



# A survey on *Shari'ah* governance practices in Malaysia, GCC countries and the UK

## Critical appraisal

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### Abstract

**Purpose** – The purpose of this paper is to understand current *Shari'ah* governance practices with the purpose of promoting greater understanding of some of the crucial issues and to provide relevant information in guiding the future development of *Shari'ah* governance system. The paper illustrates the **state of *Shari'ah* governance practices** in Malaysia, GCC countries (Kuwait, Bahrain, United Arab Emirates, Qatar and Saudi Arabia) and the UK by highlighting **five main elements** of good corporate governance that consist of **independence, competency, transparency, disclosure and consistency**.

**Design/methodology/approach** – Since the availability of secondary data on *Shari'ah* governance practices is very limited, **a detailed survey questionnaire** is generated for sourcing primary data from Islamic Financial Institutions (IFIs). The study utilizes descriptive analysis approach in extracting and analyzing the data and factual input derived from the questionnaire feedback.

**Findings** – The survey findings affirm that there are significant differences and diverse *Shari'ah* governance practices in the case countries. This position acknowledges that there are shortcomings and weaknesses to the existing governance framework which needs further enhancement and improvement.

**Practical implications** – The paper is a very useful source of information that may provide relevant guidelines in guiding the future development of *Shari'ah* governance practices in IFIs.

**Originality/value** – This paper provides fresh data and recent information on the actual *Shari'ah* governance practices of IFIs in three jurisdictions.

**Keywords** Governance, Islam, Malaysia, Persian Gulf States, United Kingdom

**Paper type** Research paper

### 1. Introduction

*Shari'ah* governance is peculiarly exclusive and unique to the Islamic system of financial management. While affirming the need for a sound and efficient *Shari'ah* governance system as a crucial portion of corporate governance in Islamic Financial Institutions (IFIs), it is nevertheless found that little is written on the subject. In view of the scarcity of literature, this study is considered as a small effort towards contributing to the development of *Shari'ah* governance system by presenting current *Shari'ah* governance practices across jurisdictions. The study employed the survey questionnaire method in getting factual input of the state of *Shari'ah* governance framework and practices.

The survey aimed at understanding current *Shari'ah* governance practices by identifying a regulatory framework (*Shari'ah* board structure, composition, role, function, independence, competence, disclosure and transparency) to create awareness of some of the crucial issues pertinent to *Shari'ah* governance of IFIs and to promote greater understanding of *Shari'ah* governance practices, thereby enabling IFIs to better



safeguard the interests of their stakeholders. The survey demonstrated IFIs' perception of roles played by the *Shari'ah* board and its influence on them.

The survey was sent to selected commercial banks, investment banks and regulatory authorities which offer Islamic financial services from Malaysia, GCC countries (UAE, Bahrain, Saudi Arabia, Qatar and Kuwait) and the UK. The survey was distributed to IFIs in Malaysia, GCC countries and the UK via ordinary mail and e-mail. Personal interviews were also conducted in order to get response from some IFIs. Within these countries, the study limited the scope of the survey to IFIs in the form of commercial banks and investment banks that offer Islamic financial services including regulatory authorities that had established their own *Shari'ah* board.

## 2. Literature review

There are a few studies that have been conducted on *Shari'ah* governance in IFIs across jurisdictions. A survey conducted by Grais and Pellegrini (2006) presented *Shari'ah* board practices in 13 IFIs while Maali *et al.* (2003) studied 29 IFIs and Abomouamer (1989) 41 IFIs. Another study carried out by the International Institute of Islamic Thought in 1996 and a survey by Hasan in the same year also presented some aspects of *Shari'ah* board practices (Bakar, 2002). In spite of all of these surveys, it is nevertheless found that **the majority of them adhered to secondary data and did not address** some pertinent and contemporary issues. In fact, strong growth and rapid development of *Shari'ah* governance practices all over the world make the data and the findings in those surveys less relevant and insignificant. The recent **IFSB survey on *Shari'ah* board** of IFIs across jurisdictions (IFSB, 2008) presented the findings of *Shari'ah* governance practices in 69 IFIs from 11 countries, namely Bahrain, Brunei, Indonesia, Iran, Jordan, Malaysia, Pakistan, Qatar, Sudan, UAE and Bangladesh. The IFSB survey, however, mainly demonstrated perceptions and behavioral responses of IFIs from a macro perspective.

Owing to the lack of literature, fresh data, empirical evidence and micro perspective analysis, the researcher undertakes to carry out a comprehensive survey on *Shari'ah* governance practices which is designed and based on international corporate governance and international *Shari'ah* governance benchmarks. **The survey takes into account the main basic elements of sound *Shari'ah* governance, namely independence, competency, consistency and transparency.** Since the nature of this study is explorative in character, the study chooses three different jurisdictions, i.e. Malaysia, GCC countries[1] and the UK as the case study. This study focuses on the *Shari'ah* governance system practice by these three respective jurisdictions from three different regions as they provide three distinctive models.

## 3. Method

Since the availability of secondary data on *Shari'ah* governance practices is very limited, a detailed survey questionnaire is generated for sourcing primary data from IFIs excluding Islamic insurance institutions. **The survey was distributed to 80 IFIs in Malaysia (20), GCC countries (Bahrain, 12; UAE, 11; Qatar, 10; Kuwait, 10 and Saudi Arabia, 12) and the UK (5) consisting of commercial and investment banks which offer Islamic financial services and regulatory authorities.** The survey excludes Oman as one of the case countries in the GCC region since the government of Oman has resisted implementing *Shari'ah*-compliant banking for political reasons. The IFIs that participated in this survey varied in terms of size and market capitalization and this enabled the study to evaluate current *Shari'ah* governance practices within each individual IFI in various

jurisdictions of the case countries. Figure 1 shows the percentage of research respondents amongst the case countries.

In designing the questionnaires, the study relies on the *OECD Principles of Corporate Governance*, the guidance by the “Basel committee on banking supervision on enhancing corporate governance for banking organizations”, the AAOIFI governance standards (for IFIs) and the IFSB published standards including the *Guidance on Key Elements in the Supervisory Review Process of Institutions offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions)*, the *Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds)* and the *Exposure Draft Guiding Principles on Shari’ah Governance System*.

This survey is divided into eight sections that consist of the general approach of *Shari’ah* governance, regulatory framework, roles of *Shari’ah* board, competence, independence, disclosure and transparency, operative procedures and *Shari’ah* board’s assessment. These sections represent the main elements of sound and proper *Shari’ah* governance system as laid down by the AAOIFI governance standards and the *Exposure Draft of IFSB Guiding Principles on Shari’ah Governance System*.

#### 4. Response rate

The response rate of 39 percent out of 80 IFIs is relatively fair and significant. There is no single response from Qatar and only one from Saudi Arabia and the UK, respectively. The survey was launched on 1 April 2009 and ended on 1 June 2009 (Figure 2).

#### 5. Survey findings

##### 5.1 *Shari’ah* board members

Only six out of 31 IFIs (19 percent) have female *Shari’ah* board members and all of them are from Malaysia. This indicates that the boardroom in GCC countries and the UK is still male territory.

##### 5.2 *General framework of Shari’ah* governance

This section attempts to evaluate the level of commitment of IFIs to *Shari’ah* governance. The study identifies seven questions in order to explore the state of *Shari’ah*

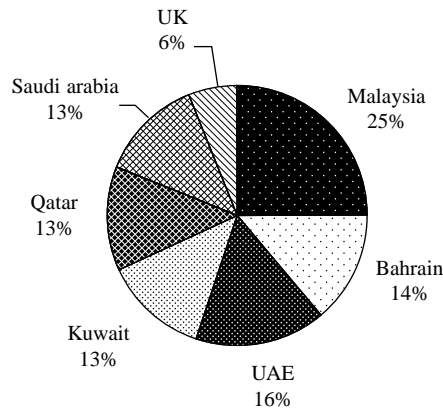
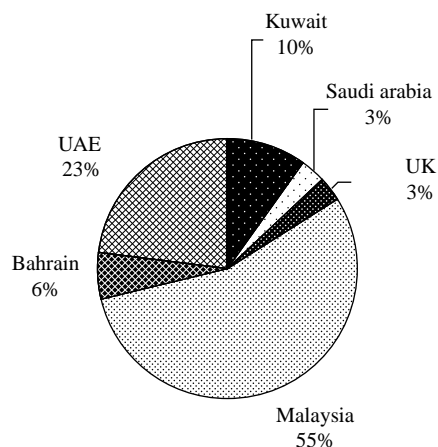


Figure 1.  
Sample description



**Figure 2.**  
Response rate

governance practices in the case countries. Table I illustrates the overall findings of IFIs' commitment to *Shari'ah* governance.

The majority of IFIs (62 percent) did not adopt the AAOIFI governance standards and some of them (45 percent) did not even know of the existence of the *Exposure Draft of IFSB Guiding Principles on Shari'ah Governance System*. About 74 percent of IFIs showed good commitment to *Shari'ah* governance by having standard processes for *Shari'ah compliance, audit and review* and 61 percent of IFIs provided guidelines on *Shari'ah* governance. In general, 74 percent of IFIs indicated that they have a *professional code of ethics for the Shari'ah board*. This demonstrates that 26 percent of IFIs' *Shari'ah* boards had not been guided by a company code of ethics. More than 80 percent of IFIs had established their own internal *Shari'ah* board while 68 percent of IFIs appointed a *Shari'ah* advisory firm for advisory services and 14 percent of IFIs had both an internal *Shari'ah* board and a *Shari'ah* advisory firm. Investment banks preferred to engage a *Shari'ah* advisory firm rather than to have their own *Shari'ah* board (Figure 3).

As a general observation, Malaysia presents a good general framework of *Shari'ah* governance by scoring higher in every question asked compared to GCC countries and the UK. An interesting observation is that despite less interference from regulatory authorities as in the case of Malaysia, IFIs in GCC countries and the UK pro-actively

Questionnaires	Percentage
Q1. Adoption of AAOIFI governance standards	38
Q2. Aware of the IFSB guiding principles on <i>Shari'ah</i> governance system	55
Q3. Standards for <i>Shari'ah</i> governance set for Islamic financial institutions	52
Q4. IFIs' requirement to provide any guidelines for <i>Shari'ah</i> governance	61
Q5. Develop standard processes for <i>Shari'ah</i> compliance, audit and review of the <i>Shari'ah</i> rulings	74
Q6. Professional code of ethics and conduct for members of the <i>Shari'ah</i> board	74
Q7. Organizational arrangement for <i>Shari'ah</i> governance	
Q7.1 Internal <i>Shari'ah</i> board	80
Q7.2 <i>Shari'ah</i> advisory firm	68

**Table I.**  
General framework  
of *Shari'ah* governance

developed their own *Shari'ah* governance framework. In fact, the majority of IFIs in GCC countries have developed their own *Shari'ah* guidelines and standard processes on *Shari'ah* compliance.

5.3 Regulatory framework

The study classifies Malaysia as the proponent of a regulation-based approach; Saudi as passive approach; Qatar, UAE, Kuwait and Bahrain as minimalist approach, and the UK as reactive approach. Thus, this section tries to explore the general understanding and perception of IFIs upon the legal framework of *Shari'ah* governance as illustrated in Table II.

Only 39 percent of IFIs indicated that there are separate rules and regulations concerning *Shari'ah* governance and all of them are from Malaysia. This figure shows that Malaysia is a strong proponent of a regulation-based approach to *Shari'ah* governance system while GCC countries prefer less regulatory interference on the market. About 77 percent of IFIs indicated that the Civil Court has jurisdiction pertaining to cases on Islamic finance, 19 percent of IFIs to *Shari'ah* Court, 45 percent of IFIs to arbitration, 19 percent of IFIs to *Shari'ah* authority such as a Central Bank or Ministry of Awqaf and 6 percent of IFIs to others like a Financial Mediation Bureau. All countries put Islamic finance cases under the Civil Court's jurisdiction and this may

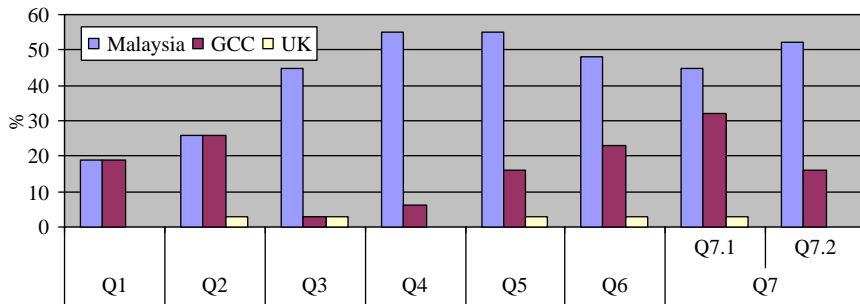


Figure 3. Comparative overview on general framework of *Shari'ah* governance

Questionnaires	Percentage
Q8. Are there separate rules and regulations concerning <i>Shari'ah</i> governance?	39
Q9. Does the bank have any written policies or by-laws specifically referring to the conduct of the <i>Shari'ah</i> board?	58
Q10. What type of dispute settlement is there for redressing legal matters concerning Islamic finance (for example, conflict of laws)?	
Q10.1 Civil Court	77
Q10.2 <i>Shari'ah</i> Court	13
Q10.3 Arbitration	45
Q10.4 <i>Shari'ah</i> Authority of the Central Bank or the Ministry of Religious Affairs	19
Q10.5 Financial Mediation Bureau	6
Q11. What is the legal position of the <i>Shari'ah</i> board's rulings?	
Q11.1 Binding	97
Q11.2 Persuasive	3
Q11.3 Non-binding	3

Table II. Regulatory framework

lead to some legal and *Shari'ah* issues. While acknowledging this important issue, only a few countries provided other alternative legal avenues such as arbitration and national *Shari'ah* board as the highest *Shari'ah* authority. In term of legal status of *Shari'ah* rulings, almost all IFIs (97 percent) indicated that the *Shari'ah* rulings are binding and only 3 percent of IFIs view that it is non-binding and persuasive, respectively, (Figure 4).

A majority of IFIs in Malaysia indicated that there are a comprehensive set of rules and regulations concerning *Shari'ah* governance. At this point, 45 percent of IFIs claimed that they had written policies specifically referring to the conduct of *Shari'ah* board. About 23 percent of IFIs posit that there were alternative legal avenues for Islamic finance disputes in the form of arbitration. With regard to GCC countries, a small percentage of IFIs (6 percent) viewed that there were separate rules and regulations on *Shari'ah* governance and 10 percent of IFIs claimed that they had specific written policies pertaining to *Shari'ah* board. IFIs in the UK on the other hand indicated positively to Q8, Q9, Q10.1 and Q11.1. The overall IFIs in all jurisdictions rightly viewed that Islamic finance cases were put under the auspices of a Civil Court and most of them agreed that there were other alternative legal avenues available such as arbitration and Financial Mediation Bureau.

#### 5.4 Roles of Shari'ah board

The ideal roles of *Shari'ah* board involve *ex ante* and *ex post* aspects of *Shari'ah* governance and these include *Shari'ah* pronouncement (*fatwa*), supervision (*raqabah*) and review (*mutabaah*). The survey attempts to clarify the actual functions of *Shari'ah* board in various IFIs in the case countries. Figure 5 shows the overall finding of the roles of *Shari'ah* board (Table III).

The survey results illustrate that some IFIs had a different perspective on the role and responsibilities of the *Shari'ah* board. Around 85 percent of IFIs considered the *Shari'ah* board as supervisory and advisory while a minority of them (10 percent) as supervisory and (17 percent) as advisory; interestingly, 4 percent of IFIs considered the *Shari'ah* board to have executive power. The majority of IFIs considered their *Shari'ah* board to have advisory and supervisory powers in which they had a responsibility to undertake *ex ante* and *ex post* responsibilities. There is inconsistency to the responses pertaining to *Shari'ah* review. While most of the *Shari'ah* boards had the function of conducting the *Shari'ah* review, only 23 percent of IFIs indicated that their *Shari'ah* board

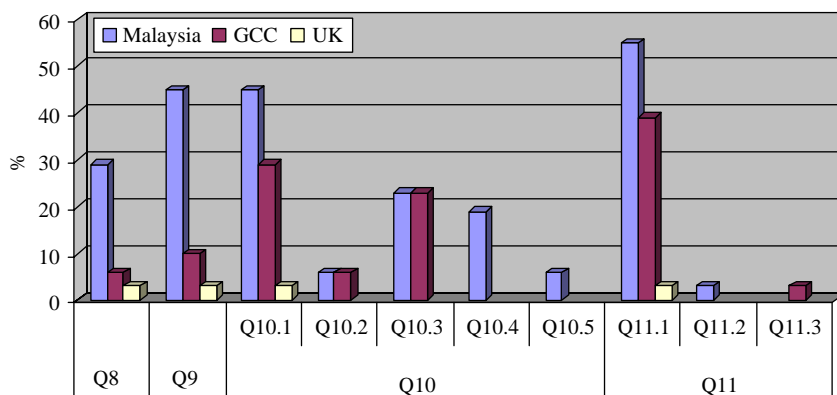
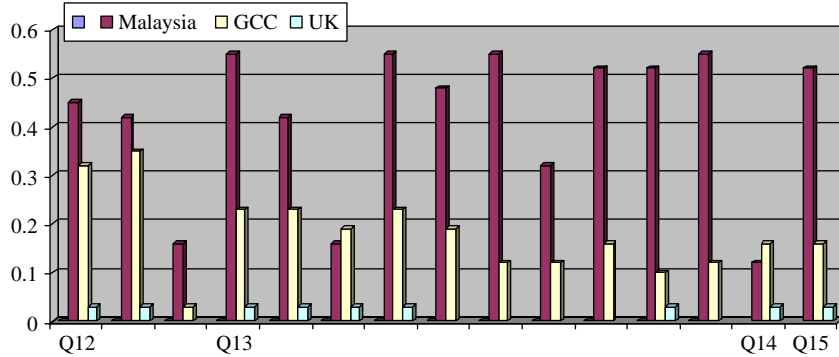


Figure 4.  
Comparative overview of  
regulatory framework

**Figure 5.**  
Comparative overview of  
roles of *Shari'ah* board



Questionnaires	Percentage
Q12. What are the roles of the <i>Shari'ah</i> board?	
Q12.1 Advisory	80
Q12.2 Supervisory	80
Q12.3 Executive	3
Q13. Do the functions of the <i>Shari'ah</i> board include	
Q13.1 <i>Shari'ah</i> pronouncements?	87
Q13.2 <i>Shari'ah</i> review or audit?	68
Q13.3 Endorsing and validating documentation pertaining to the products and services, as well as the internal policies, manuals and marketing advertisements, etc.?	71
Q13.4 Endorsement of <i>Shari'ah</i> compliance?	80
Q13.5 Overseeing the computation and payment of <i>zakah</i> ?	68
Q13.6 Examining any inquiries referred to by the IFIs?	68
Q13.7 Developing <i>Shari'ah</i> approved instruments?	45
Q13.8 Acting as a <i>Shari'ah</i> highest authority pertaining to Islamic finance?	68
Q13.9 Approving model agreements of Islamic modes of financing?	65
Q13.10 Achieving harmonization in the concepts and applications amongst the <i>Shari'ah</i> boards?	61
Q14. Does the <i>Shari'ah</i> board perform the <i>Shari'ah</i> audit?	29
Q15. Does the <i>Shari'ah</i> board have the power to delegate some of its functions to the Internal <i>Shari'ah</i> Compliance Unit?	71

**Table III.**  
Roles of *Shari'ah* board

undertook *Shari'ah* review responsibilities. In the event that the *Shari'ah* board did not undertake the *Shari'ah* review task, 58 percent of IFIs granted authority to the *Shari'ah* board to delegate its function of the *Shari'ah* review to an internal *Shari'ah* compliance unit. This position demonstrates that many *Shari'ah* boards did not conduct *Shari'ah* review as they are only concerned with the *ex ante* aspect of *Shari'ah* governance.

The survey on the roles of the *Shari'ah* board across countries indicates some interesting observations. Most IFIs in Malaysia (45 percent), GCC countries (32 percent) and the UK (3 percent) pointed out that the *Shari'ah* board had only advisory authority while 3 percent of IFIs in GCC considered it to have executive power. This position denotes that the *Shari'ah* board is an independent body that has only advisory and supervisory authorities upon IFIs. Executive power is still in the hands of a board of directors. The overall findings show that the majority of IFIs' *Shari'ah* boards undertakes *ex ante* tasks

of *Shari'ah* governance process. On the other hand, only 12 percent of IFIs in Malaysia, 16 percent of IFIs in GCC countries and 3 percent in the UK carry out *ex post* tasks of *Shari'ah* governance process, namely *Shari'ah* review. This position demonstrates a weak *Shari'ah* governance practice in the aspect of the *Shari'ah* review process particularly in GCC and the UK. In this regard, even IFIs' *Shari'ah* boards in Malaysia and the UK did not perform *Shari'ah* review but that function had been delegated to an internal *Shari'ah* compliance unit (55 percent). Unlike Malaysia and the UK, only 16 percent of IFIs' *Shari'ah* board in GCC countries indicated that the functions had been delegated to an internal *Shari'ah* compliance unit.

### 5.5 Competence

IFIs in various jurisdictions adopt different processes and criteria for *Shari'ah* board. This section specifically demonstrates the mechanism of competency practiced by IFIs in the case countries. Figure 6 shows a general overview on the mechanism of competency of *Shari'ah* board in all three jurisdictions (Table IV).

Most IFIs (64 percent) indicated that they had clear internal fit and proper criteria to access the competence of *Shari'ah* board members prior to their appointment. These criteria nevertheless vary from one IFI to another. More than 60 percent of IFIs had criteria of academic qualifications, track record and good character. Interestingly, the Central Bank of Malaysia (BNM) has added the extra criterion of strategic objectives to its *Shari'ah* board members. In this regard, the BNM has appointed different personnel from various institutions, such as the courts and religious council. While acknowledging the need for expert, experienced and well-known scholars to be included among *Shari'ah* board members, slightly less than 60 percent of IFIs provided professional training especially in the matters of finance and banking to their *Shari'ah* board. Moreover, more than 33 percent of IFIs do not evaluate or assess the performance of their *Shari'ah* board. This figure illustrates that significant numbers of IFIs did not review the *Shari'ah* board's contribution to and role with them even in the event of a renewal of their contracts.

Most IFIs in Malaysia had a comprehensive mechanism to measure the *Shari'ah* board's competency with an average of 42 percent of IFIs having fit and proper criteria as well as criteria of academic qualification, experience and exposure and track record. IFIs in GCC countries and the UK demonstrated quite similar situations except to non-*Shari'ah* background individuals as members of the *Shari'ah* board. Only IFIs in Malaysia (6 percent) had appointed non-*Shari'ah* scholars as members of the *Shari'ah* board and both of these institutions are the Central Bank of Malaysia and the Securities

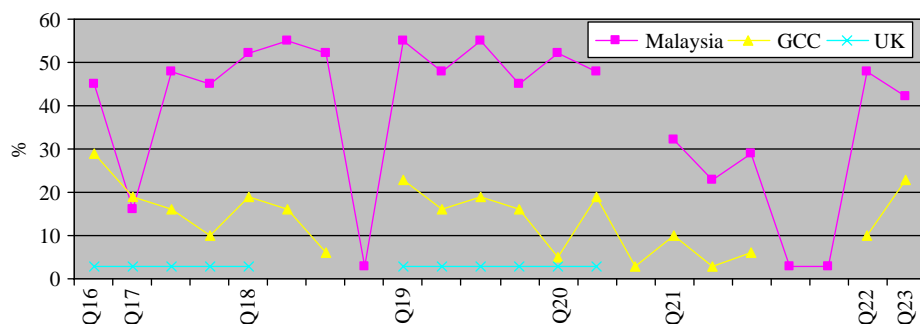


Figure 6.  
Comparative overview on  
mechanism of competency



Questionnaires	Percentage
Q16. Does your institution have policies on the fit and proper criterion for the members of <i>Shari'ah</i> board?	77
Q17. If yes, what are those criteria?	
Q17.1 Academic qualification	74
Q17.2 Experience and exposure (knowledge and skills in financial services industry)	68
Q17.3 Track record	58
Q18. What are the requirements in terms of academic qualifications?	
Q18.1 Specialised in <i>muamalat</i>	71
Q18.2 Specialised in Islamic jurisprudence	68
Q18.3 Knowledge in Arabic and English	58
Q18.4 Knowledge of banking	3
Q19. What are the requirements in terms of experience and exposure?	
Q19.1 Understanding of <i>Shari'ah</i> rules and principles	80
Q19.2 Understanding of general legal and regulatory framework	68
Q19.3 Understanding of the impact of the <i>Shari'ah</i> pronouncement?	77
Q19.4 Skills in the financial services industry	65
Q20. What are the requirements in terms of track record?	
Q20.1 Good character	74
Q20.2 Competence, diligence, capability and soundness of judgment	71
Q20.3 Suitability and exposure in <i>muamalat</i>	3
Q21. In the event your institution allows a non- <i>Shari'ah</i> background individual as a member of the <i>Shari'ah</i> board, what is the qualification for such appointment?	
Q21.1 Well versed in law	42
Q21.2 Well versed in economy	26
Q21.3 Well versed in finance	35
Q21.4 Basic <i>Shari'ah</i>	3
Q21.5 Strategic objective such as representative from religious council	3
Q22. Does the <i>Shari'ah</i> board receive adequate training to understand its role in the internal control process?	58
Q23. Is there any evaluation of the <i>Shari'ah</i> board?	65

**Table IV.**  
Mechanism  
of competency

Commission of Malaysia. As a general observation, this implies that IFIs prefer to have only *Shari'ah* scholars and not other individuals who are not specialized in *muamalat* or *usul fiqh* as members of the *Shari'ah* board for *Shari'ah* deliberation.

In terms of the *Shari'ah* board's training to strengthen their understanding on internal control processes and knowledge of the technical aspect of banking and finance, most IFIs in Malaysia (48 percent) indicated that they had allocated funds and necessary training for their *Shari'ah* board members. A small number of IFIs in GCC countries (6 percent) and none in the UK have initiated the same thing. It is presumed that this good practice of Malaysian IFIs of providing training to *Shari'ah* board members is influenced by the regulatory requirements of the BNM/GPS1. With respect to assessment as to the performance of the *Shari'ah* board, 42 percent of IFIs in Malaysia, 23 percent of IFIs in GCC countries and none in the UK had conducted proper assessments on the *Shari'ah* boards' performance or evaluated their contribution to *Shari'ah* compliance aspects. This significant finding demonstrated that the majority of IFIs did not evaluate the *Shari'ah* board despite the renewal of their contracts. This position presents a weak governance practice as the assessment and evaluation on contract of service by each

individual *Shari'ah* board member is crucial to maintain standards of competency and to avoid any potential conflict of interest.

### 5.6 Independence

There are various ways of ensuring the professional independence of the *Shari'ah* board (Table V). The survey identifies four important elements of independence, namely method of appointment, remuneration, the *Shari'ah* board's mandate and means of mitigating potential conflict of interest. Figure 7 and Table VI present the market practice as to how IFIs manage the issue of *Shari'ah* board independence.

Despite the AAOIFI governance standards' requirement for the appointment to be made by the general assembly, more than 70 percent of IFI appointments were made by the board of directors and only 35 percent of IFIs by the shareholders. As regards the *Shari'ah* board of regulatory authorities, the appointments were made by government. Only 3 percent of IFIs appointed *Shari'ah* board members through its nomination committee. 57 percent of IFIs, respectively, viewed that the *Shari'ah* board should be accountable to shareholders and BOD and the majority of IFIs' BOD determined the *Shari'ah* board's

Questionnaires	Percentage
Q24. Who has the power to approve the appointment and dismissal of the <i>Shari'ah</i> board?	
Q24.1 Shareholders in the annual general meeting	35
Q24.2 Board of directors	71
Q24.3 Management	6
Q24.4 Government	13
Q24.5 Nomination committee	3
Q25. How long is the tenure of the appointment?	
Q25.1 One year	3
Q25.2 Two years	52
Q25.3 Permanent	16
Q25.4 Three years	9
Q26. What do you think is the appropriate body for the <i>Shari'ah</i> board to be accountable to?	
Q26.1 Shareholders	52
Q26.2 Board of directors	61
Q26.3 Management	16
Q26.4 Government	6
Q26.5 National <i>Shari'ah</i> board	3
Q27. Who determines the <i>Shari'ah</i> board remuneration?	
Q27.1 Shareholders	3
Q27.2 Board of directors	58
Q27.3 Management	26
Q28. What mechanisms are in place to mitigate conflict of interest in relation to <i>Shari'ah</i> scholars sitting on various boards?	
Q28.1 Restriction on multiple appointment	38
Q28.2 Disclosure on <i>Shari'ah</i> board's information	52
Q28.3 Declaration in writing	52
Q28.4 Integrity	3
Q29. Is the power and authority of the <i>Shari'ah</i> board clearly mentioned in the following documents?	
Q29.1 Article of association	9
Q29.2 Memorandum of association	19
Q29.3 Letter of appointment	61

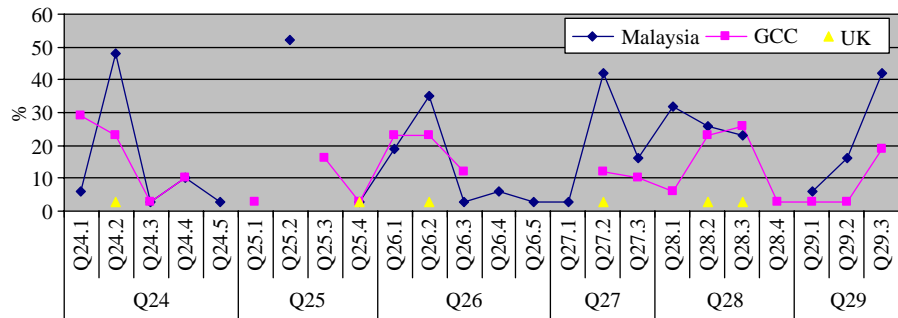
**Table V.**  
Mechanism  
of independence

remuneration whilst a minority of IFIs, i.e. 7 and 4 percent, respectively, indicated that the government and the national *Shari'ah* board could exercise such powers.

Even though most IFIs acknowledged potential conflicts of interest in the event of *Shari'ah* board members sitting on the boards of various institutions, more than 50 percent of IFIs did not have any mechanisms to mitigate such potential conflict. The survey evidences that multiple appointments are a common occurrence in IFIs in GCC countries and this may raise concern for *Shari'ah* scholars maintaining confidentiality. In order to manage this kind of potential conflict, 42 percent of IFIs declared that they imposed restrictions on the *Shari'ah* scholars from sitting on more than one *Shari'ah* board, 52 percent of IFIs made open disclosures on the *Shari'ah* board's composition to the public and 46 percent of IFIs took a declaration in writing.

Most *Shari'ah* board members served IFIs on a contractual or part-time basis and only 10 percent of IFIs' *Shari'ah* board members were permanent workers. This position seems to contradict the AAOIFI governance standards which restricts the appointment of *Shari'ah* board members who work in the same institution. As regards a mandate, more than 40 percent of IFIs did not specify the authority in the letter of appointment as well as more than 80 percent of IFIs in an article or memorandum of association. This figure illustrates that there are uncertainties on the actual authority and mandate of the *Shari'ah* board on the part of *Shari'ah* scholars, employees, management, BOD, shareholders and even the public at large.

Figure 7 shows a comparative overview on mechanisms of independence in the case countries. The overall findings present significant differences in the mechanisms of independence by IFIs in Malaysia, GCC countries and the UK. Most IFIs (48 percent) in Malaysia indicated that the appointment is made by the board of directors, only 6 percent of IFIs by shareholders, 3 percent of IFIs by management and 10 percent of IFIs



**Figure 7.**  
Comparative overview  
of mechanism  
of independence

**Table VI.**  
Mechanisms  
of transparency  
and confidentiality

Questionnaires	Percentage
Q30. Does the <i>Shari'ah</i> board have a written policy in respect of the preparation and dissemination of <i>Shari'ah</i> information?	52
Q31. Does the <i>Shari'ah</i> board have access to all documents, information, records, etc.?	77
Q32. Are the <i>Shari'ah</i> pronouncements published and made known to the public?	35
Q33. Is the <i>Shari'ah</i> board fully aware of the issue of confidentiality and sensitive information obtained in the course of performing their duties?	71

by government. On the other hand, most IFIs in GCC countries indicated that the appointment was made by shareholders, 23 percent of IFIs by BOD, 3 percent of IFIs by management and government, respectively. In the case of the UK, the appointment is made by BOD. While most IFIs in GCC countries (32 percent) indicated that the appropriate body for the *Shari'ah* board to be accountable to be shareholders, the practice showed that 23 percent of IFIs' *Shari'ah* boards were appointed by BOD and 42 percent of IFIs indicated that their remuneration was also determined by BOD. This position shows inconsistency between the "ideal" and "actual" *Shari'ah* governance practice particularly towards mechanisms of independence. Although the practice in Malaysia seems to raise an issue of potential conflict of interest, such conflict is mitigated by requiring all the appointments to be made subject to the approval from the BNM.

In terms of other mechanisms in place to mitigate conflicts of interest, 32 percent of IFIs in Malaysia indicated a restriction on multiple appointments, 26 percent of IFIs on disclosure of the *Shari'ah* board's information and 23 percent of IFIs on declaration in writing. This position demonstrates that *Shari'ah* governance practice in Malaysia has initiated various means of mitigating potential conflicts of interest of the *Shari'ah* board. In the case of GCC countries, 6 percent of IFIs indicated that they had a policy of restriction on multiple appointments, 23 percent of IFIs on disclosure on *Shari'ah* board's information and 26 percent of IFIs on declaration in writing. IFIs in the UK indicated that they only had a policy on disclosure of *Shari'ah* board's information and written declaration.

With regard to the issue of mandate and authority, most IFIs in Malaysia (42 percent) and less than 19 percent of IFIs in GCC countries indicated that the power and authority of the *Shari'ah* board were mentioned in the letter of appointment. About 6 percent of IFIs in Malaysia indicated that the authority was confirmed by article of association and 16 percent of IFIs by memorandum of association while 3 percent of IFIs in GCC countries by both article and memorandum of association, respectively. IFIs in the UK did not give any indication on this aspect. The overall finding implies that some IFIs do not grant a full mandate or fail to provide a clear mandate and authority to the *Shari'ah* board.

### 5.7 Transparency and confidentiality

The existing literature evidenced that *Shari'ah* governance practices in IFIs were less transparent. The survey attempts to explore the mechanism used by IFIs to ensure transparency and to observe confidentiality. The survey identifies one question on the aspect of confidentiality and three questions on transparency, i.e. written policy on preparation and dissemination of *Shari'ah* information, right to access all documents and necessary information and publication of *Shari'ah* rulings. Figure 8 shows the *Shari'ah* governance practice of the case countries on the mechanisms of transparency and confidentiality.

Surprisingly, less than 54 percent of IFIs did not have a written policy on the preparation and dissemination of *Shari'ah* information. In addition, not all IFIs granted authority to the *Shari'ah* board to have access to all documents, information and records for the purpose of *Shari'ah* compliance. This is a serious issue since the *Shari'ah* board is expected to endorse a declaration of *Shari'ah* compliance in the annual report. This position may disrupt the effectiveness of the *Shari'ah* review process and its impact is likely to be of material significance across the Islamic banking industry. Moreover, more than 68 percent of IFIs did not publish *Shari'ah* pronouncements which were

of the essence to all organs of governance, customers and depositors, as well as public. These overall responses demonstrate that IFIs are less transparent.

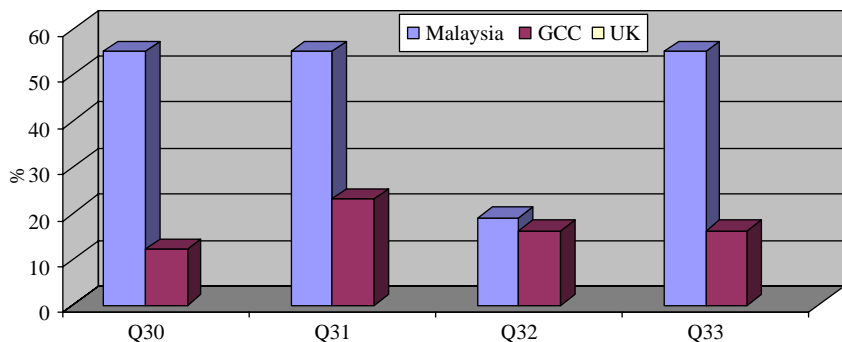
Figure 8 shows the *Shari'ah* governance practice with regard to transparency and confidentiality. These two elements are very important for a good and sound *Shari'ah* governance framework. Table VII demonstrates that 35 percent of IFIs in Malaysia and only 10 percent of IFIs in GCC countries indicated that they had a written policy with respect to the preparation and dissemination of *Shari'ah* information. All IFIs in Malaysia indicated that they granted full authority to the *Shari'ah* board to have access to all documents and information while only 23 percent of IFIs in GCC countries did the same thing. A small number of IFIs in Malaysia (16 percent) and GCC countries (12 percent) indicated that they had published *Shari'ah* rulings and made them known to the public.

In terms of confidentiality, all IFIs in Malaysia and 12 percent of IFIs in GCC countries indicated that their *Shari'ah* boards were fully aware of sensitive information obtained in the course of performing their duties. Surprisingly, IFIs in the UK had not issued any policy or authority on the mechanisms of transparency and confidentiality. Presumably, IFIs in the UK are bound to comply with existing corporate laws and related regulation concerning transparency and confidentiality without needing a separate internal policy on *Shari'ah* governance. The overall findings tend to suggest that *Shari'ah* governance practice on transparency and disclosure is still low and needs reform in order to maintain IFIs' credibility and accountability.

### 5.8 Operational procedures

Different IFIs adopt various processes and procedures on the aspect of *Shari'ah* compliance process. The survey attempts to discover the state of operational procedures in the context of *Shari'ah* governance practice particularly to standard operative procedures, *Shari'ah* board meetings, quorum, basis of decision, voting rights, preparation and dissemination of documents to the *Shari'ah* board, the *Shari'ah* report and its content, and the institutional arrangement for the *Shari'ah* review. Table VII and Figures 9 and 10 show the different practices of IFIs pertaining to operational procedures on the *Shari'ah* compliance process.

The majority of IFIs have standard operative procedures for *Shari'ah* governance. About 46 percent of IFIs conducted weekly meetings, 7 percent monthly, 39 percent quarterly, 14 percent annually and on an *ad hoc* basis and 4 percent twice a month and every two months. Most of the *Shari'ah* boards' decisions were made by consensus. Interestingly, 57 percent of IFIs submitted an agenda and documents to the *Shari'ah*



**Figure 8.**  
Comparative overview  
of mechanisms  
of transparency  
and confidentiality

Questionnaires	Percentage
Q34. Is there any standard operative procedure for <i>Shari'ah</i> board?	42
Q35. Does the <i>Shari'ah</i> board hold its meeting regularly?	
Q35.1 Weekly	16
Q35.2 Monthly	35
Q35.3 Quarterly	19
Q35.4 Annually	
Q35.5 Twice a month	3
Q35.6 <i>Ad hoc</i>	16
Q35.7 Every two months	3
Q35.8 Semi-annually	6
Q36. What is the quorum for the <i>Shari'ah</i> Board Meeting?	
Q36.1 Three	45
Q36.2 Five	
Q36.3 Seven	
Q36.4 Six	3
Q36.5 Two	19
Q37. On what basis are decisions made at the <i>Shari'ah</i> Board Meeting?	
Q37.1 Simple majority	32
Q37.2 Two-thirds majority	9
Q37.3 Consensus	45
Q38. In the event of the <i>Shari'ah</i> board consisting of non- <i>Shari'ah</i> background members, do they have the right to vote?	29
Q39. Is an agenda prepared and distributed in advance of <i>Shari'ah</i> board meetings?	
Q39.1 A week in advance	58
Q39.2 Two weeks in advance	0
Q39.3 A month in advance	6
Q39.4 Ten days in advance	3
Q39.5 Three days in advance	3
Q40. Who is responsible for dealing with the organization of the <i>Shari'ah</i> board meetings?	
Q40.1 Internal <i>Shari'ah</i> officer	68
Q40.2 Company secretary	3
Q40.3 Head of product development	3
Q40.4 Head of the legal department	3
Q40.5 Islamic capital market department	3
Q40.6 Outsource company	3
Q41. Besides the <i>Shari'ah</i> board, who attends the meeting?	
Q41.1 Representative from the internal <i>Shari'ah</i> compliance unit	71
Q41.2 Representative from risk management department	19
Q41.3 Representative from Legal Department	19
Q41.4 Representative from product department	32
Q41.5 Representative from external legal firm	6
Q41.6 Representative from the IFIs (for example, in the case of the <i>Shari'ah</i> board at the regulatory level)	9
Q41.7 Management	6
Q41.8 Executive director	3
Q41.9 Managing director	3
Q41.10 Board risk committee	3
Q41.11 Chief internal auditor	3
Q41.12 Company secretary	3
Q41.13 CEO	3

(continued)

**Table VII.**  
Operational procedures

Questionnaires	Percentage
Q42. Are the <i>Shari'ah</i> pronouncements reviewed whenever necessary?	71
Q43. Is the <i>Shari'ah</i> board required to submit a <i>Shari'ah</i> report?	68
Q44. What are the contents of the <i>Shari'ah</i> report?	
Q44.1 Information on duties and services of the <i>Shari'ah</i> board	32
Q44.2 <i>Shari'ah</i> pronouncement	45
Q44.3 <i>Shari'ah</i> board activities	32
Q44.4 Declaration of <i>Shari'ah</i> compliance	68
Q45. What is the organizational arrangement for the internal <i>Shari'ah</i> review?	
Q45.1 Independent division/department	77
Q45.2 Part of the internal audit department	29
Q45.3 Outsource company	3
Q45.4 <i>Shari'ah</i> division	3
Q45.5 <i>Shari'ah</i> compliance unit	3

Table VII.

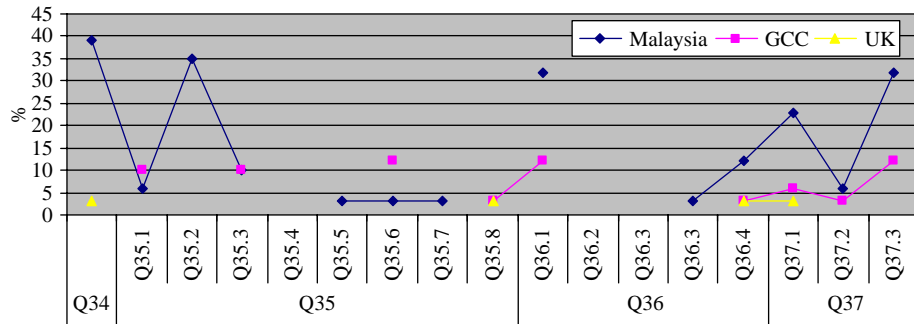


Figure 9.  
Comparative overview of operational procedures (Q34-Q37)

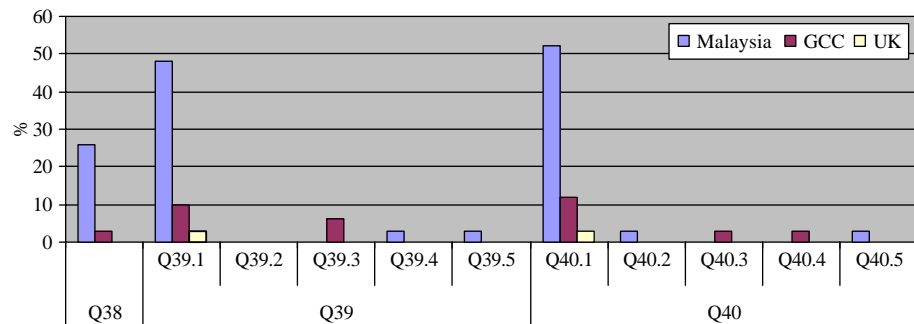


Figure 10.  
Comparative overview of operational procedures (Q38-Q40)

board a month in advance (all of them from GCC countries) while 25 percent of IFIs a week in advance and most of them represented IFIs in Malaysia. The *Shari'ah* Board Meeting was attended by various parties including the Executive director, CEO, managing director, board's risk committee, internal auditor, legal advisor and so on and so forth. In the event that the *Shari'ah* board consists of non-*Shari'ah* background members, 75 percent of IFIs did not grant voting right to them.

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According to the survey, 60 percent of IFIs confirmed that the *Shari'ah* board was required to submit a *Shari'ah* report and this indicated that more than 40 percent of IFIs did not issue a *Shari'ah* report. With respect to the contents of the report, most IFIs (60 percent) just published a declaration of *Shari'ah* compliance rather than details of the *Shari'ah* compliance activities. This illustrates poor disclosure on the part of IFIs upon *Shari'ah*-related information. In terms of the *Shari'ah* review, 75 percent of IFIs set up an independent department, 32 percent of IFIs conducted the review as part of an internal audit department and 4 percent of IFIs to an outsourced company. A sound *Shari'ah* internal audit mechanism is a tool to deter malpractice and to mitigate *Shari'ah* non-compliance risk. With 75 percent of IFIs having an independent internal *Shari'ah* review department and 32 percent of IFIs as part of their internal audit division, this clearly indicated that most IFIs undertook a continuous *Shari'ah* compliance review.

Significant variations were found across the case countries on the operational aspect of *Shari'ah* governance practice. Most IFIs in Malaysia (39 percent) indicated that they had standard operative procedures for *Shari'ah* governance process while 3 percent of IFIs in the UK and no IFIs in GCC countries indicated the same. IFIs in GCC countries indicated a lower standard of practice in terms of providing clear operative procedures of *Shari'ah* governance process. In terms of *Shari'ah* board meetings, IFIs in the case countries had conducted more than four meetings per year where 6 percent of IFIs in Malaysia and 10 percent of IFIs in GCC countries indicated that they had conducted weekly meetings, 35 percent of IFIs in Malaysia, monthly meetings, 10 percent of IFIs in Malaysia and GCC countries, respectively, quarterly meetings and 12 percent of IFIs in GCC countries had an *ad hoc* basis for holding meetings. A small percentage of (3 percent) IFIs in GCC countries and the UK indicated that they have conducted less than four meetings per year.

As regards the quorum for the *Shari'ah* Board Meeting, 12 percent of IFIs in GCC countries and 32 percent of IFIs in Malaysia indicated that three *Shari'ah* board members were the quorum. Only a minority of IFIs indicated that the quorum was six and two. With respect to the decision-making process, most IFIs in Malaysia (23 percent), 6 percent of IFIs in GCC countries and 3 percent in the UK indicated that decisions made at the *Shari'ah* Board Meeting is based on a simple majority while 32 percent of IFIs in Malaysia and 12 percent of IFIs in GCC countries by consensus. This practice demonstrates that the majority of IFIs prefer the decision to be made by consensus rather than simple majority or two-thirds majority.

In the event of the *Shari'ah* board consisting of non-*Shari'ah* individual members, 26 percent of IFIs in Malaysia and 3 percent of IFIs in the UK indicated that they should have voting rights while the majority IFIs preferred to give such rights to *Shari'ah* scholars. Most IFIs in Malaysia (48 percent) and 10 percent of IFIs in GCC countries and 3 percent of IFIs in the UK indicated that the agenda and documents for the *Shari'ah* Board Meeting is prepared and distributed a week in advance. Interestingly, 6 percent of IFIs in GCC countries indicated that they submitted the agenda and documents to the *Shari'ah* board a month in advance. In terms of *Shari'ah* coordination, most IFIs in Malaysia (52 percent), 16 percent of IFIs in GCC countries and 3 percent of IFIs in the UK indicated that their internal *Shari'ah* officer was responsible for handling the *Shari'ah* Board Meeting and *Shari'ah*-related matters. The minority of IFIs granted the responsibility to the Company Secretary, Head of Product Development, Head of the Legal Department, representative from capital market and the outsource company (Figure 11).



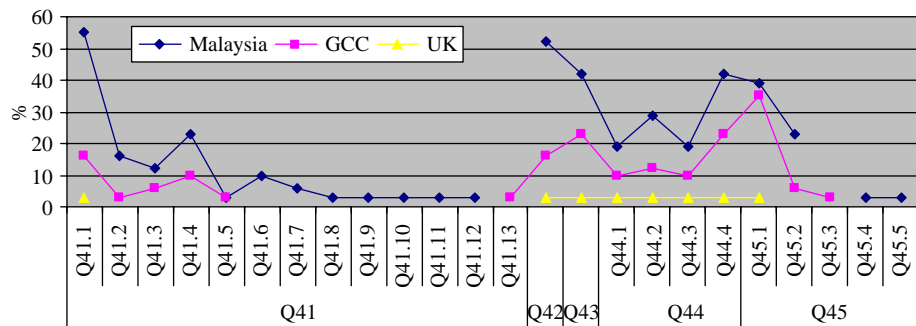
With respect to attendees of the *Shari'ah* Board Meeting, all IFIs in Malaysia, 16 percent of IFIs in GCC countries and 3 percent of IFIs in the UK indicated that the representative from the internal *Shari'ah* compliance unit was a permanent attendee. Besides that, there were some other parties who were invited to attend the meeting such as a representative from the risk management department (16 percent of IFIs in Malaysia and 3 percent of IFIs in GCC countries) and from product development (12 percent of IFIs in Malaysia and 6 percent of IFIs in GCC countries). The survey finds some interesting observations to *Shari'ah* governance practice in Malaysia when some IFIs invited the CEO, managing director, executive director, board risk committee, and/or chief internal auditor to attend the *Shari'ah* board meeting.

In the aspect of reviewing *Shari'ah* rulings, almost all IFIs in Malaysia (52 percent), 16 percent of IFIs in GCC countries and 3 percent of IFIs in the UK indicated that they had conducted such a review. On another aspect of the review, namely the *Shari'ah* compliance review, 55 percent of IFIs in Malaysia and 35 percent of IFIs in GCC countries indicated that they had established an independent division for that purpose. A small number of IFIs in the case countries indicated that the *Shari'ah* compliance review was conducted by the existing internal audit department and some of them had even appointed a *Shari'ah* advisory firm to perform that task.

Despite the regulatory requirement to submit a *Shari'ah* report in Malaysia, only 42 percent of IFIs indicated that the *Shari'ah* board was required to submit a *Shari'ah* report. Even in the absence of such a regulatory requirement as in the case of Malaysia, 16 percent of IFIs in GCC countries and 3 percent of IFIs in the UK indicated that the *Shari'ah* report was part of their internal requirement. In terms of the content of the *Shari'ah* report, 19 percent of IFIs in Malaysia indicated that the *Shari'ah* report contained information on duties and services of the *Shari'ah* board, 29 percent of IFIs on *Shari'ah* pronouncements, 19 percent of IFIs on the *Shari'ah* board activities and 42 percent of IFIs on a declaration of *Shari'ah* compliance. A similar situation occurred in the case of GCC countries and the UK where the majority IFIs indicated that the content of the *Shari'ah* report is just a declaration of *Shari'ah* compliance.

**5.9 General assessments of the *Shari'ah* board**

There have been numerous criticisms and negative allegations on the roles and functions played by the *Shari'ah* board. The problem with all sorts of criticisms is that such allegations have not been proven or supported by any empirical evidence or reliable data. The survey identifies five questions specifically to address this important issue.



**Figure 11.** Comparative overview of operational procedures (Q41-Q45)

These five questions consist of a general assessment of IFIs upon their *Shari'ah* board in terms of organisational accountability, communication with other organs of governance, ability to identify and evaluate *Shari'ah* non-compliance risk, contribution to promoting Islamic ethics and values as well as the *Shari'ah* control process. Table VIII and Figure 12 show the general IFIs' perception in the case countries upon the performance of their *Shari'ah* boards.

Regardless of numerous criticisms upon the *Shari'ah* board, the overall responses demonstrate that most IFIs are satisfied with performance of their *Shari'ah* board. Only 4 percent of IFIs viewed that the *Shari'ah* board had failed to identify and evaluate *Shari'ah* compliance risk and to promote continuous improvement on *Shari'ah* control processes and 7 percent of IFIs had neglected the duty to promote Islamic values and ethics. With understanding that the response might be biased on the part of IFIs since they engage services from the *Shari'ah* board, findings of more than 4 percent on the failure of the *Shari'ah* board to identify and evaluate *Shari'ah* non-compliance risk and to promote Islamic ethics and values is considered slightly significant.

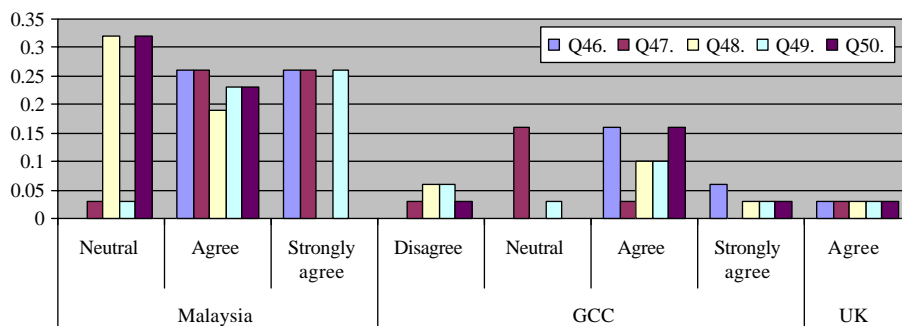


Figure 12. Comparative overview of perception of performance of the *Shari'ah* board

Questionnaires	Percentage				
	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
Q46. The <i>Shari'ah</i> board has demonstrated effective organisational accountability				45	32
Q47. The <i>Shari'ah</i> board has communicated effectively with other organs of governance, including the BOD, management and auditors		3	19	22	25
Q48. The <i>Shari'ah</i> board has properly identified and evaluated the organisation's exposure to <i>Shari'ah</i> non-compliance risk and reputational risk, and effectively communicate that risk information to appropriate bodies in the organization		6	32	28	3
Q49. The <i>Shari'ah</i> board has promoted Islamic ethics and values within the organization		6	6	35	28
Q50. The <i>Shari'ah</i> board has promoted continuous improvement of an organization's <i>Shari'ah</i> control processes		3	32	42	3

Table VIII. Perception of performance of the *Shari'ah* board

Figure 12 shows IFIs' perception on the roles and functions played by the *Shari'ah* board in five aspects, namely accountability, organizational communication, *Shari'ah* non-compliance risk, Islamic ethics and values and *Shari'ah* control process. The overall findings in Malaysia indicated that IFIs were generally satisfied with the performance of the *Shari'ah* board where 26 percent of IFIs strongly agree on Q46, Q47 and Q49; 26 percent of IFIs agree on Q46 and Q47 and 32 percent of IFIs neutral on Q48 and Q50. None of the IFIs in Malaysia indicated a negative perspective on the assessment of their *Shari'ah* board. Similarly to IFIs in the UK, they were equally agree on Q46-Q50. Unlike Malaysia, some interesting observations are found on the perception of IFIs in GCC countries. While the majority of IFIs agree on Q46 (5), Q47 (1), Q48 (3), Q49 (3) and Q50 (5), a small percentage of IFIs indicated that they were dissatisfied with the performance of the *Shari'ah* board where 3 percent of IFIs disagree on Q47, 6 percent of IFIs disagree on Q48 and Q49 and 3 percent of IFIs disagree on Q50. This interesting finding tends to show that some IFIs have identified that the *Shari'ah* board has neglected some important aspects of *Shari'ah* governance particularly the effectiveness of organizational communication, identifying *Shari'ah* non-compliance risk, contributing to Islamic ethics and values as well as the *Shari'ah* control process. This finding positively affirms that the assessment and evaluation of the *Shari'ah* board's performance is of the essence to IFIs.

## 6. Conclusion

The survey responses affirm that IFIs in these three jurisdictions have different and diverse *Shari'ah* governance practices and further acknowledge that there are shortcomings and weaknesses in the current governance framework. Based on the overall survey findings, the existing *Shari'ah* governance framework needs further enhancement and improvement in the following areas.

### 6.1 Commitment to *Shari'ah* governance

IFIs are encouraged to adopt the international benchmark for their *Shari'ah* governance particularly the AAOIFI governance standards and the IFSB guidelines. For the purposes of better implementation, IFIs shall set up a governance committee at the BOD level and issue an annual *Shari'ah* governance report. In addition, the *Shari'ah* governance standard is strongly recommended to be made mandatory by law. The regulatory authorities shall issue standards for compliance with all laws and regulations and responsibility pertaining to *Shari'ah* governance. A proper and integrated *Shari'ah* coordination governance framework may be able to resolve the issue of the remit of *Shari'ah* boards. The framework of *Shari'ah* coordination or any possible means must be able to facilitate effective communication and interactions amongst the *Shari'ah* boards. At this point, an integrated *Shari'ah* coordination framework amongst the individual IFIs' *Shari'ah* boards as well as the *Shari'ah* board at the regulatory level would be able to promote more interactive communication and effective interaction for the purpose of harmonization of practice and minimizing of conflict.

### 6.2 Regulatory framework

The IFIs shall have explicit laws and regulations for the *Shari'ah* governance system. Such regulations may adopt the AAOIFI governance standards and the IFSB guidelines as benchmarks. In the meantime, the regulatory authority shall provide proper legal

avenues for dispute settlement pertaining to Islamic finance and to ensure that *Shari'ah* rulings issued by the *Shari'ah* board are made binding.

### *6.3 Functioning and responsibilities of the Shari'ah board*

IFIs shall ensure that the *Shari'ah* board has advisory and supervisory functions which grant them power to undertake *ex ante* and *ex post* responsibilities. The executive power shall be in the hands of BOD. A full mandate shall be given to *Shari'ah* boards by allowing them to undertake the *Shari'ah* review task or to grant them full authority to delegate it to an internal *Shari'ah* audit division. In addition, the IFIs shall also have a code of conduct and ethical behavior for *Shari'ah* board members as well as the internal *Shari'ah* reviewer.

### *6.4 Independence*

IFIs shall ensure that the *Shari'ah* board is fully independent by invoking the necessary means to mitigate any potential conflict of interest. IFIs are recommended to grant a full mandate with clear terms of reference and to give sufficient powers and proper organizational status of *ex ante* and *ex post* responsibilities. IFIs are also encouraged to set up a governance committee at the board level that has the specific function of monitoring and evaluating the institution's governance aspects including the roles and efficiency of the *Shari'ah* board. This governance committee shall consist of independent board members and representatives of the *Shari'ah* board who are able to evaluate and assess the *Shari'ah* board fairly.

### *6.5 Competence*

IFIs are recommended to have a policy of fit and proper criteria with respect to the selection of *Shari'ah* board members as well as *Shari'ah* reviewers approved by the regulatory authority. IFIs are recommended to have a combination of so-called local and international *Shari'ah* scholars. It is also encouraged to have male and female *Shari'ah* board members. Gender shall not be the issue and the most important thing is that the composition of the *Shari'ah* board should include members with full qualifications and integrity who have the ability to exercise their expertise and skills on *Shari'ah* matters. The IFIs shall allocate funds to provide professional training to their *Shari'ah* board members pertaining to banking and finance. In the meantime, this requirement shall be made mandatory upon IFIs by regulatory authorities. IFIs are also recommended to periodically assess and evaluate the performance and contribution of the *Shari'ah* board to the *Shari'ah* governance process.

### *6.6 Disclosure and transparency*

IFIs shall have written policies concerning the dissemination of information as well as improving the degree of disclosure particularly in their financial and non-financial aspects such as the *Shari'ah* board's remuneration and material issues regarding employees. IFIs are also recommended to disclose details of the *Shari'ah* board's information, *Shari'ah* pronouncements, *Shari'ah* reports and organizational charts through their web site.

Besides, IFIs shall have more disclosure to the investment account holders (IAH) as they are considered as part of the shareholders. In this aspect, the IFIs shall recognize the IAH's right to monitor the performance of their investment and the associated risks,

to inform *ex ante* IAH of the risk profile of the institution, investment strategy and associated risks and to make adequate and timely disclosures to IAH and the public of material and relevant information on the investment accounts that they manage.

#### 6.7 Operational procedures

IFIs are recommended to have internal standard operative procedures of *Shari'ah* governance process in terms of meeting, *Shari'ah* coordination, the *Shari'ah* report and the *Shari'ah* review. The IFIs shall ensure that the board's meeting be conducted at least four times a year and to have standard operative procedures. It is also important for the *Shari'ah* board to conduct self-evaluation and cross-assessment. These are very important as references to all organs of governance in IFIs for the purposes of the *Shari'ah* compliance process. The IFIs shall have sound risk management by having rigorous external and internal control processes particularly pertaining to *Shari'ah* matters. The setting up of an independent department with dedicated staff with technical know-how is also critical. There must be continuous *Shari'ah* compliance review with proper reporting structures as standard operational procedures for the *Shari'ah* governance process in IFIs.

#### 6.8 Embedded functions and responsibilities of the *Shari'ah* board

Owing to the above findings, it is strongly recommended that the framework of the *Shari'ah* board shall be enhanced by not only concern for technical aspects and legalities of Islamic financial products. The *Shari'ah* board shall promote Islamic values, ethics and add value to Islamic finance practice. At this point, the *Shari'ah* board must conduct self-assessment and evaluation while IFIs undertake ongoing assessment on the performance of the *Shari'ah* board. With the purpose of ensuring the integrity and competency of the *Shari'ah* board, IFIs shall have an internal code of conduct for the *Shari'ah* board that would be able to provide reasonable assurances on *Shari'ah* compliance aspects.

It is strongly believed that the need for the above enhancement of *Shari'ah* governance practice is really crucial and would then strengthen the performance and credibility of IFIs. In this regard, regulatory authorities shall take the initiative to establish *Shari'ah* governance standards or to adopt the existing *Shari'ah* governance prudential standards for IFIs. It is firmly believed that sound *Shari'ah* governance practice would enhance the potential role of Islamic finance in contributing towards corporate reform and to mitigate certain types of risk exclusive to IFIs which would then contribute to national, regional and global financial stability.

#### Note

1. The value of *Shari'ah*-compliant assets for Saudi Arabia, the UAE, Qatar, Bahrain and Kuwait alone are worth over US\$262.6 billion and accounted for 41 percent of the total world *Shari'ah*-compliant assets (Wilson, 2009). This simply demonstrates the emergence and need of a strong and robust *Shari'ah* governance framework to address the issues pertaining to *Shari'ah* matters.

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