

## Financial Risks In Islamic Financing

**Nazarov Nodirjon Namoz  
o'g'li**

Teacher, Tashkent institute of finance  
e-mail: [nodirjonnazarov5@gmail.com](mailto:nodirjonnazarov5@gmail.com)

**Bahodirov Zokirjon Olimjon  
o'g'li**

Student of Tashkent institute of finance  
e-mail: [zokirjonbahodirov2003@gmail.com](mailto:zokirjonbahodirov2003@gmail.com)

### ABSTRACT

In this article, the following activities are listed as being against Islamic finance: Risks, gharar, or uncertainty, and activities, or numerous opinions about Islamic financial institutions and gambling-related issues. There will be opinions and remarks about Islamic financing as the article is read. Islamic nations' banks have unique qualities. That is, it is required to draw the resource entrusted to you based on the principles of Islam in order to grant a loan based on those principles. In other words, you might not be granted a loan if it is founded on Islamic principles and attracts interest deposits. because deposit attraction violates Islamic principles. First and foremost, in this regard, we need to work on raising awareness of Islamic financing.

### Keywords:

Islamic finance, Risks, gharar, Islamic Financial Institutions, futures, gambling.

**Introduction:** Islamic nations' banks have unique qualities. That is, it is required to draw the resource entrusted to you based on the principles of Islam in order to grant a loan based on those principles. In other words, you might not be granted a loan if it is founded on Islamic principles and attracts interest deposits. because deposit attraction violates Islamic principles. First and foremost, in this regard, we need to work on raising awareness of Islamic financing.

The Islamic laws, the timeless writings passed down from our great forefathers, and the historical origins of economic education in the evolution of economic thought all serve as wonderful resources for us. One of the functions of human society, economic relations, play a vital role in the Qur'anic expression of economic notions in Islamic teachings. because fundamental human traits are represented in economic ties. The equality of all persons on earth is a divine command, according to the Qur'an. The Islamic finance sector, which

offers cutting-edge financing options, is one of the industries with the fastest growth rates today. If we examine the development of Islamic finance, we see that the Prophet (peace and blessings of Allah be upon him) introduced Islam to the world, and it quickly expanded to Makka and Madina. These cities thrived before Islam through regional trade, interstate commerce, and interethnic interactions. The predominant method of addressing financial requirements at this time was interest-based lending.

An overview of Islamic finance from 650 to 750 AD can be found above. Significant local and global trade changes occurred during this time, and a variety of trade and financial strategies were employed in Rome, Tunisia, Turkey, India, and Sumatra. Most of these activities were conducted using Mushoraka as a foundation. In actuality, sukuk, Suftaja (loan receipt), Bay al-Wafo, and Bay al-Nuqud were also often employed financial tools. The interest-based

banking system started to take off at the end of the 19th and the start of the 20th centuries. For their part, Muslim scholars of the time took the situation seriously and argued for the introduction of an alternative financial system based on Sharia law for the Muslim community. In 1890, for example, an interest-free financing institution was established in India. Then, in 1923, another institution was established in Hyderabad called Anjuman Imdad-e-Bahmi Qardh Bila Sud. Then, in the early 1950s, the Local Islamic Bank, the first modern Islamic financial institution in Pakistan, was established. By the end of this year, interest-free banking products such as Muzaraba and Vakala (agency) have also been introduced.

The duty to act responsibly The Islamic financial system's objectives are founded on a few incentives and prohibitions. It aided operations and enterprises. The sale of products, services, or benefits must actually take place in every financial transaction for it to be valid. In addition, Islam has created a moral code that is practically universal in the world's developed countries. Islamic finance is organized around the legitimacy of income and the prohibition of all revenue derived from debt. It operates any state or organization, in the event that there are laws that regulate it. A set of laws that regulate the way of life of Muslim people is Sharia. Sharia is a spiritual, moral and legal and economic system for 1500 years. Islamic finance is an economic system based on Sharia law.

**Literature review:** According to the interpretations of Pulatova M, Ataniyozov J, Khamidova F about "International Financial Institutions", the Islamic Development Bank (IDB) - a multilateral development bank focused on Islamic financing, was established in 1975. It finances economic and social development projects of member countries. Based on Sharia laws and principles, the Bank operates by supporting social and economic development in its member states and Muslim communities around the world.

The Islamic Development Bank group includes the following organizations: Islamic Private Sector Development Corporation, established in 1999, provides financial services to the private sector. It provides strategic cooperation for the implementation of credit lines, advice, asset management, investment deals and other operations on a global cooperation platform. Financing options include equity and profit sharing, leasing, partial resale, and more.

The International Islamic Trade and Finance Corporation (IICFC), founded in 1999, is an autonomous division of the Islamic Development Bank. Its main task is to develop trade in order to improve the economic condition and lifestyle of people throughout the Islamic world. The main goal of the International Fund for Agricultural Development (IFAD), which was established in 1977, is to attract financial resources to increase food production in developing countries and improve the nutritional status of the poor. The fund mobilizes funds to improve the nutrition of low-income rural households, to create conditions for increasing agricultural production and income. [6]

According to O. Akhmadjonov, S Karimova, A. Abdullayev, F. Solijonova in their article entitled "Management System of the World Trade Organization", the entry into the World Trade Organization for Uzbekistan will create more opportunities for creating market reforms aimed at modernizing the economy and increasing its competitiveness. At the same time, this activity can lead to regulatory reforms and reduction of import duties. Therefore, it is necessary to strengthen the potential of local producers and increase their competitiveness. [3]

**Research methodology:** Statistical, analytical, comparative, observational, inductive, deductive, logical, monitoring, express evaluation and other methods of analysis were used in the research process. As a result of the studied literature, the topic was fully covered. Reforms carried out in cooperation with foreign countries were reviewed. Tables were formulated and compared accordingly.

**Analyses and results:** Before emphasizing the financial risks of Islamic banks, we should mention the following information about the types of risks.

*Credit risk* - Attributed to delayed, deferred, and default in payment by counterparties. Covers profit-sharing contract (Mudharabah and Musharakah), receivables and lease (Murabahah, Diminishing Musharakah, and Ijarah), and working capital financing (Salam, Istisna, and Mudharabah). Covers different stages of a contract.

*Market risk* - Attributed to adverse movement in interest rates, commodity prices, and foreign exchange rates. Covers commodity risk existing in Murabahah and Ijarah contracts.

*Equity risk* - Attributed to adverse changes in market value (and liquidity) of equity held for investment purposes. Covers all equity instruments (Mudharabah and Musharakah).

*Liquidity risk* - Attributed to adverse cash flow in situations arising mainly out of changing market risk exposures, credit risk exposures, and operational risk exposures.

*Rate of return risk* - Attributed to changes in account holder's expectations of the return on investments. Also related to fluctuations in returns due to changes in underlying factors of the contract.

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*Legal risk* - Attributed to the inadequate legal framework, conflict of conventional and Islamic laws, and conflict between Shari'ah rulings and legal decisions. [9]

In Islamic financial transaction the concept of risk management is based on the objective of Shari'ah, i.e. protection of wealth. This is to uphold the well-being of humanity and universal prosperity.

Regarding the activities of Islamic banks, we inform you that: RIBA is an increase that is deducted as compensation from the debtor. This refers to a profit made through transactions involving the exchange of money or from adding to the agreed-upon price when selling debt in order to account for payment delays. Due of the unstable state of the economy, the Sharia forbade this. Because it is strictly forbidden to engage in any transactions involving the payment of interest. As a result, it is impossible to sell debts to the master at a discount or for less money, and any exchange of money or goods, including those incompatible with money like gold and silver, must be done manually and fairly. A person can profit from the money that he used or received without giving the value against which the other party can take advantage, even though the term "equal to" is clear. As a business, the exchange of money should also be done by hand, even though any increase means that there will be a riba. Gharar is the second ban. (uncertainty). Following Islamic morality's tenets, Islamic finance upholds gharar. Gharar means the conclusion of a contract under conditions of absolute risk or uncertainty about the results of the contract, the nature and specification of the object or the rights and obligations of the parties. Gharar also participates in the event that there is a lack of relevant information of appropriate value or that there is uncertainty of any vital information and that there is uncertainty and uncertainty that leads to the exploitation of one of the parties. Intentional hiding of information related to dishonesty, fraud or costly is equivalent to gharar.

Islamic Financial Institutions should refrain from engaging in any trade where the outcomes are concealed since they cannot be certain that the delivery, which is required to complete any legitimate commercial transaction, will be made. Due to Ghar, interest, and gambling, traditional financial institutions' and insurance firms' modern activities in the futures and option markets do not comply with Sharia. The

current stock markets are buying and selling, if cleared of these elements, so it is. It is called the stock market according to Sharia. The third type of activity that it should avoid is gambling. Gambling is involved in a number of financial transactions and traditional banking products, which should avoid it. In Egypt in 1963, the first Islamic bank was established. According to the Reuters news agency, there are currently more than 300 Islamic banks operating globally in 67 different nations. Islamic banks have more than \$2 billion USD in capital. In Saudi Arabia, Iraq, Kuwait, Malaysia, the United Arab Emirates, Pakistan, Bangladesh, and Turkey, Islamic banks are significantly more developed. It also conducts business in other nations, including Leixenburg, Germany, the United States, Canada, and Great Britain. Over 130 universities around the globe train people in Islamic banking and finance. The following prestigious universities in the world organized specific courses in specialized. At the bachelor's, master's, and doctorate levels, students are enrolled in classes. The first Islamic bank in Qozogistan and the first from the Central Asian nations was given authorization to operate in al-Hilal in March 2010. On August 17, 2017, Zamanbank received a license for the provision of Islamic services and began its activities. In April 2009, in Kyrgyzstan, amendments and amendments to the law of the Kyrgyz Republic "on banking and banking activities" were adopted and others. These amendments created opportunities for the application of Islamic methods of financing in traditional banks with Islamic and "Islamic window". Traditional insurance is incompatible with Sharia due to the participation of both RIBA and (gambling). Governments, public and private sector corporations mobilize resources on the basis of lotteries and circulation, which are under the hammer of gambling and are therefore prohibited in the Islamic financial system. Current futures and option contracts, which are resolved only through price differences, are covered under gambling. Similarly, the scheme, in which investors' money is safe and inviolable, but the prizes awarded are

associated with interest from the investment collected through it, also does not correspond to Sharia due to the participation of Riba (percentage) and gambling.

For the development of Islamic finance, a Muslim office that issues fatwa is also needed. That is, Muslim authorities in Malaysia and Indonesia have such a fatwa. That is, it is a very complex and sensitive process. Ignoring these nuances, we cannot achieve the desired result by saying that this is an Islamic bank. It is necessary to carry out this work step by step and open the window of Islamic finance in commercial banks after microcredit organizations.

Islamic banking is not a new concept in the world of financiers. However, among newcomers, it is natural to ask the question: "Is it possible to combine religion with banking?" In fact, very successful results can be achieved through the principle of Islamic banking. Islamic banks work on the principles of Sharia: they provide interest-free money only for specific projects. The main difference between Islamic banking and traditional banking is the prohibition of interest on deposits. Islamic bank prohibits predetermined interest depending on the duration and size of the loan.

According to Muslim law, one must live and work with honesty and integrity. Gambling and securities transactions are prohibited in Islamic banking. This is because it is very risky to work with them as the client may lose their investment. Also, it does not approve loans for tobacco products, alcoholic beverages, arms sales, pornography distribution and other questionable activities. The most important thing in Islamic banking is to follow the principles of contract. He declared Tashkent the capital of Islamic culture. According to the decision of the 9th Conference of Ministers of Culture of the Organization of Islamic Cooperation, Bukhara (Uzbekistan), Cairo and Bamako have been approved as the capitals of Islamic culture in 2020. Uzbekistan joined the new OIC Charter on December 14, 2015. The Uzbek side recognizes the OIC as an authoritative and effective forum of the Islamic world, which

recognizes our sacred religion as a factor of peace and development. Consequently, we are interested in the strengthening of this Organization and the consistent development of our relations. Official delegations of our country regularly take part in OIC summits and annual sessions of the OIC Council of Foreign Ministers. Especially in recent years, cooperation of Uzbekistan with the OIC has intensified and reached a new level of relations. The 43rd session of the OIC Council of Foreign Ministers was held in Tashkent on October 18-19, 2016. In his opening speech, President of the Republic of Uzbekistan Shavkat Mirziyoyev focused on the priorities of the chairmanship.

OIC Council of Foreign Ministers of Uzbekistan. As the head of our state noted, the theme "Education and enlightenment - the path to peace and prosperity" is symbolic, as it is the main idea of the agenda of the 43rd session. This idea is in line with the famous hadith, "Seek knowledge from the cradle to the grave". It is no coincidence that the initiatives put forward by Uzbekistan in this regard are directly related to the development of science and education. The importance of promoting and protecting the rights of young people in building development" is a vivid expression of our views in this regard.

### Statistics of IsDB

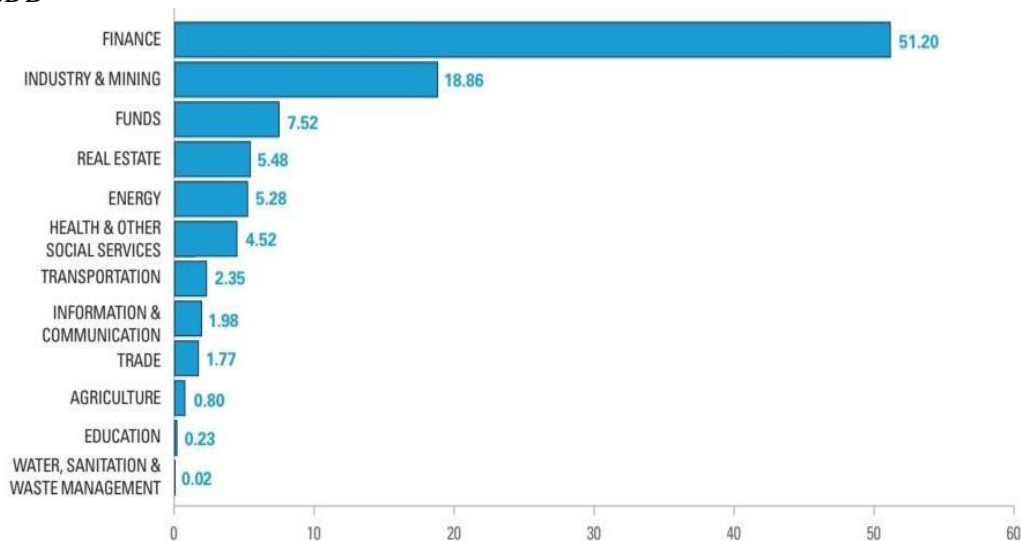


Figure 1. Total approvals by sector since inception

Islamic Development Bank invested in various fields in the amount of 94.73 billion USD in 2021. The main part of the investment, namely 51.20 billion USD, was directed to the financial sector. In addition, Islamic

Development Bank invested 0.23 billion USD in the education sector, which is 0.3% of its total investments, and its investments in the financial sector make up 54% of its total investments.

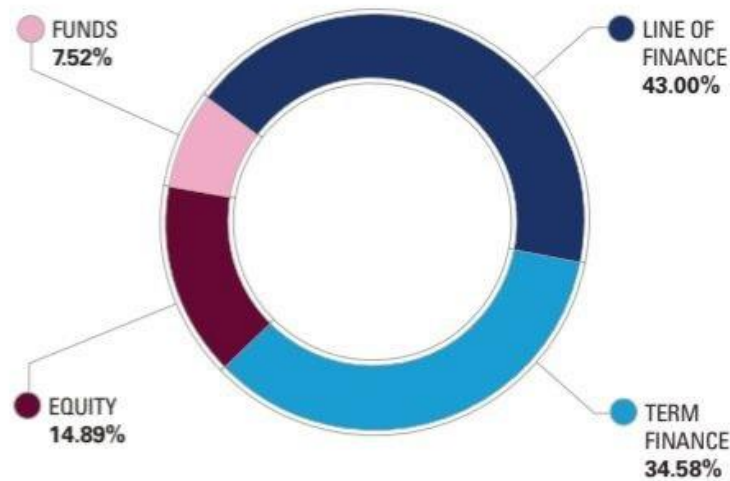


Figure 2. Total approvals by product since inception

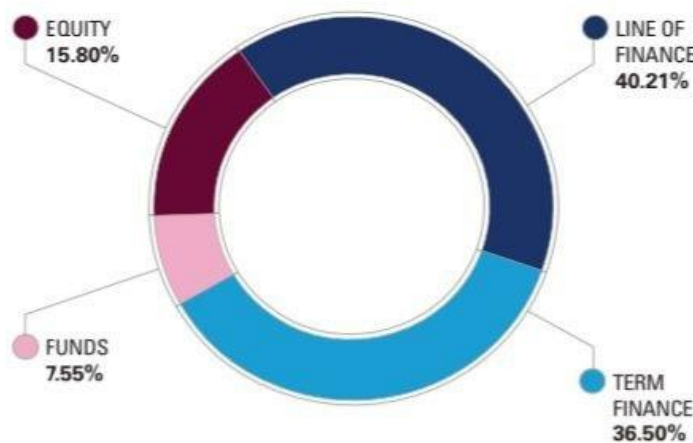


Figure 3. Total disbursements by product since inception

Approvals of ISDB also reflect its wide geographic reach. By the end of 2021, ICD investment operations covered 50 member countries, in addition to a number of regional and global – level projects spanning several economies. The middle East and North Africa (MENA) region accounts for 29.35% of gross approvals, followed by Europe and Central Asia (ECA) with 21.35%, Sub – Saharan Africa (SSA) with 18.14%, and the Asia region with 14.91%. The share of regional / global projects covering

several countries across different regions represents 16.25% of gross approvals.

ICD has disbursed a total of more than USD 375 billion since inception. Disbursements vary according to product, with line of finance and term finance projects accounting for the largest proportion (40.21% and 36.48%, respectively). Equity operations accounted for 15.76%, followed by funds at 7.55%. [8]

**Table 1**  
*Financial lines of IsDB [8]*

	Institution name	Country	Approved amount	Disbursement Status
1	Coris Bank International	Burkina Faso	EUR 15 million (USD 17.7 million) in September 2020	Fully disbursed in December 202
2	Jaiz Bank	Nigeria	USD 10 million in	Fully disbursed

			December 2020	in May 2021
3	Banque Nationale pour le Developpement Economique	Senegal	EUR 12 million (USD 14.2 million) in April 2021	Fully disbursed in June 2021
4	Banque Islamique du Senegal	Senegal	EUR 25 million (USD 29.4 million) in May 2021	Fully disbursed in September 2021
5	Orient Finans Bank	Uzbekistan	USD 10 million in March 2021	Effective, pending disbursed
6	Infin Bank	Uzbekistan	USD 10 million in April 2021	Effective, pending disbursed
7	Trust Bank	Uzbekistan	USD 10 million in April 2021	USD 1.5 million disbursed
8	Qishloq Qurulish Bank	Uzbekistan	USD 15 million in August 2021	Effective, pending disbursed
9	State Bank of Turkmenistan	Turkmenistan	USD 10 million in April 2021	Effective, pending disbursed
10	Afriland First Bank	Cameron	EUR 20 million (USD 22.8 million) in July 2021	Effective, pending disbursed
11	Bank of Maldives	Maldives	USD 10 million in August 2021	Pending signing of the agreements
12	Turan Bank	Azerbaijan	USD 10 million in November 2021	Pending signing of the agreements
	Total	8 member countries	USD 169.2 million	USD 72.9 million

**Table 2**  
*Equities [8]*

	Institution name	Country	Approved amount	Disbursed Status
1	Banque Islamique de Senegal	Senegal	XOF 7.6 billion (USD 14.2 million)	USD 3.4 million disbursed
2	IILMC	Supranational	USD 5 million	Pending disbursement
	Total	2 member countries	USD 19.2 million	USD 3.4 million

In addition, the President of the Republic of Uzbekistan Shavkat Mirziyoyev took part in the fifteenth summit of the Organization of Islamic Cooperation on November 28, 2021 in Ashgabat. The President touched upon the international and regional

situation, the economic difficulties in the context of the ongoing pandemic, and put forward a number of specific proposals on the priorities of cooperation. We need to take full advantage of the huge trade and investment potential of our countries, which have a

population of more than 500 million and a huge market. On the basis of the adopted conceptual program "Prospects of the OIC - 2025" it is expedient to further expand trade, economic and investment ties between our countries, and most importantly, to achieve practical results, - said the President of Uzbekistan.

The head of state spoke about the situation in neighboring Afghanistan. The country is facing a serious humanitarian crisis, Shavkat Mirziyoyev said. Without the help of the international community, including its close neighbors, the Afghan people alone will not be able to withstand these ordeals. The organization has taken the initiative to introduce an annual naming tradition for the development of a particular industry. The President proposed declaring 2022 the year of strengthening interdependence in the OIC. At the end of the summit, the Ashgabat Consensus was signed. The document contains important priorities for further development and strengthening of regional economic cooperation of member states.

The modernization of the system as a result of the reforms made to Uzbekistan's financial system over a twenty-five-year period reveals that the activities of Islamic investment funds were not organized and that banks were not established to offer Islamic finance services to clients. Industry reforms were restricted to a few early-year upgrades and did not reach a high degree. The integration of Islamic financial structures into the domestic financial system has not received any attention over the years. The government did not create any relevant decisions or programs. As a result, neither the use of Islamic finance in the domestic financial system nor the laws governing these interactions have a legal foundation.

The constant reform of this sector should be on the agenda as the global financial market is steadily developing. The introduction of Islamic finance in Uzbekistan in Shu zayl is becoming in demand today. Early in 2020, the United Nations Development Program conducted a study called "Analysis of Islamic Financial Products in Uzbekistan" and a survey within its

framework, and the results revealed a high percentage of bank loans and the complexity of financing, as well as the conclusion that if Islamic financial services are introduced in the nation, the majority of participants will use them. In addition, according to economist Berna Bayazit, just 5% of Uzbek citizens retain their money in commercial banks, while 12% of the country's residents use consumer credit. This is because of their religious beliefs. If the activities of Islamic finance institutions are organized, these indicators can improve, that is, a greater part of the population can use financial services, a significant decrease in the share of the hidden economy in the financial market, funds can move to the banking system.

**Conclusion:** The norm of profit in the Islamic economy-in contrast to the interest rate, it is also worth studying seriously, since a more efficient and rational mechanism of resource allocation is a system that opposes many negative trends of the modern economy (monopolization , a sharp difference between the rich and the poor, financial crises). A number of other problems facing the Islamic finance sector can also be listed, however "complexity and problems are specific to any system". Understanding and recognizing problems is a starting point in finding effective solutions. This makes the system itself and all of its, "structural parts" healthier. Even if representatives of the industry could solve at least part of the above - mentioned problems, this-would be a huge step forward in the development and growth of the system.

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