

Strengthening Shariah Structure and Governance to Facilitate the Growth of Islamic Financial Services

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BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Colloquium on Islamic Finance:
Shariah & Operational Issues in Implementing Contemporary Products

Why do we need to emphasize on Shariah governance?

OBJECTIVE FULFILMENT

Promote justice, fairness and protection of human necessity (maqasid of Shariah)



***Shariah
Compliance is the
essence of
Islamic Finance***

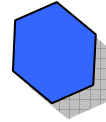
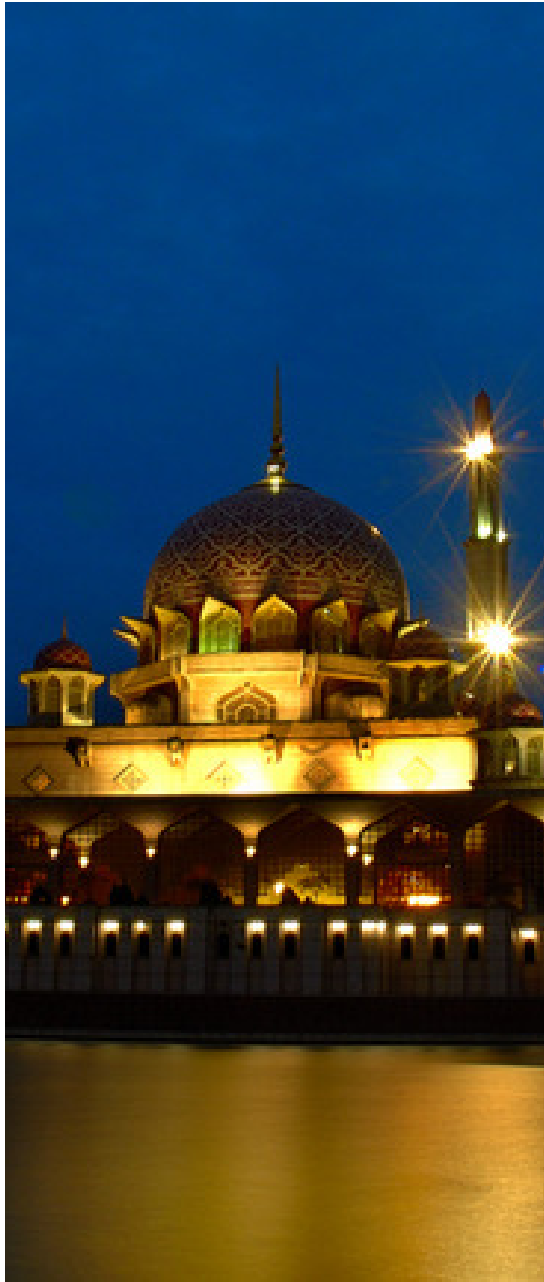
ALTERNATIVES

To create different mechanism in bringing forward the IF industry (alternative to the riba based activities).

MINIMIZING RISK

Mitigate Shariah non-compliant risk at decision making level as well as operational level





WHAT IS CORPORATE GOVERNANCE?

- *A set of processes, policies, laws affecting the way an organization is directed, administered & controlled*
- *Includes relationship amongst stakeholders, management & board of directors, employees & customers*
- *Decision making process by which decisions are implemented*



Separation of Ownership & Control

- Agency Problems
- Good CG is to ensure managers meet wider obligations to various stakeholders

Answerable to GOD

- Fulfilling the responsibility to Allah

Transparency & Market Discipline

- Timely & adequate information to IIFS investors
- Systemic stability
- Suitable disclosures to enhance transparency

Rationale for Corporate Governance



Balancing Stakeholders' Interest

- Shareholders vs. stakeholders
- Managing conflicts of interests among various stakeholders e.g. Between shareholders & IAH
- Concerns of anti-money laundering, fraud & misconduct

Information Asymmetries

- Insider dealing & abuse affect the market
- Disclosure of information to enable the IAH to make informed investment decisions.





Under Islamic finance, Shariah governance is a critical element....

- Robust Shariah governance framework required to strengthen Shariah decision making process
 - Ensures compliance with Shariah rules & principles
 - As a reference point for new principles / practices
- Governance structures provide mechanism for deliberation of Shariah issues:
 - To provide harmonisation and uniformity of Shariah interpretations; reference point for court decisions, independent central body also commands public confidence.
 - Shariah Committee at financial institutions – provides check & balance to ensure Shariah – consistent policies, complying with Shariah policies and procedures at all times.
 - Gives reasonable assurance to public at large on shariahness of products and services

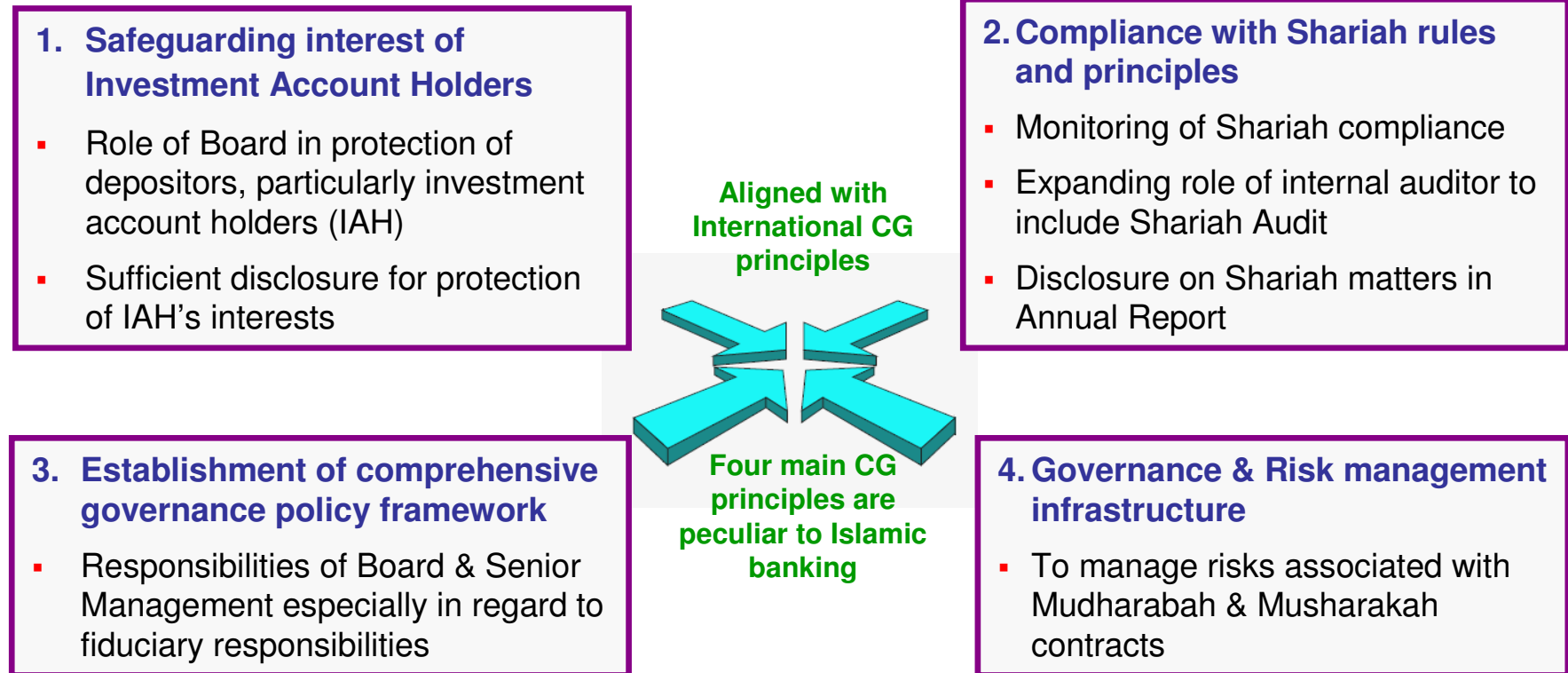


Comparison between conventional & Islamic Corporate Governance

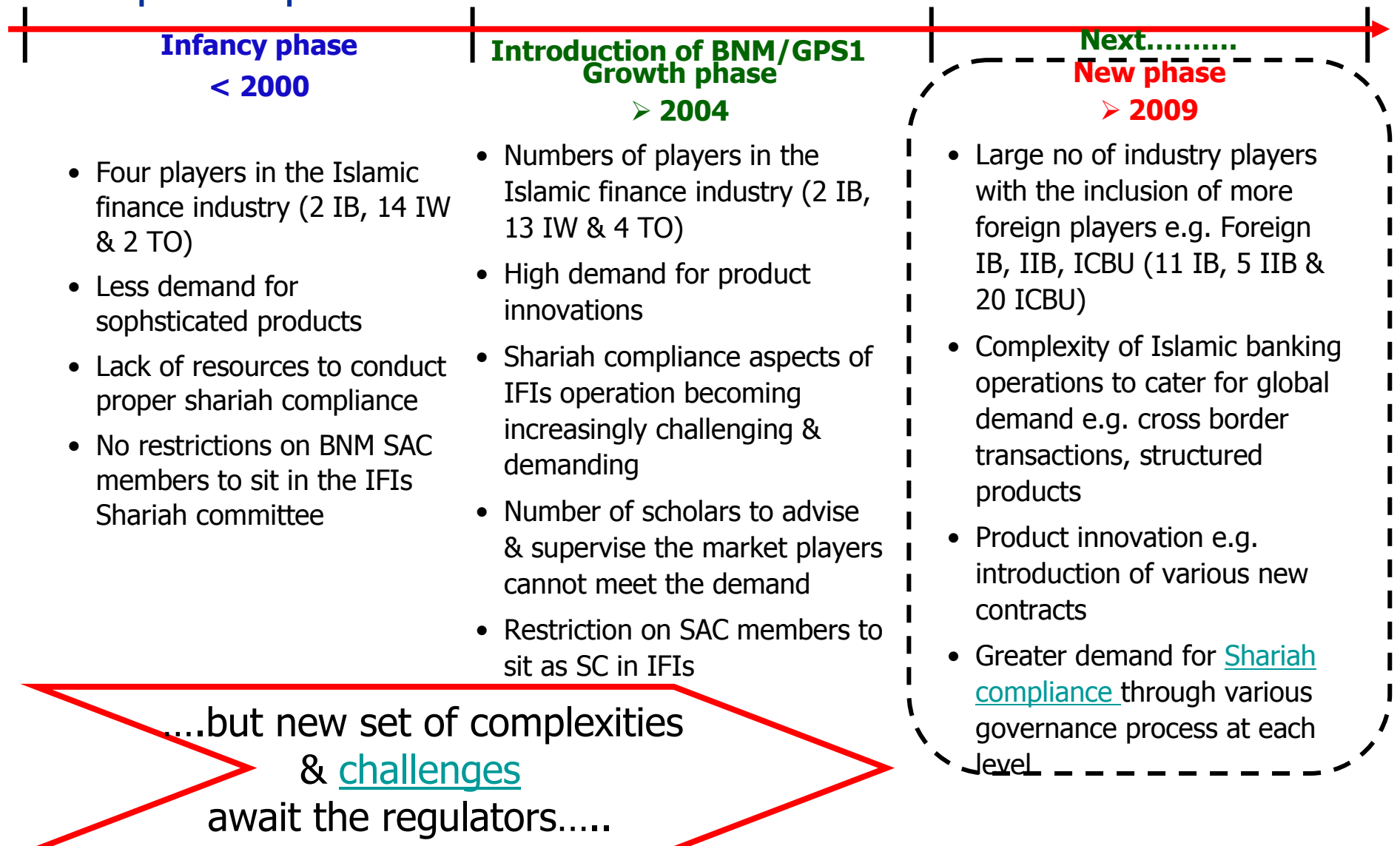
	Conventional	Islamic
The principles enshrined in	<ul style="list-style-type: none"> • The Malaysian Code on Corporate Governance; • The BIS Guidelines on “Enhancing Corporate Governance for Banking Organisations”; and • BNM / GP1-Guidelines on CG for LIs 	<ul style="list-style-type: none"> • The Malaysian Code on Corporate Governance; • The BIS Guidelines on “Enhancing Corporate Governance for Banking Organisations” • BNM / GP1-i – Guidelines on CG for Licensed IBs • The IFSB Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds); and 
Major responsibilities of the Board	<ul style="list-style-type: none"> • Every Licensed Institution should be headed by an effective board, strong independent & accountability throughout the Licensed Institution (Principle 1, 2 & 3) 	<ul style="list-style-type: none"> • Ensure protection of the interests of the depositors, particularly IAH -Principle 1 (2.10)  • In addition to the Board committees, the board is required to establish Shariah Committee -Principle 1 (2.19)
Auditing	<ul style="list-style-type: none"> • Robust auditing requirements and the auditor, board and management need to maintain professional and objective relationships - Principle 11 	<ul style="list-style-type: none"> • The internal audit function should complement the Shariah Committee in ensuring Shariah compliance in all aspects of the Islamic Bank's products, operations and activities. The internal auditors, in consultation with the Shariah Committee, shall determine the scope of Shariah audit and are encouraged to produce internal Shariah compliant reports. The auditors shall acquire the relevant and appropriate training to enhance their Shariah compliance review skills -Principle 11 (2.100)
Reporting	<ul style="list-style-type: none"> • Conducting corporate governance in a transparent manner -Principle 13 	<ul style="list-style-type: none"> • Islamic banks are required to observe the “Guidelines on Financial Reporting for Licensed Islamic Banks” (BNM/GP8-i), on a comprehensive disclosure requirement by Bank Negara Malaysia - Principle 13 (2.110)
Legal Provision	<ul style="list-style-type: none"> • These Guidelines are issued pursuant to Sections 56, 57 and 126 of the BAFIA. 	<ul style="list-style-type: none"> • These Guidelines are issued pursuant to section 53A of the IBA



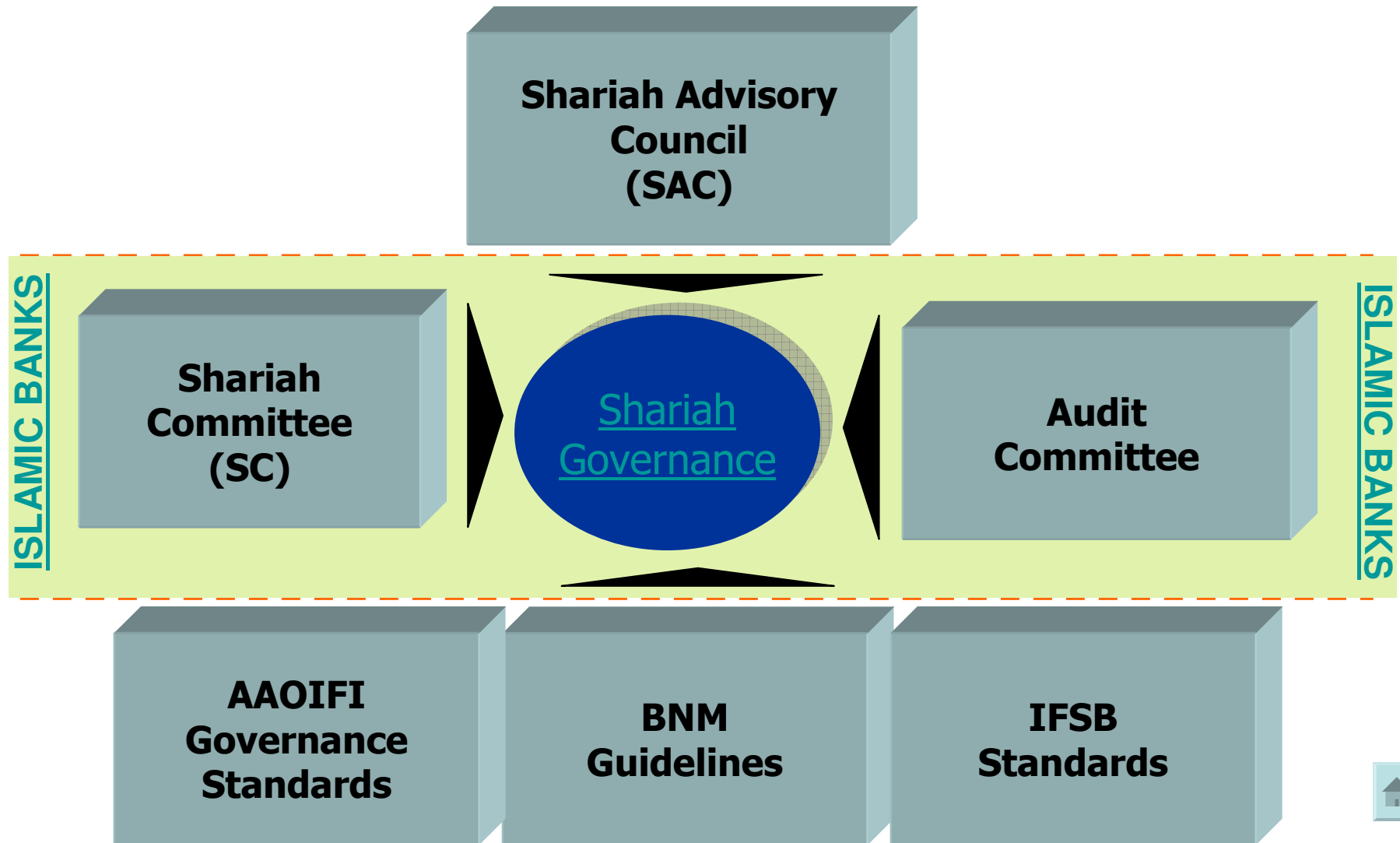
How different is Corporate Governance in Islamic Banking & Takaful.....



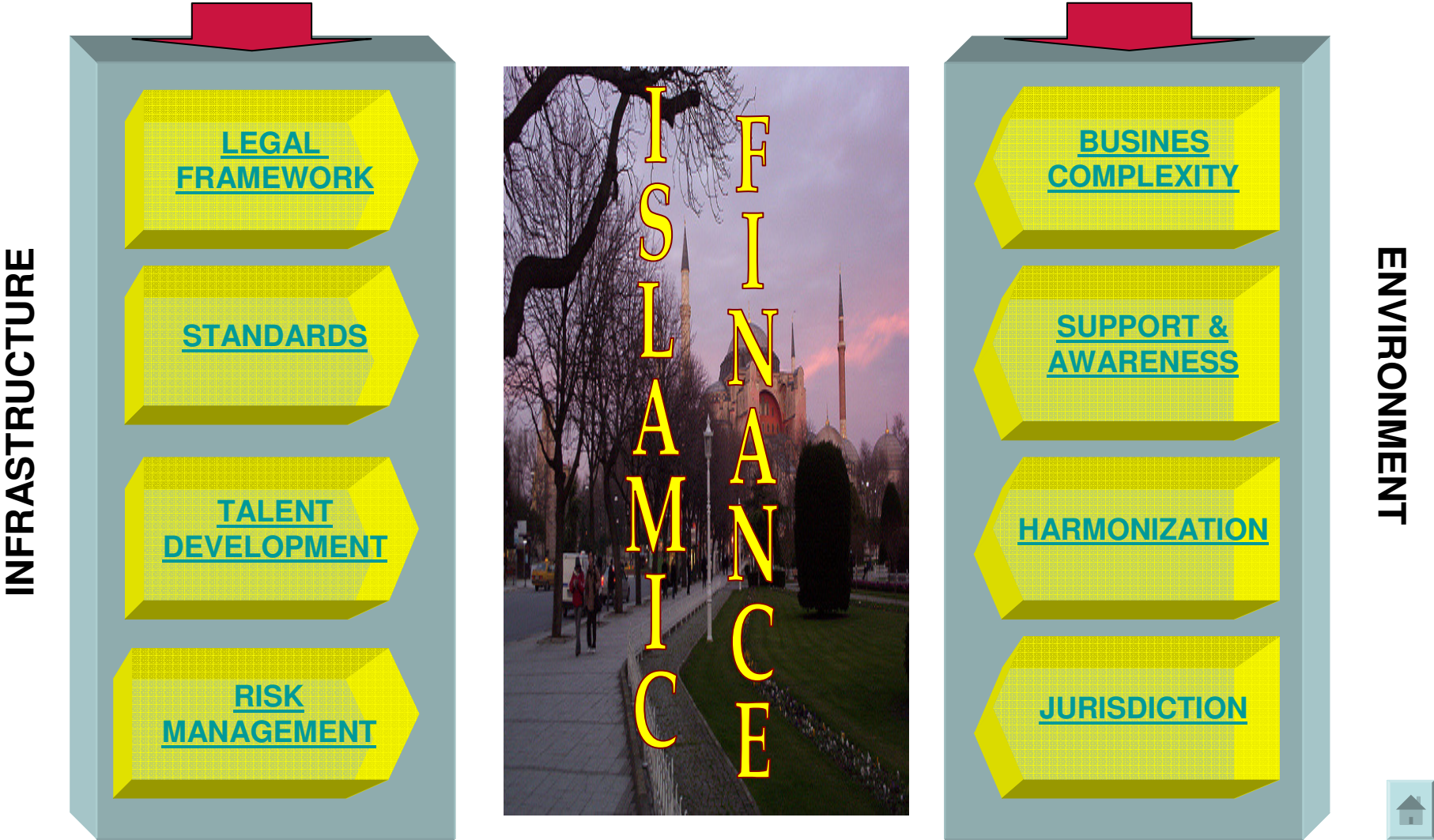
Islamic banking & takaful sectors now entering into a new development phase.....



Existing Shariah governance structure



Challenges in Strengthening the Shariah Structure and Governance.....



Thank you



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