

Shari'ah Supervision of Islamic Banking From Regulatory Perspective

Dr. Mohamad Akram Laldin

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PREAMBLE

- Among the duties of the Shari'ah Council, as stated in the statutes of the Accounting and Auditing Organization for Islamic Financial Institutions is the following:
 - To bring about mutual conformity or approximation between the conceptualizations and the practical applications of Shari'ah supervisory boards of Islamic financial institutions so as to avoid inconsistencies and contradictions between the fatawa and the implementations of these institutions in ways that lead to the effectiveness of the role of Shari'ah supervisory boards in Islamic financial institutions and central banks.

DEFINITION

- Shari'ah advisors are generally people who are entrusted to ensure the compliance aspects of particular products and instruments used in the Islamic Finance industry which broadly includes banking, capital market and takaful.
- AAIOFI: Shari'ah advisors are specialized jurists particularly in Fiqh Muamalah and Islamic Finance entrusted with the duty of directing, reviewing and supervising the activities related to Islamic finance in order to ensure that they are in compliance with Shari'ah rules and principles. The views of the Shari'ah advisor shall be binding in the specific area of supervision.

MODELS OF SHARI'AH ADVISORY SERVICES

- Central Shariah Advisory Council and different Shariah Advisory Boards at Banks level, (Malaysia, Pakistan, Sudan)
- Shariah Advisory Boards at Bank Level only (GCC)
- Outsourcing of Shariah Advisory Services (Europe)
- Central Shariah Board for the whole Group (Dallah al-Barakah)
- Individuals undertaking the Shariah Advisory role

MALAYSIAN MODEL OF SAC

- Bank Negara Malaysia has amended the Central Bank of Malaysia Act 1958 to enhance the role and functions of its Shariah Advisory Council for Islamic Banking and Takaful (SAC).
- This amendment has accorded the SAC as the sole Shariah authority in Islamic finance. As the sole Shariah authority, the SAC will be referred to by the court or arbitrator in disputes involving Shariah issues in Islamic banking, finance and takaful cases.

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- To effectively play its role, the SAC operates as an independent body. An independent SAC with high level of integrity will command public confidence and thereby will boost the industry to a greater height. There is also a crucial need to define the relationship between the SAC and Shariah bodies which act as Shariah advisers in the industry.
- Towards this end, the Shariah bodies in the Islamic financial institution need to be rationalised. A Shariah body in the industry which is to be known as a Shariah Committee, will play a complementary role to the SAC of Bank Negara Malaysia.

ESTABLISHMENT OF SHARIAH COMMITTEE

- Every Islamic financial institution is required to establish a Shariah Committee.
- In the case of a BAFIA IBS bank, it may establish one Shariah Committee for the banking group.
- However, if a takaful operator is part of that group, the takaful operator must establish its own separate Shariah Committee, due to the legal requirement under the TA.

MEMBERSHIP OF SHARIAH COMMITTEE

- The BOD of an IFI shall appoint the members of the Shariah Committee.
- The appointment and reappointment of a Shariah Committee member shall obtain prior written approval of BNM. The appointment shall be valid for a renewable term of two years.
- In approving the appointment and reappointment, Bank Negara Malaysia may impose necessary conditions it deems fit in addition to the requirements in these Guidelines. The failure to comply with any of such conditions shall nullify the approval.

QUALIFICATION & COMPOSITION

- A member of a Shariah Committee shall be an individual.
- A company, institution or body shall not constitute a Shariah Committee for the purpose of these Guidelines.
- The proposed member of the Shariah Committee shall at least either have qualification or possess necessary knowledge, expertise or experience in the following areas:
 - Islamic jurisprudence (Usul al-Fiqh); or
 - Islamic transaction/commercial law (Fiqh al-Mu'amalat).
- The composition of the Shariah Committee shall consist a minimum of three (3) members.

SECRETARIAT

- Islamic financial institution is required to have a minimum of one officer, preferably a person with knowledge in Shariah, who will serve as the secretariat to the Shariah Committee.

DISQUALIFICATION

- The members of the Shariah Committee shall be persons of acceptable reputation, character and integrity. Any member may be disqualified due to:
 - He has acted in a manner which may cast doubt on his fitness to hold the position of a Shariah Committee member;
 - He has failed to attend 75 per cent of meetings scheduled for Shariah Committee in a year without reasonable excuse;
 - He has been declared a bankrupt, or a petition under bankruptcy laws is filed against him;
 - He was found guilty for any serious criminal offence, or any other offence punishable with imprisonment of one year or more; or
 - He is subject to any order of detention, supervision, restricted residence or banishment.

RESIGNATION AND TERMINATION

- An Islamic financial institution shall notify Bank Negara Malaysia of any resignation or termination of a member of the Shariah Committee within fourteen days of the date of resignation or termination. The notice shall state the reasons of such termination.

RESTRICTIONS ON SHARIAH COMMITTEE

- In line with section 16B(6) of the Central Bank of Malaysia Act 1958, an Islamic financial institution is not allowed to appoint any member of the SAC to serve in its Shariah Committee; and
- To avoid conflict of interest and for reasons of confidentiality within the industry, an Islamic financial institution shall not appoint any member of a Shariah Committee in another Islamic financial institution of the same industry.
- For this purpose, Islamic financial institutions which are regulated under the IBA, BAFIA and DFIA are classified as of the "Islamic banking industry", whilst Islamic financial institutions that are regulated under the TA are classified as of the "takaful industry".
- Memberships in other categories of industry are excluded from the restriction.

DUTIES AND RESPONSIBILITIES OF SHARIAH COMMITTEE

- To advise the Board on Shariah matters in its business operation
 - The Shariah Committee shall advise the Board on Shariah matters in order to ensure that the business operations of the Islamic financial institution comply with Shariah principles at all times.
- To endorse Shariah Compliance Manuals
 - The Islamic financial institution shall have a Shariah Compliance Manual. The Manual must specify the manner in which a submission or request for advice be made to the Shariah Committee, the conduct of the Shariah Committee's meeting and the manner of compliance with any Shariah decision. The Manual shall be endorsed by the Shariah Committee.

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- To endorse and validate relevant documentations
 - To ensure that the products of the Islamic financial institutions comply with Shariah principles in all aspects, the Shariah Committee must endorse the following:
 - The terms and conditions contained in the proposal form, contract, agreement or other legal documentation used in executing the transactions; and
 - The product manual, marketing advertisements, sales illustrations and brochures used to describe the product.

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- To assist related parties on Shariah matters for advice upon request
 - The related parties of the Islamic financial institution such as its legal counsel, auditor or consultant may seek advice on Shariah matters from the Shariah Committee. The Shariah Committee is expected to provide assistance to them so that compliance with Shariah principles can be assured completely

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- To advise on matters to be referred to the SAC
 - The Shariah Committee must advise the Islamic financial institution to consult the SAC on any Shariah matters which have not been resolved or endorsed by the SAC.
- To provide written Shariah opinion
 - The Shariah Committee is required to record any opinion given. In particular, the Committee shall prepare written Shariah opinions in the following circumstances:
 - Where the Islamic financial institution make reference to the SAC for advice; or
 - Where the Islamic financial institution submits applications to Bank Negara Malaysia for new product approval in accordance with guidelines on product approval issued by Bank Negara Malaysia.

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- To assist the SAC on reference for advice
 - The Shariah Committee must explain the Shariah issues involved and the recommendations for a decision. It must be supported by relevant Shariah jurisprudential literature from the established sources.
 - The Shariah Committee is also expected to assist the SAC on any matters referred by the Islamic financial institution.
 - Upon obtaining any advice of the SAC, the Shariah Committee shall ensure that all SAC's decisions are properly implemented by the Islamic financial institution.

DUTIES AND RESPONSIBILITIES OF IFI

- To refer all Shariah issues to the Shariah Committee
 - The Islamic financial institution must refer all Shariah issues in its business operations to the Shariah Committee for advice. The submission for an advice or a decision must be made in a comprehensive manner for an effective deliberation by the Shariah Committee. This will include explaining the process involved, documents to be used and other necessary information.
- To adopt the Shariah Committee's advice
 - The Islamic financial institution is required to adopt and take necessary measures for implementation of Shariah Committee's advice.

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- To ensure that product documents be validated
 - The Islamic financial institution shall obtain validation of the Shariah Committee relating to Shariah issues in all product documentations.
- To have a Shariah Compliance Manual
 - The Islamic financial institution shall ensure that the Shariah Compliance Manual referred to in Paragraph 20(b) is endorsed by the Shariah Committee.

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- To provide access to relevant documents
 - The Islamic financial institution must provide necessary assistance to the Shariah Committee. The Shariah Committee must be given access to relevant records, transactions, manuals or other relevant information, as required by them to perform their duties. For this purpose, the Shariah Committee members are granted exemptions from the secrecy provisions under the respective legislations.

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- To provide sufficient resources
 - The Islamic financial institution must provide the Shariah Committee with sufficient resources, such as budget allocation, independent expert consultation, reference materials and trainings. It is also the duty of the Islamic financial institution to familiarise the Shariah Committee on its operation and business.
- To remunerate the members of the Shariah Committee accordingly
 - The Board shall determine the remuneration of the Shariah Committee members (through its Remuneration Committee). The remuneration shall commensurate and reflect the roles and functions of the Shariah Committee.

REPORTING STRUCTURE

- The Shariah Committee will report functionally to the Board of Directors of the Islamic financial institution.
- This reporting structure reflects the status of the Shariah Committee as an independent body of the Islamic financial institution.

DIFFERENT APPROACHES IN SHARI'AH SUPERVISION

- Rigidity and inflexibility (al-tadyik wa al-tashaddud) in making Shari'ah decisions.
- The driven factors are:
 - Fanaticism towards a particular mazhab, views or scholars
 - Depending on the literal meaning of the text (al-Qur'an and Sunnah) without referring to its objectives (maqasid)
 - Unnecessarily propagating the usage of sadd al-dharai'i (blocking the means to evil) in disputed issues

EXCESSIVE FLEXIBILITY (AL-TASAHUL) IN MAKING SHARI'AH DECISIONS

The Factors are:

- Excessive utilisation of the principle of maslahah and darurah which might lead to misusing these two principles
- Choosing the facility (tatabbu' al-rukhas) and taking the easiest view of the mazahib (al-talfiq bayn al-mazahib)
- Finding legal devices (al-tahayul al-fiqhiyyah) in order to justify certain rulings

THE MODERATE APPROACH IN ARRIVING AT SHARI'AH DECISIONS

- Islam is a system that emphasise on the importance of moderation (al-wasatiyyah) in everything
- The scholars shall investigate the issues and arrive at a decision without compromising the fundamentals of Shari'ah
- Imam al-Shatibi emphasised the importance of moderation when he says, "A vice mufti is the one who provides moderate and practical solutions for the public and will not burden them with unnecessary burdens (al-shiddah) and will not also be incline towards excessive flexibility (up to the point of compromising Shari'ah principles)

CHALLENGES IN SHARI'AH SUPERVISION

- Knowledge and the know-how of Islamic instruments
- Synergizing between the Shari'ah requirements with the legal and taxation framework
- Innovation in Shari'ah compliance and viable products
- Balancing between the monetary gains and fulfilling the Shari'ah objectives
- Clear and transparent procedures in decision-making

CONCLUSION

- Shari'ah advisors are the backbone of the industry without which the integrity of the whole industry will be at stake
- Advisory services are an amanah (responsibility) and must be discharged with utmost professionalism and integrity
- More interactions is needed between the Shari'ah advisors and the market players so that the supervisory role will be enhanced
- Shari'ah scholars must ensure that all the decisions made are realistic and serve the interest of the ummah