

Shariah Compliance and Governance Frameworks

Shariah Compliance and Governance Frameworks play a crucial role in the world of Islamic finance and ESG investing. These frameworks are designed to ensure that financial transactions and investments adhere to Islamic principles and values while also considering environmental, social, and governance factors. In this course, we will explore key terms and vocabulary related to Shariah compliance and governance frameworks to help you better understand and navigate this important aspect of Islamic finance and ESG investing.

1. Shariah Compliance:

Shariah compliance refers to the adherence of financial activities, products, and services to Islamic law, also known as Shariah. Shariah compliance is essential in Islamic finance to ensure that transactions are conducted in a manner that is in line with Islamic principles. This includes avoiding interest-based transactions, gambling, and investments in businesses that are considered haram (forbidden) according to Shariah.

2. Shariah Supervisory Board:

The Shariah Supervisory Board is a group of Islamic scholars who are responsible for ensuring the Shariah compliance of financial institutions, products, and services. They provide guidance and oversight to ensure that all activities are conducted in accordance with Islamic law. The decisions of the Shariah Supervisory Board are binding on the institution, and their role is crucial in maintaining the integrity of Islamic finance.

3. Murabaha:

Murabaha is a type of Islamic financing where the financial institution purchases an asset on behalf of the customer and then sells it to the customer at a markup price. This markup represents the profit for the institution, and the transaction is structured in a way that is compliant with Shariah principles. Murabaha is commonly used in Islamic finance for asset purchases and trade financing.

4. Mudarabah:

Mudarabah is a form of partnership in Islamic finance where one party provides the capital (Rab al-maal) and the other party provides the expertise and labor (Mudarib). The profits generated from the partnership are shared according to a pre-agreed ratio, while any losses are borne by the capital provider. Mudarabah is commonly used for investment and project financing in Islamic finance.

5. Wakalah:

Wakalah is a type of agency agreement in Islamic finance where one party acts as an agent on behalf of another party. The agent is entrusted with managing the assets or investments of the principal and is compensated for their services. Wakalah agreements are commonly used in Islamic finance for fund management and investment advisory services.

6. Ijarah:

Ijarah is a form of leasing agreement in Islamic finance where one party (lessor) leases an asset to another

party (lessee) for a specified period in exchange for rental payments. The lessor retains ownership of the asset while the lessee has the right to use it for the agreed-upon period. Ijarah is commonly used in Islamic finance for equipment leasing and real estate financing.

7. Sukuk:

Sukuk are Islamic bonds that represent ownership in a tangible asset, project, or investment. Sukuk holders receive a share of the profits generated by the underlying asset or investment, and the issuance of Sukuk is based on Shariah-compliant structures. Sukuk are an important tool in Islamic finance for raising capital and financing large projects.

8. Shariah Governance Framework:

Shariah Governance Framework refers to the structure and processes that are put in place by financial institutions to ensure Shariah compliance in their operations. This framework includes policies, procedures, and oversight mechanisms to ensure that all activities are conducted in accordance with Islamic principles. The Shariah Governance Framework is essential for maintaining the trust and confidence of customers and investors in Islamic finance.

9. Shariah Risk Management:

Shariah Risk Management refers to the identification, assessment, and mitigation of risks related to Shariah compliance in financial institutions. This includes ensuring that all products, services, and transactions are in line with Islamic principles and values. Shariah Risk Management is an important aspect of Shariah compliance and governance frameworks to protect the institution from potential legal, reputational, and financial risks.

10. Compliance Monitoring:

Compliance Monitoring is the process of monitoring and evaluating the adherence of financial activities to Shariah principles and values. This includes regular reviews, audits, and assessments to ensure that all operations are in compliance with Islamic law. Compliance Monitoring is a key function of Shariah compliance and governance frameworks to detect and address any potential issues or violations.

11. Ethical Screening:

Ethical Screening refers to the process of evaluating investments based on ethical, social, and environmental criteria. In Islamic finance, ethical screening involves assessing investments to ensure that they comply with Shariah principles and values. This includes avoiding investments in industries such as alcohol, gambling, and tobacco, as well as considering environmental and social factors in investment decisions.

12. ESG Investing:

ESG Investing stands for Environmental, Social, and Governance investing, which integrates environmental, social, and governance factors into investment decisions. ESG investing goes beyond financial returns to consider the impact of investments on the environment, society, and corporate governance practices. ESG investing is becoming increasingly important in the financial industry as investors seek to align their values with their investment choices.

13. Socially Responsible Investing (SRI):

Socially Responsible Investing (SRI) is an investment approach that considers both financial returns and social or environmental impact. SRI focuses on investing in companies that are socially responsible and have a positive impact on society. SRI is closely related to ESG investing and is based on the principle of investing in companies that are aligned with ethical and social values.

14. Corporate Governance:

Corporate Governance refers to the system of rules, practices, and processes by which a company is directed and controlled. Good corporate governance ensures that companies are managed in a transparent, accountable, and ethical manner. Corporate governance practices include board oversight, disclosure and transparency, and shareholder rights, among others. Strong corporate governance is essential for building trust and confidence among investors and stakeholders.

15. Ethical Finance:

Ethical Finance refers to financial services and products that are based on ethical principles and values. In Islamic finance, ethical finance is synonymous with Shariah compliance and adherence to Islamic law. Ethical finance also encompasses ESG investing and socially responsible investing, where investments are made in a way that is socially responsible and environmentally sustainable.

16. Financial Inclusion:

Financial Inclusion refers to the availability and accessibility of financial services to all segments of society, including low-income individuals and marginalized communities. Islamic finance promotes financial inclusion by offering Shariah-compliant products and services that cater to the needs of underserved populations. Financial inclusion is essential for promoting economic development, reducing poverty, and fostering social equity.

17. Risk Management:

Risk Management refers to the process of identifying, assessing, and mitigating risks that could impact the financial performance and stability of an institution. Effective risk management involves identifying potential risks, evaluating their impact, and implementing measures to mitigate or manage these risks. Risk management is a critical function in Islamic finance to safeguard the institution from financial, operational, and compliance risks.

18. Sukuk Structuring:

Sukuk Structuring refers to the process of designing and issuing Sukuk based on Shariah-compliant structures. Sukuk can be structured in various ways, such as Mudarabah, Musharakah, Ijarah, or Wakalah, depending on the underlying asset or investment. Sukuk structuring requires careful consideration of Shariah principles and legal requirements to ensure that the issuance is compliant with Islamic law.

19. Financial Ethics:

Financial Ethics refers to the moral principles and values that govern financial activities and transactions. In Islamic finance, financial ethics are based on Shariah principles, which prohibit activities such as usury, gambling, and unethical business practices. Financial ethics also encompass transparency, fairness, and accountability in financial transactions, as well as consideration for the social and environmental impact of

investments.

20. AAOIFI Standards:

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an international standard-setting body that develops and promulgates standards for Islamic finance. AAOIFI standards cover a wide range of topics, including accounting, governance, ethics, and Shariah compliance. Financial institutions that adhere to AAOIFI standards demonstrate their commitment to best practices and transparency in Islamic finance.

21. Takaful:

Takaful is a cooperative insurance system based on mutual assistance and solidarity among participants. In Takaful, participants contribute to a common fund to protect themselves against risk and loss. Takaful is based on the principles of brotherhood, mutual help, and shared responsibility, and is considered a Shariah-compliant alternative to conventional insurance.

22. Waqf:

Waqf is a charitable endowment or trust established for religious, educational, or social purposes in Islamic finance. Waqf assets are held in perpetuity and the income generated from these assets is used for charitable activities. Waqf plays a crucial role in promoting social welfare, education, and community development in Islamic societies.

23. Islamic Microfinance:

Islamic Microfinance refers to the provision of financial services to low-income individuals and micro-entrepreneurs in a manner that is consistent with Islamic principles. Islamic microfinance institutions offer Shariah-compliant products such as Qard al-Hasan (interest-free loans) and Murabaha (cost-plus financing) to empower marginalized communities and promote financial inclusion.

24. Fintech in Islamic Finance:

Fintech in Islamic Finance refers to the use of technology to innovate and improve financial services in compliance with Islamic law. Fintech solutions in Islamic finance include digital banking, peer-to-peer lending, crowdfunding platforms, and blockchain-based transactions. Fintech plays a key role in expanding access to Shariah-compliant financial services and promoting financial inclusion.

25. Green Sukuk:

Green Sukuk are Islamic bonds that are issued to fund environmentally sustainable projects, such as renewable energy, green infrastructure, and climate change mitigation initiatives. Green Sukuk combine the principles of Islamic finance with environmental sustainability, making them an attractive investment option for environmentally conscious investors. Green Sukuk are a key instrument in promoting green finance and sustainable development.

26. Ethical Investing:

Ethical Investing refers to the practice of investing in companies and projects that align with ethical values and principles. Ethical investors consider environmental, social, and governance factors in their investment decisions, and seek to support businesses that have a positive impact on society and the

environment. Ethical investing is gaining traction in the financial industry as investors look for ways to create positive change through their investments.

27. Governance Frameworks:

Governance Frameworks refer to the structures, processes, and procedures that are put in place to ensure effective governance and oversight of an organization. Governance frameworks include policies, controls, and monitoring mechanisms to ensure that the organization operates in a transparent, accountable, and ethical manner. Strong governance frameworks are essential for building trust and confidence among stakeholders and investors.

28. Sustainable Finance:

Sustainable Finance refers to financial services and products that integrate environmental, social, and governance factors into investment decisions. Sustainable finance aims to promote long-term sustainable development by considering the impact of investments on the environment, society, and governance practices. Sustainable finance is aligned with the principles of ESG investing and ethical finance, and is a growing trend in the financial industry.

29. Shareholder Rights:

Shareholder Rights refer to the rights and privileges that are granted to shareholders of a company. Shareholder rights include voting rights, the right to receive dividends, the right to participate in corporate governance, and the right to information. Shareholder rights are important for protecting the interests of shareholders and ensuring that companies are managed in a fair and transparent manner.

30. Islamic Capital Markets:

Islamic Capital Markets refer to the financial markets where Shariah-compliant securities, such as Sukuk, are traded. Islamic capital markets provide a platform for raising capital, investing in Shariah-compliant assets, and trading Islamic financial instruments. Islamic capital markets play a key role in the development of Islamic finance and provide opportunities for investors to participate in Shariah-compliant investments.

In conclusion, understanding key terms and vocabulary related to Shariah compliance and governance frameworks is essential for navigating the complex world of Islamic finance and ESG investing. By familiarizing yourself with these terms and concepts, you will be better equipped to make informed decisions, assess risks, and ensure compliance with Islamic principles and values. Shariah compliance and governance frameworks are fundamental to the integrity and sustainability of Islamic finance, and by incorporating ESG factors into your investment decisions, you can contribute to positive social and environmental impact while achieving financial returns.