



Shariah Governance in Islamic Financial Institutions in Indonesia and Malaysia: A Comparative Analysis

Muhammad Nazmi Mohd Asri^{*}, Mukhtar Arif Siraj, Elsha Robbi Mighfari,
Rizal Nazaruddin Firli

*IIUM Institute of Islamic Banking and Finance
International Islamic University Malaysia, Kuala Lumpur, Malaysia*

**Corresponding author: muhdnazmy2@gmail.com*

Abstract

Islamic finance and banking in Indonesia and Malaysia have seen significant growth regionally and globally due to the effective implementation of Shariah Governance (SG) in their respective Islamic Financial Institutions (IFIs). Hence, this study aimed to comparatively analyse Shariah Governance frameworks practiced in IFIs in these two countries. The study adopted a qualitative analysis based on a case study of SG in Indonesia and Malaysia. Official documents and policies, particularly Shariah Governance Policy Document 2019 in Malaysia and *Peraturan Bank Indonesia* 2009 in Indonesia, were comparatively analysed according to the responsibilities of the Board of Directors, senior management, Shariah supervisory board and Shariah compliance culture. The study found that SG in Indonesia and Malaysia has several similarities and differences in its SG practices. SG in Indonesia is observed to be not as comprehensive as in Malaysia as the Board of Commissioners and Board of Directors in Indonesian IFIs do not have an active responsibility in SG as compared to Malaysia. Furthermore, SG in Indonesia does not require the establishment of Shariah control functions, and there is also a lack of a robust Shariah non-compliance (SNC) risk management when compared to Malaysia. Nevertheless, the authors believe that the internal policies of Indonesian IFIs would address these issues and strive to enhance the robustness of their SG practices. In the end, the authors hope that the findings from this study would fill the knowledge gap with new developments in SG in Indonesia and Malaysia.

Keywords: Shariah governance, Islamic finance, Islamic financial institutions, Indonesia, Malaysia

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1. Introduction

The growth of Islamic banking globally has reached a significant level of systemic importance, as the global Islamic banking assets have reached USD 1.57 trillion in 2018. Particularly in Malaysia, where the Islamic banking assets amounting to 10.8% of the global share and has reported a stable growth resulting in increasing local commercial banking market share to 26.5%. Meanwhile in Indonesia, although possessing only 1.9% of global Islamic banking assets, locally, Islamic banks in Indonesia are gaining market share up to 5.7% in 2018 (IFSB, 2019). Therefore, to ensure the continuous positive growth, one of the key factors is to implement a robust set of organizational arrangements, in which Shariah compliance as the foundation of Islamic banking is prudently supervised and managed, known as Shariah Governance (SG) (Hasan, 2007; Nomran and Haron, 2020a).

Previous studies have highlighted that an Islamic financial institution (IFI) with weak SG framework could lead to inefficiency and weak Shariah compliance, which might expose them to Shariah non-compliance (SNC) risk (Hasan, 2007; Najwa et al., 2019). Grassa (2016) recorded that SG can affect the credit ratings of Islamic banks. Other than that, Basiruddin and Ahmed (2019) studied the relationship between the roles of the Board and Shariah Committee (SC) in SNC risk in Islamic banks in Malaysia and Indonesia for the period 2007-2017. They found that financial expertise among the Board and SC and frequency of SC meetings lowers SNC risk and overall strong SG contributes to the reduction of SNC risk. Hence, SG plays a crucial role in

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maintaining the integrity of IFIs and boosts confidence among investors and the public alike which directly contributes to the growth of IFIs.

Nevertheless, it is observed that there have been some developments in the current practice of SG, particularly in Malaysia with the recent introduction of the Shariah Governance Policy Document 2019 by Bank Negara Malaysia. This might have several effects on the growth of Islamic banking and finance in Malaysia. Since it is proven that good SG contributes to the growth of the industry, Indonesia is also a good example in SG, which has also seen significant growth over the years. Hence, a comparative study is needed to evaluate the practice of SG and the gaps between the two countries.

Therefore, this study aims to achieve these research objectives, which are to explore the SG practice in IFIs in Indonesia and Malaysia, and to compare the SG practices in IFIs in Malaysia and Indonesia. Findings from the study seek to answer these questions: How is SG practiced in IFIs in Indonesia and Malaysia? How different are the SG practiced in IFIs in Indonesia and Malaysia?

To achieve these objectives, this study adopted a qualitative research methodology by utilizing a comparative analysis of the SG practice in Indonesia and Malaysia. Data is collected from secondary sources such as public documents and official policies. The data is then analysed based on the responsibilities of the Board of Directors (BOD), Shariah Committee (SC), senior management, Shariah control functions and overall transparency. The main contribution of this study is to fill the knowledge gap in light of the latest developments in Malaysia and Indonesia regarding SG in Islamic banks. Furthermore, with the comparative analysis carried out in this study, SG will be further strengthened in the future by improving any gaps observed in this study, hence benefitting all Islamic banks, stakeholders and their customers. Nevertheless, this study is limited to the SG frameworks in two countries i.e. Malaysia and Indonesia. Hence, with constant development in the Islamic finance industry, further research would be recommended on other countries.

This study consists of four sections. The first section introduces the background of the study, problem statement, research objectives and questions, contributions and organisation of the research. Meanwhile, the second section reviews the past literature on SG generally and specifically in Malaysia and Indonesia. The literature review is divided into three parts, beginning with an overview of SG, followed by its implementation in Islamic banks in Malaysia and Indonesia. The third section presents the discussions, findings on the comparative analysis conducted between both countries. Lastly, the fourth section concludes the study with a summary of the study, and the contributions of the study to the policymakers and the Islamic finance industry as a whole. The study ends with the limitations of the study and recommendations for future research.

2. Literature Review

2.1 Brief Overview of Shariah Governance

It is worth noting that corporate governance practiced in conventional banks is fundamentally different from Shariah governance (SG) practiced in Islamic Financial Institutions (IFIs). Although there may be several elements from both frameworks to be similar, SG is principally derived from Shariah rules (Mizushima, 2014; Nomran and Haron, 2020a). IFSB (2009) defined Shariah Governance systems for IFIs to be: the set of institutional and organisational arrangements through which an IFI ensures that there is effective independent oversight of Shariah compliance over each of the following structures and processes: (i) Issuance of relevant Shariah pronouncements/ resolutions, (ii) Dissemination of information on such Shariah pronouncements/resolutions to the operative personnel of the IFI who monitor the day-to-day compliance with the Shariah pronouncements/resolutions vis-à-vis every level of operations and each transaction, (iii) An internal Shariah compliance review/audit for verifying that Shariah compliance has been satisfied, during which any incident of non-compliance will be recorded and reported, and as far as possible, addressed and rectified, and (iv) An annual Shariah compliance review/audit for verifying that the internal Shariah compliance review/audit has been appropriately carried out and its findings have been duly noted by the Shariah board. Meanwhile, Bank Negara Malaysia (2010) defined SG as “a set of organisational arrangements through which IFIs ensure effective oversight, responsibility and accountability of the BODs, management and Shariah committee”. In the Indonesian banking practice, Bank Indonesia (2009) defines Corporate Governance as bank governance that applies five principles, namely (i) transparency; (ii) accountability; (iii) responsibility; (iv) professional; and (v) fairness.

Previous studies have observed different models of Shariah supervisory systems in IFIs in Southeast Asia and GCC countries. It can be observed that Malaysia and Indonesia practice a dual Shariah supervisory

system, where there is a Shariah supervisory board at the regulator's level and an internal Shariah committee at every IFI. On the other hand, Bahrain does establish a higher Shariah Board in its Central Bank however, it only supervises the Central Bank in Shariah matters. Meanwhile, other GCC countries delegate this role to government bodies responsible for religious matters in the case of UAE, Kuwait and Qatar, despite only exercising its role when there is a conflict of opinions in the internal Shariah committees (Grassa, 2016; Nomran and Haron, 2020b).

2.1 Overview of Shariah Governance in Indonesia

Islamic banking in Indonesia is regulated through a special law called Law No. 21 (2008) concerning Islamic Banking. Before the birth of the Shariah Banking Law, the Shariah banking industry was still bound by conventional banking law, namely Law No. 10 (1998), the results of the amendments to Law No. 7 (1992) concerning banking. The Law on Shariah Banking is discussed further and is operational through Bank Indonesia Regulation (PBI) No. 9 and Bank Indonesia Circular Letter (SEBI). The structure of Shariah governance in Indonesia recognizes that there are two levels of Shariah supervision. The first level of supervision is the Shariah board at the national level commonly referred to as the National Shariah Board (DSN), and the second is the Shariah board at the company level called the Shariah Supervisory Board (DPS/SSB). Both institutions are clearly stated in Law No. 21 (2008) and PBI No.6/24/PBI/2004. SSB is an institution formed by the Indonesian Ulema Council (MUI) which has the function of carrying out MUI's tasks in matters relating to Islamic financial activities. MUI is an organization of *ulema* (scholars) associations originating from various Islamic organizations in Indonesia whose status is as a non-governmental organization. The fatwa issued by DSN serves as a guideline for financial institutions that offer Islamic financial services. Even though the DSN organizational status is a non-governmental organization, the *fatwa* issued specifically related to financial transactions is of a binding nature for Shariah financial industry players as stipulated in Article 26 of Law No. 21/2008 concerning Islamic banking.

The other entity responsible for supervising Islamic banks compliance to Shariah principles is referred to as the Shariah Supervisory Board (SSB) in Law No. 21 (2008) relating to Shariah banking. Any Shariah bank or conventional bank that opens a Shariah Business Unit (UUS) must form a SSB with the task of providing guidance and advice to the BODs and supervising the banks on their activities in compliance with the Shariah principles. Supervision of the implementation of *fatwa* issued by DSN is carried out by the SSB at the company level. SSB as explained by PBI No.11/33/PBI /2009 is a board that is in charge of providing advice to the directors and overseeing bank activities to be in accordance with Shariah. As such, SSB is a unique institution in the Shariah governance system in Indonesia which is an extension of DSN based on approval from Bank Indonesia. SSB plays a role in bridging the relationship between Bank Indonesia and the DSN. In a sense, SSB mediates the DSN *fatwa* into Bank Indonesia regulations. SSB supervision covers two things, namely (i) supervision of the bank's new product development process; and (ii) supervision of banking activities.

2.2 Overview of Shariah Governance in Malaysia

Meanwhile, in Malaysia, in accordance with the Central Bank of Malaysia Act 2009, under section 51 and 52, Bank Negara Malaysia (BNM) has established the highest authority in Shariah supervision of IFIs in Malaysia known as the Shariah Advisory Council (SAC). Its role is to ascertain the Islamic law relating to financial matters, advises BNM on Shariah issues and provides advice to any IFIs. In addition, BNM has the legal right to specify standards on Shariah matters for licensed Islamic banks, licensed takaful operators, Islamic windows and foreign IFIS branches (IFSA 2013 Sec. 29(2)) and prescribed development financial institutions (DFIs) carrying out Islamic financial business (DFIA 2002 Sec. 41 and 129). Similar to Indonesia, Malaysia also adopts a two-tier Shariah supervision methodology whereby the SAC sits at the apex level aforementioned and the Shariah Committee (SC) which must be established at every IFI (IFSA 2013 Sec. 30(1)). It is the SC's responsibility to evaluate business policies and operations of every IFI to adhere to SAC Shariah Guidelines. This is also the case with conventional banks operating an Islamic banking business to follow related provisions of IFSA 2013 (Sec. 15).

3. Discussion and Findings

3.1 Shariah Governance Practice in IFIs in Indonesia and Malaysia

Good Corporate Governance (GCG) implementation in Islamic banks is explained through *Peraturan Bank Indonesia* (PBI) No. 11/33 / PBI / 2009. This PBI in general explains the concept of GCG for Shariah banks and Shariah Business Units and how the respective roles of the Board of Commissioners, Directors, Committees, and Shariah Supervisory Board. In this PBI also explained about the format of self-assessment of GCG implementation in Islamic banks. The Shariah supervision section explains the appointment mechanism for SSB members, tenure, duties and responsibilities, reporting mechanism for SSB supervision results and sanctions for SSB who do not carry out their obligations. Although these guidelines are quite comprehensive, they cannot yet be referred to as a comprehensive SG framework model for Shariah banks. The format of the GCG guidelines tends to be the result of adjustments to the GCG guidelines for conventional banks previously issued by Bank Indonesia.

The difference only lies in the existence of the SSB in the company's organizational structure. A more detailed explanation of the technical implementation of GCG for Islamic banks is described through BI Circular Letter (SEBI) No. 12/13 / DPbS / 2010. In addition to the laws and regulations issued by Bank Indonesia, MUI also issued Decree No. 03 of 2000 concerning the Appointment of the Implementation of the Appointment of Members of the SSB at IFIs. It explains the terms, duties and functions and the concurrent membership of the SSB. Since DSN-MUI is not a government organization, the *fatwa* product issued is not binding and final. But based on PBI No. 6/24 / PBI / 2004 has actually made *fatwas* on Shariah banking and Shariah finance issued by DSN-MUI obligatory to become a reference for financial institutions offering Shariah financial products and services (refer DSN-MUI, 2000-2007).

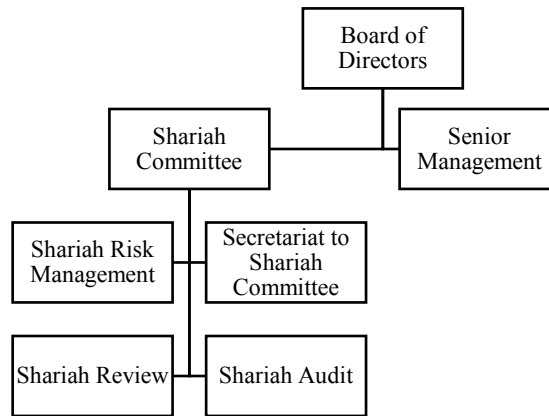
Based on the description of the regulatory aspects of the Shariah governance framework, it can be concluded that there are three main parties that play an important role in Shariah supervision in the banking system in Indonesia, namely Bank Indonesia which is currently switching to the Financial Services Authority (OJK), the National Shariah Council under the organization of the Ulema Council Indonesia and the SSB formed at the company level. The laws and regulations governing SSB are regulated separately from conventional banking laws. The law that was published was further elaborated through PBI and SEBI including related to the supervision of Shariah aspects.

On the other hand, Bank Negara Malaysia as the regulator in Malaysia has established the Shariah Advisory Council (SAC) to supervise all Islamic banking and takaful activities. Meanwhile, at the micro level, all IFIs are obligated to form a Shariah Committee (SC) to issue guidance and advice regarding Shariah matters internally. In 2011, BNM established the Shariah Governance Framework in Malaysia, highlighting the responsibilities of the organs of Shariah Governance including the Board of Directors, Shariah Committee, Senior Management and Control Functions.

However, recently in 2019, BNM has revised the SGF superseded by the Shariah Governance Policy Document (SGPD, 2019), which took effect on 1 April 2020 except Para. 12.5, is expected to be effective on 1 April 2023. The provision in this particular paragraph requires SC members to serve in a single IFI not more than nine (9) years. Hence, there is a delay to allow the current sitting of SC members in IFIs to retire and allow new members to be appointed. Furthermore, in this SGPD, it can be observed that several amendments have been made and extra attention has been given, especially on the roles of the Board to further strengthen SG in IFIs. Figure 1 shows the organizational structure of Shariah Governance.

IFIs in Malaysia are obliged to implement the SGPD (2019) including licensed Islamic banks, licensed takaful operators and professional re-takaful operators, licensed banks and licensed investment banks approved to operate Islamic banking business, prescribed development financial institutions approved to operate Islamic banking business, as well as foreign IFIs branches in Malaysia. Other than that, Shariah committee members are also required to adhere to relevant provisions. In the SGPD, it is categorized into several aspects including highlighting the responsibilities of the Board, Shariah committee (SC), senior management and control functions in Shariah governance in IFIs and instilling a Shariah compliance culture in governance, as well as maintaining transparency.

Figure 1: Organizational Structure of Shariah Governance (Malaysia)



Source: SGPD (2019)

First, the Board has the active role to approve and oversee the implementation of SG structure, evaluate the performance of senior management in implementing SAC's resolutions and SC's advice and decisions (Para. 8.1 of SGPD 2019). Importantly, the Board members have to strengthen their knowledge in Islamic banking and finance (Para. 8.2) and give due diligence to SC's advice and decisions (Para. 9.1). To ensure that SC may exercise its duties effectively, the Board must establish a formal evaluation process for SC members (Para. 9.6) and a rigorous selection process for appointment, re-appointment and cessation of SC (Para. 12.12), other than ensuring objectivity and independence of SC (Para. 9.2), establish a policy for conflict of interests (Para. 9.3) and provide a suitable remuneration policy for SC (Para. 9.7). The Board also must establish an effective communication policy with SC and review the frequency and quality of their engagements (Para. 9.4).

Second, the Shariah Committee (SC) must provide sound advice and decisions in an objective manner in Shariah matters (Para. 10.10) including supervising operations that would trigger Shariah non-compliance events, affirming them and approving rectification plans (Para. 10.2). The SC is also required to devise a robust methodology for its decision-making process (Para. 10.4) and referral has to be made to SAC in which the resolution has not been made by SAC or a decision cannot be determined by SC (Para. 10.6). For SC meetings, it must be held at least once every two months for local IFIs (Para. 11.2) and twice annually for foreign IFIs (Para. 11.3). SC members must devote time to prepare and attend the meetings (Para. 10.11) at least 75% in a financial year (Para. 11.4). The majority of SC members must be present at the meeting (Para. 11.7) and decisions are made based on simple majority (Para. 11.8). SC meetings shall be led by the SC Chairman and is also obliged to devise development plans for SC members to strengthen their knowledge on the business of the IFIs and market developments (Para. 10.14).

The IFIs must also disclose the frequency of meetings, attendance of SC members (Para. 11.6) and ensure accurate records of minutes of SC meetings (Para. 11.14). The IFIs must also ensure that SC has full access to information (Para. 11.10), provide third party experts if necessary (Para. 11.11) and obstruction of access shall be informed to the Board (Para. 11.12). An SC member must be a qualified person (Para. 12.1, 12.2), free from any conflict of interests (Para. 10.13, 12.4), may be appointed to one licensed Islamic bank, one Takaful operator and one prescribed institution at the same time (Para. 12.7) and must not be an active politician (Para. 12.8). The IFIs thus must ensure that the size of SC shall be appropriate with the business size of the IFI and be conducive for Shariah deliberations (Para. 13.1) with at least five members for local IFIs (Para. 13.2) and three members for foreign IFIs (Para. 13.4). The Secretariat of SC have the responsibilities to: (i) Coordinate communication between Board, senior management and SC, (ii) Research and studies on Shariah issues, (iii) Provide day-to-day advice to relevant parties to implement SAC rulings or SC decisions, (iv) Ensure dissemination of information to whole IFI, (v) Secretarial roles (Para. 14.1), where items (ii) & (iii) must be carried out by Shariah qualified person(s) (Para. 14.2). The Secretariat also must plan Shariah meetings that give sufficient time to SC members to deliberate/make sound decisions (Para. 14.3).

Third, the senior management of the IFIs led by the CEO shall establish a management structure and reporting arrangement that highlights the accountability of each SG units. The senior management has to implement SG policies, SAC rulings and SC advice and decisions and an effective communication policy to promote Shariah understanding across the IFI. Senior management of IFIs is required to evaluate operational support given to SC, and lastly, notify the Board and SC for potential or actual SNC risk (Para. 15.1). All senior management are required to consistently develop their understanding in Islamic finance and its developments (Para. 15.2).

Fourth, Shariah non-compliant (SNC) risk in IFIs must be managed by three control functions: Shariah risk management, Shariah review and Shariah audit (Para. 16.3). The IFIs are obliged to provide sufficient resources to these control functions (Para. 16.4), ensure that they work independently (Para. 16.6), and have access to all business lines that are exposed to SNC risk (Para. 16.7). Specifically for Shariah risk management, they are responsible for the integration of the SNC management structure with the whole IFI. Most importantly, they have to identify SNC risk in the IFI business, assess SNC risk and measure the potential impacts, construct mitigation measures, monitor SNC risk exposure and evaluate mitigation measures. Lastly, they shall notify the Board, SC and senior management of any SNC risk. Shariah risk management is also required to challenge any decisions that may trigger SNC risk (Para. 17.2).

As for Shariah review, they are responsible to identify, assess and monitor IFI business according to Shariah and report to the Board, SC and senior management of SNC issues and findings. They also have to provide updates on legal and regulatory requirements regarding the IFI business, as well as, provide guidance and training to IFI officers (Para. 18.2). As for Shariah audit, they are responsible to establish an audit methodology to assess risk profile of the IFI, establish an audit plan, provide clear audit programs to guide internal auditors to gather information, auditing procedure and assessment, and to deliver the audit results to the Board and SC through an audit report complete with findings and recommendations for rectification measures (Para. 19.2). All officers in each control function shall possess relevant knowledge in respective functions and Shariah knowledge (Para. 17.4, 18.4, 19.4).

Lastly, the IFIs must exercise transparency and disclose the oversight accountability of Shariah governance implementation of the Board and the overall Shariah compliance of the IFIs in their annual reports. In addition, their respective SC shall disclose their responsibilities in the implementation of SG and their opinion on the IFIs compliance to Shariah (Para. 22.1). All disclosures must not be false, misleading, inaccurate or incomplete (Para. 22.5). For the SC, the IFI must have a policy for the SC to form an opinion on the overall compliance of the IFIs to Shariah (Para. 22.7). The SC shall convey their opinion on whether there is no SNC event in the IFIs, or there is an SNC event(s) with details on its nature, status and plans for rectification (Para. 22.9, 22.10).

3.2 Comparative Analysis

We analysed the main policy documents concerning SG in Malaysia and Indonesia respectively i.e. SGPD 2019 and PBI 2009, and it can be observed that both policies are issued by the respective Central Banks. However, regarding its applicability to IFIs, the SGPD covers Islamic banks, takaful operators, licensed banks approved to carry out Islamic banking business, prescribed development financial institutions approved to carry on Islamic financial business, foreign IFIs in Malaysia and Shariah committee members, whereby the PBI only covers Islamic banks, Islamic windows and SSB. This is because takaful operators and DFIs are regulated by the Indonesian Financial Services Authority (OJK).

As previously mentioned, both countries have a Shariah council at the regulator's office, but the SAC is established under BNM which is a government body, meanwhile the DSN is established under MUI which is a non-governmental organisation. The distinction lies in the status of these entities as a government entity and as a non-governmental organization. However, resolutions and *fatwas* issued by these entities are legally binding on all IFIs. At the institutional level, both countries oblige IFIs to establish a Shariah committee. A unique distinction is that SGPD lays out the responsibilities of the units to specifically implement SG, whereby PBI establishes control functions to implement general Good Corporate Governance with some Shariah governance elements.

Table 1: Differences between SGPD 2019 (Malaysia) and PBI 2009 (Indonesia)

| Aspects | SGPD 2019 | PBI 2009 |
|--|---|--|
| Responsibilities of Board of Directors (BOD)/ Board of Commissioners (BOC) | SGPD requires the BOD to acquire relevant knowledge on IBF to effectively implement Shariah principles in IBF | PBI does not require this |
| | SGPD requires the establishment of Shariah control functions (Shariah risk management, Shariah review and Shariah audit) | PBI obliges the BOC to establish a Risk Monitoring Committee, Remuneration and Nomination Committee and Audit Committee |
| | SGPD requires the BOD to engage with the Shariah Committee, document their engagements and develop a conflict resolution mechanism in SC | PBI does not require this |
| Responsibilities of Shariah Committee/ Shariah Supervisory Board | SGPD emphasizes on the mitigation of Shariah non-compliance risk (SNC) | PBI does not specifically highlight Shariah non-compliance risk (SNC) |
| | SGPD highlights on the responsibilities of the SC Chairman | PBI does not require this |
| | SGPD specifically requires SC to develop a methodology for their decision-making process | PBI does not require this |
| | SGPD obliges the Secretariat to the SC to perform supporting roles for the SC | PBI does not require this |
| Appointment, Cessation, Disqualification and Composition of SC/DPS members | SGPD dictates that SC shall comprise of at least five members | PBI does not specifically dictate the number of persons to be SSB members |
| | SGPD limits the service tenure for an SC member of a maximum nine years in an IFI | PBI does not put an absolute maximum limit on the service tenure for SSB members, instead it depends on the longest service tenure of directors or commissioners |
| Responsibilities of Senior Management/Board of Directors | SGPD requires the senior management to have relevant knowledge in Islamic banking and finance, as well as the latest developments in the industry | PBI does not require this |
| Responsibilities of Shariah Control Functions | SGPD requires the establishment of Shariah risk management, Shariah review and Shariah audit | PBI requires at least one (1) independent member in the Audit Committee to be knowledgeable in Islamic banking |
| Transparency and Shariah Compliance Culture | SGPD requires IFIs to disclose any SNC events and endorsed by the Board and SC | PBI does not require this |

Source: SGPD (2019) and PBI (2009)

It can be observed that SG for IFIs in Indonesia and Malaysia are similar in terms of the law and technical regulations. The difference is that Malaysia has developed a more comprehensive framework using the term specifically, 'Shariah Governance'. Meanwhile in Indonesia, it is still using the corporate governance perspective for IFIs. This is because Indonesia adopted this from the IFSB Guidelines No. 10 (Governance for Financial Institutions Offering Islamic Financial Products and Services) (Rama, 2015). In practice, this is reflected in the responsibilities of the Board of Commissioners and Board of Directors focusing on good corporate governance practices, while the SSB is the only unit which has an active function in SG.

In the Malaysian SGPD, the BOD and senior management are required to actively engage in the fulfilment of Shariah governance by frequently conducting meetings with the SC and developing relevant knowledge about Islamic banking and finance. However, in Indonesia, the responsibilities of the BOC and BOD are more focused on corporate governance elements, rather than Shariah governance. Nevertheless, it is important to note that IFIs in Malaysia are also obliged to follow corporate governance principles as laid down in the Malaysian Code of Corporate Governance (Securities Commission, 2017).

Furthermore, in carrying out the duties of oversight of Shariah compliance in IFIs, the Shariah Committee (SC) in Malaysia is assisted by the Shariah control functions, which are: Shariah review, Shariah audit and Shariah risk management, and they are separate and independent in the organizational structure with other existing units or functions. On the contrary in the regulatory system in Indonesia, the existence of Shariah units or functions is not mentioned directly. The unit or function is integrated with units or functions that already exist in the organizational structure of the company, such as the internal audit unit and the control department. Last but not least, the SGPD specifically emphasizes on the management and mitigation of SNC risk, unlike in Indonesia, this specific risk is not directly mentioned in their policies. However, IFIs in Indonesia are most likely to adopt certain countermeasures in their internal policies to assess and mitigate SNC risk, although the guidelines from regulators do not require Indonesian IFIs to do so. For example, this may be seen with the presence of officers with Shariah background in the Audit Committee and Risk Monitoring Committee to evaluate this SNC risk.

4. Conclusion

Indonesia and Malaysia each use two levels of supervision, namely at the macro level where there is a Shariah advisory council role i.e. SAC of Malaysia and MUI of Indonesia, in the standardization and harmonization of Shariah provisions, and at the micro level there is a Shariah Committee (SC) or Shariah Supervisory Board (SSB) that regulates the implementation of the *fatwa* at the institutional (IFIs) level. Although there are quite a lot of regulations related to the SG system in Indonesia, it cannot be said that Indonesia already has a comprehensive SG regulatory framework. This is because the guidelines in the form of PBI (*Peraturan Bank Indonesia* 2009) and SEBI (*Surat Edaran Bank Indonesia*) issued by Bank Indonesia are not comprehensive to be a robust SG system. The SG system in the regulation point of view is still a sub-section, especially only located in the Shariah Supervisory Board. Meanwhile in Malaysia, SG is considered as important as good corporate governance. This is portrayed in a specific policy document, the SGPD 2019, outlining clear responsibilities of each Shariah governance units, SNC risk reporting and Shariah compliance culture within the IFI.

Therefore, the existence of a regulatory framework regarding SG systems for IFIs in each of these jurisdictions must properly be established by the relevant authorities to create harmonization of regulations in the framework for integration of Shariah financial system in Indonesia and Malaysia. Future research may also empirically evaluate the effectiveness of SG practices and its impacts on the performance of IFIs. Furthermore, since the scope of the current study is the SG practices based on the regulations of the respective countries at a macro level, a study based on the internal policies of SG in IFIs in Indonesia is recommended to evaluate whether their implementations in actuality are more robust or at par with the required provisions from the regulators.

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