



مصرف البحرين المركزي

Central Bank of Bahrain

CBB's Shari'ah Governance Module – Purpose and Themes

AAOIFI-World Bank conference

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Agenda

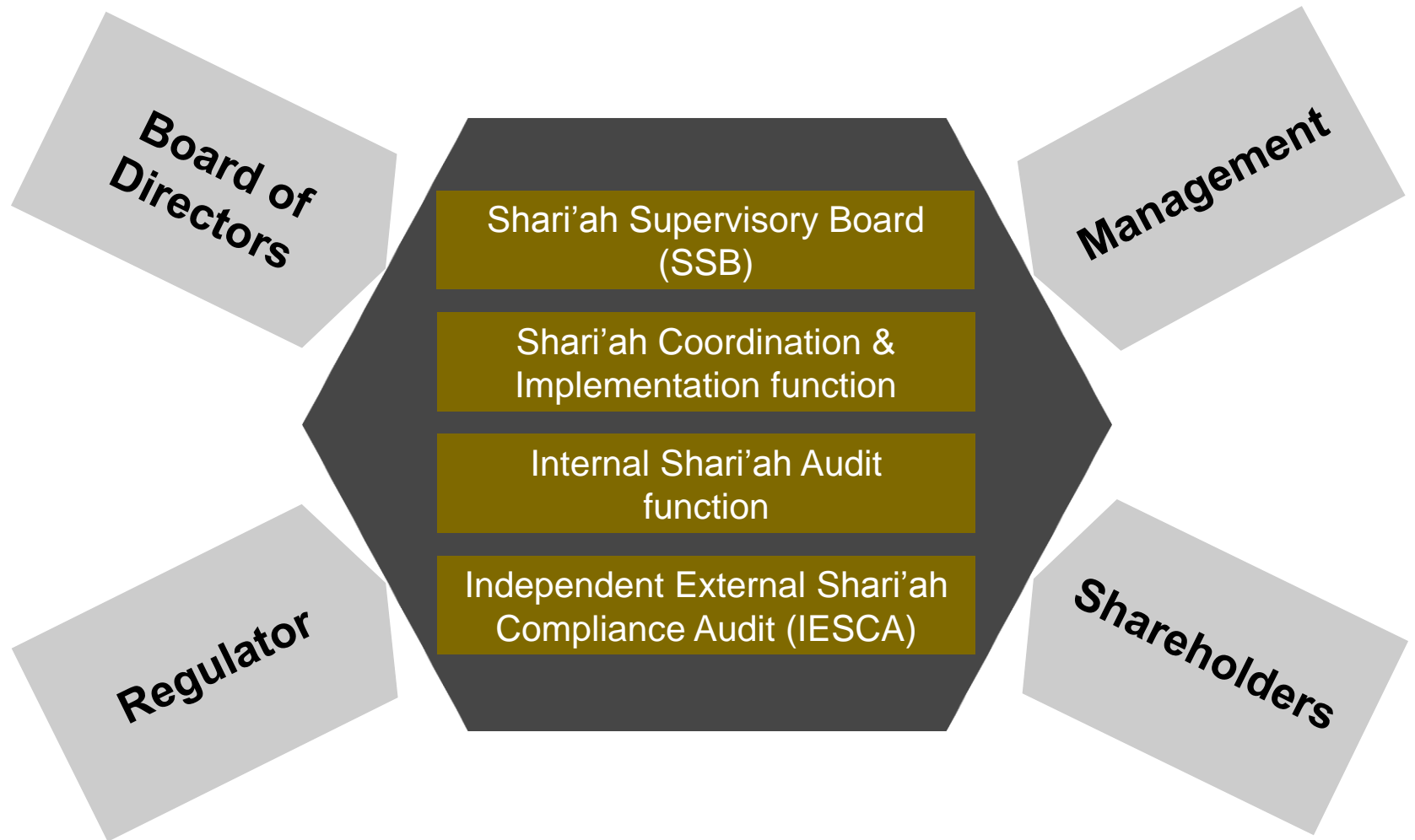
- ▶ The purpose of Shari'ah Governance (SG) module
- ▶ An integrated approach to SG
- ▶ Shari'ah Supervisory Board, the most important SG organ
- ▶ Shari'ah Coordination & Implementation, Internal Shari'ah Audit
- ▶ Independent External Shari'ah Compliance Audit
- ▶ What's next?

Purpose of SG module

- ▶ To provide a structure and a system to govern all the business activities of a Bahraini Islamic bank licensee in order to ensure Shari'ah compliance at all times and at all levels
- ▶ To enable Bahraini Islamic bank licensees to be perceived as Shari'ah compliant by the stakeholders including the general public

An effective SG framework with a functional SSB and other SG components is the best safeguard against systemic Shari'ah non-compliance risk

An integrated approach to SG



An integrated approach to SG

- ▶ More than two years to prepare and finalize SG module
- ▶ Other jurisdictions, GCC paper, IFSB and AAOIFI as sources
- ▶ Two industry consultations, received 100+ pages of comments
- ▶ Detailed consultation with Central Shari'ah Supervisory Board
- ▶ Applicable on all Islamic retail and wholesale banks in Bahrain
- ▶ Applicable from 30 June 2018; IESCA applicable from 1 Jan 2019

Shari'ah Supervisory Board

- ▶ SSB is the most important component of Islamic banks' Shari'ah Governance framework
- ▶ Public trust in the legitimacy of Islamic banks is directly related to their confidence in Shari'ah scholars at the SSB
- ▶ SSB has the final authority to issue Fatwa, but it is the responsibility of the regulator to ensure SSB governance
- ▶ CBB has also put in place a Central Shari'ah Supervisory Board with clear and broad mandate to promote harmonization

Shari'ah Supervisory Board

Appointment, Operating Procedures and Reporting Lines

- ▶ To be appointed by the shareholders in AGM on BoD's advice
- ▶ Minimum 3 scholars for a SSB; rulings binding on Islamic bank
- ▶ SSB to abide by AAOIFI Shari'ah standards and CSSB rulings
- ▶ SSB to have a detailed charter approved by BoD
- ▶ SSB to report administratively to BoD
- ▶ SSB to have a minimum tenure of 3 years

Shari'ah Supervisory Board

Appointment, Operating Procedures and Reporting Lines

- ▶ Minimum 75% attendance of SSB meetings required per annum
- ▶ Complete and unhindered access to all records and information
- ▶ At least once SSB member to attend AGM to answer shareholders
- ▶ SSB to approve Shari'ah Officer & Head of Internal Shari'ah Audit
- ▶ SSB to inform CBB in case BoD fails to address a major violation
- ▶ Annual SSB report to include bases/evidence of Fatawa

Shari'ah Supervisory Board

Fit & Proper Criteria, Code of Conduct

- ▶ Qualification: At least a bachelor degree (or equivalent) in Shari'ah
- ▶ Degree in Fiqh Muamalat with strong understanding of Usul al Fiqh
- ▶ Adequate understanding of banking, Islamic finance, accounting
- ▶ At least 7 years experience in Shari'ah related scholarly pursuits
- ▶ Strong proficiency in Arabic
- ▶ Integrity, honesty, clean background, competence, reputation

Shari'ah Supervisory Board

Fit & Proper Criteria, Code of Conduct

- ▶ SSB must exercise independence; no influence of BoD/management
- ▶ No one individual or group to dominate the SSB's decision-making
- ▶ Conflict of interest to be disclosed in writing by SSB member
- ▶ Conflicted SSB member not to participate in related SSB decision
- ▶ SSB's performance to be evaluated on self-assessment basis
- ▶ SSB to adopt a protocol for revising its Fatawa and disclosing them

Shari'ah Coordination & Implementation

- ▶ Shari'ah Officer to head Shari'ah Coordination & Implementation
- ▶ Must be involved in testing and implementation of new products
- ▶ Qualification & experience requirements being finalized by the CBB
- ▶ Primary resource for Shari'ah training of the Islamic bank's staff
- ▶ Practically works as the SSB's eyes and ears in the Islamic bank
- ▶ Reporting to the SSB, administrative reporting to the CEO

Internal Shari'ah Audit

- ▶ Head to be appointed by the management, upon SSB's approval, in consultation with the Audit Committee and approval of the CBB
- ▶ Head of the function reports to SSB, administratively reports to CEO
- ▶ Responsible for evaluating the extent of bank's compliance with:
 - 1 Shari'ah principles
 - 2 SSB's Fatawa, guidelines, pronouncements, recommendations
 - 3 Shari'ah related regulations, resolutions, directives issued by the CBB
 - 4 AAOIFI Shari'ah standards
 - 5 Shari'ah related policies and procedures of the bank

Independent External Shari'ah Compliance Audit (IESCA)

- ▶ Bank to appoint an audit firm on an annual basis to perform IESCA
- ▶ Bank can appoint its external auditor or any other audit firm
- ▶ CBB to evaluate the proficiency of the audit firm and approve it
- ▶ IESCA report to be completed before annual SSB report
- ▶ IESCA report to be submitted to Audit Committee and then to SSB
- ▶ Purpose is to have independent assessment of Shari'ah related controls, to ensure that Shari'ah compliance is embedded in the day to day functioning of the bank

Independent External Shari'ah Compliance Audit (IESCA)

- ▶ IESCA must be guided by International Standards on Assurance Engagements 3000
- ▶ IESCA is not meant to second-guess the opinion of SSB or assess the competence of the SSB members
- ▶ IESCA must test on a sample basis transaction level controls, product specific controls and other relevant controls
- ▶ A detailed template has been provided by the CBB on the format of the IESCA report
- ▶ “Management’s Shari’ah Compliance & Governance Report” is the basis on which IESCA will be issued

What next?

- ▶ Islamic windows, Takaful, Islamic investment companies, others
- ▶ Specific areas may need more regulations such as URIA pool management and profit distribution
- ▶ CBB's supervision, inspection and development departments working together to improve regulations and their implementation
- ▶ Shari'ah Governance is key to ensuring that the Islamic finance industry survives and thrives in the future

Thank you