



ANALYSIS ON *SHARĪ'AH* GOVERNANCE
STRUCTURE OF ISLAMIC BANKING AND FINANCE
IN MALAYSIA, INDONESIA AND KUWAIT

BY

IZYAN FARHANA BINTI ZULKARNAIN

A dissertation submitted in fulfilment of the requirement for
the degree of Master of Comparative Laws

Ahmad Ibrahim Kulliyyah of Laws
International Islamic University Malaysia

MAY 2014

*“And We sent not before you except men to whom We revealed (Our message).
So ask the people of the message if you do not know”
(Qur’an, an-Nahl: 43)*

ABSTRACT

Shari'ah board plays an essential role in *shari'ah* governance structure of Islamic banking and finance. This board is responsible to ensure that Islamic financial activities are *shari'ah* compliant. Basically, in establishing *shari'ah* governance structure, several approaches are identified to be adopted by different countries which include the centralised approach, self-regulatory approach and other approaches. However, this research will be focusing only on Malaysia, Indonesia and Kuwait which adopted the centralised approach in developing their *shari'ah* governance structure. The importance of *shari'ah* governance and its implementation in these three countries are also explored and discussed by the researcher. Malaysia requires the establishment of Shariah Advisory Council and Shariah Committee under the supervision of the Central Bank of Malaysia. On the other hand, the National Shariah Board in Indonesia is a non-government organisation which issues *fatwā* on *shari'ah* matters and the Sharia Supervisory Board is the term used for those scholars who are appointed in Islamic financial institutions. As for Kuwait, the final authority in deciding on matters relating to Islamic financial business is vested upon the Fatwa Board in the Ministry of Awqaf and Islamic Affairs which is a separate entity from the Central Bank of Kuwait. However, the Shariah Supervisory Board in Islamic banks is governed by the Central Bank of Kuwait. The research concluded that the *shari'ah* board is indeed significant to establish good *shari'ah* governance in Islamic financial institutions by practising *shari'ah* compliant activities in accordance with the *shari'ah*.

ملخص البحث

تلعب هيئة الرقابة الشرعية دوراً هاماً في هيكل الحكومة الشرعية والتمويل الإسلامي. وهي المسؤولة عن توفيق أنشطة التمويل الإسلامي مع أحكام الشريعة الإسلامية. على الأساس، تقوم الدول باعتماد على مناهج مختلفة في تكوين هيكل الحكومة الشرعية مثل منح التنظيم المركزي ومنح التنظيم الذاتي وغيرها. فيركز هذا البحث على منح التنظيم المركزي في دولة ماليزيا، وإندونيسيا والكويت فقط حيث يقوم البحث باكتشاف عن هذا المنهج يطبق به هذه الدول الثلاثة. يتطلب من ماليزيا إنشاء المجلس الاستشاري الشرعي واللجنة الشرعية تحت إشراف البنك المركزي الماليزي. أما في إندونيسيا، تقوم الهيئة الشرعية الوطنية وهي منظمة غير حكومية، بإصدار الفتاوى بشأن المسائل الشرعية، ويستخدم مصطلح "هيئة الرقابة الشرعية" للإشارة إلى مجلس الشريعة الذي أنشئ في جميع المؤسسات المالية الإسلامية. وبالنسبة للكويت، تناط السلطة النهائية في الأنشطة المالية الإسلامية على مجلس الفتوى في وزارة الأوقاف والشؤون الإسلامية، وهو منفصل عن بنك الكويت المركزي. أن نتائج هذا البحث جاءت لتؤكد على أن لهيئة الرقابة الشرعية دور بليغ في ضمان توفيق أنشطة التمويل الإسلامي مع أحكام الشريعة الإسلامية.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Comparative Laws.

.....
Rusni Hassan
Supervisor

I certify that I have read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Comparative Laws.

.....
Safinar Salleh
Examiner

This dissertation was submitted to the Department of Islamic Law and is accepted as a fulfilment of the requirement for the degree of Master of Comparative Laws.

.....
Mohd. Hisham Mohd. Kamal
Head, Department of Islamic Law

This dissertation was submitted to the Ahmad Ibrahim Kulliyah of Laws and is accepted as a fulfilment of the requirement for the degree of Master of Comparative Laws.

.....
Hunud Abia Kadouf
Dean, Ahmad Ibrahim Kulliyah
of Laws

DECLARATION

I hereby declare that this dissertation is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Izyan Farhana Zulkarnain

Signature.....

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

**DECLARATION OF COPYRIGHT AND AFFIRMATION
OF FAIR USE OF UNPUBLISHED RESEARCH**

Copyright ©2014 by International Islamic University Malaysia. All rights reserved.

**ANALYSIS ON *SHARĪ'AH* GOVERNANCE STRUCTURE OF ISLAMIC
BANKING AND FINANCE IN MALAYSIA, INDONESIA AND KUWAIT**

No part of this unpublished research may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright holder except as provided below.

1. Any material contained in or derived from this unpublished research may be used by others in their writing with due acknowledgement.
2. IIUM or its library will have the right to make and transmit copies (print or electronic) for institutional and academic purposes.
3. The IIUM library will have the right to make, store in a retrieval system and supply copies of this unpublished research if requested by other universities and research libraries.

Affirmed by Izyan Farhana Zulkarnain

.....
Signature

.....
Date

ACKNOWLEDGEMENTS

In the name of Allah S.W.T, the Most Beneficent, the Most Merciful.
All the praises and thanks be to Allah S.W.T, the Lord of the universe.

First and foremost, I would like to express my sincere gratitude to my supervisor, Assoc. Prof. Dr. Rusni Hassan for her continuous guidances and advices throughout finishing my dissertation. I really thank her for her kindness in assisting me by reading through my drafts and I fully hold myself responsible for any shortcomings in my writing. I would also like to thank her for giving me an opportunity to work as her Research Assistant for these past few years. These experiences taught me to become more responsible and committed in the jobs I have been assigned to do.

I would also like to express my thanks and gratitude to Dr. Safinar Salleh, an internal examiner who has been assigned to examine my dissertation. Thank you for your comments and suggestions to improve my writing.

A special thanks to my parents and siblings for their moral supports and sacrifices in order for me to be able to pursue my study at the master level. Your prayers for me encouraged me to take a step forward in my life and is what sustained me thus far.

My deepest appreciation goes to all fellow friends who have struggled, learned, attended the classes together, who willingly to share their knowledge with me and persuaded me to strive towards my goal. I am really grateful for having them as my friends and words would not be enough to express how grateful I am.

Last but not least, I owe my deepest appreciation to those who have assisted me either directly or indirectly in the process of completing this dissertation and without their kindness, it would not be possible for me to finish my writing.

May Allah S.W.T's blessings be showered upon us and ease our journey as His *khalifah* in this world and the hereafter. *Ameen*.

TABLE OF CONTENTS

Abstract	ii
Abstract in Arabic	iii
Approval Page.....	iv
Declaration	v
Copyright Page.....	vi
Acknowledgements	vii
List of Tables	x
List of Figures	xi
List of Statutes	xii
List of Abbreviations	xiii
CHAPTER 1: INTRODUCTION	1
1.1 Overview	1
1.2 Problem Statement	3
1.3 Objectives of the Study	4
1.4 Methodology of the Study.....	4
1.5 Scope and Limitations of the Study	5
1.6 Hypothesis of the Study	5
1.7 Literature Review	7
1.8 Organisation of the Study.....	12
CHAPTER 2: OVERVIEW OF SHARĪ‘AH GOVERNANCE IN ISLAMIC FINANCIAL INSTITUTIONS	14
2.1 Overview of Governance	14
2.2 Definition of Corporate Governance.....	16
2.3 Definition of <i>Sharī‘ah</i> Governance.....	18
2.4 Principles of Corporate Governance and <i>Sharī‘ah</i> Governance	19
2.4.1 Establish Effective Governance Framework.....	20
2.4.2 Rights and Functions of the Shareholders.....	21
2.4.3 Roles of the Stakeholders.....	23
2.4.4 Promote Disclosure and Transparency	25
2.4.5 Responsibilities of the Board Members	26
2.5 Differences Between <i>Sharī‘ah</i> Governance System and Corporate Governance System.....	29
2.6 Importance of <i>Sharī‘ah</i> Governance in Islamic Finance Industry	33
2.7 Significance of <i>Sharī‘ah</i> Supervisory Board in <i>Sharī‘ah</i> Governance Structure	36
2.7.1 Definition of <i>Sharī‘ah</i> Supervisory Board.....	37
2.7.2 Roles and Functions of <i>Sharī‘ah</i> Supervisory Board.....	38
2.8 Conclusion.....	38

CHAPTER 3: SHARĪ'AH GOVERNANCE STRUCTURE OF ISLAMIC BANKING AND FINANCE IN MALAYSIA	40
3.1 Introduction	40
3.2 Historical Development for Regulatory Framework on <i>Shari'ah</i> Governance of Islamic Banking and Finance in Malaysia.....	40
3.3 Current Development of Regulatory Framework for <i>Shari'ah</i> Governance of Islamic Banking and Finance in Malaysia	43
3.3.1 Islamic Financial Services Act 2013.....	43
3.3.2 Financial Services Act 2013.....	47
3.4 <i>Shari'ah</i> Governance Structure of Islamic Banking and Finance in Malaysia	48
3.4.1 Shariah Advisory Council of the Central Bank.....	49
3.4.2 Shariah Committee of the Islamic Financial Institutions	51
3.4.3 Principles of <i>Shari'ah</i> Governance of the Islamic Financial Institutions.....	54
3.4.4 Establishment of <i>Shari'ah</i> Functions in the Islamic Financial Institutions.....	59
3.5 Conclusion.....	60
CHAPTER 4: SHARĪ'AH GOVERNANCE STRUCTURE OF ISLAMIC BANKING AND FINANCE IN INDONESIA AND KUWAIT.....	61
4.1 Introduction	61
4.2 Regulatory Framework of Islamic Banking and Finance in Indonesia	62
4.3 <i>Shari'ah</i> Governance Structure of Islamic Banking and Finance in Indonesia	64
4.3.1 National Shariah Board	65
4.3.2 Sharia Banking Committee of the Central Bank.....	66
4.3.3 Sharia Supervisory Board of Sharia (Islamic) Banks and Sharia Business Units.....	69
4.3.3.1 Implementation of Good Corporate Governance Principles in Sharia (Islamic) Banks and Sharia Business Units.....	69
4.3.3.2 Establishment of Sharia Supervisory Board in Sharia (Islamic) Banks and Sharia Business Units.	72
4.4 Regulatory Framework of Islamic Banking and Finance in Kuwait.....	78
4.5 <i>Shari'ah</i> Governance Structure of Islamic Banking and Finance in Kuwait	80
4.6 Conclusion.....	84
CHAPTER 5: CONCLUSION.....	85
5.1 Concluding Remarks	85
5.2 Recommendations	88
REFERENCES.....	90

LIST OF TABLES

<u>Table No.</u>		<u>Page No.</u>
2.1	Similarities Between Corporate Governance Principles and <i>Shari'ah</i> Governance Principles	28
2.2	Differences Between Corporate Governance System and <i>Shari'ah</i> Governance System	32

LIST OF FIGURES

<u>Figure No.</u>		<u>Page No.</u>
3.1	<i>Shari'ah</i> Governance Structure of Islamic Banking and Finance in Malaysia	49
4.1	<i>Shari'ah</i> Governance Structure of Islamic Banking and Finance in Indonesia	65
4.2	<i>Shari'ah</i> Governance Structure of Islamic Banking and Finance in Kuwait	83

LIST OF STATUTES

Act No. 7 of 1992 Concerning Banking (Indonesia)
Act No. 23 of 1999 Concerning Bank Indonesia (amended by the Act No. 3 of 2004) (Indonesia)
Act No. 10/32/PBI/2008 Concerning Sharia Banking Committee (Indonesia)
Act No. 21 of 2008 Concerning Sharia (Islamic) Banking (Indonesia)
Act No. 11/3/PBI/2009 Concerning Sharia Commercial Bank (Indonesia)
Act No. 11/10/BPI/2009 Concerning Sharia Business Unit (Indonesia)
Act No. 11/23/PBI/2009 Concerning Islamic Rural Banks (Indonesia)
Banking and Financial Institutions Act 1989 (Act 372) (Malaysia)
Bank Indonesia Regulation Number 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance by Islamic Commercial Banks and Islamic Business Units (Indonesia)
Central Bank of Kuwait Law 1968 Concerning Currency, the Central Bank of Kuwait and the Organization of Banking Business (Kuwait)
Central Bank of Malaysia Act 2009 (Act 701) (Malaysia)
Development Financial Institutions Act 2002 (Act 618) (Malaysia)
Financial Services Act 2013 (Act 758) (Malaysia)
Instructions No. (2/IBS/100/2003) Concerning the Rules and Conditions for the Appointment and Responsibilities of the Sharee'a Supervisory Board in Islamic Banks. (Kuwait)
Islamic Banking Act 1983 (Act 276) (Malaysia)
Islamic Financial Services Act 2013 (Act 759) (Malaysia)
Shariah Governance Framework for Islamic Financial Institutions 2010. (Malaysia).
Takaful Act 1984 (Act 312) (Malaysia)
The Constitution of the State of Kuwait 1962 (Kuwait)

LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
BAFIA 1989	Banking and Financial Institutions Act 1989
BIR	Bank Indonesia Regulation
BOD	Board of Directors
CBMA 2009	Central Bank of Malaysia Act 2009
CEO	Chief Executive Officer
DAFIA 2002	Development Financial Institutions Act 2002
DPS	Dewan Pengawas Syariah
DSN	Dewan Syariah Nasional
GCC	Gulf Cooperation Council
FSA 2013	Financial Services Act 2013
IBA 1983	Islamic Banking Act 1983
IFSA 2013	Islamic Financial Services Act 2013
IFSB	Islamic Financial Services Board
IUC	Indonesian Ulama Council
MUI	Majelis Ulama Indonesia
NSB	National Shariah Board
OECD	The Organisation for Economic Co-Operation and Development
P.B.U.H	Peace Be Upon Him
SAC	Shariah Advisory Council
SC	Shariah Committee
SGF 2010	Shariah Governance Framework for Islamic Financial Institutions 2010
SSB	<i>Shari'ah</i> Supervisory Board
S.W.T	Subhanahu Wa Ta'ala (Praise be to Allah and the Most High)
TA 1984	Takaful Act 1984
et al.	(<i>et alia</i>): and others
Ibid.	(<i>ibidem</i>): in the same place
i.e.	That is

CHAPTER ONE

INTRODUCTION

1.1 OVERVIEW

Islamic banking and finance industry has developed throughout the world in this modern period. The main feature of Islamic banking system which differentiates it from the conventional banking system is in terms of its *shari'ah* compliance requirement. Fundamentally, Islamic banking system is established based on the *shari'ah* principles which emphasise on the prohibition of *ribā* (interest), *maysir* (gambling), *gharar* (uncertainty) as well as the involvement of prohibited commodities in Islam as compared to the conventional banking system that allows these elements in financial transactions.¹

Hence, the *shari'ah* governance system of Islamic financial institutions has a vital role in ensuring that these institutions are operating in line with the *shari'ah* principles. *Shari'ah* governance system is an additional layer to corporate governance system and must be established by all institutions operating Islamic banking business for the purpose of safeguarding the interests of all shareholders and stakeholders.² This is based on the fact that compliance with the *shari'ah* principles is the main objective of the establishment of Islamic financial institutions.³

¹ Saiful Azhar Rosly, *Critical Issues on Islamic Banking and Financial Markets: Islamic Economics, Banking and Finance, Investments, Takaful and Financial Planning*, (Kuala Lumpur: Dinamas Publishing, 2005), 20.

² International Shari'ah Research Academy for Islamic Finance (ISRA), *Islamic Financial System: Principles & Operations*, edited by Asyraf Wajdi Dusuki et al., (Pearson Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance (ISRA), 2011), 701.

³ Hamid Yunis, "Corporate Governance for Banks" in *Islamic Finance: The Regulatory Challenge*, edited by Simon Archer and Rifaat Ahmed Abdel Karim (Singapore: John Wiley & Sons (Asia) Pte Ltd, 2007), 300.

By having good *sharī'ah* governance system, it proves that these institutions are conducting their financial activities in accordance with the *sharī'ah*. Therefore, *sharī'ah* governance is considered as important as corporate governance in a way that it demonstrates how well the institutions are managed and controlled by the Board of Directors (BOD), the management, the *sharī'ah* secretariat and most important the *Sharī'ah* Supervisory Board (SSB). Those people are the key organs of *sharī'ah* governance system in Islamic financial institutions.

Sharī'ah governance system in Islamic financial institutions across the world varies from one country to another. Nonetheless, the governance structure of Islamic finance for these institutions provides similar requirement which is the establishment of the SSB in each institutions operating Islamic financial business, in which it is not a requirement for conventional banks. Accordingly, the establishment of this Board in all Islamic financial institutions is mandatory to monitor and supervise their banking operations to ensure that they are in compliance with the *sharī'ah*.⁴

There are certain qualifications to be the member of the SSB. Generally, the SSB shall comprise of experts or specialists from various fields such as Islamic jurisprudence (*usūl al-fiqh*), transactions in Islamic law (*fiqh al-mu'āmalāt*), laws, finance, accounting and others. However, the laws of one country may require extra capacities or capabilities for a person to be appointed as a member of the SSB, in which it may not be required in other countries.

This research will be focusing on *sharī'ah* governance structure of Islamic banking and finance in Malaysia, Indonesia, and Kuwait, particularly with reference to the establishment of *sharī'ah* boards because these countries adopted similar approach in establishing their *sharī'ah* governance system; i.e. the centralised approach. All

⁴ Brian Kettell, *Islamic Finance in A Nutshell: A Guide for Non-Specialists*, (United Kingdom: John Wiley & Sons Ltd, 2010), 102.

these countries practise dual banking system in which both conventional banking and Islamic banking systems operate together. However, there are few differences that can be found by referring to the *shari'ah* governance structure of these countries and in order to examine their similarities and differences, reference must be made to their regulatory framework and guidelines issued by their Central Banks.

1.2 PROBLEM STATEMENT

This research discusses on the regulatory framework and *shari'ah* governance structure of Islamic banking and finance in countries such as Malaysia, Indonesia, and Kuwait. This is due to the reason that *shari'ah* governance in Islamic finance industry is as much important as corporate governance. The study seeks to provide better understanding on approaches taken by these countries in implementing *shari'ah* governance framework since different countries adopted different approaches.⁵

It is important to see whether these institutions are operating in accordance with Islamic principles in implementing *shari'ah* governance system. For this purpose, the current research will provide answers to the following questions:

- i. What is the importance of *shari'ah* governance in Islamic banking and finance industry?
- ii. Is *shari'ah* governance system the same as corporate governance system?
- iii. What are the approaches taken by these countries in regulating Islamic banking and finance operations?
- iv. What are the structures of *shari'ah* governance practised by these countries? Are they centralised or non-centralised?

⁵ Zulkifli Hasan, *Shari'ah Governance in Islamic Banks*, (United Kingdom: Edinburgh University Press, 2012), 95.

1.3 OBJECTIVES OF THE STUDY

The aim of this research is to give overall overview on *shari'ah* governance of Islamic banking and finance in selected countries as mentioned before and approaches used by these countries to establish their own *shari'ah* governance structure which requires the establishment of the *shari'ah* boards. The *shari'ah* boards have the most important role in developing Islamic financial business because they are the ones who decide on *shari'ah* compliance issues and the institutions' reputation lies within the *shari'ah* compliance of its operations. The following are objectives of this research:

- i. To examine regulatory framework for Islamic banking and finance in Malaysia, Indonesia and Kuwait.
- ii. To provide better understanding in the practice of *shari'ah* governance between these countries which adopted similar type of approach.
- iii. To study the duties and functions of SSB in these countries.
- iv. To analyse the strength and weakness of *shari'ah* governance structure available in these countries.

1.4 METHODOLOGY OF THE STUDY

In order to achieve the abovementioned objectives, the researcher will examine the regulatory framework of these selected countries by looking at the approaches taken i.e. the centralised approach. The analysis will be focusing on this area as well as the establishment of the *shari'ah* boards in Islamic finance industry. The research will be on academic and library-based research and the main references for this research are both primary and secondary sources consists of acts or regulations, books, articles as well as website materials. No empirical study will be conducted throughout this research.

1.5 SCOPE AND LIMITATIONS OF THE STUDY

The study focuses on the discussion about regulatory framework and *shari'ah* governance system of Islamic finance in few selected countries. These countries are chosen as examples of centralised approach taken to establish *shari'ah* governance structure in Islamic financial institutions. The centralised approach concerns with the central authority which have the responsibility to provide regulations in Islamic banking and finance including the *shari'ah* governance structure of Islamic financial institutions. Nevertheless, it is to be borne in mind that different countries have their own laws and regulations for the purpose of adopting Islamic banking business into their society.

The approach taken by these countries will show their efforts in practising Islamic banking and finance in accordance with Islamic principles as well as to protect the interest of the shareholders and stakeholders. The discussion on *shari'ah* boards' establishment is the most important part because it differentiates between corporate governance practised in conventional banking system and *shari'ah* governance system of Islamic financial institutions.

1.6 HYPOTHESIS OF THE STUDY

The researcher proves that *shari'ah* governance system of Islamic financial institutions is of great significance to ensure that these institutions are conducting their transactions in accordance with the *shari'ah* principles for the benefit of all shareholders and stakeholders involve in Islamic financial business. Thus, in order to prove that the *shari'ah* governance system is important, it can be referred back to the adoption of the system into the country's regulations.

Examples for this basis are from these three countries which recognise the *shari'ah* governance system as one of their laws and regulations under Islamic banking and finance. Therefore, it is proven then that *shari'ah* governance is the substance of Islamic finance. In addition to that, other countries in this world are also moving towards enhancing and improving their *shari'ah* governance to ensure that the management of Islamic financial institutions are being conducted in line with the *shari'ah*.

A country must establish good *shari'ah* governance framework in order for them to ensure *shari'ah* compliance in Islamic finance transactions. This framework shall provide comprehensive guidelines for all Islamic financial institutions to follow and assist them in achieving their goals to be the institutions which provide an alternative for Muslims in banking business according to what has been prescribed by Allah S.W.T in the Qur'an. As such, the establishment of *shari'ah* governance framework seems to show their efforts in carrying out businesses that are recognised by the *shari'ah*.

Malaysia, Indonesia and Kuwait are examples of countries practising the centralised *shari'ah* governance structure in Islamic finance. The central banks in these countries take actions through the introduction of certain guidelines which are being imposed on all Islamic financial institutions in regard to *shari'ah* governance structure. Ultimately, it indicates that *shari'ah* governance structure is considered as the key element of Islamic banking system that must be established in all Islamic financial institutions. All players in the industry shall take this matter into consideration in order to make sure that the public will be confident with Islamic financial system.

1.7 LITERATURE REVIEW

Recently, there are many writings focused on the essence of *shari'ah* governance in Islamic finance to ensure that Islamic banking operations are in compliance with the *shari'ah* principles. *Shari'ah* governance is different from corporate governance because it requires the establishment of the *shari'ah* boards within the industry to ensure that the business is conducted in compliance with Islamic teachings.

Masudul Alam Choudhury and Mohammad Ziaul Hoque perceived corporate governance as a structure that supervises the internal integrity of a corporation or organisation.⁶ The purpose of establishing corporate governance is to point out that the relationship between the BOD and the management of the organisation is the determining factor in evaluating the corporation's performance. He further discussed that from Islamic perspective, corporate governance promotes the establishment of *shari'ah* boards to ensure the operations of the institutions are in accordance with Allah S.W.T's wills. The *shari'ah* boards have the duty to decide on any *shari'ah* matters relating to Islamic financial operations through *shuratic*⁷ process. In essence, *shari'ah* governance system in Islamic finance industry is really important to ensure *shari'ah* compliance.

Volker Nienhaus discussed that corporate governance involves the structure on how the institutions manage their operations to cater the interest of the shareholders with the risks associated in their business.⁸ For that reason, corporate governance system is important in corporations and companies to maintain their performances. As

⁶ Masudul Alam Choudhury and Mohammad Ziaul Hoque, "Corporate Governance in Islamic Perspective", *Corporate Governance*, vol. 6, no. 2 (2006): 117. Emerald Management Xtra Plus with Backfiles, via Emerald, <<http://www.emeraldinsight.com>>.

⁷ *Shuratic* process is a decision-making process which includes participation of several scholars in certain particular matter and it has been practised since the Prophet (P.B.U.H)'s time.

⁸ Volker Nienhaus, "Governance of Islamic Banks" in *Handbook of Islamic Banking*, edited by M. Kabir Hassan and Mervyn K. Lewis (United Kingdom: Edward Elgar Publishing Limited, 2007), 129.

for Islamic financial institutions, he believed that the Islamic financial institutions are exposed to higher risks than the conventional banks due to the reason that they must follow the *shari'ah* principles in their operations.⁹ The establishment of the *shari'ah* boards is mandatory to ensure *shari'ah* compliance.

Shamshad Akhtar agreed that corporate governance in Islamic financial institutions is important with the rapid growth of Islamic banking and finance industry in the world nowadays.¹⁰ The Islamic financial institutions provide opportunity for investors who intend to practice Islamic financial transactions according to the *shari'ah* principles. Despite the fact that there are various corporate governance principles issued at global level such as the Organisation for Economic Co-Operation and Development (OECD) principles, *shari'ah* governance of Islamic banking and finance is based on the Qur'an and Sunnah of the Prophet P.B.U.H. Therefore, it is necessary to establish and introduce governance that upholds Islamic teachings for the purpose of ensuring that the concept of justice, moral obligation, accountability and equality are being observed. In order to achieve this objective, she affirmed that the establishment of the *shari'ah* boards in Islamic financial institutions is important to monitor and supervise the *shari'ah* compliance of Islamic banking operations.

Aishath Muneeza agreed that *shari'ah* governance system in Islamic financial institutions is as important as corporate governance system in order to ensure that the Islamic financial institutions' activities are in conformity with the *shari'ah* principles. She also highlighted that in *shari'ah* governance system, the Islamic financial institutions have the main duty towards Allah S.W.T first and then only the duty to protect the interest of the shareholders and the stakeholders, in which there is no such

⁹ Ibid., 129.

¹⁰ Shamshad Akhtar, "Shari'ah Compliant Corporate Governance", Keynote Address delivered at Annual Corporate Governance Conference Dubai on November 27, 2006. <<http://www.bis.org/review/r070118b.pdf?frames=0>> (accessed November 5, 2012).

duty in corporate governance system.¹¹ This is the basic feature of *sharī'ah* governance system established in the Islamic financial institutions operating Islamic banking and finance according to the *sharī'ah* principles.

Abdul Ghafar Ismail discussed that Islamic financial institutions are subjected to additional layer of governance to ensure the *sharī'ah* compliant aspect for Muslims' need.¹² The *sharī'ah* boards is the key player to carry out the duty of ensuring that the Islamic financial business is being conducted in accordance with the *sharī'ah* principles because the services and products offered in Islamic financial institutions are based on the concept of partnership (*shirkah*) and profit-sharing (*mudhārabah*) as prescribed by the *sharī'ah*.¹³ It signifies that the *sharī'ah* governance structure of Islamic finance comprises of the *sharī'ah* boards whose responsible to supervise the Islamic financial institutions' operations.

Zeti Akhtar Aziz also emphasised that the *sharī'ah* governance structure of Islamic finance is important to ensure *sharī'ah* compliance.¹⁴ The establishment of the *sharī'ah* boards indicates that the governance structure of Islamic financial institutions is the distinguished feature of its governance system.¹⁵ The duty of the *sharī'ah* boards is to ensure *sharī'ah* compliance in Islamic financial institutions operating Islamic financial business. She further suggested that sound *sharī'ah* governance framework shall be introduced to enhance the governance system of Islamic financial institutions and it is the responsibility of the regulator to achieve such objective.

¹¹ Aishath Muneeza, *Corporate Governance of Islamic Banks in Malaysia*, (Kuala Lumpur: A.S. Noordeen, 2013), 4.

¹² Abdul Ghafar Ismail, *Money, Islamic Banks and the Real Economy*, (Singapore: Cengage Learning Asia Pte Ltd, 2010), 283.

¹³ Ibid.

¹⁴ Zeti Akhtar Aziz, "Effective Corporate Governance in Islamic Financial Institutions", Second Islamic Financial Services Board Summit on The Rise and Effectiveness of Corporate Governance in The Islamic Financial Services Industry, Doha, Qatar, 24th May 2005, (Kuala Lumpur: Bank Negara Malaysia, 2006), 204.

¹⁵ Ibid.

Rodney Wilson also agreed that *sharī'ah* governance system is significant for maintaining the reputation of Islamic financial institutions.¹⁶ The *sharī'ah* boards which comprise of experts and specialists in transactions in Islamic law (*fiqh al-mu'āmalāt*) need to be established to boost public confidence with the operations of Islamic financial institutions and thus, it will be able to prove that the institutions are really observing the *sharī'ah* principles in its daily transactions. The *sharī'ah* board members are appointed to advise on the products offered by the institutions. Therefore, it shows that the establishment of the *sharī'ah* boards is the vital element in *sharī'ah* governance system.

Nasser Saidi also affirmed that corporate governance aims at providing institutions with a body of rules and principles which can lead to the best practice in management.¹⁷ For that reason, the interest of the shareholders and the stakeholders can be managed and the reputation of the institutions will be highly respected for being able to abide by the laws and regulations of the country. In addition, he further elaborated that corporate governance in Islamic finance industry is not new in which it also focuses on three main areas of accountability, transparency as well as trustworthiness. Corporate governance of Islamic banking and finance will be able to ensure that the institutions operating Islamic banking business are in line with the *sharī'ah*. As for the establishment of *sharī'ah* boards within the industry, he also agreed that it need to be established in ensuring the *sharī'ah* compliance is being preserved.

¹⁶ Rodney Wilson, "The Development of Islamic Finance in the GCC", Kuwait Programme on Development, Governance and Globalisation in the Gulf States, <<http://www.lse.ac.uk/IDEAS/programmes/kuwait/research/papers/islamicfinance.aspx>> (accessed 18th March, 2013).

¹⁷ Nasser Saidi, "Corporate Governance in Islamic Finance", Hawkamah: The Institute for Corporate Governance, <<http://nassersaidi.com/wp-content/uploads/2012/08/Corporate-Governance-in-Islamic-Finance-Islamic-Wealth-ch33-FEB-2009.pdf>> (accessed 10th August, 2012).