Innovation through Islamic finance in Sri Lanka

SRI LANKA
By Shiraz Refai

Sri Lanka's financial services sector has evolved considerably over the past two decades, with Islamic finance emerging as an important segment of the industry. Supported by a conducive regulatory framework, banks, non-bank financial institutions and specialized financial institutions have introduced a range of Islamic banking, investment, leasing and financing solutions to serve diverse customer needs.

The sector's growth has been driven by increasing demand for ethical, transparent and asset-backed financial solutions. Institutions such as LOLC Al-Falaah, Amana Bank and HNB have contributed to this development through product innovation and the introduction of customer-centric financial offerings.

Against this backdrop, LOLC Al-Falaah's Tawarruq personal finance solution and HNB's margin trading finance highlight the innovation and diversity within Sri Lanka's financial services landscape, addressing distinct liquidity and investment requirements through specialized financial solutions.

Personal financing

LOLC Al-Falaah launched Al-Falaah Tawarruq, a Tawarruq-based personal finance solution in July 2026. The launch highlights Sri Lanka's ability to adopt globally recognized Islamic financial structures while addressing local liquidity requirements.

Tawarruq provides customers with access to liquidity through a structured commodity-based transaction that complies with Islamic finance principles. Under the arrangement, a commodity is acquired through a Murabahah contract on deferred payment terms and subsequently sold to a third party for cash, enabling customers to obtain immediate funds.

A distinguishing feature of Tawarruq is its asset-backed nature, which is based on genuine commodity transactions rather than conventional lending. By connecting financing to real economic activity, the structure promotes transparency, fairness and ethical financial practices. Customers benefit from clear visibility of transaction details including pricing, repayment obligations and financing tenure, enabling informed financial decision-making and greater confidence in the financing process.

The introduction of Tawarruq reflects the continued evolution of Islamic finance beyond traditional deposit and leasing products towards more sophisticated liquidity solutions. Widely utilized by Islamic financial institutions worldwide for personal finance, liquidity management and treasury operations, the successful implementation of a structured Tawarruq facility in Sri Lanka demonstrates the growing maturity of the local Islamic finance industry and its capacity to deliver innovative, internationally recognized financial solutions.

Margin trading finance

HNB's margin trading is designed for investors seeking to enhance their participation in Sri Lanka's equity market by leveraging available investment opportunities. The facility enables investors to purchase listed securities using a combination of their own capital and financing provided by the institution, thereby increasing their buying power and potential market exposure. This allows investors to take larger positions in selected stocks without committing the full investment amount upfront, providing greater flexibility to capitalize on market opportunities and potentially enhance portfolio returns during favorable market conditions.

Through the HNB investment banking arm and HNB stockbrokers, clients gain access to a comprehensive suite of capital market services that extends beyond financing. Investors benefit from professional equity research, sector-specific insights, portfolio monitoring, custodial services and dedicated relationship management support. These value-added services equip investors with timely market intelligence and expert guidance, enabling them to identify opportunities, assess risks and make informed investment decisions.

A key advantage of HNB's margin trading facility is its ability to improve capital efficiency. By utilizing leverage, investors can optimize the use of their available funds and diversify their

Table 1: Key features of Tawarruq and margin trading

Feature	LOLC Al-Falaah Tawarruq	HNB's margin trading
Primary purpose	Provides liquidity for personal financial requirements through an asset-backed structure.	Enables investors to increase market exposure and capitalize on equity investment opportunities through leverage.
Structure	Commodity-based transaction utilizing Murabahah and Tawarruq principles.	Financing facility that combines investor capital with borrowed funds for securities purchases.
Compliance framework	Based on Islamic economic principles	Conventional capital market framework
Financing mechanism	Commodity is purchased on deferred payment terms and sold to generate immediate liquidity.	Investors receive additional funding against their portfolio to acquire listed securities
Flexibility	Repayment can be structured over an agreed financing tenure	Financing limits can be tailored based on portfolio size and investor profile
Typical use cases	Education, healthcare, travel, emergency funding and other personal requirements.	Equity investments, portfolio expansion, diversification and short- to medium-term market opportunities.

Source: Author's own

portfolios across multiple sectors and securities rather than concentrating their investments in a limited number of positions. This flexibility allows investors to respond more effectively to changing market conditions and emerging investment opportunities while maintaining a diversified investment strategy.

Since investments are partially financed through borrowed funds, gains and losses can both be magnified. Market volatility, adverse price movements and margin maintenance requirements can impact investment performance. Consequently, successful margin trading requires disciplined portfolio management, a sound understanding of market dynamics and a well-defined risk management strategy.

As Sri Lanka's capital markets continue to evolve and attract a broader investor base, margin trading remains an important tool that supports investor participation, market liquidity and wealth creation. By combining financing solutions with research-driven insights, professional advisory services and seamless market access, HNB's margin trading contributes to the development of a more dynamic, sophisticated and accessible investment ecosystem in Sri Lanka.

Conclusion

Sri Lanka's financial services industry continues to evolve through innovation, diversification and the development of customer-centric solutions. The introduction of LOLC Al-Falaah's Tawarruq for personal finance marks a significant advancement in ethical and asset-backed liquidity solutions, while HNB's margin trading continues to support investors seeking greater access to capital market opportunities. Together, these offerings demonstrate the growing sophistication, inclusivity and adaptability of Sri Lanka's financial landscape, where both Islamic and conventional financial solutions coexist to meet the diverse needs of individuals, businesses and investors.

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