



# *Shari'ah* Committee Composition in Malaysian Islamic Financial Institutions: Post Implementation of SGF 2010 and IFSA 2013

Muhammad Issyam B. Itam@Ismail<sup>a</sup>, Rusni Bt. Hassan<sup>a</sup>

<sup>a</sup>*Institute of Islamic Banking and Finance, International Islamic University Malaysia*

---

## Abstract

*Shari'ah* Governance is what makes Islamic Financial Institution (IFI) different from the Conventional Financial Institution. The primary aim of *Shariah* Governance is to ensure that the operation, practice, instrument, product and management of the IFIs are compliant with the *Shari'ah* principles at all times. The *Shari'ah* Governance framework has been outlined in several standard and guideline issued by various bodies and organizations. At the global level, it has been issued by IFSB and AAOIFI, while in Malaysia specifically, it has been provided by Bank Negara Malaysia (BNM) through the *Shari'ah* Governance Framework 2010 (SGF 2010) and the newly implemented Islamic Financial Service Act 2013 (IFSA 2013). Acknowledging the significant role played by *Shari'ah* Committee in an IFI's *Shari'ah* Governance framework, all of the standards, guidelines and regulations mentioned above provide many provisions with regard to the *Shari'ah* Committee in order to enhance their role and strengthen their position in the Islamic Finance industry. In this paper, focus will be given on two specific requirements, which are the requirement of qualification background of a *Shari'ah* Committee and the minimum number of *Shari'ah* Committee that must be appointed by an IFI. This paper will also discuss the gap between the requirements as provided by AAOIFI, IFSB, SGF 2010 and IFSA 2013, and what is the practice of the IFIs in applying these requirements.

© 2016 by The International Islamic University Malaysia

*Keywords:* Islamic Finance, *Shari'ah* Governance Framework, *Shari'ah* Committee, Regulatory framework

---

## 1. Introduction

The element of *Shari'ah* Governance is what makes the Islamic Financial Institution (IFI) differs from its counterpart, the Conventional Financial Institution. In order for *Shari'ah* Governance to be fully effective and efficient in reaching its primary objective, which is to ensure *Shari'ah* compliance, a proper and systematic regulatory framework is needed.

At the early years of Islamic Finance in Malaysia, *Shari'ah* Committee has started on advisory and voluntary basis to the IFIs. It cannot be denied that the existence of a *Shari'ah* Committee in IFIs has provided a significant impact on the development of Islamic Finance, especially in Malaysia. Thus, having felt the importance and benefit of the existence of *Shari'ah* Committee in each IFI, it has been given a stress and focus by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB) and Bank Negara Malaysia (BNM) in each of their guidelines and regulation. These guidelines provide mechanism to enhance the role of *Shari'ah* Committee and to support them with clear and effective governance framework. It has been either made mandatory, adopted or as a reference for internal guidelines by IFIs from numerous countries such Malaysia, Qatar, United Kingdom, South Africa and others.

In Malaysia, the Bank Negara Malaysia (BNM) introduced the *Shari'ah* Governance Framework for Islamic Financial Institutions (SGF) in 2010 and further strengthen with the implementation of Islamic Financial Services Act 2013 (IFSA) in 2013 which provides specific provisions for *Shari'ah* Governance, something which is not visible from its predecessor, the Islamic Banking Act 1993. In Malaysia, *Shari'ah* Governance is achieved through the two-tier *Shari'ah* governance infrastructure comprising two (2) vital

components, which are a centralised Shariah Advisory Council (SAC) at the BNM and an internal *Shari'ah* Committee formed in each respective IFI.

Establishing *Shari'ah* Committee has been made mandatory by the IFSA 2013 and the SGF 2010. The SGF 2010 specifically provides requirements with regard to the qualification background of *Shari'ah* Committee and the number of members that must be appointed by the IFI. By not complying with these requirements, it may expose the IFI to legal risk. Pursuant to the regulation, the challenge and question arise is to what extent the IFIs have complied with such requirements. The cursory overview of the legal provision does not provide specific punishment of non-compliance for the above requirements. Thus, it will raise the issue of the effectiveness of the guideline and regulation to prevent non-compliance.

There are many requirements provided by the SGF 2010 and the IFSA 2013 on *Shari'ah* Governance such as appointment, duties and cessation of *Shari'ah* Committee. However, this paper will only focus on two specific requirements, which are the qualification background of a *Shari'ah* Committee and the number of member that must be appointed for each *Shari'ah* Committee Board. Thus, the objective of this research is to examine these two requirements and to study the gap between what has been provided by the frameworks (SGF 2010 and IFSA 2013) and what has been practiced by the Malaysian Islamic Financial Institutions. The reference to the global standard on *Shari'ah* governance such as AAOIFI and IFSB shall also be made in the course of the discussion.

## 2. Literature Review

Malaysia has a very comprehensive regulatory framework and good governance that support the growth and development of Islamic Finance. This can be seen by the numerous regulations and guidelines provided by BNM relevant to Islamic Finance industry and among the most important and significant among them are the IFSA 2013 and the SGF 2010. Standard and guideline also been issued by AAOIFI and IFSB at the global level and most of them has been introduced before the issuance of the SGF 2010 and the IFSA 2013. Even though the standard and guideline by AAOIFI and IFSB are adopted on voluntary basis in Malaysia, it has been made as reference for the purpose of drafting the SGF 2010 and the IFSA 2013.

### 2.1 *Shari'ah* Governance in Islamic Financial Institutions

*Shari'ah* compliance is the backbone of Islamic financial institutions. It gives legitimacy to the practices of Islamic financial institutions. It also boosts the confidence of the stakeholders that all of the practices and activities are in compliance with the *Shariah* at all times. Compliance with the *Shari'ah* principles can be achieved by having a proper *Shari'ah* governance framework (Hasan, 2007)

Generally, the term *Shari'ah* Governance refers to structures and processes adopted by an institution to ensure compliance with *Shari'ah* rules and principles in its business and operation. *Shari'ah* Governance is a component that is peculiar to Islamic Financial Institutions (Hasan, 2007). A strong and adequate regulatory and supervisory system in Islamic Financial system is an essential ingredient towards accelerated growth and innovation in the Islamic finance, which has resulted in a wide range of financing products and services.

Islamic Financial Services Board (IFSB) defines *Shari'ah* Governance as a set of institutional and organisational arrangements through which IFIs ensure that there is an effective independent oversight of *Shari'ah* compliance over the issuance of relevant *Shari'ah* pronouncements, dissemination of information and an internal *Shari'ah* compliance review<sup>1</sup>.

Thus, *Shari'ah* Advisory Board must be established for effective *Shariah* governance system and to ensure that Islamic finance products and operations match with *Shari'ah* principles.

#### 2.1 *Shari'ah* Governance Framework 2010

Superseding the previous Guidelines on the Governance of *Shari'ah* Committee for the Islamic Financial Institutions issued in 2004, this new guideline developed with the primary objective of

<sup>1</sup> IFSB-10 – *Shari'ah* governance system

enhancing the role of the board, the *Shari'ah* Committee and the management in relation to *Shari'ah* matters.

According to the SGF 2010, the number of *Shari'ah* Committee members that must be appointed must not be less than five (5), the majority of whom shall at least hold bachelor's degree in *Shari'ah*, which includes study in *Usul Fiqh* (the origin of Islamic law) or *Fiqh Mu'amalat* (Islamic law of transactions) from recognised university.

Having background in *Shari'ah* is essential since it is the bedrock of Islamic Finance. The permissibility or prohibition of a transaction or business activity is governed by the *Shari'ah*, which provides the framework for a set of rules and laws.

### **2.3 Islamic Financial Services Act 2013**

In order to ensure full *Shari'ah* compliance of Islamic Banking services and products, BNM has strengthened the regulatory and supervisory framework of Islamic Banks with the enactment of the IFSA 2013, repealing the Islamic Banking Act 1983 and the Takaful Act 1984.

One of the important provision provided by the IFSA 2013 with regard to *Shari'ah* Governance is the statutory responsibility of the IFIs to establish *Shari'ah* Committee. Section 30(1) of the IFSA 2013 states that:

*“Section 30. (1) a licensed person shall establish a Shari'ah committee for purposes of advising the licensed person in ensuring its business, affairs and activities comply with Shari'ah.”*

However, the IFSA 2013 is silent about the requirement of qualification background and the number of *Shari'ah* Committee that must be appointed.

Before the implementation of the IFSA 2013, each and every IFI has already appointed its' own *Shari'ah* Committee as compliance to the SGF 2010. However, the existence of the above section is important to provide the establishment of *Shari'ah* Committee as something that is required by law.

*“Section 29 (3) Every institution, its director, chief executive officer, senior officer or member of a Shari'ah committee shall at all times comply with the standards specified by the Bank under subsection (1) and (2) which are applicable to such person”*

Among the standard that may be specified by BNM under subsection (2) is *Shari'ah* Governance, which in our current situation is the SGF 2010.

### **2.4 Accounting and Auditing Organization for Islamic Finance Institution (AAOIFI)**

AAOIFI plays an important role in developing and issuing standards for international Islamic Finance Industry at the global level. The organization is supported by 200 institutional members from over 40 countries, which consist of central banks, Islamic financial institutions and other participants from the international Islamic banking and finance industry, worldwide<sup>2</sup>.

Among the standard issued by the organization is Governance Standard where it provides guidance on *Shari'ah* compliance and supervision processes and framework for Islamic financial institutions. This standard was introduced before the issuance of the SGF 2010 and the IFSA 2013.

According to the standard, the composition of the *Shari'ah* Supervisory Board (*Shari'ah* Committee) must be at least 3 members and consist of experts in Islamic commercial jurisprudence (*Fiqh Al-Mu'amalat*). The board may include 1 member with expertise in Islamic finance (rather than jurisprudence). Based on this requirement, it is much more specific than what have been provided by the SGF 2010 where it accepts those with *Shari'ah* background (*Fiqh Mu'amalat* is a branch of *Shari'ah*).

Malaysia has neither made the Governance Standard as a part of mandatory requirement nor adopted it. However, as mentioned before, it has been made as reference in drafting the SGF 2010 and the IFSA 2013.

### **2.5 Islamic Financial Service Board (IFSB)**

Based in Kuala Lumpur Malaysia, IFSB is an international standard-setting organization with the aim of promoting and enhancing the soundness and stability of the Islamic Financial services industry. The members of the IFSB comprise of regulatory and supervisory bodies, international inter-governmental organizations and various market players.

<sup>2</sup> <http://www.aaofii.com/en/about-aaofii/about-aaofii.html>

In December 2009, the IFSB has issued the Guiding Principles on *Shari'ah* Governance Systems for Institutions Offering Islamic Financial Services.

According to the IFSB, Shariah Board (Shariah Committee) referring to a person who is learned, expert and specialized in *Fiqh Mu'amalat* (Islamic law of transactions) rather than *Shari'ah* more widely or other areas of Islamic studies. It has similar requirement with what has been provided by AAOIFI (expert in *Fiqh Mu'amalat*).

With regard to the number of Shariah Committee, applying no "single model" and "one-size-fits-all" approach, the IFSB stressed that IFIs should consider its size with a view to determine the impact of the number of members upon effective decision-making. IFIs should also take into consideration the scope and nature of their operations. In other words, it is up to the IFI to decide the most appropriate size of their *Shari'ah* Board and as far as possible, with a mixture of experience and competencies.

### 3. Methodology

The methodology adopted in this paper is the qualitative legal method where the examination will be made on the provisions of IFSA 2013 and SGF 2010 especially on the requirement of qualification background of a *Shari'ah* Committee and the number of member that must be appointed for each *Shari'ah* Committee Board. Besides that, standard and guideline by AAOIFI and IFSB will also be discussed on the requirements provided by the bodies. Finally, the actual practice of IFIs applying both requirements post implementation of IFSA 2013 and SGF 2010 will be derived from each Islamic banks annual report, or end of year financial statement, from the year 2012 to year 2014. These years are chosen because the implementation date for SGF is January 2011 and all IFIs have six month to comply with the framework.

### 4. Findings

#### 4.1 Difference on the Requirements of *Shari'ah* Committee (Qualification Background and Number of Member) by the SGF 2010, IFSA 2013, AAOIFI and IFSB

It has been observed that the 4 regulations (SGF 2010, IFSA 2013, AAOIFI and IFSB) have provided different specific requirements on the *Shari'ah* Committee composition with regard to the qualification background and the number of member. The summary of the differences is as follow:

Table 1: Difference on the requirements of *Shari'ah* Committee (Qualification Background and number of member)

No.	Standard/Regulation	Qualification Background Requirement	Number of Member Requirement
1	Islamic Financial Services Act 2013 (IFSA 2013)	Not mentioned	Not mentioned
2	<i>Shari'ah</i> Governance Framework 2010 (SGF 2010)	At least hold bachelor's degree in <i>Shari'ah</i> , which includes study in <i>Usul Fiqh</i> (Islamic jurisprudence) or <i>Fiqh Mu'amalat</i> (Islamic law of transactions) from recognised university.	At least 5
3	Accounting and Auditing Organization for Islamic Finance Institution (AAOIFI)	Experts in Islamic commercial law ( <i>Fiqh Mu'amalat</i> ). The board may include 1 member with expertise in Islamic finance (rather than jurisprudence).	At least 3
4	Islamic Financial Service Board (IFSB)	Learned, expert and specialized in <i>Fiqh Mu'amalat</i> (Islamic law of transactions)	Up to the IFI considering its size, nature and scope of operation.

All standard/regulation, except IFSA, requires the *Shari'ah* Committee to have a background in area relating to *Shari'ah*. However, in terms of specialization, both IFSB and AAOIFI specifically mentioned that the *Shari'ah* Committee must specialize in Islamic law of transactions (*Fiqh Mu'amalat*), which is a branch of *Shari'ah*. Whereby, SGF 2010 allows the *Shari'ah* committee to have a background in *Shari'ah* itself or in a specific area of *Shari'ah*, which are *Usul Fiqh* (Islamic jurisprudence) or *Fiqh Mu'amalat* (Islamic law of transactions).

SGF 2010 specifically requires the *Shari'ah* Committee to hold at least a bachelor's degree in *Shari'ah*, *Usul Fiqh* or *Fiqh Mu'amalat*, while others are not clear on the level of qualification. Among all standard/regulation, SGF 2010 also requires the most number that must be appointed by the IFI should be 5. Looking into the complex nature of IFI, it is better to have greater number of *Shari'ah* Committee.

Based on the above discussion, this paper is in the opinion that SGF 2010 provides better requirements than other standard/regulation because it suits best the nature and complexity of Islamic Financial Institution business.

#### 4.2 Composition of the *Shari'ah* Committee of the Islamic Financial Institution

The following table is presenting the actual practice of Islamic Banks in Malaysia with regard to the composition of *Shari'ah* Committee. The data will be examined against the regulatory requirements of the SGF 2010 that requires:

- 1) The majority of the members must be formed by members with at least hold bachelor's degree in *Shari'ah*, which includes study in *Usul Fiqh* (Islamic jurisprudence) or *Fiqh Mu'amalat* (Islamic law of transactions) from recognised university.
- 2) The minimum number of *Shari'ah* Committee member must be 5.

Table 2: Composition of *Shari'ah* Committee in Malaysian Islamic Financial Institutions

NO	BANK	2012		2013		2014	
		MSB	TM	MSB	TM	MSB	TM
1	Affin Islamic	4	5	4	5	4	5
2	Rajhi Bank	5	5	3	<u>3</u>	4	<u>4</u>
3	Alliance Islamic	4	5	4	5	4	5
4	Ambank Islamic	5	5	5	5	5	5
5	Bank Islam	4	5	4	5	4	5
6	Bank Muamalat	6	6	6	6	6	6
7	CIMB Islamic	5	6	5	6	5	6
8	Hong Leong Islamic	4	5	5	5	5	5
9	HSBC Amanah	<u>2</u>	5	<u>2</u>	5	<u>2</u>	5
10	Kuwait Finance House	5	5	5	5	5	5
11	Maybank Islamic	4	5	6	7	7	7
12	OCBC Al-Amin	4	5	4	5	4	5
13	Public Islamic Bank	4	5	4	5	4	5
14	RHB Islamic	5	5	4	5	4	5
15	Standard Chartered Saadiq	4	5	4	5	4	5

**Source: Annual Report and Annual Financial Report of IFIs.**

**Indicator:**

**MSB** = Number of *Shari'ah* Committee member with *Shari'ah* /*Fiqh*/*Usul Fiqh* background

**TM** = Total member of *Shari'ah* Committee

Based on the analysis, there are two event of non-compliance by HSBC Amanah and Al-Rajhi Bank.

HSBC Amanah failed to comply with the first requirement which is the majority of the members must be formed by members with at least holding bachelor's degree in *Shari'ah*, which includes study in *Usul Fiqh* (Islamic jurisprudence) or *Fiqh Mu'amalat* (Islamic law of transactions) from recognised university.

The no-compliance has been observed in three consecutive years from the year of 2012 to 2014 where only two out of five members fulfilled the first requirement

The qualification background of the members is as follow:

Table 3: HSBC Amanah *Shari'ah* Committee background<sup>3</sup>

NO.	NAME	BACKGROUND
1	Assoc. Prof. Dr. Younes Soualhi	Degree, Master and PHD in Usul Fiqh
2	Prof. Dr. Abdul Rahim	Bachelor degree in Finance and Accounting, Master degree in Accounting and Management Sciences and PhD in Accounting
3	Prof. Dr. Obiyathulla	Bachelor of Social Science from University Sains Malaysia (USM), Master of Business Administration (High Honors), Master of Arts (Economics) and Doctor of Business Administration
4	Dr. Muhammad Yusuf Saleem Ghulam Nabi	Bachelor in Law (LL.B) from International Islamic University, Malaysia, obtained a Master of Comparative Law (M.C.L) and Phd (Law)
5	Khairul Ahmad	Bachelor and Master of <i>Shari'ah</i>

Source of background: HSBC Amanah website<sup>4</sup>

Whereby Al-Rajhi Bank failed to comply with the second requirement, which is the minimum number of *Shari'ah* Committee member appointed must be at least five. According to the finding, the total number of their *Shari'ah* Committee members was three in 2013 and four in 2014.

Other Malaysian Islamic banks are showing positive result where 13 out of 15 Islamic Banks fulfil the first and second requirements since 2012 until 2014.

Based on the findings, majority of the Islamic Banks in Malaysia have complied with the requirements of qualification background and the minimum number of *Shari'ah* Committee member as provided by the SGF 2010 and the IFSA 2013. However, we can see that there are two events of non-compliance by HSBC Amanah on the first requirement<sup>5</sup> and by Al-Rajhi Bank on the second requirement<sup>6</sup>.

*Shari'ah* Committee is very important in order to ensure that all of the IFIs' operation and services are in line with *Shari'ah*. Its existence can also boost the public confidence and trust of the Islamic financial institution. These are more than enough reason for the IFIs to have their own *Shari'ah* Committee.

Supposedly, when there is a non-compliance with any requirement, the IFI must remedy that situation immediately. However, the result shows that the non-compliance in terms of background qualification requirement has been observed in three consecutive years (2012-2014) by HSBC Amanah and the non-compliance in terms of the minimum number of *Shari'ah* Committee members requirement has been observed in two consecutive years (2013-2014) by Al-Rajhi Bank. The relaxed attitude by the IFIs may be attributable to the fact that there is no legal punishment provided if the above requirements are not complied with.

Prior to the implementation of the SGF 2010 and the IFSA 2013, the role of *Shari'ah* Committee was treated as a part-time body, which meets when the Board or the CEO needs them to meet because it was not a requirement under any statute or guideline. Thus, the composition of the Shariah Committee was totally at the IFI's discretion.

<sup>3</sup> Same members from 2012 until 2014 based on HSBC Amanah Annual Report.

<sup>4</sup> <https://www.hsbc.com.my/1/2/amanah/hsbc-amanah-and-you/shariah-supervision>, accessed on 15 July 2016.

<sup>5</sup> The majority of the members must be formed by members with at least hold bachelor's degree in *Shari'ah*, which includes study in *Usul Fiqh* (Islamic jurisprudence) or *Fiqh Mu'amalat* (Islamic law of transactions) from a recognised university.

<sup>6</sup> The number of *Shari'ah* Committee members must be at least 5.

Then, the implementation of SGF 2010 was indeed a great step forward where it requires IFIs to establish Shariah Committee<sup>7</sup> with specific guideline with regard to its composition and other requirements. Even though IFIs are required to comply with the guidelines and are given 6 months from the effective date to comply with all the requirements, it does not state any consequences in the event of non-compliance with the guideline. This highlight as to whether the regulation is stringent enough, or not, in order to ensure conformity with the law. It must be stringent to prevent any non-compliance.

The lack of consequence in the event of non-compliance with SGF 2010 on the establishment of *Shari'ah* Committee is remedied with the implementation of IFSA 2013. In this new Act, it is a statutory requirement for the institution to set up *Shari'ah* Committee. Section 30(1) of the IFSA 2013 stated that:

*“Section 30. (1) A licensed person shall establish a Shari'ah committee for purposes of advising the licensed person in ensuring its business, affairs and activities comply with Shari'ah.”*

Furthermore, the IFSA 2013 also provides that it is statutorily wrong not complying with the SGF 2010. Section 29(2) and Section 29(3) of IFSA 2013 provides that:

*“Section 29. (2) In addition, the Bank may also specify standards relating to any of the following matters which does not require the ascertainment of Islamic law:*

*(a) Shari'ah governance including—*

*(i) functions and duties of the board of directors, senior officers and members of the Shari'ah committee of an institution in relation to compliance with Shari'ah;”*

*(ii) fit and proper requirements or disqualifications of a member of a Shari'ah committee; and*

*(iii) internal Shari'ah compliance functions; and”*

*“29(3) Every institution, its director, chief executive officer, senior officer or member of a Shari'ah committee shall at all times comply with the standards specified by the Bank under subsections (1) and (2) which are applicable to such person”*

However, the implementation of IFSA 2013 in relation to SGF 2010 still gives rise to two issues:

Firstly, the issue of stringent compliance requirement is still exist because even though by virtue of the above Section 29(3)<sup>8</sup> and Section 30(1)<sup>9</sup>, nowhere in the IFSA 2013 provides any punishment or penalty in the event of non-compliance with both sections 29(3) and Section 30. Section 29(6)<sup>10</sup> only provides punishment for those who fail to comply with Section 29(1)<sup>11</sup> and Section 30 is silent about any punishment for any IFIs that fails to establish *Shari'ah* Committee<sup>12</sup>.

Secondly, SGF 2010 still provides that any reference to 'IFI' in the framework refers to Islamic bank licensed under Islamic Banking Act 1983 (IBA), Takaful and Retakaful operator registered under the Takaful Act 1984 (TA) and financial institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) that participates in the Islamic Banking Scheme. It is yet to be updated in accordance with the newly implemented IFSA and Financial Service Act 2013. Thus, In order to avoid the confusion, the current SGF must be updated to be more relevant to the industry.

<sup>7</sup> Principle 1.3(ii) stated that the Shariah governance framework of an IFI shall, at the minimum, comprise a *Shari'ah* Committee with qualified members who are able to deliberate Islamic finance issues brought before them and provide sound *Shariah* decisions. 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 *Shari'ah*.

<sup>8</sup> Section 29(3) of the IFSA 2013: Every institution, its director, chief executive officer, senior officer or member of a *Shari'ah* committee shall at all times comply with the standards specified by the Bank under subsections (1) and (2) which are applicable to such person (in this case, the SGF 2010).

<sup>9</sup> Section 30(1) of the IFSA 2013: A licensed person shall establish a Shariah committee for purposes of advising the licensed person in ensuring its business, affairs and activities comply with *Shari'ah*.

<sup>10</sup> Section 29(6) of the IFSA 2013: Any person who fails to comply with any standards specified under subsection (1), commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding eight years or to a fine not exceeding twenty-five million ringgit or to both.

<sup>11</sup> Section 29(1) of the IFSA 2013: The Bank may, in accordance with the advice or ruling of the *Shari'ah* Advisory Council, specify standards—

(a) on *Shari'ah* matters in respect of the carrying on of business, affair or activity by an institution which requires the ascertainment of Islamic law by the *Shari'ah* Advisory Council; and

(b) to give effect to the advice or rulings of the *Shari'ah* Advisory Council.

<sup>12</sup> This however does not deny the possibility of invoking section 245 whereby BNM may impose administrative action for any IFI who does not comply with the requirements.

Based on the findings and result, the current guideline and regulation need to be improved and enhanced.

Firstly, the scope of application of SGF 2010 must be updated to the newly implemented IFSA 2013. Where any reference to 'IFI' for the purpose of the Framework must be referred to all IFIs under the IFSA 2013 and FSA 2013. Currently, it refers to all IFIs under the IBA 1983 and BAFIA 1989

Secondly, punishment provided under Section 29(6) of the IFSA 2013<sup>13</sup> must be extended to include Section 29(2) as an offence that is liable to such punishment. This will give statutory effect with punishment in the event of non-compliance with SGF 2010.

Thirdly, to provide punishment under Section 30 of the IFSA 2013<sup>14</sup> besides the statutory obligation to establish *Shari'ah* Committee so that the requirement will be more stringent.

Fourthly, the non-compliance may be caused by various reasons that lead to resignation or termination. Thus, such situation can be remedied by providing a procedure where the IFI has to give valid excuse and justification to BNM for the non-compliance and will be given a certain period of time to rectify the situation.

## 5. Conclusion

The findings of this study benefit the regulator and the practitioner in Islamic banking and finance industry to look into the real practice of *Shari'ah* Governance especially with regard to the composition of *Shari'ah* Committee in IFIs. In order to ensure that *Shari'ah* Governance Framework is fully effective and efficient in achieving its primary objective of ensuring *Shari'ah* principles are abided at all times, it requires co-operation from the IFIs to implement the framework properly. At the same time, the framework must be very comprehensive and stringent enough to prevent any non-compliance.

In our case, the non-compliance by HSBC Amanah and Al-Rajhi Bank may be attributable to the lack of stringent compliance requirement due to the absence of punishment for non-compliance of both requirements (Section 29(3) and Section 30 of the IFSA 2013). Thus, amendment can be made by the regulators to remedy this situation and to avoid possible non-compliance in the future.

Since this paper is only focusing on the composition of *Shari'ah* Committee, specifically with regard to qualification background and number of members, further research can be conducted to look into other areas to improve the effectiveness of *Shari'ah* Governance as outlined by the IFSA 2013 and SGF 2010.

However, even without the punishment, our Islamic Banks deserve some praise because only a year after the implementation of the SGF 2010, almost all of our Islamic Banks (14 out of 16) managed to establish their own *Shari'ah* Committee, which is not an easy task.

## REFERENCES

- Malaysia, B. N. (2010). *Shari'ah* governance framework for Islamic financial institutions. *Bank Negara Malaysia, Kuala Lumpur*.
- AAOIFI. (2005). Governance Standards for IFIs, No 1-5. Bahrain AAOIFI
- IFSB. (2009). Guiding Principles on *Shari'ah* Governance System in Institutions Offering Islamic Financial Services. Kuala Lumpur: IFSB.
- Hasan, A. B., & LAWS, A. I. K. O. (2007). Optimal Shariah Governance in Islamic Finance. *Islamic Finance News*, 4(14), 7.

## STATUTES

Islamic Banking Act 1983

Banking and Financial Institutions Act 1989

<sup>13</sup> Imprisonment for a term not exceeding eight years or to a fine not exceeding twenty-five million ringgit or to both.

<sup>14</sup> Section 30(1) of the IFSA 2013: A licensed person shall establish a *Shari'ah* committee for purposes of advising the licensed person in ensuring its business, affairs and activities comply with *Shari'ah*.



Islamic Financial Services Act 2013  
Central Bank Act 2009

## **ANNUAL REPORTS**

Affin Islamic Bank Berhad Annual Reports 2012-2014  
Alliance Islamic Bank Berhad Annual Reports 2012-2014  
Al-Rajhi Banking and Investment Corporation (Malaysia) Berhad Annual Reports 2012-2014  
Ambank Islamic Berhad Annual Reports 2012-2014  
Bank Islam Malaysia Berhad Annual Reports 2012-2014  
Bank Muamalat Malaysia Annual Reports 2012-2014  
CIMB Islamic Bank Berhad Annual Reports 2012-2014  
Hong Leong Islamic Bank Annual Reports 2012-2014  
HSBC Amanah Malaysia Berhad Annual Reports 2012-2014  
Kuwait Finance House (Malaysia) Berhad Annual Reports 2012-2014  
Maybank Islamic Berhad Annual Reports 2012-2014  
OCBC Al-Amin Bank Berhad Annual Reports 2012-2014  
Public Islamic Bank Berhad Annual Reports 2012-2014  
RHB Islamic Bank Berhad Annual Reports 2012-2014  
Standard Chartered Saadiq Berhad Annual Reports 2012-2014