

Shariah Governance for Islamic Financial Institutions in Malaysia on the Independency of Shariah Committee and Efficiency of Its Shariah Decisions

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Abstract: Shariah governance for Islamic Financial Institutions (IFIs) in Malaysia is governed by the Shariah Governance Framework for the Islamic Financial Institutions 2010 (SGF 2010) that was developed and introduced by Central Bank of Malaysia (CBM) [1]. SGF 2010 provides that Shariah Committee as an internal Shariah advisory body formed in each respective Islamic financial institution (IFI) is important to ensure the overall Islamic financial practices of such institution operate in accordance with the Shariah principles. Similarly, SGF 2010 provides a comprehensive guidance to the Shariah Committee in discharging its duties and responsibilities in matters relating to Shariah. To ensure that all of its duties and responsibilities are carried out accordingly, Shariah Committee must be independent. Its independency shall be observed at all times while exercising its duties and responsibilities. To ensure Shariah Committee independency, the Board of Directors (Board) needs to be notified on the minutes of Shariah Committee meetings. The Shariah Committee shall also have access to accurate, timely and complete information from the management. Its independency requires the findings of Shariah audit and Shariah review to be tabled before the Shariah Committee members for their comments and endorsements. In a situation where the Shariah Committee has reasons to believe that the IFI has been carrying on Shariah non-compliant activities, the Shariah Committee shall inform the Board and recommend suitable measures to rectify the situation. Independency of Shariah Committee leads to the efficiency of Shariah Committee decisions made during the Shariah Committee meetings. In order to facilitate the Shariah Committee members’ decisions, they shall be given the necessary access to files, records, draft materials and conversations, including those categorised as confidential, so long as the information is related to the work undertaken by the Committee. This means that Shariah Committee needs to be given sufficient information, and full disclosure and transparency on all issues during meetings. Not only that, to facilitate and reach good decisions, Shariah research needs to be carried out by the Shariah research officers of the IFI to facilitate Shariah decisions and research conducted by the Shariah research officers would assist the Shariah Committee to reach good decisions.
1 Introduction
Central Bank of Malaysia (CBM) has introduced a two-tier Shariah governance infrastructure comprising of two vital components, i) Shariah Advisory Council (SAC) which is a centralised Shariah advisory body at CBM and ii) Shariah Committee which is an internal Shariah advisory body formed in each respective Islamic financial institution (IFI). This is important in ensuring the overall Islamic financial system in Malaysia operates in accordance with the Shariah principles.

For IFI, CBM has developed, introduced and issued the Shariah Governance Framework for the Islamic Financial Institutions (SGF 2010) with the primary objective of enhancing the role of the Board of Directors (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. The introduction of SGF 2010 is at the same time to cope with new developments of the Islamic finance as well as higher expectation of the key stakeholders of the IFI pertaining to the Shariah compliance process.

Thus, this article investigates the independency of the Shariah Committee and the efficiency of its Shariah decisions. This is done through the collection of data and information by distributing the questionnaire to the respondents who are involved in IFIs’ industries such as the management of the IFIs, be it Islamic banks and Takaful institutions, Shariah Committee and Shariah Officers. Likert scale is used to measure the level of approval for the resources effectiveness and manpower efficiency on the implementation of SGF 2010. These factors are assessed according to the Likert scale scores 1 (strongly disagree) to 5 (strongly agree). Most of the data in this study were collected and analyzed using the Statistical Package for Social Sciences (SPSS) software version 16.0 and Microsoft Excel. Additional the descriptive analysis is used to determine the number of frequencies and percentages.

2 Appointment and Roles of Shariah Committee

SGF 2010 has mentioned clearly that the Shariah Committee members shall be appointed by the board upon the recommendation of its Nomination Committee. The number of Shariah Committee members to be appointed must not be less than five. The following Chart 1 shows the existing number of Shariah Committee members amongst the IFIs in Malaysia.

![Chart 1. Respondents’ distribution based on number of Shariah Committee members](image)

From Chart 1, it indicates that most of the institutions have 5 members of Shariah Committee. 75.3% of the respondents mention that they have 5 members, 16.0% of the respondents have more than 5 members while only 8.6% of respondents have less than 5 members. This is a very good indication as about 92.4% of the institutions have achieved the required numbers of the Shariah Committee members.

It is also the requirement of SGF 2010 that the majority of Shariah Committee members must possess strong knowledge in Shariah and backed by the appropriate qualifications in that area. In this regard, every IFI is required to establish a Shariah Committee of which the majority shall comprise persons with appropriate qualifications and experience in Shariah. The competency and credibility of the Shariah Committee members provide the assurance that the IFI’s operations are being monitored by a credible and competent committee. The numbers of Shariah Committee that possess Shariah qualification are shown in Table 1.
Based on the above Table 1, the requirement that each of the IFI must have majority of Shariah Committee possess Shariah qualification is fulfilled accordingly especially the IFIs that have five Shariah Committee members.

Moreover, SGF 2010 provides a comprehensive guidance to the Shariah Committee members in discharging their duties and responsibilities for matters relating to Shariah. Their main duties and responsibilities are as follows,

a) To be responsible and accountable for all Shariah decisions, opinions and views provided by them.

b) To advise the board and provide input to the IFI on Shariah matters in order for the IFI to comply with Shariah principles at all times.

c) To endorse Shariah policies and procedures prepared by the IFI and to ensure that the contents do not contain any elements which are not in line with Shariah.

d) To endorse and validate relevant documentations including the terms and conditions contained in the forms, contracts, agreements or other legal documentations used in executing the transactions; and the product manual, marketing advertisements, sales illustrations and brochures used to describe the product comply with Shariah principles.

e) To assess the works carried out by Shariah review and Shariah audit are in order and compliance with Shariah matters which form part of their duties in providing their assessment of Shariah compliance and assurance information in the annual report.

f) To assist related parties of the IFI such as its legal counsel, auditor or consultant who seeks advice on Shariah matters from the Shariah Committee.

g) To advise on Shariah matters to be referred to the SAC that could not be resolved.

h) To provide written Shariah opinion in circumstances where the IFI make reference to the SAC for further deliberation, or where the IFI submits applications to the BNM for new product approval.

3 Independency of Shariah Committee
To ensure that all the abovementioned duties and responsibilities are carried out accordingly, Shariah Committee must be independent. Its independency is clearly mentioned in the SGF 2010 that provides, “Independence of the Shariah Committee shall be observed at all times in exercising its duties to make objective and informed judgment. The Board shall recognise the independence of the Shariah Committee and ensure that the Committee is free from any undue influence that would hamper the Shariah Committee from exercising objective judgment in deliberating issues brought before them. Correspondingly, the Shariah Committee is expected to make sound decisions on Shariah matters in an independent and objective manner.”

The agreement amongst the respondents as regard to the independency of Shariah Committee is mentioned by Chart 2.

Chart 2. Respondents’ distribution on Shariah Committee has independence in making Shariah decision without any influence from the management.
Chart 2 shows that it is strongly agreed by the respondents that Shariah committee has independence in making Shariah decision without any influence from the management.

To ensure Shariah Committee independency, the Board of Directors needs to be notified about the minutes of Shariah Committee meetings. Chart 3 shows clearly about it.

Chart 3. Respondents’ distribution notification of Shariah Committee meeting minutes to the Board

Chart 3 shows that 87.5% of the respondents agree (64.8% strongly agree and 22.7% agree) that minutes of Shariah Committee meetings need to be notified to the Board.

Similarly, the Shariah Committee shall report directly to the Board and regularly inform the Board on relevant Shariah matters. The Board at the same time shall ensure that decisions made by the Shariah Committee are duly observed and implemented by the IFI and should not be set aside or modified without Shariah Committee’s consent.

Its independency requires the findings of Shariah auditor and Shariah review have to be tabled before the Shariah Committee for comments and endorsements. This is indicated by Chart 4 and Chart 5 respectively.

Chart 4. Respondents’ distribution on communication of Shariah audit to Shariah Committee

Chart 4 indicates that out of 78.4% of the respondents strongly agree that the findings of the Shariah audit must be communicated to the Shariah Committee. Similarly, as shown in Chart 5 they are strongly agreed (75.0% of the respondents) that the findings of the Shariah review must be communicated to the Shariah Committee.

Chart 5. Respondents’ distribution on communication of Shariah review to Shariah Committee

Its independency is also based on the fact that the Shariah Committee shall have access to accurate, timely and complete information from the management. If the information provided is insufficient, the Shariah Committee may request for additional information which shall be duly provided by the management.

In the event where the Shariah Committee is not provided with the required information, the Board shall be informed of the fact and appropriate action.
shall be taken to rectify the situation. Where appropriate, the Board shall consider taking the necessary punitive measures against parties who intentionally failed to extend the required information.

In a situation where the Shariah Committee has reason to believe that the IFI has been carrying on Shariah non-compliant activities, the Shariah Committee shall inform the Board and recommend suitable measures to rectify the situation. In cases where Shariah non-compliant activities are not effectively or adequately addressed or no rectification measures are made by the IFI, the Shariah Committee shall inform the CBM on the fact.

Furthermore, the independency of the Shariah Committee may be implied from the restrictions mentioned in the SGF 2010 itself. It provides, “The Shariah Committee member shall not have any relationship that could interfere or be reasonably perceived to interfere with the exercise of independent judgment, with the following persons:

i) an immediate family member such as spouse, children or siblings who are, or who were during the last financial year, employed by the IFI or any of its related companies as a chief executive officer (CEO) or non-independent board members; and

ii) a substantial shareholder of, or a partner in (with a stake of 5% or more), or an executive officer of, or a director of any for-profit business organisation to which the IFI or any of its subsidiaries made, or from which the IFI or any of its subsidiaries received, significant payments in the current or immediate past financial year.”

4 Efficiency of Shariah Committee Decisions

Independency of Shariah Committee leads to the efficiency of Shariah Committee decisions made during the Shariah Committee meetings. It is a mandatory requirement of the SGF 2010 for the Shariah Committee meetings to be held regularly at least once in every two months. The Shariah Committee member must attend at least 75% of the Shariah Committee meetings held in each financial year. The number of Shariah Committee meetings held in the year, as well as the attendance of every Shariah Committee member shall be disclosed in the IFI’s annual report.

The participation of the Shariah Committee can be facilitated by means of video or telephone conferencing when necessary. This is to ensure that the Shariah Committee is kept sufficiently in touch with the business of the IFI and the operations of the IFI are not adversely affected because of the difficulty in securing the Shariah Committee’s approval for policy and decision.

The frequency of the Shariah Committee meeting is shown in Chart 6. Chart 6 shows that 44.3% respondents said they meet every month, 29.5% respondents said that they have the meeting once in the month and 12.5% respondents is more than once in the month. This shows that the requirement of SGF 2010 for the Shariah Committee meeting to be held once in two months has been fulfilled and observed by the majority of the IFIs.

![Chart 6 Respondents’ distribution based on the frequencies of Shariah Committee meeting](image-url)

For Shariah Committee decisions, usually there are made in the formal Shariah Committee meetings. This is shown in Chart 7.
From Chart 7, the respondents have indicated that the Shariah decision makings are made mostly through the formal Shariah Committee meeting (100%). The decision also made through circulation (69.0%) and email (63.2%) while only 20.7% made using individual consultant and 40.2% using phone. The rest are using other methods.

In order to facilitate the Shariah Committee decisions, they shall be given the necessary access to files, records, draft materials and conversations, including those categorised as confidential, so long as the information is related to the work undertaken by the Committee. This means that Shariah Committee are given sufficient information, and full disclosure and transparency on all issues during meetings. Chart 8 and Chart 9 indicate such practice.

Chart 8 shows 81.8% of the respondents agree (43.2% strongly agree and 38.6% agree) that Shariah Committee members have been given sufficient information about the issues discussed in the meeting. The respondents also agree as shown in Chart 9 that out of 84% (54.5% strongly agree and 29.5% agree) that institution exercises full disclosure and transparency on all issues deliberated in Shariah Committee meeting.

The relevant information must be that which is critical for the Shariah Committee to form their decisions, views and opinions on matters brought to their attention. In this regard, it is the responsibility of the individual Shariah Committee to observe the principle of confidentiality at all times. Confidential or sensitive information obtained by any member of the Shariah Committee while serving his or her duties shall not be used in any manner that could be detrimental to the IFI.

Confidential information is information received by members of the Shariah Committee that is not public in nature and has not been authorised to be made public. Confidential information includes, but is not limited to, the following:

(i) information on the development of new products and services;
(ii) decisions of the board or management;
(iii) internal memorandums or reports prepared in connection with matters presented, or to be presented to the Shariah Committee;
(iv) the content or occurrence of conversations among members of the Shariah Committee concerning matters deliberated in the meeting and representatives of the IFI;
(v) the progress status on a business transaction or action that has not been made public;
(vi) views expressed by various parties in the course of discussions on a particular matter deliberated by the Shariah Committee; and 
(vii) any subject matter that the IFI has indicated should not be revealed, such as internal policies and procedures.

Notwithstanding the above, the Shariah Committee will not be regarded as breaching the confidentiality and secrecy code if the sensitive information were disclosed to the BNM in good faith when reporting serious breaches of Shariah by the IFI.

Furthermore, to ensure the Shariah Committee decisions are thoroughly discussed and appropriate made, the IFI shall engage other professionals such as lawyers, accountants and economists to provide appropriate assistance and advice to the Shariah Committee, especially regarding issues on law and finance.

Not only that, to facilitate and reach good decisions, Shariah research needs to be carried out by the Shariah research officers of the IFI. The following Chart 10 and Chart 11 have shown this respectively.

Chart 10 Respondents’ distribution on sufficient Shariah research conducted to facilitate Shariah decision

<table>
<thead>
<tr>
<th>Strongly Agree</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>19.3%</td>
<td>3.4%</td>
<td>11.4%</td>
<td>13.6%</td>
<td>52.3%</td>
</tr>
</tbody>
</table>

Chart 11 Respondents’ distribution on research conducted by the Shariah research officers assist the Shariah Committee to reach good decisions

<table>
<thead>
<tr>
<th>Strongly Agree</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>36.3%</td>
<td>3.3%</td>
<td>8.8%</td>
<td>13.2%</td>
<td>38.5%</td>
</tr>
</tbody>
</table>

Chart 10 and Chart 11 indicate that 71.6% agree (19.3% strongly agree and 52.3% agree) that there is sufficient Shariah research conducted to facilitate Shariah decision and 74.8% also agree (36.3% strongly agree and 38.5% agree) that research conducted by the Shariah research officers assist the Shariah Committee to reach good decisions.

5 Conclusion
All duties and responsibilities in matters relating to Shariah are basically discharged by the Shariah Committee members. To ensure that they are carried out accordingly, they must be independent. Their independency shall be observed at all times. The Board needs to be notified about the minutes of Shariah Committee meetings. They shall have access to accurate, timely and complete information from the management. Their independency requires the findings of Shariah audit and Shariah review to be tabled before them for their comments and endorsements. In a situation where the Shariah Committee members have reasons to believe that the IFI has been carrying on Shariah non-compliant activities, they shall inform the Board and recommend suitable measures to rectify the situation.

Independency of Shariah Committee leads to the efficiency of Shariah Committee decisions made during the Shariah Committee meetings. In order to facilitate the Shariah Committee decisions, they shall be given the necessary access to files, records, draft materials and conversations, including those categorised as confidential, so long as the information is related to the work undertaken by the Committee. This means that Shariah Committee is given sufficient information, and full disclosure and transparency on all issues during meetings. Not only that, to facilitate and reach good decisions, Shariah
research needs to be carried by the Shariah research officers of the IFI in assisting the Shariah Committee.

Reference: