



**DARA**

Digital Asset Rating Agency GmbH  
Transforming Investment into Sustainable Wealth

# SETTING THE GLOBAL STANDARD FOR ISLAMIC DIGITAL FINANCE

**Malaysia's Unique Edge in a Web3 World**

*Islamic Digital Asset Rating Agency (iDARA)*

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## Executive Summary

Web3 is redefining the future of global finance through decentralization and universal accessibility. By leveraging blockchain and tokenization, it promises to reduce costs, enhance efficiency, and unlock financial access worldwide. Yet this transformation overlooks the ethical and faith-based principles governing 1.9 billion Muslims, nearly a quarter of the world's population.

This omission represents not just a missed opportunity but a structural gap in the digital economy. Islamic finance is a global force with Shariah-compliant assets surpassing USD 5.5 trillion in 2024, projected to reach USD 7.5 trillion by 2028. Sukuk, the backbone of Islamic capital markets, are expected to grow from USD 971 billion to USD 1.5 trillion, reflecting investor demand for ethical, value-driven financial solutions.

Malaysia is uniquely positioned to lead this convergence. As the world's leading Islamic finance hub, Malaysia commands over one-third of the global sukuk market. It pioneered the world's first green sukuk and is advancing Islamic digital banking. Anchored by frameworks including the Shariah Governance Framework and Labuan IBFC's Islamic Digital Asset Guidelines, Malaysia bridges financial innovation with Shariah integrity.

The convergence of Web3 and Islamic finance is a strategic imperative. Tokenization of sukuk exemplifies this by democratizing access, enhancing liquidity, and lowering barriers. Through blockchain-enabled smart contracts and fractional ownership, tokenized sukuk can broaden retail access and accelerate cross-border flows. Malaysia's recent first digital sukuk issuance on blockchain demonstrates that this is no longer theoretical. It is happening now.

Embedding Shariah principles into Web3 infrastructure is not optional; it is essential. Doing so ensures the digital economy evolves inclusively and equitably, respecting cultural and ethical diversity while reinforcing trust in decentralized systems.

This paper argues that Malaysia can set the global benchmark for Web3 ecosystems that are faith-compliant, innovation-driven, and financially inclusive, delivering digital sovereignty and economic empowerment for Muslim communities worldwide.

# Introduction

Web3 promises to transform digital ecosystems through decentralization, transparency, and trustless transactions, redefining how value is created and exchanged. However, its design cannot focus solely on technical sophistication; it must also incorporate the ethical and cultural values of diverse global communities to ensure inclusivity and sustainability.

This consideration is especially critical for Islamic finance, one of the world's fastest-growing ethical financial systems. Projected to expand by 36%, from USD 5.5 trillion in 2024 to USD 7.5 trillion by 2028, Islamic finance adheres to principles of fairness, risk-sharing, and transparency, which align naturally with the foundational ethos of Web3.

Malaysia is uniquely positioned to lead this convergence. The country is the world's largest sukuk issuer, ranks third globally in Islamic banking assets, and has maintained the top position in the Islamic Finance Development Indicator for 11 consecutive years. Islamic financing accounts for 45.6% of Malaysia's total national financing, underscoring its systemic importance. Malaysia has also pioneered significant innovations, including the world's first green sukuk (2017) and the first Islamic digital bank (2024). These initiatives demonstrate Malaysia's commitment to sustainability and digital transformation.

Malaysia's leadership extends beyond markets to governance and global standard-setting. It hosts the Islamic Financial Services Board (IFSB), a key body in shaping regulatory standards, and chairs the Centralized Shariah Authorities Forum, promoting cross-border harmonization of Shariah principles. These credentials position Malaysia as the ideal catalyst for embedding Shariah values into Web3, creating decentralized ecosystems that uphold equity, moral governance, and digital sovereignty for Muslim communities worldwide.

## Web3's Misalignment with Shariah Principles

Web3 holds immense potential for decentralization, financial inclusion, and user empowerment. However, its development to date has been shaped predominantly by Western-centric paradigms that often overlook religious, ethical, and cultural diversity. For Muslim communities representing over 1.9 billion people globally (Pew Research Center, 2021), this creates a critical disconnect between technological innovation and faith-based financial principles.

Malaysia commands over 36% of the global sukuk market outstanding and hosts a mature ecosystem of Islamic banks, takaful operators, fund managers, and regulatory bodies (Bank Negara Malaysia, 2023). Sukuk, in particular, has emerged as a flagship Islamic financial product, contributing to Malaysia's global leadership. Yet challenges remain. Sukuk structures often require significant upfront funding and involve complex arrangements that limit accessibility for smaller issuers and innovators. Islamic financial products more broadly face issues of scalability and product diversity, which are further complicated in a Web3 environment.

### Addressing Challenges of Web3 in Islamic Finance

Web3's core innovations such as decentralized finance (DeFi), DAOs, NFTs, and tokenomics frequently involve practices like *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (speculation) that contravene Islamic financial principles. Without careful design, these technologies risk excluding faith-conscious users from the digital economy and undermining trust in emerging digital financial systems.

Key challenges with Web3.0 for Islamic finance include:

1. The ethical foundations of Islamic finance, which emphasize transparency, shared risk, and fairness, are often absent in current Web3 infrastructures. Smart contracts, token designs, and governance models frequently lack moral safeguards, creating opportunities for digital exploitation, value extraction, and financial manipulation under the guise of decentralization.
2. Another pressing concern is the question of digital sovereignty, especially for developing nations with majority-Muslim populations. Many of these countries, including Malaysia, rely on external platforms and protocols that were not designed with local legal systems, Shariah compliance, or data governance in mind. This dependency threatens national autonomy and exposes critical vulnerabilities in financial, legal, and identity systems.

## Malaysia's Leadership in Islamic Finance

Malaysia is uniquely positioned to lead the integration of Shariah-compliant principles into Web3 ecosystems, addressing one of the most pressing gaps in the emerging digital economy. With over one-third of the global sukuk market share and approximately 60% of historical global sukuk issuance, Malaysia has consistently been recognized as the world's most developed Islamic finance market for 11 consecutive years under the Islamic Finance Development Indicator (IFDI). This leadership spans banking, capital markets, and takaful, supported by a comprehensive ecosystem and a robust regulatory infrastructure.

### **Regulatory and Institutional Strengths:**

Malaysia's forward-thinking regulatory framework includes Bank Negara Malaysia's Shariah Governance Framework, Securities Commission Malaysia's SRI Sukuk Framework, and Labuan IBFC's Islamic Digital Asset Guidelines. These frameworks and guidelines provide clarity, compliance, and investor confidence for both traditional and digital financial products. Malaysia is also home to global standard-setting bodies, such as the Islamic Financial Services Board (IFSB) and the International Islamic Liquidity Management Corporation (IILM), as well as educational institutions like INCEIF, positioning the nation as a global hub for policy, liquidity solutions, and knowledge leadership in Islamic finance.

### **Innovation and Sustainability Leadership:**

Malaysia has pioneered several world-first initiatives that demonstrate its ability to combine innovation with ethical governance. These include:

- The world's first green sukuk (2017), aligning Islamic finance with ESG objectives and the UN Sustainable Development Goals (SDGs).
- Launch of the first Islamic digital bank (2024), driving digital financial inclusion.
- Development of a centralized Shariah advisory model under the Shariah Advisory Council (SAC), ensuring consistency, transparency, and trust in Islamic rulings.

### **Driving Global Harmonization and Market Growth:**

Malaysia chairs the Centralized Shariah Authorities Forum, advancing cross-border harmonization for Islamic finance standards and plays a critical role for global interoperability of Shariah-compliant digital assets. Its Islamic capital market offers a diversified suite of products, including sukuk, Islamic ETFs, REITs, and equity funds, while its Capital Market Masterplan 3 integrates digitalization and sustainability as strategic priorities.

### Strategic Alignment with Web3 Principles:

By embedding the core values of Islamic finance of fairness, risk-sharing, and moral governance into Web3 infrastructures, Malaysia can pioneer a next-generation decentralized ecosystem that is inclusive, transparent, and socially responsible. This convergence offers transformative benefits:

1. Financial inclusion for underserved and unbanked communities.
2. Borderless investment access through tokenized sukuk and digital Islamic instruments.
3. Trust and transparency for ethical investors through blockchain traceability.

These initiatives also align with national priorities such as Malaysia's Digital Economy Blueprint (MyDIGITAL) and the National Energy Transition Roadmap (NETR), reinforcing the country's commitment to digital sovereignty, ESG integration, and economic resilience.

With these combined strengths, Malaysia is poised to set the global benchmark for Web3 ecosystems that harmonize innovation, ethics, and sustainability, delivering faith-compliant, inclusive, and future-ready digital finance.

### What a Shariah-Compliant Web3 Requires

The concept of Shariah outlines a comprehensive framework of Islamic law. It provides a robust foundation for guiding financial transactions and societal interactions, emphasizing justice, fairness, and ethical conduct. For Web3 innovations to be truly "Shariah Compliant," they must inherently embody five fundamental tenets:

- **Fairness and Justice ('Adl)** dictates designing protocols that promote equitable distribution of network benefits, fair governance mechanisms, and transparent smart contracts, ensuring open access and preventing predatory practices or undue favoritism in tokenomics.
- **Prohibition of Exploitation, Interest (Riba), and Excessive Speculation (Maysir)** means meticulously avoiding interest-bearing models common in traditional finance, structuring lending protocols on profit-and-loss sharing or fee-based services, and scrutinizing speculative instruments to prevent maysir or gharar (excessive uncertainty), ensuring income stems from legitimate productive activities.



- **Ethical Purpose (Maqasid al-Shariah) and Societal Benefit** is paramount, requiring Web3 applications to be designed with clear, beneficial use cases that align with the higher objectives of Shariah, such as financial inclusion, ethical trade, and community development, while strictly forbidding activities that promote harm or illicit trade.
- **Asset-Backed and Real Economy Link (Tamlik & Haqiqah)** is crucial for tokenization; Shariah-compliant tokens must represent ownership or usufruct rights in real, identifiable, and permissible underlying assets, shifting the focus from purely financial transactions to supporting real economic growth.
- **Risk-Sharing Instead of Risk Transfer (Gharar Avoidance)** necessitates that DeFi protocols ensure risks are transparently disclosed and equitably shared among participants, structuring investment vehicles to involve genuine profit and loss sharing, and designing smart contracts free from excessive uncertainty.

By embedding these Shariah principles into the very architecture of Web3 protocols, tokenomics, and governance models, we can foster a digital ecosystem that is not only technologically advanced but also ethically sound, inclusive, and genuinely beneficial for all, aligning with the values of the global Muslim community.



# Tokenizing Sukuk to Unlock Financial Inclusion

Sukuk, often referred to as Islamic bonds, have long played a central role in Islamic finance, enabling Shariah-compliant investment in real assets while prohibiting interest and speculative elements. Globally, sukuk have helped mobilize funding for infrastructure, real estate, and economic development across Muslim-majority countries. The global sukuk market continues to expand, with total issuance expected to grow from USD 904.5 billion in 2023 to over USD 1.08 trillion in 2024 (AlHashmi, 2024), reflecting their enduring appeal as an alternative to conventional bonds.

## Barriers in Traditional Sukuk

Despite the success and growing popularity of sukuk as a Shariah-compliant fundraising instrument, several structural challenges continue to limit their accessibility, liquidity, and broader adoption across markets. These limitations hinder the potential of sukuk to democratize capital markets and attract a more diverse base of investors.

Key challenges include:

### 1. High Minimum Investment Threshold

Traditional sukuk typically require investors to commit significant capital upfront, often ranging from USD 1,000 to as high as USD 200,000, making them inaccessible to the majority of retail investors. This contrasts sharply with conventional bonds and equities, which can often be accessed through lower investment thresholds via online brokerages and investment platforms.

**Case Study:** In Malaysia, while the government has launched retail sukuk like Sukuk Tabung Haji and Sukuk Prihatin to broaden access, most corporate and international sukuk issuances remain out of reach for individual investors due to minimum lot sizes of RM100,000 and above. As a result, participation is typically limited to institutional investors, high-net-worth individuals, and sovereign entities.

### 2. Limited Market Liquidity and Regional Concentration

Sukuk markets remain relatively illiquid compared to conventional bond markets. Secondary market trading is sparse, with most investors adopting a buy-and-hold approach. This lack of liquidity makes price discovery difficult and limits the ability of investors to exit their positions easily. Additionally, sukuk issuance is geographically

concentrated, with over 90% of global sukuk originating from just a handful of jurisdictions: Malaysia, Saudi Arabia, the UAE, and Indonesia (AlHashmi, 2024).

**Case Study:** According to the International Islamic Financial Market (IIFM), as of 2023, nearly 85% of outstanding sukuk were issued in domestic currencies and targeted domestic investors, further restricting cross-border trading. In markets like the GCC, sukuk listings often do not benefit from robust trading platforms, which exacerbates the liquidity issue. For instance, the Dubai Financial Market (DFM) recorded very low sukuk trading volumes in 2022 despite having multiple listings.

While sukuk continue to serve as a vital tool for Islamic finance and infrastructure development, these structural challenges highlight the need for innovation. Digital solutions such as sukuk tokenization, alternative distribution channels, and regulatory harmonization could help overcome these barriers and pave the way for a more inclusive and dynamic sukuk ecosystem.

## How Tokenization Improves Access and Liquidity

To overcome the structural limitations of traditional sukuk, tokenization using Web3.0 technologies offers a transformative solution. Tokenization involves converting sukuk instruments into blockchain-based digital tokens, each representing a fractional share of the underlying sukuk.

These tokens can be issued, traded, and managed through decentralized or regulated digital platforms, unlocking several game-changing benefits:

### 1. Fractional Ownership and Retail Accessibility

Tokenization allows sukuk to be broken down into smaller units, enabling fractional ownership. This drastically lowers the barrier to entry for retail investors, who would otherwise be excluded due to minimum investment requirements of USD 100,000 or more in traditional sukuk markets.

**Case Study:** The Saturna Sustainable Bond Fund in the U.S., while not fully tokenized, demonstrated investor demand for Shariah-compliant, sustainable fixed-income products with low entry thresholds. Tokenization would further extend this accessibility globally.

**Impact:** Tokenized sukuk could be sold in denominations as low as USD 10–100, opening access to millions of underbanked Muslims and ESG-conscious investors around the world.

## 2. Liquidity Through Digital Exchanges

Most sukuk markets today are illiquid, with investors holding until maturity due to limited trading platforms and institutional dominance. Tokenised sukuk can be traded peer-to-peer or on regulated digital asset exchanges, facilitating real-time, transparent, and low-cost transactions.

**Case Study:** In October 2023, the Labuan International Business and Financial Centre (IBFC), in collaboration with Fusang Exchange, successfully listed Malaysia's first digital sukuk. The tokenized format allowed near-instant trading and fractional purchases, marking a first for Malaysia's Islamic capital market.

Global Reference: The ADIB Sukuk Fund in the UAE has also been exploring tokenization, with discussions around deploying it via regulated UAE blockchain sandboxes.

**Market Potential:** S&P Global estimates that global sukuk issuance could reach USD 160–170 billion annually, and tokenization could unlock 10–15% growth by tapping underserved segments.

## 3. Operational Efficiency via Smart Contracts

By using smart contracts, tokenized sukuk can automate profit-sharing (e.g., periodic disbursements in mudarabah/murabahah structures), principal repayment, and compliance checks. This reduces reliance on intermediaries, enhances transparency, and minimizes errors.

**Example:** Platforms like SWIFT's recent CBDC pilot with blockchain integration highlight the future direction of programmable finance. Applying similar frameworks to sukuk could reduce operational costs by 30–50% across lifecycle management.

## 4. Stronger Shariah Assurance and Traceability

Web3.0 enables real-time integration with on-chain Shariah oracles, Halal registries, and auditing tools, offering end-to-end visibility on compliance. This builds trust among retail investors and global regulators.

**Example:** HAQQ Network, launched in 2023, is a Layer-1 Shariah-compliant blockchain designed specifically for Islamic finance. It integrates Shariah governance, Halal certifications, and smart contract audits natively into its ecosystem, providing a compliant backbone for tokenized sukuk offerings.

## Laying the Groundwork for a Faith-Aligned Digital Economy

To fully realize the potential of tokenized sukuk, key enablers must be addressed:

- **Regulatory Clarity:** Tokenized sukuk must be recognized under securities laws in key jurisdictions, including treatment under AAOIFI and IFSB standards. Cross-border legal frameworks will be needed to support global adoption.
- **Technology Infrastructure:** Shariah-compliant blockchains (e.g., HAQQ, Tezos with Shariah layers), asset tokenization platforms, and custodians must be integrated into digital sukuk issuance processes.
- **Standardization and Interoperability:** The lack of standardized protocols remains a barrier. Initiatives such as the Islamic Fintech Alliance and collaborations between central banks (e.g., BNM and DIFC) are essential to harmonize digital sukuk structures.

## From Financial Instrument to Inclusive Ecosystem

Tokenized sukuk have the potential to evolve beyond merely a digital form of conventional issuance. They represent a new class of financial instruments that combine Islamic values with Web3 efficiency, capable of reshaping capital markets in the following ways:

- **Democratizing Finance:** Reaching young, tech-savvy Muslim investors across Southeast Asia, MENA, and Africa, a demographic traditionally excluded from Islamic capital markets.
- **Bridging Islamic Finance with ESG and Impact Investing:** Tokenized sukuk can be structured to include sustainability-linked KPIs and ESG data verification via oracles, offering both compliance and purpose.
- **Building a Borderless Financial Ummah:** By connecting Shariah-compliant markets across jurisdictions digitally, tokenization can foster a globalized Islamic finance ecosystem powered by transparent, decentralized technologies.

Tokenization and Web3.0 present a pivotal opportunity to reinvigorate sukuk markets. With the right infrastructure and regulatory support, tokenized sukuk can shift the paradigm from exclusive, regionally siloed instruments into accessible, programmable, and globally tradable assets, staying true to Islamic principles while embracing the future of finance.

# iDARA as the Standard for Shariah and ESG Ratings

The Islamic Digital Asset Rating Agency (iDARA) was founded in response to a fundamental challenge shaping the future of Islamic finance: as tokenization and Web3.0 technologies unlock unprecedented potential for broader financial inclusion and liquidity, particularly through instruments like tokenized sukuk, they simultaneously create a new problem.

The decentralized, borderless nature of digital finance brings with it greater complexity, less regulatory clarity, and a heightened risk of ethical and religious misalignment. In this evolving environment, investors and regulators alike face a critical question: how can we trust that these new financial instruments remain true to the principles of Shariah and the values of sustainability?

## Dual Assurance for Faith and Sustainability

As the world's first dedicated agency focused on the dual rating of digital assets based on Shariah and ESG principles, iDARA addresses a growing vacuum in the global Islamic digital finance ecosystem. Today, most tokenized instruments lack proper oversight, due diligence, or independent evaluation frameworks, especially in terms of Islamic compliance and ESG impact. This creates a credibility gap for investors, particularly among the estimated 1.9 billion Muslims globally, who seek investment products that not only offer financial returns but also align with their faith and ethics. Likewise, the global rise of ESG investing, now surpassing USD 41 trillion in AUM (Bloomberg, 2023), has yet to fully penetrate the Islamic capital markets, particularly in the digital space. iDARA bridges both these gaps.

Through its proprietary methodology, iDARA evaluates digital assets such as tokenized sukuk, Islamic stablecoins, halal DeFi protocols, and Web3-native investment vehicles using a robust, transparent, and standards-aligned framework. On the Shariah side, ratings assess compliance with contract structures (e.g., mudarabah, wakalah, ijarah), purpose of proceeds (halal vs non-halal activities), and underlying asset ownership, in line with AAOIFI, IFSB, and national Shariah councils. On the ESG side, iDARA's framework aligns with global benchmarks such as the UN SDGs, TCFD, ISSB, and sectoral taxonomies (e.g., Malaysia's Climate Change and Principle-based Taxonomy), enabling investors to screen for environmental integrity, social inclusion, and governance transparency.



But iDARA is not just a rating body; it is a market infrastructure builder. In a world where digital finance is evolving faster than regulation, iDARA is helping shape the foundational systems that will define the future of Islamic finance. This includes building on-chain Shariah oracles, Halal registries, and ESG tagging layers that plug into token issuance platforms, DeFi protocols, and digital exchanges. These tools allow for real-time validation, automated compliance monitoring, and greater confidence for users, especially retail investors entering the Islamic digital economy for the first time.

## A Use Case in Tokenized Sukuk

Consider the tokenization of sukuk as a breakthrough solution for enhancing retail participation and liquidity in Islamic capital markets. While this innovation lowers entry barriers and opens access, it also introduces new risks: whether a tokenized sukuk continues to represent real asset ownership, maintains Shariah compliance throughout its lifecycle, or meets ESG disclosures if linked to green projects. Without proper rating and assurance mechanisms, trust breaks down.

This is where iDARA steps in by rating the sukuk on both ESG and Shariah dimensions, flagging non-compliant structures, and even embedding real-time monitoring into the token through smart contract integration. For example, a green sukuk tokenized on a blockchain can be tagged with iDARA's ESG score, indicating the climate impact of the underlying project, while simultaneously carrying a Shariah rating showing full alignment with Islamic contracts and asset usage.

iDARA anchors trust in an unregulated, fast-moving, and often opaque digital asset environment not by resisting innovation, but by enhancing it with principled oversight. It empowers:

- **Investors**, with tools to make informed decisions based on faith and ethics, not just financial returns;
- **Issuers**, with clear pathways to structure tokenized assets that meet global best practices and Islamic values;
- **Regulators**, with a credible independent agency to support licensing, supervision, and cross-border harmonization.

In doing so, iDARA unlocks the true potential of Islamic digital finance: building a financial system that is not only technologically advanced but also morally grounded, globally trusted, and universally accessible. As the digital economy continues to expand, and as Web3.0 infrastructure becomes mainstream, the need for credible, values-based rating systems will only grow more urgent.

## Conclusion: Malaysia's Role in Ethical Digital Finance

The convergence of Web3 and Islamic finance offers an unprecedented opportunity to build a digital economy that is technologically advanced, ethically grounded, and globally inclusive. Today's Web3 ecosystems, while innovative, remain rooted in Western-centric models that often overlook the cultural and religious principles guiding the financial decisions of 1.9 billion Muslims worldwide. These disconnects risk excluding a significant population from the next generation of finance while undermining trust in decentralized systems.

This paper has highlighted the fundamental gaps between current Web3 paradigms and Shariah principles from financial structuring and governance to digital sovereignty. Bridging these gaps requires more than technical innovation; it demands a trust architecture that embeds ethical values at the core of decentralized infrastructures.

Malaysia is uniquely positioned to lead this transformation. With its dominance in the global sukuk market, progressive regulatory frameworks, and pioneering innovations such as the world's first green sukuk and tokenized sukuk issuance, Malaysia combines market strength with visionary policy leadership. Its hosting of global standard-setting bodies like the Islamic Financial Services Board (IFSB) further reinforces its role as a catalyst for harmonizing faith-based principles with emerging digital technologies.

iDARA aims to address a vital gap by providing transparency, compliance assurance, and investor confidence for tokenized instruments, halal DeFi protocols, and other Web3-native solutions. By embedding real-time Shariah validation and ESG verification into digital finance, iDARA sets the foundation for a values-driven decentralized economy.

Realizing a Shariah-aligned Web3 future requires collaboration among regulators, industry players, scholars, and technology innovators. Together, they can create systems where risk-sharing, fairness, and ethical governance are not optional features but fundamental design principles.

Malaysia now stands at a historic inflection point. By championing Shariah-compliant Web3 development, the nation can set the global benchmark for ethical digital finance, empowering faith-conscious participation while ensuring technological progress serves not only economic growth but also the common good. The future of



Islamic finance will not be defined by passive adaptation to innovation but by active leadership in shaping technology with purpose and values. This ensures that digital transformation upholds, rather than compromises, the principles that matter most.

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