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International Shari'ah Research Academy for Islamic Finance



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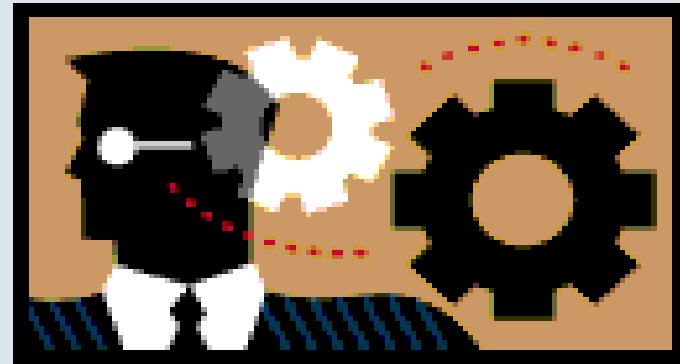
OVERVIEW OF SHARI'AH GOVERNANCE IN MALAYSIA AND GLOBALLY

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Outline

- **Introduction**
- **Shari'ah Governance in Malaysia and Globally**
 - **Existing Frameworks:**
 - **BNM Shari'ah Governance Framework, IFSB Standards and AAOIFI Standards**
 - **Overall Developments – Malaysia and Globally**
 - **Developments in Malaysia**
- **Way forward**





Introduction

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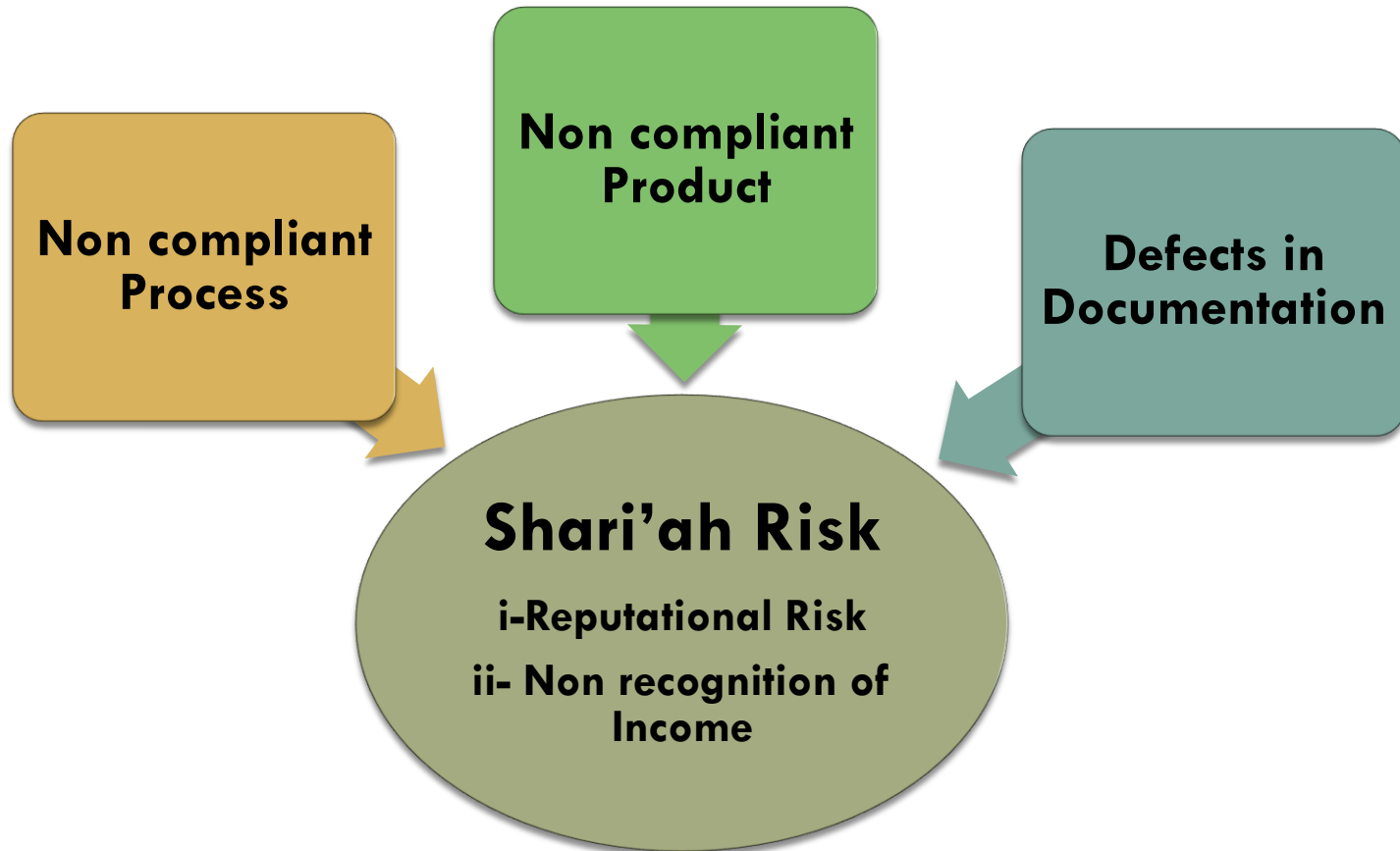


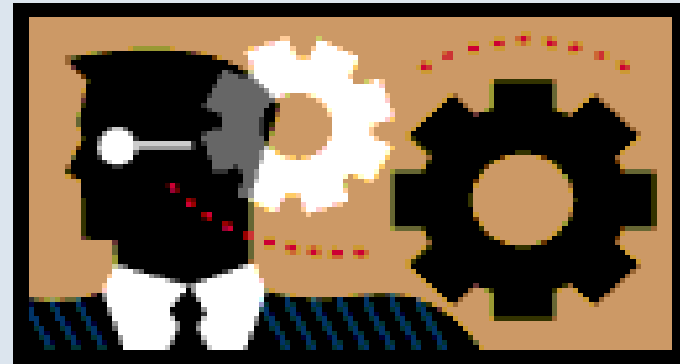
Shari'ah Governance

- ✓ **Shari'ah compliance is the basic component of Islamic financial institution**
- ✓ **Over the years, Shari'ah governance have been discussed in the context of Shari'ah board's duty.**
- ✓ **Recent development in the industry shows that Shari'ah governance has gain more attention and more efforts are being made to observe complete Shari'ah compliance chain.**
- ✓ **Because, non compliance with Shari'ah will injure IFI and cause adverse effect on the industry.**



Non Compliance Risk





Existing Frameworks: BNM's SGF, IFSB Guiding Principles and AAOIFI Standards

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BNM Shari'ah Governance Framework

The Role of SGF:

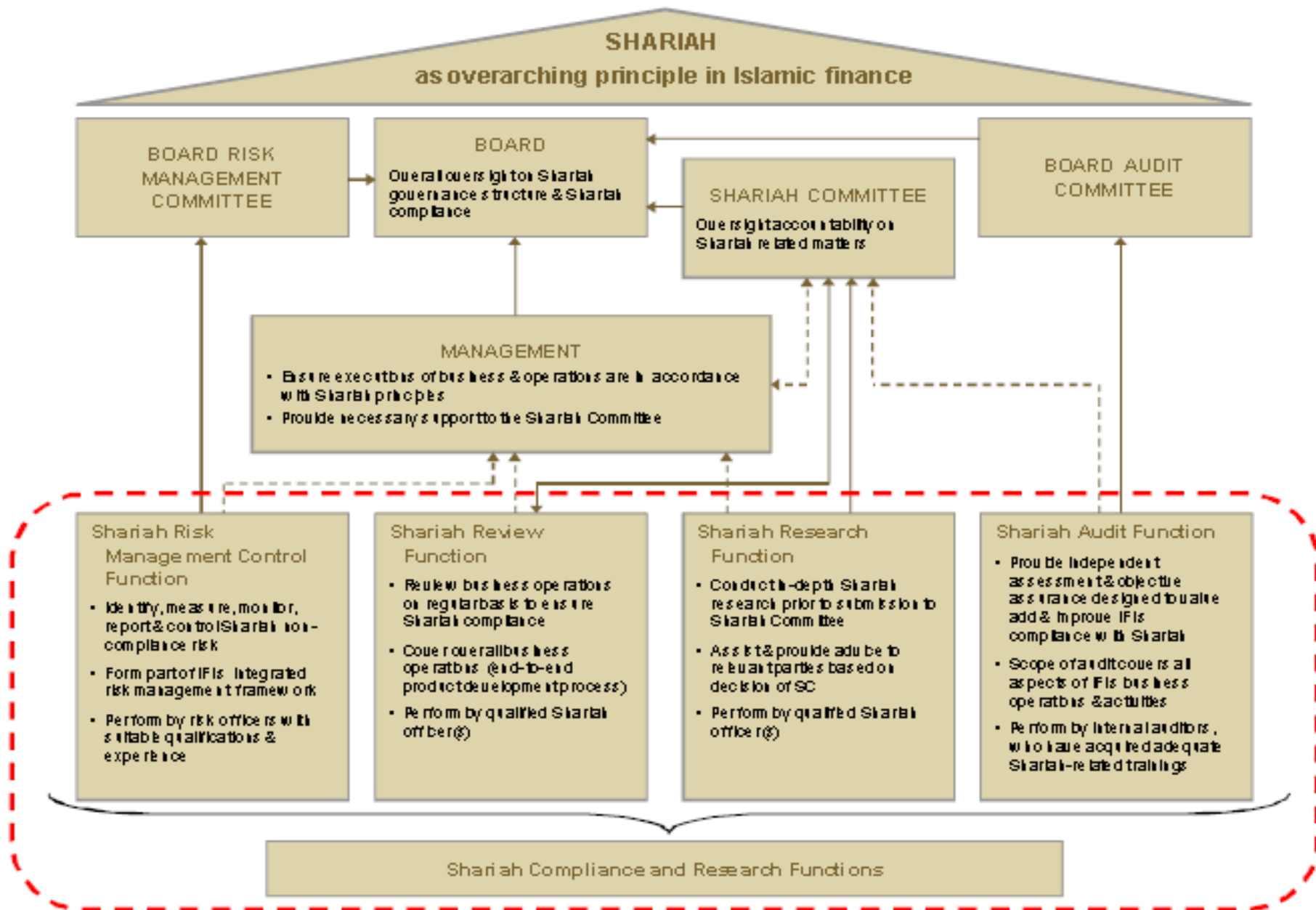
“To enhance the role of the board, the Shariah committee and the management in relation to Shariah matters, including enhancing the relevant key organs having the responsibility to execute the Shariah compliance and research functions aimed at the attainment of a Shariah-based operating environment.”

Effect:

SGF supersede the Guidelines on Governance of Shariah Committee for the Islamic Financial Institutions issued in 2004. Most of the provisions of the Guideline are included in the new SGF



Model of the New Shariah Governance Framework for IFIs



IFSB Standards

- **IFSB 10 - Guiding Principles on Shari'ah Governance System** recommends that Islamic finance institution must ensure proper functioning *Shari'ah* governance is in place in the institution and that *Shari'ah* compliance is a shared responsibility and not solely placed on the *Shari'ah* board.
- It also emphasized that *Shari'ah* board should have clear mandate and responsibility and they should meet certain 'fit and proper' criteria.
- IFSB also recommends the installation of the 4 values:-
 1. Competence
 2. Independence
 3. Confidentiality
 4. Consistency

Another relevant standard of IFSB is IFSB-3: Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services



AAOIFI Standards



AAOIFI Standards

□ Details

□ AAOIFI Governance Standards

- **Standard No. 1: Shari'ah Supervision Body: Appointment, Composition and Report**
- **Standard No. 2: Shari'ah Review**
- **Standard No. 3: Internal Shari'ah Review**
- **Standard No. 4: Auditing and Governance Committee for Islamic Financial Institution**
- **Standard No. 5: Independence of Shari'ah Supervisory Board**
- **Standard No. 6: Statement on Governance Principles for Islamic Financial Institution**
- **Standard No. 7: Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institution**



AAOIFI Standards

□ Relevant Standards

□ AAOIFI Shari'ah Standard

- Standard No. 29: Stipulations and Ethics of Fatwa in the Institutional Framework

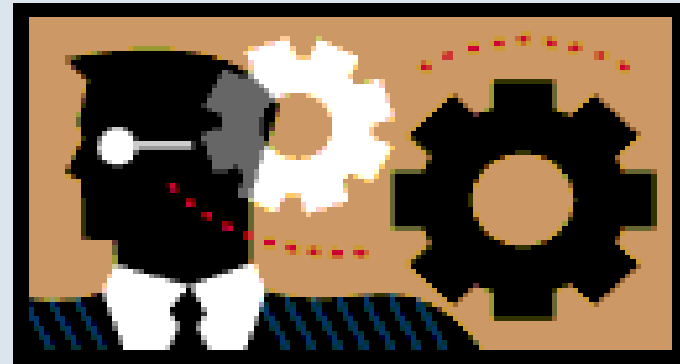
□ AAOIFI Standard on Ethics

- Standard No. 1: Code of Ethics for Accountants and Auditors of Islamic Financial Institutions
- Standard No.2: Code of Ethics for Employees of Islamic Financial Institutions

□ AAOIFI Standards on Audits

- Eg. Standard No. 4: Testing for compliance with Shari'ah rules and principles by an external auditor





Overall Developments – Malaysia & Globally

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Shari'ah Governance Standards and the Frameworks Impacts

Shari'ah Boards - Emphasis

- **Continuous Professional Development (Training & Exposure)**
- **Succession Plan – Serious action required**
- **Independence & Transparency**
- **Performance Assessment (Collective & Individually)**
- **Assistance of Supportive organs**

Shari'ah Governance - Organs

- **To include: Shari'ah Review, Audit, Secretariat, Risk Management and Research Organ**
- **Emphasis on Research**

Shari'ah Governance – Other requisites

- **Active involvement of: BOD and Shareholders**
- **Fatwa: To use acceptable Shari'ah method to derive legal ruling**
- **IFI to disclose full, accurate and timely information**
- **Shari'ah Corporate Governance**
- **Empowerment of CSR**
- **Observation of ethics and best business practice**

Nevertheless, where the Shari'ah governance framework and the standards are not adopted, the following concerns of the industry is still persistent.

Apart from that, in many jurisdictions, various concerns on legal risks are not addressed too.



Concerns in the Industry:

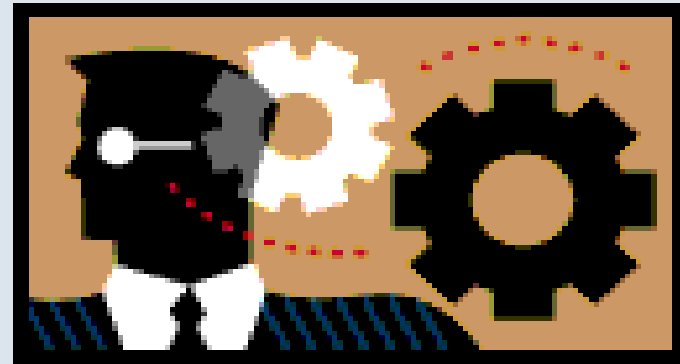
- 1. Shari'ah scholars sitting on many Shari'ah boards (Fund@Work report). Quality and complete supervision is questionable.**
- 2. Shari'ah advisor's lack understanding on finance**
- 3. Check and balance of Shari'ah advisory. Effective Shari'ah review and audit**
- 4. Scholars' remuneration: question of transparency and mode of calculation.**
- 5. Shari'ah scholars hold different opinion than the Shari'ah committee of IFI that they represent**
- 6. Competency. Shari'ah board taken as learning ground for new/ inexperienced Shari'ah advisors. Passive.**
- 7. Fatwa Shopping**



Concerns in the Industry:

8. **Legal Uncertainty**
 - **Islamic finance cases are tried in English courts**
 - **English court judges and lawyers are not familiar with Shari'ah**
 - **Conflict on choice of laws**
9. **Documentation risk**
10. **Rooms to argue deals are non Shari'ah compliance in court by parties**
11. **Uncertainty of the legal status of Islamic instruments – mostly untested.**





Significant Developments – Malaysia

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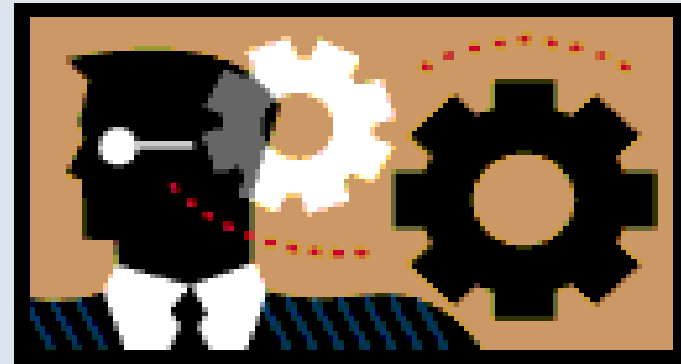
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Existing Shari'ah Governance Framework

1. **BNM Shari'ah Governance Framework – could be blueprint for global practice**
2. **Problems with legal uncertainty – Malaysia have taken serious actions to solve them, such as:**
 - **New Central Bank Act 2009**
 - **Muamalah division in High Court**
 - **KLRCA**
 - **Law Harmonization Committee**
3. **Thus, Malaysia is said to have the most advanced legal environment for settlement of Islamic finance cases.**
4. **It has encountered various experience (Islamic finance dispute) in the country.**
5. **It has enabling laws and infrastructures**
6. **It can be come one of the best choices of law.**





Way Forward

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WAY FORWARD
ASAS (Association of Shari'ah Advisors)
Towards an independent Shari'ah Committee/ Board
Regulatory Body

Central Banks and IFI to seek their services



Alternative Dispute Resolution (ADR)

- **Fast settlement to solve Islamic finance disputes**
 - It is the fastest solution to overcome the challenge to provide suitable dispute settlement forum for Islamic finance cases
- **Supported by the existing of ADR Regional Centers in Kuala Lumpur and Dubai. Malaysia also has Financial Mediation Bureau (FMB)**
 - The centers can also settle cross boarder trade disputes.
- **It require insertion of a clause in the contract to permit its application**
 - Lawyers need to advise their clients to chose this option prior to settlement in court. It has a lot of advantages.
- **Good experience: Sanghi Polyesters Ltd (India) v. The International Investor KCSC (Kuwait) [2001] C.L.C.**
 - It involved Istisna' Financing. The Arbitrator, an Islamic Law expert, respected Shari'ah restrictions when awarding damages.



- ❖ **Shari'ah governance standards and framework are crucial and need to be adopted globally.**
- ❖ **Shari'ah compliance is not the sole responsibility of Shari'ah board but all parties involved in Islamic finance.**
- ❖ **Shari'ah compliance need to be ensured up until the deal is settled or when disputed in court**



Thank You

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