

Centralization of Governance and Sharia Supervision on Financial Institutions and Islamic Banks: A Critical Study

*Dr. Ghalib Mohammad Al-Bulooshi**

Abstract

In terms of corporate governance, particularly financial institutions, it is generally argued that over- or under-regulation should be avoided. On one hand, tightness of regulation could prove to be counterproductive. Therefore, providing a degree of discretion for supervisors regarding how much legality to stipulate could be desirable. On the other hand, regulations need to be enforced by effective supervision, where the objectives must be clear and the mechanisms appropriate. Hence, the degree of regulatory authorities' independence from governmental influence is important.

Taking that in consideration, this research paper aim to present an analytical discussion in regard of the current Sharia Governance System in Islamic Finance and Banking Industry (IFB). In main, it points to the framework evolved by supportive international organizations, namely the IFSB and AAOIFI in their capacity as standard-setter bodies, which thought to be largely respected. In this context, it provides a case-study for particular countries, namely, Bahrain, UAE (Dubai), Kuwait, and Oman, where the trend emerged of having a so-called Higher or Central Sharia Authority regarding IFB.

Since the announcements of establishing such bodies was only in recent years (2014-2019), the scope of their work and actual authorities worth examining. Without doubt, the existence of such bodies consist a step forward toward the enhancement of the Sharia-Governance and supervision Framework. On one hand, this study notes that they should assist in the harmonization of the IFB practices at the national level. This assumption is supported when taking in consideration the very recent Governance Standard of AAOIFI-8 about Central Sharia Boards, which was announced in summer of 2017.

On the other hand, the study notes that limiting the scope of their work in such manner may not necessarily help in having stronger and more efficient Sharia Governance framework. Despite that, harmonization of Fataws should raise the credibility of the IFB nationwide, such bodies can minimize but cannot

* Assistant Professor of Commercial Law, College of Law, University of Bahrain.

eliminate some practical and legal concerns surrounding the Sharia Governance and Supervision issues such as shortage of Sharia-Scholars, conflict of interest, the scope of SSBs supervision, the legal status of their pronouncements. At least, not without assigning real regulatory and supervisory powers to those bodies.

Keywords: Sharia Governance, financial regulator, Central bank, AAOIFI, IFSB, Islamic Finance and Banking.

1. Introduction

It is known that, attempts at Islamic banking in the 1950s-60s lacked the necessary regulatory support.⁽¹⁾ Although some Islamic states have issued special laws for Islamic banks, no country has formulated a law based entirely on Sharia for its Islamic Financial and Banking Sector (IFB).

In 1995, it was emphasised that for the most effective regulation, Islamic banks should be supervised by authorities who have extensive knowledge and experience of Islamic financing. However, it was noted that most of the supervisory authorities lack the knowledge of Sharia which is the distinguishing feature of Islamic banking. Therefore, any assistance that may be required by Islamic banks for their operations will not be met, and any supervision and regulation will be based upon the experience gained from conventional banks.⁽²⁾ In fact, it was evident that they are functioning merely as supplements to conventional ones,⁽³⁾ and the financial regulators do not always take into consideration the exceptional characteristics of Islamic finance.⁽⁴⁾

Perhaps, this prospective need be revised when taking in consideration the newly emerged trend of having a so-called Higher or Central Sharia Authority in modern Islamic-states. In this capacity, Malaysia established the so-called Sharia Advisory Council (SAC) in 1997, which was empowered to have a legal authority in regard of Islamic financial and banking disputes only in 2013.⁽⁵⁾ In the State of Kuwait, disputes in regard of Islamic banking matters maybe transferred by the Board of Directors of the Islamic Banking Institutions to the Fatwa Board in the Ministry of Awqaf and Islamic Affairs.⁽⁶⁾ Other Gulf Corporation Countries (GCC) announced the appointment of similar bodies only few years back, respectively the Sultanate of Oman decided on October

(1) Dahlia El-Hawary, Wafik Grais, and Zamir Iqbal, "Diversity in the Regulation of Islamic Financial Institutions," *The Quarterly Review of Economics and Finance* 46, no. 5 (February 2007): P: 778-800.

(2) Gafoor, A. L. M. Abdul. *Interest Free Commercial Banking*. APPTTEC Publications, 1995

(3) Mahmoud El-Gamal, "Money Laundering and Terror Financing Issues in the Middle East" (Statement for US Senate Committee on Banking, Housing and Urban Affairs' Hearing, July 13, 2005), P: 20, http://banking.senate.gov/public/_files/gamal.pdf.

(4) Mostaque Hussain et al., "Accounting Standards and Practices of Financial Institutions in GCC Countries," *Managerial Auditing Journal* 17, no. 7 (2002): P: 181.

(5) The Malaysian Islamic Financial Services Act No (759) of 2013.

(6) Article (93) of the Law No (32) of 1968 Concerning Currency, the Central Bank of Kuwait and the Organisation of Banking Business.

2014 to have a National Sharia Supervisory Board⁽⁷⁾ which will advise the Central Bank of Oman (CBO),⁽⁸⁾ the United Arab Emirates (UAE) decided on 17 March 2015 to set up Higher Sharia Authority⁽⁹⁾ attached to the Ministry of Justice and Islamic Affairs,⁽¹⁰⁾ the Central Bank of Bahrain (CBB) declared on December 2014 setting up a Central Sharia Board⁽¹¹⁾ which was established later by the issuance of resolution no. (3/2016).⁽¹²⁾ Most recently, on 1st of April 2019, the Governor of the Central Bank of Kuwait said that they just finished drafting a law concerning so-called “Central Sharia Committee”, which is pending authorities’ approval.⁽¹³⁾

It is to be noted that, the financial regulators’ willingness to support the Islamic banks varies across different countries, as do the necessary alterations to their regulatory and supervisory frameworks.⁽¹⁴⁾ Regardless of their form and allocated role, the existence of such bodies is actually a step forward toward the enhancement of the Sharia-compliance task at the national level. Since the announcements of establishing such bodies was only in recent years, the scope of their work and authorities worth examination.

The paper argues that the scope of such bodies’ work could actually be limited to the harmonization of the IFB practices at the national level. Actually, this assumption is supported when taking in consideration the Governance Standard AAOIFI-8 about Central Sharia Board issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).⁽¹⁵⁾

Taking a descriptive and analytical approach, this research will examine the

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- (7) “Oman: Central Bank Appoints Sharia Board,” Issue 979, Gulf State News, October 16, 2014. <http://archive.crossborderinformation.com/Article/Oman+Central+bank+appoints+sharia+board.aspx?date 20141016#>.
 - (8) Bernardo Vizcaino, “Oman Sets up Central Sharia Board in Move to Boost Islamic Finance.” Reuters, October 8, 2014. <http://www.reuters.com/article/2014/10/08/oman-islam-financing-idUSL6N0-S305J20141008>.
 - (9) Haseeb Haider. “Shariah Authority on Cards.” Alkhaleej Times, March 22, 2015. http://www.khaleejtimes.com/biz/inside.asp?xfile=/data/uaebusiness/2015/March/uaebusiness_March255.xml§ion=uaebusiness
 - (10) Article (5) of the U.A.E Federal Law No. (6) of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies.
 - (11) Bernardo Vizcaino, “Bahrain to Develop Central Sharia Board for Islamic Banks,” Reuters, December 3, 2014, <http://www.reuters.com/article/2014/12/03/bahrain-islam-regulations-idUSL3N0TN1A020141203>.
 - (12) The CBB Resolution no. (3/2016) concerning the formation of the Central Sharia Supervisory Board.
 - (13) Mai Mamoon, “Completion of the draft law of the Central Sharia Committee”, Alqabas Electronic Newspaper, April 2019. <https://alqabas.com/651977/>.
 - (14) Karbhari, Naser, and Shahin, “Problems and Challenges Facing the Islamic Banking System in the West: The Case of the UK.” *Thunderbird International Business Review* 46, no. 5 (September 2004), P: 524.
 - (15) The AAOIFI-8 Governance Standard concerning Central Sharia Board, 2017.

Standards of IFSB and AAOIFI related to Sharia Corporate Governance. It will underline their influence in regard of the regulatory framework for Sharia Governance implemented by the selected countries under study. Examining similarities and differences in application of those standards, the study aim to present a true understanding for the legal positioning of the so-called Higher or Central Sharia Authority within the given Sharia Governance frameworks and the influence of IFSB and AAOIFI as standard setter in this regard.

Therefore, the paper is divided into four main parts. First, attempts toward the establishment of a regional/international Sharia body will be addressed. These unsuccessful attempts encouraged the leading efforts of Standard-setting bodies (IFSB and AAOIFI) to provide the framework for so-called Sharia corporate governance and supervision, which is discussed next. This is followed by showcasing the influence of the standards and the implementation of National Sharia Authority in the IFB of selected countries. Finally, the study concludes its findings in the form of legal observations concerning the adopted Sharia Supervision Frameworks and the role of the National Sharia Authority nationwide.

2. Establishment of Higher Sharia Authority: Previous Attempts

The idea of having a Central Sharia Authority is not new, dating from the 1970s when several regional and international Sharia Supervisory Committees were formed to supervise the institutional SSB. Since the inception of Islamic banks, attempts have been made to unify Islamic banking practices. For instance, the International Islamic Fiqh Academy in Jeddah was established with the intention of unifying fatawa and issuing opinions from a multitude of scholars rather than individual experts.⁽¹⁶⁾ However, there is no standardisation in practice amongst the institutional SSB in the Organization of Islamic Cooperation member countries, so if one SSB approves transactions in one country, it does not follow that it can secure the approval of other SSB within the other member countries.

The first attempt to establish a regional or international Sharia supervisory committee was made by the International Association of Islamic Banks, which is known today as the General Council for Islamic Banks and Financial Institutions. The Sharia supervisory committee of this Organization was founded in 1977-78 to monitor the institutional SSB in member countries. The initial idea was to group the representatives of the institutional SSB at the

(16) "International Islamic Fiqh Academy", accessed March 27,2019. <http://www.fiqhacademy.org.sa/>.

Cooperative Development Bank headquarters, in order to introduce current issues. The Association established the first High SSB in 1983 under the patronage of the Dubai Islamic Bank and held a number of meetings under the supervision of the Union Secretariat General. However, this very first attempt was not successful due to the short life of the International Association of Islamic Banks itself.⁽¹⁷⁾

The second regional or perhaps international, supervisory committee was established by the AAOIFI in 1991. The AAOIFI's group of religious scholars sitting on this committee were authorised to issue Islamic legal opinions or decisions on Islamic financial products, and to supervise the institutional SSB of AAOIFI members on a voluntary basis. That is, the committee was established with the clear mandate of issuing Sharia and governance standards to guide the IFI.⁽¹⁸⁾

Others regional or international Sharia Supervisory Committees followed, for example, those of the International Islamic Financial Market in 2001,⁽¹⁹⁾ and the International Islamic Rating Agency in 2005, to provide an optional service to any institutional SSB in the IFI in any jurisdiction of measuring governance and credit rating. The Islamic Development Bank⁽²⁰⁾ and Liquidity Management Centre⁽²¹⁾ have their own Sharia Supervisory Committees; however, they draft proposals to the Organization of Islamic Cooperation's and International Islamic Fiqh Academy.

All of these Sharia Supervisory Committees were established to fulfill objectives set out by their originating Organizations. As part of these larger bodies, it is hoped that they will play a regional or international role and help the development of the IFB industry within their area of expertise. Although their contribution is undeniable, they are not considered as the ultimate sharia authority at either regional or international levels.

2.1 Standard Setting Bodies: IFSB and AAOIFI

In the absence of a so-called Higher Sharia Authority, some supportive Organizations nevertheless play a much needed role in the identification

(17) Nicholas Ray. *Arab Islamic Banking and the Renewal of Islamic Law*. 1st edition. Springer, 1995, P: 7.

(18) "Accounting and Auditing Organization of Islamic Financial Institutions," accessed March 25, 2019. <http://www.AAOIFI.com>

(19) "International Islamic Financial Market," Accessed March 25, 2019. <http://www.iifm.net>.

(20) "The Islamic Development Bank," accessed March 25, 2019. <http://www.isdb.org>.

(21) "Liquidity Management Centre," accessed March 26, 2019. <https://www.lmc Bahrain.com/>.

and harmonization of Islamic financial services worldwide. In fact, it is their efforts that are currently helping in the production and consistency of practices among IFB, bringing the regulatory and supervisory frameworks of Muslim countries closer to each other.

According to each Organization's nature and purpose, their influence over the IFB varies across nations. Some bodies are concerned with Islamic research and awareness of Islamic finance, aiming at the coordination of fatawa, such as the International Islamic Fiqh Academy⁽²²⁾ and the International Sharia Research Academy.⁽²³⁾ Such bodies, although carrying out the role of unifying fatawa or perhaps the process of Ijtihad (effort or exertion), are based in different regions and in fact are serving different purposes and market needs.

However, for the purpose of this study, bodies involved in providing regulatory and supervisory services for the IFB in a regional and international capacity will be examined, respectively, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).

The central banks and national monetary authorities of Muslim countries officially inaugurated the Islamic Financial Services Board (IFSB) on 3 November 2002, and it started operating on 10 March 2003. The IFSB coordinates its activities closely with the Bank for International Settlements and includes entities like the International Monetary Fund and the Islamic Development Bank in its membership. It is argued that the work of the IFSB complements that of the Basel Committee on Banking Supervision, International Organization of Securities Commissions, and the International Association of Insurance Supervisors. It strives toward adopting globally accepted prudential standards that smoothly integrate IFB with the conventional financial system, taking into account any specificities of Islamic finance. It therefore ensures a level playing field between the IFB and conventional banking institutions.⁽²⁴⁾

As the list of standards suggests, the IFSB's working areas cover all the important regulatory aspects of the financial industry, including IFSB-3 on Guiding Principles on Corporate Governance for IFB, IFSB-10 on Guiding Principles on Sharia Governance Systems for IFB, and the more

(22) "International Islamic Fiqh Academy", accessed March 27, 2019. <http://www.fiqhacademy.org.sa/>.

(23) "The International Sharia Research Academy," accessed March 25, 2019. <http://www.isra.my>.

(24) Hesse, Jobst, and Solé, "Trends and Challenges in Islamic Finance." *World Economics* 9, no. 2 (2008). P: 190.

recent IFSB-16 on Revised Guidance on Key Elements in the Supervisory Review Process of IFB.

The Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) was established in accordance with the agreement of association signed by the IFB on 26 February 1990 in Algiers. It was registered on 27 March 1991 and based in Bahrain.

From 1993, the Organization has produced standards in the areas of accounting, auditing, ethics, governance, and sharia for IFI. The Sharia Council of the AAOIFI has produced a substantial work on how to standardise financial reporting, including reporting on sharia-compliance. These standards are gaining wider acceptance and hence are being adopted by the financial regulators and applied by IFI worldwide. As such, they are compatible with the International Financial Reporting Standards.

The AAOIFI has issued a vast number of standards, which includes accounting standards and Sharia standards with the purpose of bringing diverse Sharia opinions to universally acceptable standards. Overall, there are Six Auditing Standards including the late AAOIFI-6 Standard about External Sharia Auditing Standard, and Eight Governance Standards including the late AAOIFI-8 Governance Standard concerning Central Sharia Board.

It is of importance to recognise that both AAOIFI and IFSB as Organizations agree on the need for more specific governance for IFB. Despite being independent international Organizations, based in two different countries, their work needs to be seen as complementary to each other.

The standards issued by the IFSB, although aiming to provide a favorable regulatory and supervisory environment for IFB, remain optional for central banks. The AAOIFI standards are more closely related to the governance standards of the SSB of IFB; they are mostly applied by IFB and recommended by financial regulators. Nonetheless, are not binding unless the regulatory authorities have chosen to implement and impose them, or the IFB willingly accepts them.

Herein is a list of standards that concerns Sharia Governance:

- IFSB-3 on Guiding Principles on Corporate Governance for IFB.⁽²⁵⁾
- IFSB-10 on Guiding Principles on Sharia Governance Systems for IFB.⁽²⁶⁾
- IFSB-16 on Revised Guidance on Key Elements in the Supervisory Review Process of Islamic Financial Institutions.⁽²⁷⁾
- AAOIFI-1 Governance Standard for IFB on SSB: Appointment, Composition and Report.⁽²⁸⁾
- AAOIFI-2 Governance Standard for IFB on Sharia Review.⁽²⁹⁾
- AAOIFI-3 Governance Standard for IFB on Internal Sharia Review.⁽³⁰⁾
- AAOIFI-5 Governance Standard for IFB on Independence of SSB⁽³¹⁾
- AAOIFI-8 Governance Standards for Central Sharia Board.⁽³²⁾
- AAOIFI-6 Auditing Standard for External Sharia Auditing⁽³³⁾

Since AAOIFI was established earlier than IFSB and worked first on providing standards for IFB, special attention was paid to its standards directly concerned with the Sharia governance of IFB, particularly the SSB, including but not limited to the definition, appointment, composition, report, and general duty to ensure Sharia-compliance of transactions, as well as fixing remuneration, selection and dismissal of the members, and the incompatibility clauses for the avoidance of conflicts of interest. The IFSB standards address central banks with regard to Sharia governance, and in fact re-state the same requirements for sharia governance as AAOIFI's.

A close examination of the IFSB standards shows that the IFSB works

(25) "IFSB Standard No.3: Guiding Principles on Corporate Governance for Islamic Financial Institutions," December 2006.

(26) "IFSB Standard No.10: Guiding Principles on Sharia Governance Systems for Islamic Financial Institutions," December 2009.

(27) "IFSB Standard No.16: Revised Guidance on Key Elements In The Supervisory Review Process of Islamic Financial Institutions," March 2014.

(28) "AAOIFI Governance Standard No.1: Sharia Supervisory Board: Appointment, Composition and Report," 2008.

(29) "AAOIFI Governance Standard No.2: Sharia Review," 2008.

(30) "AAOIFI Governance Standard No.3: Internal Sharia Review," 2008.

(31) "AAOIFI Governance Standard No.5: Independence of Sharia Supervisory Board," 2008.

(32) The AAOIFI-8 Governance Standard concerning Central Sharia Board, 2017.

(33) The AAOIFI-6 Auditing Standard about External Sharia Audit, 2017.

toward the efficiency of regulation and supervision in regard to IFB. Therefore, it develops and issues standards that are based mainly on the identification, management and disclosure of risks relevant to Islamic products and operations. Its far-reaching publications help the establishment of IFB and the improvement of their corporate governance frameworks. Like the internationally recognised promoter of good governance, the Organization for Economic Co-operation and Development, it takes the position that “No single model and No single cure” suits all the IFB globally, and that the effectiveness and soundness of a corporate governance will depend on the specificities of the individual IFB. Therefore, its guiding principles do not set out detailed prescriptions in addressing all corporate governance issues, leaving it to the supervisory authorities to review and adapt according to their specific needs any of the published recommendations.⁽³⁴⁾

However, the standards are typical of what is known as ‘soft law’.⁽³⁵⁾ Despite the fact that some countries advise or require IFB to follow them, others do not fully adhere to or comply with the standards. Moreover, the standards take a no-single model or one-size-fits-all approach. It is duly acknowledged that there are various sharia governance structures and models that have been adopted in different jurisdictions where IFB are present. In fact, most supervisory authorities in Islamic-states actually permit IFB to decide what kind of Sharia governance system to adopt, and therefore the market is left to determine freely which system lends sufficient credibility to the products and services that each IFB offers.

Therefore, the authority for sharia matters is actually delegated to the respective Institutional Sharia Supervisory Boards (SSB), which in public perception confirms the legality of an IFB’s practices from the sharia perspective. Hence, the qualifications, professionalism and integrity of Sharia scholars constitute the only guarantee of sharia-compliance of the IFB with Sharia laws. In fact, it is stated that the SSB are necessary whether Sharia rules are standardised

(34) “IFSB Standard No.3: Guiding Principles on Corporate Governance for Islamic Financial Institutions,” P: 15; “IFSB Standard No.10: Guiding Principles on Sharia Governance Systems for Islamic Financial Institutions,” P: 4–6.

(35) Soft law has been widely used on the international financial scene, which certainly has its effects on any domestic legal and regulatory reform. Abdul Karim Aldohni, “Soft Law, Self-Regulation and Cultural Sensitivity: The Case of Regulating Islamic Banking in the UK,” *Journal of Banking Regulation* 15, no. 2 (April 2014): 164–79.

or not.⁽³⁶⁾ Recognising their vital role, some Muslim countries have made the existence of the SSB a statutory requirement for institutions offering Islamic finance services.

2.2 Sharia Governance and Supervisions

In term of Corporate Governance, the Organization for Economic Cooperation and Development (2004) was more specific about the meaning of stakeholders:⁽³⁷⁾

“Corporate Governance is the procedures and processes according to which an Organization is directed and controlled. The Corporate Governance structure specifies the distribution of rights and responsibilities among the different participants in the Organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.”

However, the IFB institutions need to satisfy customers and other stakeholders for the ultimate satisfaction of Allah (SWT).⁽³⁸⁾ In main, there are three tenets regarding the corporate governance of IFB: first and foremost to God, then to the shareholders and then other stakeholders.⁽³⁹⁾ Besides protecting the commercial interests of the shareholders,⁽⁴⁰⁾ corporate governance is concerned with the rights of the non-shareholding stakeholders which may include:⁽⁴¹⁾

- The shareholders (as owners)
- The BOD (a representatives of the owners)
- The bank’s corporate entity (as mudarib)
- The management of the bank

(36) Jamal Abbas Zaidi, “Shari’a Harmonization, Regulation and Supervision.” AAOIFI & World Bank Conference on Islamic Banking and Finance. 2008. P: 4. <http://www.iirating.com/Documents/PresentationSpeeches/speeches/Sharia%20Harmonization%20Regulation%20and%20Supervision%20AAOIFI%20World%20Bank%2010-11%20November%20Manama%20Bahrain.pdf>.

(37) “Glossary of Statistical Terms” (European Central Bank, Frankfurt: The Organisation for Economic Cooperation and Development, 2004), accessed March 26, 2019. <http://stats.oecd.org/glossary/detail.asp?ID=6778>.

(38) Mamunur Rashid, “Customer-Centric Corporate Social Responsibility: A Framework for Islamic banks on Ethical Efficiency,” *Management Research Review* 36, no. 4 (2013): 359–78.

(39) Aishath Muneeza and Rusni Hassan, “The Legal Conflicts in Shari’ah Corporate Governance of Islamic Financial Institutions in Malaysia,” *JKAU: Islamic Econ* 24, no. 1 (2011): 207–10.

(40) Abdul Karim Aldohni, “Islamic Banking Challenges Modern Corporate Governance: The Dilemma of Sharia Supervisory Board,” *Sweet & Maxwell Ltd* 29, no. 5 (2008): at 158.

(41) Sohail Zubairi, “Corporate Governance for Islamic Financial Institutions” (Dar Alsharia Legal and Financial Consultancy, U.A.E, 2010), <http://www.daralsharia.com/Driver/Mcontent4/Mcnt20245270104655706.pdf>.

- The account holders (depositors on a mudaraba basis)
- The Sharia board (in a supervisory role as representative of owners and guardians of the rights of the stakeholders, more specifically depositors).

It is to be noted that, the scope of sharia-compliance is actually not confined to products or services, but in fact extends to all aspects of the financial institution and its functions. It involves the protection of stakeholders' interests and rights from the corporation's actions and decisions, by taking into account maqasid-al-sharia (the objectives of the Sharia).⁽⁴²⁾ Therefore, every IFB institution should have an appropriate corporate and Sharia governance mechanism in order to ensure the systems, policies and procedures are in compliance with Islamic principles and guidelines in all of its 'forms, spirit and substance'.⁽⁴³⁾

In line with this vast scoped concept of Corporate Governance, the IFSB-10 (P: 14) refers the sharia governance system to the "set of institutional and Organizational arrangements through which an IFB ensures that there is effective independent oversight of sharia-compliance over each of the following:

- a) Issue of relevant Sharia pronouncements given by the appropriately mandated SSB or the central Sharia authority (if any).
- b) Dissemination of information on such sharia pronouncements to the operative personnel of the IFB who monitor the day-to-day compliance with the sharia pronouncements vis-à-vis every level of operation and each transaction.
- c) An internal Sharia compliance review/audit for verifying that Sharia-compliance has been satisfied, during which any incident of non-compliance will be recorded and reported and, as far as possible, addressed and rectified.
- d) An annual sharia compliance review/audit for verifying that the internal Sharia compliance review/audit has been appropriately carried out and its findings have been duly noted by the SSB".

It should be emphasised that this standard rejects the single model and one-size-fits-all approach. It acknowledges that there are various sharia governance structures and models that have been adopted in different jurisdictions where IFB are present, as Principle 1.1 of IFSB-10 (P: 7-10) clearly states.

(42) Zulkifli Hasan, "Corporate Governance: Western and Islamic Perspectives," *International Review of Business Research Papers* 5, no. 1 (2009): P: 288.

(43) Zeti Akhtar Aziz, "The International Dimension of Islamic Finance" (INCEIF Global Forum, Malaysia, 2007), P: 2, <http://www.bis.org/review/r070903b.pdf>.

Nonetheless, there is as yet no standard definition of so-called sharia supervision. In its resolution number 177 (19/3) issued in April 2009, during its 19th meeting in the UAE, the International Islamic Fiqh Academy determined the role of sharia supervision in regulating the operations of Islamic banks, its importance, stipulations and the way it operates. This resolution states that Sharia supervision means “issuing fatawa that are of relevance to the IFB activities following of its execution, and assuring its correct implementation”.⁽⁴⁴⁾

Also, it was stressed that for supervision to be effective, the objectives must be clear and the mechanisms appropriate. In this context, the degree of regulatory authorities’ independence from governmental influence is important.⁽⁴⁵⁾ Therefore, a degree of discretion is necessary for institutional organs involved in Sharia Governance, having a great impact on the scope of their responsibilities as well as their legal position.

Here, reference should be made to those bodies regarded by the resolution of the International Islamic Fiqh Academy as the main components of Sharia supervision.⁽⁴⁶⁾

- a) The SSB
- b) The internal Sharia supervisory department
- c) Central Sharia supervision

In terms of the approach selected by regulators for Islamic finance, some notes that this, in fact, depends on the relationship between the secular laws of banking and the religious law in any given country.⁽⁴⁷⁾ Countries that maintain a greater separation between secular and divine laws of Sharia may be reluctant to assign the Sharia supervision task, as being of a religious nature, to its secular or liberal governmental authorities, such as the financial regulator. However, the case would be quite the opposite in countries with less separation. While some countries demand direct involvement of the regulatory authorities in sharia supervision and placing Sharia-based legal and supervisory requirements, this is not universally true.

(44) “International Islamic Fiqh Academy’s Resolution Number 177 (19/3),” April 2009.

(45) Muhammad Chapra Umer and Habib Ahmed. “Corporate Governance in Islamic Financial Institutions.” Occasional Paper No 6, Islamic Research and Training Institute of Islamic Development Bank, 2002. P: 105. <http://www.irtipms.org/pubtext/93.pdf>

(46) “International Islamic Fiqh Academy’s Resolution Number 177 (19/3),” April 2009.

(47) El-Hawary, Grais, and Iqbal, “Diversity in the Regulation of Islamic Financial Institutions,” *The Quarterly Review of Economics and Finance* 46, no. 5 (February 2007): P: 778–800

Some argues that financial services regulators and central banks cannot take on the responsibilities for Sharia-compliance and therefore Sharia supervision. Nonetheless, they should ensure procedures are in place to conduct these tasks. Hence, they should be aware of what Sharia law implies and follow its developments in order to reach international Sharia classification standards. In particular, regulators should concern themselves with issues of corporate governance, including examining the remit of the Sharia advisors and their responsibility to end users and management. With the increasing internationalisation of IFB operations, regulators must focus on improved transparency.⁽⁴⁸⁾

The current practices of the regulatory authorities in determining standards of sharia corporate governance for financial institutions follow one of two approaches. Either, the regulatory authorities themselves stipulate the Sharia standards against which the financial institution must measure its services, or they specify the form by which the financial institution must do so. The first approach is recognised as the substantive model; the regulator's own Sharia advisors are involved in deciding sharia standards and supervising the work of institutional SSB. The second approach is recognised as the formal model, in which scholars of the institutional SSB enjoy freedom in determining Sharia standards and applying supervisory frameworks. Although the substantive model appears more attractive and reflects a direct approach to Sharia supervision by the regulatory authorities, it is evident that the formal model is preferred and more widely practiced.⁽⁴⁹⁾

Some supervisory authorities permit IFB to decide what kind of Sharia Governance system (i.e. Sharia corporate governance system) to adopt, and therefore, the market is left to determine freely which system lends sufficient credibility to the products and services that each IFB offers. Other supervisory authorities are concerned with market deficiencies and the need for client protection, requiring that each IFB should have a properly functioning sharia governance system in place. A few other supervisory authorities seem to take the view that SSB have a significant role to play in monitoring the health of IFB, therefore imposing the requirement that each IFB must have a minimum number of members of the board, who must also meet certain fit and proper

(48) Mohammad Kabir Hassan and Masudul Alam Choudhury, "Islamic Banking Regulations in Light of Basel II," Proceedings of the Fifth Harvard Research Forum on Islamic Finance, April 12, 2004, http://ibtra.com/pdf/journal/v1_n1_article1.pdf.

(49) Michael Blair QC, George Walker, and Robert Purves, *Financial Services Law*, 2nd edition. (Oxford University Press, USA, 2009), P: 980–981.

criteria; this is similar to the assurance sought when banks are appointing their BOD. In some jurisdictions, supervisory authorities have their own Sharia board that works with them in issuing standardised sharia pronouncements, as well as aligning relevant policy and regulatory frameworks with the Sharia. Although they may be known by different names, such as National Sharia Advisory Council, National Fatawa Council or High Sharia Board, their functions are similar, that is, to become the highest body issuing Sharia pronouncements for Islamic finance services in their country.

Whatever the adopted framework, the SSB plays a major and undeniable role in terms of Sharia corporate governance. Principle 1.1 of IFSB-3 (P: 7-10), regarding the establishment of a comprehensive governance policy framework, identifies the SSB and auditors (internal and external) as the main organs of governance, emphasising that each IFB may tailor its governance policy framework to suit its business, taking into consideration international best practice.

According to the AAOIFI-1 standard (P: 4-5), the prime purpose of the SSB is to assure the compliance of the IFB and its operations with Sharia rules and principles. Nonetheless, depending on the memorandum of association of individual IFB and the secular laws of the country hosting the IFB, the specifications of the legal position and role of the SSB may differ.

As a matter of principle, the SSB should have the authority to impose its viewpoint on management. However, logistic considerations do not necessarily permit this since the BOD possesses the real power since it has the right to accept or reject the advice of the SSB.⁽⁵⁰⁾ In fact, Principle 2.1 of IFSB-10 (P: 7-10) confirms that “most jurisdictions holds the BOD as the body ultimately responsible with regard to the governance of an IFB”. Similarly, AAOIFI-1 standard (P: 5-7) while illustrating the basic elements of the SSB report, clearly states that “the management of the IFB is responsible for properly complying with Sharia rules and principles, and the SSB has to perform appropriate tests, procedures and review work as appropriate to ensure such compliance”.

Nonetheless, Principle 3.2 of IFSB-3 (P: 11-12), states that the IFB shall comply with the Sharia rules and principles as expressed in the rulings of the IFB’s Sharia scholars. With firmer wording, AAOIFI-1 (P: 4-5) in its definition

(50) Hisham Yaacob, “Issues and Challenges of Shari’ah Audit in Islamic Financial Institutions: A Contemporary View,” Proceedings of 3rd International Conference on Business and Economics Research, 2012, P: 2676. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2175700.

of the SSB states that “the fatawa, and rulings of the SSB shall be binding on the Islamic financial institution”.

2.3 Internal and External Sharia Governance Tools

Although the SSB have a duty to provide assurance that all transactions of the IFB are actually in conformity with its verdicts, the reality is that members of the SSB are not full-time employees of the IFB. They are merely hired to provide their services, and actually attend a limited number of meetings during the financial year.⁽⁵¹⁾

This gave birth to the requirement for supplementary internal tools for assuring the compliance of the IFB with Sharia. The IFSB-10 standard (P: 1-4) strongly recommends that IFB institutions have a dedicated in-house Internal Sharia Compliance Unit (ISCU) and Internal Sharia Review Unit (ISRU) comprising Sharia officers with appropriate qualifications and experience. Although, AAOIFI-3 standard (P: 22-26) did not such a distinction since it referred only to the existence of ISRU, the recent AAOIFI exposure draft (No. G1/2018) about Internal Sharia Audit actually seem to make similar distinction between the previously used term “Internal Sharia Review” function and the newly adopted “Internal Sharia Audit” (ISA) function. Hence, it provides the following definition in section (4/C):⁽⁵²⁾

“Internal Sharia Audit – is a function as a part of the governance organs of an IFI, being independent of management, with the primary objective to provide assurance to those charged with governance and the SSB in relation to the IFI’s adherence to the Sharia principles and rules”.

While the ISCU is part of the IFB’s compliance team, the ISRU/ISA may be established to function in a similar manner to the IFB’s internal audit team. The major difference is that while the internal auditor will usually report to the audit committee, the ISRU reports to the SSB. Where appropriate, the ISRU reports shall require or recommend the management of the IFB to address and rectify any issues of Sharia-compliance. At least quarterly a written report should be prepared and signed by the Head of the ISRU, addressed to the BOD and copied to the SSB and management. However, there is limited guidance

(51) Anwar Al-Sadah, “Corporate Governance of Islamic Banks, Its Characteristics and Effects on Stakeholders and the Role of Islamic Banks Supervisors” (Ph.D-Degree, School of Management, University of Surrey, 2007), P: 71.

(52) “AAOIFI Exposure Draft No. G1/2018 of the Governance Standard for Islamic Financial Institutions, 2018. P: 9.

on the format of the Sharia review report.⁽⁵³⁾

Although, the importance of the internal mechanism being in place to comply with Sharia is unquestionable, it needs to be backed or supported by external supervision to become more efficient and reliable. Principle 3.1 of IFSB-3 Standard (P: 7-10), concerning the appropriate mechanisms for Sharia Governance states that it shall cover both ex-ante and ex-post aspects of all financial transactions carried out by the IFB. According to Principle 1.1 of standard IFSB-10 Standard (P: 4 and 7-10), ex-ante considerations include (i) issue of Sharia pronouncements, and (ii) compliance checks, before the product is offered to the customers. Ex-post considerations include the internal Sharia review and Sharia Governance reporting. For external Sharia-compliance reviews, Principle 3.1 of IFSB-3 Standards (P: 4 and 11-12) states that the Audit Committee shall ensure as far as possible that the external auditors are capable of conducting, and do conduct, ex-post sharia-compliance reviews within their terms of reference.

In this context, IFSB-10 standard (P: 1-4) provides that an annual Sharia-compliance review/audit shall verify that the internal Sharia-compliance review/audit has been carried out correctly and its findings duly noted by the SSB. This standard further suggests that this task may be assigned to an appropriately competent external auditor or external Sharia firm. Nonetheless, the SSB which issued the sharia pronouncements can take charge of this process, having received feedback and reports from the ISRU.

It is assumed that the external sharia audit shares similar functions to the company audit, but is focused more on the compliance of the IFB with Sharia precepts and requirements. This raises the question of using service providers such as external chartered auditing and/or Sharia firms to perform such tasks. It has been noticed that the conduct of external ex-post Sharia-compliance reviews is generally lacking amongst IFB and is mostly carried out by their governing central banks on a limited scale.

3. National Frameworks of Selected Countries

To mitigate the risk of Sharia non-compliance, there is a need for sound institutional Sharia governance supervised at the national level. The regulatory authorities should give due attention to the suitability and procedures of sharia governance, particularly the legal status of fatawa, dispute-resolving

(53) "IFSB Standard No.10: Guiding Principles on Sharia Governance Systems for Islamic Financial Institutions," P: 4 and 7-10); "AAOIFI Exposure Draft No. G1/2018 of the Governance Standard for Islamic Financial Institutions, 2018. P: 12-13.

mechanisms, monitoring and supervisory tools for Sharia-compliance.

To help reaching that, some countries have established what is known as a National Sharia Authority, which influence and role is addressed bellow.

3.1 The Kingdom of Bahrain

Being the single financial regulator in Bahrain, the CBB has a detailed rulebook governing all financial activity in the country and a separate volume (2) is specifically used to regulate Islamic-banks, where this principle is actually embodied in the High Level Controls (HC) No.9 named as The Principles of Sharia. HC-9.2.2 as follows:

“Islamic bank licensees which refer to themselves as ‘Islamic’ are subject to additional governance requirements and disclosures to provide assurance to stakeholders that they are following Sharia principles. In ensuring compliance with Sharia principles, each Islamic bank licensee must establish an independent SSB consisting of at least three sharia scholars and complying with AAOIFI’s Governance Standards for IFB No.1 and No.2”.

Being the host country of AAOIFI, the CBB imposed the implementation of its guidelines and standards by considering them as mandatory on financial institutions. In Principles of Business (PB) under Volume (2) of the Central Bank Rulebook, Principle 10 (PB-1.1.10) on Management, Systems & Controls of Islamic bank licensees emphasised that: “In particular, the CBB requires that banks comply with all AAOIFI issued accounting standards as well as the sharia pronouncements issued by the Sharia Board of AAOIFI.

In term of Sharia review, section (HC-9.2.6) under High Level Controls (HC) requires that “The Islamic bank licensee must have a separate function of sharia review to verify compliance with the above. The internal Sharia review must be carried out in accordance with AAOIFI governance standard No.3. The Sharia review function may be located in the internal audit function of the Islamic bank licensee.

From such provisions it is clear that the CBB is supporting the regulatory efforts of the AAOIFI, and therefore the financial institution must comply with the requirements of the CBB in accordance to the relevant AAOIFI standards. Failure to do so would result in a breach of the CBB’s directives, which constitutes a ground for applying penalties and/or withdrawing the bank’s licence. However, the specifics of those requirements are left to be determined by the licensed bank itself, which opens the door for a variety of best practices.

Nevertheless, in such a case the bank should refer first to the guidelines and recommendations (if any) of AAOIFI. Hence, AAOIFI standards are to be considered where there is no clear provision on the matter in question.

For instance, there is no restriction on the membership of the Sharia scholars, so individuals are free to be members of any number of institutional SSB. AAOIFI standards are silent on this matter. Although AAOIFI's definition of SSB states that sharia scholars must be knowledgeable in *usul-fiqh* (the origin of Islamic law), it does not provide any criteria for qualification.

Perhaps, the exception is the Head of Sharia Review, who is considered to be in a controlling position, and needs to be approved by the CBB in accordance to Section (LR-1A.1.1 and LR-1A.1.2) under Licensing Conditions (LR-1A).

In regard of Training and Competency Requirements for Controlled Functions, section (TC-1.1.1) states that "Individuals occupying controlled functions in an Islamic bank licensee must be qualified and suitably experienced for their specific roles and responsibilities. He should have a minimum of five years' relevant experience in a bank or financial institution dealing with Islamic products and services. Also, he should:

- a) Hold a bachelor's degree in sharia, which includes study in *usul-fiqh* and/or *fiqh-almuamalat*; or
- b) Hold a university degree in banking and finance together with a qualification in Sharia review.

Obviously, the regulatory provisions do not entail detailed mechanisms for the implementation of AAOIFI standards or the sharia governance and supervision framework. The IFB are left to decide their strategies in accordance with the AAOIFI governance standards, with little supervision from the financial regulator.

Having established that the CBB requires that Islamic banks comply with all AAOIFI-issued accounting standards as well as the Sharia pronouncements issued by the Sharia Board of AAOIFI, it is interesting that the CBB has now a Central Sharia Supervisory Board (CSSB) which is accommodated within its premises. Just in 2017, this Board was created by the CBB itself to serve and verify the Sharia-compliance of the financial products nationwide. In this context, section (SG-2.10.1 and SG-2.10.2) of the CBB rulebook about the relationship with the CBB's Centralised SSB (CSSB) states that:

"In all cases, Bahraini Islamic bank licensees must comply with the Sharia pronouncements and opinions issued by the CSSB. In case of a

conflict between the opinion or interpretation of the CSSB and the SSB of the Bahraini Islamic bank licensee with respect to any Sharia matter, the opinion of the CSSB shall prevail”.⁽⁵⁴⁾

However, it seems that that the CSSB have no other role or particular supervisory authorities over other banks’ SSB,⁽⁵⁵⁾ since its role is actually confined to advising on sharia matters without any regulatory or supervisory power. Thus, financial institutions and Islamic-banks as a matter of principle adhere to their own SSB fatawa and internal sharia governance in accordance to AAOIFI standards. Also, it is unclear whether the AAOIFI governance standards are applicable to this CSSB, and if it must avoid pronouncements which contradict those issued by the Sharia Board of AAOIFI. This is despite section (26/A) of AAOIFI-8 Governance Standard (P: 9-10) concerning Central Sharia Board, which clearly states that:

“The Central Sharia Board shall focus on harmony of Islamic banking and finance practices: globally, through adoption of AAOIFI Sharia standards and/or other widely accepted Sharia principles, which do not conflict with AAOIFI Sharia Standards”.

Nonetheless, this step from the CBB as a financial regulator is an important one, because it shows a level of commitment and recognition of the significance of Sharia-compliance.

In addition, there are no restrictions on membership of the CSSB and, as for the institutional SSB; members are allowed to serve on any number of SSB. For example, some eminent Bahraini Sharia scholars and others are members of the CBB’s Sharia Board and also members of other local and international SSB.⁽⁵⁶⁾

There is no doubt that hiring members of the Sharia Board of the CBB is beneficial for local IFB. However, this does give rise to serious concerns about the impartiality, credibility and independence of these scholars. Nonetheless, membership of several local, national or international Sharia boards might minimise the contradictions among the fatwas of different SSB. Common

(54) “The Central Bank of Bahrain Rulebook,” accessed March 25, 2019. http://cbb.complinet.com/cbb/display/display_viewall.html?rbid=1821&element_id=10143.

(55) Bernardo Vizcaino, “Bahrain to Develop Central Sharia Board for Islamic Banks,” Reuters, December 3, 2014, <http://www.reuters.com/article/2014/12/03/bahrain-islam-regulations-idUSL3N0T-N1A020141203>.

(56) Bernardo Vizcaino, “Bahrain to Develop Central Sharia Board for Islamic Banks,” Reuters, December 3, 2014, <http://www.reuters.com/article/2014/12/03/bahrain-islam-regulations-idUSL3N0T-N1A020141203>.

membership would bring consistency to the legal opinions, and in to Islamic financial practices in local as well as international markets.

It remains to be seen if the CBB will take further regulatory steps to assign a supervisory role to its existing CSSB i.e. to help oversee Islamic finance products nationally and to introduce new rules to strengthen governance in the sector. However, such step seems to be remote taking in consideration AAOIFI-8 Governance Standard (P: 9-10) about Central Sharia Board, which states in section (27 and 28) that:⁽⁵⁷⁾

“This standard encourages that all Central Sharia Boards shall have primarily advisory capacity coupled with a limited level of supervisory authority. The functions of the board may be divided in three broad functions which are:

- a) Advisory and Fatwa;
- b) Regulations; and
- c) Oversight and limited supervision.

3.2 The United Arab of Emirates (Dubai)

The Emirate of Dubai occupies a unique position in the UAE, leading the way as a centre for Islamic finance. The Dubai International Financial Centre (DIFC) enjoys certain privileges and economic incentives from the government.⁽⁵⁸⁾ All institutions and corporate entities under the jurisdiction of the DIFC fall under the regulatory powers of the Dubai Financial Services Authority (DFSA) as an independent regulator of all financial and ancillary services conducted through the DIFC (a purpose-built free-zone in Dubai) and subject to DIFC Laws, the DIFC Court and the DIFC Arbitration Centre.⁽⁵⁹⁾ DIFC Law No. (13) of 2004,⁽⁶⁰⁾ and the Islamic Financial Business Module of the DFSA provide the legal framework for regulating Islamic financial business and sharia boards.⁽⁶¹⁾

At the Emirate level, Dubai Law No. (9) of 2004 in Respect of The Dubai International Financial Centre,⁽⁶²⁾ recognises the financial and administrative independence of the DIFC in Article (3/1).

(57) The AAOIFI Governance Standard No. (8) concerning Central Sharia Board, 2017. P: 9-10.

(58) The U.A.E Federal Decree No (35) of 2004 to Establish Financial Free Zone in Dubai.

(59) “Dubai Financial Services Authority,” accessed March 26, 2015, <http://www.dfsa.ae/>.

(60) Dubai International Financial Centre Law No. (13) of 2004.

(61) The Islamic Finance Rules Module of the DFSA Rulebook, accessed March 26, 2019, [VER8/06-14].

(62) Dubai Law No. (9) of 2004 In Respect of The Dubai International Financial Centre.

In term of Sharia Governance, Article (13/2) empowers the DFSA to make rules pertaining to SSB. The underpinning law regulating an SSB's appointment, formation, conduct and operation is the Islamic Financial Business Module of the DFSA Rulebook, known as the Islamic Finance Rule (IFR).⁽⁶³⁾

In this context, Section (IFR 3.4) of the Islamic Finance Rule requires an authorised person undertaking Islamic financial business to implement and maintain a policy and procedures manual which addresses: matters concerning sharia-compliance; functioning of the SSB; recording of the fatawa, rulings and guidelines disseminated and implemented and the internal sharia review undertaken; addressing disputes between the SSB and the authorised person in respect of sharia-compliance; the process for approving those internal systems and controls to ensure that the Islamic financial business is carried out in compliance with sharia; identifying and managing conflicts of interest.

In terms of the SSB, section (IFR 3.5.1) requires the authorised person in the appointment of the SSB to ensure the following:

- a) The SSB to consist of at least three members;
- b) The competence of the appointed members to perform their functions;
- c) Approval of any appointments, dismissals or changes in respect of members of c) the SSB by the governing body of the authorised person; and
- d) No member of the SSB is a director or controller of the authorised person.

The guidance for the purposes of this section recommends that an authorised person should assess whether the proposed SSB member is competent to advice on the Islamic financial business to be undertaken by the authorised person, and thereby consider the previous experience and qualifications of such members. As the provision does not specify the organ of the financial institution which is responsible, the members of the SSB could be appointed or dismissed, assessed for qualifications, and their remuneration decided by either the BOD or the shareholders.

In terms of sharia review, section (IFR 3.6.1) provides that an authorised person must ensure that all reviews are undertaken by the SSB in accordance with AAOIFI Governance Standard No (2). Accordingly, sections (IFR 3.7.1 - IFR 3.7.3) require both the IFB and Islamic windows to perform an internal Sharia review in accordance with AAOIFI Governance Standard No (3), and

(63) The Islamic Financial Business Module of the Dubai Financial Services Authority, accessed March 26, 2019, [VER8/06-14].

that Islamic windows must document the manner in which it will conduct any part of the internal review that is not conducted in accordance with the named AAOIFI standard.

Finally, section (IFR 3.6.2) requires that the annual report from the SSB must comply with AAOIFI Governance Standard No (1), a copy of which must be submitted to the DFSA within 14 days of having received it. In terms of financial statements, section (IFR 4.2.1) provides that an authorised person carrying out Islamic financial business must ensure that its financial statements contain disclosures on the role and authority of the SSB in overseeing the business, and subject matters of Zakat.

From the previous provisions, it is understood that the DIFC obtains a distinct position in the UAE and is regulated separately by the DFSA as an independent regulator. In terms of Sharia Governance and supervision of the IFB and windows, it considers itself as a Sharia Systems Regulator, not a Sharia Regulator. Therefore, the Sharia Governance system is guided by the DFSA without the imposition of any specific form. This means that any firm which conducts Islamic financial business must put systems in place to ensure that the business is conducted in accordance with Sharia. This includes the appointment of a SSB. The firm must have systems in place to disseminate the SSB's rulings, conduct regular Sharia reviews and also conduct an internal audit.

It is interesting that there is no Central Sharia Authority at the DIFSC level. Nonetheless, the DFSA's rulebook refers to some of the AAOIFI governance standards, as discussed above. However, this does not necessarily mean that the DIFC accepts them as mandatory, because the rulebook stipulates different provisions in some areas from those in the AAOIFI standard.

3.3 The State of Kuwait

According to Article (13) of Law No (32) of 1968 (amended by Law 130/1977) Concerning Currency, the Central Bank of Kuwait and the Organization of Banking Business, the CBK was established as an independent public institution.⁽⁶⁴⁾ Article (15/4) of this law states that the CBK has the object of controlling the banking system in the State of Kuwait. Section (10), introduced under Law No. (30) of 2003, Articles (86-100) clearly vest in the CBK the

(64) The Law No (32) of 1968 Concerning Currency, the Central Bank of Kuwait and the Organisation of Banking Business.

power to regulate and supervise Islamic banks. .

In terms of sharia governance and supervision, Article (93) provides that:

“Each Islamic bank shall have an independent SSB, comprising not less than three members appointed by the bank’s General Assembly. The Memorandum of Agreement and Articles of Association of the bank shall specify the establishment of the Board as well as its formulation, powers, and workings. In case of a conflict of opinions among members of the SSB concerning a Sharia rule, the BOD of the designated bank may transfer the matter to the Fatwa Board in the Ministry of Awqaf and Islamic Affairs that shall be the final authority on the matter”.

Also, Article (15) of the Commercial Companies Law of 1961 (replaced by Law No. 25 of 2012) states that, the SSB has the duty to submit a Sharia report to the bank’s general assembly containing its opinion on the bank’s operation in term of sharia-compliance, including comments and views on Sharia issues, which must be included in the Islamic-bank’s annual report.

In the case of conflict of opinions among members of the SSB concerning a fatwa, the BOD of the designated Islamic bank may transfer the matter to the Fatwa Board in the Ministry of Awqaf and Islamic Affairs. Therefore, the CBK law recognises this Fatwa Board as the Final Sharia Authority for any dispute involving IFB. However, the referral of issues or disputes to this Board is not mandatory, since the decision of referral is left to the discretion of the BOD.

Further examination of the nature and operational side of this process suggests that the power of being the Final Sharia Authority is more theoretical than actual, because referring matters to the ministerial Fatwa Board is limited to the case of a dispute, which might never occur. As the institutional SSB make their decisions on a majority basis, approval or rejection of any given product is made regardless of an individual member’s opinions, so there could be no dispute to transfer to the Fatwa Board.

Also, the CBK law is silent about the status of the decisions that may be made by the Fatwa Board attached to the Ministry of Awqaf and Islamic Affairs. There also appears to be no restriction on the members of the Fatwa Board or institutional SSB serving on any number of institutional SSB. Further, there is no mention of sharia review, internal sharia review/audit, or competence and qualifications of sharia scholars.

It is also evident that, unlike the case of Bahrain and Dubai, these laws and

regulations do not refer to any of AAOIFI governance standards. Nor do the CBK Instructions for Islamic Banks cover these shortcomings, in particular Instruction No (2/IBS/100/2003) concerning the Rules and Conditions for the Appointment and Responsibilities of the SSB in Islamic-Banks.⁽⁶⁵⁾ The instructions establish a framework for the performance of SSB duties, providing independence for their members in expressing their opinions, and defining the role of the external auditor in relation to the bank's compliance with the rules and principles of Sharia.

However, it is worth noting that this situation is about to change. In fact, Dr. Mohammad Al-Hashel, the Governor of the (CBK) just announced in an interview conducted on 1st of April 2019 the CBK a law concerning so-called "Central Sharia Committee" is now pending approval of authorities.⁽⁶⁶⁾ Therefore, it is to be seen if such body would take the place of the existing Fatwa Board attached to the Ministry of Awqaf and Islamic Affairs or it may play a different role. Also, the question remain if it will be obtain regulatory and supervisory powers or not, taking in consideration the Governor's announcement that the "Committee" should assure the harmonization of "Fatawa".

3.4 The Sultanate of Oman

In Sultanate of Oman, free zones are permitted by the Omani Royal Decree No (56/2002) of 2002 promulgating Free Zones Law.⁽⁶⁷⁾ The Salalah Free Zone was established in 2006 through Royal Decree No. (62/2006) of 2006 promulgating the Establishment of Salalah Free Zone.⁽⁶⁸⁾

Oman was the last nation of the six-member GCC to introduce Islamic finance publishing rules for it in 2012. All of the financial institutions operate under the licensing and regulation of the Central Bank of Oman (CBO), which began operation on 1 April 1975 after its establishment in December 1974, replacing the Oman Currency Board as the principal currency authority in Oman.⁽⁶⁹⁾ Article (1) of the Omani Royal Decree No. (114/2000) of 2000 promulgating Banking Law⁽⁷⁰⁾ empowers the CBO to supervise the banking business in the Sultanate

(65) "The Central Bank of Kuwait Instruction No (2/IBS/100/2003) Concerning the Rules and Conditions for the Appointment and Responsibilities of the Sharia Supervisory Board in Islamic Banks".

(66) Mai Mamoon, "Completion of the draft law of the Central Sharia Committee", Alqabas Electronic Newspaper, April 2019. <https://alqabas.com/651977/>.

(67) The Omani Royal Decree No (56/2002) of 2002 Promulgating Free Zones Law.

(68) The Omani Royal Decree No. (62/2006) of 2006 Promulgating the Establishment of Salalah Free Zone.

(69) "The Central Bank of Oman," accessed March 28, 2015, <http://www.cbo-oman.org/>.

(70) The Omani Royal Decree No. (114/2000) of 2000 Promulgating Banking Law.

and advises the Government on domestic and international economic affairs.

In term of Islamic banking, their regulation and supervision is made possible by the Omani Royal Decree No (69/2012) of 2012 Amending the Banking Law promulgated by Royal Decree No (114/2000),⁽⁷¹⁾ as well as the CBO's Circular No (IB 1) of 2012,⁽⁷²⁾ which adopted the CBO's Islamic Banking Regulatory Framework of 2012.⁽⁷³⁾

In terms of sharia governance and supervision, Article (126/1) requires a bank licensed to practice Islamic banking to have an SSB. Nonetheless, it leaves its composition, competence and work procedure, along with the requisite qualifications of its members, whose appointment and remuneration shall be decided by a resolution of the general assembly of the bank, to be determined by regulations.

Title 2 (General Obligations and Governance) is the main part of the IFB rules that regulate aspects of Sharia Governance and supervision. It is clear that the wider concept of sharia corporate governance is considered in terms of Sharia-compliance, as this section clearly states that "there are many stakeholders, and licensees are encouraged to follow the relevant and applicable standards of IFSB, namely IFSB-3 and IFSB-10.

According to section (2.1.2), the four key elements of sharia governance framework are the SSB of the licensee, the Internal Sharia Reviewer, the Sharia Compliance Unit and the Sharia Audit Unit. Nonetheless, Section (2.1.4) provides that maintaining a strong sharia governance framework is the ultimate responsibility of the BOD, which shall approve all the policies and procedures for the licensee related to Sharia matters in consultation with the SSB and shall put in place a mechanism to ensure that such policies and procedures are effectively implemented.

The definition provided for the SSB does not fall far from that given by AAOIFI-1. To develop Omani expertise in the field, Omani SSB members are preferred. In addition, non-scholars with the necessary professional expertise are allowed as non-voting members; voting power remains with the Scholars because of the very nature and purpose of the SSB. An SSB member can serve a maximum of two consecutive terms in an institution".

(71) The Omani Royal Decree No (69/2012) of 2012 (Amending the Banking Law).

(72) The Circular No (IB 1) of 2012 concerning Islamic Banking Regulatory Framework of "The Central Bank of Oman.

(73) The Central Bank of Oman's Islamic Banking Regulatory Framework of 2012, accessed March 25, 2015, <http://www.cbo-oman.org/>.

Importantly, section (2.2.3) under Title 2 of the IFB rules contains a number of required qualifications, called fit and proper standards that are directed especially to SSB members; these do not exist in the countries discussed before.

According to this section, members of the SSB “have to be Muslim individual“. Nonetheless, it is unclear whether this applies only to Sharia scholars and/or to non-scholar members. Obviously, the word ‘individuals’ in this provision excludes the use of Sharia firms in the functions attributed to the SSB, and the word ‘Muslim’ excludes the use of non-Muslim experts as members of the SSB.

In terms of qualifications, the requirements for Sharia scholar members are different from those for non-scholar members of the SSB. Sharia scholars must have an academic qualification in the field of sharia (a minimum of a bachelor’s degree) that includes the study of *usul-al-fiqh* and *fiqh-almumalat* from “a recognised institution”. They must demonstrate “an adequate understanding of finance/banking in general and Islamic finance/banking in particular”, as well as an understanding of the legal and regulatory frameworks applicable to the functions of the licensee. In terms of experience, they must have accumulated overall experience of ten years or more (in teaching, research, issuing of *fatawa* and similar matters). Also, they must demonstrate a strong proficiency in Arabic, and it is recommended that they have reasonable understanding of English.

The non-scholar members of SSB must hold at least a master’s degree, and must be “individuals generally recognised for their expertise in their respective field (e.g. banking, finance, economics, law, accounting, etc.)”. They must have accumulated experience of 15 years or more in the relevant field, and demonstrate reasonable proficiency in English, and it is recommended they have some understanding of Arabic. Both Sharia scholars and non-scholars “must be of respectable character and be of good conduct, particularly in terms of honesty, integrity and reputation in their professional business and financial dealings”.

To support the independence of SSB members and avoid conflicts of interest, there is a restriction in the terms of SSB membership. Section (2.2.4.18) requires that:

“No member can be on the SSB of more than one competing institution in Oman. However, an SSB member can be on the board of more than one non-competing institution (e.g. the SSB member of an Islamic bank can also sit on the SSB of a Takaful company or an Islamic fund management company). Overall, no SSB member can be on the SSB of more than four institutions in Oman”.

In term of Internal Sharia Review (2.3.1-2.3.3), the Internal Sharia Reviewer shall head both the Sharia Compliance and Sharia Audit Units of the licensee. He shall be a qualified Sharia scholar, and assisted by a team of Sharia Compliance Officers and Sharia Audit Officers who shall work independently and report to the SSB, with administrative reporting to the CEO (of a fully-fledged Islamic bank) or the Head of Islamic Banking (in the case of an Islamic window). He shall be responsible for providing sharia guidance and direction to the licensee's management in day-to-day matters, and may escalate an issue to the SSB to seek their guidance and approval if deemed necessary. The management will be responsible for providing him with all the information relating to the licensee's compliance with Sharia.

In regard of Sharia Compliance Unit (2.4.1 – 2.4.2), Reporting to the Internal Sharia Reviewer as part of their sharia governance framework, this unit will facilitate the management to ensure compliance with sharia, in accordance with guidelines and fatawa issued by the SSB and Islamic banking stipulations of the CBO on a day-to-day basis in all its business activities. The purpose of this is to minimise the possibility of Sharia non-compliance and rectify any such issues (where possible) during the year before the annual Sharia Audit. It may also disseminate knowledge by publishing and distributing pamphlets, brochures, etc. explaining the principles of Islamic banking and the fatawa, guidelines and instructions issued by the SSB concerning the products and services offered by the licensee.

Also, the Sharia Audit Unit (2.5.1 -2.5.3), is as an integral part of the Sharia Governance framework operating under the policies established by the SSB, it will examine and evaluate the extent of compliance with Sharia principles, fatawa, guidelines and instructions issued by the SSB through an actual audit of the business transactions. Its charter shall make clear that Sharia Audit Officers shall have no executive authority or responsibility for the activities they audit.

Section (2.5.1.17) states that the Internal Sharia Audit team shall discuss findings, recommendations and conclusions with the Internal Sharia Reviewer and appropriate levels of management before issuing the final written report, and a written report shall be prepared at least quarterly which must be signed by the Internal Sharia Reviewer, addressed to the SSB and copied to the management. Any difference of opinion between the management and the Sharia Audit Officers on matters relating to sharia interpretation shall be referred to the Internal Sharia Reviewer and the SSB (if required), and the SSB shall be the final authority on such matters.

Finally, Article (126/2) of the amended Law of Banking No. (69/2012) requires the Board of Governors of the CBO to establish a High Sharia Supervisory Authority (HSSA) the aim of which is to ensure the compatibility of Islamic banking and Takaful products with Sharia principles. The CBO is to specify the High Authority's composition and members' competence, their work procedures, qualifications, and remuneration. In fact such body was found in 2016 in accordance to Circular (BM 1118) about Establishing and Organizing the High Sharia Supervisory Authority in CBO.

The HSSA is to be considered as the ultimate authority in Sharia financial and banking matters. However, vesting such exceptional judicial or quasi-judicial authority in this body certainly raises the issue of the balance of power and authority between the courts and arbitrators and the HSSA. Currently, the status of the determinations of the HSSA vis-à-vis court and arbitrator determinations is unclear. However, Article (124) of the amended Law of Banking No. (69/2012) seems to indicate that Islamic banks must practice Islamic banking in accordance with the restrictions set by the Board of Governors, even where those restrictions might conflict with interpretations of the regular nature of the applicable Sharia principles.

In term of the HSSA functions, Article (9) mainly suggests that it plays an advisory role for the CBO in matters concerning Islamic financing, but the decisions resolving disputes between SSBs are of binding nature.⁽⁷⁴⁾ It is thought that the HSSA have direct oversight of Islamic banking institutions, similar to the approach taken by regulators in Malaysia and other countries.⁽⁷⁵⁾

4. Concluding Marks

4.1 Legal Observations at the Institutional Level

The shortage of well qualified and experienced sharia scholars is an issue that affects all Muslim countries. It is evident therefore, that none of the countries requires Sharia scholars to be their own citizens, although this is encouraged. Oman is the only country, where the regulatory provisions clearly encourage the appointment of its nationals to the SSB.

Most of the countries allow sharia scholars to be members of any number

(74) The Circular (BM 1118) about Establishing and Organizing the High Sharia Supervisory Authority in CBO. February 24, 2014.

(75) Such as Malaysia, Pakistan, Morocco and Nigeria. Bernardo Vizcaino, "Oman Sets up Central Sharia Board in Move to Boost Islamic Finance." Reuters, October 8, 2014. <http://www.reuters.com/article/2014/10/08/oman-islam-financing-idUSL6N0S305J20141008>.

of SSB. This is the case in Bahrain, Kuwait and Dubai. In turn, this raises questions concerning the true independence of Sharia scholars and the risk of factual dependence regarding membership of the SSB. This concern is further supported by the lengthy contracts with SSB members. In Bahrain, there is no indication as to the duration of SSB membership, reflecting the omission of this in AAOIFI standards. This is also the situation in Kuwait, where some Sharia scholars obtain open-ended contracts with IFB.

Restrictions on SSB membership further support its independence and avoid the conflict of interests taking place because of multiple appointments of Sharia scholars. However, only Oman chooses to restrict the membership of Sharia scholars to a single SSB in any given industry, and limit the overall number of SSB to which a Sharia scholar can belong. Therefore, the risk of conflict of interest is potentially raised in other countries, allowing multiple appointments of Sharia scholars, as in Bahrain, Kuwait and Dubai.

The regulatory authorities in countries referring to AAOIFI governance standards (No. 1, 2 and 3), are assumed not to impose a comprehensive revision of Sharia-compliance on IFB as they suggest only limited scope of Review/Audit. A point in further support of this argument is the fact that such countries do not demand a high level of qualification or experience for members of SSB or Sharia reviewers/auditors. It is evident that only Oman requires a university degree as a proof of qualification. Oman even goes a step further in distinguishing the qualification requirements of Sharia scholars from non-Sharia scholars of the SSB. Specific experience and qualification are required for members of SSB, Sharia review, and a Sharia audit.

The IFSB as well as AAOIFI guidelines and standards, suggest an annual external audit (i.e. covers Sharia Audit) function performed by a third party to help in reassuring the degree of compliance of the IFB with Sharia. The need for such external audit is significant because the review performed by the ISRU/ISA, although accepted and approved by the SSB, is done in their capacity as employees of the IFB, and because of the use of the SSB as an internal tool of Sharia Governance.

Although the CBB demands the IFB use external Sharia auditors and requires they attend the general meeting of shareholders, the provisions do not specify their involvement in Sharia auditing. Similar provisions exist in regard of financial institutions in Dubai, but the IFR of DFSA makes no mention of

external auditors in regard of IFB and Islamic-banks. Also, the CBO requires the IFB to use external audit to conduct an accounting audit in accordance with the AAOIFI standards and international standards of auditing.

On the other hand, the CBK instruction specifically provides that the task of external audit must cover the examination of new products and modification of existing products in order to ensure that they are compliant with Sharia principles. This should include the review undertaken by the management and the SSB. In its report, the external auditor should indicate the degree of IFB compliance with the fatawa issued by its SSB.

As Bahrain promotes the AAOIFI standards, the SSB rulings should be binding on the IFB and they report directly to the shareholders. Also, an ISRU must be established by the management to oversee the implementation of the SSB's rulings. In Kuwait, the same is applied without any particular reference to AAOIFI standards or the Sharia review function. In Dubai, there is no provision with regard to the binding nature of its rulings. However, this should be the case, as there is a requirement for Sharia review functions according to the AAOIFI standards. In Oman, the rulings of the SSB should be binding on the IFB and it should be supported by an independent Sharia reviewer who heads an ISRU as well as ISAU. This independent Sharia reviewer reports to the SSB with administrative reporting to the CEO as well.

4.2 Legal Observations at the National Level

The recent developments in Standards as well as national level regulations concerning IFB in the countries under study suggest that so-called Sharia corporate governance is being changed in favour of a more focused and centralised framework.

The CBB implementation of AAOIFI-8 Governance Standard concerning Central Sharia Board declares its intention to oversee Islamic finance products in the country and to introduce new rules to strengthen governance in the financial sector.

On the other hand, Kuwait refers to the Fatwa Board in the in Awqaf Ministry as the Final Sharia Authority in any dispute regarding IFB. However, the role of this Board is largely theoretical, given that an IFB has the power to transfer a dispute to it in the case of disagreement between members of the institutional SSB, when at the same time the SSB always pass their rulings by a majority of votes in cases of disagreement, making transferring a dispute to the Fatwa Board is unlikely to happen.

The UAE federal law allows for the establishment of a Higher Sharia Authority. It is assumed that this authority possesses the power to issue fatawa at the national level. Unfortunately, the role and effect of this body is unknown as it has not yet been established.⁽⁷⁶⁾

Although Oman has the most recent experience in developing an IFB sector, its framework of Sharia Governance and supervision is thought to be more comprehensive and stronger than in its peer GCC. However, the HSSA is intended to be a reference point for CBO and IFB, and thought to have direct oversight of Islamic banking institutions.

Although, the existence of such Authorities, may increase to some extent the credibility of the IFB at the national level, it cannot in fact eliminate or minimize all of the legal challenges concerning the Sharia-governance framework such as such as shortage of Sharia-Scholars, conflict of interest attached to appointed Sharia-Scholars, the scope of Sharia-Boards supervision, the legal status of their pronouncements, as discussed in the previous section. Therefore, it is true to say that their role for now is confined to harmonize Fataws and minimize Sharia conflicts in IFB nationwide.

Hence, it remains a future matter if any of them will be given extended regulatory and supervisory roles, and whether these would be similar to existing ones in countries which are more experienced in this field.⁽⁷⁷⁾

Until this is done, the aforementioned corporate governance and supervisory frameworks at the institutional level shall permit financial institutions to develop their own framework without undue interference from the regulatory authorities.

4.3 Further Perception

A Regional Sharia Authority might be preferable to serve the overall GCC, without imposing any restrictions on Sharia scholars' membership. Its functions would be complementary to the work already done by the National Sharia Authorities.

Obviously, this project would require the cooperation of the GCC, to circumvent any additional difficulties and barriers resulting from individual sovereignty

(76) Haseeb Haider. "Shariah Authority on Cards." Alkhaleej Times. March 22, 2015..

(77) Such as Malaysia, Pakistan, Morocco and Nigeria. Bernardo Vizcaino, "Oman Sets up Central Sharia Board in Move to Boost Islamic Finance." Reuters, October 8, 2014. <http://www.reuters.com/article/2014/10/08/oman-islam-financing-idUSL6NOS305J20141008>.

with different legal and financial systems.

Therefore, it remains to be seen whether the establishment of National Sharia Authorities would affect negatively or positively the existence of a united or supreme sharia authority for the Gulf region.

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