

## Shariah Governance and Compliance

**Advisory Council** – a group of scholars and industry experts that provides strategic guidance on Shariah matters. Related terms: Shariah Advisory Board, Shariah Committee. The council reviews new products, assesses compliance risks, and advises on governance policies. For example, a bank launching an Islamic mortgage may seek the council's opinion on the contract structure to ensure it aligns with Murabaha principles. Practical application includes drafting minutes of meetings, documenting recommendations, and integrating feedback into product development pipelines. Challenges often arise from differing scholarly opinions, which can delay product launches and increase legal costs. Effective councils balance scholarly rigor with commercial pragmatism, fostering a culture of continuous improvement.

**Board of Directors** – the highest corporate authority responsible for overseeing overall strategy, risk, and compliance, including Shariah governance. Related terms: Governance Framework, Executive Committee. Directors must ensure that the institution's activities are consistent with Islamic law and that appropriate internal controls exist. An example is a fintech company that appoints a director with Shariah expertise to monitor algorithmic trading for compliance with Riba prohibitions. Practical steps include setting key performance indicators for Shariah compliance, approving annual Shariah audit reports, and allocating budget for compliance functions. The main challenge is aligning fiduciary duties with Shariah obligations, especially when profit-maximisation pressures conflict with ethical constraints.

**Compliance Monitoring** – the systematic process of tracking adherence to Shariah policies, regulations, and contractual obligations. Related terms: Compliance Framework, Ongoing Surveillance. Monitoring involves periodic reviews of contracts, transaction records, and operational procedures. For instance, an Islamic insurance firm conducts quarterly checks to verify that its Takaful contributions are invested in permissible assets. Practical application includes using compliance dashboards, automated alerts for policy breaches, and regular reporting to the Shariah Advisory Council. Challenges include data fragmentation across legacy systems, limited automation tools, and the need for staff with both technical and Shariah expertise.

**Due Diligence** – the comprehensive assessment performed before entering a partnership, investment, or acquisition to verify Shariah compliance. Related terms: Risk Assessment, Shariah Screening. The process evaluates legal documents, financial statements, and operational practices against Islamic principles. For example, before acquiring a conventional bank's portfolio, an Islamic bank conducts due diligence to ensure no interest-bearing assets remain. Practical steps involve checklists, site visits, and consultations with the Shariah Committee. Challenges include incomplete documentation, hidden non-compliant exposures, and time-sensitive deal structures that limit thorough review.

**Ethical Screening** – the evaluation of business activities against moral and religious standards, focusing on prohibited sectors and practices. Related terms: Sectoral Exclusion, Black-list Screening. Screening filters out industries such as alcohol, gambling, and pork production. A practical example is an asset manager using a proprietary database to exclude non-halal equities from an Islamic equity fund. Implementation requires

robust data providers, clear criteria, and periodic updates to reflect changes in business activities. Challenges include inconsistent classification across jurisdictions, limited transparency from target companies, and the need to balance screening rigor with portfolio diversification.

**Fatwa** – a formal legal opinion issued by a qualified scholar on a specific issue of Islamic law. Related terms: Scholarly Ruling, Jurisprudential Opinion. Fatwas guide institutions on complex matters such as the permissibility of cryptocurrency in Islamic finance. For instance, a bank may seek a fatwa to determine whether a blockchain-based payment system complies with Qur’anic prohibitions on uncertainty (Gharar). The practical process involves submitting detailed documentation to a recognized mufti, receiving a written opinion, and integrating the guidance into policy. Challenges include divergent fatwas from different schools of thought, the time required for scholarly review, and the need to translate theological language into operational terms.

**Governance Structure** – the formal arrangement of roles, responsibilities, and reporting lines that ensure effective Shariah oversight. Related terms: Organisational Chart, Accountability Matrix. A typical structure includes the Board of Directors, a Shariah Committee, an Internal Audit function, and an external Shariah Auditor. For example, a sovereign wealth fund may embed a dedicated Shariah compliance unit within its risk department to streamline reporting. Practical implementation involves drafting charters, defining escalation procedures, and establishing performance metrics. Common challenges are overlapping responsibilities, unclear authority levels, and resistance from business units accustomed to conventional governance models.

**Halal Certification** – the official endorsement that a product, service, or process conforms to Islamic dietary and ethical standards. Related terms: Certification Body, Compliance Mark. Certification is often required for food-related financial products, such as sukuk linked to agricultural assets. A practical scenario involves a fintech platform obtaining halal certification for its digital wallet to assure Muslim customers of permissible usage. The certification process includes document review, site inspections, and periodic audits. Challenges include varying certification standards across countries, the cost of maintaining certification, and the risk of revocation if non-compliant practices emerge.

**Islamic Financial Institution (IFI)** – any bank, investment house, or insurance entity that conducts business in accordance with Shariah principles. Related terms: Sukuk Issuer, Takaful Operator. IFIs must embed Shariah governance into all layers of operation, from product design to risk management. For example, a regional Islamic bank may establish a dedicated Shariah risk dashboard to monitor exposure to prohibited assets. Practical steps include staff training, integration of Shariah checks into core banking systems, and regular reporting to regulators. Challenges include competing regulatory expectations, the need for specialised technology, and maintaining consistency across multinational operations.

**Juristic Opinions (Ijma’)** – the consensus of scholars on a particular issue, forming a binding precedent in Islamic jurisprudence. Related terms: Scholarly Consensus, Legal Precedent. Ijma’ is often invoked when contemporary financial innovations lack explicit textual guidance. A real-world example is the adoption of a consensus view that leasing contracts (Ijarah) can be structured to meet modern leasing standards while remaining Shariah-compliant. Practically, institutions document the ijma’ in their policy manuals and

reference it during product approval. Challenges arise when consensus is not universally accepted, leading to divergent implementations across markets.

**Kafalah** – a guarantee or surety provided by a third party, permissible under Islamic law when structured correctly. Related terms: Guarantee, Collateral. In practice, a bank may act as a guarantor for a trade finance transaction, provided the guarantee does not involve interest. The practical application requires drafting a Wakalah agreement that outlines the guarantor's responsibilities without violating Riba. Challenges include ensuring that the guarantee does not create hidden interest, obtaining appropriate insurance, and aligning the guarantee with local regulatory frameworks.

**Liquidity Management** – the process of ensuring that an institution has sufficient cash or liquid assets to meet its obligations while remaining Shariah-compliant. Related terms: Cash Management, Asset Allocation. Islamic banks often use liquid Shariah-compliant instruments such as Salam contracts, commodity Murabaha, or Sukuk to manage short-term funding. For example, a takaful operator may invest surplus premiums in overnight Islamic money market funds to preserve liquidity. Practical steps include setting liquidity ratios, stress testing, and maintaining a diversified pool of permissible assets. Challenges involve limited market depth for liquid instruments, higher transaction costs, and the need to balance liquidity with profitability.

**Mudarabah** – a profit-sharing partnership where one party provides capital and the other provides expertise, with profits distributed according to a pre-agreed ratio. Related terms: Profit-Sharing, Partnership Contract. In a banking context, a Mudarabah account allows depositors to earn returns from the bank's investment activities, subject to Shariah compliance. Practical application requires clear documentation of profit-sharing ratios, transparent reporting of investment performance, and robust internal controls to prevent prohibited activities. Challenges include measuring and attributing profits accurately, managing loss allocation, and ensuring that the underlying investments remain permissible throughout the contract term.

**Nasihah** – the principle of counsel or advice, encouraging ethical behaviour and compliance with Islamic values. Related terms: Ethical Guidance, Moral Advisory. Nasihah is embedded in governance by promoting a culture of integrity and continuous improvement. For instance, a senior Shariah officer may provide nasihah to product development teams, reminding them to avoid excessive uncertainty. Practical implementation includes regular workshops, mentorship programmes, and inclusion of nasihah metrics in performance reviews. Challenges are intangible, as the impact of moral guidance is difficult to quantify, and may clash with short-term commercial pressures.

**Operational Risk** – the risk of loss resulting from inadequate or failed internal processes, people, systems, or external events, with a focus on Shariah-related failures. Related terms: Risk Management, Process Failure. Operational risk in an IFI can arise from mis-classification of assets, erroneous Shariah rulings, or breaches of compliance procedures. A practical example is a processing error that leads to the inadvertent payment of interest on a deposit, violating Shariah. Mitigation strategies include segregation of duties, automated compliance checks, and regular staff training. Challenges include the complexity of integrating Shariah checks into existing IT systems and maintaining vigilance against human error.

**Policy Framework** – a collection of documented policies that define how Shariah governance is executed

across the organization. Related terms: Procedural Manual, Governance Documentation. The framework typically includes a Shariah Policy, Conflict-of-Interest Policy, and Investment Policy. For example, an IFI may adopt a policy stating that all new contracts must receive Shariah approval within ten business days. Practical steps involve drafting, board approval, dissemination to all employees, and periodic review. Challenges include keeping policies up-to-date with evolving jurisprudence, ensuring consistent interpretation, and preventing policy fatigue among staff.

**Qur'anic Principles** – foundational concepts derived directly from the Qur'an that guide Shariah governance, such as prohibition of Riba, Gharar, and Maysir. Related terms: Divine Sources, Core Tenets. Institutions embed these principles in product design, risk assessments, and ethical standards. A concrete example is a sukuk issuance that avoids interest-based cash flows, thereby adhering to the prohibition of Riba. Practical application includes mapping each principle to specific compliance checkpoints and training staff on their theological basis. Challenges involve interpreting ambiguous verses, reconciling differing scholarly opinions, and translating abstract concepts into measurable controls.

**Risk Management** – the systematic identification, assessment, and mitigation of risks that could affect Shariah compliance and overall business objectives. Related terms: Enterprise Risk Management, Compliance Risk. A robust risk management program integrates Shariah risk registers, scenario analysis, and mitigation action plans. For instance, a Islamic micro-finance institution may assess the risk of loan default and its impact on profit-sharing arrangements. Practical steps include establishing risk appetite statements, regular reporting to the Board, and embedding risk controls in product life-cycle processes. Challenges consist of aligning conventional risk metrics with Shariah-specific concerns, securing senior management buy-in, and maintaining a dynamic risk culture.

**Shariah Audit** – an independent review that evaluates the effectiveness of Shariah governance, compliance processes, and adherence to contractual obligations. Related terms: Audit Report, Assurance Engagement. Audits are conducted either internally or by external auditors specializing in Islamic finance. A typical audit may examine the segregation of Shariah-compliant assets, verify that profit-sharing calculations are accurate, and assess the adequacy of documentation. Practical application includes preparing audit work-papers, presenting findings to the Shariah Advisory Council, and implementing corrective actions. Challenges involve the scarcity of qualified auditors, the need for consistent audit standards, and potential conflicts of interest when auditors are also product providers.

**Transparency** – the openness and clarity with which an institution discloses its Shariah governance structures, decisions, and performance. Related terms: Disclosure, Public Reporting. Transparency builds stakeholder confidence and regulatory trust. For example, an Islamic bank may publish an annual Shariah compliance report detailing the volume of Shariah-compliant assets, audit outcomes, and any breaches. Practical measures include maintaining a publicly accessible repository of Shariah rulings, providing real-time dashboards for investors, and ensuring that marketing materials accurately reflect compliance status. Challenges include balancing commercial confidentiality with disclosure requirements and managing reputational risk when minor breaches become public.

**Upholding Shariah** – the commitment of an institution to maintain adherence to Islamic law throughout its

operations, culture, and strategic direction. Related terms: Commitment, Ethical Alignment. Upholding Shariah is reflected in governance charters, employee codes of conduct, and continuous monitoring. A practical illustration is a fintech startup that integrates a Shariah compliance engine into its API, automatically rejecting non-permissible transaction types. Challenges include sustaining long-term dedication amid leadership changes, ensuring that all subsidiaries share the same commitment, and measuring the intangible aspects of ethical alignment.

**Verification Process** – the systematic steps taken to confirm that a product, transaction, or asset meets Shariah standards before execution. Related terms: Validation, Compliance Check. Verification may involve document review, legal analysis, and approval by the Shariah Committee. For instance, before issuing a sukuk, an issuer runs a verification checklist to ensure that cash flows are derived from permissible activities. Practical implementation includes using workflow software to route items for review, maintaining audit trails, and issuing formal certificates of verification. Challenges encompass time-intensive manual reviews, inconsistencies in verification criteria across jurisdictions, and the need for continuous staff training.

**Waqar** – a term denoting dignity and respect, often invoked in governance to ensure that decisions honor Islamic ethical standards. Related terms: Ethical Conduct, Moral Integrity. In practice, waqar influences board deliberations, encouraging members to avoid actions that could bring shame to the institution. For example, a board may reject a lucrative but ethically questionable investment to preserve waqar. Practical steps include embedding waqar into the institution's code of conduct, providing scenario-based training, and evaluating decisions against a waqar-impact matrix. Challenges involve quantifying the effect of dignity on financial performance and resisting short-term profit temptations.

**Xenial (Collaborative) Shariah** – an emerging concept that emphasizes cooperative engagement among scholars, regulators, and industry participants to achieve consistent compliance outcomes. Related terms: Co-operative Governance, Stakeholder Engagement. Xenial approaches may involve joint workshops, shared research platforms, and harmonised standards. A practical case is a regional consortium of Islamic banks that develop a common template for Shariah-compliant trade finance, reducing duplication of effort. Implementation requires clear communication channels, mutual trust, and formal agreements on intellectual property. Challenges include aligning diverse legal jurisdictions, managing competing interests, and maintaining confidentiality while fostering openness.

**Yaqeen** – the state of certainty or confidence, crucial for decision-making in Shariah governance where ambiguity must be minimised. Related terms: Confidence, Assurance. Yaqeen is sought through rigorous documentation, thorough audits, and peer review of scholarly opinions. For example, an IFI may obtain multiple fatwas on a novel product to achieve yaqeen before market launch. Practical mechanisms include cross-checking rulings, maintaining a knowledge repository, and conducting internal simulations. Challenges revolve around the subjective nature of certainty, the potential for analysis paralysis, and the cost of obtaining multiple scholarly endorsements.

**Zakat Compliance** – the process of ensuring that an institution correctly calculates, collects, and distributes Zakat in accordance with Islamic law. Related terms: Charitable Obligation, Wealth Purification. Compliance involves identifying Zakat-eligible assets, applying the appropriate rate (typically 2.5%), and allocating

funds to approved recipients. A practical illustration is an Islamic bank that integrates Zakat calculation modules into its core banking system, automatically generating Zakat statements for each account holder. Implementation steps include establishing a Zakat policy, training staff on asset classification, and conducting annual audits. Challenges include accurately classifying mixed-use assets, reconciling differing regional Zakat rulings, and managing donor expectations regarding the use of Zakat proceeds.