

The Impact of Shariah Non-Compliance Risk on Islamic Financial Institutions

Authors : Ibtissam Mharzi Alaoui, Camélia Sehaqui

Abstract : The success of a bank depends upon its effective risk management. With the growing complexity and diversity of financial products and services, as well as the accelerating pace of globalization over the past decade, risk management is becoming increasingly difficult. thus, all measurement and monitoring functions must be much more vigorous, relevant and adequate. The Shariah non-compliance risk is specific aspect of Islamic finance which ipso facto, deserves particular attention. It affects the validity of all Islamic financial contracts and it turns out to be likely to result in considerable losses on the overall Islamic financial institutions (IFIs). The purpose of this paper is to review the theoretical literature on Shariah non-compliance risk in order to give a clearer understanding of its sources, causes and consequences. Our intention through this work is to bring added value to the Islamic finance industry all over the world. The findings provide a useful reference work for the Islamic banks in structuring (or restructuring) of their own system of shariah risk management and internal control.

Keywords : Shariah non-compliance, risk management, financial products, Islamic finance.

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