

Regulatory Framework of Shariah Governance

Zulkiflihasan.com

CG in IFIs

“A set of relationships between a company’s management, its BOD, its shareholders and other stakeholders which provides the structure through which the objectives of the company are set; and the means of attaining those objectives and monitoring performance are determined” (IFSB, 2006).

In the context of IFIs: “a set of organizational arrangements whereby the actions of the management of IIFS are aligned, as far as possible, with the interests of its stakeholders; provision of proper incentives for the organs of governance such as the BOD, SSB and management to pursue objectives that are in the interests of the stakeholders and facilitate effective monitoring, thereby encouraging IIFS to use resources more efficiently; and compliance with Islamic Shari’ah rules and principles” (IFSB, 2006).

Shari'ah Governance

A set of institutional and organizational arrangements through which IFIs ensure that there is independent oversight of Shari'ah compliance.

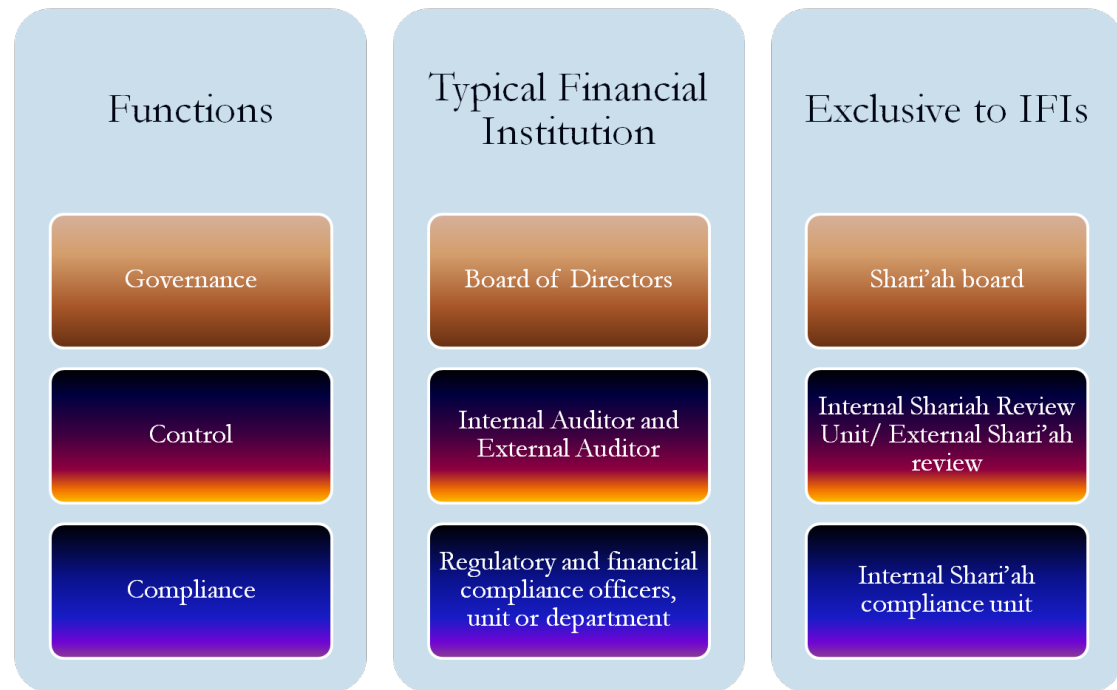
Key Participants of SG in IFIs

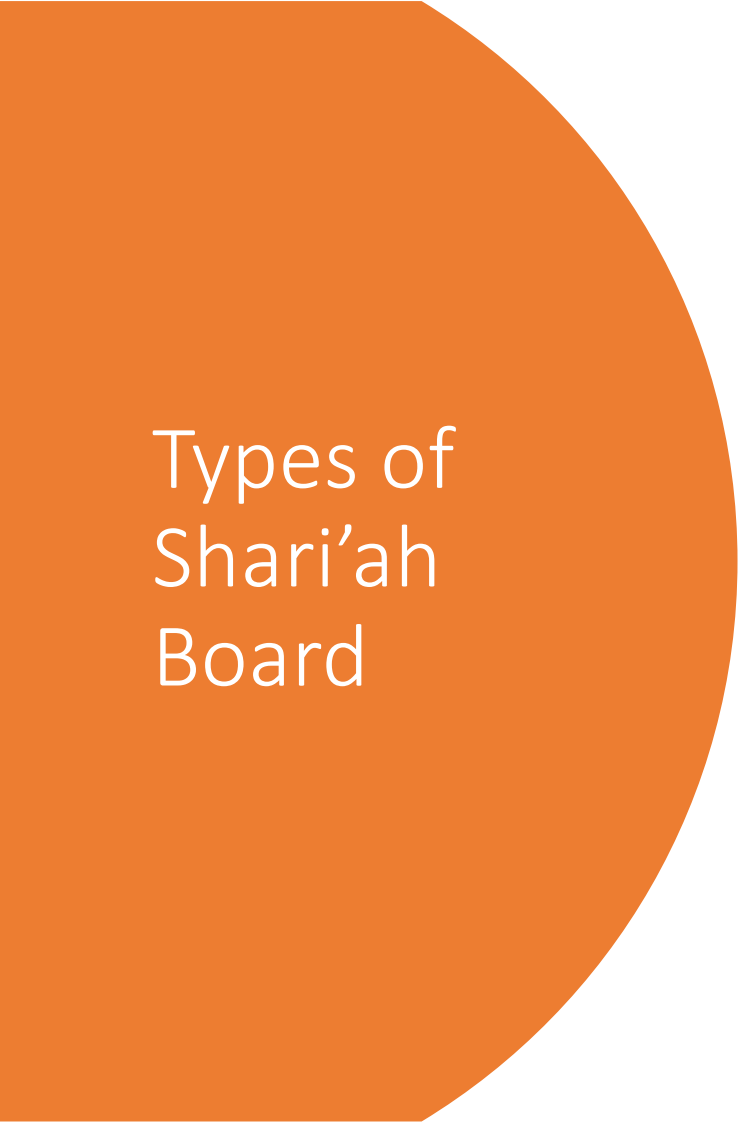
Key Participants	Interest	Functional Roles
<ul style="list-style-type: none"> Regulatory /Supervisory authority 	<ul style="list-style-type: none"> Economic Stability and Compliance with the laws and regulation 	<ul style="list-style-type: none"> Set regulatory framework for sound and proper CG To supervise and monitor the effectiveness of CG and to check compliance with regulation
<ul style="list-style-type: none"> Shareholders 	<ul style="list-style-type: none"> Wealth maximization; Satisfactory earnings per share; Dividends; 	<ul style="list-style-type: none"> Appoint fit and proper boards, management auditors and <i>Shari'ah</i> board
<ul style="list-style-type: none"> IAH 	<ul style="list-style-type: none"> Repayment of deposits on the agreed terms; Protection of their interests and Profit 	<ul style="list-style-type: none"> To monitor the investment performance
<ul style="list-style-type: none"> <i>Shari'ah</i> Board 	<ul style="list-style-type: none"> Compliance with <i>Shari'ah</i> 	<ul style="list-style-type: none"> To ensure <i>Shari'ah</i> compliance and protect the rights and interest of depositors and other stakeholder.
<ul style="list-style-type: none"> BOD 	<ul style="list-style-type: none"> Monetary and non-monetary compensation; 	<ul style="list-style-type: none"> To set the IFIs direction and policies
<ul style="list-style-type: none"> Management 	<ul style="list-style-type: none"> Monetary and non-monetary compensation and commitment to claims of the contract. 	<ul style="list-style-type: none"> To implement policies set by the BOD

Corporate Structure

Guidelines on Governance	Regulation	Regulator			
	Electing BOD/ Approving Key Policy	Shareholder			
Infrastructure	Investor/ Shareholder Protection	BOD			Shari'ah Board
Due Diligence					
Communication	Board Oversight	Risk Committee	Audit Committee	Governance Committee	
Internal Control					
Monitoring					Internal Shari'ah Compliance Unit/ Department
Enforcement	Management Oversight	Risk Management	Internal Audit	Compliance Officer	

How SG complements CG framework in IFIs?



A large orange shape on the left side of the slide, consisting of a vertical rectangle on the left and a quarter-circle on the right side.

Types of Shari'ah Board

Shari'ah boards at Individual IFI Level

Central *Shari'ah board* for the Whole Group

National *Shari'ah boards*

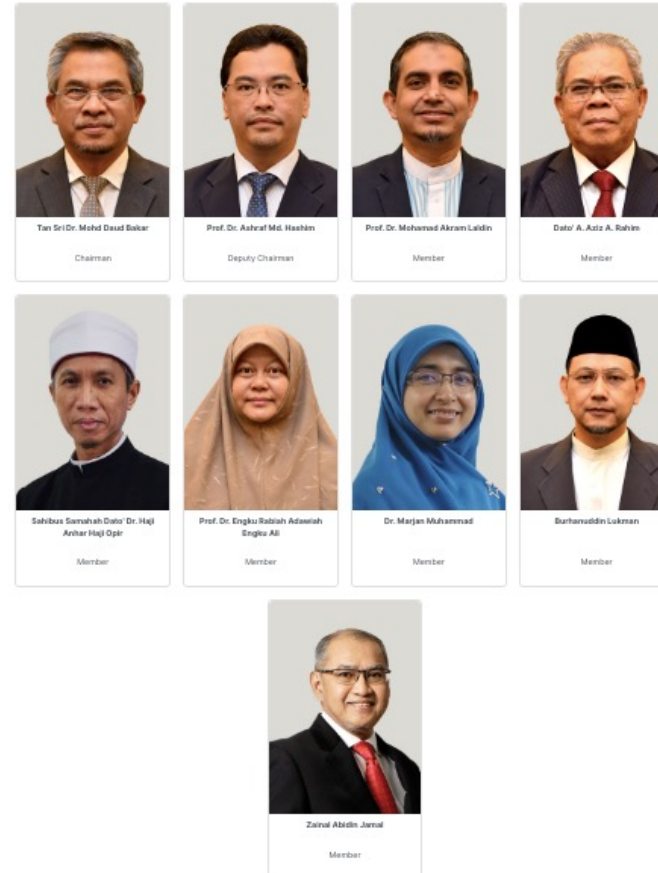
Shari'ah boards at International Level

Shari'ah Advisory Firms

Individuals Undertaking *Shari'ah* Advisory
Roles



Shariah Advisory Council BNM



Shariah Advisory Council (Securities Commission)



Datuk Dr. Mohd Daud Bakar
Group Chairman,
Amanie Advisors



Dato' Ahmad Tajudin Haji Abdul Rahman
Former Managing Director,
Bank Islam Malaysia Berhad



Professor Dr. Ashraf Md Hashim
Chief Executive Officer,
ISRA Consultancy Sdn Bhd



Professor Dr. Engku Rabiah Adawiah Engku Ali
Professor,
IIUM Institute of Islamic Banking and Finance (IIIBF),
International Islamic University Malaysia



Professor Dr. Asmadi Mohamed Naim
Dean,
Islamic Business School,
Universiti Utara Malaysia



Associate Professor Dr. Aznan Hasan
Associate Professor,
IIUM Institute of Islamic Banking and Finance (IIIBF),
International Islamic University Malaysia



Associate Professor Dr. Syed Musa Syed Jaafar Alhabshi
Associate Professor,
IIUM Institute of Islamic Banking and Finance (IIIBF),
International Islamic University Malaysia



Associate Professor Dr. Mohamed Fairouz Abdul Khir
Associate Professor,
School of Law and Shariah,
Islamic University of Malaysia



Dr. Shamsiah Mohamad
Former Senior Researcher,
International Shari'ah Research Academy for Islamic
Finance (ISRA)



AAOIFI BOARD MEMBERS

Why *Shari'ah* Governance Matter?

Cases	Implication
<i>The Investment Dar Company v Blom Developments Bank</i>	TID claims that the wakala based deposit in the amount of USD10m did not comply with the Shari'ah and therefore should be considered void.
Judgment on BBA	The High Court decreed that the profit derived from BBA facility is unlawful. The defaulters of BBA facility were only liable as to the original facility amount and not the selling price.
Kleinwort Benson	One of the factors that lead to the closure of KB in 1986 was due to investor's reservation about the absence of a SB (Iqbal, 2002)
The Majma' Fiqh declaration on <i>Tawarruq</i>	Resolution on Tawarruq at the 19th meeting in Sharjah, UAE on 26-30th April 2009 which confirmed its impermissibility
Statement of 85% of potential Shari'ah non-compliance sukuk	Has negated in some way public confidence on legitimacy and Islamicity of the sukuk. Sales of sukuk dropped 50% in 2008 and prices fell at an average of 1.51%. According to Bloomberg, sales of global sukuk had dropped to USD856 million in 2008 (Sobri, 2008).
Misused of funds by BCCI	Due to weak supervision on SG, it is found that BCCI has misappropriated the funds obtained from IFIs in non-Shari'ah portfolio (Grais and Pellegrini, 2006).

Shari'ah Governance Practices

Countries	Practices
Malaysia	- Islamic Financial Services Act 2013 and Policy Document on <i>Shari'ah</i> Governance 2019. SAC and SC.
Indonesia	- Law No. 21 (2008), PBI No.6/24/PBI/2004 and PBI No.11/33/PBI /2009 - National <i>Shari'ah</i> Board (DSN) and <i>Shari'ah</i> Supervisory Board (DPS/SSB)
Turkey	- Banking Law No. 5411 at 2005 - Central <i>Shari'ah</i> Advisory Board within the Participation Banks Association of Turkey (TKBB) - The Declaration on Compliance with Principles and Standards of Interest-Free Banking published by BRSA.
Bahrain	- The CBB Rule Book Volume 2, Islamic Banks, Part A, High Level Control - National <i>Shari'ah</i> board under Central Bank
UAE	- <i>Shari'ah</i> Governance Standards for Islamic Financial Institutions 2020 - Higher <i>Shari'ah</i> Authority at the Central Bank
Qatar	- Instruction to Banks November 2011 - Supreme <i>Shari'ah</i> Council attached to Awqaf Ministry - A centralised <i>Shari'ah</i> supervisory body Qatar Central Bank (QCB)
Saudi Arabia	- <i>Shari'ah</i> Governance Framework (SGF) for Islamic financial institutions (IFIs) 2020. <i>Shari'ah</i> board of IFIs
Kuwait	- <i>Shari'ah</i> Supervisory Governance for Kuwaiti Islamic Banks - Supreme <i>Shari'ah</i> Supervisory Board at the Central Bank of Kuwait (CBK)
Pakistan	- Instruction and Guidelines for <i>Shari'ah</i> Compliance in Islamic Banking Institutions - <i>Shari'ah</i> Governance Framework 2015 and revised 2018.
Bangladesh	- <i>Shari'ah</i> governance guideline for Islamic banks 2009 - Central <i>Shari'ah</i> Board for Islamic Banks of Bangladesh established in 2002.

RELATED LAWS

CBA 2009

- S 2 Islamic financial business means any financial business in ringgit or other currency which is subject to the laws enforced by the Bank and consistent with the Shariah;

IFSA 2013

- S 28(1): An institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with Shariah.

DFIA 2002

- S33 D (1) shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with Shariah.

Guidelines

- Shariah Governance Framework (SGF) 2010 and the Shariah Governance Policy Document (SGPD) 2019.

International Guidelines

- AAOIFI Governance Standards 1-5
- IFSB-10

Islamic Banking Act 1983

S 3 (5) The Central Bank shall not recommend the grant of a licence, and the Minister shall not grant a licence, unless the Central Bank or the Minister, as the case may be, is satisfied—*(a)* that the aims and operations of the banking business which it is desired to carry on will not involve any element which is not approved by the Religion of Islam; and

(b) that there is, in the articles of association of the bank concerned, provision for the establishment of a Syari'ah advisory body, as may be approved by the Central Bank, to advise the bank on the operations of its banking business in order to ensure that they do not involve any element which is not approved by the Religion of Islam.

S13A. (1) An Islamic bank may seek the advice of the Syariah Advisory Council on Syariah matters relating to its banking business and the Islamic bank shall comply with the advice of the Syariah Advisory Council.

(2) In this section, "Syariah Advisory Council" means the Syariah Advisory Council established under subsection 16B(1) of the Central Bank of Malaysia Act 1958.

BAFIA 1989 and Financial Services Act 2013

S 124. (3) of the BAFIA: Any licensed institution carrying on Islamic banking business or Islamic financial business, in addition to its existing licensed business may, from time to time seek the advice of the Syariah Advisory Council established under subsection (7), on the operations of its business in order to ensure that it does not involve any element which is not approved by the Religion of Islam.



Section 15 (7) of the FSA: The board of directors of— (a) a licensed bank or licensed investment bank; or (b) an approved person or operator of a designated payment system which is required by the Bank under subsection 30(3) of the Islamic Financial Services Act 2013 to establish a Shariah committee, shall, without prejudice to section 56, have due regard to the advice of its Shariah committee in respect of the Islamic financial business

IFSA



GATE KEEPING PROVISIONS

- ✓ Licensing
- ✓ Approval
- ✓ Authorization
- ✓ Designation
- ✓ Shareholders

- ✓ Directors
- ✓ Chief Executive Officer
- ✓ Shariah Advisory Council
- ✓ Auditors
- ✓ Shariah Committee

IFSA 2013
Part IV
Shari'ah
Requirements
of the IFSA

S29 (2): Duty of Islamic banks to ensure Shariah compliance (end to end) which includes responsibility of the BOD.

S29: BNM supervisory power to issue Shariah Standards and Practice Guides

S28(5): Severe penalties for Shariah non compliance

Islamic banks conduct financial intermediation functions using Shariah contracts. For asset – clarity on scope of provision of finance. For liability – deposit vs investment

Enhanced business conduct which is in compliance with the essence of Shariah especially prohibition of unfair and deceptive business contract.

S37-38: Expand the scope of audit for External Auditor to include Shariah audit (4th Level of Defence).

IFSA 2013

“Shariah Advisory Council” means the Shariah Advisory Council on Islamic finance established under section 51 of the Central Bank of Malaysia Act 2009;

“Shariah committee” means the Shariah committee of an institution established pursuant to section 30;

Shariah Governance

- S 29 (2) (a) Shariah governance including
 - (i) functions and duties of the board of directors, senior officers and members of the Shariah committee of an institution in relation to compliance with Shariah;
 - (ii) fit and proper requirements or disqualifications of a member of a Shariah committee; and
 - (iii) internal Shariah compliance functions; and
 - any other matter in relation to the business, affair and activity of an institution for the purposes of compliance with Shariah. (Refer S33E (2) (a) of the DFIA 2002)

Compliance to Shariah means compliance to SAC rulings and Shariah Committee advise

S28. (1) An institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with Shariah.

(2) For the purposes of this Act, a compliance with any ruling of the Shariah Advisory Council in respect of any particular aim and operation, business, affair or activity shall be deemed to be a compliance with Shariah in respect of that aims and operations, business, affair or activity. (Similar provision in S 33D of the DFIA 2002)

Shariah Non-compliance Reporting

S 28 (3) Where an institution becomes aware that it is carrying on any of its business, affair or activity in a manner which is not in compliance with Shariah or the advice of its Shariah committee or the advice or ruling of the Shariah Advisory Council, the institution shall

(a) immediately notify the Bank and its Shariah committee of the fact;

(b) immediately cease from carrying on such business, affair or activity and from taking on any other similar business, affair or activity; and

(c) within thirty days of becoming aware of such non-compliance or such further period as may be specified by the Bank, submit to the Bank a plan on the rectification of the non-compliance.

(5) Any person who contravenes subsection (1) or (3) commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding eight years or to a fine not exceeding twenty-five million ringgit or to both. (Similar provision in S 33D of DFIA)

Power of bank to specify standards on Shariah matters

S 29 (1) The Bank may, in accordance with the advice or ruling of the Shariah Advisory Council, specify standards

- (a) on Shariah matters in respect of the carrying on of business, affair or activity by an institution which requires the ascertainment of Islamic law by the Shariah Advisory Council; and
- (b) to give effect to the advice or rulings of the Shariah Advisory Council.

(2) In addition, the Bank may also specify standards relating to any of the following matters which does not require the ascertainment of Islamic law:

(6) Any person who fails to comply with any standards specified under subsection (1), commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding eight years or to a fine not exceeding twenty-five million ringgit or to both. (Similar provision in Section 33E of the DFIA 2002)

Shariah Committee

30. (1) A licensed person shall establish a Shariah committee for purposes of advising the licensed person in ensuring its business, affairs and activities comply with Shariah.

31. No person shall be appointed, reappointed or accept any appointment as a member of a Shariah committee unless such person meets the requirements as set out in any standards as may be specified by the Bank under subparagraph 29(2)(a)(ii) and has obtained the prior written approval of the Bank. (Refer S 33F of the DFIA 2002)

Qualified privilege and duty of confidentiality

S 36 A member of a Shariah committee shall not be liable—

(a) for a breach of a duty of confidentiality between such member and the institution in respect of

- (i) any reporting to the Bank; or
- (ii) the discharge of his duties and performance of his functions,
- pursuant to any standards specified by the Bank under subparagraph 29(2)(a)(i) which was done or made in good faith; or

(b) to be sued in any court for defamation in respect of any statement made by the member without malice in the discharge of his duties under this Act. (Refer S33L of the DFIA 2002)

SHARIAH GOVERNANCE CBA 2009

- Section 51: BNM may establish a Shariah Advisory Council on Islamic Finance which shall be the authority for the ascertainment of Islamic law for the purposes of Islamic financial business.
- Section 53: The Yang di-Pertuan Agong may appoint from amongst persons who are qualified in the Shariah or who have knowledge or experience in the Shariah and in banking, finance, law or such other related disciplines as members of the SAC.
- Section 56: Reference to SAC for ruling from court or arbitrator.
- Section 57: SAC ruling shall be binding on IFI and court/arbitrator.
- Section 58: SAC ruling prevails over other Shariah authorities sought by IFIs.

Section 16B CBA 1958 (2004)

- (1) states that Bank Negara Malaysia may establish a Shariah Advisory Council, which shall be the authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by the Bank.
- Section 16B (7) states that Bank Negara Malaysia shall consult the Shariah Advisory Council on Shariah matters relating to Islamic banking business, Takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia, and may issue written directives in relation to those businesses in accordance with the advice of the Shariah Advisory Council.
- Section 16B (8) states that where in any proceedings relating to Islamic banking business, Takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles and is supervised and regulated by Bank Negara Malaysia before any court or arbitrator any question arises concerning a Shariah matter, the court or the arbitrator, as the case may be, may take into consideration any written directives issued by Bank Negara Malaysia as provided in sub-section (7); or refer such question to the Shariah Advisory Council for its ruling.
- Section 16B (9) states that any ruling made by the Shariah Advisory Council pursuant to a reference made shall, for the purposes of the proceedings in respect of which the reference was made if the reference was made by a court, be taken into consideration by the court in arriving at its decision; and if the reference was made by an arbitrator, be binding on the arbitrator.
- Section 16B (11) states that any request for consultation or reference for a ruling of the Shariah Advisory Council under the Act or any other law shall be submitted to the secretariat.
- Section 16B (10) states that the Bank Negara Malaysia may establish a secretariat and such other committees as it considers necessary to assist the Shariah Advisory Council in the performance of its functions and may appoint any of the officers of the Bank or any other person to be a member of the secretariat or any of such committees.

Pre-CBA 2009

Affin Bank Berhad v Zulkifli Abdullah [2006] 3 MLJ 67 :

- It is not a question of shariah law.
- It is the conclusion of this court. There is no necessity to refer the question to another forum.

Arab Malaysian Merchant Bank Berhad v Silver Concept Sdn Bhd [2005] 5 MLJ 210 :

- s 16B does not make reference to the SAC mandatory.
- Only binding to the arbitrator.

Reference to SAC

The court or
arbitrator shall

(a) take into
consideration any
published rulings of
the Shariah Advisory
Council; or

(b) refer such
question to the
Shariah Advisory
Council for its ruling.

(2) Any request for
advice or a ruling of
the Shariah Advisory
Council under this
Act or any other law
shall be submitted to
the secretariat.

Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad [2009] 6 MLJ 416

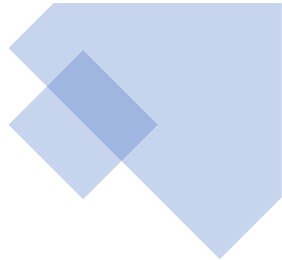

For the first time in the history of the Malaysian court that the High Court judge made reference to the SAC for confirmation of the *Shari'ah* status of the agreement.

BBA is recognized form of transaction.

*Bank Islam
Malaysia Bhd
v Lim Kok Hoe
& Anor And
Other Appeals*
[2009] 6 CLJ 2
2; [2009] 6
MLJ 839

The ct will have to assume that the SAC and the SC would have discharged their duty to ensure that the operation of Islamic banks are complied with the syariah.


The judge should not have taken upon himself to rule otherwise without having regard the view of the SAC.

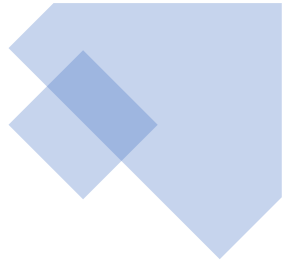



Tan Sri Abdul Khalid
bin Ibrahim v Bank
Islam Malaysia Bhd
[2012] 7 MLJ

(Mohd Zawawi J): It is settled law that ss 56 and 57 of the Act are valid federal laws enacted by Parliament and as such were not in contravention of the FC.

Difference of opinion on Shariah issues relating to Islamic banking should be resolved within the SAC. It is advisable and practical that a special body like the SAC should ascertain the Islamic law most applicable to the Islamic banking industry in Malaysia






Azhar bin Osman & 3 Other Cases (2010) 9 MLJ

Counsel for the bank contended that in a BBA contract the Bank has a legal right to claim for the full sale price as stipulated in the Property Sale Agreement, as.

The HC observed that in specifying the amount due, the issue which confronts a BBA contract is the agreement is silent on:

Since the tenure of the contract has not completed, normally the bank will further deduct as *ibra* (a term used in Islamic banking for rebate) what it refers to as 'unearned profit', i.e. the amount which has yet to be earned by the bank, based on an Amortization table.

when a BBA contract is prematurely terminated upon default by the borrower, the court cannot allow the bank to enforce the payment of the full sale price in a premature termination:



MK Associates Sdn Bhd v. Bank Islam Malaysia Bhd [2015] 6 CLJ

The plaintiff must know of the imposition of Ta'widh so that consent could be given freely. Obviously, the plaintiff in this case did not know the imposition of Ta'widh on the financing facility granted to it.

At the time the agreements were entered into Ta'widh was not practised by the IFI. Ta'widh was only introduced after the SAC's Resolution in 1998. The said resolution was to take effect only on 1 January 1999 to existing and new agreements. Therefore, Ta'widh shall be applicable only on or after 1 January 1999.

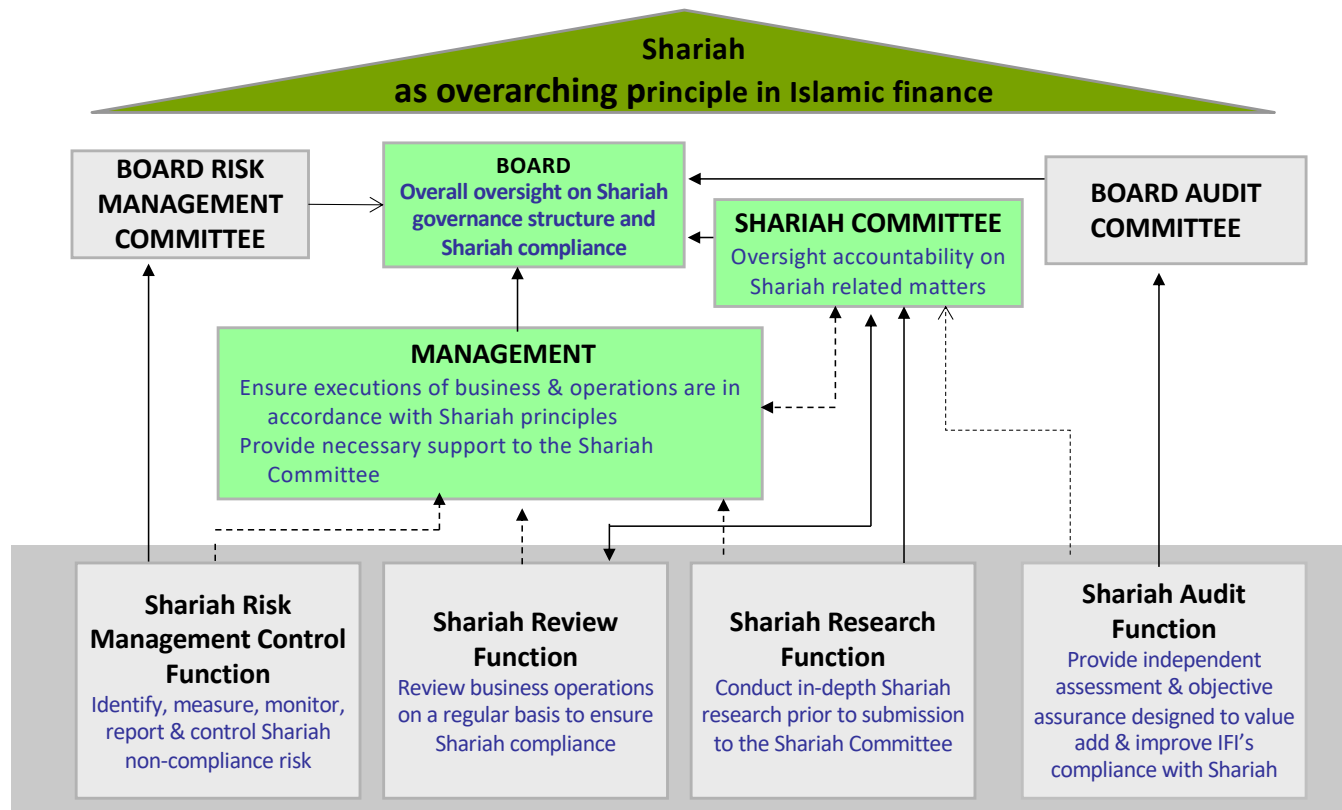
*JRI RESOURCES SDN
BHD v. KUWAIT
FINANCE HOUSE
(MALAYSIA) BERHAD;
PRESIDENT OF
ASSOCIATION OF
ISLAMIC BANKING
INSTITUTIONS
MALAYSIA & ANOR
(INTERVENERS) [2019]
3 MLRA 87*

- Whether ss 56 and 57 of the CBA 2009, had the legal effect of encroaching on the judicial power of the courts, hence, were unconstitutional having contravened Part IX of the FC.
- **HC:** The respondent's claim at the High Court premised on the applicant's failure to make payment of the amount outstanding to the respondent under various Islamic Facilities Agreements granted, was allowed.
- **COA:** Allowed the applicant's appeal and directed that the question relating to the Shariah compliance of clause 2.8 of the facilities agreements granted by the respondent to the applicant be referred to the SAC. The SAC decided that the said clause was Shariah compliant. Dissatisfied, the applicant filed the present application for reference.
- **Federal Court:** RICHARD MALANJUM, CJ AHMAD MAAROP, PCA ZAHARAH IBRAHIM, CJM DAVID WONG DAK WAH, CJSS RAMLY HAJI ALI, FCJ AZAHAR MOHAMED, FCJ ALIZATUL KHAIR OSMAN KHAIRUDDIN, FCJ MOHD. ZAWAWI SALLEH, FCJ IDRUS HARUN, JCA
- Dismissing the application and holding that ss 56 and 57 of the 2009 Act were not in breach of the FC and unconstitutional.
- The ascertainment of Islamic laws for the purposes of Islamic financial business was a function or power delegated by the legislative branch to the judicial branch and the SAC.

Guidelines on Shari'ah Governance for IFIs

Issuer	Guidelines
AAOIFI	■ Governance Standards 1-5
IFSB	■ Guiding Principles on SG System for Institutions offering Islamic Financial Services
Malaysia	■ Shari'ah Governance Framework 2010 and 2019
Pakistan	■ Instruction and Guidelines for Shari'ah Compliance in Islamic Banking Institutions.
Bahrain	■ The CBB Rule Book Volume 2, Islamic Banks, Part A, High Level Control
DIFC	■ the DIFC Services Authority (DFSA) Rulebook on Islamic Financial Business Module
QFC	■ the Islamic Finance Rule Book 2007
Bank Indonesia	■ BI Rule No 6/24/PBI/2004

Shariah Governance Framework



Shariah
Governance
Policy
Document

This policy document is issued pursuant to

(a) sections 29(2), 57(1) and 155 of the Islamic Financial Services Act 2013 (IFSA); and

(b) sections 33E(2), 41 and 116 of the Development Financial Institutions Act 2002 (DFIA).



The guidance in this policy document is issued pursuant to section 277 of the IFSA and section 126 of the DFIA.

Standard and Guidance



“S” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action



“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted

Governance Arrangements

(i) The BOD;

(ii) SC;

(iii) Senior management;

(iv) Control functions;

(v) Shariah compliance culture and remuneration; and

(vi) Transparency and disclosures.

Board of Directors

- **S 8.1** The board's oversight accountability over Shariah governance and compliance must reflect the integration of Shariah governance considerations within the business and risk strategies of the IFI.
- (a) approve policies relating to governance structure and reporting arrangements, Shariah non-compliance risk management and other areas that are material to the effective implementation of Shariah governance within the IFI;
- (b) oversee the implementation of SAC rulings and decisions or advice of the Shariah committee within all business and functional lines, including any business or risk implications arising from such implementation;
- (c) oversee the implementation of the internal control framework to prevent Shariah non-compliance and any rectification measures to resolve incidences or circumstances that may result or have resulted in Shariah non-compliance ;
- (d) oversee the performance of senior management and other officers entrusted to implement Shariah governance framework such that the board is satisfied that the measures of their performance are aligned with Shariah governance objectives; and
- (e) promote a sound corporate culture which reflects the importance of adhering to Shariah requirements in product development and marketing, strategy formulation, business operations, risk management practices and other aspects that promote end-to-end compliance with Shariah.

Shariah Committee

- **S 10.2** The Shariah committee has the responsibility to provide objective and sound advice to the IFI to ensure that its aims and operations, business, affairs and activities are in compliance with Shariah.
- (a) providing a decision or advice to the IFI on the application of any rulings of the SAC or standards on Shariah matters that are applicable to the operations, business, affairs and activities of the IFI;
- (b) providing a decision or advice on matters which require a reference to be made to the SAC;
- (c) providing a decision or advice on the operations, business, affairs and activities of the IFI which may trigger a Shariah non-compliance event;
- (d) deliberating and affirming a Shariah non-compliance finding by any relevant functions; and
- (e) endorsing a rectification measure to address a Shariah non-compliance event.

Shariah Committee Meeting

S 11.2 IFI must hold its Shariah committee meetings at least once in every two (2) months.

S 11.3 IFI operating as an Islamic window or a foreign branch in Malaysia must hold its Shariah committee meetings at least two (2) times a year.

S 11.4 A Shariah committee member must attend at least 75% of the Shariah committee meetings held in each financial year, and must not appoint another person to attend or participate in Shariah committee meetings on his behalf.

S 11.8 An IFI shall ensure that any decision of the Shariah committee must be made on the basis of simple majority.

Appointment, Cessation and Disqualification of the SC Member

<i>Shariah</i> Compliance Function	Criteria
Appointment	<ul style="list-style-type: none"> ▪ Muslim individual; ▪ Fulfill all requirements as stated in the <i>Fit and Proper Criteria</i>; and ▪ <i>Shariah</i> qualified or an expert with relevant skills, knowledge and experience required by the SC.
<i>Shariah</i> Qualified Person	<ul style="list-style-type: none"> ▪ Minimum a bachelor degree in <i>shariah</i> (includes <i>usul fiqh</i> or <i>fiqh muamalat</i>); ▪ Have solid knowledge in <i>shariah</i> with sound Islamic finance knowledge and experience; and ▪ Have strong proficiency and knowledge in Arabic (written and verbal), with good command in the IFI's preferred language.
Disqualification	<ul style="list-style-type: none"> ▪ An undischarged bankrupt; ▪ Charge for criminal offence relating to dishonesty or fraud; or ▪ Under any law relating to prevention of crime, drug trafficking or immigration.
Conflict of Interest	<p>SC member or his/her immediate family:</p> <ul style="list-style-type: none"> ▪ Not an executive or within the last two years of his/her proposed appointment of the IFI; ▪ Not a substantial shareholder, executive director or senior officer of the IFI or any of its affiliates; or ▪ Not have a significant business or other contractual relationship with the IFI or any of its affiliates within the last two years.

Appointment

- S 12.5 A Shariah committee member must not serve the same IFI for more than nine (9) years.
- S 12.6 A Shariah committee member must not have competing time commitments that may impair his ability to discharge his duties effectively. In respect of multiple appointments, a Shariah committee member is required to manage his commitments effectively, observe professional objectivity and confidentiality in carrying out his duties.
- S 12.7 A Shariah committee member must not accept any appointment in more than one licensed Islamic bank, one licensed takaful operator and one prescribed institution. S 12.8 A Shariah committee member must not be an active politician.
- G 12.17 Where a Shariah committee member resigns or is disqualified pursuant to the relevant paragraphs in this policy document, sections 33(2) and 34(1) of the IFSA impose obligations on an IFI and the Shariah committee member to notify the Bank of that fact and its reason immediately or in any cases no later than fourteen (14) days of such circumstance.

Composition

- **S 13.2** An IFI shall ensure that Shariah committee must be of a sufficient size that– (a) reflects the business needs of the IFI or the financial group; and (b) enables a conducive environment for sound deliberation of Shariah matters.
- **S 13.2** An IFI must ensure that its Shariah committee, at minimum, comprise of at least five (5) Shariah committee members.
- **S 13.3** An IFI must ensure that– (a) majority of its Shariah committee members are Shariah qualified persons; and (b) the chairman of the Shariah committee must be a Shariah qualified person.
- **S 13.4** Notwithstanding paragraph 13.2, an IFI operating as an Islamic window or a foreign branch in Malaysia must ensure that its Shariah committee, at minimum, comprise at least three (3) Shariah committee members.

Shariah Secretariat

- **S 14.1** An IFI shall appoint a secretariat to serve the Shariah committee. The secretariat has the responsibility to provide operational support for effective functioning of the Shariah committee, which includes–
 - (a) coordinating communications and disseminating information among the Shariah committee, the board and senior management;
 - (b) performing in-depth research and studies on Shariah issues;
 - (c) providing day-to-day advice to relevant parties within the IFI on Shariah matters based on the rulings of the SAC and decisions or advice of the Shariah committee;
 - (d) ensuring proper dissemination of decisions or advice of the Shariah committee within the IFI; and
 - (e) undertaking administrative and secretarial functions to support the Shariah committee.
- **S 14.2** An IFI must ensure that officers who perform the responsibilities in relation to paragraph 14.1(b) and (c) are officers with Shariah qualification.

Functions of Control Functions (S 16)

Control Functions	Functions
<i>Shariah</i> Risk Management	<ul style="list-style-type: none"> ▪ To integrate between <i>shariah</i> non-compliance risk with conventional risk management; ▪ To identify potential <i>shariah</i> non-compliance risk exposures; ▪ Assess and measure potential impact of <i>shariah</i> non-compliance risk exposures; ▪ To develop appropriate risk mitigation measures; ▪ To closely monitor on both <i>shariah</i> non-compliance risk exposures and effectiveness of the risk mitigation measures; ▪ To report to the BOD, the SC and senior management on the <i>shariah</i> non-compliance risk exposures; and ▪ To develop constructive decisions that may give escalate to <i>shariah</i> non-compliance risks.
<i>Shariah</i> Review	<ul style="list-style-type: none"> ▪ To identify, assess and monitor on <i>shariah</i> compliance by the IFI; ▪ To report on regular basis on <i>shariah</i> non-compliance issues and findings to the BOD, the SC and senior management; ▪ To inform and provide the latest updates on regulatory requirements especially SAC rulings to the BOD, the SC and senior management; and ▪ To ensure IFI's officers were provided with adequate training and guidance on relevant <i>shariah</i> requirements.
<i>Shariah</i> Audit	<ul style="list-style-type: none"> ▪ To assess the risk profile and each auditable area exposures by developing a strong audit methodology; ▪ To develop a comprehensive <i>shariah</i> audit plan for <i>shariah</i> audit process; ▪ To provide guidance on gathering information, auditing procedures and audit assessment by developing a clear documented <i>shariah</i> audit programs; and ▪ To communicate the audit findings, recommendations for rectification measures and auditee's responses and action plans to the BOD and the SC through an audit report.

Shariah Risk Management

S 17.2 The Shariah risk management function, at minimum, must–

- (a) integrate Shariah non-compliance risk considerations with enterprise wide risk management;
- (b) identify Shariah non-compliance risk exposures in the business operations and activities of the IFI;
- (c) assess Shariah non-compliance risk and measure the potential impact of the risk exposures to the IFI;
- (d) establish appropriate risk mitigation measures;
- (e) monitor Shariah non-compliance risk exposures and effectiveness of the risk mitigation measures;
- (f) report to the board, Shariah committee and senior management on the Shariah non-compliance risk exposures in relation to paragraph 17.2(b) to (e); and
- (g) constructively challenge decisions that may give rise to Shariah non-compliance risks.

S 17.3 The senior officer principally accountable and responsible for risk management shall be responsible for Shariah risk management which forms part of the IFI's integrated risk management framework.

S 17.4 An IFI shall ensure that its risk officers who perform the Shariah risk management function have the requisite knowledge on Shariah requirements applicable to Islamic financial business.

Shariah Review

S 18.2 The Shariah review function, at minimum, must–

- (a) identify, assess and monitor the compliance of the IFI's business operations and activities with Shariah;
- (b) report to the board, Shariah committee and senior management regularly on Shariah non-compliance issues and findings;
- (c) inform and provide updates to the board, Shariah committee and senior management on the latest developments in legal and regulatory requirements in Islamic finance, especially in relation to issuance of the SAC rulings; and
- (d) ensure adequate training and guidance are provided to the officers of an IFI on relevant Shariah requirements governing the IFI's operations, business, affairs and activities.

S 18.3 The senior officer principally accountable and responsible for compliance shall be responsible for Shariah review which forms part of the IFI's overall compliance responsibilities in ensuring sound management of compliance risk.

S 18.4 An IFI shall ensure that officers who perform the Shariah review function are qualified to undertake compliance function responsibilities and have sound understanding of relevant Shariah requirements applicable to Islamic financial business.

Shariah Audit

- **S 19.2** The Shariah audit function, at minimum, must
 - (a) establish an audit methodology to assess the risk profile and vulnerabilities of each auditable area;
 - (b) generate an audit plan for the assignments to be performed;
 - (c) establish clear documented audit programs that provide guidance to the internal auditors in gathering information, auditing procedures and audit assessment; and
 - (d) communicate results to the board and Shariah committee through an audit report, detailing the audit findings and recommendations for rectification measures, as well as the auditee's responses and action plans.
- **S 19.3** The senior officer principally accountable and responsible for internal audit shall be responsible for Shariah audit which forms part of the overall internal audit function in an IFI.
- **S 19.4** An IFI must ensure that its internal auditors who perform the Shariah audit function are qualified to perform internal audit and have the requisite knowledge on Shariah requirements applicable to Islamic financial business.

Transparency and Disclosure

S 22.1 An IFI must disclose in the annual report information on its Shariah governance policies and practices. Such disclosures must include

(a) disclosure by the board on its oversight accountability for Shariah governance implementation and the IFI's overall compliance with Shariah; and

(b) disclosure by the Shariah committee on its– (i) responsibilities relating to Shariah governance; and (ii) opinion on the state of the IFI's compliance with Shariah.



S 22.10 The Shariah committee's disclosure must include the nature, status and measures undertaken to address the material Shariah non-compliance events reported.



[Sample of Shariah Report](#)

International Guidelines on Governance for IFIs

IFSB	AAOIFI
<ul style="list-style-type: none"> ■ 10 prudential standards for IFIs, 2 for capital adequacy requirements, 1 for risk management and 7 for governance, disclosure and supervisory review process ■ Guiding Principles on CG for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (<i>Takaful</i>) Institutions and Islamic Mutual Funds) ■ Guiding Principles on Governance for Islamic Collective Investment Schemes, ■ Guiding Principles on Governance for <i>Takaful</i> (Islamic Insurance) Undertakings ■ Guiding Principles on Governance for Takaful Operations ■ Guiding Principles on Conduct of Business for Institutions offering Islamic Financial Services ■ Guiding Principles on SG System for Institutions offering Islamic Financial Services 	<ul style="list-style-type: none"> ■ 81 standards and guidelines which include 25 accounting standards, 6 auditing standards, 7 governance standards, 41 <i>Shari'ah</i> standards and 2 codes of ethics. ■ Shari'a Supervisory Board: Appointment, Composition and Report; ■ Shari'a Review ■ Internal Shari'a Review ■ Audit and Governance Committee ■ Independence of Shari'a Board ■ Statement on Governance Principles for IFIs ■ Corporate Social Responsibility

AAOIFI

Governance
Standard for IFIs
No. 1: *Sharī'ah*
Supervisory
Board:
Appointment,
Composition and
Report

- It consists of eight parts, namely introduction, definition, appointment, composition, selection and dismissal, basic elements of report, publication of the report, publication of *Sharī'ah* rulings and guidelines, and the effective date.
- Section 2 '*Sharī'ah* board'. Firstly, a *Sharī'ah* board is an independent body of specialized jurists in *fiqh al muāmalāt*. This section allows the appointment of *Sharī'ah* board members who are not specialized in *fiqh al muāmalāt* but who are expert in the field of Islamic finance. Secondly, it elaborates the role of the *Sharī'ah* board to ensure compliance with *Sharī'ah* principles by having the authority to direct, review and supervise the activities of IFIs. Thirdly, it indicates the binding authority of the *Sharī'ah* board upon the IFIs.

AAOIFI

Governance
Standard for
IFIs No. 2:
Sharī'ah
Review

- It consists of eight parts with eighteen sections. Section 3 explains the *Sharī'ah* review as an examination of the extent of the IFIs' *Sharī'ah* compliance. section 5 puts the responsibility for compliance upon the management.
- The *Sharī'ah* board is only responsible for forming and expressing opinions on the extent of *Sharī'ah* compliance. Sections 7–13 detail the *Sharī'ah* review procedures, which involve planning, designing, executing, preparing and reviewing. The *Sharī'ah* review report should be submitted to the AGM.

AAOIFI Governance Standard for IFIs No. 3: Internal *Sharī'ah* Review

- It consists of eleven parts and thirty sections which complement Governance Standard No. 2. Standard No. 3 aims at establishing standards and guidance on the internal *Sharī'ah* review.
- As the management of IFIs is responsible for the extent of *Sharī'ah* compliance, it is incumbent upon them to have a proper mechanism of internal *Sharī'ah* review. While the AAOIFI requires IFIs to carry out an internal *Sharī'ah* review, it does not specify the requirement of establishing a separate internal *Sharī'ah* audit department.
- The internal *Sharī'ah* review can be carried out by either an independent department or part of the internal audit division.

AAOIFI Governance Standard for IFIs No. 4: Audit and Governance Committee

- To complement the corporate governance framework for IFIs, the AAOIFI strongly recommends the establishment of an Audit and Governance Committee (AGC) at the board level.
- The AGC should consist of a minimum of three members, appointed by the BOD from its non-executive and independent board members, who are knowledgeable about the affairs of the institution and applicable regulations and laws, including *Shari'ah* rules and principles.

AAOIFI Governance Standard for IFIs No. 5: Independence of *Sharī'ah* Board

- Guidelines to resolve issues of independence.
- The state of independence of the *Sharī'ah* board is of the essence in enhancing public confidence on the aspect of *Sharī'ah* compliance. Section 3 restricts the *Sharī'ah* board to subordinating their judgment on *Sharī'ah* supervision to third parties. The *Sharī'ah* board is not recommended to consist of employees of the same IFIs or be involved in managerial decisions and operational responsibilities. The *Sharī'ah* board is required to conduct continuous assessment of the IFIs and do anything necessary to resolve any issues of independence impairment.

IFSB-10 Shariah Governance

The set of institutional and organizational arrangements: This refers to the *Sharī'ah* board and its related institutions, such as an internal audit department and *Sharī'ah* division.

Effective independent oversight of *Sharī'ah* compliance: This indicates the aims and objectives of the *Sharī'ah* governance system to provide efficient mechanisms for the purpose of *Sharī'ah* compliance.

Sharī'ah pronouncements, dissemination of information and an internal *Sharī'ah* compliance review: This involves the overall *Sharī'ah* governance processes that cover both *ex ante* and *ex post* aspects of the *Sharī'ah* compliance framework.

Key Elements

Key Element	Principle	Operational Framework
Competence	Fit and proper criteria	Ex ante: Screening process Ex post: Review and assessment
	Professional training	
	Formal assessment	
Independence	Adequate capability to exercise objective judgment	Ex ante: Appointment, disclosure and full mandate Ex post: Review and assessment
	Complete, adequate and timely information	
Confidentiality	Strictly observe the confidentiality	Ex ante: Undertaking secrecy Ex post: Review and assessment
Consistency	Fully understand the legal and regulatory framework strictly observes the said framework	There must be consistency in all ex ante and ex post Shari'ah governance processes