

## STEP-BY-STEP INTRODUCTION OF ISLAMIC BANKING PRODUCTS AND THE “ISLAMIC WINDOW” MODEL

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**Annotation:** this article examines the institutional, prudential, operational, and market prerequisites for the phased introduction of Islamic banking products and the Islamic window model within dual financial systems. The study systematizes contemporary international experience, evaluates the compatibility of Shariah-compliant instruments with existing banking infrastructures, and proposes a sequenced implementation framework that balances financial inclusion, regulatory proportionality, consumer protection, and systemic stability. The paper argues that a carefully staged Islamic window approach can serve as a lower-friction transition mechanism for emerging markets, particularly Uzbekistan, by enabling demand testing, governance standardization, and gradual ecosystem formation before full-fledged Islamic banking expansion.

**Keywords:** Islamic banking; Islamic window; Shariah governance; Murabaha; Ijarah; Mudarabah; Musharakah; regulatory sandbox; dual banking system; financial inclusion; prudential supervision

### Introduction

Across many emerging economies, Islamic finance is increasingly viewed as a strategic complement to conventional intermediation rather than a parallel niche structure. The expansion of Shariah-compliant finance is associated not only with religious preference satisfaction, but also with market diversification and funding innovation. Industry evidence shows that Islamic finance has continued expanding in asset size, geographic spread, and product sophistication during recent years [1]. In 2024, global Islamic finance assets approached six trillion US dollars, confirming the sector's movement from peripheral relevance toward mainstream financial architecture. This trajectory has encouraged regulators to consider pragmatic entry routes that avoid abrupt institutional disruptions while preserving prudential discipline. Within such a context, the Islamic window model has emerged as a particularly important transitional mechanism for jurisdictions that currently operate predominantly conventional banking systems.

Unlike full-fledged Islamic banks, Islamic windows allow conventional institutions to provide ring-fenced Shariah-compliant products under controlled governance arrangements. That model is especially attractive where market demand is visible, yet institutional capacity, legal infrastructure, and supervisory experience remain incomplete. Comparative evidence from jurisdictions with mature regulatory systems demonstrates that windows can support product experimentation, operational learning, and customer education before deeper structural transformation [7]. From a policy perspective, the window approach also reduces entry costs because it reuses existing branch networks, digital channels, and customer acquisition systems. Such efficiency is highly relevant for economies seeking broader financial inclusion without duplicating costly distribution infrastructure. Therefore, the academic and practical significance of step-by-step Islamic window introduction lies in its ability to combine innovation, prudence, and institutional realism.

Uzbekistan presents a particularly meaningful case for discussing phased Islamic finance introduction because demand-side interest has long exceeded supply-side availability. The country's broader financial reforms, private sector development agenda, and search for diversified long-term funding sources create a favorable background for measured Shariah-compliant expansion. Official and analytical materials published during 2024–2025 indicate that the domestic market is beginning to form legal and operational foundations for Islamic finance development [8]. At the same time, international assessments suggest that Islamic banking assets in Uzbekistan could reach approximately USD 2.4 billion by 2033 under favorable institutional conditions [10]. These projections make the discussion of sequencing especially important, because premature liberalization may create governance inconsistencies, while excessive delay may suppress latent demand. For that reason, this article focuses on how Islamic banking products and the Islamic window model can be introduced gradually, coherently, and safely.

### **Main Part**

Any serious discussion of Islamic banking introduction should begin with the conceptual distinction between conventional debt intermediation and asset-linked Shariah-compliant finance. Islamic banking prohibits *riba*, *gharar* in excessive forms, and transactions connected with impermissible sectors, thereby altering both product architecture and revenue logic. Instead of charging predetermined interest on cash loans, Islamic structures normally rely on trade, lease, partnership, and agency-based contractual relationships. *Murabaha*, *Ijarah*, *Salam*, *Istisna'*, *Mudarabah*, and *Musharakah* therefore represent functional financing tools rather than merely symbolic

legal labels [12]. This distinction matters for policymakers because regulatory treatment cannot simply imitate conventional product classification without considering substance, risk transfer, and documentation requirements. Consequently, phased implementation must start from clear product taxonomy and consistent legal interpretation rather than from promotional rhetoric alone.

From the regulator's standpoint, the Islamic window model is valuable because it enables incremental market entry under supervisory containment. A window is not merely a marketing division, but an operationally segregated Shariah-compliant business line embedded within a conventional institution. International supervisory literature has emphasized that Islamic finance requires legal clarity, governance quality, and risk-sensitive oversight equivalent in seriousness to conventional banking [4]. In practice, this means funds segregation, independent Shariah review, transparent product approval procedures, and distinct accounting treatment where relevant. Without such safeguards, institutions may face commingling risks, reputational damage, customer disputes, and weak enforceability of contractual arrangements. Hence, the success of Islamic windows depends less on branding and more on the discipline of internal architecture.

Sequencing is crucial because Islamic finance ecosystems do not emerge simultaneously across law, accounting, taxation, technology, liquidity management, and human capital domains. A phased strategy allows policymakers to prioritize lower-complexity products first, then widen the product set as institutional confidence increases. In most emerging markets, retail-friendly trade and lease products are typically introduced earlier than sophisticated partnership or capital market structures. That order is rational because Murabaha and Ijarah are easier to standardize, document, audit, and explain to both clients and supervisors [2]. Early success with simpler instruments helps establish data histories, consumer trust, process maps, and staff competence. Once these foundations mature, the system can move toward investment accounts, treasury instruments, and eventually sukuk-linked liquidity solutions.

Comparative policy experience strongly supports the argument that the Islamic window path works best when backed by a dedicated regulatory framework. Bank Negara Malaysia's Islamic Banking Window Policy Document, issued in November 2024, is particularly significant because it sets approval, governance, prudential, and operational requirements in a coherent format [7]. This document demonstrates that windows should not be regulated through scattered interpretive notes alone, especially where institutions need clarity on control functions and reporting obligations. Well-designed frameworks define eligibility criteria, board responsibilities, Shariah

governance structures, capital treatment logic, disclosure expectations, and recovery planning interfaces. They also reduce supervisory ambiguity by distinguishing window-specific obligations from bank-wide governance obligations. For Uzbekistan and similar jurisdictions, that lesson suggests that legal certainty should precede large-scale product rollout.

The prudential dimension deserves separate attention because Islamic windows create layered risk profiles inside hybrid institutions. Credit risk remains relevant, but it appears through trade receivables, lease rentals, counterparty obligations, and asset performance rather than through interest-bearing loans. In addition, Islamic finance introduces displaced commercial risk, Shariah non-compliance risk, equity investment risk, and fiduciary tensions linked to profit-sharing structures [5]. Supervisors therefore need a methodology that captures both familiar banking risks and contract-specific Islamic finance exposures. If prudential rules remain overly generic, institutions may underestimate provisioning needs, profit equalization decisions, and operational vulnerabilities. A sequenced rollout should accordingly align product introduction with the supervisory capacity to identify, measure, monitor, and mitigate these differentiated risks.

Shariah governance forms the intellectual and ethical backbone of an Islamic window and cannot be treated as a ceremonial appendage. An institution may have attractive products, strong digital channels, and sizable demand, yet still fail if governance bodies lack authority, competence, or independence. Revised IFSB corporate governance guidance stresses the need for robust governance structures and processes for institutions offering Islamic financial services [6]. In operational terms, this requires clearly defined mandates for Shariah boards or advisors, internal Shariah compliance units, internal audit coordination, and escalation procedures for breaches. The board of directors must also understand that Shariah compliance is inseparable from conduct risk, consumer trust, and franchise value. For this reason, phased implementation should begin with governance readiness assessments before any aggressive product launch.

Another strategic issue concerns the choice of first-wave products, because not all Islamic contracts are equally suitable for initial market entry. Retail Murabaha for household durables and SME equipment, together with Ijarah-based vehicle or machinery financing, usually provide the most manageable starting point. These contracts are comparatively easier to standardize, digitally process, and explain to customers accustomed to installment-based financial behavior. Official reporting from Uzbekistan indicates that microfinance institutions were permitted in 2024 to offer

Islamic finance services, including Murabaha, Ijarah, Salam, Musharakah, and Mudarabah mechanisms [8]. During August–December 2024, the reported volume of such financing reached about UZS 1.1 billion, offering an early domestic signal of operational feasibility. Although small in scale, that experience is analytically important because it provides a local prototype for phased Shariah-compliant deployment.

Demand estimation should not rely on anecdotal assumptions, because Islamic finance uptake depends on trust, affordability, digital convenience, and legal enforceability in addition to religious preference. A structured market assessment should segment customers by retail, microenterprise, SME, corporate, agricultural, and diaspora-linked financing needs. It should also differentiate between clients who prefer fully Shariah-compliant banking relationships and those who are open to selected products only. In this regard, an Islamic window offers a practical advantage because it can test actual demand using existing customer channels and transaction data. Product pilots reveal whether consumers value transparent asset-backing, fixed margin clarity, partnership sharing, or simply alternative branding. Such evidence-based sequencing prevents the costly mistake of overbuilding institutional capacity before validated market demand materializes.

Tax neutrality is often underestimated, yet it is one of the decisive conditions for viable Islamic window expansion. Because Islamic finance may involve multiple sale, transfer, lease, or agency steps, poorly aligned tax regimes can unintentionally create double taxation or timing mismatches. If Murabaha transactions trigger additional VAT exposure, registration costs, or legal transfer expenses compared with conventional lending, product competitiveness weakens immediately. Likewise, lease-based and commodity-linked structures may suffer if tax law ignores the economic equivalence of Shariah-compliant financing arrangements. Therefore, phased introduction should include a tax diagnostics exercise covering VAT, profit taxation, stamp duties, and asset transfer obligations. A credible Islamic window framework is not only a banking reform project, but also an interagency harmonization exercise.

Legal enforceability must develop in parallel with product rollout, otherwise front-end product design will exceed back-end dispute resolution capacity. Islamic contracts depend on precise drafting around ownership transfer, possession, agency, purchase undertakings, late payment treatment, and event-of-default mechanisms. Judges, arbitrators, notaries, external counsel, and compliance officers therefore require a shared understanding of how contractual form relates to economic substance. When that ecosystem is underdeveloped, even technically sound products may generate

litigation uncertainty and reputational damage. For this reason, model documentation and standardized clauses should be prepared before scale-up, particularly for Murabaha, Ijarah, and Wakalah-linked structures. Phased implementation should thus proceed from legal standardization toward market expansion, not the other way around. Technology architecture is equally central because Islamic windows are easier to supervise and scale when product logic is embedded into core systems rather than managed manually. Conventional banking software often assumes interest accrual mechanics, loan schedules, and penalty structures that do not fit Islamic contracts without customization. Digital transformation therefore becomes a governance issue, not just an efficiency initiative. Systems must support contract tagging, asset traceability, Shariah screening, profit allocation, customer disclosure, and exception management. In a phased plan, institutions should first digitize simpler products and create auditable data layers before launching complex profit-sharing structures. Such system readiness reduces operational risk, improves reporting quality, and strengthens the evidentiary basis for internal and external Shariah audits.

Funding and liquidity management represent one of the most difficult constraints for Islamic windows operating inside predominantly conventional markets. A bank may successfully originate Shariah-compliant assets, yet still struggle to manage short-term liquidity if no suitable interbank and high-quality liquid instruments exist. International regulatory discussions have long recognized that Islamic finance requires prudential infrastructure adapted to its contractual specificities rather than mechanical transplantation from conventional systems [5]. In the absence of domestic sukuk, commodity murabaha facilities, or Shariah-compliant money market instruments, window growth can become balance-sheet constrained. That problem is especially serious when deposit mobilization outpaces deployable Islamic assets, or when treasury placement options remain limited. Accordingly, the phased model should coordinate product rollout with central bank and market infrastructure reforms addressing liquidity management tools.

Human capital formation often becomes the hidden bottleneck that slows otherwise promising Islamic finance initiatives. Product manuals can be translated quickly, but genuine competence in Shariah governance, documentation, accounting, risk management, and customer communication takes sustained investment. Staff training should extend beyond relationship managers and include legal teams, internal auditors, compliance units, treasury officers, tax specialists, and IT architects. Moreover, training should distinguish between product knowledge and suitability assessment, because mis-selling can damage trust more rapidly than operational delays.

Universities, banking academies, regulators, and professional associations therefore need a coordinated certification ecosystem. Without that ecosystem, Islamic windows may expand numerically while remaining fragile substantively.

Consumer protection has unusual importance in Islamic window environments because customers are especially sensitive to authenticity and transparency concerns. If clients suspect that Islamic products merely mimic conventional interest under new terminology, reputational damage can spread quickly across the broader financial system. Disclosure standards should therefore explain transaction structure, ownership sequence, pricing basis, fees, rights, obligations, and Shariah approval status in accessible language [3]. Complaint resolution mechanisms should also be specialized enough to address disputes involving both banking service quality and Shariah compliance expectations. From a sequencing perspective, strong disclosure should appear in the first phase, not after products have already entered mass retail channels. Trust is a scarce asset in new Islamic finance markets, and early disclosure failures are disproportionately costly.

The relationship between Islamic windows and financial inclusion deserves deeper emphasis because inclusion benefits do not arise automatically from product introduction. Islamic windows can broaden participation among individuals and businesses that previously avoided formal finance due to religious considerations or mistrust of conventional products. However, inclusion will remain shallow unless products are priced competitively, documentation is simplified, and digital onboarding is made efficient. This is why the window model may outperform the immediate creation of new stand-alone institutions in early-stage markets. Existing banks already possess branch infrastructure, payment rails, customer data, and digital ecosystems that can reduce distribution costs. When used responsibly, that installed capacity can translate Islamic finance from symbolic availability into practical accessibility.

A phased Islamic window model also creates macroeconomic advantages if it supports SME formalization, trade finance diversification, and broader capital mobilization. Asset-backed and partnership-oriented products can align well with commerce, leasing, agribusiness, equipment financing, and value-chain transactions common in developing economies. Analytical projections for Central Asia indicate meaningful room for future Islamic banking and sukuk expansion, with Uzbekistan expected among the region's leading markets under favorable assumptions [11]. Such forecasts should not be interpreted mechanically, yet they indicate that delayed institutional preparation may carry opportunity costs. Investor appetite, diaspora interest, and development-finance partnerships generally favor jurisdictions that prepare early and

regulate coherently. Therefore, gradualism should not become passivity; it should be a disciplined route toward credible scale.

International standardization remains essential because domestic Islamic windows benefit from alignment with globally recognized governance and accounting practices. AAOIFI standards and related industry guidance help reduce interpretation gaps across contracts, documentation, and financial reporting expectations [12]. Their importance lies not in rigid uniformity, but in providing a credible benchmark for product design, auditability, and market confidence. When regulators and banks selectively align with recognized standards, they lower the cost of future cross-border partnerships and investor engagement. Standardization also protects local markets from ad hoc improvisation that may later require costly remediation. For that reason, any phased implementation roadmap should specify which global standards are mandatory, which are persuasive, and which require local adaptation.

The Uzbekistan case is especially instructive because the market appears to be moving from conceptual discussion toward measured operational experimentation. Official reporting confirms that Islamic finance services have already entered the microfinance segment under a defined regulatory basis, even if volumes remain modest [8]. This matters because many banking reforms fail by attempting large-scale launch without prior domestic operational learning. The existence of an early micro-level pilot creates an empirical foundation for later banking-sector expansion through carefully controlled Islamic windows. It enables regulators to observe customer behavior, documentation frictions, system limitations, and staff training needs in real conditions. Such learning-by-doing should become an explicit design principle of the national sequencing strategy.

A workable rollout architecture can be divided into several cumulative phases, each with different regulatory and institutional priorities. Phase one should focus on legal definitions, tax diagnostics, governance templates, and product standardization for a narrow retail-oriented portfolio. Phase two should authorize selected Islamic windows under strict eligibility criteria, limited product menus, ring-fencing rules, and enhanced disclosure obligations. Phase three may extend the product range toward SME, agricultural, and trade finance solutions once supervisory data and operational competence improve. Phase four should deepen market infrastructure through liquidity tools, sukuk development, Shariah-compliant treasury management, and specialized dispute resolution arrangements. Finally, phase five can evaluate whether selected windows are mature enough for conversion, subsidiarization, or coexistence with full-fledged Islamic banks.

It is equally important to define measurable indicators for each phase, because implementation quality cannot be inferred from the mere number of opened windows. Relevant indicators include complaint ratios, product turnaround times, training completion rates, Shariah audit findings, operational loss events, portfolio performance, and customer retention metrics. Prudential authorities should also track concentration by product type, funding source, maturity profile, and sectoral exposure to avoid hidden fragilities. Governance indicators are particularly important, including the timeliness of Shariah reviews, remediation closure rates, and board-level oversight quality. A phased framework without metrics quickly degenerates into symbolic reform and inconsistent supervisory practice. Effective sequencing therefore requires a dashboard-based approach integrating legal, market, governance, and risk indicators. One should also recognize the limits of the Islamic window model, because it is not a universally sufficient long-term solution. In some markets, windows may remain transitional and never evolve into deeper institutional ecosystems if treasury tools, talent pipelines, and legal frameworks stagnate. In other cases, strong demand may eventually justify separate balance sheets, dedicated subsidiaries, or full-fledged Islamic banks with clearer identity and governance. Yet these limits do not weaken the case for windows in early-stage environments; rather, they clarify the conditions under which windows remain useful. The question is not whether windows are perfect, but whether they are proportionate to current institutional readiness. For Uzbekistan and similar systems, the answer is often affirmative if sequencing is carefully governed. Ultimately, the phased introduction of Islamic banking products through an Islamic window framework should be viewed as a state-building exercise in financial governance. It requires cooperation among central banks, ministries of finance, tax authorities, judiciary institutions, higher education providers, standard-setting bodies, and private banks. Forecasts indicating future Islamic finance expansion in Uzbekistan and Central Asia reinforce the strategic value of acting early, but they also underscore the necessity of disciplined preparation [10]. A robust framework must combine legal clarity, Shariah governance, tax neutrality, digital readiness, consumer protection, and liquidity infrastructure into a coherent institutional sequence. When these elements are synchronized, Islamic windows can move from experimental offering toward trusted national financial architecture. When they are fragmented, the same model may produce reputational controversy, shallow adoption, and regulatory stress.

**Table 1.**

**Proposed phased roadmap for introducing Islamic banking products and the Islamic window model**

Phase	Main objective	Core instruments / actions	Key institutional output
Phase 1	Establish legal and conceptual basis	Definitions, taxonomy, licensing concepts, tax review	Foundational legal clarity
Phase 1	Build governance architecture	Shariah governance rules, board mandates, internal controls	Governance readiness
Phase 1	Standardize initial products	Murabaha, Ijarah, basic deposit/investment structures	Standard product documentation
Phase 2	Pilot limited Islamic windows	Restricted licenses in selected banks	Controlled market entry
Phase 2	Strengthen systems and reporting	Core banking adjustments, ring-fencing, reporting templates	Operational traceability
Phase 2	Launch consumer protection tools	Disclosure forms, complaint handling, suitability protocols	Trust and transparency
Phase 3	Expand target segments	SME, agriculture, trade finance, micro and retail scale-up	Broader inclusion impact
Phase 4	Develop market infrastructure	Liquidity tools, interbank solutions, sukuk groundwork	Prudential sustainability
Phase 5	Evaluate structural deepening	Conversion, subsidiarization, or coexistence models	Long-term sector architecture

**Source:** Developed by the author based on IMF, IFSB, BNM, CBU, and international Islamic finance industry materials, 2021–2025.

### **Conclusion**

The analysis demonstrates that the Islamic window model is not merely a temporary commercial arrangement, but a structured institutional bridge between conventional banking dominance and Shariah-compliant financial diversification. Its central advantage lies in allowing regulators and banks to test real demand, develop governance capability, and accumulate operational evidence without imposing abrupt systemic transformation. The study also shows that successful implementation depends on several mutually reinforcing conditions, including legal clarity, tax neutrality, product standardization, digital traceability, and independent Shariah governance. Where those conditions are absent, Islamic windows risk becoming superficial branding mechanisms rather than credible financial innovations. Conversely, where sequencing is coherent, windows can expand inclusion, attract new capital, and build market legitimacy for later structural deepening. For emerging financial systems,

especially Uzbekistan, the phased model offers a realistic and policy-efficient route toward sustainable Islamic finance development.

The main findings of the article may be summarized in four final conclusions. First, the most appropriate entry strategy for early-stage jurisdictions is a phased rollout beginning with lower-complexity products such as Murabaha and Ijarah. Second, governance quality is the decisive determinant of long-run credibility, meaning Shariah compliance mechanisms must be integrated into board oversight, audit, disclosure, and remediation systems. Third, prudential sustainability requires Islamic window expansion to proceed simultaneously with tax reform, legal standardization, technology adaptation, and liquidity management infrastructure. Fourth, domestic pilot experience and international standard alignment together create the strongest basis for gradual scaling, whether toward larger windows, dedicated subsidiaries, or eventually full-fledged Islamic banks. Therefore, the path to effective Islamic finance expansion lies neither in haste nor in hesitation, but in disciplined institutional sequencing. Such sequencing converts latent demand into sustainable intermediation capacity while preserving trust, stability, and supervisory coherence.

### Proposals

**Proposal 1.** Uzbekistan should adopt a **two-tier licensing design** for Islamic windows, where the first tier permits only standardized retail Murabaha and Ijarah products, while the second tier is granted only after verified compliance performance, system segregation, and Shariah audit maturity.

**Proposal 2.** A **national Shariah governance template pack** should be issued for all pilot institutions, including model board charters, product approval workflows, breach escalation matrices, disclosure forms, and internal audit checklists, so that implementation quality does not depend on fragmented institutional improvisation.

**Proposal 3.** The Central Bank, Ministry of Finance, tax authorities, and judicial training institutions should create a **joint Islamic finance implementation lab**, where legal clauses, tax treatment scenarios, accounting entries, and dispute patterns are stress-tested before large-scale market rollout.

**Proposal 4.** Pilot banks should be required to build a **digital traceability module** inside their core systems that tags every Islamic contract by product type, asset flow, approval path, and Shariah review status, thereby enabling real-time supervisory analytics and stronger customer trust.

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