
Strengthening the Relationship between Shariah Committee and Board of Directors of Islamic Banks

Mohammad Azam Hussain^{a*}, Fauziah Mohd Noor^b, Mohd Zakhiri Md. Nor^c, Alias Azhar^d

^{a,c,d}*School of Law, Universiti Utara Malaysia, Sintok, Kedah, Malaysia*

^b*Islamic Business School, Universiti Utara Malaysia, Sintok, Kedah, Malaysia*

^a*Legal & Justice Research Centre, School of Law, Universiti Utara Malaysia, Sintok, Kedah, Malaysia*

Email: mnfauziah@uum.edu.my^b, zakhiri@uum.edu.my^c, az.alias@uum.edu.my^d

**Corresponding author: hmazam@uum.edu.my^a*

Abstract

Shariah Committee (SC) is a key person in ensuring the Islamic banking business of Islamic bank comply with Shariah principles. The Board of Directors (BoD) of Islamic bank also the key person to oversee the entire operation and activities of Islamic bank. The roles and responsibilities of these two bodies are crucial to the Islamic bank. In principle, the two bodies are to complement each other to monitor the Shariah compliance of Islamic bank. However, in reality there is a gap between the SC and the BoD in carrying out their roles and responsibilities in the running of Islamic banking business. This study is carried out to seek the opinion of SC in order to bridge the gap between the two bodies and to find out the best method to be offered to the Islamic bank in this regard. The data of thematic analysis is gathered from the interview of selected nine respondents. The finding shows that the gap exists between SC and BoD in several ways and several factors contributed to it. Among the three methods to be implemented in order to bridge the gap between them, it seems that the appointment of SC member to sit in the BoD is a preferred method. Several steps need to be done in order to bridge the gap between these two significant bodies of the governance structure of Islamic bank.

Keywords: Shariah Committee; Shariah Governance; Shariah Compliance; Islamic Banking; Islamic Finance.

1. INTRODUCTION

The Shariah Committee (SC) is an independent committee who plays a crucial role to monitor and oversight the Islamic financial business and operations of the Islamic banking institutions comply with Shariah principles [12] and enhancing the credibility of the Islamic banks [14]. They are independent body with the expertise in Islamic law of transaction [6] and entrusted in ensuring the Shariah compliance aspects in the Islamic finance industry [10][1][5]. On the other hand, the Board of Directors (BoD) is the key person to oversee the entire operation and activities of the Islamic bank. The presence of the two entities reflecting the significant difference of monitoring mechanism in governance structure between Islamic banks and its counterpart [2].

The roles and responsibilities of the two bodies are crucial to the Islamic banks especially in ensuring the Shariah compliance [8]. As a key person to the Islamic banks, the SC and the BoD are required to complement each other in governing and monitoring the Shariah matters. Hence both should support each other and share control and advisory responsibilities. This is relatively significant to minimize the Shariah risks and enhance the financial performance of the Islamic financial institutions [11].

Several guidelines issued by Central Bank of Malaysia stating the accountability and responsibility of the BoD for the entire Shariah governance as well as Shariah compliance framework of Islamic bank [13][3]. Undoubtedly the reasonable knowledge and understanding of the principles of the Shariah and its broad application in Islamic finance is crucial for BoD to guarantee the effectiveness in carrying out their duties and responsibilities towards Shariah compliance of the Islamic bank. Alternatively, the BoD may appoint SC member to sit in BoD which could serve as a 'bridge' between the BoD and the SC [13]. This also consistent with requirement of Guidelines on Corporate Governance for Licensed Islamic which able to enhance the effectiveness of the BoD.

However, in reality there is a gap between the SC and the BoDs in carrying out their roles and responsibilities in Islamic banking business. In performing duties, few conflict took place between the SC and BoD of the Islamic

bank. The conflict happened due to the differences of view on certain matters for example, pertaining to the approval of certain products. It was claimed that some BoD just think about the profit while SC stress about the Shariah compliant of the product. There was also a claim from members of BoD that SC does not understand the accounting and operational concept etc. [4][9][7] in their scholarly work highlighting the issues pertaining to the existing of gap between SC and BoD of Islamic banks such as conflict of interest and also the legal issues if the SC member is appointed to sit as a member of BoD.

2. RESEARCH METHODOLOGY

This research is a qualitative. The primary data consists of statute, guidelines and interviews while secondary data consists of books, articles etc. Two types of data collection methods were used namely library based and field work. The interviewees consist of nine selective SC members of Islamic banks in Malaysia. The interview was conducted using structured interview method. The content analysis and descriptive analysis method were carried out to analyse the collected data.

3. FINDINGS AND DISCUSSION

3.1 The existence and area of gap between Shariah Committee and Board of Directors of Islamic Bank

The research found that four (4) respondents (44.44%) strongly agree and another four (4) respondents (44.44%) agree on the existence of gap between the two (2) parties. However one (1) respondent (11.11%) has no response in this regard. Since majority of the respondents in the category of strongly agree and agree, this indicates the existence of gap between SC and BoD of Islamic banks.

The study also found that the areas of the gap largely pertaining to the knowledge of Shariah principles in Islamic finance; the decision of Shariah issues; and also pertaining to the roles and functions of both parties. There are several factors which relatively contribute to the existence of these gaps. The study found that among the factors are: lack of understanding on Shariah principles by BoD; different nature of each function; insufficient engagement between the bodies; no exposure on Islamic finance; nature of the committee; education background; over emphasis on economic benefits / returns / advantages on the BoD side; and majority board members have no Shariah background.

3.2 Methods to bridge the gap between Shariah Committee and Board of Directors of Islamic Bank

Method 1: The appointment of member of SC as member of BoD of Islamic banks

The first option is the appointment of SC as a member of BoD of Islamic banks. For this option, four (4) respondents (44.44%) are strongly agree and four (4) respondents (44.44%) agree with this method. However one (1) respondent (11.11%) disagree with this method.

Pertaining to this, eight (8) respondents provide their opinion why SC member should be appointed as a member of BoD of Islamic banks as follows: (a) For a better communication between SC and BoD; (b) More engagement of SC with BoD; (c) Consolidation; (d) SC could give more input and explanation to BoD; (e) To provide Islamic inputs and counter balance the BOD's position on extreme economics benefits at the expense of Shariah position; (f) As an important reference for Shariah related matter pertaining to business, operation, activities and affairs of Islamic banks (g) To make the understanding possible; and (h) To understand the whole affairs and reason behind the policy taken.

In term of the appropriate number of SC member to be appointed as a member of BoD, five (5) respondents (55.56%) which is majority opine that one (1) member from SC to be appointed as member of BoD. Out of those five (5) members, two (2) members strongly agree, while three (3) members agree with the appointment of one (1) member. While two respondents (22.22%) strongly agree to choose two (2) members; one (1) respondent (11.11%) agree to choose one (1) member. One (1) respondent (11.11%) has no response.

Next is pertaining to who will be appointed to sit as a member of BoD whether the Chairman of SC or ordinary member of SC or both Chairman and member. The study found that, four (4) respondents (44.44%) prefer the Chairman of SC; one (1) respondent (11.11%) prefers the ordinary member; and three (3) respondents (33.33%) prefer to appoint both Chairman and member. One (1) respondent (11.11%) has no response.

The respondents also been asked whether the appointed member should be paid with additional allowance. In this regard, three (3) respondents (33.33%) strongly agree; four (4) respondents (44.44%) agree; one (1) respondent (11.11%) disagree; and one (1) respondent (11.11%) has no response. Hence, we can conclude majority of respondents (77.77%) agree with additional allowance to be paid for those member of SC appointed as a member of BoD of Islamic banks.

For those agree with such additional allowance, based on the following reasons: (a) different functions, roles, responsibilities and accountability to be carried out by such member; (b) for more transparency; (c) *al-ghurmbial-ghunm*; (d) certain issues require rigorous research by SC; and (e) If other BoD members are paid, why shouldn't the SC be paid as well? For one (1) respondent who disagree with such payment, saying that the meeting allowance receives is more than enough. So no need any additional allowance to be paid to such member.

Another issue is regarding the appointed member of SC to be appointed as member to any BoD's Committee of Islamic banks. The study found that, four (4) respondents (44.44%) strongly agree and another four (4) respondents (44.44%) agree with this matter. One (1) respondent (11.11%) has no response and no reason given by the respondent. Hence we can conclude that majority respondents (88.88%) agree to appoint such appointed member to sit in any BoD's committee of Islamic banks.

However, out of eight (8) respondents, three (3) respondents have no answer in relation to which BoD's committee suitable to the appointed member of SC to sit in. One (1) with the response not sure. Another option is to in to sit in all BoD's committee; relevant BoD committee to Shariah compliance; BoD Audit and Risk Committee; and finally to sit as ordinary member of BoD (four (4) respondents with different opinion respectively).

Another significant element is how to mitigate the unresolved gap between BoD and SC. In this matter two (2) respondents are of opinion that such gap should be mitigate by Bank Negara Malaysia and another two (2) respondents chose BoD. While the management, the CEO of the bank, the Shariah Department and the Chairman are another options chose by another four (4) respondents respectively. One (1) respondent has no response.

Finally in this section, this study seeks to find out how to bridge the gap between BoD, SC and Shariah Department in the event of Shariah non-compliance. Eight (8) respondents provide their solution to resolve the issue as follows: (a) Communicate effectively to the board to ensure they understand; (b) Proper discussion with BoD; (c) Back to function; (d) Give a comment and ask for rectification/correction; (e) A special meeting must be held involving all three parties. And with proper understanding of the whole situation, the SC must insist on the Shariah position on any issue at stake; (f) Internal policy on Shariah non-compliance and procedures should be in place to close the gap; (g) Discussion and meeting; and (h) Deliberate the reason for the decision.

Method 2: The Appointment of Member of BoD as Member of SC of Islamic banks

The second option is to appoint a member of BoD as a member of SC of Islamic bank. Several questions have been asked to the respondents in order to get their opinion in this regard. The study found that two (2) respondents (22.22%) strongly agree with the method; four (4) respondents (44.44%) agree and three (3) (33.33%) respondents disagree. Hence, we can see majority of respondents (66.67%) of opinion that this method is also able to bridge the gap between SC and BoD.

Those six (6) respondents have their own opinion to implement this method including: (a) Able to share BoD's views; (b) They can understand any topic or problem; (c) To close the gap of lack of understanding on Islamic principles and concepts on the part of the BODs. And also, to give a better understanding on economic scenarios to the appointed SC in the Board, It should work both ways; (d) They know better than SC in term of bank's technical aspects of management and operations. Their engagement as SC member would complement the function of SC; (e) To reach the understanding; and (f) To understand the reason the decision.

Meanwhile pertaining to the number of BoD member to be appointed as SC member, six (6) respondents prefer one (1) only; one (1) respondent prefers three (3) members; and two (2) respondents have no response. Majority of the respondents feel comfortable when BoD is available during SC's meeting with one (1) respondent strongly agree and five (5) agree with this matter. However three (3) respondents have no answer since they disagree with this method. Majority of respondent also agree that BoD should play dual function roles as BoD

and SC at the same time and the appointment be approved by Bank Negara Malaysia. Two (2) respondents strongly agree, three (3) respondents agree and one (1) respondent disagree. Three (3) respondents have no answer since they disagree with this method.

Finally, the respondents also been asked with the question on how to mitigate the gap on relying of international fatwa and Shariah resolution between the BoD and SC. In these issue, six (6) respondents provide their opinion as follows: (a) Proper discussion to be conducted; (b) Always refer to fatwa; (c) Serious consideration or priority must be given to the local circumstances. International fatwa may serve as guidelines only; (d) No composition on international SC, therefore not much international fatwa were adopted; (e) Look into the relevancy of the fatwa with the industry practice; and (f) Understand *FiqhWaqi'iyah*.

Method 3: Inviting Representative of Shariah Committee to Participate in BoD's Meeting

The last method in by inviting representative of SC to participate in BoD's meeting. Four (4) respondents (44.44%) strongly agree with this method; four (4) respondents (44.44%) agree; and one (1) respondent (11.11%) disagree with this method. In term or number of representatives, out of eight (8) respondents, four (4) respondents agree with one (1) representative; two (2) respondents with two (2) representatives; and two (2) respondents agree with three (3) representatives. To become the representative, four (4) respondents prefer Chairman and member to become the representatives; three (3) respondents prefer Chairman only; and one (1) respondent opts for member only.

Finally regarding the role of representative in the BoD's meeting, eight (8) respondents opine that the roles of representative are: (a) To explain about Shariah requirements; (b) To ensure the board understand Shariah decision made by SC; (c) To explains Shariah matters; (d) To highlight important issues and to clarify any ambiguity; (e) To provide Islamic inputs on economic matters raised by BODs; (f) To ensure Shariah compliance of the bank whilst advising the BOD on Shariah related matter pertaining to business, operations, activities and affairs of the bank; (g) To give advice for Shariah matters; and (h) To observe, analyse and give opinion where appropriate

3.3 The Best Method to Bridge the Gap between SC and BoD of Islamic Banks

Based on the above three (3) methods to bridge the gap between SC and BoD, we can see that the SC has their own opinion with those methods and each method able to plays a significant role in this matter. However in order to select the best method to be implemented by Islamic banks, four (4) respondents (44.44%) opine that the method of appointment of member of SC as a member of BoD of Islamic banks is the best mechanism. Then followed by the method of appointment of member of BoD as a member of SC of Islamic banks with three (3) respondents (33.33%); and finally the last method i.e. by inviting representative of SC to participate in BoD's meeting with two (2) respondents (22.22%).

Apart from that, six (6) respondents also came out with other methods to be considered by Islamic banks in order to bridge the gap between SC and BoD. This includes:

- (a) R1: Method: Engagement session twice a year between SC and BoD; Reason: If the Shariah Committee become BoD, SC must be able to understand everything not only Shariah which include the operations, strategic directions, financial performance. Therefore, more responsibility to SC. Engagement will be able to solve that problem.
- (b) R2: Method: Frequent engagement sessions; Reason: Effective communication between the two (2) bodies.
- (c) R5: Method: A meeting between SC and BODs at least once a month; Reason: Can share any problem or issue.
- (d) R6: Method: Convene special meeting(s) involving both parties when certain economic issues are not clear from Islamic perspective; Reason: Proper understanding is vital for both sides. If they come to any seemingly dead end, then a discussion must be held.
- (e) R8: Method: Having a regular meeting; Reason: Meeting and discussion will solve problem.
- (f) R9: Method: Reporting system; Reason: *Musyawah*.

4. CONCLUSION

Based on the above discussion, the gap between SC and BoD of Islamic bank is crystal clear which need to be addressed by the relevant authority, Central Bank of Malaysia in particular. The recommendation of the Shariah Governance 2019 i.e. to appoint a member of the SC as a member of the BoD is a very good approach taken by

the government. However, to what extent such recommendation is practiced by the Islamic banks is something to be worried about. Difference approaches taken by the Islamic banks need to be addressed for the sake of bridging the gap between SC and BoD of Islamic bank in carrying out their duties and responsibilities in guaranteeing the Shariah compliance and the growth of Islamic banking industry in this country.

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