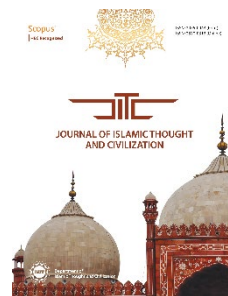
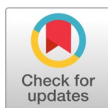


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# Rethinking Islamic Finance: Toward A Hybrid Model

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## Abstract

This paper critically reexamines the foundational approaches in the development of Islamic finance by exploring the evolution from idealist to pragmatic and liberal paradigms, and proposes a hybrid model that synthesizes ethical imperatives with economic practicality. The study begins by evaluating the idealist approach, which emphasizes profit-and-loss sharing (PLS) as an Islamic alternative to conventional finance, yet faces challenges in practical implementation. It then explores the pragmatic approach, which adapts classical jurisprudence to modern realities, often relying on debt-based instruments while seeking legitimacy through legal stratagems. The liberal approach, in contrast, interprets *riba* within a modern context and promotes the integration of Islamic values into existing financial structures without the need for separate institutions. A central contribution of this paper is the elaboration of a hybrid model that balances the *maqasid al-Shari'ah* (objectives of Islamic law) with operational and ethical considerations, supported by examples such as cash waqf linked *sukuk*, green *sukuk* (Islamic bonds), *musharakah mutanaqisah* (diminishing partnership) and *takaful* (Islamic insurance) cooperative model. This study highlights the necessity of institutional innovation, regulatory flexibility, and contextual interpretation to advance the global relevance and sustainability of Islamic finance. The paper concludes that the hybrid model offers a viable path forward, providing a nuanced framework that reconciles form with substance, tradition with innovation, and Shari'ah compliance with socio-economic impact.

**Keywords:** hybrid model, idealist approach, Islamic finance, liberal model, *maqasid al-Shariah*, pragmatic approach, Sharia compliance, socio-economic impact

## Introduction

Over the past decades, Islamic finance has evolved as a distinct discipline, often positioned as a moral and ethical alternative to conventional finance. One of the core debates in Islamic financial discourse revolves around the legitimacy of Western financial institutions, particularly concerning practices deemed incompatible with Islamic law or *Shar'ah*<sup>1</sup>, such as *riba* (usury), *gharar* (excessive uncertainty), and *maysir* (gambling).<sup>2</sup> These debates have formed the intellectual and legal

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<sup>1</sup>This law is derived from the primary sources namely the Qur'an and the practices and saying of the Prophet Mohammad (*Hadiths*) and from the secondary sources of Islamic law: *Ijma* (consensus among *ulama* or Moslem scholars) and *qiyas* (analogical reasoning). Shari'ah encompasses all daily activities pertaining to the relationship between man and God, man and man, and man with its environments including animals. The great part of Shari'ah is found in the corpus of *fiqh* which often referred in the Western legal tradition as the science of Islamic law or jurisprudence; H. Patrick Glenn, *Legal Traditions of the World: Sustainable Diversity in Law* (Oxford: Oxford University Press, 2014).

<sup>2</sup>Walid S. Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," *Chicago Journal of International Law* 7 (2006): 581–600, <https://chicagounbound.uchicago.edu/cjil/vol7/iss2/13>; Mahmoud A. El-Gamal, *Islamic Finance: Law, Economics, and Practice* (Cambridge: Cambridge University Press, 2006); Abdul Rahim Abdul

Department of Islamic Thought and Civilization

foundation for the emergence of Islamic financial systems, and have influenced the trajectory of Islamic banking development across the globe.

Within this context, scholars have generally identified three major approaches in theorizing and operationalizing Islamic finance. The idealist approach, often termed the socio-economic model, emphasizes the transformative and ethical dimensions of Islamic finance. It advocates for the strict adherence to Sharia principles, and envisions Islamic financial institutions as instruments of social justice responsible for an equitable distribution of wealth.<sup>3</sup> This model prioritizes profit-and-loss sharing (PLS) mechanisms, such as *mudharabah* and *musyarakah*,<sup>4</sup> while rejecting any instruments that resemble interest-based contracts. The pragmatic approach, alternatively labelled the legalistic model, seeks to adapt Islamic finance to the realities of modern banking by utilizing Sharia-compliant instruments that functionally replicate conventional products. These instruments—such as *murabaha*, *ijarah*, and *tawarruq*<sup>5</sup>—are designed to operate within the confines of Islamic jurisprudence (*fiqh*), yet aim to meet regulatory, operational, and market demands. This model acknowledges the technical challenges of implementing pure PLS systems, and is therefore more accommodating to risk management and regulatory frameworks,<sup>6</sup> and the liberal approach offers a more interpretive framework, arguing that not all forms of interest fall under the prohibition of *riba* as traditionally defined. Advocates of this approach emphasize that substance should take precedence over form.

Despite extensive literature examining these three approaches, several gaps remain in the current body of knowledge. First, most studies tend to treat these models in isolation, failing to analyse their dynamic interaction within actual institutional settings. Second, empirical studies have largely focused on the dominance of the pragmatic approach, with limited attention to why and how this

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Rahman, "Islamic Banking and Finance: Between Ideals and Realities," *International Journal of Economics, Management and Accounting* 15, no. 2 (2007): 123–141, <https://doi.org/10.31436/ijema.v15i2.132>.

<sup>3</sup>M. Umar Chapra, *Towards a Just Monetary System*, vol. 35 (Leicester: The Islamic Foundation, 1985); Mohammad N. Siddiqi, "Islamic Banking and Finance in Theory and Practice: A Survey of State of the Art," *Islamic Economic Studies* 13, no. 2 (2006): 1–48.

<sup>4</sup>*Musharakah* is a contract between two parties whereby both parties contribute agreed proportion of capital in running a business. The profit is to be distributed according to the agreement meanwhile the loss is to be borne in proportion to capital contribution; Muhammad Taqi Usmani, "The Concept of Musharakah and Its Application as an Islamic Method of Financing," *Arab Law Quarterly* 14 (1999): 203–220, <https://doi.org/10.1163/026805599125826435>. Meanwhile *Mudharabah* is a contract between two parties, one is a capital owner (*sahibul maal*) contributes money, and the other is an agent-manager (*mudharib*) contributes times and managerial skills. These two parties agree to commence a business venture. The profit will be shared between the two based on the profit ratio decided at the beginning of the contract and the loss will be borne by the capital owner; Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance: Theory and Practice* (Singapore: John Wiley & Sons, 2007), 110.

<sup>5</sup>*Murabahah* is a cost-plus profit sale contract. Under this contract, a seller purchases an asset from a supplier and resells it to the buyer at cost plus profit. Meanwhile, *ijarah* is a lease contract, and *tawarruq* is a series of sale contracts (*murabahah*) are entered into whereby a buyer buys an asset from a seller for a deferred payment and subsequently sells it to a third party for cash at a lower price for the purpose of obtaining cash; Iqbal and Mirakhor, *Introduction to Islamic Finance: Theory and Practice*.

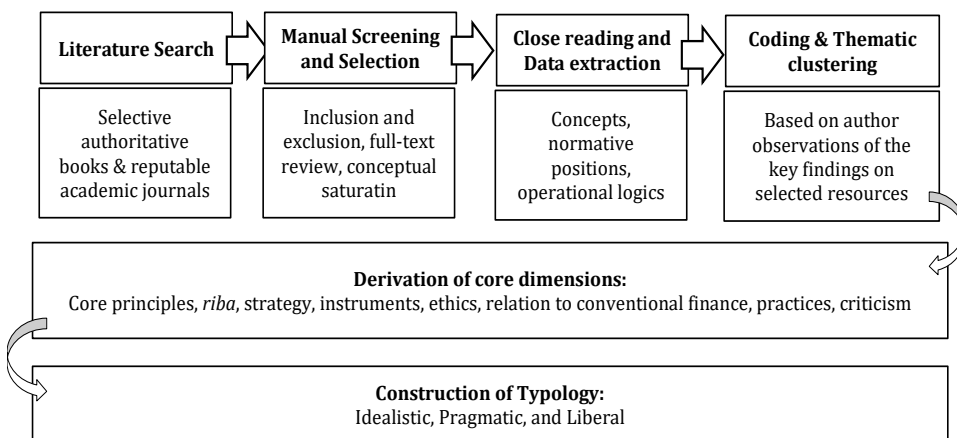
<sup>6</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*; Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600; Abdullah Saeed, *Islamic Banking and Finance* (Singapore: Institute of Southeast Asian Studies, 2004).

model has overtaken the idealist vision in shaping the architecture of modern Islamic finance.<sup>7</sup> Third, there is a growing concern that the prevailing pragmatic model, driven by market mimicry and regulatory arbitrage, undermines the ethical foundations of Islamic economics. However, this tension between form and substance, or between legalistic replication and authentic transformation, remains under-theorized and rarely subjected to comparative critical analysis.

This study contributes to the discourse by offering a comparative framework that critically evaluates the idealist, pragmatic, and liberal approaches to Islamic finance. It also interrogates the institutional, political, and market forces that shape the operational preferences of Islamic financial institutions. Ultimately, the paper aims to foster a more nuanced understanding of how Islamic finance navigates between its normative aspirations and practical adaptations in a rapidly evolving global financial system.

## 2. Method

This study adopts a qualitative and conceptual methodology grounded in the comparative analysis of Islamic finance paradigms—namely the idealist, pragmatic, and liberal approaches. The research does not rely on primary empirical data but engages critically with secondary sources, primarily academic literatures. The primary method involves a typological analysis as follows:



**Figure 1.** Typological Analytical Flow

At first, the literature search was conducted selectively by focusing on key scholarly works that explain the typology of modern Islamic finance thought, including both authoritative books and articles published in reputable academic journals database such as Scopus. For book sources, the search was conducted manually in libraries, guided by initial references identified from citations in reputable academic journals. Journal articles were searched manually in the Scopus database. Relevant articles were then filtered using the Text Search Query feature in NVivo 12 to identify the most pertinent sources, which were subsequently subjected to in-depth reading, content analysis, and

<sup>7</sup> Mehmet Asutay, “Conceptualising and Locating the Social Failure of Islamic Finance: Aspirations of Islamic Moral Economy vs the Realities of Islamic Finance,” *Asian and African Area Studies* 11, no. 2 (2012): 93–113, <https://doi.org/10.14956/asafas.11.93>; Mohamad Akram Laldin and Hafas Furqani, “Innovation versus Replication: Some Notes on the Approaches in Defining Shariah Compliance in Islamic Finance,” *Al-Jami’ah: Journal of Islamic Studies* 54, no. 2 (2016): 249–272, <https://doi.org/10.14421/ajis.2016.542.249-272>.

coding in the next two steps.

The key dimensions of the typology as appeared in discussions below were selected because of their consistent presence across the academic sources reviewed. In addition, the researcher's scholarly experience and theoretical justification informed the determination of relevance for the systematic comparison of certain aspects. Using these dimensions, the idealist, pragmatic, and liberal approaches were constructed. When individual sources exhibited mixed or ambiguous positions, the classification was also informed by the author's justification. Meanwhile, when overlaps and tensions between ideas were identified, these were retained as part of the analytical discussion to facilitate comparison across typologies.

Lastly, a constructive normative lens is applied in proposing the hybrid model. This normative synthesis draws from the strengths and critiques of each approach to formulate a forward-looking vision of Islamic finance that balances ethical imperatives with practical adaptability. While theoretical in orientation, this framework offers policy and institutional implications for regulators, scholars, and practitioners seeking to align Islamic finance with inclusive and sustainable paradigms.

### 3. Findings and Discussion

#### 3.1. The Idealist Model

The idealist model in Islamic finance emerged during the 1950s and 1960s with a central proposition: that Islamic finance must serve as a vehicle for achieving social justice, economic empowerment, and ethical conduct in accordance with Islamic legal and moral principles.<sup>8</sup> Rather than merely mimicking conventional finance, this approach promotes a distinct and autonomous financial system grounded in the ethical teachings of Islam. It claims the superiority of the Islamic economic framework as a solution to economic disparities, especially in post-colonial Muslim societies that suffered from financial exclusion and systemic poverty.<sup>9</sup>

Much of the intellectual foundation for this model is attributed to early Islamic revivalist movements, particularly the Muslim Brotherhood in Egypt. The movement redefined Islam as a comprehensive way of life—extending beyond rituals to include economic and political dimensions.<sup>10</sup> Among their key reformist proposals were: (i) the complete abolition of *riba* (usury, interest), even by the state; (ii) the elimination of speculative instruments (*maysir*, and *gharar*) as practiced in future markets; (iii) the nationalization of natural resources; (iv) state control of major financial institutions; and (v) the integration of *zakat* (obligatory almsgiving) into the formal taxation system.

The pioneering figure of this model, Ahmad Al-Najjar, implemented these ideas pragmatically by establishing the *Mit Ghamr* Savings Bank in 1963 in Egypt. Influenced by his observations of cooperative banking in West Germany, Al-Najjar sought to create an Islamic financial institution

<sup>8</sup>Saeed, *Islamic Banking and Finance*; Rahman, "Islamic Banking and Finance: Between Ideals and Realities," 123–141; Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600.

<sup>9</sup>Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600.

<sup>10</sup>Delwin A. Roy, "Islamic Banking," *Middle Eastern Studies* 27, no. 3 (1991): 427–456, <https://doi.org/10.1080/00263209108700869>; Charles Tripp, *Islam and the Moral Economy: The Challenge of Capitalism* (Cambridge: Cambridge University Press, 2006), <https://doi.org/10.1017/CBO9780511617614>; Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600.

based on mutual assistance, non-interest lending, and risk-sharing.<sup>11</sup> The bank aimed to serve socially excluded segments such as small farmers, artisans, and informal workers—those typically neglected by commercial banks. His model introduced profit-and-loss sharing (PLS) mechanisms based on *mudharabah* and *musharakah* contracts, as a Shariah-compliant alternative to interest-bearing loans.

These PLS contracts lie at the heart of the idealist model, reflecting core Islamic values such as *'adl* (justice), *ukhuwwah* (brotherhood), and *takaful* (mutual support). PLS contracts ensure fairness by sharing business risks between financiers and entrepreneurs, unlike interest-based contracts where entrepreneurs bear all risks. This risk-sharing mechanism aligns with the Islamic principle of justice, ensuring equitable distribution of wealth and income.<sup>12</sup> Moreover, the inherent risk-sharing promotes ethical responsibility and discourages the concentration of wealth.

Despite its strong normative foundation, the idealist model has struggled to gain mainstream traction. Empirical studies reveal that globally, less than 20% of Islamic finance assets utilize PLS mechanisms, with most Islamic banks favouring debt-like contracts such as *murabaha* and *ijarah* due to their operational simplicity and risk-aversion.<sup>13</sup> Critics argue that this reflects a significant drift from the original objectives of Islamic finance, which aimed to foster financial inclusion and socio-economic equity rather than emulating the efficiency logic of capitalist banking systems. Asutay argued that Islamic finance has failed to embody the moral economy envisioned by the idealist model.<sup>14</sup> In response, a model called a socially responsible Islamic finance is introduced drawing inspiration from European ethical banks, which prioritize social impact, transparency, and sustainability.<sup>15</sup>

Recent developments, particularly in Indonesia, show renewed interest in operationalizing this idealist model through Islamic social finance. The revitalization of traditional institutions such as *waqf* and *zakat* to fund public infrastructure and support Sustainable Development Goals (SDGs) illustrates a pluralistic model of Islamic finance that goes beyond commercial banking. This demonstrates that the idealist ethos is still relevant, particularly when channelled through hybrid institutional forms, social and commercial financial instruments.

A parallel critique has also emerged against the over-legalization and product mimicry in the current Islamic financial landscape. This has given rise to a school of thought promoting authenticity in Islamic finance, which calls for innovations rooted in Islamic jurisprudential tradition (*usul al-fiqh*), rather than cosmetic adjustments to conventional instruments. This school proposes four key

<sup>11</sup>Ann Elizabeth Mayer, “Islamic Banking and Credit Policies in the Sadat Era: The Social Origins of Islamic Banking in Egypt,” *Arab Law Quarterly* 1 (1985): 32–50, <https://doi.org/10.2307/3381671>; Rania Kamla and Rana Alsoufi, “Critical Muslim Intellectuals’ Discourse and the Issue of Interest (Ribā),” *Accounting Forum* 39, no. 2 (2015): 140–154, <https://doi.org/10.1016/j.accfor.2015.02.002>.

<sup>12</sup>Aisyah Abdul-Rahman and Reza Gholami, “Islamic Finance and COVID-19 Recovery: The Role of Profit-Loss Sharing Contract,” *Jurnal Pengurusan* 59 (2020): 7–10, <https://doi.org/10.17576/pengurusan-2020-59-02>

<sup>13</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*.

<sup>14</sup>Asutay, “Conceptualising and Locating the Social Failure of Islamic Finance: Aspirations of Islamic Moral Economy vs the Realities of Islamic Finance,” 93–113; Mehmet Asutay, “Conceptualisation of the Second-Best Solution in Overcoming the Social Failure of Islamic Banking and Finance: Examining the Overpowering of Homo Islamicus by Homo Economicus,” *International Journal of Economics, Management and Accounting* 15, no. 2 (2007): 167–195, <https://doi.org/10.31436/ijema.v15i2.134>

<sup>15</sup>Umar F. Moghul, *A Socially Responsible Islamic Finance: Character and the Common Good* (Cham: Springer International Publishing, 2017), <https://doi.org/10.1007/978-3-319-48841-7>.

principles: (i) harmonizing legal form with economic substance; (ii) rejecting the singular pursuit of profit maximization; (iii) adopting a risk-sharing rather than risk-transfer paradigm; (iv) designing contracts that fulfill *the maqasid al-Shari'ah* (the objectives of Shari'ah) in practice.<sup>16</sup> The "authenticity approach" argues for re-contextualizing Islamic finance within its historical and ethical trajectory, asserting that mere compliance without substance undermines the legitimacy and social trust in Islamic financial institutions.<sup>17</sup>

### 3.1.1. Decline of the Idealist Model and the Ascendancy of Pragmatism

Despite its strong ethical foundations and social aspirations, the idealist approach to Islamic finance has largely failed to shape the operational reality of the Islamic financial industry. While early Islamic economists and visionaries envisioned a system built on justice, equity, and profit-and-loss sharing (PLS), the commercial pressures of the financial sector, combined with regulatory constraints and risk aversion, have led to the dominance of a more pragmatic, Shariah-compliant but not necessarily Shariah-based model.

The failure of the idealist model can be attributed to several interlocking structural and operational challenges: (i) high transaction costs and information asymmetry: PLS contracts such as *mudharabah* and *musharakah* require close monitoring, trust, and transparency between financiers and entrepreneurs. Islamic financial institutions often struggle to assess and monitor micro-enterprise projects, especially compared to the straightforward nature of debt-based contracts like *Murabaha*; (ii) regulatory and risk-management constraints: financial regulators across jurisdictions tend to prefer instruments that offer risk certainty and capital adequacy. Debt-based Islamic financial contracts can be more easily standardized, securitized, and incorporated into risk-weighted asset frameworks under Basel regulations.<sup>18</sup> This technical advantage has incentivized Islamic financial institutions to adopt these models at the expense of the original risk-sharing ideal; (iii) market behaviour and demand pressures: many clients of Islamic financial institutions are not ideologically committed to Islamic economic values; they seek competitive pricing, fast processing, and familiarity with conventional financial products. This consumer behaviour has also encouraged Islamic banks to "Islamise" conventional contracts rather than create authentically new financial instruments<sup>19</sup>; and (iv) Shari'ah arbitrage and legal stratagems: the widespread use of *hilah* (legal tricks) and *tafīq* (selective combination of juristic opinions) in structuring Shariah-compliant products has drawn criticism for undermining the spirit of Islamic law. Critics argue that such practices have allowed for a superficial compliance with Shari'ah while ignoring its socio-economic objectives (*maqasid al-shari'ah*).<sup>20</sup>

These conditions have given rise to what is now called the pragmatic approach—a legalistic, market-oriented adaptation of Islamic finance. This model emphasizes Shari'ah compliance in form rather than in substance and operationalizes Islamic finance primarily through debt-based instruments that are functionally equivalent to their conventional counterparts. While this approach has enabled rapid growth and institutional integration of Islamic finance into the global financial system, it has

<sup>16</sup>Ayraf Wajdi Dusuki, and Said Bouheraoua, "The Framework of Maqasid al-Shari'ah and Its Implication for Islamic Finance," *ICR Journal* 2, no. 2 (2011): 316–336, <https://doi.org/10.52282/icr.v2i2.651>.

<sup>17</sup>Zeeshan Hussain, "A Search for Authenticity," *SOAS Law Journal* 1 (2014): 1.

<sup>18</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*.

<sup>19</sup>Ibrahim Warde, *Islamic Finance in the Global Economy* (Edinburgh: Edinburgh University Press, 2000); Rodney Wilson, *The Development of Islamic Finance in the GCC* (London: The Kuwait Programme on Development, Governance and Globalisation in the Gulf States, 2009).

<sup>20</sup>Siddiqi, "Islamic Banking and Finance in Theory and Practice: A Survey of State of the Art, 1–48; Muhammad Taqi Usmani, *An Introduction to Islamic Finance* (Leiden: Brill, 2002).

also sparked intellectual and ethical criticism.<sup>21</sup> Asutay famously termed this divergence as the social failure of Islamic finance, arguing that the industry has succeeded financially but failed to deliver on its moral and developmental promises. He asserts that the dominance of the pragmatic model has delinked Islamic finance from the ideals of Islamic economics, reducing it to a mechanical replication of conventional finance with Arabic labels.<sup>22</sup>

This paradigm drift has not gone unnoticed. A growing body of scholarship calls for a recalibration of the industry toward greater authenticity and alignment with *Sharia*. Proposals include the adoption of hybrid models that integrate social finance (e.g., waqf, zakat) with commercial Islamic banking, the establishment of impact measurement frameworks, and the revitalization of ethical screening mechanisms beyond mere Shari'ah board approval.<sup>23</sup>

### 3.2. The Pragmatic Model: Legal Adaptation and Market Accommodation

The dominant approach in the development of Islamic finance is the pragmatic approach, which focuses on legal adaptation, market compatibility, and institutional feasibility. Unlike the idealist model that places moral economy and social justice at the centre of Islamic finance, the pragmatic approach accepts the structural dominance of conventional financial systems and seeks to align Islamic principles within this context through legal engineering and product adaptation.<sup>24</sup>

Historically, this approach emerged out of the necessity to make Islamic finance operationally viable in both Muslim-majority and secular financial environments. It prioritizes the elimination of *riba* (interest, usury) as a central prohibition, while allowing a broader interpretation of Shari'ah principles to develop financial products that resemble conventional banking instruments but are formally compliant with Islamic law.<sup>25</sup>

One of the earliest proponents of this model is Muhammad Baqir al-Sadr, a leading Shi'a scholar whose works like *Iqtisaduna* (Our Economics) offers an early framework for Islamic finance based on functional adaptation. Sadr's moderate pragmatism distinguishes between the ideological foundations of capitalism and the objective-driven functions of banking—such as savings mobilization and capital allocation—which, according to him, can be retained in Islamic finance if

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<sup>21</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*; Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600; Saeed, *Islamic Banking and Finance*; Asutay, "Conceptualisation of the Second-Best Solution in Overcoming the Social Failure of Islamic Banking and Finance: Examining the Overpowering of Homo Islamicus by Homo Economicus," 167–195, <https://doi.org/10.31436/ijema.v15i2.134>.

<sup>22</sup>Asutay, "Conceptualising and Locating the Social Failure of Islamic Finance: Aspirations of Islamic Moral Economy vs the Realities of Islamic Finance," 93–113; Asutay, "Conceptualisation of the Second-Best Solution in Overcoming the Social Failure of Islamic Banking and Finance: Examining the Overpowering of Homo Islamicus by Homo Economicus," 167–195, <https://doi.org/10.31436/ijema.v15i2.134>.

<sup>23</sup>Ayraf Wajdi Dusuki, and Said Bouheraoua, "The Framework of Maqasid al-Shari'ah and Its Implication for Islamic Finance," *ICR Journal* 2, no. 2 (2011): 316–336, <https://doi.org/10.52282/icr.v2i2.651>; Laldin and Furqani, "Innovation versus Replication: Some Notes on the Approaches in Defining Shariah Compliance in Islamic Finance," 249–272, <https://doi.org/10.14421/ajis.2016.542.249-272>.

<sup>24</sup>Saeed, *Islamic Banking and Finance*; Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600; Hussain, "A Search for Authenticity," 1.

<sup>25</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*; Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600.

stripped from exploitative practices.<sup>26</sup>

Sadr advocated for two key financial instruments in Islamic banking: *qard al-hasan* (benevolent loans) and *mudarabah* (profit-sharing partnerships). However, recognizing market realities, Sadr also proposed juristic mechanisms that would allow Islamic banks to provide guarantees on deposits and minimum returns—objectives traditionally achieved through interest in conventional banks. He creatively applied agency contracts and legal stratagems to reconcile these guarantees with Islamic jurisprudence, arguing that if the bank acts as an intermediary and not a party to the *mudarabah*, it may voluntarily assume the investment risks.<sup>27</sup> Despite the formalism of these solutions, Sadr's model was influential in shifting the debate from idealistic moral economy to operational Islamic finance, paving the way for modern Islamic banks to function within secular legal systems while maintaining symbolic Sharī'ah compliance (ibid).

Another early figure in this approach is Sami Humud, who promoted the coexistence of Islamic and conventional financial systems through selective *fiqh* adaptation. His contributions laid the groundwork for Islamic financial product development by focusing on the use of juristic preferences (*ikhtilaf*) and the legitimacy of multiple legal opinions (*talfiq*) to craft Islamic alternatives to conventional practices. Humud's method resonates with the practice of many modern Islamic banks, particularly in jurisdictions like the GCC and Southeast Asia, where Sharī'ah supervisory boards often adopt hybrid jurisprudential positions to approve products like *murabaha*, *ijarah*, and *tawarruq* that mimic interest-based transactions but fulfill formal Islamic legal criteria.<sup>28</sup>

In the more recent phase of pragmatic adaptation, *talfiq* method has emerged, characterized by the liberal use of *hilah* (legal stratagems) and *talfiq* to reconcile conventional financial practices with Islamic legal forms. As noted by Saeed<sup>29</sup> and Rahman,<sup>30</sup> this model has become dominant in jurisdictions such as Malaysia, where Islamic finance is institutionally embedded and required to compete with conventional banking under a dual system.

This more pragmatic trend is evident in the widespread use of *murabaha* financing, which has drawn criticism for resembling conventional interest-based loans in form and function. Critics point to: (i) the use of an interest rate benchmark as a pricing benchmark for Islamic financial products, (ii) legally binding promises to purchase before banks possess the goods, and (iii) pre-determined markups that render the risk-sharing rhetoric meaningless.<sup>31</sup>

It can be argued that there are three systemic forces behind the dominance of debt-based contracts over PLS: (i) macroeconomic constraints: operating within capitalist structures and regulatory environments that favour fixed-income products; (ii) sociocultural behaviour: low transparency, weak accountability, and preference for predictability hinder the uptake of risk-sharing contracts; (iii) market incentives: risk-averse behaviour of Islamic banks and consumer demand for

<sup>26</sup>Hegazy, "Contemporary Islamic Finance: From Socioeconomic Idealism to Pure Legalism," 581–600; Rodney Wilson, "The Contribution of Muḥammad Bāqir Al-Ṣadr to Contemporary Islamic Economic Thought," *Journal of Islamic Studies* 9, no. 1 (1998): 46–59, <https://doi.org/10.1093/jis/9.1.46>; Rodney Wilson, *Islam and Economic Policy: An Introduction* (Edinburgh: Edinburgh University Press, 2015).

<sup>27</sup>Wilson, "The Contribution of Muḥammad Bāqir Al-Ṣadr to Contemporary Islamic Economic Thought," 46–59; Rodney Wilson, *Islam and Economic Policy: An Introduction*.

<sup>28</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*.

<sup>29</sup>Saeed, *Islamic Banking and Finance*.

<sup>30</sup>Rahman, "Islamic Banking and Finance: Between Ideals and Realities," 123–141.

<sup>31</sup>El-Gamal, *Islamic Finance: Law, Economics, and Practice*; Asutay, "Conceptualising and Locating the Social Failure of Islamic Finance: Aspirations of Islamic Moral Economy vs the Realities of Islamic Finance," 93–113.

products with similar return profiles to conventional banking. Moreover, the reinterpretation of core concepts such as money and *riba* has facilitated further pragmatism. The idealist view of money as a medium of exchange only has shifted toward the acceptance of money's time value, allowing for pricing mechanisms and penalties (*ta'widh*) in default scenarios. *Riba* is now often understood in legal rather than economic terms, opening the door for contractual innovations that are technically Shariah-compliant but arguably devoid of its ethical spirit.<sup>32</sup>

### 3.3. The Liberal and Contextualist Model: Reframing *Riba* and Embracing Functional Equivalence

The liberal and contextualist model in Islamic finance challenges conventional assumptions by reframing traditional interpretations of *riba* and rejecting the notion that interest, as it exists in modern banking, is inherently prohibited. This approach is most notably advocated by scholars such as Saeed<sup>33</sup>, who argues that the Qur'anic condemnation of *riba* was directed at a specific form of exploitative usury, not the regulated, interest-based financial transactions of contemporary banking systems. Saeed distinguishes between the socially destructive nature of classical *riba* and the functional necessity of modern interest in facilitating economic growth, especially in non-Muslim or pluralistic societies.

This model emphasizes the moral objectives (*maqasid al-shariah*) and contextual understanding of Islamic financial ethics over rigid legal formalism. Rather than replicating Islamic finance as a parallel institutional system, proponents of the liberal model advocate for functional integration with conventional finance, as long as moral and ethical principles—such as fairness, transparency, and risk awareness—are observed. Saeed<sup>34</sup> asserts that conventional banks are not inherently un-Islamic, as they fulfill socially useful roles such as capital allocation, risk management, and financial intermediation.

One of the key features of the liberal approach is its emphasis on substance over form. Proponents argue that the spirit of Shari'ah—that is, promoting justice, equity, and socioeconomic development—should take precedence over the literal form of financial contracts. This perspective allows for the use of mathematical models, ethical screens, and behavioural economics to assess whether a financial practice contributes to exploitation or fulfills communal wellbeing. Rather than strictly prohibiting interest-bearing transactions, this approach calls for evaluating the real economic and social impact of such arrangements.<sup>35</sup>

This model is also associated with a reinterpretation of traditional sources considering contemporary realities. For instance, Sheikh Muhammad Sayyid Tantawi, while serving as the Grand Mufti of Egypt, issued a landmark *fatwa* that permitted Muslims to deposit funds in interest-bearing accounts. Tantawi's reasoning, grounded in his interpretation of the intent and objectives of Islamic law, considered bank depositors as passive investors and the bank as their investment agent. As such, the returns received by depositors were seen not as *riba*, but as profit-sharing arrangements in line

<sup>32</sup>Asyraf Wajdi Dusuki, and Nurdianawati Irwani Abdullah, "Maqasid al-Shariah, Maslahah, and Corporate Social Responsibility," *American Journal of Islamic Social Sciences* 24, no. 1 (2007): 25–45, <https://doi.org/10.35632/ajis.v24i1.415>; El-Gamal, *Islamic Finance: Law, Economics, and Practice*.

<sup>33</sup>Abdullah Saeed, *Islamic Banking and Finance* (Singapore: Institute of Southeast Asian Studies, 2004); Abdullah Saeed, *Islamic Banking and Interest: A Study of the Prohibition of Riba and Its Contemporary Interpretation*, vol. 2 (Leiden: Brill, 1996).

<sup>34</sup>*ibid.*

<sup>35</sup>Kamla and Alsoufi, "Critical Muslim Intellectuals' Discourse and the Issue of Interest (Ribā)," 140–154, <https://doi.org/10.1016/j.accfor.2015.02.002>

with modern financial practices.<sup>36</sup>

Tantawi's *fatwa* opened the door for a broader acceptance of conventional banking under Islamic ethical guidelines. His stance reflects a trend toward harmonization between Islamic ethics and global finance, particularly in contexts where Muslim minorities operate within secular financial systems. This liberal understanding does not necessarily advocate for the complete abandonment of Islamic finance institutions but questions the necessity of a segregated Islamic financial system when existing institutions can accommodate Islamic moral values through reform. Caeiro<sup>37</sup> has argued that the liberal model represents a social construction of Shari'ah norms in the West. His ethnographic studies in Europe reveal that Muslim communities often navigate their financial practices by balancing Islamic identity with pragmatic financial needs. In this light, the liberal model reflects lived Islam, which is adaptive, contextual, and responsive to socio-economic constraints rather than being rigidly fixed to classical jurisprudence. Furthermore, Kamla & Alsoufi<sup>38</sup> argue that Islamic finance should be viewed not merely as a system of contracts but as part of a broader ethical project of economic justice. They call for integrating Islamic finance within movements for global financial reform, focusing on inclusion, sustainability, and equality.

Nevertheless, this approach is not without criticism. Traditionalists argue that the liberal stance dilutes the distinctiveness of Islamic finance, leading to a convergence with interest-based systems, which undermines the prohibition of *riba* and weakens Islamic identity. Moreover, some critics suggest that liberal interpretations risk being co-opted by neoliberal frameworks and may fail to address deeper structural inequalities.<sup>39</sup>

**Table 1.** Approaches in Developing Islamic Finance (Idealistic, Pragmatic, and Liberal)

Dimension	Idealist Approach	Pragmatic Approach	Liberal Approach
Core Principle	Normative Islamic moral economy; social justice and equitable distribution	Functional equivalence; legal compliance with Shariah	Contextual moral framework
View on <i>Riba</i> (Interest)	Total prohibition; intrinsic moral and ethical problem	Legal prohibition; <i>riba</i> defined as contractual interest	Reinterpreted; not all interest is <i>riba</i> if not exploitative
Operational Strategy	Emphasis on risk-sharing and Profit and Loss Sharing (PLS) contracts; financial inclusion	Legal adaptation using Islamic jurisprudence tools (such as <i>talfiq</i> , <i>hillah</i> – Legal stratagem)	Ethical compatibility with conventional systems; integrationist
Key Instruments	<i>Mudharabah</i> , <i>Musyarakah</i> , <i>Qard Hasan</i>	<i>Murabaha</i> , <i>Ijarah</i> , <i>Tawarruq</i> , in some cases	Interest-bearing deposits, ethical

<sup>36</sup>Mahmoud A. El-Gamal, "'Interest' and the Paradox of Contemporary Islamic Law and Finance," *Fordham International Law Journal* 27, no. 1 (2003): 108–149, <https://ir.lawnet.fordham.edu/ilj/vol27/iss1/6>.

<sup>37</sup>Alexandre Caeiro, "The Social Construction of Shari'ah: Bank Interest, Home Purchase, and Islamic Norms in the West," *Die Welt des Islams* 44 (2004): 351–375, <https://doi.org/10.1163/1570060042562516>

<sup>38</sup>Kamla and Alsoufi, "Critical Muslim Intellectuals' Discourse and the Issue of Interest (Ribā)," 140–154, <https://doi.org/10.1016/j.accfor.2015.02.002>.

<sup>39</sup>Asutay, "Conceptualising and Locating the Social Failure of Islamic Finance: Aspirations of Islamic Moral Economy vs the Realities of Islamic Finance," 93–113.

Dimension	Idealist Approach	Pragmatic Approach	Liberal Approach
		<i>Bay al Innah (Malaysia)</i>	screens, impact investing
Ethical Foundation	Objectives of Shari'ah (Islamic law), ethics, justice, and brotherhood	Form-based Shari'ah compliance, not always substance-based	Substance over form; ethical outcomes prioritized
Relation to Conventional Finance	Avoid conventional frameworks; aims to create distinct Islamic financial system	Seeks to replicate conventional instruments within Islamic form	Accepts coexistence with conventional finance under ethics
Practices	Limited on global Islamic finance assets in PLS	Dominant; over 80% of Islamic financial assets use this model	Limited but growing in pluralistic societies
Criticism	Operational difficulties, high monitoring cost, low market demand	Accused of legal mimicry, loss of Islamic moral vision	Dilution of Islamic distinctiveness, risk of neoliberal co-optation

### 3.4. Toward a Hybrid Approach: Synthesizing Legal, Ethical, and Impact Dimensions

The hybrid approach in Islamic finance represents an emerging effort to bridge the gap between the idealist model's ethical aspirations, the pragmatic model's operational viability, and the liberal model's contextual sensitivity. This model acknowledges the shortcomings of pure paradigms and integrates the strengths of multiple approaches to develop financial systems that are both Shariah-compliant and economically viable. It aims to achieve the *Maqasid al-Shari'ah* (objectives of Islamic law) while navigating the modern complexities of financial systems, global markets, and pluralistic societies.

Unlike the idealist model which demands strict adherence to profit and loss sharing (PLS) mechanisms, or the pragmatic model which often resorts to debt-based contracts like *murabaha* for ease of implementation, the hybrid approach explores a middle path. It encourages the use of financial instruments that balance risk-sharing, ethical financing, and practical modern banking and finance needs. In doing so, it accepts some form of compromise but under the guidance of the *Maqasid al-Shari'ah* (objectives of *Sharia*), and social benefit.

There are some characteristics that might be identified in this hybrid model: (i) balanced risk management: combines PLS schemes like *mudarah* and *musyarakah* with risk-mitigated contracts such as *ijarah* and diminishing *musharakah*; (ii) ethical screening and impact metrics: integrates ESG (Environmental, Social, and Governance) criteria and SDG (Sustainable Development Goals) alignment in product evaluation, echoing the liberal emphasis on moral substance; (iii) legal and economic substance alignment: avoids mere legal mimicry by ensuring that contracts achieve genuine economic transformation aligned with Shari'ah spirit; (iv) institutional innovation: encourages institutional reforms and regulatory support that favour inclusive finance, fintech adaptation, and green finance; and (v) integration of Islamic social and commercial finance.

**Table 2.** Dimension of Hybrid Approach

Dimension	Hybrid Approach (Synthesised Principles)
Core Principles	Principled adaptability: a commitment to Islamic moral economy combined with institutional and market realism, allowing adaptive solutions without sacrificing core ethical commitments

Dimension	Hybrid Approach (Synthesised Principles)
View on <i>Riba</i> (Interest, Usury)	Substantive prohibition of exploitation: <i>riba</i> is understood not merely as a formal legal category but as any structurally unjust or exploitative return, assessed through both legal form and economic substance
Operational Strategy	Substance-guided innovation: instruments and structures are designed through juristic tools and financial engineering, but evaluated primarily by their real economic effects and social impact
Proposed Instruments	Impact-oriented and risk-sharing instruments: e.g., Cash Waqf Linked Deposit/Sukuk, Green Sukuk, <i>Diminishing Musharakah</i> , and Cooperative Takaful—selected not as replicas, but as vehicles for social impact, sustainability, and shared value creation
Ethical Foundation	Ethical evaluation prioritizes justice, welfare, inclusion, and harm prevention over mere formal compliance with contractual structures
Relation to Conventional Finance Practices	Critical coexistence: engagement with conventional finance is permitted where it advances ethical and developmental objectives, while maintaining a normative distance from purely profit-maximizing or extractive logics Context-responsive and scalable: still emerging, but potentially applicable across Muslim and non-Muslim majority contexts, especially in sustainability finance, social finance, and inclusive development agendas

### 3.4.1 Cash *Waqf* Linked Deposit

Some modern Islamic financial products might be viewed in the light of this hybrid model. Cash *Waqf* Linked Deposit (CWLD) is an innovative financial instrument in Indonesia that exemplifies the integration of social finance and commercial banking. The model channels philanthropic funds through Islamic banks by allowing depositors to allocate a portion of their deposit as *waqf* (endowment), while the principal remains invested in Sharia-compliant instruments. Returns generated from the investment are then distributed for social welfare programs such as education, healthcare, and micro-enterprise support, in line with the objectives of *maqasid al-Shari'ah* (Preservation of life, wealth, and dignity).<sup>40</sup>

This integration addresses the dual goals of Islamic finance: ensuring economic viability and promoting social justice. Unlike traditional *waqf* that often involves immovable assets (e.g., land or buildings), CWLD represents a significant innovation in Islamic finance, offering a flexible and impactful way to utilize *waqf* for socio-economic development. By leveraging the liquidity and risk-sharing mechanisms of commercial banking, CWLD enhances financial inclusion, sustainability, and public trust. The role of Islamic banks as intermediaries is pivotal in ensuring the success of CWLD, making it a valuable tool for achieving broader financial and social goals.<sup>41</sup> In Indonesia, Sharia

<sup>40</sup>Ascarya and I. A. Rahmawati, "Cash Waqf Linked Sukuk (CWLS) Model and Its Application in Indonesia," *Journal of Islamic Monetary Economics and Finance* 7, no. 2 (2021): 225–248, <https://doi.org/10.21098/jimf.v7i2.1334>.

<sup>41</sup>Ahmad Jafar, Hafsa Ibrahim, and Rizwan Malik, "Waqf: From Classical Charitable System to Modern Financial Tool," *International Journal of Ethics and Systems* (2025), <https://doi.org/10.1108/IJOES-10-2024-0354>; Mitra Sami Gultom and Muhammad Iman Sastra Mihajat, "Cash Waqf Linked Deposit: A Proposed Waqf Model for Education Program and Poverty Alleviation in Indonesia," in *Strategic Islamic Business and Management: Solutions for Sustainability*, ed. Ahmad Rafiki, Veland Ramadani, Léo-Paul Dana, and Sutan Emir Hidayat (Cham: Springer Nature Switzerland, 2024), 313–325, [https://doi.org/10.1007/978-3-031-61778-2\\_17](https://doi.org/10.1007/978-3-031-61778-2_17); Romzie Rosman, Razali Haron, and Nurul Balqis Mohamed Othman, "The Impact of Zakāt Contribution on the Financial Performance of Islamic Banks in Malaysia," *Al-Shajarah* (2019): 1–19, <https://doi.org/10.31436/shajarah.v0i0.894>.

banking institutions and Indonesia *Waqf* Institution (BWI) have adopted CWLD as part of a broader strategy to mobilize dormant capital and empower the Islamic social finance ecosystem. Empirical studies suggest that the model increases donor participation<sup>42</sup> and institutional collaboration,<sup>43</sup> making it a viable hybrid between charity and investment. Thus, CWLD serves as a practical embodiment of the hybrid model in Islamic finance, promoting ethical intermediation and inclusive development.

### 3.4.2. Green Sukuk

Green sukuk represents a pioneering financial innovation that exemplifies the hybrid model in Islamic finance by integrating Shari'ah principles with environmental sustainability. Structurally, green sukuk are Shari'ah-compliant investment certificates where proceeds are earmarked for climate-resilient or environmentally beneficial projects, such as renewable energy, sustainable transport, or green infrastructure.<sup>44</sup> These instruments embody the core values of *maqasid al-shariah*—notably the protection of life (*hifz al-nafs*), wealth (*mal*), and environment—while also ensuring economic viability through structured returns and risk-sharing.

As a hybrid model, green *sukuk* bridges the ethical focus of the idealist Islamic finance paradigm with the market-driven practicality of the pragmatic model. It avoids excessive legalism by embedding substantive outcomes—carbon reduction, energy transition, and ecological welfare—within the contractual framework. Simultaneously, it resonates with the liberal approach through compatibility with global ESG standards and green bond frameworks. This dual alignment enhances the sukuk's appeal among both faith-based and mainstream investors, fostering broader financial inclusion.

Indonesia and Malaysia have emerged as global leaders in green sukuk issuance. Indonesia's sovereign green sukuk—first launched in 2018—has successfully mobilized billions of dollars to fund projects aligned with the SDGs and climate action commitments, making it a model for sustainable Islamic finance (OECD, 2023).<sup>45</sup> Empirical studies show that such instruments not only uphold Shari'ah compliance but also enhance transparency, governance, and impact measurement.<sup>46</sup> Thus, green *sukuk* exemplifies the operationalization of Islamic finance's ethical vision in service of global sustainability.

<sup>42</sup>Rina Maulina, "Factors Influencing the Success of Retail Cash Waqf Linked Şukūk (CWLS) Issuance: A Lesson from Indonesia," *Journal of King Abdulaziz University: Islamic Economics* 35, no. 1 (2022): 57–74, <https://doi.org/10.4197/Islec.35-1.4>.

<sup>43</sup>Muhammad M. Said, and Dwi Irianti Hadiningdyah, "Cross-Sector Collaboration and Innovation in Cash Waqf Linked Sukuk in Indonesia," in *Innovative Ventures and Strategies in Islamic Business*, ed. Ahmad Rafiki and Adel Sarea (Hershey, PA: IGI Global, 2025), 415–432, <https://doi.org/10.4018/979-8-3693-3980-0.ch020>; Asyharul Muala, and Muhammad Lutfi Hakim, "Cash Waqf Linked Sukuk for Islamic Social Welfare and National Development: Evidence from Indonesia," *Global Journal Al-Thaqafah* 13, no. 1 (2023): 16–34, <https://doi.org/10.7187/GJAT072023-2>.

<sup>44</sup>World Bank, *Green Sukuk: Islamic Finance and Climate Change* (Washington, DC: World Bank, 2021).

<sup>45</sup>OECD, *Green Islamic Finance: Scaling Up the Green Sukuk Market in Emerging Economies* (Paris: OECD, 2023).

<sup>46</sup>Ali Said and Rania Grassa, "The Determinants of Sukuk Market Development: Does Macroeconomic Factors Influence the Construction of Certain Structure of Sukuk?" *Journal of Applied Finance & Banking* 3, no. 5 (2013): 251–267.

### 3.4.3. Diminishing *Musharakah*

Diminishing *musharakah* (DM) represents a pragmatic and ethically grounded hybrid model in Islamic finance that combines the profit-and-loss sharing ethos of classical Islamic contracts with the predictability of debt-based structures. Initially conceived as a joint ownership agreement between a financial institution and a client, DM allows the client's share of the asset—typically a home or real estate—to gradually increase through periodic payments, while the financier's share diminishes accordingly. This dual-layered contract integrates equity participation with a lease-like instalment arrangement, balancing risk-sharing with repayment certainty.<sup>47</sup>

Unlike pure *mudabah* and *musharakah*, which expose financiers to high market and informational risks, DM mitigates asymmetric information and moral hazard by linking the transfer of ownership to a pre-agreed payment schedule. Meanwhile, the client benefits from asset acquisition without engaging in interest-based lending. This design responds to both Sharī'ah requirements and consumer preferences for structured, low-risk financing mechanisms.<sup>48</sup>

The adoption of Islamic mortgage financing in countries with dual banking systems like the UK, Malaysia, and Indonesia is facilitated by the flexibility and innovation these systems offer. The dual banking structure supports economic growth, financial stability, and the development of Shariah-compliant financial products, although it also presents regulatory and legal challenges that need to be addressed.<sup>49</sup> Its hybrid nature also aligns with *maqasid al-Sharī'ah* by promoting home ownership, economic stability, and financial inclusion while avoiding *riba*. Regulatory innovations—such as legal recognition of co-ownership and default protection clauses—have further enhanced its viability and compliance.

### 3.4.5. *Takaful* Cooperative Model: A Hybrid Approach in Islamic Finance

The *Takaful* cooperative model represents a hybrid approach in Islamic finance, combining elements of mutual insurance and cooperative principles to create a Shariah-compliant alternative to conventional insurance. This model is grounded in the principles of mutual collaboration and mutual guarantee, where participants contribute to a collective fund to cover losses and expenses.<sup>50</sup> The

<sup>47</sup>Usmani, *An Introduction to Islamic Finance*.

<sup>48</sup>Alfred Kammer, Mohamed Norat, Marco Pinon, and Ananthakrishnan Prasad, *Islamic Finance: Opportunities, Challenges, and Policy Options*, IMF Staff Discussion Note (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1505.pdf>.

<sup>49</sup>Pejman Abedifar, Iftekhar Hasan, and Amine Tarazi, "Finance-Growth Nexus and Dual-Banking Systems: Relative Importance of Islamic Banks," *Journal of Economic Behavior & Organization* 132 (2016): 198–215, <https://doi.org/10.1016/j.jebo.2016.03.005>; Omar Masood, Jamila E. Chichti, Walid Mansour, and Qaiser A. Amin, "Role of Islamic Mortgage in the UK," *International Journal of Monetary Economics and Finance* 2, nos. 3–4 (2009): 366–383, <https://doi.org/10.1504/IJMEF.2009.029069>; Janice CY How, Melina Abdul Karim, and Peter Verhoeven, "Islamic Financing and Bank Risks: The Case of Malaysia," *Thunderbird International Business Review* 47, no. 1 (2005): 75–94, <https://doi.org/10.1002/tie.20041>; Murat Ustaoglu and Ahmet Incekara, eds., *Balancing Islamic and Conventional Banking for Economic Growth: Empirical Evidence from Emerging Economies* (Cham: Springer, 2017), <https://doi.org/10.1007/978-3-319-59554-2>; and Shah, S. M. A. R., M. H. Helmi, M. U. Syed Muhammad Abdul Rehman Shah et al., "Interbank Rate and Monetary Policy: Evidence from Dual Banking System of Developing Countries," *ISRA International Journal of Islamic Finance* 16, no. 2 (2024): 131–153, <https://doi.org/10.55188/ijif.v16i2.553>.

<sup>50</sup>Shahid Rizwan and Husam-Aldin N. Al-Malkawi, "Islamic Insurance (*Takaful*): An Overview," in *Islamic Finance in the Modern Era*, ed. Hussain Mohi-ud-Din Qadri and M. Ishaq

Takaful cooperative model offers a robust and Shariah-compliant alternative to conventional insurance, emphasizing mutual assistance and risk-sharing. While various models exist, the industry continues to evolve to address challenges and enhance compliance. The positive economic impact and growing acceptance of Takaful highlight its potential as a key component of the Islamic financial ecosystem.<sup>51</sup>

The hybrid nature of the takaful model emerges from its combination of commercial viability with ethical intermediation. While the risk-sharing component adheres to the classical concept of mutual cooperation (*mudharabah* or *wakalah*), the operational framework integrates regulatory oversight, professional fund management, and surplus distribution mechanisms that mirror the best practices of conventional insurance. This duality allows takaful institutions to remain competitive while avoiding *gharar* (excessive uncertainty) and *riba* (interest), the key prohibitions in Islamic finance.<sup>52</sup>

Modern Takaful operators effectively balance their roles as fiduciary managers and social trustees, ensuring that the Takaful system remains ethical, cooperative, and sustainable. The surplus-sharing model further enhances the cooperative nature of Takaful, aligning with its core principles of mutual assistance and social welfare.<sup>53</sup> The regulatory frameworks in Malaysia, Bahrain, and Pakistan have successfully institutionalized takaful through dedicated legislation, ensuring that financial innovation does not compromise Shari'ah principles. These frameworks emphasize strong

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Bhatti (London: Routledge, 2024), 112–124, <https://doi.org/10.4324/9781003366751-8>; Mervyn K. Lewis, “The Evolution of Takaful Products,” in *Islamic Capital Markets: Products and Strategies* (Hoboken, NJ: Wiley, 2012), 185–199, <https://doi.org/10.1002/9781119206040.ch9>.

<sup>51</sup>Lewis, “The Evolution of Takaful Products,” in *Islamic Capital Markets: Products and Strategies*, 185–199, <https://doi.org/10.1002/9781119206040.ch9>; Azman Mohd Noor, and Muhammad Abd Hadi Bin Abd Rahman, “Cooperative Takaful for Non-Banking Financial Institutions: Islamization of SOCSO in the Case of Malaysia,” *Intellectual Discourse* 24 (2016): 459–476, <https://doi.org/10.31436/id.v24i0.929>; Aisha Naz and Muhammad Ali, “Takaful Governance and Sustainable Practices,” in *Islamic Finance and Corporate Governance: Synergies for Sustainable Growth*, ed. Muhammad Ali et al. (Bingley: Emerald Publishing Limited, 2025), 175–201, <https://doi.org/10.1108/978-1-83662-346-520251023>; Umidjon Dadaboev et al., “Econometric Analysis of the Impact of Takaful Financial Services on Economic Development: A Case Study of Malaysia,” in *International Conference on WorldS4* (Singapore: Springer Nature Singapore, 2024), 491–501, [https://doi.org/10.1007/978-981-97-9559-8\\_43](https://doi.org/10.1007/978-981-97-9559-8_43); Hayat Khan, “A Nontechnical Guide on Optimal Incentives for Islamic Insurance Operators,” *Journal of Risk and Financial Management* 12, no. 3 (2019): 127, <https://doi.org/10.3390/jrfm12030127>.

<sup>52</sup>Dila Puspita, Adam Kolkiewicz, and Ken Seng Tan, “Discrete Time Ruin Probability for Takaful (Islamic Insurance) with Investment and Qard-Hasan Activities,” *Journal of Risk and Financial Management* 13, no. 9 (2020): 211, <https://doi.org/10.3390/jrfm13090211>.

<sup>53</sup>Rusni Hassan, Syed Ahmed Salman, and Syarah Syahira Mohd Yusoff, “Risk Mitigation of Sustainable Finance and the Effective Role of Takaful,” in *Islamic Sustainable Finance*, ed. Mohd Ma'Sum Billah et al. (London: Routledge, 2024), 119–132, <https://doi.org/10.4324/9781003395447-15>; Amirul Afif Muhamat, and Ronald McIver, “Linking Governance Qualities and Stewardship Attributes: Findings from Malaysian Takaful Operators,” *Journal of Islamic Accounting and Business Research* 10, no. 5 (2019): 736–755, <https://doi.org/10.1108/JIABR-04-2016-0048>; Naz and Ali, “Takaful Governance and Sustainable Practices,” 175–201; R. Hassan, S. Kassim, H. Majdi, and S. A. Salman, “Is Takaful Industry Innovative? Examining the Perception of Takaful Operators in Malaysia,” paper presented at the 32nd IBIMA Conference, 2018; Hamim Syahrums Ahmad Mokhtar, Izwayu Abdul Aziz, and Noraziyah Md Hilal, “Surplus-Sharing Practices of Takāful Operators in Malaysia,” *ISRA International Journal of Islamic Finance* 7, no. 1 (2015): 99–126, <https://doi.org/10.12816/0021398>.

governance, transparency, and accountability, which are crucial for the credibility and growth of the takaful industry. However, continuous improvements and adaptations are necessary to address emerging challenges and enhance the effectiveness of Sharī'ah compliance mechanisms.<sup>54</sup>

Empirical studies suggest that the takaful cooperative model enhances financial inclusion by offering ethical risk protection to underinsured populations, particularly in Muslim-majority regions. Thus, takaful exemplifies a sustainable hybrid model—anchored in Islamic ethics, responsive to market demands, and conducive to social equity.

The hybrid approach reflects a sophisticated evolution in Islamic finance, where legal form, ethical substance, market practicality, and developmental aspirations are fused into a coherent framework. It offers a realistic path to rejuvenate the Islamic finance project in both Muslim-majority and pluralistic contexts by making finance more inclusive, impactful, and principled.

#### 4. Conclusion

This paper has critically examined three foundational approaches in the development of Islamic finance: the idealist, pragmatic, and liberal models. Each presents distinct assumptions, motivations, and methodologies. The idealist model envisions Islamic finance as a transformative tool rooted in justice, equity, and the moral economy; the pragmatic model focuses on functional legalism and market adaptation to achieve operational viability within global finance; and the liberal model emphasizes ethical contextualism, prioritizing substance over form. These paradigms represent both historical trajectories and ongoing tensions in the Islamic finance discourse.

While the pragmatic model currently dominates the industry, it has led to a growing disconnect between Sharī'ah compliance and Sharī'ah substance. In response, the paper highlights the emergence of a hybrid approach—an integrative model that seeks to align legal compliance, ethical vision, and practical innovation. Through examples from Malaysia, Indonesia, and the UK, this study demonstrates how hybridization offers a pathway for inclusive, purpose-driven Islamic finance. The hybrid approach suggests that the future of Islamic finance lies not in rigid orthodoxy or mimicry but in principled adaptation. The study contributes to the literature by offering a typological synthesis and comparative critique of the dominant models, while advocating for a recalibration of Islamic finance toward *maqasid al-Sharī'ah* goals: dignity, justice, sustainability, and shared prosperity.

Despite its comprehensive analytical scope, this study is primarily conceptual and relies heavily on secondary literature and institutional reports. As such, it does not offer empirical data from practitioners, consumers, or regulatory authorities. The hybrid model, although promising, is still under-theorized in terms of its governance metrics, risk-return profiles, and impact measurement frameworks. Regional contexts and the digital Islamic finance ecosystem remain underrepresented. These limitations suggest caution in generalizing the findings, and call for an empirical validation of the proposed typologies.

There are some suggestions for future research as follows: (i) empirical evaluation of the hybrid

<sup>54</sup>Sherin Kunhibava, "Legal Issues in Sharī'ah Governance in the Islamic Finance Industry in Malaysia," *ISRA International Journal of Islamic Finance* 7, no. 2 (2015): 55–80; Mohd Ismail A. Mohd Arif and Rahmah Markom, "Role and Status of the Shariah Advisory Council in Enhancing the Islamic Financial System in Malaysia," *Jurnal Pengurusan* 38 (2013): 127–132, <https://doi.org/10.17576/pengurusan-2013-38-12>; Ahmed Mansoor Alkhan and M. Kabir Hassan, "Takaful Operators: Analysing Segregated Accounts between Operator/Participants," *Journal of Islamic Accounting and Business Research* 11, no. 9 (2020): 1649–1664, <https://doi.org/10.1108/JIABR-01-2020-0005>; Rusni Hassan and Syed Ahmed Salman, "Guiding Principles in Developing Shari'ah Governance Framework for Islamic Capital Market," *International Journal of Economic Research* 14, no. 6 (2017): 27–38.

model: future studies should assess how hybrid financial products (e.g., green *sukuk*, cash *waqf* linked *sukuk*, ESG-integrated Islamic portfolios) perform in terms of financial returns, ethical compliance, and socio-economic impact. Case studies from Islamic banking institutions both in Muslim and Non-Muslim majorities countries could be examined; (ii) Islamic Fintech and digital inclusion: with the rise of AI, blockchain, and digital identity systems, Islamic finance must engage with digital transformation. Research could explore how digital *waqf*, Shariah-compliant crowdfunding, and Islamic digital banks can promote financial inclusion and ethical finance in both Muslim-majority and minority contexts; (iii) cross-cultural reception and pluralism: comparative studies between Islamic finance implementation in secular versus Islamic legal contexts could illuminate how cultural and regulatory environments shape consumer trust and product innovation; and (iv) Islamic finance and climate change: there is limited but growing research linking Islamic finance to climate resilience. Exploring how Islamic principles can drive sustainable finance, aligns Islamic finance with the global ESG and SDGs movements.

#### Authors' Contribution

**Yudi Ahmad Faisal:** sole author.

#### Conflict of Interest

The author of the manuscript has no financial or non-financial conflict of interest in the subject matter or materials discussed in this manuscript.

#### Data Availability Statement

Data supporting the findings of this study will be made available by the corresponding author upon request.

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