

Durham Research Online

Deposited in DRO:

08 March 2021

Version of attached file:

Accepted Version

Peer-review status of attached file:

Peer-reviewed

Citation for published item:

AlQassar, A. and Ahmed, H. (2022) 'Regulatory Regimes for Shariah Governance: A Framework of Assessment and Analysis.', *Journal of banking regulation.*, 23 (2). pp. 139-154.

Further information on publisher's website:

<https://doi.org/10.1057/s41261-021-00153-5>

Publisher's copyright statement:

This is a post-peer-review, pre-copyedit version of an article published in *Journal of Banking Regulation*. The definitive publisher-authenticated version, AlQassar, A. Ahmed, H. (2021). *Regulatory Regimes for Shariah Governance: A Framework of Assessment and Analysis*. *Journal of Banking Regulation* is available online at: <https://doi.org/10.1057/s41261-021-00153-5>.

Additional information:

Use policy

The full-text may be used and/or reproduced, and given to third parties in any format or medium, without prior permission or charge, for personal research or study, educational, or not-for-profit purposes provided that:

- a full bibliographic reference is made to the original source
- a [link](#) is made to the metadata record in DRO
- the full-text is not changed in any way

The full-text must not be sold in any format or medium without the formal permission of the copyright holders.

Please consult the [full DRO policy](#) for further details.

Regulatory Regimes for Shariah Governance: A Framework of Assessment and Analysis

Abdulrahman Bader AlQassar
Senior Banking Supervisor
Kuwait Central Bank
Kuwait
Email: aalqassar@cbk.gov.kw

and

Habib Ahmed*
Sharjah Chair in Islamic Law & Finance
Durham University Business School
Durham University
Mill Hill Lane, Durham DH1 3LB
United Kingdom
e-mail: habib.ahamed@durham.ac.uk

*Corresponding author

On behalf of all authors, the corresponding author states that there is no conflict of interest.

Regulatory Regimes for Sharī'ah Governance: A Framework of Assessment and Analysis

Abstract: This paper develops a framework of assessing *de jure* adoption of Sharī'ah governance standards of international standards setting bodies and uses it to assess the legal and regulatory framework of Sharī'ah governance regimes (SGR). Using leximetrics and content analysis, the framework is used to assess SGR in four countries (Kuwait, Malaysia, Pakistan and UAE) in an objective manner. The results show that Malaysia has the most robust SGR and UAE has the weakest legal and regulatory environment of Sharī'ah governance. The results also identify the weaknesses in the SGR and areas that can be improved further. Furthermore, the paper reveals the diversity in the qualitative nature of SGR in terms of the extent to which the laws and regulations are used to develop the SGR in different countries. As the Islamic financial industry continues to grow globally, regulators would need to mitigate the Sharī'ah noncompliant risk by introducing the international Sharī'ah governance standards to promote growth and ensure stability of the sector. The framework to assess the SGR can be used as a first step to assess the SGR in different jurisdictions to identify the weaknesses and come up with relevant laws and regulations to strengthen the SGR for the development of a robust Islamic financial sector.

Key Words: Sharī'ah governance; Sharī'ah noncompliant risk; Sharī'ah supervisory board; leximetrics.

1. Introduction

Islamic finance was initiated to provide Sharī'ah compliant financial services to people who do not engage with the conventional interest based financial institutions due to religious reasons. To satisfy stakeholders' desire for Sharī'ah compliant finance, Islamic financial institutions (IFIs) institute Sharī'ah governance mechanism to ensure that the products and operations comply with the principles of Islamic law. The status of Sharī'ah governance in different jurisdictions, however, depends on the legal and regulatory regimes. Countries in which there are no legal and regulatory requirements for Sharī'ah governance, IFIs establish Sharī'ah assurance mechanisms internally to convince the religious minded masses to engage with the banks both as provider and user of funds (Kahf 2004). This is done mainly by establishing an in-house Sharī'ah supervisory board (SSB) that provides guidance on Sharī'ah compliance of products and operations.

Although in principle, IFIs are expected to mitigate Sharī'ah non-compliant risk to fulfill their fiduciary duties, this may not happen if the Sharī'ah governance framework is weak. Absence of regulatory overview on Sharī'ah governance can lead to cases where the Sharī'ah aspects of the banking operations can be diluted. In a market-driven industry the key motivation of the shareholders and managers of Islamic banks may be to profit from a niche market in which customers are willing to pay a premium for Sharī'ah compliant products (Ullah et. al 2018). In such situations there can be cases where the Sharī'ah principles are diluted to achieve the economic goals (Abozaid 2016). In particular, when there is a trade-off between the economic goals and Sharī'ah principles, the former may be given priority at the cost of the latter. These practices can

result in Sharī'ah non-compliant risks that can lead to loss of income in the short-term¹ and reputational risks in the long-term.

Other than ensuring that IFIs perform their fiduciary duty of complying with Sharī'ah, there may be a need to ensure Sharī'ah compliance in the Islamic financial industry from a public policy perspective for a couple of reasons. First, Islamic finance can be viewed as a developmental issue since its absence can lead to voluntary financial exclusion in many Muslim countries due to religious reasons. Given that finance and development are closely linked, absence of Islamic finance can adversely affect the quality of life of the households and growth of the business sector in these countries. Thus, providing Sharī'ah compliant financial services can enhance financial inclusion and positively contribute to the overall developmental objectives. Second, Sharī'ah non-compliant risk and reputational risks can potentially erode credibility of the Islamic finance industry that can impact the growth of the financial sector. Since most of the clients use Islamic finance due to religious reasons Sharī'ah non-compliance and reputation risk can make the Islamic finance sector susceptible to instability and in extreme cases trigger bank failure (Qattan 2006).

Recognizing the importance of Sharī'ah compliance in Islamic finance and the unique risks that can arise, international standard setting bodies such as Islamic Financial Services Board (IFSB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have developed guidelines and standards of sound Sharī'ah governance framework. These guidelines and standards highlight the key elements of a robust Sharī'ah governance regime (SGR) that can potentially mitigate the Sharī'ah non-compliant and reputational risks and enhance the credibility of the Islamic financial industry.

A growing literature examines different aspects of Sharī'ah governance that includes both conceptual and empirical studies. One category of literature on Sharī'ah governance relates to the legal and regulatory aspects of establishing Sharī'ah governance framework. While there are empirical studies examining various aspects of SGR, literature on the status of SGRs in light of the guidelines of international standing setting bodies is scant. A few studies that examine the overall legal and regulatory framework do so without referring to the international guidelines in a comprehensive manner. Hasan (2011) assesses the *de facto* implementation of AAOIFI and IFSB standards in IFIs globally without examining the legal and regulatory framework under which the IFIs operate under.²

This paper aims to fill this gap by developing a framework of evaluating the *de jure* legal and regulatory regimes for SGR in accordance with the international standards setting bodies and then uses this framework to assess the SGR statuses in a sample of four countries (Malaysia, Pakistan, Kuwait and UAE). The paper contributes to the literature in three significant ways. First, an assessment framework is developed that can be used to evaluate the status of SGR in different jurisdictions in an objective manner. While most of the papers examining the SGR (such as Grais and Pellegrini 2006a) identify a few elements of the SGR, this paper provides a comprehensive framework of SGR by using different elements suggested in the guidelines of AAOIFI and IFSB. Second, the framework is applied to assess the SGR for four countries (Kuwait, Malaysia, Pakistan

¹ In the short term Sharī'ah non-compliant income excluded from the revenues of IFIs and must be distributed to some charitable cause and in the long run it can cause reputation risk which can affect its business growth.

² Empirical studies studying implementation of international standards can be broadly classified as *de jure* and *de facto*. While the former examines the adoption of international standards in legal and regulatory framework in different jurisdictions, the latter explores the use of the standards in firms (Nobes, 1998; Soewarso *et al.*, 2003; Tay and Parker, 1990).

and UAE) and identifies the strengths and weaknesses in their respective SGRs. The analyses can be used to take appropriate policy actions to further improve the overall Shari'ah governance practices. Finally, the paper identifies the qualitative nature of the SGR by identifying the role of laws and regulations in establishing in the Shari'ah governance framework in different jurisdictions. The implication is that the legal and regulatory framework of SGR can be instituted in various ways.

This paper is organized as follows. The next section provides an overview of literature on Shari'ah governance followed by a section that identifies the key elements of SGR identified in the international guidelines provided by AAOIFI and IFSB. Section 4 provides the methodology used to assess the SGR and identifies the sources of data used in the study. Section 5 presents and discusses the results and the last section concludes.

2. Shari'ah Governance: An Overview of the Literature

Since the *raison d'être* of Islamic finance is to provide Shari'ah compliant financial services, corporate governance in IFIs would have to cater to the stakeholders' expectations of Shari'ah compliant products and operations (Graiss and Pelligrini 2006b). This is done by instituting a Shari'ah governance mechanism which becomes an additional element of corporate governance framework in IFIs. Generally, Shari'ah governance (SG) constitutes the structures and processes to ensure compliance with Shari'ah rules and principles (IFSB 2009). Shari'ah governance can be viewed from a legitimacy theoretical perspective which postulates that organizations' governance and operations comply with the society's norms, values and principles (Golant and Sillince 2007, O'Donovan 2002, Suchman 1995). Shari'ah governance contributes to the organizational image by achieving religious legitimacy and assists Islamic banks to conduct and control their religious and social obligations (Harifan et. al. 2018, Karbhari et. al. 2020). Since most of the clients use Islamic finance due to religious reasons, Shari'ah non-compliance and reputation risk can potentially erode credibility of the Islamic finance industry that can impact the growth of the financial sector. In extreme cases, Shari'ah non-compliant risk (SNCR) can make the Islamic finance sector susceptible to instability.³ Thus, from IFI's perspective Shari'ah governance is a strategic measure to enhance legitimacy and justify its right to exist (Elamer et. al 2020).

The literature on Shari'ah governance can be viewed at two levels: the legal and regulatory frameworks that determine the SGR at the national level and the structures and mechanism used at the organizational level to ensure Shari'ah compliance. The rationale of a national level SGR is to mitigate SNCR and protect the interest of other stakeholders (i.e., customers and community or society) who may not be served well by IFIs. COMCEC (2016) identifies three elements of a national level SG regulatory regime. First, law and regulations defining the SG framework which includes regulations that provides guidance on the SG related issues at the organizational level. Second, existence of a national level Shari'ah authority that oversees the Shari'ah related issues including authorizing contracts used by IFIs. Finally, developing Shari'ah parameters for different types of contracts that can help harmonize contracts used in Islamic finance within a jurisdiction.

Establishing a national Shari'ah authority (NSA) is considered an important feature of a sound SGR. IMF (2015: 21-22) asserts that an NSA can be advantageous in ensuring consistent approaches. Ahmed (2011) identifies benefits of NSA to include identifying all permissible modes

³ Chapra and Ahmed (2002) report that in a survey shows that 381 (or 81.4 percent) total number of 468 depositors from Bahrain, Bangladesh and Sudan will move funds to other banks due to non-compliance of Shari'ah and a total 328 (70 percent) would move funds if they learnt that learn that income of the banks come from interest earnings.

of financing that IFIs can use. This will limit the use of controversial products that might damage the industry reputation and, hence, affect the entire banking system and financial stability of the economy. The NSA can also resolve the disputes, if any, between SSB members in an IFI, or between SSB and BOD/management regarding specific product or service. The decision taken by NSA would be binding in this regard. To be objective the appointment, compensation, and dismissal of NSA members should be independent to protect this body from direct intervention from the regulator (Farooq & Farook 2011). Establishing NSA that develops Shari'ah parameters could also help reduce the variations or sometimes contradictory edicts (fatwas) issued on a product and thereby mitigate the Shari'ah non-compliant and legal risks (Malkawi 2013).

Hamza (2013) classifies SG models broadly as centralized and decentralized and asserts that the former has various benefits for IFIs such as enhancing Shari'ah compliance and the fit and proper criteria regarding SSB members. Ahmed (2011) provides a more nuanced classification by presenting diverse experiences and identifies four SG regimes. First, in the legally constructed regime that exists in Iran the Shari'ah related issues are identified in the Islamic banking law and there are no active Shari'ah supervisory bodies at the national or organizational levels. Second, a robust SG regime that has a national level Shari'ah board as well regulations for a sound Shari'ah governance at the organizational level. Malaysia, Pakistan, and Indonesia belong to this group of countries with the former two also defining Shari'ah parameters of different Islamic financial contracts used in the industry. Third, passive SG regime has no active national level Shari'ah board but has some regulations for SG related issues at the organizational level. Countries belonging to this category include Bangladesh and Qatar. Finally, the market driven SG regimes do not have a central Shari'ah board and no specific regulations related to SG at the organizational level. Examples of countries in this category include Saudi Arabia and United Kingdom where SG mechanisms instituted in banks are market-driven to satisfy the stakeholders' desires of using Shari'ah compliant products.

At the organizational level, IFSB (2009) identifies the key Shari'ah functions of SG as pronouncements of Shari'ah rulings (*fatwa*) by the Shari'ah supervisory board (SSB), management of Shari'ah compliance related activities carried out by an internal Shari'ah compliance unit/department (ISCU) and auditing the compliance with the rulings made by SSB done by an internal Shari'ah review/audit unit (ISRU). While SG would constitute all three functions supported by the Shari'ah organs, the focus of the literature at organizational level SG appears to be on the SSB. For example, Malkawi (2013) views SG as a 'system of determining how the Shari'ah board is being controlled and directed for the purpose of Shari'ah compliance'. Other than discussing issues such as the structure, appointment processes, composition, procedures related to SSB, he identifies the roles of Shari'ah board more broadly to include issuance of *fatwa*, supervision and audit. Grais and Pellegrini (2006a) adds additional roles to SSB to include issuing Shari'ah pronouncements ex-ante, carrying out Shari'ah audit ex-post, disposing non-Shari'ah compliant income, advising on the distribution of income and expenses among the shareholders and investment account holders and calculating zakat payments.

Some studies view the status of SGR critically and raise issues on the status of Shari'ah compliance. For example, there is a feeling that Islamic financial products have higher costs and are similar to their conventional counterparts whereby Islamic banks are simply replacing conventional banking terminology with Arabic terms (Khan, 2010: 818). An example is the use of organized *tawarruq* in many jurisdictions even though the product has been declared non-Shari'ah

complaint by International Fiqh Academy as it resembles an interest-based loan.⁴ In literature, dilution of Shari'ah principles is discussed in terms of 'fatwa repositioning' which involves minimum and superficial Shari'ah compliance (Ullah et. al 2018), 'fatwa-shopping' or 'fishing for fatwa' that seeks for a friendly ruling on the compliance (Oseni et al., 2016, p. 121) and 'Shari'ah arbitrage' in which contracts that impose the least cost on the IFIs are chosen (El-Gamal, 2005).

Islamic financial products resembling conventional products can result due to weak CGR affecting the independence of the SSB (Abozaid 2016, Grais and Pellegrini 2006a, Oseni et al., 2016, Rowland & Marz, 1982). This is likely to happen in countries that do not have a legal and regulatory framework for SG and decisions on Shari'ah compliant are made at the organizational level. When decisions of appointment, compensation, and dismissal of SSB members are left to the IFI, it can lead to cases in which the former have direct or indirect influence on SSB members (Dar & Azmi, 2015). Abozaid (2016) asserts that Shari'ah-related issues are determined by the market players that can lead to dilution of Shari'ah principles. SSB members can be under pressure to choose between the Islamic law and economic incentives (compensation) from Islamic banks to protect their positions and financial rewards (Grais & Pellegrini, 2006a; Farooq et al., 2011). For example, in a study of 18 Malaysian Islamic banks, Waemustafa and Abdullah (2015) find a positive and significant relationship between SSB remuneration and mode of financing, especially focusing more on debt-based products rather than the preferred profit-loss sharing (PLS) products.

One way of enhancing the efficiency and independence of SSB and reduce the influence of BOD and senior management is to pay the compensation and remuneration of SSB members from a third party such as the central bank, ministry of finance or waqf (religious endowment) (Farooq et al., 2011, Ginena & Hamid, 2015). Furthermore, to ensure that SSB members spend adequate time and effort in their respective tasks, there are suggestions of restricting cross-membership of Shari'ah scholars in multiple SSBs (IFSB, 2009; Abozaid, 2016). Another weakness in unregulated SG regimes relates to Shari'ah audit function that is carried out internally. In a self-regulated environment, the market players determine what is suitable with regards to Shari'ah and SG matters including Shari'ah control may not be done objectively (Abozaid, 2016; Ginena, 2014). One way to resolve this issue is to have clear indications of the power, authority, and auditing responsibilities in the article of association of the IFIs (Malkawi 2013, Grais and Pellegrini 2006a).

Some empirical studies examine the status of SG in different jurisdictions. Grassa (2013) compares the Shari'ah supervisory systems for a sample of Southeast Asia and GCC countries by developing SG models and discusses the challenges in SG related to the roles and duties of national Shari'ah authorities (NSAs) and the SSBs at the organizational level. Grais and Pellegrini (2006a) study CGR in 11 jurisdictions focusing on the regulatory regimes related to composition and functions of SSB. In a comprehensive empirical study 80 IFIs from seven countries, Hasan (2011) examines the features of organizational level SG practices related to the SSB that include its role and functions, competence (fit and proper criteria) of SSB members; independence (in terms of method of appointment, remuneration etc.), transparency and confidentiality of published fatwas, operational procedures such as SSB meetings and Shari'ah board assessments. After examining national level issues related to SG in terms of adoption of AAOIFI governance standards, Hasan (2011) recommends having the appropriate regulatory framework of SG to strengthen Shari'ah compliance in IFIs in order to enhance the public trust and the credibility of the industry. To

⁴ The International Council of *Fiqh* Academy, an international jurisprudential body, issued a ruling declaring organized *tawarruq* illegal as it entails elements of *riba*. The ruling was the Academy's 19th session held in Sharjah, United Arab Emirates during 26 – 30 April 2009.

mitigate direct or indirect influence of the BOD by using their leverage to influence the opinion of SSB members, (Graiss & Pellegrini, 2006a) suggests that the appointment and dismissal decision should be taken after prior approval from regulatory authorities.

3. Sharī'ah Governance Regime: Framework and Elements

Sharī'ah compliance issues arising in unregulated markets calls for establishing a sound regulatory environment that can ensure a robust SGR. As indicated, the international standards setting institutions related to Islamic financial industry, AAOIFI and IFSB, have developed guidelines and standards for a sound SGR. While AAOIFI has published eight governance standards that include aspects of Sharī'ah governance, IFSB issued a separate standard entitled *Guiding Principles on Sharī'ah governance system for Institutions Offering Islamic Financial Services* (IFSB-10). This section presents the key elements of sound SGR proposed by AAOIFI and IFSB standards which can be discussed under two broad categories. First category relates to the overall legal and regulatory framework that identifies the key components of SGR that promotes sound practice of SG. The second component deals with regulatory guidelines on establishing independent and effective SSB at the organizational level. The key elements of these broad SGR categories identified in the governance standards of AAOIFI and IFSB-10 are presented below.

SG Regulatory Regime

SGR 1: BOD's Responsibilities Related to Sharī'ah Issues

Paragraph 4 of AAOIFI Governance Standard No. 4 entitled *Audit and Governance Committee for Islamic Financial Institutions* relates to Audit and Governance Committee under the Board of Directors (BOD) and stipulates a specific role of reviewing the compliance with Sharī'ah rules and principles. This is done by examining the reports produced by internal Sharī'ah review and SSB and taking appropriate remedial actions. IFSB-10 identifies various ways in which the BOD would interact with Sharī'ah relates issues. These include nominating the SSB members for approval of the shareholders (p. 23), considering the appropriate fitness and propriety criteria for SSB members (para 27), evaluate the performance of the SSB (para 39) and receive annual Sharī'ah compliance report from SSB and distribute it to the shareholders.

SGR 2: BOD Committees

AAOIFI Governance Standard No. 4 stipulates establishment of Audit and Governance Committee (AGC) in IFI. Other than overseeing the appointment and dismissal of the SSB and external auditors and internal Sharī'ah reviewers, the functions of AGC include reviewing the compliance with Sharī'ah rules and principles (Governance Standard No. 4, para 8) and reviewing the use of restricted investment accounts' funds (Governance Standard No. 4, para 9). Similarly, IFSB-10 (p. 25) stipulates that Nomination or Audit Committee should nominate the Sharī'ah board and external auditor for approval of the shareholders. Furthermore, the Sharī'ah audit/review report should be made available to the Audit Committee (p. 25).

SGR 3: Internal Sharī'ah Compliance/Audit

While the Sharī'ah pronouncements are made by the SSB, AAOIFI Governance No. 2 (para 5) makes the management of IFIs responsible to ensure that the operations and products comply with the rulings. AAOIFI Governance Standard 3 (para 2) entitled *Internal Shari'a Review* requires that Sharī'ah review should be carried out by an independent body on the internal audit department to assess the extent of compliance of the operations with the Sharī'ah rulings of the SSB. IFSB-10 (para 3b) requires IFIs to have an internal Sharī'ah compliance unit/department (ISCU) that is

responsible for monitoring compliance with the Sharī'ah pronouncements in operations and transactions. IFSB further stipulates that the ISCU to be separate and independent from other business units of the bank. IFSB-10 (para 3c) also postulates that an internal Sharī'ah review/audit unit/department (ISRU) be established to verify that the operations and products comply with rulings of the SSB. IFSB-10 further maintains that findings of ISRU should be reported to the SSB.

SGR 4: External Sharī'ah Audit

AAOIFI's Auditing Standard No 4 outlines the principles governing external Sharī'ah audit by outlining the responsibility and the scope of work of external auditors and to provide reasonable assurance that the transactions of the IFI examined comply with the rulings of the SSB (para 3). IFSB-10 (para 3d) requires IFIs to carry out annual Sharī'ah compliance review/audit to ensure that internal Sharī'ah compliance review/audit has been carried out appropriately. The audit can be done either by SSB or by external auditor/Sharī'ah firm.

SGR 5: Sharī'ah Reporting and Transparency

AAOIFI Governance Standard No. 4 identifies one of the functions of Audit and Governance Committee (AGC) is to enhance transparency and disclosure in financial reporting. Furthermore, AAOIFI Governance Standard No. 1 (para 26) recommends the publication of fatwas, rulings and guidelines issued by SSB and also requires publication of the report of SSB to be published in the annual report of the IFI (para 25). IFSB-10 (para 3) postulates that after carrying out the Sharī'ah audit/review, a general report on Sharī'ah compliance should be include in the annual report and a more detailed statement on compliance should be prepared for the supervisory bodies.

SGR 6: Central Sharī'ah Board (CSB)

AAOIFI's Governance Standard 8 entitled *Central Sharī'ah Board (CSB)* deals with different aspects of a national level Sharī'ah board for the Islamic financial sector. Among others, the Standard provides guidance on the appointment, composition, terms of reference, tenure and functions of the members, functions and responsibilities, fit and proper criteria and independence of the CSB. IFSB-10, however, takes the view of "no one-size-fit-all" and "no single model" (Principle 1.1) and does not require having a central Sharī'ah board at the national level leaving it to the discretion of the regulatory authorities.

SGR 7: Standardization of Sharī'ah Rulings

AAOIFI's Governance Standard 8 (para 2) identifies one of the rationale of having central Sharī'ah board is to achieve greater harmony in the practices of Islamic finance with a recommendation of adopting the AAOIFI Sharī'ah standards by all such bodies which would enable to a greater level of harmony of Islamic financial practices at the global level. While not requiring a central Sharī'ah board, IFSB-10 (para 3a) recognizes that the rulings of a national Sharī'ah body in jurisdictions that have one will be implemented by the IFIs implying harmonization of Sharī'ah standards across different IFIs.

SSB at the Organizational Level

SGR 1: SSB Appointment

AAOIFI's Governance Standard 1 (paragraphs 2 & 3) stipulates that each IFI would have an SSB that is appointed by the shareholders and defines the roles SSB to include directing, reviewing and supervising the activities of the IFI to ensure their compliance with Sharī'ah rules and principles. Similarly, IFSB-10 stipulates IFIs to appoint reputable and credible SSB (para 17) and identifies

the key role of SSB to issue Shari'ah pronouncements. IFSB-10 (p. 11) suggests that Nomination or Audit Committee nominates the Shari'ah board and external auditor for approval of the shareholders.

SSB 2: Competence (fit and proper)

Both AAOIFI and IFSB require appointment of reputable and credible SSB members in an IFI. AAOIFI's Governance Standard No. 6 (principle 4) asserts that an IFI should lay down a set of criteria to govern the appointment of persons to serve on the BOD and SSB as well as for the appointment of management. Similarly, IFSB-10, Principle 2.1 (p. 11) states that the IFIs "shall ensure that any person mandated with overseeing the Shari'ah governance system fulfils acceptable fit and proper criteria". The fit and proper criteria include good character (honesty, honesty, integrity, fairness and reputation) and other features such as competence, diligence, capability and soundness of judgment.

SSB 3: Independence

AAOIFI Governance Standard No. 5, Item 3 asserts that the independence of SSB is important since it enhances the objectivity of SSB members' opinion and judgment which increases the public confidence and helps to accomplish the IFI objectives. Principle 3.1 of IFSB-10 also states that the SSB should play a strong and independent oversight role and have adequate capability to exercise objective judgment on Shari'ah-related matters. It further maintains that 'no individual or group of individuals shall be allowed to dominate the Shari'ah board's decision-making' (p. 15).

SSB 4: Confidentiality

While AAOIFI does not have anything specific about confidentiality, Principle 4.1 of IFSB-10 requires that members of SSB keep the internal information that they obtain in carrying out their duties confidential. Asserting that confidentiality as an important aspect of professional ethics, IFSB stipulates that any confidential and sensitive information obtained while serving in the SSB that is not in public domain should be used in ways that is detrimental to the IFI or can benefit the competitors.

SSB 5: Consistency

AAOIFI standards do not have any requirements on consistency of the rulings. IFSB-10 Principle 5.1 stipulates that the SSB should observe the legal and regulatory framework and promote the convergence of Shari'ah by following appropriate procedures and processes of interpreting the Shari'ah rules and principles. While it would be preferable that SSB arrive at decisions by reaching a consensus or with the majority of the SSB members agreeing to the resolution to maintain internal consistency, rulings based on the basis of a simple majority is also acceptable.

SSB 6: Compensation and dismissal

Although the shareholders have the authority to determine issues related to SSB, the responsibility of making certain decisions are transferred to the BOD. AAOIFI Governance Standard 1, Item 3 maintains that shareholders can authorize the BOD to determine the remuneration of the SSB. Similarly, Item 8 of the standard states that the dismissal decision of any SSB member is taken by shareholders based on the recommendation of the BOD. IFSB-10 does not have statements on compensation and dismissal of SSB members.

SSB 7: Cross-membership

While AAOIFI does not have any specific view on cross-membership of SSB members, Principle 1 of IFSB-10 indicates that each member should have restriction on the number of SSBs he/she can serve. The purpose of the restriction is to ensure that the members of SSB can devote adequate time and effort to each IFI that they serve and also to minimize the conflict of interest and maintain confidentiality (IFSB-10, p. 7).

SSB 8: Assessment of SSB members

AAOIFI Governance Standard No. 5, Item 5 focuses on assessing SSB members continuously to identify any situations that may impair independence and in needed resolve it. IFSB-10 Principle 2.3 stipulates that a formal assessment system should be in place to evaluate the effectiveness of SSB as a whole and also to assess the contribution by each member to the overall effectiveness. IFSB-10 also provides examples of performance measures for collective and individual assessments of the SSB and its members respectively in Appendix 5.

4. Methodology, Sample and Data

To assess the statuses and robustness of SGR in different jurisdictions, this paper uses leximetrics which allows quantitative analysis of law. Initially used in law and economics literature, leximetrics is “the process of translating legal materials, principally texts of statutes, decrees and judgments, into a form which can be used in statistical analysis” (Adams et al., 2017: 7). The method is used in comparative law studies and enables quantifying legal texts to carry out analysis of comparative data on legal systems (Cooter and Ginsburg 2003, Buchanan et. al 2014, Lele & Siems, 2007). By providing comparative data on legal systems, leximetric techniques can reduce complexity and enable carrying out objective analysis of comparative law and legal systems (Katelouzou, 2014).

Operationalizing leximetrics involves content analysis and quantifying laws/regulations to develop indices by using three steps. First, selecting the elements or variables from relevant sources that serve as the elements of benchmark for assessment. In this paper the key elements of the SGR are identified from the SG guidelines of the international standards setting bodies which serve as benchmark against which the SGR of different jurisdictions are compared with. The specific documents that serve as benchmark for assessing SGR are eight governance standards published by AAOIFI and *Guiding Principles on Shari’ah governance system for Institutions Offering Islamic Financial Services* (IFSB-10) published by IFSB. The elements presented in the Section 3 are used to assess the SGR and listed in Table 1 below.

Second, laws/regulations that are being assessed in different jurisdictions in light of these benchmark elements/variables are coded. A simple way to quantify the qualitative documents/texts is to use a binary coding by observing if the relevant variable is present or absent and assigning a score of ‘1’ and ‘0’ respectively (Lele & Siems, 2007). This approach has been used in other studies such Belal et. al (2014), Haniffa and Hudaib (2007), Ibrahim and Ahmed (2018). The binary coding used to evaluate various qualitative features of the benchmark variables in the laws/regulations of different jurisdictions included in this study are shown in Table 1. Final step is to calculate the index value by adding the individual scores. The final index value shows the overall status of SGR relative to the benchmark standards.

Table 1: Elements for Assessing SGR and Codes

Elements	Criteria & Code
<i>SG Regulatory Regime</i>	

SGR 1: BOD's Responsibilities Related to Shari'ah Issues	Present (1), absent (0)
SGR 2: BOD Committees	Present (1), absent (0)
SGR 3: Internal Shari'ah Compliance/Audit	Present (1), absent (0)
SGR 4: External Shari'ah Audit	Present (1), absent (0)
SGR 5: Shari'ah Reporting and Transparency	Present (1), absent (0)
SGR 6: Central Shari'ah Board (CSB)	Present (1), absent (0)
SGR 7: Standardization of Shari'ah Rulings	Present (1), absent (0)
<i>SSB at the Organizational Level</i>	
SSB 1: SSB Appointment	Present (1), absent (0)
SSB 2: Competence (fit and proper)	Present (1), absent (0)
SSB 3: Independence	Present (1), absent (0)
SSB 4: Confidentiality	Present (1), absent (0)
SSB 5: Consistency	Present (1), absent (0)
SSB 6: Compensation and dismissal	Present (1), absent (0)
SSB 7: Cross-membership	Present (1), absent (0)
SSB 8: Assessment of SSB members	Present (1), absent (0)

This paper uses the above framework to assess CGR of four countries Kuwait, Malaysia, Pakistan and United Arab Emirates (UAE). It should be noted that since regulations in general and SGR in particular can evolve over time, the cut-off period of the documents examined for different countries in this study is 30 October 2020. The countries are chosen since they have significant Islamic financial sectors and also because of the availability of relevant data and information on SG related laws and regulations. The relevant laws and regulations used to assess CGR in these countries are listed in Table 2.

Table 2: Laws and Regulations Used in the Study

Countries	Laws	Regulations
<i>Kuwait</i>	<ul style="list-style-type: none"> • Law No. (30) of the year 2003 (amendment of Law No 32 of 1968 Concerning Currency, The Central Bank of Kuwait and the Organization of Banking Business) (BL 2003) • Law No. (3) of the year 2020 (amendment some provisions of Law No 32 of 1968 Concerning Currency, The Central Bank of Kuwait and the Organization of Banking Business). 	<ul style="list-style-type: none"> • Shari'ah Supervisory Governance (SSG) for Kuwaiti Islamic Banks 2016 (repeals the Instructions No. 2/IBS/100/2003 Concerning the Rules and Conditions for the Appointment and Responsibilities of the SSB in Islamic Banks) (SSG 2016)
<i>Pakistan</i>	<ul style="list-style-type: none"> • Amended Banking and Financial Services Ordinance 1984 (BFSO 1984) 	<ul style="list-style-type: none"> • Instructions for Shari'ah Governance Framework for Islamic Banking Institutions updated in June 2018 (SGF 2018)
<i>Malaysia</i>	<ul style="list-style-type: none"> • Central Bank of Malaysia Act 2009 (CBM 2009) • Islamic Financial Services Act 2013 (IFSA 2013) 	<ul style="list-style-type: none"> • Shari'ah Governance Framework for Islamic Financial Institutions 2010 (SGF 2010), updated in Sep 2019.
<i>UAE</i>	<ul style="list-style-type: none"> • Federal Law No (6) of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies (IBL 1985) • Decretal Federal Law No. (14) of 2018 Regarding the Central Bank & Organization of Financial Institutions and Activities' (CBL 2018) 	<ul style="list-style-type: none"> • Central Bank of the UAE Press Release on May 2018 on meeting of The Higher Sharia Authority at the Central Bank (CBR 2018) • Central Bank of the UAE Press Release on 27 January 2019 on meeting of The Higher Sharia Authority at the Central Bank (CBR 2019)

5. Findings and Discussion

The assessment and results of SGR for each of the sample country are discussed below.

Kuwait

The Banking Law No. 30 of 2003 (BL 2003 Chapter III) amended the Law No. 32 of 1968 concerning currency, the Central Bank of Kuwait (CBK) and the organization of banking business to include a special section on Islamic banks by (Ginena & Hamid, 2015). This was followed by Instructions No. (2/IBS/100/2003) issued by CBK that outlines the rules and conditions for the appointment and responsibilities of the SSB in Islamic banks. These instructions were repealed by CBK with the issuance of more detailed Shari'ah Supervisory Governance document (SSG 2016) regulatory guidelines for Islamic banks in 2016. Recently, new amendment (Law No. 3 of the year 2020) has added some provisions in the Law No. 32 of 1968 and allows CBK to establish their higher Shari'ah supervision authority (HSSA).

The elements of SG regulatory framework in Kuwait are mainly covered in SSG 2016 which addresses various Shari'ah governance related issues. Chapter 3 Principle 1 of SSG 2016 identifies the role of BOD, BOD committees and the SSB and Chapter 4 Section 1 deals with internal Shari'ah audit and Section 2 with external Shari'ah audit. SSG 2016 also requires Islamic banks to disclose various aspects of operations including conformity with Islamic law, SSB meetings, and investment account related issues, etc. While the amendment Law No. 3 of 2020 calls for establishing HSSA, Kuwait does not yet have a central Shari'ah board for the Islamic financial industry and there are no standardized Shari'ah rulings at the national level.

The elements of SSB related issues at the organizational level are covered partly in the banking law and also in the SSG 2016. Article 93 of Law No. 30 states that Islamic banks shall have an independent Shari'ah supervisory board which should be appointed by the general assembly after nomination from the BOD. SSG 2016 also requires SSB be nominated by BOD for approval by the general assembly. Principle 3 of SSG 2016 also addresses fit and proper criteria and Principle 2 discusses issues related to independence of the SSB. Furthermore, Principle 4 requires SSB to preserve the confidentiality of the documents and information and Principle 5 stipulates that the decisions made by SSB should be internally consistent with the majority of the SSB members agreeing to the resolution or decisions arrived at unanimously. SSG 2016 (p. 16) states that the remuneration of SSB members should be determined by the Remuneration Committee and must be approved by the general assembly or the latter may delegate this right to the BOD. SSG 2016 limits the number of SSBs that each Shari'ah scholar can serve to three and also requires BOD to assess the members of SSB with regards to their fit and proper criteria.

Table 3 shows the sources of the elements and the status of SGR in Kuwait. The SG Regulatory Framework has a score of 6 (out of 7) and the SSB component is robust with a score of 8. The overall SGR score for Kuwait stands at 14 (or 93.3%). In terms of legal/regulatory structure, establishing central Shariah board and SSBs in IFIs have basis in the laws and other the specific elements of the SGR are stipulated in the regulations.

Table 3: Shari'ah Governance Regime in Kuwait

Elements	Laws	Regulations	Others	Scores
<i>SG Regulatory Framework</i>				

SGR 1: BOD's Responsibilities Related to Sharī'ah Issues		SSG 2016		1
SGR 2: BOD Committees		SSG 2016		1
SGR 3: Internal Sharī'ah Compliance/Audit		SSG 2016		1
SGR 4: External Sharī'ah Audit		SSG 2016		1
SGR 5: Sharī'ah Reporting and Transparency		SSG 2016		1
SGR 6: Central Sharī'ah Board (CSB)	BL 2020			1
SGR 7: Standardization of Sharī'ah Rulings				
<i>SG Regulatory Framework Sub-total (7)</i>				6
<i>SSB at the Organizational Level</i>				
SSB 1: SSB Appointment	BL 2003	SSG 2016		1
SSB 2: Competence (fit and proper)		SSG 2016		1
SSB 3: Independence		SSG 2016		1
SSB 4: Confidentiality		SSG 2016		1
SSB 5: Consistency		SSG 2016		1
SSB 6: Compensation and dismissal		SSG 2016		1
SSB 7: Cross-membership		SSG 2016		1
SSB 8: Assessment of SSB members		SSG 2016		1
<i>SSB Sub-total (8)</i>				8
<i>Overall SGR Index (15)</i>				14
<i>Overall SGR Index (in percentage)</i>				93.3.7%

Malaysia

Malaysia has one of the most developed legal/regulatory environment Islamic financial industries. Islamic banking commenced in 1983 with the passage of Islamic Banking Act 1983 and the establishment of first Islamic bank in the same year (COMCEC 2016, Ginena & Hamid, 2015; Hasan, 2012). The law allowed conventional banks open Islamic window to serve clients who preferred to deal with Sharī'ah-compliant products. While Bank Negara Malaysia (BNM), the central bank of Malaysia established its own Sharī'ah Advisory Council (SAC) in 1997, the Central Bank of Malaysia Act 2009 (CBM 2009) further clarified the role of SAC. The legal framework was further strengthened by the Islamic Financial Service Act 2013 (IFSA 2013) which covers different aspects of Islamic banking and takaful sectors in a comprehensive way. Part IV of IFSA 2013 entitled *Sharī'ah Requirements*, has divisions on Sharī'ah compliance, Sharī'ah Governance and Audit on Sharī'ah compliance. BNM has played an active role to promote Islamic finance in the country by providing various regulations. To strengthen the SG in Islamic banking, BNM issued *Sharī'ah Governance Framework for Islamic Financial Institutions 2010* and updated in 2019 (SGF 2019).

Sharī'ah Governance division (Item 29.2.a.i) of IFSA 2013 stipulates that BNM can specify the functions and duties of BOD, senior management and SSB in relation to Shariah compliance. SGF 2010 makes BOD responsible to implement the SG regulations issued by BNM and the board audit committee is required to consult with the SSB to determine the deliverables of Sharī'ah audit function. Both IFSA 2013 and SGF 2019 require Islamic banks to have sound and effective inter control systems and carry out internal Sharī'ah audit. SGF 2010 also requires carrying out external Sharī'ah audit and that the SSB disclose sufficient information about the state of compliance in the annual financial reports. Sharī'ah Advisory Council (SAC) advises BNM on Sharī'ah-related matters and issues SG regulations and instructions for SSBs in each bank. CBM 2009 affirms the

roles and responsibilities of SAC by making SAC decisions and rulings are binding, and the arbitrator and the courts rely on SAC as the final opinion concerning Shari'ah issues in disputes related to Islamic banking and takaful. Other than the rulings of SAC obligatory, BNM has also come up with Shari'ah parameters for various Islamic financial contracts which provide standard rulings for different stakeholders. Shari'ah Governance part (Item 28.3) of IFSA 2013 requires Islamic banks not to carry out any activity of business that contradicts the rulings of SAC.

Both IFSA 2013 and SGF 2019 require Islamic banks to establish SSB, define the fit and proper criteria for its members and require SSB members to maintain confidentiality. While SGF 2010 specifies that the SSB members be appointed by BOD, both documents require that the membership is approved by BNM. SGF 2019 Principle III requires SSB members to be independent and make objective judgments and Principle V deals with confidentiality and consistency. SGF 2019 also asserts that appointment, reappointment, resignation and removal of the SSB members shall be made by BOD subject to the approval by BNM and the SAC. SGF 2019 restricts membership of SSB to one financial institution within an industry and requires that a formal process should be in place to assess the performance of SSB members.

Table 4 shows the status of SGR along with the sources of each element for Malaysia. The scores show a robust SGR with an overall SGR score of 15 (or 100%). The sources of SGR in the country come from both laws and regulations.

Table 4: Shari'ah Governance Regime in Malaysia

Elements	Laws	Regulations	Others	Scores
<i>SG Regulatory Framework</i>				
SGR 1: BOD's Responsibilities Related to Shari'ah Issues	IFSA 2013	SGF 2019		1
SGR 2: BOD Committees		SGF 2019		1
SGR 3: Internal Shari'ah Compliance/Audit	IFSA 2013	SGF 2019		1
SGR 4: External Shari'ah Audit		SGF 2019		1
SGR 5: Shari'ah Reporting and Transparency		SGF 2019		1
SGR 6: Central Shari'ah Board (CSB)	CBM 2009			1
SGR 7: Standardization of Shari'ah Rulings	CBM 2009			1
<i>SG Regulatory Framework Sub-total (7)</i>				7
<i>SSB at the Organizational Level</i>				
SSB 1: SSB Appointment	IFSA 2013	SGF 2019		1
SSB 2: Competence (fit and proper)	IFSA 2013	SGF 2019		1
SSB 3: Independence		SGF 2019		1
SSB 4: Confidentiality	CBM 2009	SGF 2019		1
SSB 5: Consistency		SGF 2019		1
SSB 6: Compensation and dismissal	IFSA 2013	SGF 2019		1
SSB 7: Cross-membership		SGF 2019		1
SSB 8: Assessment of SSB members		SGF 2019		1
<i>SSB Sub-total (8)</i>				8
<i>Overall SGR Index (15)</i>				15
<i>Overall SGR Index (in percentage)</i>				100%

Pakistan

The Banking and Financial Services Ordinance of 1984 (BFSO 1984) amended several laws and paved the way for functioning interest-free transactions in the banking system. The Supreme Court of Pakistan has made a historic judgment in December 1999 that directed that “laws involving interest would cease to have effect finally by June 30, 2001” (SBP, 2002, p. 190). The court concluded that the financial system had to be changed to bring it into conformity with the Shari‘ah (Kalim & Lodhi, 2006). Accordingly, the State Bank of Pakistan (SBP) established a specific department for Islamic banking and issued various guidelines and instructions concerning IB sector. One of these instructions issued by SBP is *Shari‘ah Governance Framework for Islamic Banking Institutions* in 2015 and latter updated in 2018 (SGF 2018) that serves the key regulatory document to ensure Shari‘ah compliance in all IBs and enhance public trust and credibility of Islamic finance in Pakistan.

SGF 2018, Item 1 entitled ‘Role of Board of Directors (BOD)’ lists various responsibilities of the BOD which includes its ultimate responsibility for ensuring full conformity of the operations of the bank with Shari‘ah principles (Item 1.i). Item 2.vi states that management of the bank should provide orientation to the BOD regularly on the importance of an enabling Shari‘ah compliance environment and Item 3A.ii suggests that members of SSB members should get BOD’s approval before finally getting clearance from the SBP. Item 7.i stipulates that the Internal Shari‘ah Audit Unit of the bank should report to the Board Audit Committee (BAC) and Item 5.iv defines one of the roles of the Committee to ensure compliance of the corrective actions determined by SSB and identified in the internal and external Shari‘ah audits. Item 7 of SGF 2018 is entitled ‘Internal Shari‘ah Audit’ and outlines various functions of the Internal Shari‘ah Audit Unit which includes preparing Internal Shari‘ah audit plan which is reviewed by SSB and approved by BAC and prepare an Shari‘ah audit report that is presented to SSB for appropriate corrective actions. Similarly, Item 8 entitled ‘External Shari‘ah Audit’ covers various aspects of external Shari‘ah audit that provides an independent assessment of the Shari‘ah governance and compliance environment of the bank. SGF 2018 3.E requires SSB of Islamic banks to prepare an annual report with regards to the status of Shari‘ah compliance and the Annexure-B provides the minimum requirements of the report. Shari‘ah Advisory Committee (SAC) is a Shari‘ah board of SBP that is responsible to issue rulings (Item 3B) which the SSBs at the bank level have to abide by (Item 8.iv). The Shari‘ah standards used in the industry are thus standardized since the Islamic banks are required to comply with the Shari‘ah rulings of the SAC (Item 8.i).

SGF 2018, Item 1.iii makes BOD responsible to appoint the SSB and approve the terms of reference of the appointment. Item 3A (i) requires all Islamic banks to have SSB with at least three members. Annexure A of SGF 2018 provides various fit and proper criteria for the SSB members and Item D entitled ‘Independence of Shari‘ah Board’ stipulates that the SSB would discharge its duties independently. Item A. vi requires Islamic banks to include a confidentiality clause in the contract of appointing SSB members to keep the bank’s non-public information secret and confidential. Item 1.iii makes BOD responsible to set the remuneration of the SSB members and Item 3A.ix outlines the terms under which a SSB member can be terminated. After the BOD has heard the views of the member, a recommendation for termination has to be sent to SBP which makes the final decision. Item 3A.v indicates that Shari‘ah scholars can serve in SSBs of three Islamic banks.

Table 5 shows the status of SGR in Pakistan along with the sources of the elements. While the SG Regulatory Framework scores well (7), the SSB component has a score of 6 giving an overall SGR

score of 13 (or 86.7%). It is interesting to note that in Pakistan the source of the SGR comes from regulations only.

Table 5: Shari‘ah Governance Regime in Pakistan

Elements	Laws	Regulations	Others	Scores
<i>SG Regulatory Framework</i>				
SGR 1: BOD’s Responsibilities Related to Shari‘ah Issues		SGF 2018		1
SGR 2: BOD Committees		SGF 2018		1
SGR 3: Internal Shari‘ah Compliance/Audit		SGF 2018		1
SGR 4: External Shari‘ah Audit		SGF 2018		1
SGR 5: Shari‘ah Reporting and Transparency		SGF 2018		1
SGR 6: Central Shari‘ah Board (CSB)		SGF 2018		1
SGR 7: Standardization of Shari‘ah Rulings		SGF 2018		1
<i>SG Regulatory Framework Sub-total (7)</i>				7
<i>SSB at the Organizational Level</i>				
SSB 1: SSB Appointment		SGF 2018		1
SSB 2: Competence (fit and proper)		SGF 2018		1
SSB 3: Independence		SGF 2018		1
SSB 4: Confidentiality		SGF 2018		1
SSB 5: Consistency				
SSB 6: Compensation and dismissal		SGF 2018		1
SSB 7: Cross-membership		SGF 2018		1
SSB 8: Assessment of SSB members				
<i>SSB Sub-total (8)</i>				6
<i>Overall SGR Index (15)</i>				13
<i>Overall SGR Index (in percentage)</i>				86.7%

UAE⁵

While the first Islamic bank was established in Dubai, UAE in 1975, a law governing Islamic banking was enacted in 1985. The Federal Law No. (6) of 1985 (FL 1985) constituting 10 articles and covers some general issues related to Shari‘ah governance. In 2018, UAE enacted the ‘Decretal Federal Law No. (14) of 2018 Regarding the Central Bank & Organization of Financial Institutions and Activities’ (CBL 2018) that covers some aspects of Shari‘ah governance. Article 6 of FL 1985 stipulates that ‘articles and memorandum of associations of each Islamic banks, financial institution and investment company should clearly stipulate that a Shari‘ah Supervision Authority shall be formed of minimum three members to render their transactions and practices accordant with the principles and provisions of Islamic Shari‘ah Law.’ The law, however, leaves it to the banks to determine ‘the way in which this authority shall be formed, the manner in which it will discharge its tasks and its other terms of conditions’.

CBL 2018 provides some more details on the role of SSB. Other than requiring establishment of SSB in Islamic financial institutions to supervise their business and activities within the framework provided by Higher Shari‘ah Authority (HSA) (Article 79), the law stipulates members of SSB be

⁵ This research relies only on what laws and regulations cover all emirates by the Central Bank of UAE. Dubai Islamic Financial Centre (DIFC) is an offshore financial centre based in Dubai and has its own regulations. Since this paper examines SGR for national jurisdictions, DIFC is not included in the study.

appointed by the general assembly and approved by HSA and avoid any activities that could lead to conflict of interest. While not going into details of fit and proper criteria of SSB members CBL 2018 states that members of the committee should be experienced specialists in Islamic financial and banking transactions jurisprudence. The law also requires Islamic financial institutions to have internal Shari'ah audit to monitor application of rulings of SSB. Internal Shari'ah audit would be headed by a Shari'ah controller that is appointed by and reports to the BOD (Article 79.5). The law stipulates internal SSB to prepare an annual report on Shari'ah compliance status of operations for presentation at the general assembly. Furthermore, Article 17 of law states that HSA can conduct Shari'ah external audit of the business of any licensed financial institution and can may seek assistance of a specialized party, if necessary.

Article 5 of FL 1985 states that a 'Higher Shari'ah Authority shall be formed by a cabinet decision, incorporating Shari'ah, legal and banking personnel to undertake higher supervision over Islamic banks Islamic banks, financial institutions and investment companies to ensure legitimacy of their transactions according to the provisions of Islamic Shari'ah Law'. The law further stipulates that the Higher Shari'ah Authority (HSA) with offer opinions on different matters and their rulings would be binding on these agencies. Article 6 of the law further asserts that the members of the SSB should be approved by the Higher Shari'ah Authority. This was further confirmed in the CBL 2018, Article 17 entitled Higher Shari'ah Authority which states that HSA 'shall determine the rules, standards and general principles applicable to Shari'ah compliant businesses and Licensed Financial Activities' and makes its rulings binding on other SSBs. It further requires HSA to 'undertake supervision and oversight of the internal Shari'ah supervisory committees of Licensed Financial Institutions'.

After the decision no. 102/2w/1 of Council of Ministers to establish the HSA in 2016, the Central Bank of UAE announced its establishment in February 2018. The HSA has been operational since then and have carried out various activities. The HSA decided to consider adopting AAOIFI Shari'ah standards (CBR 2018)⁶ in the May 2018 meeting and confirmed their adoption the standards in January 2019 meeting (CBR 2019).⁷ The overall SGR score in UAE is rudimentary with the SGR index score of 7 (46.7%). While HSA is discussing the adoption of various aspects of standards for Shari'ah governance established by international standard settings bodies,⁸ these have not been implemented yet.

Table 6 shows the status of SGR in UAE along with the sources of its elements. While the SG Regulatory Framework scores 5, the SSB component has a low score of 2 giving an overall SGR score of 7 (or 46.7%). While the main source of the SGR comes from laws, an interesting aspect of UAE is that the HSA has a role to play in setting up of the standardization of Shari'ah rulings.

Table 6: Shari'ah Governance Components and Regime in UAE as of 1st Sep 2017

Elements	Laws	Regulations	Others	Scores
<i>SG Regulatory Framework</i>				
SGR 1: BOD's Responsibilities Related to Shari'ah Issues				
SGR 2: BOD Committees				

⁶ <https://www.centralbank.ae/sites/default/files/2018-10/PressRealse13052018.pdf>

⁷ https://www.centralbank.ae/sites/default/files/2019-01/1st%20Higher%20Sharia%20Meeting%20for%202019-%2027Jan2019_0.pdf. Also see <http://aaoifi.com/announcement/aaoifi-welcomes-uaes-adoption-of-its-standards/?lang=en>

⁸ <https://www.centralbank.ae/sites/default/files/2018-10/PressRealse02072018.pdf>

SGR 3: Internal Sharī'ah Compliance/Audit	CBL 2018			1
SGR 4: External Sharī'ah Audit	CBL 2018			1
SGR 5: Sharī'ah Reporting and Transparency	CBL 2018			1
SGR 6: Central Sharī'ah Board (CSB)	CBL 2018			1
SGR 7: Standardization of Sharī'ah Rulings		CBR 2018		1
SG Regulatory Framework Sub-total (7)				5
SSB at the Organizational Level				
SSB 1: SSB Appointment	CBL 2018			1
SSB 2: Competence (fit and proper)	CBL 2018			1
SSB 3: Independence				
SSB 4: Confidentiality				
SSB 5: Consistency				
SSB 6: Compensation and dismissal				
SSB 7: Cross-membership				
SSB 8: Assessment of SSB members				
SSB Sub-total (8)				2
Overall SGR Index (15)				7
Overall SGR Index (in percentage)				46.7%

5.1 Discussions of the Results

The results of the SGR in the four countries are summarized in Table 7.

Table 7: Status of SGR in Different Countries

Elements	Kuwait	Malaysia	Pakistan	UAE
Overall SG Regulatory Framework				
SGR 1: BOD's Responsibilities Related to Sharī'ah Issues	1	1	1	0
SGR 2: BOD Committees	1	1	1	0
SGR 3: Internal Sharī'ah Compliance/Audit	1	1	1	1
SGR 4: External Sharī'ah Audit	1	1	1	1
SGR 5: Sharī'ah Reporting and Transparency	1	1	1	1
SGR 6: Central Sharī'ah Board (CSB)	1	1	1	1
SGR 7: Standardization of Sharī'ah Rulings	0	1	1	1
Overall SG Regulatory Framework Sub-total	6	7	7	5
SSB at the Organizational Level				
SSB 1: SSB Appointment	1	1	1	1
SSB 2: Competence (fit and proper)	1	1	1	1
SSB 3: Independence	1	1	1	0
SSB 4: Confidentiality	1	1	1	0
SSB 5: Consistency	1	1	0	0
SSB 6: Compensation and dismissal	1	1	1	0
SSB 7: Cross-membership	1	1	1	0
SSB 8: Assessment of SSB members	1	1	0	0
SSB Sub-total	8	8	6	2
Overall SGR Index	14	15	13	7
Overall SGR Index (in percentage)	93.3%	100%	86.7%	46.7%

The results show some interesting features of different aspects of SGR in the four jurisdictions. First, the overall SGR index provides an objective way to assess the status of SGR in different jurisdictions. While Malaysia appears to have the best SGR with an index score of 15 (or 100%), UAE has the weakest regime with an index score of 7 (or 46.7%). Second, the sub-scores of the SGR index show the relative strength SGR components. While Kuwait has a score of 14 (or 93.3%) and Pakistan have index score of 13 (or 86.7%), the results indicate that the former has a relatively better regulatory framework for SSB at the organizational level with a score of 8 and the latter is better at the overall SG regulatory framework with a score of 7. The implication is that there is room for strengthening the regulatory framework for SSB at the organizational level in Pakistan and for the developing the SG regulatory framework in Kuwait.

Finally, examination of the specific structures of the legal and regulatory framework for SGR reveals qualitative differences in the SGR in different jurisdictions. For example, whereas in Malaysia both the laws and regulations provide guidelines for the SGR, in Kuwait and Pakistan the SGR is established mainly by regulatory guidelines. In UAE, the laws provide some framework of the overall SG regulatory regime, but the regulations are absent. Instead, the national Shari'ah authority (HSA) has the authority to deal with different aspects of SGR in the country. The HSA has already instructed Islamic financial institutions to adopt AAOIFI Shari'ah standards and has issued a draft of Shari'ah governance framework that will be implemented in the future.

6. Conclusion

Recognizing the importance of Shari'ah compliance in Islamic finance, international standards setting bodies (such as AAOIFI and IFSB) have developed standards that can ensure a sound framework for Shari'ah governance. While some studies have discussed the legal and regulatory framework and others have examined the Shari'ah governance framework, these have not been done in light of the standards outlined by the international standards setting bodies. This paper provides a framework of assessing *de jure* adoption of key features of the SG standards developed by AAOIFI and IFSB. Content analysis and leximetrics are used to collect information and analyze data and used to evaluate the legal and regulatory framework of SGR in four countries (Kuwait, Malaysia, Pakistan and UAE). Other than observing the overall status of SGR in different jurisdictions, the framework identifies the strengths and weaknesses of different components of the SGR.

The results show that Malaysia has the most robust SGR and UAE has the weakest legal and regulatory environment of Shari'ah governance. Furthermore, the paper reveals that the regulatory framework in Pakistan for SSB can be further improved at the organizational level and the SG regulatory framework in Kuwait can be further strengthened. The study also shows the diversity in the qualitative nature of SGR in terms of the laws and regulations used to establish the SGR in different countries. While in Malaysia both laws and regulations are used to establish the SGR, regulations determine the SGR in Pakistan and Kuwait and laws are used for the same in UAE. Furthermore, in UAE the HSA is responsible to determine various aspects of SGR in the country.

Since abiding by Shari'ah principles is the key defining feature of Islamic finance, there is a need to strengthen SGR by enacting enabling laws and regulations. Shari'ah non-compliance can potentially pose reputational risks that can erode the credibility and affect the long-term stability and growth of the industry. There is, therefore, a need to develop the enabling laws and regulations that can ensure sound Shari'ah governance that can promote Islamic finance in a sound and stable manner. From a regulatory perspective, it will be desirable to introduce the international standards

of Shari'ah governance to promote growth and ensure stability of the sector. The framework to assess the SGR developed in this paper can be used as a first step to assess and identify the weaknesses in different jurisdictions and come up with relevant laws and regulations to strengthen the SGR for the development of a robust Islamic financial sector.

References

- AAOIFI, A. (2010). *Auditing and governance standards for Islamic financial institutions*.
- AAOIFI (2018) Exposure draft ver. 7.0 of Governance Standard No. 8 Central Shari'ah Board, <http://aaoifi.com/wp-content/uploads/2017/02/Governance-Standard-on-Central-Shari'ah-Board-Exposure-Draft-v9-by-Board-without-BoC-with-team-comments-no-blanks-clean.pdf> (accessed August 7, 2018).
- AAOIFI (2018) Exposure Draft of the Auditing Standard for Islamic Financial Institutions No. 6 External Shari'ah Audit (Independent Assurance Engagement on an Islamic Financial Institution's Compliance with Shari'ah Principles and Rules) <http://aaoifi.com/wp-content/uploads/2017/06/Auditing-Standard-on-External-Shari'ah-Audit-Exposure-Draft-v-8.pdf> (accessed August 27, 2018).
- AAOIFI, Accounting and Auditing Organization for Islamic Financial Institution, <http://aaoifi.com/certification/certified-sharia-adviser-and-auditor-csaa/?lang=en>, (accessed August 22, 2017).
- Abdullah Saif Al Nasser, S., Datin, & Muhammed, J. (2013). Introduction to history of Islamic banking in Malaysia. *Humanomics*, 29(2), 80-87.
- Abozaid, A. (2016). The internal challenges facing Islamic finance industry. *International Journal of Islamic and Middle Eastern Finance and Management*, 9(2), 222-235.
- Adams, Z., Bastani, P., Bishop, L., & Deakin, S. F. (2017). *The CBR-LRI dataset: Methods, properties and potential of leximetric coding of labour laws*.
- Ahmed, A. (2010). Global financial crisis: an Islamic finance perspective. *International Journal of Islamic and Middle Eastern Finance and Management*, 3(4), 306-320.
- Ahmed, H. (2011). Shari'ah governance regimes for Islamic finance: Types and appraisal. *International Economics*, 64(4), 393-412.
- Ahmed, H. (2014). Islamic banking and Shari'ah compliance: A product development perspective. *Journal of Islamic Finance*, 3(2), 15-29.
- Belal, A. R., Abdelsalam, O., & Nizamee, S. S. (2015). Ethical reporting in Islamic bank Bangladesh limited (1983-2010). *Journal of Business Ethics*, 129(4), 769.
- Bhutta, N. T., & Saeed, M. M. (2011). Accounting scandals in the context of corporate social reporting. *Journal of Database Marketing & Customer Strategy Management*, 18(3), 171.
- BNM, Bank Negara Malaysia, Shari'ah Governance Framework for Islamic Financial Institutions 2010 (BNM, <http://www.bnm.gov.my/index.php?ch=3&pg=10&ac=37&bb=file> (accessed August 12, 2017).
- BNM, Bank Negara Malaysia, "Shari'ah Governance" 2019, <https://www.bnm.gov.my/index.php?ch=57&pg=144&ac=836&bb=file> (accessed November, 2020).
- BNM, Bank Negara Malaysia, "Financial stability and payment system report 2016," <http://www.bnm.gov.my/files/publication/fspd/en/2016/cp04.pdf> (accessed August 16, 2017).
- BNM, Bank Negara Malaysia, "Islamic financial service act" (2013), http://www.bnm.gov.my/documents/act/en_ifsa.pdf (accessed August 12, 2017).

- BNM, Bank Negara Malaysia, “central bank of Malaysia act” (2009), <http://www.bnm.gov.my/index.php?ch=59&pg=160&ac=486&bb=file> (accessed August 13, 2017).
- CBK, Central Bank of Kuwait, <http://www.cbk.gov.kw/en/images/Shari'ah-Governance-Islamic-Banks-10-122718-2.pdf> (accessed August 8, 2017) (in Arabic).
- CBK, Central Bank of Kuwait, <http://www.cbk.gov.kw/en/legislation-and-regulation/cbk-law/chapter-three.jsp> (accessed August 9, 2017).
- Central Bank of Kuwait. (2016). *Press release regarding Shari'ah supervisory governance for Kuwaiti Islamic banks (20 December)*. https://www.cbk.gov.kw/en/images/press-20dec2016-122718_v40_tcm10-122718.pdf, (accessed November 24, 2020).
- CBK, Central Bank of Kuwait, “Islamic banks Law No. (30) of the year (2003),” <http://www.cbk.gov.kw/en/legislation-and-regulation/cbk-law/chapter-three.jsp> (accessed August 9, 2017).
- CBK, Central Bank of Kuwait, (2020). *CBK Press release regarding forming the higher committee of Shari'ah supervision (5 October)*, <https://www.cbk.gov.kw/en/cbk-news/announcements-and-press-releases/press-releases/2020/10/202010051120-cbk-forms-the-higher-committee-of-Shari'ah-supervision> (accessed November 24, 2020).
- Chapra, M. Umer and Habib Ahmed. 2002. *Corporate Governance in Islamic Financial Institutions*. Jeddah: Islamic Research and Training Institute, Islamic Development Bank.
- Cohen, M., & Sundararajan, A. (2015). Self-regulation and innovation in the peer-to-peer sharing economy. *U. Chi. L. Rev. Dialogue*, 82, 116.
- Dar, H., & Azmi, W. (2015). *Shari'ah governance regimes in the gulf cooperation council countries: A comparative study*. In Asutay M. & Turkistani A. (Eds.), *Islamic Finance: Political Economy, Values and Innovation* (Volume 1) (pp. 63-78). Berlin, Germany: Gerlach Press. Retrieved from <http://www.jstor.org.ezphost.dur.ac.uk/stable/j.ctt1df4hjh.7>.
- DeLorenzo, S. Y. T. (2006). Shari'ah compliance risk. *Chi. J. Int'l L.*, 7, 397.
- Elamer, Ahmed A., Collins G. Ntim and Hussein A. Abdou (2020), “Islamic Governance, National Governance, and Bank Risk Management and Disclosure in MENA Countries”, *Business and Society*, 59 (5), 914-955.
- Farook, S. Z., & Farooq, M. O. (2011). Shari'ah governance for Islamic finance: Challenges and pragmatic solutions. Available at SSRN 1813483.
- Ginena, K. (2014). Shari'ah risk and corporate governance of Islamic banks. *Corporate Governance*, 14(1), 86-103.
- Ginena, K., & Hamid, A. (2015). *Foundations of Shari'ah governance of Islamic banks*. John Wiley & Sons.
- Grassa, R. (2013). Shari'ah supervisory system in Islamic financial institutions: New issues and challenges: A comparative analysis between Southeast Asia models and GCC models. *Humanomics*, 29(4), 333-348.
- Golant, B. D., & Sillince, J. A. A. (2007), “The constitution of organizational legitimacy: A narrative perspective”, *Organization Studies*, 28(8), 1149–1167.

- Harifan, Nurfarahim M., Ahmad F. S. Hassan and Yusuf Karbhari (2018), “Governance, religious assurance and Islamic banks: Do Shari‘ah boards effectively serve?”, *Journal of Management and Governance*, 22, 1015-1043.
- Grais, W. and Pellegrini, M. (2006a). Corporate governance and Shari‘ah compliance in institutions offering Islamic financial services. *World Bank, Policy Research working paper No. WPS4054*.
- Grais, W. and Pellegrini, M. (2006b). Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options. *World Bank, Policy Research working paper No. WPS4052*.
- Hamza, H., (2013). Sharia governance in Islamic banks: Effectiveness and supervision model. *International Journal of Islamic and Middle Eastern Finance and Management*, 6(3), 226-237.
- Hasan, Z. (2011). Shari‘ah governance in Islamic financial institutions in Malaysia, GCC countries and the UK (Doctoral dissertation, Durham University).
- Hassan, M. (2007). The Islamization of the economy and the development of Islamic banking in Pakistan. *Kyoto Bulletin of Islamic Area Studies*, 1(2), 92-109.
- IFSB (Islamic Financial Service Board) (2010), *Guiding principles on Shari‘ah Governance System for Institutions offering Islamic Financial Services*, [http://www.ifsb.org/standard/IFSB-10%20Shari‘ah%20Governance.pdf](http://www.ifsb.org/standard/IFSB-10%20Shari%20Governance.pdf).
- IIRA, Islamic International Rating Agency, <http://iirating.com/corprofile.aspx> (Accessed 23/8/2017).
- IMF, International Monetary Fund, “Ensuring Financial Stability in Countries with Islamic Banking” (2017), <http://www.imf.org/en/publications/cr/issues/2017/06/20/multi-country-report-ensuring-financial-stability-in-countries-with-islamic-banking-case-44969> (accessed August 31, 2017).
- Kalim, R., & Lodhi, S. A. (2006). Strategic directions for developing an Islamic banking system. *Review of Islamic Economics*, 10, 5-21.
- Kammer, M. A., Norat, M. M., Pinon, M. M., Prasad, A., Towe, M. C. M., & Zeidane, M. Z. (2015). Islamic finance: Opportunities, challenges, and policy options (No. 15). International Monetary Fund.
- Karbhari, Yusuf, Md. Kausar Alam and Md. Mizanur Rahman (2020), “Relevance of application of institutional theory in Shari‘ah governance of Islamic banks”, *PSU Research Review*, DOI 10.1108/PRR-05-2020-0015
- Katelouzou, D. (2014). *A leximetric approach to comparative corporate governance: The case of hedge fund activism*.
- Khan, F. (2010). How ‘Islamic’ is Islamic banking? *Journal of Economic Behavior and Organization*, 76(3), 805-820.
- Lele, P. P., & Siems, M. M. (2007). Shareholder protection: A leximetric approach. *Journal of Corporate Law Studies*, 7(1), 17-50.
- Malkawi, B. H. (2013). Shari‘ah Board in the Governance Structure of Islamic Financial Institutions. *The American Journal of Comparative Law*, 539-577.

- Mollah, S., & Zaman, M. (2015). Shari'ah supervision, corporate governance and performance. *Journal of Banking & Finance*, 59, 418-435.
- Muhamad, R. (2011). Market Segmentation and the Shari'ah Compliancy Process in Islamic Banking Institutions (IBIs). 1-46.
- Nobes, C. W. (1998), 'Towards a General Model of the Reasons for International Differences in Financial Reporting', *ABACUS*, Vol. 34, No. 2, pp. 162-187.
- O'Donovan, G. (2002), "Environmental disclosures in the annual report: Extending the applicability and predictive power of legitimacy theory", *Accounting, Auditing & Accountability Journal*, 15(3), 344-371.
- Oseni, U. A., Ahmed, A. U. F., & Hassan, M. K. (2016). The legal implications of 'fatwā shopping' in the Islamic finance industry: Problems, perceptions and prospects. *Arab Law Quarterly*, 30(2), 107-137.
- Pande, S., & Ansari, V. A. (2014). A theoretical framework for corporate governance. *Indian Journal of Corporate Governance*, 7(1), 56-72.
- Qattan, Muhammad A. 2006. "Shari'ah Supervision: The Unique Building Block of Islamic Financial Architecture." Pp. 273-87 in: *Islamic Financial Architecture: Risk Management and Financial Stabilit*. Edited by Tariqullah Khan and Dadang Muljawan, 273-87. Jeddah: Islamic Research and Training Institute, Islamic Development Bank.
- Rowland, C. K., & Marz, R. (1982). Gresham's Law: The regulatory analogy. *Review of Policy Research*, 1(3), 572-580.
- SBP, State Bank of Pakistan, "Shari'ah governance framework for Islamic banking institutions," <http://www.sbp.org.pk/ibd/2015/C1-Annex.pdf> (accessed August 7, 2015).
- SBP, State Bank of Pakistan, SBP Shari'ah Board, <http://www.sbp.org.pk/departments/ibd/Shari'ah.asp> (accessed August 8, 2017).
- Soewarso, E., G. Tower, P. Hancock and R. Taplin (2003), 'A comparative study of de jure and de facto disclosure between Australia and Singapore', *Asia Review of Accounting*, Vol. 11, No. 1, pp. 18-47
- Suchman, M. C. (1995), "Managing legitimacy: Strategic and institutional approaches", *Academy of Management Review*, 20, 571-611.
- Tay, J. S. W. and R. H. Parker (1990), 'Measuring International Harmonization and Standardization', *ABACUS*, Vol. 26, No. 1, pp. 71-88.
- Unal, M., & Ley, C. (2008). Shari'ah scholars in the GCC: A network analytic perspective. URL: www.funds-at-work.com.
- UAE Central Bank, Federal Law No. 6 of 1985 regarding Islamic banks, financial institutions and investment companies, <https://www.centralbank.ae/pdf/LawNo6-1985-IslaminBanks.pdf> (accessed August 19, 2017).
- Waemustafa, W., & Abdullah, A. (2015). "Mode of Islamic bank financing: Does effectiveness of Shari'ah supervisory board matter?" *Australian Journal of Basic and Applied Sciences*, 9 (37): 458-464.