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Islamic Corporate Governance: The Significance and Functioning of *Shari'ah* Supervisory Board in Islamic Banking

Syeda Nitasha Zahid
Imran Khan

Abstract: The stability and resilience that Islamic banking (IBs) industry has shown during the current global crisis is based on the principles of Islamic economic laws that rest on equity, participation, and business ethics. The literature on Islamic corporate governance (ICG) is growing quite rapidly and the industry has emerged as an alternative to its conventional counterpart. This paper critically reviews the existing literature on ICG with a particular focus on the significance and functions of Shari'ah supervisory board (SSB), which differentiate IBs from CBs. This review describes ICG framework, elaborates and summarizes SSB functions, compares IBs with CBs and assesses the impact of SSB on IB's performance. The key findings show that majority of the literature on SSB describes advising and monitoring as the two main functions of a Shari'ah board and past literature supports positive association between Shari'ah governance and the performance of IBs. This work might be helpful for scholars and practitioners approaching this field to study the role and functioning of SSB.

Keywords: *Shari'ah* Supervisory Board, Corporate Governance, Shari'ah Board Functions, Performance, Islamic Banks

JEL Codes: G2, G3

Introduction

Islamic corporate governance (ICG) has received much attention in the recent years. After the financial global crisis of 2008, Islamic banking and finance has emerged as an alternative to its conventional counterpart (Aebi et al., 2012; Pathan & Faff, 2013; Baki & Sciabolazza, 2014). The literature on ICG is growing quite rapidly and has attracted the attention of scholars and society. Islamic financial centres

Postgraduate Student, COMSATS University. syeda.nitasha@ymail.com
Asst. Prof. Dr., COMSATS University. imrankjadoon@ciit.net.pk

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are establishing throughout the world and universities and research institutes are arranging seminars on Islamic finance quite frequently. The fame that Islamic banking and finance is receiving as an alternative to its conventional counterpart lies in its foundation i.e. the *Shari'ah* laws. Islamic *Shair'ah* requires clear transparency in every transaction between trading parties (Alnasser & Muhammed, 2012). Islamic banking system is providing a variety of financial products and services, and has become an important part of global financial market which has extended beyond Islamic countries (Grassa, 2013; Khan & Bhatti, 2008). Islam is not just a religion but a way to live in which economy is seen as an area where profitable financial relations occurs (Ramadan, 2009). To deal with any sort of situation Islam has provided general principles for every sphere of life therefore, Islamic banking (IBs) is said to be performed when all the activities are aligned with *Shari'ah* laws. In an effort to ensure their continuous compliance with *Shari'ah* rules, an additional board composed of Islamic experts in jurisprudence with sufficient knowledge of contemporary finance emerged known as *Shari'ah* supervisory board (SSB). Choudhury & Hoque (2006) called it "Supra Authority". They act as a constraint on operations of IBs as well as form an extra layer of monitoring and control in addition to the regular board of directors therefore; governance of IBs is referred as "multi-layer" governance.

In this study we review the growing literature on ICG of IBs focusing on SSBs. The SSB differentiate CG of IBs from their conventional counterparts. Many studies have examined the role of SSBs such as (Bhatti & Bhatti, 2008; Abu-Tapanjeh, 2009; Garas & Pierce, 2010; Ginena, 2014). Islamic doctrine contains four major Schools (1) *Hanafii,* (2) *Malikii*, (3) *Shafii* and (4) *Hambalii* with different opinions. These schools of thought differ in their interpretations of *Shari'ah* laws. *Shari'ah* board in its decision making is not allowed to combine different opinions in a particular single situation due to the risk embedded in the combination of doctrines resulting in "*Haram* output" (Ayedh & Echchabi, 2015) which is referred as "*Fatawa* fishing/shopping". The members of *Shari'ah* board do not follow any specific doctrine, instead they reach their decisions by following the interpretations of Holy *Quran* and *Hadith* along with reassuring evidences of *Fiqah* councils, *Shari'ah* audit and most importantly through *Ijmaa* (where the scholars of Islam unanimously agree in their rulings), and *Ijtihad* (independent reasoning or exertion of jurists) based upon *Qiyas* (comparing teachings of *Hadith* with *Quran*).

To harmonize the industry's practices, the *Accounting and Auditing Organization for Islamic Financial Institutions'* (AAOIFI) regularly publishes *Shari'ah* standards and Islamic Development Bank (IDB) *Shari'ah* board provides *Shari'ah* opinions by working closely with other international agencies. AAOIFI is working as an independent organization comprising of 200 members from IFIs worldwide, for providing IFIs standards on *Shari'ah,* accounting & auditing, corporate governance, and ethics. So far AAOIFI has issued eighty eight (88) standards out of which forty eight (48) standards are related to *Shari'ah*, thirty one (31) deal with accounting & auditing, seven (7) standards cover corporate governance and two (2) standards are on ethics (AAOIFI, 2015). AAOIFI defines SSB as:

"An independent body of specialized jurists in *Fiqh-al-Muamalat* (Islamic commercial jurisprudence) to ensure that IFIs are in compliance with *Sharia* principle"

The remainder of the study is structured into the following four core themes; (i) ICG framework is comprised of conflict of interest/agency problem, *Shari'ah* risk, appointment of *Shari'ah* scholars, regulatory model for *Shari'ah* supervision, and *Shari'ah* board independence (ii) functioning of *Shari'ah* board consisting of importance of *Shari'ah* governance, *Shari'ah* board activities, and disclosure level of IBs (iii) Islamic vs. conventional banks and (iv) *Shari'ah* supervision and performance.

ICG Framework

Extensive amount of literature has examined the issues relating to corporate governance and its optimal structure in conventional banking industry. In contrast the literature relating to ICG is at nascent stage but a growing stream of literature has contributed in the evolution of ICG framework. ICG framework, in compliance with *Shari'ah* rules and principle of Divine Unity of *Allah,* not only focuses on earning profits and increasing wealth but also safeguards the interest of all stakeholders and embraces the ethics. There are two frameworks or models of CG that have emerged from the literature that provides strong justification for stakeholders' oriented ICG structure. In the first framework, for the achievement of "Divine Unity of *Allah*" the view is that Islamic corporations are the legal entities of shareholders (Choudhury & Hoque, 2006; Bhatti et al 2008; Hassan, 2012). And in second framework, interests of all the stakeholders are involved (Chapra& Ahmed, 2002; Iqbal & Mirakhor, 2004; Dusuki, 2006). In the context of ICG, the stakeholders' oriented theory has gained strong roots in which organizations are managed to serve the interest of all the stakeholders based on the following three main assumptions: (i) in the process of decision-making all the stakeholders (being affected by the decision to be taken) are involved; (ii) it is the prime responsibility of manager to hold the stakeholders' interest and (iii) organizational objective is to promote the interest of all the stakeholders. Iqbal & Mirakhor (2004) argued that stakeholders' oriented theory views the organization as a "nexus-of-contracts" between stakeholders, where wealth maximizing is their main objective. According to Chapra & Ahmed (2002) stable and sound financial system depends upon organizations that maintain the stakeholders' confidence and protect stakeholders' interest by showing fairness with transparency and accountability. Dusuki (2006) argued that CG in Islamic system holds "equitable manner" while protecting the stakeholders' interest as well as social welfare.

Conflict of Interest/Agency Problem

Islamic *Shari'ah* considers conflict of interest as "*haram*" and is referred as a situation which creates doubtfulness for others therefore; it is not acceptable in Islam. *Hadith* about it narrates that: "Who keeps himself away from doubts, will highly exalt his religion and his integrity and whoever commits doubtful things, commits offenses (*haram*)…" (Al-Bukari I, p. 13). Rizk-Al Qazzaz (2008) defined it as:

"The impairment of decision maker's objectivity and independence due to physical or emotional desire for himself or his relative(s) or his friend(s); or the changes in the person's performance due to direct or indirect personal concerns or awareness of some information"

This definition highlights the impact of conflict of interest on decisions and performance relevant to the SSB's work. Among Muslims *Shari'ah* members are the most regarded people. Therefore, *Shari'ah* scholars maintain their integrity and reputation by keeping themselves away from doubtful situations. However, it is hard for *Fuqaha* (representing more than one SSB) to give independent opinion to IBs during the development of new products by competitors that create conflict of interest or agency problem (Bakr, 2002). Garasa (2012) found that agency problem occurs when SSB holding executive position in Islamic Financial Institutions (IFIs), have membership in Islamic funds and when members of SSB establish relationship with BODs. Another study has determined a unique nature of agency problem in the IBs which revealed that lack in actual practices and agency structure give rise to trade-offs between *Shari'ah* compliance mechanisms and investors' rights (Safieddine, 2009). Al Qari (2002) reported remuneration to SSB as an important factor in creating conflict of interest among SSB and has showed negative relationship between the remuneration paid to them and their independence. Similarly, Grais & Pellegrini (2006) argued that SSB serving as assessors of business' operations and being paid by the same business could result in conflict of interest. However, in contrast Rachdi & Ameur (2011) argued that SSB members can play an important role in reducing agency issues that ultimately lead towards improved performance.

Shari'ah risk

ICG is based on ethics and social welfare for achievement of *Shari'ah* objectives (Hasan, 2009). The depositors act like the backbone of banking system to a greater extent (Leventis et al., 2013) therefore, the success of banking system depends upon earning, maintaining and further strengthening their trust and confidence. Particularly maintaining their trust in IBs is very important as activities of IBs are supposed to be in compliance with the *Shari'ah* law (Archer and Haron, 2007). Most important risk to IBs is *Shari'ah* risk as they have to reassure that the claims of *Shari'ah* adherence made by them have no window dressing (Chapra & Ahmed, 2002; Mohd *et. al.,* 2018). Belz (2008) defines *Shari'ah* risk as: "the chance that an Islamic financing transaction is challenged on grounds that it does not comply with Islamic laws''

IBs are subjected to credible hazards due to the risk of *Shari'ah* non-compliance leading IBs towards failure (Ginena, 2014). Further, it is also an operational risk to measure monitoring losses that did not cover the non-financial risk and is defined as: "The risk of financial losses that an IFI may experience as a result of non-compliance with *Shari'ah* precepts in activities, as ascertained by the SSB or the pertinent authority in the relevant jurisdiction"

Shari'ah risk should be managed properly by the IFIs, otherwise the trust of depositors will shatter that may induce them to withdraw their deposits as a result. *Shari'ah* risk ultimately transforms into the credit risk leading banks toward failure (Ginena, 2014). According to Islamic Financial Services Board (IFSB, 2015), violation of *Shari'ah* results in the reputational risk as depositors and stakeholders lose their trust and in turn IBs lose their market position. To exalt transparency and to control *Shari'ah* risk IBs are required to submit *Shari'ah* governance reports to the supervisors regarding SSBs resolutions, as well as *Shari'ah* audited reports and any refinement to the *Shari'ah* governance (Ginena, 2014). In this way the supervisory authorities can find out the deficiencies where they lag behind and coerce the IBs to take cardinal measures to overcome the deficiencies within the stipulated timeframe.

Appointment of Shari'ah scholars

One of the important issues affecting the credibility of *Shari'ah* scholars is setting a benchmark criterion to recognize them as qualified (IFSB, 2006). Ullah (2014) studied the compliance level of Bangladeshi IBs with *Shari'ah* laws and principles and found that IBs were weak in *Shari'ah* compliance. He attributed the weak *Shari'ah* compliance to the lack of; knowledge, sincerity with compliance, and talented and skillful SSB, and not giving importance to *Shari'ah* audit, research and training. Al-Walidi (2013) discussed the practical and theoretical aspects of the *Shari'ah* supervision and concludes that SSBs should be formed with qualified and experienced *Shari'ah* scholars to increase efficiency and recommended that IBs should create departments specialized in *Shari'ah* training, research and marketing to strengthen the *Shari'ah* compliance practices. He further identified that some SSB members had not been rigorously performing their field supervision and training which caused loss of customer confidence. Therefore, IBs were recommended to put in place and follow strictly FPT "fit & proper test" criteria for their appointment. Further, BODs should ensure that recruited members have the capability to extend valuable contribution towards board (Ayedh & Echchabi, 2015). Table 1 shows the internal regulatory structure of SSB and has been built upon the work of Grais and Pellegrini (2006).

Table 1.
Regulations on internal *Shari'ah* supervisory board

Country	Composition *	Decision-making **	Appointment & Dismissal	Fit and Proper Criteria	SSB Terms of Reference
Bahrain	Specified	Unspecified	Appointed by Shareholders, dismissal is proposed by BOD and approved by shareholders (according to AAOIFI standards)	Specified	Yes
Bangladesh	Specified	Unspecified	According to AAOIFI standards	Not disclosed	Yes
Brunei	Specified	Specified	According to AAOIFI standards	Specified	Yes
Indonesia	Unspecified	Unspecified	Appointment or replacement of SSB members must be reported to Bank Indonesia and approved by the National *Shariah*board.	Specified	Yes
Jordan	Specified	Specified	Appointed by the general assembly of shareholders, discharged only through a reasoned decision taken by 2/3 of the board of directors.	Unspecified	Yes

Kuwait	Specified	Specified	Unspecified	Unspecified	Yes
Lebanon	Specified	Unspecified	Appointment for a renewable three- year period.	Unspecified	Yes
Malaysia	Unspecified	Unspecified	Unspecified	Specified	Yes
Maldives	Not disclosed	Not disclosed	Unspecified	Unspecified	Yes
Oman	Specified	Unspecified	By the Central Bank	Unspecified	Yes
Pakistan	Specified	Unspecified	Appointment must be approved by State Bank of Pakistan.	Specified	Yes
Qatar	Specified	Unspecified	According to AAOIFI standards	Unspecified	Yes
Saudi Arabia	Specified	Unspecified	According to AAOIFI standards	Unspecified	Yes
Sri-lanka	Specified	Specified	According to AAOIFI standards	Based upon AAOIFI standards	Yes
Syria	Specified	Specified	According to AAOIFI standards	Not disclosed	Yes
Thailand	Specified	Unspecified	Approved by the Bank of Thailand	Specified	Yes
Turkey	Specified	Specified	According to AAOIFI standards	Not specified	Yes
United Arab Emirates	Specified	Unspecified	SSB members must be 0approved by the Higher *Shariah* Authority	Unspecified	Yes
Yemen	Unspecified	Unspecified	According to AAOIFI standards	Unspecified	Yes

*Specified = at least three members,**Specified = By unanimous or majority vote & Unspecified = To be decided by shareholders

Regulatory models for Shari'ah supervision

SSB serves as an independent body in the IBs without being influenced by the authority of management, board of directors or shareholders (Garas & Pierce, 2010). There exist two regulatory models of *Shari'ah* governance namely national regulatory model and institutional regulatory model (Grassa, 2013). The national regulatory model provides nearly every element of regulation for *Shari'ah* practices with more participation of regulatory authorities. While, institutional level provides regulatory framework for *Shari'ah* supervision with little participation of regulatory authorities. Malaysian IBs are progressing very fast (Laldin, 2008) therefore; other countries should set Malaysian model as the benchmark to be successful in providing Islamic banking services. Findings of Ayedh and Echchabi (2015) support the notion that IBs still lacks regulations and standards, as the Yemeni IBs are still just following the minimum requirements and compulsory standards. Further, for *fatawa* issuance the SSBs refer to different *Mazhabs'* which is not allowed in Islam. Table 2 shows the external regulatory structure of SSB and this table is an extension of the work of Grais and Pellegrini (2006).

Table 2. Regulations on external *Shari'ah* supervisory board

Countries	Regulatory Models		Centralized Ssb or High *Shariah* Authority or Fatwa Board
	National Regulatory Model	Institutional Regulatory Model	
Bahrain	Yes	Yes	No
Bangladesh	No	Yes	No
Brunei	No	Yes	Yes
Indonesia	Yes	Yes	Yes
Jordan	No	Yes	No
Kuwait	No	Yes	Yes
Lebanon	No	Yes	Yes
Malaysia	Yes	No	Yes
Maldives	No	Yes	No
Oman	No	Yes	Yes
Pakistan	Yes	No	Yes
Qatar	No	Yes	Yes
Saudi Arabia	No	Yes	Yes
Srilanka	No	Yes	Yes
Syria	No	Yes	Yes
Thailand	No	Yes	Yes
Turkey	No	Yes	Yes
UAE	No	Yes	Yes
Yemen	No	Yes	Yes

Shari'ah board independence

As it is argued in ICG framework that the decisions taken by the SSB will be biased if they are influenced by BODs or any other stakeholders, Bin Ibrahim (2010) shows the importance of independent SSBs and emphasizes that BODs should appreciate SSBs to work independently without any influence for the protection of long-term interest of IBs. Moreover, their uprightness, trustworthiness, and nobility is realized when they discharge their responsibilities independently, that in turn fortify IBs' integrity and reliability. In the ICG structure of IBs, SSBs should be strong and independent in decision making process for getting efficient and effective results. Hamza (2013) compared decentralized and centralized model of *Shari'ah* governance and found that IBs having centralized governance system are more effective and the principal component of the effectiveness was SSBs' independence. Moreover, Malaysian IBs provide a big amount of profit as *Shari'ah* governance system is working freely and independently.

Functions of *Shari'ah* Supervisory Boards (SSBs)

The functions of SSBs have been described by various regulatory institutions and researchers from time to time according to the needs of SSBs and based upon their activities. Their functions have been categorized. For instance, Fayyad (2004) categorized the *Shari'ah* supervision functions in to five categories: (1) moral function; *Shari'ah* scholars achieve depositors' confidence in the activities of IFIs by ensuring that they are compliant with *Shari'ah* laws. (2) Practical function; they provide *fatawas* on newly developed products/services for strengthening the depositors' confidence. (3) Consulting function; they guide CG bodies based upon Islamic canons and laws. (4) Administrative function; attending meetings of BODs to discuss the issues pertaining to them and intimate their opinions regarding annual reports. (5) Control function; auditing all the transactions performed by the IFIs.

Similarly, Hammad (2009) categorizes their functions into two categories: (1) Academic function; it involves research for strengthening the Islamic theory based upon issues that *Shari'ah* scholars face in their day-to-day operations and from review of *Shari'ah* non-compliant activities. Training of employees on *Shari'ah* matters so that employees becomes able to answer the questions raised by their customers. (2) Executive function; it is further categorized into three sub categories: (i) Preventive function; complete assessment of all the transactions/operations of IFIs and reviewing policies, products/services and articles of associations prior to their publication to assure that they are *Shari'ah* compliant. (ii) Remedial function;

all the transactions are audited during their execution for assuring the proper implementation of issued *fatawas*. (iii) Complementary function; intact enquiry for all the transactions accompanying internally audited *Shari'ah* report.

According to Hassan (2001) it has two main functions: (i) Guiding function; they amend the contracts, policies and agreements in light of *Shari'ah* laws and undertake research for solving the problems they face in their day-to-day operations. (ii) Controlling function; they give *fatawas* and take the ultimate decisions by ensuring that all the transactions and operations are compliant with *Shari'ah* laws.

Garas and Pierce (2010) argued that they perform two main functions: (1) Supervisory function; issuing *fatawas* prior to the execution of transactions, sanction or veto any proposal in the light of *Shari'ah*, intact enquiry for all the transactions accompanying with *Shari'ah* internal audited reports, audit of annual reports and approval to distribute net income among the shareholders. (2) Consultation function; proposing *Shari'ah* compliant solutions, describing ways to calculate the *zakat* payments , directing management to allocate non-*Shari'ah* income for charity purposes and arrange trainings for management and investment account holders (IAHs).

While, institutional definitions regarding *Shari'ah* board functioning are as under:

AAOIFI defines SSB as: "An independent body of specialized jurists in *Fiqh-al-Muamalat* (Islamic commercial jurisprudence) to ensure that IFIs are in compliance with *Sharia* principle"

State Bank of Pakistan (SBP) in its *Shari'ah* Governance Framework (SGF, 2016) describes the role of *Shari'ah* board as: "The SB shall ensure that all the procedure manuals, product programs/structures, process flows, related agreements, marketing advertisements, sales illustrations and brochures are in conformity with the rules and principles of *Shari'ah*".

Bank Negara (2013: 1) declared that, '"The *Shariah* Committee is expected to advise the board and provide input to the IFI on *Shariah* matters in order for the IFI to comply with *Shariah* principles at all times and is expected to endorse *Shariah* policies and procedures prepared by the IFI and to ensure that the contents do not contain any elements which are not in line with *Shariah*."

IFSB (2006) also highlighted facilitation aspect of SSBs stating that, "Some *Shari'ah* scholars acting in advisory or monitoring roles to IIFS need to use their best knowledge and efforts in order to facilitate the development of the industry and not to hamper it, since too many restrictions and prohibitions may lead customers to the only other alternative – that is, a conventional financial institution"

Based on the discussion above, we have summarized the following functions of the *Shari'ah* boards as proposed by many authors and institutions;

- That they (*Shari'ah* supervisory board) approve the official documents in light of *Shari'ah* laws derived from sources that involve reasoning based upon interpretations of *Quran* and *Hadith*.
- That they approve the transactions being performed by IBs to ensure their compliance with *Shari'ah* to achieve the confidence of stakeholders as well as the credibility of industry.
- That they comprehensively review and audit the transactions fulfilled or completed by the IBs to ensure that they have been performed without any window dressing and were compliant with *Shari'ah* laws.
- That when the activities performed by IBs are non-compliant with the *Shari'ah* they provide solutions to take corrective actions.
- That for the rapid growth of industry, they should significantly contribute towards creating new products and approve them in the light of *Shari'ah*. Moreover, for harmonizing the industry practices instead of completely rejecting the products they suggest to make some alterations in the products under the grounds of *Shari'ah* laws.
- That they provide *fatawas* on newly developed products and services to ensure that they are according to the teachings of Islam and are not based upon any activity that is considered as offensive in Islam.
- That they audit the financial statements of IBs to ensure their compliance with *Shari'ah* and give their independent opinions that ultimately reflect the true picture of the industry.
- That they ensure that the income or profit generated by the IBs is in compliance with the *Shari'ah.*
- That they establish and comprehensively explain the way for the calculation of *zakat*.
- That they provide *Shari'ah* legislations.

- That they answer the issues or questions raised by the stakeholders, depositors and public at large, and consider them in their meetings to clarify the issues and provide *fatawas* where appropriate.
- That keeping in view the current rapid growth of IBs they should be engaged in more research and development activities regarding Islamic banking.

In theory, the role of SSBs involves providing *fatawas* (on newly developed financial products), conducting *Shari'ah* audit (to ensure that products are in line with *Shari'ah* laws), calculating *zakat*, disposal and distribution of *Shari'ah* compliant income to investment account holders and guiding banks on their wider social role, hence acting as the backbone for IBs. Their ultimate goal is to preserve the credibility of Islamic industry and to enhance the confidence of stakeholders in products and activities of IBs. However, in practice their role varies significantly from one country to another. They are facing double pressure i.e. for commercial reasons and to preserve their reputation by ensuring strict *Shari'ah* compliance.

Importance of Shari'ah governance

Shari'ah governance is referred as the system that provides conformity of all commercial transactions and activities of IFIs with *Shari'ah*. Its significance is procured from religious, social, economic and legal resources. An important pillar on which Islamic banking rests is *Shari'ah* governance, as all the activities and operations of Islamic banks have to be in compliance with *Shari'ah*. Ali (2002) highlighted the importance of *Shari'ah* governance and reported that *Shari'ah* non-compliance results in deposits withdrawals leading banks toward failure. He further suggested that for assurance of *Shari'ah* compliance IFIs should upgrade their products, designs and structures. Similarly, the study of Chapra and Ahmed (2002) conducted an empirical survey based on questionnaire at three different levels: regulators' level, institutional' level and depositors' level to find out the impact of CG on IFIs. The results at depositors' level indicated that if the activities of IBs were not in compliance with *Shari'ah* IBs' depositors in Bahrain (84.6%), Bangladesh (66.8%) and Sudan (94.6%) would shift their deposits to other banks. SSBs hold very respectable position and provide *fatawas* on newly developed products and services; as a result stakeholders' conviction about the validity of transaction is achieved. Product and services on which SSBs do not give *fatawas* will be vetoed by the depositors (Omar, 2002). Further, doubts of depositors are eliminated due to the presence of SSBs (Zighaba, 2009) as they assure the compliance of *Shari'ah* laws and principles. Collectively, these studies suggested the presence of *Shari'ah* governance at appropriate level is an important mechanism to increase depositors' confidence on IBs and hence improves the performance of IBs.

Disclosure levels of IBs

The participatory mode of financial intermediation with risk sharing by the depositors requires IBs to maintain a greater level of disclosure as compared to conventional banking. The SSBs can play pivotal role to ensure appropriate level of disclosure. In this regard, Wan et al. (2013) reported that SSBs having background of contemporary finance in addition to *Shari'ah* have a significant positive impact on the disclosure by the IBs. Similarly, large board exercises, better monitoring as the level of expertise and information increases, uncertainty and information asymmetry decreases, and collective knowledge and experience of SSB will lead to greater disclosure (Singh *et al.*, 2004). However, Hussainey *et al., (*2016) found insignificant relationship between board independence and level of corporate disclosure.

In IBs, level of disclosure has increased with the presence of SSBs as they discharge their duties according to *Shari'ah* principles with the prime objective to protect the shareholders' interest (Farook, *et al.*, 2011). Therefore, *Shari'ah* matters should be transparent and disclosed properly so that stakeholders become informed about the activities of *Shari'ah* scholars and immediately concede the *Shari'ah* contravention. Otherwise there is the possibility for the existence of *Shari'ah* risk that ultimately leads towards banking distress and financial crisis. However, Hasan (2012) stated that IBs' annual reports are not standardized as *Shari'ah* matters and important information through which stakeholders' confidence is achieved like the issued *fatawas*, numbers of meetings held during a year etc. are not disclosed. According to Haniffa and Hudaib (2006) mostly IBs didn't publish the issued *fataws* or any such documents on the websites so it is predicted that they are hiding things from general people. It is anticipated that IBs should disclose the SSB related matters to a greater extent, so that stakeholders become confident that the resources managed by the banks are in conformity with *Shari'ah* laws.

Shari'ah board activities

Sometimes *Shari'ah* scholars without giving due consideration issue *fatawas* and as a result IBs are encountered with losses (Hammad, 2007). Therefore, it is cardinal to arrange meetings between key personnel of relevant departments, so they can accurately and comprehensively understand the matter and provide flawless *fatawas*. The SSBs members are specialized more in *Shari'ah* than other fields therefore; it is preferred to have periodic meetings between SSB members and the management of banks to ensure that all the practices are aligned with *Shari'ah* (Ghayad, 2008). Through periodic meetings, management of bank will be able to present the questions arising from their clients and disclose problems from their day-to-day operations which are not in compliance with the *Shari'ah*. Furthermore, SSBs' meetings are important for clarifying *Shari'ah* non-complaint issues as SSBs are not always available to the banks. Moreover, with proper understanding of commerce, economics and finance, they are able to resolve the banking issues efficiently leading towards improved performance (Bukhari *et al*. 2013; Ghayad, 2008).

Ownership over applicable information and aptitude empower the members to comprehend the nature and ramifications of product(s) submitted for *fatawa*. Khan et al, (2017) found that SSB members having knowledge of accounting and finance in addition to the *Shari'ah have* significant positive impact on the performance and profitability of IBs. Similarly, Ghayad, (2008) and Kolsi & Grassa, (2017) reported that increase in IBs profitability is associated with members of SSBs having accounting background.

Islamic vs. Conventional Banks

Islamic banking and governance reforms significantly contribute towards stable and credible financial markets internationally (Wilson, 2010). IBs remained resilient and stable during financial crisis (Chapra, 2009; Green, 2010), and showed better growth than conventional banking (CBs) during global financial crisis (Phulpoto, et. al. 2012). Many researchers compared the Islamic and conventional banks on the grounds of stability, efficiency, profitability and their business orientations to find out the differences and similarities between them (Hutapea & Kasri, 2010; Mollah & Karim, 2011; Wasiuzzaman & Gunasegavan, 2013; Grassa & Matoussi, 2014; Khan et al., 2017; Mollah & Zaman 2015; Mollah et al., 2017; Bitar et al., 2017). According to Beck et al. (2013) business orientations of IBs and CBs don't have any significant differences. However, Dridi and Hasan (2010) indicated that their business orientations are significantly different that minimized the effect of crisis on the profitability of IBs. Although CBs are cost effective compared to IBs but IBs have higher intermediation and capital-to-asset ratio, suggesting that IBs are adopting orthodox and cautious approach towards risk taking (Beck et al., 2013; Bourkhis & Nabi, 2013). Thus IBs appeared to be cost effective during crisis and made high profits (Abedifar et al., 2013; Olson & Zoubi, 2008). Ayub et al.,

(2012) argued that IBs performed better in capital adequacy and liquidity position while management and earning ability of CBs is better than IBs.

Since, non-PLS modes of financing are supposed to reduce the level of compliance with the *Shari'ah* and are used by the CBs as a benchmark, therefore, it is suggested that similarities exists between IBs and CBs (Abedifar et al. 2013; Beck et al. 2013; Mollah & Zaman, 2015 and Bitar et al., 2017). Therefore, it is considered important to investigate how IBs compared to CBs are affected by these financing modes (Bitar et. al. 2017). Firstly, some instruments of IBs are based on PLS principles, thus are considered to be better capitalized compared to CBs. Secondly, IBs have more liquidity buffers and are safeguarded for liquidity shortages as they do not offer short term liquid instruments and debt instruments to CBs. Moreover, central banks act as "the lender of last resort" still IBs don't borrow from them. However, it put negative impact on their stability and performance. Still, IBs are contemplated as more liquid compared to the CBs. Thirdly, leverage investment accounts being used by the IBs are backed by IAH. Therefore, Islamic banking investments don't accord to "financial bubbles" as compared to the CBs (Bitar et. al., 2017). Lastly, for financing, IBs use investment accounts instead of equity therefore, they are considered to yield increased profit as compared to CBs (Olson & Zoubi, 2008). Leon & Weill (2017) examined the effect of IBs expansion upon access to credit and didn't found any impact of IBs' expansion on credit constraints in contrast to CBs' development that creates hurdles to financing.

Shari'ah supervision and bank performance

Shari'ah supervision is one of the critical areas in Islamic finance for being the part of overall ICG of IBs. *Shari'ah* supervision is an additional layer as compared to the conventional banking governance system to implement *Shari'ah* financial laws.

The literature on *Shari'ah* supervision's association with firm performance is limited, however rapidly growing. Abdullah et al. (2012) analyzed that CG plays a vital role in IBs as CG helps SSBs to perform their work in the best way to connect to Islamic banking. Grassa and Matoussi (2014) described the differences and similarities between Gulf Cooperation Council (GCC) and Southeast Asian countries. They found big differences because in different countries CG of IBs is influenced by different laws and regulatory frameworks and to overcome these weaknesses it needs some positive changes and improvement. Further, the composition of BODs and SSBs is affected by culture, economy, regulatory environment and social contexts under which these banks operate. Wasiuzzaman and Gunasegavan (2013) found that average assets, board size and bank size of IBs were lower as compared to CBs. While assets quality, operational efficiency, liquidity, board independence and capital adequacy were higher for the IBs. Kolsi and Grassa (2017) examined the effect of ICG on earnings management through discretionary loan loss provision (DLLPs) and reported that larger *Shari'ah* board size in IBs manages less DLLP and AAOIFI member banks have higher expertise in accounting, financial markets and *Shari'ah* prescriptions than non-members. Therefore, SSB members having knowledge of finance are very important in improving the performance of IBs. Furthermore, a negative relationship has been found for director's independence and the range to which IBs manage DLLP. The presence of block-holders has positive impact on earnings management and there is no impact of bank size and institutional ownership on earnings management through DLLPs. Quttainah (2013) found that in IBs, earning management is not affected by the presence of SSBs. Grassa et al. (2010) did not find any significant relationship between SSB characteristics and financial performance. However, *Shari'ah* governance attributes are efficient in terms of *Shari'ah* compliance transactions. Bukhari *et. al.,* (2013) investigated the perceived importance of management of IBs and Islamic banking windows of CBs regarding different dimensions of CG in Pakistan. Results revealed that CG of IBs is affected by BOD and SSB whereas for the CG of Islamic banking windows, all dimensions were important. Mollah and Zaman (2015) found positive impact of SSB and role duality on the performance during crisis, which shows that *Shari'ah* supervision significantly impacts performance as it ameliorates the dissenting impact of additional risk taking. Mollah et al., (2017) concluded that due to the *Shari'ah* compliant products and complex nature of transactions of IBs, the CG structure of IBs allowed them to undertake high risks and improved their performance. Moreover IBs compared to CBs maintain high capitalization.

Concluding Remarks and Future Direction

The Islamic corporate governance has received much attention in the recent years, partly due to the global financial crisis of 2008 that severely hit the conventional financial system and partly due to the stability and resilience that the IBs have shown during that period. The fame that Islamic banking and finance has received worldwide is because of its reliance on the principles of Islamic financial laws that rest on equity, participation and business ethics. The literature on Islamic banking and finance is growing quite rapidly and has attracted considerable attention of the concerned bodies. This paper surveyed the existing literature on ICG and focused on the characteristics of SSB that differentiate the IBs from CBs. The research is structured in four main themes that are thoroughly explored in the recent literature.

Islamic banking is said to be done when all the activities carried out by them are aligned with the *Shari'ah* laws as Islamic *Shari'ah* requires transparency in every transaction between trading parties (Alnasser & Muhammed, 2012; Thomas et al., 2005). Therefore, to ensure *Shrai'ah* compliance in IBs, the ICG has incorporated an additional board called SSB which is comprised of *Shrai'ah* scholars having expertise in Islamic jurisprudence as well as contemporary finance. These *Shrai'ah* scholars are generally of good reputation in the Muslim community that enhances the reputation and credibility of IBs in general public. The SSBs have shown a significant role in improving the quality of ICG in IBs and their performance.

This paper has explored the optimal structure of ICG framework and concludes that the extant literature provided strong foundations to label it as stakeholders' oriented. It involves showing fairness with transparency and accountability to all the stakeholders in an equitable manner. Islamic *Shari'ah* considers conflict of interest as offensive i.e. "*haram*". In the light of *Shari'ah* it is referred to as a situation that creates doubts for others, therefore, it is not acceptable in Islam. The most important risk to IBs is *Shari'ah* compliance risk as they have to reassure IAHs that the claims of *Shari'ah* adherence made by them involve no window-dressing (Chapra & Ahmed, 2002). However, one of the important but uncertain issues affecting the credibility of *Shari'ah* scholars is the non-availability of standard criteria to recognize them as qualified.

This study has also examined the role and functions of SSBs. Different researchers defined the SSB's functions differently. Based upon prior findings it is concluded that key functions performed by SSBs involve providing *fatawas*, conducting *Shari'ah* audit, calculating *zakat*, disposal and distribution of *Shari'ah* non-compliance income to investment account holders and guiding banks on their wider social role on the basis of *Shari'ah* laws and principles hence, act as backbone for IBs. Their ultimate goal is to preserve the credibility of Islamic industry and enhances the confidence of stakeholders in products and activities of IBs. For stable financial system, it is necessary to gain the confidence of depositors by constituting *Shari'ah* supervisory boards (Ali, 2002) as *Shari'ah* non-compliance will result in deposits withdrawals leading banks toward failure.

Furthermore, we compared the Islamic and conventional banking system and concluded that IBs performed better during financial crisis as the business orientation of IBs and CBs is different and IBs appeared to be cost effective (Beck et al., 2013; Bourkhis & Nabi 2013). We also studied the empirical impact of *Shari'ah* supervision on firm performance. Furthermore, many studies confirmed that the impact of *Shari'ah* supervision on firm performance is positive and significant.

The survey of the literature suggests few important future research directions such as (i) more research is needed to improve the quality of the present work by using primary data sources especially conducting interviews with the *Shari'ah* board scholars regarding the contemporary issues in Islamic finance, their selection, education, and gender diversity, (ii) the extant literature lacked in exploring the diversity factor of SSB and its implications , and (iii) the future research could also consider the experiences of IBs in the non-Muslim majority countries so that comprehensive and generalized implications could possibly be drawn.

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