THEORETICAL MODELS FOR INTRODUCING ISLAMIC FINANCIAL SERVICES IN COMMERCIAL BANKS

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Abstract. *This thesis analyzes the theoretical models for introducing Islamic financial services in commercial banks from a scientific and academic perspective. Today, Islamic finance is regarded as one of the fastest-growing segments of the global financial market. Its core principles — the strict prohibition of interest (riba), equitable risk-sharing, linkage to real economic activity, and commitment to social justice — open new opportunities for commercial banking operations. The research explores several theoretical models for integrating Islamic financial services into commercial banking, namely the Islamic window model, the subsidiary model, and the full-fledged Islamic bank model. The advantages, limitations, and application opportunities of each model are examined in detail, along with their potential to expand Shariah-compliant financial services within the broader economic system. The paper also discusses the theoretical foundations and institutional as well as legal requirements for implementing Islamic financial mechanisms in commercial banks in Uzbekistan.*

Keywords: *Islamic finance, commercial banks, theoretical model, Shariah principles, Murabaha, Musharaka, Mudaraba, Sukuk, Takaful, financial inclusion.*

Introduction

In the context of the rapid development of the global financial system, various types of financial services and instruments have emerged. However, the conventional financial system demonstrates several weaknesses — dependence on fluctuating interest rates, speculative activities, economic inequality, and practices that contradict social justice principles — all of which have created a demand for alternative financial mechanisms.

From this perspective, Islamic finance has evolved as a viable alternative model grounded in Shariah principles, emphasizing the prohibition of interest (riba), equitable distribution of risk and profit, asset-backed transactions, and a close connection with the real sector of the economy.

Commercial banks play a central role in financial systems. The introduction of Islamic financial services into their operations is not only important for meeting the financial needs of Muslim populations but also for enhancing financial inclusion,

mobilizing new investment resources, and promoting macroeconomic stability. Therefore, it is essential to study the theoretical models of integrating Islamic services into commercial banking activities, analyze their strengths and weaknesses, and develop mechanisms for their adaptation to national financial systems.

In international practice, three major theoretical models have been developed for integrating Islamic financial services into conventional banking operations:

1. The Islamic Window Model
2. The Subsidiary Model
3. The Full-Fledged Islamic Bank Model

Each of these models differs in institutional structure, degree of Shariah compliance, financial stability mechanisms, and resource requirements. Their theoretical foundations are closely linked with the fundamental principles of Islamic finance — the prohibition of riba (interest), the avoidance of excessive uncertainty (gharar), and equitable risk-sharing — all of which are codified in international standards developed by AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) and IFSB (Islamic Financial Services Board).

The integration of Islamic financial services into the operations of conventional commercial banks has emerged as a significant area of academic inquiry and practical experimentation in contemporary financial systems. Among the most widely recognized theoretical models for implementing Islamic finance within commercial banking structures are the Islamic window model, the subsidiary model, and the full-fledged Islamic bank model, each of which embodies distinctive institutional, operational, and regulatory characteristics that reflect varying degrees of Shariah compliance and organizational independence. These models collectively represent a spectrum of approaches through which conventional banks can respond to the increasing global demand for ethical and Shariah-compliant financial solutions, while simultaneously enhancing financial inclusion, promoting social justice, and ensuring greater economic stability.

The Islamic window model [1] constitutes the most preliminary and flexible form of Islamic financial integration, whereby a conventional commercial bank establishes a dedicated internal division — often referred to as a “window” — that offers a limited range of Shariah-compliant products and services alongside its conventional operations. In this model, Islamic financial activities are recorded within the bank’s general balance sheet; however, they are managed separately with independent accounting systems, governance mechanisms, and oversight by a Shariah Supervisory Board (SSB). In accordance with the standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), these specialized divisions must operate under continuous supervision to ensure that all

transactions adhere to the principles of Islamic jurisprudence (fiqh al-mu‘amalat), thereby maintaining a clear segregation between conventional and Islamic financial flows [2]. The major advantage of this model lies in its relatively low operational cost and its capacity for rapid implementation, which enables conventional banks to respond swiftly to the emerging demand for Islamic financial products without the need for significant restructuring. Furthermore, the model provides institutional flexibility and allows banks to test market receptiveness to Islamic products before committing to more capital-intensive organizational transformations. Nonetheless, despite these advantages, the Islamic window model is not without limitations, as it entails the risk of commingling conventional and Islamic funds, which could undermine the integrity of Shariah compliance. Moreover, the coexistence of conventional and Islamic financial operations within the same institution can generate substantial operational and reputational risks, particularly in cases where governance and risk management systems are insufficiently robust. As highlighted by the Islamic Financial Services Board (IFSB), such risks may constitute serious threats to operational stability if not adequately addressed [3]. Despite these constraints, the Islamic window model is often regarded as an effective transitional mechanism for introducing Islamic finance within conventional banking environments, particularly in countries where the Islamic financial infrastructure is still in its formative stage.

The subsidiary model, in contrast, represents a more advanced and structurally distinct approach to integrating Islamic finance into conventional banking. Under this framework, Islamic financial services are offered through a legally independent subsidiary that operates under the ownership of a conventional parent bank. This subsidiary maintains its own balance sheet, financial accounts, and governance system, including an autonomous Shariah Supervisory Board responsible for ensuring the strict observance of Islamic principles in all financial operations. The AAOIFI guidelines explicitly emphasize the necessity of complete segregation between conventional and Islamic capital flows, which serves to enhance transparency, ensure Shariah compliance, and minimize potential conflicts of interest. The subsidiary model offers several notable advantages, including the strengthening of customer trust through institutional independence, the reinforcement of financial discipline, and the provision of a more credible framework for Shariah governance [2]. It also facilitates the development of specialized expertise within the subsidiary, thereby allowing for the creation of innovative Islamic financial instruments tailored to the needs of specific markets. However, the implementation of this model entails substantial challenges, as it requires extensive organizational restructuring, significant start-up capital, and the recruitment of professionals with both financial and Shariah expertise. For this reason, the subsidiary model is most commonly observed in financially

developed jurisdictions where the demand for Islamic finance is well established and where regulatory institutions possess the capacity to support its effective operation.

At the most comprehensive level of institutional transformation lies the full-fledged Islamic bank model, which entails the establishment of an entirely independent banking institution that operates exclusively in accordance with Shariah principles. Within this framework, all financial products and services — encompassing Murabaha (cost-plus financing), Musharaka (joint venture partnership), Mudaraba (profit-sharing), Ijara (leasing), Takaful (Islamic insurance), and Sukuk (Islamic bonds) — are conducted solely through contracts compliant with Islamic commercial jurisprudence. In such institutions, the Shariah Supervisory Board occupies a central role within the governance structure, ensuring that every operational and strategic decision conforms to the ethical and legal precepts of Islamic law. The advantages of the full-fledged Islamic bank model are manifold: it represents the most authentic and institutionally coherent embodiment of Islamic finance, facilitates the full integration of social finance instruments such as Zakat (obligatory alms), Sadaqah (voluntary charity), and Waqf-based financing (endowments), and contributes to the development of a more inclusive and morally grounded financial system. Nevertheless, the establishment of such institutions requires considerable financial resources, a comprehensive legal and regulatory framework, and a highly qualified workforce proficient in both modern finance and Shariah. Consequently, this model is typically implemented in economies where Islamic finance has achieved significant maturity and where policymakers and regulators have created enabling environments that foster its sustainable growth.

From a comparative and evolutionary perspective, international experience reveals a gradual progression from partial to full Islamic banking systems. For example, in Malaysia and Bahrain, Islamic finance initially emerged within the structure of conventional banks through the establishment of Islamic windows, followed by the creation of separate subsidiaries, and ultimately the foundation of full-fledged Islamic banks as market demand expanded and regulatory institutions strengthened. This evolutionary process allows financial systems to mitigate transitional risks, develop human capital, and establish comprehensive regulatory and supervisory frameworks before committing to complete institutional transformation. Accordingly, the choice of an optimal model for integrating Islamic financial services depends on several interrelated contextual factors, including the developmental stage of the national financial system, the robustness of legal and regulatory frameworks, the degree of public awareness and demand for Shariah-compliant financial services, and the institutional readiness of commercial banks to undertake structural reforms.

In conclusion, the theoretical models for introducing Islamic financial services into commercial banks hold profound significance for promoting financial diversification, expanding access to Shariah-compliant alternatives, and reinforcing socioeconomic stability. Each of the three models — the Islamic window, the subsidiary, and the full-fledged Islamic bank — presents distinct advantages and limitations that must be carefully assessed in light of a country's specific economic, legal, and institutional conditions. In the context of Uzbekistan, the Islamic window model presently constitutes the principal practical framework for integrating Islamic financial mechanisms into conventional banking operations. However, with the progressive development of financial infrastructure, legal frameworks, and public awareness, the future implementation of the subsidiary and full-fledged Islamic bank models may considerably enhance the scope and impact of Islamic financial services in the national economy. Consequently, the comprehensive academic study and practical adaptation of these models represent a strategic imperative for strengthening the stability, inclusiveness, and overall efficiency of Uzbekistan's financial system in alignment with global trends in Islamic finance.

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