitly mandate:

- Separate books of accounts dedicated solely to the Islamic Window.
- Distinct pools for Islamic assets and liabilities.
- Transparent, pre-disclosed profit-sharing ratios for investment accounts.

"IFSB-23 (Guiding Principles on Liquidity Risk Management for IIFS offering Islamic Financial Services via Windows): A dedicated standard addressing the unique risks of Windows."



Consumer Protection & Transparency

Mandatory disclosure requirements are crucial to ensure clients are fully aware they are dealing with an Islamic Window, not a full-fledged Islamic bank. All marketing materials must be clear, unambiguous, and not misleading.



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Comparative Analysis: Structural & Operational View

A strategic overview of the distinct characteristics defining each Islamic banking model.

Feature	Full-Fledged Bank	Subsidiary	Window
Legal Entity	Separate	Separate	Not Separate
Capital	Dedicated	Dedicated	Shared
Brand	Pure Islamic	Islamic (Parent Link)	Conventional/Islamic
Ease of Setup	Complex & Slow	Moderate	Fast & Simple
Cost	High	Moderate	Low
Market Signal	Full Commitment	Strategic Investment	Market Testing

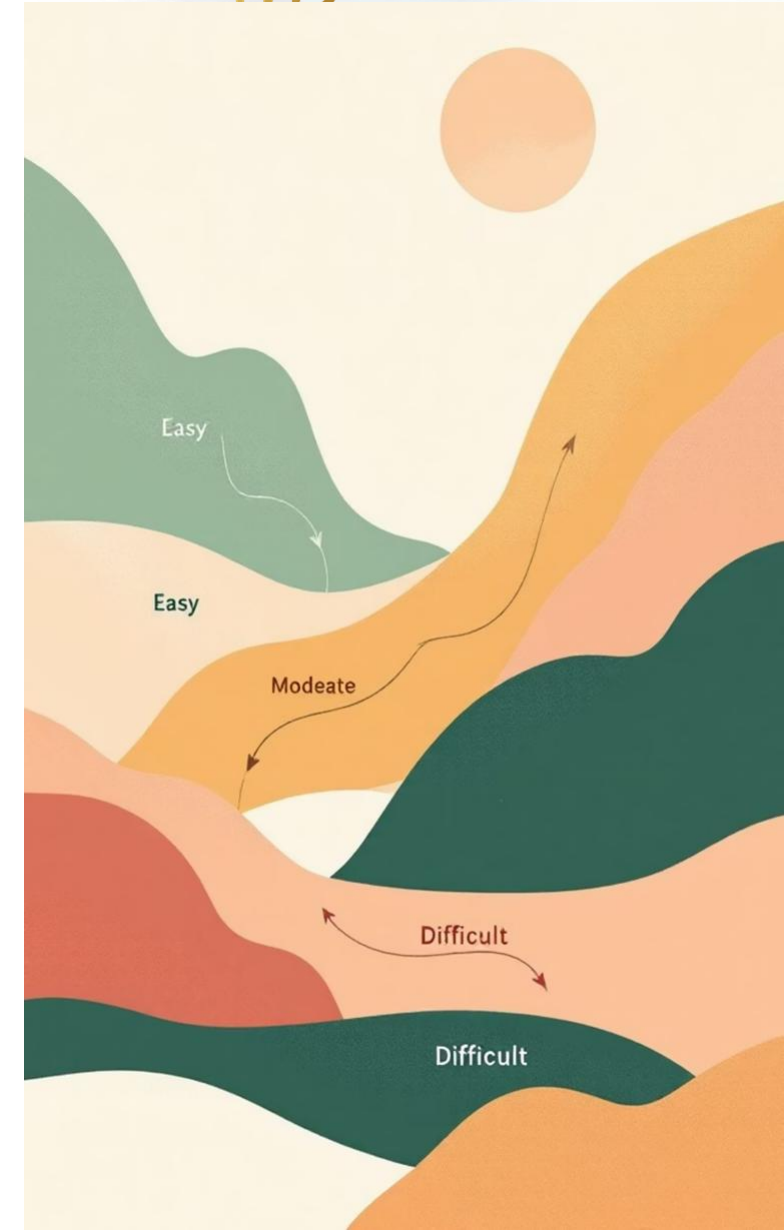
Each model presents a distinct approach to market entry and operational structure, influencing capital allocation,

brand perception, and the signal sent to the Islamic finance market.

Comparative Analysis: Shariah & Regulatory

View

Comparative Shariah & Regulatory Efficacy



A side-by-side evaluation of each model's adherence to Shariah principles and the clarity of its regulatory framework.

Aspect	Full-Fledged Bank	Subsidiary	Window
Shariah Governance	Most Robust	Potentially Robust	Most Challenging
Risk of Commingling	None	Low (if managed)	Very High
Regulatory Clarity	High (Dedicated Law)	Moderate (Ring-fencing)	Low (Guidelines)
Consumer Trust	Highest	Moderate to High	Varies (Lowest)
Alignment with IFSB/AAOIFI	Full	High (if independent)	Moderate

From Entry to Maturity: The Industry Lifecycle

The three models can be viewed as stages in the natural evolution of an Islamic finance ecosystem.



Stage 1: Market Introduction (The Window)

- **Goal:** Test demand, build basic regulatory experience, and develop consumer awareness.
- **Risk:** Stagnation at this stage due to complacency.



Stage 2: Market Development (The Subsidiary)

- **Goal:** Signal serious commitment, build dedicated expertise, and improve Shariah governance.
- **Trigger:** Growing market share, regulatory comfort, and competitive pressure.



Stage 3: Market Maturity (The Full-Fledged)

- **Goal:** Achieve operational and Shariah purity, drive authentic innovation, and become a systemically important institution.
- **Trigger:** Critical mass of assets, sophisticated demand, and a supportive dual regulatory system.

Regulators should incentivise this evolution through policy, recognising that Windows are a means to an end, and at the same time may not be transient option, but viable ones for achieving the critical mass for the industry.

The Bedrock of Success: Building Human Capital

The sustainability of any Islamic banking model hinges on the availability of skilled professionals adept at navigating the complex intersection of finance, Shariah, and regulation.



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The Talent Gap:

A critical shortage exists of experts proficient in both conventional finance and the intricate principles of Islamic jurisprudence (Fiqh al-Mu'amalat).

Model-Specific Challenges:

Full-Fledged:

Requires a complete, dedicated team across all functions, from Shariah audit to product structuring, to ensure authentic compliance.

Subsidiary:

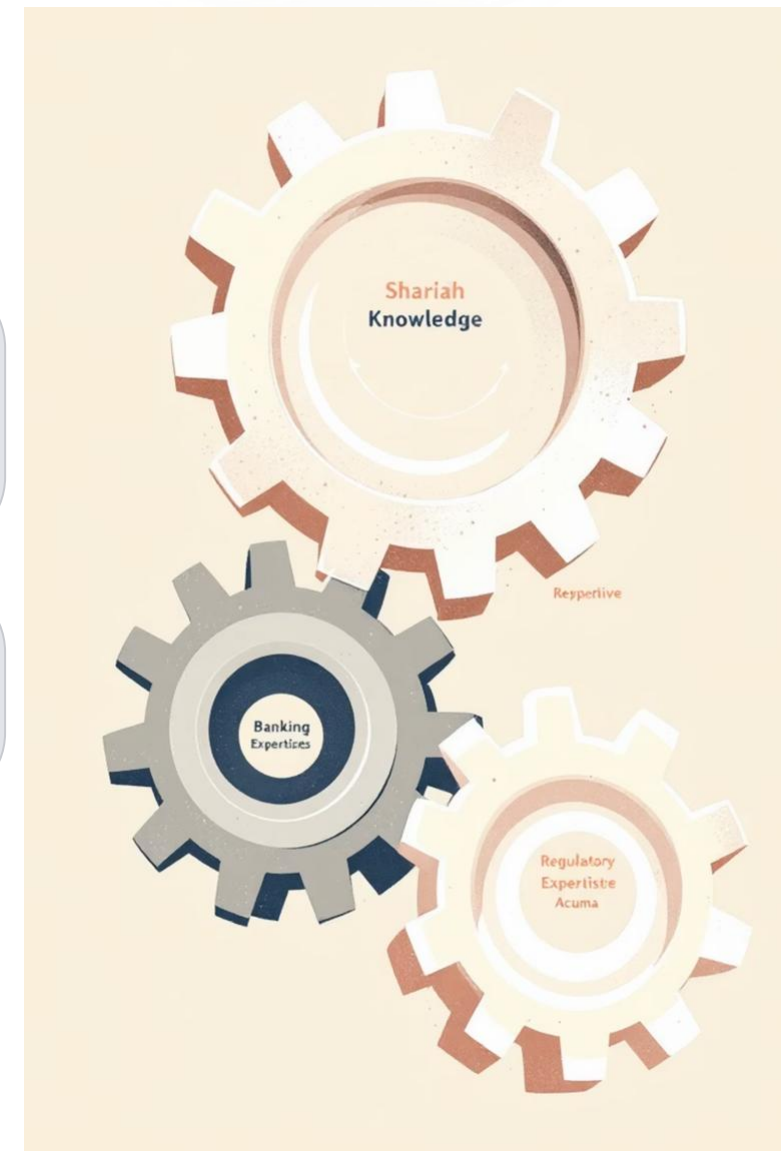
Faces a risk of talent "contamination" or poaching from the conventional parent, necessitating clear career paths and incentivised retention.

Window:

Staff often perform dual roles, leading to split priorities and a potentially superficial understanding of Islamic finance principles and operations.

IFSB-10, Principle 4.3: IIFS must "ensure that there is an adequate number of competent personnel... in the areas of Shariah, banking, and law."

This necessitates ongoing, significant investment in specialized training and education programs to ensure the operational and Shariah integrity across all models.



Strategic Imperative: A Phased and



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Principles-Based Regulatory Approach

Regulators must be proactive architects, not passive spectators. A clear roadmap is essential for guiding the development of the Islamic finance ecosystem.



Phase 1: Introduction (Enabling Windows)

Issue comprehensive Islamic Windows Guidelines, focusing on fund segregation, profit calculation, and disclosure. This phase adapts IFSB-23 (Revised Capital Adequacy Standard) into local regulation, providing initial clarity.



Phase 2: Development (Encouraging Subsidiaries)

Introduce robust Ring-fencing Regulations for subsidiaries, clarifying exposure limits and governance requirements. A basic programme should also be developed to address the liquidity management needs of these



Phase 3: Maturity (Empowering Full-Fledged)

Enact a dedicated Islamic Banking Law or equivalent charter to provide complete legal certainty. Formalise a Dual Supervision framework with specialised units within the central bank, mirroring IFSB-17 (Core Principles) for a

Fortifying the Foundation: Enhancing Shariah Governance Across Models

Robust Shariah governance is the non-negotiable cornerstone of credibility for every Islamic banking model.

Mandate SSB Independence

Regulations should explicitly mandate the independence of Shariah Supervisory Boards (SSBs), including criteria for their appointment, removal, and remuneration to avoid conflicts of interest.

AAOIFI Governance Standard No. 1: Serves as the gold standard for SSB independence, which regulators should codify.

Standardise Shariah Audit Practices

Move beyond compliance checking to a risk-based internal Shariah audit function, ensuring comprehensive oversight of Islamic financial operations.

Reference: AAOIFI Governance Standard No. 3:

Provides detailed guidance on the scope and practice of internal Shariah review, which should be a regulatory requirement.

Promote Transparency and Disclosure

Mandate the full public disclosure of SSB reports, fatwas on key products, and details of profit calculation mechanisms. This builds market confidence and discipline.

Quranic Principle: "O you who have believed, avoid much [negative] assumption. Indeed, some assumption is sin. And do not spy or backbite each other..." (Surah Al-Hujurat, 49:12). Transparency prevents negative assumptions and backbiting about the integrity of operations.

Independence

Competence

Confidentiality

Consistency

Transparency

IFSB-10 outlines the above principles of robust Shari'ah Governance for IIFS

Conclusion: Balancing Pragmatism and Principle

Synthesis: Navigating the Tension Between Growth and Purity

The journey of Islamic banking is a continuous effort to balance market realities with unwavering principles.

No One-Size-Fits-All

The choice of model is a strategic decision based on market maturity, regulatory capacity, and long-term vision.

Content Determines Value

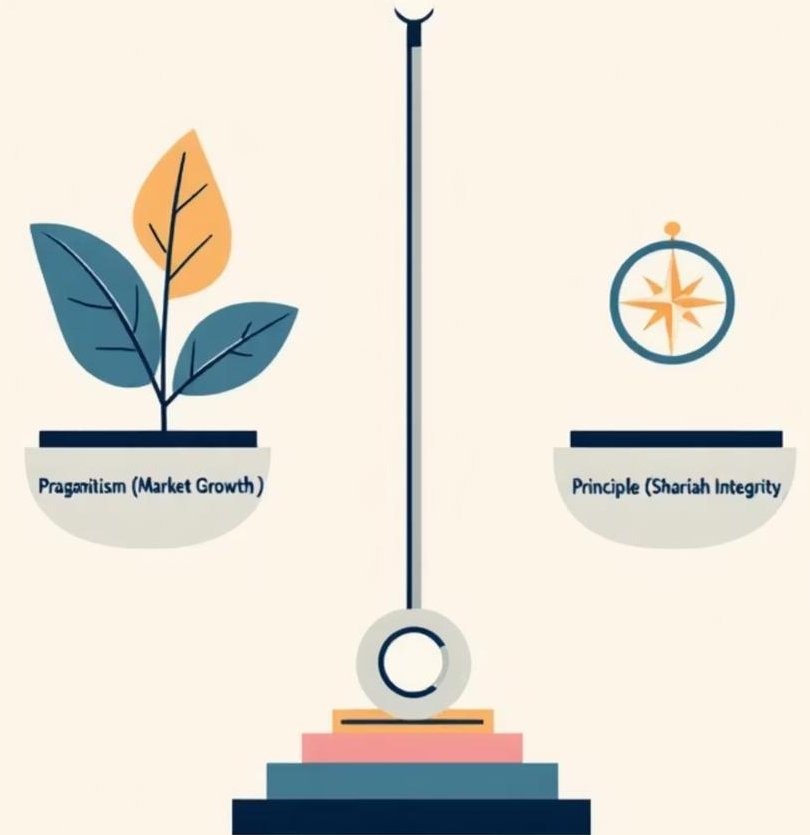
A poorly governed Full-Fledged bank can fail its mandate, while an excellently managed Window can be a positive force. However, the Full-Fledged model represents the ideal from a Shariah and financial stability perspective.

Evolutionary Path

The industry should view Windows as an introductory phase, and a pragmatic option not a permanent solution, and incentivise migration towards more robust structures.

Ultimate Goal: Maqasid al-Shariah

The aim is to promote justice, equity, and welfare through a financial system that is not only compliant in form but also transformative in substance.



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