

A CRITICAL APPRAISAL OF SHARIAH GOVERNANCE FRAMEWORK

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POINTS OF DISCUSSION

- Background of the issue
- IFSB Guiding Principles
- Some Points to ponder
 - One tier or two tiers governance structure
 - Members of SC
 - Shariah Personnel
 - Pronouncements of Shariah Compliance: Ex-ante and Ex-post

Background

- Shariah compliance remains the central focus of Islamic finance industry.
- Without proper shariah governance framework, Shariah compliance of Islamic financial products and instruments may be perceived to have been compromised
- Moreover, the possible lack of sufficient understanding from other stakeholders on Shariah compliance, the diversity of jurisprudence on permissible transactions, and the limited disclosure of relevant and reliable financial information compound the need for proper Shariah governance framework.

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- Principle 3.1 of the “IFSB Guiding Principles on Corporate Governance” states that an appropriate mechanism must be created to ensure the compliance with the Shariah principles
- Similarly, Principle 7.1 of the “IFSB Guiding Principles on Risk Management” states that Islamic FI shall have in place adequate systems and controls, including Shariah Board/advisor to ensure compliance with the Shariah principles

IFSB Guiding Principles

- IFSB has issued four Guiding Principles that relates to Shariah Governance Framework
 - *IFSB-3: Guiding Principles for Governance for Institutions offering only Islamic Financial Services (IIFS excluding Islamic insurance/Takaful institutions and Islamic mutual funds),*
 - *IFSB-6: Guiding Principles on Governance for Islamic Collective Investment Schemes,*
 - *IFSB-8: Guiding Principles on Governance for Takaful Operations, also known as*
 - *IFSB-10: Guiding Principles on Shariah Governance Systems for Institutions offering Islamic Financial Services*
- IFSB 10 is considered the most focused guiding principles that deal directly with the function of Shariah advisory
- No “single model” and “one-size-fits-all” approach
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- It recognises the fact that in Shariah Governance Framework → No “single model” and “one-size-fits-all” approach should be taken
- What is important is the outcome which is: “effective independent oversight of *Shari`ah* compliance”
- What is important? Correct opinion or proper framework to ensure the proper procedure and processes have been followed (ex ante and ex post)
- The intention of this presentation is to analyse some of the important practices that lead to possible right decision.

Prelude

- Shariah Governance framework shall not be viewed and focus on the members of Shariah Board, but all the holistic procedure to achieve the highest level of compliance.
- It should encompass all the processes and procedures in ensuring full compliance to Shariah, pre, during and post.
- Again, it is not just about result. Elements of subjectivity?

Points to Ponder

- 1) One tier or two tiers Shariah Governance Framework
- 2) Composition of members
 - Appointment, Qualifications, Evaluations (KPIs), Enhancement (CPE Points),
- 3) Procedures in obtaining Shariah pronouncement
- 4) How to deal with the pronouncement
- 5) How to ensure that the bank (officers) comply with the pronouncement

One tier or two tiers Shariah Governance Framework

- Varied From one practice to another
- Which one is more suitable
 - Pro and Con
 - Detaching the members from the market?
 - How to resolve the issue
- Shariah Advisory Firms.
 - How they can add value?
 - Can they replace the SC?

Members of SAC (SC)

- Appointment
- Composition
- Qualifications (definition of Shariah Advisors),
- Evaluations and assessment (KPIs)
- Enhancement (CPE Points). Allocations for training
- Efforts towards enhancements
- Relation between SC & BOD
- Role of BOD in ensuring effective Shariah Governance Framework
- Appointment of one member of SC to BOD
- Independency of SC

Shariah Personnel

- Very important component
- Composition of the staff (shariah Officers)
- Functions:
 - Secretariat
 - Advisory
 - Review and Audit
 - Research
- Quality of the Officers

Procedures in obtaining Shariah pronouncement

- The importance of Shariah manual
- Preparing papers
- Presentation and full disclosure of material facts
- Rigorous deliberation among members of the *Shari`ah board over any proposed Shari`ah-compliant products or transactions that require a Shari`ah endorsement, as well as detailed scrutiny of the legal contracts and other documents relevant to the products or transactions*
- Time to market

How to deal with the pronouncement

- Once the pronouncement is made, it becomes binding upon the Bank
- Can the management resort to higher authority?
- Pronouncement: Between confidentiality and full disclosure
- Dissemination of Shariah rulings to respective officers to ensure full compliance

How to ensure that the bank (officers) comply with the pronouncement

- The needs for framework of review and audit
- Internal audit vis-a-vis external audit
- Necessary remedies for non compliance



THANK YOU
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