

# *Shari'ah* Scholars' Insight on *Shari'ah* Governance Framework for Islamic Banking Institutions in Pakistan

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## Abstract

One of the major reasons behind the financial crises generally and the 2008 crises especially, was the poor corporate governance in financial institutions. For ensuring good Islamic corporate governance as well as *Shari'ah* compliant environment in Islamic banking institutions (IBIs), *Shari'ah* governance framework (SGF) was developed in many countries including Pakistan. This study is conducted to evaluate the SGF, its implementation level, and the challenges facing the IBIs in the implementation of the SGF in Pakistan. For this purpose, the insight of the *Shari'ah* scholars is taken on SGF by following the qualitative research approach with semi-structured interviews of the scholars. The respondents included *Shari'ah* Board's (SB) members and Incharges of *Shari'ah* Compliance Department (SCD) in various IBIs in Pakistan. The researchers used Nvivo12 software for the analysis of the interviews data. The study discovered some important issues faced by Islamic banks in the implementation of SGF. It is evident from the research that there are shortcomings and weaknesses in the implementation of *Shari'ah* governance framework which requires improvements such as interpretation and quantification of the provisions of the SGF, approval from *Shari'ah* Board (SB) for all minute requirements, reporting line issues, and communication gap between the board of directors (BODs) and the members of SB. This research work suggests that the State Bank of Pakistan (SBP) should revisit the SGF in the light of the present study and further improve its provisions as well ensure the implementation of SGF in true letter and spirit.

**Keywords** *Shari'ah* governance framework, *Shari'ah* scholars, Implementation, Islamic banking institutions

## 1. Introduction

The historic financial crisis pushed the corporations to good governance and accountability (Ginena & Hamid, 2015). This financial crisis hit the big financial institutions like Merrill Lynch, Barclays, Credit Suisse, Bear Stearns, and Citibank

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etc. (Kirkpatrick, 2009). Islamic financial institutions (IFIs) are also not safe without good *Sharī'ah* governance. The historical evidence of losses in Islamic bank of South Africa, Ihlas Finance House, and Dubai Islamic Bank pushed Islamic banks towards strong *Sharī'ah* governance (Ginena, 2014). *Sharī'ah* governance is critical for the stability of Islamic banking industry. Two international bodies contributed a lot in governance of Islamic banking institutions namely the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Service Board (IFSB). AAOIFI established various standards of accounting, auditing and *Sharī'ah* principles for Islamic finance industry around the world. IFSB contributed in provision of standards on risk management, corporate governance and *Sharī'ah* (Wahyudi, Rosmanita, Prasetyo, & Putri, 2015). To ensure the compliance of IFIs to *Sharī'ah* bindings, guidelines and rulings, *Sharī'ah* Governance Framework (SGF) was developed in some jurisdictions including Pakistan. The SGF in Pakistan plays a significant role in implementation of *Sharī'ah* to safeguard the interest of all the stakeholders of IBIs. SB and *Sharī'ah* compliance departments (SCD) are responsible to ensure and review the compliance of IBIs with the SGF.

Recent studies (Ayaz and Mansoori, 2017; Ayaz, Shah, & Yusuf, 2018) argued that the existing SGF's provisions do not expressly provide punishments for the violators of the provisions of the SGF, which opens door to non-compliance with SGF. Ayub (2019) pointed out that there is also lack of solid basis for *Sharī'ah* pronouncements by the *Shari'ah* Advisors. Further, conflicts of interests in *Sharī'ah* Advisory Framework has been observed like a special kind of employer and employee relationship exists between the IBIs and the SB members. The existing SGF does not cover these issues.

Moreover, according to the existing SGF, the SB's members are allowed to attain multiple memberships of different IBIs where the issue of senior-junior or teacher-student relationships among the SB members also arises. That is why the study intends to find out the issues in the status of implementation of the SGF in Pakistan so that they are overcome and the SGF is further improved. This study takes interviews of the *Sharī'ah* board and SCD members' to explore their insight to examine their views on the SGF, its implementation, and the issues and barriers in its compliance and implementation. Suggestions are taken from these experts as to how the SGF can be further improved. This research also emanates from the initiative undertaken by the State Bank of Pakistan to implement the SGF.

This paper has five (5) sections. In the next section, the existing literature is discussed. Then in section 3, the methodology for the research is presented. Section 4 continues with the key finding and suggestions followed by the conclusion and recommendations in section 5.

## 2. Literature Review

*Sharī'ah* Governance is a new concept in comparison with conventional concept of corporate governance. Some researchers started working on this topic but most of the research conducted was quantitative in nature. First work on *Sharī'ah* board practices was carried out by Abomouamer (1989) on 41 Islamic financial institutions. Afterwards, in 1996, International Institute of Islamic Thought carried out research on different aspects of *Sharī'ah* board practices (Hasan, 2014). Different scholars did a good research on 65 topics after the year 2000 like Grais & Pellegrini (2006); Shafii, Abidin, Salleh, Jusoff & Kasim (2013); Omar, et al. (2014); Hasan (2014); Ginena & Hamid (2015); Shamsheer, Sori, & Shah (2015), Samra (2016); Bahari & Baharudin (2016), Shahzad, Saeed & Ehsan (2017), Ayaz and Mansoori, 2017, and Ayub, 2019.

Chapra and Ahmed (2002) depicted the concerns of the depositors that in case of *Sharī'ah* non-compliance, they are committed to withdraw their money. Grais & Pellegrini (2006) pointed out the importance of corporate governance for Institutions offering Islamic financial services (IIFS) and discussed prevalent corporate governance arrangements for IIFS and suggested to ensure the consistency of their operations with Islamic finance principles. Islamic Financial Services Board (IFSB) conducted a survey from 11 countries and included 69 IFIs in search for the perception and behavioural response from a macro perspective in 2008 (Hasan, 2014). Shafii, Abidin, Salleh, Jusoff & Kasim (2013) discussed the impact of *Sharī'ah* audit function towards the role of *Sharī'ah* committee in implementation of *Sharī'ah* Governance Framework issued by Bank Negara Malaysia in 2011. It reveals that *Sharī'ah* audit function has an added value in ensuring the compliance of *Sharī'ah*. Omar, et al. (2014) investigated the advantages and constraints resulting from the implementation of SGF in Malaysia. He finds that with the introduction of SGF 2010, the institutions become more efficient.

Ginena & Hamid (2015) wrote a book on the foundations of *Sharī'ah* Governance of Islamic banks and discussed all the organs of the Islamic banks. Shamsheer, Sori, & Shah (2015) did a qualitative research using interview technique involving the seventeen chairmen of the *Sharī'ah* committees of Islamic banks in Malaysia and figured out the effectiveness of *Sharī'ah* committees. Samra (2016) discussed the corporate governance challenges that are exclusive for Islamic financial institutions (IFIs) and suggested steps to develop vigorous corporate governance standards in collaboration with regulators, policy makers, and the courts. Bahari & Baharudin (2016) discussed the role of *Sharī'ah* Review and *Sharī'ah* Auditing and challenges that are being faced by the Islamic financial institutions and suggested a one year comprehensive review and also suggested

that the statement of *Sharī'ah* opinion must be included in the annual report. Shahzad, Saeed & Ehsan (2017) investigated the *Sharī'ah* Audit mechanism and the challenges faced by Islamic banking institutions (IBIs) after the implementation of *Sharī'ah* Governance Framework (SGF) by State Bank of Pakistan. The study suggests that more training is required for external audit firms and employees of IFIs and discussed that the idea to establish SBP *Sharī'ah* board is a right step towards future conflict resolution. The study explored that *Sharī'ah* Governance Framework might have certain implications for Islamic banking institutions (IFIs).

Ayaz & Mansoori (2017) analysed the corporate governance in Islamic banks and supported that *Sharī'ah* supervisory board is fit with the stakeholders theory. Parker (2017) reported that Governor Tan Sri Muhammad Ibrahim presided over two significant changes in the SGF function in Islamic finance which have positive effects for the global market. The developments are introduced to strengthen the effectiveness of *Sharī'ah* governance within Islamic finance institutions (IFIs). Ayub (2019) wrote a complete chapter in his book '*Research in Corporate and Shari'ah Governance in the Muslim World: Theory and Practice*' and critically analysed the *Sharī'ah* Governance Framework (SGF) issued by the State Bank of Pakistan (SBP) in 2015 and examined the strengths and weaknesses. Ayub (2019) pointed out that there is also a lack of solid basis for *Sharī'ah* pronouncements by the *Sharī'ah* Advisors. Further, conflicts of interests in *Sharī'ah* Advisory Framework has been observed like a special kind of employer and employee relationship exists between the IBIs and the SB members. Moreover, the SB's members are allowed to attain multiple memberships of different IBIs. There also arises the issue of senior-junior or teacher-student relationships among the SB members

Though, there are several studies conducted on *Sharī'ah* governance, there is not a single study conducted so far to record the insight of *Sharī'ah* scholars on *Sharī'ah* Governance Framework (SGF) 2018.

Generally, the comprehensive and rigorous studies on *Sharī'ah* governance are still in scarcity, especially in case of Pakistan, which is an Islamic democratic state and has a long Islamic history in the sub-continent. Hence, this research paper fills the gap by exploring the perspectives of *Sharī'ah* scholars of IBIs on the importance of SGF, its implementation, compliance and major issues in its implementation. Due to the novelty of the topic and scarcity of available literature, and to get an empirical evidence, the researcher collected the data through semi-structured interviews with the selected *Sharī'ah* scholars of Islamic banking institutions (IBIs).

Based on the above literature, it can be concluded that no study has so far checked the level of implementation of the SGF in Pakistan. Moreover, the Shariah Scholars' insight on the implementation of the SGF is also missing which is indicative of an obvious gap. Therefore, the current study is conducted to fill this gap. Further, the Shariah Scholars have also given suggestions for a more comprehensive *Shari'ah* governance framework for Islamic banking institutions in Pakistan.

### 3. Research Methodology

This research uses the qualitative approach to analyze the perspectives of *Sharī'ah* scholars of IBIs on *Sharī'ah* Governance Framework (SGF) and its implementation. The best approach for exploration is qualitative (Sekaran & Bougie, 2016). Qualitative research is well-versed to describe events, people, and processes (Miles & Huberman, 1984). This approach is suitable to this research because the qualitative research addresses the questions of how and why (Freeman & Cavusgil, 2007). Qualitative research gives freedom to the researcher to understand the phenomenon of how people interpret their experiences, build their worlds, and attach meanings to their experiences (Merriam, 2009). The qualitative research has the feature to collect in-depth data for exploration without considering the numerical data (Creswell, 2013). The qualitative research methodology has the ability to generate ample and comprehensive details about the SGF, its importance, implementation and issues to implement it in letter and spirit.

As the objective of the research is to explore, so the most appropriate data collection method for this research is interview (Creswell, 2013; Sekaran & Bougie, 2016). The interview method is one of the best data collection techniques that have been used in number of prominent social sciences research (Blee & Taylor, 2002).

The prospective interviewees' list of SB and SCD members was developed by considering key informant interviewing approach aligning with the objective of the study. The selected members represent the Islamic banks (all five fully-fledged IBIs and standalone branches of the conventional banks) of Pakistan. Thirty (30) interviewees were selected on the basis of precise criteria. The criteria consist of their Islamic banking experience, position, role, qualification, and the criteria mentioned in SGF (Ayedh & Echchabi, 2015). Afterwards, SB and SCD members of the Islamic banks were formally contacted, interview request letters were sent, and calls were made to finalize the time and place for conducting the interviews. After facing several problems and restraints, twenty (20) members of

the *Sharī'ah* boards and *Sharī'ah* compliance departments from ten IBIs were finalized with their consent to conduct the interviews. All participants agreed to have interview either in person or over the telephone.

It is already an established fact that the structured questions do not provide the in-depth details of a problem to suffice the purpose of such a research (Ayedh & Echchabi, 2015). To fetch the interviewees' experiences, semi-structured in-depth interviews were conducted. The semi-structured interview method has flexibility to modify the questions and to ask more questions for clarity and detailed information in comparison with the structured interviews (Bryman, 2012). Same questions were provided to all the interviewees to seek the answer to the research questions on checking the level of implementation in all the selected Islamic banks. The semi-structured interviews were conducted both face to face and through telephonic communication mode to find the insight of *Sharī'ah* board and *Sharī'ah* compliance department members on *Sharī'ah* Governance Framework and its implementation. The recorded semi-structured interviews range between half an hour to one hour which is in line with the suggestion of Jacob & Furgerson (2012). According to Jacob & Furgerson (2012), the lengthy interviews lose the interest of the respondent. The interview questions developed for the purpose of this study were first shared with the Islamic finance experts who validated them to be adequate for achieving the objectives of this study. The interview questions were drafted in a standardized format in a semi-structured interview guide. Each interview question addressed only one explicit issue. This helped the respondents to understand the questions and context of the questions easily and hence provided the best answers. The interview questions were developed with the point of view to be analyzed appropriately through coding and thematic approach with NVivo 12 software.

The interviewees were guaranteed of the confidentiality of their information and identity. It was assured that name and details of interviewees will not be publicized. Interviews iterated in review process and transcribed to ensure the validity and reliability of information. On the sound grounds of interpretive philosophy, thematic analysis is applied on the transcribed data to achieve the holistic understanding of the SGF (Cassol, et al., 2018). In thematic analysis, the themes are developed on the basis of patterns available in answers of the respondents and being named on the basis of previous studies (Berg & Lune, 2004).

#### 4. Key Findings, Analysis, and Discussions

A number of key findings have been identified through the interviews of the IBIs' Shariah Scholars regarding their insight on the importance of SGF, its status

of implementation, and the issues and barrier in its implementation which are discussed as follows:

#### 4.1 Concept of *Sharī'ah* Governance Framework (SGF)

*Sharī'ah* Governance Framework (SGF) was introduced and implemented by the State Bank of Pakistan (SBP) in 2015 and revised in 2018 to ensure the compliance with *Sharī'ah* in IBIs in Pakistan (Shahzad, Saeed, & Ehsan, 2017). The question about the basic concept of SGF helped the researchers to comprehend how the respondents perceive the concept. This not only manifested the underlying concept of SGF but also validated the selection of the respondents in line with the topic (Ayedh & Echchabi, 2015).

The interviewers have admitted that SGF provides in detail the roles and responsibilities of all the key players namely, the Board of Directors (BODs), Management, *Sharī'ah* Board (SB), Resident *Sharī'ah* Board Member (RSBM), *Sharī'ah* Compliance Department, Internal *Sharī'ah* Audit, and External *Sharī'ah* Audit.

*“Sharī'ah governance is related to those departments which pertain to shari'ah, to move them in organize way like Shari'ah Board (SB), Shari'ah Compliance Department (SCD), Internal Shari'ah Audit (ISA), External Shari'ah Audit (ESA) with common goal to govern, control and carry forward in one direction and synergize them.”* (IB2)

*“The objective of the SGF is Shari'ah Compliance”* (IB10).

According to the interviewees, SGF has three important functions which are very crucial for the smooth working of the Islamic banks in *Sharī'ah* compliant manner. The three important functions include SBP and SB guidance, SCD implementation and Audit Department cross checking.

*“State Bank of Pakistan (SBP) provided a framework on Shari'ah governance and also in other countries it is being provided. The mechanism consists of three components, shari'ah ruling by SBP for opinion and guidance, Compliance Department for implementation and audit department for cross checking.”* (IB3)

Further, they stated that SGF is a document of rules, regulations, policies and SOPs which prevent the Islamic banks form *Sharī'ah* non-compliance. In Pakistan SGF, is a standard for shariah governance in Islamic banks and all their departments as well as at all levels of management. It addresses banking transactions, control, governance, organization, policies, *Sharī'ah* compliance and synergy.

*“SGF basically provides all rules and regulations. SGF means practices of Islamic banks for which guidelines are prepared like how SB will develop and function; what will be the responsibilities of BODs, EM, every concerned department and their limitations with reference to Shari’ah and its implementation?” (IB10)*

So SGF is implemented in Islamic banks to ensure the compliance of *Shari’ah* laws. This will only be possible if all the organs in Islamic banks work with coordination and in true synergy with one sole objective of *Shari’ah* compliance. The analysis of the interviews confirms the appropriation of the selected *Shari’ah* scholars and clearly defines the objectives of the SGF.

#### **4.2 Importance of *Shari’ah* Governance Framework (SGF)**

Regarding importance of the SGF, the interviewees rightly pin point the facts which depicts the importance of SGF. The IB1 stated:

*‘Yes, SGF is very important because if you do not comply with shari’ah governance and depend on self-governance, then chances of error will increase. Even though in shari’ah Board, roles must be defined what every employee has to do. Otherwise it is detrimental for the organization” (IB1)*

The self-governance is not a solution to avoid chances of error and uniformity; SGF is mandatory. The interview IB3 explained:

*“Yes, it is very important because if there is no check mechanism, then it will not be fruitful. For example, a person gets fatwa then he is not bound to do as per fatwa because there is no check and balance, It is his own discretion to follow it or not. But the SGF ensures implementation” (IB3)*

In the interviewees’ opinion, SGF works as a safeguard for Islamic banks to minimize the chances of errors, ensure implementation, mitigate risk, and maintain uniformity and standardization in Islamic banking practices. The answers given by the *Shari’ah* scholars affirm the importance of the SGF. All the respondents confirm that it was the need of the hour.

*Shari’ah* Governance Framework (SGF) was developed after a long history of Islamic banking in Pakistan. In late 1970s, Pakistan had started to transform its financial system on the strong footing of *Shari’ah*. The long passage from Non-Interest based (NIB) banking system to full-fledged Islamic banks and general *Shari’ah* guidelines to *Shari’ah* Governance Framework took almost 30 years (Ayub, 2019). There were a number of reasons to introduce SGF and to prove that the Islamic banks are in reality Islamic.



Grais & Pellegrini (2006) pointed out the importance of corporate governance for Institutions offering Islamic financial services (IIFS) and discussed the prevalent corporate governance arrangements for IIFS, and suggested to ensure the consistency of their operations with Islamic finance principles. Omar, et al. (2014) investigated the advantages and constraints resulting from the implementation of SGF in Malaysia. He finds that with the introduction of SGF 2010, the institutions became more efficient. *Sharī'ah* Governance supports the stakeholders theory. *Sharī'ah* Governance boosts the trust and confidence of the stakeholders of Islamic banks. This trust and confidence impact the stability of Islamic banks, their functions and their performance (Ginena & Hamid, 2015).

#### 4.3 *Sharī'ah* Governance Framework (SGF) Implementation Status

Some of the respondents admitted that there are flaws in implementation of *Shari'ah* Governance Framework (SGF). The interviewee 3 responded that the *Shari'ah* Governance Framework is completely implemented in his bank but he was not confident and added that still there are some minor issues related to its implementation. It is very easy to say that SGF is 100% implemented in any bank but difficult to handle the probing questions. This fact proves that implementation is missing in some areas.

*‘Yes, it is completely implementing / complying with SGF. But some minor issues are there.’ (IB3)*

The interviewee 4, in his response, clearly mentioned that in some areas implementation was missing because of its new plan and design which requires time for implementation. The lacuna in implementation raises a serious question on ensuring *Shari'ah* compliance in Islamic banks of Pakistan.

*“We cannot say that completely but, yes, overall we cover it. In some areas, implementation is missing. It was new plan and new design; with the passage of time things become clear and easy to implement.” (IB 4)*

Interviewee 8 admitted that there is no 100% compliance, and some areas needed improvement. The majority of the respondents were struggling to ensure that SGF is 100% implemented in their Islamic banks.

It is evident from the scholars' views that there are some issues in the implementation of *Shari'ah* Governance Framework which urgently needs to be resolved. The poor implementation of the SGF could shake the trust of the public which is already stereotypical about Islamic banking system and could severely hit the image and credibility of the Islamic banks in Pakistan. Chapra and Ahmed (2002) depicted the concerns of the depositors that in case of *Sharī'ah* non-

compliance, they are committed to withdraw their money. At this point, this study specifies that the scholars have acknowledged the weaknesses in implementation of *Shari'ah* Governance Framework.

#### 4.4 Issues in Implementation of *Shari'ah* Governance Framework (SGF)

Although the SGF resolved many issues and improved the process of implementation and *Shari'ah* compliance (Ayub, 2019), but still some issues have been highlighted by the interviewees. These issues are given below:

1. Regulator's Role
2. Dual Banking System
3. Management of *Shari'ah* Compliance Department
4. Communication Gap between Management and SB
5. Interpretation, Quantification, and Review
6. Multiple Memberships Issue
7. Conflict of Interest

##### 4.4.1 Role of the Regulator

The respondents disclosed that there are communication and understanding gaps between regulators and IBIs in implementation of *Shari'ah* Governance Framework (SGF). SBP has its own *Shari'ah* Board which provides the interpretation of the rules and regulations. Number of times the interpretation provided by the IBIs' SB was not acceptable by the *Shari'ah* Board of SBP. The difference in understanding the rules and regulations established a serious problem in implementation. At this point, the *Shari'ah* Scholars insisted for the uniformity of the interpretations and break down of the communication gaps. *Shari'ah* scholars admit that there is a communication and understanding gap between the regulator and IBIs. Moreover, the review process is also weak in Islamic banking institutions. The regulator should improve and ensure a proper review of IBI's activities by the SBP inspection team (Shahzad, Saeed, & Ehsan, 2017).

*"SBP did not accept our interpretations." (IB 5)*

The respondents highlight that the regulator imposes a number of regulations and requires minute requirements from IBIs' SB which are not realistic. Moreover, some requirements are concerned with the regulator itself which are unnecessary to be required from IBIs. For example, one of the requirements of the regulator is that all the activities of the Human Resource (HR) Department must be approved by the *Shari'ah* Board of IBI. This is an unnecessary requirement which should be removed from SGF. These requirements are another hurdle and not possible to be implemented.

*“Yes, but we face some issues in implementation/compliance of SGF in such a way that it is not at our part but at the end of SBP. For example, SGF requires very minute requirements from SB but our SB is much occupied that it is not possible to comply with these minute things. They require that minutes things like all activities of HR must be approved by SB. Our SB is of international level; it is not possible for them to spare time for these minute things.” (IB5)*

Further, in terms of the review process by the regulator, the interviewee 3 highlighted that the existing review process by the SBP inspection team is not appropriate. Hence, they insisted to have a strong review process to address the procedural and operational issues. The weak review process cannot be able to ensure the 100% compliance of SGF in Islamic banking institutions (IBIs).

It means that there is communication and understanding gap between the regulator and IBIs. Moreover, the review process is also weak in Islamic banking institutions. The regulator should improve and ensure a proper review of IBI’s activities by the SBP inspection team.

#### **4.4.2 Dual Banking System**

Interviewee 10, from a conventional bank having Islamic branches, argued that dual banking system was adopted as a strategy to slowly switch from conventional banking system to Islamic but the competition in the dual system is one of the hurdles for IBIs to fully comply with SGF. This is because the conventional banks take benefits from fluctuation of non-compliant rates of return in the market (Ayub, 2019). The Interviewee 10 stated:

*‘The main issue in any country is dual banking system in terms of shari’ah implementation. For example, if discount rate rises, the conventional banking system is in advantageous position. The conventional banks could raise the profits but Islamic banks couldn’t use this opportunity due to shari’ah restrictions. We have to comply completely but when we comply with shari’ah, our business and profitability hits. Conventional banking has many other benefits and liberties but for Islamic banks SCD, SB, SA and SBP all are there to check for compliance. For any investment, we have to check if SGF allowed it or not. Issues are many and multiple.’ (IB 10)*

This has rightly been identified by Ayub (2019) that the dual banking system is contrary to the original Vision as envisioned by ‘Father of the Nation’ Muhammad Ali Jinnah. Separate Islamic banking system should be introduced by the SBP and eliminate Riba as early as possible [Article 38 (f)]. This foundational flaw in the

approach has very solemn implications with regards to the results of implementing the system. Therefore, from now on, SBP should play its role by not allowing any conventional bank to open a conventional branch so that their operations are squeezed and phased out gradually.

#### 4.4.3 Management of *Shari'ah* Compliance Department

It is the requirement of the SGF that IBIs must have SCD which will work under the supervision of SB. The head of the SCD will report to SB, and performance evaluation of SCD head will also be finalized by the SB. Interviewee 8 stated:

*“Yes there are some issues at the end of management which sometimes leads to non-compliance with SGF. These issues are related to business and compliance which banks feel creating problem in implementation. Banks are not ready to implement it. For example, reporting line issues of Head SCD and RSBM.” (IB8)*

For smooth reporting, the SBP has to ensure the reporting line procedures.

*“The SCD is functionally reporting to SB but the Management administrates their function. The SCD reporting to management will impact SCD directly and indirectly. The function of the SCD should be with the SB both functionally and administratively.” (IB4)*

Further, in some banks there is only one resource person in SCD which is practically burdensome for the resource person. The SCD is the crucial department in implementation of the SGF. If there is a shortage of human resources, it will definitely impact the *Shari'ah* compliance. The SGF should include a provision to quantify the resource persons in SCD.

*“One person in SCD is not enough.” (IB1)*

One of the functions of SCD is to present the Internal *Shari'ah* Audit and External *Shari'ah* Audit report to SB after evaluation. The head of the SCD or other member of the SC department must be a qualified and experienced officer as guided in the SGF. He should be able to evaluate and present comprehensive internal and external audit reports. The minimum number of human resources in SCD should be two (2). One must be *Shari'ah scholar* and other one should be good in business administration, accounts, audit, compliance as well as *Shari'ah*.

*“SGF guided that in SCD there should be a qualified and experienced officer. He should be well-versed in business administration, accounts, audit, compliance and Shari'ah. If SC and Internal Shari'ah Audit reports are weak then definitely it will affect the annual reports of the bank. SGF should quantify the number of persons in SCD” (IB 1, IB2)*

*“SCD person should be qualified and experienced in Audit and have good knowledge of shari’ah as well. Fit and Proper Criteria must be for IS Auditor.” (IB1)*

According to the majority of the interviewees, the management of Islamic banks interferes in the reporting structure provided in the SGF. This attitude of management towards the SCD sometimes makes the department’s personnel under pressure while complying with the SGF provisions related to reporting. The problem in reporting lines disturbs the SCD department and creates issues in the implementation process. The analysis suggests that SGF must clearly state and ensure the functional and administrative reporting of the Shari’ah compliance department (SCD). Deficiencies in SCD functions give rise to Shari’ah non-compliance and Shari’ah risk (Ginena, 2014). The interviewees also suggested that SGF must state the minimum staff members in SCD to enable it to discharge its responsibilities properly and timely. In addition, the members of the SCD must be well-equipped in audit function of the bank to ensure compliance by presenting the real process in terms of accounting and auditing perspective.

#### **4.4.4 Communication Gap between Management and Shari’ah Board**

The respondents disclosed that there are communication gaps between management and Shari’ah board in implementation of Shari’ah Governance Framework (SGF). The Shari’ah knowledge of the BOD is weak. The members of the management have different educational backgrounds that makes it difficult for them to understand the essence of the recommendations provided by the SB. The management needs to give them more training to understand the rules of Shari’ah.

In this situation, instructions provided in SGF regarding the half yearly meeting are not appropriate. A smaller number of meetings is one of the factors in delays to understand the issues and may lead to inapt decisions. The inapt decisions will lead to non-compliance and will shake the confidence of the stakeholders and general public. At least, the number of meetings should be eight (8).

*“shari’ah board should do eight meetings in a year with BOD.” (IB1, IB2)*

#### **4.4.5 Interpretation, Quantification and Review**

Regarding this issue, the interviewees responded:

*“Interpretation of SBP inspection team and our bank is different regarding SGF. Sometimes, SBP did not accept our interpretations.” (IB5)*

*“Shari’ah governance framework should be quantified.” (IB11, IB2)*

*“Yes, we have some issues like procedural or some operational issues. These issues will be resolved by review process.” (IB3)*

These interviewees responded that the IBIs also face the issues of the interpretation of the guidelines provided by SGF and lack of proper quantification. If the framework is in the quantified form, it will be easy to implement. For example, if SGF inculcates the minimum number of staff members in SCD, it will definitely resolve the issue. Due to the difference in interpretation of the SGF, some banks implement according to their own understanding which the SBP inspection team do not accept afterwards in many cases. Due to vagueness in the provisions of the SGF, Islamic banks face some procedural and operational issues which require a strong review process by SB to rectify and ratify. The analysis shows that SBP must improve the SGF to resolve quantification and interpretation issues (Harun & Abdullah, 2017). The respondents also emphasized that the review process needed improvement.

#### 4.4.6 Multiple Memberships Issue

The interviewee 7 and 9 emphasized that multiple memberships should be eliminated.

*“The multiple memberships is another issue which must be addressed properly. According to SGF, one SBM is allowed to work for up to three Islamic banks. This creates review problem and disturb the quality of work. One SBM cannot handle work of three IBIs. Poor quality of work generates Shari’ah non-compliance issues. The Shari’ah non-compliance pushes the IBI towards Shari’ah non-compliance risk. SGF should address this issue and restrict SBM to work only for one IBI.” (IB7)*

*“SBM should not be allowed to work for more than one IBI. This will create serious non-compliance issues. Single SBM cannot handle the work of three IBIs.”(IB9)*

SBP must improve the SGF by removing the clause ‘SB members except RSBM, may serve on the SBs of up to three IBIs in Pakistan’. The multiple memberships issue must be addressed properly. SBM should not be allowed to work for more than one IBI (Ayub, 2019).

The scholars stated that the Shari’ah board members have the privilege to serve on the SBs of up to three IBIs in Pakistan. This privilege is provided to Shari’ah board members on the ground that Shari’ah scholars are not available in the market to fulfill the required criteria of SBP (SGF, 2018). This multiple membership of SBMs creates a serious issue of non-compliance. The SBMs who have multiple memberships are unable to manage the workload. It is observed that most of the time SBM depends on RSBM and overlooks the provided review task.

#### 4.4.7 Conflict of Interest

One of the interviewees' explained the conflict of interest:

*“The appointment of RSBM with high salary package and good payment for quarterly meeting for SBMs put RSMB and SB under pressure to give leverage to management in decisions making. This pressure hits the independence of SB. This conflict of interest leads to Shari’ah non-compliance.” (IB16)*

It means that the independence of RSBM and SB must be ensured. The independence of SB and RSBM is directly proportional to the Shari’ah compliance. The reporting of SB should be to the State Bank of Pakistan (SBP) (Hamza, 2013).

The respondents disclosed that there was a conflict of interest in the appointment of RSBMs. RSBM is a regular employee of an Islamic bank. Management is generally desirous to pay relatively high monthly salary to RSBM. The other SBMs are required to meet once in a quarter of year. The high monthly salary and handsome package for the quarterly meetings create pressure on SB and hit the independence of SB. The SB has to be flexible in the approval of products and ignoring gaps. This conflict of interest opens back doors to Shari’ah non-compliance and becomes a big hurdle to implement SGF.

### 5. Conclusion and Recommendations

The main objective of the study was to comprehensively examine the *Shari’ah* scholars’ insight on *Shari’ah* governance framework in Islamic banking institutions (IBIs) in Pakistan. The findings revealed that the selected *Shari’ah* scholars of the Islamic banks have good exposure of *Shari’ah* governance framework. Furthermore, SGF is important and gives strength to ensure *Shari’ah* compliance. The research indicates that *Shari’ah* scholars have dissimilar views on the question about 100% implementation of SGF which is a question mark on *Shari’ah* compliance because some scholars admit that SGF is not 100% implemented in their respective banks. The analytical findings specify that there are a number of issues, gaps, and shortcomings in SGF. There is a communication and understanding gap between the regulator and IBIs. The review process is also weak in Islamic banking institutions. The regulator should improve and ensure proper review of IBI’s activities by the SBP inspection team. The SBP should introduce separate Islamic banking system to eliminate Riba. The study reveals that SGF must clearly state and segregate the functional and administrative reporting of the Shari’ah compliance department (SCD). Moreover, SGF must state the minimum staff members in SCD to enable it to discharge its

responsibilities properly and timely. In addition, the members of the SCD must be well equipped in audit function of the bank to ensure compliance by presenting the real process in terms of accounting and auditing perspective. It is recommended that the SBP should improve SGF to reduce the communication gap between BOD and SB. It is only possible with training and enhancing the number of meetings of SB with BOD to excavate the problems in implementation and compliance. The SBP must improve the SGF to address the interpretation problem, quantify it and discourse procedural and operational issues. These flaws are creating the problem in the compliance of the SGF in true letter and spirit.

This study has significant contributions to the body of knowledge, for practitioners, policymakers, and regulators. This study provides a comprehensive overview of the SGF and its issues from the practitioners' perspective. The findings suggest that the SBP should take initiative to improve the SGF in the light of the research findings and ensure the implementation of SGF in its true essence. The study proposes a valuable source of information that may activate policymakers and practitioners for further improvements and developments in the *Shari'ah* governance framework as well as its implementation.

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