

# Comparative Analysis on *Shariah* Governance in Malaysia: SGF 2010, IFSA 2013 and SGPD 2019

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## Abstract

The main focus of *shariah* governance for an organization is to ensure that it is comply with *shariah* laws and regulations. Under Islamic finance industry, *shariah* governance is being given attention due to rapid growth of this industry in the world. For Malaysia, the authority through Bank Negara Malaysia (BNM) have taken a proactive role by introducing *shariah* governance guidelines including the *Shariah Governance Framework (SGF) 2010*, the *Islamic Financial Services Act (IFSA) 2013* and the latest is the *Shariah Governance Policy Document (SGPD) 2019*. These *shariah* governance guidelines are supposed to support the development of *shariah* governance practices especially by Islamic Financial Institutions (IFIs) in Malaysia. However, there is limited to none study conducted to compare these guidelines. These *shariah* governance guidelines is necessary to be compared in order to find out whether these guidelines are complemented each other and to identify any differences among these guidelines. Therefore, the aim of this study is to compare between these *shariah* governance guidelines. Based on the analysis, it has been found that SGPD 2019 is the most comprehensive covers on *shariah* governance as compared to IFSA 2013 and SGF 2010. However, these three guidelines still not become comprehensive enough, as there is still limited to none discussion on the definition and objectives of *shariah* governance itself.

**Keywords:** Shariah governance, SGF 2010, IFSA 2013, SGPD 2019

## 1. Introduction

The emergence of *shariah* governance, especially in Islamic financial institutions (IFIs) is consistent with the requirements of *maqasid shariah*. Ibn ‘Ashur defined *maqasid shariah* as the meaning and secrets that can be understood from *shariah* perspectives as part of the *shariah* process (Abdul Rahman, 2015). In general, *maqasid shariah* is classified into three categories, which are: (i) necessities (*dharuriyyat*); (ii) conveniences (*hajiyyat*); and (iii) refinements (*tahsiniyyat*). Under *dharuriyyat*, it consists of five elements including religion (*ad-din*), life (*an-nafs*), mind (*al-aqal*), descendent (*an-nas*) and wealth (*al-mal*).

Abozaid and Dusuki (2007) posit that to realize the true meaning of *maqasid shariah*, IFIs must make sure that all its transactions are *Shariah* compliant, not limited to legal technicalities and forms but also on the economic substance that is based on the objectives outlined by *shariah*. Furthermore, Shafii et al. (2010) states that the development of *shariah* governance is important for determining the procedures (*maqasid shariah*) for each of the Islamic products and services provided by IFIs. Thus, it can be said that *shariah* governance in IFIs is important as to achieve financial and economic stability.

Due to the rapid developments in Islamic finance and banking, it can be contended that the developments and actual practice of *shariah* governance in Malaysia are at a crossroads. It means that Malaysian stakeholders have to make important decisions and choices with regard

to compliance and performance of public listed Islamic banks. Nevertheless, the potential of Islamic finance cannot be underrated. First, Malaysia can be considered ahead in Islamic finance industry (Khan & Bhatti, 2008; Ibrahim, 2009; Khiyar, 2012). According to the Islamic Finance Country Index (IFCI) by the *Global Islamic Finance Report 2016*, Malaysia holds the first place at the first time it was introduced (GIFR, 2016). In addition, the *World Islamic Banking Competitiveness Report 2016* also highlights the fact that from US\$920 billion of total Islamic finance asset reported in 2015, Malaysia has taken the second place in the global Islamic finance industry with 17 per cent contribution in Islamic financial assets and 15.5 per cent controlling in the global Islamic finance market share (Ernst&Young, 2016). Furthermore, Malaysia is the world's biggest *sukuk* market, constituting about 67 per cent of the global outstanding *sukuk* (CIBAFI et al., 2015). However, despite the huge achievement gained by Malaysia in the Islamic finance industry globally, market share is only found to comprise only 21.3 per cent of the total banks' market share in Malaysia.

Secondly, we observed significant positive developments by Bank Negara Malaysia (BNM) as a regulatory body by introducing the *Shariah Governance Framework* (SGF) in 2010. SGF has managed to strengthen *shariah* governance practices in IFIs. The objective of SGF was to ensure good *shariah* practices in IFIs. Besides, BNM also took an initiative by issuing the *Islamic Financial Services Act* (IFSA) in 2013. This shows that BNM's efforts in strengthening *shariah* governance practices in IFIs are ongoing. In September 2019, BNM issued the *Shariah Governance Policy Document* (SGPD) after having issued an ED in 2017. The SGPD tightens the role of the board, management and the *shariah* committee (SC). The SC in comparison is the guardian for ensuring that products and instruments adhere to *shariah* principles. Under the latest SGPD, the SC has to bear more responsibility as compared to SGF. This indicates the utmost importance of *shariah* governance placed by the regulator on IFIs.

Third, it is also observed that there are an increasing number of international and national level conferences, seminars and workshop programs to deliberate issues related to *shariah* governance in IFIs (Hanefah & Kamaruddin, 2019). These programs involve not only academia, but also experts in *shariah* governance who are interested in the issues. Moreover, these conferences and programs have helped to enhance societal awareness and understanding on *shariah* governance and assurance as well as to put this agenda on a higher pedestal over the past few years.

Last but not least, there have been a number of unresolved concerns and challenges in the area of *shariah* governance especially among the IFIs. This includes the centralization or decentralization of the *shariah* body in IFIs, the competence of *shariah* scholars and practitioners in IFIs, the availability of adequate *shariah* scholars and practitioners in IFIs and the capabilities of IFIs in carrying all *shariah* functions (Abdul Rahman, 2010; Kamaruddin & Hanefah, 2017; Shafii et al. 2013). Many of these issues and challenges refer mainly to the need for competent *shariah* scholars and practitioners such as *shariah* auditors and *shariah* officers that are currently insufficient in the country.

A comparative analysis between *shariah* governance framework (SGF) 2010, IFSA 2013 and

SGPD 2019 is discussed in this paper. It begins with an overview of *shariah* governance including characteristics and limitations of *shariah* governance practices. Then, this paper continues with discussions on SGF 2010, IFSA 2013 and SGPD 2019. Impact on Islamic finance is then discussed. Lastly, this paper concludes with several recommendations for the regulators and the industry.

## 2. Overview of *Shariah* Governance

*Shariah* governance is about the relationship between organizations and its stakeholders, which include employees, creditors, government, society and others. *Shariah* governance is different from conventional corporate governance whereby it also considers *shariah* law or *maqasid shariah* in its relationship. These relationships are solely used to determine and control the strategic direction and performance of the Islamic banks.

As *shariah* governance differs in several aspects in comparison to corporate governance, it is crucial for us to understand these differences. First, in terms of the definition, there is a similar agreement between the definition of corporate governance and *shariah* governance. For corporate governance, the worldwide acceptable definition on corporate governance is the *Cadbury Report 1992*, which defines corporate governance as:

*The system by which companies are directed and controlled. Board of Directors (BOD) is responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate structure is in place (Cadbury, 1992).*

Meanwhile, for Malaysia, *Malaysian Code of Corporate Governance (MCCG) 2017* issued by the Securities Commission of Malaysia defines corporate governance as:

*The process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value, whilst taking into account the interests of other stakeholders (SC, 2017).*

For corporate governance in financial institutions, the term of corporate governance for financial institutions has been specifically identified by BNM in the *Guideline on Corporate Governance for Licensed Institutions 2013* as:

*Involves the manner in which the business and affairs of the individual banking institutions are being governed by their BOD and senior management, how the economic returns are generated to the owners, the day-to-day running of the operations of the business and the consideration of the interests of recognized stakeholders including depositors; and how they behave in a safe and sound manner, in compliance with applicable laws and regulations (BNM, 2013a).*

In contrast, for *shariah* governance definition, at present there is yet to have a common understanding on the general definition on *shariah* governance. Literatures also show that most of *shariah* governance studies are in financial sectors (Abdullah Saif Alnasser & Muhammed, 2012; Hanefah & Kamaruddin, 2019; Hasan, 2009; Miskam & Nasrul, 2013).

However, the definition of *shariah* governance for IFIs is defined by IFSB-10 of the Islamic Financial Services Board (IFSB): *Guiding Principles on Shari'ah Governance Systems for Institutions Offering Islamic Financial Services*, as the following:

*Set of the strategic roles and functions of each organ of governance and mechanisms for balancing the institutions that offering Islamic financial services accountabilities to various stakeholders (IFSB, 2009).*

Second, in terms of the objective, basically the objective of corporate governance is about decision making by whom and for whom that can be viewed in three alternative views, which are: (i) the legal view; (ii) the economic view; and (iii) the accounting view (Lewis, 2005). From legal view perspective, an organization is separate entity that is owned by the shareholders as capital provider, directors as stewardship of the organizations' capital and employees as manager to conduct the operation of the organization using the power delegated to them by the directors. Meanwhile, from an economic view, corporate governance can be viewed as separation between ownership and management of organization in decision making. Thus, corporate governance will ensure agency problems can be solved when shareholders as owner can secure their rights and investments while managers can carry-out their duties and compensated fairly based on their achievements in managing the organization without reducing the interest of shareholders in their decision-making. On the other hand, from an accounting view, corporate governance can be viewed as an accountability and transparency of management toward shareholders as owner and other related interest stakeholders such as employees, creditors, debtors, government and society. These accountability and transparency can be achieved with proper record keeping and disclosure management practices by management according to guidelines and standards given.

Meanwhile, for *shariah* governance, Nathan Garas and Pierce (2010) attempts to identify the objective of *shariah* governance from five important resources, which are: (i) religious; (ii) social; (iii) economic; (iv) legal; and (v) governance. Under the religious resources, *shariah* governance concerns on the capability of the *shariah* committee in understanding and interpreting *shariah* principles. Meanwhile, under social resources, *shariah* governance focused to gain stakeholders' confidence on the transactions and activities conducted by the organization. On the other hand, under economic resources, *shariah* governance stressed on the performance of the *shariah* committee as it will effect on the profitability of the organization. While, under legal resources, *shariah* governance ensure that all related regulators frameworks and guidelines are to be imposed by the organization. Last but not least, under the governance resources, the hierarchical position of the *shariah* committee gives power for them to set and monitor *shariah* compliant within the organization.

In other words, the objective of *shariah* governance is to enhance the role of the BOD, the *shariah* committee and the management of an organization to execute the *shariah* compliance and aimed to operate as *shariah* required (BNM, 2010). Based on this objective, IFSB highlighted four structures and processes that are crucial in *shariah* governance as documented in IFSB-10, which are:

1. Issue relevant *shariah* resolutions;

2. Deployment of such *shariah* resolutions to operation personnel who monitor daily *shariah* compliance;
3. Verification of *shariah* compliance by internal *shariah* compliance review/audit;
4. Findings on verification of *shariah* compliance have been noted by the *shariah* committee.

Third, in terms of the good corporate governance practices, the Organization for Economic Cooperation and Development (OECD, 2014) identified four main components for good corporate governance practices to secure the interests of the shareholders as owners of the organization which are:

1. An active BOD.
2. Imposing the duality role between the Chairman and the Chief Executive Officer (CEO).
3. Outside or non-executive directors as majority of the BOD.
4. Two-tier board (using supervisory boards to supervise BOD).

There are several verses in Quran that encourage Muslims to have good corporate and *shariah* governance practices. This includes a story of Dzulqarnain, a ruler who followed the righteous path to rule a kingdom. His story is depicted in the following:

*Indeed We established him upon the earth, and We gave him to everything a way. So he followed a way* (Al-Kahfi 18:84-85).

Corporate governance in Islam is also related with justice and on how to manage an organization according to *shariah* laws. This had been stated in the following Quranic verses:

*Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice. Excellent is that which Allah instructs you. Indeed, Allah is ever Hearing and Seeing* (An-Nisa' 4:48).

*And We made from among them leaders guiding by Our command when they were patient and [when] they were certain of Our signs* (As-Sadjah 32:24).

Chapra and Ahmed (2002) have identified 12 main elements regarding good *shariah* governance practices for IFIs which are: (i) BOD; (ii) non-executive directors; (iii) executive directors; (iv) senior management; (v) employees; (iv) *shariah* board; (vii) auditors; (viii) accountability and controls; (x) compensation policies; (xi) board meetings; (xii) annual report, information disclosure and transparency; and (xiii) code of ethics. These elements are closely similar to the good practices that have been suggested for conventional corporate governance.

Thus, it can be concluded that corporate governance and *shariah* governance have similar definitions, objectives and good practices and conduct. In addition to that, *shariah* governance requires compliance to *shariah* which is not required in a normal corporate governance framework.

2.1 Shariah Governance Framework (SGF 2010)

The SGF 2010 issued by BNM in 22 October 2010 sets out the *shariah* governance process for the IFIs in Malaysia. It issued with the objective to enhance the role of the BOD, the SC and the management of IFIs especially on *shariah* matters. Besides, this guideline also covers relevant key organs with the responsibility to execute the *shariah* compliance. Specifically, the SGF 2010 (BNM, 2010) covers:

1. Expectations on IFI’s *shariah* governance structures, processes and arrangements;
2. Guidance for the BOD, the SC and the management of the IFI on *shariah* matters; and
3. Functions of *shariah* review, *shariah* audit, *shariah* risk management and *shariah* research.

Generally, the framework is discussed in six sections related to: (i) general requirements of *shariah* governance; (ii) oversight, accountability and responsibility; (iii) independence; (iv) competency; (v) confidentiality and consistency; and (vi) *shariah* compliance and research function. First, under the general requirement of *shariah* governance, IFIs are responsible to establish *shariah* governance with the comprehensive roles of key organ functions (BNM, 2010). In this section, SGF 2010 highlights that three key organs in *shariah* governance are the BOD, the SC and the management. Besides, there are also four *shariah* functions, consist of *shariah* review, *shariah* audit, *shariah* risk management and *shariah* research. The following Figure 1 illustrates *shariah* governance model structure that highlight on the roles, functions and reporting relationships for these key organs in IFIs.

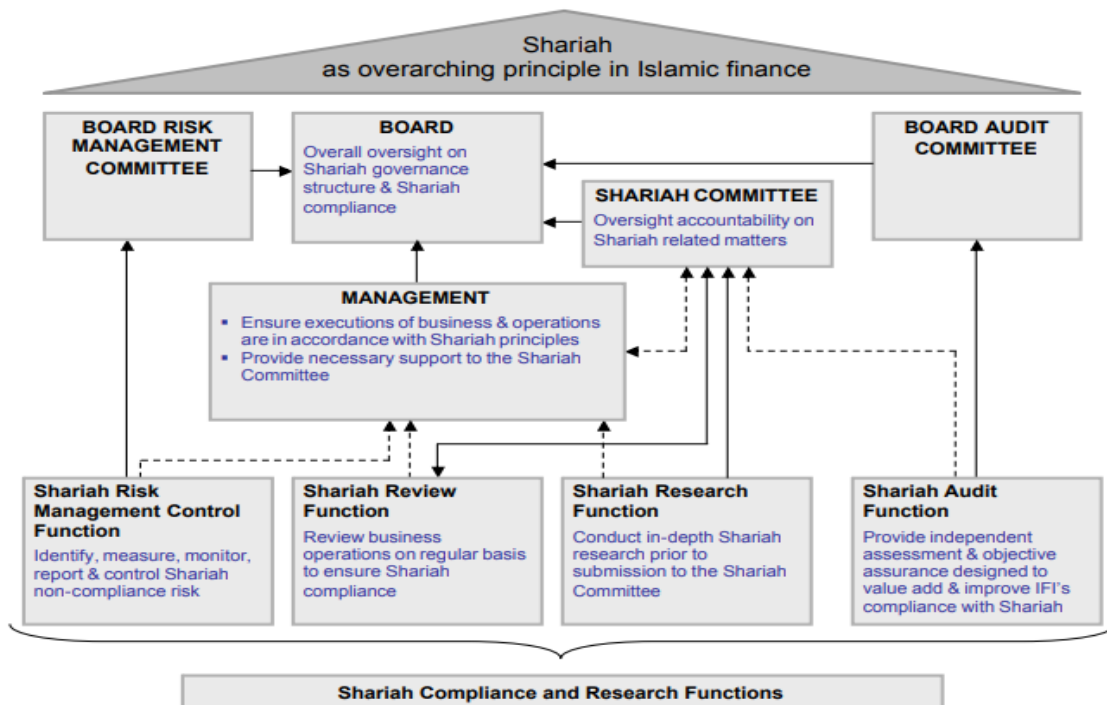


Figure 1. SGF Model for IFIs

Source: BNM (2010)

Second, under the oversight, accountability and responsibility, IFIs are required to follow strictly the SGF to ensure full compliance. In this section, duties and responsibilities for all three key organs are explained in details. Besides, SGF 2010 also has provided some additional guidelines on duties, responsibilities and accountability of the SC. The details are as in Table 1.

Table 1. Duties, Responsibilities and Accountability of the SC

Duties & Responsibilities	Explanations
Responsibility and accountability	To responsible and accountable for all <i>shariah</i> decisions, opinions and views.
Advise to the BOD and IFI	To advise the BOD and provide input to the IFI on <i>shariah</i> matters.
Endorse <i>shariah</i> policies and procedures	To endorse and ensure that <i>shariah</i> policies and procedures are in line with <i>shariah</i> .
Endorse and validate relevant documentations	To ensure that IFI's products and services are comply with <i>shariah</i> principles.
Assess the work of <i>shariah</i> review and <i>shariah</i> audit	To assess the work of <i>shariah</i> review and <i>shariah</i> audit to ensure the compliance with <i>shariah</i> by IFI.
Assist related parties on <i>shariah</i> matters	To assist related parties such as legal counsel, auditor or consultant that seek for advice on <i>shariah</i> matters.
Advise on matters to be referred to the SAC	To advise IFI to consult with the <i>Shariah</i> Advisory Council (SAC) of BNM on <i>shariah</i> matters that could not be resolved.
Provide written <i>shariah</i> opinions	To provide written <i>shariah</i> opinions for IFI to engage with the SAC or BNM on <i>shariah</i> matters.

Source: BNM (2010)

Third, under independence, the SC must be observed on their independence to ensure that they can exercise their duties with objective and informed judgment. In this case, the BOD is required to ensure the independence of the SC to ensure the sound *shariah* decision-making (Kasim et al., 2013). Regarding organizational structure, the independence of the SC is reflected by their position which is at the same level as the BOD. In other words, any decisions made by the SC could not be overruled by the BOD (Hasan, 2009). The BOD has to ensure that IFI implement the decisions made by the SC and ensure the decisions made are



not modified without their consent.

Fourth, under competency, all IFI's key organs and functions in *shariah* governance must have necessary competency based on their responsibilities. Besides, they are also need to enhance their knowledge on *shariah* on continuous basis and update themselves on the latest developments in Islamic finance. For the SC composition, the majority of the SC members should have a qualification in *shariah* which includes the study in *usul fiqh* (Islamic jurisprudence) or *fiqh muamalat* (Islamic transaction). Besides, IFIs should have a proper process on how to assess the performance of the SC members and also developing suitable succession planning program for the SC.

Fifth, under confidentiality and consistency, the SC must ensure that any information obtained by them in delivering their duties must be treated as confidential and not be misused. Furthermore, this section also stresses that the SC members must maintain their professional ethics, judgment and consistency in ensuring *shariah* compliance.

Last but not least, under *shariah* compliance and research function, the framework suggests that IFI must ensure that all its *shariah* functions, consisting of *shariah* review, *shariah* audit, *shariah* risk management and *shariah* research must in a good and sound condition. Functions of these four *shariah* functions in IFIs are summarized in Table 2.

Table 2. Functions of Four *Shariah* Compliance Functions by SGF 2010

<i>Shariah</i> Compliance Function	Functions
<i>Shariah</i> Review	<ul style="list-style-type: none"> <li>▪ Regular assessments on <i>shariah</i> compliance in the activities and operations.</li> <li>▪ Examine and evaluate the level of <i>shariah</i> compliance.</li> <li>▪ Identify corrective measures to resolve <i>shariah</i> non-compliance.</li> <li>▪ Propose a sound control mechanism to avoid recurrences of <i>shariah</i> non-compliance.</li> <li>▪ Covers IFI's overall business operations including end-to-end product development process from product structuring to product offering.</li> </ul>
<i>Shariah</i> Audit	<ul style="list-style-type: none"> <li>▪ Periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to assess its value and improves the degree of compliance in relation to the IFI's business operation.</li> <li>▪ Covers overall IFI's business operation, including: (i) audit of financial statement; (ii) compliance audit on organizational structure, people, process and information technology application system; and (iii) review of adequacy</li> </ul>

	of the <i>shariah</i> governance process.
<i>Shariah</i> Risk Management	<ul style="list-style-type: none"> <li>▪ Identify, measure, monitor and control of <i>shariah</i> non-compliance risks to mitigate any possible of <i>shariah</i> non-compliance events.</li> <li>▪ Formulate and recommend <i>shariah</i> non-compliance risk management policies, procedures and guidelines.</li> <li>▪ Develop and implement <i>shariah</i> non-compliance risk awareness processes.</li> </ul>
<i>Shariah</i> Research	<ul style="list-style-type: none"> <li>▪ Conduct pre-product approval process, research, vetting of issues for submission and undertake administrative and secretarial matters relating to the SC.</li> <li>▪ Perform in-depth research and studies on <i>shariah</i> issues, day to day <i>shariah</i> advice and consultancy to relevant parties including product development.</li> </ul>

Source: BNM (2010)

## 2.2 Islamic Financial Services Act (IFSA 2013)

The IFSA 2013 issued by BNM on 22 March 2013 is enacted to provide the regulations and supervision for IFIs, payment systems, regulatory objectives as well as power and functions of the bank and other relevant aspects related to Islamic finance in Malaysia. *Shariah* governance becomes one of the important aspects in IFSA, which is stated in Part IV – Division II of the statute.

The main objective of IFSA as stated in Section 6 is to promote financial stability and *shariah* compliance. To achieve this objective, the IFIs under the supervision of BNM must ensure the safety and soundness of their operations, and that their businesses are carried out fairly, responsibly and professionally, as well to ensure that the customers' rights are protected. Whilst observing the above, the IFIs shall also to ensure that their operations are complying with *shariah* principles (BNM, 2013b).

Under Part IV – Division II on *shariah* governance, Section 31 stated that for the establishment of the SC, IFIs are needed to apply such establishment directly to BNM. This will ensure BNM to have direct and adequate information on the SC members in IFIs. At the same time, BNM also can have a proper supervision on the SC's duties and activities in IFIs (Miskam & Nasrul, 2013).

Section 31 of IFSA touches on the appointment of the SC members. This section requires that each SC member must meet the requirements as stated in Section 29(2)(a)(ii) – only those who are really fit and qualified can be appointed as the SC members. Besides, each SC member appointed must get approval from the BNM. This will ensure that all SC members are capable to play their important roles to ensure that IFIs' operation is complied with

*shariah* principles.

The following Section 32 requires that the SC must set out their duties and functions as stated in Section 29(2)(a)(i) - including functions and duties of the BOD, senior officers and the SC members in relation to compliance with *shariah*. This section extends the scope of *shariah* governance as one of the integral parts in IFIs and the SC shall not be treated only as part or division of IFIs (Miskam & Nasrul, 2013).

On the other hand, Sections 33 and 34 enables BNM to continuously be updated by IFIs on their SC members. This provision sets out the clause on cessation of the SC members including situations where they can be disqualified from the post. This is to ensure that only those who are qualified can be maintained as the SC members.

Meanwhile, Section 35 instructs the management to provide necessary information to the SC for them to exercise their roles and duties. In this case, the management need to provide any document or information within its or his knowledge, or capable of being obtained by it or him, which the SC may require and ensure that such document or information provided is accurate, complete, not false or misleading in any material particular.

Last but not least, Section 36 requires the SC members to maintain the duty of confidentiality in discharging their duties and functions. Besides, the SC members also are guaranteed with the protection that prevents IFIs from taking any legal action on them if they can prove that they are conducting their duties in good faith.

### *2.3 Shariah Governance Policy Document (SGPD 2019)*

The SGPD 2019 issued by BNM on 19 September 2019 strengthened the oversight accountabilities of the BOD, the SC and other key organs who are involved in the implementation of *shariah* governance. Besides, this policy document also relates to the SC's objective to achieve an effective management on *shariah* non-compliance risks by strengthening their decision-making process and internal control functions. By implementing SGPD 2019, it is expected for IFIs to have a better arrangement in supporting a strong *shariah* compliance risk culture. This is based on more active roles from the BOD, the SC and senior management.

Generally, there are six main parts highlighted in SGPD 2019, covering: (i) the BOD; (ii) SC; (iii) senior management; (iv) control functions; (v) *shariah* compliance culture and remuneration; and (vi) transparency and disclosures. First, under the BOD responsibilities, it emphasizes the importance of interaction between the BOD and the SC. Among the BOD responsibilities include approving policies related to the effective implementation of *shariah* governance, oversee implementation of the SAC rulings and SC advice, oversee implementation of internal control and any rectification measures on *shariah* non-compliance, supervise the performance of the senior management in implementing *shariah* governance and promoting a sound corporate culture adhering to *shariah*. In addition, the BOD members itself is also required to continuously update themselves with Islamic finance knowledge.

For interaction with the SC, the BOD is required to have due regards on SC decisions and advice, ensure that the SC is free from undue influence by taking necessary actions, establish written policy to identify, assess and manage conflict of interest of the SC, establish effective communication with the SC, allocate sufficient resources for the SC to continuously develop their skills and expertise, establish the proper performance and effectiveness assessment in order to assess the SC and approve remuneration policy that commensurate the SC.

Second, SGPD spells out the responsibilities of the SC, SC meetings, appointment, cessation and disqualification of the SC, SC composition and secretariat to the SC. Among the SC responsibilities include provides an outline that stressed on their mandate, responsibilities and procedures, provide objective and sound advice to the IFIs, responsible for every decisions and advice made, develop a comprehensive procedures to guide its decision-making process, immediately update the BOD on *shariah* issues, requests for a ruling or advice from the SAC or advice and submit SC decisions and advices to the BNM. Besides, responsibilities of the individual SC members are to exercise objectivity and free from conflict of interest, allocate adequate time for preparation and for attending the SC meetings, ensure consistency in providing their views and not contradict with the SAC and SC rulings, inform on the nature and extent of his or her conflict of interest with the IFI and constantly learns to understand the IFIs' business and operations.

For SC meetings, the Chairman of the SC is responsible to ensure the SC meetings are effectively functions. Besides, the SC meetings required to be conducted at least once in every two (2) months. Moreover, IFIs also need to ensure that the presence of each the SC members in the SC meetings for each financial year must not below than 75%, non-physical presence in the SC meetings by the SC members must not become the norm and provide information on the number and attendance of the SC meetings held during the year in the IFI's annual report. Furthermore, IFIs also needs to ensure that minutes of the SC meetings must be maintained, each of the SC meetings must be attended by a majority of *shariah* qualified members, decisions made by the SC must be based on simple majority agreement, provide the SC with adequate and sufficient information and such information is accurate, comprehensive and clear. In addition, the BOD or senior management is also required to provide useful insights on any business, technical or operational matters during the SC meetings and any matter that gives conflict of interest, the particular SC member is restrained to involve and voting in that particular discussion.

For appointment, cessation and disqualification of the SC, there are several requirements need to be met in order to become a SC member. The criteria for SC member are detailed in the following Table 3.

Table 3. Appointment, Cessation and Disqualification of the SC Member

Shariah Compliance Function	Criteria
Appointment	<ul style="list-style-type: none"> <li>▪ Muslim individual;</li> <li>▪ Fulfill all requirements as stated in the <i>Fit and Proper Criteria</i>; and</li> <li>▪ <i>Shariah</i> qualified or an expert with relevant skills, knowledge and experience required by the SC.</li> </ul>
Shariah Qualified Person	<ul style="list-style-type: none"> <li>▪ Minimum a bachelor degree in <i>shariah</i> (includes <i>usul fiqh</i> or <i>fiqh muamalat</i>);</li> <li>▪ Have solid knowledge in <i>shariah</i> with sound Islamic finance knowledge and experience; and</li> <li>▪ Have strong proficiency and knowledge in Arabic (written and verbal), with good command in the IFI's preferred language.</li> </ul>
Disqualification	<ul style="list-style-type: none"> <li>▪ An undischarged bankrupt;</li> <li>▪ Charge for criminal offence relating to dishonesty or fraud; or</li> <li>▪ Under any law relating to prevention of crime, drug trafficking or immigration.</li> </ul>
Conflict of Interest	SC member or his/her immediate family: <ul style="list-style-type: none"> <li>▪ Not an executive or within the last two years of his/her proposed appointment of the IFI;</li> <li>▪ Not a substantial shareholder, executive director or senior officer of the IFI or any of its affiliates; or</li> <li>▪ Not have a significant business or other contractual relationship with the IFI or any of its affiliates within the last two years.</li> </ul>

Source: BNM (2019)

Based on the above Table 3, any application for appointment, reappointment, termination, resigns and disqualified must be informed and get approval from the BNM. In addition, as the SC member, he/she cannot serve the same IFI for more than nine years. Besides, the SC member is also must not have clash in time commitments that can affect his/her capability to discharge his/her duties effectively, not accept for more than one appointment either in Islamic bank, *takaful* operator or other prescribed institution and be an active politician.

Moreover, the BOD is encouraged to appoint a SC member as a BOD member, developing a suitable succession planning for the SC and also developing a tight process for the appointment, reappointment and cessation of the SC members.

In term of the SC composition, IFIs must ensure that the SC is consists of by at least five members, the SC must be of a sufficient size and majority of the SC members and the chairman of the SC are *shariah* qualified person. Meanwhile, the secretariat to the SC must be able to coordinate, communicate and disseminate information among the SC, the BOD and senior management, conducting in-depth research and studies on *shariah* issues, providing day to day *shariah* advice and consultancy to relevant parties, proper distribution of *shariah* decisions or advice within the IFI and responsible on the administrative and secretarial functions to support the SC.

The third section outlines the responsibilities of the senior management on *shariah* governance. This include such as develop a sound management structure and reporting arrangement, implement *shariah* governance policies, procedures and practices, implement the rulings, decisions and advice of the SAC and the SC, support a sound understanding of *shariah* matters by conducting an effective communication policy, evaluate the operational support's quality to the SC on regular basis and report any potential or actual *shariah* non-compliance events to the BOD and the SC. Besides, senior management is also required to continuously update themselves with Islamic finance knowledge.

Fourth, under control functions, it focused on the effective management of *shariah* non-compliance risk by *shariah* risk management, *shariah* review and *shariah* audit on ongoing basis. Basically, IFI must ensure that the overall of *shariah* non-compliance risk management is structured, provide sufficient resources for the control functions and they must have direct access and without being worried to the SC. Besides, they are also must independent and have access to every potential *shariah* non-compliance risk in all business lines. In term of functions for each control function, the following Table 4 summarized the necessary functions that need to be performed by each function under *shariah* governance.

Table 4. Functions of Control Functions under *Shariah* Governance by SG 2019

Control Functions	Functions
<i>Shariah</i> Risk Management	<ul style="list-style-type: none"> <li>▪ To integrate between <i>shariah</i> non-compliance risk with conventional risk management;</li> <li>▪ To identify potential <i>shariah</i> non-compliance risk exposures;</li> <li>▪ Assess and measure potential impact of <i>shariah</i> non-compliance risk exposures;</li> <li>▪ To develop appropriate risk mitigation measures;</li> <li>▪ To closely monitor on both <i>shariah</i> non-compliance risk exposures</li> </ul>

	<p>and effectiveness of the risk mitigation measures;</p> <ul style="list-style-type: none"> <li>▪ To report to the BOD, the SC and senior management on the <i>shariah</i> non-compliance risk exposures; and</li> <li>▪ To develop constructive decisions that may give escalate to <i>shariah</i> non-compliance risks.</li> </ul>
<i>Shariah</i> Review	<ul style="list-style-type: none"> <li>▪ To identify, assess and monitor on <i>shariah</i> compliance by the IFI;</li> <li>▪ To report on regular basis on <i>shariah</i> non-compliance issues and findings to the BOD, the SC and senior management;</li> <li>▪ To inform and provide the latest updates on regulatory requirements especially SAC rulings to the BOD, the SC and senior management; and</li> <li>▪ To ensure IFI's officers were provided with adequate training and guidance on relevant <i>shariah</i> requirements.</li> </ul>
<i>Shariah</i> Audit	<ul style="list-style-type: none"> <li>▪ To assess the risk profile and each auditable area exposures by developing a strong audit methodology;</li> <li>▪ To develop a comprehensive <i>shariah</i> audit plan for <i>shariah</i> audit process;</li> <li>▪ To provide guidance on gathering information, auditing procedures and audit assessment by developing a clear documented <i>shariah</i> audit programs; and</li> <li>▪ To communicate the audit findings, recommendations for rectification measures and auditee's responses and action plans to the BOD and the SC through an audit report.</li> </ul>

Source: BNM (2019)

Fifth, under *shariah* compliance culture and remuneration, effective implementation of *shariah* governance can be obtained by ensuring effective communication policy is in place by the BOD. Besides, *shariah* compliance reinforce a risk culture in IFIs can be attained through adequate remuneration policy and performance measures by senior management, which is in line with the objective of *shariah* governance.

Last but not least, under transparency and disclosures, it is required for IFIs to disclose its *shariah* governance policies and practices information in the annual report. In this case, the BOD is responsible to disclose on its duties in monitoring the *shariah* governance implementation and also IFI's compliance with *shariah* in overall. Meanwhile, the SC is responsible to disclose their responsibilities on *shariah* governance and opinion on the level of *shariah* compliance by IFI. In the SC's disclosure, it also addresses the material *shariah*

non-compliance events including its nature, status and measures undertaken. Such disclosure made by the SC must be signed by not less than two SC members. Besides, opinion made by the SC must be based on the written policy endorsed by the SC and approved by the BOD.

### 3. Research Methodology

This study applied a comprehensive analysis on three *shariah* governance guidelines in Malaysia under BNM which are: (i) *Shariah Governance Framework (SGF) 2010*; (ii) *Islamic Financial Services Act (IFSA) 2013*; and (iii) *Shariah Governance Policy Document (SGPD) 2019*. In applying the critical comparison between these *shariah* governance guidelines, several themes under *shariah* governance are identified to be used including the definition, objectives, structure, responsibility of key organs, control functions, independence, competency, confidentiality, consistency, appointment, cessation and disqualification, composition, meetings, remuneration, *shariah* compliance culture, transparency and disclosures and allocation of punishment. These themes will be used in comparative analysis made for this study.

### 4. Comparative Analysis among SGF 2010, IFSA 2013 and SGPD 2019

Based comparative analysis conducted among three *shariah* governance frameworks in Malaysia, namely: (i) SGF 2010, IFSA 2013 and SFPD 2019, the following Table 5 summarized the comparative analysis findings as follow.

Table 5. Functions of Control Functions under *Shariah* Governance by SG 2019

Discussion	SGF 2010	IFSA 2013	SGPD 2019
Definition of <i>shariah</i> governance	Not provided	Not provided	Not provided
Objectives of <i>shariah</i> governance	Discussed	Not provided	Not provided
Structure of <i>shariah</i> governance	Discussed – limited within IFI only (Tier 1)	Not provided	Discussed – within IFI and IFI to BNM (Tier 1 & 2)
Responsibility of the BOD for <i>shariah</i> governance	Discussed	Not provided	Discussed – including on continuous development of the BOD on <i>shariah</i> knowledge
Responsibility	Discussed	Discussed	Discussed



of the SC			
Responsibility of the management for <i>shariah</i> governance	Discussed	Not provided	Discussed – including on continuous development of the management on <i>shariah</i> knowledge
Control functions for <i>shariah</i> governance	<ul style="list-style-type: none"> <li>▪ <i>Shariah</i> review</li> <li>▪ <i>Shariah</i> audit</li> <li>▪ <i>Shariah</i> risk management</li> <li>▪ <i>Shariah</i> research</li> </ul>	<i>Shariah</i> audit by BNM (Tier 2)	<ul style="list-style-type: none"> <li>▪ <i>Shariah</i> review</li> <li>▪ <i>Shariah</i> audit</li> <li>▪ <i>Shariah</i> risk management</li> <li>▪ <i>Shariah</i> research function merged with the secretariat to the SC – not classified under control functions</li> </ul>
Independence of SC	Discussed	Not provided	Discussed
Competency of SC	Discussed	Not provided	Discussed
Confidentiality of SC	Discussed	Discussed	Discussed
Consistency of SC	Discussed	Not provided	Discussed
Appointment, cessation & disqualification of SC	Discussed in general	Discussed in general	Discussed in detail – tenure not more than 9 years in the same IFI, not active in politics.
Composition of SC	Discussed in general	Not provided	Discussed in details – at least 5 members
SC Meetings	Discussed in general	Not provided	Discussed in details – concern on non-physical meetings

Remuneration of SC	Discussed	Not provided	Discussed
<i>Shariah</i> compliance culture	Discussed	Not provided	Discussed
Transparency and disclosures	Provide example of minimum annual disclosure in appendix	Not provided	Discussed – report on <i>shariah</i> governance practices in annual report
Allocation for punishment	Not provided	Imprisonment for a term not exceeding eight years or to a fine not exceeding RM25 million or to both	Not provided

Based on Table 5, the biggest loopholes for these three *shariah* governance guidelines is the absence of the definition of *shariah* governance itself. Besides, another important element which is *shariah* governance objectives is only discussed in SGF 2010. In term of *shariah* governance structure, both SGF 2010 and SGPD 2019 are discussed where SGF 2010 is focused on the IFI level, while SGPD 2019 have a broad coverage when it also included in details on the national level with the authority which is BNM.

Next, on the responsibility of the BOD of IFI, both SGF 2010 and SGPD 2019 are discussed, however, SGDP 2019 have more extensive discussion as it also include the needs for continuous development on the *shariah* knowledge. This is in line with the ultimate responsibility of *shariah* compliance, which is on the BOD responsibility. Similarly, on the responsibility of the management, both SGF 2010 and SGPD 2019 are discussing the content with SGDP 2019 have the same extensive discussion and also proposing the needs for the management to have continuous development on the *shariah* knowledge. Meanwhile, on the responsibility of the SC, all three *shariah* governance frameworks are well discussed.

On control functions of *shariah* governance, SGF 2010 proposes four types of control functions which are: (i) *shariah* review; *shariah* audit; (iii) *shariah* risk management; and (iv) *shariah* research. However, in SGDP 2019, these control functions becoming only three types where *shariah* research function is combine with the secretariat to the SC function and no longer classified under control function. In IFSA 2013, the discussion on the is focused on the *shariah* audit but it is not referred to the IFI level but instead it refers to the national level or second tier, which is the responsibility of the BNM to have such *shariah* audit on IFIs in Malaysia.

In term of independence, competency, confidentiality and consistency of the SC, both SGF 2010 and SGPD 2019 are discussing on these matters except for IFSA 2013, which only covering on the confidentiality of the SC on information accessed in order for them to make decision. In term of the appointment, cessation and disqualification of the SC, SGPD 2019 provide in-depth guideline as compared to SGF 2010 including by introduction of the tenure of the SC which not exceed nine years in an IFI, and also not to be involved actively in politics. For composition of the SC, both SGF 2010 and SGPD 2019 are covering this aspect where SGPD 2019 provides a new requirement where SC must be consist of at least five members. Similarly, under SC meeting, SGPD 2019 also have additional concerns on the non-physical meetings and urges for IFI to ensure this kind of meeting do not downgraded the effort and commitment of the SC members in fulfilling their obligations as compared to SGF 2010. On the other hand, IFSA 2013 only covering in general on the appointment, cessation and disqualification of the SC as stated in the Section 33 and 34. For remuneration of the SC, both SGF 2010 and SGPD 2019 provide the discussion, while there is no discussion on this matter under IFSA 2013.

For *shariah* compliance culture, both SGF 2010 and SGPD 2019 are discussed while IFSA 2013 does not touch on this aspect. Meanwhile, for transparency and disclosures aspect, previous SGF 2010 only provide the example of the minimum annual disclosure in the appendix, while SGPD 2019 have more extensive discussion especially on the report of *shariah* governance practices in the IFI annual report. Last but not least, on the allocation of punishment for the breach of the duties, only IFSA 2013 have such provision where breach on the *shariah* governance is subjected to imprisonment for a term not exceeding eight years or to a fine not exceeding RM25 million or to both.

## 5. Conclusion

This paper discusses the important role of *shariah* governance guidelines in the Islamic finance industry to ensure that the whole activities of financing activities are in line with the *shariah*. Comparative analysis on the *shariah* governance guidelines issued by BNM, which consist of SGF 2010, IFSA 2013 and SGPD 2019 are provided and discussed.

In short, all these three guidelines still can be concluded are not comprehensive enough, especially on the definition and objectives of *shariah* governance. Perhaps in the future, it is suggested to include these two important aspects in *shariah* governance guidelines. However, other aspects on *shariah* governance are well covered especially by SGPD 2019. Thus, it can be concluded that SGPD 2019 is the most comprehensive guideline for *shariah* governance as compared to SGF 2010 and IFSA 2013. Another suggestion is to cover in-depth on both first and second tier of *shariah* governance in the future amendment *shariah* governance guidelines. It is expected that the highlights in this research will be the interests of regulators and industrial players for future development in the said guidelines.

The growth of Islamic based organizations especially in Malaysia practices cannot be taken lightly. IFIs can lead not only to serves shareholders wealth, but it also can be as a key player in economic and social growth and development. As for that, *shariah* governance being demanded and its existence are highly significant especially for society overall. The

challenges for IFIs should be taken seriously. It is because the failure of IFIs would have an impact on the economy and image of Islam. Thus, further studies should be carried out on how to strengthen IFIs governance and their impact on the society at large.

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