THE RECRUITMENT CRITERIA OF SHARIA COMMITTEE MEMBERS OF ISLAMIC BANKS IN MALAYSIA: AN ANALYSIS BASED ON *ADAB AL-FATWA WA AL-MUFTI WA AL-MUSTAFTI* BY AL-NAWAWI

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by

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institution
ADB	African Development Bank
ADB	Asian Development Bank
AH	After Hijra
BCBS	Basel committee on Banking Supervision
BIBD	Bank Islam Brunei Darussalam
BNM	Bank Negara Malaysia
BOD	Board of Directors
CBM	Central Bank Malaysia
CV	Curriculum Vitea
DFSA	Dubai Financial Services Authority
DIFC	Dubai International Financial Center
EB	European Bank
EM	Executive Management
ETP	Economic Transformation Programme
FFIBs	Full Fledge Islamic Banks
FHCs	Financial Holding Companies
GCC	Gulf Cooperation Council
GFC	Global Financial Crisis
IBF	Islamic Banking and Finance
IBs	Islamic Banks
ICT	Information Centre Technology
IDB	Inter-American Development Bank
IFF	Islamic Fatwa Framework
IFIs	Islamic Financial Institutions

IFSA	Islamic Financial Services Act
IFSB	Islamic Financial Services Board
IMF	International Monetary Fund
IOS	iPhone Operating System
ISRA	International *Sharia* Research Academy for Islamic Finance
IWs	Islamic Windows
JAKIM	*Jabatan Kemajuan* Islam Malaysia
MDBs	Multilateral Development Banks
MKI	*Majlis Kebangsaan HalEhwal Islam*
MUI	*Dewan Sharia* National
MUI	*Majelis Ulama Indonesia*
NCIA	National Council of Islamic Affairs
NIFIs	Non-interest Financial Institutions
NSCIA	Nigerian Supreme Council of Islamic Affairs
OIC	Organization of Islamic Cooperation
PBUH	Peace Be Upon Him
RASF	Regulatory and Supervisory Framework
SAC	Sharia Advisory Council
SBP	State Bank of Pakistan
SC	Securities Commission
SC	*Sharia* committee
SCD	*Sharia* compliance Department
SGE	*Sharia* Governance Exposure Draft
SGFW	*Sharia* Governance Framework
SGPD	*Sharia* Governance Policy Document
SRFW	*Sharia* Regulatory Framework
SSB	*Sharia* Supervisory Board

TAIB	*Perbadanan Tabung Amanah* Islam Brunei
UAE	United Arab Emirates
WBG	World Bank group
WIBF	World Database for Islamic Banking and Finance
WML	World Muslim League

LIST OF TRANSLITERATIONS

Table of the system of transliteration of Arabic words and names used in the Thesis

Readout	Arabic Letter	Transliteration
Alif	ا	-
ba`	ب	B
tha`	ت	T
Tha	ث	Th
Jim	ج	J
ha`	ح	Ḥ
kha`	خ	Kh
Dal	د	D
Dhal	ذ	Dh
Ra	ر	R
Zay	ز	Z
Sin	س	S
Shin	ش	Sy
Sad	ص	Ṣ
Dad	ض	Ḍ
ta`	ط	Ṭ
za`	ظ	Ẓ
‘ayn	ع	‘
Ghayn	غ	Gh
Fa	ف	F
Qaf	ق	Q
Ka	ك	K
Lam	ل	L
Mim	م	M
Nun	ن	N
Waw	و	W
ha`	ه	H
Hamzah	ء	‘
ya`	ي	Y
ta`	ة	T̲

KRITERIA PENGAMBILAN AHLI JAWATANKUAASA SYARIAH BANK ISLAM DI MALAYSIA: ANALISIS BERDASARKAN *KITAB ADAB AL-FATWA WA AL-MUFTI WA AL-MUSTAFTI* OLEH AL-NAWAWI

ABSTRAK

Jawatankuasa Syariah dianggap sebagai salah satu bahagian terpenting dalam sistem tadbir urus Syariah dalam Institusi Kewangan Islam (IFI). Mereka memainkan banyak peranan dalam industri perbankan Islam seperti penyeliaan, perundingan, semakan produk baharu, pengeluaran fatwa dan lain-lain lagi dalam IFI. Bagaimanapun, ahli jawatankuasa Syariah (SCM) menghadapi isu dan cabaran baharu yang pembangunan dan penambahbaikan rangka kerja tadbir urus Syariah yang komprehensif nampaknya diperlukan hari ini lebih daripada sebelumnya. Oleh itu, penginstitusian fatwa Islam di Malaysia menjadi faktor utama untuk menggabungkan dan membangunkan garis panduan kriteria pengambilan dan pelantikan SCM berdasarkan pemikiran al-Nawawiy dan menurut Dokumen Dasar Tadbir Urus Syariah (SGPD2019) kerana mempunyai pematuhan Syariah yang mencukupi dalam Bank Islam (IB) di Malaysia, sebaik sahaja ia diinstitusikan maka kriteria pengambilan mufti Islam akan dimasukkan dengan sewajarnya kepada SCM IB. Oleh yang demikian, penyelidikan ini dijalankan untuk mengenal pasti, menganalisis dan mengkonseptualisasikan kualiti dan kelayakan SCM. Penyelidikan dokumen telah disemak, dan kandungan dianalisis dengan analisis kandungan, juga kaedah kualitatif digunakan dalam menjalankan temu bual untuk pegawai Syariah, ketua jawatankuasa Syariah, ahli jawatankuasa Syariah dan ahli akademik berlatar belakang perbankan dan kewangan Islam menggunakan persampelan bertujuan. Data yang dibentangkan dalam penyelidikan ini sesuai untuk mencadangkan satu kriteria baharu dalam merekrut SCM

dalam mencapai mardat Allah dan habl min Allah di samping habl min al-nas bagi mengukuhkan mekanisme pematuhan Syariah industri perbankan Islam. Penemuan penyelidikan telah membantu kestabilan pengawal selia pusat dan, lebih khusus lagi, industri perbankan individu. Kajian itu mengenal pasti dan mendapati pematuhan Syariah cukup mencukupi berdasarkan kriteria pengambilan SCM di Malaysia, tetapi ia memerlukan lebih banyak instrumen untuk dikekalkan. Kajian ini telah menganalisis dan menemui beberapa elemen utama dalam IFF klasik yang penting dan akan digabungkan dalam SGPD dan/atau F&P masa hadapan integriti, keikhlasan, kebenaran dan niat yang baik. Fatwa Islam dalam mengkonseptualisasikan IFF klasik dengan rangka kerja tadbir urus Syariah IFI, dan menunjukkan keistimewaan bank Islam dengan kehadiran bank konvensional yang hanya berurusan dengan akibat duniawi dan meninggalkan akhirat. Justeru, penyelidikan ini telah membuka jalan kepada penyelidikan masa hadapan untuk menghasilkan mekanisme pematuhan Syariah yang lebih lengkap dan menyeluruh dengan menggabungkan idea-idea ulama Islam lain daripada tiga mazhab utama.

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ABSTRACT

The *Sharia* Committee is considered as one of the most important parts of the *Sharia* governance system in Islamic Financial Institutions (IFIs). They played many roles in the Islamic banking industry such as supervision, consultation, review of new products, *fatwā* issuance and many others within the IFIs. However, *Sharia* committee members (SCMs) are facing new issues and challenges that the development and improvement of a comprehensive *Sharia* governance framework seem to be needed today more than before. Thus, the institutionalization of Islamic *fatwā* in Malaysia became main factor of incorporating and developing its guidelines of recruitment and appointment criteria of SCMs based on al-Nawawiy's thought and according to *Sharia* Governance Policy Document (SGPD2019) for having sufficient enough Sharia compliance in the Islamic banks (IBs) in Malaysia, as soon as it is institutionalized then the recruitment criteria of Islamic *muftiys* would be duly incorporated to SCMs of IBs. As such, this research is conducted to identify, analyze and conceptualize the qualities and qualifications of SCMs. A document research was reviewed, and content was analyzed with content analysis, also qualitative method was used in conducting interviews for *Sharia* officers, heads of *Sharia* committee, members of Sharia committees and academician with Islamic banking and finance background using purposive sampling. The data presented in this research is suitable to propose a new criterion in recruiting SCMs in achieving *marḍāt Allāh* and *ḥabl min Allāh* beside *ḥabl min al-nās* to strengthen the *Sharia* compliance mechanism of the Islamic banking

industry. The research findings have aided the stability of the central regulator and, more specifically, the individual banking industry. The study identified and found that *Sharia* compliance is sufficient enough based on the Malaysian criteria of recruitment for SCMs, but it needs more instruments to maintain. The study has analysed and found some primary elements in classical IFF that are of essence and to be incorporated in future SGPD and/or F&P integrity, sincerity, truthfulness and good intention, The study also presented the required features, spiritual conduct, and mannerism of Islamic *fatwā* in conceptualizing the classical IFF with the Sharia governance framework of IFIs, and pointed out the peculiarity of Islamic bank in the presence of conventional banks which deals with only worldly consequences and abandon hereafter. Thus, this research has paved the way for future research to produce a more complete and comprehensive *Sharia* compliance mechanism by incorporating the ideas of other Islamic scholars from the three major *madhhab*.

CHAPTER 1

INTRODUCTION

1.1 Introduction

In general, this research aims to examine the criteria recruitment of *Sharia* Committee Members (SCMs) of Islamic banks in Malaysia. Thereafter, the research aims to analyze the recruitment criteria of SCMs based on the classical Islamic *fatwā* framework (IFF).

Being an exploratory research, the central theme of this study is on the recruitment criteria of SCMs according to the classical IFF. This research intends to examine in depth the recruitment criteria of SCMs of Islamic banks in Malaysia as stipulated in the *Sharia* Regulatory Framework (SRFW) of Islamic Financial Institutions (IFIs) in Malaysia which is based on the *Sharia* Governing Policy Document (SGPD) 2019.

The core focus of this research is on the recruitment criteria of SCMs. It starts with the identification of the recruitment criteria of SCMs from the basis of SGPD 2019 and analyse the criteria requirement of SCMs from the basis of Islamic *fatwā* i.e. the thought of al-Nawawiy from his book *Adāb al-Fatwā wa al-Muftiy*. The analyses of requirement criteria of SCMs from the basis of classical IFF would then allow this study to conceptualize the recruitment criteria of SCMs to be in accordance with the thought of al-Nawawiy from his book of *Adāb al-Fatwā wa al-Muftiy* under classical IFF.

As an introductory chapter, this chapter comprises Background of the Study followed by Problem Statement, Objectives of the Study, Research Questions, Scope and Limitation of the Study, Operational Definition, Significance of the Study, Contribution of the Study, Organization of the Thesis and the Summary of the Chapter.

1.2 Background of the Study

The background of the study entails different sub themes revolving around discussing the main theme of recruitment criteria of SCMs under classical IFF. As the main focus of this research on the recruitment criteria of SCMs in Islamic banks in Malaysia, there are two main sub-topics that is discussed within the research background. Firstly, sub-topic (a) discusses the current phenomena relating to SCMs, SGFW/SRFW of IFIs. History of IFIs, Islamic Banking, the SAC at national and institutional/industrial level. Secondly, sub-topic (b) discusses on the recruitment criteria of the Islamic *muftiy* under classical IFF. The discussion here covers on classical IFF based on the thought of al-Nawawiy from the book of *Adāb al-Fatwā wa al-Muftiy*, the historical background of Islamic *fatwā* and its concept, Islamic *fatwā* in contemporary transactional jurisprudence. These sub-topics are related to the main topic of the study, since the recruitment criteria of SCMs of Islamic banks is mentioned in the document of SGPD 2019 of SRFW. The analysis of these SCM recruitment criteria would be based on the Islamic *muftiy* in classical IFF from the book of *Adāb al-Fatwā wa al-Muftiy*, where this research needs to discuss the history of Islamic *fatwā* and its concepts that have arisen.

1.2.1 Recruitment Criteria of *Sharia* Board

The procedures of appointment and recruitment of the SCMs are among the most important points that would be explored in this study as core focus of the research. Since the procedure reflects the effectiveness, objectivity and independence of the SCMs in discharging their duties, the research would consider it worthy of investigation. In Malaysia as a result, the appointment, re-appointment and cessation of the member of *Sharia* committee are regulated by central regulatory body i.e. Bank Negara Malaysia (BNM) for governing Islamic financial business, with the objective to scrutinize the procedures prescribed by laws. As such, the appointment of SCMs is prescribed by the Policy Document of SGPD 2019. The document stipulates the provisions pertaining to the eligible persons to be appointed to the *Sharia* board or *Sharia* committee, procedures, qualities, qualifications, terms and conditions of appointment as well as remuneration and allowances (Hussain et al., 2016). The SGPD 2019 highlighted that:

> "In determining a *Sharia* qualified person under paragraph 12.1(c)(i), an IFI must assess whether the person fulfils the following: (a) holds, at minimum, a bachelor's degree in *Sharia*, which includes study in *uṣūl al-fiqh* (principles of Islamic jurisprudence) or *fiqh al-mu'āmalāt* (Islamic transaction/commercial law); (b) possesses solid knowledge in *Sharia* with reasonable Islamic finance knowledge and experience of the relevant industry; and (c) demonstrates strong proficiency and knowledge in written and verbal Arabic, with good command in the preferred language of the IFI, either Bahasa Malaysia or English language".

This qualification is required for the individual SCM before being recruited and appointed for this important task, where a combination of *al-syarī'at* knowledge and finance knowledge are needed to ensure competency for the SCMs and to safeguard proper understanding of the issue and sound decision or resolution that has been issued (Hussain, 2019).

The appointment of SCM with expertise in the field of *al-syarī'at* and Islamic finance remained the target of all Islamic financial institutions. Further, the existence of knowledgeable committee members in the field of *al-syarī'at* and Islamic finance would enhance the effectiveness of the industry in carrying out the responsibilities towards *Sharia* compliances. At the same time, such a member would provide necessary checks and balances in ensuring the IFI operates in a safe and sound manner parallel with the objectives (Hussain, 2019); (Kamaruddin et al., 2020).

The recruitment criteria of SCMs of Islamic bank as the core of this study as far mentioned, is being exercise under *Sharia* board of the Islamic banks. Yet, *Sharia* boards in different jurisdictions around the Muslim world differ "in issues of methods of appointment, composition of members, and legal status of the ruling, internal supervision", among other things. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) works to bring harmony to all this, since the advent of modern Islamic banking, the work of the *Sharia* committees has become more standardized (Abdullah, 2012).

According to Abdullah (2012), in most of Muslim majority countries some industry-oriented non-governmental bodies set the requirements for SCMs, while according to Warde 2010**,** one such body is the International Association of Islamic Banks which requires that members of SCMs be jurists and men of Islamic jurisprudence with conviction and firm belief in Islamic banking, not be employees of the financial institution they supervise, and be appointed by and have their remuneration set by a general assembly rather than the institution's board of directors.

However, the governmental bodies play an important part in supervision. As of 2013, for example, the regulators in Bahrain, Indonesia, Jordan, Kuwait, Lebanon, and Pakistan have developed guidelines for SCMs in their respective jurisdictions. Some countries, like Indonesia, Kuwait, Malaysia, Pakistan, Sudan, and the UAE have centralized SCMs.

In Malaysia a *Sharia* Advisory Council was established in 1997 to determine Islamic law regarding Islamic financial institutions, and in 2009 became the "sole authoritative body" for *Sharia* for the country's Islamic finance industry. It was set up at BNM. The individual *Sharia* committee that are in each Malaysian Islamic financial institution provide a second tier of supervision (Warde, 2010).

In Indonesia, all Islamic banks are required to have a SCMs. According to the National *Sharia* Board of Indonesia issues *Fatawa* on all Islamic financial products created in Indonesia, the National *Sharia* Board uses the *Fatawa* to regulate the Indonesian Islamic Financial industry, while the individual *Sharia* supervisory boards or *Sharia* boards ensure the National *Sharia* Board *Fatawa* are followed. In April 2015 the national *Sharia* board approved "*Sharia*-compliant currency hedging tools and a standard contract template for *Sharia*-compliant repurchase agreements", for example. But "weak government management (a lack of ministerial-level coordination)" and "an uncertain legal environment" have hindered expansion of Islamic banking in Indonesia (Abd Razak, 2019).

The Central Bank of Pakistan (State Bank of Pakistan) has an Islamic Banking Department that as of 2016 describes itself as enabling legal, regulatory and *Sharia* compliance framework for that country's Islamic banking industry (along with other tasks such as promoting Islamic finance). Also the Central Bank of Kuwait issued instructions on “*Sharia* Supervisory Governance for Kuwaiti Islamic Banks” in December 2016 as part of their "*Sharia* supervisory regulations for Islamic banks as per applicable best practices" (Lone, 2017).

As of late 2014, Bahrain was planning to set up a central *Sharia* board for Islamic banks. In non-Muslim majority UK, the government banking regulatory body, the Financial Services Authority, recognizes the special position of the SCMs within Islamic banks, and will not regulate "the composition, competencies, or operation" of such boards or its personnel if the board is "purely advisory" and uninvolved with management of the institution. If the board does have a management roll, it will be subject to the Financial Service Act (FSA) approval process, including "fulfilment of legal qualification and competency criteria (Lone, 2017).

This study on its background, focuses on the recruitment of SCMs in Indonesia, Pakistan, Bahrain, and Kuwait etc. because they are among the top Islamic countries in Islamic banking and finance practices, which include SCMs practices. The research is attempting to highlight how Islamic *fatwā* relates to the recruitment criteria of SCMs in these countries in order to demonstrate its relevance to this study (Kamaruddin et al., 2020).

Furthermore, the recruitment exercises of SCMs is being regulated and affirmed by the SAC as a central body of *Sharia* law for Islamic finance in Malaysia under BNM as deliberated by following section.

1.2.1(a) *Sharia* Advisory Council in Malaysia at National and Industrial levels

The *Sharia* governance framework of Islamic financial institution Malaysia has stated the following definition and guidelines in respect of *Sharia* advisory council at the national level.

"The *Sharia* Advisory Council of Bank Negara Malaysia (SAC) is a body established under section 51 of the BNM Act 2009 that has positioned the SAC as the apex authority for the determination of Islamic law for the purposes of Islamic financial business. The mandates of the SAC among others, are to ascertain the relevant Islamic law on any financial matter and issue a ruling upon a reference made to it, as well as to advise the bank and the IFI concerned on any *Sharia* issues relating to Islamic financial business operations, activities and transactions" 1/3 (SGFW for IFIs 2010).

Furthermore, it also declared the duties and responsibilities of the institutional/industrial *Sharia* committee as stated in the act below.

“At the industry level, the duties and responsibilities of the internal *Sharia* committee in advising the respective IFIs on *Sharia* matters were further deliberated in the guidelines on the governance of *Sharia* committee for the Islamic financial institutions issued in 2004. The guidelines are now superseded in light of new developments in Islamic finance as well as higher expectation of the key stakeholders of the IFI pertaining to the *Sharia* compliance process” 1/4 (SGFW for IFIs, 2010).

However, “The bank has developed the *Sharia* governance framework for IFIs with the primary objective of enhancing the role of the board, the *Sharia* committee and the management in relation to *Sharia* matters, including enhancing the relevant key organs having the responsibility to execute the *Sharia* compliance and research functions aimed at the attainment of a *Sharia* based operating environment” 1/5 (SGFW for IFIs, 2010).

However, the people who will be recruited and appointed are SCMs of Islamic bank. As a result, this background study focuses on the roles and Functions of SCMs, their attitudes prior to recruitment, and their industrial practices after being appointed. This is to link the aforementioned attitudes and practices to the criteria for recruiting and appointing SCMs.

1.2.1(b) The Roles and Functions of *Sharia* Committee Members of Islamic Bank

SCMs are the group of *Sharia* scholars who are in charge of issuance of Islamic banking products, an advisory and supervisory mandate to ensure all activities and business transactions by Islamic Banks are free from non-allowable elements such as *ribā* (Usury), *gharār* (Uncertainty), *maysir* (Gambling) and other similar attributes. They are also term as *Sharia* advisors, *Sharia* supervisors, *Sharia* committee members, *Sharia* supervisory board (SSB) as well as Islamic *muftiys* in contemporary Islamic *fatwā* institutions (Miajee, 2018). Hamza (2013) defines *Sharia* supervision itself as follows :

> "The SCM is composed of experts (*fuqahā'*) in Islamic jurisprudence or *fiqh al-mu'amalāt* and with sufficient knowledge of contemporary finance. The main role of the SCM is focused on consists in the formulation of *fatwās* and the revision of processes for the purpose of providing a common position in economics, finance and banking" (AAOIFI, 2005).

The *Sharia* committee members must be independent of the Board of Directors; however, can be permitted to be present in the Board of Directors' meetings to discuss the religious aspects of their decisions (Baklouti, 2020).

However, Baklouti, 2020 emphasized on the importance of *Sharia* supervision which is derived from five different resources namely religious, social, economic, legal and governance. The religious position is derived from the ability of *Sharia* scholars in understanding and interpreting *Sharia* principles to others. The social power of the

Sharia supervision provides confidence to the stakeholders about the legitimacy of the transactions and activities of the Islamic financial institutions.

The economic power of the *Sharia* supervision can be seen from the fact that the profitability of an Islamic financial institution is dependent on the performance of *Sharia* 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 *Sharia* 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 tasks, responsibilities and relations with other governance organs in the Islamic financial institutions (Miajee, 2018).

Furthermore, some of the first Islamic financial institutions to have a *Sharia* Boards were the Faisal Islamic Bank of Egypt, (founded in 1976); the Jordan Islamic Bank, (founded in 1978); the Sudanese Faisal Islamic Bank (founded in 1978); the Kuwaiti House of Finance (founded in 1979) (Warde, 2010).

A *Sharia* Committee (also *Sharia* Supervisory Board, Advisory Board or Religious Board) certifies Islamic financial products as being *Sharia*-compliant because compliance with *Sharia* law is the underlying reason for the existence of Islamic finance, Islamic banks as well as conventional banking institutions that offer Islamic banking products and services. They should establish a SCMs to advise them on whether their products are compliant, and to ensure that their operations and activities are compliant with *Sharia* principles. There are also national *Sharia* boards in many

Muslim majority countries that regulate Islamic financial institutions nationwide (Abd Razak, 2019).

According to Lone, 2017 the first measure that an institution wishing to offer Islamic products must undertake, is to appoint a *Sharia* board or, at a very minimum, a *Sharia* counsellor.

However, one of the most important required conditions for a conventional bank entering Islamic banking is the existence of SCMs, they have both supervisory and consultative functions to review the operations of their financial institution, and to make sure they comply with the *Sharia* and answer questions of their institution's staff on whether or not some proposed transactions or products follows the *Sharia* and issues *fatwā* on them (Warde, 2010).

According to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, 2008):

> "SSB is an independent body of specialized jurists in *fiqh al-mu ʻāmalāt* (Islamic commercial jurisprudence). The SSB is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution. The *fatwās* and ruling of the Board shall be binding".

This includes first: Certifying financial instruments for their compliance with the *Sharia*; second: Verifying transactions for compliance with the *Sharia*; third: Calculating *zakāṯ* payable by Islamic financial institutions; fourth: Disposing of non-

Shariah-compliant income; e. Advising on the distribution of income among investors and shareholders.

According to the Institute of Islamic Banking and Insurance, a *Sharia* board must have at least three members. Lone (2017) states that, most of *Sharia* boards have three to six members in practice, with one chair and one general secretariat. He notes that one *Sharia* board at (HSBC Amanah) had regional committees for Malaysia, Saudi Arabia, Indonesia, and Singapore to deal with the spectrum of beliefs across the Muslim world. A number of *Sharia* advisory firms have now emerged to offer *Sharia* advisory services to the institutions offering Islamic financial services. The World Database for Islamic Banking and Finance (WDIBF) has been developed to provide information about all the websites related to this type of banking practices (Jamaldeen, 2012).

In addition to the individual *Sharia* boards that every Islamic financial institution has, there are organizations that have issued guidelines and standards for *Sharia* compliance: Accounting and Auditing Organization for Islamic Financial Institutions, Fiqh Academy of the Organization of Islamic Cooperation, Islamic Financial Services Board (IFSB) (2009). However, since Islamic financial institution have their own SCM, they are not obliged to follow these guidelines and standards. A number of *Sharia* advisory firms have emerged to offer *Sharia* advisory services to institutions offering Islamic financial services (Warde, 2010).

After having the background on recruitment criteria of SCMs which include the background of *Sharia* committee of the Islamic banking industry, the study would now explore on the SGFW of IFIs since the recruitment criteria of SCMs is regulated under

SGFW. This research as such, discusses on different jurisdiction of the countries on the SGFW to correlate all the frameworks together, and show which one is suitable with the framework of classical IFF on SCM's recruitment process.

1.2.2 *Sharia* Governance Framework of Islamic Financial Institutions as the Source of SCMs' recruitment

As an introduction, this study will discuss the history of IFIs and IBs where the activities of SCMs occurred, followed by SGFW, which is the regulated body of law for BNM's recruitment and practices of SCMs.

1.2.2(a) History of Islamic Financial Institutions and Islamic Banking

The economic activities could not be achieved without financial institutions in conventional setup, such as commercial banks, savings and loan associations, credit unions, mutual savings banks, insurance companies and investment companies (Alhajji, 2003).

Hamalawy (2014) stated that the establishment of the international financial institution became reality after the incident of the first World War 1944 by world developing countries to ensure economic safety and currency value and to facilitate monetary expansion policy and in reforming the monetary and exchange system. Furthermore, international financial institutions are the institutions that maintain financial backing and well advice for economic and social development activities for world developing countries and boost international economic cooperation and endurance.

The term international financial institution generally refers to the International Monetary Fund (IMF) and the five multilateral development banks (MDBs) the World Bank group, the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, and the European Bank for reconstruction and development (Bhargava, 2006). Nevertheless, this research will concentrate on Islamic financial institutions only which include Islamic investment companies, Islamic insurance companies (Takaful) and Islamic banking industry which will be the main subject matter and the topic of discussion of the research.

The history of Islamic banking can be traced back to half of the century during the second conference of finance ministries of the Muslim countries held in August 1974. When they accepted to establish the Islamic Development Bank (IDB) then the phenomenon of Islamic banking institutions commenced and appeared to become reality (Alhajji, 2003). Furthermore, Islamic banks commenced with the instruction of handling all transactions in compliance with *al-syarī'aṯ* (Islamic Law), which stops the receipt and payment of interest, (*ribā*). Islamic banks circulate funds basically through investment accounts using profit and loss sharing (PLS), unlike conventional banks that operate based on the interest rate (Al-Deehani et al., 1999). The activities of Islamic banks can be seen in following categories:

i. Services with charge: these are the services which the bank provides for its customers for a fee, notably, hiring boxes, transfer of money etc.
ii. Investment of money on a *musyārakaṯ* basis and

iii. Services without charge, for example collection and distribution of Zakat, making interest-free loans to the poor and needy etc (Ansary, Hassan & Mutawally, 2002).

Meanwhile, an important aspect of the commencement of Islamic banking in Malaysia is the piecemeal approach. The setting up of Bank Islam Malaysia Berhad (BIMB) in 1983 was an important first step. Also, an important feature of the Malaysian model is that, even before the setting up of the first Islamic bank in Malaysia, there was already in place the extensive Islamic banking legislation to guide the activities of Islamic banking institutions (Alhajji, 2003); (Akbar et al., 2015).

Moreover, the Islamic Banking Act was introduced in Malaysia in 1983 and ensured that the operations of the Islamic banking system in Malaysia had to comply with *Sharia* laws. It is significant to note that, at that time, the common practice among Islamic countries over the world whenever it was decided to set up Islamic financial institutions a certain restriction would merge and allocate a certain exemption from the conventional banking regulators to degrade the effort of the people not to adopt specific *Sharia* regulations, and this was complemented by a set of administrative guidelines. Whereas in Malaysia, the view at that time was that, if Islamic banking was going to be established and developed into a fully-fledged system, it had to be supported by comprehensive Islamic banking legislation and *Sharia* regulatory framework that is in order to comply with *Sharia* laws (Ansary et al., 2002).

According to Alhajji (2003) many agencies have contributed to the successful fulfilment of the Islamic financial system in Malaysia. These include:

i. The support and backing of the Ministry of Finance, as well as the BNM and the Securities Commission.

ii. A piecemeal approach in the background of an overall long-term blueprint.

iii. Extensive Islamic banking legislation and board of *Sharia* supervisory council for all Islamic banking institutions (Hashim, 2002).

Having established the background on the recruitment criteria of SCMs of Islamic banks, history of IFIs as well as Islamic banking industry. From the start, this research needs to investigate these issues in order to provide a general understanding of SCMs and the recruitment criteria which are governed by national or industrial regulator and practiced within the IFIs and Islamic banking industry particularly. As such, this leads to the discussion on SGFW of IFIs, its model as well as different jurisdiction.

1.2.2(b) *Sharia* Governance Framework of Islamic Financial Institutions

Sharia governance framework (SGFW) can be referred to as *Sharia* regulatory framework at the regulatory and central levels, which according to Islamic Financial Services Board (IFSB) (2009) is the

> "*Sharia* governance system refers to the set of institutional and organizational arrangements through which an IFIs ensures that there is effective independent oversight of *Sharia* compliance".

The SGFW has been classified into three distinct models: the Fully Islamic model, which relies on the Islamic law framework, the Dual System (or Hybrid) model, which is primarily based on a conventional framework with special laws on IFIs, and the Neutral or Partial Inclusion model, which relies on the conventional framework (Adawiyah, 2007); (Syarif, 2019); (Hassan, 2010). This classification of different distinctive models would affect the recruitment criteria of SCMs in terms of its nature and model style.

Table 1.1 Classification of Models and the Corresponding Legal and Regulatory Framework

Models	Legal & Regulatory framework	Countries
Fully Islamic	Islamic Law framework	Kingdom of Saudi Arabia, and other GCC, Pakistan Before 2001
Dual System	Conventional framework with special laws for IFIs	Malaysia, Brunei Darussalam Indonesia, Bahrain, Pakistan After 2002, and Nigeria
Neutral or Partial Inclusion	Conventional framework	China, USA, UK, Hongkong, Luxembourg and Japan

(Adapted from Rabiah Adawiah, (2007), Syarif, (2019); and Hassan, (2010)

Table 1.1 provides a summary depicting that, generally, the classification of the IFIs can be grouped into three basic models known as the Fully Islamic Model, the Dual System (or Hybrid) Model and the Neutral or Partial Inclusion Model. Based on such categorisation, it is noted that these models are dependent on the existing legal and regulatory framework of the country in which the IFIs operate. Thus a Fully Islamic Model exists in countries in which the legal framework is based on Islam, such as those in the Kingdom of Saudi Arabia and other Gulf Cooperation Council (GCC) countries and thus resort to a purely Islamic *fatwā* construct based on both classical and contemporary applications.

In the meantime, for countries whose legal framework is essentially a conventional framework with special laws enacted for IFIs, their model is known as the Dual (or Hybrid) System Model that touches some aspects of Islamic *fatwā*. The Dual (or Hybrid) System Model is notably suitable for countries where the population of non-Muslims are relatively high too, such as those in Malaysia, Brunei Darussalam, Bahrain, Nigeria and Indonesia. In the meantime, countries that have not promulgated any special laws to cater for IFIs, on the other hand, and use the conventional framework, are found in the non-Muslim majority countries where the Islamic *fatwā* is not expected to function thoroughly due to the nature of the legal systems in the countries, such as in China, Japan, Luxembourg, the United States and the United Kingdom. Therefore, these countries are found to use the Neutral or Partial Inclusion Model. Nonetheless, whatever is the model that an IFI in a country resorts to, there exists the need for *Sharia* governance (Salisu, Saniff & Hassan 2021).

According to the recruitment criteria of SCMs in the model of these countries, the Fully Islamic Model would accept the classical IFF in recruitment criteria of SCMs without any challenges, since it is fully Islamic model. While the Dual System (or Hybrid) Model would accept the classical IFF in the recruitment criteria of SCMs, even though, it may face some difficulties or challenges due to the nature of its model. For the Neutral or Partial Inclusion Model, acceptance of the framework of classical IFF in its recruitment criteria of SCMs is extremely difficult (Hassan, 2010).

Moreover, among the documents to be considered for the recruitment criteria of SCMs in Malaysia under SGFW is Islamic Financial Service Act (2013)(IFSA), it outlined the *Sharia* governance functions, duties as well as requirements exercises in section 29 (2) as follows:

> “*Sharia* governance including (i) functions and duties of the board of directors, senior officers and members of the *Sharia* committee of an institution in relation to compliance with *Sharia*; (ii) fit and proper requirements or disqualifications of a member of a *Sharia* committee; and (iii) internal *Sharia* compliance functions”. While, the main objectives of the SGFW for IFIs is designed to meet the following:
>
> “(i) sets out the expectations of the bank on an IFI’s *Sharia* governance structures, processes and arrangements to ensure that all its operations, sales products, transactions and any other business activities are in accordance with *Sharia*, (ii) provides a comprehensive guidance to the board, *Sharia* committee and management of the IFI in discharging its duties on matters relating to *Sharia*; and (iii) outlines the functions relating to *Sharia* review, *Sharia* audit, *Sharia* risk management and *Sharia* research” *Sharia* governance framework (SGFW, 2010).

However, *Sharia* governance of IFIs in Malaysia is administered by the SGFW of the IFIs (SGFW, 2010) and other subsequent amendment of 2017, that was grown and brought up by the Central Bank of Malaysia (BNM) (Nafees, Risna, Rukshana & Zahira, 2017).

The *Sharia* governance refers to all aspects of the *Sharia* committee's active role and *Sharia* compliance as fundamental to Islamic banks in particular, as well as the implementation of *Sharia* governance, which is encouraged by many *Sharia* bodies. notably, Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) Islamic Financial Service Board (IFSB) Islamic Financial Services Act (IFSA) and *Sharia* Governance Framework (SGFW) of the Bank Negara Malaysia. This is where the significance of this study's investigation of SGFW and SRFW comes into play, in order to demonstrate to these *Sharia* bodies and frameworks on how they are relevant to this research in terms of SCM recruitment criteria (Nafees et al., 2017). Further, is the background of the countries at a global setup with different active or non-active *Sharia* governance/regulation mode and approach, from the country's central regulator to determine which country's model is suitable for the recruitment criteria of SCMs in conceptualizing with classical IFF.

1.2.2(c) *Sharia* Regulation of Islamic Bank in a Global Setup

The following is background on the seven countries within Africa, Asia and South Asia which were chosen to represent the global setup with different active or non-active *Sharia* regulation mode and approach in the activities of Islamic banking industry specifically, it contains among others recruitment criteria of SCMs. While discussing on these countries; it is important to note that the overview of *Sharia* regulation of IBs in the following countries would be useful to establish which country is suitable to adapt and adopt the classical IFF for the recruitment and appointment of SCMs in its *Sharia* SRFW and on the *fatwā* practices.

1.2.2(c)(i) Tanzania

Omar, Yusoff, and Sendaro (2017) confirmed the absence of a regulatory framework governing Islamic banking in Tanzania in their study, which was thought to be impeding its development. Furthermore, they claimed that numerous literatures revealed this absence not only in local, but also in global standard regulatory and supervisory frameworks dealing with Islamic banking in Tanzania. The study also establishes a link between the rise of Islamic banking in Tanzania and the traditional regulatory framework that was used to oversee Islamic banks. Furthermore, in order to achieve *Sharia* compliance, the transformation of conventional financial products into Islamic financial products necessitates specific regulations and supervision in regulating Islamic financial institutions.

Again, Omar et al., (2017) argued that standardization and centralization of *fatwās* among *Sharia* boards will emphasize the standardization of operations between Islamic banks, this is after having standard *Sharia* regulatory framework in its Islamic banking. They also suggested that in order to achieve the goal, the government of Tanzania must institutionalize and standardize first, so that the regulatory framework for Islamic banking must be established in order for Islamic banking to become fully *Sharia* compliant.

However, the study acknowledged Malaysia's regulatory framework among the advanced and the most inclusive in today's world. Its framework comprises of Islamic banking Act. 1983, Central Bank of Malaysia Act 2009, and Islamic Financial Services Act 2013 (Zanirah & Muhamad, 2016).

The study of Omar et al., (2017) as such, is opposed to the adoption of classical IFF on its recruitment criteria for SCMs, because there is no regulatory framework in Tanzanian Islamic banking governance that would allow the classical IFF aspect to be active within, except in a situation where the governance framework is regulated.

1.2.2(c)(ii) Nigeria

The compliance with *Sharia* principles is a critical element of non - interest banking and finance. For this reason, the Central Bank of Nigeria (CBN), herein designated guidelines for all non-interest banks and other financial institutions who are non-interest financial institutions (NIFIs) in Nigeria and required them to set up a *Sharia* advisory body as part of their governance structure to be known as *"Sharia* advisory committee" SAC (GSGNIFI, 2010). The guideline is developed by CBN for the appointment, duties and responsibilities of the *Sharia* advisory committees of NIFIs. Non- interest bank is the fixed name of Islamic Bank according to GSGNIFI (2010), it comes preferably due to the religion barrier in the country. According to Salisu & Muhammad (2019) despite the above approved mentioned guidelines, Nigerian Islamic bank or non- interest bank as popularly mentioned in the above guideline, its contribution in terms of economic growth remains low compared to other countries such as Malaysia, it is still an infant and just coming up. The Nigerian government initiated its permission which was given in 2005. The Jaiz Bank was the first full-fledged Islamic bank started its operation in 2012 under *Sharia* compliant, it based within the four largest Nigerian cities in the northern part of the country namely Abuja, Kaduna, Kano and Maiduguri, and later followed by Taj Bank which was started its operation in the early 2019 and lastly Lotus Bank in 2021.

Moreover, Islamic bank is one of the satisfactory policies that accommodates financial exclusion in Northern Nigeria where the population of the region is hugely excluded from the financial institutions. Within a year with the operation, the Jaiz Bank in 2014 witnessed remarkable growth from 33.9 billion to 42 billion. Jaiz Bank is appeared to be one of the strongest mechanisms and successful financial institution that fought financial exclusion and attracting more inclusion with different strategy regardless of ethnicity or religion, it provides a platform for people to operate and participate at all levels (Salisu & Muhamad, 2019). Since *Sharia* advisory body is set up as part of the governance structure by CBN then the aspects of Islamic *Fatwa* could be adopted and adapted within the exercises of recruitment and appointment of SCMs for non-interest bank in Nigeria, even though the non-interest bank is still infant in the country.

1.2.2(c)(iii) Bangladesh

The lack of a well-defined regulatory and supervisory framework for Islamic banks in Bangladesh was affirmed by Ahmad & Hassan (2007) in their research for their effective functioning in line with the *Sharia* law, they even made it as most important issue in the context. In addition to that, other major issues derived from the absence of an Interbank Islamic money market. Hence, they followed the same policy and guidelines for Islamic and conventional banking by the Bangladesh bank. For this purpose, the study suggested that Islamic banks in Bangladesh should have an independent banking act that controls, guides, and supervises their functions and provide legal support to the parties concerned based on *Sharia* Islamic law (Ahmad & Hassan, 2007); (Amanullah, 2015).

Specifically, the study focuses on the shortcomings of the regulatory framework and how the deficiencies can be overcome, also enumerate on how Islamic banking can be made a viable alternative banking system in Bangladesh. In this regard, the study explained the main differences between a conventional interest-based banking system and an interest-free Islamic banking system. And utilize data collected from the bank scope and individual banking financial statements to show the operational differences of these two banking systems in Bangladesh. Finally, the study concludes with a specific policy recommendation which may not accept the adoption of aspect of Islamic *Fatwa* for the recruitment and appointment of SCMs.

Consequently, the Bangladesh bank - central bank of the country - was given the task of regulating and supervision of both conventional and Islamic banking systems. As such, Bangladesh bank has legal authority to supervise and regulate all the banks - including Islamic banks - in Bangladesh, the Islamic banks being part of the financial industry, are subject to the regulation and supervision of Bangladesh central bank. To conclude, a policy of equal treatment for all conventional and Islamic banks is being followed by Bangladesh bank. However, in view of the lack of Islamic financial markets and instruments in the country, Bangladesh bank had granted some preferential provisions for the development of Islamic banking in country (Ahmad & Hassan, 2007).

In the case of legal framework of Islamic banks in Bangladesh, in most of Muslim countries a special law is passed before the establishment of an Islamic bank that specifies the *Sharia* rules and regulations for the institution willing to engage in banking business based on Islamic principles such as Malaysia and Nigeria for instance, this is in contrary to Bangladesh that the task was only given to central bank of the country. Nevertheless, in Bangladesh, there is no separate Islamic banking act or any specific laws or independent regulations that control, guide, and supervise the functions of Islamic banks, Bangladesh bank exercises power over Islamic banks under laws and regulations assign to control and supervise traditional banks whose goals and functions are different from Islamic banks (Ahmad & Hassan, 2007); (Akbar, et al., 2015).