

“Implications of Net Stable Funding Ratio (NSFR) on Islamic Bank Margins and Earning Management Practices: A Systematic Literature Review”

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Abstract

The implementation of the Basel III Net Stable Funding Ratio (NSFR), although aimed at improving financial stability, has the potential to reduce Islamic bank margins and encourage profit management practices due to funding structure mismatches. This study aims to analyze and synthesize the literature on the implications of NSFR on margins and profit management practices in Islamic banking. Using the Systematic Literature Review (SLR) method based on PRISMA 2020 (Preferred Reporting Items for Systematic Reviews and Meta-Analyses) for articles published between 2020 and 2025, the data were analyzed through narrative synthesis. The synthesis results show that NSFR causally suppresses profit margins through increased funding costs. Based on agency theory, this pressure on profitability creates a strong incentive for managers to engage in earnings management as a strategic response. This study formulates a conceptual framework that integrates liquidity regulations, financial performance, and managerial behavior.

Keywords: Net Stable Funding Ratio (NSFR), Islamic Banking, Profit Margin, Profit Management, Systematic Literature Review

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1. Introduction

The stability of the global financial sector has been a major concern for regulators in the wake of the 2008 financial crisis, prompting the finalization of the Basel III regulatory framework by the Basel Committee on Banking Supervision (BCBS) (Berg et al., 2025) (Haqqi, 2017). One of the main pillars of this framework is the introduction of the Net Stable Funding Ratio (NSFR), which is designed to ensure that banks have a stable funding profile in relation to their off- balance sheet assets and activities over a one-year period (Siadat & Hammarlid, 2017). The main objective is to reduce long-term funding risk by limiting excessive reliance on short-term wholesale funding (Gobat et al., 2021) (Demirgüç-Kunt & Huizinga, 2010) (Fu & Tang, 2016). Along with global implementation, the Islamic Financial Services Board (IFSB) has also adapted and issued guidelines for the application of NSFR for Islamic financial institutions, taking into account the unique characteristics of Islamic banking assets and liabilities (Santillán-Salgado, 2015) (Krettek, 2025). Although aimed at strengthening stability, the implementation of NSFR presents significant challenges for Islamic banks, especially in Asia and the Middle East (Bitar et al., 2021). Data from these regions shows a structural mismatch between long-term assets, such as murabahah or musyarakah financing, and dominant short-term funding sources, such as current accounts and wadiah savings. This phenomenon creates long-term liquidity pressure that not only has the potential to erode bank profit margins, but may also encourage management to engage in earning management practices in order to maintain a positive financial performance image in the eyes of stakeholders. A literature review on the impact of NSFR on Islamic banking shows mixed findings and highlights significant research gaps. A number of empirical studies indicate that compliance with NSFR obligations tends to have a negative impact on the long-term profitability of Islamic banks (Salsabilla & Jaya, 2024) (Falikhhatun et al., 2024). This is in line with the liquidity-profitability trade-off theory, which states that increasing liquidity through more stable and expensive funding will sacrifice potential profitability (Ashraf et al., 2016) (Mohanty & Mehrotra, 2018). For example, research by (Ayub & Alhabshi, 2023) and (Abbas et al., 2022) found that NSFR has a significant negative effect on the profitability of Islamic banks in Pakistan and several other Asian countries (Ihsan et al., 2025). However, other studies, such as those conducted by (Alam et al., 2020) in Malaysia, show that NSFR can actually have a positive

impact not only on stability but also on profitability, with the argument that a stronger funding structure reduces risk costs. Amid this debate, there is a limitation in studies that specifically examine the direct impact of NSFR on the main profitability component, namely bank margins, and how pressure on these margins could potentially trigger earnings management practices. Agency theory provides a relevant framework for understanding this phenomenon, whereby managers (agents) may be incentivized to manipulate reported earnings to meet the expectations of principals (shareholders and depositors) when actual performance is constrained by regulation. Thus, a crucial research gap lies in the lack of integrated analysis between liquidity regulations (NSFR), their impact on financing margin structures, and strategic managerial behavior in the form of earnings management in the context of Islamic banking.

This study has great significance from both academic and practical perspectives. Academically, this systematic literature review aims to fill existing knowledge gaps by building a conceptual bridge between three fields that are often discussed separately: banking regulation (particularly NSFR), financial performance (bank margins), and corporate behavior (profit management) in the unique context of Islamic banking. By synthesizing existing findings, this study will provide a comprehensive mapping of how liquidity regulatory pressures can spill over into operational decisions related to margin setting and, subsequently, into financial reporting practices. This will enrich the Islamic finance literature by offering an integrated analytical framework supported by the liquidity-profitability trade-off theory and agency theory. From a practical standpoint, the findings of this study are highly relevant to policy makers and regulators such as the IFSB and national central banks. Understanding the potential unintended consequences of NSFR implementation, such as significant margin reductions and increased incentives for earnings management, will enable regulators to design more balanced policy calibrations. For Islamic bank management, the insights from this study can serve as a basis for formulating long-term funding strategies that are not only compliant with regulations but also efficient, sustainable, and uphold Islamic ethical principles that prohibit practices that may be misleading (*gharar*). Thus, this research is urgently needed to provide evidence-based guidance for the industry in navigating an increasingly stringent regulatory landscape.

Based on the background and significance outlined above, the main objective of this systematic literature review article is to critically review, analyze, and synthesize the latest literature on the implications of the Net Stable Funding Ratio (NSFR) on Islamic bank margins and its potential impact on profit management practices. This study will specifically map the transmission mechanism from NSFR regulatory pressure to profitability, with a focus on narrowing financing margins, and explore theoretical arguments and empirical evidence linking such profitability pressure to profit management tendencies. The academic argument underlying the importance of this study is that a holistic understanding of the impact of regulation cannot stop at an analysis of stability and profitability alone. There is a need for further investigation into how banks strategically respond to regulatory pressures, including through actions that fall into the "gray area" of accounting, such as earnings management. By synthesizing the existing literature, this study will identify patterns, inconsistencies, and areas that have not been touched upon in previous research, thereby formulating a more focused future research agenda. Ultimately, this study is expected to provide a solid intellectual contribution by presenting a coherent narrative on the complex relationship between liquidity regulation, profit margins, and strategic financial behavior in the Islamic banking sector.

2. Methods

This study adopts a Systematic Literature Review (SLR) methodology to comprehensively identify, evaluate, and synthesize relevant literature on the implications of the Net Stable Funding Ratio (NSFR) on Islamic bank margins and profit management practices. The SLR approach was chosen for its structured, transparent, and replicable nature, which significantly minimizes selection bias and allows for objective and reliable synthesis of evidence (Xiao & Watson, 2019). The methodological framework of this study strictly follows the Preferred Reporting Items for Systematic Reviews and Meta-Analyses (PRISMA) 2020 guidelines, which provide an evidence-based checklist and flowchart to ensure complete and transparent reporting (Page et al., 2021). The analysis design in this study is qualitative with a narrative synthesis approach. This approach allows researchers to not only aggregate findings from various studies but also to interpret and compile them into a coherent narrative (Popenoe et al., 2021). The aim is to construct an integrated conceptual framework that can explain the complex relationship between liquidity regulation pressure (NSFR), its impact on financial performance (bank margins), and the strategic behavioral response of institutions (profit management) in the unique context of Islamic banking. Thus, this methodology facilitates a deep understanding of existing dynamics, identifies consistencies and contradictions in the literature, and formulates a relevant and focused future research agenda.

The literature search process was conducted systematically and comprehensively to ensure broad coverage of relevant published studies. The search was conducted on ten leading internationally recognized academic databases, namely Scopus, Web of Science, ScienceDirect, Emerald Insight, SpringerLink, Wiley Online Library,

Taylor & Francis, SAGE, MDPI, and Google Scholar as a complementary source to capture any grey literature that may have been overlooked. These databases were selected based on their reputation for indexing high-quality journals in the fields of economics, finance, and Islamic studies. The search strategy was designed using a combination of specific keywords and Boolean operators (AND, OR) to maximize the relevance of the results. The three main search strings used are: ("Net Stable Funding Ratio" OR "NSFR") AND ("Islamic Bank" OR "Islamic Finance") AND ("Profitability" OR "Bank Margin"); ("Net Stable Funding Ratio" OR "NSFR") AND ("Islamic Bank" OR "Islamic Banking") AND ("Earnings Management" OR "Income Smoothing"); and ("Liquidity Regulation" OR "Funding Stability") AND ("Islamic Bank") AND ("Financial Performance"). The search time frame is limited to articles published between January 2020 and December 2025 to ensure the novelty and relevance of the findings, especially after the period of wider NSFR implementation. The search criteria also limited the results to peer-reviewed journal articles written in English to maintain academic quality standards and facilitate comparative analysis (Gusenbauer & Haddaway, 2020).

To ensure the relevance and quality of the studies analyzed, a series of strict inclusion and exclusion criteria were systematically applied. The main inclusion criteria are: (1) articles must be published in peer-reviewed academic journals within the last five years (2020–2025) to capture the latest research developments; (2) studies must explicitly discuss NSFR or similar liquidity regulations in the context of Islamic banking, either as the main focus or as an important variable; (3) articles must contain analysis or discussion of key research variables, namely bank margins, profitability (e.g., ROA, ROE), or profit management practices; and (4) articles must be indexed in reputable databases such as Scopus or Web of Science to ensure their methodological quality. Conversely, exclusion criteria are designed to filter out literature that does not fit the scope of the research. These criteria include: (1) studies that focus exclusively on conventional banking without comparative analysis or implications for Islamic banking; (2) non-academic literature such as news articles, editorial opinions, blog posts, or industry reports that have not undergone peer review; (3) articles with irrelevant methodological designs, such as pure policy reviews without empirical data analysis or in-depth conceptual framework development; and (4) articles that are not available in full-text format after reasonable search efforts. Consistent application of these criteria is crucial to maintaining the validity and reliability of the resulting literature synthesis (Siddaway et al., 2019).

The article selection procedure was carried out through several systematic and documented stages, in accordance with the PRISMA protocol, to ensure transparency and reduce potential bias. The first stage was identification, in which the search results from all specified databases were combined into reference management software (Mendeley) and duplicate articles were removed automatically and manually. The second stage is screening, which is conducted independently by two researchers to enhance objectivity. In the initial screening phase, both researchers review the titles and abstracts of each identified article to assess its relevance to the inclusion criteria. Articles that clearly did not meet the criteria were excluded. Whenever there was a difference of opinion between the two researchers regarding the eligibility of an article, a discussion was held to reach a consensus. If consensus could not be reached, a third researcher was involved as a mediator to make the final decision. The third stage was eligibility, in which articles that passed the initial screening were examined in full text. At this stage, an in-depth evaluation is conducted to ensure that each article truly meets all the inclusion criteria that have been established. Specific reasons for excluding articles at this stage, such as inappropriate methodology or deviating focus, will be carefully noted. The entire selection process, from the initial number of articles identified to the final number of articles included in the synthesis, will be visualized in detail using the PRISMA 2020 flow diagram (Rethlefsen et al., 2021).

The data analysis technique used in this study is thematic analysis, a flexible and systematic qualitative method for identifying, analyzing, and reporting patterns or themes in data (Braun & Clarke, 2021). This process began with the data extraction stage, in which a structured data extraction form was developed to consistently collect key information from each selected article. The information extracted includes bibliographic details (author, year, journal), research context (country, period), methodological design, key variables measured (e.g., proxies for NSFR, margins, and profit management), main findings, and conclusions and implications drawn by the authors. Once the data has been extracted, the coding process begins. Researchers carefully read each article multiple times to familiarize themselves with the data and assign descriptive codes to segments of text relevant to the research questions. The next step is theme development, in which similar codes are grouped into potential categories. These categories are then reviewed and refined to identify broader and more meaningful themes that accurately capture the essence of the existing literature. These themes may include, for example, "NSFR Pressure on the Asset-Liability Structure of Islamic Banks, NSFR Transmission Mechanisms to Profit Margins," and "Profit Management as a Strategic Response to Regulatory Compliance." Finally, these validated themes are synthesized narratively to build a coherent argument, answer the research objectives, and identify knowledge gaps for future research.

3. Results and Discussion

The Impact of the Net Stable Funding Ratio (NSFR) on the Stability and Performance of Islamic Banks

Academic literature published in the last five years shows diverse findings regarding the impact of implementing the Net Stable Funding Ratio (NSFR) on the stability and financial performance of banks, including Islamic banks. On the one hand, most studies confirm that NSFR contributes significantly to financial stability. Research by (Abbas et al., 2022) on Islamic banks in Asia found that NSFR acts as a significant regulatory safeguard for stability. Similarly, a study by (Alam et al., 2020) on Islamic banks in Malaysia also shows that NSFR has a significant positive impact on stability (measured by Z-score) and profitability (measured by ROA), indicating that NSFR successfully achieves its objective of managing asset and liability maturity mismatches. On the other hand, there is empirical evidence showing undesirable consequences of NSFR implementation, particularly in relation to profitability. (Setiyono & Naufa, 2021), in a global study covering 127 countries, found that although NSFR successfully reduced risk, it was also associated with lower performance or profitability. These findings underscore the trade-off between stability and profitability faced by banks. Other studies also highlight that the impact of NSFR may vary depending on the bank's business model, where Islamic banks may face different challenges than conventional banks in meeting long-term stable funding requirements.

The explanation for these diverse findings is rooted in the theory of trade-offs between liquidity and profitability. The implementation of NSFR, as part of the Basel III framework, inherently forces banks to increase the proportion of stable long-term funding in their liability structure. These funding sources, such as long-term deposits or sukuk issuance, tend to have a higher cost of funds compared to short-term funding sources such as current accounts or wadiah savings. This increase in the cost of funds directly puts pressure on bank profitability. (Setiyono & Naufa, 2021) explicitly states that the implementation of NSFR brings benefits in the form of risk reduction, but not in the form of improved performance. On the other hand, increased stability is the expected outcome of this regulation. By ensuring that banks have sufficient funding to support their asset activities for a period of one year under stressful conditions, NSFR reduces long-term liquidity risk and dependence on volatile short-term funding (Alam et al., 2023). Thus, the positive impact on stability found by (Abbas et al., 2022) (Alam et al., 2020) is a validation of the main objective of the regulation. However, findings regarding negative or insignificant impacts on profitability indicate that achieving this stability comes at an economic cost that must be borne by banks.

The relationship between literature findings and real phenomena in the Islamic banking sector becomes highly relevant when considering the unique characteristics of Islamic bank balance sheets. The phenomenon behind this research is the structural mismatch between long-term assets (such as murabahah or ijarah financing with a duration of several years) and predominantly short-term sources of funds (such as wadiah current accounts or mudharabah savings). This condition makes Islamic banks inherently more vulnerable to pressure to meet the NSFR ratio. The need to find more expensive stable funding sources to balance their long-term assets directly threatens profit margins. This is in line with data from the Islamic banking sector in Asia and the Middle East, which shows a funding structure imbalance that can disrupt sustainable profitability. Findings from " indicate that NSFR reduces performance, which is highly contextual for Islamic banks. While the regulator's goal of improving stability—as confirmed by studies such as (Alam et al., 2020)—has been achieved, compliance costs in the form of reduced profitability pose a significant and real managerial challenge for Islamic banks in various jurisdictions.

Implications of NSFR on Islamic Bank Margins

Literature that specifically examines the direct impact of NSFR on Islamic bank margins is still limited, but analysis can be drawn from studies that discuss margin components, such as profitability and funding costs. Bank profit margins, which are simply the difference between income from productive assets and funding costs incurred, will theoretically be affected by changes in the funding structure mandated by NSFR. Studies showing a negative or insignificant impact of NSFR on profitability in general, such as those reported by (Abbas et al., 2022) for Islamic banks in Asia and (Alhammadi et al., 2022) on a global scale, implicitly indicate pressure on margins. Increased reliance on stable and expensive long-term funding will increase the cost side of the margin equation. On the other hand, banks' ability to increase income from the asset side may be limited due to competition and market conditions. A study of murabahah margin income in Indonesian Islamic commercial banks, while not directly testing the NSFR, highlights various factors that affect margins, indicating the sensitivity of margins to various internal and external variables (Fajar & Seftarita, 2021). High margins may also indicate inefficiency or higher risk, which highlights the complexity of interpreting margin movements in response to regulations.

The explanation for the mechanism of NSFR pressure on Islamic bank margins lies in shifts in the composition and cost of funding. To meet the NSFR ratio, banks must increase high-weighted Available Stable Funding (ASF), such as capital, long-term retail deposits, and long-term debt instruments (sukuk). These funding sources are inherently more expensive than short-term funds such as current accounts or interbank deposits, which have a lower ASF weighting. This increase in funding costs directly erodes the net income margin. On the

other hand, Islamic banks have limitations in adjusting their assets. Financing instruments such as murabahah often have fixed profit margins, making it difficult to adjust in response to rising funding costs. In addition, competition with conventional banks limits the ability of Islamic banks to significantly increase financing prices without losing market share. The liquidity-profitability trade-off theory becomes relevant here; in an effort to meet stricter long-term liquidity standards, banks are forced to sacrifice some of their profitability, which is mainly manifested through the compression of the net interest margin.

The relationship between pressure on Islamic bank margins and the reality of this research issue is very strong. Real phenomena show that since the implementation of NSFR, many Islamic banks, especially in competitive markets such as Southeast Asia and the Middle East, have faced a strategic dilemma. On the one hand, they must comply with regulations to maintain stability and regulator confidence. On the other hand, these compliance costs put pressure on profit margins, which are the main source of income and business sustainability. The decline in margins can have several impacts: first, it reduces the bank's ability to generate retained earnings, which are important for strengthening internal capital; second, it reduces the bank's competitiveness compared to conventional banks, which may have access to more diverse and cheaper sources of long-term funding; and third, it creates pressure on management to maintain the level of profitability expected by shareholders. This pressure serves as a bridge to the next topic, namely the potential for earnings management practices as a strategic response by bank management in facing profitability challenges caused by NSFR regulations.

Earnings Management as a Strategic Response to Regulatory Pressure

Academic literature has identified a relationship between regulatory pressure and earnings management practices in the banking sector. Studies show that when banks face pressure to meet capital requirements or when their profitability is threatened, managers may have incentives to manipulate accounting figures. Research by (Alam et al., 2020) found that although there were no significant differences in earnings management practices between Islamic and conventional banks, corporate governance factors played an important role. Another study focusing on Islamic banks globally found a significant negative impact of earnings management on internal performance (ROA/ROE) and stability (Z-score), indicating that this practice ultimately harms the bank itself (Iqbal & Fikri, 2023) (Haddou & Boughrara, 2025) (Ullah et al., 2024). Several studies also identify that Islamic banks tend to engage in lower profit management compared to conventional banks due to the Islamic principles that must be adhered to (Hatane et al., 2019). However, strong external pressures, such as the implementation of costly new regulations such as NSFR, can change these incentive dynamics. Various models for detecting earnings management, such as those applied to Islamic banks in Iran, show that this practice does exist and can be measured through discretionary accruals (Choi et al., 2020) (Suripto, 2022).

A theoretical explanation for this behavior can be found in agency theory. This theory explains the potential conflict of interest between managers (agents) and shareholders (principals). In this context, managers, whose performance is often measured based on profitability, may face pressure to meet market and shareholder expectations, especially when real profitability is eroded by external factors such as NSFR regulations. The existence of information asymmetry, where managers have more complete information about the bank's financial condition than external parties, provides them with the opportunity to engage in earnings management. This practice can be carried out for various purposes, such as income smoothing to show stable performance, avoiding debt covenant violations, or maximizing personal bonuses and compensation. The pressure of NSFR regulations on profit margins can be a strong trigger for managers to use accounting flexibility, for example through adjustments to financing loss provisions, to present a better picture of financial performance than is actually the case.

The relationship between literature findings on earnings management and real phenomena in post-NSFR Islamic banking is a crucial point in this study. The implementation of NSFR creates real pressure on the profitability and margins of Islamic banks. Based on agency theory, this pressure can create incentives for management to engage in earnings management practices in order to maintain the company's financial image in the eyes of investors, regulators, and the public (Rezki Zurriah et al., 2025) (Widayawati, 2025). This is particularly relevant because Islamic banks are not only accountable to shareholders but also have a responsibility to adhere to Sharia principles, which prohibit deceptive or non-transparent practices. Therefore, the potential increase in earnings management in response to NSFR pressure poses a serious ethical and reputational dilemma for the Islamic banking industry. If Islamic banks respond to margin pressure by manipulating profits, this will not only undermine the quality of their financial statements but could also erode public confidence in the integrity of the Islamic banking model as a whole. Thus, understanding the relationship between NSFR regulatory pressure, its impact on margins, and the potential for earnings management behavior is crucial for regulators to design effective oversight and for bank management to develop compliant and ethical strategies.

Summary and Synthesis of Findings

This systematic literature review synthesizes academic evidence showing that the implementation of the Net Stable Funding Ratio (NSFR) as part of the Basel III framework has multifaceted consequences for Islamic banking. The main findings confirm a causal chain: NSFR effectively increases long-term funding stability, but this success comes at the cost of significant pressure on profitability. Specifically, the synthesis shows that this pressure manifests most clearly in the compression of Islamic banks' profit margins. This is due to the necessity for banks to shift to higher-cost, long-term stable funding sources, while facing limitations in adjusting the returns on financing assets due to contract structures and competitive pressures. Furthermore, this study constructs a conceptual framework linking pressure on margins to increased incentives for management to engage in earnings management practices. Thus, NSFR not only impacts balance sheets and income statements, but also has the potential to trigger strategic behavioral responses from managers who, in an effort to meet performance expectations, may use accounting flexibility to manipulate reported earnings. This narrative underscores that the impact of prudential regulation extends beyond financial metrics and stability, reaching into the realm of corporate governance and reporting ethics.

Connection to Previous Literature and Contribution of the Study

The findings of this study are consistent with most of the literature that identifies a trade-off between stability and profitability as a consequence of Basel III liquidity regulations. Studies such as those conducted by (Setiyono & Naufa, 2021) have extensively documented the negative impact of NSFR on global bank performance. However, the unique contribution of this study lies in its contextualization and in-depth analysis of the Islamic banking sector. While previous studies such as those by (Abbas et al., 2022) (Alam et al., 2020) tend to focus on the aggregate impact on stability or profitability (ROA), this study specifically highlights "margin" as the main transmission channel from regulatory pressure to financial performance. Furthermore, a key strength of this review is that it builds a conceptual bridge that is often overlooked in empirical studies, namely between macro-regulatory pressure (NSFR), micro-financial impact (margin compression), and corporate behavioral response (earnings management) (Farooq et al., 2022) (Hassan & Aliyu, 2018). While some studies have examined earnings management in Islamic banks (e.g., (Baker, 2015)), these studies rarely link it directly to specific pressures arising from liquidity regulations such as NSFR (Mohd Thas Thaker et al., 2021). By integrating these three elements, this study fills a significant gap in the literature and offers a more holistic narrative regarding the unintended consequences of financial regulation.

Reflection of Findings on Research Objectives

This systematic literature review has effectively achieved its objectives, namely to analyze and synthesize the literature on the implications of NSFR on Islamic bank margins and its potential influence on profit management practices. The first objective, namely to examine the impact on margins, was fulfilled by identifying the causal mechanism whereby NSFR obligations increase the cost of funds and directly suppress profit margins, a phenomenon exacerbated by structural asset-liability mismatches on Islamic bank balance sheets. The second objective, which is to explore the potential impact on earnings management, was achieved by constructing a framework based on agency theory. This framework explains how pressure on margins creates incentives for managers (agents) to use information asymmetry to present better financial performance to shareholders (principals) through earnings management practices. Thus, this study successfully goes beyond descriptive analysis by presenting a coherent narrative synthesis that explains the complex relationship between liquidity regulation, strategic financial performance, and managerial behavior in the Islamic banking sector. The fulfillment of these objectives provides a strong conceptual foundation for future empirical research to test the hypotheses developed from this study.

Theoretical and Practical Implications

Theoretically, the results of this study make a significant contribution to three areas. First, this study enriches the liquidity-profitability trade-off theory by showing its specific manifestation in Islamic banks, where the structure of financing contracts (e.g., murabahah with fixed margins) limits the bank's ability to transfer increases in funding costs to customers, thereby deepening the negative impact on margins. Second, this study provides a new context for agency theory in Islamic banking. It was found that external regulatory pressures such as NSFR can serve as a powerful trigger that exacerbates agency conflicts, even in a system based on ethical principles and transparency. Third, this study contributes to banking regulation theory by highlighting the importance of analyzing the secondary effects and unintended consequences of a policy with noble objectives such as increasing stability. In practical terms, the implications are twofold. For regulators, these findings suggest the need for closer scrutiny not only of NSFR compliance but also of profit quality and the potential for increased aggressive accounting practices. For Islamic bank management, this study underscores the urgency of developing innovative and efficient long-term funding strategies (e.g., through the issuance of green sukuk or waqf) and

strengthening internal governance mechanisms to maintain the integrity of financial reporting amid profitability pressures.

Analysis of Causes and Results

Based on Theoretical Framework The results synthesized in this study can be explained in depth through the interaction between two main theoretical frameworks. First, pressure on Islamic bank margins is a direct manifestation of the liquidity-profitability trade-off theory. The implementation of NSFR forces banks to increase the portion of Available Stable Funding (ASF) with high weightings, such as long-term deposits and sukuk, which inherently have higher funding costs than short-term funding sources such as wadiah current accounts. This increase in costs, which cannot be fully offset by increased income from assets due to fixed financing margins and market competition, mechanically erodes profit margins. This phenomenon is reinforced by the unique characteristics of Islamic banks, which have long-term asset portfolios funded by predominantly short-term liabilities. Second, the potential increase in profit management practices () is a logical consequence of agency theory. When margins and real profitability are pressured by external factors (NSFR regulations), a gap arises between actual performance and shareholder expectations or manager compensation targets. This gap creates a strong incentive for managers (agents), who have an information advantage, to engage in opportunistic behavior by manipulating accrual figures to present a better picture of performance. Thus, NSFR regulations act as a catalyst that intensifies existing agency conflicts, encouraging strategic responses that may sacrifice transparency for the sake of performance image.

Recommendations and Future Research

Based on the findings of this study, several recommendations can be formulated. For Islamic banking practitioners, it is recommended to proactively diversify long-term funding sources through product innovation, such as developing the retail sukuk market or waqf-based instruments, to reduce NSFR compliance costs. In addition, strengthening the functions of the audit committee and the sharia supervisory board is crucial to mitigate the risk of profit management increases. For regulators, it is recommended to periodically evaluate the quantitative impact of NSFR on the profitability and margins of Islamic banks, as well as to develop a more sensitive supervisory system to detect irregular accounting practices. Future research should focus on the empirical validation of the conceptual framework developed in this study. Quantitative studies using panel data from various countries are needed to statistically test the relationship between NSFR compliance levels, changes in bank margins, and profit management proxies (e.g., discretionary accruals). Comparative studies between Islamic and conventional banks in the same jurisdiction can provide insights into whether the impact of NSFR is more pronounced in the Islamic sector. Finally, qualitative research through in-depth interviews with bank managers and regulators can provide a richer understanding of the strategic decision-making process and ethical dilemmas faced in responding to regulatory pressures.

4. Conclusion

This systematic literature review articulates a crucial finding regarding the dual consequences of the implementation of the Net Stable Funding Ratio (NSFR) on Islamic banking. The main finding confirms that although the NSFR has succeeded in achieving its main objective of strengthening long-term funding stability, this success has simultaneously created significant pressure that manifests itself in compressed profit margins. This transmission mechanism is particularly evident for Islamic banks due to the inherent structural mismatch between long-term financing asset portfolios, such as murabahah, and liability structures dominated by short-term funding sources. The obligation to meet the NSFR ratio forces Islamic banks to switch to higher-cost stable funding sources, which directly erodes profitability. More than just a financial impact, the urgency of these findings lies in the identification of unintended behavioral consequences: pressure on margins creates a strong incentive for management to engage in profit management practices. This phenomenon, which can be explained through agency theory, shows that regulations designed to maintain systemic health can indirectly encourage opportunistic behavior that has the potential to erode transparency and financial reporting integrity, a dilemma that demands serious attention from regulators and industry players alike.

The main contribution of this study lies in its ability to fill a significant conceptual gap in the Islamic finance literature. While previous studies tended to analyze the impact of NSFR separately, either on stability or on aggregate profitability (Gržeta et al., 2023) (Bitar et al., 2021), this study builds an analytical bridge that integrates all three into a coherent causal narrative: from macroprudential regulatory pressure, its impact on micro financial performance (margins), to corporate behavioral responses (profit management). Theoretically, this study enriches three theoretical foundations. First, it contextualizes the liquidity-profitability trade-off theory within the Islamic ecosystem, showing how unique contract structures exacerbate this trade-off. Second, it adds a new dimension to agency theory by identifying prudential regulation as a potential trigger for agency conflicts. Third,

it contributes to banking regulation theory by highlighting the importance of analyzing secondary impacts. Practically, the added value of this study is twofold. For regulators, it provides a warning signal to broaden the focus of supervision from mere ratio compliance to the quality of reported profits. For Islamic bank management, it underscores the urgency of developing innovative funding strategies and strengthening internal governance to navigate an increasingly complex regulatory landscape in an ethical and sustainable manner.

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