

Focusing on Shari‘ah Governance in Regulating the Islamic Banking Institutions

Indeed, Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice. (Q: 4: 58)

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Around 20 percent annual growth of Islamic banking and finance over last many years, despite global crises and recession, points to its resilience and broader level appeal. While appeal from large Muslim population around the world in the wake of severe prohibition of interest and gambling is obvious, the resilience could be by dint of distinctive Islamic finance principles that stay focused on equity participation, risk and reward sharing and linkage between real economy and finance [IMF WP 120/15]. Islamic system of finance can serve the real purpose of financial intermediation as a means to create sustainable value in the real economy at national and global levels.

The resilience can be tested by analysing the practices, products and investments of Islamic financial institutions (IFIs) whether they avoid such factors or love to apply any products or procedures that even might be contrary to their basic principles. Causes of the crises are generally divided into three categories namely i) financial innovations leading to the development of risky and complex financial products, ii) built-in fragility and vulnerability of the financial system; and iii) inadequacy of the regulatory and supervision systems over banks and financial markets (El Hussein, 2013) ¹. As the crisis erupted in 2008, a number of regulatory measures were introduced. But mere regulatory approaches and prudential oversight remained insufficient to restrict excessive risk taking (Stijn, 2014). Despite the regulatory measures, use of financial derivatives sharply increased and some market analysts estimated the derivatives market at more than 10 times the size of the total world GDP (\$1.2

¹ El Hussein, Nawal Hussein Abbas; *Islamic finance: Is it a viable option to restrain financial crisis?* Interdisciplinary Journal of Contemporary Research in Business; Vol. 5, No. 4, Aug, 2013. Also see Askari, Hossein, Zamir Iqbal, Krichene and Mirakhor, *The Stability of Islamic Finance*, John Wiley and Sons, Singapore, 2010; Maghrebi, 2015.

quadrillion in 2015). Hence, the other two categories of causes also need to be taken care of which would require moving from '*financialisation*' to risk based and real sector related finance and investment activities. It, of course, has to be supplemented by rigorous regulations and their effective implementation to ensure purposeful intermediation.

The factors that caused recent crises and their spread are not allowed under the rules of Shari'ah, which have the capacity of making Islamic finance a model system. It, however, would require adherence of the principles of Islamic finance by the IFIs that, in turn, would require the regulators to ensure that Islamic banks or other IFIs implement the ethical principles that underpin Islamic finance.

The issue of concern, despite the impressive growth, is that Islamic banking and finance has not been able to establish its identity as a just system to offer equitable solution of finance problem to all groups in economies and to bring stability in the national and global markets. Therefore, the move to Islamic finance is very slow even in Muslim majority countries. It requires an effective regulatory framework with different approach aimed at adoption of the principles of Islamic finance in letter as also in spirit.

We plan here to evaluate the regulatory framework and measures that govern Islamic banking by focusing on Pakistan as a case study. Pakistan is the country where pioneering work on Islamic banking and finance has been conducted since 1970s. Major changes were made in 2002, 2008 and then in 2015 when the '*Shari'ah Governance Framework*' (SGF) was introduced for Islamic banking institutions (IBIs) operating in the country in parallel with the conventional banks.

Islamic Finance Products and Services

Trading in goods or instruments representing their ownership and leasing of assets can be used for financing, in addition to partnership based modes, and the IBFIs are required to observe essential features of such modes of business and finance. However, IFIs' portfolios practically comprise the structured products and instruments innovated to replicate the conventional products. Hence, many IFIs are investing in a variety of financial derivatives using the concepts of *w'ad*, *tawarruq* and *muqāṣṣah* (netting-off) by invoking the simple principles of *maṣlaḥah* and *ibāḥah*.² With developments in the conventional derivatives market, work is in

² Kamali, Mohammad Hashim; *Islamic Commercial Law: An Analysis of Futures and Options*; Islamic Texts Society, UK; 2000.

progress for more structured Islamic derivatives such as structured FX options and commodity derivatives that would be without observing the *salam* based conditions that, of course, validate forward trading in goods other than monetary units³. Financial derivatives almost never involve delivery by the parties as they reverse the transaction and settle the price difference only (Jobst, 2008), and this is against the spirit of the Sharī'ah.

A very gloomy impact of the above developments is that even some renowned peers of Islamic economics have started rethinking about redefining *ribā* not to include any of modern day investment and hedging instruments. For example, M. Akram Khan (2016) says in this regard:

“We have now landed at a sad state of affairs. Islamic financial institutions (IFIs) are competing with each other to claim similarity with conventional financial institutions and in devising ever new tricks. They are now effectively in the business of defeating the very objective which was the justification for their existence. We think it is time they come out of this hypocrisy and do some innovative thinking (*ijtihad*) about the definition of *ribā*.”⁴

It's a point to consider, however, that if ‘*bills discounting*’ and ‘*foreign exchange transactions of all types*’ are not included in *ribā*, then what is *ribā* as prohibited by the Sharī'ah? With all respect to the learned scholar, we would differ and contend that a clearer stance could be suggesting closure of Islamic banks and permitting all conventional finance transactions. But, ground reality is that majority of Muslims are not ready to accept such kind of ‘*ijtihādi*’ pronouncement all arguments for which have already been sufficiently rebutted. The jurists and Sharī'ah scholars who are leading the Islamic finance industry may take up this issue seriously, to bring reforms to the evolving system.

In some markets, where AAOIFI's Sharī'ah standards are considered as guidelines for products' development, and in case of many institutions across the globe, financial derivatives are not used by the IFIs; and Pakistan is one such market. However, some grey area structured products are used even in such markets and this requires more careful governance by the regulators. To discuss issues relating to governance in such markets, we have selected Pakistan as a case study.

³ See for such conditions: Resolution of the Islamic *Fiqh* Council [No. 107 (1/12) 23–28 September 2000]

⁴ See paper https://issuu.com/makram100/docs/reconstruction_of_ie_thought-need_f

Islamic Banks' Regulations in Pakistan⁵

In Pakistan, the world's second most populous Islamic country with around 95 % Muslim population, the Islamic banking industry held 11.4 percent share in assets in June 2016, barely changed from a year ago, and well below levels of around 25 percent in Gulf Arab states and even Malaysia where Muslims are around 51 per cent of the population.

Pakistan is following the AAOIFI's Sharī'ah Standards based mainstream approach avoiding *bai' al-dayn*, *bai' al-īnah*, and financial derivatives to promote Islamic banking with clear emphasis on Sharī'ah compliance. The IBIs have been advised to consider the '*Sharī'ah Essentials*' of modes approved by the SBP's Sharī'ah Board as the minimum requirement for Sharī'ah compliance. For the Islamic modes for which essentials have not been prescribed, AAOIFI Sharī'ah standards may be used as guidelines in consultation with IBI's Sharī'ah Boards. Six Sharī'ah Standards of AAOIFI [Nos. 3, 8, 9, 12, 13 and 17 up to 2015] have been adapted with some amendments.

Some important measures have been taken by the Government and SBP to facilitate the banks and the businesses / industry to convert to Islamic finance. SBP recently exempted Islamic banks from using interest-based benchmarks for some financing products (IBD Circular No. 01, 2016). It also reduced Statutory Liquidity Ratio (SLR) by 5 % enabling IBIs to enhance their financing to business and commodity sectors. Three centres of excellence have been established for developing human resources for Islamic finance. The Government introduced a 2 percent tax rebate for Sharī'ah-compliant manufacturing firms in July 2016 to encourage them to exclude interest-bearing debt from their balance sheets.

The SGF 2015 covers all instructions given by IFSB (2009)⁶ with addition of external audit. It provides guidelines for the central Sharī'ah Board in the SBP, Sharī'ah Boards (SB) in the IBIs, Resident Sharī'ah Board members (RSBM) in each IBI, Board of Directors (BOD) of the IBIs, Executive Management (EM) and Sharī'ah Compliance Department (SCD) of each IBI, Sharī'ah Review Officers, internal auditors, external

⁵ Islamic finance industry in Pakistan consists of Islamic banks, microfinance banks, Islamic mutual funds, *muḍārabah* companies, *takāful* companies and Islamic REITs. Commercial and microfinance banks operate under SBP non-bank finance entities are supervised by the Securities and Exchange Commission of Pakistan (SECP). Here we will be focusing on regulation of IBIs only.

⁶ IFSB. (2009). *Guiding principles on Sharī'ah governance systems for institutions offering islamic financial services*. Islamic financial services board.

auditors, personnel involved in product development, risk management, liquidity management, and other staff for business development.

BOD of each IBI is responsible and accountable for ensuring conformity of the bank's operations with the Sharī'ah principles. It has to ensure that Sharī'ah Board is not subjected to any undue influence or pressure from the management. It is required to meet the SB at least on half yearly basis and ensure timely and effective enforcement of the SB decisions and recommendations. SB is also required to specify the process for changing or revisiting *fatāwá* / rulings already issued by SB.

Sharī'ah Board has to review the scope, methodology, checklists/work programs, Sharī'ah audit manual and format of internal Sharī'ah audit report and the annual Audit Plan. It has also to give advice on issues pointed out in internal and external Sharī'ah audits and Sharī'ah compliance review, and take up unresolved issues with Management and the BOD. It may also refer Sharī'ah issues to SBP for seeking opinion of its Sharī'ah Board.

The RSBM is required to provide explanation/clarification to management and staff of the bank on products, documents, etc, in the light of decisions, rulings, *fatāwá* issued by the SB; and such clarifications are binding on the bank. The SCD is required to keep a continuous watch on the IBI's Sharī'ah compliance environment to ensure that all organs of Sharī'ah Governance are operative and are effectively discharging their respective functions and responsibilities as defined in the Framework. SCD is also required to conduct Sharī'ah compliance review (in addition to internal audit) to re-ensure that the IBI's operations are in conformity with guidelines issued by SB and directives, instructions and guidelines issued by SBP in accordance with the rulings of SBP's Sharī'ah Board.⁷

Evaluation of the SGF, 2015

Making the BOD accountable ultimately for the Sharī'ah compliance and decisions of the Sharī'ah board and the RSBM binding for the management, instructions for education and training of all organs of the management and operational staff, intensive role of the internal reviewers, requirement for external audit, inspection by the regulator (SBP), enforcement of internal and external audit reports, conflict resolution procedure, etc. all tend to imply strengths of the Framework.

⁷ [For details, see SBP, IBD Circular 01 Of 2015 April 07 2015; with Encl: Sharī'ah Governance Framework for IBIs]

All inspection /review reports by the internal auditors, State Bank's inspection team and the external auditors are to be shared with the Shari'ah Boards and remedial actions recommended by the Shari'ah boards are binding on the IBIs' management. In the light of all these reports, the Shari'ah Boards have been advised to furnish report(s) to the SBP about the remedial actions taken by the management and the role of the BOD.

For safeguarding rights of all stakeholders and stability and soundness of the system, sufficient emphasis has been laid down on disclosure, transparency, deposits pools management, profit sharing ratio (PSR), and parameters of *hibah*, if any, to the pools and not to any individuals in any pools. Timely and full disclosure has to be made about the PSR, the weightages assigned to various deposits pools while the practice of *hibah*, if any, has been restricted to pools only.

It is for the banks now to launch Shari'ah-compliant products to finance the commodity and energy producing sectors for facilitating industry, agriculture, infrastructure, communication, trade and business. By judiciously distributing the profits so earned and enhancing credibility, Islamic banking sector can pull more people into the formal banking sector that may be helpful in boost economic growth as they will be offering such Shari'ah compliant products that really connect the real and the finance sectors.

The Issues still to be taken care of

However, the banks are still focusing on treasury products for risk-free return even by compromising on the widely accepted Shari'ah principles. The treasury products like interbank *bai'al-mu'ajjal* of *ṣukūk* (organized *tawarruq*) etc; are being used aggressively by some IBIs for clean lending to conventional banks. This approach makes the people risk averse and increases the greed and lust for risk free return from money as in the conventional interest based system. While risk aversion behavior is an obstacle to growth of investments in any economy, greed has been characterized as one of the prime catalysts behind the 2008 financial crisis.

Hence, the ultimate outcome in terms of Shari'ah compliance and credibility of the Islamic banking system in the country is not likely to be improved; and this is due to some intriguing built-in issues in products approval, decisions and issuance of pronouncements with regard to Shari'ah certification, lower than expected performance of the Shari'ah scholars involved in decision making for the IBIs' products due to lack of

finance related knowledge and requisite expertise, and an increasing number, categories and level of conflicts of interests. The code of conduct for Sharī'ah scholars as also for the professionals is still ineffective due to some basic flaws. It may be the reason that even after introduction of the new SGF in 2015, the critique of the Islamic banking system in vogue has increased both in print and electronic media and among the relevant circles in the society, negatively affecting public perception. Specifically, it is due to two major gaps as indicated below:

A. Absence of any Solid Basis for Sharī'ah Pronouncements: Despite the '*Sharī'ah Essentials*' of modes suggested by the SBP and general instruction that AAOIFI's standards be followed where no specific instructions have been given by the regulator, there is no solid common basis for deciding the Sharī'ah matters. Sharī'ah advisors and Boards are free to decide and take any position taking benefit from any contemporary practice under path dependency effect. This gap exists both at the level of SBP's Sharī'ah board as also the IBIs' SB level. The former's example, among others, is approval of '*bai'al-mu'ajjal of (GoP) ijārah šukūk*'.⁸ At the level of the IBIs' Sharī'ah Boards, the examples of such freedom in products approval are '*Currency Salam*' as alternative to 'bills discounting', organized *tawarruq* using *šukūk*, and running *mushārah* as alternative to 'Over Draft' in the conventional finance (JIBM, Dec. 2016). The most of the IBIs are using these grey area products. SBP's Sharī'ah Board has not taken initiative to undertake detailed studies prior to approving the structured products or to standardize the products in the country. The lack of such standardization is a big hurdle in enhancing the outreach of Islamic banking in the country⁹.

Issues and Conflicts of Interests in Sharī'ah Advisory Framework:

There are a number of conflicts of interests in the Sharī'ah advisory framework. Earlier, there was only one Sharī'ah Advisor serving as an employee in an IBI paid directly by the respective banks. Now that position has been assigned to the RSBM with additional requirement of Sharī'ah Board comprising at least three Sharī'ah Scholars¹⁰. As a result, the increased demand for scholars associated with such institutions /

⁸ See for the details and Sharī'ah related issues: *JIBM Discussion Forum on bai'al-mu'ajjal of GoP ijārah šukūk introduced vide SBP DMMD Circular 17 dated Oct 17, 2014*. Vol 5; No. 2; Dec; 2015 <http://jibm.org/?q=node/82>

⁹ Dr. Shamshad Akhtar, SBP, Islamic Banking Sector Review: 2003 to 2007.

¹⁰ The rationale for full-fledged Sharī'ah Board in an IBI becomes fragile in the wake of SGF's instruction that banks Sharī'ah boards shall be deciding in accordance with pronouncements of SBP's Sharī'ah Board.

madāris that have flexible approach towards replicating conventional products has increased the intensity of conflict of interest. Cartels of such scholars came into being to ensure a minimum level of salaries. Sharī'ah compliance level has rather deteriorated, due to a variety of issues and conflicts of interests as discussed below:

- i. **A special kind of Employer-Employee relationship:** While the RSBMs are regular employees of all IBIs, the banks' management generally agrees to pay relatively high monthly pay, also to other Sharī'ah board members who attend meeting only once in a quarter of year, that may cause a formal or informal pressure on them to be flexible in approval process.
- ii. **The Issue of Time and Multiple Memberships:** In the draft SGF issued by the SBP in 2014 for seeking comments from the banks, SBP had required the RSBM to give full time to the bank. But some senior Sharī'ah scholars put pressure on the regulator to allow them to undertake activities at *madāris* despite being RSBM in any bank, and ultimately in the final SGF, issued in April 2015, the RSBMs were allowed not only to give some time daily to teaching / research activities at *madāris*, but also to take positions as member of Sharī'ah board in any non-bank financial institutions. Some Sharī'ah advisors who were earlier working for only one IBI have taken positions in other IFIs with lucrative packages, vis-à-vis the time given, in each institution.
- iii. **Senior-Junior or Teacher-student Relationship:** The environment and practice in '*madāris*' is such that the juniors / students always have to accept what their teachers or seniors say or opine. SBP has to ensure that such conflict is not there in case of its Sharī'ah Board.
- iv. **Path dependence Syndrome:** In case a product is approved generally anywhere in the world, and specifically by any IBI in Pakistan, it tends to oblige Sharī'ah Boards of other IBIs to approve it as it has happened in case of organized *tawarruq* and '*Running Mushārakah*'.
- v. **Business Proposition vs. Sharī'ah Compliance:** Having got a good business proposal, IBIs find one way or the other to avail that by getting approval from the respective Sharī'ah Boards. Secured lending by way of lien mark of interest based T. Bills and PIBs just to improve CAR that deteriorated due to *tawarruq* based clean lending, is the worst example, among others, of this trend.

The aforesaid may imply that there are some built-in flaws, loopholes and conflicts of interests pertaining to tricky role of the Sharī'ah scholars,

and inability of the regulator to enforce the framework so far, as per its objectives, that may lead to even worse situation, if not taken care of forthwith.

Islamic Banking and Socio-economic Justice

Regarding the objective of promoting social justice, all practices of the IBIs— taking deposits and financing and investments, may lead to the contrary, even worse than in the conventional banks. Islamic banks' return on equity and earning per share (EPS) have increased visibly over past some years¹¹ but the profit rates for depositors, particularly the general (savings) depositors have decreased drastically. While the conventional banks have to pay presently a minimum historically lowest profit of about 4 % per annum on savings deposits at the time when the benchmark interest rate in Pakistan is around 6 percent, IBIs are paying as low as 2 percent in many cases, simply because the SBP has not obliged them to pay a minimum due to the features of *mudārabah* contract.

We shall give only one example each for deposits and financing sides to explain ineffective implementation of the regulatory instructions. SBP did a good job by prohibiting *hibah* to individual depositors (Nov. 19, 2012) and phased out the individuals *hibah* by July, 2015. But the IBIs circumvented the regulation and offered higher weightage based products to their 'priority' deposits at the cost of common depositors. Some banks have been giving over 5 % annual profit to priority Savings Account holders by offering special PLS deposits against 2-2.5 % annual profit to common PLS savings depositors. On financing side, accounting / financial reporting by banks in case of *ijārah* financing needs regulatory overwatch. Only 3 Islamic Financial Accounting Standards (IFAS-I, 2, and 3) could be notified by the SECP over the last 12 / 13 years. IFAS 2 requires *ijārah* income to be recognized on accrual basis - as and when the rental becomes due (clause 10.4) meaning that full amount of due rent has to be included in the installments for payment of rent and the principal. But, IBIs normally charge in the initial stage a much higher part as rent and smaller part from the principal that results in loss to the lessee in case of pre-mature termination due to theft, major accident or non-payment due to

¹¹ For example: Meezan Bank's Profit after tax for the year 2015, increased to Rs 5.023 billion compared to Rs 4.570 billion recorded in 2014. Its EPS increased during the period from Rs 4.56 to Rs 5.01. The market value of the Share at 42.50 (face value of Rs. 10), the per cent earning for shareholders is 11.79, higher from about 11.4 per cent for the previous year (Business Recorder, Feb. 26, 2016).

any problem with the lessee. As per IFAS-2, IBIs may be advised to recover the principal commensurate with the depreciation charge.

As regards the objective of facilitating the real sector through supply of sufficient purchasing power, the IBIs continue to be ignoring it having even better avenues to get risk free returns by using grey area products. Replacing genuine *murābahah*, *ijārah*, *salam*, *istiṣnāʿ*, etc with *Running Mushārakah*, secured or unsecured lending to conventional banks by *tawarruq* simply means that IBIs are interested in maximizing their risk free earnings only without care for social contribution or even Sharīʿah compliance in letter.

Required Role of the Jurists / Sharīʿah Advisors

According to the instructions of SBP, the burden whether a product passes Sharīʿah compliance test, rests on the shoulders of IBIs' Sharīʿah Boards. Sharīʿah scholars have been assigned the Divine responsibility of ensuring a Sharīʿah compliant, trustworthy and robust system that could be helpful in enhancing financial and social inclusion and provide necessary support for sustainable growth and development of the economies and the societies. They need to perform this duty as a trust and without any conflict of interests while ensuring that each and every transaction conforms to the principles of Sharīʿah, and that justice is done with all stakeholders particularly the general account holders. [Q: 4:58 and 33:39].

Measures for Regulatory Improvements

The prime factors behind the problems as indicated above are non-availability of any single basis for products' approval and decision making, and SBP's inability to properly govern the skills and role of RSBMs and Sharīʿah Boards. Below, we recommend some steps to be taken instantly:

- a) **Basis for Sharīʿah Decision Making and Products Approval:** There has to be one basis for products approval and decision making. AAOIFI's Sharīʿah Standards may be made mandatory; Further, SBP may enforce an SOP and a "*Code of Conduct - Ethics and Principles for approval of Structured Products*";
- b) **Products Approval Process:** Products suggested by IBIs Sharīʿah Departments may be analyzed thoroughly by the Sharīʿah Research Unit of the IBD (SBP) to ensure that nothing is against AAOIFI's Standards; and then submitted to the SBP's Sharīʿah Boards for approval keeping in view implications of products for stakeholders and objectives of Islamic banking; IBIs may then be advised not to use any

structured product unless approved expressly by the SBP's Sharī'ah Board¹².

- c) **Ṣukūk Market:** Till the whole system is Islamised (as discussed in JIBM's Editorial of December 2015 Issue), primary and secondary market for sovereign *ṣukūk* should be opened for IBIs only, excluding conventional banks. This step will also help in curbing the clean and collateralized lending by IBIs to conventional banks in contravention of the AAOIFI's Sharī'ah Standard No. 30 on *tawarruq*.
- d) **Sharī'ah Advisory System in Banks:** Having a Sharī'ah Board in all IBIs may not be mandatory as it has caused unnecessary costs to the IBIs without any visible benefit. One Sharī'ah Advisor could be sufficient serving full time to facilitate the banks in day-to-day business as per standardized products approved through process as in (b) above. Banks may, however, be allowed, as prior to 2015, to constitute their own Sharī'ah Boards at their discretion. The members of such Sharī'ah Boards might be paid the honorarium, if any, for the meetings attended or work accomplished, and not any regular pay.

Some others steps need to be taken in short/ medium / long run:

- a) Practically, the ability of the Sharī'ah boards /advisors to fulfill their mandate is constrained by the time given for the banks affairs, their understanding about finance and access to monitoring systems, complexity of the products and transactions, and effectiveness of their independence.¹³ State Bank may maintain a panel of '**SBP Certified Islamic Finance Scholars**' for Islamic banks and finance institutions. Its training arm, NIBAF, may design and arrange an advance level rigorous training course on Islamic fiqh, economics, accounting, banking and finance for Sharī'ah scholars having sufficient knowledge of Islamic law of contracts, banking, finance and accounting, followed by a comprehensive written Exam. Only the scholars securing (70) % or more marks may be eligible to become *Certified Sharī'ah Advisors* in Islamic banking system of the country¹⁴.

¹² As per SGF, 2015, IBIs have to inform SBP about any new product approved by their Sharī'ah board 30 days prior to its proposed launch, and if any reply is not received within 30 days of its intimation to IBD/SBP, such product is considered as implicitly approved by the State Bank.

¹³ Grais W. and Pellegrini, Corporate Governance in Institutions Offering Islamic Financial Services; World Bank Policy Research Working Paper 4052, 2006.

¹⁴ SBP may exempt some senior level Sharī'ah scholars who in its view are already well aware of the innovative techniques and instruments in conventional finance.

- b) SBP may nominate, with approval by its Sharī'ah Board, any of the Panel members for any IBIs for the period of three years, after which they may be deputed to any other IBIs. SBP may be deciding the monthly salaries, allowances, etc. to the IBIs' RSBM, that SBP will be taking from each IBI keeping in view its number of branches, business, expertise of its Sharī'ah scholar, size of internal Sharī'ah control and Sharī'ah research / review departments, and the level of Sharī'ah compliance (lower the level, greater the amount).
- c) There has to be some shift from the maximization of shareholders' value to that of the "*aggregate welfare of the stakeholders*". [WB PRWP 4052, 2006]. IBIs may be asked to provide CSR related activities from their equity or the philanthropists.
- d) Efforts at integrating finance with technology for developing innovative projects for development (fintech is increasingly emerging as a tool for improving financial performance and increasing efficiency and sustainability; it can contribute efficiently to social and financial inclusion and sustainable development).

To conclude, SBP has tried to ensure independence of the Sharī'ah Boards of the IBIs and required the banks' BoDs and Executive Management to be fully involved in the process of development of the new system and be accountable for any non-Sharī'ah compliance. But, there are some built-in flaws, particularly the missing basis for products approval, and a variety of conflicts of interests in the Sharī'ah advisory function. Lower return rates paid by the IBIs to their depositors need special investigation by the regulator. The combination of requirements of Sharī'ah compliance and healthy business performance of the IBIs raises specific challenges and agency problems, and underlines the need for distinct governance structure (IMF W/P-40522).

The regulator needs to further fix-up the framework and emphasize upon the Sharī'ah scholars that increasing use of controversial modes has adversely affected the image and true identity of Islamic banking and finance. Once such built-in flaws are removed, the main responsibility would lie on the Sharī'ah scholars who are sitting on the 'driving seat' and who could lead Islamic banks not only to get rid of *ribā* in letter, but also lead for transformation of the national and the global finance to infuse in it morality and Divine ethics and to make it really beneficial for mankind.