



Consultation Paper: Amendments to the Shariah Governance Regulations, 2023

Regulatory Review of Shariah Governance in SECP's regulated sectors

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1. Preamble

Pakistan's financial policy framework is anchored in constitutional and judicial directives mandating the elimination of Riba and the promotion of Shariah-compliant financial alternatives. Within this national mandate, the Securities and Exchange Commission of Pakistan (SECP) plays a central role in advancing Islamic finance while ensuring investor protection, market integrity, and financial stability. In this regard, the SECP regulates a wide spectrum of Shariah-compliant financial services, including the licensing of Takaful operators, authorization of Modarabas, registration of Shariah advisors, and certification of Shariah-compliant structures of securities and companies.

Against this backdrop, this consultation paper undertakes a comprehensive review of the regulatory approach to the approval, certification, and supervision of Shariah-compliant financial products and services across SECP-regulated sectors. It covers engagements with Islamic financial institutions and issuers of Shariah-compliant instruments, such as Sukuk, mutual funds, exchange-traded funds, real estate investment trusts, and pension funds, as well as ancillary areas including Shariah stock screening, development of Islamic indices, and governance of Shariah advisory services by individual advisors and institutional Shariah Supervisory Boards.

The paper is informed by international best practices, including standards issued by the AAOIFI and the IFSB, as well as regulatory models adopted by the Securities Commission Malaysia, the Central Bank of Bahrain, and the Dubai Financial Services Authority, alongside comparable practices in Pakistan's banking sector. These frameworks reflect a spectrum of approaches, ranging from centralized Shariah oversight with binding rulings to decentralized, standards-based regimes supported by robust institutional governance. Collectively, they underscore the effectiveness of a balanced or hybrid model that combines regulatory oversight for market integrity and standardization with strong internal Shariah compliance functions, independent Shariah audits, and reliance on qualified entity-level Shariah boards for product-level approvals.

The analysis highlights key risks arising from weak or fragmented Shariah governance, including erosion of investor confidence, inconsistencies in Shariah interpretation, consumer protection concerns, mis-selling, legal disputes, reputational risks, systemic vulnerabilities, and reduced international acceptability of Pakistani Islamic financial instruments. To address these challenges and strengthen the credibility and sustainability of Islamic finance in Pakistan, there is a need for a coherent and well-calibrated regulatory framework, supported by clear institutional mandates and harmonized Shariah governance standards.

Accordingly, this consultation paper proposes targeted amendments to the Shariah Governance Regulations, 2023, with the objective of achieving an appropriate balance of responsibilities between the regulator, regulated entities, issuers, and Shariah governance mechanisms. It seeks to promote efficiency, enhance transparency, and align Pakistan's regulatory approach with evolving international practices, while preserving the integrity and authenticity of Shariah compliance. Stakeholder feedback is invited on the proposed reforms and the overall policy direction to inform the development of a comprehensive and forward-looking Shariah governance framework.

2. Legal and policy context in Pakistan

Pakistan's constitutional and judicial context, including Article 38(f) of the Constitution and rulings from the Federal Shariat Court (FSC), places a national policy imperative on reducing and ultimately eliminating Riba and promoting Shariah-compliant financial practices. Under the said Article 38(f), the State, and by extension, all its organs including the SECP, is obligated to eliminate Riba by January 1, 2028 and promote Shariah-compliant financial alternatives. On the enforceability of this principle of policy, Article 29(3) requires every authority to act in accordance with it within its mandate and resources.

Accordingly, the SECP has a constitutional and statutory duty, reinforced by Section 20(4) of the SECP Act, 1997, to regulate and facilitate growth of Islamic finance and capital markets in line with Shariah principles. This entails progressively aligning its regulatory frameworks, supervision, and product approvals with Islamic injunctions, coordinating with other state institutions for systemic transition, and ensuring market integrity through effective Shariah governance.

The FSC's rulings have further affirmed this obligation, making the SECP's proactive role essential in realizing Pakistan's constitutional goal of a Riba-free financial system. SECP has explicitly prioritised enabling Islamic finance across its regulated sectors, as articulated in its Strategic Action Plan 2024–26 for the development of Islamic finance, and has issued comprehensive guidelines for offering Islamic financial services within the regulated sectors. Further, the Shariah Governance Regulations, 2023 govern Shariah-compliant companies, securities and Islamic financial institutions under its jurisdiction. These instruments signal SECP's dual role: (a) promote development of Islamic finance, and (b) ensure market integrity and investor protection.

3. Distinct roles: SECP review vs entity Shariah advisors

Firstly, the SECP functions as a public-interest regulator endowed with statutory powers to authorize, supervise, and sanction entities and activities within the capital market and non-bank financial sectors. It ensures that market conduct, disclosure, and governance practices align with public policy objectives such as investor protection, market stability, and financial integrity. The SECP is ultimately accountable to the public through statutory reporting and parliamentary oversight. Therefore, the SECP is mandated to ensure the authenticity and quality of Islamic financial services within its regulated sectors through a robust regulatory framework. This responsibility entails ensuring that Shariah-compliant products are genuinely aligned with Islamic principles rather than conventional structures in disguise. In practice, the SECP fulfills this mandate through the licensing of Modarabas, authorization of Takaful operators, approval of structures of Sukuk, Islamic securities, and Shariah-compliant companies; and registration of qualified Shariah advisors, while advancing reforms such as Shariah governance and oversight frameworks. By promoting transparency, consistency, and doctrinal integrity, SECP safeguards investor confidence and strengthens Pakistan's transition toward a credible, Riba-free financial system.

Conversely, entity-level Shariah advisors or Shariah Supervisory Boards (SSBs) operate within individual Islamic financial institutions (IFIs) or issuers. Their core function is to issue fatwas (juristic opinions), guide product structuring, and certify Shariah compliance of financial instruments or corporate activities. While their role is indispensable for doctrinal legitimacy, their accountability is internal, primarily to the appointing institution and its stakeholders, rather than to the public at large. For instance, a Modaraba's Shariah advisor approving a new

Murabaha financing structure acts on behalf of the Modaraba's management and certificate holders, but the opinion itself has no enforceable status outside that institution unless reviewed or endorsed by the regulator.

Secondly, the SECP's competencies lie in its regulatory and enforcement authority, it ensures legal enforceability of financial contracts, sets and monitors disclosure standards, assesses prudential and market-structure risks, and administers sanctions and remedies for misconduct. Its strength is institutional oversight: ensuring that products like Sukuk, mutual funds, and Islamic REITs comply with both the Companies law and investor protection regulations. In contrast, Shariah advisors possess expertise in fiqh al-muamalat (Islamic commercial jurisprudence), focusing on underlying contract, rights and obligations of contracting parties and overall Shariah compliance. They assess the doctrinal soundness of Shariah structures, such as determining whether a Sukuk al-Ijarah genuinely reflects asset-backed ownership or whether contract-based financing adheres to Shariah principles. Their competency lies in applying juristic reasoning (ijtihad) to evolving market instruments, a skill beyond the technical and legal purview of regulators.

Thirdly, the comparable practices from international and local regulatory authorities and standard setting bodies demonstrates that effective Islamic financial regulation depends on complementarity between regulatory and Shariah supervisory functions. Regulatory review ensures uniform standards, investor confidence, and systemic stability, while Shariah advisors safeguard doctrinal integrity and ethical authenticity. For example, in Malaysia, Bank Negara Malaysia and the Securities Commission Malaysia exercise centralized Shariah oversight to maintain consistency across institutions, while each financial entity retains its own Shariah committee for product-level certification. In Pakistan, the State Bank of Pakistan also requires Islamic banks to submit the salient features of the products along with certificate from their Shariah board before the launch of new products and services.

Fourthly, in Pakistan, Shariah scholars belong to diverse schools of thought and often hold varying interpretations on financial matters. While this intellectual diversity enriches the academic landscape, it may also lead to inconsistency in product structures and market practices if not harmonized. Therefore, as a regulator, the SECP, responsible for ensuring the consistency of Pakistan's Islamic capital market with international standards, reviews products and structures in light of the standards issued by AAOIFI and IFSB. Sole reliance on institution-level Shariah opinions, without regulatory review against these benchmarks, could result in fragmented interpretations and inconsistencies across financial products, ultimately undermining investor confidence and market coherence.

Therefore, both functions are although complementary but serve different purposes. If only one function operates in isolation, crucial gaps arise: without regulatory oversight, divergent Shariah interpretations may lead to fragmented markets and reputational risk; without qualified Shariah input, products risk doctrinal non-compliance and loss of investor trust. Hence, a well-coordinated dual framework, where the SECP enforces systemic standards and Shariah advisors ensure substantive compliance, creates a balanced ecosystem that upholds both market integrity and Shariah legitimacy.

4. Potential risk analysis of different approaches of Shariah review

A comparative risk analysis between regulatory-led and entity-led Shariah review highlights the critical need for balance between oversight and autonomy within SECP's Islamic finance framework. Under a regulator-led or oversight-based model, where the SECP retains

authority for reviewing and approving Shariah structures, the risks to market integrity and investor confidence remain minimal. Regulatory validation ensures impartiality, consistency with global standards such as AAOIFI and IFSB, and strengthens public trust. This approach prevents doctrinal fragmentation, ensures comparability of products, and enhances consumer protection through accurate disclosures, clear labeling, and transparent marketing of Islamic financial products. Moreover, regulatory involvement mitigates legal uncertainty by ensuring standardized documentation and rulings that enhance contract enforceability and reduce judicial disputes. Systemic and reputational risks are likewise contained, as the SECP can detect and address Shariah non-compliance early, preserving market stability and sustaining international investor confidence. The trade-off, however, lies in moderate implementation costs, developing internal Shariah expertise and review mechanisms may initially slow product approvals but ultimately strengthens institutional credibility and market discipline.

In contrast, a fully delegated or entity-led Shariah review model, where regulated institutions' own Shariah advisors hold exclusive responsibility for certification, introduces significantly higher risks. Without impartial regulatory validation, investor confidence can weaken due to perceived conflicts of interest and self-certification. Divergent interpretations among institutional Shariah boards may cause doctrinal fragmentation and non-comparable products, issues previously seen in early Sukuk markets, where inconsistent Tawarruq rulings led to market confusion and reputational strain. Consumer protection risks also rise, as issuers might prioritize commercial objectives over doctrinal integrity, resulting in mis-selling or cosmetic compliance where conventional instruments are merely rebranded as Islamic. The absence of regulatory oversight further increases legal uncertainty, as inconsistent fatwas and documentation complicate enforcement. Over time, these weaknesses may lead to systemic contagion and reputational damage, undermining Pakistan's credibility in global Islamic finance markets and restricting access to international investment and index inclusion, given global investors' preference for jurisdictions with recognized regulatory involvement. While this model offers greater flexibility and faster innovation, the long-term costs include erosion of trust, doctrinal inconsistency, and diminished market discipline.

Given these trade-offs, the SECP is considering to avoid either extreme, excessive regulatory control that stifles innovation and responsiveness, or complete deregulation that risks doctrinal inconsistency and reputational loss. As the Islamic financial services industry under SECP's purview remains fragmented and still at a nascent stage of institutional development, a cautious and phased decentralization is warranted. Unlike mature jurisdictions with established market infrastructure and supervisory experience, Pakistan's ecosystem requires sustained regulatory guidance, alignment, and capacity building before autonomy can be expanded safely.

In the short to medium term, SECP may therefore retain a structured oversight role while progressively empowering market participants. This includes investing in human capital development, strengthening certification and accreditation of Shariah advisors, and mandating robust internal compliance mechanisms within entities. In parallel, the industry should focus on standardizing baseline Shariah-compliant products and structures that are broadly accepted across institutional Shariah boards, thereby reducing interpretative divergence and enhancing investor confidence. Concurrently, SECP should develop comprehensive guidelines, adopt global standards, and enhance its internal monitoring and enforcement capabilities.

Ultimately, the most effective model lies in a hybrid approach that balances regulatory oversight with institutional autonomy. Under this co-governance framework, the SECP may

maintain authority for reviewing and approving Shariah structures of systemically significant or publicly offered products, while institutional Shariah boards handle operational-level compliance and internal Shariah audits. Such calibrated division of responsibilities preserves investor confidence, doctrinal authenticity, and international credibility while granting market participants the flexibility to innovate responsibly within a harmonized, Shariah-compliant regulatory environment. This sequenced, capacity-driven model offers the most sustainable pathway toward a credible, innovative, and inclusive Islamic financial system in Pakistan.

5. Proposed Amendments

The proposal has been prepared to formally adopt a hybrid Shariah governance model that balances regulatory oversight with institutional autonomy. The salient features of the proposed amendments to the Regulations are as follows:

- i. In line with the policy decision for gradual decentralization of Shariah supervision, it is proposed to empower the company-level Shariah Supervisory Board (SSB) or Shariah Advisor to approve the Shariah-compliant status of companies other than regulated persons, while retaining SECP's authority for regulated persons. This, along with appropriate reporting requirements, is aimed at enhancing efficiency and reducing regulatory bottlenecks, while ensuring continued oversight of entities with greater systemic significance and investor protection considerations.
- ii. In line with the reporting mechanism applicable to repeat issuers using the same Shariah structure, it is proposed to replace the approval requirement with a reporting regime for Islamic Collective Investment Schemes based on standardized structures of *Wakala*. This would facilitate ease of doing business and expedite time-to-market, while maintaining adequate regulatory visibility.
- iii. To simplify procedural requirements, it is proposed to replace the existing requirement of registration of a member of the SSB with a reporting requirement for the establishment or any change in the composition of the SSB. This would reduce administrative burden while ensuring transparency, given that such advisors are already registered with SECP.
- iv. To streamline the regulatory framework, it is proposed to omit the requirement for a registered Shariah advisory company to obtain separate certification as a Shariah-compliant company, as this creates regulatory overlap without adding substantive value.

In addition to the above, minor and consequential amendments have also been proposed to enhance regulatory coherence, remove ambiguities, and ensure consistency in the application and interpretation of the Regulations. A detailed comparative statement is attached as Annexure-A.

6. Conclusion and Way Forward

A balanced and phased regulatory strategy, where SECP provides leadership through oversight, capacity building, and standardization while progressively empowering industry participants, will safeguard Shariah authenticity, investor trust, and systemic stability. This hybrid governance approach represents not only regulatory prudence but also Pakistan's

commitment to developing a credible, innovative, and globally competitive Islamic financial system.

This consultation paper invites stakeholders to review and provide feedback on the subject for developing a robust framework for regulatory review of shariah structures of financial products and securities in Pakistan, as per the following

Format for sharing feedback/comments

Any feedback should be sent via email to islamic.finance@secp.gov.pk or by post to the Head of Islamic Finance Department, SECP Head Office, NICL Building, Jinnah Avenue, Islamabad, in the following format.

Name of the Commenter	
Name of the related Entity	

Sr. No.	Existing provisions in the Regulation	Proposed Changes in track-change format	Rationale for the change

Confidentiality

If you wish to keep all or any parts of your submission and your identity confidential, please indicate the same. In all other cases, your provided comments may be made public, except your contact information.

Indicative Timeline

Stage	Date/Timeline	Detail
1	dd-Apr-2026	SECP releases Consultation Paper
2	Within 15 days of issuance of Consultation Paper	Comments due on consultation paper
3	Within 15 days of receipt of comments on Consultation Paper	Stakeholder consultation/ roundtables
4	Within 30 days of conclusion of stakeholder consultation /roundtables	Issuance of final regulations

Disclaimer

- *The objective of the issuance of the consultation paper is to seek stakeholders' feedback as required under section 512 of the Act on the proposed regulations.*
- *SECP is fully empowered, at its discretion, to accept or not to accept a recommendation in accordance with its mandate and policy objectives.*
- *SECP reserves the right not to publish any submission received where SECP considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.*
