

Shariah Governance: Perspective of Islamic Finance

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Abstract

The present short paper is an attempt to analyze the Shariah Governance of Islamic Finance. Corporate governance issues are especially important in developing economies, since these countries do not have a strong, long-established financial institution infrastructure to deal with corporate governance issues.

Keywords: Syariah Governance, Islamic Finance, regulatory framework.

Islamic financial institutions have the duty to ensure the compliance with Shariah principles in all aspects of their products, instruments, operations, practices and management which will be achieved by the establishment of a proper Shariah governance framework. Thus Shariah supervision plays an essential role in the governance of Islamic financial institution and forms part of the principal component of the Shariah governance framework (Hamza, 2013). One of the roles of the Shariah supervisory board is to advise the Islamic financial institutions on Shariah matters to ensure conformity with Shariah rule in its operations at all time, endorsing and validating relevant documentations pertaining to the products and services of the Islamic financial institutions. The ideal role of Shariah supervision involve ex ante and ex post aspects of Shariah governance and these include Shariah pronouncement, supervision and review. (Zulkifli Hasan, 2011)

In this aspect, the Shariah governance framework in Malaysia is based on the centralised model as compared to the decentralized being practiced in the GCC countries (Hamza, 2013). The centralised model is formed on the basis that the Central Bank itself has its own Shariah supervisory board called the Shariah Advisory Board by virtue of section 51 of the Central Bank of Malaysia Act 2009 and all Islamic financial institutions are required to form their own Shariah committee which must comply with the rules set by the Shariah Advisory Board of the Central Bank.

The importance of Shariah supervision is derived from five different resources namely religious, social, economic, legal and governance. The religious position is derived from the ability of Shariah scholars in understanding and interpreting Shariah principles to others. The social power of the Shariah supervision provides confidence to the stakeholders about the legitimacy of the transactions and activities of the Islamic financial institutions. The economic power of the Shariah supervision can be seen from the fact that the profitability of an Islamic financial institution is dependent on the performance of Shariah scholars. As far as legal power is concerned it is derived from a variety of sources including regulators of the respective countries. The hierarchical position of Shariah supervision under the shareholders of the Islamic financial institutions

emphasizes its supremacy over other governance organs thus giving them authority to set their internal policy including task, responsibilities and relations with other governance organs in the Islamic financial institutions. (Garas and Pierce, 2010)

The Shariah governance which refers to all the elements about the active role of the Shariah board and compliance with Shariah is fundamental to Islamic banks in particular and the implementation of Shariah governance is encouraged by international institutions of regulations like Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) and Islamic Financial Services Board (IFSB) (Hamza, 2013).

The independence of the supervisory board in the mission of supervision and the consistency of Shariah ruling can contribute to an efficient Shariah governance framework. The confidence on part of the stakeholders in the product of the Islamic financial institutions generally and the Islamic bank in particular will be enhanced with the existence of an efficient Shariah governance framework. (Hamza, 2013).

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