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Experts' Perceptions on Saudi's Shari'ah Governance Framework for Banking

Mohamed Sharif Bashir [1], Abdo Aglan Babiker [2]

[1] Applied College, Imam Mohammad Ibn Saudi Islamic University, Riyadh, Saudi Arabia

https://orcid.org/0000-0001-5110-8503

[2] College of Business, Imam Mohammad Ibn Saudi Islamic University, Riyadh, Saudi Arabia

https://orcid.org/0009-0001-9405-6392

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Abstract: This research investigates *Shari'ah* governance in Islamic banks situated in Saudi Arabia based on the perceptions of Islamic finance experts. A descriptive analytical approach is employed. The research reveals that the Saudi *Shari'ah* governance structure for local financial institutions is still far from that applied and practiced in most Islamic financial institutions in Gulf Cooperation Countries (GCCs) in terms of compulsory implemented standards and requirements. This research highlights some challenges faced by Saudi authorities in implementing the *Shari'ah* governance structure, while also suggesting some policy changes to improve *Shari'ah* governance practices in Saudi banks.

Keywords: Islamic banking, Islamic finance, governance practices, *Shari'ah* governance.

Introduction

Due to significant annual growth rates of Islamic financial institutions worldwide in recent decades, there has been a rising interest in *Shari'ah* (Islamic law) governance for Islamic banking sector. According to recent data, the economies of the Middle East are crucial to the growth of Islamic financial institutions (Al-Zamel, 2018; Bashir & Babiker, 2023; Yousufi & Sara, 2018). Saudi Arabia has gained a prominent position in the realm of Islamic finance through the Financial Sector Development Program and the strategic plan for Islamic finance (Bashir, 2023; Bashir et al., 2023; Vision 2030, 2023).

The current research holds importance in its focus on the framework of *Shari'ah* governance within the Saudi context. On the practical level, this research can assist policymakers and decision makers in regulatory bodies in developing the *Shari'ah* governance framework in Saudi Arabia, providing insight into the key challenges facing the implementation of the *Shari'ah* governance regulatory framework. Furthermore, this research can help in formulating appropriate policies and procedures to enhance the *Shari'ah* governance framework implemented in Saudi banking sector. This research primarily aims to investigate the *Shari'ah* governance framework in Saudi financial institutions based on the perceptions of Islamic finance experts.

In Islamic financial institutions, there is an association between *Shari'ah* and corporate governance. One model involves having both external and internal *Shari'ah* supervisory boards (Bashir & Babiker, 2023; Osemy, 2020; Salama, 2020; SAMA, 2020). The Islamic Financial Services Board (IFSB) defined *Shari'ah* governance within banks as "the system through which Islamic financial services institutions ensure that there is independent and effective supervision of the *Shari'ah* compliance" (Al-Noubani & Sadiqi, 2016; Al-Salehi, 2020). Several prominent organizations have developed *Shari'ah* governance principles; for instance, both the Accounting and Auditing Organization for Islamic Financial Institutions (AAOFI) and the IFSB have adopted governance principles and issued standards regarding *Shari'ah* governance in the context of Islamic banks (Bashir & Babiker, 2023; SAMA, 2021).

Research Results

Semistructured interviews were conducted to investigate and understand how *Shari'ah* governance is implemented in Saudi financial institutions. The interviews involved a sample of 9 managerial leaders who are experts and practitioners in Islamic banking and responsible for supervising Islamic banking transactions in some Saudi's banks. Examples of these responsibilities include the Head of the *Shari'ah* Committee, Secretary of the Committee, Head of the Compliance Unit, Head of the Internal Audit Unit, as well as advisors (Aljuaid et al., 2022). These interviews allowed for capturing the opinions of the sample participants at these senior managerial levels regarding the study's questions and the implementation of governance practices.

Content analysis demonstrates that there are differences and variations in opinions among the study sample regarding how important the level of implementation of *Shari'ah* governance framework in Saudi banks is. These opinions can be summarized as follows.

Application of Shari'ah Governance

Some of the sample participants perceived the implementation of *Shari'ah* governance within Saudi banks as important. However, their perceptions varied among different banks. Participants from banks that fully practice Islamic banking exhibited greater awareness of the importance of implementation. Their previous Islamic banking practices have contributed to their understanding of the importance of implementing the *Shari'ah* governance framework. On the other hand, banks that operate Islamic windows were found to have a relatively low perception of the importance of implementation. This can be attributed to the lack of previous experiences with these windows before the issuance of the *Shari'ah* governance framework.

Compliance with the Requirements of the Shari'ah Governance Framework

Some experts believed that local financial institutions are committed to adhering to the *Shari'ah* governance framework of the Saudi Arabian Monetary Authority (SAMA; also called the Saudi Central Bank). They viewed the central bank as having contributed to enhancing this commitment through the periodic issuance of circulars and guidelines to the Islamic finance sector. They also perceived that full-fledged Islamic banking has a distinctive experience and a strong commitment to SAMA's directives. With regard to the Islamic windows, the governance framework itself is considered a positive addition to the sector. However, there is a need for a clear strategy within the branches and Islamic windows, as well as attracting and qualifying personnel within the bank.

Challenges Facing Shari'ah Governance in the Saudi Context

Experts' responses to the most important obstacles to implementation of *Shari'ah* governance in local Saudi financial institutions have been classified as follows:

Regulatory and Legislative Challenges: Some experts believed that there are regulatory and legislative challenges hindering implementation of SAMA's *Shari'ah* governance framework. These challenges include the following:

- Lack of clear details within the framework regarding roles and responsibilities, regarding *Shari'ah* committees as well as *Shari'ah* auditing. The tasks of internal control and *Shari'ah* auditing differ due to the nature of their work and practice, especially in *Shari'ah* aspects.
- Lack of clarity in the framework regarding organizational structure. No clear differentiation exists between *Shari'ah* auditing, compliance, and supervision, resulting in confusion in practices and designations within banks. Additionally, no minimum standard exists for the organizational structure in *Shari'ah* departments in fully Islamic banks and banks with Islamic windows.
- Lack of guidance outlining the procedures and policies for implementing Islamic banking in relevant departments and the mechanism of collaboration between risk management and *Shari'ah* departments regarding the risks of noncompliance.

Technical Challenges

Some important technical challenges include the following:

- Lack of a clear mechanism for the accountability segregation between fully *Shari'ah*-compliant assets and liabilities and conventional ones, and lack of harmonized standards for the implementation of

Islamic banking in local banks in Saudi Arabia. There is a need for central standards (hybrid model) while ensuring the suitability of *Shari'ah* governance for the nature of traditional financial practices.

- Absence of a centralized guide from SAMA for Islamic banking products in banks operating in Saudi Arabia. This is despite the imposition of typical products and contracts by the central bank without seeking the opinions of *Shari'ah* bodies and committees.
- Differences in implementation of *Shari'ah* governance between Islamic windows in conventional banks and those that comply with *Shari'ah* in terms of fulfilling *Shari'ah* governance requirements. The nature of Islamic banking practice in fully compliant banks is not adequately considered compared with conventional banks providing products and services that comply with *Shari'ah* through Islamic windows.

Administrative Challenges

Most experts believed that administrative obstacles affect restrictions on *Shari'ah* governance implementation in local banks in Saudi Arabia. Some important administrative challenges include the following:

- Lack of a centralized strategy for developing qualified personnel in Islamic banking that combines banking expertise with the relevant jurisprudential issues related to *Shari'ah* governance practices in local banks.
- Shortage of specialists in Islamic banking and finance in Saudi banks, as well as limited experience in dealing with contemporary Islamic banking issues in the banking environment of Saudi Arabia.
- Lack of local academic institutions offering specialized programs and professional certifications in Islamic finance and banking, which is likely to facilitate accumulation of knowledge and experience among Islamic finance scholars.
- Insufficient number of competent individuals with both banking and jurisprudential qualifications in local banks in Saudi Arabia, resulting in some *Shari'ah* committee members serving in multiple banks without a defined timeframe.

Conclusions

The relevant conclusions of this research can be summarized as follows.

1. Based on experts' opinions on the Saudi *Shari'ah* governance framework, this research shows that a key feature of the Saudi *Shari'ah* governance framework is that it adheres to the minimum requirements set out in the international standards governing Islamic financial institutions and adopted by AAOIFI and IFSB.

2. According to the perspectives of individuals in the selected sample, the dimensions of governance in Saudi banks were ranked based on their level of implementation. The dimension of organizational structure was the most implemented, followed by disclosure and transparency; independence and confidentiality of information; and control, audit, and accountability. This ranking indicates the banks' focus on organizational structure, as well as their evolving practices related to disclosure, transparency, and independence, in line with the requirements of the *Shari'ah* governance framework. It also reflects the strong commitment of banks' boards of directors to *Shari'ah* governance, in addition to the instructions administered by SAMA regarding *Shari'ah* governance practices and their continuous enhancement.

3. The research results show diverse opinions on the most effective ways to introduce *Shari'ah* governance to local financial institutions. Some experts believed that the implementation should be

carried out in stages, thereby learning from mistakes and gradually enhancing and generalizing the framework. Others emphasized the necessity of integrating a *Shari'ah* supervision department into the central bank, to monitor the implementation process, continuously emphasize the importance of *Shari'ah* governance, develop regulations and guidance, and promote ongoing compliance. Some participants highlight the importance of capacity building and competency development to ensure appropriate, effective implementation of the framework.

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