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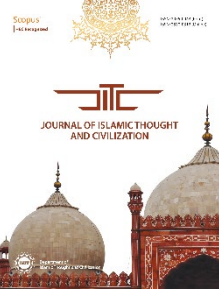
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***Sharī'ah* Governance and *Sharī'ah* Non-Compliance Risk Management: A *Maqāsīd Sharī'ah* Based Appraisal**

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Abstract

The current study aims to explore the *Sharī'ah* Governance (SG) and the management of *Sharī'ah* Non-Compliance Risk (SNCR) in Islamic Banks (IBs) of Pakistan through the lens of *Maqāsīd Sharī'ah*. For this purpose, the content analysis method was employed on the *Sharī'ah* Governance Framework (SGF) issued by the State Bank of Pakistan (SBP), by concerning the related literature. Content analysis revealed that SGF explicitly defined the roles and responsibilities of various organs of SG of IBs towards *sharī'ah* compliance. Moreover, the study also revealed that IBs were exposed to SNCR whenever they failed to comply with *Sharī'ah* and consequently, SNCR lead to such a situation that threatened the stability and viability of IBs. The findings of this paper suggested that the viability and stability of IBs, as one of *Maqāsīd Khassah* of the Islamic financial system, is being fully realized through different SG mechanisms provided in SGF, which strengthened the overall *sharī'ah* compliance environment of IBs in Pakistan. It was also confirmed that different *Maqāsīd Sharī'ah*, such as transparency, protection and growth of wealth, equity and justice in return distribution, and two dimensions of the well-being of society from the perspective of *Maqāsīd Sharī'ah*, namely, safeguarding religiosity and safeguarding wealth were being realized through SG mechanisms of IBs in Pakistan.

Keywords: Islamic banking, *Maqāsīd Sharī'ah*, *Maqāsīd Khassah* of IBF, *Sharī'ah* governance, *Sharī'ah* Non-Compliance Risk Management (SNCR).

JEL Classification: A14, D02, D31, D63, D64, E58, G18, G21, I31, K12, M14

Introduction

Islamic banks (IBs) provide financial services distinctively different from interest-based conventional banks (CBs).¹ Significantly, the element, which makes IBs distinctive from CBs is that IBs follow *Sharī'ah* principles regarding financial contracts and dealings. Therefore, it is believed that all those commercial transactions and financial dealings are Islamically permissible, which are not prohibited explicitly by the Lawgiver and does not contain any impermissible elements. Importantly, innovative product development can be done based on this general rule of permissibility.² Essentially, it is important to realize that Islamic finance is more concerned about certain prohibitions, like prohibitions of *Riba* (interest), *Gharar* (grave uncertainty), *Qimar*

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¹Rafiullah Sheikh, and Atiquzzafar Khan, "Liquidity Management Mechanisms of Islamic and Conventional Finance: A Shariah Appraisal," *Policy Perspectives* 15, no. 2 (2018): 1-24, <https://doi.org/10.13169/polipers.15.2.0001>.

²Muhammad Yousuf Saleem, *Islamic Commercial Law* (Hoboken, N.J: John Wiley and Sons Ltd., 2013).

(gambling), *Maysir* (games of chance), and *Bay al-Dayn* (sale of debt)³ Moreover, Islam requires financial contracts and dealings, which are not contradicting *Maqasid Sharī'ah* (*sharī'ah* objectives).⁴ Under such conditions, the concept of *Sharī'ah* Governance (SG), parallel to Corporate Governance (CG), has been evolved for IBs to ensure their *Sharī'ah* compliance, which is the underlying reason for IBs' establishment and existence.⁵

SG is considered an essential part of IBs' overall CG structure but unfortunately, it has not received much attention in the literature on Islamic banking and finance.⁶ Researchers, however, asserted that IBs were not able to perform their religious and ethical responsibilities, usually required by IBs' stakeholders, without having effective governance mechanisms. Keeping this in mind, SG frameworks have been developed explicitly by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), International Financial Services Board (IFSB), and various other regulatory bodies worldwide. Importantly, these SG frameworks demand the implementation of appropriate structures and processes from IBs, for ensuring complete *Sharī'ah* compliance in all operational activities.⁷

It is a common understanding that an effective SG framework of IBs would be comprising such SG mechanisms that facilitate the oversight and supervisory functions of IBs' board of directors (BODs), their executive management (EM), and especially, their *Sharī'ah* Supervisory Boards (SSBs).⁸ Researchers, however, argued that any such process lacking an ethical and moral dimension would probably fail to establish an absolute Islamic governance system.⁹ Contrary to Western secular thought, Islam has integrated both the spiritual and the material gains in business activities.¹⁰ Furthermore, it was strongly asserted that when Islam is practiced in totality without any negligence, then all its socioeconomic aspirations would be realized.¹¹

Sharī'ah supervision holds an extremely important position in the IBs' governance structure. Whenever IBs fail to observe *Sharī'ah* guidelines in their business activities, *Sharī'ah* non-compliance risk (SNCR) arises, and consequently, the financial transaction was nullified, thereby,

³Muhammad Ayub, *Understanding Islamic Finance* (Chichester, West Sussex: John Wiley and Sons Ltd., 2007).

⁴Muhammad Tahir Mansoori, *Islamic Law of Contract: Applications in Islamic Finance* (Islamabad, Pakistan: Institute of Policy Studies, 2020).

⁵Saleh Abdulrahman Al-Amer, *Shariah Supervisory Board in Islamic Banks: A Critical Analysis of the Current Framework* (Doctoral Dissertation, University of Leeds, 2018).

⁶Scott Morrison, "Shariah Boards and the Corporate Governance of Islamic Banks in the United Kingdom," *Journal of Islamic Economics Banking and Finance* 10, no. 1 (2014): 96-109, <https://doi.org/10.12816/0025699>.

⁷Md. Kausar Alam, Muhammad Shahin Miah, Md. Naim Siddiqui, and Mohammad Intiaz Hossain, "The Influences of Board of Directors and Management in Shariah Governance Guidelines of the Islamic Banks in Bangladesh," *Journal of Islamic Accounting and Business Research* 11, no. 9 (2020): 1633-1647, <https://doi.org/10.1108/jiabr-08-2019-0155>.

⁸Yusuf Karbhari, Md. Kausar Alam, and Md. Mizanur Rahman, "Relevance of the Application of Institutional Theory in Shariah Governance of Islamic Banks," *PSU Research Review* 5, no. 1 (2020): 1-15, <https://doi.org/10.1108/prr-05-2020-0015>.

⁹Abdussalam Mahmoud Abu-Tapanjeh, "Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles," *Critical Perspectives on Accounting* 20, no. 5 (2009): 556-67, <https://doi.org/10.1016/j.cpa.2007.12.004>.

¹⁰Simon Archer, and Rifaat Ahmed Abdel Karim, *Islamic Finance: The Regulatory Challenge* (Singapore: John Wiley and Sons Ltd., 2007).

¹¹Rania Kamla, "Critical Insights into Contemporary Islamic Accounting," *Critical Perspectives on Accounting* 20, no. 8 (2009): 921-932, <https://doi.org/10.1016/j.cpa.2009.01.002>.

the income from that transaction cannot be recognized.¹² Additionally, the reputation of IBs got damaged, due to which, they suffered financial losses because their profitability was dependent on the general public trust regarding their *Shari'ah* compliance.¹³ To mitigate SNCR, IBs appointed renowned *Shari'ah* scholars, who were well versed in *Fiqh Al-Muamalat* generally and the contemporary financial transactions particularly, on their SSBs.

Aforementioned, financial contracts and dealings should not be contradicting *Maqasid Shari'ah* objectives otherwise; they would be invalid. Majority of Muslim scholars believe that *Shari'ah* laws are given by the Lawgiver to achieve certain objectives related to human well-being. These objectives, termed *Maqasid Shari'ah*, which also are mentioned in various verses of the *Quran* and different *Hadith* (sayings) of Prophet Muhammad (*SAW*). According to Al-Ghazali, *Maqasid Shari'ah* is meant to preserve and protect humans' religion, life, progeny, intellect, and wealth.¹⁴ *Maqasid Shari'ah* is alternatively referred to as *Huqūq Allah* (rights of Allah (SWT)). Here, *Huqūq Allah* refers to all things, which are essential for human welfare. The rights of fellow human beings (sometimes called public rights) quite obviously have priority over contractual rights. The requirement of *shari'ah* that a financial contract should confirm to *Maqasid Shari'ah*, is similar to that in modern law, according to which, if any contract is found contradicting the public policy of that contract would be invalid.¹⁵

Therefore, the primary aim of this research is to undertake a *Maqasid Shari'ah* -based appraisal of SG and management of SNCR in IBs to explore the achievement realization of *Maqasid Shari'ah* through SG mechanisms of IBs in Pakistan. Furthermore, the aim is to look at the following four objectives: to explore the distinctive SG mechanisms of IBs; to establish a link between the SNCR and the credit, legal and compliance, reputational, and market risks; to identify those *Maqasid Shari'ah*, which can be realized in Islamic banking & finance; and to explore the SG and SNCR management policies and practices of IBs through the lens of *Maqasid Shari'ah*.

The rest of the paper is structured as follows: section 2 discusses SG of the Islamic banks, section 3 describes SNCR and its implications, section 4 discusses *Maqasid Shari'ah* and their realization in Islamic banking and finance, section 5 makes *Maqasid Shari'ah* based appraisal of SG and SNCR management in Islamic banks, and the final section 6 concludes the paper.

1.1. Research Objectives

1. To explore the distinctive SG mechanisms of IBs.
2. To establish a link between the SNCR and the credit, legal and compliance, reputational, and market risks.
3. To identify *Maqasid Shari'ah*, which can be realized through Islamic banking and finance (IBF).

¹²Erdem Oz, Zahid ur Rehman Khokher, Mohammad Mahbubi Ali, and Dr. Romzie Rosman, *Shariah Non-Compliance Risk in the Banking Sector: Impact on Capital Adequacy Framework of Islamic Banks* (Kuala Lumpur, Malaysia: IFSB Working Paper Series, Islamic Financial Services Board, 2016), <https://www.ifsb.org/download.php?id=4409&lang=English&pg=/index.php>.

¹³Saleh Abdulrahman Al-Amer, *Review of Shariah Supervisory Board in Islamic Banks: A Critical Analysis of the Current Framework* (Doctoral Dissertation, University of Leeds, 2018).

¹⁴Abu Hamid Al-Ghazali, *Ihya' Ulumuddin (Arabic)* (Beirut: Dar al-Khair, 1990).

¹⁵Muhammad Tahir Mansoori, *Islamic Law of Contract: Applications in Islamic Finance* (Islamabad, Pakistan: Institute of Policy Studies, 2020).

4. To explore the SG and SNCR management policies and practices of IBs through the lens of *Maqasid Shari'ah*.

2. *Shari'ah* Governance of Islamic Banks

Currently, IBs are rapidly growing worldwide among Muslims as well as in the developed countries where Muslims are not in the majority. Parallel to this remarkable growth, IBs are facing many regulatory challenges and governance-related issues across jurisdictions.¹⁶ Responding to these challenges and issues, supervisory authorities in many countries have developed SG frameworks to regulate IBs' activities effectively.¹⁷ It is pertinent to note that the SG framework not only meant for ensuring *Shari'ah* compliance of IBs but also to facilitate mitigating SNCR, which damaged IBs' reputation and minimized their profitability as well.¹⁸

SG can be described as an overall system for ensuring IBs' activities conform to the *Shari'ah* guidelines related to commercial transactions.¹⁹ SG is exclusively unique to IBs, where the SSB plays a leading role.²⁰ According to a recent report, SG is a relatively weak area, which requires the authorities' attention. Furthermore, the report highlighted some issues related to SG, which include the lack of diverse experience of the SSB members and their infrequent meetings. The report also recommended that IBs need improvement in their 'Risk Governance.'²¹ It is worth mentioning here that ensuring *Shari'ah* compliance should not be the responsibility of SSBs only but rather need to be shared by all stakeholders of IBs. Therefore, detailed guidelines on SG are important, so that all IBs' stakeholders completely understand and fulfill their responsibilities.

Islamic Financial Services Board (IFSB), in this regard, issued detailed guidelines, according to which, the SG system is referred as the institutional arrangements for ensuring effective and independent oversight of *Shari'ah* compliance. Through issuance of relevant *Fatwas* (*shari'ah* rulings), dissemination of such *Fatwas* to the personnel of Islamic financial institutions (IFIs) who monitor the *shari'ah* compliance of their operations and each transaction, and an internal *shari'ah* compliance review or audit.²²

¹⁶Naji Mansour Nomran, and Razali Haron, "Shariah Governance for Islamic Banking," *Growth and Emerging Prospects of International Islamic Banking*, ed., Abdul Rafay (Hershey, Pennsylvania: IGI Global, 2020).

¹⁷Rifaat Ahmed Abdel Karim, "International Accounting Harmonization, Banking Regulation, and Islamic Banks," *The International Journal of Accounting* 36, no. 2 (2001): 169-93, [https://doi.org/10.1016/s0020-7063\(01\)00093-0](https://doi.org/10.1016/s0020-7063(01)00093-0).

¹⁸Hayathu Mohamed Ahamed Hilmy, and Rusni Hassan, "Shariah Governance Structure of Islamic Financial Institutions in Sri Lanka," *International Journal of Management and Applied Research* 6, no. 4 (2019): 245-258, <https://doi.org/10.18646/2056.64.19-018>.

¹⁹Karim Ginena, and Azhar Hamid, *Foundations of Shari'ah Governance of Islamic Banks* (Chichester, West Sussex: John Wiley & Sons Ltd., 2015).

²⁰Dewi Fatmawati, Noraini Mohd. Ariffin, Nor Hafizah Zainal Abidin, and Ahmad Zamri Osman "Shari'ah Governance in Islamic Banks: Practices, Practitioners and Praxis," *Global Finance Journal* 51, (2020), <https://doi.org/10.1016/j.gfj.2020.100555>.

²¹General Council for Islamic Banks and Financial Institutions, and The World Bank Group, *Corporate Governance Practices in Islamic Banks 2017* (Manama, Bahrain: General Council for Islamic Banks and Financial Institutions and The World Bank Group, 2017).

²²Islamic Financial Services Board, *Guiding Principles on Shari'ah Governance Systems for Institutions Offering Islamic Financial Services* (Kuala Lumpur, Malaysia: Islamic Financial Services Board, 2009), <https://www.ifsb.org/download.php?id=4366&lang=English&pg=/published.php>.

This comprehensive definition of the SG system revealed that there are mechanisms within IBs that are established to ensure *Shari'ah* compliance with all their products and business activities. SSB is the most important mechanism in this regard,²³ which is required to coordinate and interact with other SG mechanisms. For instance, SSB needs to coordinate with the product developers and the *Shari'ah* compliance unit, during the whole process of product development. Similarly, SSB is required to participate in designing and accordingly implementing training programs in *Shari'ah* compliance along with enhancing IB employees' awareness regarding Islam.²⁴ Therefore, strengthening SSBs' interaction with other SG mechanisms are critical for ensuring the ultimate goals of IBs.²⁵ Moreover, SSB is anticipated to contribute to the Islamic banking industry's development concerning its social responsibilities and ethical behaviour.²⁶

The BOD of each IB is another SG mechanism, which is accountable or responsible to ensure *Shari'ah* compliance about all its operations. The responsibility of approving all Islamic banking-related policies rests with the SSB and BOD. The BOD is also responsible for ensuring the independence of SSB. The BOD and EM are liable to establish a *Shari'ah* compliance mechanism inside an IB. The BOD has also a responsibility toward the investment account holders (IAHs) who have accepted the same risks as those of the shareholders. However, IAHs have no voting rights and forums such as AGMs to communicate their dissents over IBs' performance. The BOD is mandated to meet with SSB twice a year, at minimum, to ensure that the SSB's decisions and recommendations are timely and effectively enforced.²⁷ Other SG mechanisms in an IB include the *Shari'ah* compliance department (SCD), product developers, and internal and external auditors. Whereas, SCD assists SSB and acts as a channel between the SSB and the EM of an IB. Product developers are responsible for the development of new and innovative products and services. Internal and external *Shari'ah* auditors make audit all IB's transactions and ensure their *Shari'ah* compliance.²⁸

Different countries of the world have opted for three different approaches, while establishing regulatory SG structures and processes for IBs. The first approach is identified as the strict approach, according to which, the IBs' regulators have implemented a detailed SG framework. Countries like Bahrain, Kuwait, Malaysia, Oman, and Pakistan follow this approach. However, Bangladesh, Indonesia, Qatar, and UAE have adopted the second approach, which is the moderate one, in which the regulatory body, while leaving other aspects at IBs' discretion provides some major provisions

²³Zulkifli Hasan, "In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System," *International Journal of Islamic and Middle Eastern Finance and Management* 7, no. 1 (2014): 22-36, <https://doi.org/10.1108/imefm-07-2012-0059>.

²⁴Yahia Abdul-Rahman, *The Art of RF (Riba-Free) Islamic Banking and Finance: Tools and Techniques for Community-Based Banking*, 2nd ed. (Hoboken, NJ: John Wiley & Sons, 2014).

²⁵Zulkifli Hasan, *Shari'ah Governance in Islamic Banks* (Edinburgh: Edinburgh University Press, 2012).

²⁶Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus Press, 2009).

²⁷Muhammad Ayub, "Strengths, Gaps and Issues in Shariah Governance Framework 2015 for IBs in Pakistan," *Research in Corporate and Shariah Governance in the Muslim World: Theory and Practice*, eds. Toseef Azid, Ali Abdullah Alnodel, and Muhammad Azeem Qureshi (Bingley: Emerald Publishing Limited, 2019).

²⁸State Bank of Pakistan, *Shari'ah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018), <https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>.

of SG. Whereas, Turkey and Saudi Arabia are among those countries, which have opted for a flexible approach, where all decisions related to SG structures and processes are left at IBs' discretion.²⁹

Sharī'ah scholars have acknowledged that existing SG frameworks have certain imperfections and limitations, which must be addressed.³⁰ Furthermore, it is argued that robust SG mechanisms are necessary for augmenting stakeholders' trust and confidence in Islamic banking.³¹ Such confidence would enhance IBs' stability, capabilities of functioning as financial intermediaries, and financial performance.³² IFSB, in this regard, asserted that strong SG would help in improving stakeholders' knowledge and understanding of *Sharī'ah* concerning financial transactions and consequently enabled them to make decisions wisely. Based on the adequate *Sharī'ah* compliance disclosures from IBs, their investors would then decide whether to invest or divest.³³ Moreover, investors would be capable, comparing the *Sharī'ah* compliance levels of different IBs. In this way, information asymmetries among the management and stakeholders would be reduced, consequently increasing competition and enhancing market discipline. It is further asserted that standardization of SG practices would restrict deceitful activities of IBs' management because *sharī'ah* non-compliance can shake stakeholders' confidence in IBS' credibility, thereby, resulting in withdrawals of the funds.³⁴

3. *Sharī'ah* Non-Compliance Risk and Its Implications

According to IFSB (2005), there are six types of risks being faced by IFIs, which include credit risk, equity investment risk, liquidity risk, market risk, operational risk, and finally, and rate of return risk. However, SNCR is considered an operational risk.³⁵ Importantly, Basel Committee on Banking Supervision (BCBS) defined operational risk as "the risk of financial loss or damage

²⁹Dewi Fatmawati, Noraini Mohd. Ariffin, Nor Hafizah Zainal Abidin, and Ahmad Zamri Osman "Shariah Governance in Islamic Banks: Practices, Practitioners and Praxis," *Global Finance Journal* 51 (2020), <https://doi.org/10.1016/j.gfj.2020.100555>.

³⁰Zulkifli Hasan, "In Search of the Perceptions of the Shariah Scholars on Shariah Governance System," *International Journal of Islamic and Middle Eastern Finance and Management* 7, no. 1 (2014): 22-36, <https://doi.org/10.1108/imefm-07-2012-0059>; See also, Muhammad Ayub, "Strengths, Gaps and Issues in Shariah Governance Framework 2015 for IBIs in Pakistan," *Research in Corporate and Shariah Governance in the Muslim World: Theory and Practice*, eds., Toseef Aziz, Ali Abdullah Alnodel, and Muhammad Azeem Qureshi (Bingley: Emerald Publishing Limited, 2019).

³¹Islamic Financial Services Board, *Guiding Principles on Corporate Governance for Institutions Offering only Islamic Financial Services* (Kuala Lumpur, Malaysia: Islamic Financial Services Board, 2006), <https://www.ifsb.org/download.php?id=4359&lang=English&pg=/published.php>.

³²Wafik Grais, and Matteo Pellegrini, "Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services" *World Bank Policy Research Paper*, No. 4054 (2006).

³³Islamic Financial Services Board, *Guiding Principles on Shariah Governance Systems for Institutions Offering Islamic Financial Services* (Kuala Lumpur, Malaysia: Islamic Financial Services Board, 2009), <https://www.ifsb.org/download.php?id=4366&lang=English&pg=/published.php>.

³⁴Karim Ginena, and Azhar Hamid, *Foundations of Shariah Governance of Islamic Banks* (Chichester, West Sussex: John Wiley & Sons Ltd., 2015).

³⁵Islamic Financial Services Board, *Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) offering only Islamic Financial Services* (Kuala Lumpur, Malaysia: Islamic Financial Services Board, 2005), <https://www.ifsb.org/download.php?id=4357&lang=English&pg=/published.php>.

resulting from inadequate or failed internal processes, people and systems or external events.”³⁶ Henceforth, SNCR can be defined as the risk of financial losses IFIs may experience due to non-*sharī'ah* compliance in banking activities, as required by SSBs or the relevant regulatory authority.³⁷

Importantly, SNCR is linked with the credit, legal and compliance, reputational, and market risks of an IFI. Researchers believe that if SNCR is not appropriately mitigated; it may curtail stakeholders' confidence in the *Sharī'ah* compliance level of an IFI and consequently, they would start realizing that the organization is not meeting its commitments.³⁸ This realization may result in a breach of customers', which are financing contracts with an IB, thereby, causing a credit risk for that IB. Moreover, researchers have argued that non-observance may occur in such cases when customers are not ready to meet their obligations for the following three reasons. Firstly, the customers believe that the contract they made with an IB is nullified on *Sharī'ah* grounds, secondly, customers are not confident about an IB's practices concerning *Sharī'ah* compliance, or thirdly, customers feel that the IB is betraying them. As discussed earlier, if the financial contract is voided due to some *Sharī'ah* violations, then profits generated through such nullified contracts would be unlawful and excluded from the IB's income³⁹ and can be deposited in a charity fund, which is supervised by the SSB for its appropriation for some charitable causes.⁴⁰ Importantly, regulatory bodies of IBs require proper disclosure in this regard.⁴¹

Furthermore, Researchers have argued that SNCR can trigger legal and compliance risks. Although both types of risks are considered interchangeable. However, it is argued that legal risk arises when either an individual or a company fails to fulfill contractual obligations under certain circumstances, contracts become void, and unenforceable. Whereas compliance risk arises when an individual or a company fails to comply with laws and regulations. BCBS defined legal risk as “the possibility that lawsuits, adverse judgments or contracts that turn out to be unenforceable, which can disrupt or adversely affect the operations or condition of the bank.”⁴² In a likewise manner, compliance risk is defined as “the risk of legal or regulatory sanctions, material financial loss, or loss

³⁶ Basel Committee on Banking Supervision, *Principles for the Sound Management of Operational Risk* (Basel, Switzerland: Bank for International Settlements, 2011),

<https://www.bis.org/publ/bcbs195.pdf>.

³⁷Karim Ginena, “Sharī'ah Risk and Corporate Governance of Islamic Banks,” *Corporate Governance: The International Journal of Business in Society* 14, no. 1 (2014): 86-103,

<https://doi.org/10.1108/cg-03-2013-0038>.

³⁸IRTI, and IFSB, *Islamic Financial Services Industry Development: Ten-Year Framework and Strategies* (Jeddah, Saudi Arabia: Islamic Research & Training Institute, Islamic Development Bank, 2007), <https://www.ifsb.org/download.php?id=4420&lang=English&pg=sec03.php>.

³⁹“Accounting and Auditing Organization for Islamic Financial Institutions,” (2022), <http://aaoifi.com/aaoifi-gs-1-sharia-supervisory-board-appointment-composition-and-report/?lang=en>.

⁴⁰Karim Ginena, and Azhar Hamid, *Foundations of Sharī'ah Governance of Islamic Banks* (Chichester, West Sussex: John Wiley and Sons Ltd., 2015).

⁴¹State Bank of Pakistan, *Sharī'ah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018), <https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>.

⁴²Basel Committee on Banking Supervision, *Customer Due Diligence for Banks* (Basel, Switzerland: Bank for International Settlements, 2001), <https://www.bis.org/publ/bcbs85.pdf>.

to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organization standards, and codes of conduct applicable to its banking activities.”⁴³

An IB claims to follow *Shari'ah* guidelines in its memorandum of association and articles of association. If an IB fails to fulfill such claims, its stakeholders can go to court and file lawsuits against the IB due to false advertising and the institution's non-commitment to its claims. For instance, making false claims about services is a criminal offense under the UK's Trade Descriptions Act of 1968. Similarly, there is another UK law, the Fraud Act of 2006, which prohibits making untrue or misleading representations of products or services to make money. These examples confirm that SNCR triggers legal risk.⁴⁴ According to DeLorenzo and McMillen, IFIs face legal risk whenever there is an uncertainty in the interpretation of certain clauses about *shari'ah* in secular courts and there is a possibility of a failure to enforce the *Shari'ah*-based contract in secular jurisdictions, which negatively influences the Islamic financial market.⁴⁵

Scholars have further argued that SNCR can give rise to compliance risk. For example, a regulatory body directs IBs to set up SG mechanisms for effective *Shari'ah* compliance but if IBs fail to do so then they may either be fined for their non-observance or even lose their banking licenses. The Malaysian Islamic Financial Services Act of 2013 obligated IFIs to ensure *Shari'ah* compliance completely. In case IFIs become aware of any non-*shari'ah*-compliant activity, they are required to inform urgently the regulatory body, stop engaging in such non-*Shari'ah*-compliant activity, and within 30 days of noticing the non-compliance, submit a corrective action plan. In case, anybody is found contravening these guidelines, they may either be imprisoned for a term, not more than eight years or penalized for a sum, not more than 25 million ringgit (approximately PKR1.234 billion) or in some cases they might face both.⁴⁶

SNCR may cause reputational risk. BCBS has defined reputational risk as “the potential that adverse publicity regarding a bank's business practices and associations, whether accurate or not, will cause a loss of confidence in the integrity of the institution.”⁴⁷ It is believed that a banking institution deals with the public at large. Therefore, it is crucial for banking success to earn and protect the general public trust and confidence.⁴⁸ Particularly, IBs are vulnerable to reputational risk. They cannot afford to lose their credibility regarding their *Shari'ah* compliance, which is the

⁴³Basel Committee on Banking Supervision, *Compliance and the Compliance Function in Banks* (Basel, Switzerland: Bank for International Settlements, 2005), <https://www.bis.org/publ/bcbs113.pdf>.

⁴⁴Karim Ginen, and Azhar Hamid, *Foundations of Shari'ah Governance of Islamic Banks* (Chichester, West Sussex: John Wiley & Sons Ltd., 2015).

⁴⁵Yusuf DeLorenzo, and Michael McMillen, “Law and Islamic Finance: An Interactive Analysis,” *Islamic Finance: The Regulatory Challenge*, eds., Simon Archer, and Rifaat Ahmed Abdel Karim (Singapore: John Wiley and Sons, 2007).

⁴⁶Mohamad Akram Laldin, and Hafas Furqani, “Islamic Financial Services Act (IFSA) 2013 and the Shariah-Compliance Requirement of the Islamic Finance Industry in Malaysia,” *ISRA International Journal of Islamic Finance* 10, no. 1 (2018): 94-101, <https://doi.org/https://doi.org/10.1108/IJIF-12-2017-0052>.

⁴⁷Basel Committee on Banking Supervision, *Customer Due Diligence for Banks* (Basel, Switzerland: Bank for International Settlements, 2001), <https://www.bis.org/publ/bcbs85.pdf>.

⁴⁸Stergios Leventis, Panagiotis Dimitropoulos, and Stephen Owusu-Ansah, “Corporate Governance and Accounting Conservatism: Evidence from the Banking Industry,” *Corporate Governance: An International Review* 21, no. 3 (2013): 264–86, <https://doi.org/10.1111/corg.12015>.

underlying reason for IBs' establishment and existence as well⁴⁹ because such credibility is consequential for their business.⁵⁰

SNCR may even lead to market risk for an IB. For instance, an IB owns equities, which become non-*Shari'ah*-compliant due to some reason, let us suppose, the debt-to-total assets ratio has exceeded the threshold of 33% and then it is obligatory for the IB to liquidate such equities. Sometimes, such a situation occurs at a time when the equities' market price is less than their purchase price, thereby, leading to several losses. SSB may allow a limited time for market conditions to improve so that major losses are minimum, however, the extension in the grace period would not be beneficial, especially during a recession.⁵¹ To summarize, SNCR may result in the following situations withdrawal of funds, difficulties in attracting deposits at affordable costs, facing financial losses directly and indirectly, liquidity problems, bank runs, bank failures, and financial instability in certain circumstances.⁵² Moreover, SNCR may even damage the reputability of the Islamic banking industry, which relies heavily on stakeholders' trust in the matter of the industry's *Shari'ah* compliance.⁵³

4. Maqasid *Shari'ah* and their realization in Islamic Banking and Finance

According to different prominent *Shari'ah* scholars, *Maqasid Shari'ah* (*shari'ah* objectives) has varied definitions. Al-Ghazali has defined *Maqasid Shari'ah* (*shari'ah* objective) as promoting the well-being of the people, which is based on the protection of their religion, life, progeny, intellect, and wealth. Whatever ensures the preservation of these five serves the *Maslahah* (public interest) and is desirable, however, whatever harms them is against the *Maslahah* and its removal is required.⁵⁴ However, according to Al-Shatibi, *Maqasid Shari'ah* means those objectives, which are fulfilled through the rulings of Allah (*SWT*) that He (*SWT*) meant to preserve people's well-being.⁵⁵ It is pertinent to note that *Maqasid Shari'ah* is either directly stated in the *Qur'an* and the *Sunnah* of the Prophet Muhammad (*SAW*) or deduced by *Shari'ah* scholars from these divine sources. Generally, all *Maqasid Shari'ah* address the justification for the existence of the *Shari'ah*, which is to protect human beings from harm and to serve their interests.⁵⁶

Researchers have believed that concepts of compassion and guidance are at the core of *Maqasid Shari'ah*. According to a *Qur'anic* saying in *Surah Yunus*, "O mankind, there has to come to you instruction from your Lord and healing for what is in the breasts and guidance and mercy for the

⁴⁹Saleh Abdulrahman Al-Amer, *Shari'ah Supervisory Board in Islamic Banks: A Critical Analysis of the Current Framework* (Doctoral Dissertation, University of Leeds, 2018).

⁵⁰Karim Ginena, "Shari'ah Risk and Corporate Governance of Islamic Banks," *Corporate Governance: The International Journal of Business in Society* 14, no. 1 (2014): 86-103, <https://doi.org/10.1108/cg-03-2013-0038>.

⁵¹Karim Ginena, and Azhar Hamid, *Foundations of Shari'ah Governance of Islamic Banks* (Chichester, West Sussex: John Wiley & Sons Ltd., 2015).

⁵²Dahlia El-Hawary, Wafik Graiss, and Zamir Iqbal, *Regulating Islamic Financial Institutions: The Nature of the Regulated (Policy Research Working Paper No. 3227)* (Washington, D.C: World Bank, 2004), <https://openknowledge.worldbank.org/handle/10986/14732>.

⁵³IRTI, and IFSB, *Islamic Financial Services Industry Development: Ten-Year Framework and Strategies* (Jeddah, Saudi Arabia: Islamic Research & Training Institute, Islamic Development Bank, 2007), <https://www.ifsb.org/download.php?id=4420&lang=English&pg=/sec03.php>.

⁵⁴Abu Hamid Al-Ghazali, *Ihya' Ulumuddin (Arabic)* (Beirut: Dar al-Khair, 1990).

⁵⁵Abu Ishaq Al-Shatibi, *Al-Muwafiqat fi Usul Al-Shari'ah (Arabic)* (Beirut: Al-Maktabah Al-Asriyah, 2002).

⁵⁶Muhammad al-Tahir Ibn-Ashur, *Treatise on Maqasid Al-Shari'ah* (London: The International Institute of Islamic Thought, 2006).

believers.”⁵⁷ Similarly, in *Surah Al-Anbiyaa*, a *Qur'ānic* saying indicated, “And We have not sent you, [O Muhammad], except as a mercy to the worlds.”⁵⁸ Importantly, Islam aspires to achieve justice, eradicate discrimination, and ease human suffering by implementing *Sharī'ah*.⁵⁹ Concisely, Islam seeks to realize *Maslahah* (public interest), which was considered by *Sharī'ah* scholars as comprehensive and *Maqasid Sharī'ah*. *Maslahah* occasionally has the same meaning as *Maqasid*, thereby, *Sharī'ah* scholars have used both terms almost interchangeably.⁶⁰ Muslim jurists have historically endeavoured to serve the public interest and alleviate social evils or injustice by using the *Maslahah* as a legal device.⁶¹

Maqasid Sharī'ah has the following four main characteristics, firstly, they are the foundation of legislation, which must protect and advance the interests of all human beings, secondly, these are universal, intended to promote the interest of all humanity and demand everyone to adhere to them, thirdly, these are inclusive, encompassing all human acts either related to *Ibadāt* (responsibilities towards Allah (SWT) or *Muamalat* (relations with other human beings), and lastly, these are definitive, which indicates that *Maqasid Sharī'ah* has not been established based on a single text or type of evidence but rather from multiple texts and various types of evidence.⁶²

Sharī'ah scholars have generally divided *Maqasid Sharī'ah* into the following two main categories: *Maqasid Aammah* (general objectives) and *Maqasid Khassah* (specific objectives). According to Ibn-Ashur, *Maqasid Aammah* of *Sharī'ah* is comprised of such deeper meanings underlying aspects of wisdom that the Lawgiver regarded in all or most of the circumstances of the legislation. They are not limited to a certain category of *Sharī'ah* laws. As a result, they cover the fundamental features of the *Sharī'ah*, its overall goal and ideas that the legislation takes into account. They also have various concepts and meanings, which are contained in many of the *Sharī'ah* rulings.⁶³

In *Usul al-Fiqh*, *Sharī'ah* scholars, such as Al-Shatibi, subdivide *Maqasid Aammah*, sometimes denoted as *Maslahah*, into the following three categories: *Daruriyyah* (necessities), *Haajiyyah* (needs or complimentary), and *Tahseeniyyah* (embellishments).⁶⁴ Where, *Daruriyyah* are the essential interests of people comprising the protection of religion, life, progeny, intellect, and wealth. These *Daruriyyah* act as the cornerstone for establishing welfare for human beings in both this world and the hereafter. If they are disregarded, harmony and balance cannot be achieved in this world, and there will be significant losses in the afterlife. Some *Sharī'ah* scholars have also suggested additional

⁵⁷Yunus 10:57.

⁵⁸Anbiya 21:107.

⁵⁹Asyraf Wajdi Dusuki, and Said Bouheraoua, “The Framework of Maqasid Al-Shariah and Its Implication for Islamic Finance,” *ICR Journal* 2, no. 2 (2011): 316-336, <https://doi.org/10.52282/icr.v2i2.651>.

⁶⁰Deina Abdelkader, “Modernity, the Principles of Public Welfare (Maslahah) and the End Goals of Shariah (Maqasid) in Muslim Legal Thought,” *Islam and Christian Muslim Relations* 14, no. 2 (2003): 163-174, <https://doi.org/10.1080/0959641032000057298>.

⁶¹Imran Ahsan Khan Nyazee, *Islamic Jurisprudence (Usūl Al-Fiqh)* (Islamabad, Pakistan: Islamic Research Institute, 2000).

⁶²Asyraf Wajdi Dusuki, and Said Bouheraoua, “The Framework of Maqasid Al- Sharī'ah and Its Implication for Islamic Finance,” *ICR Journal* 2, no. 2 (2011): 316-336, <https://doi.org/10.52282/icr.v2i2.651>.

⁶³Muhammad al-Tahir Ibn-Ashur, *Treatise on Maqasid Al- Sharī'ah* (London: The International Institute of Islamic Thought, 2006).

⁶⁴Mohammad Hashim Kamali, “Sources, Nature and Objectives of Sharī'ah,” *Islamic Quarterly* 33, no. 4 (1989): 215-235.

Daruriyyah, such as equality, freedom, and environmental protection.⁶⁵ However, *Haajiyah* (needs or complementary) are interests that add value to the primary interests. It relates to interests, which is neglected and has caused suffering without completely upsetting the regular order of life. It also acts as a framework for provisions, which simplify life and eliminate hurdles. An illustration of this can be seen in the field of commercial transactions, where the *Shari'ah* recognized various contracts due to the needs of the people, such as the Salam sale, despite the anomalies that are present in it.⁶⁶ While *Tahseeniyyah* (embellishments) refer to endeavours, which contribute to the improvement and perfection of social norms and behaviour at all levels of accomplishment. For instance, the required level of *Zakaah*, the *Shari'ah* encourages people to give charity who are in need. Importantly, *Shari'ah* promotes kindness, pleasant speech and behaviour, and fair dealing in customary affairs and interpersonal relationships. Other examples include having the right to use lovely, comfortable goods, eat delectable cuisine, wear nice clothes, and so forth.⁶⁷

Maqasid Khassah (specific objectives) are focused on a particular discipline, such as Islamic business transactions, family law, criminal justice, and politics. According to Ibn-Ashur (2006), *Maqasid Khassah* comprised of approaches, which the Lawgiver intended to achieve the beneficial aspirations of people or to protect their public interests concerning their personal conduct. The ultimate goal is to stop carelessness, irrational mistakes, and selfish impulses of people in the pursuit of their personal interests undermining their established public interests.⁶⁸ It is pertinent to note that there exists overlapping and integration between the *Maqasid Aammah* and the *Maqasid Khassah*. Therefore, it would be naive to treat any of the objectives as discrete. To reach absolute bliss in eternity, these two categories, thus, serve as the basic structure guiding the people in this world.⁶⁹

An IB is anticipated to follow the *Maqasid Shari'ah* since it is a *Shari'ah*-based corporate entity. Selecting the right *Maqasid* for any IB is important for at least two reasons. Firstly, the management would use these *Maqasid* to create corporate policies and objectives. Secondly, these *Maqasid* provide evidence of an IB's adherence to the fundamental Islamic principles. Developing products and services that are *Shari'ah*-compliant without compromising the business concerns of being competitive, profitable, and viable in the end is in fact one of the main issues facing IBs today.⁷⁰

Essentially, *Maqasid Shari'ah* relevant to Islamic banking and finance are *Maqasid Khassah* as they engage with particular disciplines. However, *Maqasid Aammah* is also significant and connected directly because Islamic banking and finance aims at preserving wealth, which is interlinked with the preservation of religion.⁷¹ Ibn-Ashur highlighted five *Maqasid Khassah* of financial transactions,

⁶⁵Abdul Majeed Al-Najjaar, *Maqasid Al-Shari'ah (Arabic)* (Beirut: Dar Al-Gharb Al-Islami, 2006).

⁶⁶Imran Ahsan Khan Nyazee, *Islamic Jurisprudence (Usul Al-Fiqh)* (Islamabad, Pakistan: Islamic Research Institute, 2000).

⁶⁷Abu Ishaq Al-Shatibi, *Al-Muwafiqat fi Usul Al-Shari'ah (Arabic)* (Beirut: Al-Maktabah Al-Asriyah, 2002).

⁶⁸Muhammad al-Tahir Ibn-Ashur, *Treatise on Maqasid Al-Shari'ah* (London: The International Institute of Islamic Thought, 2006).

⁶⁹Asyraf Wajdi Dusuki, and Said Bouheraoua, "The Framework of Maqasid Al-Shari'ah and Its Implication for Islamic Finance," *ICR Journal* 2, no. 2 (2011): 316-336, <https://doi.org/10.52282/icr.v2i2.651>.

⁷⁰Asyraf Wajdi Dusuki, and Abdulazeem Abozaid, "A Critical Appraisal on the Challenges of Realizing Maqasid al-Shari'ah in Islamic Banking and Finance," *IJUM Journal of Economics and Management* 15, no. 2 (2007): 143-165.

⁷¹Asyraf Wajdi Dusuki, and Said Bouheraoua, "The Framework of Maqasid Al-Shari'ah and Its Implication for Islamic Finance," *ICR Journal* 2, no. 2 (2011): 316-336, <https://doi.org/10.52282/icr.v2i2.651>.

which are circulation, transparency, preservation, stability, and equity/justice.⁷² Afterward many contemporary scholars and researchers have contributed to the *Maqasid Khassah* of economic order and financial transactions.⁷³ In this regard, justice, equity, the well-being of society, generosity, and efficiency are determined as *Maqasid Khassah* of the Islamic financial system.⁷⁴

Based on the opinions of contemporary Islamic economists and *Shari'ah* scholars, *Maqasid Khassah* relevant to Islamic banking and finance have been identified as protection and growth of wealth in the Islamically permissible way, equity and justice in returns distribution, circulation of wealth, transparency in financial transactions, satisfaction of social demands and the well-being of society, linking financial activity with the economic activity, adherence to the form and substance of the *Shari'ah* in the financial dealings to prevent *Hiyal* (stratagems), and preserve the true purpose and intent of *Shari'ah* in financial dealings.⁷⁵ Moreover, SG-related *Maqasid Khassah* is determined as viability or stability of IFIs and transparency.⁷⁶

5. Maqasid Shari'ah Based Appraisal

The current section explores how far *Maqasid Shari'ah* is being realized through SG mechanisms in IBs of Pakistan.

5.1. Viability or Stability of Islamic Financial Institutions

IFIs have been operating for almost 50 years but they are still considered beginners to the global financial industry as compared to CFIs, which have existed for nearly four centuries.⁷⁷ Researchers have claimed that IFIs struggle to establish a distinctively Islamic character, while adapting their system to fit the modern financial system, which appears to be hindering their growth. In this context, the viability or stability of IFIs should be regarded as an essential Maqasid *Shari'ah* in the domain of Islamic banking and finance.⁷⁸

Researchers have expounded on many factors contributing to the global financial crisis of 2007-2008. Importantly, poor regulatory/supervisory oversight and faulty risk management were two of

⁷²Muhammad al-Tahir Ibn-Ashur, *Treatise on Maqasid Al-Shari'ah* (London: The International Institute of Islamic Thought, 2006).

⁷³Ameen Ahmed Abdullah Qasem Al-Nahari, Abu Talib Mohammad Monawer, Luqman Bin Haji Abdullah, Abdul Karim Bin Ali, Noor Naemah Binti Abdul Rahman, and Meguellati Achour, "Common Conceptual Flaws in Realizing Maqasid Al-Shari'ah vis-a-vis Islamic Finance," *ISRA International Journal of Islamic Finance*, Vol. ahead-of-print No. ahead-of-print (2022), <https://doi.org/10.1108/ijif-12-2020-0259>.

⁷⁴Mohammad Nejatullah Siddiqui, *Maqasid e Shariat (Urdu)* (Islamabad, Pakistan: Islamic Research Institute, 2009).

⁷⁵Muhammad Tahir Mansoori, *Islamic Law of Contract: Applications in Islamic Finance* (Islamabad, Pakistan: Institute of Policy Studies, 2020).

⁷⁶Azmir Azri Ahmad, and Muhammad Shahrul Ifwat Ishak, "Realizing Maqasid Al-Shari'ah in Shariah Governance: A Case Study of Islamic Banking Institutions Malaysia," *International Journal of Islamic Economics and Finance Research* 3, no. 2 (2020): 39-52.

⁷⁷Muhammad Shahrul Ifwat Ishak, "Considering Maalat as an Approach to Applying Maslahah in Reality," *ICR Journal* 9, no.2 (2018):147-160, <https://doi.org/10.52282/icr.v9i2.118>.

⁷⁸Azmir Azri Ahmad, and Muhammad Shahrul Ifwat Ishak, "Realizing Maqasid Al-Shari'ah in Shariah Governance: A Case Study of Islamic Banking Institutions Malaysia," *International Journal of Islamic Economics and Finance Research* 3, no. 2 (2020): 39-52.

them.⁷⁹ Hence, IBs must establish effective SG and risk management mechanisms to avoid such failures. Furthermore, the foundation and rationale for the establishment of the Islamic banking industry is *Sharī'ah* compliance. To instill, confidence in the public about the *Sharī'ah* compliance of IBs' products and services, a robust and efficient *Sharī'ah* compliance framework is crucial. Since the reintroduction of Islamic banking in 2001, the State Bank of Pakistan (SBP), which regulates IBs in Pakistan, has been implementing regulations, guidelines, and directives to ensure that IBs' operations remain *Sharī'ah* compliant.⁸⁰

SBP is following the AAOIFI's *Sharī'ah* -Standards-based mainstream approach avoiding *Bay al-Dayn*, *Bay al-Inah* and financial derivatives to advance Islamic banking, while emphasizing *Sharī'ah* compliance. The '*Sharī'ah* Essentials' of modes of financing endorsed by the SBP's *Sharī'ah* Board were recommended to IBs in 2008 as the essential requirement for *Sharī'ah* compliance. For the Islamic modes, essentials, which are not prescribed by SBP, AAOIFI's *Sharī'ah* standards are advised to be used as guidelines in consultation with their SSBs.⁸¹ However, SBP revised several of its instructions and guidelines highlighting the change in global Islamic banking industry and a comprehensive *Sharī'ah* governance framework (SGF) was developed in 2015, which was further reviewed in 2018.⁸² While reviewing SGF, it was observed that explicit roles and responsibilities of various organs of SG of IBs toward *Sharī'ah* compliance were discussed in it.

SGF stated that SSBs have the authority to ban any IBs' operations or activities that do not comply with *Sharī'ah*. The decisions of SSBs in this regard are binding even for the BOD. This indicated that having an effective SSB, as a SG mechanism, is of utmost importance to IBs. Weak and ineffective SSBs, additionally, IAHs, could negatively affect the reputation, integrity, and credibility of IBs and the industry as a whole and depositors may lose confidence in IBs, which could affect the financing and investment decisions made by IBs' prospective and current customers.⁸³ SSBs must interact with other SG mechanisms. For instance, the SSB may have to work with the product developers and the *Sharī'ah* compliance unit during the product development process. To guarantee that the ultimate objectives of IBs were achieved, it is essential to strengthen the interaction between the SSB and other SG mechanisms.⁸⁴

It is pertinent to note that an IB is exposed to a unique risk called SNCR, which arises whenever the IB fails to comply with *Sharī'ah* precepts in its activities.⁸⁵ As discussed earlier, SNCR may

⁷⁹Rasem N. Kayed, and M. Kabir Hassan, "The Global Financial Crisis and Islamic Finance," *Thunderbird International Business Review* 53, no. 5 (2011): 551–64, <https://doi.org/10.1002/tie.20434>.

⁸⁰State Bank of Pakistan, *Shariah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018), <https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>.

⁸¹Muhammad Ayub, "Focusing on Sharī'ah Governance in Regulating Islamic Banking Institutions: Editorial," *Journal of Islamic Business and Management* 6, no. 2 (2016): 7–18.

⁸²State Bank of Pakistan, *Shariah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018), <https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>.

⁸³Abdus Sattar Abbasi, "Sharī'ah Governance Framework for Islamic Banking Institutions (IBIs): A Critical Analysis," *Islamic Banking and Finance Review* 7, no. 1 (2020): 1-18, <https://doi.org/10.32350/ibfr.2020.07.01>.

⁸⁴Zulkifli Hasan, *Sharī'ah Governance in Islamic Banks* (Edinburgh: Edinburgh University Press, 2012).

⁸⁵Karim Ginena, "Sharī'ah Risk and Corporate Governance of Islamic Banks," *Corporate Governance: The International Journal of Business in Society* 14, no. 1 (2014): 86–103, <https://doi.org/10.1108/cg-03-2013-0038>.

result in the withdrawal of funds, facing difficulties in attracting deposits, facing financial losses, liquidity problems, bank runs, bank failures, and financial instability in certain circumstances.⁸⁶ Moreover, SNCR may even hurt the reputability of the Islamic banking industry, which relies heavily on stakeholders' trust in the matter of the industry's *Sharī'ah* compliance.⁸⁷ In short, the viability and stability of IBs, an important *Maqasid Sharī'ah* according to Ibn-Ashur, is threatened.

To realize the viability and stability of IBs, SBP has developed a comprehensive SGF that strengthens the entire structure of SG for IBs in Pakistan and specifically outlines the functions and duties of several SG organs of IBs.⁸⁸ Therefore, it can be inferred that all of IBs' stakeholders are jointly responsible for retaining *Sharī'ah* compliance in IBs' activities.⁸⁹

5.2. Transparency

Transparency is one of the five *Maqasid Khassah* of financial transactions, which were highlighted by Ibn-Ashur.⁹⁰ An IB is required to report all of its activities, overall profitability, and *Sharī'ah* compliance status, including *Sharī'ah* -non-compliant income detected during the *Sharī'ah* audit and disseminated charity account. They were required to do so following the principle of accountability in Islam. The appropriate implementation of SG addresses the public's desire for transparency and disclosure regarding IBs; furthermore, such an implementation is essential since it helps to ensure all activities and operations, which are *Sharī'ah* -compliant. This is consistent with the principle of *Maqasid Sharī'ah* that the public interest, including the rights of IBs' stakeholders, must be protected and preserved.⁹¹

In this regard, SGF issued by SBP requires SSB to submit a report on the overall *Sharī'ah* compliance environment of the particular IB by mentioning, whether IB has a comprehensive mechanism for ensuring *Sharī'ah* compliance in their overall operations, whether IB has a well-defined system for ensuring that any earnings realized from Islamically prohibited sources are being credited to the charity account. Importantly, this report is required to be published in English with Urdu translation in the IB's annual report.⁹²

⁸⁶Dahlia El-Hawary, Wafik Graiss, and Zamir Iqbal, *Regulating Islamic Financial Institutions: The Nature of the Regulated (Policy Research Working Paper No. 3227)* (Washington, D.C: World Bank, 2004), <https://openknowledge.worldbank.org/handle/10986/14732>.

⁸⁷IRTI, and IFSB, *Islamic Financial Services Industry Development: Ten-Year Framework and Strategies* (Jeddah, Saudi Arabia: Islamic Research & Training Institute, Islamic Development Bank, 2007), <https://www.ifsb.org/download.php?id=4420&lang=English&pg=/sec03.php>.

⁸⁸State Bank of Pakistan, *Sharī'ah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018), <https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>.

⁸⁹Azmir Azri Ahmad, and Muhammad Shahrul Ifwat Ishak, "Realizing Maqasid Al-Sharī'ah in Sharī'ah Governance: A Case Study of Islamic Banking Institutions Malaysia," *International Journal of Islamic Economics and Finance Research* 3, no. 2 (2020): 39-52.

⁹⁰Muhammad al-Tahir Ibn-Ashur, *Treatise on Maqasid Al-Sharī'ah* (London: The International Institute of Islamic Thought, 2006).

⁹¹Azmir Azri Ahmad, and Muhammad Shahrul Ifwat Ishak, "Realizing Maqasid Al-Shariah in Shariah Governance: A Case Study of Islamic Banking Institutions Malaysia," *International Journal of Islamic Economics and Finance Research* 3, no. 2 (2020): 39-52.

⁹²State Bank of Pakistan, *Shariah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018), <https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>.

Table 1. *Shari'ah* Board Report of IBs in Pakistan

No.	Islamic Bank	<i>Shari'ah</i> Board Report	<i>Shari'ah</i> -non-compliant Income Disclosure
1	Al-Baraka Bank Pakistan	Yes	Yes
2	Bank Islami Pakistan	Yes	Yes
3	Dubai Islamic Bank Pakistan	Yes	Yes
4	MCB Islamic Bank	Yes	Yes
5	Meezan Bank Pakistan	Yes	Yes

Source: Researchers' own Compilation

The above Table 1 exhibits all the five full-fledged IBs of Pakistan, which have properly disclosed their *Shari'ah* compliance along with any *Shari'ah* -non-compliant income received during the financial year. During the internal or external *Shari'ah* audit it was detected that the avenues are the prime place where such income was being utilized as a charity in consultation with their SSBs. Hence, it was concluded that the *Maqsad Shari'ah* of transparency in financial transactions is being fully realized through SG of IBs of Pakistan.

5.3. Protection and Growth of Wealth in an Islamically Permissible Way

Protection of wealth falls under the *Daruriyyah* (necessities) category of *Maqasid Aammah*.⁹³ Muslim jurists maintained that there are at least five key dimensions through which wealth could be protected. One such dimension is the protection of wealth through its augmentation or development.⁹⁴ Islam has forbidden the use of wealth to remain idle and underutilized, instead encouraging and persuading the owner of wealth to invest it so that the wealth can be multiplied, which in turn benefits the entire community.⁹⁵ This is especially true if one is aware of the rationale behind the imposition of *Zakat* on material possessions. Muslims must pay *Zakat* to fulfill their religious obligations, which indicates a need to develop or augment wealth. One way to accomplish this is by making investments, which guarantee an asset, which would ultimately continue to grow. In this regard, Prophet Muhammad (*SAW*) once said "As for the one who is the guardian of an orphan who has wealth, then let him do business with it and not leave it until it becomes consumed by charity."⁹⁶ Furthermore, *Shari'ah* scholars argued that if the protection of wealth is a *Maqsad Shari'ah*, then its acquisition should take precedence over its protection.⁹⁷ A Qur'anic saying, in this regard, in *Surah Al-Jumuah*: "And when the prayer has been concluded, disperse within the land and seek from the bounty of Allah (*SWT*) and remember Allah (*SWT*) often that you may succeed."⁹⁸ Prophet Muhammad (*SAW*), considering the core of this notion, once said: "Rightly acquired wealth is good for an honest man."⁹⁹

Protection and augmentation of wealth in an Islamically permissible way, as a *Maqsad Shari'ah*, is being fully realized through SG of IBs in Pakistan. For this purpose, SBP (2018) has developed a thorough SGF, which explicitly defines the roles and responsibilities of various SG organs of IBs to

⁹³Mohammad Hashim Kamali, "Sources, Nature and Objectives of Shari'ah," *Islamic Quarterly* 33, no. 4 (1989): 215-235.

⁹⁴Abdul Majeed Al-Najjaar, *Maqasid Al-Shari'ah (Arabic)* (Beirut: Dar Al-Gharb Al-Islami, 2006).

⁹⁵Muhammad Tahir Mansoori, *Islamic Law of Contract: Applications in Islamic Finance* (Islamabad, Pakistan: Institute of Policy Studies, 2020).

⁹⁶Jami Al-Tirmizi: The Book on Zakaah, Hadith no. 641.

⁹⁷Asyraf Wajdi Dusuki, and Said Bouheraoua, "The Framework of Maqasid Al-Shari'ah and Its Implication for Islamic Finance," *ICR Journal* 2, no. 2 (2011): 316-336, <https://doi.org/10.52282/icr.v2i2.651>.

⁹⁸al-Jumuah 62:10.

⁹⁹*Mishkat al-Masabih*, The Book on the Offices of Commander and Qadi, Hadith no. 3756.

ensure complete *Shari'ah* compliance with IBs' activities.¹⁰⁰ Through SGF, the rights or interests of depositors are being protected by ensuring timely and complete disclosure on deposits pools management, profit sharing ratio (PSR), profit equalization reserve (PER), investment risk reserves (IRR), and parameters of *Hibah*, if any, to the pools and not to any individual in any pool. Moreover, the movement of assets from one pool to another has also been restricted and can only be made with the approval of the Resident *Shari'ah* Board Member (RSBM). With all these rules, instructions, and measures of SGF, it seems probable that the level of *Shari'ah* compliance could be quite close to 100% and SNCR could be mitigated effectively. Moreover, depositors are also expected to get fair treatment in terms of profits,¹⁰¹ which leads to the realization of another *Maqсад Shari'ah*, that is, equity and justice in returns distribution.¹⁰²

5.4. Well-being of Society

The well-being of society has been identified as one of the many *Maqasid Khassah* of the Islamic financial system.¹⁰³ Well-being is referred to as the general condition of a nation's households, society, and populace. It depicts the comfort level of humanity.¹⁰⁴ Importantly, the living conditions of a family, such as a place to live, food, clothing, safety, which are included in their well-being.¹⁰⁵ Happiness, however, could not be used as a stand-alone indicator of well-being. Currently, one of the top priorities for policymakers in improving sustainability and living conditions is well-being.¹⁰⁶ According to Islam, well-being is the fulfillment that can be found both inside and outside of oneself, and consequently, leads to living a peaceful life (*Hayaat al-Tayyibah*).¹⁰⁷

As discussed earlier, *Maqсад Shari'ah* is to enhance people's well-being by protecting their faith, life, posterity, intelligence, and wealth.¹⁰⁸ However, according to Al-Shatibi (2002), *Maqсад Shari'ah* is objectives fulfilled through the rulings of Allah (SWT), which He meant to preserve

¹⁰⁰State Bank of Pakistan, *Shariah Governance Framework for Islamic Banking Institutions* (Karachi, Pakistan: Islamic Banking Department, State Bank of Pakistan, 2018),

<https://www.sbp.org.pk/ibd/2018/C1-Annex-A.pdf>

¹⁰¹Muhammad Ayub, "Strengths, Gaps and Issues in Shariah Governance Framework 2015 for IBs in Pakistan," *Research in Corporate and Shariah Governance in the Muslim World: Theory and Practice*, eds. Toseef Azid, Ali Abdullah Alnodel, and Muhammad Azeem Qureshi (Bingley: Emerald Publishing Limited, 2019).

¹⁰²Muhammad Tahir Mansoori, *Islamic Law of Contract: Applications in Islamic Finance* (Islamabad, Pakistan: Institute of Policy Studies, 2020).

¹⁰³Mohammad Nejatullah Siddiqui, *Maqasid e Shariat (Urdu)* (Islamabad, Pakistan: Islamic Research Institute, 2009).

¹⁰⁴Mohamed Saladin Abdul Rasool, Mohamed Azmil Mohd Yusof, and Siti Mariam Ali, "Well-being of the Society: A Maqasid Al-Shariah Approach," *Afkar Special Issue*, no. 1 (2020): 25-46, <https://doi.org/https://doi.org/10.22452/afkar.sp2020no1.2>.

¹⁰⁵Allister McGregor, Sarah Coulthard, and Laura Camfield, "Measuring What Matters: The Role of Well-Being Methods in Development Policy and Practice," *Development Progress* (2015): 1-26, <https://odi.org/documents/4861/9688.pdf>.

¹⁰⁶Judith Schleicher, Marije Schaafsma, Neil D. Burgess, Chris Sandbrook, Fiona Danks, Chris Cowie, and Bhaskar Vira, "Poorer without It? The Neglected Role of the Natural Environment in Poverty and Well-being," *Sustainable Development* 26, no. 1 (2018): 83-98, <https://doi.org/https://doi.org/10.1002/sd.1692>.

¹⁰⁷Mohamed Saladin Abdul Rasool, Mohamed Azmil Mohd Yusof, and Siti Mariam Ali, "Well-being of the Society: A Maqasid Al-Shariah Approach," *Afkar Special Issue*, no. 1 (2020): 25-46, <https://doi.org/https://doi.org/10.22452/afkar.sp2020no1.2>.

¹⁰⁸Abu Hamid Al-Ghazali, *Ihya' Ulumuddin (Arabic)* (Beirut: Dar al-Khair, 1990).

people's well-being.¹⁰⁹ The Qur'an conveys an overwhelming concern for the general welfare of humanity, as well as the necessity to strike a balance between this world and the Hereafter. In this context, a Qur'anic saying in *Surah Al-Baqarah*: "But among them is he who says, 'Our Lord, give us in this world [that which is] good and in the Hereafter [that which is] good and protect us from the punishment of the Fire.'"¹¹⁰ While, in *Surah Al-Qasas*, there is a Qur'anic saying: "But seek, through that which Allah (*SWT*) has given you, the home of the Hereafter; and [yet], do not forget your share of the world. And do good as Allah has done good to you. And desire not corruption in the land. Indeed, Allah (*SWT*) does not like corrupters."¹¹¹

Researchers have argued that the well-being of society could be addressed through the following five dimensions of *Maqasid Shari'ah*, through religiosity, life, knowledge, posterity, and wealth.¹¹² However, SG and management of SNCR in IBs are linked with dimensions of religiosity and wealth only, because Islamic banking and finance aims at preserving wealth in the Islamically permissible way, therefore, it is interlinked with the preservation of religion as well.¹¹³ Hence, it is concluded that two dimensions of the well-being of society, as *Maqasid Shari'ah*, are being realized through the SG in IBs of Pakistan. While government agencies with related policies might effectively address societal well-being through all five dimensions of *Maqasid Shari'ah* in partnership with non-governmental organizations.¹¹⁴

6. Conclusion

This study aimed to explore SG and SNCR management through the lens of *Maqasid Shari'ah*. For this purpose, this study employed the content analysis method to SGF, by concerning the related literature to determine the recent developments in SG mechanisms in Pakistan. Secondly, the study established a link between the SNCR and the credit, legal and compliance, reputational, and market risks through content analysis of related literature. Thirdly, the study identified, those *Maqasid Shari'ah*, which can be realized through Islamic banking and finance, especially, through SG of IBs. Finally, this study conducted a content analysis of the annual reports of all five full-fledged IBs of Pakistan to gain insights about the element of *Maqasid Shari'ah*, which was realized through SG practices in Pakistan.

The findings of the study revealed that SGF explicitly defined the roles and responsibilities of various organs of SG of IBs towards *shari'ah* compliance. Moreover, SSBs have the authority to prohibit non-*shari'ah*-compliant IBs' operations and activities. The decisions of SSBs in this regard are binding even for the BOD. This implies that having an efficient SSB, as an SG mechanism, needs to be the highest concern for IBs. Weak and ineffective SSBs, on the other hand, may harm the reputation, integrity, and perception of IBs and the Islamic banking industry as a whole.

¹⁰⁹Abu Ishaq Al-Shatibi, *Al-Muwafiqat fi Usul Al-Shariah (Arabic)* (Beirut: Al-Maktabah Al-Asriyah, 2002).

¹¹⁰al-Baqara 2:201.

¹¹¹al-Qasas 28:77.

¹¹²Rahmatina Kasri, and Habib Ahmed, "Assessing Socio-Economic Development Based on Maqasid al-Shariah Principles: Normative Frameworks, Methods and Implementation in Indonesia," *Islamic Economic Studies* 23, no. 1 (2014): 73-100.

¹¹³Asyraf Wajdi Dusuki, and Said Bouheraoua, "The Framework of Maqasid Al-Shariah and Its Implication for Islamic Finance," *ICR Journal* 2, no. 2 (2011): 316-336, <https://doi.org/10.52282/icr.v2i2.651>.

¹¹⁴Mohamed Saladin Abdul Rasool, Mohamed Azmil Mohd Yusof, and Siti Mariam Ali, "Well-being of the Society: A Maqasid Al-Shariah Approach," *Afkar Special Issue*, no. 1 (2020): 25-46, <https://doi.org/https://doi.org/10.22452/afkar.sp2020no1.2>.

Furthermore, the findings of the study also revealed that IBs are exposed to a unique risk called SNCR, which arises only when the IB fails to comply with *Sharī'ah* precepts in its activities. Consequently, SNCR causes deposit withdrawals, increased deposit acquisition costs, direct and indirect monetary losses, liquidity challenges, different banking crises, and financial instability, which may even damage the reputation of the Islamic banking industry at large, primarily fueled by stakeholders' trust. In short, the viability and/or stability of IBs, an important *Maqṣad Sharī'ah*, is threatened. To realize the viability of IBs, SBP has developed an SGF that strengthens the overall SG structure of IBs in Pakistan.

Moreover, it was found that all the five full-fledged IBs of Pakistan are properly disclosing their *Sharī'ah* compliance along with any *Sharī'ah* -non-compliant income received during the financial year and the avenues where such income was utilized as a charity in consultation with their SSBs. Hence, it was concluded that the *Maqṣad Sharī'ah* of transparency in financial transactions was being fully realized through SG of IBs. Furthermore, the *Maqṣad Sharī'ah* of protection and growth of wealth in an Islamically permissible way is also fully realized through SG of IBs, which leads to the realization of another *Maqṣad Sharī'ah*, that is, equity and justice in returns distribution. Finally, it was found that two dimensions of the well-being of society from *Maqṣad Sharī'ah* perspective, namely, safeguarding religiosity and safeguarding wealth, were being realized through the SG in IBs of Pakistan.

Conflict of Interest

Author(s) declare that they have no conflicts of interest.

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