How do Shariah committees perceive their role in risk management practices in Islamic Banks in KSA?

BADR AYED ALQAHTANI

RMIT UNIVERSITY

Abstract

Purpose: The study aims to provide a comprehensive understanding of how Shari'ah committees can play an enhanced and effective role in shaping risk management practices within Islamic banks, contributing to the broader discourse on Islamic finance. Focusing on the intricacies of risk management within the Saudi Arabian context, the research intends to explore the pivotal role played by Shari'ah committees in upholding Shari'ah compliance.

Research Design: The research employed a qualitative approach, conducting semi-structured interviews. 34 participants were selected through purposive sampling. Collected data was subjected to thematic analysis, facilitated by NVivo software which aided in discerning patterns from interviews conducted in Arabic. Ethical considerations are paramount, with explicit permissions obtained from participants, assurance of confidentiality, and adherence to ethical guidelines outlined by RMIT University.

Findings: The research revealed the significant role of Shariah committees in implementing Shariah Compliance. It highlights that fostering collaboration between Shari'ah committees, senior management, and risk management professionals within Islamic Banks is a key factor to ensure compliance which can be achieved through regular forums, workshops, and training sessions. It further emphasizes the need to embrace technological tools for risk management which include leveraging advanced software solutions for risk assessment and monitoring while ensuring compliance with Islamic finance standards.

Originality: This study addresses a notable research gap by investigating avenues to enhance the engagement of Shari'ah committees in risk management practices within IBs.The findings contribute valuable insights into the intersection of Shari'ah compliance and risk management in Islamic banking.

Keywords: Shariah committee, Risk Management Practices, Islamic Banks, Islamic Financial Institutions Kingdom of Saudi Arabia.

1. Introduction

Islamic banking emerged in the mid-1970s with the primary aim of providing financial services aligned with Shari'ah (Islamic law). This initiative aimed to cater to the needs of Muslims who, driven by religious convictions, refrained from engaging in conventional interest-based finance. In its relatively brief history, the Islamic financial sector has experienced rapid growth, evolving into a globally significant phenomenon. Estimates suggest that the industry's worth reached USD 1.13 trillion in 2012. Projections indicate continued vigorous growth, with assets in the Middle East and North Africa (MENA) region expected to more than double from USD 416 billion in 2010 to USD 990 billion by 2015 (Ernst and Young, 2011).

Despite its remarkable growth, the Islamic financial industry has faced increasing scrutiny regarding the nature of its offered products. Criticisms have centered on the observation that Islamic financial products seem to emulate those in conventional finance, raising concerns about the potential dilution of Shari'ah requirements. The contention is that, while the formalities of contractual forms are adhered to, the underlying substance and spirit of Islamic law may be compromised (Khan, 2010; ElGamal, 2008). Islamic banking, adhering to Shari'ah principles and ethical finance, has gained prominence as a viable alternative to conventional banking in the financial world. In the Kingdom of Saudi Arabia (KSA), a hub of Islamic finance, Islamic Banks (IBs) play a pivotal role in the economy. Ensuring the compliance of financial activities with Islamic principles, particularly through the guidance of Shari'ah Committees (SCs), is at the heart of Islamic banking (Hassan *et al.,* 2022).

This research embarks on a journey to explore a critical facet of Islamic banking in KSA: the role of SCs in risk management practices. While risk management is a fundamental aspect of financial institutions, it acquires a unique dimension within Islamic banks due to the need for Shari'ah compliance. Islamic finance principles prohibit engaging in activities deemed unethical or speculative, hence necessitating specialized risk management practices (Alahmadi *et al*., 2017). The central question guiding this inquiry is, to what extent do SCs influence the risk management practices in Islamic banks in KSA? The intersection of religious guidance, ethical finance, and sound risk management is of paramount importance, not only to the banks themselves but also to the broader Islamic finance industry. The compliance, effectiveness, and ethical soundness of risk management practices have a significant impact on the trust and confidence of investors and depositors (Ahmed, 2014).

In this context, this study is focused on exploring the role and ways to advance the involvement of Shariah committees in risk management practices in Islamic banks in the Kingdom of Saudi Arabia. By delving into the dynamics of this relationship, this research aims to contribute to a deeper understanding of how Islamic banks manage risks in a Shari'ah-compliant manner. This study will explore the processes, challenges, and opportunities that arise when SCs are involved in the risk management practices of Islamic banks, offering insights that can enhance the resilience and ethical character of these financial institutions.

2. Literature Review

2.1 Risk Management in Islamic Banking: An Overview

Islamic banking has gained significant prominence globally, particularly in Saudi Arabia, where it plays a pivotal role in the financial sector. The core principle of Islamic banking is to ensure financial activities adhere to the principles of Shariah law. This unique approach introduces a distinct dimension to risk management, which is critical in the financial industry. Researchers such as Abdul Rahman (2010), Mulyany (2008), Binti Kasim *et al*. (2009), Yaacob and Donglah (2012), Arwani (2018), and Haridan *et al*. (2018) have shed light on critical aspects of Shariah compliance audit, revealing concerns encompassing independence, confidentiality, qualifications, inconsistencies in pronouncements, the scope and timing of audits, Shariah audit evidence, audit programs and procedures, and the need for an independent regulatory body.

Abdul Rahman (2010) emphasizes the internal nature of Shariah compliance, asserting that internal auditors should conduct the Shariah compliance audit. However, Chapra and Ahmed (2012) point out challenges including independence, confidentiality, and a scarcity of professionals possessing both Shariah and financial expertise. Consequently, the Shariah Board is often limited in performing thorough evaluations of Islamic Financial Institutions (IFIs) operations (Abdul Rahman, 2010). To address these challenges, Grais and Pellegrini (2006) suggest the development of a comprehensive framework, both internal and external, emphasizing market discipline. This framework serves as a guide to Shariah Boards through standardization and harmonization. According to this proposed framework, IFIs' internal review units would conduct transaction reviews, while external auditors would express opinions on the Shariah compliance of IFIs' operations.

In an investigation by Mulyany (2008), the perspectives of accounting professionals, academicians, audit practitioners, and Shariah scholars on fundamental issues in Shariah auditing were empirically explored. Critical issues identified included the definition of "Shariah audit," the appointment and qualification requirements of Shariah auditors, the scope of Shariah audits, the content of Shariah audit reports, the regulatory framework for Shariah audit practice, and Shariah auditing standards. Mulyany (2008) suggests a need for a proper definition of Shariah audit, standardized qualification requirements for certified Shariah auditors, clarity on the scope, extent, and timing of Shariah audits, regulations and standardization of the content of Shariah audit reports, the establishment of an independent body to regulate and enforce standards, and practical application of AAOIFI standards.

This body of literature collectively underscores the multifaceted challenges and issues surrounding Shariah compliance audit and proposes strategic solutions to enhance the effectiveness and credibility of Shariah audit practices in the realm of Islamic finance.

2.2 Risk in the Realm of Islamic Financial Institutions (IFIs)

Risk in the realm of Islamic Financial Institutions (IFIs) has been systematically classified by Iqbal and Mirakhor (2011) into four principal categories: financial risk, business risk, treasury risk, and governance risk. Financial risk, the foremost concern in risk management discussions, pertains to the potential for direct financial losses involving assets and liabilities. Notably distinct for IFIs is the nature of their financial risk, which encompasses credit risk, market risk, and equity investment risk—unlike traditional financial institutions that grapple solely with credit risk and market risk (Iqbal and Mirakhor 2011; Hassan and Aliyu, 2018).

Business risk, intricately tied to the IFIs' operations and the broader economic context encompasses factors such as macroeconomic shifts, policy alterations, legal and regulatory dynamics, and the infrastructure of the financial sector. Although IFIs encounter routine business risks akin to conventional financial institutions, Iqbal and Mirakhor (2011) emphasize a specific business risk for IFIs—the rate of return risk.

This risk is associated with the potential insolvency of a business when its capital proves inadequate to sustain operations without viable capital or operational solutions.

When it comes to treasury risk, IFIs deal with two major categories: hedging risk and liquidity risk. This aspect has to do with managing cash and equity, as well as short-term liquidity and assets and liabilities. Because of the limited liability of money and interbank markets that are compliant with Shariah, as well as the shallowness of the secondary market for Islamic financial products, liquidity risk is particularly significant for IFIs. Shamas (2019) highlights the difficulty Islamic banks (IBs) face in obtaining liquidity, blaming it on the differences in regulations between central banks and IBs as well as the restricted use of financial instruments that adhere to Shariah.

Last but not least, governance risk includes dangers from breaches of the governing body's obligations, carelessness in commercial dealings, fulfilling contractual commitments, and a weak internal and external institutional framework. This group includes legal hazards related to situations in which financial institutions have trouble upholding commitments (Iqbal and Mirakhor 2011). The dilemma of Shariah risk in the governance space is exclusive to IFIs; conventional financial institutions do not face this problem.

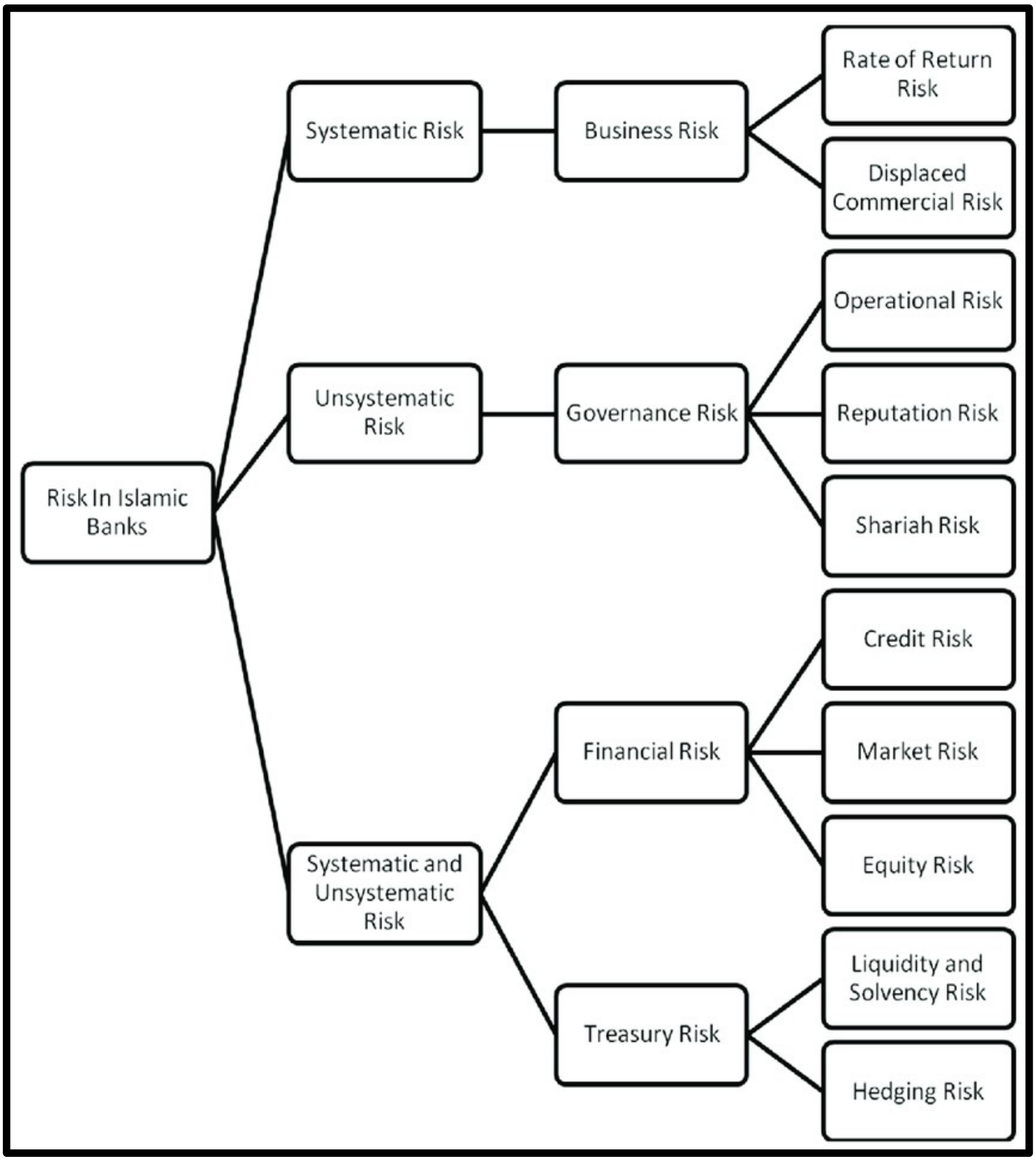

Figure 1: Risk categorization in Islamic Banking. (Source: Al Rahahleh, Ishaq, and Najuna 2019).

2.3 Islamic Financial Institutions (IFIs)

2.3.1 Evolution of Islamic Financial Institutions (IFIs)

The legacy of Islamic finance and its institutions spans over a millennium, characterized by a notable absence of significant financial crises within Muslim-governed regions across Asia, Europe, and Africa. However, the landscape of the Islamic Banking and Finance (IBF) sector has undergone substantial transformations, influenced by historical events such as the colonization of Muslim territories by European powers. This colonization era, commencing with the European empires' ascent and the reclamation of Spanish Muslim territories in 1492, the overthrow of the Mughals in India in 1857, the nineteenth-century "scramble for Africa," and the division of the Ottoman Empire's Arab territories through the Sykes-Picot Agreement in 1915, played a pivotal role in shaping the trajectory of Islamic finance (Aman, 2020).

The post-World War II period marked the conclusion of the colonial era, with Britain and France withdrawing from the majority of their colonial Muslim territories. This shift ushered in the modern era of Islamic Banking and Finance (IBF), particularly when formerly colonized Islamic nations gained independence. Consequently, the history of IBF unfolds in two distinct phases: the formative era of Islamic financial transactions and the contemporary phase marked by experiments and advancements. The first stage begins with the Prophet Muhammad (PBUH) and includes the early generations up to and including the Umayyad and Abbasid Eras, the Orthodox Caliphate, and the noble companions. Modern IBF is characterized by its second phase, which began to take shape in the nineteenth century (Mohammed, Mohd, and Ahmad, 2019).

2.4 Risk Management of Islamic Banks

Risk management stands as a fundamental pillar in the responsible operations of banking institutions. In essence, the application of robust risk management principles and effective practices indirectly contributes to the enhanced profitability and enduring viability of banks. Recognizing the imperative for sound risk management and a comprehensive framework, the Basel Committee on Banking Supervision (BCBS) introduced risk guidelines for commercial banks (Abu Hussain and Al-Ajmi, 2012). The aftermath of the Global Financial Crisis (GFC) underscored the heightened importance of risk management. According to Rahman and Shahimi (2010), risk management assumes paramount significance in the financial services sector, surpassing its relevance in other economic domains. The repercussions of a deficient risk management system extend far beyond immediate losses, potentially leading to the collapse of individual banks and, on a broader scale, impacting the entire banking system with serious implications for the broader economy.

Efficient risk management serves to safeguard an organization's assets and profits by minimizing the potential for loss and mitigating the impact when losses occur, thereby facilitating a swift recovery (Coffin, 2009). Murunga (2017) asserts that financial risk management involves identifying risks in transactions, comprehending and measuring those risks, determining the associated factors, and establishing procedures to reduce them. Waring and Glendon (1998), as cited in Kalapodas and Thomson (2006), posit that risk management practices are instituted to eliminate, reduce, and manage risk while maximizing benefits and avoiding harm. Essentially, risk management involves avoiding risky activities, and when avoidance is not possible, transferring the risk to a third party. In a study examining the risk-taking behavior of Islamic Banks (IBs) in seven countries during 2006–2009, Hassan and Mollah (2014) found that the nature of Shariah boards does not inherently limit risk-taking; instead, corporate governance and financial disclosure emerge as pivotal factors influencing risk-taking in IBs.

The dynamic nature of risk management makes it an ongoing process, directly responsive to changes in the internal and external environments of banks (Abu Hussain and Al-Ajmi, 2012). For IBs, the intricacies of risk management arise from their inability to simply adopt the practices of conventional banks (CBs). Despite this, the risk management process shares similarities between the two. Kayed and Hassan (2011) argue that the risk management processes of IBs and CBs are akin, commencing with risk identification, mitigation, and efforts to control risk exposure to ensure profitability. Notably, IBs must align all tools within the evolving framework with Shariah requirements. In the IB context, risk identification involves a two-step process: negative Shariah screening, excluding transactions based on Riba, Gharar, and Maysir to reduce risk exposure, and positive screening, emphasizing justice, ethics, and accountability issues. The Shariah board of the bank conducts the first screening for every product offered by an IB.

2.5 The Role of Shari'ah Committees

Shari'ah Committees (SCs) are central to ensuring Shariah compliance in Islamic banks. These committees consist of Islamic scholars who guide financial transactions, products, and investment decisions. Their role extends to risk management, as they evaluate the potential ethical and legal risks associated with financial activities.

2.5.1 Significance of Shari'ah committees in Islamic banking:

SCs are responsible for evaluating the compliance of risk management practices with Shariah principles. They ensure that risk management strategies do not involve prohibited activities such as riba (usury) or gharar (excessive uncertainty) (Zainal Abidin, Mat Yasin, and Zainal Abidin, 2021). SCs contribute to maintaining the ethical character of Islamic banks. They review risk management policies to ensure that they align with Islamic ethical standards. Shari'ah committees guide banks in identifying and mitigating risks in a Shariah-compliant manner (Ahmad and Abdul-Rahman, 2020). They help in developing risk management frameworks that are in harmony with Islamic finance principles.

3 Research Methodology

This study employed a qualitative approach, utilizing interviews to investigate the intricacies of risk management in Islamic Banks (IBs) with a specific focus on the connection with Shari'ah Committees in Saudi Arabia. Qualitative research was chosen for its ability to explore the natural environment and provide an in-depth understanding of the phenomena under investigation (Omar, 2019).

3.1 Interview Process

The research involved 34 participants of Shari'ah committees, senior management, risk management professionals, and other stakeholders in four prominent Islamic Banks in Saudi Arabia selected through purposive sampling, to conduct semi-structured, in-depth interviews. While the majority of the interviews were conducted in person, some were held virtually due to the COVID-19 pandemic, utilizing various video and audio platforms such as Skype, phone calls, and Zoom. Participants were transparently briefed on the interview's purpose, and consent was sought for recording to ensure accurate transcriptions for subsequent analysis. Confidentiality was assured, and participants were informed that recordings would be used exclusively for the project, adhering to RMIT ethical guidelines, with the recordings scheduled for disposal after five years. Notably, some participants opted for open-ended responses rather than video recordings. The interviews were conducted in Arabic to ensure effective communication, given that it was the primary language of both the researcher and participants (Murray & Wynne, 2001). Translations were performed to maintain the integrity of the questions and responses.

3.2 Data Analysis

Thematic analysis, a widely recognized qualitative data analysis approach, was employed to identify patterns, similarities, and differences within the data (Thompson, 2022). This method offers a detailed and minimally organized exploration of data, aligning with the richness inherent in qualitative research (Boyatzis, 1998). NVivo software facilitated the analysis, providing an efficient means to manage extensive interview datasets. The analysis involved five key steps: familiarization, generating initial codes, searching for themes, and reviewing and finalizing themes.

3.3 Ethical Considerations

The study adhered to ethical guidelines, with permission granted to conduct research from July 15, 2018, to July 15, 2022, in alignment with the University Research Governance Framework. In-person and virtual interviews were conducted following ethical recommendations from RMIT University. Participants, including members of Shari'ah Committees and IB professionals, provided written consent, understanding the voluntary nature of participation and their right to withdraw at any stage before the deadline. Participant contact details were shared for communication purposes. The researcher maintained the confidentiality of interview transcripts, as per RMIT ethical requirements, securing them separately from raw and processed data for five years.

4. Results

4.1 Role and Responsibilities of SCs in Risk Management

The results highlighted various aspects of SCs and their function in IB risk management. Based on the participants' opinions, this theme has been divided into subthemes discussed below.

The findings indicate that the Committee's primary responsibility is to ensure adherence to Shariah principles. While discussing the duties and responsibilities of the SC, participants revealed that the Committee reviews the Bank's products and services and ensures that they are according to Islamic principles. According to them, this authorization ensures that a product or service adheres to Islamic law.

"……..The Shariah Committee plays the role of the heart of the Bank. Banks, such as Al-Rajhi Bank and Alinma Bank, conduct their banking work in compliance with the Shariah rules and regulations………" (P 15)

According to the participants, the committees are typically comprised of dedicated members who strive to ensure that the services or products provided align with the tenets of Islamic principles. They reported that the Committee takes considerable measures to meet Shariah compliance criteria, ensuring that no transaction is permitted unless it adheres to Islamic values.

"………..They even take samples from all the transactions concluded over the past three months, and if, upon examination, any irregularity or violation of what has been approved by the Shariah committee, such violation is promptly reported to the

members of the Shariah committee and that is why I believe that the Shariah committee plays an effective role in ensuring Shariah compliance………" (P 11)

Moreover, they shared that the committees are responsible for verifying the compliance of these offerings and ensuring their correct implementation. Participants also said that they also do field visits for this purpose to verify adherence to Shariah requirements.

"……….Of course, the SC can't monitor all transactions at all times at all branches, but representatives of the Shariah Committee make field visits, take random samples, and verify its compliance or lack thereof……." (P14)

Some participants shared that SCs are not merely advisory bodies but also have a role in making executive decisions. The products and services are introduced based on the Committee's decision. Suppose they feel that something needs to be aligned with the Shariah law. It is promptly reported to the Bank's management team in that case. Hence, the Committee's role is not limited to monitoring transactions they have approved but also extends to providing guidance, issuing fatwas, and actively addressing any irregularities or violations of Shariah principles. This comprehensive approach ensures that all areas, such as treasury, retail, corporate, and investment, adhere to Shariah principles.

"………The Committee here in the Bank reviews the services and products provided by the Bank and issues a decision on their compatibility with Shariah, and this is either complete approval or notes in which the internal Shariah group is informed of their amendment before issuing them and presenting them to customers……." (P18)

4.1.1 Composition and Competence of SCs

This theme pertains to the examination of the roles and responsibilities of SCs in IBs KSA. As per the accounts of the participants, the Committee is tasked with reviewing and analyzing the Bank's commercial operations to ensure their compliance with Shariah principles, in addition to approving the products and services. One of the participants shares his responsibilities as a member of the Committee:

"……..Yes, I am a member of an SC for a Saudi bank, which is responsible for reviewing and studying all the Bank's business and monitoring its activities in terms of their compliance with the Shariah principles……." (P1)

The participants reported that the Committee's function is both supervisory and executive in nature, as it ensures that products comply with Islamic principles and conducts oversight and monitoring to ensure that everything is proceeding as planned. Participants discussing the function of monitoring reported that it monitors specific departments and can make crucial decisions. However, they need complete access to the Bank's operations.

"………The SC cannot penetrate the Bank; it provides everything that is asked of it, some things it does not pass; the Committee presents everything and tries with the Bank. The role of the Committee is supervisory and executive because the supervisors supervise the products……" (P2)

The participants reported that the Committee engages in meetings, concludes agendas, and responds to inquiries. The Committee presents its perspective and reports on a specific product or service to the Bank's Board of Directors. The presentation highlights the Bank's adherence to Shariah principles and identifies areas where improvements may be necessary.

"………Among the main roles are also: supervising the Bank's work in general and its commitment from a Shariah point of view, and this is through submitting Shariah supervision reports to the Board; Accordingly, they issued an annual report directed to the Board of Directors, and their opinion on the Bank's commitment from Shariah point of view……." (P8)

4.1.2 Accurate Information

This theme discusses Shariah compliance and legal guidance and highlights the significance of communication and information regarding the Islamic legal aspects of Shariah. Participants discussed how transparent and clear communications, accurate information dissemination, and efficient discussion of Shariah issues within committees promote the effective execution of duties by committee members and increase the institution's credibility.

"………..Ensure that committee members receive timely, complete, clear, correct, and not misleading information. Ensure that the Committee discusses all Sharia issues referred to it in an efficient and timely manner………." (P18)

According to the participants, they have observed that Some clients are very concerned with the Islamic legal aspects, or "Shariah", whenever they want to affiliate themselves with Islamic banks. So, when such customers are interested in attaining services or products, they need to ensure that they receive timely and accurate information, so one of the Committee's roles is to provide clear and accurate information to the clients. The participants acknowledge the Committee's efforts in this regard while sharing that the Committee makes sure that they provide detailed information, whether for stakeholders or customers. They shared that most of the Committee's decisions, whether related to investments or other matters, are clear and are only issued when there is a strong basis for them.

"…………The Shariah committee is so transparent that it has issued four booklets with a detailed description of all the products, whether approved or not. It also maintains open communication channels with all stakeholders, whether partners or shareholders. Even as a bank employee and the same goes for bank customers because I used to be a customer before I became an employee, I have the right to report anything seemingly irregular directly. So, the fact of the matter is that the Shariah committee's performance is excellent as it goes to extreme lengths to ensure that no transaction violates the provisions of Shariah……..." (P11)

4.1.3 Consultative Role

Within the discussed theme, the participants highlighted the predominant consultative role of the Committee. They indicated that the Committee's consultation pertains to the approval process of new products or services, to ensure their adherence to Islamic Shariah principles. The Committee offers guidance and provides clear information regarding these specific products or services, striving to maintain their compliance with Islamic principles. According to one of the participants:

"……….It is a consultative one, as the Shariah Committee gives consultative suggestions, so it is called a consultative body or advisory board………" (P9)

Moreover, the participants noted the executive role played by the Committee in overseeing the approved products and services. They emphasized the Committee's responsibility to monitor and review these offerings after their implementation, ensuring their continued alignment with Islamic principles. The participants underscored the Committee's authority to act in non-compliance with Islamic Shariah, which may result in the suspension of the respective product or service. Thus, the Committee possesses the necessary control and mandate to suspend any transaction that deviates from the principles of Islamic Shariah.

"……..Both because the Bank's Shariah Committee is empowered to suspend any transaction if it is found to be incompliant with Islamic Shariah………." (P14)

The theme concludes that the Shariah Committee plays a significant role in providing consultative guidance, ensuring compliance with Islamic law principles, approving new products, and monitoring compliance with previously approved products. While the Committee's primary role is consultative, it may also have executive responsibilities, such as enforcing compliance and suspending non-compliant transactions.

5. Discussion

The research findings provide a comprehensive elucidation of the role played by Shariah Committees (SCs) in risk management within Islamic banks (IBs) in Saudi Arabia. The participants emphasized the importance of SCs in upholding Shariah norms as being at the core of the bank's operations. The research conducted by Masruki, Hanefah, and Dhar (2020) supports the notion that the Shariah Committee (SC) plays a crucial role in ensuring the adherence of Islamic Banks (IBs) to Shariah principles and regulations. This finding aligns with the conclusion above. The perspectives shared by the participants underscore the significance of Shariah committees in upholding Islamic banks' Islamic ethos and moral values.

The participants further observed that Shariah committees diligently scrutinize Islamic banking offerings to ensure compliance with Islamic principles before approving their sales. To guarantee strict adherence to Shariah law (P15), this procedure serves as an authoritative mechanism. Alkhamees (2013) has presented comparable findings, affirming that Shariah Committees (SCs) are responsible for meticulously evaluating and authorizing Islamic financial products to ensure their adherence to Shariah principles. Many scholars and practitioners are in consensus regarding the necessity of Shariah Compliance (SC) to ensure that the practices of Islamic Banks (IBs) adhere to the principles of Shariah (Fatmawati *et al*., 2022; Masruki, Hanefah and Dhar, 2020).

Another significant finding was the participants' acknowledgment of the substantial efforts made by Shariah committees to ensure adherence to Shariah principles in

Islamic banks. Based on the information provided (P11), it can be inferred that Shariah Compliance Officers (SCs) diligently carry out regular inspections, meticulously examining transactions spanning the preceding three months. Their objective is to identify any irregularities or deviations from the principles of Shariah. The findings align with the research conducted by Noordin and Kassim (2019), emphasizing the importance of routine audits and monitoring by supply chains to identify any non-compliance within international businesses. The accounts provided by participants support the preventive measures implemented by the security consultants (SCs) to protect the integrity of the intelligence bureau (IB) operations.

The participants also made a noteworthy observation regarding the decision-making authority held by SCs, which complemented their consultative role. It has been mentioned that the committees actively participate in developing new products and services, ensuring their strict adherence to the principles of Shariah law (P18). According to the research conducted by Siddiquee (2010), it is argued that strategic business units, commonly referred to as SCs, possess significant executive powers and hold a crucial position in determining the strategic trajectory of international businesses. This discovery provides support for the assertion above. The insights provided by the participants showcase the extensive range of responsibilities that Shariah councils (SCs) undertake. These responsibilities encompass offering guidance on various matters, issuing authoritative religious rulings known as fatwas, and addressing non-compliance or infringements of Shariah principles.

Regarding assessing Shariah compliance, the survey respondents underscored the significance of on-site inspections conducted by Shariah committees (SCs) to ascertain adherence to Shariah principles and regulations. Alkdai and Hanefah (2012) have asserted that the performance of on-site visits and audits by Shariah committees (SCs) is imperative for effectively enforcing Shariah compliance. These visits and audits are essential measures to ascertain adherence to Shariah principles. In addition to conducting thorough reviews and granting approvals for transactions, participants observed a proactive involvement of supervisory committees in diligently monitoring the compliance of internal business operations.

The viewpoints of the participants are in line with prior scholarly investigations, thereby underscoring the importance of Shariah Compliance (SC) in upholding adherence to

Shariah principles, scrutinizing offerings of goods and services, and proactively addressing any instances of irregularities or violations. In addition, the information gleaned from the participants' observations is extremely helpful in understanding the preventative measures SCs took to guarantee compliance and their participation in decision-making processes. These results help us better understand how Shariah Committees (SCs) function and how well they manage Shariah risk in Islamic financial institutions.

5.1 Composition and Competence of SCs

The panelists outlined the several the Shariah Committees (SCs) responsibilities, highlighting the committees' executive and supervisory functions. They emphasized the value of SCs in ensuring conformity to Shariah law. According to our compiled data, SCs do in-depth audits of commercial banking activities to guarantee they comply with Shariah law's principles and norms. This entails approving the banks' recently launched products and services. The findings align with the outcomes of a study conducted by Aziah Abu Kasim (2012), wherein they similarly demonstrated the pivotal role of SCs in developing products in compliance with Shariah law.

The participants further observed that the Supreme Courts in the Kingdom of Saudi Arabia undertake a dual role encompassing executive and supervisory responsibilities. They diligently monitor specific divisions of the bank to ensure strict adherence to Islamic principles. The members of the SCs hold significant sway as decision-makers and actively participate in shaping the operational framework of the bank. The findings presented here align with the research conducted by Isa *et al*. (2022) in Malaysia, wherein they observed that strategic committees (SCs) significantly contribute to the governance and decision-making processes of international banks (IBs).

The participants emphasized the importance of granting supervisory committees unrestricted access to the bank's operations, enabling them to carry out their responsibilities effectively. The statement above underscores the imperative of fostering open lines of communication and promoting collaborative efforts between supply chain entities and financial institutions. In their study conducted in Pakistan, Ayub, Hassan, and Saba (2023) discovered that Shariah committees (SCs) emphasized the importance of readily accessible knowledge and resources to ensure effective compliance with Shariah principles.

The participants discussed the Senior Consultants' (SCs) responsibilities when reporting to the upper echelons of the bank's management. The report by the Shariah Compliance Committee evaluates the bank's observance of Shariah principles and suggests improvements where applicable. This finding is consistent with a thorough study done in Malaysia by Puspitasari and Handayani (2020). Their research showed that Shariah Committees (SCs) were crucial in ensuring the bank's adherence to Shariah principles and providing helpful suggestions for improving its practices.

This research yields essential new information about the makeup and competence of SCs in the Kingdom of Saudi Arabia (KSA). However, more study is needed to confirm and improve upon these results. The present study is constrained by its small sample size. Therefore, it would be beneficial to hear from other highly respected members of the Saudi Arabian financial community and citizens from different parts of the nation. Such insights would greatly aid a more profound knowledge of the topic at issue. In summary, this conducted a comprehensive analysis of the responsibilities held by Shariah Committees (SCs) in Islamic Banks (IBs) in the Kingdom of Saudi Arabia (KSA). The primary focus of this analysis was on the crucial roles played by SCs in ensuring strict adherence to Shariah principles within the banking sector. The findings align with research conducted in various nations and underscore the significance of supervisory committees in international business governance and decision-making. The study emphasizes that achieving effective Shariah risk management in Islamic banking operations hinges upon crucial factors such as transparency, information accessibility, and effective communication between Shariah Committees (SCs) and banks.

5.2 Accurate Information

The study's participants underscored the significance of precise information and transparent communication within Shariah committees. The individuals emphasized the importance of delivering timely, comprehensive, lucid, accurate, and unbiased information to committee members to streamline and enhance decision-making. This discovery is to the perspectives of Haridan, Hassan and Karbhari (2018) put forth, who underscored the importance of transparency and communication within Shariah governance processes.

As per the feedback provided by the participants, it has been observed that clients of Islamic banks exhibit a heightened level of concern about the adherence to Shariah principles and the legal intricacies associated with their interactions with these financial institutions. The importance of Shariah committees in delivering transparent and precise information to clients, thereby ensuring their comprehensive understanding of the products and services provided, was emphasized. The discovery aligns with the research conducted by Kontot, Hamali and Abdullah (2016), which underscored the significance of Shariah compliance information in influencing customers' decision-making processes within Islamic banking institutions.

The participants also commended the commendable efforts of Shariah committees in upholding transparency and fostering effective communication channels with all pertinent stakeholders, encompassing shareholders, partners, and consumers. The resolute commitment of the Shariah committee to transparency is evident by its publication of thorough instructions that precisely distinguished between the categories of products that were sanctioned and those considered inappropriate. Aldohni (2014) highlighted the significance of developing transparent avenues of communication between Shariah committees and shareholders. This strategy is essential to foster trust and ensure compliance with legal standards.

The Shariah committee's persistent dedication to attention to detail and precision in their decision-making process was also acknowledged by the participants. The committee emphasized that decisions are strictly built on solid reasons, underscoring the committee's unshakable commitment to preserving Shariah principles. This finding is consistent with the study by Alziyadat and Ahmed (2019), which stressed the value of developing robust Shariah decision-making processes in Islamic financial organizations.

It is imperative to acknowledge that the individuals involved in this study expressed favorable sentiments concerning the efficacy of the Shariah committee. However, it is crucial to consider that their perspectives might be subject to potential bias due to their association with the Islamic bank. To enhance the depth of comprehension, it would be advantageous to integrate the viewpoints of external stakeholders, including regulators, scholars, and customers, into forthcoming research endeavors. In general, the results of this study are consistent with the existing body of literature on the subject of Shariah risk management in Islamic banks. The prioritization of precise information, open and honest communication, and meticulous decision-making procedures within Shariah committees align seamlessly with prior research findings. The pivotal significance of Shariah committees lies in their responsibility to furnish clients with unambiguous and precise information while simultaneously upholding transparent lines of communication with stakeholders. This imperative function guarantees Shariah compliance and bolsters Islamic banks' credibility.

This makes a valuable contribution to the current body of knowledge by delving into the specific context of the Kingdom of Saudi Arabia. Future research has the potential to broaden its scope by encompassing additional jurisdictions and conducting a comparative analysis of the practices and efficacy of Shariah committees in diverse nations. Furthermore, it would be highly advantageous to explore the perspectives held by external stakeholders to acquire a comprehensive and all-encompassing comprehension of the intricacies surrounding Shariah risk management within the realm of Islamic banks.

5.3 Consultative Role

The study's participants underscored the consultative essence of the committee, emphasizing its role in offering guidance and recommendations throughout the approval process for novel products or services. This consultative role is of utmost importance to guarantee the adherence of these offerings to Islamic law principles. The consultative nature of the Shariah Committee is underpinned by prior research conducted in the field. Ahmad and Halim (2014) conducted seminal research in which they analyzed the critical function of Shariah committees inside Islamic banks. Their research showed that these committees ensure that goods and services comply with Islamic values by providing advice and consultation. Shariah committees play a crucial advisory role in ensuring Shariah compliance, and Bahari and Baharudin (2016) conducted a thorough analysis of Shariah governance systems inside Islamic banks to shed light on this.

The Shariah Committee is responsible for providing advice and taking on an executive role in the company by carefully monitoring the rollout of Shariah-compliant goods and services. Study participants understood that the committee was responsible for monitoring and assessing the implemented offers to ensure they were still according to Islamic standards. Research by Hamza *et al*. (2013) analyzed the procedures of Shariah committees at Islamic banks, which support the committee's executive function. It has been found that Shariah committees can guarantee adherence and take necessary steps, such as the suspension of transactions that do not conform with the mandated norms.

The results also highlighted the significance of the Shariah Committee's influence and obligation to ensure conformity to Islamic principles. The participants recognized and respected the committee's right to terminate any transaction deviating from Islamic Shariah's core values. Similarly, Grassa (2013) advocated the value of Shariah committees in supporting the compliance of Islamic banks to Shariah principles. The author stated that the Shariah committees play a crucial role in ensuring compliance by having the authority to halt transactions that do not follow the guidelines of Islamic Shariah.

During the approval procedure for unique products or services, the committee provides crucial counseling by providing insightful advice and suggestions. It demonstrates the significance of the committee to maintain a strict commitment to Islamic values and conformity with its teachings. Furthermore, the executive function of the committee in its oversight and monitoring of approved offerings serves as a testament to its power to ensure adherence and halt transactions that do not meet compliance standards. The oversight and jurisdiction of the Shariah Committee in ensuring adherence to Islamic principles are crucial for upholding the integrity and credibility of Islamic financial institutions.

6. Conclusion

The study culminates by shedding light on the profound significance of Shariah committees in effectively navigating and mitigating risk within the realm of Islamic banking. The research sought to address a notable gap in the existing literature by exploring avenues to enhance the participation of Shari'ah committees in risk management practices within the unique context of Islamic banking. The research suggests fostering collaboration between Shari'ah committees, senior management, and risk management professionals within Islamic Banks. This can be achieved through regular forums, workshops, and training sessions. It further emphasizes the need to embrace technological tools for risk management that align with Shari'ah principles. This includes leveraging advanced software solutions for risk assessment and monitoring while ensuring compliance with Islamic finance standards.

Despite a comprehensive analysis, there are still some limitations of the study which include the geographical focus that primarily centers on Islamic banking institutions situated within the Kingdom of Saudi Arabia (KSA). While essential for the study's contextual relevance, this geographic constraint may limit the broader applicability of findings to other Islamic financial systems operating in diverse national contexts. Additionally, the qualitative nature of the research approach, while providing depth, brings inherent limitations, including restricted sample size and the subjectivity of data interpretation. The study's emphasis on the role of Shariah Committees in risk management, though crucial, may inadvertently sideline other aspects of corporate governance within Islamic banking. Lastly, the study lacks a comprehensive integration of perspectives from various stakeholders. These limitations highlight the need for future research to adopt a nuanced methodology, considering diverse stakeholders and ensuring a more comprehensive understanding of the Shari'ah Committee's connection to risk management in Saudi Arabian Islamic banks.

7. Future Research Direction

After a thorough review of the identified limitations, numerous insightful suggestions can be put forth for the pursuit of future research endeavors. Future research efforts must embrace the concept of performing a thorough cross-cultural study, one that spans a large number of different areas or nations if they are to adequately examine the complexities of this topic. In the pursuit of advancing research, it is imperative to encompass the invaluable viewpoints of various stakeholders, ranging from esteemed regulators and shareholders to borrowers, depositors, and non-Islamic banking entities. Every stakeholder involved possesses a myriad of distinctive insights and experiences about the realm of Islamic banking practices, thereby offering invaluable contributions towards the attainment of a comprehensive comprehension of risk management within the Islamic banking sector. To fully comprehend the dynamic and ever-changing landscape of practices and regulations within the Islamic banking sector, future studies are encouraged to embrace the invaluable longitudinal approach. Furthermore, the present study delves into the intricate realm of specific factors that exert influence on the engagement of Shariah committees in the realm of risk management. Future investigations may be directed towards a more refined examination of distinct variables and their consequential impact. Moreover, an intriguing avenue for future research lies in the realm of conducting a comprehensive comparative analysis, delving into the intricate nuances of risk management practices employed by Islamic and conventional banks. This endeavor has the potential to illuminate the distinctive perils and complexities inherent in the realm of Islamic banking, while concurrently offering bespoke remedies meticulously crafted to address them.

References

Abdul Rahman, A.R. (2010), “Shariah audit for Islamic financial services: The needs and challenges”, *The Journal of Muamalat and Islamic Finance Research*.

Abu Hussain, H. and Al-Ajmi, J. (2012), “Risk management practices of conventional and Islamic banks in Bahrain”, *The Journal of Risk Finance*, Vol. 13 No. 3, pp.215-239.

Ahmad, A.A. and Halim, M.A.A. (2014), “The concept of hedging in Islamic financial transactions”, *Asian Social Science*.

Ahmad, N. F. G. and Abdul-Rahman, A. (2020), “Shari'ah governance and audit assurance in Islamic banks”, In *Growth and Emerging Prospects of International Islamic Banking* (pp. 278-297). IGI Global.

Ahmed, H. (2014), “Islamic banking and Shari’ah compliance: a product development perspective”, *Journal of Islamic finance.*, Vol. *3* No. 2, pp.15-29.

Al Rahahleh, N., Ishaq Bhatti, M., and Najuna Misman, F. (2019), “Developments in risk management in Islamic finance: A review”, *Journal of Risk and Financial Management*, Vol. 12 No. 1, p.37, https://doi.org/10.3390/jrfm12010037

Alahmadi, H.A., Hassan, A.F., Karbhari, Y. and Nahar, H.S. (2017), “Unravelling Shariah audit practice in Saudi Islamic Banks”, *International Journal of Economic Research*, Vol. 14 No. 15, pp.255-269.

Aldohni, A.K. (2014), “Morality and religion: Complementing or complicating corporate governance”, *Journal of Religion and Business Ethics*, Vol. *3* No. 1, pp.1-13.

Alkdai, H.K.H. and Hanefah, M.M. (2012), “Audit committee characteristics and earnings management in Malaysian Shariah-compliant companies”, *Business and management review*, Vol. 2 No. 2, pp.52-61.

Alkhamees, A. (2013), “The impact of Shari’ah governance practices on Shari’ah compliance in contemporary Islamic finance”, *Journal of Banking Regulation*, Vol. 14, pp.134-163.

Alziyadat, N. and Ahmed, H. (2019), “Ethical decision-making in Islamic financial institutions in light of Maqasid Al-Sharia: A conceptual framework”, *Thunderbird International Business Review*, Vol. 61 No. 5, pp.707-718.

Aman, A. (2020), “Islamic marketing ethics for Islamic financial institutions”, *International Journal of Ethics and Systems*, Vol. 36 No. 1, pp.1-11.

Arwani, A. (2018), “Issues and challenges of shariah auditing in Islamic financial institution and corporate governance compliance”, *Media Riset Akuntansi, Auditing & Informasi*, Vol. 18 No. 2, pp.169-186.

Ayub, M., Hassan, M.K. and Saba, I. (2023), "Revisiting the paradigm of Sharīʿah governance of Islamic financial institutions" *Journal of Islamic Accounting and Business Research*.

Aziah Abu Kasim, N. (2012), "Disclosure of Shariah compliance by Malaysian takaful companies", *Journal of Islamic Accounting and Business Research*, Vol. 3 No. 1, pp.20-38.

Binti Kasim, N., Ibrahim, S.H.M. and Sulaiman, M. (2009), "Shariah auditing in Islamic financial institutions: exploring the gap between the 'desired'and the 'actual' ", *Global economy and finance journal*, Vol. 2 No. 2, pp.127-137.

Boyatzis, R.E. (1998), "Transforming qualitative information: Thematic analysis and code development", Sage.

Chapra, M.U. and Ahmed, H. (2002), "Corporate governance in Islamic financial institutions", Occasional Paper No. 6, Jeddah, IRTI/IDB.

Coffin, Bill. (2009), "The 2008 Financial Crisis: A Wake-up Call for Enterprise Risk Management". New York: Risk and Insurance Management Society, Inc., available online: **http//:www.community.rims.org/RIMS**

ElGamal, M. A. (2008), "Incoherence of Contract-based Islamic Financial Jurisprudence in the Age of Financial Engineering." *Wisconsin International Law Journal,* Vol. 25 No. 4, pp.605-623.

Ernst and Young (2011), "A Brave New World of Sustainable Growth, The World Islamic Banking Competitiveness Report 2011-2012", Dubai, available at: https://issuu.com/omaralami/docs/wibc_competitiveness_report_2011-12 (accessed 16 Oct 2023)

Fatmawati, D., Ariffin, N.M., Abidin, N.H.Z. and Osman, A.Z. (2022), "Shariah governance in Islamic banks: Practices, practitioners and praxis". *Global Finance Journal*, Vol. 51, p.100555.

Grais, W. and Pellegrini, M. (2006), *Corporate governance and Shariah compliance in institutions offering Islamic financial services* (Vol. 4054). World Bank Publications.

Grassa, R. (2013), "Shariah supervisory system in Islamic financial institutions: New issues and challenges: A comparative analysis between Southeast Asia models and GCC models". *Humanomics*, Vol. 29 No. 4, pp.333-348.

Hamza, A.S., Khalifa, S.S., Hamza, H.S. and Elsayed, K. (2013), "A survey on inter-cell interference coordination techniques in OFDMA-based cellular networks", *IEEE Communications Surveys and Tutorials*, Vol. 15 No. 4, pp.1642-1670.

Haridan, N.M., Hassan, A.F. and Karbhari, Y. (2018), "Governance, religious assurance and Islamic banks: Do Shariah boards effectively serve?", *Journal of Management and Governance*, Vol. 22, pp.1015-1043.

Hassan, A., Sohail, M. S., & Munshi, M. M. R. (2022). Sharīʿah governance and agency dynamics of Islamic banking operations in the Kingdom of Saudi Arabia. ISRA International Journal of Islamic Finance, 14(1), 89-106.

Hassan, M.K. and Aliyu, S. (2018), "A contemporary survey of Islamic banking literature. Journal of Financial Stability", Vol. 34, pp.12-43.

Hassan, M.K. and Mollah, S. (2014), "Corporate governance, risk-taking and firm performance of Islamic banks during global financial crisis", *In Finance and development in Islamic economies conference*, pp.1-36.

Iqbal, Z. and Mirakhor, A. (2011). *An introduction to Islamic finance: Theory and practice*, John Wiley & Sons, Asia.

Isa, M., Lee, S.P., Bacha, O.I. and Ahmad, R. (2022), "Some thoughts on resetting the roles and functions of Sharīʿah committees of Islamic banks in Malaysia", *ISRA International Journal of Islamic Finance*, Vol. 14 No. 2, pp.175-189.

Kalapodas, E. and Thomson, M.E. (2006), "Credit risk assessment: a challenge for financial institutions", *IMA Journal of Management Mathematics*, Vol. 17 No. 1, pp.25-46.

Kayed, R.N. and Hassan, M.K. (2011), "The global financial crisis and Islamic finance", *Thunderbird International Business Review*, Vol. 53 No. 5, pp.551-564.

Khan, F. (2010), "How 'islamic'is islamic banking?", *Journal of economic behavior & organization*, Vol. 76 No. 3, pp.805-820.

Kontot, K., Hamali, J. and Abdullah, F. (2016), "Determining factors of customers' preferences: A case of deposit products in islamic banking", *Procedia-Social and Behavioral Sciences*, Vol. 224, pp.167-175.

Masruki, R., Hanefah, M.M. and Dhar, B.K. (2020), "Shariah governance practices of Malaysian Islamic banks in the light of Shariah compliance", *Asian Journal of Accounting and Governance*.

Mohammed, N. F., Mohd Fahmi, F. and Ahmad, A. E. (2019), “The need for Islamic accounting standards: the Malaysian Islamic financial institutions experience”, *Journal of Islamic Accounting and Business Research*, Vol. 10 No. 1, pp.115-133.

Mulyany, R. (2008). “Shariah audit for Islamic financial institutions: perceptions of accounting academicians, audit practitioners, and Shariah scholars”, Masters Dissertation, International Islamic University Malaysia.

Murray, C.D. and Wynne, J. (2001), “Using an interpreter to research community, work and family”, *Community, Work and Family*, Vol. 4.

Murunga, P.M. (2017), “*Financial risk management as a tool for improving financial performance in real estate investment in Nairobi county*” (Doctoral dissertation).

Noordin, N.H. and Kassim, S. (2019), “Does Shariah committee composition influence Shariah governance disclosure? Evidence from Malaysian Islamic banks”, *Journal of Islamic Accounting and Business Research*, Vol. 10 No. 2, pp.158-184.

Omar, M. (2019), “Issues and Challenges of Shari’ah Compliance Auditing in Islamic Financial Institutions”, *Advanced International Journal of Banking, Accounting and Finance*, Vol. 1 No. 1, pp.13-24.

Puspitasari, L.L. and Handayani, W. (2020), “Do the Characteristics of Internal Audits and Compliance Functions Affect Sharia Compliance?”, *Journal of Indonesian Economy and Business: JIEB.,* Vol. 35 No. 2, pp.97-111.

Rahman, A.A. and Shahimi, S. (2010), “Credit Risk and Financing Structure of Malaysian Islamic Banks”, *Journal of Economic Cooperation & Development*, Vol. 31 No. 3.

Shamas, G. B. (2019), “Moderating Role of Staff Efficiency in Determining Liquidity Risk Of Islamic Banks In The GCC Countries”.

Siddiquee, N.A. (2010), “Combating corruption and managing integrity in Malaysia: A critical overview of recent strategies and initiatives”, *Public Organization Review*, Vol. 10, pp.153-171.

Thompson, J. (2022). “A guide to abductive thematic analysis”.

Waring, Alan E., and A. Ian Glendon. (1998), “Managing Risk” *Andover: Cengage Learning EMEA*.

Yaacob, H. and Donglah, N.K. (2012), "Shari'ah audit in Islamic financial institutions: the postgraduates' perspective", *International Journal of Economics and Finance*, Vol. 4 No. 12, pp.224-239.

Zainal Abidin, N. H., Mat Yasin, F. and Zainal Abidin, A. (2021), "Independence from the perspective of the Shari'ah committee", *Asian Journal of Accounting Research*, Vol. *6 No*. 2, pp.196-209.