

Transitioning Conventional Banks to Islamic Finance:

Global Lessons
and Strategic
Frameworks

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Executive Summary

The global banking landscape is witnessing a paradigm shift as financial institutions and regulators explore conversion from conventional, interest-based operations to Islamic finance. This transition reflects both rising ethical-finance awareness and the proven resilience of Islamic banking during periods of systemic stress. The transformation, however, requires deep structural, legal, and cultural realignment.

This paper synthesizes international experience from Malaysia, Indonesia, Pakistan, the Gulf Cooperation Council (GCC), and selected non-Muslim jurisdictions to present a strategic framework for successful conversion. It identifies five inter-related pillars of readiness—regulatory infrastructure, Shari’ah governance, operational architecture, liquidity management, and transparency—and integrates them into a phased roadmap adaptable to diverse markets.

The study concludes that conversion is viable and commercially sustainable when supported by enabling regulation, independent Shari’ah supervision, skilled human capital, and robust liquidity tools such as sukuk and Islamic interbank facilities. Policymakers should prioritize harmonization of AAOIFI and IFSB standards, while institutions should invest in digital transformation to bridge compliance and efficiency. The proposed model offers both practitioners and regulators a pathway for balancing faith-based ethics with modern prudential objectives.

Abstract

This research explores the strategic, regulatory, and operational dimensions of converting conventional banks into Islamic financial institutions. By combining jurisprudential analysis with comparative policy review, it provides a comprehensive understanding of how transformation can be achieved without compromising financial stability. Drawing on standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), the paper identifies the enabling factors that differentiate successful conversions from partial or failed attempts.

Through qualitative synthesis of cross-country experiences and secondary empirical data, the study reveals that effective Shari'ah governance, liquidity infrastructure, and legal certainty are essential for sustainable conversion. The paper contributes to professional practice by proposing a four-phase roadmap—from diagnostic assessment to post-conversion audit—designed for regulators, boards, and executives. Findings underscore that conversion initially compresses profitability but yields long-term gains in transparency, inclusion, and resilience.

Keywords: Islamic banking, bank conversion, Shari'ah governance, liquidity management, sukuk markets, AAOIFI standards, IFSB principles.

Introduction

1. Context and Rationale

Over the last four decades, Islamic finance has evolved from a niche ethical movement into a sophisticated component of the global financial system. As of 2024, Islamic financial assets exceed US \$3 trillion, with double-digit growth rates in markets across Asia, the Middle East, Africa, and Europe (IFSB, 2024). What distinguishes Islamic banking from its conventional counterpart is its adherence to the principles of *maqāṣid al-Sharīʿah*—the objectives of Islamic law—which emphasize justice, transparency, and shared prosperity (Chapra, 2016).

The post-2008 financial crisis and, later, the COVID-19 pandemic reignited interest in Islamic banking's risk-sharing architecture. Conventional banks observed that Islamic models demonstrated greater balance-sheet resilience and lower default rates due to asset-backed financing structures (Hassan & Aliyu, 2018). As a result, several governments—including Indonesia, Pakistan, and Nigeria—adopted policies encouraging conventional institutions to transition wholly or partially into Islamic modes.

Beyond regulatory incentives, social demand also drives change. Younger, financially literate consumers increasingly seek products that reflect ethical or faith-aligned values. Global surveys by Thomson Reuters (2023) show that more than 60 percent of Muslim consumers would switch banks if Islamic alternatives were available. For executives, therefore, conversion is both a market-expansion strategy and a reputational investment.

2. Problem Statement

Despite the conceptual appeal, conversions remain operationally complex. Conventional banks operate within interest-based frameworks deeply embedded in their legal, accounting, and technological infrastructure. Transitioning requires simultaneous transformation of governance structures, product design, risk-management systems, and human resources. In many jurisdictions, legal and tax codes still lack explicit recognition of Islamic contracts such as *murābaḥah* (cost-plus sale), *mushārah* (partnership), and *ijārah* (lease).

Empirical evidence demonstrates mixed results. While Malaysian and Indonesian conversions achieved sustainable growth, other attempts—such as early experiments in Egypt and Sudan—encountered operational inefficiencies and liquidity constraints (Kahf & Hassan, 2017). The absence of standardized Shari’ah governance, limited human capital, and inadequate liquidity instruments often impede success. Therefore, the central research problem addressed by this paper is: How can conventional banks transition to Islamic finance frameworks effectively while maintaining regulatory compliance and operational viability?

3. Objectives and Research Questions

This study pursues three objectives:

1. To identify the regulatory and institutional enablers that facilitate successful conversion.
2. To analyze empirical experiences from multiple jurisdictions to derive comparative lessons.
3. To propose a structured, implementable roadmap integrating prudential and Shari’ah requirements.

The guiding research questions are:

- What are the primary legal and governance prerequisites for conversion?
- How do AAOIFI and IFSB standards influence policy harmonization and institutional compliance?
- What operational and liquidity challenges emerge during conversion, and how can they be mitigated?
- What phased roadmap can ensure both Shari'ah integrity and financial stability?

4. Significance of the Study

This paper contributes simultaneously to academic discourse and professional practice. Academically, it enriches the limited comparative literature on conversion by synthesizing findings across regions. Professionally, it serves as a practical manual for executives, regulators, and consultants engaged in transformation planning. By aligning Shari'ah principles with Basel-aligned prudential norms, it bridges the perceived gap between religious compliance and modern risk management.

Furthermore, the research addresses Sustainable Development Goal 8 (Decent Work and Economic Growth) by promoting inclusive, ethical finance. Conversion processes stimulate innovation in fintech, compliance technology (RegTech), and capacity building—areas critical for the future competitiveness of Islamic financial institutions.

5. Scope and Delimitations

The scope encompasses national and institutional conversion strategies undertaken since 2000, focusing on case studies from Malaysia, Indonesia, Pakistan, and GCC countries.

Partial conversions (Islamic windows) and digital Islamic banking models are included. The paper does not attempt to provide a quantitative performance regression; rather, it employs qualitative synthesis of existing empirical and policy literature. Non-bank Islamic institutions such as takaful (insurance) or Islamic microfinance are referenced only where relevant to regulatory frameworks.

6. Structure of the Paper

The remainder of the paper is organized as follows:

- Section 2: Comprehensive literature review covering jurisprudential, institutional, operational, and technological perspectives.
- Section 3: Methodology and conceptual framework outlining the analytical model used.
- Section 4: Findings and discussion integrating empirical results and thematic insights.
- Section 5: Roadmap and recommendations translating lessons into actionable steps for policymakers and executives.
- Section 6: Conclusion highlighting strategic implications and directions for future research.

7. Contribution and Originality

The originality of this work lies in its dual focus: it unites doctrinal analysis with practical implementation. While earlier literature examined Islamic banking either through theological or macro-economic lenses, few studies have articulated an integrated roadmap that connects Shari'ah governance, liquidity management, and technological transformation within a single framework. This paper advances that integration. It also incorporates post-pandemic digital trends and environmental, social, and governance (ESG) considerations—topics increasingly relevant to central banks and investors alike.

8. Ethical and Theoretical Foundation

Conversion to Islamic finance aligns with the ethical imperative of *adl* (justice) and the economic principle of *maslahah* (public interest). Theoretically, the study is anchored in institutional-change theory (North, 1990) and stakeholder theory (Freeman, 2010), positing that organizations evolve through the interaction of regulatory pressures, social expectations, and leadership values. Islamic finance embodies this interaction by embedding ethical constraints within market mechanisms. Therefore, the research situates conversion not merely as a regulatory event but as a transformative journey of institutional culture.

9. Anticipated Outcomes

By synthesizing cross-regional experiences and regulatory frameworks, the study is expected to:

1. Produce a detailed comparative model illustrating the stages and critical success factors of conversion.
2. Clarify how Shari'ah governance and liquidity instruments interact to preserve stability.
3. Offer practical policy templates that can be localized by central banks and financial institutions.

The anticipated outcome is a professional yet academically credible reference document for policymakers, consultants, and scholars seeking to operationalize Islamic-finance transformation.

2. Literature Review

2.1 Historical Evolution of Islamic Banking

Modern Islamic banking emerged in the mid-20th century as a response to Muslim economists' call for financial systems aligned with Shari'ah principles (Siddiqi, 1983; Chapra, 2016). Early experiments such as the Mit Ghamr Savings Bank in Egypt (1963) and the Dubai Islamic Bank (1975) demonstrated that commercial intermediation could function without interest-based lending (Wilson, 1997). Subsequent decades saw institutional consolidation through national reforms in Malaysia, Pakistan, and Iran, culminating in a global industry recognized by the IMF (2017) and the World Bank (2018) as systemically relevant.

Historically, the movement progressed through three stages. Stage 1 (1960s–1980s) focused on conceptual legitimacy and the development of basic contracts such as *murābahah* and *mushārahah* (Kahf, 1999). Stage 2 (1990s–2000s) introduced prudential regulation via the creation of AAOIFI (1991) and IFSB (2002). Stage 3 (post-2010) witnessed global integration and digitalization, with over 500 Islamic banks operating in 80+ jurisdictions (IFSB, 2024).

2.2 Jurisprudential Foundations and Ethical Rationale

The jurisprudential base of Islamic finance derives from prohibitions of *riba* (usury), *gharar* (excessive uncertainty), and *maysir* (gambling). Classical scholars such as Ibn Taymiyyah and Al-Ghazālī linked these prohibitions to economic justice and real-sector productivity. Modern theorists—including Chapra (2016) and Mirakhor & Smolo (2019)—frame Islamic finance as a moral economy seeking equilibrium between profit and social welfare.

Conversion from conventional to Islamic banking therefore implies an ethical transformation in corporate purpose. Empirical research by El-Gamal (2006) and Dusuki & Bouheraoua (2011) emphasizes that compliance must be substantive rather than cosmetic, avoiding “form over substance.” Consequently, Shari’ah governance, internal control, and audit mechanisms form the operationalization of faith-based ethics within institutional design.

2.3 Global Regulatory Architecture: AAOIFI and IFSB

Regulatory convergence has become the backbone of the modern Islamic-finance ecosystem. AAOIFI issues Shari’ah, accounting, auditing, and governance standards, while the IFSB develops prudential guidelines analogous to Basel III. Together, they have narrowed interpretive gaps across jurisdictions (Bhatti et al., 2025). Adoption, however, remains uneven. Elhalaby et al. (2023) found that banks implementing AAOIFI standards displayed enhanced transparency and lower earnings-management risk.

IFSB-12 (Liquidity Risk Management) and IFSB-17 (Core Principles for Islamic Finance Regulation) provide the supervisory toolkit for conversion oversight. Yet, national transposition varies: Malaysia integrates these within its Islamic Financial Services Act 2013; Pakistan embeds them in the Banking Companies Ordinance 2016; and GCC regulators adopt hybrid Basel–IFSB frameworks. The literature agrees that convergence improves cross-border comparability, though contextual adaptation remains vital (Grassa & Matoussi, 2014).

2.4 Legal and Institutional Frameworks Across Jurisdictions

Malaysia represents the most comprehensive legal model, combining dual banking legislation and centralized Shari'ah oversight via the Shari'ah Advisory Council (SAC) of Bank Negara Malaysia (BNM, 2022). Indonesia follows a phased national-conversion policy under OJK supervision, where state-owned Bank Syariah Indonesia (BSI) was created through merger. Pakistan mandates parallel operations and targets a fully Islamic system by 2030 (State Bank of Pakistan, 2022).

In GCC states, conversion pathways differ: Kuwait Finance House and Al Rajhi Bank emerged organically as full Islamic institutions; Qatar and Bahrain permit both standalone Islamic banks and windows under dedicated regulation. Non-Muslim jurisdictions such as the UK and Turkey provide Islamic-bank licenses within secular legal systems, illustrating flexibility and global relevance (Wilson, 2013).

Comparative analysis shows that countries with explicit enabling acts and tax neutrality provisions report smoother transitions. Conversely, jurisdictions relying solely on central-bank circulars encounter interpretive disputes, particularly on profit recognition and asset-transfer taxation (Hasan & Dridi, 2011).

2.5 Shari'ah Governance and Compliance Structures

Shari'ah governance ensures that all products, processes, and reporting adhere to Islamic principles. The literature distinguishes between ex-ante (approval) and ex-post (audit) mechanisms (Archer & Kareem, 2017). AAOIFI Governance Standard 1 (GS 1) prescribes independence, competence, and transparency as core attributes of Shari'ah Supervisory Boards (SSBs).

Empirical studies affirm the governance–performance link. Farook et al. (2018) observed that banks with independent SSBs and formal Shari’ah audit units recorded higher market valuations. In contrast, symbolic boards correlated with reputational risk. Moreover, disclosure of Shari’ah audit reports enhances stakeholder trust and mitigates asymmetric information (Abdullah et al., 2021).

For conversion contexts, Shari’ah governance must evolve from advisory to strategic. New institutions require integration of SSB review into product development, treasury management, and compliance technology (RegTech).

2.6 Liquidity Management and Monetary Integration

Liquidity management has received extensive scholarly attention because Islamic banks cannot employ conventional interest-based instruments. The IFSB (2015) and IMF (2007) identify sukuk, Islamic interbank markets, and central-bank commodity-murābahah facilities as essential components. Research by Hasan & Dridi (2011) demonstrates that Islamic banks maintained stronger liquidity buffers during the 2008 crisis, partly due to lower leverage.

Malaysia’s Commodity Murābahah Programme and Qatar’s Liquidity Support Facility illustrate how central banks can create Shari’ah-compliant refinancing tools. Meanwhile, the International Islamic Liquidity Management Corporation (IILM) provides short-term cross-border sukuk recognized as high-quality liquid assets (HQLA). Empirical work by Al Arif et al. (2024) confirms that participation in IILM programs reduces liquidity-volatility ratios by 15 percent.

2.7 Operational Transformation and Institutional Change

Conversion requires deep restructuring of organizational design, risk culture, and technology. Institutional-change theorists (North, 1990; Mahoney & Thelen, 2010) argue that durable transformation occurs when external regulatory pressures intersect with internal strategic incentives. In banking, this means aligning Shari‘ah compliance with profitability metrics.

Case evidence shows that successful conversions treat Shari‘ah integration as a core-strategy initiative, not a compliance add-on. Meezan Bank (Pakistan) and Bank Syariah Indonesia executed cross-functional conversion programs combining board governance, product engineering, and staff retraining (Nasir, 2021). By contrast, partial conversions in Egypt and Nigeria struggled because business units retained interest-based performance indicators (Kahf & Hassan, 2017).

Operational change also entails the reconfiguration of core-banking systems. Conventional platforms are built on interest-accrual logic; Islamic modes require contract-based tracking of ownership and profit distribution. Vendors such as Path Solutions, Temenos T24 Islamic, and Oracle Flexcube Islamic introduced dedicated modules to manage murābaḥah, ijārah, and mushāarakah contracts. Studies by Rahman (2020) and Al-Marri (2022) demonstrate that automation reduces Shari‘ah-audit exceptions by nearly 40 percent.

2.8 Digitalization and FinTech Convergence

The fourth industrial revolution reshapes how Islamic banks deliver value. Digital channels expand reach and compliance efficiency simultaneously. Scholars identify three FinTech vectors relevant to Islamic conversion: digital identity (eKYC), smart-contract automation, and AI-based Shari‘ah validation (Abedifar et al., 2020).

Bahrain’s regulatory sandbox allowed Islamic neobanks such as ila and Meem to experiment with AI-assisted contract vetting. Early findings indicate cost savings and improved customer satisfaction (Central Bank of Bahrain, 2022). Qatar’s 2022 FinTech Strategy similarly promotes hybrid Islamic-digital models linking payments, remittance, and micro-investment platforms. Digital conversion enhances transparency, reduces manual errors, and facilitates near-real-time profit allocation.

Nonetheless, literature warns of digital-ethics challenges. Automated decision systems must be audited to ensure alignment with maqāṣid al-Sharī‘ah principles of justice and privacy (Hussain & Oladapo, 2023). Therefore, regulators are urged to develop digital-Shari‘ah governance frameworks incorporating cyber-risk, data integrity, and algorithmic accountability.

2.9 Environmental, Social, and Governance (ESG) Integration

Recent research situates Islamic banking within the global sustainability discourse. The ethical foundations of Islamic finance—prohibition of harm (ḍarar) and pursuit of public benefit (maṣlaḥah)—resonate with ESG investing. Hassan et al. (2022) note that Islamic banks can leverage green sukuk, waqf-based social finance, and zakat-linked micro-projects to advance the UN SDGs.

Malaysia pioneered green sukuk in 2017, channeling proceeds to renewable-energy infrastructure (Securities Commission Malaysia, 2023). GCC markets followed with sovereign green sukuk issuances exceeding US \$15 billion by 2024 (Refinitiv Islamic Finance Report, 2024). Converting banks are encouraged to integrate sustainability criteria into credit assessment and disclosure policies, reinforcing Islamic finance's dual ethical-environmental identity.

Empirical evidence remains limited but promising: Amalia and Rosman (2022) found that ESG-compliant Islamic portfolios outperformed conventional benchmarks during market downturns, suggesting resilience through ethical screening.

2.10 Empirical Evidence on Performance and Stability

Quantitative literature comparing Islamic and conventional banks offers mixed yet instructive findings. Beck, Demirgüç-Kunt, and Merrouche (2013) analyzed 510 banks across 22 countries and found that Islamic banks exhibited higher capitalization and lower asset-volatility ratios. Bourkhis and Nabi (2013) reported that Islamic institutions were less affected during the 2008 crisis due to limited exposure to toxic assets. Conversion-specific studies are scarcer but growing. Al Arif et al. (2024) observed that Indonesian converted banks achieved comparable profitability within three years post-conversion. Hasan and Dridi (2011) documented stronger liquidity buffers among GCC Islamic banks versus their conventional peers. Meanwhile, Ullah et al. (2018) highlighted persistent partial-compliance issues, reinforcing the need for continuous Shari'ah audit.

Collectively, these findings imply that conversion yields long-term governance and stability benefits, though short-term efficiency losses are inevitable. Profitability trajectories follow an inverted-U curve—initial decline, recovery by year three, and plateau by year five once operational synergies mature.

2.11 Human-Capital Development and Knowledge Management

The literature consistently identifies talent scarcity as a bottleneck. Islamic-finance education expanded from fewer than 20 programs in 1995 to over 400 universities and training institutes worldwide (IFSB Education Survey, 2023). Nevertheless, mismatch persists between academic curricula and market needs. Studies by Obaidullah (2020) and Rosly (2021) emphasize the necessity of interdisciplinary training combining *fiqh al-mu'āmalāt* with quantitative risk management. Converted banks address this through blended-learning academies, e-training portals, and joint programs with Shari'ah scholars. Qatar Finance and Business Academy's 2022 Diploma in Islamic Banking, for instance, integrates fintech modules, preparing staff for digital-Islamic operations. Human-capital investment therefore emerges as both a compliance requirement and a competitive differentiator.

2.12 Comparative Jurisdictional Insights

Malaysia and Indonesia

Malaysia's dual-banking system remains the reference model for policy design. The SAC's binding rulings ensure uniform jurisprudence, while tax incentives neutralize cost differentials between Islamic and conventional instruments. Indonesia's 2021 merger creating Bank Syariah Indonesia demonstrates state-led consolidation as an efficiency driver (OJK, 2022).

Pakistan

Pakistan's phased roadmap targets 100 percent Islamic operations by 2030. The State Bank of Pakistan (2022) emphasizes Shari'ah-compliance inspections, industry training, and sukuk liquidity lines. Empirical data show Islamic-banking assets now exceed 20 percent of sector totals, reflecting policy success.

GCC Region

GCC regulators balance flexibility with prudential oversight. Bahrain's Central Bank Rulebook and Qatar's Instructions on Shari'ah Governance 2023 institutionalize board-level compliance. However, fragmentation across jurisdictions complicates cross-listing and liquidity management (Sani, 2023).

Non-Muslim Jurisdictions

The UK and Luxembourg position themselves as hubs for Islamic investment banking. London's regulatory neutrality and tax parity measures have attracted sukuk listings exceeding £50 billion (London Stock Exchange, 2024). These cases demonstrate that Islamic finance principles can thrive within secular legal contexts given policy support.

2.13 Critical Gaps and Emerging Research Themes

Despite significant progress, scholarly gaps remain.

1. Data scarcity: Public datasets rarely distinguish converted banks from Islamic start-ups, limiting econometric assessment (Beck et al., 2022).
2. Digital-governance metrics: No standardized measures exist for algorithmic Shari‘ah compliance or AI-audit reliability.
3. ESG integration: Few studies evaluate the causal relationship between Islamic ethical screening and ESG-based risk adjustment.
4. Cross-border supervision: Divergent Shari‘ah interpretations hinder mutual recognition of products and sukuk.
5. Consumer behavior: Research on generational attitudes toward Islamic banking remains fragmented.

Emerging areas include Islamic open banking, central-bank digital currencies (CBDCs) compatible with Shari‘ah, and Islamic fintech sandboxes—domains where academic-policy collaboration is urgently needed (Huda & Khan, 2024).

2.14 Synthesis

The literature collectively indicates that conversion success depends on a triad of regulatory coherence, governance integrity, and technological readiness. Jurisdictions with integrated legal frameworks and proactive supervisory bodies (Malaysia, Indonesia, Pakistan) display smoother transitions. Where governance or liquidity infrastructure is weak, conversion yields partial or symbolic compliance. Digital transformation and ESG integration now represent the next frontier linking Islamic finance to broader sustainable-development and fintech agendas.

3. Methodology and Conceptual Framework

3.1 Research Design and Philosophical Orientation

This study adopts a qualitative comparative research design guided by the pragmatic philosophy of applied finance research. The pragmatic paradigm recognizes that financial systems are complex socio-technical institutions, where empirical observation and policy application are equally important (Creswell & Plano Clark, 2018). Thus, the purpose of this study is not merely to describe the transition from conventional to Islamic banking but to develop an actionable framework for effective conversion.

The research is exploratory, descriptive, and prescriptive in nature. It is exploratory because global experiences with conversion are limited and diverse; descriptive because it maps institutional features and practices; and prescriptive because it proposes a structured roadmap for implementation.

Rather than relying on primary surveys or econometric models, this paper synthesizes secondary qualitative evidence—peer-reviewed research, regulatory frameworks, industry reports, and institutional case studies—to identify the consistent enablers and obstacles observed in actual conversions.

The approach reflects the constructivist epistemology, assuming that knowledge about Islamic banking conversion is socially constructed through regulatory dialogue, institutional learning, and interpretive jurisprudence. In this sense, the research follows the logic of policy triangulation—cross-verifying findings from academic, regulatory, and industry perspectives (Yin, 2017; Stake, 2010).

3.2 Research Questions and Analytical Logic

The research questions guiding this study are reproduced and refined as follows:

1. Regulatory Preconditions: What legal and supervisory enablers determine the success or failure of conversion from conventional to Islamic banking?
2. Institutional Transformation: How do Shari'ah governance and operational frameworks evolve during conversion?
3. Liquidity and Stability: What mechanisms ensure liquidity management and prudential soundness under Islamic principles?
4. Technological Integration: How can FinTech and digital innovation facilitate compliance and efficiency?
5. Strategic Roadmap: What sequence of actions optimally balances regulatory oversight, market readiness, and operational capability?

These questions are analyzed through thematic synthesis, grouping insights under the five-pillar framework introduced earlier:

- (١) Regulatory Infrastructure,
- (٢) Shari'ah Governance,
- (٣) Operational Systems,
- (٤) Liquidity and Risk Management, and
- (٥) Disclosure & Transparency.

Each pillar functions as a theoretical lens for comparative evaluation across jurisdictions.

3.3 Data Sources and Sampling Strategy

3.3.1 Documentary and Regulatory Sources

Data were derived from:

- Regulatory frameworks:
Bank Negara Malaysia (BNM) Islamic Financial Services Act 2013, State Bank of Pakistan Islamic Banking Department Circulars (2024–2021), Qatar Central Bank Shari’ah Governance Instructions (2023), Central Bank of Bahrain Rulebook (Volume 2).
- Standard-setting bodies:
AAOIFI Shari’ah Standards (2023 Edition), IFSB Standards Series (Nos. 24–1).
- International institutions:
IMF Working Papers (2024–2007), World Bank Reports on Islamic Finance (2020 ,2016).

3.3.2 Academic and Empirical Sources

Over 80 peer-reviewed papers were analyzed from journals including: Journal of Islamic Accounting and Business Research, Review of Financial Economics, Applied Economics Letters, and Journal of Central Banking and Islamic Finance.

Selection criteria focused on:

- Studies addressing conversion or Shari’ah-compliance frameworks;
- Empirical analyses of performance, liquidity, or governance in Islamic banks;
- Regulatory-comparative papers from 2010 onward;
- Publications in English to ensure interpretive consistency.

3.3.3 Triangulation and Thematic Coding

The documentary and academic sources were coded using a five-theme matrix corresponding to the conceptual pillars.

Cross-jurisdictional triangulation ensured that insights derived from Malaysia or Indonesia were validated against GCC and non-Muslim-country experiences. This process reflects the methodological rigor of qualitative comparative analysis (QCA) (Ragin, 2014).

3.4 Analytical Framework

The analytical approach combines comparative institutionalism (North, 1990) with stakeholder theory (Freeman, 2010).

Institutional theory explains how rules, norms, and enforcement mechanisms shape organizational behavior. Stakeholder theory introduces moral responsibility toward multiple constituencies—shareholders, regulators, customers, and society—consistent with Islamic values of justice (‘adl) and trust (amānah).

These frameworks together explain why conversion cannot be reduced to technical compliance: it is a multi-actor negotiation involving regulators, Shari’ah boards, shareholders, and communities. Each actor’s alignment with Islamic objectives determines the depth and sustainability of transformation.

3.5 Conceptual Model: The Five-Pillar Framework

The conceptual framework developed through synthesis is depicted textually below. It serves as the theoretical model for conversion analysis and policy design.

Pillar 1 – Regulatory Infrastructure

Regulatory infrastructure comprises the enabling legal, tax, and supervisory environment.

Conversion success correlates with jurisdictions that:

- Enact specific Islamic finance laws (e.g., Malaysia's IFSA 2013, Pakistan's Islamic Banking Rules 2022).
 - Offer tax neutrality between conventional and Islamic transactions.
 - Establish conversion guidelines with explicit capital, disclosure, and reporting requirements.
- Regulatory readiness ensures predictability and reduces compliance friction (Hasan & Dridi, 2011).

Pillar 2 – Shari'ah Governance

This pillar anchors institutional integrity. It includes:

- National Shari'ah boards issuing binding rulings (e.g., Malaysia's SAC, Pakistan's National Shari'ah Board).
 - Institutional Shari'ah Supervisory Boards (SSBs) embedded within corporate governance.
 - Shari'ah audit units performing continuous reviews.
- Empirical work (Farook et al., 2018; Elhalaby et al., 2023) shows that independence and disclosure enhance market confidence.

Pillar 3 – Operational Systems

Conversion necessitates redesigning IT systems, accounting modules, and internal controls. Key success factors include:

- Integrating contract-based modules for murābahah, ijārah, and mushāarakah.
- Retraining staff in Islamic product structuring and ethics.
- Developing internal profit-purification processes.
- Deploying RegTech and AI-based compliance monitoring (Abedifar et al., 2020). Operational maturity ensures that Shari'ah compliance is embedded in daily processes.

Pillar 4 – Liquidity and Risk Management

Liquidity and risk frameworks must reconcile Islamic prohibitions with Basel prudential requirements. Mechanisms include:

- Sukuk and Islamic money-market instruments (IILM, 2023).
- Commodity murābahah interbank placements.
- Central-bank liquidity windows.
- Capital adequacy alignment with IFSB-15 and IFSB-17.

This pillar links stability to Shari'ah legitimacy by ensuring real-sector asset-backing and equitable risk-sharing.

Pillar 5 – Disclosure, Transparency, and Stakeholder Communication

Transparency sustains stakeholder trust and regulatory credibility.

Recommended actions include:

- Publishing Shari'ah audit reports alongside financial statements.
- Disclosing profit-allocation, purification, and zakat policies.
- Engaging customers through education campaigns to reduce misinformation.

Transparency bridges ethical compliance and market discipline (Archer & Karim, 2017).

3.6 Data Analysis Procedures

Thematic content analysis was performed following Braun and Clarke's (2006) six-step method:

1. Familiarization with global regulatory texts and case reports.
2. Initial coding aligned with conceptual pillars.
3. Theme development through comparison of jurisdictions.
4. Review and consolidation to identify common enablers/barriers.
5. Definition and naming of final themes.
6. Narrative synthesis integrating findings into the roadmap presented later.

PTThis process allowed transformation of diverse qualitative evidence into a coherent analytical structure. Findings were cross-validated using triangulation—academic literature, regulatory circulars, and institutional case documentation.

3.7 Validity, Reliability, and Limitations

Validity

Triangulation of data sources enhances construct validity, ensuring that conclusions represent the multifaceted reality of bank conversion.

Cross-country comparison adds external validity by generalizing beyond single jurisdictions.

Reliability

Reliability was addressed by consistent coding using a standardized five-theme matrix. Audit trails (document logs, references, and coding records) ensure replicability by other researchers or regulatory evaluators.

Limitations

- The study relies on publicly available secondary sources; primary interviews could further deepen insight.
- Cross-country heterogeneity limits direct comparability of performance indicators.
- Rapid fintech evolution may render some technological findings time-sensitive.

Nevertheless, these limitations are offset by the breadth of triangulated evidence and the clear conceptual model proposed.

3.8 Ethical Considerations

Ethical integrity is foundational to Islamic-finance research. All data used were publicly accessible and properly cited according to APA 7th edition standards. The research avoids advocacy for specific institutions and focuses instead on systemic improvement. The analysis is grounded in the ethical precepts of *maqāṣid al-Sharīʿah*, particularly justice (ʿadl), transparency (*bayān*), and avoidance of harm (*lā ḍarar wa-lā ḍirār*).

3.9 Expected Outputs and Policy Application

The methodological design yields practical outputs for:

- Regulators – standardized conversion roadmaps, audit templates, and governance models.
- Financial Institutions – operational guidelines and capacity-building checklists.
- Academics – a unified conceptual model for future empirical validation.

This methodological framework thus balances theoretical depth with professional applicability, aligning scholarly rigor with policy utility.

4. Findings and Discussion

4.1 Overview

Analysis of conversion experiences across multiple jurisdictions reveals that success depends on the coherent interaction of five institutional pillars—regulatory infrastructure, Shari‘ah governance, operational transformation, liquidity management, and transparency. Evidence indicates that countries exhibiting top-down regulatory clarity, centralized Shari‘ah oversight, and digital-process readiness experience smoother transitions and shorter break-even periods. Conversely, fragmented legal frameworks, ad-hoc supervision, and inadequate human-capital development remain the dominant failure drivers.

4.2 Regulatory Preconditions and Legal Alignment

4.2.1 Legislative Frameworks

Comparative document review shows that jurisdictions with codified Islamic-finance statutes—such as Malaysia’s IFSA 2013 or Pakistan’s Banking Companies Amendment 2022—establish clear mandates for conversion licensing, capital adequacy, and dispute resolution. These laws grant regulators explicit authority to approve products and to enforce Shari‘ah compliance (BNM, 2022; SBP, 2023).

By contrast, countries that rely on central-bank circulars without parliamentary endorsement (e.g., Egypt, Nigeria) face legal ambiguities regarding taxation of asset transfers and enforceability of Islamic contracts (Hasan & Dridi, 2011).

4.2.2 Supervisory Adaptation

Regulators that integrate Islamic-finance supervision within macro-prudential departments achieve greater efficiency than those that maintain parallel units.

Malaysia's integrated model allows on-site inspections to evaluate both Basel III and IFSB compliance simultaneously. Indonesia's OJK follows a hybrid model combining thematic reviews with Shari'ah audits. Evidence from interviews published by IMF (2023) indicates that regulatory dualism increases compliance costs by up to 25 percent. Therefore, convergence between prudential and Shari'ah supervision emerges as a policy imperative.

4.3 Shari'ah Governance and Institutional Integrity

4.3.1 Governance Architecture

Robust Shari'ah governance correlates strongly with stakeholder confidence. Empirical analysis by Elhalaby et al. (2023) shows that banks adopting AAOIFI governance standards exhibit lower discretionary accruals and higher transparency indices. Effective models display three tiers:

1. National Shari'ah Board for systemic harmonization;
2. Institutional SSB embedded in corporate governance;
3. Internal Shari'ah-audit unit ensuring continuous compliance.

4.3.2 Independence and Accountability

Bhatti et al. (2025) emphasize that SSB independence mitigates conflict of interest, particularly when profit pressures arise. Disclosure of SSB decisions in annual reports—practiced in Malaysia, Bahrain, and Qatar—has proven effective in preserving reputational capital. Conversely, symbolic SSBs or limited audit transparency contribute to investor skepticism, as documented by Abdullah et al. (2021).

4.3.3 Integration with Corporate Governance

Integration occurs when SSB deliberations inform board risk-committee agendas and remuneration policies. In Qatar and the UAE, joint governance workshops between SSBs and audit committees are now mandatory (QCB, 2023). This institutionalization transforms Shari'ah oversight from an advisory formality into a strategic governance mechanism—a hallmark of mature Islamic-banking systems.

4.4 Operational Readiness and Systems Migration

4.4.1 Technology and Core-Banking Platforms

Conversion requires complete recalibration of core systems. Evidence from Pakistan's Meezan Bank and Indonesia's BSI shows system-migration timelines of two to three years, involving hundreds of new contract modules (Nasir, 2021). Costs range from 35–25 percent of total project budgets. Automation of contract processing through platforms such as Temenos T24 Islamic reduces manual Shari'ah-audit exceptions by 40 percent (Rahman, 2020).

4.4.2 Accounting and Reporting

Islamic contracts demand recognition of profit and risk participation rather than interest accrual. AAOIFI's Financial Accounting Standards (FAS 39–1) redefine revenue recognition for sale- and lease-based financing. Studies by Rosly (2021) confirm that full compliance enhances comparability and audit assurance, though it initially increases reporting complexity.

4.4.3 Human-Capital Preparedness

Conversion also necessitates cultural realignment. Research by Obaidullah (2020) highlights that only 40 percent of banking staff in emerging markets possess basic Islamic-finance literacy. Malaysia's Financial Sector Blueprint 2022 and Qatar's National FinTech Talent Strategy address this through certification and continuous professional-development programs. Effective transformation therefore requires sustained investment in people alongside technology.

4.5 Liquidity Management and Financial Stability

4.5.1 Instrumental Infrastructure

Islamic banks face inherent liquidity constraints due to the prohibition of interest-bearing instruments. The emergence of short-term sukuk and interbank commodity-murābahah markets mitigates this gap.

Participation in IILM's short-term sukuk programs improves liquidity ratios and enables compliance with IFSB-17 liquidity-coverage requirements (Al Arif et al., 2024).

4.5.2 Central-Bank Facilities

Malaysia, Bahrain, and Qatar introduced Islamic liquidity-support facilities allowing collateralized financing via sukuk. IMF (2023) findings show that banks with access to such facilities maintain 20–15 percent higher liquidity buffers. Absence of these tools forces reliance on cash reserves, depressing returns on assets. Hence, regulatory provision of Shari‘ah-compliant lender-of-last-resort instruments is a decisive enabler of stable conversion.

4.5.3 Risk Management Alignment

IFSB (2015) recommends integration of profit-rate-risk models, equity-investment risk measurement, and displaced-commercial-risk provisions into capital-adequacy computations. Empirical work by Hassan and Dridi (2011) demonstrates that Islamic banks' asset-quality metrics outperform conventional peers during downturns, validating the prudential soundness of Shari‘ah-based models.

4.6 Performance Dynamics and Profitability Trajectories

A synthesis of case studies reveals a consistent performance trajectory comprising three phases:

1. Phase I – Adjustment: First 24–12 months marked by decline in ROA/ROE (average -1.2 percentage points) due to IT investment and restructuring.
2. Phase II – Stabilization: Margins recover as deposit mobilization increases through ethical branding.
3. Phase III – Sustainability: Profitability reaches parity with conventional peers within 5–3 years (Al Arif et al., 2024).

Malik et al. (2020) link this rebound to improved governance and risk-sharing discipline. Moreover, consumer surveys show higher customer-retention rates driven by perceived fairness and transparency (Thomson Reuters Islamic Finance Outlook, 2023).

4.7 Digital Transformation and FinTech Integration

4.7.1 Operational Efficiency

FinTech integration accelerates compliance and service innovation. Bahrain's AI-based Contract Validator and Qatar's Digital KYC Framework 2022 reduce manual processing times by 60 percent. Abedifar et al. (2020) find that blockchain-enabled murābaḥah settlements lower operational risk and enhance audit traceability.

4.7.2 Customer Inclusion

Digital channels democratize access to Islamic banking for under-banked populations. Indonesia's LinkAja Syariah and Saudi Arabia's STC Pay Islamic wallets demonstrate scalable inclusion through mobile platforms. These initiatives align Islamic finance with Sustainable Development Goal 9 (Industry, Innovation, and Infrastructure).

4.8 Social and ESG Impact

Islamic finance inherently supports social-responsibility outcomes. Integration of zakat, waqf, and green-sukuk financing channels demonstrates how converted banks can internalize ESG principles. Malaysia’s 2017 Green Sukuk Framework and Qatar’s 2023 Sustainability Strategy illustrate alignment between environmental policy and Shari‘ah objectives (Hassan et al., 2022). Empirical findings by Amalia and Rosman (2022) confirm superior downside protection in ESG-screened Islamic portfolios, reinforcing the proposition that ethical alignment contributes to resilience.

4.9 Cross-Jurisdictional Comparative Synthesis

Jurisdiction	Conversion Model	Key Enablers	Main Challenges
Malaysia	Dual-banking with full Islamic subsidiaries	Centralized SAC; tax neutrality; liquidity facilities	Limited equity-finance uptake
Indonesia	State-led merger (BSI)	Phased roadmap; fintech support	Scholar shortage; legacy systems
Pakistan	Parallel system → full conversion by 2030	Legal mandate; sukuk markets	Liquidity depth
Qatar/Bahrain	Mixed subsidiary models	High capitalization; regulatory clarity	Cross-border harmonization
UK/Turkey	Non-Muslim jurisdictions	Tax parity; regulatory neutrality	Limited retail scale

The comparative table confirms that regulatory maturity, liquidity instruments, and governance transparency are universal determinants of success, regardless of cultural context.

4.10 Stakeholder Perceptions and Market Behavior

Surveys by Refinitiv (2024) show that 65 percent of retail clients cite “ethical alignment” as the top reason for choosing Islamic banks. Among corporate clients, the main motivators are cost-competitiveness and regulatory credibility. Consequently, transparency in profit-allocation formulas and consistent Shari‘ah audits significantly influence customer trust.

Investors also reward credible conversion: event-study analyses by Beck et al. (2022) reveal positive abnormal returns surrounding announcements of Islamic conversion, particularly where national regulators signal policy support.

4.11 Policy and Strategic Implications

4.11.1 For Regulators

- Enact dedicated Islamic-finance laws and ensure tax neutrality.
- Integrate Shari‘ah oversight within prudential frameworks.
- Develop Islamic interbank and lender-of-last-resort facilities.
- Establish digital-governance standards addressing AI and blockchain compliance.

4.11.2 For Financial Institutions

- Conduct comprehensive diagnostic audits before conversion.
- Form independent SSBs with transparent reporting.
- Invest in Islamic-compliant core-banking systems and staff retraining.
- Adopt ESG-linked product innovation to diversify portfolios.

4.11.3 For Academia and Training Bodies

- Align curricula with market needs—combining fiqh al-mu‘āmalāt, data analytics, and risk management.
- Establish research alliances for digital-Shari‘ah auditing and impact-measurement models.

4.12 Synthesis and Theoretical Contribution

The study validates the Five-Pillar Conceptual Framework developed earlier and refines it into an actionable theory of change for financial-institution transformation. Conversion success depends on systemic complementarity: regulatory alignment enables governance; governance directs operations; operations rely on liquidity infrastructure; and all are legitimized through transparent disclosure. This interdependence confirms the proposition that Islamic-finance conversion is a systemic transformation, not a product-level adjustment.

Roadmap, Recommendations, and Conclusion

5.1 Strategic Roadmap for Conversion

Drawing on the evidence analyzed across jurisdictions and the five-pillar framework, a Four-Phase Strategic Roadmap is proposed to guide conversion from conventional to Islamic banking. Each phase integrates regulatory alignment, operational implementation, and stakeholder management.

Phase	Objective	Core Activities	Key Deliverables
Phase 0 – Diagnostic & Strategy Formulation	Establish feasibility and stakeholder alignment	Legal audit, market demand analysis, gap assessment, engagement with central bank and Shari‘ah authorities	Feasibility report; formal board resolution to convert; roadmap approval
Phase 1 – Governance & Policy Architecture	Build institutional legitimacy	Constitute Shari‘ah Supervisory Board; draft Shari‘ah Governance Charter; define risk, audit, and product-approval processes; secure regulatory license	Governance framework; SSB endorsement; regulator approval letter
Phase 2 – Product Design & Operational Migration	Execute transformation	Redesign contracts; reconfigure IT and accounting systems; train staff; migrate existing assets and liabilities; implement purification of interest income	Fully functional Islamic-core banking platform; staff certification; Shari‘ah- audit readiness
Phase 3 – Audit, Disclosure &	Consolidate compliance and	Conduct internal and external Shari‘ah audits; publish profit-allocation	Public annual Shari‘ah-audit report; investor

This phased sequence ensures that conversion occurs sequentially and transparently, preventing operational disruption and protecting consumer confidence.

5.2 Implementation Guidelines by Stakeholder

5.2.1 Regulators and Policymakers

- Legislative Mandate: Enact clear legal recognition for Islamic contracts to avoid judicial ambiguity.
- Supervisory Harmonization: Integrate Shari‘ah and prudential oversight within a unified framework.
- Liquidity Support: Develop Islamic interbank markets and short-term sukuk to fulfill LCR and NSFR standards.
- Tax and Accounting Neutrality: Align tax codes to treat Islamic sales and leases equivalently to loans.
- Digital Supervision: Issue guidelines for AI-based compliance and cyber-risk governance consistent with maqāṣid al-Sharī‘ah.

5.2.2 Financial Institutions and Boards

- Vision Alignment: Treat conversion as strategic transformation, not compliance obligation.
- Capacity Building: Invest in multidisciplinary training—Shari‘ah, risk, fintech, ESG.
- Technology Investment: Adopt modular Islamic-core systems and RegTech automation.
- Corporate Culture: Embed ethics and Shari‘ah awareness in incentive structures.
- Market Education: Communicate conversion milestones to customers through transparent disclosures and social channels.

5.2.3 Shari‘ah Supervisory Boards

- Independence: Ensure appointment by shareholders rather than management.
- Audit Integration: Link SSB reviews with internal audit findings and risk-management dashboards.
- Transparency: Publish concise rulings and compliance summaries accessible to the public.

5.2.4 Academia and Training Bodies

- Curriculum Modernization: Combine classical jurisprudence with data science, AI, and ESG finance.
- Certification Standards: Develop regional qualification frameworks under AAOIFI or IFSB endorsement.
- Research Collaboration: Establish applied-research centers bridging regulators and universities.

5.3 Success Metrics and Evaluation

Conversion success can be evaluated using five quantitative and qualitative indicators:

1. Regulatory Compliance Index – proportion of AAOIFI/IFSB standards adopted.
2. Shari‘ah-Audit Maturity Level – degree of independence and disclosure quality.
3. Liquidity Adequacy Ratio (Islamic-LCR) – availability of sukuk and cash buffers.
4. Operational Efficiency Ratio – cost-to-income improvements post-conversion.
5. Stakeholder Confidence Score – consumer and investor perception surveys.

Regular reporting on these metrics allows regulators and boards to monitor conversion integrity over time.

5.4 Strategic Risk Considerations

Risk Type	Description	Mitigation Strategy
Legal Risk	Ambiguity in contract enforceability	Legislative reform; standardized templates
Liquidity Risk	Lack of short-term instruments	Central-bank sukuk; interbank facilities
Operational Risk	System and process failure during migration	Phased rollout; parallel-run testing
Reputational Risk	Public skepticism of compliance	Independent audits; transparent reporting
Human-Capital Risk	Skill shortage	Continuous training; partnerships with academia

5.5 Comparative Conversion Case Insights

- Indonesia: The 2021 merger forming Bank Syariah Indonesia achieved 13 % asset growth in its second year; success attributed to strong state backing and unified branding.
- Pakistan: Gradual conversion allows smaller banks to adopt modular approaches; State Bank’s monitoring ensures steady progress toward 2030 target.
- Malaysia: Continuous regulatory refinement demonstrates that long-term consistency outweighs rapid transition.
- GCC: Financial depth and sovereign support enable hybrid models, but harmonization across jurisdictions remains a challenge.

Cross-case analysis validates that policy consistency, institutional learning, and market communication are the most influential variables.

5.6 Broader Economic and Social Implications

Conversion extends beyond institutional reform—it redefines the socio-economic architecture of finance.

- Financial Inclusion: Profit-sharing contracts facilitate access for SMEs and individuals excluded from collateral-based lending.
 - Stability: Asset-backing reduces systemic contagion risk, complementing macro-prudential objectives.
 - Ethical Investment: Integration with ESG and waqf instruments channels capital toward sustainable sectors.
 - Global Integration: Islamic finance attracts cross-border investors seeking diversification and moral assurance.
- Thus, conversion aligns domestic policy with global sustainable-finance trends.

5.7 Conclusion

This study examined the transition of conventional banks to Islamic finance through comparative analysis, regulatory synthesis, and conceptual modeling. The evidence confirms that conversion is both a feasible and beneficial strategic transformation when guided by structured governance, robust liquidity tools, and human-capital readiness.

The proposed Five-Pillar Framework—regulation, governance, operations, liquidity, and transparency—serves as the foundation for the Four-Phase Roadmap, translating theory into practice. Successful jurisdictions demonstrate that conversion's early-stage profitability decline is temporary; governance credibility and customer loyalty ultimately enhance long-term value.

Islamic banking thus represents not only an ethical alternative but also a resilient financial architecture aligned with sustainability and inclusive growth. Policymakers and practitioners are urged to approach conversion as a holistic reform rather than a compliance exercise. Future research should quantify post-conversion performance and explore digital-Shari'ah governance metrics to deepen empirical understanding of this evolving paradigm.

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