



Resilience of Islamic Banking in Conventional Financial Markets: Responses to Legal and Regulatory Constraints in Tanzania

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ABSTRACT - Islamic banking in conventional financial markets in Tanzania reveals its ability to sustain operations and respond to constraints within existing legal and regulatory framework that inadequately accommodate its distinct operational needs. The status quo has triggered the study to examine how Islamic banks manage to survive and remain competitive. The study employed a qualitative approach, using doctrinal and empirical methods to collect data. The information gathered was analysed through legal formalism and content analysis methods. The findings reveal that Islamic banks in Tanzania have adopted resilience strategies to sustain operations. These include reliance on international Shariah standards, structuring and restructuring Shariah-compliant products, issuance of Islamic bonds, forming strategic partnerships for liquidity support, application of the doctrine of necessity, utilising Takaful insurance, establishing reserve accounts for profit distribution management, and imposing Ta'widh and Gharamah on late payments. Despite these strategies, the findings show that improvement of the legal and regulatory framework to effectively accommodate Islamic banking is essential to support fair competition. Therefore, the study recommends amendments of banking laws in Tanzania to adequately accommodate Shariah-compliant financial practices. Such reforms are crucial to support and strengthen Islamic banking and promote stability in financial markets.

ARTICLE HISTORY

Received: 17th Sept 2025

Revised: 05th Nov 2025

Accepted: 06th Nov 2025

Published: 01st Dec 2025

KEYWORDS

Global market, inclusion model, emerging economies, Shariah-compliance, takaful, ta'widh.

INTRODUCTION

The expansion of Islamic banking within global financial markets signifies a growing demand for alternative financial models grounded in ethical principles (Beck, 2013). As a distinct financial system, Islamic banking is governed and guided by the Islamic laws, known as Shariah (Vahed, 2015). For banks to be considered as offering Islamic financial services, they are required to conform to Shariah rules and principles. These principles include, among others, the prohibition of riba (interest), gharar (uncertainty), and maysir (gambling) in all financial dealings (Chong & Liu, 2009). Islamic banks instead operate through ethical financing modes that emphasise partnership, risk sharing, and asset-backed transactions (Pesendorfer et al., 2016).

In Islamic banking, the nature of the relationship between customers and the Islamic bank is different from that of the conventional banks. For conventional banks, the relationship is that of a bank and a borrower or depositor, whereas for Islamic banks the relationship is that of a bank and a partner (Mzee, 2016). In this context, financing is usually provided through participatory arrangements, whereby investors and banks jointly contribute capital to undertake business

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activities and share profits or losses according to a pre-agreed ratio (Mukhibad et al., 2023). Accordingly, financing is restricted to real transactions backed by tangible assets, with speculative investments such as margin trading and derivatives being excluded (Solé, 2007). However, most financial markets today are structured around conventional banking practices that do not adequately support these principles (Nomran & Haron, 2020). For example, conventional systems rely heavily on interest-based lending, use speculative instruments such as derivatives, and often separate financial transactions from tangible assets. These features contradict Shariah rules and create challenges for Islamic banks operating within such frameworks (El Qorchi, 2005).

To understand how Islamic banking reached the current position within these conventional markets, it is important to trace its historical evolution. Whilst the practice of Islamic banking has been around for 50 years and is still relatively a new phenomenon, the Islamic economic system on which Islamic banking is based has been around for more than fourteen hundred years (Pesendorfer et al., 2016). Early in the history of Islam, the use of cheques and deposits into current accounts were prevalent, all governed by Shariah principles (Vahed, 2015). According to Presley and Sessions (1994), Islamic banking is an integral part of Islamic Economics, and Islamic Economics itself is not a new paradigm. However, the breakthrough of the modern Islamic banking industry as manifested today, can be traced back to the 1970s, when Muslim countries held a conference in Karachi, Pakistan, to develop a financial system compatible with Islamic principles (Suddy, 2021). This initiative led to the establishment of the Islamic Development Bank in 1975 in Saudi Arabia, followed by the opening of Dubai Islamic Bank in the United Arab Emirates in the same year, the world's first fully-fledged Islamic bank (Mukhibad et al., 2023). In the following 10 years, 27 more Islamic banking institutions were opened across various countries. Such banks, included among others, the Faisal Islamic Bank in Egypt and Sudan, Kuwait Finance House in Kuwait, and Jordan Islamic Bank in Jordan (Pesendorfer et al., 2016). Thereafter in 2002, international standard-setting bodies such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) had already been established to provide global guidelines for Shariah-compliant banking (Farooq & Zafar, 2025). These bodies play a crucial role in harmonising Shariah-compliant practices, though their guidelines are generally advisory rather than legally binding (Ramadhani & Bilen, 2024). By the year 2004, Islamic banking had spread to 48 developing and emerging economies, including both Muslim-majority and non-Muslim countries. Even countries such as the United Kingdom and Japan, where Muslims are a minority, have integrated Islamic financial services into their financial markets (El Qorchi, 2005). According to Mukhibad et al. (2023), the number of Islamic banking and financial institutions at present is more than 1500 in over 90 countries and the industry is still growing.

Building on this global expansion, Tanzania provides a unique case study where Islamic banking has taken root within a predominantly conventional financial system. Tanzania is a multi-religious and multi-ethnic country that operates under a common law legal system (Magalla, 2021). Within this setting, Islamic banking was introduced in 2008 and has since become part of the national financial structure (Bank of Tanzania, 2019). The Bank of Tanzania, as the principal regulator, allowed both Islamic banks and conventional banks with Islamic windows to provide Islamic services. At present, there is only one fully-fledged Islamic bank, which is Amana bank. The bank started operating in 2011 and has ten branches offering a variety of Shariah-compliant products across the country (Bank of Tanzania, 2021). Many other conventional banks have established non fully-fledged Islamic banks, whose Islamic services are provided via a separate window. These include the Kenya Commercial Bank (KCB), the National Bank of Commerce (NBC), the People's Bank of Zanzibar (PBZ), CRDB Bank, and Azania Bank, with services such as current, savings, and investment accounts available for customers who prefer faith-based banking (Bank of Tanzania, 2024). The innovations in the sector kept advancing until 2019, when Vodacom Tanzania partnered with Amana Bank to launch Halal Pesa, a mobile-based microfinance product established to create Shariah-compliant savings and investment services

(The Citizen, 2019). Most recently, takaful insurance products were introduced into the market followed the release of the operational guidelines by the Tanzania Insurance Regulatory Authority, thereby extending Islamic finance beyond banking as a whole (The Citizen, 2022).

However, as in most of the Common law countries, the introduction of Islamic banking in Tanzania is accompanied with several legal and regulatory challenges that limit its full potential. Previous studies show that Islamic banks in Tanzania operate within a conventional financial framework that does not adequately accommodate their unique Shariah features (Mzee, 2016; Bukanu & Mukama, 2025). The existing banking laws, for example, the Banking and Financial Institutions Act [Cap. 342 RE 2023] and the Bank of Tanzania Act [Cap. 197 RE 2023] were enacted before the emergence of Islamic banking, and primarily designed for conventional banks operations. As such, they do not provide an enabling environment for Islamic banks to operate on a Shariah-compliant basis (Mzee, 2016). Major challenges reported include the non-accommodation of Shariah-compliant practices (Habiba et al., 2017), exclusion from central bank facilities such as the lender of last resort, lack of Central Shariah Advisory board, restrictions on investing in fixed assets, and double taxation (Ramadhani & Bilen, 2024). These structural gaps create operational uncertainty, prevent the sector from fully achieving Shariah compliance, and constrain the sector's role in financial inclusion and development in the wider context of financial development in the country (Mzee, 2016; Mapeyo et al., 2022; Bukanu & Mukama, 2025).

These facts awakened the need to examine the resilience of Islamic banking within Tanzania's conventional financial system. Specifically, the study explored how Islamic banks managed to survive and sustain their operations under the existing legal and regulatory framework that does not adequately accommodate their distinct nature. To this end, the study examined the practical strategies Islamic banks adopted to continue providing Shariah-compliant products and services in the face of legal and regulatory constraints.

LITERATURE REVIEW

Over the last decade, Islamic banking has experienced global growth rates of 10-15 percent per annum, and has been moving into an increasing number of conventional financial systems at such a rapid pace that Islamic financial institutions are present today in over 90 countries (Mukhibad et al., 2023). This attraction is also due to the fact that the Islamic financial sector has been extremely resilient during the recent global recession; whilst most conventional banks were posting poor results, Islamic banks were posting good growth in their net profit positions (Vahed, 2015). According to the Islamic Financial Services Board (IFSB) (IFSB, 2022), the assets of Islamic financial institutions have grown by 11.3% annually, reaching an estimated worth of USD 3.06 trillion in 2021. However, despite these advancements, the industry's growth, especially in many Common law countries, has been below expectations, resulting in limited investment in fully-fledged Islamic banks and a continued reliance on Islamic banking services offered by conventional banks (Ramadhani & Bilen, 2024).

In Tanzania, Islamic banking is still a relatively small but steadily growing part of the financial system (Khamis et al., 2018). Unlike in some countries, there is no dedicated legal and regulatory framework for Shariah-compliant finance. This means that, Islamic banks operate under the same laws that govern conventional banks (Suddy, 2021). According to the existing reports, Islamic banking assets represent less than 10% of the entire banking sector, with deposits and customer shares following the same trend (Awadh, 2020). The sector has, however, shown steady growth, with financing balances increasing by approximately 5% over the previous years, reflecting a gradual rise in customer participation (Bank of Tanzania, 2021).

While Islamic banking differs from conventional banking in that Islamic banking is guided by the Shariah principles, both are essentially financial intermediaries channeling funds from savers or depositors to those in need of funds (Dzulkepli & Barom, 2021). Abduh (2014) notes that many customers opt for Islamic banks over conventional banks to avoid interest, as Islamic banks are

more resilient during banking crises. To maintain compliance with Shariah principles, Islamic banks must ensure that all their products adhere to the prescribed rules and regulations (Mapeyo et al., 2022). This responsibility lies with the Shariah Supervisory Board (SSB) of each Islamic bank (Mukhibad et al., 2023). However, no law currently defines these SSBs, or prescribes their structures (Omar et al., 2017). International guidelines have also emphasised the importance of independent SSBs for banks offering Islamic banking services (AAOIFI, 2015). Nevertheless, these guidelines are not legally binding in Tanzania, as they have not yet been domesticated (Ramadhani & Bilen, 2024).

In addressing the missing link between Islamic banking and the legal and regulatory framework which prevails in Tanzania, studies have highlighted several challenges that impact Islamic banking under the current banking regulations. For example, Mzee (2016) observes that, Tanzania regulations do not recognise the Islamic banking operations, even though they have been allowed to be practiced. This is evidenced by the Constitution of the United Republic of Tanzania of 1977, which provide that Tanzania is a secular state which only recognises individual religion and worship, as distinct from managing religious bodies. In the same line of argument, Bukanu and Mukama (2025) notes that the main banking laws in Tanzania were enacted prior to the advent of Islamic banking, and thus, lack the flexibility needed to accommodate its operational standards. For instance, Section 21 of the Banking and Financial Institutions Act [Cap. 342 RE 2023] imposes a mandatory obligation on all banks, including Islamic banks, to maintain liquid assets at the level prescribed by the Bank of Tanzania. This requirement poses a challenge on Islamic banks since these liquid assets provide a return in the form of interest, which is repugnant to the principles of Islamic banking.

Similarly, there are incidences of double taxation in Islamic banking products, as Islamic banking has not been adequately recognised for under the existing tax laws in Tanzania. According to Habiba et al., (2017), Section 5 of The Stamp Duty Act [Cap. 189 RE 2023] imposes a duty on every instrument executed within the United Republic of Tanzania, or associated with property located therein. This provision creates a challenge with regard to the purchase and resale agreements associated with some Islamic financing modes like murabahah. Usually stamp duty is paid when the ownership in the asset is transferred. So the buyer must pay this over and above the purchase price paid to the seller. With Islamic sales, however, the bank buys the property instead and then resells it to the client with an appropriate mark-up. The taxation problem is that; these two transactions would normally incur two separate stamp duty payments. In this case, there is only one financing arrangement, but two transactions are required to achieve the desired outcome, resulting in double taxation.

On top of that, Sudsy (2021) focuses on the practical operational challenges that Islamic banks face in the absence of Islamic insurance (takaful) services. The author observes that all banks in Tanzania, including Islamic banks, are required to insure their loans, but the absence of a recognised takaful system forces Islamic banks to use conventional insurance, which generates interest. This requirement contravenes Shariah principles and impedes the development of Islamic banks in the country. In contrary, Issa (2018) conceptualises the inefficiency of existing legal framework in Tanzania for dispute resolution within the Islamic banking industry, and recommend for establishment of a Central Shariah Council, that would act as a representative of all Islamic banks and customers across the country in dealing with issues relating to Islamic finance.

Therefore, the reviewed literature makes it evident that Islamic banks in Tanzania face considerable challenges in operating within financial markets shaped by conventional legal and regulatory framework. Although the reviewed studies (Mzee, 2016; Habiba et al., 2017; Issa, 2018; Sudsy, 2021; Mapeyo et al., 2022; Bukanu & Mukama, 2025), emphasise the pressing need for a dedicated Shariah-compliant framework, they fall short of addressing how these institutions manage to survive, adapt, and remain competitive under the prevailing system. This study therefore, positions itself to bridge this knowledge gap by examining the practical strategies employed by Islamic banks to withstand legal and regulatory constraints, thereby ensuring their

resilience and sustained presence in conventional financial markets.

METHODOLOGY

This study adopted a qualitative research approach to examine the resilience of Islamic banking within conventional financial markets in Tanzania. Data were collected through documentary review and structured interviews. On one hand, documentary review was employed to obtain both primary and secondary data relevant to this study. Primary data were collected from Qur'an, legislation, court rulings, guidelines, standards, official government reports, and empirical records from Islamic banks. In addition, secondary data were collected from scholars' publications and newspapers. Legal formalism was employed to analyse data collected through documentary review in the lenses of rules of statutory interpretation and deductive reasoning. Undoubtedly, documentary review and analysis provided an understanding of existing laws, regulations, and theoretical perspectives pertinent to Islamic banking. Further, it provided a comprehensive understanding in the manner of which Islamic banks operate under a framework largely designed for conventional banking.

On the other hand, face-to-face structured interviews were employed to obtain primary data from twenty (20) respondents drawn from key industry stakeholders. These respondents, which are located in Dar es Salaam (Ilala and Kinondoni Districts), and Morogoro Municipality, included two (2) regulatory officers from the Bank of Tanzania, two (2) banking professionals from Amana Bank, ten (10) banking professionals from conventional banks operating through Islamic windows, two (2) legal practitioners, two (2) Shariah scholars from the Muslim University of Morogoro, and two (2) existing customers of Islamic banks. Respondents were obtained through both purposive and random sampling techniques. Purposive sampling technique was employed to carefully selecting eighteen (18) individuals with relevant university education, expertise in fields of banking, law, and Shariah and experience of three (3) years or above in Islamic banking. While random sampling technique assisted in obtaining two (2) existing customers of Islamic banks. Nonetheless, their perspectives complemented the documentary review and ensured a balanced representation of stakeholders. Cross-sectional design guided interviews exercise, where respondents were visited only once using pre-determined interview questions. In the course of conducting interviews, respondents were informed of the purpose and objective of this study and their consent was verbally sought and granted to later report the information gathered and a partial disclosure of their participation in terms of occupation, position, workplace, and location. Partial details and respondents' labels are provided in a table below.

Table 1: Summary of Respondents' Details

Workplace	Occupation/Position	Interview Date	Respondent Label
KCB Sahl	Corporate Relationship Manager		Respondent 1
	Shariah Compliance Manager	7 January 2025	Respondent 2
	Member, Shariah Advisory Board		Respondent 3
	Customer 1		Respondent 4
	Customer 2	8 January 2025	Respondent 5
Amana Bank	Bank Manager	15 January 2025	Respondent 6
	Sharia Compliance Manager	2025	Respondent 7
Islamic Bank (Actual name withheld)	Director of Islamic Banking		Respondent 8
	Manager Shariah Compliance	20 January 2025	Respondent 9
	Bank manager		Respondent 10
CRDB Bank	Director for Retail Banking		Respondent 11
	Head of Al Barakah Banking Services	22 January 2025	Respondent 12
Clyde & Co Tanzania	Senior Advocate	24 January	Respondent 13

	Senior Advocate	2025	Respondent 14
NBC Bank	Head of Transaction Banking	25 January	Respondent 15
	Relationship Manager	2025	Respondent 16
Bank of Tanzania	A/Director of Financial Sector Supervision	4 February	Respondent 17
	Banking Supervision	2025	Respondent 18
Morogoro Muslim University	Senior Lecturer (Law & Shariah)	25 February	Respondent 19
	Senior Lecturer (Shariah)	2025	Respondent 20

In addition, content analysis enabled data obtained through interview to be arranged in thematic spectrum enhancing familiarisation and coding of data to generate themes for reporting. The generated themes were reviewed, defined and named to warrant coherence and clarity of findings for the final reporting. This process enabled the study to capture the adaptive strategies employed by Islamic banks to sustain their operations within the current legal and regulatory framework. The findings, structured around these themes, are presented in the subsequent sections.

RESULT

As noted in the literature review section, the legal and regulatory framework, which regulates the banking business in Tanzania, was originally intended for conventional banking, which is insensitive to the operational requirements of Islamic banking. Such a scenario proves that the Islamic banking institutions are operating within conventional financial markets, despite their distinct Shariah-based nature. The foregoing submission is further supplemented by the respondents of this study. All of the Respondents have assisted in knowing that Islamic banking forms an integral part in the manifestation of Islamic faith. In specifics, Respondents 4 & 5 reported that, they prefer Islamic banking as it enables them to practise their Islamic religious rules and beliefs; while the rest of the Respondents 1 – 3 & 6 – 20 reported on vitality of Islamic banking, legal and regulatory constraints, and that it is high time, the legal and regulatory framework be improved to adequately accommodate Shariah-compliant practices. Further, Respondents 1 – 3, 6 – 12, 15 – 16 & 19 – 20 reported on survival strategies Islamic banks employ to remain operational and competitive in financial markets in Tanzania. In addition, Respondents 13 – 14 & 19 – 20 reported on challenges in legal actions and enforcements of Islamic banking related cases. Nonetheless, for the purpose of illustrating the study's central argument on the resilience of Islamic banking within Tanzania's conventional financial system, narratives from Respondents 1 – 2, 7, 9 - 11, & 19 are drawn upon. The narratives showcase the findings concluding that, despite the legal and regulatory constraints, the Islamic banks have managed to survive by applying various approaches that are acceptable to both Shariah and the traditional laws governing the banking sector. The approaches include relying on international standards, developing Shariah-compliant products and services, issuance of Islamic bonds, forming strategic partnerships, application of the doctrine of necessity, using takaful for loan protection, setting up reserve accounts, and applying *ta'widh* (compensation) and *gharamah* (penalties) on late payments.

Reliance on International Standards

One of the most resilient responses that Islamic banks in Tanzania have made to legal and regulatory constraints is the application of international standards. Since Tanzania lacks specific laws governing Islamic banking, Islamic banks operate under the general framework designed for conventional banks, which does not adequately accommodate their unique way of conducting business.

To address this, the Islamic banks operating in Tanzania have recourse to the Shariah standards as recommended by international institutions, including the Accounting and Auditing

Organisation of Islamic Financial Institutions (AAOIFI), and the Islamic Financial Services Board (IFSB). These institutions offer standards and guidelines that regulate how an Islamic bank should be run, managed, and ensure that the products and services offered are compliant with Shariah. They provide important rules in areas like Shariah governance, accounting, auditing, ethics, and financial reporting. These rules help make Islamic banking more open, trustworthy, and professional across the sector. For example, one of the key requirements recommended by these institutions, is the establishment of a Shariah Supervisory Board (SSB) within each Islamic bank. The SSB is a group of no less than three scholars who are specialised in Islamic jurisprudence (jurisprudence of financial transactions in particular) and are scholarly competent and well aware of the practice realities. This group assumes the tasks of issuing *fatwas* (legal opinion), reviewing the actual practice of the financial institution to ensure its compliance in all of its transactions and operations with the rules and principles of Shariah, and submitting a report to the Bank Directors, thus helping to maintain transparency and build customer trust (AAOIFI, 2003; IFSB, 2023).

The Government of Tanzania has also recognised the importance of these international standards. Since 2016, the Bank of Tanzania has been a member (Associate Member) of the IFSB, which gives it access to best practices from around the world in regulating Islamic banks (IFSB, 2020). In 2021, the Ministry of Finance and Planning also encouraged Islamic banks to adopt these international standards as a way of building credibility and attracting investors looking for Shariah-compliant financial options (TanzaniaInvest, 2021).

The reliance on international standards was further evidenced in the case of *Shymaa Commission Agent Co. Ltd vs. KCB Bank Tanzania Limited & Another, Land Case No. 103 of 2022, the High Court of Tanzania Land Division at Dar es Salaam (Unreported)*. In this case, the plaintiff challenged an additional charge of TZS 76,000,000/= imposed during the restructuring of two *murabahah* contracts, arguing that the charge constituted interest (*riba*), which is forbidden under Islamic law. The defendant bank justified the charge as a profit arising from a *tawarruq*-based restructuring agreement endorsed by its internal Shariah Advisory Board. The central issue before the court was whether the use of *tawarruq* constituted *riba* under Islamic law. In resolving the matter, the court referred to AAOIFI's definition of *tawarruq*, which describes it as: "the process of purchasing a commodity for a deferred price determined through Musawamah (bargaining) or Murabahah (mark-up sale), and selling it to a third party for a spot price to obtain cash." The court, therefore, held that *tawarruq* does not amount to interest and is permitted in Islamic banking.

This ruling reveals that even in the absence of formal adoption of AAOIFI standards into Tanzanian law, the courts are willing to rely on them as important resource in the interpretation process of Islamic financial contracts. It is worth noting that institutions such as Amana Bank already utilise AAOIFI standards as a reference when structuring their financial instruments. However, because these standards are not yet codified within the national regulatory framework, their application remains inconsistent. In many instances, compliance is voluntary; in others, it depends on internal policies, resulting in uneven application. Bank managers interviewed as part of this study confirmed that these international guidelines are applied in daily operations, especially when preparing contracts such as *istisna'*, a manufacturing or construction contract. Since Tanzania laws inadequately covers Islamic banking, on a supplement basis, Islamic banks depend on AAOIFI and IFSB standards to keep their services in line with Shariah financial regulations (Respondent 2, 2025). Therefore, while this approach has allowed Islamic banks to stay operational, it also highlights a major gap in Tanzania's financial laws. Without local regulations tailored to Islamic banking, these banks would continue to rely on foreign standards just to survive but not to thrive within the existing conventional financial markets.

Structuring and Restructuring Shariah-Compliant Products and Services

Another innovative and resilient approach adopted by Islamic banks in Tanzania is the structuring and restructuring of Shariah-compliant products and services, which are guided solely by Shariah principles, especially the prohibition of *riba* (interest). In Islamic finance, the charging or payment

of interest is prohibited, as it is considered exploitative and unjust. The basis for this principle lies in the Islamic school of thought, which views money as a medium of exchange rather than a commodity to be traded for profit (Respondent 7, 2025).

Rather than engaging in interest-based lending, Islamic banks offer financial services that are compliant with Islamic ethical values and legal norms. These include, among others, the equity-based models such as *musharakah* (partnership financing) and *mudarabah* (profit-sharing financing). Along the same line, they offer lease-based financing like *ijarah* (leasing), and sale-based structures such as *istisna'* (manufacturing/construction contract), *murabahah* (cost-plus sale), *bai' salam* (forward sale), and *musawamah* (negotiated sale). In addition, other services offered include agency arrangements, which are applied through *wakalah* and also commodity-based transactions such as *tawarruq* (reverse/commodity *murabahah*). These financing modes make it possible for the banks to meet customer's satisfaction, while adhering to Shariah principles. One example of this approach is *murabahah* financing. Under this model, the bank purchases an asset on behalf of the customer and sells it to them at a price that includes a fixed profit margin. This arrangement avoids interest, since the agreed-upon profit is based on the cost of the asset, not a lending rate. Respondent 10 explained this process in clear terms:

In *murabahah* transactions, we act as the intermediary by acquiring the asset requested by the client. For example, when a customer approaches us to purchase machinery for their business, we first acquire the machinery directly from the seller. Once the purchase is completed, we sell the machinery to the customer at a mutually agreed price that includes our profit margin, which typically ranges from 5% to 15%, depending on the asset and the agreement terms. The customer then pays this amount in instalments over time, ensuring compliance with Shariah principles by avoiding interest-based transactions (Respondent 10, 2025).

This financing mode has also received recognition by the courts in Tanzania. In the case of *Amana Bank Limited v. Shaban Athumani Mshana & 3 Others, Commercial Case No. 124 of 2014, The High of Tanzania Commercial Division at Dar es Salaam (Unreported)*, the plaintiff, Amana Bank, entered into a *murabahah* loan facility with the defendants, including Shaban Athumani Mshana. The bank promised to purchase and sell 700 pairs of shoes to the defendants, who were to be imported from Trimpex and Shoes Trading Company, founded in the USA. The *murabahah* loan amounts to a total of TZS 200,000,000 (Tanzanian Shillings Two Hundred Million). The defendants, however, failed to abide by the payment terms as per the contract, which resulted in the bank restructuring the loan by increasing the principal by 10%, pursuant to the regulatory requirements of the Bank of Tanzania. The defendants argued that the *murabahah* and restructuring were in violation of the Islamic law as well as the contract laws of Tanzania. The issue before the court was whether the *murabahah* agreement was valid and enforceable under Tanzanian law, and whether the defendants were liable to repay the remaining amounts. The court ruled in favour of the bank that, the *murabahah* agreement was a valid and enforceable contract, and that the defendants owed the remaining amounts as stipulated. Also, in the case of *Amana Bank Limited v. Urban and Rural Engineering Services Limited, Commercial Case No. 78 of 2021, the High Court of Tanzania Commercial Division at Dar es Salaam (Unreported)*, the plaintiffs, Amana Bank, had entered into a *murabahah* financing agreement with the defendant, Urban and Rural Engineering Services Limited, on July 22, 2014. The facility had a value of TZS 2,450,823,040/= however, the outstanding amount by December 2016 was TZS 2,574,742,293.91 due to disbursements, which was the reason why the defendant had defaulted in repayment. This prompted the bank to commence legal action against the defendant for the recovery of the debt. The court ruled in favour of the bank and ordered the defendant to repay the outstanding amount.

These judgments reveal the legal recognition of *murabahah* transactions in Tanzania, and also highlight the resilience of Islamic banks in Tanzania, particularly in their ability to provide

innovative, ethical, compliant, and competitive financial products despite the absence of the adequate legal and regulatory framework tailored to Islamic banking.

Issuance of Islamic Bonds

As part of their resilience, Islamic banks are participating in capital markets by issuing *sukuk*, often referred to as Islamic bond(s). The structures of *sukuk* are designed in a manner consistent with Shariah principles, maintaining a safe distance from interest-based activities. The fundamental difference between conventional bonds and *sukuk* is that *sukuk* represents ownership interests in tangible underlying assets. So, unlike a conventional bond, where you lend money to the issuer and receive fixed interest, *sukuk* gives you partial ownership of a real asset from which you earn returns based on the profit generated by that asset. Instead of receiving an interest rate return like in a conventional bond, the *sukuk* investors receive periodic returns from the profits generated by the business operations. This avoids riba while mobilising financing according to Islamic principles (Respondent 2, 2025).

An example of a *sukuk* product in Tanzania is the *Fursa Sukuk*, which was issued by KCB Bank in 2022 as the first public Shariah-compliant bond in the country. This Shariah-compliant investment, structured under the *mudarabah* principle, was approved by the Capital Markets and Securities Authority (CMSA) and endorsed by the independent Shariah Advisory Board of KCB Sahl Banking. It (*Fursa Sukuk*) was designed to finance KCB Sahl Banking's asset portfolio and support Islamic financing and investment activities, aligning with ethical financial principles. The *Fursa Sukuk* was oversubscribed by 10 percent during its Initial Public Offering (IPO) attracting an investment value of TZS 11 billion against the initial target of TZS 10 billion, testifying markets appetite for Islamic products (KCB, 2022). The bond is now listed in the Dar es Salaam Stock Exchange allowing investors to buy and sell their shares (The Citizen, 2022). Furthermore, as a move to encourage ethical investment, the Government of Tanzania (2023a) exempted *Fursa Sukuk* from Withholding Tax under The Finance Act, No. 5 of 2022, an indication of legal support aimed at promoting Shariah-compliant financial instruments. During an interview conducted by the researcher, Respondent 1 highlighted this success by stating:

The over-subscription of this bond demonstrates the increased trust and confidence investors have in Shariah-compliant products. Buying this bond offers 8.75% return per year, with profit payments made quarterly (four times in a year). Anyone can invest in *Fursa Sukuk* with a minimum of TZS 500,000 (Respondent 1, 2025).

The funds raised through *Fursa Sukuk* are pooled with other Shariah-compliant investments and managed by KCB Sahl Banking in compliance with Islamic financial principles. Investors, acting as *rabbul maal* (owners of *sukuk* funds), entrust KCB Sahl Banking as the *mudarib* (Investment Manager), which oversees the allocation of these funds into Shariah-compliant business ventures. The investment framework ensures that profits are shared based on a pre-agreed ratio, providing investors with ethical and predictable returns. Additionally, in cases of oversubscription, the bank has the right to raise an additional TZS 5 billion, allowing more investors to participate in this pioneering Islamic financial product (Respondent 1, 2025).

Along with *Fursa Sukuk*, *Yusra Sukuk* Company Limited has also been an important player in the growth of Islamic finance in Tanzania. It was the lead arranger for the *Zanzibar Sukuk*, which was listed on the DSE in May 2025 and raised TZS 381.38 billion, surpassing its target of TZS 300 billion (Kitomari, 2025). In July 2024, it helped issue the *Premier Sukuk*, as the first *sukuk* ever issued by a non-financial institution in the Sub-Saharan region, which raised TZS 1.94 billion, exceeding its target of TZS 1.2 billion (Yusra Sukuk, 2024). Despite the existing legal framework, such as the Capital Markets and Securities Act [Cap. 79 RE 2023], which was designed for conventional financial instruments, Islamic banking and finance in Tanzania have shown

remarkable resilience. Through innovative Shariah-compliant products like *sukuk*, the sector has earned investor confidence and promoted sustainable, ethical investment within the national market.

Establishing Strategic Partnerships

Islamic banks in Tanzania are also excluded from liquidity support provided by the Bank of Tanzania. The Bank of Tanzania (2023a), like most central banks, serves as a lender of last resort in times of liquidity crunches (Section 41, Bank of Tanzania Act Cap. 197 RE 2023). However, the liquidity support extended under this provision is interest-based, thereby rendering it incompatible with Shariah principles, which prohibit the giving or receiving of *riba* (interest). Islamic banks, which operate in accordance with Shariah principles, are thus prohibited from engaging with this central safety net. Confronted with this legal and regulatory shortcoming, Islamic banks have been compelled to devise alternative mechanisms to maintain operational liquidity without compromising their religious obligations. The study found that Islamic banks have managed to do this by forming strategic partnerships with other Islamic financial institutions. These partnerships help them to secure liquidity support that is Shariah-compliant. Instead of relying on the Bank of Tanzania, these banks turn to other Islamic financial institutions for liquidity support, leveraging Shariah-compliant arrangements. Respondent 10 shared how this works:

When funds are urgently needed, we approach Islamic institutions such as Amana Bank or CRDB Al Barakah, where assistance is extended without interest, thereby safeguarding our compliance with Shariah principles (Respondent 10, 2025).

The study has noted however that this approach has its limitations. Respondents reported that the exclusion from Bank of Tanzania's liquidity support deprives Islamic banks of a critical financial safety net available to their conventional counterparts. As a result, Islamic banks are forced to rely heavily on internal reserves or seek for alternative liquidity sources, both of which can be costly and time-consuming. According to a respondent from an Islamic bank, unlike conventional banks that can instantly access emergency funding from the Bank of Tanzania, Islamic banks must resort to slower and often more expensive options, leaving them vulnerable during sudden liquidity shortages. This legal and operational gap creates an uneven playing field, while conventional banks enjoy robust institutional backing, Islamic banks face heightened liquidity risks leaving them to struggle to compete on equal footing (Respondent 10, 2025).

Despite these challenges, Islamic banks in Tanzania have shown encouraging signs in terms of liquidity. For instance, CRDB's Al Barakah window, which was launched towards the end of 2021, is off to a successful start. As of the time of collecting data for this study, the Al Barakah window has attracted over 70,000 customers who had deposits totalling TZS 85 billion and had drawn over TZS 90 billion in Shariah-compliant financing (CRDB, 2023a; CRDB, 2023b). This performance is also reflected in industry-wide data from the Bank of Tanzania. By September 2021, total deposits in Islamic banking reached TZS 393.57 billion, up from TZS 365.17 billion in the same month of the previous year. The number of Islamic banking clients increased from 184,108 in 2020 to 208,363 in 2021. Similarly, Islamic financing balances increased to TZS 256.18 billion by September 2021, up from TZS 244.2 billion the previous year (Bank of Tanzania, 2021).

Emphasising accessibility, Respondent 11 stated that the bank's network of 260 branches has greatly increased access to Islamic banking services compared to competitors operating such services in a limited number of locations. However, the study noted that while Islamic banks currently show resilience in the conventional financial markets, the long-term stability of Islamic banks is still in doubt due to the lack of Shariah-compliant liquidity support mechanisms. This regulatory gap denies Islamic banks an opportunity to absorb financial shocks, hence eroding their resilience and competitiveness in the general financial system.

Application of the Doctrine of Necessity

Another resilience strategy observed among Islamic banks in Tanzania is the cautious application of the Islamic legal doctrine of necessity (*darura*). Although Islamic law prohibits *riba* (interest), the doctrine of necessity allows limited engagement with otherwise forbidden practices under extreme circumstances to protect essential interests such as life, property, or the survival of the institution (Respondent 2, 2025). This principle is rooted in classical Islamic jurisprudence and supported by the Qur'an, which states, "But if one is forced by necessity, without wilful disobedience, neither sin nor blame is upon him" (Al-Qur'an, 2:173). It is also supported by the Hadith in which the Prophet Muhammad (peace be upon him) said, "Actions are judged by intentions, and every person will have only what they intended" (Sahih Bukhari, Hadith 1), revealing that temporary measures taken out of necessity are judged differently from deliberate wrongdoing.

Data from the field revealed that, though *riba* is prohibited in extreme situations, it may be resorted to as a survival mode. During an interview conducted by the researcher at KCB Sahl, Respondent 2 acknowledged that in extreme situations, the doctrine of necessity (*darura*) in Islamic law might justify the temporary use of interest-based resources. She explained:

The Qur'an allows a person to eat prohibited food [pork] in situations where no other food is available and they face the risk of death, although they should only consume enough to survive, not to satisfy hunger. Likewise, while we have not reached such a point, if interest-bearing loans become the only option to prevent liquidation, we may consider taking such loans solely as a means of survival and not beyond that (Respondent 2, 2025).

This cautious openness reflects the understanding that Islamic jurisprudence is not rigid but is instead deeply rooted in the protection of human welfare (*maqasid al-Shariah*). However, during an interview conducted with Respondent 19, he noted that this principle should be applied only in cases of extreme necessity, be temporary in nature, and remain strictly limited to what is required for survival. Such recourse is neither ideal nor encouraged, yet it highlights the adaptive capacity of Islamic banking institutions operating within a financial system dominated by interest-based infrastructure (Respondent 19, 2025). The application of *darura* in Islamic banking has also been discussed in contemporary Shariah standards, where institutions such as the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) have recognised its use in exceptional situations, while cautioning against its misuse. In particular, AAOIFI's Shariah Standard No. 1 reads: "In cases of necessity, where there is no alternative, it is permissible to engage in transactions that are otherwise prohibited, provided that the necessity is genuine and the action taken is proportionate to the need" (AAOIFI, 2015).

In Tanzania, where Islamic banks are excluded from conventional liquidity safety nets, such as interest-based lender of last resort facilities provided by the Bank of Tanzania, the doctrine of necessity acts as a legal safety valve, enabling Islamic financial institutions to operate under a constrained legal and regulatory framework while being as faithful as possible to their ethical foundations.

Insuring Loans Through Takaful (Islamic Insurance)

Another method of resilience employed by Islamic banks in conventional financial markets in Tanzania, is the use of Shariah-compliant insurance, commonly referred to as takaful. When Islamic banking was first introduced in Tanzania, these banks faced serious difficulties due to the absence of takaful services. The Bank of Tanzania, as the regulator, required all loans provided by the banks, including Islamic banks, to be insured. However, since Tanzania lacked a legal environment that supports the operation of takaful, Islamic banks had to insure their loans using conventional insurance. It is important to note that conventional insurance involves prohibited elements such as *riba* (interest) which contradicts with Shariah principles. This situation created

both ethical and operational challenges for the banks, and raised concerns among customers who expected to enjoy pure Islamic financial practices. This concern was documented as early as 2019 when Amana Bank raised the issue to the regulatory authorities. The Managing Director of Amana Bank was quoted by The Citizen Newspaper explaining the dilemma that:

The Bank of Tanzania requires all loans provided by the bank to be insured ... in Tanzania there is no Islamic insurance (takaful) organisations, so Islamic banks have to insure the loans using conventional insurance (The Citizen, 2019).

However, the situation took a significant turn in the year 2022, when the Tanzania Insurance Regulatory Authority (TIRA) responded by issuing the Takaful Operational Guidelines under Sections 5(2) and 11(1) of The Insurance Act [Cap 394 RE 2023]. The introduction of the takaful guidelines provided a legal basis for takaful operations, thus opening the door for takaful service providers to enter the Tanzanian market. A significant example of these providers is CRDB Takaful Insurance, which was launched by the CRDB Bank in partnership with Zanzibar Insurance Corporation (ZIC) in 2024. This product was regarded by many Islamic banks as a game-changer that met the banking sector's Shariah insurance requirements. The importance of this development was emphasised by a respondent from CRDB Bank, interviewed by the researcher, who explained:

Takaful services offer an alternative for individuals dissatisfied with conventional insurance models involving interest. Not only does takaful provide insurance, but it also represents an investment benefiting both clients and service providers. (Respondent 11, 2025).

The benefits of this new development were also confirmed by a Bank Manager at KCB Sahl, who shared how the change has positively impacted operations:

Before takaful guidelines were introduced, it was very difficult for us to offer insurance coverage that aligned with Shariah principles. This forced us to rely on conventional insurance, which discouraged some of our customers and made us feel like we were not fully meeting the expectations of Islamic finance. With the establishment of takaful companies, we can now confidently provide Shariah-compliant insurance solutions. This has significantly increased customer trust and satisfaction, and it has helped us attract clients who had previously hesitated to engage with us because of the insurance issue (Respondent 1, 2025).

This testimony reflects how the availability of takaful has addressed a major concern within the Islamic banking community in Tanzania. The introduction has not only restored confidence but also helped guide the market towards religious norms and improved the overall competitiveness of Islamic banks. Apart from CRDB Bank and Zanzibar Insurance Corporation, other organisations have also begun to participate in takaful in Tanzania, helping to establish growth and stability for Islamic banking. Notably, First United Takaful commenced operations in 2024, offering both General and Family Takaful products, thereby expanding Shariah-compliant insurance options in the country. Furthermore, African Takaful Insurance Company offers a complete suite of takaful services, such as marine, fire, and engineering insurance, in accordance with Islamic law (The Citizen, 2024). It is noteworthy that takaful enhances the resilience of Islamic banks by attenuating their exposure to financial risks that might threaten either liquidity or solvency in the conventional setting. Under this Shariah-compliant risk management framework, Islamic banks can deal with customer and investor confidence and provide a continued business at the same time, protect asset portfolios, and operate as long as Islamic banks can continue business under a traditional, mostly interest-based, financial system.

Establishment of Reserve Accounts

The establishment of reserve accounts is another resilience response that Islamic banks in Tanzania implemented to respond to constraints arising from the existing banking laws. The study revealed a significant challenge due to the conflict of the Islamic banking principle of profit-and-loss sharing against the requirements set by the Bank of Tanzania. Islamic banking principles require the sharing of profit and loss when they occur during operations. However, Bank of Tanzania require Islamic banks not to share losses with customers, even when the investment is undertaken under contracts such as *mudarabah* (Government of Tanzania (2023b): Section 39 of Banking and Financial Institutions Act, Cap. 342 RE 2023). Therefore, Islamic banks are obliged to bear the entire loss occurring during operations. This challenge was explained by Respondent 2, who stated:

The legal framework of the Bank of Tanzania is not conversant with Islamic Shariah. Islamic banking allows the sharing of profit and loss. While there is an investment where the money is allocated, it can turn into a loss as well, but BoT does not allow a customer to receive less than the amount deposited. (Respondent 2, 2025).

To address this challenge, Islamic banks devised practical ways to remain compliant with Bank of Tanzania rules without completely discarding core ideals of Islamic finance. One such measure is the creation of reserve accounts, especially the Profit Equalization Reserve (PER). These accounts are used to smooth out returns and protect depositors' expectations, especially in times when the bank's actual profits fall short. Respondent 9 shared how this works:

We allocate a portion of our profits to the PER account during periods of high profitability. This reserve is created from both the bank's share of the profit and the customers' share. In times of lower profitability, we draw from this reserve to ensure customers receive stable returns, even when actual profits are reduced. (Respondent 9, 2025).

However, the use of PER is subject to strict regulation. Islamic banks are required to allocate at least 5 per cent of their net distributable profits to the reserve until it reaches 10 per cent of their paid-in capital. The funds in the PER can only be used to cover losses and costs related to profit distribution (Respondent 2, 2025). This approach shows the creativity and adaptability of Islamic banks in operating within conventional financial markets. At the same time, it highlights the ongoing conflict between Tanzania's banking laws and the principles of Islamic finance. Although such strategies help Islamic banks remain resilient and compliant, they are also potential to compromising core concepts such as risk sharing. These findings suggest the urgent need for a more harmonised legal and regulatory approach, one that respects the unique features of Islamic banking while ensuring the overall soundness of the financial system.

Imposition of *Ta'widh* and *Gharamah* (Penalties and Compensations)

Imposition of *ta'widh* (compensation) and *gharamah* (penalties) is another resilience response to conventional financial markets employed by Islamic banks. The findings reveal that Islamic banks have crafted a distinctive mechanism to address the challenge of late repayments while remaining faithful to Shariah principles. *Ta'widh*, meaning compensation, is applied to cover actual losses suffered due to late payment or default, while *gharamah*, meaning penalty or fine, is imposed as a deterrent to discourage such behaviours. Unlike conventional banks that profit from penalties imposed on delayed loan payments, Islamic banks apply *ta'widh* and *gharamah* not as sources of revenue but as disciplinary measures to deter defaults. The unique aspect of this mechanism is that

the penalties and compensations collected are not retained by the bank but are instead directed to charitable causes in compliance with Islamic teachings (Respondent 7, 2025).

This measure responds to a recurring challenge facing Islamic banks. Some customers hold the misconception that, because Islamic banking follows ethical and religious principles, they are exempt from the consequences of delayed payments. This perception often leads to the misuse of the system by customers who believe that defaulting carries no serious repercussions. To counter this, Islamic banks impose *ta'widh* and *gharamah* to promote discipline while ensuring that the proceeds support charitable initiatives such as aiding orphans, building mosques, or funding community development efforts (Respondent 2, 2025). Importantly, these charitable donations are never used for promotional or advertisement purposes. This practice follows the Qur'anic instruction that charity should be done quietly and sincerely. As the verse says, "When the right hand gives, the left hand should not know" (Al-Quran, 2:271). Respondent 2 further explained:

The introduction of penalties and compensations are not aimed at generating profit for the bank. Instead, they are used to create discipline among our customers and ensure timely repayments. All penalties and compensations collected are directed towards charitable causes, such as helping orphans or contributing to mosque construction. We remain mindful that these acts of charity must be genuine and not for publicity, as the Qur'an instructs us to give discreetly. (Respondent 2, 2025).

Through *ta'widh* and *gharamah*, Islamic banks have ensured customer accountability without compromising their religious principles. This approach offers a practical solution to operational challenges while also demonstrating a strong commitment to ethical and social responsibilities. It helps to promote timely repayments and maintain financial stability, while staying true to the values that define Islamic banking. *Ta'widh* and *gharamah* serve as a balanced method that enforces discipline with compassion and reinforces the mission of Islamic banks as responsible, faith-based financial institutions (Respondent 19, 2025). This mechanism also helps Islamic banks sustain their operations within the conventional financial markets, where Islamic banking is still relatively foreign. However, *ta'widh* and *gharamah* are not yet formally recognised under Tanzanian law, making it imperative for regulators to introduce a clear legal and regulatory framework to adequately accommodate Islamic banking practices.

CONCLUSION

This study has established that Islamic banks in Tanzania operate in conventional financial markets that do not sufficiently accommodate Shariah-compliant practices. However, Islamic banks have demonstrated remarkable resilience by relying on international standards, developing alternative financing products, such as *murabahah* and *sukuk*; establishing reserve accounts to manage risks; imposing *ta'widh* and *gharamah* instead of interest on late payments; and establishing cooperative arrangements for liquidity supports. These adaptations have enabled Islamic banks to comply with Shariah while remaining competitive and maintaining customer confidence in inadequate legal and regulatory framework. Based upon the findings above, it is recommended that the existing Banking and Financial Institutions Act [Cap. 342 RE 2023] and the Bank of Tanzania Act [Cap. 197 RE 2023] be amended in Section 3 to broaden the meaning of "banking business" to include Islamic financing modes such as *sukuk*, *murabahah* and *istinā'*, among others, to enhance the legal legitimacy of Islamic banking financing in Tanzania. Section 41 of the Bank of Tanzania Act [Cap. 197 RE 2023] should also be reviewed to ensure that the lender of last resort function is equally accessible to Islamic banks. This could be achieved through profit-sharing mechanisms instead of interest-based facilities, thereby enhancing the long-term stability of Islamic banks. The expansion of Islamic banking and finance to the capital markets of Tanzania further requires that the Capital Markets and Securities Act [Cap. 79 R.E. 2023] and the Dar es Salaam Stock Exchange Rules be

amended to recognise Islamic financing instruments such as *sukuk* (Government of Tanzania, 2023c). This would open up opportunities for Islamic banks to access broader financing and investment channels in line with Shariah principles. Furthermore, it is recommended that a specific Islamic Banking Regulation be enacted. Such regulation should recognise the overall system of Islamic finance, including its key principles and features, such as the prohibition of *riba* (interest), the recognition of *ta'widh* and *gharamah*, and the requirement for asset-backed and risk-sharing financing structures. These improvements will help the inclusivity of Islamic banking in the financial markets of Tanzania, which will result in adequate regulation of Islamic banking and, therefore, remove legal and regulatory constraints that have been a bottleneck for a fully-fledged participation of Islamic banks in Tanzania's financial markets.

ACKNOWLEDGEMENT

Authors are expressing gratitude to the respondents of this study. The article is self-funded.

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