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FİNANSAL ARACILIĞIN ASLÎ İŞLEV VE FAALİYETLERİNE GERİ DÖNDÜRÜLMESİ

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ÖZ

Finansal aracılık, para fazlası olan birimlerden para açığı olan birimlere aktarım yaparak ekonomideki para dolaşımını sağlayan hayati bir işlevdir. Ne yazık ki, aracı kurumlar bu temel işlevinden sapmışlar ve bu süreçte, doğası gereği dilsiz olan (katma değer yaratamayan) bir borçlanma araçları kompleksini kullanarak spekülatif ticaret faaliyetlerine girişmişlerdir. Buna karşılık, İslami finans düşüncesi, orjinal işlevi olan kaynakların likidite fazlası olan ekonomik birimlerden likidite noksanı olan ekonomik birimlere aktarılmasına odaklanmak için finansal aracılığı geri getirmenin yollarını sunar. Bu çalışma, finansal kuruluşların borca dayalı faizli kredilendirme araçları yerine satış, kiralama, ortaklık gibi finansal araçları kullanmasının reel ekonomiyi desteklemekle birlikte temel işlevlerinden uzaklaşmasını da engellemekteki ekonomik avantajlarını ortaya koymayı amaçlamaktadır. Bu, finansal işlemleri insan refahına faydalı olan şeylerle sıkı bir şekilde ilişkilendiren finansal kurumların faaliyetlerine etik değerleri dahil etmenin ekonomik avantajlarına ektir. Bu makale teorik bir analiz yaklaşımı benimsemekte ve finansal literatür, bildiriler ve makaleler aracılığıyla ikincil bilgilere dayanmaktadır.

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TAKING FINANCIAL INTERMEDIATION BACK TO ITS ORIGINAL FUNCTIONS AND ACTIVITIES

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ABSTRACT

Financial intermediation is a vital function that permits money circulation by getting it from surplus units in the economy and giving it to deficit units. Unfortunately, intermediary institutions deviated from this essential function and indulged in speculative trading activities using, in the process, a complex of debt instruments which are mute (unable to create added value) by nature. In contrast, Islamic finance ideas offer ways to bring financial intermediation back to focus on its original function of channeling resources from the liquidity fluent economic units to the liquidity hungry units. This paper aims to explore the economic advantages of applying principles such as using financial instruments of sale, lease, and sharing instead of the debt-based instrument of interest lending, especially in confining financial institutions to supporting the real economy through activities of financial intermediation and preventing them from going away from this fundamental function. This is in addition to the economic advantages of incorporating ethical values in the activities of financial institutions, which make financial transactions strictly associated with what is beneficial to human welfare. This paper takes a theoretical analysis approach and is based on secondary information through financial literature, papers, and articles.

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INTRODUCTION

The financial sector has always known crises leading to recessions and economic downturns; the last one was the crisis of 2008, the subprime crisis. Traditional banks were heavily affected in the downturn because of their focus on interest-based trading book activities (e.g., securitization of mortgage debts), which carried them away from their principal function as financial intermediaries. The process of financialization expanded this deviation and made the main source of profit from the trading book rather than the banking book (Seccareccia, 2013, p.283). This diversion calls for a revisit to the primary role of financial institutions and reflection on what changes or potential alternatives will assure bringing back the financial sector's institutions to focus again on intermediation.

Islamic finance seems to be a candidate alternative that has widely revealed itself over the past few decades. Although Islamic financial intermediation is a new industry, which has been developed within the last fifty years, it seems to have a better ability to withstand the turbulence which rocked the conventional financial sector in 2007 and 2008 (Bourkhis & Nabi, 2011, p.2). Islamic finance has continued to achieve good growth rates because it sticks to the real market transactions, as required by the Shari'ah principles in all its financial activities (Hamdi et al., 2019, p.377). It is a Riba-free banking model that requires founding all transactions on real assets, avoiding any speculative and gambling behavior, as well as any unethical use of funds. Thus, it removes from the financial basket all the activities related to alcohol, tobacco, the arms industry, entertainment games such as lotto and horse–race betting, in addition to lending on interest. These points allow us to put forward the following problematic: How does the application of the Shari'ah principles make the Islamic financial intermediation institutions more focused on performing their intermediary role to the benefit of the real economy, and at the same time, more resilient at times of crises than their conventional counterparts. In other words, the inquiry of this paper is about going back to achieve financial intermediation in its full sense, and what are the effects of applying the Islamic principles in this regard? This paper is not intended as a comparison between Islamic banking and conventional banking.

In order to give a detailed answer to the above question, we divide this paper into two main parts: the first section discusses the causes of deviation of conventional financial intermediation from its original course, and the second section presents Islamic financial intermediation and the causes of its resilience.

FINANCIAL INTERMEDIATION AND CAUSES OF BANKS' DEVIATION FROM ITS ORIGINAL FUNCTIONS

This section will briefly review the basic functions of financial intermediation and why financial institutions went away from these original functions.

What Financial Intermediation Brings About?

A firm can choose between two modes of funding to finance its activity: direct funding and indirect funding.

In the first one, there is a direct contracting relationship between lenders and borrowers whereby firms needing liquidity can issue bonds and\or stocks and sell them directly in the capital market to be bought by households or other firms having excess liquidity. In the second type of funding, there is a financial intermediation system, of which the bank constitutes a central financial intermediary that channels funds mobilized from the surplus units of the economy (savers) towards the deficit units of the economy (businesses and consumers).

Financial intermediation presents an alternative or provides a solution for capital market insufficiency, as it helps reducing information asymmetry, transaction cost and monitoring cost. Furthermore, banks can offer services that cannot be available in the capital market, such as guarantees and rescheduling in case of distress of a firm as it will be easy for it to restructure its debts if it relies on bank borrowing. At the same time, it will be challenging to do such solutions if it depends on loans from the public because it is always easier to negotiate with one or a few banks than with many bondholders.

Besides, by depositing money in bank accounts, investors have the right to withdraw at any time, making their funds easily transferable into liquid. But by placing money in the capital market, investors may not find buyers for their securities when they need to sell for liquidity.

Functions of Financial Intermediaries

Reducing Monitoring Cost

Information asymmetry is likely to exist widely in the relationship between investors and users of funds. This means that the investor cannot know what is the specific amount of the output that the company has produced and then whether the borrower might not be able to honor its payment. That is why borrowers should be monitored, but the problem is that the monitoring by borrowers is costly, especially if one entrepreneur has several capital providers, because each one of them will be expected to bear the monitoring costs, which will raise the problem of duplication of monitoring costs. For that reason, it is

better to delegate the task of monitoring to a single agent (Diamond, 1984, p.394).

The bank, as a specialized agent, can overcome the problem of information asymmetry and monitor borrowers by producing information about the borrowers' realized profits using the technology, making it more efficient and cheaper (Diamond, 1984, p.396).

Furthermore, in the case where the lender monitors the borrower, the decision of monitoring is made after the entrepreneur's project income has been generated and after a payment has been received by the lender, which deals with the "costly state verification." However, in the case where the task of monitoring is commissioned to a financial intermediation institution, the decision of monitoring is made before the transaction, meaning that the bank determined beforehand the capacity of the borrower to repay the loan (Townsend, 1979, p.269).

Producing Information and Reducing its Cost

In the light of the usual insufficiency or even absence of information in the capital market about investment opportunities, it is necessary for investors to produce such information, but it will be costly, especially if the same information needs to be searched and acquired by many investors. This duplicates the cost of information production many folds (Gorton & Winton, 2003, p.444). Here also, if these investors would delegate the task of producing information to a small number of agents, how will they ensure that those agents have credibly searched and produced the relevant information (Hirshleifer, 1971, p.547). This matter is called "the reliability problem." Let us consider that the produced information is valuable; the information buyers may sell it to other rival investors, which creates an "appropriability problem." (Gorton & Winton, 2003, p444).

These complex problems related to investment opportunities, information production, and diffusion may be solved by the existence of an intermediary financial institution. First, the "reliability problem" will be overcome because the intermediary will invest its own funds in assets to produce potential information. So it will be beneficial for it to have credibly valuable information (Leland & Pyle, 1977, p.384).

Second, the "appropriability problem" can also be solved by offering stocks and bonds and investing in assets about which the bank has become confidentially informed. Thus, the bank produces and supplies credible information, which the bank needs anyway for its own investments. Failure to have reliable information exposes the bank to the risk of losing part of its own

wealth that is invested in the capital market securities (Leland & Pyle, 1977, p.383).

Allowing Consumption Smoothing

Consumption smoothing refers to a situation in which an economic unit has adequate resources to match its expenses' needs, but the timing of generating its resources inflow is different from the timing of having to spend for fulfilling its timely needs. This time matching is difficult to achieve in the securities of the capital market because of its size, frequency, and short-term characteristics, but it is possible to achieve with an intermediary financial institution. The latter can act as consumption smoother by offering funding arrangements using traded securities and deposit streams of customers.

Also, regarding corporations and government because of the holes in their cash on both sides of inflow and outflow (Demopoulos et al., 1987, p.1027), financial 'intermediaries allow them to fill the gap by giving them sufficient access to financial resources by which they could balance their situations and smooth their consumption (Le Ngoc & Nguyen, 2009, p.867).

Providing Liquidity

The concept of liquidity in this regard is related to three issues:

First: The economic agents cannot meet altogether at a central location. Hence, they cannot trade simultaneously (Freeman, 1996, p. 1129-1130), but this problem can be solved by the bank's role in creating a payment settlement system.

Second: The economic units in need to consume usually face trading losses because of the private information by their counterpart traders who attempt to make trading profits. This problem can also be overcome as the financial intermediary can privately produce the information properly (Gorton & Winton, 2003, p.455).

Third: The economic agent needing liquidity cannot efficiently meet the economic agent with excess liquidity due to the moral hazard and the search cost and time, but the financial intermediary can control a decentralized market by providing liquidity to the agent who needs liquidity and at the same time collect excess liquidity that other agents have.

Commitment Device

The bank's activity comprises transforming its liquid liabilities into illiquid assets, which makes its financial structure more fragile than any other type of business as depositors can reduce their demand deposits by taking out their money from their accounts at any time. What drives the bank to limit its free

disposal of funds is more careful about any decision it has to make and control the risk of its banking activities because depositors' actions produce information for the bank, which leads to sequential service constraints. For instance, a bank may have 2,000 depositors, but only 1,000 of them are in active contact with the bank at each moment. If depositors hear information about a situation that can make their money in danger, they will step up to withdraw their money, and those who hear the information first will come first and then will be served first. When the 1,001st depositor comes to withdraw its money, it won't get anything because it is last, and the rule says first-come, first-served. This makes the fragility of the intermediary financial institution works as a commitment device that forces the bank to avoid some activities that may create such risks although they may be profitable (Gorton & Winton, 2003, p.457).

Redistributing Risk and Reducing its Burden on Individual Economic Units

Financial intermediaries protect depositor's funds, whereby every individual can keep his money safe in a bank account rather than store it outside where they are exposed to be destroyed or lost. Also, when the individual invests his money in buying securities, the bonds or stocks that he purchases might be illiquid while current accounts or saving accounts contain liquid money that can be withdrawn at any time and with a cost less than the broker's fees or even without costs. Furthermore, by providing this service, the bank reduces the uninsurable risk of early death faced by customers because they are able to withdraw their money early (Bryant, 1980, p.339).

Deviation of Financial Institutions from the Intermediation Functions

Effect of Financialization

Epstein (2005, p.3) describes financialization in his book “Financialization and the World Economy” as "the increasing role of financial motives, financial markets, financial actors, and financial institutions in the operation of domestic and international economies". Financialization refers to a situation in which the incomes generated by the financial market are growing fast in a way that exceeds the creation of flows capital and real assets, while the real sector, including commodities production and trade, remain behind, either stagnant or with a much lower rate of growth. This makes the financial sphere far ahead of the real economic sphere and the financial intermediaries' activities more complicated and then causes dominance of the capital market transactions (trading book activities) over financing transactions (banking book activities).

The spread of financialization had a negative impact on the functions of financial intermediation as it is directly related to the deviation of banks from their traditional original role as financial intermediaries who collect money from the economic units with excess liquidity and provide money to the

economic units with the need of liquidity to meet their due payments, start their new project or expand their businesses. Instead, banks have become brokers between savers and users of capital in the financial markets in a speculative way. In other words, the primary sources of revenue for intermediary financial institutions have changed completely. It mainly consisted of the interest margin (interest received for granting credit minus interest paid on deposits), with a secondary commission's revenue for some services provided by the bank. With financialization, bank revenues become derived from the trading book with a high level of securitization that consists of transforming bankable projects to tradable securities, in addition to using financial derivative contracts and high augmentation of the volume of foreign exchange transactions.

The financial markets' actors such as securities investors, brokers investment banks can make overnight wealth from speculative operations, including trading debts or speculating the borrowed money and the hole categories of securities that do not have any relationship with the real economy. Windfall gains from their trading activities make them reluctant to use resources in less profitable financing of the real sector's consumers and corporations. Resources and profits of trading activities make them more powerful and able to take down the entire economy. The best example of this was the 2008 crisis and its consequences which were not limited to the financial sphere alone but spread to abolishing the public services, destroying infrastructures, creating unemployment, and the trade deficit became higher more and more (Seguino, 2010, p.10).

Debt Discounting and Debt Trading

Debt Discounting

The contemporary financial system is based on debt; almost every person in society is indebted to a credit institution. The latter can reconstruct debts and then create liquidity and money, using a lot of modern financial techniques such as discounting debts which enables banking institutions to overcome the problem of insufficiency of cash by capitalizing on the existent debtor's obligations, which also change the source of revenue of banks from intermediating liquidity to buying costumer's debts.

Macleod (1883, p.314) in his book “The Theory and Practice of Banking: with the elementary principles of Currency, Prices, Credit, and Exchanges” defined discounting as "a method by which the present price of a debt is constructed in relation to its prospective value that is in view of future earnings which are expected to flow from its ownership." According to this definition, if a bank wants to discount a debt in favor of its client before maturity, she has

to calculate the amount of the discount based on the current interest rate to find the present value of the debt. In an instance, a debt worth $2,000 in its future maturity, and at the discount of $400 calculated by the bank, the customer will receive only $1,600, which is equal to the nominal value of the debt minus the discount (2,000-400). This is made according to the principle that a sum of debt due in one year is worth less than that same sum today (Sgambati, 2016, p.282). This operation is generally made without collateral because the debt will be collected along with other debts to serve as an intangible guarantee for the obligation of the banks' own debt. As a consequence, the bank transforms the discounted debt to security which will be accumulated as the bank's assets, which lead to the marginalization of cash (Sgambati, 2016, p.283).

Debt Trading

The trading for a bank is all its short-term market-based activities, while its normal long-term activity, which is collecting deposits and granting credits, the bank can use the difference between how much it gets deposits and how much it gives financing in trading, which can create benefits for it and be profitable (Boot & Ratnovski, 2012, p.13). But the problem occurs when the bank increases its involvement in trading by allocating for it a big capital which impacts negatively on its performance and its principal mission which is intermediating liquidity between lenders and borrowers. This can even create distortions and increase the riskiness of the bank when it is used in an exaggerated way (King et al., 2013, p.34).

The trading activities banks undertake under financialization include loan origination under hard information lending. This is the process of taking an application made by a borrower for a new loan and disbursing the funds until the full payment of the loan. They also include investing in mortgage-backed and asset-backed securities and proprietary trading, which is when a commercial bank invests in the money market and capital market on its own behalf and gains directly from the market rather than invests on behalf of its customers and gain commissions only. Trading activities undertaken by commercial banks today also include Market-making, which is buying and selling securities to satisfy the market where the price is determined by the supply and demand forces; when the supply for security is low, and the demand is high, the price of the security will go up.

Profiteering from Pure Financial and Speculative Transactions

Under the financialization, banks started to seek earnings from other profitable speculative transactions in the financial market, including the sale of securities or foreign currencies when the price drops and buying securities or foreign

currencies when the price increases to make a speculative profit the price differentials. All the activities mentioned above drove banks away from their original intermediation activities.

RESILIENCE OF ISLAMIC FINANCIAL INTERMEDIATION AND ITS CAUSES

After a short introduction, this section will explore the causes of the resilience of Islamic financial intermediation. The section will then be followed by conclusions and recommendations.

Islamic Finance as Financial Intermediation

While financial intermediation is defined as the process of channeling funds mobilized from the surplus units of the economy (savers) towards the deficit units (investors, government, and consumers) by the intervention of a specific agent called financial intermediary, Islamic financial intermediation can be defined as channeling funds mobilized from the surplus units of the economy on a loan basis for depositors who want to guarantee their savings or on a profit\loss-sharing basis in which the bank is the Mudarib, and the depositor is Rabb al Mal for depositors who prefer using their money in venture capital to generate profit and providing these funds to the deficit units on sale (e.g., Murabahah), Ijarah (lease) or sharing basis.

Funds in Islamic banks may originate from three sources and through three contractual channels:

First: Shareholders' funds, where the bank acts as a manager of funds by doing some defined legal actions on behalf of shareholders on an ownership-sharing basis, which implies a Wakalah granted by shareholders to the management.

Second: Guaranteed depositors' funds through the Qard contract. These deposits take the form of current accounts whereby the bank guarantees depositors' funds, and the latter may withdraw them at any time. At the same time, the depositor does not receive any remuneration for depositing funds in a current account because the loan transfers ownership and replaces funds by guaranteed debts on the bank. Funds accumulating in current accounts are used at the risk and discretion of the bank and on the bank's responsibility (Kahf, 2014, p. 36).

Third: investment funds offered to the Islamic bank by savers on the Mudarabah contract, which is based on sharing in profits and bearing the risk of loss. These are deposited in saving and investment accounts that make the main funding source for Islamic banks. Depositors are often allowed to withdraw their funds in these accounts with certain conditions or restrictions. Withdrawals amount to reducing depositor's principal in the Mudarabah, a

matter which is considered permissible in Shari'ah with the Mudarib's consent (Kahf, 2014, p. 167).

The Islamic financial intermediation is based on the principle of Wakalah, in which the bank's management takes all investment decisions to manage the shareholder's funds and the depositors' money based on agency relationship. This agency relation implies that the bank should be cautious about its investment decisions and uses of funds; that's why it is preferable to use the funds on Murabahah and Ijarah because they are less risky rather than Musharakah and Mudarabah (Kahf, 2006, p.14).

Causes of the Resilience of the Islamic Financial Intermediaries

Effect of Financing Through Sale, Lease, and Sharing

Islamic banks can only finance through three instruments: 1) Financial sale, which replicates the well-known sale in trading transactions in which goods are exchanged from one hand to another. 2) Ijarah is a financial instrument emulating the renting\hiring\leasing transaction in the real market between two parties; the lessor who owns the asset and the lessee who buys its usufruct. 3) Sharing is partnership contracts in which capital and human resources are put together in a new project to create new value. All these relationships reflect transactions that are connected directly, on one-to-one correspondence, to the real sector of the economy. This tight connection of finance to the real market prevents the financial sector from growing away dramatically on its own and becoming far away from the real economy (Kahf, 2018).

Effect of the Honest Commitment in Transactions

Honesty and credibility of Islamic banks bring customers' confidence, which helps develop the relationship between the bank and their clients and then the sustainability of earning. Reciprocally, the bank also relies on the costumers' honesty in all transactions, whether sale transaction such as Murabahah or İjarah in which the bank trust the customer to fulfill his obligations on time, and it cannot charge him interest for rescheduling on delinquent payments or delinquent rentals. Partnership transactions such as Mudarabah, in which Rabb al-mal believes in the honesty of the Mudarib and puts his money in the Mudarib's hands. Or Wakalah transaction in which the customer charges the bank to acts legally on his behalf. In this regard, the Prophet Muhammed (May God's peace and prayers be showered onto him) said: "The two parties to a sale transaction have the choice so long as they have not separated. If they are honest and open, their transaction will be blessed, but if they tell lies and conceal anything, the blessing of their transaction will be lost." (Hifiz & Abdur, 2007, p.261). And in another pronouncement, "The best gain is the gain of merchants who, if they speak, do not tell lies. If they are trusted, they do not

betray the trust. And if they promise, they do not break the promise. And if they buy, they do not disparage. And if they sell, they do not over-compliment. And if they borrow, they do not delay. And if they owe (someone), they do not make it difficult." (Suyuti, 1990) As. He, pbuh, showed the great standing of honesty when he said, "The truthful, trustworthy merchant is with the prophets, the truthfuls, and the martyrs." (Tirmidhi et al , 2007, p.24.).

Effect of the Obligation of All Financial Transactions to Deal with the Real Market

This obligation implies the need to back up every financial transaction with a real asset. This backing means that all financial operations must be based on tangible or intangible real property or real assets that are halal, i.e., assets in accordance with Islamic law. A portfolio of financial securities must always represent real assets; it can be a vehicle, a residential or commercial building, or even raw material inputs for industry or agriculture. This backing must be effective in reality because it gives legal certainty to Islamic finance transactions; without it, such transactions lose their legitimacy. Hence, Islamic financial transactions are structured to add real value to the real sector of the economy.

Effect of Prohibition of Riba

Charging interest of loans is prohibited by Islam as well as Christianity and Judaism. All three religions agree on the prohibition of exploiting the debtor's need for money by charging him an increment over the loan principal. (Yahiya 2010, p.15)

In Islam, Riba is described as a big sin. This is reported in the pronouncement of our Prophet Muhammad (May God's peace and prayers be showered onto him). Abu Hurairah said: The Prophet Muhammad (May God's peace and prayers be showered onto him) said: "Avoid the seven devastating sins." The people enquired, "O Allah's Apostle! What are they? " He said, "To associate others with Allah in worship, to practice sorcery, to kill a soul which Allah has forbidden except for a just cause, to eat up Riba (interest), to eat up an orphan's property, to give back to the enemy and fleeing from the battlefield at the time of fighting, and to accuse chaste believing women who never even think of anything touching chastity (Khan, 2009, p.639).

And the Qur'an talks about the prohibition of Riba in four surahs. In Surah aL Rum (30:39), Allah says: "And whatever you give for Riba to increase in the properties of people will not increase with Allah…". In Surah al Nisa' (4:160-161), Allah says: "For wrongdoing by the Jews, We made unlawful for them [certain] good foods which had been lawful to them, and for their averting from the way of Allah many [people], and their taking of Riba while they had

been forbidden from it and their consuming of other people's properties unjustly, and we have prepared for the disbelievers among them a painful punishment.". In Surah Al Imran (3:130), Allah says: "O you who believe! Do not consume Riba doubled and multiplied, but fear Allah that you may be successful". And finally, in Surah al Baqarah (2:275-280), Allah says: "Those who consume Riba cannot stand except as one stands who is being beaten by Satan into insanity. That is because they say, "sale is [just] like Riba." But Allah has permitted the sale and has forbidden Riba. So, whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns, those are the companions of the Fire; they will abide eternally therein. Allah destroys Riba and gives increase for charities… O you who have believed, fear Allah and give up what remains of Riba if you should be believers. And if you do not, then be notified of war from Allah and His Messenger. But if you repent, you are entitled to have your principal [back], you do no injustice, nor injustice is done to you. And if someone is in hardship, then [let there be] postponement until [a time of] ease. But if you give [from your right as] charity, then it is better for you, if you only knew.".

Riba is any increment above the principal of a loan or debt claimed only on the basis of passage of time, no matter how this increment is determined at the beginning of the contract, whether it is a specific amount or a percentage, a small amount or a big one, paid at the beginning of lending or at any other time. This is exactly interest as known in conventional banking and finance, and it is 'the Riba' that Allah prohibits in the Qur'an as clearly indicated in 2:279 above.

Riba (interest) is forbidden in Islam because a debt does not generate or create any increment or added value. The Qur'an (30:39) draws our attention to the fact that any claimed increment in a debt given on Riba is a false claim made on the property of other people since if any growth may happen in the property of the borrower, the latter is exclusively entitled to own it being an increment within his owned properties.

The prohibition of Riba protects Islamic banking\finance from any deviation away from the course of its financial intermediation function because of several reasons, some of them are as follows:

First, it makes deserving returns related to and based on ownership of properties that generate added values. This proposition is a necessary condition of sustainable earning,

Second, it preserves Islamic banks' consistency and affirms their sticking in all their transactions to the real economy, which means that Islamic finance will

always be developmental. It enhances and supports the production and exchange of real goods and services.

Third, it excludes trading and discounting of debts being non-productive activities as the change of entities of debtors or creditors does not create any added value and therefore does not contribute to human welfare.

Fourth, it rediverts financial and human resources, which are used for all kinds of transactions that do not generate added value, to be used in supporting the production and exchange in the real sector of the economy.

Fifth, it eliminates the exploitation of the inability of debtors to pay back their debt by charging them an extra amount above the debt principal. Allah commands creditors to be patient with debtors who have hard times financially. In the above-quoted verses, Allah says: "and if the debtor is having a hard time, then grant him time till it is easy for him to repay."

Effect of Prohibition of Gharar

Gharar means peril, danger, risk, uncertainty, and hazard. The notion of Gharar is a complex concept which covers uncertainties and/or unforeseen events linked to an exchange contract. It can be defined as any sale transaction in which the item subject of the sale is unknown, or its existence is uncertain, or the date of its delivery is unspecified. This concept implies the prohibition, in exchange relationships, of any speculation on the future or random investment. It also means the rejection of any ambiguity in the contract terms.

According to Islamic law, a contract not affected by Gharar is a contract in which all the fundamental terms, namely the price, object, the identity of the parties, and the time limits, are clearly known in advance on the day of concluding the contract. Gharar may lead to consuming one another's property unfairly. Allah said: "O you who have believed, do not consume one another's wealth unjustly but only [in lawful] trade by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful." (The Qur'an, 4:29)

The prohibition of Gharar is beneficial for Islamic financial intermediation and helpful in its consistency in many ways. First, by banning Gharar, none of the parties in a transaction will face fraudulence or cheating. Second, it induces avoidance of any injustice or unfair dealing that may harm one or both parties. Third, transparency about all elements of the contract, including time of performance, the existence of the object and its specific characteristics or a specific amount, date of delivery of the object, all that leads to avoiding conflicts between the contracting parties, and thus avoiding conflicts between

Islamic financial intermediaries and their customers and improving their relationships.

Effect of Prohibition of Unethical Uses of Funds

In Islamic finance, both aims and means should be consistent, ethical, and legitimate. Any earning generated by unethical use of funds won't be accepted and cannot be included in the profit pool; it should be either returned to the payer or given to charity, which is considered unearned income. Islamic finance rejects the idea of "aims justify means," which may be accepted in financial transactions under conventional finance. In Islamic law, financial transactions cannot be separated from ethics because the latter constitutes the heart of success in the religion of Islam. That is why Islamic banks' practices are based on ethics, whether in the use of funds or in their relations with their customers, which realize positive results, especially at the level of resilience of Islamic banks to shocks. We may give in the following paragraphs a few examples to clarify this point.

The prohibition of gambling: The Qur'an prohibits gambling as Allah says in the Qur'an (2:219): "They ask you concerning alcoholic drink and gambling? Say: In them is a great sin, and benefits for men, but the sin of them is greater than their benefit. And they ask you what they ought to spend? Say: That which is beyond your needs. Thus, Allah makes clear to you His Laws in order that you may give thought."

Contract fulfillment and exact documentation: one of the fundamental values that Islamic finance focuses on is contract documentation and fulfillment as Allah says: O you who have faith, when you contract a debt for a specified term, write it down. And let a scribe write [it] between you in justice." (The Qur'an, 2:282). God also says: ("o you who believe fulfill (your) contracts." (The Qur'an, 5:1).

Practicing ethics while operating their activities leads Islamic banks to avoid all illegal earning methods and keep away from unethical activities. They avoid extending finance to any unethical operations or items such as pornography, liquor, and alcoholic or toxic products, weapon manufacturing and armaments industry, gambling, and games such as lotto and horse race betting, tobacco production and exchange, etc.

Effect of Relying on Equity Depositors

The most important source of funds in Islamic banks, which provides the bulk of funding for their activities, is deposited on a Mudarabah basis. These deposits that take the form of either investments accounts or saving accounts are provided by Arbab al Amwal (s.Rrabb al Mal), who expect to earn profits on

their deposits, and at the same time, they are exposed to bear losses if the results of the efforts of the Mudarib turn negative (AlAbbad et al., 2021, p.3). This kind of relationship gives these funds a feature similar to the bank's own equity. It is very beneficial for Islamic banks because, on the one hand, this reduces the liabilities of the bank and replaces it with risk-bearing equity. And on the other hand, the bank has no guarantee burden for these funds because they are equity deposits and not loans. The depositor cannot guarantee deposits in these investment and saving accounts, and any violation is a deviation from the participatory Shari'ah principle of profit and loss sharing (PLS). That's why the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) accounting standards prevent showing these deposits as creditors in the balance sheet of the Islamic Bank and require calling them 'equity from depositors' and having a special category for them in the balance sheet of the bank. AAOIFI also calls for considering them in the calculation of the capital adequacy ratio (AAOIFI, standard 23).

Conclusions

This paper aimed at highlighting the effect of applying the Shari'ah principles on mending the activities of banks to strictly stick to original functions of financial intermediation. While conventional banking institutions deviated from these original functions, Islamic financial intermediaries present a pure model of financial intermediation. During operating their activities and all their transactions, Islamic banks must take into consideration the teachings of Shari'ah which provide them with the guidance to derive their profits from funding the real sectors of the economy and providing them with other financial intermediary services. That allows them to be more resilient when faced with financial squeezes and also in regards to the conservation of their principal mission. The main mission of financial intermediation is to play the proper rules of liquidity management by channeling money from depositors, who have money but don't know how to invest towards firms and people who need funds to meet their needs or realize their projects. Following the Shari'ah principles brings many benefits to Islamic banks because the principles of the Islamic economic-cum-financial system, through their teaching, protect the interests of all parties concerned in the financial transactions and assure the sanctity of contractual relationships. At the same time, they prevent unjust, unfair, and unethical use of funds or exploitation of counterparties.

Furthermore, by limiting their trading book activities in the market and concentrating on their principal mission of the banking book financing transactions, Islamic banking reduces the level of risk of capital. As a result, it brings more confidence for their clients and partners, conserves their alinement

with the real market, preserves their role as financial intermediaries, and ensures the resilience and efficiency of the Islamic banking system.

Recommendations

Accordingly, through this modest paper, we suggest that the Islamic bank should continue the same pattern activities with trying to improve their services to meet the variable needs of their customers. We also believe that it is important to improve the Shari'ah governance both at the level of each bank and at the level of central banking in order to assure their full compliance with both spirit and texts of Shari'ah principles as highlighted in this paper and to improve auditing and checking of transactions for more transparency. That will reduce the notoriety of Islamic banking, increase the public's confidence, and consequently enhance the persistence of the pure and resilient financial intermediation.

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AUTHORS' PERCENTAGE-BASED CONTRIBUTION

The contributions of each author to the study by percentages are as follows: The percentage-based contributions of the 1st author and 2nd author are %50, respectively.
1st Author: Literature review, data analysis, writing.
2nd Author: Research design, model construction, writing.

DECLARATION OF CONFLICTING INTERESTS

There is no financial or individual relationship with a person or an institution in the context of the study. Also, conflicting interests do not exist.

ETHICAL APPROVAL OF THE STUDY

All rules within the scope of "Instruction on Research and Publication Ethics for the Higher Education Institutions" were observed throughout the study. No actions mentioned in the Instruction's second chapter titled "Actions Against to Scientific Research and Publication Ethics" were taken in the study.