

Holistic approach to Shariah governance framework



MALAYSIA

By Ruslena Ramli

Shariah governance is integral to the stability of the Islamic financial system. A sound Shariah governance framework strengthens public confidence in the integrity, management and business operations of Islamic financial institutions. In the last two decades, many cases have been brought to the courts, challenging the Shariah compliance aspects of some Islamic banking products.

The decisions of some judges to annul the underlying contracts of several Islamic banking products have posed financial risks to Islamic financial institutions, according to the article titled 'Better governance with new Islamic finance framework' published in the New Straits Times on the 5th October 2019.

Against this backdrop, Bank Negara Malaysia (BNM) released the Shariah Governance Framework (SGF) for Islamic financial institutions in October 2010. Due to strengthening demand for Islamic finance solutions and the increasing complexity of products and services, a new framework was established in September 2019. Known as the Shariah Governance Policy (SGP), the new framework will take effect on the 1st April 2020, superseding the SGF.

According to BNM's Financial Stability and Payment Systems Report 2018, the new regulatory framework is envisaged to:

1. Promote effective integration of Shariah governance and risk management within the operations and processes of Islamic financial institutions.

2. Strengthen compliance with Shariah standards in the execution of Shariah contracts.
3. Encourage innovation, particularly in the Takaful industry, by clarifying the application of a wider range of Shariah contracts for Takaful products.

Ultimately, the SGP aims to transform Islamic financial institutions from a largely compliance-based and process-driven focus to a more closely-integrated approach to Shariah governance that is well-embedded in their business and risk strategies. ☺

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Table 1: Key differences between SGF and SGP

	SGF	SGP
Tenure of Shariah committee members (effective the 1 st April 2023)	-	Maximum of nine years
Politically exposed Shariah committee member	-	A Shariah committee member must not be an active politician.
Key responsibilities of Shariah committee	-	Placement of additional restrictions above the Shariah Advisory Council (SAC) of Bank Negara Malaysia rulings requires Islamic financial institutions to: 1. Document the deliberations and justifications of the Shariah committee's decision. 2. Ascertain the board's views on the decision or advice made by the Shariah committee with regards to SAC rulings. 3. Ensure immediate notification to BNM of such decision or advice.
Shariah committee meetings	-	Chairman of the Shariah committee must: 1. Ensure appropriate procedures are in place to govern the Shariah committee's deliberations and proceedings. 2. Act as a direct liaison between the board and Shariah committee to foster greater understanding between both committees. 3. Ensure that Shariah decisions or advice are made on a sound and well-informed basis, including based on a robust decision-making methodology which ensures that all businesses, operations and risk implications are considered by the Shariah committee. 4. Encourage healthy discussion, participation and contribution and ensure that dissenting views can be freely expressed and discussed. 5. Ensure sufficient records of the discussion leading to the formulation of the Shariah committee's decision or advice are maintained.
Shariah review function	Conducted by a qualified Shariah officer with a Bachelor's degree in Shariah, including studies in Usul Fiqh (principles of Islamic jurisprudence) and Fiqh Muamalat (Islamic transaction/commercial law)	Officers who perform the Shariah review are qualified to undertake compliance function responsibilities, have sound understanding of relevant Shariah requirements and may include officers with Shariah qualifications.
Shariah research function	Conducted by a qualified Shariah officer	Consolidated under the Shariah secretariat function

Sources: SGF and SGP