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Shortcomings and proposed reforms in the existing shariah governance of islamic banking

Abdulazeem Abozaid [1]*

[1] *Hamad Bin Khalifa University, Qatar*

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ABSTRACT

Since its inception a few decades ago, the Islamic banking and finance industry has been self-regulated with regards to Shariah governance. Despite the existence of certain regulatory authorities from within the industry, such as Accounting and Auditing for Islamic Financial Institutions (AAOIFI) and Islamic Financial Services Board (IFSB), none of their resolutions or standards are effectively binding. Few countries have enforced some rules related to Shariah-governance. Still, in most cases, these rules did not go beyond the requirement of formulating Shariah controlling bodies, which is practically left to the banks themselves. Islamic banks are almost left to choose or dismiss their Shariah controllers, and no clear criteria are set by any authority to ascertain the proper qualifications of the Shariah controllers. Moreover, some of the Shariah standards and fatwas are found to conflict with the established resolutions issued by Fiqh academies. These matter point to the deficiencies in the existing Shariah governance and hence the need to address them.

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Tantangan dan usulan reformasi tata kelola syaiah di perbankan Syariah. Sejak didirikan beberapa dekade yang lalu, industri perbankan dan keuangan Islam telah diatur sendiri terkait dengan tata kelola Syariah. Terlepas dari keberadaan otoritas pengatur tertentu dari dalam industri, seperti Akuntansi dan Audit untuk Lembaga Keuangan Islam (AAOIFI) dan Dewan Layanan Keuangan Islam (IFSB), tidak ada resolusi atau standar mereka yang mengikat secara efektif. Beberapa negara telah memberlakukan beberapa aturan yang terkait dengan pemerintahan Syariah. Namun, dalam banyak kasus, aturan ini tidak melampaui persyaratan pembentukan badan pengendali Syariah, yang secara praktis diserahkan kepada bank itu sendiri. Bank syariah hampir dibiarkan memilih atau memberhentikan pengendali Syariah mereka, dan tidak ada kriteria yang jelas yang ditetapkan oleh otoritas manapun untuk memastikan kualifikasi yang tepat dari pengendali Syariah. Selain itu, beberapa standar dan fatwa Syariah ditemukan bertentangan dengan resolusi yang ditetapkan oleh akademi Fiqh. Hal ini menunjukkan kekurangan dalam tata kelola Syariah yang ada dan karenanya perlu mengatasinya.

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* Corresponding Author. aabozaid@hbku.edu.qa

1. Introduciton

What is Shariah Governance? According to IFSB, the "Shariah Governance System" refers to the set of institutional and organizational arrangements through which institutions offering Islamic financial services ensure that there is effective independent oversight of Shariah compliance over different structures and processes" including the issuance of fatwas, the internal Shariah compliance audit and the annual Shariah compliance review (IFSB, 2009).

Shariah governance is a fundamental component of corporate governance to Islamic financial institutions (IFIs), which refers to the method by which a financial institution is administered, controlled, or managed. However, in addition to the Islamic banking and finance industry needing the usual corporate governance, Islamic banking and finance have the responsibility to ensure compliance with the Shariah principles in its products, instruments, operations, practices, management, etc. and therefore, Shariah governance is another component of corporate governance, one that is peculiar to Islamic banking and finance.

Although there have been some works addressing matters related to Shariah governance, the vast majority of these works are either related to a particular jurisdiction or country, such as "Shariah Governance; Case of Malaysia" by Hasan Rafiqul Islam, or they are treated different aspects of Shariah governance excluding its critical Shariah appraisal and the deficiencies in its existing models. This paper comes to address these critical matters and to propose a new framework for Shariah governance that overcomes the drawbacks of the existing ones, as identified in the study.

Originality/Value – Although the paper addresses a topic (Shariah governance) that has been addressed before, it acquires its significance and value from treating different aspects of the topic and from setting the basis for what constitutes a robust framework of Shariah governance after locating the areas of deficiencies that would necessitate the change and reform.

2. Research Method

The paper addresses these issues by firstly clarifying the shortcomings, and secondly, by proposing the necessary reforms to help reach effective Shariah governance that would protect the industry from within and help it achieve its goals. The paper employs a qualitative research methodology that adopts a comparative analysis approach. The methodology also incorporates a macro perspective for treating the subject by analyzing the effects of the existing Shariah governance framework on a macro level. Having Identifed the defects and analysied their effects, the paper then adopts a constructive methodology to set the foundations of a new robust framework of Shariah governance, in consideration of the existing market practices and needs.

3. Result and Discussion

The Importance and Significance of Shariah Governance

One of the unique characteristics of Islamic banking and finance in compliance with Shariah principles and rulings. Shariah compliance is what distinguishes an Islamic bank from a conventional bank as the former observes certain rules and prohibitions not observed by the latter. Failing to fulfill the Shariah compliance requirements would generate a risk called 'the Shariah non-compliance risk. This risk is unique to the Islamic banking and finance industry, and it is particularly significant to it for the following reasons: 1) It generally impacts the industry's reputation as well as the reputation of the financial institution, and thus, it may deteriorate reliance of the depositors, investors, customers, and stakeholders in the long-term. 2) Contracts containing Shariah-repugnant elements and already executed should be deemed null and void, which would, in

turn, render the profit derived thereof non-halal, and as a result, the tainted income arising from such transactions must be channeled to charity and cannot be kept by the bank. 3) It may involve some legal costs as potential suits may lead to the payment of damages. Therefore, the existence of non-Shariah compliant elements would not just affect the confidence of the public in Islamic banking and finance, but it might also expose Islamic banks to profitability, fiduciary and reputational risks.

Hence, Shariah compliance is the backbone of Islamic banking & finance. It gives legitimacy to the practices of Islamic banking and finance and thus validates the profits. It also boosts the confidence of all stakeholders that all the practices and activities of the bank are in compliance with the Shariah. However, compliance with the Shariah will be confidently achieved only by having a proper Shariah governance framework. This is because Shariah governance is meant only to ensure compliance of the Islamic banking and finance industry with the rules of the Shariah.

Principle 3.1 of the "IFSB Guiding Principles on Corporate Governance" stresses the importance of Shariah governance by stating that an appropriate mechanism must be created to ensure compliance with the Shariah principles. Similarly, Principle 7.1 of the "IFSB Guiding Principles on Risk Management" states that Islamic financial institutions shall have in place adequate systems and controls, including a Shariah board/advisor, to ensure compliance with the Shariah principles.

The Problem with the Existing Shariah Governance

Briefly, it can be said that the Islamic banking and finance industry is left to regulate itself in terms of Shariah governance. Despite the importance of regulating this relatively new industry and the critical risks resulting from weak Shariah governance, there is no genuine or effective interference by the high authorities to regulate this industry. There is no one unified Shariah governance system, and in most jurisdictions, supervisory authorities may permit the Islamic financial institutions to decide for themselves what kind of Shariah governance system to adopt. The market is left to determine freely, which system lends enough credibility to the products and services that each Islamic financial institution offers. This self-regulation has, in fact, led to many cautions rendering Shariah control ineffective in most cases.

Even in the very few countries that have national Shariah governance frameworks, like Malaysia, Oman and Syria, this framework has not been effective enough to address the Shariah concerns associated with a lack of or improper Shariah governance. If Shariah governance is meant to assure compliance of the bank's products as well as operations with Shariah, both in fact are widely criticized for harboring some Shariah concerns, and possibly in some of these countries than any other jurisdictions. Therefore, the existing Shariah governance frameworks have failed to fulfill their objective as a guarantee of Shariah compliance.

More importantly, the Shariah as a whole need to be safeguarded and protected from being possibly manipulated or twisted by Islamic banks to serve their self-interests. This also requires setting robust Shariah governance for the Islamic finance industry to guarantee the preservation of the Shariah rules and the protection of its Shariah image.

Now, to identify the problems with the existing Shariah governance we need to locate the existing Shariah concerns over the practices of the industry because every Shariah concern in the current practices relates to some corresponding deficiency in the existing Shariah governance frameworks. Generally, the basic Shariah concerns over the practices of the industry are the following: i) The invasion of highly controversial products, which are no different in essence from the conventional banking products that are believed to be unlawful. ii)The non-independence of the Shariah controllers, including the Shariah supervisory board members, from the financial institution

they are supposed to control and supervise. This could create a conflict of interest and inevitably open the door for subjective and arbitrary endorsement of the banking products and services. iii) The existence of unqualified Shariah controllers lacking the necessary expertise and knowledge; naturally, this would, in turn, lead to the wrong evaluation and assessment of the financial products.

These Shariah concerns are natural outcomes of weak Shariah governance, which fails to fulfill its purpose in safeguarding the Shariah aspects of the business. Obviously, the problem with the existing Shariah governance in Islamic finance relates to the legitimacy of some Islamic financial products and the efficiency of the Shariah control in Islamic finance. Noticeably, these two problems are interrelated since an inefficient Shariah control will lead to questionable products.

The Core Components of Shariah Governance

Shariah governance includes a variety of issues; the focus of this paper will be on two core components: i) Islamic finance products and ii) Shariah control.

Islamic finance products and transactions

Islamic banking and finance products need to be subject to sound Shariah governance given the existence of several controversial products in the market, as well as the conflict of opinions regarding endorsing some of the products. The same product may be deemed permissible in one bank but impermissible in another simply because the Shariah boards of different banks have different opinions. While it is true that the traditional schools of Islamic law (fiqh) differed on many issues, never made their differences lead to such a level of controversy and discord, especially in matters pertaining to interest (*riba*).

Schools of Islamic law differed about validating certain transactions as only a valid contract produces legal consequences, but never did they differ about the impermissibility of a contract whose essence contains *riba*, either implicitly or explicitly (Abozaid, 2010)[1]. In the early years of the Islamic banking and finance industry, some transactions were perceived to be 'un-Islamize-able' due to their essence being in clear conflict with the principles of the Shariah. However, over time they received endorsement in some institutions and subsequently entered the market. Examples can be found in numerous financial derivatives that caught the attention of certain Shariah advisory firms that sought to convert them into allegedly Shariah-compliant instruments (Abozaid, 2014).

Furthermore, some Islamic financial institutions have loosened the Shariah rules they had previously set. For example, the 5% toleration limit on unlawful income in stock trading, or Islamic Retail Investment Funds (REITs), has been increased to 10%. Similarly, in some recent standards pertaining to the tradability of Sukuk and shares in the secondary market, the 30% benchmark set for the assets composition ratio of tradable assets to the total assets has been reduced to 10% (Abozaid, 2012; Aljarhi, 2009)

As a matter of fact, it is no secret or surprise that Shariah advisory firms are competing together to Islamize as conventional products by stretching the limits of permissibility, and they tend to attract the attention of their clients by adopting a lenient approach towards the endorsement of products and services after lobbying some of the established names (scholars) in the industry to better market their services.

The conflicting and inconsistent opinions about endorsing Islamic banking and finance products have created confusion and suspicion over their legitimacy amongst the public. Recent surveys have found that a large number of Muslims refrain from dealing with Islamic banks altogether or avoid some of their services for these reasons. They have also found that Muslims deal with Islamic banks

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[1] See Abozaid (2010), For more details on this issue and the difference between a valid contract and a permissible contract see.

not out of confidence in the legitimacy of their products but on the basis of 'assuming the lessor of two evils'—the greater evil being dealing with conventional banks.

Table 1. Survey on shariah compliance of banks

Q.11- If you have doubts over the Shariah compliance in Islamic banks, what is the reason that drives you to still deal with Islamic banks?	Response Rate
They are less bad than conventional banks	34%
I limit my dealing with Islamic banks to the minimum because of my doubts	37%
Islamic banks, and not clients, bear the sin and take the blame	23%
I do not deal with Islamic banks because of my doubts	4%
Other reasons	2%

Source: Al-Dasouqi (2019)

In fact, the academic discourse on Islamic banking and finance tends to reflect deep concern, disappointment, and increasing resentment. Many academics have therefore sought to address the ethical and moral issues pertaining to the industry, while several academic institutions have introduced courses on the higher objectives of Islamic law (Maqasid al-Shariah) to critically review the performance of Islamic banking and finance in light of the higher objectives and philosophy of Islamic law.

Also, the choice of the theme of academic conferences on Islamic banking and finance expresses concern about the ethical performance of the industry. Themes include:

- "Islamic Finance: Reality v. Expectations."
- "Islamic Finance: Idealism v. Reality."

Such themes reflect the great concern over the legitimacy and ethical performance of Islamic banks, and the realization that in order for Islamic banking products to be labeled as Shariah-compliant, there is a need to go beyond the Shariah technical requirements in finance. At the present time, the essence and spirit of Islamic banking and finance are far from achieving the goal of social justice that is embedded in the Islamic economy.

In light of the aforementioned problems—the increasing differences and conflict amongst scholars in endorsing Islamic financial products, on the one hand, and increasing resentment of the public towards such disorder, on the other—standardization of Islamic banking products is necessary in order to restore and maintain the credibility of the Islamic banking and finance sector. Standardization should be limited to products only and not extended to day-to-day transactions because most of these transactions are tailored according to the needs of the clients and the special conditions governing them. Nevertheless, certain contracts may be ruled out as unlawful if they are used as an underlying contract in structuring the transaction, such as eina and *tawarruq* contracts that are commonly used as a subterfuge to *Riba*[2].

Finally, the task of standardizing products can be assigned to certain existing regulatory authorities, such as the Fiqh Academy or AAOIFI, after restructuring these authorities in order to ensure professionalism, integrity, full independence, and high-quality scholarship. In turn, certain mechanisms need to be established so that Islamic financial institutions abide by the standardized products. Such mechanisms may include legal measures, but if this is unfeasible, then by blacklisting the non-abiding banks. It is expected that if an Islamic bank or a financial institution is

[2] Eina is a sale that is mostly resorted to for the purpose of circumventing the prohibition of *riba* by selling a commodity to the person seeking financing at a deferred price then instantly buying it back at a lesser spot price. Tawarruq is to purchase a commodity from one party on credit then sell it immediately to another for cash. Thus, tawarruq shares the same objective of eina as both are meant for extending cash money. However, Tawarruq remains technically distinguished from eina as in the later the commodity is resold to its original seller, while in tawarruq it is sold to a third party (Abozaid, 2004).

blacklisted by an entity trusted by the public, then this would create an incentive for the financial institution to honor Shariah rules. This incentive would never be less effective than the incentive of the binding laws. If the existing regulatory authorities cannot undertake such tasks, then it may require another entity to be set up to assume such supervisory responsibility for Islamic financial institutions. It would require grouping and rallying a considerable number of reliable Shariah scholars in the Muslim world under one banner, and then have these scholars review all the so called 'Islamic financial products' to declare the Shariah incompliant ones and blacklist them and the institutions dealing with them.

Shariah supervision and control

As would be expected, Sharia control over Islamic financial institutions is supposed to be a legal requirement in every institution to ensure that the institution's activities comply with the rules of the Shariah. However, in many countries, Shariah control has been left to the discretion of the Islamic financial institutions themselves, such that Islamic financial institutions are effectively self-regulated with regards to Shariah control, while the involvement of higher authorities remains technical, if not superficial. Being self-regulated, this has led to them exercising Shariah control simply in order to market themselves as Sharia-compliant institutions. They hire some people known to be Shariah specialists to perform Shariah supervision and auditing functions, such as reviewing the products and activities of financial institutions and to supervise the proper implementation of their fatwas, or legal pronouncements. Although on the face of it, such an arrangement seems reasonable and acceptable, in fact, it harbors the seeds of deviousness and manipulation in order to realize the business interests of these institutions. This begins from the selection process of the Shariah supervisory board members who are chosen on the basis of being well-known and lenient, but not necessarily competent. The same banking institution is then effectively capable of dismissing or replacing a Shariah board member at its own convenience. Additionally, all internal Shariah auditors and compliance officers effectively report to the management of the bank. Altogether, such practices create conflicts of interest and render Shariah control work neither transparent nor independent, and open the door to manipulation of Shariah control work to realize the interest of the banks.

Figure 1 shows, based on a recent survey conducted by some Master students of Qatar Foundation, the perceived impact of the self-regulation of Islamic banks on the credibility of these banks from the clients' perspective. It responded to the statement "The Islamic finance industry is self-regulated, which affirms its institutions' adherence to Shariah":

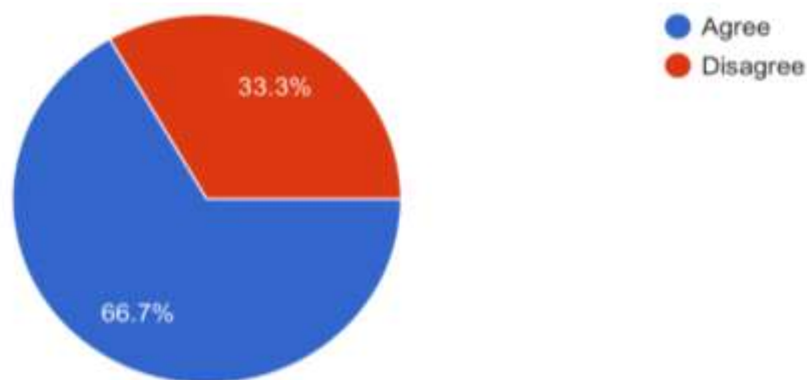

Figure 1, Perceived Impact of self-regulation on the credibility of Islamic banks, by Hassan and Basil on 2019

Response to the statement "The Islamic finance industry is self-regulated, which poses a real threat to its institutions' adherence to Shari'a' was as follows:

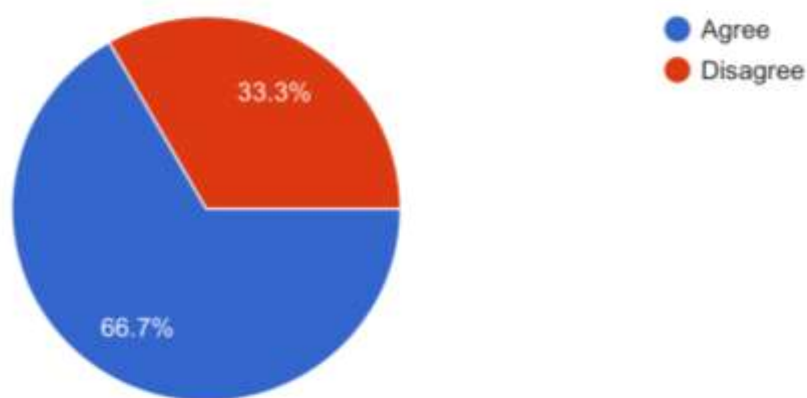

Figure 2, Survey responses by Hassan and Basil on 2019

The aforementioned practices explain why only a very limited number of Shariah scholars occupy (numerous) Shariah supervisory boards, despite the existence of many highly qualified Shariah scholars across the world. In order to address this problem and ensure the genuine independence of Shariah scholars and Shariah control personnel, it is necessary to address the relationship of mutual interest between them and the bankers. This would allow the Shariah control work to align with the general norms and principles of the Shariah. It is unprecedented in the history of Islam that the same entity that is bound by the Shariah rules is paying the party who passes those rules. From the Islamic perspective, the judge, for example, cannot be selected by those individuals or bodies upon whom he will pass judgment, nor can he receive any financial compensation from them, such as payment or gifts. As for Islamic financial institutions, despite the fact that they are bound by the pronouncements of their Shariah boards, they have the ability to select them, dismiss them, and pay them their salaries! These pronouncements cannot be considered simply advice or fatwa[3] (a juristic opinion) in order to justify the current practice. Rather, they are binding on the institution in the same way as a juridical decision. Furthermore, Islam recognizes that no human being apart from a Prophet is immune to the temptations of wealth or worldly gain. Such temptation is strong if we consider the multi-million-dollar income that Shariah board membership may yield.

Proposed Shariah Governance Rules

To address the aforementioned deficiencies in the existence of Shariah governance, the following Shariah governance rules can be suggested:

Accreditation of Shariah controllers (board membership)

Shariah board membership must be contingent upon full qualification and accreditation of the Shariah scholars. Rather than simply holding a degree or diploma in Shariah or Islamic studies, the Shariah board member should hold a Master's degree or doctorate in Islamic financial law, in addition to possessing some basic knowledge in banking and finance (Aljarhi, 2009). They must also be accredited by an institution set up for this purpose, after passing exams and taking intensive courses if necessary.

IFSB stipulates that a Shariah board member must hold a bachelor's degree (ijāzah) in Shariah from a recognized university (IFSB, Standard (10) on Shariah Governance, Appendix 4). AAOIFI simply stipulates that a Shariah board member must be well-versed in Islamic jurisprudence (fiqh),

[3] Fatwa refers to the Shariah opinion given by a Shariah scholar over some matter. Unlike the judgment given in the court of law, fatwa is non-binding so it is left to the one who seeks it to apply it, ignore it or source a different fatwa from a different Shariah scholar. Therefore, the use of the word "fatwa" in the context of Islamic banking and finance is actually inaccurate. Fatwa is non-binding and it is just a Shariah legal opinion given by a scholar to one who asks for it without binding him, while the Shariah pronouncement issued by the Shariah board is binding and the Shariah board members recognize it as such.

without mentioning possessing an academic degree or whether his area of expertise is in Islamic financial law[4].

While it is true that there are many learned Shariah scholars who do not possess a degree in Shariah or banking and finance, given the high degree of sensitivity of the task of Shariah control in the IFIs, all Shariah board members are required to possess the minimum of a Masters or Ph.D. degree in order to protect the industry from incompetency. Such a measure is essential, especially given that many Muslims are unable to distinguish between a preacher and a Shariah scholar, and between the various branches of Islamic law – the most complex of which is the Islamic law of transactions (*Fiqh al-Muamalat).*

Shariah board members should have the ability to read in both English and Arabic if contracts are written in English. Knowledge of written English is necessary because translated versions of banking and finance contracts from English into Arabic (or another language) may fail to fully convey the exact meanings of words, especially given the highly technical language of the contracts. Good knowledge of written Arabic should also be a requirement since the Shariah board member needs to be conversant with primary sources of the Shariah. To summarize, a Shariah board member should hold Masters or PhD degree in Islamic financial law and possess basic knowledge of banking and finance and be able to read Arabic, as well as English, if documents are presented in English.

In order to practice, a Shariah scholar who possesses the relevant qualifications should be licensed after taking certain exams to ensure that he has the necessary knowledge and is capable of practicing. Doctors and lawyers must hold licenses in order to practice in the fields of medicine and law. The same should apply to Shariah scholars who are members of Shariah boards.

Independence of the Shariah control

As aforementioned, the independence of Shariah board members and all Shariah controllers from the IFI is an absolutely necessity and is indispensable in order to avoid a conflict of interest and ensure integrity and credibility of their work. An independent third party, such as the central bank or an international institution, such as the Council for Islamic Banking and Financial Institutions, should be tasked with selecting, appointing and dismissing Shariah board members.

According to the policies of Islamic banks, the BOD (Board of Directors) is assigned with the task of selecting and appointing the Shariah board members. The appointment then receives approval from the shareholders in the General Meeting. However, in practice, the bank executive managers select the Shariah board members.

According to the IFSB standard on Shariah governance, "the BOD shall appoint the Shari'ah board but the appointment shall require approval from the shareholders in a General Meeting, similar to the appointment of an external auditor. The BOD may wish to delegate the power to another party – for example, the Nomination Committee or the CEO. However, the BOD must remain ultimately responsible with regard to the appointment of the Shariah board. This is to ensure that the independence of the Shari`ah board, especially from the influence of the management of the IIFS[5], is not compromised"[6].

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[4] The AAOIFI Shariah Standard No. 29/5 reads "A board member must be well versed in Fiqh (Islamic Jurisprudence), well informed of the contributions of diligent fiqh scholars, and has the ability to use the Shari'a-accepted methods of deriving reasonable rulings on merging issues. He should also be known for his discernment, cautiousness and knowledge about the circumstances and traditions of people, and should always remain alert against the different means of human misbehavior. Competence in fiqh is usually manifested by the vast reputation of the scholar or his distinguishable contributions especially in the area of financial transactions performed by institutions".

[5] An abbreviation used by IFSB for "Islamic Institution offering Financial Services"

[6] IFSB Standard (10) on Shariah Governance, Appendix1, footnote No. 28.

The viability of this arrangement is questionable given that neither the executive members nor the BOD is truly independent as both parties are hired to serve the best interests of the bank (i.e. to ensure profitability), which may at times conflict with Shariah compliance. Similarly, the shareholders—as owners of the bank—seek higher profitability and do not represent an independent party. Hence, giving them the authority to appoint Shariah board members, as stated by AAOIFI[7], does not meet the condition of independence and absence of conflict of interest.

Conflict of interest explains why a defendant or claimant is not given the right to choose his own judge. The same applies to a bank owner, or an in-house/out-house bank manager who should not be given the right to choose the Shariah controller as it results in a conflict of interest. It is puzzling as to why this is not recognized in the current selection practice of Shariah board members, especially given that issuing Shariah pronouncements that outline prohibitions (haram) in the Shariah is a more crucial and serious task than a court case.

Islam, if fact, is a practical religion revealed by the Creator. While it outlines the necessary positive characteristic of judges, such as being from amongst the most righteous, knowledgeable and experienced people, it also acknowledges the fallibility of human nature. Therefore, it outlines negatives measures that must also be complied with, such as not accepting gifts[8] or salaries from those bound by their judgements. Such measures are clearly intended for the purpose of removing conflict of interest and safeguarding the integrity of the work. The work of a Shariah controller who issues Shariah pronouncements is similar and no less important than the work of a judge—both outline the permissible and impermissible for people to follow, and therefore they both sign on behalf of the Almighty Lawgiver[9].

The integrity of the Shariah boards depends upon the independence of Shariah board members and Shariah controllers. If the Shariah board member finds himself appointed, paid, and possibly dismissed by the bank that is the subject to his binding pronouncements, then it is logical that he will be inclined to take a more lenient approach in his pronouncements in order to safeguard his position at the bank and also to possibly induce other Islamic banks to hire him (as Shariah scholars can sit on multiple Shariah boards in many jurisdictions).

Adding financial and legal experts to Shariah boards

Shariah board membership should also include financial and legal experts who have no voting rights and whose role it is to advise and brief the Shariah scholars on any relevant financial or legal concerns, as well as any possible implications of issuing any Shariah pronouncement. This measure is particularly important if Shariah board members do not possess sufficient legal, financial, or market experience and need to consult trustworthy and independent experts before issuing a Shariah pronouncement. It also protects against passing wrong pronouncements due to a misunderstanding on behalf of Shariah board members or due to misrepresentation on behalf of bankers.

Restricting multiple Shariah-board memberships

A noticeable feature of Islamic banking and finance is that a handful of Shariah scholars dominate the Shariah boards. This undesirable phenomenon is caused by a number of factors, all of which relate to a lack of proper and effective Shariah governance. It is understandable that banks would want to hire the most tolerant Shariah scholars. It is also known to be the case that recently-opened institutions ask existing Shariah board members to recommend members for their own

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[7] AAOIFI Governance Standard for Islamic Financial Institution, 1/3.

[8] For rules on gifting judges and paying them wages see: (Al–Sarkhasi, 1987, p.82)

[9] Ibn al-Qayyem interestingly named his book in which he explicitly talked about fatwa in the context of the legal tricks to riba "I'lam Al-Muwaqi'een 'an Rabell'almeen" which means "warning the signatories (Muftis) on behalf of the Lord"!

boards, which may lead to the same Shariah scholars working on a number of different Shariah boards for different institutions (Aljarhi, 2009). It is a highly unprofessional practice and has a number of negative implications, such as subjecting the whole industry to the views of a limited number of people, and rendering the Shariah board members incapable of efficiently discharging their responsibilities. It is incumbent therefore to limit the number of Shariah boards that a single person may sit on, to a manageable number - say three. This would also give the chance to other qualified scholars to enter and benefit the industry.

While AAOIFI standards are silent on this issue, IFSB standards actually recognize and tolerate it. According to the IFSB: “When a member of the Shariah board has multiple Shariah board responsibilities/appointments, he or she must ensure that sufficient time and attention is given to the affairs of each IIFS” (IFSB, 2009). Surprisingly, the standard places the onus on the Shariah board members themselves to know whether or not they can commit sufficient time and attention to the affairs of each Islamic financial institution. Then the very same standard shifts the responsibility to the financial institution itself, stating: “The IIFS should decide if a member of the Shariah board is able to and has been adequately carrying out his or her duties in serving his or her Shariah board” [10].

A careful reading of both the AAOIFI and the IFSB standards on Shariah governance gives one the impression that both sets of standards do not refute or disapprove any of the existing problematic practices. Rather, they tend either to completely ignore them, or at best, to hint to them. This brings to the attention the matter of very independence of these regulatory authorities, given that AAOFI Shariah board members used to be members of Shariah boards in Islamic banks, and that IFSB’s position and strength in the industry makes it too vulnerable to clearly pinpoint incorrect practices and describe them as such.

Formation of an international Shariah board

A means of solving the aforementioned Shariah governance problems would be through the establishment of an international Shariah board. Its responsibility would involve endorsing main products and contracts only, since it would not be feasible for it to evaluate the transactions of the Islamic banks that are customized on a daily basis or the ones that tailor a particular bank’s need. It should comprise of a specific number of the most credible, experienced and qualified Shariah scholars from various jurisdictions and schools of law. These scholars should be fully independent and not members of individual Shariah boards. The board could be made an affiliate of the Organization of Islamic Cooperation (OIC) and also paid by the OIC after receiving funds from member banks. Its resolution should be made binding on the individual Islamic banks. In the case of a proven infringement of the Shariah by one of the banks it should have the authority to declare it as not being Shariah compliant. Individual Shariah board members should also be given the right to report any infringement by their respective bank. Even if it did not possess the legal authority to withdraw the license of a non-compliant bank, it would still have great influence over the banks and their Shariah boards if it blacklisted a particular bank given that the particular bank and its Shariah board would fear losing its credibility amongst the public. To ensure compliance with its regulations the board should have an audit arm to carry out unannounced inspection visits to the banks to scrutinize their products and to report any infringements.

[10] The complete standard reads “When a member of the Shariah board has multiple Shariah board responsibilities/appointments, he or she must ensure that sufficient time and attention is given to the affairs of each IIFS. The IIFS should decide if a member of the Shariah board is able to and has been adequately carrying out his or her duties in serving his or her Shariah board”. IFSB Standard (10) on Shariah Governance, Independence, 45.

The Importance and Significance of Shariah Governance

One of the unique characteristics of Islamic banking and finance is compliance with Shariah principles and rulings. Shariah compliance is, in fact, what distinguishes an Islamic bank from a conventional bank as the former observes certain rules and prohibitions not observed by the latter. Failing to fulfill the Shariah compliance requirements would generate a risk called 'the Shariah non-compliance risk'. This risk is unique to the Islamic banking and finance industry, and it is particularly significant to it for the following reasons: i) It generally impacts on the industry's reputation as well as the reputation of the financial institution and thus, it may deteriorate reliance of the depositors, investors, customers and stakeholders in the long-term. ii) Contracts containing Shariah-repugnant elements and already executed should be deemed null and void, which would in turn render the profit derived thereof non-halal, and as a result the tainted income arising from such transactions must be channeled to charity and cannot be kept by the bank. iii) It may involve some legal costs as potential suits may lead to payment of damages. Therefore, the existence of non-Shariah compliant elements would not just affect the confidence of the public in Islamic banking and finance, but it might also expose Islamic banks to profitability, fiduciary and reputational risks.

Hence, Shariah compliance is the backbone of Islamic banking & finance. It gives legitimacy to the practices of Islamic banking and finance and thus validates the profits. It also boosts the confidence of all stakeholders that all the practices and activities of the bank are in compliance with the Shariah. However, compliance with the Shariah will be confidently achieved only by having a proper Shariah governance framework. This is because Shariah governance is meant only to ensure compliance of Islamic banking and finance industry with the rules of the Shariah.

Principle 3.1 of the "IFSB Guiding Principles on Corporate Governance" stresses the importance of Shariah governance by stating that an appropriate mechanism must be created to ensure the compliance with the Shariah principles. Similarly, Principle 7.1 of the "IFSB Guiding Principles on Risk Management" states that Islamic financial institutions shall have in place adequate systems and controls, including a Shariah board/advisor to ensure compliance with the Shariah principles.

The Problem with the Existing Shariah Governance

Briefly, it can be said that the Islamic banking and finance industry is left to regulate itself in terms of Shariah governance. Despite the importance of regulating this relatively new industry and the critical risks resulting from weak Shariah governance, there is no genuine or effective interference by the high authorities to regulate this industry. There is no one unified Shariah governance system, and in most jurisdictions supervisory authorities may permit the Islamic financial institutions to decide for themselves what kind of Shariah governance system to adopt. The market is left to determine freely which system lends sufficient credibility to the products and services that each Islamic financial institution offers. This self-regulation has in fact led to many cautions rendering Shariah control ineffective in most cases.

Even in the very few countries that have national Shariah governance frameworks, like Malaysia, Oman and Syria, this framework has not been effective enough to address the Shariah concerns associated with a lack of or improper Shariah governance. If Shariah governance is meant to assure compliance of the banks products as well as operations with Shariah, both in fact are widely criticized for harboring some Shariah concerns, and possibly in some of these countries than any other jurisdictions. Therefore, the existing Shariah governance frameworks have failed to fulfil their objective as a guarantee of Shariah compliance.

More importantly, the Shariah as a whole need to be safeguarded and protected from being possibly manipulated or twisted by Islamic banks to serve their self-interests. This also requires

setting robust Shariah governance for the Islamic finance industry to guarantee the preservation of the Shariah rules and the protection of its Shariah image.

Now, to identify the problems with the existing Shariah governance we need to locate the existing Shariah concerns over the practices of the industry, because every Shariah concern in the current practices relates to some corresponding deficiency in the existing Shariah governance frameworks. Generally, the basic Shariah concerns over the practices of the industry are the following: i) The invasion of highly controversial products, which are no different in essence from the conventional banking products that are believed to be unlawful. ii) The non-independence of the Shariah controllers, including the Shariah supervisory board members, from the financial institution they are supposed to control and supervise. This could create conflict of interest and inevitably open the door for subjective and arbitrary endorsement of the banking products and services. iii) The existence of unqualified Shariah controllers lacking the necessary expertise and knowledge; naturally, this would in turn lead to the wrong evaluation and assessment of the financial products.

These Shariah concerns are natural outcomes of weak Shariah governance, which fails to fulfil its purpose in safeguarding the Shariah aspects of the business. Obviously, the problem with the existing Shariah governance in Islamic finance relates to the legitimacy of some Islamic financial products and the efficiency of the Shariah control in Islamic finance. Noticeably, these two problems are interrelated since an inefficient Shariah control will lead to questionable products.

The Core Components of Shariah Governance

Shariah governance includes a variety of issues; the focus of this paper will be on two core components: i) Islamic finance products and ii) Shariah control.

Islamic finance products and transactions

Islamic banking and finance products need to be subject to sound Shariah governance given the existence of several controversial products in the market, as well as the conflict of opinions regarding endorsing some of the products. The same product may be deemed permissible in one bank but impermissible in another simply because the Shariah boards of different banks have different opinions. While it is true that the traditional schools of Islamic law (fiqh) differed on many issues, never did their differences lead to such a level of controversy and discord, especially in matters pertaining to interest (*riba*).

Schools of Islamic law differed about validating certain transactions as only a valid contract produces legal consequences, but never did they differ about the impermissibility of a contract whose essence contains *riba*, either implicitly or explicitly (Abozaid, 2004)[11]. In the early years of the Islamic banking and finance industry, some transactions were perceived to be 'un-Islamize-able' due to their essence being in clear conflict with the principles of the Shariah. However, over time they received endorsement in some institutions and subsequently entered the market. Examples can be found in numerous financial derivatives that caught the attention of certain Shariah advisory firms that sought to convert them into allegedly Shariah-compliant instruments (Abozaid, 2014).

Furthermore, some Islamic financial institutions have loosened the Shariah rules they had previously set. For example, the 5% toleration limit on unlawful income in stock trading, or Islamic Retail Investment Funds (REITs), has been increased to 10%. Similarly, in some recent standards pertaining to the tradability of sukuk and shares in the secondary market, the 30% benchmark set

[11] For more details on this issue and the difference between a valid contract and a permissible contract see "Contemporary Islamic Financing Modes between Contracts Technicalities and Shariah Objectives", Journal of Islamic Economics Studies, Islamic Research and Training Institute, Islamic Development Bank, Volume 17, No2. Jan, 2010.

for the assets composition ratio of tradable assets to the total assets has been reduced to 10% (Abozaid, 2012; Aljarhi, 2009).

As a matter of fact, it is no secret or surprise that Shariah advisory firms are competing together to Islamize as conventional products by stretching the limits of permissibility, and they tend to attract the attention of their clients by adopting a lenient approach towards the endorsement of products and services after lobbying some of the established names (scholars) in the industry to better market their services.

The conflicting and inconsistent opinions about endorsing Islamic banking and finance products have created confusion and suspicion over their legitimacy amongst the public. Recent surveys have found that a large number of Muslims refrain from dealing with Islamic banks altogether or avoid some of their services for these reasons. They have also found that Muslims deal with Islamic banks not out of confidence in the legitimacy of their products but on the basis of 'assuming the lessor of two evils'—the greater evil being dealing with conventional banks.

Table 2. Results from survey

Q.11- If you have doubts over the Shariah compliance in Islamic banks, what is reason that drives you to still deal with Islamic banks?	Response Rate
They are less bad than conventional banks	34%
I limit my dealing with Islamic banks to the minimum because of my doubts	37%
Islamic banks, and not clients, bear the sin and take the blame	23%
I do not deal with Islamic banks because of my doubts	4%
Other reasons	2%

Source: Al-Dasouqi (2017)

In fact, the academic discourse on Islamic banking and finance tends to reflect deep concern, disappointment, and increasing resentment. Many academics have therefore sought to address the ethical and moral issues pertaining to the industry, while several academic institutions have introduced courses on the higher objectives of Islamic law (Maqasid al-Shariah) to critically review the performance of Islamic banking and finance in light of the higher objectives and philosophy of Islamic law.

Also, the choice of theme of academic conferences on Islamic banking and finance expresses concern about the ethical performance of the industry. Themes include:

• "Islamic Finance: Reality v. Expectations"

• "Islamic Finance: Idealism v. Reality"

Such themes reflect the great concern over the legitimacy and ethical performance of Islamic banks, and a realization that in order for Islamic banking products to be labeled as Shariah compliant, there is a need to go beyond the Shariah technical requirements in finance. At the present time the essence and spirit of Islamic banking and finance is far from achieving the goal of social justice that is embedded in the Islamic economic.

In light of the aforementioned problems—the increasing differences and conflict amongst scholars in endorsing Islamic financial products, on the one hand, and increasing resentment of the public towards such disorder, on the other—standardization of Islamic banking products is necessary in order to restore and maintain the credibility of the Islamic banking and finance sector. Standardization should be limited to products only and not extended to day-to-day transactions because most of these transactions are tailored according to the needs of the clients and the special conditions governing them. Nevertheless, certain contracts may be ruled out as unlawful if they are

used as an underlying contract in structuring the transaction, such as eina and tawarruq contracts that are commonly used as subterfuge to *Riba*.[12]

Finally, the task of standardizing products can be assigned to certain existing regulatory authorities, such as the Fiqh Academy or AAOIFI, after restructuring these authorities in order to ensure professionalism, integrity, full independence and high-quality scholarship. In turn, certain mechanisms need to be established so that Islamic financial institutions abide by the standardized products. Such mechanisms may include legal measures, but if this is unfeasible, then by blacklisting the non-abiding banks. It is expected that if an Islamic bank or a financial institution is blacklisted by an entity trusted by the public, then this would create an incentive for the financial institution to honor Shariah rules. This incentive would never be less effective than the incentive of the binding laws. If the existing regulatory authorities cannot undertake such tasks, then it may require another entity to be set up to assume such supervisory responsibility over Islamic financial institutions. It would require grouping and rallying a considerable number of reliable Shariah scholars in the Muslim world under one banner, and then have these scholars review all the so called 'Islamic financial products' to declare the Shariah incompliant ones and blacklist them and the institutions dealing with them.

Shariah supervision and control

As would be expected, Shariah control over Islamic financial institutions is supposed to be a legal requirement in every institution to ensure that the institution's activities comply with the rules of the Shariah. However, in many countries, Shariah control has been left to the discretion of the Islamic financial institutions themselves, such that Islamic financial institutions are effectively self-regulated with regards to Shariah control, while the involvement of higher authorities remains technical, if not superficial. Being self-regulated, this has led to them exercising Shariah control simply in order to market themselves as Shariah compliant institutions. They hire some people known to be Shariah specialists to perform Shariah supervision and auditing functions, such as reviewing the products and activities of financial institutions and to supervise the proper implementation of their fatwas, or legal pronouncements. Although on the face of it, such an arrangement seems reasonable and acceptable, in fact, it harbors the seeds of deviousness and manipulation in order to realize the business interests of these institutions. This begins from the selection process of the Shariah supervisory board members who are chosen on the basis of being well-known and lenient, but not necessarily competent. The same banking institution is then effectively capable of dismissing or replacing a Shariah board member at its own convenience. Additionally, all internal Shariah auditors and compliance officers effectively report to the management of the bank. Altogether, such practices create conflicts of interest and render Shariah control work neither transparent nor independent, and open the door to manipulation of Shariah control work to realize the interest of the banks.

Figure 3, based on a recent survey conducted by some Master students of Qatar Foundation, the perceived impact of the self-regulation of Islamic banks on the credibility of these banks from the clients' perspective. It responded to the statement "The Islamic finance industry is self-regulated, which affirms its institutions' adherence to Shariah":

[12] Eina is a sale that is mostly resorted to for the purpose of circumventing the prohibition of riba by selling a commodity to the person seeking financing at a deferred price then instantly buying it back at a lesser spot price. Tawarruq is to purchase a commodity from one party on credit then sell it immediately to another for cash. Thus, tawarruq shares the same objective of eina as both are meant for extending cash money. However, Tawarruq remains technically distinguished from eina as in the later the commodity is resold to its original seller, while in tawarruq it is sold to a third party (Abozaid, 2004).

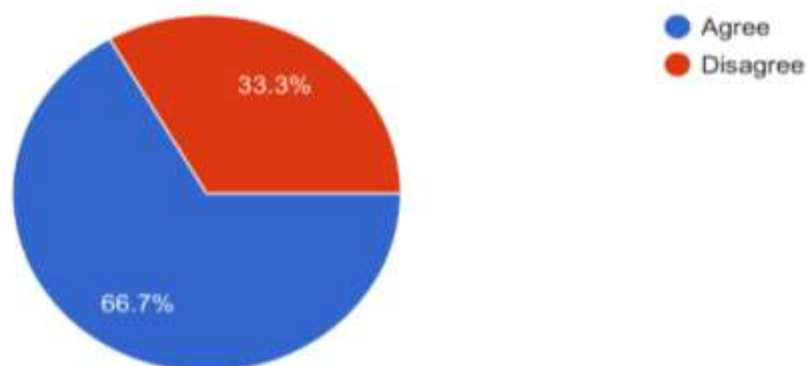

Figure 3, impact of the self-regulation of Islamic banks on the credibility of these banks from the clients' perspective by Hassan and Basil on 2019

Response to the statement "The Islamic finance industry is self-regulated, which poses a real threat to its institutions' adherence to Shari'a' was as follows:

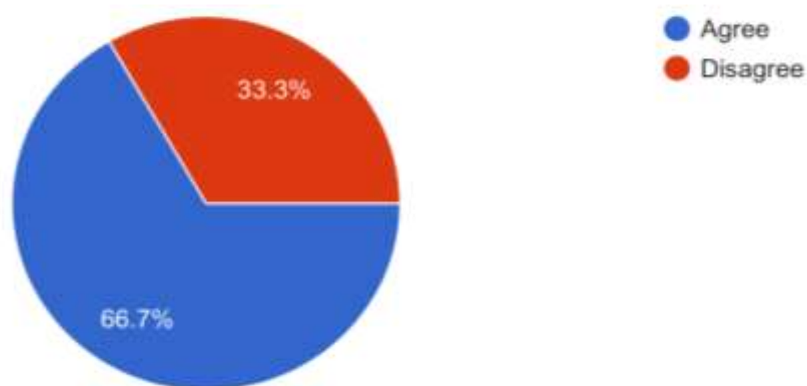

Figure 4, Impact of self-regulation by Hassan and Basil on 2019

The aforementioned practices explain why only a very limited number of Shariah scholars occupy (numerous) Shariah supervisory boards, despite the existence of many highly qualified Shariah scholars across the world. In order to address this problem and ensure genuine independence of Shariah scholars and Shariah control personnel, it is necessary to address the relationship of mutual interest between them and the bankers. This would allow the Shariah control work to align with the general norms and principles of the Shariah. It is unprecedented in the history of Islam that the same entity that is bound by the Shariah rules is paying the party who passes those rules. From the Islamic perspective, the judge, for example, cannot be selected by those individuals or bodies upon whom he will pass judgement nor can he receive any financial compensation from them, such as payment or gifts. As for Islamic financial institutions, even though they are bound by the pronouncements of their Shariah boards, they have the ability to select them, dismiss them and pay them their salaries! These pronouncements cannot be considered simply advice or fatwa [13] (a juristic opinion) in order to justify the current practice. Rather, they are binding on the institution in the same way as a juridical decision. Furthermore, Islam recognizes that no human being apart from a Prophet is immune to the temptations of wealth or worldly gain. Such temptation is strong if we consider the multi-million-dollar income that Shariah board membership may yield.

[13] Fatwa refers to the Shariah opinion given by a Shariah scholar over some matter. Unlike the judgment given in the court of law, fatwa is non-binding so it is left to the one who seeks it to apply it, ignore it or source a different fatwa from a different Shariah scholar. Therefore, the use of the word "fatwa" in the context of Islamic banking and finance is actually inaccurate. Fatwa is non-binding and it is just a Shariah legal opinion given by a scholar to one who asks for it without binding him, while the Shariah pronouncement issued by the Shariah board is binding and the Shariah board members recognize it as such.

Proposed Shariah Governance Rules

To address the aforementioned deficiencies in the existence Shariah governance, the following Shariah governance rules can be suggested:

Accreditation of Shariah controllers (board membership)

Shariah board membership must be contingent upon full qualification and accreditation of the Shariah scholars. Rather than simply holding a degree or diploma in Shariah or Islamic studies, the Shariah board member should hold a Master degree or doctorate in Islamic financial law, in addition to possessing some basic knowledge in banking and finance (Aljarhi, 2009). They must also be accredited by an institution set up for this purpose, after passing exams and taking intensive courses if necessary.

IFSB stipulates that a Shariah board member must hold a bachelor's degree (ijāzah) in Shariah from a recognized university (IFSB, Standard (10) on Shariah Governance, Appendix 4). AAOIFI simply stipulates that a Shariah board member must be well-versed in Islamic jurisprudence (fiqh), without mentioning possessing an academic degree or whether his area of expertise is in Islamic financial law.[14]

While it is true that there are many learned Shariah scholars who do not possess a degree in Shariah or banking and finance, given the high degree of sensitivity of the task of Shariah control in the IFIs, all Shariah board members are required to possess the minimum of a Masters or PhD degree in order to protect the industry from incompetency. Such a measure is essential, especially given that many Muslims are unable to distinguish between a preacher and a Shariah scholar, and between the various branches of Islamic law – the most complex of which is the Islamic law of transactions (Fiqh al-Muamalat).

Shariah board members should have the ability to read in both English and Arabic if contracts are written in English. Knowledge of written English is necessary because translated versions of banking and finance contracts from English into Arabic (or another language) may fail to fully convey the exact meanings of words, especially given the highly technical language of the contracts. Good knowledge of written Arabic should also be a requirement, since the Shariah board member needs to be conversant with primary sources of the Shariah. To summarize, a Shariah board member should hold Masters or PhD degree in Islamic financial law and possess basic knowledge of banking and finance, and be able to read Arabic, as well as English if documents are presented in English.

In order to practice, a Shariah scholar who possesses the relevant qualifications should be licensed after taking certain exams to ensure that he has the necessary knowledge and is capable of practicing. Doctors and lawyers must hold licenses in order to practice in the fields of medicine and law. The same should apply to Shariah scholars who are members of Shariah boards.

Independence of the Shariah control

As aforementioned, the independence of Shariah board members and all Shariah controllers from the IFI is an absolutely necessity and is indispensable in order to avoid a conflict of interest and ensure integrity and credibility of their work. An independent third party, such as the central

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[14] The AAOIFI Shariah Standard No. 29/5 reads "A board member must be well versed in Fiqh (Islamic Jurisprudence), well informed of the contributions of diligent fiqh scholars, and has the ability to use the Shari'a-accepted methods of deriving reasonable rulings on merging issues. He should also be known for his discernment, cautiousness and knowledge about the circumstances and traditions of people, and should always remain alert against the different means of human misbehavior. Competence in fiqh is usually manifested by the vast reputation of the scholar or his distinguishable contributions especially in the area of financial transactions performed by institutions".

bank or an international institution, such as the Council for Islamic Banking and Financial Institutions, should be tasked with selecting, appointing and dismissing Shariah board members.

According to the policies of Islamic banks, the BOD (Board of Directors) is assigned with the task of selecting and appointing the Shariah board members. The appointment then receives approval from the shareholders in the General Meeting. However, in practice, the bank executive managers select the Shariah board members.

According to the IFSB standard on Shariah governance, "the BOD shall appoint the Shari'ah board but the appointment shall require approval from the shareholders in a General Meeting, similar to the appointment of an external auditor. The BOD may wish to delegate the power to another party – for example, the Nomination Committee or the CEO. However, the BOD must remain ultimately responsible with regard to the appointment of the Shariah board. This is to ensure that the independence of the Shari`ah board, especially from the influence of the management of the IIFS[15], is not compromised".[16]

The viability of this arrangement is questionable given that neither the executive members nor the BOD is truly independent as both parties are hired to serve the best interests of the bank (i.e. to ensure profitability), which may at times conflict with Shariah compliance. Similarly, the shareholders—as owners of the bank—seek higher profitability and do not represent an independent party. Hence, giving them the authority to appoint Shariah board members, as stated by AAOIFI[17], does not meet the condition of independence and absence of conflict of interest.

Conflict of interest explains why a defendant or claimant is not given the right to choose his own judge. The same applies to a bank owner, or an in-house/out-house bank manager who should not be given the right to choose the Shariah controller as it results in a conflict of interest. It is puzzling as to why this is not recognized in the current selection practice of Shariah board members, especially given that issuing Shariah pronouncements that outline prohibitions (haram) in the Shariah is a more crucial and serious task than a court case.

Islam, if fact, is a practical religion revealed by the Creator. While it outlines the necessary positive characteristic of judges, such as being from amongst the most righteous, knowledgeable and experienced people, it also acknowledges the fallibility of human nature. Therefore, it outlines negatives measures that must also be complied with, such as not accepting gifts[18] or salaries from those bound by their judgements. Such measures are clearly intended for the purpose of removing conflict of interest and safeguarding the integrity of the work. The work of a Shariah controller who issues Shariah pronouncements is similar and no less important than the work of a judge—both outline the permissible and impermissible for people to follow, and therefore they both sign on behalf of the Almighty Lawgiver.[19]

The integrity of the Shariah boards depends upon the independence of Shariah board members and Shariah controllers. If the Shariah board member finds himself appointed, paid, and possibly dismissed by the bank that is the subject to his binding pronouncements, then it is logical that he will be inclined to take a more lenient approach in his pronouncements in order to safeguard his position at the bank and also to possibly induce other Islamic banks to hire him (as Shariah scholars can sit on multiple Shariah boards in many jurisdictions).

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[15] An abbreviation used by IFSB for "Islamic Institution offering Financial Services"

[16] IFSB Standard (10) on Shariah Governance, Appendix1, footnote No. 28.

[17] AAOIFI Governance Standard for Islamic Financial Institution, 1/3.

[18] For rules on gifting judges and paying them wages see: (Al–Sarkhasi, 1987) Al-Mabsoot, 16/82.

[19] Ibn al-Qayyem interestingly named his book in which he explicitly talked about fatwa in the context of the legal tricks to riba "I'lam Al-Muwaqi'een 'an Rabell'almeen" which means "warning the signatories (Muftis) on behalf of the Lord"!

Adding financial and legal experts to Shariah boards:

Shariah board membership should also include financial and legal experts who have no voting rights and whose role it is to advise and brief the Shariah scholars on any relevant financial or legal concerns, as well as any possible implications of issuing any Shariah pronouncement. This measure is particularly important if Shariah board members do not possess sufficient legal, financial, or market experience and need to consult trustworthy and independent experts before issuing a Shariah pronouncement. It also protects against passing wrong pronouncements due to a misunderstanding on behalf of Shariah board members or due to misrepresentation on behalf of bankers.

Restricting multiple Shariah-board membership

A noticeable feature of Islamic banking and finance is that a handful of Shariah scholars dominate the Shariah boards. This undesirable phenomenon is caused by a number of factors, all of which relate to a lack of proper and effective Shariah governance. It is understandable that banks would want to hire the most tolerant Shariah scholars. It is also known to be the case that recently-opened institutions ask existing Shariah board members to recommend members for their own boards, which may lead to the same Shariah scholars working on a number of different Shariah boards for different institutions (Aljarhi, 2009). It is a highly unprofessional practice and has a number of negative implications, such as subjecting the whole industry to the views of a limited number of people, and rendering the Shariah board members incapable of efficiently discharging their responsibilities. It is incumbent therefore to limit the number of Shariah boards that a single person may sit on, to a manageable number - say three. This would also give the chance to other qualified scholars to enter and benefit the industry.

While AAOIFI standards are silent on this issue, IFSB standards actually recognize and tolerate it. According to the IFSB: "When a member of the Shariah board has multiple Shariah board responsibilities/appointments, he or she must ensure that sufficient time and attention is given to the affairs of each IIFS" (IFSB, 2009). Surprisingly, the standard places the onus on the Shariah board members themselves to know whether or not they can commit sufficient time and attention to the affairs of each Islamic financial institution. Then the very same standard shifts the responsibility to the financial institution itself, stating: "The IIFS should decide if a member of the Shariah board is able to and has been adequately carrying out his or her duties in serving his or her Shariah board" [20].

A careful reading of both the AAOIFI and the IFSB standards on Shariah governance gives one the impression that both sets of standards do not refute or disapprove any of the existing problematic practices. Rather, they tend either to completely ignore them, or at best, to hint to them. This brings to the attention the matter of very independence of these regulatory authorities, given that AAOFI Shariah board members used to be members of Shariah boards in Islamic banks, and that IFSB's position and strength in the industry makes it too vulnerable to clearly pinpoint incorrect practices and describe them as such.

Formation of an international Shariah board

A means of solving the aforementioned Shariah governance problems would be through the establishment of an international Shariah board. Its responsibility would involve endorsing main products and contracts only, since it would not be feasible for it to evaluate the transactions of the Islamic banks that are customized on a daily basis or the ones that tailor a particular bank's need. It should comprise of a specific number of the most credible, experienced and qualified Shariah

[20] The complete standard reads "When a member of the Shariah board has multiple Shariah board responsibilities/appointments, he or she must ensure that sufficient time and attention is given to the affairs of each IIFS. The IIFS should decide if a member of the Shariah board is able to and has been adequately carrying out his or her duties in serving his or her Shariah board". IFSB Standard (10) on Shariah Governance, Independence, 45.

scholars from various jurisdictions and schools of law. These scholars should be fully independent and not members of individual Shariah boards. The board could be made an affiliate of the Organization of Islamic Cooperation (OIC) and also paid by the OIC after receiving funds from member banks. Its resolution should be made binding on the individual Islamic banks. In the case of a proven infringement of the Shariah by one of the banks it should have the authority to declare it as not being Shariah compliant. Individual Shariah board members should also be given the right to report any infringement by their respective bank. Even if it did not possess the legal authority to withdraw the license of a non-compliant bank, it would still have great influence over the banks and their Shariah boards if it blacklisted a particular bank given that the particular bank and its Shariah board would fear losing its credibility amongst the public. To ensure compliance with its regulations the board should have an audit arm to carry out unannounced inspection visits to the banks to scrutinize their products and to report any infringements.

4. Conlusions

From the above discussions, it can be concluded that Islamic banking and finance is facing some serious governance challenges, which require immediate action. While other challenges facing Islamic banking may be beyond the capacity of the industry players, there is no excuse to overlook or turn a blind eye to these workable challenges. These can be simply addressed by enacting Shariah governance for both products and Shariah control, as outlined in this paper. If the existing challenges remain unaddressed, it is feared that a day may come when people will lose total confidence in Islamic finance, and then Islamic banks and financial institutions would lose their biggest asset and the only competitive factor against their giant rivals; i.e., their Islamic identity, which gave them a firm foothold in the global financial industry. While having the industry players realize and appreciate the necessity for urgent Shariah governance reform is the real challenge, working out a solution is straightforward because even though it does not take much to identify the problem, its far-range and serious effects are still seemingly not realized by the key stakeholders.

Finally, it worth noting that the intervention of central banks to rectify Shariah governance may not be the optimum solution because the core problem resulting from the existing ineffective and deficit Shariah governance ultimately relates to the credibility of the products and their resemblance to the conventional banking counterparts. Naturally, central banks will not be pleased with Islamic banks offering genuinely Islamic products because these products will then inherently carry various business risks. Therefore, balanced Shariah governance with minimum interference by central banks is required, and the full independence of any potential Shariah regulatory authority from the Islamic financial institutions remains a prerequisite.

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