

## Best Practices for Internal *Shariah* Governance Framework: Lessons from Malaysian Islamic Banks

ROS LI ABDUL AZIZ, AISYAH ABDUL-RAHMAN & RUZIAN MARKOM

### ABSTRACT

*Comprehensive compliance to Shariah principles ensure confidence among stakeholders and strong credentials for the banking institutions. The Shariah Governance Framework (SGF) was introduced by the BNM in 2010 to safeguard Islamic financial institutions' Shariah compliancy. Non-compliancy to SGF will pose risks to the banks and cause instability in the financial industry. This study explores the implementation of the internal SGF in selected Islamic banks. Document reviews and interviews were conducted to analyse the SGF documentations and practices. The banks' practices are compared to the Guidelines on the Governance of Shariah Committee (GGSC) 2005 and the SGF 2010. Roles of major Shariah committees were reviewed with regard to the banks' internal SGF compliancy to the SGF 2010. The findings indicate that the Islamic banks are generally compliant to the SGF 2010 provisions. The banks' implementation of major Shariah organs has facilitated regulators in monitoring and mitigating Shariah non-compliancy events or risks. The most challenging issue faced by the Shariah audit team is limited resources in terms of on-the job work experience or Shariah knowledge. Thus, it is essential for Islamic banks to enhance their internal SGF within the scope of the SGF 2010 and collaborate with training agencies or higher education-related parties in addressing shortage of skilled manpower.*

*Keywords: Shariah Governance Framework; Islamic banking; best practices; non-compliance risk; Shariah committee*

### INTRODUCTION

Unlike conventional banks, Islamic banking operations are required to abide to the *Sharia'h* law. *Shariah* law advocates that the banking system should be free from transactions forbidden by Islam such as usury (*riba'*), gambling (*maisir*), and uncertainty (*gharar*). Furthermore, *Shariah*-compliant banking does not permit the funding of illicit activities (Grassa 2016; Beck et al. 2013). Interest is forbidden in Islamic banking given its many harmful consequences. Unlike conventional banking products which are based on interest, the crux of Islamic banking products is on sales and profit-sharing contracts based on real assets or commodities. The governance of Islamic banks is considerably challenging, yet more rewarding compared to its conventional counterparts as the system and operations are based on the Islamic law.

*Shariah* governance play a vital role in ensuring the confidence of shareholders, the Board of Directors (BODs), the management, and stakeholders (Muneeza & Hassan 2014; Abdul-Rahman 2012). For Islamic financial institutions, the *Shariah* Governance Framework (SGF) not only pertain to their system and operations; but of their integrity and reputation; and ultimately, of obedience to the Command of Allah (SWT). Therefore, for Islamic banks, safeguarding their *Shariah* compliancy to the SGF 2010 are of utmost importance.

SGF 2010 was introduced by the Central Bank of Malaysia (BNM) as guidelines for both Islamic Banks and Islamic Subsidiary Banks to ensure *Shariah* compliancy. To augment the function and role of *Shariah* Advisory Councils (SAC) for Islamic Banking, the Central Bank of

Malaysia (BNM) has amended the Central Bank of Malaysia Act 1958. It is now known as the Central Bank of Malaysia Act 2009. Since then, SAC acts as the Solitary Expert in Islamic Banking cases (Arif & Markom 2017).

The SGF 2010 provides the fundamentals of Islamic governance framework for Islamic banks in Malaysia. Many Islamic Financial Institution implemented the SGF with modifications, known as internal SGF, to suit their institutions' organisational structure. The SGF 2010 provides the basic skeleton that posit the minimum *Shariah* governance requirements that Islamic banks should have. Some Islamic banks are more proactive in having more stringent internal GSF procedures in managing *Shariah* non-compliance risks. Variances in (SGF) practice among Islamic banks usually pertain to internal process of implementing SGF 2010, such as staffing, systems, processes, and measures for *Shariah* non-compliance risks (Haqqi 2014).

Common *Shariah* non-compliancy events identified from samples of Malaysian banks are: improper *aqad* performed prior to the disbursement of financing, inaccurate computation of profits charged to customers who exceeded the bank's sale price, allowance of rollover, or extension of financing without proper *aqad*., and wrongful use of transaction documents for different *Shariah* contracts (Ginena 2014). Despite the SGF 2010 implementation, *Shariah* non-compliance events still occur (Muhammad Sori et al. 2015); albeit the degree of non-compliance differs between Islamic banks (Lahsasna 2014).

The aforementioned issues informed the aim of this study to investigate the banking institutions practices *vis a vis* SGF 2010. Hence, the objectives of the study are threefold; namely, to explore the current practice of internal SGF in Islamic banks in Malaysia, to investigate the adequacy of SGF 2010 in guiding the Islamic banks *Shariah* practices, and to highlight the existing best practices for internal SGF of Islamic banks.

LITERATURE REVIEW

The literature review focus on the key terms backgrounding the *Shariah* governance issues, namely the SGF 2010, Board Risk Management, Board Audit Committee, *Shariah* Committee, *Shariah* Review Audit, *Shariah* Law on Non-Compliance, and Management of *Shariah* Non-Compliance Risks.

SHARIAH GOVERNANCE FRAMEWORK SGF 2010)

SGF 2010 is a controlling system to safeguard the Islamic Financial Institutions (IFIs) compliancy to *Shariah* principles. The Board of Directors (BODs) of Islamic Financial Institutions need to ascertain that the entire Islamic banking industry is functioning in accordance with *Shariah* (Kasim et al. 2013). Governance practices that comply with *Shariah* guidance are essential for the sustainability of the Islamic banking industry. The aim of the SGF is to ensure adherence to *Shariah* philosophies are not compromised at any cost (Muneeza 2014). The SGF becomes more essential as IFIs are visible to additional risks such as *Shariah non-compliance* risk; and that *mudharabah* depositors are unprotected due to risk sharing, thus conjecturing that the IFIs are in dire need of an appropriate SGF (Chapra & Ahmed 2014).

Hassan et al. (2013) observed that all IFIs have variably implemented the SGF 2010 requirements for their internal *Shariah* compliance functions. Most of the IFIs have adopted the four main internal *Shariah* compliance functions, namely *Shariah* audit, *Shariah* review, *Shariah* research, *Shariah* risk management. Most of the IFIs have dedicated staff executing the internal *Shariah* compliance functions. The study also indicated that more than 81 percent of *Shariah* officers performing *Shariah* related functions possess *Shariah* qualifications varying from Diploma, Bachelor and Master degrees to professional certificates. Furthermore, most of the IFIs have adopted the *Shariah* Compliance handbook for *Shariah* review and product development. The commitment of regulators in enhancing the *Shariah* governance is shown via the SGF. Lahsasna (2014) noted that SGF have been proven to be effective in guiding the IFIs with *Shariah* compliancy.

The SGF 2010 is an enhancement to the Guidelines on the Governance of *Shariah* Committee (GGFC) for the Islamic Financial Institutions 2005. Both were issued by the Bank Negara Malaysia as guides for the *Shariah* Committee, Board, and Senior Management of Islamic Banks to maintain compliancy and mitigate *Shariah non-compliance* risks. Figure 1 provides a snap-shot on the functions and responsibilities of every organ in the SGF.

The unbroken lines indicated that teams for *Shariah* Risk Management, *Shariah* Review, *Shariah* Research, and *Shariah* Audit report directly to the respective Board and *Shariah* Committees. While, the dotted lines show the respective teams who indirectly report to the *Shariah* Committee and Islamic Bank Management Team. Among the responsibilities of the Board of Directors is to act as the Board Risk Management Committee and Board Audit Committee.

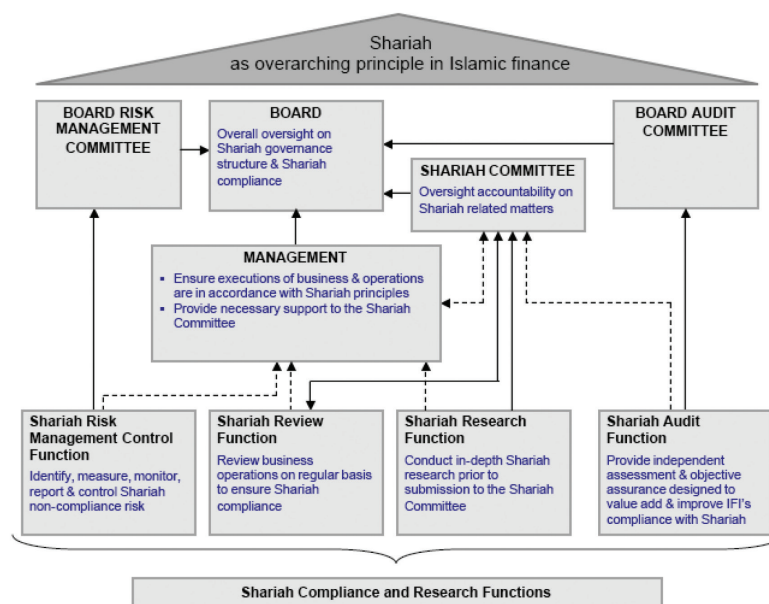


FIGURE 1. *Shariah* Governance Framework Model for Islamic Financial Institution

Source: *Shariah* Governance Framework (BNM 2010)

#### BOARD RISK MANAGEMENT COMMITTEE (BRMC)

The BRMC is responsible for controlling the *Shariah* risk management. The function of the BRMC is to identify the risks of *Shariah* non-compliance. The BRMC systematically identifies, measures, monitors and controls for *Shariah* non-compliance risks, besides mitigating non-compliance events (SGF 2010). The systematic method of managing *Shariah* non-compliance risks allows the IFIs to effectively carry out their activities and operations without endangering the IFIs' risk levels. Once a risk of *Shariah* non-compliance is identified by the *Shariah* risk management, these *Shariah* risks will be measured and monitored. These risks will be reported to the committee, which in turn will need to monitor and mitigate the risk of *Shariah* non-compliance. According to the SGF 2010, the functions of BRMC involve:

1. Assisting the procedures for recognising, measuring, controlling and monitoring *Shariah* non-compliance risks which are built in an IFI's transactions;
  - i. Classify and comprehend natural *Shariah* non-compliance risks, and consider existing controls that have been implemented and their effectiveness in mitigating such risks;
  - ii. Calculate the possible effect of such risks to the IFI based on the historical and actual income derived from *Shariah* non-compliance activities;
  - iii. Monitor *Shariah* non-compliance risks to enable the effective and efficient management of such risks. A report on the *Shariah* non-compliance risk indicators shall be periodically escalated to the BRMC; and
  - iv. Control the recurrences of *Shariah* non-compliance issues by keeping track of unrecognised income from *Shariah* non-compliance operations, besides calculate for the probability of comparable cases rising in the future.
2. Suggesting and formulating suitable *Shariah* non-compliance risk management guidelines and procedures; and
3. Promoting *Shariah* non-compliance risk awareness in the IFI.

#### BOARD AUDIT COMMITTEE

The role of the Board Audit Committee is to monitor and make decisions based on a report prepared by the audit officer from time to time. The *Shariah* Audit is a periodical evaluation which offers an independent assessment and unbiased assurance design by providing an effective internal control system for *Shariah* Compliance. The Board Audit Committee, upon consultation with the SC shall govern the result of the *Shariah* audit function. The result must be in line with accepted auditing standards. The scope of the *Shariah* audit covers all aspects of the IFI's business activities, including: 1) audit on the financial statements of the IFI; 2) compliance audit on the organisational structure,

process, people, and application systems of information technology; and 3) assessment of appropriateness of *Shariah* governance procedures.

The function of a *Shariah* Audit Officer is to provide an independent assessment and additional value-added interventions in Islamic banking institutions in compliance with *Shariah* principles (Ali et al. 2018). They are assisted by the *Shariah* Review, *Shariah* Risk and *Shariah* Research Officers. The *Shariah* Review Officer's function is to periodically evaluate the activities and business operations of Islamic banking institutions to ensure compliance to *Shariah* principles. On the other hand, the *Shariah* Research Officers have to do in-depth studies on issues before they are presented to the *Shariah* committee to make decisions. Finally, the *Shariah* Risk Officers, *Shariah* Review Officers and *Shariah* Research Officers will need to report their findings to the senior management of the Islamic banking institution first before the same findings are presented to the *Shariah* Committee. After the findings have been deliberated on by the *Shariah* Committee, the senior management will ensure that all of the bank's operations and business activities are *Shariah* compliant. In addition, the senior management will provide assistance to the *Shariah* Committee if needed.

Hence, with the introduction of the SGF 2010, the Senior Management, Board members and *Shariah* Committee members play equal roles in monitoring and controlling all *Shariah* non-compliance risks in Islamic banking institutions. Although all Islamic banks in Malaysia abide the basic SGF 2010, most of them have their own internal SGF that slightly differs with each other. Therefore, it is crucial to analyse the various roles of IFIs' internal boards in upholding *Shariah* compliance operations to examine the best practices for the SGF.

#### SHARIAH COMMITTEE

Hasan (2010) highlighted that the key players for an effective SGF are the *Shariah* Committee, the government regulatory body, the IFIs as implementers, lawyers, accountants, and auditors. The growth of IFIs relies on good *Shariah* governance. The main goal of the formation of the *Shariah* Committee is to counsel the IFIs on all *Shariah*-related matters, besides ensuring compliance with *Shariah* principles in their day-to-day business and operations. According to Hasan (2010), the core responsibilities of the *Shariah* Committee are as follows:

1. To analyse and assess the structure of Islamic banking products;
2. To analyse and evaluate documentations, including proposal forms, terms and conditions, contracts or other legal documentations adopted in implementing the business operations, product handbook, marketing announcements, sales photographs, and flyers;
3. To advise associated parties on *Shariah* matters (upon request);
4. To offer printed *Shariah* views;

5. To approve *Shariah* compliance guidebooks;
6. To provide assistance to the SAC of the Central Bank of Malaysia; and
7. To oversee general tasks and duties.

The most challenging issue encountered by the *Shariah* committees is that their tasks required them to have practical skills instead of just theoretical knowledge. SC members that lacked operational and technical knowledge may face limitation on their decision-making ability and quality of their advice to bank officers. As a result, the bank is unable to execute their decisions, leading to operational lapses and risks. Despite practicality skills, the SC's decisions should not compromise *Shariah* principles.

There is controversy concerning the role of *Shariah* Committee in assessing the Islamic banking products, there is suggestion that *Shariah* committee should solely be an advisory gatekeeper to the Islamic banks' top management on development of *Shariah*-compliant products. That the committee should focus on resolving issues pertaining to justice in partnership financing contracts (*mudharabah* and *musyarakah*), and the debt-based financing contract (*murabahah*) that is perceived as yet to be completely free from forbidden elements of the interest-based systems (Rosly 2011; Usmani 2004; Anwar 2003). Nonetheless, empirical evidence by Waemustafa and Abdullah (2015) showed that *Shariah* committees usually lacked significance influence on the selections of Islamic mode of financing offerings, with weak positive relationship between the recommendation of *Shariah* committee and debt-based financing offerings.

#### SHARIAH REVIEW AND AUDIT

*Shariah* Review function in SGF 2010 is defined as regular valuation of *Shariah* compliance of the banks' operations and activities by qualified *Shariah* officers (Shafii et al. 2013). The review process covers the overall business operations such as: 1) Planning, designing, and executing the review program, 2) Documenting the procedures involved in the review, 3) Communicating the outcome of the review to *Shariah* committee and management, and rectifying the non-compliance events and preventing it from recurring. Meanwhile, the *Shariah* audit function refers to an independent periodical assessment to ensure a sound and effective internal control system besides improving the level of compliance in IFIs. It is a systematic process of getting enough and relevant evidence to form a decision as to whether the subject matter (human resource, procedure, systems, marketing, financial and non-financial position) are in accordance to *Shariah* principles and to finally report to the stakeholders. In addition, *Shariah* audit also review the adequacy of *Shariah* governance process besides developing a comprehensive internal audit programme.

#### SHARIAH LAWS ON NON COMPLIANCY

The introduction of the Islamic Financial Services Act (IFSA) 2013 has enhanced the improvement of the end-to-end *Shariah* compliance supervisory framework of IFIs in Malaysia (Miskam & Nasrul 2013). The new act provides a comprehensive legal framework to ensure full *Shariah* compliance of Islamic financial operation and businesses<sup>1</sup>. Prior to the IFSA's implementation on 30 June 2013, the legal framework related to *Shariah* governance in Islamic finance was not statutory compared to the Islamic Banking Act 1983 (IBA 1983), the Central Bank of Act 2009, the Islamic Banking Act 1983 and the Central Bank of Act 2009. In the IFSA 2013, the researchers found that the function of the SAC is enhanced by the introduction of new provisions with regards to *Shariah* compliance.

In Section 28 of the IFSA 2013, "an institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with *Shariah*. Any irregularities or non-compliance with the *Shariah* requires the institution to inform the SAC so the necessary steps can be taken. A rather distinct rule which was introduced is the reinforced penalty clause whereby failure on part of the institution to comply with the above provision shall be liable to imprisonment not exceeding eight years or to fine not exceeding RM250 million, or both whereas to provision under Section 46 of the Islamic Banking Act (IBA) 1983 which only set penalties on directors and managers of an Islamic bank who fail to take all reasonable steps to secure compliance with the requirements of this act as well as Section 50 which provides a fine not exceeding fifty thousand ringgit. Therefore, the new Act highlights the duty of the institution to ensure stricter *Shariah* compliance and impose a more severe punishment under the law for the financial institutions who infringes it" (IFSA 2013).

#### MANAGING SHARIAH NON-COMPLIANCE RISK

Lahsasna (2014) highlighted the importance of managing *Shariah* non-compliance risk. He noted the nine line of defence in managing *Shariah* non-compliance risk in IFIs. The line of defence based on the sequence is as follows: -

1. Product Owner: Product design and development;
2. CEO / Management: Managing the Islamic Financial Institutions;
3. *Shariah* Risk Management: Managing Risk Management;
4. *Shariah* Management;
5. *Shariah* Committee: Approval and supervision / institution level;
6. Board of Directors: Management;
7. *Shariah* Advisory Councils Bank Negara Malaysia & *Shariah* Advisory Councils Securities Commission;
8. *Shariah* Review: Examination and assessment / internal; and
9. *Shariah* Audit: Examination and assessment / internal.

#### METHOD OF STUDY

In the context of this study, a case study method is employed to explore the current practice of *Shariah* Governance Framework (SGF), internal SGF; and features for best practices of SGF in selected Islamic banks. Case studies have been employed to investigate various *Shariah* related issues (e.g Khairun Najmi Saripudin et al. among others). Case study is deemed appropriate for this study's exploratory orientation, that the best practices for internal SGF, although existed, is an instance of 'a phenomenon under investigation that is yet to have a strong bound model (Swanborn 2010; Abdul-Rahman et al. 2016). This means, the Islamic banks and its best practices should be further clarified for the sake of academic or professional interest.

#### BEST PRACTICES

Best Practices in the context of this study are features of internal SGF that promote *Shariah* compliance and mitigate risks of non-compliance risks effectively. The features are drawn from the analysis of the Banks internal SGF practices *vis a vis* SGF 2010 and relevant regulations.

#### THE BANKS

The names of the banks are disguised due to the respondents' requests, as disclosing the actual names may jeopardise the respondents' reputation and put the banks at risk.

The three selected Islamic banks are (1) ABC Islamic Bank Berhad is the largest Islamic bank in the Asia Pacific region. ABC Islamic Bank Berhad is also owned by one of largest financial institutions in Malaysia (2) FGH Islamic Bank Berhad is an Islamic bank and a subsidiary of a non-financial institution company and (3) XYZ Islamic Bank Berhad is an Islamic bank owned by one of the IFIs in Malaysia, and is the first *Shariah*-based banking institution in South-East Asia and Malaysia.

#### DATA COLLECTION PROCEDURES

The SGF 2010 documentation and operational documents of the banks pertaining to *Shariah* compliance guidelines are analysed using a document analysis checklist. The checklist items cover //documentations that provide information specific to SGF and current banking practices. Relevant documents are also obtained through library research and accessed from online sources. The checklist items are in-tandem with, and complementary to the interview protocol indicated below:

1. What is your view on the SGF 2010 in terms of explaining the roles and responsibility of each organ? Do you believe the current structure of the SGF is appropriate in ensuring the effectiveness of *Shariah* governance in your bank?
2. How does your bank implement internal policies on the SGF 2010? Did your bank compare your internal *Shariah* governance policy with other banks? Did your bank refer to Middle-East *Shariah* governance as reference?
3. How often does your bank review your internal *Shariah* governance policy?
4. What are the challenges faced by your audit team in performing their auditing task?
5. What are the tools used by your Audit team in performing its auditing task?
6. What are the examples of common *Shariah* non-compliance events in your bank?
7. How many staff are allocated for *Shariah* audit, *Shariah* risk, *Shariah* review and *Shariah* advisory in your bank? What are the minimum qualifications for them?
8. If your bank receives new regulations or guidelines from the central bank, how does your bank ensure the competency of its staff to implement it?

Face-to face interviews for primary data were conducted at three Islamic banking institutions. Follow-up telephone call were made and emails sent for additional information and clarifications. The interview sessions ranged between 40 to 50 minutes, guided by an interview protocol. The interviewee information are shown in Table 1.

#### DATA ANALYSIS

Data from the document analysis of the SGF 2010, and banking documentations; and interviews on the banks' current practices are collated for the analysis. The data are analysed as in following techniques:

1. Analysis of interviews transcriptions.
2. Cross-case and within-case analyses conducted after the cross-case analysis is adopted to search for patterns of events;
3. Cases were then compared to each other and linkages between different types of practices of the SGF were highlighted; and
4. Finally, the differences and similarities between the cases were gathered for further analysis. Cases that

TABLE 1. Interviewee Respondents

No.	Interviewee	Gender	Age	Functional Background	Tenure	Organizations
1.	Mr. A	Male	37	Head, <i>Shariah</i> Management	7 years	ABC Islamic Bank Berhad
2.	Pn. B	Female	39	Head, Audit Division	4 years	FGH Islamic Bank Berhad
3.	Mr. C	Male	35	Manager, Research and Advisory, <i>Shariah</i> Division	4 years	XYZ Islamic Bank Berhad

showed different designs from the other cases were subjected to further comparison with one another.

## FINDINGS AND DISCUSSION

### DOCUMENT ANALYSIS

Data from the document analysis (SGF 2010, *Shariah* compliance guidelines, documentations of banks operational and banking practices) have generally indicated that the SGF 2010 guidelines have been complied by the banks. This is evident with the establishment of their internal SGF to suit their operations. It is deemed unnecessary to tabulate or present these data in graphic forms, for the specifics are presented (in tandem with the data from the interviews) throughout in the (article) discussion.

### INTERVIEWS

Table 2 shows the interviewees from the three Islamic banks on their current practices of internal SGF 2010 in Malaysia. It shows that ABC Islamic bank has 22 officers in its *Shariah* Audit, *Shariah* Risk, *Shariah* Review, and *Shariah* Advisory organs. In contrast, FGH and XYZ Islamic banks have 11 and 15 officers and advisory members, respectively. Also, our findings revealed that all of the officers and advisory members are qualified as required by the SGF 2010. Common *Shariah* non-compliance events revealed are cases involving people, processes, and systems such as pronunciation (*aqad*) performing issues for financing accounts; and excessive charging on late payment of overdue accounts. Respondents suggested for management to provide adequate training for officers in charge of legal documentations, and enforcement of the Islamic financing contracts.

#### ABC ISLAMIC BANK BERHAD (ABC)

ABC Islamic Bank initiated an internal ABC Group *Shariah* Compliance Policy for their businesses *Shariah* compliancy. the, regardless if the transaction is executed at any location. Approval for the ABC Group *Shariah* Compliance Policy was obtained from the ABC Board and ABC Bank's Group Risk Committee in 2014. Training has been conducted through the ABC's Knowledge Management Team of Product Management Department. The objective of the briefing is to explain the Governance Framework of the ABC Group and to create awareness among the staff of the ABC. ABC does not compare its *Shariah* Governance Policy with other IFIs before it implemented its SGF in its organisation. This was because all Islamic Financial Institutions were in the midst of strengthening or building their own *Shariah* Governance Framework. ABC did refer to the best practices of banks in the Middle East as reference. BNM reviews the ABC's SGF on a yearly basis. ABC also reviews its SGF every two years. The effectiveness of ABC's *Shariah* team is measured based on the achievement

of the *Shariah* Audit Plan by year end. Among the main challenges faced by ABC's *Shariah* Audit are as follows:

1. To have a dedicated team of talent to perform *Shariah* Audits;
2. To keep updated with the latest resolutions / standard (knowledge); and
3. To understand Islamic banking itself.

The tools used by the ABC's *Shariah* Audit Team during their auditing task are *Shariah* ruling or resolutions of ABC Islamic Bank Berhad, BNM *Shariah* Resolutions and *Shariah* standards globally.

#### FGH ISLAMIC BANK BERHAD (FGH)

FGH was established in 1998 during the height of Asian financial crisis. Currently, FGH has a staffing strength of 2,000 employees nationwide. FGH has been serving the community's financial needs for 15 years. Based on FGH's Annual Report 2015, FGH's assets are increasing from year to year. FGH has separate frameworks for each of its main SGF organs such as *Shariah* Management, *Shariah* Audit, *Shariah* Review, and *Shariah* Risk. Each organ maintains its own framework to support the SGF 2010 requirements by BNM. The SGF at FGH is led by the Senior Management Team of FGH instead of the *Shariah* Management team as practised by ABC Islamic Bank Berhad.

FGH compared its SGF Policy with other IFIs before implementing SGF in its organisation. FGH also referred to the best practices of several Islamic banks in the Middle East. Both BNM and FGH reviews FGH's SGF on a yearly basis. The effectiveness of FGH's *Shariah* audit team is measured based on the achievement of the *Shariah* Audit Plan by year end. Among the main challenges of FGH's *Shariah* Audit Team in performing its tasks are as follows:

1. Shortage of a dedicated team of talent to perform *Shariah* Audits;
2. Lack of knowledge and skills in identifying issues in *Shariah* Auditing;
3. Alertness to keep update with the latest resolutions, standards or knowledge; and
4. Insufficient knowledge and understanding of Islamic banking itself.

The tools used by FGH's *Shariah* Audit Team for their auditing tasks are market analysis, *Shariah* ruling or resolutions of FGH and how it is executed, minutes of *Shariah* Committee meetings, Standard Operating Procedures of each product and service, *Shariah* Risk profiles, BNM *Shariah* Resolutions and *Shariah* standards globally.

#### XYZ ISLAMIC BANK BERHAD (XYZ)

XYZ Islamic Bank Berhad (XYZ) is the first full-fledged *Shariah*-based banking institution in Malaysia and South-East Asia. XYZ also plays a leading role in the development

TABLE 2. Summary of interview analysis: Current Practices of internal SGF

Issues	ABC	FGH	XYZ
<b>Current Practices of Internal SGF:</b>			
Adopting Single SGF	/	-	-
Adopting Separate SGF		/	/
Compare with middle East SGF as reference	/	/	/
Frequency of internal SGF being reviewed	Every two years	yearly	yearly
No. of supporting tools for the <i>Shariah</i> Auditing tasks	3	7	3
No. of <i>Shariah</i> Audit Officers	6	3	3
No. of <i>Shariah</i> Risk Officers	7	2	3
No. of <i>Shariah</i> Review Officers	6	3	5
No. of <i>Shariah</i> Advisory	3	3	4
Total number of <i>Shariah</i> officers	22	11	15
Qualification for <i>Shariah</i> Audit Officers	Degree in business related + working experience	Degree in business related + working experience	Degree in business related + working experience
Qualification for <i>Shariah</i> Review Officers	Degree in <i>Shariah</i> without experience	Degree in <i>Shariah</i> without experience	Degree in <i>Shariah</i> without experience
Qualification for <i>Shariah</i> Advisory Officers	Degree in <i>Shariah</i> without experience	Degree in <i>Shariah</i> without experience	Degree in <i>Shariah</i> without experience
Which team lead the SGF	<i>Shariah</i> management team	Senior management team	Senior management team
<b>Common <i>Shariah</i> non-compliance events:</b>			
1. Wrongful use of conventional terms in documents for customers	-	/	/
2. Wrongful use of conventional terms by appointed solicitors in preparing legal documentations for financing customers	-	/	/
3. Pronunciation ( <i>aqad</i> ) performing issues for financing accounts	/	/	/
4. Charging more than the Late Payment Charges rate for accounts that are in excess or overdue	/	/	/
5. Debiting Islamic Financing accounts of insurance premiums	-	/	-

of Malaysia's Islamic Banking industry. XYZ was incorporated in 1983 for the sole purpose of assisting the financial needs of Muslim population of Malaysia. Since then, XYZ has extended its services and products to the non-Muslims in fulfilling its "Banking-for-All" principle. Currently, XYZ offers a comprehensive range of *Shariah* compliance banking and financial solutions to its more than five million customers. Primarily, it is a retail bank with consumer banking constituting of more than 70% of its total financing. To serve its expanding customer base, XYZ currently has the widest dedicated Islamic banking network in Malaysia with 144 branches and more than 1,000 self-service terminals nationwide. XYZ does not compare its SGF Policy with other Islamic Financial institutions before it implemented its SGF in its organisation. Also, XYZ referred to the best practices of banks in the Middle East as reference. BNM reviews XYZ's

SGF on a yearly basis. XYZ also reviews its SGF on a yearly basis or as when required. The effectiveness of XYZ's *Shariah* audit team is measured based on the achievement of the *Shariah* Audit Plan by year end. Among the main challenges of FGH's *Shariah* Audit Team in performing their tasks are as follows

1. Insufficient knowledge and skills in *Shariah* Audit to identify *Shariah* Audit issues;
2. Level of Alertness to keep updated with the latest resolutions or standards; and
3. Insufficient understanding of banking operations.

The tools used by XYZ's *Shariah* Audit Team for their auditing tasks are *Shariah* ruling or resolutions of XYZ's *Shariah* Committee, minutes of *Shariah* Committee meetings and BNM *Shariah* Resolutions.

## SGF 2010 GUIDELINES

The respondents regarded the SGF 2010 as providing more details and clearer responsibilities of the Board Committees and *Shariah* organs of Islamic banks. Respondents noted that most Islamic banks internal *Shariah* governance policy owed its guidelines from the SGF 2010. All respondents also viewed SGF 2010 guidelines as useful for Islamic Banks to establish either one of the two types of internal SGF; single type, led by the *Shariah* Management Team, or separate SGF led by the Senior Management Team.

Table 2 shows that ABC Islamic Bank has adopted the single SGF approach. This is confirmed by the respondent from the bank:

*“Even though SGF 2010 was very comprehensive, we have coming out with internal SGF, which was called as ABC Shariah Governance Framework. The function of this ABC SGF is to support the SGF 2010.” (Mr. A)*

ABC internal *Shariah* governance framework provides more details compared to BNM’s SGF 2010. Their four (4) lines of defences are Business Units, *Shariah* Advisory, *Shariah* Operational Risk and *Shariah* Compliance Review and *Shariah* Audit Team.

Compared to ABC, both FGH and XYZ have separate frameworks for each of their main SGF organs such as *Shariah* Management, *Shariah* Audit, *Shariah* Review, and *Shariah* Risk. Each of these organs maintained its own framework to support the SGF 2010 by the BNM. As for FGH and XYZ their internal SGFs are led by the Senior Management Team instead of the *Shariah* Management practised by ABC Islamic Bank Berhad.

In general, respondents are convinced that the current SGF 2010 of Islamic banks are quite comprehensive to support their Islamic banking activities. Under the SGF 2010, the *Shariah* organs, i.e. *Shariah* Risk, *Shariah* Audit, *Shariah* Review, and *Shariah* Research, have been introduced as innovative mechanisms for their *Shariah* compliancy governance. These four *Shariah* Organs support the Board Committees and *Shariah* Committees in monitoring *Shariah* compliance.

Respondents also confirmed each Islamic bank has designed its *Shariah* Governance Policy to suit its respective culture, size, operations activities, and business activities. The bigger the size of the Islamic banks, the more comprehensive the *Shariah* Governance Policy need to be. A respondent from ABC Islamic bank agreed that the SGF 2010 has reduced the gap in corporate governance and elevated the level of *Shariah* Governance as follows:

*“The SGF 2010 objective is aims to reduce the gap on Corporate Governance Requirements in terms of providing Roles and Responsibilities, Accountabilities, and Independent of Shariah Unit as compared to other Business Units.” (Mr. A)*

*“SGF 2010 is elevating the level of Shariah Governance and reduce the gap between Corporate Governance and Shariah Governance. Furthermore, prior to the introduction of SGF,*

*Corporate Governance has not detailed out the Roles and Responsibilities, Accountabilities of Shariah Committee, Management, and Shariah Unit functions.” (Mr. A)*

Respondents from the FGH and XYZ Islamic banks with internal SGF led by the Senior Management team supported the view that SGF 2010 is transformative:

*“SGF 2010 was a transformation from GGSC 2005 for Shariah Compliance, Shariah Audit, and Shariah Risk Management. This transformation has taken place after Islamic Banking markets in Malaysia have become more matured.” (Pn. B)*

*“I feel that in the existing GGSC 2005 provisions of Shariah Governance are very limited and unclear.” (Pn. B)*

Another view from the same respondent claimed that her bank was ahead of SGF 2010 regarding *Shariah* review team, details and governance mechanisms:

*“We already have a Shariah Review team ahead of other industry players, i.e. since year 2004. FGH have adopted the internal governance framework by providing more details as compared to BNM’s SGF 2010. The three lines of defense are: a) Shariah Advisory; b) Shariah Risk and Shariah Review; and c) Shariah Audit Team.” (Pn. B)*

The respondent from XYZ agreed that the SGF 2010 has innovatively introduced the roles and responsibilities, accountabilities, and independency of the *Shariah* Unit, compared to the other business units such as the *Shariah* Audit, *Shariah* Review, and *Shariah* Risk.

*“Prior to the introduction of SGF, the existing Corporate Governance have not detailed out the Roles and Responsibilities, and Accountabilities of Shariah Unit functions such as Shariah Review, Shariah Risk, and Shariah Audit, which are additional components.” (Mr. C)*

*“I also agreed with other respondents that the requirements of Shariah Governance are very limited and unclear in the existing GGSC 2005.”*

*“We also have three lines of defences such as a) Shariah Advisory; b) Shariah Risk and Shariah Review; and c) Shariah Audit Team.” (Mr. C)*

In a nutshell, the findings show that generally most respondents agreed that SGF 2010 has innovatively introduced the roles, responsibilities, accountability and independence of the *Shariah* Unit, *vis a vis* other units such as the *Shariah* Audit, *Shariah* Review, and *Shariah* Risk. SGF 2010, surpassed the Corporate Governance 2005, in detailing out the roles and responsibilities of *Shariah* Unit, *Shariah* Review, *Shariah* Risk, and *Shariah* Audit. Establishment of internal SGF by the banks, is an instance whereby SGF 2010 elevates the level of *Shariah* Governance, and reduce the gap between Corporate Governance and *Shariah* Governance.



#### BEST PRACTICES IN INTERNAL *SHARIAH* GOVERNANCE

The Best Practices in internal SGF are features of the banks internal SGF that effectively promote *Shariah* compliance or mitigate risks of non-compliance risk *vis a vis* the SGF 2010 guidelines. It can be deduced from the findings that features of Best Practices are evidently present in current banking practices of the Islamic banks. Examples of the Best Practices of the Islamic banks are as in the following. ABC Islamic Bank Berhad adhered to the SGF 2010 as primary guideline for designing their *Shariah* Governance Policy; as well from selected Middle East *Shariah* practices. The bank introduced the Group *Shariah* Governance Policy to ensure *Shariah* compliance of their operations outside Malaysia. ABC Islamic Bank Berhad, a subsidiary of the largest financial institution and enjoys rapid growth due to its *Shariah*-compliant operations.

ABC Islamic conducted *Shariah* Awareness training for its staff to create *Shariah* Compliance awareness. A commendable approach by IFIs with global presence. Since it is a subsidiary of a financial institution, its *Shariah* Management Division is mandated by ABC's Islamic Board to lead the SGF Policy for ABC Islamic Bank Berhad and its Group *Shariah* Governance Policy. The four *Shariah* Organs for ABC have supported the *Shariah* Committee in ensuring that ABC's businesses and operations are *Shariah* compliant. The *Shariah* Audit Team of ABC always prepares its *Shariah* Audit plan on a yearly basis. This assists the team in executing their *Shariah* auditing exercise systematically. The *Shariah* Audit team is an independent team which reports directly to the Board Audit Committee instead of the Management of ABC Islamic Bank Berhad. This ensures no interference by the Management team in any *Shariah* Audit findings.

FGH *Shariah* Governance Policy maintained a separate *Shariah* Governance Policy to ensure the effectiveness of their *Shariah* Governance. The SGF Policy for FGH is led by its Senior Management Team. FGH's SGF is reviewed every two years or as and when needed. Compared to the other two selected Islamic Banks, FGH started its implementation of the *Shariah* Review team in 2004, which is much earlier, and before the introduction of the SGF 2010.

XYZ's SGF as an established full-fledged Islamic Bank maintains a separate SGF policy for each of its *Shariah* organ to ensure that Malaysia and the Asia Pacific region operations are *Shariah* compliant. XYZ also refers to the SGF 2010 as major guide, and compares its practices to the Middle East *Shariah* governance practices to ensure that its SGF Policies are robust.

#### CONCLUSION AND RECOMMENDATION

Evidently the findings on the *Shariah* governance framework in selected Islamic banks and the current practices of Islamic banks' internal SGF policies, are beneficial to Malaysian IFIs for improvement of their internal SGFs. The itself embodies Best Practices in *Shariah*

governance. It fulfils the criteria that SGF Best Practices may be derived from a *Shariah* governance system with effective management and supervision; *Shariah* Advisory Board; *Shariah* compliance review; and transparency and disclosure and other exemplary provisions. Considerable Best Practices for Banks Internal SGF have been derived from SGF 2010.

All of the selected Islamic banks adhere to SGF 2010 guidelines for *Shariah* governance. This is evident when they set up their own internal SGF, with Senior Management Team commonly appointed to lead their internal SGF. The banks also set up governance organs such as *Shariah* unit, *Shariah* Audit, *Shariah* Review, and *Shariah* Risk Management functions to ensure their compliance to the *Shariah* principles. Each organ or unit has separate frameworks for auditing confidentiality and integrity. The banks used common sets of audit tools for each *Shariah* audit team for their auditing functions, such as global *Shariah* standards, *Shariah* rulings or resolutions of the individual Islamic banks; BNM *Shariah* Resolution. The banks have been proactive in addressing shortage of expertise such as providing on-the-job training for their Internal Audit Officers to conduct the *Shariah* auditing.

Regarding SGF 2010 adequacy in guiding the banks *Shariah* practices, the SGF are generally perceived by respondents as quite comprehensive to support their Islamic banking activities. It is regarded as more effective compared to predecessor GGSC 2005 for *Shariah* Compliance, *Shariah* Audit, and *Shariah* Risk Management. The GGSC 2005 was limited and lacked provisions for certain *Shariah* governance issues. SGF 2010 guidelines are useful for banks to draw their own *Shariah* Governance Policy to suit its respective culture, size, operations activities, and business activities. The guidelines reduce the gap between Corporate Governance and *Shariah* Governance. SGF 2010 introduced the *Shariah* organs, i.e. *Shariah* Risk, *Shariah* Audit, *Shariah* Review, and *Shariah* Research, to support the Board Committees and *Shariah* Committees in observing *Shariah* compliance of Islamic banking industry.

The flexibility of SGF provisions enabled banks to add additional details into their own internal SGF such as their *Shariah* 'lines of defences' i.e Business Units; *Shariah* Advisory; *Shariah* Operational Risk; and *Shariah* Compliance Review and *Shariah* Audit Team. SGF 2010 extends the scope of *Shariah* Governance by recognising the roles and responsibilities, accountabilities, and independence of the *Shariah* Unit. The framework empowered the *Shariah* Unit with autonomous roles, responsibilities, accountability, independent of other aforementioned units of *Shariah* Audit, *Shariah* Review, and *Shariah* Risk. Thus, the SGF 2010 has successfully narrowed the gap between its provisions with the Corporate Governance Requirements 2005, hence elevating the level of *Shariah* Governance in the operations of the Islamic banks.

Regarding Best Practices, a point to note, is that some of these have been mentioned under the preceding sections on SGF 2010, Current Practices of SGF at the Islamic Banks, and SGF Adequacy in Guiding the *Shariah* Practices. Instances of the Best Practices under this section are derivations of those under the two preceding sections. The existing best practices for the Islamic banks are collectively as follows:

1. Extension of Islamic banks *Shariah* Unit scope of governance turning it into an independent unit; with strategic operational links to other business units such as the *Shariah* Audit, *Shariah* Review, and *Shariah* Risk.
2. Flexibility for Islamic banks to opt for either single or separate SGF to implement internal SGF. Single SGF under *Shariah* Management Division for SGF Policy. Separate SGF has each *Shariah* organ maintaining a separate Governance Policy.
3. Usage of common audit tools or standards for each of their auditing tasks such as the internal *Shariah* Ruling or resolutions of the bank, BNM *Shariah* resolutions, and *Shariah* global standards.
4. Proactive solutions for addressing shortage of dedicated talent by providing on-job training to their Internal Audit Officers, and planned collaboration with training agencies and higher education institutions. Augmenting professional manpower with both *Shariah* knowledge and operational skills to support Islamic banking industry.
5. Augmenting internal SGF through adherence to the SGF 2010, and learning from other major world SGF standards, one of which is AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institution).

It is evident that Malaysian Islamic banks Internal *Shariah* governance practices *vis a vis* SGF 2010 are essentially the Best Practices for *Shariah*-compliance of Islamic banks and financial industry. These are also the outcomes of the banks learning from their operational experiences of success and setbacks. These banks emerged as resilient Islamic banks, making Malaysia as one of the world's leading IFI centre. SGF 2010 and internal SGF of the Malaysian Islamic banks can look at themselves as leaders, and at other SGFs elsewhere as partners, such as Dubai AAOIFI or other prominent *Shariah* governance standards in the Middle East, Western financial capitals or in the Islamic world.

In conclusion, the SGF 2010 and Islamic banks' internal SGFs vigorous *Shariah* compliance framework have established a number of learnable Best Practice pertaining to SGF organization, structure and operations, such as review and audit functions, risk management control procedure. in-house research capability and other related aforementioned. The Best Practices indicated that the banks have effectively created a robust and sound internal SGF in ensuring effective implementation of the SGF 2010.

## NOTES

- <sup>1</sup> The effect of this IFSA 2013 has repealed the Islamic Banking Act 1983, the Takaful Act 1984, the Payment System Act 2003 and the Exchange Control Act 1953.

## ACKNOWLEDGEMENT

The authors would like to gratefully acknowledge the YTI-UKM research grant (EP-2015-049) in supporting this study on *Shariah* Governance Practices.

## REFERENCE

- Abdul-Rahman, A. 2012. *Risk Exposures and Lending Structures of Malaysia Banks*. Bangi: Penerbit UKM.
- Abdul-Rahman, A., Shahimi, S. & Ismail, A.G. 2016. *Case Studies in Islamic Banking & Finance*. Bangi: Penerbit UKM.
- Ali, N.A.M., Shahida, S. & Shafii, Z. 2018. Knowledge, Skills and Characteristics Requirements for *Shariah* Auditors. *Asian Journal of Accounting and Governance* 9: 181-200
- Anwar, M. 2003. Islamicity of banking and modes of Islamic banking. *Arab Law Quarterly* 62-80.
- Arif, M.I.A.M. & Markom, R. 2017. Status Quo Perundangan Majlis Penasihat Syariah dalam Kerangka Kerja Tadbir Urus Syariah bagi Sistem Perbankan Islam di Malaysia Selepas Akta Perkhidmatan Kewangan Islam 2013. *Jurnal Undang-undang dan Masyarakat* 21: 63-71
- Bank Negara Malaysia. 2008. Prudential Regulation and Supervisory Framework. <http://www.bnm.gov.my/files/publication/fsps/en/2007/cp03.pdf>. (accessed on 1 January 2018).
- Beck, T., Demircuc-Kunt, A. & Ourda, M. 2013. Islamic Vs. Conventional Banking: Business Model, Efficiency and Stability. *Journal of Banking and Finance* 37: 433-447
- Chapra, M.U. & Ahmed, H. 2014. Corporate Governance in Islamic Financial Institutions. Munich Personal RePEc Archive.
- Ginena, K. 2014. *Shariah* Risk and Corporate Governance of Islamic Banks. *Corporate Governance* 14(1): 86-103
- GGSC. 2005. Guidelines on the Governance of *Shariah* Committee for the Islamic Financial Institutions. <https://www.bnm.gov.my/index.php?ch=57&pg=137&ac=51&bb=file> (accessed on 1 January 2018).
- Grassa, R. 2016. Corporate governance and credit rating in Islamic banks: Does *Shariah* governance matters? *Journal of Management & Governance* 20(4): 875-906.
- Haqqi, A.R.A. 2014. *Shariah* governance in Islamic financial institution: An appraisal. *US-China L. Rev.* 11: 112.
- Hassan, R., Ariffin, M., Othman, A.A., Napiah, M.D.M., Omar, M.N., Yusoff, A., Khatimin, N. & Zaharim, A. 2013. Survey on Implementation of Internal *Shariah* Compliance Function in Malaysian Islamic Banks and Takaful Companies. *Recent Advances in Management, Marketing and Finances. Proceedings of the 7<sup>th</sup> WSEAS International Conference on Management, Marketing and Finances, Cambridge, MA, USA, Jan 30-Feb 1, 2013. Organized by UKM*. 101-107
- Hasan, Z. 2010. *Sharia* Governance in Islamic Financial Institutions and the effect of the Central Bank of Malaysia Act 2009. *eJournal of International Banking Law and Regulation* 3.
- Kasim, N., Htay, S.N.N. & Salman, S.A. 2013. Conceptual Framework for *Shariah* Corporate Governance with Special

- Focus on Islamic Capital Market in Malaysia. *International Journal of Trade, Economics and Finance* 4(5): 336-339
- Khairun Najmi Saripudin et al. *Case Study on Sukuk Musharakah Issued in Malaysia*. Middle-East Journal of Scientific Research 12(2): 168-175. IDOSI Publications, 2012
- Lahsasna, A. 2014. *Non-Shariah compliance Risk Management and Legal Documentation in Islamic Finance*. John Wiley & Sons (ISBN 978-1-118-79680-1)
- Miskam, S. & Nasrul, M.A. 2013. *Shariah Governance in Islamic Finance: The Effects of the Islamic Financial Services Act 2013. Proceeding of the World Conference on Integration of Knowledge, WCIK 2013. 25-26 November 2013, Langkawi, Malaysia. (e-ISBN 978-967-11768-2-5). Organized by WorldConferences.net 462.*
- Muhammad Sori, Z., Mohamad, S. & Shah, M.E. 2015. *Shariah Governance Practices in Malaysian Islamic Financial Institutions*. SSRN. Electronic Journal. DOI: 10.2139/ssrn.2579174.
- Muneeza, A. 2014. *Shariah Governance Applicable to Islamic Banks in Malaysia: Effect of Islamic Financial Services Act 2013. The Developing Role of Islamic Banking and Finance: From Local to Global Perspectives. Contemporary Studies in Economic and Financial Analysis* 95: 31-44
- Muneeza, A. & Hassan, R. 2014. *Shari'ah Corporate Governance: The Need for A Special Governance Code. Corporate Governance* 14(1): 120-129
- Rosly, S.A., Risk-Based Pricing in *Al-Bai Bithaman Ajil (BBA)/ Murabahah Sales: Fiscal Liability with Business and Credit risk exposure*. In 14th International Business Research Conference, (28-30 April 2011) Crown Plaza Hotel, Sheikh Zayed Road, Dubai. UAE.
- Swanborn, P. 2010. *Case study research: What, Why and How?* Sage.
- SGF. 2010. SGF for Islamic Financial Institutions. [https://www.bnm.gov.my/guidelines/05\\_Shariah/02\\_Shariah\\_Governance\\_Framework\\_20101026.pdf](https://www.bnm.gov.my/guidelines/05_Shariah/02_Shariah_Governance_Framework_20101026.pdf) (accessed on 1 January 2018).
- Shafii, Z. Abidin, A.Z., Salleh, S., Jusoff, K. & Kassim, N. 2013. Post Implementation of *Shariah Governance Framework: The Impact of Shariah Audit Function towards the Role of Shariah Committee. Middle-East Journal of Scientific Research* 13 (SPLISSUE): 7-11.
- Usmani, T. 2004. *An Introduction to Islamic Finance*. Arham Shams.
- Waemustafa, W. & Abdullah, A. 2015. Mode of Islamic Bank Financing: Does Effectiveness of *Shari'ah* Supervisory Board Matter? *Aust. J. Basic & Appl. Sci.* 9(37): 458.
- Rosli Abdul Aziz  
Community Banking  
Maybank Islamic Berhad  
Kuala Lumpur  
MALAYSIA  
E-mail: rosli.aziz@gmail.com
- Aisyah Abdul-Rahman\*  
Faculty of Economics and Management  
Universiti Kebangsaan Malaysia  
43600 UKM Bangi Selangor  
MALAYSIA  
E-mail: eychah@ukm.edu.my
- Ruzian Markom  
Faculty of Law  
Universiti Kebangsaan Malaysia  
43600 UKM Bangi Selangor  
MALAYSIA  
E-mail: ruzian@ukm.edu.my

\*Corresponding author

## APPENDIX A. Differences between GGSC 2005 and SGF 2010 SGF 2010

Items	GGSC 2005	SGF 2010
Effective Date	1 April 2005	1 January 2011
Objectives	<ol style="list-style-type: none"> <li>To establish the regulations and procedures of a <i>Shariah</i> Committee.</li> <li>To outline the role, responsibilities, and scope of tasks of a <i>Shariah</i> Committee.</li> <li>To describe connection and working procedure between the SAC of BNM and a <i>Shariah</i> Committee.</li> </ol>	<ol style="list-style-type: none"> <li>List the expectations of the bank on an IFI's <i>Shariah</i> governance structures, arrangement, and processes in guaranteeing that all business transactions are <i>Shariah</i> compliant;</li> <li>Offers a complete guidance to the BODs, <i>Shariah</i> Committee and management of the IFI in carrying out its tasks in <i>Shariah</i> related matters; and</li> <li>Outlines the roles of <i>Shariah</i> research, <i>Shariah</i> review, <i>Shariah</i> risk management, and <i>Shariah</i> audit.</li> </ol>
Scope of Application	<ol style="list-style-type: none"> <li>An Islamic bank licensed under the IBA 1983; A financial institution licensed under the BAFIA 1989 that offers Islamic Banking Scheme;</li> <li>A financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) that offers Islamic Banking Scheme; and</li> <li>A takaful operator registered under the Takaful Act 1984 (TA).</li> </ol>	<ol style="list-style-type: none"> <li>An Islamic bank licensed under the IBA 1983;</li> <li>A financial institution licensed under the BAFIA 1989 that offers the Islamic Banking Scheme;</li> <li>A financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) that offers Islamic Banking Scheme; and</li> <li>A takaful operator registered under the Takaful Act 1984 (TA).</li> </ol>
Establishment	Formation of <i>Shariah</i> Committee	Nil
Appointment and Reappointment	Appointment and reappointment of <i>Shariah</i> Committee members must attain consent from BNM.	Appointment and reappointment of <i>Shariah</i> Committee members must attain consent from BNM and the SAC.
Application Procedures	The request for the reappointment or appointment of <i>Shariah</i> Committee members shall be submitted to BNM at least sixty days before the proposed date of appointment takes effect.	The request for the reappointment or appointment of <i>Shariah</i> Committee members shall be submitted to BNM at least sixty days before the proposed date of appointment takes effect.
Qualification	<ol style="list-style-type: none"> <li>An individual;</li> <li>Have qualification or possess expertise or experience in either 1) Islamic transaction/commercial law (<i>Fiqh al-Muamalat</i>) or 2) Islamic jurisprudence (<i>Usul al-Fiqh</i>)</li> </ol>	<ol style="list-style-type: none"> <li>A muslim individual;</li> <li>Most <i>Shariah</i> Committee members shall at least possess bachelor's degree in <i>Shariah</i> either in <i>Usul Fiqh</i> or <i>Fiqh Muamalat</i> from reputable university;</li> <li>Most <i>Shariah</i> Committee members should capable of demonstrating high proficiency and expertise in written and oral Bahasa Malaysia, Arabic, and English language;</li> <li>Shall require specialists from finance and law background;</li> <li>May comprise committee of varies backgrounds in terms of experience, qualification, and expertise.</li> </ol>
Compositions	At least three (3) members.	Nil
Secretariat	At least one (1) officer, preferably a <i>Shariah</i> expert person.	A secretariat with a role to serve the <i>Shariah</i> Committee; and
Resignation and Termination	To inform BNM within fourteen (14) days from the date of termination or resignation.	To inform BNM within fourteen (14) days from the date of termination or resignation.
Restrictions on <i>Shariah</i> Committee	<ol style="list-style-type: none"> <li>Not permitted to hire any members of the SAC to act as <i>Shariah</i> Committee members; and</li> <li>May not hire any member of a <i>Shariah</i> Committee in another IFI.</li> </ol>	Negative list of <i>Shariah</i> Committee

Continue

## Continued APPENDIX A.

Items	GGSC 2005	SGF 2010
Effective Date	1 April 2005	1 January 2011
Duties and Responsibilities of <i>Shariah</i> Committee	<ol style="list-style-type: none"> <li>1. To assist the BODs on <i>Shariah</i> related matters;</li> <li>2. To approve <i>Shariah</i> Compliance Handbooks;</li> <li>3. To endorse and validate relevant documentations;</li> <li>4. To assist related parties on <i>Shariah</i> matters for advice upon request;</li> <li>5. To advise on matters to be referred to the SAC;</li> <li>6. To provide written <i>Shariah</i> opinion;</li> <li>7. To assist the SAC on reference for advice.</li> </ol>	<ol style="list-style-type: none"> <li>1. Accountable and responsible for all <i>Shariah</i> decisions and views</li> <li>2. To counsel the BODs on <i>Shariah</i> related matters;</li> <li>3. To approve <i>Shariah</i> Compliance handbooks;</li> <li>4. To approve and authenticate <i>Shariah</i> related documentations;</li> <li>5. To help related parties on <i>Shariah</i> related matters (upon request);</li> <li>6. To assist on <i>Shariah</i> matters to be referred to the SAC;</li> <li>7. To provide printed <i>Shariah</i> opinion; and</li> <li>8. To advise the SAC on <i>Shariah</i> reference.</li> </ol>
Reporting Structure	<i>Shariah</i> Committee reports functionally to the BODs of the IFI.	Independence of the <i>Shariah</i> Committee shall be witnessed at all times when exercising their tasks and making informed decision.
Competency	Nil	All employees bearing responsibilities highlighted in the SGF shall have required competency and constantly improve their skill and comprehending both <i>Shariah</i> knowledge and alert of the latest advances in Islamic finance.
Confidentiality & Consistency	Nil	<ol style="list-style-type: none"> <li>1. Internal and privileged data attained by the <i>Shariah</i> Committee members shall be retained confidential at all times and must not misused; and</li> <li>2. Professional judgement, ethics, and consistency shall be upheld in safeguarding <i>Shariah</i> compliance.</li> </ol>
Research Functions and <i>Shariah</i> Compliance	Nil	There shall be a vigorous <i>Shariah</i> compliance framework, involving review and audit functions, reinforced by risk management control procedure and in-house research capability.

