



ISLAMIC FINANCIAL
SERVICES BOARD

Islamic Financial Services Industry **STABILITY REPORT** **2025**

NAVIGATING SHALLOW WATERS:
Addressing Structural Vulnerabilities and
Shoring Up Resilience to Global Shocks

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ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a comprehensive due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which involves, but is not limited to, the issuance of exposure drafts, the holding of workshops and, where necessary, public hearings. The IFSB also conducts research and coordinates initiatives on industry-related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

For more information about the IFSB, please visit www.ifsb.org

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FOREWORD

The Islamic Financial Services Industry (IFSI) entered 2025 with renewed growth momentum and broad-based expansion into new markets and across all three core sectors—banking, capital markets, and insurance. Total IFSI assets rose significantly, with double-digit growth recorded in all three sectors, driven by the continuing dynamism of the Islamic banking sector, and a growing momentum in the non-bank segments of the industry. The IFSI's growth trajectory reflects not only sustained demand but also the positive impact of regulatory reforms and increased market participation across jurisdictions.

Encouragingly, emerging markets, particularly in Africa and Central Asia—some of which posted the highest growth rates globally—are opening new frontiers for Islamic finance. These jurisdictions represent important opportunities to broaden financial inclusion, deepen local financial markets, expand access to Islamic financial products and services, and reinforce the industry's global footprint. Supporting these developments through the adoption of IFSB standards will be critical to ensuring that growth is underpinned by strong regulatory foundations and long-term resilience.

Financial soundness indicators across the industry have remained broadly stable. Capital, leverage, liquidity, and asset quality positions in both the banking and insurance sectors have proven resilient—particularly in jurisdictions that have strengthened their regulatory and supervisory frameworks. However, emerging pressures and existing vulnerabilities across jurisdictions underscore the continued importance of supervisory vigilance and prudent risk management. The broader adoption and implementation of IFSB standards have played an important role in reinforcing sectoral stability and supporting investor confidence across the IFSI.

Notwithstanding the positive developments, the IFSI remains exposed to structural vulnerabilities. The structural concentration of the IFSI in the Islamic banking sector continues to pose imbalances that constrain the industry's scalability and overall resilience. Non-bank segments—particularly Islamic capital markets and insurance—remain broadly underdeveloped. This underdevelopment has limited the availability of Islamic finance investment and liquidity management instruments, narrowed financial intermediation channels, and heightened the industry's vulnerability to external shocks, especially during periods of financial stress.

At the same time, the ability of the IFSI to fully capitalise on growth and market opportunities is increasingly determined by the depth, liquidity, and sound functioning of its capital markets, which are essential for effective financial intermediation and stability. As highlighted in this year's report, the development of robust Islamic capital markets—particularly deep and liquid *ṣukūk* markets—is essential to unlocking the next phase of growth. While 2024 saw strong issuance volumes and growing issuer diversity, structural impediments persist: limited benchmark issuances, shallow secondary markets, and continued reliance on complex, bespoke structures. These constraints reduce market liquidity, limit price discovery, and weaken the broader utility of *ṣukūk* as instruments for investment, risk management, and liquidity support within the financial system. If unaddressed, these issues may undermine the IFSI's long-term growth prospects and carry broader financial stability implications—particularly for Islamic financial institutions that depend on capital markets to manage their funding, investment portfolios, and liquidity positions effectively.

To address these structural constraints and ensure the long-term resilience of the Islamic financial system, the IFSI Stability Report 2025 outlines a set of targeted policy recommendations. These include the promotion of regular local currency şukūk issuances to establish benchmark yield curves, the simplification and standardisation of şukūk structures to improve market access and liquidity, and the development of supporting market infrastructure that caters to the specificities of şukūk. Broader efforts to strengthen regulatory frameworks and encourage cross-border market integration will also be critical in fostering investor confidence and deepening participation.

A coordinated policy response—among regulators, policymakers, and industry participants—is essential to address the structural vulnerabilities of the IFSI and unlock its full potential. As global interest in ethical, inclusive, and resilient finance continues to grow, Islamic finance is uniquely positioned to lead. With the right policy actions, robust regulatory foundations, and a sustained commitment to reform, the IFSI can evolve into a more scalable, resilient, and globally relevant pillar of the financial system.

Dr. Ghiath Shabsigh

Secretary General

Islamic Financial Services Board

EXECUTIVE SUMMARY

The global Islamic financial services industry (IFSI) continued to expand in 2024, recording a robust 14.9% year-on-year growth to reach USD 3.88 trillion in total assets. While Islamic banking remains the dominant segment, strong year-on-year growth in the *ṣukūk* (25.6%) and Islamic insurance (16.9%) sectors underscore the increasing momentum of non-bank segments within the IFSI. However, growth continues to be uneven and structurally concentrated in the banking sector and in specific regions, underscoring the importance of developing non-bank segments and fostering market development in emerging and frontier jurisdictions.

Islamic banking continued to anchor the IFSI in 2024 with strong balance sheet growth and broad-based expansion, though structural limitations and evolving risk dynamics call for targeted policy responses. Islamic banking accounted for over 70% of IFSI assets in 2024 and recorded strong growth. Assets remain concentrated in mature, domestic systemically significant jurisdictions, although momentum is gradually building in other markets, particularly in Africa and Central Asia. Growth trends reflect both the deepening of the Islamic banking footprint in traditional markets and broader growth in other markets. Shifts in asset allocation toward safer instruments such as government *ṣukūk* and cash in some jurisdictions in response to elevated macro-financial risks point to underlying constraints stemming from the limited availability of a wider range of Islamic finance investment alternatives. Similarly, deposit-based funding remains the principal source of funds, with limited access to wholesale markets that may provide a more diversified funding base. Together, these structural trends highlight constraints in the Islamic banking sector—particularly the limited availability of Islamic investment and funding alternatives—underscoring the need to deepen Islamic capital markets to enhance financial intermediation, improve funding flexibility, and strengthen liquidity and risk management capabilities in the Islamic banking sector.

While the financial soundness of Islamic banks remained broadly stable in 2024, emerging vulnerabilities underscore the need for continued supervisory vigilance. Capital and leverage positions of Islamic banks remained sound overall, though rising risk-weighted assets and heavy reliance on hybrid instruments such as commodity *murābahah* in some jurisdictions point to emerging vulnerabilities that require ongoing supervisory vigilance.¹ Profitability strengthened across most regions, driven by financing income and operational efficiency, but in some markets remains sensitive to fiscal risks and rate of return volatility due to heavy reliance on investment income and sovereign instruments. Liquidity indicators remain well above regulatory minima, though persistent structural liquidity surpluses in several jurisdictions indicate potential inefficiencies. Asset quality showed modest improvement globally, although sectoral and regional vulnerabilities persist, particularly in jurisdictions with elevated exposure to certain segments.

¹ Hybrid Islamic financial instruments are debt-based structures designed to serve the liquidity and financing needs of Islamic banks. While they apply Sharī'ah-compliant contractual forms, they replicate the risk profile of conventional debt products, which in turn introduces leverage, market volatility exposure, and systemic interconnectedness similar to traditional banking. Their growing dominance in Islamic financial markets raises concerns about financial stability, as they contribute to higher debt accumulation and potential spillover risks, challenging the fundamental risk-sharing principles of Islamic finance.

The Islamic insurance sector saw strong growth in 2024, though regional disparities and structural gaps highlight the need for strengthening regulatory and institutional frameworks. In 2024, Islamic insurance assets and gross written contributions increased by 16.9% and 15.4%, respectively. Growth was driven by both general and family lines, though with significant variation across regions. Regional development remains uneven, with differences in market maturity shaping growth dynamics and strategic priorities. While advanced jurisdictions are moving towards consolidation and digitalisation, emerging markets are still in early stages of regulatory and institutional development. This underscores the need for broader market development, tailored policy approaches and capacity-building support.

Despite sustained growth, rising pressures in the Islamic insurance sector, particularly in less mature markets, highlight vulnerabilities that must be addressed to safeguard long-term resilience. Solvency positions have held up in aggregate, but pressure is mounting in less mature or under-regulated markets. Rising technical provisions, weaker underwriting performance, and inflation-driven cost pressures are exposing vulnerabilities in capital frameworks, particularly for smaller operators with limited buffers. Profitability trends reflect a growing divergence between regions with strong underwriting discipline and those facing structural inefficiencies. As rising claims and pricing constraints squeeze margins, investment income has become increasingly important, but reliance on investment returns also exposes insurers to market volatility and fiscal risks. Liquidity conditions are becoming more complex, with inflation, claims volatility, and shortened settlement cycles reshaping liquidity management strategies. Markets with shallow Islamic financial markets remain particularly constrained, often forced to rely on cash holdings or cross-border placements, underscoring the need for deeper capital markets. Overall, while the sector's growth trajectory remains promising, long-term resilience will depend on strengthening regulatory frameworks, improving capital and liquidity planning, and expanding the range of investment and risk management tools available to Islamic insurers.

The Islamic capital markets delivered strong performance in 2024, driven primarily by a surge in *shukūk* issuance. Global *shukūk* issuances rose by 25.6% to reach USD 230.40 billion, reflecting favourable financing conditions and growing demand from both sovereign and corporate issuers. Despite this momentum, the market remains shallow and geographically concentrated, with activity dominated by sovereign and quasi-sovereign entities in a limited number of jurisdictions. Corporate and cross-border participation is expanding but remains insufficient relative to broader market needs. The Islamic funds industry also recorded modest growth in 2024, buoyed by global equity market performance. However, the sector remains structurally fragmented, with a large share of small-sized funds, resulting in scale-related inefficiencies. While domicile trends suggest gradual geographic diversification, market activity remains concentrated in certain regions. Sustainability-related *shukūk* and Islamic funds are gaining traction, reflecting broader global trends toward ethical and green finance, but they continue to account for a small share of the overall market, underscoring untapped potential.

The şukūk market continues to face significant structural vulnerabilities that constrain its resilience and effectiveness. Complex, bespoke contractual structures limit standardisation and fungibility and discourage broader issuer participation. The absence of large, regularly issued local currency sovereign benchmarks across maturities hampers yield curve development and effective price discovery. Secondary market activity remains weak, largely due to a concentrated and captive investor base. These factors contribute to wide bid-ask spreads, constrained liquidity, and poor price signals—factors that impair efficient capital allocation, limit financial institutions' flexibility in managing liquidity, and reduces the effectiveness of şukūk as tools for monetary policy and systemic stability support.

To address these structural weaknesses, a comprehensive and coordinated strategy is essential to deepen and broaden şukūk markets and enhance their role in supporting the wider Islamic financial system. Key priorities include the regular issuance of local currency sovereign şukūk across various maturities to establish pricing benchmarks and support yield curve development. Promoting simpler and standardised şukūk structures and documentation is essential to deepen the market, improve fungibility and reduce transaction costs. Strengthening regulatory, legal, and Sharī'ah governance frameworks is also crucial in building investor confidence, reducing market access barriers, and deepening the şukūk market. In parallel, the development of market infrastructure is required to enable efficient trading, transparent pricing, and alignment with şukūk market characteristics. In particular, şukūk market participants should be encouraged to develop the necessary new infrastructure institutions that could facilitate the transition from the current complex şukūk structures to a simpler and more market friendly structures. In addition, strengthening secondary market liquidity through formal market-making arrangements and targeted incentives, alongside efforts to broaden the investor base—including retail access and cross-border integration—will be critical to deepening the market and supporting its long-term resilience.

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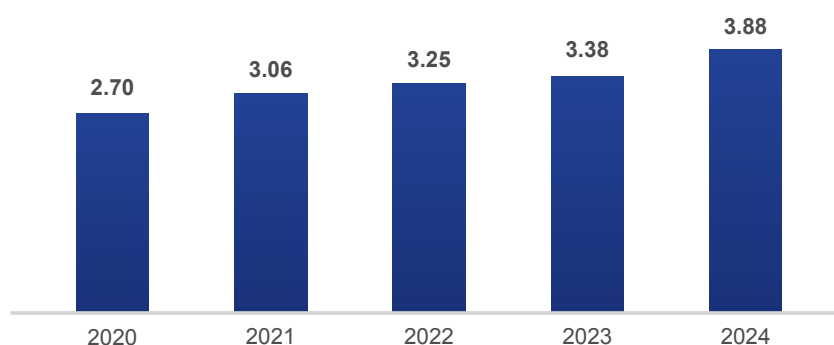


GROWTH AND DEVELOPMENT TRENDS AND RESILIENCE OF THE ISLAMIC FINANCIAL SERVICES INDUSTRY

The global Islamic financial services industry (IFSI) recorded strong growth in 2024.

Total IFSI assets reached USD 3.88 trillion, marking a significant 14.9% year-on-year (YoY) growth compared to 2023. This acceleration in asset growth outpaced the average rates of recent years. The growth momentum reflected accommodative global financial conditions in 2024 driven by lower interest rate expectations and easing inflation, which revived market sentiment and capital flows,² alongside sustained demand for Islamic financial services, and increased market participation across key Islamic finance jurisdictions.

Chart 1.1: Global IFSI Total Asset Size (USD in Trillion) (2020 - 2024)



Source: IFSB PSIFIs, data extracted from various RSAs' websites, and annual financial reports of Islamic banks.

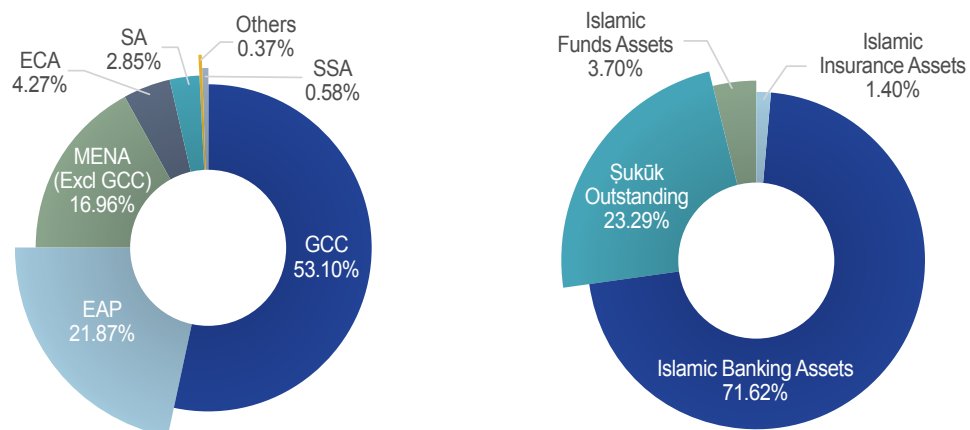
Notes: a) Data are from the IFSB Prudential and Structural Islamic Financial Indicators (PSIFIs) database and other primary sources (regulatory authorities' statistical databases, annual reports and financial stability reports) and b) Where primary data is unavailable, third-party data providers have been used, including Eikon-Refinitiv, IMF database, etc.

The IFSI remains significant in traditional markets but is expanding steadily in non-traditional markets. As of the end-of-year 2024, the Gulf Cooperation Council (GCC) region accounted for 53.1% of total global IFSI assets. The East Asia and Pacific (EAP) region followed with 21.9%, driven by Malaysia and Indonesia's well-established Islamic finance ecosystems. Middle East and North Africa (MENA, excluding GCC) contributed 16.9%, while other regions such as Europe and Central Asia (ECA), South Asia (SA), and Sub-Saharan Africa (SSA) held relatively small shares, but represent emerging growth frontiers.

The composition of IFSI assets remains dominated by Islamic banking, although non-bank segments are expanding at a strong pace. Islamic banking assets represented the largest share of total IFSI assets at 71.6%, followed by *ṣukūk* outstanding at 23.3%. The capital market segment continued to expand, driven by strong *ṣukūk* issuances, and supported by favourable financing conditions, sustained investor appetite, and increased issuer participation. Global Islamic insurance (*takāful*) assets accounted for 1.4%. However, *ṣukūk* and Islamic insurance sectors recorded strong annual growth of 25.6% and 16.9% respectively. The IFSI still remains structurally concentrated in the banking sector, and there is a need for further development of the capital markets and insurance sectors to support a more balanced and resilient financial ecosystem.

² International Monetary Fund, Global Financial Stability Report: *Steadying the Course—Uncertainty, Artificial Intelligence, and Financial Stability* (Washington, DC: IMF, October 2024).

Chart 1.2: Regional and Sectoral Distribution of Global IFSI Assets



Source: IFSB PSIFIs, data extracted from various RSAs' websites, and annual financial reports of Islamic banks.

Notes: a) The Secretariat has adopted a regional classification made up of the following regions: Gulf Cooperation Council (GCC), Middle East and North Africa (MENA excl. GCC), East Asia and Pacific (EAP), South Asia (SA), Europe and Central Asia (ECA) and Sub-Saharan Africa (SSA) b) The breakdown of Islamic funds' assets is by domicile of the funds, while for sukūk outstanding, it is by domicile of the obligor.

1.1 Islamic Banking

1.1.1 Islamic Banks Demonstrated Continued Growth Momentum

The global Islamic banking sector recorded sustained growth in 2024, supported by stable financing activity and a solid funding base. Total Islamic banking assets³ recorded a YoY growth of 17.05%, exceeded the sector’s long-term trend. Growth was further reinforced by regulatory reforms, market development and digitalisation initiatives. The alignment between asset and financing growth suggests effective deployment of funds and balanced intermediation, while steady deposit growth points to continued customer confidence and a stable funding base (see Table 1.1.1). These growth trends also underscore the sector’s capacity to maintain its growth momentum in an evolving economic environment.

Table 1.1.1: Global Islamic Banks’ Financing and Deposit Growth

	Financing	Deposit
CAGR	11.60%	9.36%
YoY Growth	9.96%	8.76%

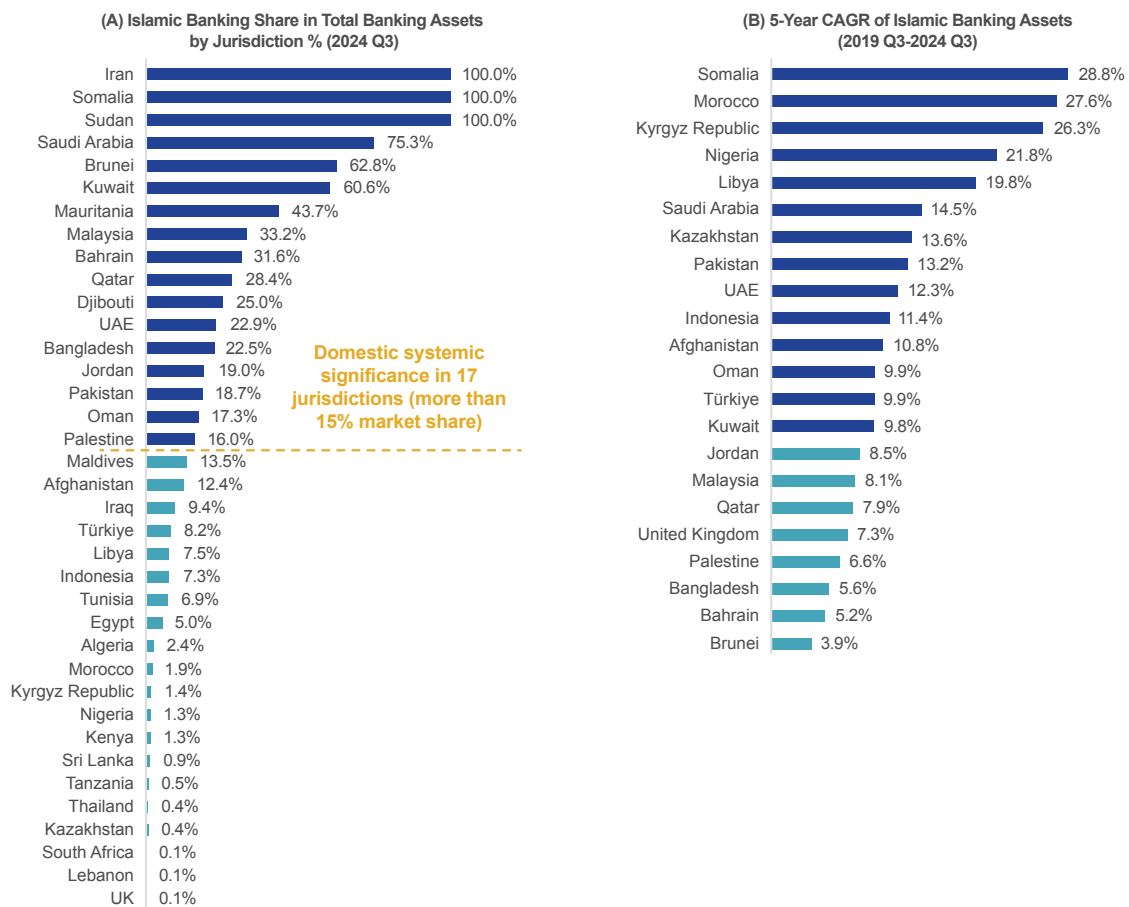
Source: Data used in calculating CAGR, as well as YoY growth rates for financing, and deposits, were obtained from the IFSB PSIFIs data.

Note: Compound annual growth rate calculated for the period September 2019 – September 2024.

Islamic banking activity remains strong in core markets, while expanding in emerging regions. 17 domestic systemically significant markets—where Islamic banking assets represent 15% or more of total domestic banking assets—collectively accounted for over 92.9% of global Islamic banking assets (Chart 1.1.1.a). However, compounded annual growth rates (CAGR) over the past five years show that several smaller jurisdictions, particularly in SSA, ECA and some parts of MENA (excluding GCC) have recorded growth rates exceeding those of mature markets (Chart 1.1.1.b). At the same time, some established markets continue to post strong growth, further entrenching their systemic importance. These trends suggest that Islamic banking is both deepening its penetration in traditional strongholds and gaining traction in new regions.

3 Total Islamic banking assets include data from jurisdictions beyond the coverage of the IFSB PSIFIs database.

Chart 1.1.1: Islamic Banking's Market Share and Growth Rates Across Jurisdictions

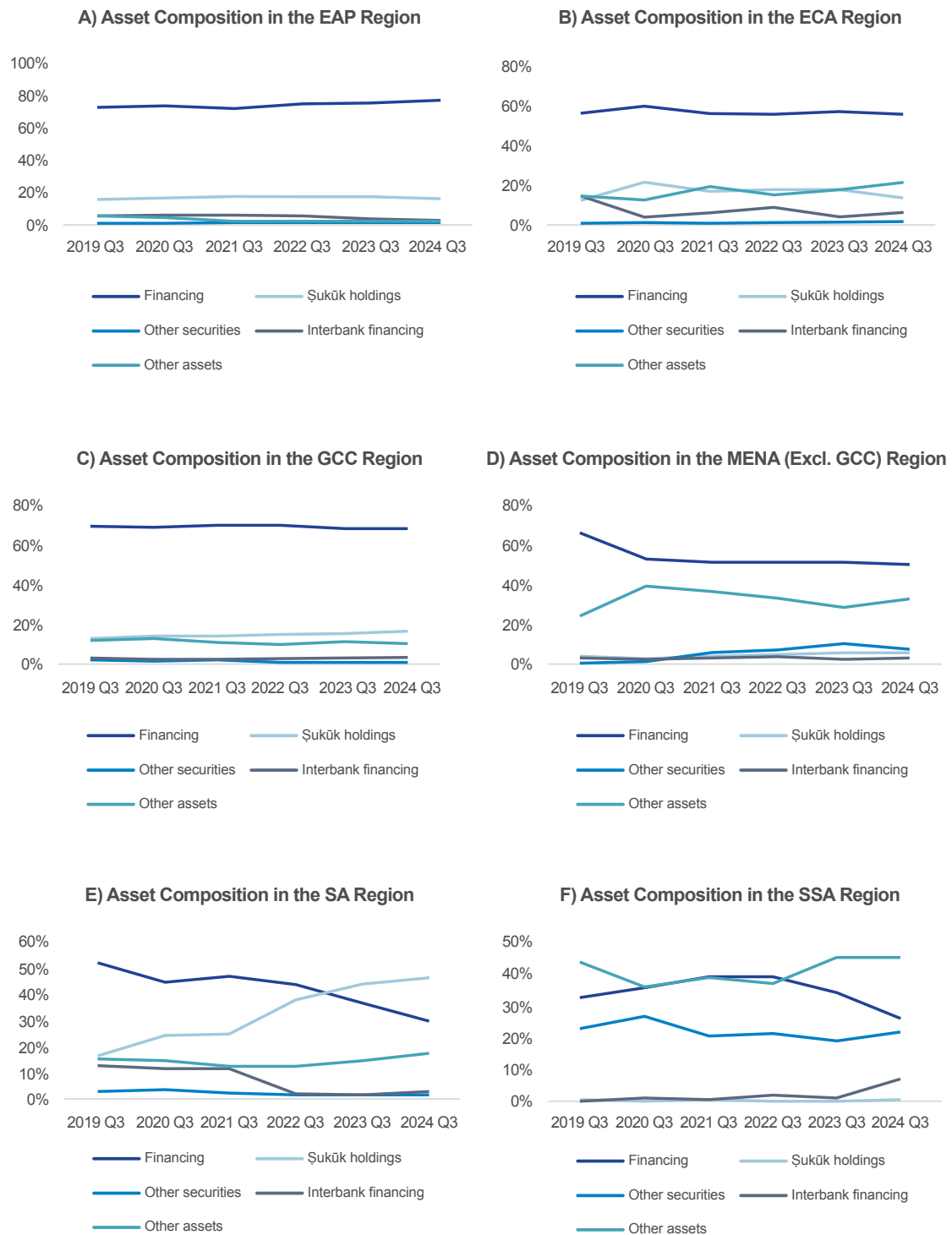


Source: IFSB PSIFs, data extracted from various RSAs' websites, and annual financial reports of Islamic banks.

Financing growth remained robust, supported by strong demand in traditional sectors and opportunities in emerging economic segments. Financing portfolios remained concentrated in household, real estate, and trade-related sectors, particularly in the GCC, EAP, and SA regions. In 2024, these sectors continued to drive financing growth, reflecting sustained demand and alignment with Islamic banks' traditional risk appetites. In parallel, financing for renewable energy, digital infrastructure, and transition-related activities gained some traction in select markets, especially in the GCC and EAP, as part of broader economic diversification efforts. However, the overall share of these emerging sectors in total financing remains relatively small.

Asset allocation strategies shifted in some markets as Islamic banks responded to rising credit and liquidity risks. In jurisdictions facing elevated macro-financial risks, Islamic banks reallocated assets toward government sukūk, central bank placements, and cash balances. This trend was particularly evident in SA, SSA, ECA, and parts of MENA (excluding GCC), where banks reduced their financing exposures in favour of more liquid and lower-risk assets (Charts 1.1.2 and 1.1.3). While these reallocations helped mitigate near-term risks, they may potentially increase exposure to sovereign-related vulnerabilities in the longer-term. The trend mirrored similar behaviour in conventional banks in the same jurisdictions, but cash holdings⁴ were more pronounced among Islamic banks, due to a narrower range of Islamic investment alternatives and limited development of Islamic capital markets.

⁴ Cash holdings are reflected in the 'other assets' category.

Chart 1.1.2: Regional Islamic Banks' Asset Composition

Source: IFSB PSIFIs

Chart 1.1.3: Global and Regional Islamic Banks' Asset Structure

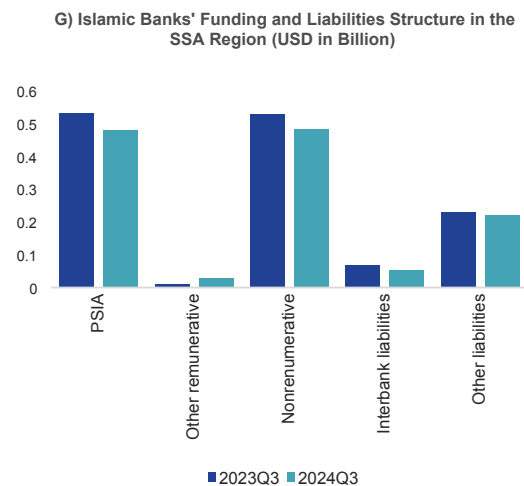
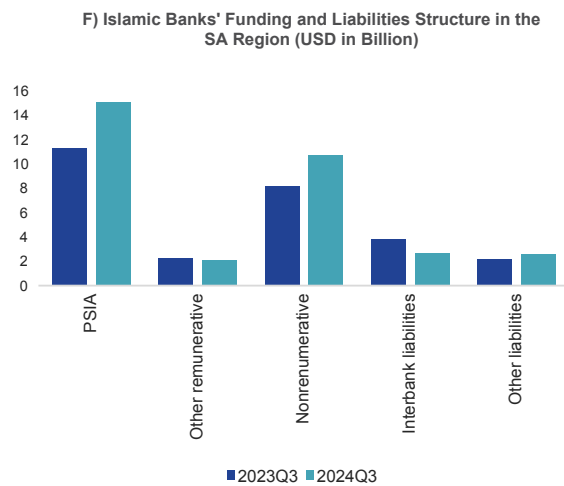
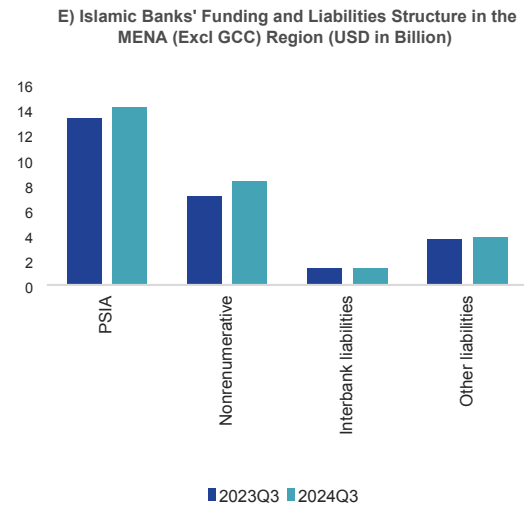
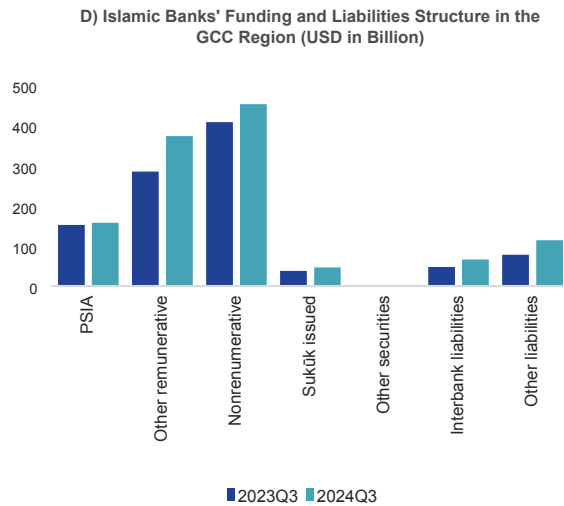


Source: IFSB PSIFIs

Deposits remained the principal funding source for Islamic banks, shaped by market structure, regulatory frameworks, and depositor preferences. Islamic banks continued to rely predominantly on deposit-based funding, though with notable variation in the composition of deposits (see chart 1.1.4). In the GCC and EAP, deposit growth was primarily driven by other remunerative deposits and non-remunerative accounts, supported by stable macro-financial conditions and depositors' preference for fixed returns. In some jurisdictions, commodity murābahah-based deposit products, structured to provide fixed returns, are used. Profit-Sharing Investment Accounts (PSIAs) growth remained subdued or negative. In MENA (excluding GCC), PSIAs and non-remunerative deposits constituted the bulk of deposit growth. In the ECA region, deposit growth was broad-based across all deposit types. Across all regions, Islamic banks' limited use of wholesale funding instruments, such as sukūk or interbank liabilities, reflected both structural factors, including regulatory requirements and shallow Islamic capital markets, and a strategic preference for stable, retail-based funding sources to mitigate refinancing and liquidity risks. These funding patterns contribute to the overall stability of Islamic banks' funding profiles but may also constrain balance sheet flexibility and limit access to longer-term or diversified funding sources. Reliance on deposits, in the absence of deep and liquid Islamic capital markets, underscores the importance of continued market development to support more diversified and resilient funding structures.

Chart 1.1.4: Global and Regional Islamic Banks' Total Funding and Liabilities Structure





Source: IFSB PSIFIs

In addition to traditional growth drivers, the growing adoption of financial technologies is reshaping intermediation channels and driving structural shifts within the industry. While these developments offer new avenues for growth, efficiency, and financial inclusion, they also introduce emerging risks related to Shari'ah compliance, governance frameworks, operational resilience, and financial stability. **Box 1.1** provides an overview of recent fintech advancements within the IFSI, highlighting key developments and the associated risks that warrant continued regulatory attention.

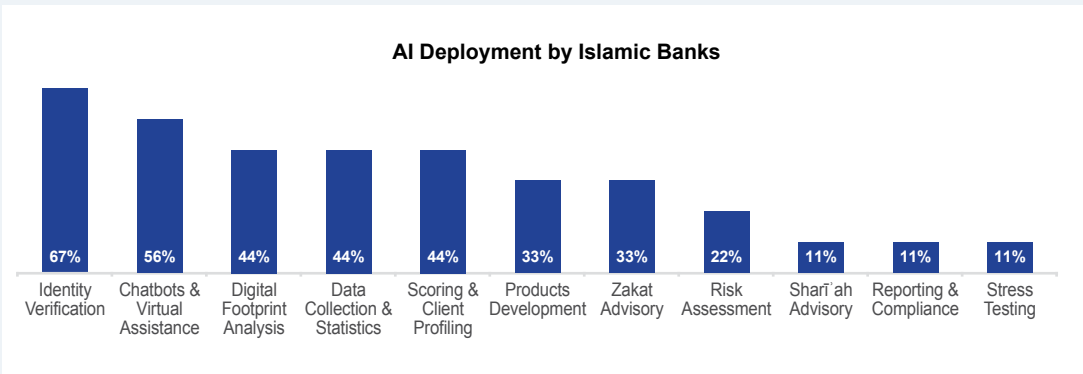
Box 1.1. Fintech Advancement in the IFSI — Structural Shifts and Emerging Risks

Technological innovation is reshaping the structure and risk dynamics of the global financial system, including the Islamic Financial Services Industry (IFSI). The Islamic fintech sector, valued at USD 138 billion in 2024 and projected to exceed USD 300 billion by 2027, is transforming service delivery and introducing alternative intermediation channels beyond traditional banking, including increased reliance on third-party providers. While these developments support growth, diversification, and efficiency, they also introduce new vulnerabilities and structural shifts that require close regulatory and supervisory attention.

Digital financing platforms, including Islamic equity crowdfunding and peer-to-peer lending have emerged as important sources of financing, particularly for small and medium-sized enterprises and underserved market segments. However, they require close attention to issues of investor protection, sufficient transparency and disclosure, and appropriate Sharī'ah governance frameworks. In response, regulatory authorities in several jurisdictions have strengthened Sharī'ah governance and disclosure requirements, introduced enhanced business screening criteria, and implemented regulatory sandboxes to monitor and mitigate emerging risks in this segment.

Crypto asset-related activity is also emerging within the IFSI, albeit still limited, and introduces complex compliance and governance considerations. The growing interest among retail investors and emergence of Sharī'ah-compliant offerings call for careful assessment of risks including investor protection, governance, and Sharī'ah compliance. As activity grows and exposures of Islamic financial institutions increase, ongoing supervisory monitoring will be essential.

The adoption of artificial intelligence (AI) in Islamic finance offers efficiency gains but increases the need for oversight, strong governance and risk management frameworks. Islamic financial institutions are progressively deploying AI technologies across a range of functions, including credit assessment, risk management, and product development, as well as in Islamic-specific applications such as Zakāh calculation and Sharī'ah advisory services. While these innovations enhance operational efficiency, they also introduce risks such as model integrity, data quality and algorithmic biases. Of particular concern is the potential lack of interpretative judgment in AI systems when applied to complex Sharī'ah rulings and jurisprudential differences across jurisdictions. Moreover, the opaque and evolving nature of AI models poses significant challenges for supervisory authorities and Sharī'ah boards in exercising effective oversight and informed judgment.



Source: IFSB Survey

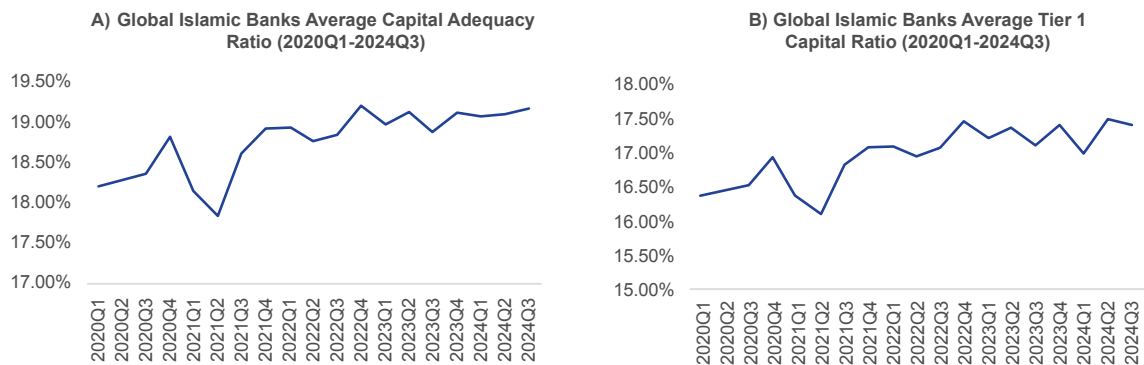
As Islamic finance becomes increasingly digitalised, the evolving risk landscape calls for enhanced oversight and greater supervisory vigilance to address new and emerging risks. It is essential to strengthen supervisory oversight, enhance Sharī'ah governance frameworks, and promote proactive supervisory engagement, including the identification and monitoring of risks specific to Islamic financial institutions.

1.1.2 Capital Positions Remained Strong Despite Emerging Pressures

Capital buffers remained adequate, though emerging pressures warrant continued vigilance.

The global Islamic banking sector remained well-capitalised, with average Capital Adequacy Ratio (CAR) and Tier 1 capital ratios staying comfortably above regulatory thresholds (Chart 1.1.5). Growth in Tier 1 capital was supported by new Tier 1 *shukūk* issuances in the GCC region, alongside improved retained earnings and lower non-performing financing (NPF) provisions. This capital build-up enhanced the sector's resilience against unexpected losses and macroeconomic shocks. However, a marginal decline in the global CAR was recorded during the reporting period, reflecting a rise in risk-weighted assets (RWAs) due to increased financing activity, particularly in the GCC and EAP regions. In some jurisdictions, growth in regulatory capital lagged the expansion of financing portfolios, signalling the need for continued capital management efforts as banks scale up intermediation. These developments underscore the importance of ensuring that capital growth remains commensurate with rising risk exposures to safeguard financial stability.

Chart 1.1.5: Global Islamic Banks' Capital Adequacy Structure (2020Q1–2024Q3)



Source: IFSB PSIFIs

Regional differences in capital positions reflected asset composition, profitability trends, and regulatory practices (Chart 1.1.6). In the ECA region, capital buffers remained strong, underpinned by retained earnings from financing and investment activities, supplemented by fee-based income and declining NPF provisions. In the SA region, the capital structure was strengthened by robust regulatory capital accumulation, supported by retained earnings generated from income on government securities, financing activities, and fee-based revenues, despite increased provisioning in response to past losses. In the MENA region (excluding GCC), capital adequacy ratios declined slightly due to rising RWAs and reduced retained earnings amid higher NPFs. In response, regulatory authorities introduced higher minimum capital requirements to strengthen sector resilience. In SSA, Islamic banks' capital positions remained above regulatory thresholds, although capital adequacy weakened in one jurisdiction due to the use of retained earnings to absorb prior losses. This resulted in a notable decline in the capital adequacy ratio during the period, prompting regulatory authorities to introduce recapitalisation measures to strengthen banks' capital buffers in response to ongoing economic and financial pressures. Overall, while capital positions remained sound across regions, emerging pressures in select markets highlight the need for sustained regulatory oversight and prudent capital planning to ensure continued sector resilience.

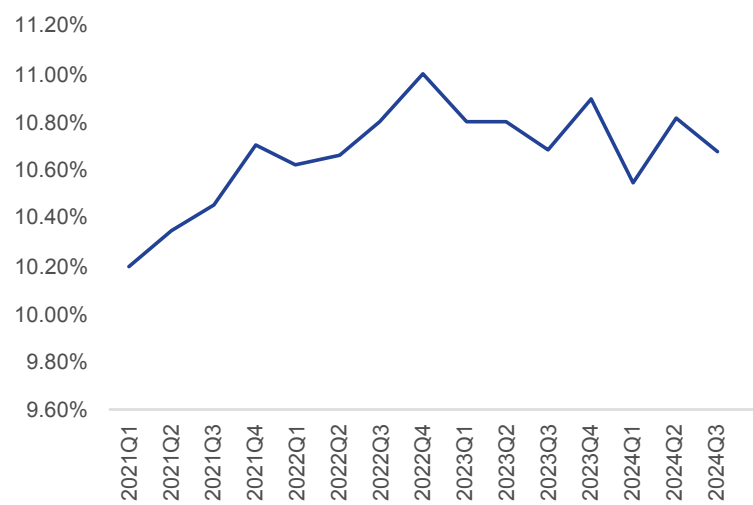
Chart 1.1.6: Regional Islamic Banks' Capital Adequacy Structure

Source: IFSB PSIFIs

1.1.3 Leverage Positions Remained Sound

Islamic banks sustained leverage ratios well above regulatory thresholds, underscoring their structurally conservative financial profiles. The global average leverage ratio of Islamic banks remained stable at around 10.7% during the reporting period—well above the 3% regulatory minimum requirement (Chart 1.1.7). This reflects the sector's prudential balance sheet structure, shaped by limitations on debt trading, speculative instruments, and excessive leverage. Islamic banks' leverage exposures are therefore largely confined to certain types of instruments, mainly commodity murābaḥah. Issues related to commodity murābaḥah and other hybrid financial instruments that may lead to high leverage are discussed in Box 1.2. While current leverage ratios remain adequate, increased use of commodity murābaḥah structures may elevate leverage risks over time. This underscores the need for continued regulatory vigilance to ensure that leverage growth remains prudent and aligned with the sector's underlying economic activity.

Chart 1.1.7: Islamic Banks' Leverage Ratios (2020 Q1 - 2024 Q3)

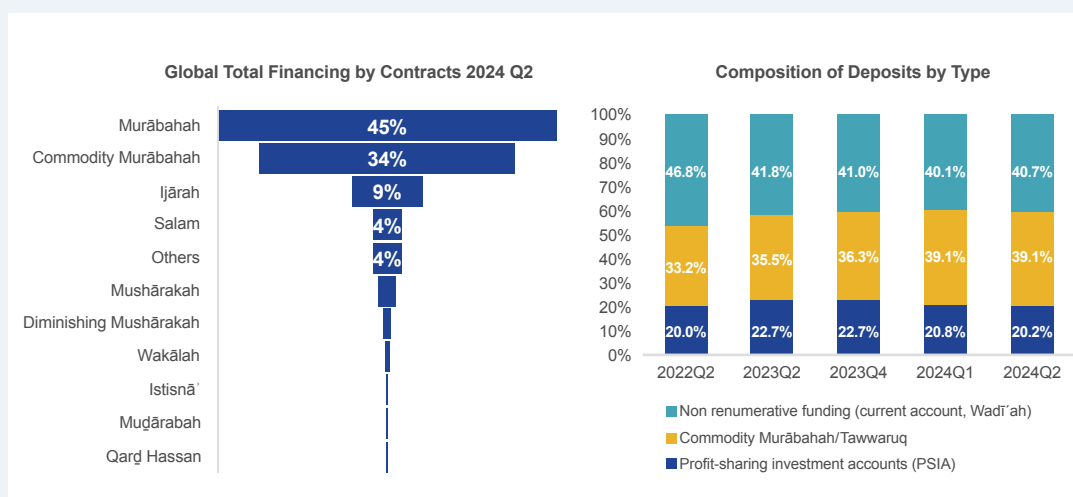


Source: IFSB PSIFIs

Box 1.2. Risks and Financial Stability Implications of Hybrid Islamic Financial Instruments

The growing reliance on hybrid Islamic financial instruments—such as commodity murābahah (CM)—raises important financial stability considerations. While these instruments have enabled the expansion of Islamic banking product offerings, their economic characteristics often closely resemble those of conventional debt-based contracts. From a stability perspective, the widespread use of such instruments may lead to greater credit risk concentration, interconnectedness within the financial system, and vulnerability to liquidity mismatches on Islamic banks' balance sheets, particularly if these structures are used for short-term funding or interbank transactions. Over time, this could amplify systemic vulnerabilities typically associated with conventional banks and other highly leveraged financial models.

CM has become a significant mode of Islamic banking transactions in some regions. CM-based contracts accounted for USD 512 billion in deposits as of Q2 2024 (+41% CAGR⁵ since Q2 2022) and USD 380 billion in financing in Q2 2024 (+104% CAGR since Q2 2020), reflecting their growing role in Islamic banking. In the deposits segment, the EAP and GCC regions hold the largest share of CM-based contracts, accounting for 51.1% and 30.3% respectively. In the financing segment, these regions are also the most reliant on these contracts with 57% for EAP and 37.8% for GCC, followed by ECA at 18.9%.



Source: IFSB Survey

The widespread use of hybrid instruments such as CM may introduce both micro- and macroprudential vulnerabilities to the Islamic banking sector. At the micro level, these instruments generate fixed-payment debt obligations that can elevate leverage and produce balance sheet structures resembling those of conventional banks, thereby heightening sensitivity to macroeconomic shocks. At the macro level, the growing reliance on CM for liquidity management, coupled with the increasing interconnectedness among Islamic financial institutions, may amplify systemic risk and contagion channels, particularly in jurisdictions where CM activity is heavily concentrated.

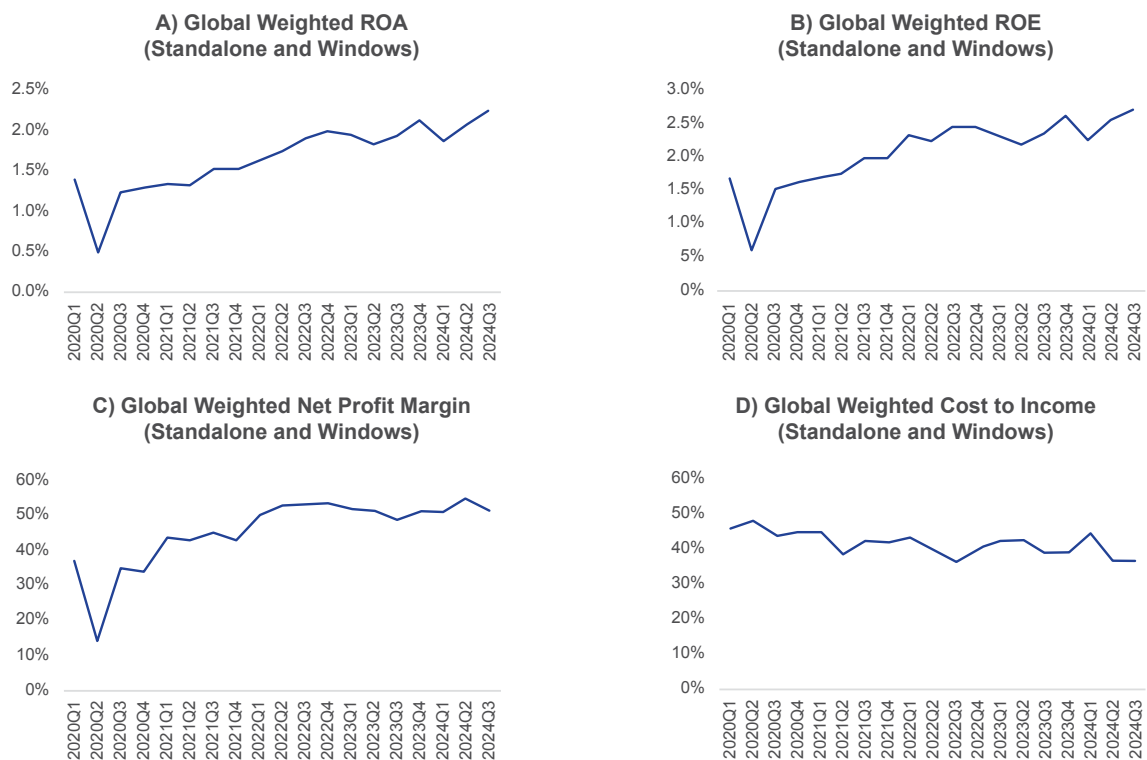
Operational risks associated with commodity murābahah transactions (CMT) may further compound these vulnerabilities in systems that are highly dependent on such instruments for liquidity and financing. Widespread and frequent use of CMT can magnify the systemic impact of any disruption in commodities markets or a failure of commodity trading platforms. While operational risks linked to CMTs are not inherently systemic, they can act as amplifiers of financial instability under stress conditions, particularly through liquidity channels and shared infrastructure dependencies.

5 Compound Annual Growth Rate.

1.1.4 Profitability Improved Driven by Income Growth and Operational Efficiency

Global Islamic banking profitability improved, reflecting strong financing-driven income growth, lower impairment costs, and operational efficiency gains. The global Islamic banking sector recorded higher profitability during the reporting period, with both Return on Assets (ROA) and Return on Equity (ROE) surpassing pre-pandemic levels (Charts 1.1.8a and b) and remaining above global banking averages. This improvement was largely driven by sustained financing growth amid stable demand in key sectors and healthy investment returns. At the same time, in some regions, a decline in provisioning and impairment charges, reflecting better credit conditions and reduced non-performing financing, supported earnings. Cost efficiency also improved, as reflected in a lower Cost-to-Income Ratio (CTI), aided by stable funding costs and scale efficiencies in key markets (Chart 1.1.8d). However, the Net Profit Margin (NPM) moderated slightly from its earlier peak (Chart 1.1.8c), reflecting some pressure on income growth and rising operating costs in select jurisdictions. Overall, the sector's profitability trends point to a solid earnings capacity, although continued vigilance is warranted given the evolving macro-financial environment.

Chart 1.1.8: Global Islamic Banks' Profitability Indicators

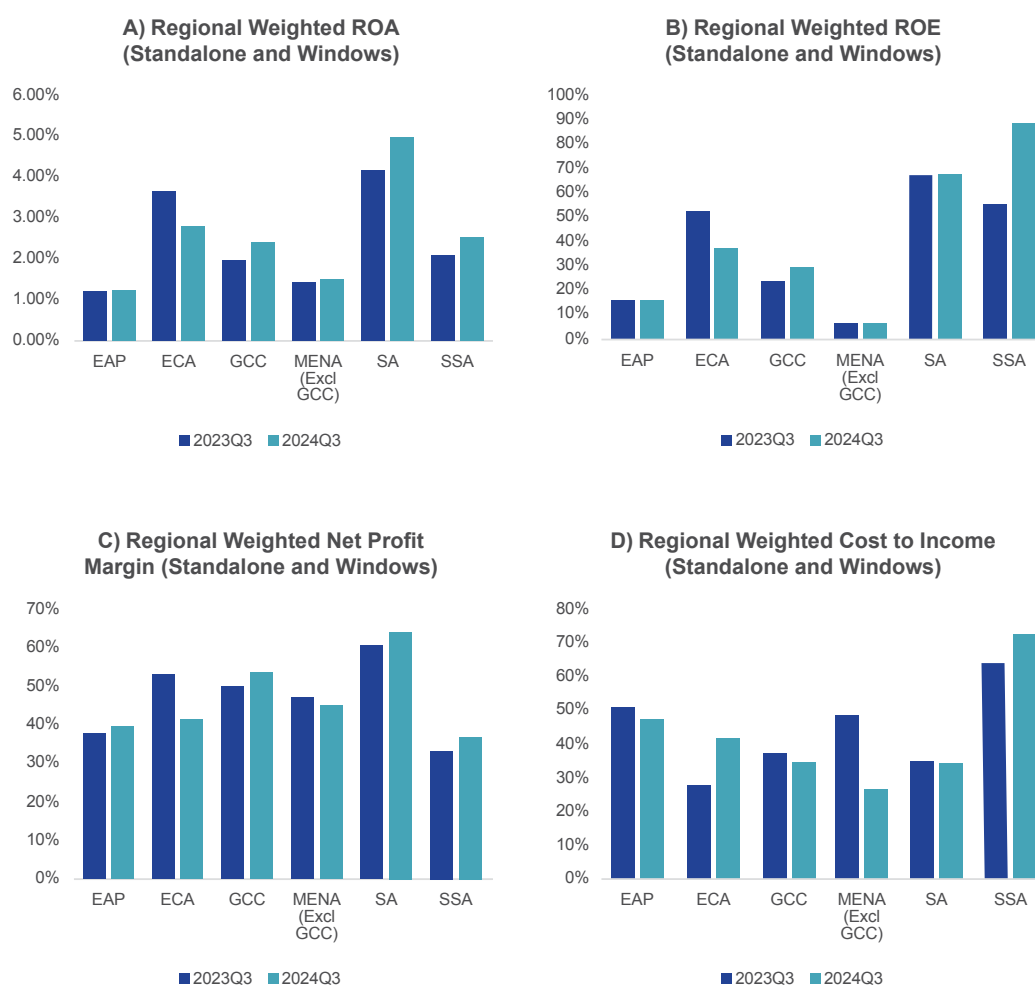


Source: IFSB PSIFIs

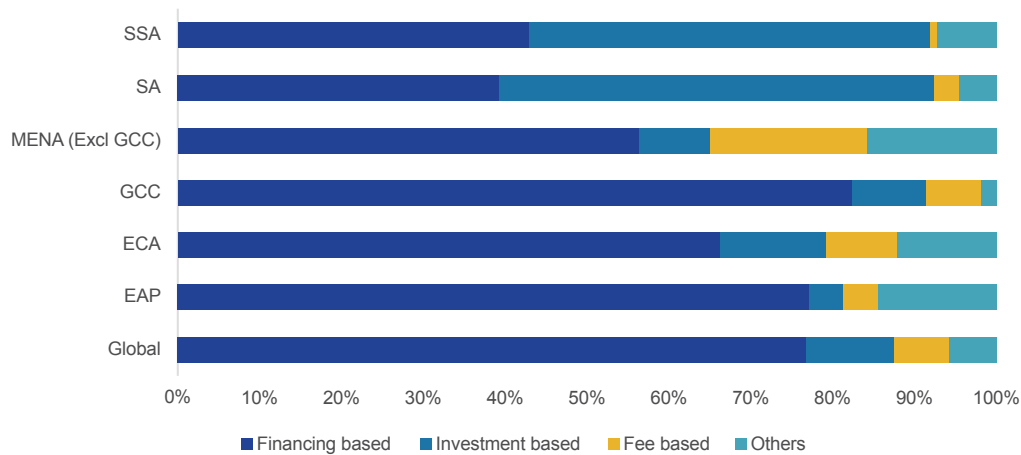
Regional profitability trends were mixed, shaped by macro-financial conditions and revenue composition. Profitability gains were most prominent in the GCC and EAP regions, supported by strong financing demand and favourable funding conditions (Chart 1.1.9e). In the ECA region, profitability remained positive but moderated due to higher funding costs and negative foreign exchange effects. In the MENA region (excluding GCC), profitability remained stable despite pressures from rising credit impairments and provisioning needs. In the SA and SSA regions, income from government securities and fee-based activities compensated for weaker financing income, supporting overall profitability. The decline in CTI across most regions reflected efficiency gains and increased revenues from diversified sources.

These profitability dynamics signal stronger earnings resilience but highlight emerging vulnerabilities. The sector's improved profitability has reinforced its capacity to absorb shocks and support sustainable growth. However, in some regions, profitability remained reliant on investment income and sovereign exposures, underscoring potential vulnerability to interest rate movements and fiscal risks. Sustained profitability will require continued focus on credit risk management, revenue diversification, and cost efficiency to mitigate emerging macroeconomic headwinds.

Chart 1.1.9: Regional Islamic Banks' Profitability Indicators and Revenue Composition



E) Regional Islamic Banks Revenue Composition

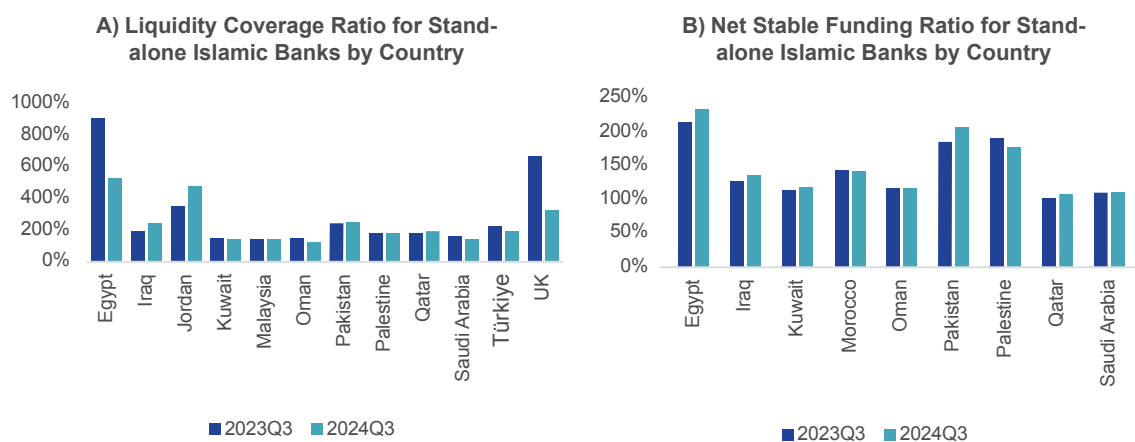


Source: IFSB PSIFIs

1.1.5 Strong Liquidity Buffers, though Structural Inefficiencies Persist

Islamic banks sustained robust liquidity positions though structural surpluses persisted in certain markets. The global Islamic banking sector maintained healthy liquidity conditions during the reporting period, with key liquidity indicators, including the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), remaining well above regulatory minimum requirements in most jurisdictions (Chart 1.1.10). These buffers reflected both prudent liquidity risk management practices and structural characteristics of Islamic banking business models. Notably, several jurisdictions recorded exceptionally high LCR and NSFR levels, suggesting a strong capacity to withstand short-term liquidity shocks.

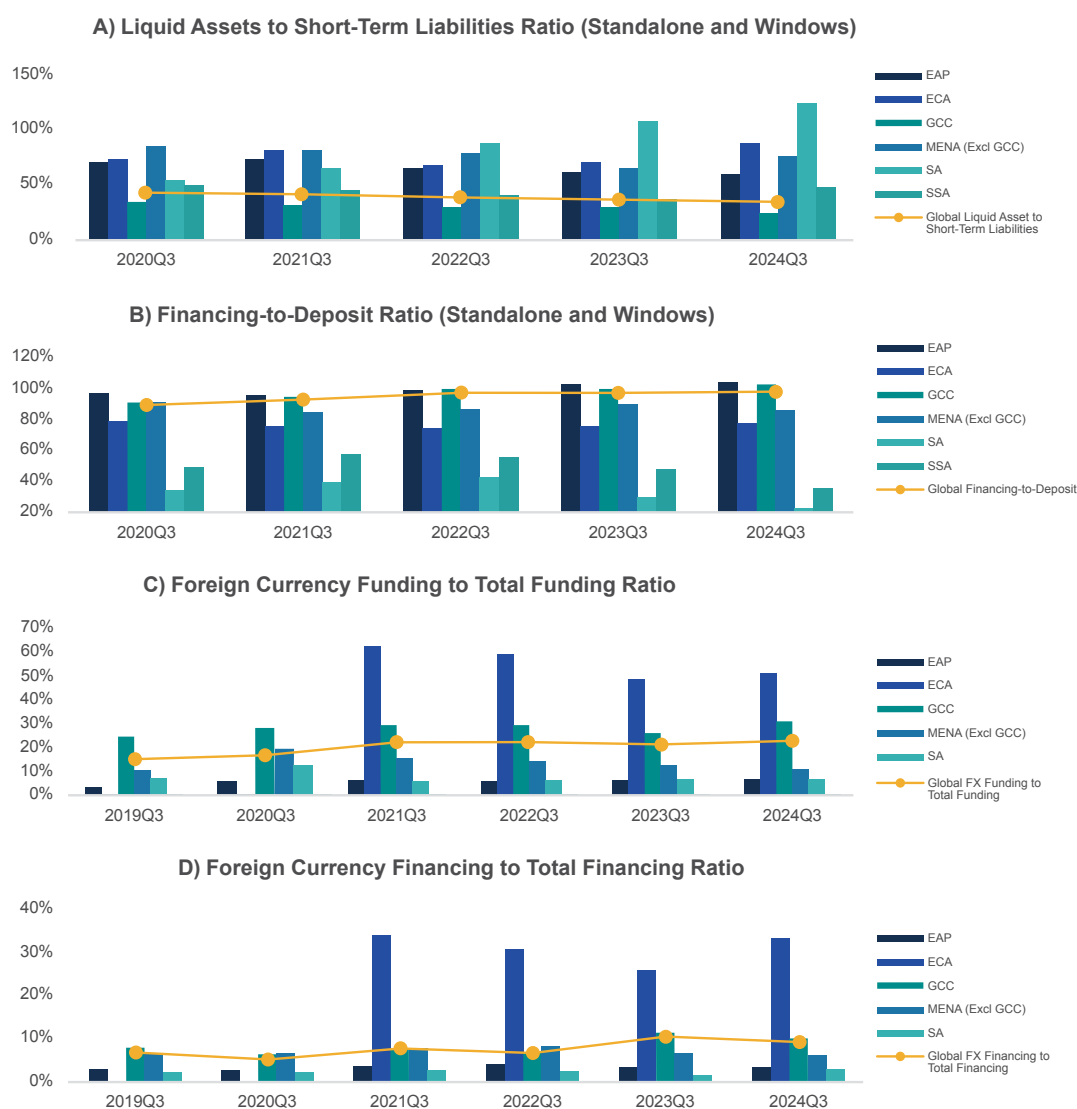
Chart 1.1.10: Global Islamic Banks' LCR and NSFR



Source: IFSB PSIFIs

Structural liquidity surpluses in some regions reflected limited intermediation opportunities and market underdevelopment. The liquid assets-to-short-term liabilities ratio (LASTL) remained significantly elevated in certain jurisdictions, particularly in SA, SSA, and parts of MENA (excluding GCC), far exceeding global averages (Chart 1.1.11a). These buffers were primarily composed of sovereign instruments, including government securities and *shukūk*, alongside central bank placements and cash balances. The elevated liquidity buffers primarily reflected structural factors—including limited depth of Islamic financial markets and regulatory prudence—rather than active liquidity risk management strategies. While supporting near-term liquidity resilience, these excess buffers implied an opportunity cost and reduced intermediation capacity. In jurisdictions with more developed Islamic capital markets, particularly the GCC and EAP, Islamic banks maintained lower LASTL ratios (Chart 1.1.11b). Their liquidity positions were supported by access to a broader range of Islamic investment instruments. As a result, liquidity buffers in these markets were more diversified and less reliant on cash and central bank placements. This facilitated more efficient liquidity management and enhanced banks' ability to intermediate financing while maintaining resilience against liquidity shocks.

Chart 1.1.11: Global and Regional Islamic Banks' Liquidity Metrics



Source: IFSB PSIFIs

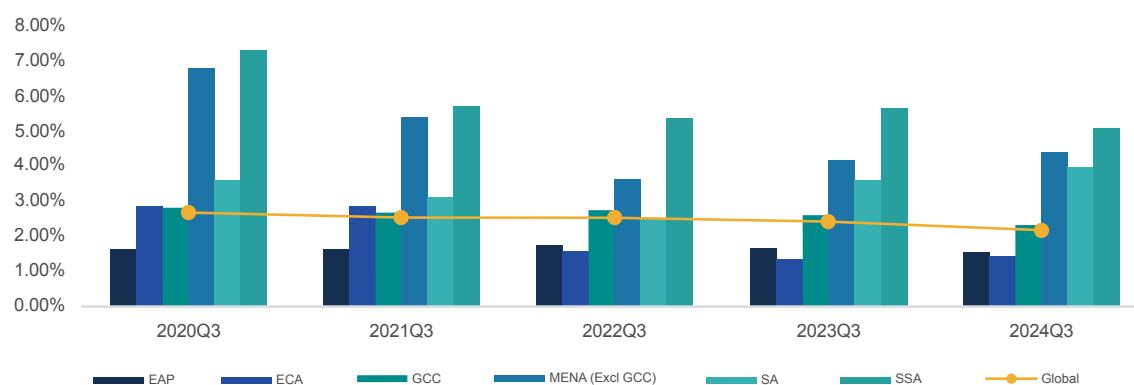
Persistently low Financing-to-Deposit Ratios (FDR) reflected limited liquidity transformation and credit intermediation in several regions. Low FDR, particularly in SA and SSA, reflected a conservative deployment of deposit funding into financing activities (Chart 1.1.11b). As noted in Section 1.1.4, the sector's funding structure remained heavily reliant on deposit-based sources, with limited wholesale or market-based funding. These patterns may also point to deeper underlying structural factors—including underdeveloped Islamic financial markets and a narrow range of funding options—that may weigh on the sector's potential to scale up credit intermediation over time.

Foreign currency liquidity exposures remained contained but warrant monitoring in specific markets. Globally, Islamic banks' foreign currency funding and financing ratios remained stable and relatively low (Charts 1.1.11c and d), indicating limited vulnerability to foreign currency liquidity shocks. However, certain jurisdictions in MENA and ECA exhibited higher foreign currency funding shares, reflecting cross-border deposit inflows and investor participation. These exposures, while enhancing funding diversification, increase sensitivity to external liquidity conditions, currency volatility, and potential capital flow reversals during periods of financial stress.

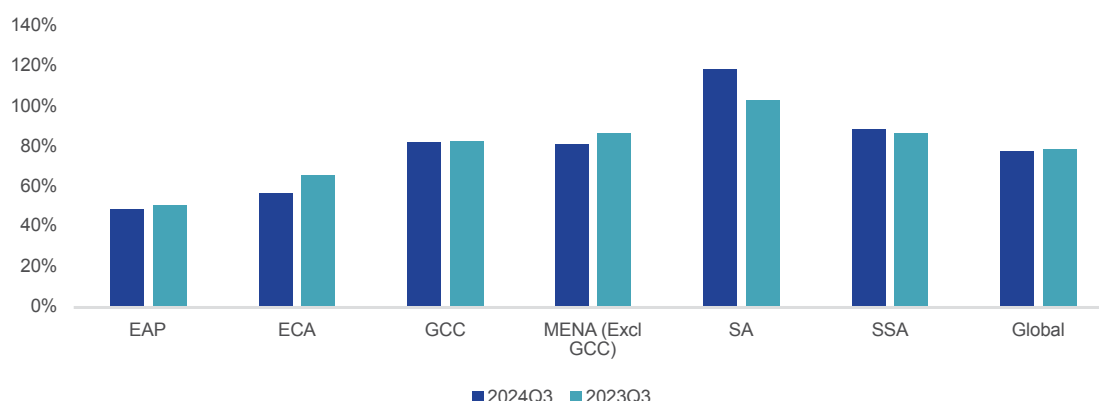
1.1.6 Asset Quality Improved, but Challenges Exist in Some Markets

The global asset quality of Islamic banks strengthened marginally, supported by effective risk management and improved macroeconomic conditions in some jurisdictions. During the reporting period, the global average non-performing financing (NPF) ratio declined slightly, remaining below pre-pandemic levels (Chart 1.1.12). This improvement reflected sustained financing growth, particularly in the household, real estate, and trade sectors, which continue to account for the largest share of Islamic banks' financing portfolios across most regions (Chart 1.1.14). The decline in NPF was further supported by prudent credit risk management, including targeted restructuring and provisioning policies (Chart 1.1.13).

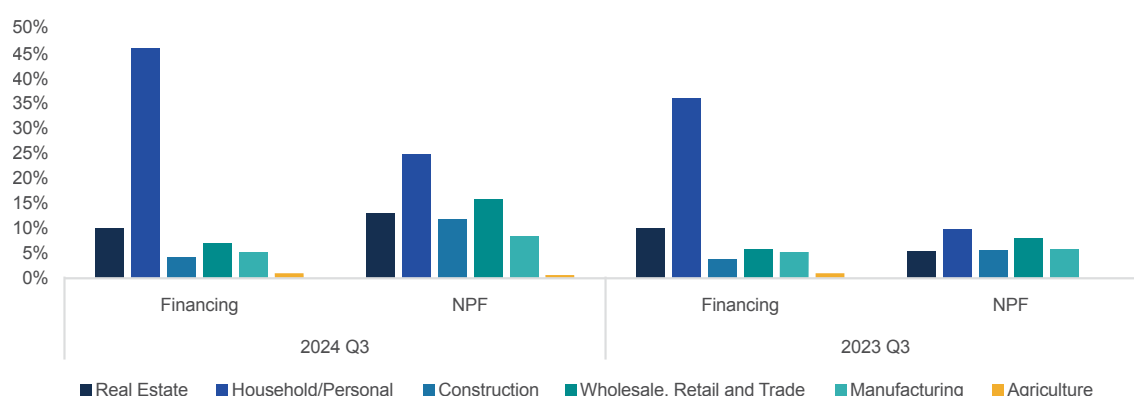
Chart 1.1.12 Global and Regional Islamic Banks' Average Gross NPF to Total Financing (%) (2020 Q3 – 2024 Q3)



Source: IFSB PSIFIs

Chart 1.1.13: Global and Regional Islamic Banks' Provision to NPF Ratio

Source: IFSB PSIFIs

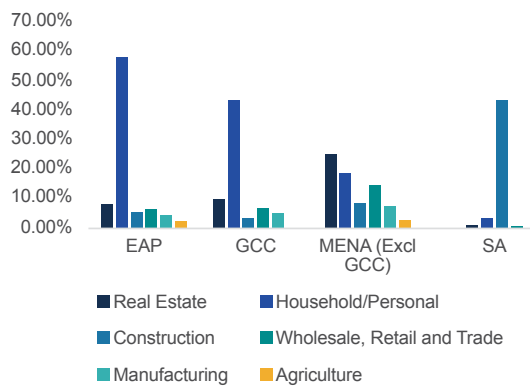
Chart 1.1.14: Global Islamic Banks' Weighted Average Percentage of Financing and Non-Performing Financing to Selected Economic Sectors (2023 Q3 and 2024 Q3)

Source: IFSB PSIFIs

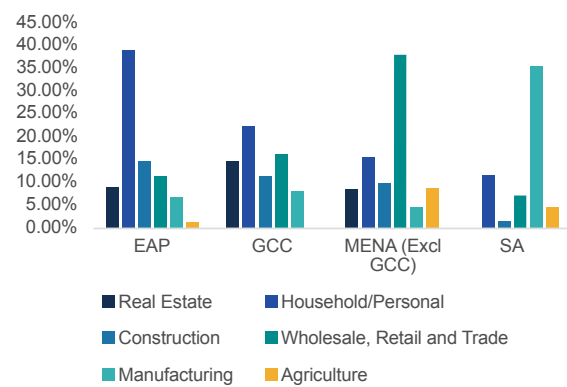
Regional asset quality trends reflected differing sectoral exposures and macro-financial conditions. In the GCC region, NPF ratios remained stable at low levels, supported by favourable operating conditions, strong provisioning practices, and sustained demand in core sectors, particularly real estate and trade (Chart 1.1.15). In the EAP region, the overall NPF ratio declined; however, household financing continued to exhibit elevated impairment levels. Asset quality pressures persisted in the MENA (excluding GCC) and SA regions, with distinct sectoral vulnerabilities. In MENA (excluding GCC), elevated NPF ratios were concentrated in trade and household financing, reflecting continued macroeconomic fragility and repayment pressures. In SA, impairments were higher in manufacturing, wholesale, and retail trade sectors; segments particularly exposed to domestic economic challenges, natural disasters, and rising input costs. While provisioning buffers remained adequate in these regions (Chart 1.1.13), the persistence of elevated NPF ratios underscores the need for ongoing credit risk vigilance, particularly in sectors facing structural and cyclical headwinds.

Chart 1.1.15: Regional Islamic Banks' NPF and Financing by Sector

A) Economic Sector-Wise Financing by Region (%) 2024 Q3



B) Economic Sector-Wise NPF by Region (%) 2024 Q3



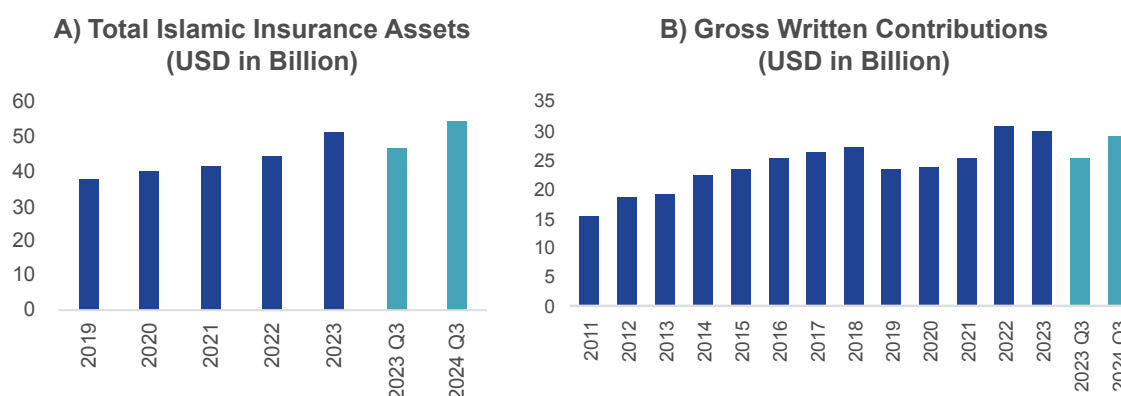
Source: IFSB PSIFIs

1.2 Islamic Insurance

1.2.1 Sustained Growth but Distinct Regional Patterns

The Islamic insurance sector demonstrated sustained growth momentum in 2024, significantly outpacing the broader insurance industry. Islamic insurance assets reached USD 54.4 billion by Q3 while Gross Written Contributions (GWC) reached USD 28.6 billion, marking 16.9% and 15.1% YoY growth respectively (see Chart 1.2.1). These figures substantially outperform the broader insurance market's 3.20%⁶ premium growth. However, structural challenges persist, particularly the limited availability of Islamic financial instruments and concentration risks in investment portfolios.

Chart 1.2.1: Islamic Insurance Assets and Gross Written Contributions

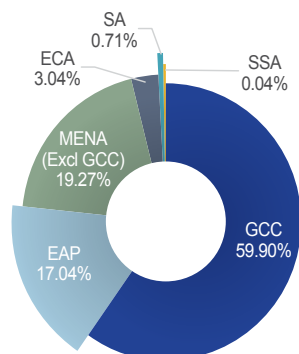


Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports and financial stability reports.

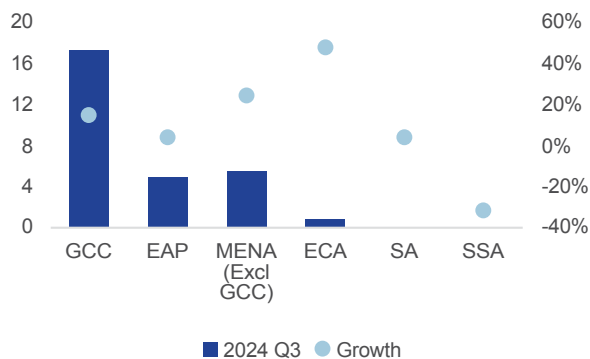
Varying market maturity levels characterised the Islamic insurance landscape, with distinct development patterns emerging across markets (see Chart 1.2.2). The GCC region dominated the global Islamic insurance market, accounting for 59.9% of the total GWC, supported by consolidation activity and comprehensive regulatory frameworks in major jurisdictions. MENA (excluding GCC) and EAP regions accounted for 19.3% and 17.0% of global GWC. SA and SSA regions are at earlier stages of market development, prioritising regulatory framework enhancement and infrastructure building. ECA experienced the highest growth rate (47.5%), through the strengthening of the broader Islamic financial system, driven by increased demand and regulatory reforms.

Chart 1.2.2: Regional Share and Growth of Islamic Insurance Gross Written Contribution

A) GWC Regional Share

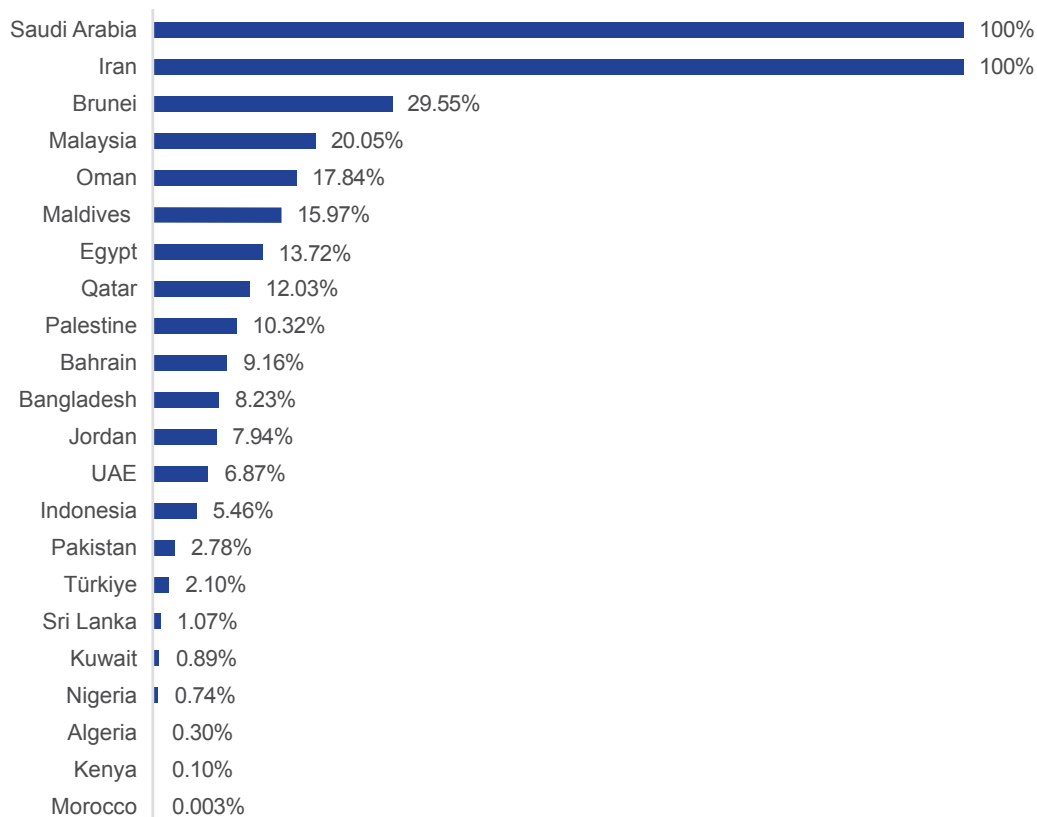


B) Regional Contribution (USD in Million) and Growth Rate



Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports and financial stability reports.

Chart 1.2.3: Islamic Insurance Share in Total Insurance Assets by Jurisdiction (%) 2024 Q3



Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports and financial stability reports.

Note: Market share data has been revised to an asset-based methodology to ensure comparability with the Islamic banking sector, though this limits year-on-year comparison.

Business line breakdown revealed distinct regional patterns shaped by regulatory frameworks and consumer needs. The general business line⁷ (non-life) dominates GCC, MENA (excluding GCC), and ECA regions (exceeding 89.9% of contributions), driven by mandatory motor and health coverage requirements. These markets demonstrated product evolution beyond traditional coverage, particularly in the motor line with electric vehicle protection and usage-based insurance models, while medical lines show accelerated growth through mandatory schemes and specialised health solutions. The sector is increasingly addressing emerging risks through environmental coverage and natural catastrophe protection, reflecting the growing risk assessment capabilities. Conversely, the family business line⁸ (life) is more predominant in the EAP and SA regions, accounting for over 70.2% of contributions, driven by sophisticated product development focusing on ethical financial planning, retirement solutions, and education protection.

Developments in distribution infrastructure varied among jurisdictions, reflecting market maturity and institutional capacity. The GCC region and parts of EAP have successfully integrated bancassurance and digital platforms into their distribution frameworks, supported by established financial sector infrastructure and high digital adoption rates. SA, MENA (excluding GCC), and SSA regions primarily rely on traditional agency networks, reflecting the importance of direct customer engagement in markets where insurance concepts and product understanding require detailed explanations. While digital transformation offers significant market development potential through improved reach and accessibility, its implementation varies based on market readiness factors, including digital infrastructure maturity, regulatory frameworks, and consumer preferences.

1.2.2 Solvency Positions Remained Adequate, but Pressures are Evident in Weaker Markets

The global Islamic insurance sector generally maintained solvency positions above regulatory thresholds in 2024, although resilience varied across regions. This trend was broadly aligned with the conventional insurance sector, with most Islamic insurers remaining adequately capitalised (see Chart 1.2.4). However, capital positions differed considerably across jurisdictions, shaped by differences in regulatory frameworks and market development stages. Some markets, such as EAP, recorded robust solvency levels, while others—particularly in parts of SA and SSA—remained near minimum compliance thresholds.

Capital quality and operator size influenced solvency outcomes in key markets. In the MENA region (excluding GCC), capital strength was supported by an increasing proportion of shareholders' equity and improved governance frameworks. In the GCC, market segmentation based on operator size became more pronounced. Larger insurers maintained strong capital buffers through prudent reserve management and underwriting discipline, while smaller entities struggled with compliance due to weaker technical performance.⁹ This performance gap has accelerated market consolidation, expected to result in stronger, better-capitalised entities.

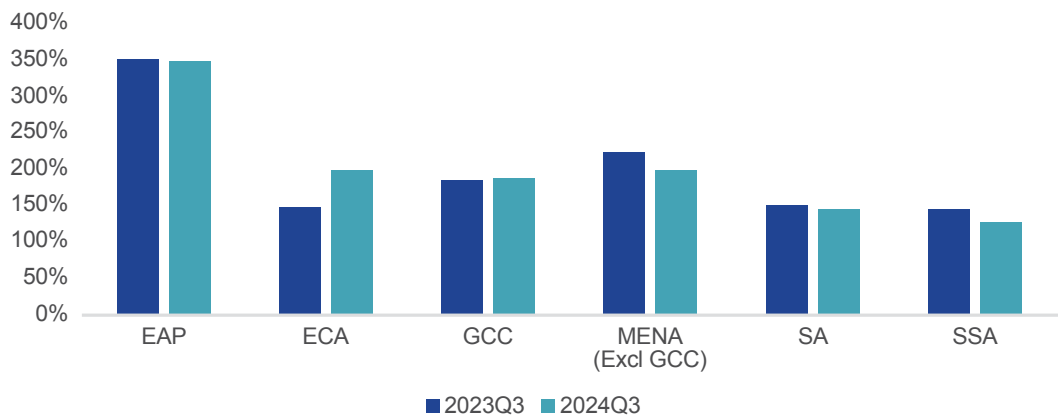
⁷ The *general business line* refers to short-term Islamic insurance products that provide coverage for non-life risks, such as property, motor, marine, liability, accident, and health.

⁸ The *family business line* refers to long-term Islamic insurance products that combine protection and savings/investment features (life and long-term risks).

⁹ Technical performance reflects the insurer's core insurance operations, measuring how well it manages underwriting risk and related expenses, before considering investment income and is commonly assessed using metrics like the combined ratio.

Several regions recorded notable improvements in solvency positions. ECA demonstrated substantial improvement evidenced by rating upgrades, while MENA (excluding GCC) maintained strength aided by conservative regulatory requirements despite emerging pressures on technical provisions.¹⁰ EAP’s resilience stemmed from effective adaptation strategies and claims control measures that preserve public trust despite weakened consumer purchasing power. Conversely, in markets with delayed regulatory reforms (parts of SA and SSA) asset quality weaknesses contributed to downward pressure on solvency ratios.

Chart 1.2.4: Islamic Insurance Solvency Ratio (2023 Q3, 2024 Q3)



Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities’ statistical databases, annual reports and financial stability reports.

Differences in business line composition further influenced capital adequacy patterns. The general business line maintained relative capital stability, due to short-tail insurance products that allow for quicker claims settlement and lower long-term risk exposure. However, increased weather-related claims during the year highlighted the need for stronger capital buffers. The family business line exhibited higher but more volatile ratios, particularly in growth markets where business expansion often outpaced internal capital generation, underscoring the need for more sophisticated capital planning and allocation frameworks.

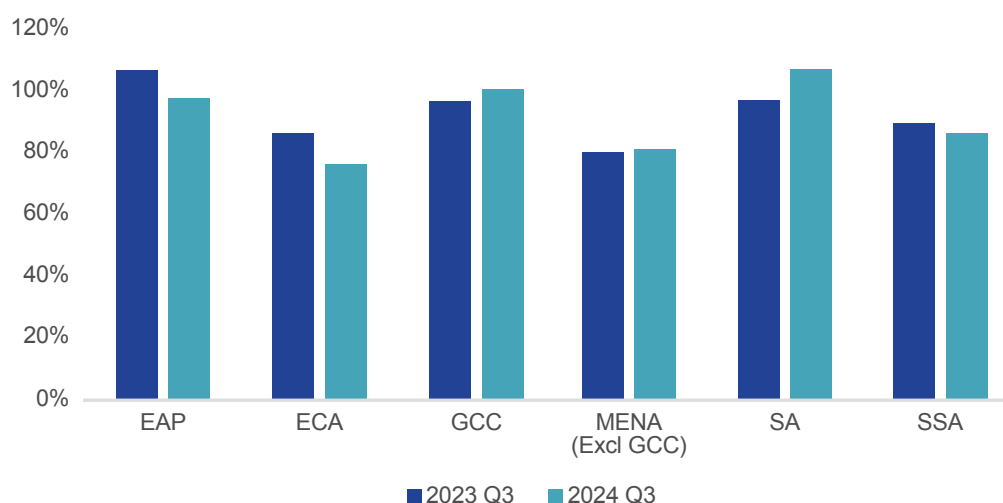
Structural vulnerabilities continued to affect capital resilience in certain markets. Rising technical provisions and weakening underwriting results placed additional strain on internal capital generation, particularly in jurisdictions facing higher claims volatility or inflation-related cost pressures. Effectiveness of capital frameworks varied significantly, with heightened vulnerability in regions where regulatory and supervisory frameworks for Islamic insurance had not evolved in tandem with market developments.

¹⁰ Assets or liabilities that represent the economic value of the insurer fulfilling its insurance obligations to policyholders.

1.2.3 Profitability Varied Among Regions but Structural Weaknesses Emerged

Profitability in the general business line varied across regions, with some markets facing rising claims pressures. In the GCC, underwriting results weakened due to rising motor and liability claims. These pressures were further compounded by intense market competition that limited the ability of operators to adjust pricing adequately as many prioritised retaining or expanding market share. Regulatory requirements for enhanced service quality further increased operational costs, placing additional strain on profitability. In the MENA region (excluding the GCC), technical performance deteriorated due to rising claims and regulatory limits on pricing adjustments, which restricted operators' ability to increase contributions in line with inflation; efforts to improve expense ratios were insufficient to restore underwriting profitability. In the EAP region, underwriting performance improved markedly, supported by increased vehicle sales, growing demand for natural catastrophe coverage, and prudent pricing strategies. ECA markets similarly preserved profitability despite pressures from declining vehicle financing and rising credit costs, reflecting effective underwriting discipline and claims management.

Chart 1.2.5: Combined Ratio (General) (2023 Q3, 2024 Q3)

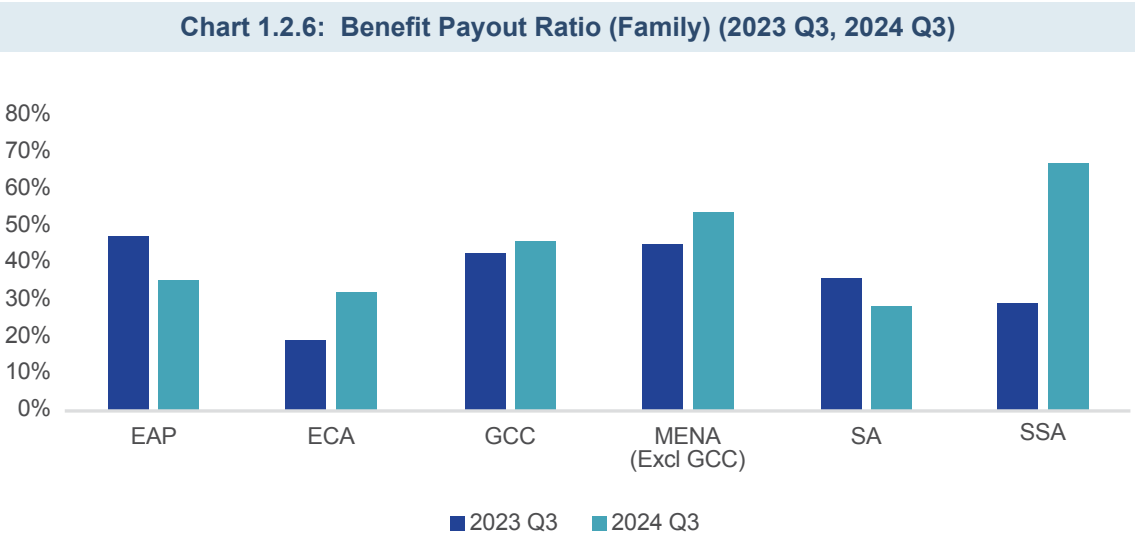


Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports, and financial stability reports.

Family business lines experienced declining underwriting performance¹¹ across regions with some exceptions, as increasing policy surrenders and medical claims pressured margins. Benefit payout ratios increased across several markets in 2024, reflecting escalating health-related claims and elevated policy lapses amid inflationary pressures (see Chart 1.2.6). In the GCC, profitability remained relatively stable through effective risk selection strategies. In MENA (excluding GCC) payout ratios rose, with higher claims and policy surrenders outweighing operational efficiency improvements. SA markets recorded an overall decline in payout ratios;

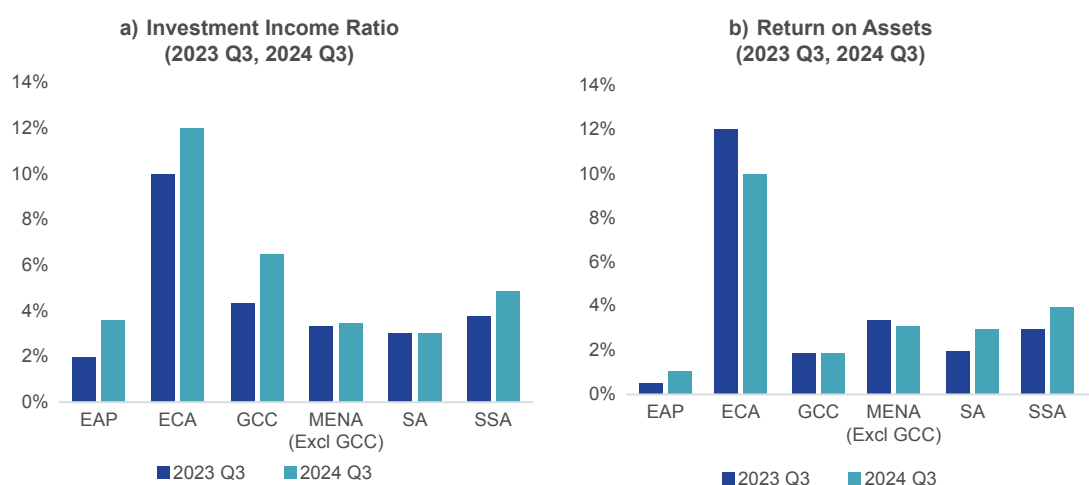
¹¹ Underwriting performance refers to the financial outcome of an insurer's core risk-taking activities, specifically the process of underwriting insurance policies. It measures how effectively the insurer collects premiums to cover claims and underwriting expenses.

however, performance varied across jurisdictions, with some facing strain from higher risk retention due to limited access to Islamic reinsurance. ECA experienced a notable increase in payout ratios, driven by rising claims costs and market expansion. SSA markets recorded the sharpest deterioration, with a substantial increase in payout ratios reflecting structural weaknesses and higher claims. In contrast, EAP markets improved performance, supported by contribution rate adjustments and effective claims management.



Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports, and financial stability reports.

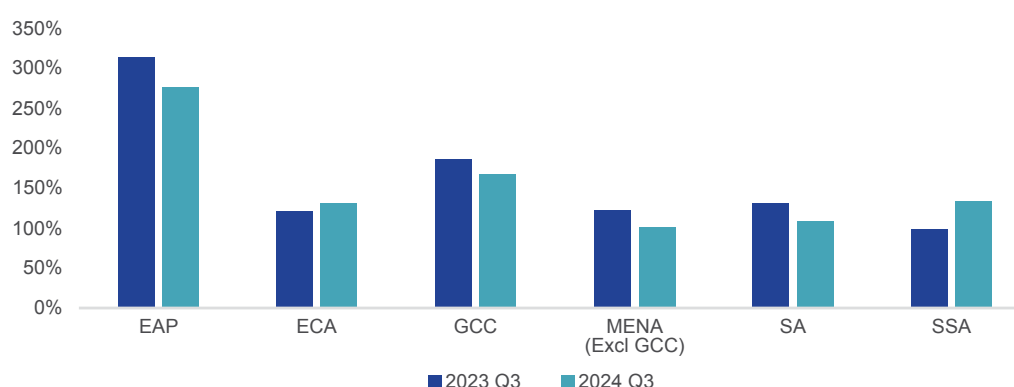
Investment returns played a key role in supporting profitability, partially offsetting underwriting losses in several regions, although performance varied. ECA recorded strong investment returns, supported by market expansion and portfolio diversification (see Chart 1.2.7). GCC operators reported improved returns, underpinned by diversified fixed-income portfolios, particularly sukūk investments. EAP and SSA markets posted moderate gains. In MENA (excluding GCC), operators engaged in portfolio restructuring strategies to partially offset declining ROA. SA presented mixed outcomes: jurisdictions with developed Islamic financial sectors maintain moderate yields, while others remained constrained by limited investment avenues due to shallow Islamic capital markets and heavy reliance on cash holdings. While investment dynamics mirrored broader insurance industry trends, the extent to which Islamic insurers benefited from rising yields remained uneven across markets. This reflected deeper structural limitations—such as shallow Islamic capital markets and a narrow range of Islamic financial instruments—that continued to constrain operators’ ability to enhance returns and diversify investment risk.

Chart 1.2.7: Profitability Ratio (Q3 2023, Q3 2024)

Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports, and financial stability reports.

1.2.4 Liquidity Conditions Shaped by Structural and Regulatory Factors

Liquidity conditions across the Islamic insurance sector remained uneven in 2024, shaped by regional differences in market development, investment strategies, and external pressures. Liquidity ratios declined in most regions—including EAP, GCC, MENA (excluding GCC), and SA—driven by increased claims settlements and policy surrenders (see Chart 1.2.8). In general business, motor and property claims were key contributors, while in family business, rising medical payouts and policy lapses added further pressure. These effects were amplified by inflation and declining household income.¹² In contrast, ECA and SSA recorded stable or improved liquidity, the latter supported by continued deposit placements in Islamic banks.

Chart 1.2.8: Islamic Insurance Liquidity Ratio (2023 Q3, 2024 Q3)

Source: Data provided by regulatory and supervisory authorities, as well as regulatory authorities' statistical databases, annual reports, and financial stability reports.

¹² These trends mirror similar patterns observed in the broader insurance sector. See 2024 Global Insurance Market Report- [IAIS Global Insurance Market Report-2024.pdf](#)

The depth of Islamic financial markets significantly influenced liquidity management strategies across regions. In more developed markets, including GCC, EAP, ECA, and select SA jurisdictions, operators continued to transition from cash-heavy holdings toward diversified portfolios comprising *ṣukūk* and Islamic money market instruments. Some GCC operators further expanded into alternative assets such as precious metals. Jurisdictions with underdeveloped Islamic financial markets, particularly in MENA (excluding GCC) and parts of SA, continued to rely on cash positions, cross-border holdings, or conventional government securities as permitted exceptions to meet liquidity requirements, due to lack of alternatives in the local market.

Greater use of contingent liquidity sources introduced additional risk considerations for Islamic insurers. Reinsurance arrangements provided crucial liquidity relief in response to large-scale climate-related flood claims in 2024, particularly in the GCC region. However, this increasing dependence exposed insurers to counterparty risks and delays in recoveries—challenges that are especially significant in markets with large outstanding claims. In addition, cross-border investment holdings, which are common in MENA (excluding GCC) and select GCC jurisdictions, further elevated liquidity risk by exposing operators to potential capital transfer restrictions and foreign exchange volatility during periods of financial stress. These dynamics highlight the trade-offs associated with relying on external liquidity sources, especially in jurisdictions with limited domestic financial depth.

Structural reforms and evolving market dynamics introduced new liquidity management challenges for Islamic insurers, particularly in less mature markets. In the GCC, market consolidation pressures exposed liquidity vulnerabilities among smaller operators, especially those lacking economies of scale and access to diversified investment instruments. Regulatory reforms in markets such as the GCC or parts of EAP, requiring faster claims settlement, have shortened liquidity cycles, forcing operators to maintain higher liquid asset positions, often at the expense of yield or investment flexibility. These structural changes required operators to adapt their liquidity strategies and presented different outcomes across markets based on their level of development and regulatory environment.

1.3 Islamic Capital Markets

1.3.1 Strong Growth in Şukūk Markets but Structural Concentration Remains

The Islamic capital market recorded strong growth in 2024, primarily driven by the continued expansion of the şukūk market. New şukūk issuances rose by 25.6% to USD 230.4 billion, with total outstanding şukūk surpassing USD 900 billion (see Chart 1.3.1). Lower interest rate expectations, coupled with ample global liquidity and tighter credit spreads, created conducive financing conditions, encouraging issuers to tap the şukūk market to meet refinancing needs and fund new projects. Governments and corporates in key Islamic finance jurisdictions increased şukūk issuance to finance large-scale infrastructure and economic diversification initiatives

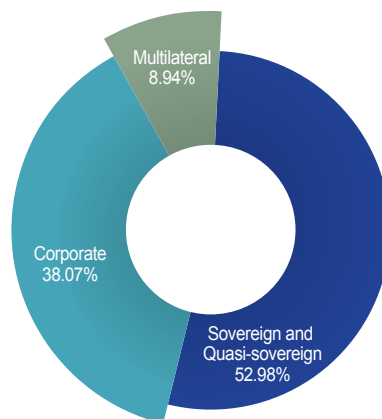
Chart 1.3.1: Global Şukūk Issuances and Outstanding (2004-2024) (USD in Billion)



Source: IFSB estimates based on data from Refinitiv and regulators.

The şukūk market saw increased participation from corporate issuers, although issuance activity continues to be dominated by public sector issuers. Sovereign and quasi-sovereign issuers accounted for around 52.9% of total issuances. However, corporate şukūk issuance grew by 21.2% to USD 87.7 billion, reflecting increasing private sector participation and recognition of şukūk as a viable alternative to conventional debt (Chart 1.3.2). Issuances by multilateral institutions, notably the Islamic Development Bank and the International Islamic Liquidity Management Corporation, also increased to over USD 20 billion in 2024, driven by efforts to mobilise development funding and facilitate cross-border liquidity management. While these developments signal broader issuer participation, the market structure remains concentrated in key markets and sectors.

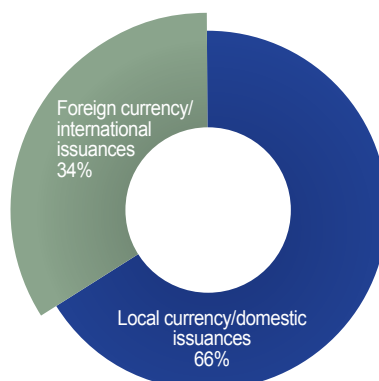
Chart 1.3.2: Şukūk issuances by Issuer Type (2024)



Source: IFSB estimates based on data from Refinitiv

Foreign currency-denominated şukūk increased in 2024, reflecting deeper integration with international capital markets, signalling market development but also raising potential vulnerabilities. Foreign currency şukūk accounted for 34% of total issuances, up from 26% in 2023 (Chart 1.3.3). The growth was driven by issuers seeking to diversify their investor base, access international markets, and benefit from favourable global financing conditions. The increased use of foreign currencies signals greater integration of the şukūk market with international capital markets. However, it also introduces heightened exposure to foreign exchange risks and potential currency mismatches, particularly for issuers with revenues primarily in local currency. A sharp depreciation of the domestic currency could significantly increase debt servicing costs and strain fiscal or corporate balance sheets. It therefore warrants close monitoring and strengthened risk management to safeguard financial stability, particularly during periods of market stress.

Chart 1.3.3: Şukūk Issuances by Market

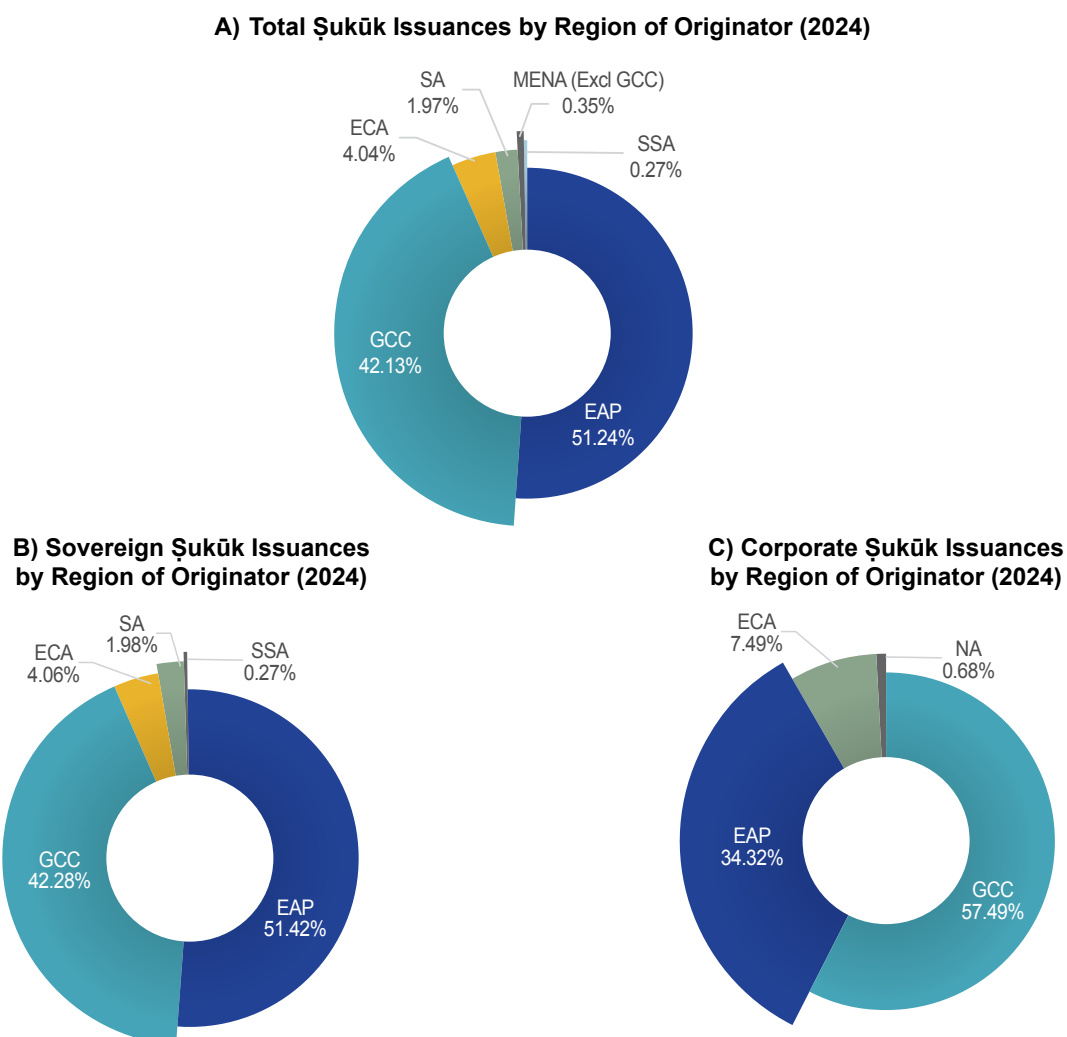


Source: IFSB estimates based on data from Refinitiv

Şukūk issuance activity remained concentrated in mature markets, with distinct issuance patterns across regions and issuer types. Overall, şukūk issuances were dominated by the EAP region and the GCC, accounting for 51.2% and 42.1% of total issuances, respectively, while

other regions contributed marginally (Chart 1.3.4). Sovereign *shukūk* issuance was led by the EAP region, representing 51.4% of global sovereign *shukūk*, reflecting use of *shukūk* for public financing and monetary operations, particularly in Malaysia and Indonesia. The GCC followed with 42.2%, driven by increased fiscal needs and infrastructure funding. Corporate *shukūk* issuances increased in the GCC, which accounted for 57.5% of global corporate *shukūk*, reflecting the region's growing private sector reliance on *shukūk* as a financing tool amid economic diversification efforts. The EAP region contributed 34.3% to corporate *shukūk*, while ECA accounted for 7.5%. Participation from other regions remained limited across both issuer categories. These patterns underscore the concentration of *shukūk* activity in a few core markets and the limited development of *shukūk* markets in other jurisdictions, highlighting the need for broader geographical diversification to support the market's long-term depth and resilience.

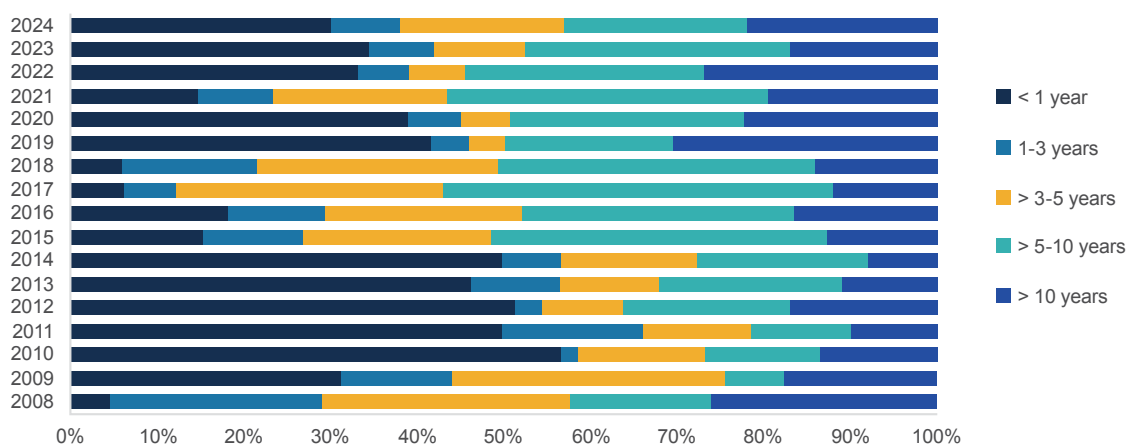
Chart 1.3.4: Regional Distribution of *Shukūk* Issuances in 2024



Source: IFSB estimates based on data from Refinitiv

The maturity structure of şukūk issuances in 2024 continued to reflect underlying market dynamics, driven by liquidity preferences, funding strategies, and evolving market conditions. Short-term şukūk (maturities below one year) continued to account for a significant share of total issuances, around 30%, down slightly from 2023 but elevated compared to earlier periods (Chart 1.3.5). This sustained presence underscores ongoing demand for liquidity management instruments and flexible refinancing options. Medium-term şukūk, particularly in the 3–5 year range, recorded a noticeable increase in 2024, reflecting rising investor willingness to take on moderate duration risk and issuers' preference for funding stability. Long-term şukūk (maturities above five years) maintained a substantial share, particularly in the GCC, where they support large-scale infrastructure and development financing. Over time, however, the maturity structure has remained broadly stable, with no clear trend towards lengthening maturities. The şukūk market continues to exhibit a concentration in short- and medium-term issuances, highlighting an enduring trade-off between liquidity, refinancing risk, and the development of a deeper long-term şukūk market.

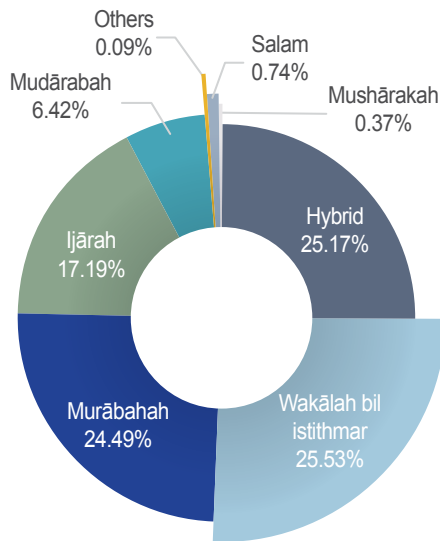
Chart 1.3.5: Maturity profiles of Şukūk Issuances (2008-2024)



Source: IFSB estimates based on data from Refinitiv

Şukūk issuances remained concentrated in agency-based, composite, and debt-based structures. Wakālah and hybrid şukūk were the most widely used, each accounting for over a quarter of total issuances, supported by their flexibility in pooling assets and ease of execution (see chart 1.3.6). Murābahah-based şukūk also maintained a significant share. However, the dominance of debt-based şukūk, particularly murābahah, is accompanied by Sharī'ah constraints on tradability, which limit liquidity in the secondary market. Equity-based şukūk structures, such as muḍārabah and mushārahah, remained marginal, largely due to their structural complexity and limited investor appetite for variable returns. This structural concentration in debt-like şukūk underscores market preference for instruments with fixed-income characteristics but also highlights constraints to the development of a deeper and more diversified secondary market.

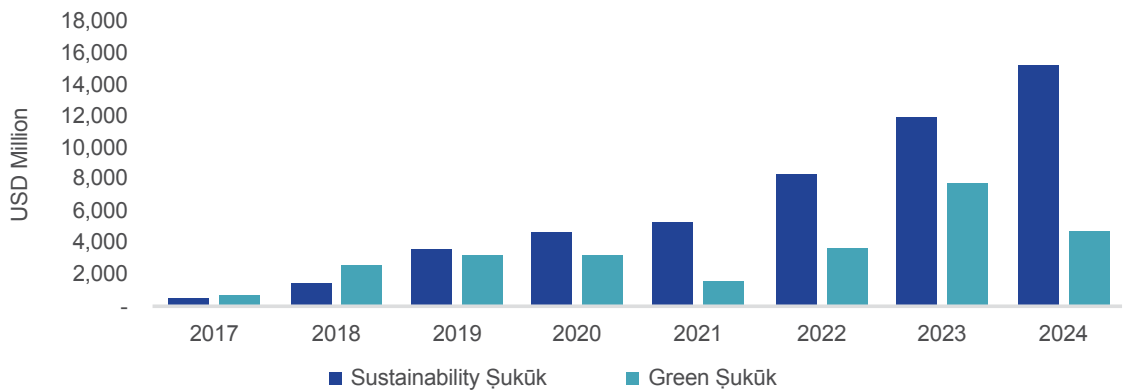
Chart 1.3.6: Global Şukūk Issuances by Structure (2024)



Source: IFSB estimates based on data from Refinitiv

The sustainable şukūk market continued to expand in 2024, though its growth remained uneven and modest relative to broader trends in the global sustainable bond market. Total sustainable şukūk issuances reached USD 15.3 billion in 2024, increasing by 27.9% from the previous year and accounting for 5.8% of global şukūk issuances (Chart 1.3.7). This growth was primarily driven by corporate issuers in the GCC and EAP regions, supported by government-led sustainability frameworks and rising demand for ESG-linked instruments. However, the composition of sustainable şukūk shifted notably, with green şukūk issuances declining to USD 4.81 billion from USD 7.75 billion in 2023. This decline reflects structural challenges, including a limited pipeline of eligible green projects and a shift in issuer preference toward broader sustainability şukūk. While the sustainable şukūk segment shows positive momentum, its share of the overall şukūk market remains small, underscoring the need for stronger policy support to align şukūk markets with the global sustainable finance agenda.

Chart 1.3.7: Global Sustainability and Green Şukūk Issuances (2017-2024)

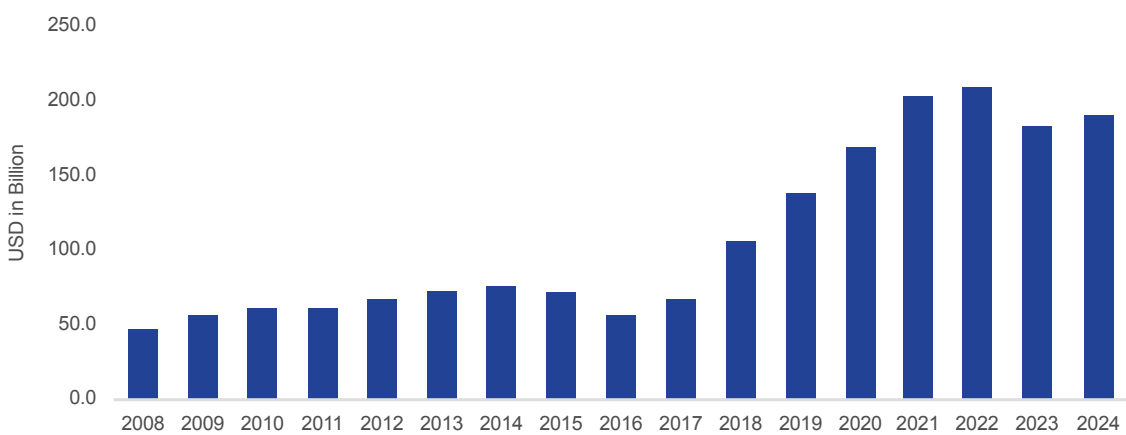


Source: IFSB estimates based on data from Refinitiv

1.3.2 Moderate and Fragmented Growth in Islamic Funds

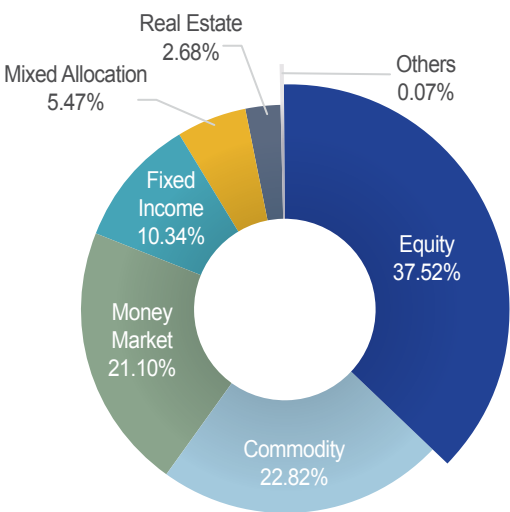
The global Islamic funds industry recorded moderate growth from the previous year, with total assets under management (AuM) increasing by 9.2% to USD 193.6 billion (Chart 1.3.8). This recovery follows a decline in 2023 and was largely supported by robust performance in global equity markets. Equities remained the largest asset class in Islamic fund portfolios, accounting for 37.5% of total AuM (see Chart 1.3.9), followed by commodity (22.8%) and money market instruments (21.1%). The positive performance of these asset classes, particularly equities, was a key driver of the overall growth in Islamic fund assets.

Chart 1.3.8: Growth of Islamic Assets under Management (2008-2024)



Source: IFSB estimates based on data from Refinitiv

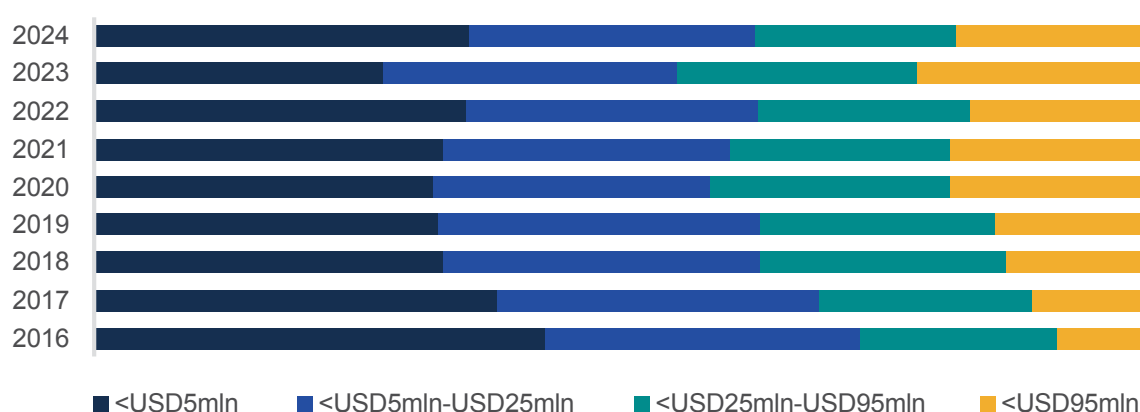
Chart 1.3.9: Islamic Fund’s AuM by Asset Class (2024)



Source: IFSB estimates based on data from Refinitiv

The Islamic fund industry remains fragmented, with a large concentration of small-sized funds, presenting potential structural vulnerabilities. In 2024, more than 63% of Islamic funds had AuM below USD 25 million, and nearly 30% held less than USD 5 million (Chart 1.3.10). This fragmentation reflects continued market entry by new funds and a decline in large-sized funds, suggesting a shift towards niche or specialised strategies. However, the predominance of small funds may also present vulnerabilities, given their lack of economies of scale, resulting in higher operational costs relative to their assets and lower profitability. They may also face heightened liquidity risks, as limited fund size reduces their ability to absorb large redemptions or adjust portfolios during periods of financial stress. This may potentially increase the vulnerability of the Islamic fund segment to market shocks and constrain its ability to contribute meaningfully to the stability and depth of the broader Islamic finance ecosystem.

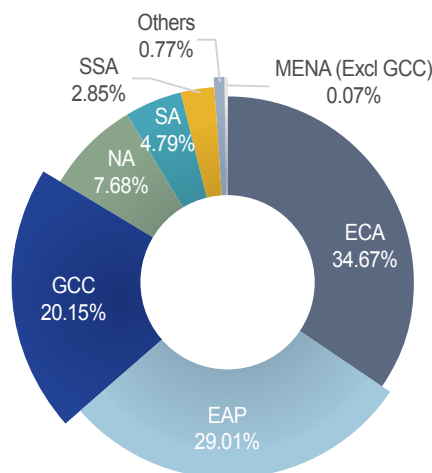
Chart 1.3.10: Number of Islamic Funds by Asset Size (2016-2024)



Source: IFSB estimates based on data from Refinitiv

The domicile distribution of Islamic fund assets in 2024 points to growing geographical diversification, although with continued concentration in some regions. ECA accounted for the largest share of global Islamic funds' AuM at 34.7%, indicating the continued importance of established financial centres in hosting Islamic fund vehicles. This was followed by the EAP region with 29%, reflecting the strong presence of Islamic finance markets in Malaysia and Indonesia. The GCC region held a significant share of 20.2%, an increase from 11.3% in 2023, signalling a growing shift of fund domiciles to the region. This increase reflects regulatory improvements, enhanced market infrastructure, and rising investor demand within the GCC. North America accounted for 7.7%, while other regions such as South Asia (4.8%), Sub-Saharan Africa (2.9%), and MENA (excluding GCC) (0.07%) had marginal shares. The presence of fund domiciles across a wide set of regions suggests increasing internationalisation of Islamic funds, although the dominance of a few jurisdictions—Europe, EAP, and GCC—indicates that the industry's structural development remains geographically concentrated.

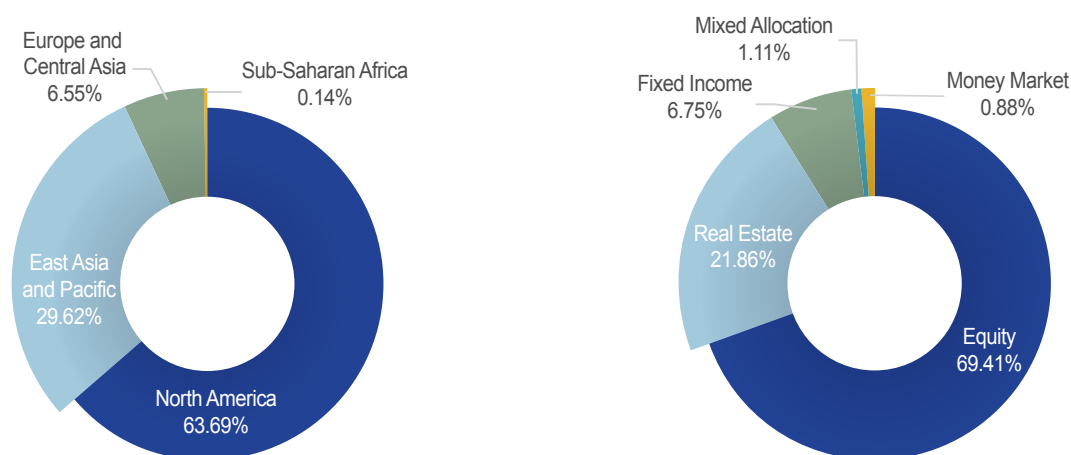
Chart 1.3.11: Islamic Fund Assets by Domicile (2024)



Source: IFSB estimates based on data from Refinitiv

Sustainability-themed Islamic funds continued to expand in 2024 highlighting their growing relevance in driving the growth of the Islamic fund industry and its alignment with global sustainability objectives. AuM of sustainability-themed funds increased by around 21% to USD 9.7 billion, outpacing the overall growth of the Islamic fund sector (nearly 9%). This trend reflects the broader global trends, although sustainability-themed Islamic funds remain relatively small compared to the conventional ESG fund market, pointing to untapped potential for Islamic finance. Their growth has been supported by increased issuance of sustainable *shukūk*, reinforcing the positive interplay between *shukūk* and fund markets. Nevertheless, these funds account for only around 5% of total Islamic funds' AuM and remain at an early stage of development, with portfolios heavily concentrated in equities and real estate. These trends underscore both the increasing relevance of ESG principles in Islamic finance and the need to further strengthen market infrastructure, regulatory clarity, and diversification to support sustainable, long-term growth.

Chart 1.3.12: Domicile and Asset Classes of Sustainability-themed Islamic Funds in 2024



Source: IFSB estimates based on data from Refinitiv

1.4 Policy Recommendations

While the IFSI has seen sustained, broad-based growth, structural concentration and uneven development remain key challenges. The overall growth of the IFSI has been underpinned by rising demand, regulatory progress, and increasing market participation. The geographical footprint of the IFSI is expanding, with encouraging developments across banking, insurance, and capital markets. However, growth remains uneven and structurally concentrated in the banking sector and in certain regions, highlighting the need to advance non-bank segments and strengthen market development in emerging and frontier markets. At the same time, global financial stability risks have increased in 2025, driven by tighter global financial conditions and heightened trade and geopolitical uncertainty.¹³ These factors may weigh on market confidence, funding access, and balance sheet resilience—underscoring the need for enhanced supervisory vigilance, stronger financial safety nets, and greater preparedness across the Islamic finance ecosystem.

Islamic banking demonstrated broadly strong performance in 2024, in terms of growth, resilience and stability, but persistent structural vulnerabilities and emerging new risks calls for vigilance and action. Islamic banking recorded robust growth in mature markets and sustained expansion in new markets, coupled with broadly strong capital and liquidity positions and profitability gains. However, shifts in asset allocation toward safer instruments such as government *shukūk* and cash in some jurisdictions in response to elevated macro-financial risks point to underlying constraints stemming from the limited availability of a wider range of Islamic finance investment alternatives and the underdevelopment of *shukūk* and money markets. These factors have also contributed to a relatively narrow funding base. Concerted efforts, particularly at the policy level, at deepening Islamic capital and money markets are essential to the industry's long-term growth and stability. In addition, rising risk-weighted assets, sovereign exposure, concentrated use of hybrid instruments, such as CM, and, to a lesser extent, fintech advances, are changing the industry's risk profile, highlighting the need for ongoing vigilance in capital planning and risk oversight.

The Islamic insurance industry continues to outperform the broader conventional insurance industry, but sustainability depends on addressing structural challenges and regional disparities. The strong performance of the industry was underpinned, particularly in advanced jurisdictions, by consolidation, digitalisation, and improved sophistication in terms of product offerings and distribution models, as well as adequate solvency and liquidity positions. However, this performance masks persistent structural challenges that could undermine long-term sustainability if not addressed—particularly the limited availability of Islamic finance investment and liquidity management instruments, and high concentration risks in asset portfolios. Regional development remains uneven with significant room for regulatory improvement in less mature or under-regulated markets, where rising technical provisions, weaker underwriting performance, and inflation-driven cost pressures are exposing vulnerabilities in capital frameworks. Overall, the industry's growth trajectory remains promising, but concerted efforts are needed to strengthen regulatory frameworks, improve capital and liquidity planning, and expand the range of capital market investment and risk management tools available to Islamic insurers.

13 International Monetary Fund, Global Financial Stability Report: *Enhancing Resilience Amid Uncertainty* (Washington, DC: IMF, April 2025).

The Islamic capital markets experienced strong growth in 2024, driven primarily by the expansion of the şukūk market, but remain shallow and concentrated, significantly limiting their financial intermediation role. While şukūk issuance volumes and issuer diversity increased, the market remains structurally concentrated, shallow, and largely underdeveloped (see Chapter 2 for more detailed discussion on şukūk markets). The Islamic funds industry showed modest growth in 2024, supported by equity market performance, yet continues to face structural fragmentation, and costs and scaling challenges. The underdevelopment of the Islamic capital market, particularly the şukūk market, is emerging as the single most important factor in shaping the future of Islamic finance. Concerted efforts by authorities, regulators, and standard setters, to address structural and regulatory impediments, are critically needed to unlock the enormous potential of the Islamic capital markets and support the growth of Islamic finance globally.

2.0



**ADDRESSING
STRUCTURAL
VULNERABILITIES
AND STRENGTHENING
RESILIENCE IN
ŞUKŪK MARKETS**

2.1 Introduction

Structural challenges continue to impede the development of sufficiently deep, broad, and liquid şukūk markets, notwithstanding their steady growth over the past two decades (as highlighted in Chapter 1). These structural weaknesses stem from a combination of supply-side and demand-side factors, and have important implications for effective price discovery, market efficiency, and the market's capacity to absorb shocks and facilitate efficient capital allocation. This chapter examines the structural vulnerabilities that limit the depth and breadth of the şukūk market, assesses their implications for market functioning and financial stability, and outlines policy priorities to address these challenges and strengthen market resilience.

2.2 Structural Characteristics Affecting Market Breadth, Depth, and Liquidity

On the supply side, şukūk issuances are often fragmented, non-fungible and structurally complex: features that limit secondary market liquidity. The depth of şukūk markets is limited by fragmented and small-scale issuance practices that reduce the ability of investors to transact at scale without incurring price impact. Fungibility refers to the ability of investors to trade securities interchangeably without concern for differences in contractual terms, structure, or legal treatment. In contrast, fragmentation arises when the outstanding stock of securities is dispersed across a large number of small, bespoke, and non-standardised issuances. In the case of the şukūk market, fragmentation is particularly pronounced as issuers often design şukūk to meet jurisdiction-specific regulatory and Sharī'ah compliance requirements, resulting in significant contractual heterogeneity. This reduces fungibility, complicates valuation, and impedes the development of liquid secondary markets.

Complex structures and high issuance costs pose an additional barrier to the development of deep and liquid şukūk markets. The process of issuing şukūk has thus far involved significant, legal, operational, and structuring complexity, which significantly raises transaction costs. Current practices of şukūk issuances require the creation of structures that often involve the identification and transfer of underlying tangible assets and establishment of special purpose vehicles (SPVs), combined with complex interconnected sell, lease, and buyback contracts. These requirements increase documentation, legal and Sharī'ah advisory, and operational costs for issuers. Moreover, the lack of standardised issuance frameworks and contractual templates further amplifies these costs, as each issuance often requires bespoke structuring. For corporate issuers, these additional costs can be prohibitively high, discouraging them from tapping the şukūk market. Even for sovereigns, the incremental cost relative to conventional debt issuance may deter frequent, large-scale issuance—particularly in jurisdictions with limited expertise or underdeveloped Islamic finance ecosystems. The cumulative effect of these elevated costs and complexities is to constrain the overall supply of şukūk, limit issuance volumes and frequency, reduce the availability of liquid instruments in the secondary market, and ultimately undermine şukūk market development. Experience from conventional bond market development shows that lower issuance costs—facilitated by standardised documentation, efficient regulatory processes, and predictable issuance frameworks—are essential to support market depth and encourage broad issuer participation.¹⁴

¹⁴ IMF (2005) Chapter IV Development of Corporate Bond Markets in Emerging Market Countries

Absence of local-currency sovereign benchmark şukūk limits price discovery and market development. The lack of regular, large-scale sovereign şukūk issuance across different maturities further constrains market depth by depriving the market of liquid, risk-free benchmark instruments. This absence undermines price discovery, increases pricing uncertainty, and hinders the development of active market-making and trading. Local-currency sovereign şukūk issuance has been undermined by similar factors affecting the broader market, particularly design complexity and high costs. In many cases, sovereign issuance patterns are driven by short-term funding needs rather than a strategic objective to support the development of a deep and liquid market.

Demand-side factors, particularly the dominance of buy-and-hold strategies among key investors further constrains şukūk market liquidity. A significant proportion of şukūk is held by domestic Islamic financial institutions that often hold them until maturity due to several interrelated factors. First, regulatory frameworks in many jurisdictions require Islamic banks and insurers to hold high-quality Islamic finance assets to meet liquidity and capital adequacy requirements, making şukūk a preferred instrument for balance sheet management. Second, the limited supply of eligible and liquid Islamic instruments leaves investors with few alternatives to diversify their portfolios or manage liquidity needs, reinforcing incentives to retain şukūk positions over the long term. Third, the absence of well-developed Islamic money markets and liquidity management tools restricts investors' ability to adjust their positions without incurring significant costs, further entrenching buy-and-hold preferences. Fourth, the lack of active market-making arrangements and thin secondary market trading discourages opportunistic trading and incentivises investors to lock in returns by holding şukūk until maturity. Moreover, many şukūk issuances are concentrated among a small group of institutional investors, who may have limited need or willingness to trade once their investment objectives are met. In some cases, investors may face legal, tax, or operational barriers to active trading, particularly in cross-border transactions. These factors, combined with structural fragmentation on the supply side, create a self-reinforcing dynamic of limited liquidity: with few sellers in the market, trading volumes remain low, bid-ask spreads remain wide, and price discovery is weak—further disincentivising investors from trading in secondary markets. Consequently, even in jurisdictions with vibrant primary issuance activity, the depth of secondary market trading remains structurally constrained.

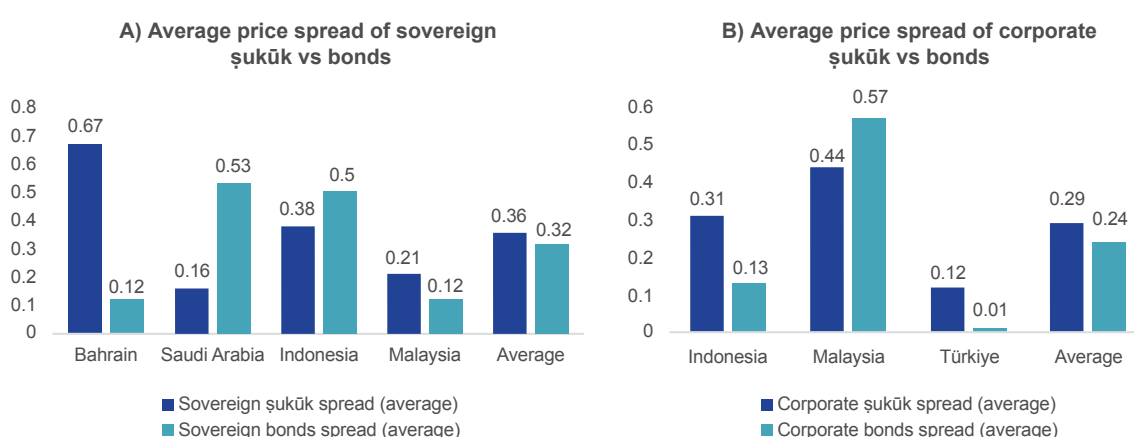
Investor concentration reduces diversity of trading motives and impedes secondary market liquidity. The investor base of the şukūk market remains narrow and concentrated, dominated by a limited range of institutional investors. This concentration reduces the diversity of investment horizons, risk appetites, and trading strategies; factors that are critical for sustaining continuous market activity and liquidity. In contrast, developed bond markets benefit from a broad and varied investor base that facilitates active secondary market trading.

Limited access for retail and foreign investors constrains market breadth and liquidity. On the supply side, market structure and issuance practices in the şukūk market have historically catered predominantly to institutional investors, with limited focus on broadening access. High minimum investment thresholds and complex contractual arrangements of şukūk issuances have created significant entry barriers for retail investors, who often lack the financial capacity, expertise, or access to participate in the market. While select jurisdictions have introduced retail şukūk instruments with smaller denominations and accessible distribution channels, such initiatives remain limited and fragmented elsewhere. Foreign investor participation is similarly constrained by regulatory and market entry barriers. These barriers can limit investor diversity and inhibit the development of deep and liquid local şukūk markets.

2.3 Indicators of Shallow and Illiquid Markets

Price spread differentials between şukūk and conventional bonds reflect structural liquidity constraints and embedded liquidity premia. Average price spreads for both sovereign and corporate şukūk are consistently wider than those observed in equivalent conventional bond markets across key jurisdictions (Chart 2.1).¹⁵ While there are jurisdictional differences in the magnitude of spread differentials, the overall trend remains consistent: şukūk markets exhibit structurally wider spreads, signalling lower liquidity and higher transaction costs inherent in şukūk markets due to the structural characteristics discussed earlier. The wider spreads also reflect the liquidity premia embedded in şukūk markets: investors require additional compensation for holding less liquid şukūk instruments, which is reflected in higher bid-ask spreads and yield differentials relative to conventional bonds.

Chart 2.1: Average Price Spread of Şukūk vs Bonds

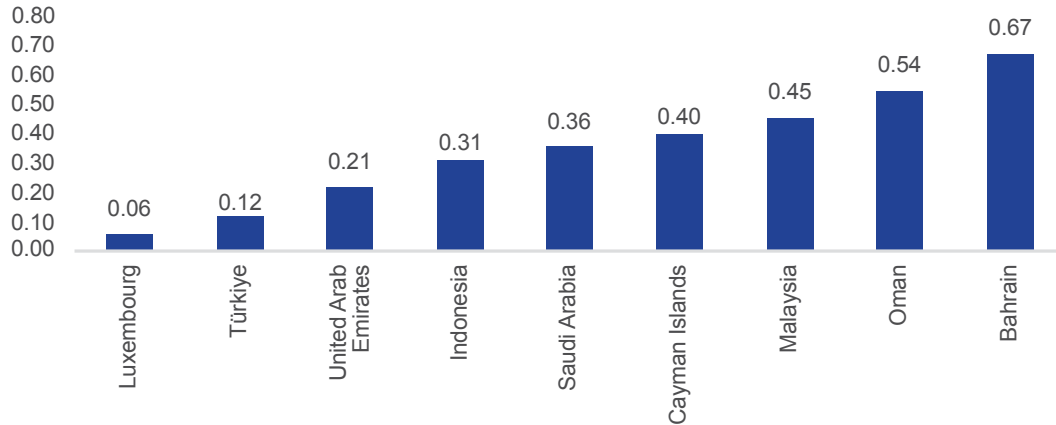


Source: IFSB estimates based on data from Refinitiv

Jurisdictional differences in the average price spread of şukūk reflect underlying structural and institutional factors that shape market liquidity. Variations in price spreads across issuing domiciles are influenced by differences in market development, investor composition, and issuance practices (Chart 2.2). In jurisdictions with wider spreads, these differentials typically reflect structural impediments such as limited market depth, fragmented issuance, and a concentrated domestic investor base. However, tighter spreads in some markets may not necessarily signal active and liquid secondary market trading. Instead, they may reflect structural features of the issuances themselves—such as larger issuance sizes, standardised contractual formats, and stronger disclosure practices—that enhance pricing transparency and reduce perceived risks. Tighter spreads may also be supported by captive demand from specific institutional investors, or the role of certain jurisdictions as international listing hubs (e.g., Luxembourg) where instruments are issued primarily to access global investors rather than to foster active domestic market trading.

¹⁵ This comparison consists of two samples of 77 sovereign şukūk and bonds (for each), that were issued during 2024 across four jurisdictions with similar tenors. In addition, another two samples of 162 corporate şukūk and bonds across three jurisdictions were also used.

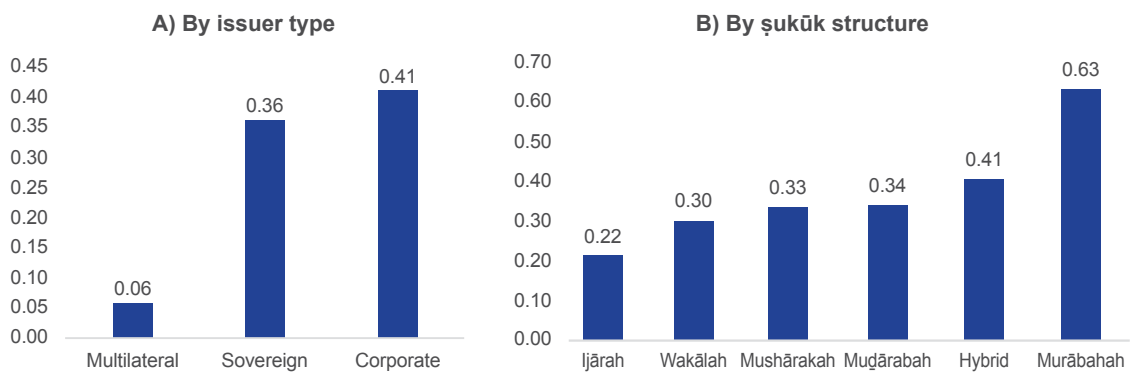
Chart 2.2: Average Price Spread for the Şukūk Issued in 2024 by Domicile



Source: IFSB estimates based on data from Refinitiv

Price spreads differed by issuer type and şukūk structure, reflecting credit risk, contractual complexity, and market acceptance. Multilateral issuers demonstrate narrower spreads, supported by their strong credit profiles and predictable issuance patterns. Corporate şukūk, by comparison, exhibits wider spreads, reflecting higher credit risk, smaller issuance volumes, and less diversified investor participation (Chart 2.3a). Differences in contractual structures further shape spreads and liquidity conditions. Murābahah şukūk exhibits wider price spreads, consistent with Sharī'ah-related restrictions on debt trading that limit their eligibility for secondary market transactions. In contrast, ijārah and wakālah based şukūk display narrower spreads, reflecting simpler contractual features, broader investor acceptance, and fewer impediments to trading (Chart 2.3b).

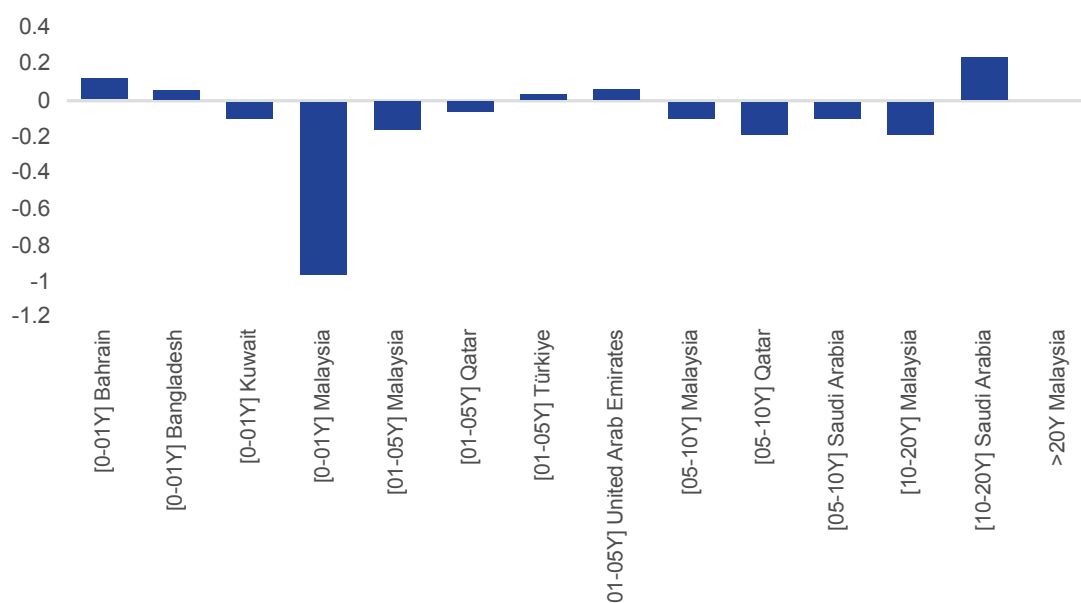
Chart 2.3: Average Price Spread for the Şukūk Issued in 2024 by Issuer and Structure



Source: IFSB estimates based on data from Refinitiv

The yield spread between şukūk and conventional bonds provides an important, though imperfect, indicator of relative market liquidity. The comparison of average yield spreads across jurisdictions and maturities (Chart 2.4) reveals two notable patterns. First, in many cases, yield spreads are narrow or even negative, with şukūk yields lower than those of comparable conventional bonds. This pattern is particularly evident in mature Islamic finance markets. While positive spreads usually reflect a liquidity premium, negative spreads do not necessarily indicate better liquidity conditions. Instead, they may reflect other factors unrelated to market efficiency. Negative spreads may arise from strong, captive demand from Islamic financial institutions and investors who are required or prefer to hold Islamic finance assets and are willing to accept lower yields to do so. They may also reflect a ‘scarcity premium’ stemming from the limited supply of high-credit-quality şukūk. These factors can drive yield compression in şukūk markets despite underlying structural liquidity constraints.

Chart 2.4: Average Yield Spread of Şukūk vs Conventional Bonds by Jurisdictions and Maturities

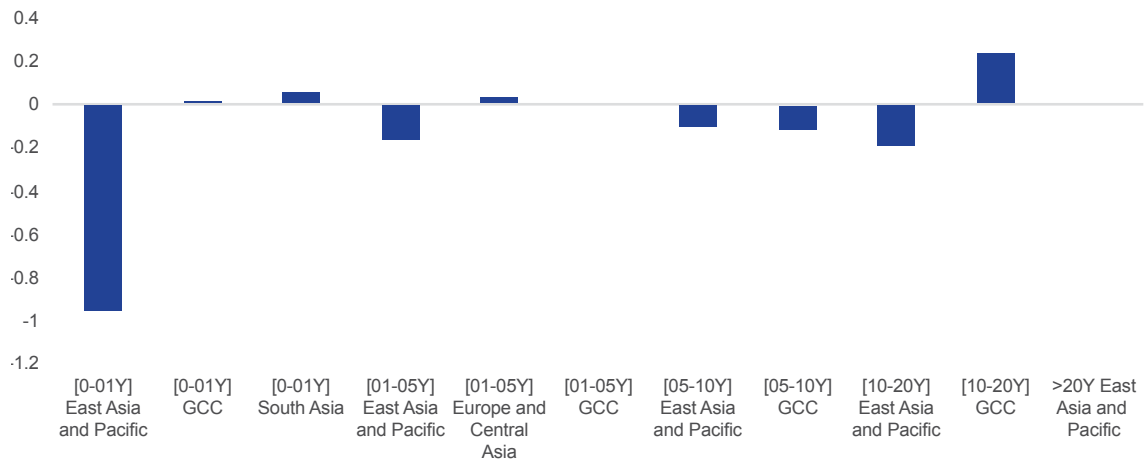


Source: IFSB estimates based on data from Refinitiv

Note: Negative yield reflects a lower yield on şukūk

Yield spreads between şukūk and conventional bonds vary significantly across regions and maturities (Chart 2.5). In EAP markets, particularly Malaysia, significantly lower yields for short-term şukūk likely reflect a combination of structural demand factors and a relatively more developed and liquid domestic şukūk market. In contrast, in less developed markets, negative or narrow spreads are more likely driven by structural factors such as strong captive demand from Islamic financial institutions, the dominance of high-credit-quality sovereign issuers, and supply constraints, which contribute to scarcity premiums and yield compression. In some markets and maturities, positive yield spreads also persist, reflecting the presence of liquidity premia and underlying market inefficiencies.

Chart 2.5: Average Yield Spread Şukūk vs Conventional Bonds by Regions and Maturities



Source: IFSB estimates based on data from Refinitiv

Note: Negative yield reflects a lower yield on şukūk

2.4 Implications for Market Functioning and Financial Stability

Shallow and fragmented şukūk markets impair price discovery and weaken market signals.

In well-functioning capital markets, frequent and diverse trading activity enables prices to reflect current information about issuer fundamentals and market conditions. In the şukūk market, the structural limitations discussed earlier—particularly, fragmented issuance, low trading volumes, and concentrated investor holdings—impede this mechanism. Prices may remain static not as a reflection of fundamental stability, but as a result of limited trading activity. This weakens the information content of market prices, making it more difficult for investors and regulators to gauge risk exposures accurately or respond to changes in underlying conditions. As a result, prices may provide less reliable signals for risk monitoring, portfolio valuation, and financial decision-making, particularly during periods of heightened uncertainty.

Limited market depth and breadth reduces market efficiency and increases transaction costs.

In an efficient market, prices adjust quickly and transparently with minimal transaction cost. However, the constraints in the şukūk market—including small issuance sizes, lack of standardised benchmarks, and a narrow investor base—can contribute to persistent market inefficiencies. These inefficiencies manifest in wider bid-ask spreads, higher trading costs, and limited ability for market participants to adjust portfolios without incurring significant price impacts. The lack of large, benchmark issuances can further exacerbate market inefficiencies by depriving market participants of reliable reference points for timely price formation and valuation, which are essential for efficient market functioning.

Illiquid şukūk markets may impair capital allocation and misprice risk.

Liquidity constraints in the şukūk market can undermine the efficiency of market-based capital allocation and lead to mispricing of risk. On one hand, investors may demand higher yields to compensate for limited liquidity, embedding a liquidity premium into şukūk pricing and raising funding costs for issuers. On the other hand, demand from captive Islamic financial institutions and a limited supply of high-quality şukūk can drive overpricing, as scarcity premiums emerge irrespective of underlying fundamentals. Both outcomes result in pricing distortions that misalign risk and return, discourage broader investor participation, and weaken market discipline. Over time, these inefficiencies can channel capital toward less productive uses, raise financing costs, and impair the market's capacity to support sustainable economic growth and financial deepening.

Liquidity risk management for Islamic financial institutions can be constrained.

Islamic banks, Insurance operators, and fund managers depend heavily on the şukūk market as a primary source of high-quality, tradable assets to manage liquidity and diversify portfolios. However, limited secondary market activity and a narrow range of tradable instruments can hinder the ability to quickly convert şukūk holdings into liquidity. For Islamic banks, this increases exposure to liquidity risk, further exacerbated by limited access to alternative liquid instruments and the absence of deep money markets in many jurisdictions as discussed in Chapter 1. This may heighten the sensitivity of Islamic banks to liquidity disruptions, reducing their capacity to respond effectively to short-term liquidity pressures and increasing the risk of liquidity mismatches during periods of market stress. Similarly, takāful operators and fund managers face challenges in rebalancing portfolios and meeting investor redemptions in the absence of an active and liquid secondary market. In extreme cases, these constraints may force Islamic funds to suspend redemptions or

conduct fire sales of illiquid assets at a discount, with broader spillover effects. The cumulative effect of these structural limitations is to amplify liquidity risks across the Islamic financial system, undermine market resilience, and constrain the ability of institutions to manage shocks effectively.

Policy response capacity can be reduced. The shallow and illiquid nature of şukūk markets can also limit the ability of central banks and regulators to use şukūk in monetary operations, liquidity provision, or crisis management frameworks. Limited secondary market activity and the absence of sizable, highly liquid benchmark instruments also reduce the scope for şukūk to serve as eligible collateral in liquidity facilities or to support open market operations. This can narrow the policy toolkit available to manage liquidity shocks and stabilise market conditions during periods of financial stress.

Market concentration and limited depth can amplify systemic risk and market fragility. Shallow şukūk markets and a concentrated investor base increase the potential for systemic risk transmission within the Islamic financial system. The narrow investor base—dominated by domestic Islamic financial institutions with similar liquidity constraints, regulatory requirements, and risk exposures—creates vulnerabilities. During periods of market stress, synchronised liquidity needs and herding behaviour among these captive investors can trigger abrupt price declines and liquidity shortages. This dynamic can set off self-reinforcing feedback loops, as forced sales further depress prices and intensify funding pressures. The lack of a broad and diverse investor base, including foreign investors, non-bank institutions, and retail participants, deprives the market of stabilising counterparties who could absorb selling pressures. As a result, liquidity risks in the şukūk market can become pro-cyclical, exacerbating market volatility and increasing the likelihood of spillovers to the broader financial system.

2.5 Policy Recommendations

The development of deep, liquid, and resilient şukūk markets is essential to support the long-term stability and growth of the Islamic financial system. As highlighted in this report, persistent structural vulnerabilities, stemming, in large part, from current practices that give rise to contractual and operational complexities, heterogeneity, and high legal and Sharī'ah compliance costs, continue to limit the capacity of şukūk markets to fulfil their intermediation function effectively and may heighten financial stability risks during periods of market stress. Addressing these challenges requires a comprehensive and well-coordinated set of strategic measures to encourage the development and adoption of simpler and more standardised şukūk structures, which is foundational to şukūk market development, as well as to foster active primary and secondary market participation, broaden the investor base, and strengthen market infrastructure and regulatory frameworks.

Regular local currency sovereign benchmark şukūk issuance is critical to support şukūk market development. A well-functioning domestic şukūk market requires the consistent issuance of sizable, standardised, and plain vanilla sovereign şukūk across a range of maturities to establish credible market benchmarks. These benchmark issuances are essential for fostering deep and liquid markets by providing reliable reference points for pricing, trading, and valuation. A well-developed domestic currency sovereign şukūk yield curve also facilitates private sector issuance by reducing pricing uncertainty and enhancing market confidence. To achieve this, governments should adopt clear and transparent issuance strategies, including re-opening existing issuance lines to increase the size of individual şukūk series. Concentrating issuance in a limited number of large, standardised instruments helps to consolidate liquidity, reduce market fragmentation, and enhance the fungibility of şukūk, thereby supporting more active secondary market trading.¹⁶

Promoting standardisation of şukūk structures and documentation will enhance fungibility and reduce transaction costs. Issuance fragmentation and contractual heterogeneity in the şukūk market impede market liquidity and complicate cross-border investment. Authorities, in collaboration with industry stakeholders, should prioritise the development and adoption of standardised contractual templates, issuance frameworks, taxonomies, and disclosure practices. Standardisation will reduce legal uncertainty, facilitate cross-border investments, and lower the cost and complexity of issuing şukūk.

Strengthening regulatory, legal, and Sharī'ah governance frameworks will build investor confidence and deepen the market. A clear and predictable legal and regulatory environment is necessary to support market development. Authorities should ensure consistency in Sharī'ah governance frameworks, clarify investor rights in şukūk transactions, and enforce robust disclosure and reporting standards. Removing legal and tax uncertainties and enhancing adoption of global disclosure standards and cross-border legal harmonisation is also essential in reducing barriers to market access and improving investor confidence.

¹⁶ World Bank and International Monetary Fund. (2001). *Developing Government Bond Markets: A Handbook*. Washington, DC: World Bank and IMF. See Chapter 1, p.14. and International Monetary Fund. (2013). *Local Currency Bond Markets—A Diagnostic Framework*. IMF Policy Paper, July 2013. Washington, DC: IMF.

Developing supporting market infrastructure will underpin market development, facilitate trading, and enhance liquidity. An efficient and transparent trading environment is essential to support active primary and secondary market activities. Existing market infrastructures and operations should be systematically adapted to the specificities of şukūk to enable efficient trading, and fair and transparent price dissemination. Moreover, şukūk market participants should be encouraged to develop new infrastructure institutions that could facilitate the transition from the current complex şukūk structures to a simpler and more market friendly structures.

Well-developed and deep şukūk markets, local currency sovereign markets in particular, will facilitate the development of money markets and liquidity instruments and facilities. Liquid money markets provide an anchor for short-term pricing, facilitate cash management and position financing by financial institutions and corporates, and manage liquidity risks, as well as acting as conduits for monetary policy transmission.¹⁷

Encouraging market-making and enhancing liquidity provision can improve secondary market activity. Market liquidity can be improved by establishing formal market-making arrangements. Authorities may appoint primary dealers or other designated market-makers with defined obligations.¹⁸ Supporting measures, such as access to liquidity facilities, favourable capital treatment, or incentives for inventory holdings, can encourage active market-making. Effective market-making has been instrumental in improving liquidity in many emerging bond markets.

Broadening the investor base is necessary to improve market breadth and resilience. The concentration of şukūk holdings among domestic Islamic financial institutions limits market activity and increases vulnerability to liquidity shocks. Expanding access to retail investors through small-denomination offerings and accessible distribution platforms can diversify trading motives and improve day-to-day liquidity. Similarly, easing regulatory and tax barriers for foreign investors and linking domestic settlement systems with international depositories can encourage cross-border participation and reduce over-reliance on captive domestic investors.

¹⁷ IMF (2005). *An Anatomy of Corporate Bond Markets: Growing Pains and Knowledge Gains*.

¹⁸ IMF (2013). *Local Currency Bond Markets—A Diagnostic Framework*, p. 1

ANNEXURES

Glossary

Commodity Murābahah	A murābahah transaction based on the purchase of a commodity from a seller or a broker and its resale to the customer on the basis of deferred murābahah, followed by the sale of the commodity by the customer for a spot price to a third party for the purpose of obtaining liquidity, provided that there are no links between the two contracts.
Ijārah	A contract made to lease the usufruct of a specified asset for an agreed period against a specified rental. It could be preceded by a unilateral binding promise from one of the contracting parties. The ijārah contract is binding on both contracting parties.
Islamic window	That part of a conventional financial institution (which may be a branch or a dedicated unit of that institution) that provides both fund management (investment accounts), financing and investment that are Sharī'ah-compliant, with separate funds.
Murābahah	A sale contract whereby the institution offering Islamic financial services sells to a customer a specified kind of asset that is already in its possession, whereby the selling price is the sum of the original price and an agreed profit margin.
Sharī'ah	The practical divine law deduced from its legitimate sources: the Qur'ān, Sunnah, consensus (ijmā'), analogy (qiyās) and other approved sources of the Sharī'ah.
Sharī'ah board	An independent body set up or engaged by the institution offering Islamic financial services to supervise its Sharī'ah compliance and governance system.
Şukūk	Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or specific investment activity that is Sharī'ah-compliant.
Wakālah	An agency contract where the customer (principal) appoints an institution as agent (wakīl) to carry out the business on his behalf. The contract can be for a fee or without a fee.
Zakāh	An obligatory financial contribution disbursed to specified recipients that is prescribed by the Sharī'ah on those who possess wealth reaching a minimum amount that is maintained in their possession for one lunar year.

Assumptions and Conventions

In this IFSI Stability Report 2025, the following conventions are used:

- IFSI Stability Report “2025” implies that the report covers activities for the year 2024 and is published in the year 2025.
- “2024Q3” means quarter 3 of the year 2024.
- “Billion” means one thousand million.
- “Trillion” means one thousand billion.
- “IFSB Secretariat workings” means figures indicated in the corresponding table or chart are based on IFSB staff estimates or calculations.
- “PSIFIs” implies that the data used in a corresponding table or chart are obtained from the IFSB’s Prudential and Structural Islamic Financial Indicators database.
- The data and analysis in the IFSI Stability Report are compiled by IFSB staff from various sources and are assumed to be correct at the time of publication. The data analysed corresponds to the latest data available to the IFSB.
- Data for şukūk outstanding and Islamic funds are for the full year 2024.
- Data for Islamic banking are mainly as of 2024 Q3 except where indicated otherwise.
- Data for Islamic insurance are mainly for 2024 Q3.
- In all cases, where data for the periods indicated above are not available to the IFSB Secretariat, the latest data available to the IFSB Secretariat have been used.
- Data used are mainly from primary sources (regulatory authorities’ statistical databases, annual reports and financial stability reports, official press releases and speeches, etc.), as well as from the IFSB’s Prudential and Structural Islamic Financial Indicators (PSIFIs) database and IFSB surveys.
- Where primary data are unavailable, third-party data providers have been used.
- As much as possible, the data used, and the charts and figures provided in the IFSI Stability Report 2025 have been checked for accuracy, completeness and timeliness. Discrepancies in the sums of component figures and totals shown are likely due to rounding effects. Where errors are observed, corrections and revisions will be incorporated into the online version of the report. The IFSB appreciates feedback on the report, which is available for free download at www.ifsb.org.

Regional Classification

The regional classification is based on UN classifications, for the purpose of standardisation and comparability of the data.

East Asia and Pacific (EAP)

Australia, Brunei Darussalam; China; Indonesia; Japan; Malaysia; Philippines; Republic of Korea; Singapore, Thailand

Europe and Central Asia (ECA)

France; Germany; Ireland; Kazakhstan; Kyrgyzstan; Luxembourg; Russian Federation; Serbia; Tajikistan; Türkiye; Uzbekistan; United Kingdom

Gulf Cooperation Council (GCC)

Bahrain; Kuwait; Oman; Qatar; Saudi Arabia; United Arab Emirates

Middle East and North Africa (MENA excluding GCC)

Algeria; Egypt; Iran (Islamic Republic of); Iraq; Jordan; Lebanon; Libya; Morocco; State of Palestine; Syrian Arab Republic; Tunisia; Yemen

North America (NA)

Canada; Caymen Islands; United States

South Asia (SA)

Afghanistan; Bangladesh; India; Maldives; Pakistan; Sri Lanka

Sub-Saharan Africa (SSA)

Benin; Burkina Faso; Côte d'Ivoire; Djibouti; Ethiopia; Gambia; Guinea-Bissau; Kenya; Mali; Mauritania; Mauritius; Mozambique; Niger; Nigeria; Senegal; Somalia; South Africa; Sudan; Tanzania; Togo; United Republic of Zambia

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List of Abbreviations

AI	Artificial Intelligence
AuM	Assets under management
CAGR	Compound annual growth rate
CAR	Capital Adequacy Ratio
CMT	Commodity murābahah transactions
CTI	Cost to Income
ECA	Europe and Central Asia
EAP	East Asia and Pacific
ESG	Environmental, social and governance
FDR	Financing-to-deposits ratio
GCC	Gulf Cooperation Council
IB	Islamic Bank
ICM	Islamic capital market
IFSB	Islamic Financial Services Board
IFSI	Islamic financial services industry
IIFS	Institutions offering Islamic financial services
IMF	International Monetary Fund
LASLR	Liquid assets to short-term liabilities ratio
LCR	Liquidity coverage ratio
MENA	Middle East and North Africa
NPF	Non-performing financing
NPM	Net profit margin
NSFR	Net stable funding ratio
PSIA	Profit-sharing investment accounts
PSIFIs	Prudential and Structural Islamic Financial Indicators
ROA	Return on assets
ROE	Return on equity
RPSIA	Restricted profit-sharing investment account
RSA	Regulatory and supervisory authority
RWA	Risk-weighted assets
SA	South Asia
UAE	United Arab Emirates

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