SHARIAH GOVERNANCE OF MALAYSIAN ISLAMIC BANKING INSTITUTIONS

Amir Shaharuddin
Islamic Science University of Malaysia

Abstract: The major concern of Islamic banking institutions is to conduct their business in accordance to the principles of shari'ah. In order to ensure that all their products and services comply with the principles, most of the Islamic banks have set up shari'ah advisory committees. The committees consist of experts in Islamic commercial law (fiqh muamalat) and are expected to perform an oversight role on shari'ah matters related to Islamic banking operations. The present article discusses the shari'ah governance framework adopted by Malaysian Islamic banks. It explains the roles and functions of three important entities namely National Shari'ah Advisory Council (NSAC), Shari'ah Committee (SC) and internal shari'ah department. The discussion is in light of the new shari'ah governance framework issued by Central Bank of Malaysia (BNM) in January 2011.

Keywords: Islamic banking and shari'ah governance

INTRODUCTION
Shari'ah principles are the foundation of Islamic banking operations. The comprehensive compliance with shari'ah principles differentiates Islamic banking institutions from their conventional counterparts. Hence, a sound and robust shari'ah governance framework is vital to avoid non-compliance risk. The systematic approach of managing shari'ah non-compliance risks will ensure public confidence on the shari'ah compliance of Islamic banking products. Customers especially pious Muslims will continue to support Islamic banks and this should maintain a steady growth of the industry. At present, the framework of shari'ah governance in Muslim countries is varied. Countries such as Bahrain, United Arab Emirates (UAE), Saudi Arabia, Kuwait, Indonesia and Malaysia have established their own shari'ah governance framework to monitor the governance structures, process and arrangements of their local Islamic banking institutions. Previous studies show that there are distinctive models and approaches of shari'ah governance implemented in these countries. Malaysia is argued as the proponent of a “Regulation-based Approach”, Saudi Arabia as a “Passive Approach” and Qatar, UAE, Kuwait and Bahrain as a “Minimalist Approach”. These different models and approaches are adopted mainly due to diverse legal environments. Acknowledging such diversification, the key members of the Islamic Financial Service Board (IFSB) have no plan to establish a unified shari’ah governance framework. Each of the respective country is at its own liberty to implement shari’ah governance framework which suits its legal and economic backgrounds.

However, it should be noted that the implementation of the current models and approaches require major improvement. The shari’ah governance frameworks in Gulf Co-operation Councils (GCC) and Malaysia are in need of enhancement in the aspects of regulatory framework, internal policies on shari’ah governance, roles of shari’ah committees, attributes of shari’ah committees in terms of competency,
independency, transparency and confidentiality, operational procedures and shari’ah committees’ assessments (Hasan, 2010). Malaysia has taken a reactive approach by issuing a revised shari’ah governance framework- BNM /RH/GL_012_3 which takes effect starting 1 January 2011. The new framework would replace the Guidelines on the Governance of Shari’ah Committee for the Islamic Financial Institutions issued in 2004.

RESULT

Duties, Responsibilities and Accountability of the Shari’ah Committee

In general, the main duty and responsibility of the committee is to assure that the business operations in Islamic banks comply with shari’ah principles at all times. So far, the monitoring process of the shari’ah compliance is carried out mainly before a new banking product is to be launched. The product development team or business unit will present to the shari’ah committees on the terms and conditions, shari’ah contracts applied and legal documentations used in executing the transactions. After the proposal presentation, the shari’ah committees are expected to rigorously deliberate issues at hand before arriving at any decisions. If all the contents in the proposal comply with shari’ah principles, the shari’ah committees will endorse and validate them. However, if the shari’ah committees do not satisfy with the proposal, the related parties will be requested to refine the contents of the documents with comprehensive shari’ah research. In addition to that, the shari’ah committees are also responsible to check the product manual, marketing advertisement, sales illustrations and brochures used to describe the new product. This is to ensure that Islamic banking products are not only comply with legal technicality but also follow the norms of business ethic.

The members of shari’ah committee are appointed by the board of directors of an Islamic bank upon the recommendation of its nomination committee. Normally the appointment is for a renewable term of two years. The shari’ah committee members should have vast knowledge in Islamic law, either in Islamic legal methodology (usul fiqh) or Islamic commercial transactions (fiqh al-mu’malat) (BNM, 2004). A part from individual who possesses shari’ah background, Islamic banks are allowed to appoint other professional such as lawyers, accountants and economists to provide assistance to the committee, especially on matters regarding law and finance. Such flexibility is appropriate as it will support the depth and breadth of the shari’ah deliberations, particularly with the increase minimum number of shari’ah committees from 3 to 5. The performance of shari’ah committees will be assessed. The assessment will evaluate shari’ah committees’ performance in terms of competency (i.e. deliberation on the shari’ah issues), contribution (i.e. attendance to meeting, conduct training to staff) and overall effectiveness. Under the new shari’ah governance framework, Islamic banks are required to develop a succession planning program for the shari’ah committees. In order to nurture new talents, Islamic banks are encouraged to identify and hire young shari’ah scholars (BNM, 2011).

The issue of independency is given great attention. Since the shari’ah committee members are appointed and their allowances are paid by the banks, it is argued that the bank’s management may influence them in making proposed products legal. Despite all efforts in enhancing the shari’ah governance framework, some people still not convinced that the shari’ah committee members has full freedom in expressing their opinions and is fully independent. Hence, the new shari’ah governance framework again emphasizes the independency matter. BNM stresses that Islamic banks must ensure that the shari’ah committees are free from any undue influence that would hamper them from making objective judgement. In relation to this, re-appointment, resignation and removal of the shari’ah committees cannot be decided at the bank’s level. It is must be approved by the National Shari’ah Advisory Council (NSAC) formed by Central Bank of Malaysia (BNM).
Based on my interviews with 4 scholars who directly involve in the committees, the issue of independency is not justified. According to them, the shari’ah committees have total freedom to make ruling although it may not in favour of the bank. Furthermore, their opinions are respected by the bank’s management. In her defence of the shari’ah committee, Engku Rabiah argues that there is no ‘negative influence’ from the bank management except, administratively speaking; they sometimes have to response to the problems too quickly. Another scholar, Joni Tamkin contends that the banks respect resolutions made by the committees because their endorsement are needed to maintain the banks’ reputation. The Islamic banks are aware that the existence of any non-compliant shari’ah element in their operation will affect the confidence of the public.

In order to avoid a conflict of interest and for reasons of confidentiality, the BNM restricts the multiple appointments of scholars within the same industry. However, a scholar is permitted to become a member of shari’ah committees in different industries. For example, if a scholar is appointed as member of shari’ah committee in Bank Islam Malaysia Berhad, he is not eligible to become committee member in other Islamic bank. However, he can still be appointed as member of committee in other industries such as in takaful (Islamic insurance) or Islamic fund management. The policy has a profound impact on the shari’ah landscape of Islamic banking institutions in the country. It creates more opportunities for the shari’ah scholars to participate in this industry. As the number of Islamic financial institutions increases every year, more shari’ah scholars are needed to fill in the shari’ah committee quota. This is because previously the same scholars who deem to have high reputation in fiqh al-muamalat were likely to sit on many committees. Such phenomena are viewed as hindering the original shari’ah discussion as the decisions were drawn from opinions of a few similar scholars.

Currently, there are more than 40 scholars appointed as members of the shari’ah committee in various Islamic banks in Malaysia. The majority of the members are academics in universities. Perhaps academics become the popular choice as committee members because the BNM has prohibited the function of shari’ah supervision in the development of private business. The restriction aims to maintain the public confidence in decisions or resolutions made by the committee members. Most of them specialise in Islamic law, holding doctorate from various universities in United Kingdom, Middle East or Malaysia. In addition to that, as a consequence of the liberalisation, the committees’ members are not limited to Malaysian scholars but also consist of foreign experts especially from the Middle East.

**Internal Shari’ah Department and National Shari’ah Advisory Council (NSAC)**

The new shari’ah governance framework has enhanced the function of internal shari’ah department. Previously, the full-time shari’ah officers mainly function as liaison between the bank and the shari’ah committee members. They serve as a secretariat, drafting the minutes of the shari’ah committee meeting. Besides, they involve in the design of new products particularly in giving advice on the appropriate Islamic contract to be adopted. However, the introduction of new shari’ah governance framework has given bigger tasks to this internal department. Nowadays, the full-time shari’ah officers are expected to conduct shari’ah review, shari’ah risk management and shari’ah research.

The enforcement of shari’ah review in Malaysian Islamic banking institutions is regarded as a positive initiative. Despite of comprehensive framework outlined, prior shari’ah monitoring process is argued concentrating only on the ex-ante compliance process. What are meant by ex-ante compliance process are the reviewing, monitoring and controlling tasks before the product is approved (i.e. during the designing of contracts and agreement). Very few Islamic banks undertake ex-post shari’ah compliance process which requires the shari’ah committee members or the
Shari’ah internal officers to check the transactions that took place after the execution of the contracts. As the ex-post shari’ah compliance process is viewed as equally important, the current situation is considered as a serious loophole in the Malaysian shari’ah governance system (Abdul Rahman, 2010).

The implementation of shari’ah review in RHB Islamic Bank has shown very good feedback. Based on shari’ah review conducted, some non-compliance risks had been detected. For example, during opening a mudarabah account in one of RHB Islamic branches, customer was verbally informed about the profit sharing ratio but the ratio was not written in the Summary Account Opening Application Form. In view of enhancing the transparency regarding the distribution of profit with customers, the internal shari’ah department officers had requested the branch to include the profit sharing ratio in the said form. In another case, profits of the bank become doubtful as the transaction of Commodity Murabahah financing (based on tawwaruq contract) was undertaken without following proper sequences. The shari’ah committees have decided to remove the profit and ask the customer to re-do the transaction. It is important to emphasize here that the disclosure of such shari’ah non-compliance activities will not jeopardise public confidence regarding the shari’ah compliance of RHB Islamic bank’s products. Rather, it could strengthen customers' assurance that the bank is serious in ensuring that all its products and services follow the principles of shari’ah.

In addition to this, BNM has also founded the National Shari’ah Advisory Council (NSAC). The NSAC is regarded as the most authoritative body relating to the shari’ah issues of the Islamic banking in the country. The NSAC is responsible to make final decision whenever different interpretations between the shari’ah committees in Islamic banks occur. The resolutions made by the NSAC are binding and should be applied by all shari’ah committees of the Islamic banks. For example if the NSAC decide to abandon the use of a disputed contract, the shari’ah committees can not overrule the decision and allow them to be use in their respective banks. Hence, it is obvious that the main reason for establishing the NSAC is to ensure the standardisation of Islamic banking rulings.

It is important to note however, the authority of the NSAC is currently limited within the Islamic banking institutions. The NSAC’s resolutions do not have any influence in the civil court where disputes between the Islamic banks and their customers are decided. Judges of the civil courts are free to adhere to the NSAC’s resolutions or not. This situation has created confusion with regard to the legality of the bay’ bithamanin ajil (BBA) home financing offered by Bank Islam Malaysia Berhad (BIMB). A judge of High Court has dismissed the NSAC’s resolution on the shari’ah compliance of the product, claiming that the product is merely a duplication of conventional housing loan. As a result, the customer has been awarded win in a court in his battle against BIMB over default payment issue (Cheng Wee, 2009).

After the incident, BNM has proposed a new rule to be passed by members of the Malaysian parliament, requiring the judges of civil court to consult the NSAC members before giving verdict in the Islamic banking matters. As such, the Central Bank of Malaysia Act 2009 has been passed on recently. The Act affirms the authority of the NSAC as the sole authoritative body on shari’ah matters pertaining to Islamic banking and finance. The Act also makes mandatory for the court or arbitrator to refer the NSAC for deliberation on any shari’ah issues.

**CONCLUSION**

The new shari’ah governance framework issued by Central Bank of Malaysia provides strong foundation for the betterment of Islamic banking industry. It outlines clear guidelines of duties and responsibilities for the shari’ah committees, internal shari’ah department and National Shari’ah Advisory Committee in performing their important tasks. Indeed, these three entities are the backbone of the shari’ah governance in Malaysian Islamic banking.

The improvement of the shari’ah governance framework is timely due to
increasing criticism on the decisions made by the Malaysian shari’ah committees. Because of a few controversy rulings such as the acceptance of bay’ al-inah contract, Malaysian shari’ah scholars are viewed as adopting a more lenient or relaxed approach when compared to their Middle East counterparts. Malaysian shari’ah scholars are accused to be very pragmatic in assessing the compliance of new banking products to the principles of Islamic commercial law. Future research can be conducted to investigate the extents to which (1) Malaysian shari’ah scholars adopt the so-called “lenient approach” and (2) the effect of new shari’ah governance framework towards public perception.

REFERENCES