Shariah Governance Framework For Islamic Co-Operatives As An Integral Social Insitution In Malaysia

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Abstract: In Malaysia, Islamic cooperatives are recognized as providers of some form of Islamic financial service similar to Islamic Banks and Takaful Operators. An Islamic Co-operative refers to a co-operative conducting activities and businesses based on Shariah principles. Being a non-banking financial institution, its main objective is to enhance social economic welfare of its members. As a form of captive social institution, it enables the less economically privileged members of society to pool resources as a cooperative. Malaysia is spearheading the Islamic banking and finance industry globally by having in place a proper and well-designed legal and regulatory framework for Islamic Financial Institutions, which includes the area of Shariah governance. However, the Shariah governance framework for the Islamic Co-operative in Malaysia is still in its infancy stage. In this paper, this area will be given focus and properly highlighted. Later, comparison will be made with the Shariah governance framework for the Islamic financial institutions. This paper will conclude that the requirements with regard to Shariah governance for the Islamic Co-operative are flexible and not as strict as required for the Islamic financial institutions.

Keywords: Islamic banking and finance, Captive social institution, Cooperatives, Shariah Governance

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Kata kunci: perbankan dan kewangan Islam, institusi kewangan sosial, koperasi, tadbir urus syariah

1.0 Introduction

In addition to the Islamic banks and takaful companies, there are a number of non-banking financial institutions that provide financial services and products based on Shariah principles. Among them are Lembaga Tabung Haji, Al-Rahnu Institutions, and also the Islamic Co-operatives. The Islamic Co-Operatives which is founded on the concept of cooperation (ta’awun) is essential body in the community that contributes to the economic development of the country in terms of poverty reduction, social integration and fair globalization (United Nations, 2014). The co-operatives and Islamic cooperatives are involved in a broad range of economic activities including credit and finance, industry, housing, plantations and others.

Various forms of cooperatives include school co-operatives, home co-operatives, credit co-operatives and others. Nowadays, the modern form of co-operative society is practiced by most of the countries in the world. International Co-operative Alliance (ICA) stated that over 800
million people are members of co-operatives around the world and this concept of business has been running successfully for the last 150 years. (ICA, 2012).

The advancement of Islamic finance is also attributed to some extent to the ‘Islamic Co-operatives’. The first Islamic co-operative in Malaysia was established in 1977, namely, Koperasi Belia Islam Malaysia Berhad (KBI), and it precedes the first Islamic commercial bank, Bank Islam Malaysia Berhad, which was established in 1983. KBI was the first co-operative that introduced Shariah-based financing. As a result, Co-operative Act 1993 has been amended to include rules and guidelines in accordance with Shariah principles.

There are a few factors that have motivated the establishment of the Islamic co-operative. Among them are to avoid riba-based transactions, to implement the theory of Islamic Commercial law and to create awareness among Muslims (Salleh, Arshad, Shaarani & Kasmuri, 2008).

Since most of the co-operative members (which includes Islamic co-operatives) are those from the low and middle income people, the Islamic co-operatives are also offering financial products as a measure to ease the financial burden of its members. Most of the Islamic Co-operatives focus on retail-based financial products such as Qard Hassan and Bai Al-Inah to help its members buy house, car, cover-living cost and others. These products facilitate personal finance, affordable homes, vehicle financing and related expenditures. The application and approval process are simple, effective and less restrictive if compared to the banking institutions.

Some cooperatives such as Koperasi Muslimin Malaysia Berhad are also offering financing based on Bai Al-Inah. In Islamic banking and finance sector, Bank Negara Malaysia has already produced a guideline that makes Bai Al-Inah quite impractical in Malaysia. The requirements actually reflect the conditions required by the Shariah Advisory Council in order to render Bai Al-Inah legitimate in the eyes of Fiqh al-Muamalat.

The question is whether the practice by the Islamic co-operative is in line with what is required by Shariah, for example in the case of Bai Al-Inah as mentioned above. This raises the issue of how Shariah compliance is being administered by the Islamic co-operatives since
they also offer Islamic financial products and services. Thus, it is important to discuss the Shariah governance framework in the context of Islamic Co-operatives.

Generally, the term “Shariah Governance” refers to structures and processes adopted by an institution to ensure compliance with Shariah rules and principles in its business operations. In addition to ensuring Shariah compliance, it is very important to instill confidence of the stakeholders and to promote financial stability.

BNM’s Shariah governance model is directed to the Islamic financial institutions. The model in Malaysia is recognized by the global Islamic banking and the finance sector due to its comprehensiveness and adequacy. In order to provide similar assurance, there is effort by the Islamic Co-operative sector to adopt the practice of Shariah governance, especially with the recently issued Shariah Governance Guideline (GP28) by Suruhanjaya Koperasi Malaysia (SKM) which is the regulator for cooperatives in Malaysia.

2.0 Problem Statement

Co-operative societies are essential bodies among the community in giving assistance to its members’ welfare, especially with high cost of living standard. Most of them offer services like financing and credit facilities for housing, vehicle and agriculture financing. In fact, some of them also offer Qard Hasan or benevolent financing without any interest charged. When it comes to financing and investment, it is important to look into its contract and application to avoid any element of riba, gharar, maysir and other prohibited elements in Islam. This can be done through a proper and well-administered Shariah governance framework. However, Shariah governance in the Islamic co-operative is relatively new and is in developing stage. The current framework must be analyzed to identify which area can be improved to ensure that compliance to Shariah is observed at all times in the business operation of Islamic co-operatives.

3.0 Research Objectives

The objective of this research is to examine and analyze the existing Shariah Governance Framework for Islamic co-operatives. A comparison will be made between the more established Shariah Governance
Framework for Islamic Financial Institutions issued by Bank Negara Malaysia and the Islamic Cooperative framework under SKM. Based on the findings, suggestion and recommendation will be proposed to improve and enhance the existing Shariah governance framework for the Islamic Co-operatives.

4.0 Research Methodology

The methodology adopted in this paper is the qualitative legal method where the examination will be made on the provisions provided by law and regulation with regard to Islamic Co-operative. Comparison will also be made between the Shariah Governance framework for Islamic Financial Institutions and the Shariah governance framework for Islamic Co-operative in order to identify which area can be improved by the Islamic Co-operative sector.

In this context of discussion, the term ‘Islamic Co-operative’ in this paper also excludes the Islamic Co-operative Banks, such as Bank Kerjasama Rakyat Malaysia Bhd (Bank Rakyat), Bank Persatuan Malaysia Bhd (Bank Persatuan) and the Islamic Cooperative Bank of Malaysia (ICBM). These Islamic Co-operative Banks are placed directly under the supervision of both Bank Negara Malaysia and Suruhanjaya Koperasi Malaysia (SKM). Thus, the regulatory and Shariah governance framework for the Islamic Co-operative Banks are different from the Islamic Co-operative intended by this paper.

5.0 Literature Review

5.1 The Concept of Cooperative

The International Co-operative Alliance (ICA), defines a co-operative in its statement of co-operative identity (ISCI) 1995 as, “...an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise” (Othman & Kari, 2008). According to the Co-operative Societies Act 1993, “co-operative” is defined as an autonomous organization which voluntarily united to meet the needs and aspirations of the economic, social and cultural development through a jointly owned company, democratically controlled as per registered under the Act (Laws of Malaysia, 1993). A co-operative enterprise is a unique form of captive social institution that promotes and enhance the welfare of its less economically privileged
members. It is different from the traditional shareholder-owned enterprise or investor-owned firm. It is also different from the conventional not for profit or non-profit entity. According to Tim Mazzarol (2009), there are five-fold key principles that define a co-operative.

1. It must be a voluntary formation of members, as compared to communist collectives or government imposed organizations.

2. It must be governed by principles of democracy in which a “one-member-one-vote” rule exists. This compares to a shareholder owned enterprise in which voting power is determined by the size of the shareholding.

3. The co-operative must be independent of government control and owned solely by its members.

4. The co-operative can be formed by individuals or organizations (e.g. other businesses).

5. The co-operative enterprise exists only for the benefit of its members. It cannot be used to benefit the wider community as might a charity or a political or religious cause.

5.2 Co-operatives in Malaysia

On an individual basis cooperatives may seem small, but the collective power of cooperatives is very impressive. The data stated in the National Co-operative Policy 2011-2020 indicates that the number keeps growing year by year that affects the increment of assets and revenues. In a five-year period, the number of co-operatives increases approximately 9.4% annually on average. The increase shows that co-operatives have gained the trust of the people in Malaysia as a mechanism to improve their economic and social environment.

However, there are a lot of weaknesses faced by the co-operative in Malaysia. Among them are a lack of involvement in high value and competitive businesses; a lack of exploration of new opportunities within or outside the country; as well as lagging behind in skills, knowledge and technology (The Borneo Post, 2013). The majority of the co-operatives are small in terms of size and capital backing, their members are indifferent, and networking and synergies among them are lacking (Ministry of Land and Co-operative Development, 2010).
5.3 Islamic co-operatives

Stressing on the importance of Shariah compliance in the context of the co-operative’s business and operation may come from the ‘spillover’ effect of the Islamic banking and finance sectors.

Even though the term “Islamic co-operative” is trending, but the concept has a traditional presence. A seminar entitled “Cooperation in Islamic Society” was held in 1978 at the Cooperative College of Malaysia, Petaling Jaya. The seminar concluded that the cooperative system in this country should be augmented to the requirements of Islamic law. This is important given that most co-operative members in the country has a Muslim majority (Samad, R. R., & Shafii,n.d). As a result, there were many co-operatives established with Islamic paradigms in places such as Koperasi Belia Islam Malaysia and Koperasi Al-Hilal (Kohilal) and others.

Islamic cooperatives are very similar to non-Islamic cooperatives. They are locally owned and the members are represented by the board of directors and staff. There are some tenets that distinguish between the Islamic cooperatives with other cooperative societies. The main difference between both types of co-operatives is the Shariah compliance aspect of the products and services offered to the members. Further the concept of ‘ta’awun’ or mutual assistance and goodwill is the binding ‘spirit’, and hence the essence of Islamic cooperative. In a nutshell, the Islamic co-operative has its own unique characteristics. The features of the Islamic co-operative as highlighted by Ismail and Said (2012) and Buchori (2009) are as follows:

i. The policies and objectives must be in line with the al-Quran, the as-Sunnah, Ijma’ and other sources of Islam.
ii. The capital used in business must be agreed to by all members.
iii. All members must agree on management and operation of the co-operative and delegate certain members to perform activities of the company.
iv. Profit and loss proportions are based on shares and fees contributed.
v. Institution of zakat, infaq, sadaqah and waqf must function well.
vi. Admit the profit-oriented motive as long as the *Shariah* principles are strictly followed.

vii. Acknowledge freedom of business and common rights.

However, it must be noted that being an Islamic Co-operative does not mean that the co-operative is registered as ‘Islamic Co-operative’. There is no categorization between whether it is an Islamic co-operative or not during the registration of the co-operative. Thus, an Islamic co-operative only refers to the co-operative carrying on activities based on the *Shariah* principle with focus on the mutuality principle for goodness.

### 6.0 Regulatory Framework of the Islamic Co-Operative In Malaysia

#### 6.1 The Regulator

Suruhanjaya Koperasi Malaysia (SKM) is an entity that was incorporated on January 1, 2008. SKM was formerly known as the Co-operative Development Department of Malaysia (JPK). (MDTCC). SKM is a statutory body under the Ministry of Domestic Trade, Cooperatives and Consumerism. It acts as a registrar and a regulator of co-operatives in Malaysia. Among the objectives of SKM are:

a. To stimulate cooperative development and a strong and organized cooperative sector according to values as well as the principles of cooperatives to contribute towards the achievement of the objectives of the National socio-economics;
b. To increase involvement of cooperatives in various sectors of the economy; and
c. To develop human capital with competence and entrepreneurial culture.

#### 6.2 Laws and Regulation for Islamic Co-Operatives

The main regulation for the Islamic Co-operative is the Co-operative Act 1993 (Amendment) 2007. The latest amendment was brought forth by the Malaysia Co-operative Commission. The introduction of Co-operative Act 2007 (Act A1297) was deemed necessary to tighten the regulations and provide better oversight of the movement (Manap & Tehrani, 2014). The amended Act came into force on 1st January, 2008 and the Department of Co-operative Development was replaced by the SKM. The Act’s objectives are to promote the development of co-
operative societies based on the principles of honesty, trustworthiness and transparency and to contribute towards achieving the socioeconomic objectives of the nation and related matters.

Figure 1: Regulatory framework for Islamic Co-operative in Malaysia
Source: Authors’ own

Currently, there is no specific act that governs the Islamic Co-operative. In Islamic banking and finance industry, the Islamic financial institutions are governed by a specific act which is the Islamic Financial Services Act 2013. It provides specific requirements for the Islamic financial institutions. The absence of a specific act or regulation for the Islamic cooperative may trigger issues in cases where the current regulation may not be in compliance with the Shariah principles or may hinder the process of Shariah compliance.

6.3 Guidelines for the Islamic Co-operative in Malaysia

According to Section 86B of the Cooperative Societies Act 1993 (Amendment) 2007, the SKM may issue any directives, guidelines, circulars or notices in relation to any provision of the cooperatives Act in the country from time to time. As of July 2016, there are 26 guidelines produced by SKM related to the whole operation and management of the co-operative. Nonetheless, not all of these guidelines relate to the Shariah compliance aspects of the Islamic co-operative. For instance, GP6 which is the Guideline on the Credit Services by the Cooperative, does not put any restriction about the type of financing given nor that it must be in compliance with the Shariah. (SKM, 2009a). Among the guidelines that has relation to the Shariah compliance nature of Islamic co-operative are:
<table>
<thead>
<tr>
<th>Code</th>
<th>Guideline</th>
<th>Implementation Date</th>
<th>Summary</th>
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<tbody>
<tr>
<td>GP07</td>
<td>Guidelines on Islamic Financing by Co-operatives</td>
<td>16 November 2009</td>
<td>To monitor and control the co-operative that gives financing facility based on the <em>Shariah</em> principle.</td>
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<tr>
<td>GP07A</td>
<td>Guidelines on Giving Control Financing Prudently</td>
<td>24 December 2012</td>
<td>To be read together with GP07. The financing referred by this guideline is the credit facility and Islamic financing offered by the co-operative.</td>
</tr>
<tr>
<td>GP07B</td>
<td>Guidelines for Giving <em>Ibra‘</em> (rebate) Share-based Islamic Financing Purchase</td>
<td>1 July 2015</td>
<td>To standardize the practice of giving <em>Ibra‘</em> (rebate) to protect the interest of the members and to streamline the financing activities based on the <em>Shariah</em> principle in the Co-operative sector.</td>
</tr>
<tr>
<td>GP09</td>
<td>Guidelines for Recruitment Special Savings and Loan Deposit or Acceptance</td>
<td>5 May 2010</td>
<td>To monitor and to control the co-operative conducting recruitment special savings and deposit or acceptance.</td>
</tr>
<tr>
<td>GP10</td>
<td>Guidelines on Special Investment Scheme</td>
<td>5 May 2010</td>
<td>To monitor and control the activities of the cooperative conducting special investment scheme activities.</td>
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<td>For the purposes of carrying out Islamic investments, cooperatives shall establish a <em>Shariah</em> Advisory Committee or refer to <em>Shariah</em> advisors in other institutions that are registered with the Securities Commission to ensure the implementation of the investment in accordance with the principles of <em>Shariah</em>.</td>
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<tr>
<td>Code</td>
<td>Guideline</td>
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<tr>
<td>GP15</td>
<td>Guidelines on Micro Financing Scheme by Cooperatives</td>
<td>1 July 2011</td>
<td>To provide guidance to cooperatives to carry out micro finance scheme (conventional or Islamic) for its members.</td>
</tr>
<tr>
<td>GP17</td>
<td>Guidelines for Establishing, Features, acquire or establish subsidiaries</td>
<td>1 September 2011</td>
<td>All cooperatives must adhere to these guidelines to enable a cooperative’s request to establish, own or acquire any subsidiary to be considered. It also aims to monitor and control the cooperative that has subsidiaries. Cooperatives should obtain approval in the general meeting and written approval from the commission under subsection 19 (2) of the Act to give any Islamic financing or credit facility to subsidiaries.</td>
</tr>
<tr>
<td>GP20</td>
<td>Guidelines on Credit Co-operative Federation</td>
<td>30 November 2011</td>
<td>To give guidance on the registration, operations and regulatory requirements federation of credit co-operative societies. The Federation should establish a Shariah Committee as reference for the members who perform activities based on the Shariah principle.</td>
</tr>
<tr>
<td>GP23</td>
<td>Co-operative Financial Statement Reporting Guidelines</td>
<td>18 October 2012</td>
<td>To establish necessary accounting standards and procedures to be adhered to and to be followed by cooperatives in reporting its financial statements in accordance with the Cooperative Societies Act 1993 and Regulations of Cooperatives.</td>
</tr>
<tr>
<td>GP25</td>
<td>Guidelines on Islamic Pawnbroking (Ar-Rahnu) Activities</td>
<td>14 April 2013</td>
<td>To provide guidance to cooperatives to implement an Ar-Rahnu activity in a more orderly and prudent manner.</td>
</tr>
<tr>
<td>GP28</td>
<td>Shariah Governance Guidelines</td>
<td>1 July 2015</td>
<td>Apply to cooperatives engaged in financial intermediation activities based on the Shariah principle.</td>
</tr>
</tbody>
</table>
7.0 Findings

7.1 Shariah Governance Framework For the Islamic Co-Operative In Malaysia

Shariah compliance is the backbone of any institution that claims itself as following the Shariah principles in its daily operation and business, whether it is a financial institution or co-operative. Thus, it is very important to have in place adequate systems and controls to ensure Shariah compliance. This can be done through a proper Shariah Governance framework.

Shariah governance framework in the context of Islamic banking and finance in Malaysia has already strengthened its foundation and has gained a lot of recognition from the global Islamic banking and finance industry, especially with the implementation of Shariah Governance Framework 2010 and Islamic Financial Services Act 2013.

Following the success of the Islamic finance industry, there were continuous efforts by the regulator of the co-operative to emulate the success. Firstly, amendment was made to the Co-operative Societies Act 1993, where the role of the Shariah Advisory Council of Bank Negara Malaysia is mentioned in the amended Act. Secondly, it is through the issuance of several guidelines as mentioned before. The latest significant guideline issued is the guideline on Shariah Governance (GP28) issued on 1st July 2015. This guideline shows the effort of the regulator to adopt the Shariah Governance framework for the Islamic cooperatives, following the good practice of the Islamic banking and finance industry.

7.1.1 Shariah Governance Structure for the Islamic Cooperative

The Shariah governance structure for the Islamic co-operative is illustrated in Figure 2. Generally, there is a body at both the regulator level and the Islamic co-operative level that advise on the issue of Shariah. At the regulatory level, SKM is required to consult the Shariah Advisory Council of Bank Negara in any Shariah arrangement conducted by the co-operative and to issue a directive based on the consultation. At the Islamic co-operative level, it is required to establish a Shariah committee as a mechanism to ensure Shariah compliance in the business and operation of the Islamic Co-operative.
7.1.2 Reference to the Shariah Advisory Council of Bank Negara Malaysia

Unlike BNM, the regulator for Islamic financial institutions in Malaysia which has the Shariah Advisory Council (SAC) as the highest authority in Islamic banking and finance, such a body or authority is not present at SKM as the regulator of co-operatives in Malaysia. Thus, it is crucial to refer to Section 26 (1) of the Malaysian Co-operative Societies Commission Act 2007 which requires SKM to consult the SAC of BNM on matters relating to any cooperative arrangement that is based on Shariah and to issue written directives in relation to the arrangement following the advice of the Shariah Advisory Council.

Section 26(2) provides that in any proceedings relating to Shariah-based co-operative arrangements, monitored and regulated by the SKM, any question arising on Shariah matters, the court or arbitrator, as the case may be, can -

(a) take into account any written directive issued by the Commission under subsection (1) or

(b) refer such a question to the Shariah Advisory Council for its decision.

The above section gives the court or arbitrator, in cases involving Shariah-based co-operative arrangement, the option whether or not to
take into account the written directive issued by SKM or to refer such a question directly to the SAC of BNM. The question that might arise here is that, giving the option may pose an issue in cases whereby the court may refuse to refer such matter to the SAC of BNM whereby the issue at hand may be a complex Shariah matter that had to be decided by Shariah expert without which the court may interpret something incorrectly. Such a situation may prove to be very detrimental to the Islamic cooperatives in terms of reputational risks with financial consequences. Whereas for a similar situation in the Islamic banking and finance industry, it is binding on the court or arbitrator to refer to the rulings of SAC and to refer any question concerning Shariah matters in the Islamic financial business as stated in Section 56 of the Central Bank of Malaysia Act 2009.

The above section explains the indirect relationship between SKM and the SAC of BNM of which the cooperatives may have referred to the SAC of BNM. It is interesting to note that there is no provision for the appointment of SAC at the SKM level, and thus may raise up the issue of suitability of the application of the SAC BNM’s decision in the context of cooperative business. As such, it is proposed that, a Shariah panel that plays similar role to the Shariah Advisory Council of BNM be placed at SKM as the regulator for Islamic Co-operative. It is to ensure certainty in the application of Shariah matters at the co-operative level.

7.1.3 Shariah Governance Guideline (GP28) By Suruhanjaya Koperasi Malaysia

In 2015, SKM issued a guideline on Shariah governance for the Islamic Co-operative (also referred as GP28). This guideline is issued under section 86B of the Co-operative Societies Act 1993 (Act) to regulate cooperatives doing business or activity based on Shariah principle.

The guidelines shall apply to cooperatives engaged in financial intermediation activities based on Shariah principle involving the following activities:

1) banking functions;
2) credit function;
3) financing; and
4) Ar-Rahnu
It is interesting to note that most of the contents of GP28 are the same with the Shariah Governance Framework 2010 (SGF), except in some requirements. The discussion is crucial in this paper. Thus, as the discussion goes along, a comparison will be made between GP28 and SGF.

There are two main components provided by GP28 which are the establishment of the Shariah committee and the Shariah governance aspects of cooperatives.

(1) The establishment of the Shariah Committee

Co-operative carrying on business or activities based on the Shariah principle is required to establish Shariah committees to advise the co-operative on Shariah matters with regard to their business and operation. The Shariah committee can either be established as:

a. An internal Shariah Committee for a co-operative
b. A Shariah Committee for the whole group of co-operative
c. An external Shariah Committee

To ensure the Shariah committee to functions effectively, the composition of the Shariah committee shall consist of at least three members. The co-operatives are also required to appoint at least one officer who will serve as the secretariat to the Shariah committee. This officer should have at least a Diploma in Shariah or studies in Fiqh, Usul Fiqh and Fiqh al-Muamalat.

GP28 also provides requirements with regard to the qualification of the Shariah Committee:

1. The Shariah Committee member shall be a Muslim individual.
2. The majority of members in the Shariah Committee shall at least a hold bachelor’s degree in Shariah, which includes a study in Usul Fiqh (the origin of Islamic law) or Fiqh Muamalat (Islamic transactions/commercial law) from a recognised university.
3. The majority members of the Shariah Committee should be able to demonstrate strong proficiency and knowledge in written and verbal Arabic, and have a good understanding in Bahasa Malaysia and the English language.
4. The Shariah Committee may comprise experts from relevant backgrounds such as finance and law, which could support the
depth and breadth of the *Shariah* deliberations. However, these members must not form the majority of the *Shariah* Committee.

5. The *Shariah* Committee preferably shall comprise members of diverse backgrounds in terms of qualification, experience and knowledge.

There is no clear relationship between the SAC of BNM and the Shariah Advisor appointed at each co-operative. The question that may arise is which opinion or decision will be referred to in case there is a clash between the opinion or decision of SAC and the *Shariah* Committee in each Islamic Co-operative. It may further lead to a Shariah non-compliance event and create confusion among the members as to the activities of the cooperative.

(2) *Duties of the Management to ensure Shariah Compliance*

GP28 sets out the duties and responsibilities for each main component in the Islamic Co-operative management which are:

a) The Co-operative Board  
b) The Shariah Committee  
c) The Co-operative Management  
d) The Internal Audit Committee

The summary for the duties and responsibilities of each component is as follows:

<table>
<thead>
<tr>
<th>Component</th>
<th>Duties And Responsibilities</th>
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<tbody>
<tr>
<td>Co-operative Board</td>
<td>• To be responsible for the overall <em>Shariah</em> governance and compliance of the cooperative on the advice of the <em>Shariah</em> committee.</td>
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<td>• To establish appropriate mechanisms to carry out the responsibilities, including oversight and other <em>Shariah</em> governance related tasks.</td>
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<td>• To approve all policies pertaining to <em>Shariah</em> matters and to ensure that the policy is implemented effectively.</td>
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<td></td>
<td>• To ensure that the <em>Shariah</em> committee understand their fiduciary responsibility.</td>
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<td>• To monitor the performance of <em>Shariah</em> committees.</td>
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<td>• To ensure that there is effective communication.</td>
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<tr>
<td>Component</td>
<td>Duties And Responsibilities</td>
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<tr>
<td>Shariah Committee</td>
<td>• To be aware and responsible for all the decisions, views and opinions relating to Shariah matters.</td>
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<td></td>
<td>• To perform the role of supervision on Shariah matters related to the business operations and activities of the cooperative.</td>
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<td>• To identify issues of concern and propose preventive and corrective measures, if necessary.</td>
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<td>• To report directly to the Board of Cooperatives.</td>
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<tr>
<td>Co-operative Management</td>
<td>• To implement the decisions made by the Shariah committees.</td>
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<td></td>
<td>• To identify and to refer any Shariah issues to the Shariah committee for its decision, view and opinion.</td>
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<td>• To submit promptly complete and accurate information to the Shariah committee and to be transparent about any area that requires clarification by the Shariah committee.</td>
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<td>• To allocate resources and manpower sufficient to support Shariah governance.</td>
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<td>• To provide the education and continuous training programs to the Board and Shariah committee.</td>
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<td>• To establish Shariah compliance culture in the cooperative.</td>
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<td>• To ensure that the policies and procedures of the Shariah can be accessed at any time.</td>
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<td></td>
<td>• To ensure that the operations are carried out in accordance with policies and procedures.</td>
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<tr>
<td>Internal Audit Committee</td>
<td>• To ensure a strong and effective internal control and risk management system.</td>
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<td>• To ensure that the management adheres to the policies and procedures regarding Shariah matters as decided upon by the Shariah committee.</td>
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<td>• To monitor the implementation of recommendation, comment or opinion issued by the Shariah committee</td>
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<td>• To investigate the matter as directed by the Shariah committee (if any).</td>
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<td></td>
<td>• To inform the Shariah committee and the Board of any inconsistencies that occur in the administration, financial management and activities of the cooperative.</td>
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<td></td>
<td>• To review the adequacy of the Shariah governance process</td>
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<td></td>
<td>• To investigate and inform the Shariah committee of any suspicious transactions.</td>
</tr>
</tbody>
</table>
It is observed from the summary above that the four components are similarly responsible and accountable to the overall Shariah governance aspect of the cooperative. Although the Board has the ultimate responsibility and accountability for the overall Shariah governance of the cooperative, the Board must rely on the decisions, Shariah views and opinions of the Shariah committee relating to the business of the cooperative.

Since the accountability of any Shariah decision lies on the Shariah committee, the management shall provide complete, accurate and transparent information to the Shariah committee to enable them to discharge their duties effectively.

(3) Shariah non-Compliance Event

In cases where the management discover or identify any event or aspect in the business or operation of the Islamic Co-operative that do not adhere to the Shariah principle or that the advice and opinion of the Shariah committee is not followed, the management should:

1) Immediately notify the Board, the Shariah committee and SKM concerning the facts;

2) Immediately cease conducting the businesses that do not comply with the Shariah; and

3) within thirty (30) days after it becomes aware of any Shariah non-compliance or such extended period as may be allowed by SKM, to submit a plan of correction for the Shariah non-compliance event, recommended by the Shariah committee and approved by the Board.

If SKM finds any activities or arrangement that does not comply with Shariah, SKM may impose certain corrective measures on the cooperative to rectify the situation.

This process of Shariah non-compliance event is adopted from the provisions in Islamic Financial Services Act 2013 (IFSA). However, this guideline (G28) does not provide an important element, that is, the consequences on the cooperative if it fails to follow the prescribed procedures.
It is also not clear from the provision of GP28 whether the reporting of Shariah non-compliance event is mandatory or otherwise. In other words, the provision lacks clarity. Moreover, the provision does not provide any penalty for non-compliance. GP28 only provides this if SKM finds that a cooperative’s operation or business does not comply with Shariah. SKM may impose certain corrective measures on the cooperative.

7.2 COMPARISON BETWEEN SHARIAH GOVERNANCE FRAMEWORK 2010 AND SHARIAH GOVERNANCE GUIDELINE (GP28)

Most of the content of GP28 are found to be similar with the Shariah Governance Framework 2010 issued by Bank Negara Malaysia. However, there are certain aspect of differences between the two guideline which are summarized in the following table:

<table>
<thead>
<tr>
<th>Subject Matter</th>
<th>Islamic Financial Institution</th>
<th>Islamic Co-Operative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective Date</td>
<td>1 January 2011</td>
<td>1 July 2015</td>
</tr>
<tr>
<td>Scope of Application</td>
<td>1) Islamic bank licensed under the IFSA.</td>
<td>Cooperatives that conduct business or activities based on Shariah principle.</td>
</tr>
<tr>
<td></td>
<td>2) <em>Takaful</em> and <em>Retakaful</em> operator registered under the IFSA.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>3) Financial institution licensed under the Financial Services Act 2013 (FSA) that participates in the Islamic Banking Scheme.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>4) Development financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) that participates in the Islamic Banking Scheme.</td>
<td></td>
</tr>
<tr>
<td>Legal Provision</td>
<td>Issued pursuant to section 59 of the Central Bank of Malaysia Act 2009, section 29 of the IFSA, section 15 (2)(b) of the FSA and section 126 of the DFIA.</td>
<td>Issued pursuant to Section 86B of the Malaysian Cooperative Societies Commission Act 2007.</td>
</tr>
</tbody>
</table>
The need to establish Shariah compliance and research functions within the organization (will depend on the size, complexity and nature of the business operations of the institution) which are:

1) The Shariah Audit Function
2) The Shariah Review Function
3) The Shariah Risk Management Control Function
4) The Shariah Research Function

No clear Shariah compliance and research functions mentioned. Except for the internal audit committee that is also responsible for the Shariah compliance aspect.

Composition of the Shariah committee
At least five (5) members
At least three (3) members

Qualification of the Majority Members
The majority of the members shall at least hold a bachelor’s degree in Shariah, which includes study in Usul Fiqh (the origin of Islamic law) or Fiqh Muamalat (Islamic transaction/commercial law) from a recognised university.

Other Qualification
- The majority members of the Shariah Committee should be able to demonstrate strong proficiency and knowledge in written and verbal Arabic, and a good understanding of Bahasa Malaysia and the English language.
- May comprise experts from relevant backgrounds such as finance and law, which could support the depth and breadth of the Shariah deliberations. However, these members must not form the majority of the Shariah Committee.
- Preferably shall comprise members of diverse backgrounds in terms of qualification, experience and knowledge.

8.0 OBSERVATIONS AND RECOMMENDATIONS
The Legal implication of G28 is not clear as to whether the provisions provided therein are mandatory or otherwise. It is because GP28 does not provide legal implication in the event of non-compliance with its requirements. For example, GP28 does not provide any punishment or penalty if an Islamic Co-operative fails to establish or fails to appoint at least three members of the Shariah committee as required by GP28.
GP28 only provides if SKM finds that a cooperative’s operation or business does not comply with Shariah, SKM may impose certain corrective measures on the cooperative. It is unclear as to what the provision means by ‘corrective measure’. Corrective measure can be ranged from advising, administrative action or even the imposition of penalty. It is recommended that the guideline should be clear on the enforcement of penalty if any is to be imposed on the Islamic Co-operative in the case of non-compliance.

It is observed that the Islamic financial institutions under the supervision of BNM are subjected to a more rigorous and stringent process of Shariah governance. As compared to the Islamic Co-operatives, they are subjected to less stringent and flexible requirements. However, this is more suitable given the size and nature of cooperatives which are normally small and limited in their business capabilities. Furthermore self-governance based on the principle of mutual benefit would present a more collective form of rigorous voting that take into account all ‘individual member’ votes. Hence the overall social benefit of the members are pertinent as compared to selected benefit of controlling interest in the corporation.

Another issue is that GP28 provides that the number of Shariah committee for the Islamic Co-operative must be at least three. However, the question is whether such a requirement is suitable for the small cooperative given their limited capital and size. It is also very hard to find a Shariah committee with the prescribed qualification, especially those who can commit their time and effort. Thus, the authority in this situation should adopt a more flexible approach, taking into consideration the small co-operatives.

It is stated in GP7 that the co-operatives need to refer to the book of “Shariah Resolution in Islamic Finance” produced by BNM. However, the question is whether the resolution of SAC of BNM is suitable to the nature of the Co-operative because the resolution by SAC of BNM is made by taking into consideration the nature and complexity of the Islamic financial industry.

In cases where matters relating to Shariah is brought to court, the court is given an option to make reference to SAC of BNM or otherwise by virtue of section 26 of the Malaysian Co-operative Societies Commission Act 2007. Reference to the Shariah Advisory Council of
Bank Negara must be made binding on the court or arbitrator to avoid any misinterpretation or application of the Shariah principle relating to the co-operative’s arrangement. The fact that the law provides an option to the court may result to an unfavourable situation because the issue at hand may be a complex Shariah matter that must be decided on by a Shariah expert without which the court may interpret the Shariah-based arrangement wrongly.

9.0 CONCLUSION

The Islamic banking and finance industry have already reached its full potential in Malaysia. It is time for the regulator to shift attention to the non-banking institutions so that they can reach their full potential as an added value to the current banking and finance products offered by the Islamic financial institutions. The Islamic co-operative is a good prospect since it has already in place a regulatory framework which can be improved further. The difference highlighted above between the practice of Shariah Governance in the Islamic Co-operative and the Islamic financial institutions (IFI) indicates that the IFIs possess better Shariah compliance infrastructure and are subject to more detailed and strict requirements by the regulator that must be followed. This shows the areas that can be improved by the regulator of the Islamic co-operative in order to provide a conducive environment for a better Shariah governance framework.

The Islamic cooperative is also a component of the Islamic financial system, and more importantly, a captive social institution that promotes the interest and welfare of its members based on the principal of mutuality. If the function of the Islamic co-operative can be improved by strengthening its regulatory framework, it can become another piece of the ideal Islamic financial system that will benefit the financial consumer at every level.

Endnote

1. This is unlike a corporation where voting is subject to share ownership.
REFERENCES

Al-Quran Al-Karim.


Samad, R. R., & Shafii, Z. *Adoption Of Shariah Governance In Cooperative Sector In Malaysia: Case Of Cooperative Banks And Credit Unions*. n.d. from [http://www.cfi.aer-fsegs.org/Articles/111.pdf](http://www.cfi.aer-fsegs.org/Articles/111.pdf)

