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## Session 2: Regulatory and Supervisory Framework For Islamic Social Bank

### Shariah Governance on Islamic Social Banking & Finance

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## **Shariah Governance on Islamic Social Banking & Finance**

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What is the value proposition of Islamic Social Banks?

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## Understanding the differences in the Value Proposition – Islamic Social Banking

#	Promises	CB	IB	SB
1	Objective	Profit for shareholders is utmost priority	IB is not solely place emphasis on financial profit, but also distributive justice and socially responsible (Taqi-Usmani 2002; Al-Zuhayli 2003; Haniffa & Hudaib 2007).	Gaining financial as well as social and environmental results (Benedikter 2011; De Clerck 2009; Weber 2014)
2	Response to financial crisis	More prone to financial and banking shock	Affected by financial crisis, but it has been arguably more resilient to financial shock (Kasim & Majid 2010; Hasan & Dridi 2011)	More resilient to financial meltdown (Korslund & Spengler 2012)
3	Transparency	No detailed information about clients. Taking care of the privacy of the debtors	It seems similar to CB.	More transparent as they provide detailed information as to where the collected fund is distribute to clients (Benedikter 2011; San-Jose et al. 2011)
4	Guarantee	Certain collateral guarantee	IB requires collateral (Aggarwal & Yousef 2000)	Developing alternative guarantee system (San-Jose et al. 2011).

*Note:* CB (Conventional bank), IB (Islamic bank), and SB (Social bank)

(Hamidi & Worthington, 2018)

We all know what happens when governance fails . .

But is it any different at ***Social Banks*** ?

## Recent challenges at Conventional Social Banks

- **2013**

- >50 Deposit-taking Microfinance institutions collapse in Ghana
- Primary Causes of collapse include poor governance
  - Disregard of due diligence
  - Mismanagement
  - Violation of Bank of Ghana Rules and Guidelines
  - Excessive interest charged and paid (>35% p.a)

- **2019**

- PMC Bank (Punjab Maharashtra Cooperative)
- 24<sup>th</sup> Cooperative bank placed under RBI administrators in 2019
  - Over-borrowing from property developers, poor governance

## Existing Governance Challenges in Islamic Social Finance

- Potential of zakat collection is largely untapped:
    - Global challenges in the effective **collection** and **distribution** of zakat
- In collection . .***
- IDB estimates zakat potential is +/-3% of GDP, whereas actual collection is +/-0.15% of GDP for OIC countries

**For example:**

- **OIC Member Countries: \$6 trillion GDP**
- **Actual Zakat Estimate: \$10 billion p.a**
- **Potential Zakat Estimate: \$200 billion p.a**

## Poor Governance of Waqf delaying the impact of Islamic Social Finance

- **India:** Size of Awqaf Assets estimated at US\$24 billion. At 10 percent return, annual resources would constitute 0.3 percent of India's GDP (required percentage: 0.344 percent)
  - **However, figures are largely inaccurate due to poor disclosure and transparency**
- **Karnataka State Board of Waqfs: Land Scandal**
  - Waqf Board owned 33,741 properties, spread over 54,000 acres of land
  - 22,000 to 27,000 acres of land worth **two lakh crore rupees (+- \$30 billion)** was laundered to private individuals
  - Properties illegally sold were to be utilised for charitable purposes such as building mosques, dargahs, graveyards, bridges, caravanserais, Khanqahs, etc.
- **Indonesia:** Size of Awqaf Assets estimated at US\$60 billion. At 10 percent return, annual resources would constitute 0.849 percent of India's GDP (required percentage: 0.35 percent)
- IRTI and WB estimate of potential: USD 550-600 billion





## Existing Shariah Governance Standards focused on Islamic Financial Institutions

- Shariah Governance Standards are not always applied to Islamic Social Finance Institutions that have no clear licensing
  - Countries that have regulation for Islamic banks, Takaful and Investment Institutions, don't always have any for co-operatives or microfinance institutions when they are not deposit-taking
  - Islamic microfinance institutions, therefore, lack Shariah Boards, Shariah Governance Frameworks and Shariah oversight
  - In the rural areas of the Indian sub-continent, for example, some villages have been exploited by moneylenders with excessive interest
  - Specific Islamic microfinance institutions in Pakistan do not have Shariah boards as they do not fall within the purview of the SBP rules on Islamic banks

## Malaysia, Islamic Social Banks and Shariah Governance

- Koperasi Belia Islami Malaysia Berhad (KBI) established in 1977, the first Islamic financial institution
- SKM Guidelines on Shariah Governance (GP28) covers governance for all co-operatives involved in financial intermediation and in line with the SGF of Malaysia, for example:
  - The establishment of the Shariah Committee
  - Duties of the Management to ensure Shariah Compliance
  - Shariah non-Compliance Event

# Way Forward

Islamic Social Banks (ISB) must be clearly defined

Shariah Governance Standards must consider unique structures of ISBs to provide adequate Shariah guidance

Regulators should ensure that Shariah compliance is implemented at non-bank financial institutions

Examples from countries that have no Shariah Compliance at Central Banks, should be considered as a short-term solution

Market awareness of Shariah compliance will drive ISBs towards better governance – Therefore, knowledge empowerment is required

Thank you

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