



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Shariah Governance

Applicable to:

1. Licensed Islamic banks
2. Licensed takaful operators including professional retakaful operators
3. Licensed banks and licensed investment banks approved to carry on Islamic banking business
4. Prescribed development financial institutions approved to carry on Islamic financial business
5. Shariah committee members

TABLE OF CONTENTS

| | | |
|---------------|--|-----------|
| PART A | OVERVIEW | 1 |
| 1 | Introduction..... | 1 |
| 2 | Applicability | 1 |
| 3 | Legal provisions..... | 2 |
| 4 | Effective date..... | 2 |
| 5 | Interpretation | 2 |
| 6 | Related legal instruments and policy documents | 3 |
| 7 | Policy documents superseded | 4 |
| PART B | THE BOARD | 5 |
| 8 | Key responsibilities..... | 5 |
| 9 | Interaction with the Shariah committee | 5 |
| PART C | SHARIAH COMMITTEE | 7 |
| 10 | Key responsibilities | 7 |
| 11 | Shariah committee meetings | 8 |
| 12 | Appointment, cessation and disqualification | 10 |
| 13 | Composition | 13 |
| 14 | Secretariat to the Shariah committee..... | 13 |
| PART D | SENIOR MANAGEMENT | 15 |
| 15 | Key responsibilities..... | 15 |
| PART E | CONTROL FUNCTIONS | 16 |
| 16 | Control functions under Shariah governance | 16 |
| 17 | Shariah risk management..... | 16 |
| 18 | Shariah review..... | 17 |
| 19 | Shariah audit | 18 |
| PART F | SHARIAH COMPLIANCE CULTURE AND REMUNERATION | 19 |
| 20 | Shariah compliance culture | 19 |
| 21 | Remuneration..... | 19 |
| PART G | TRANSPARENCY AND DISCLOSURES..... | 20 |
| 22 | Disclosures by the board and Shariah committee | 20 |
| | Appendix 1 Secretariat of the SAC | 22 |

PART A OVERVIEW

1 Introduction

- 1.1 Shariah governance is integral to Islamic financial system stability. The institutionalisation of a sound Shariah governance framework strengthens public confidence in the integrity, management and business operations of the Islamic financial institutions.
- 1.2 The Shariah Governance Framework for Islamic Financial Institutions introduced in 2011 has played a critical role in supporting robust and orderly developments of the Islamic finance industry in Malaysia. In particular, the framework has led to the institutionalisation of governance structures, policies and processes to promote end-to-end Shariah compliance in Islamic finance operations.
- 1.3 The requirements in this policy document outline the Bank's strengthened expectations for effective Shariah governance arrangements that are well-integrated with business and risk strategies of the Islamic financial institutions. This augurs well with the growing scale and complexity of Islamic financial business, and recent policy developments in the areas of governance, compliance and risk management. Specifically, this policy document sets out strengthened oversight accountabilities on the board, Shariah committee and other key organs involved in the implementation of Shariah governance. Another area relates to Shariah committee's objectivity to reinforce sound decision-making process and robustness of internal control functions for effective management of Shariah non-compliance risks.
- 1.4 Accordingly, Islamic financial institutions should demonstrate that their Shariah governance arrangements are operating effectively and appropriate to their size, nature of business, complexity of activities and structure. The Bank also expects to see evidence of better alignment in promoting a strong Shariah compliance risk culture within Islamic financial institutions. This is in line with the more active roles expected of the board, Shariah committee and senior management.

2 Applicability

- 2.1 This policy document is applicable to Islamic financial institutions as defined in paragraph 5.2.
- 2.2 For Islamic financial institutions operating as a foreign branch in Malaysia, the requirements in this policy document shall apply in respect of the Malaysian operations of the branch with the following modifications:
 - (a) any references to the board in this policy document shall be deemed as a reference to the governing body of the foreign branch or any of its committees locally; and

- (b) any references to senior management in this policy document shall include a reference to the chief executive officer (CEO) of the branch and officers performing a senior management function in respect of the branch operations.

3 Legal provisions

- 3.1 This policy document is issued pursuant to—
(a) sections 29(2), 57(1) and 155 of the Islamic Financial Services Act 2013 (IFSA); and
(b) sections 33E(2), 41 and 116 of the Development Financial Institutions Act 2002 (DFIA).
- 3.2 The guidance in this policy document is issued pursuant to section 277 of the IFSA and section 126 of the DFIA.

4 Effective date

- 4.1 This policy document comes into effect on 1 April 2020, with the exception of paragraph 12.5.
- 4.2 Paragraph 12.5 comes into effect on 1 April 2023.

5 Interpretation

- 5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the Financial Services Act 2013 (FSA), IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

- 5.2 For purposes of this policy document—

“S” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;

“G” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“active politician” refers to an individual who is a member of any national or state legislative body, or who is an office bearer of, or holds any similar office or position in a political party;

“affiliate”, in relation to an entity, refers to any corporation that controls, is controlled by, or is under common control with, the entity;

“board” refers to the board of directors of an Islamic financial institution;

“control function” refers to the definition as provided in the policy document on *Corporate Governance* issued by the Bank;

“Islamic financial institution” or “IFI” refers to—

- (a) licensed Islamic banks;
- (b) licensed takaful operators including professional retakaful operators;
- (c) licensed banks and licensed investment banks approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (d) prescribed institutions approved under section 33B(1) of the DFIA to carry on Islamic financial business;

“senior management” refers to the CEO and senior officers of the IFI;

“senior officers” refer to a person, other than the CEO or a director, having authority and responsibility for planning, directing or controlling the activities of an authorized person or a financial holding company including the chief operating officer, members of decision-making committees and other persons performing key functions such as risk management, compliance, internal audit or other functions as may be specified by the Bank under section 57 of the IFSA, but shall not include a member of a Shariah committee;

“Shariah non-compliance risk” refers to the risk of legal or regulatory sanctions, financial loss or non-financial implications including reputational damage, which an IFI may suffer arising from failure to comply with the rulings of the Shariah Advisory Council of Bank Negara Malaysia (SAC), standards on Shariah matters issued by the Bank pursuant to section 29(1) of the IFSA and section 33E(1) of the DFIA, or decisions or advice of the Shariah committee.

6 Related legal instruments and policy documents

6.1 This policy document must be read together with—

- (a) other relevant legal instruments and policy documents that have been issued by the Bank, in particular—
 - (i) *Corporate Governance*;
 - (ii) *Fit and Proper Criteria*;
 - (iii) *Compliance*;
 - (iv) *Risk Governance*;
 - (v) *Operational Risk*;
 - (vi) *Outsourcing*;
 - (vii) *Guidelines on Internal Audit Function of Licensed Institutions*;
 - (viii) *Financial Reporting for Islamic Banking Institutions*;
 - (ix) *Guidelines on Financial Reporting for Development Financial Institutions*; and
 - (x) *Financial Reporting for Takaful Operators*; and
- (b) Manual Rujukan Institusi Kewangan Islam kepada Majlis Penasihat Syariah.

7 Policy documents superseded

- 7.1 This policy document supersedes the following:
- (a) *Shariah Governance Framework for Islamic Financial Institutions* issued on 22 October 2010;
 - (b) Paragraph 11.4 of *Financial Reporting for Islamic Banking Institutions* issued on 2 February 2018;
 - (c) Paragraph 10.4 of *Guidelines on Financial Reporting for Development Financial Institutions* issued on 24 December 2012; and
 - (d) Paragraph 13.5 of *Financial Reporting for Takaful Operators* issued on 2 February 2018.

PART B THE BOARD

8 Key responsibilities

- S** 8.1 As part of the board's responsibility to promote sustainable growth and financial soundness of an IFI, the board must institutionalise a robust Shariah governance framework that is commensurate with the size, complexity and nature of the IFI's business. The board's oversight accountability over Shariah governance and compliance must reflect the integration of Shariah governance considerations within the business and risk strategies of the IFI. In fulfilling this role, the board must–
- (a) approve policies relating to governance structure and reporting arrangements, Shariah non-compliance risk management and other areas that are material to the effective implementation of Shariah governance within the IFI;
 - (b) oversee the implementation of SAC rulings and decisions or advice of the Shariah committee within all business and functional lines, including any business or risk implications arising from such implementation;
 - (c) oversee the implementation of the internal control framework to prevent Shariah non-compliance and any rectification measures to resolve incidences or circumstances that may result or have resulted in Shariah non-compliance¹;
 - (d) oversee the performance of senior management and other officers entrusted to implement Shariah governance framework such that the board is satisfied that the measures of their performance are aligned with Shariah governance objectives; and
 - (e) promote a sound corporate culture which reflects the importance of adhering to Shariah requirements in product development and marketing, strategy formulation, business operations, risk management practices and other aspects that promote end-to-end compliance with Shariah.
- S** 8.2 A director must continuously develop and strengthen his knowledge and understanding on Islamic finance, as well as keep abreast with developments that may impact Islamic financial business, to fulfil his responsibility to the IFI.

9 Interaction with the Shariah committee

- S** 9.1 The board must have due regard to any decisions or advice of the Shariah committee on any Shariah issues relating to the operations, business, affairs or activities of the IFI. This duty requires the board to–
- (a) give sufficient attention to the facts, rationale and basis for any decisions or advice of the Shariah committee before arriving at its own decision;
 - (b) give fair consideration to the implications of implementing any decisions or advice of the Shariah committee;

¹ This requirement is in addition to section 28(3) of the IFSA and section 33D(3) of the DFIA on the obligation imposed on IFIs to report Shariah non-compliance incidences and develop a plan to rectify such non-compliances.

- (c) put in place conflict resolution mechanism to deal with any differences in views between the board and the Shariah committee; and
 - (d) maintain a record of deliberations between the board and the Shariah committee in matters where the differences in views exist, and its resolution.
- S** 9.2 The board must take reasonable steps to ensure that the Shariah committee is free from any undue influences that may hamper the Shariah committee from exercising its professional objectivity and independence in deliberating issues brought before them.
- S** 9.3 The board must establish a written policy to identify, assess and manage any conflicts of interest arising from any additional activities or services performed by the Shariah committee member for the IFI, or his other external professional commitments. This shall include policies relating to the involvement of a Shariah committee member in the provision of consultancy services to any clients of the IFI, with or without remuneration.
- S** 9.4 The board must establish effective communication with the Shariah committee on all matters relating to Shariah requirements, Shariah governance or Shariah non-compliance risks to enable both parties to effectively discharge respective responsibilities under the Shariah governance framework. The board must regularly review the quality and frequency of its engagement with the Shariah committee.
- S** 9.5 The board must allocate sufficient resources for continuous development of skills and expertise of the Shariah committee. This shall include allocating adequate budget, having in place development plans for Shariah committee members and regularly updating such plans to ensure that each member possesses the requisite knowledge and skills to fulfil his responsibilities.
- S** 9.6 The board must establish a formal process to assess, at minimum annually, performance and effectiveness of the Shariah committee and every Shariah committee member. The assessment must consider the competence, knowledge and contribution of each Shariah committee member to the overall functioning of the Shariah committee.
- S** 9.7 The board must approve a remuneration policy that is commensurate with the accountabilities, duties and responsibilities of the Shariah committee.
- S** 9.8 In the event that the board delegates any of its responsibilities to the Shariah committee, the board must—
 - (a) ensure that the mandate, areas of delegated authority and operating procedures are set out clearly in the board and the Shariah committee's charter;
 - (b) establish reporting arrangements to be kept informed of the Shariah committee's work, key deliberations and decisions on delegated matters; and
 - (c) remain fully accountable for the decisions and any ensuing implications arising from the delegated responsibility.

PART C SHARIAH COMMITTEE

10 Key responsibilities

- S** 10.1 The Shariah committee must have a charter that sets out the mandate, responsibilities and procedures of the Shariah committee including matters reserved for its decision or advice.
- S** 10.2 The Shariah committee has the responsibility to provide objective and sound advice to the IFI to ensure that its aims and operations, business, affairs and activities are in compliance with Shariah. This includes—
 - (a) providing a decision or advice to the IFI on the application of any rulings of the SAC or standards on Shariah matters that are applicable to the operations, business, affairs and activities of the IFI;
 - (b) providing a decision or advice on matters which require a reference to be made to the SAC;
 - (c) providing a decision or advice on the operations, business, affairs and activities of the IFI which may trigger a Shariah non-compliance event;
 - (d) deliberating and affirming a Shariah non-compliance finding by any relevant functions; and
 - (e) endorsing a rectification measure to address a Shariah non-compliance event.
- S** 10.3 The Shariah committee shall be accountable for the quality, accuracy and soundness of its own decision or advice.
- S** 10.4 The Shariah committee must establish a robust methodology to guide its decision-making process. The Shariah committee must take into account relevant business and risk practices in arriving at a decision or advice.
- S** 10.5 Where the Shariah committee has reason to believe that any Shariah issues or matter may affect the safety and soundness of the IFI, the Shariah committee must immediately update the board on such matter.
- S** 10.6 In cases where the SAC has not made any rulings on a particular matter or the Shariah committee is not able to arrive at a decision or advice, the IFI shall refer to the SAC for a ruling in accordance with Manual Rujukan Institusi Kewangan Islam kepada Majlis Penasihat Syariah. Any requests for a ruling or advice shall be communicated through the Secretariat of the SAC as provided in **Appendix 1**.
- S** 10.7 In the event where the Shariah committee decides or advises to place additional restrictions on the operations, business, affairs and activities of the IFI in applying the SAC rulings, the IFI must—
 - (a) document the deliberations and justifications of the Shariah committee decision or advice;
 - (b) ascertain the board's views on the decision or advice made by the Shariah committee with regards to the SAC ruling; and
 - (c) ensure immediate notification to the Bank of such decision or advice.

- S 10.8 An IFI shall ensure that any records of Shariah committee's decision or advice to be submitted to the Bank, including a rectification plan to address a Shariah non-compliance event (under section 28(3) of the IFSA and section 33E(3) of the DFIA), is supported with key deliberations, rationale and any significant concerns or dissenting views to the decision or advice.
- S 10.9 In the event that the Shariah committee delegates any of its responsibilities to any persons or functions,—
 - (a) an IFI must ensure that the mandate, areas of delegated authority and operating procedures are set out clearly in the Shariah committee's charter and IFI's internal policies;
 - (b) an IFI must establish reporting arrangements to keep the Shariah committee informed of the work, key deliberations and decisions on the delegated matters; and
 - (c) the Shariah committee must remain fully accountable for the decisions and any ensuing implications arising from the delegated responsibility.
- S 10.10 A Shariah committee member must exercise objectivity in coming up with his judgment and be free from associations or circumstances that may impair the exercise of his professional objectivity. In fulfilling his responsibility, a Shariah committee member must ensure that his judgment in arriving at a Shariah decision or advice is not affected by his other professional commitments.
- S 10.11 A Shariah committee member must devote sufficient time to prepare for and attend Shariah committee meetings.
- S 10.12 A Shariah committee member must ensure consistency in providing his views and must not act in a manner that would undermine the rulings of the SAC or any decisions of the Shariah committee that they represent.
- S 10.13 Every Shariah committee member must disclose the nature and extent of his interest that constitutes or gives rise to a conflict or potential conflict of interest upon the appointment, reappointment or as soon as there is any changes in his circumstances that may affect his status.
- S 10.14 A Shariah committee member must continuously develop a reasonable understanding of the business and operations of the IFI and keep abreast with relevant market and regulatory developments. The chairman of the Shariah committee must lead efforts to manage the Shariah committee's developmental plans.

11 Shariah committee meetings

- S 11.1 The chairman of the Shariah committee, in leading the Shariah committee is responsible for the effective functioning of the Shariah committee. In fulfilling this role, the chairman of the Shariah committee must—
 - (a) ensure appropriate procedures are in place to govern the Shariah committee's deliberations and proceedings;
 - (b) act as a direct liaison between the board and Shariah committee to foster greater understanding between both organs;

- (c) ensure that Shariah decisions or advice are made on a sound and well-informed basis, including based on a robust decision-making methodology which ensures that all business, operations and risk implications are considered by the Shariah committee;
 - (d) encourage healthy discussion, participation and contribution, and ensure that dissenting views can be freely expressed and discussed; and
 - (e) ensure sufficient records of the discussion leading to formulation of the Shariah committee's decision or advice are maintained.
- S** 11.2 At minimum, an IFI must hold its Shariah committee meetings at least once in every two (2) months.
- S** 11.3 Notwithstanding paragraph 11.2, an IFI operating as an Islamic window or a foreign branch in Malaysia must hold its Shariah committee meetings at least two (2) times a year.
- S** 11.4 A Shariah committee member must attend at least 75% of the Shariah committee meetings held in each financial year, and must not appoint another person to attend or participate in Shariah committee meetings on his behalf.
- S** 11.5 An IFI must ensure that attendance of members at a Shariah committee meeting, by way other than physical presence, remains the exception rather than the norm, and is subject to appropriate safeguards to preserve confidentiality of the deliberations.
- S** 11.6 An IFI shall disclose the number of Shariah committee meetings held during the financial year and the attendance of every Shariah committee member in the IFI's annual report.
- S** 11.7 In respect of the quorum for Shariah committee meetings, an IFI must ensure that there is a majority of Shariah qualified members to be present at each meeting.
- S** 11.8 An IFI shall ensure that any decision of the Shariah committee must be made on the basis of simple majority.
- S** 11.9 In relation to paragraph 10.13, if a matter to be brought before the Shariah committee gives rise to a conflict of interest to any Shariah committee members, the Shariah committee must excuse himself from the discussion and abstain from voting on that particular matter.
- S** 11.10 An IFI must provide the Shariah committee with access to all information required and ensure that the information provided is timely, accurate, comprehensive and clear.
- S** 11.11 An IFI must provide the Shariah committee with access to advice from third party experts on any matters deliberated by the Shariah committee as and when required, and the cost of such advice shall be borne by the IFI.

- S 11.12 In relation to paragraphs 11.10 and 11.11, any party with the knowledge or awareness of a Shariah committee's access to any relevant information or request for third party expert advice being declined, denied or withheld by any officers or employees of the IFI, must inform the board of the situation. The board shall take appropriate action to rectify the situation.

For avoidance of doubt, reference to "any party" in this paragraph shall include a Shariah committee member.

- S 11.13 While the board or senior management may provide useful insights on any business, technical or operational matters discussed during a Shariah committee meeting, the board and senior management must not exercise undue influence that could hinder the Shariah committee in exercising objective judgment in its deliberations and decision-making.
- S 11.14 An IFI shall ensure that clear and accurate minutes of Shariah committee meetings are maintained to record the decisions or advice of the Shariah committee, including the key deliberations, rationale for each decision or advice made, and any significant concerns and dissenting views.

12 Appointment, cessation and disqualification

- S 12.1 Subject to section 31 of the IFSA, an IFI shall only appoint or reappoint a person to be its Shariah committee member if the following are fulfilled:
- (a) the person is a Muslim individual;
 - (b) the person has been assessed to have met the requirements specified in the policy document on *Fit and Proper Criteria* on a continuous basis; and
 - (c) the person is either—
 - (i) a Shariah qualified person; or
 - (ii) an expert who possesses skills, knowledge and experience relevant to support the roles and responsibilities of the Shariah committee.
- S 12.2 In determining a Shariah 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 Shariah, which includes study in *Usul Fiqh* (principles of Islamic jurisprudence) or *Fiqh Muamalat* (Islamic transaction/commercial law);
 - (b) possesses solid knowledge in Shariah 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.
- S 12.3 Pursuant to section 33(1)(c) of the IFSA, a person is disqualified from being appointed or reappointed, accepting any appointment or reappointment or holding office as a Shariah committee member of an IFI if—
- (a) he is an undischarged bankrupt, has suspended payments or has compounded by his creditors whether in or outside Malaysia;

- (b) a charge for criminal offence relating to dishonesty or fraud under any written law or the law of any country, territory or place outside Malaysia, has been proven against him; or
- (c) under any law relating to prevention of crime, drug trafficking or immigration—
 - (i) an order for detention, supervision or deportation has been made against him; or
 - (ii) any forms of restriction or supervision by bond or otherwise, has been imposed on him.

Where any criminal proceedings is pending in any court for any offence referred to in paragraph 12.3(b) against a Shariah committee member of an IFI, such person shall not—

- (a) act in such capacity, hold any other office or act in any other capacity, in that IFI; or
- (b) be concerned with, take part or engage in, any manner, whether directly or indirectly, in any activity, affairs or business of, or in relation to, that IFI, except as may be permitted by the board subject to such conditions as may be specified by the Bank.

For the purpose of this paragraph, “criminal proceedings” shall be deemed to be pending from the date that the accused person is first charged in court for the offence until the date of the final conclusion of the proceedings, whether in the court of original jurisdiction or, in the event of any appeal by any party, in the court of final appellate jurisdiction.

- S** 12.4 A Shariah committee member or his immediate family member must not—
- (a) be an executive of the IFI during the tenure of his appointment or within the last two (2) years of his proposed appointment as a Shariah committee member;
 - (b) be a substantial shareholder, executive director or senior officer of the IFI or any of its affiliates; or
 - (c) have a significant business or other contractual relationship with the IFI or any of its affiliates within the last two (2) years.

For the purpose of paragraph 12.4(c), the board must clearly define what constitutes a “significant business or other contractual relationship”, taking into account the nature, size and complexity of the IFI’s operations.

- S** 12.5 A Shariah committee member must not serve the same IFI for more than nine (9) years.
- S** 12.6 A Shariah committee member must not have competing time commitments that may impair his ability to discharge his duties effectively. In respect of multiple appointments, a Shariah committee member is required to manage his commitments effectively, observe professional objectivity and confidentiality in carrying out his duties.

- S** 12.7 A Shariah committee member must not accept any appointment in more than one licensed Islamic bank, one licensed takaful operator and one prescribed institution.
- S** 12.8 A Shariah committee member must not be an active politician.
- S** 12.9 A Shariah committee member must immediately disclose to the board any circumstances that may affect his ability to meet the minimum requirements under paragraphs 12.1 to 12.8.
- G** 12.10 The board is encouraged to appoint a Shariah committee member as a board member. The Shariah committee member appointed is expected to foster closer integration of Shariah governance consideration within the business and risk strategy of the IFI.
- S** 12.11 The board must establish and regularly review succession plans for the Shariah committee members. Such process must involve assessment of candidates against the minimum requirements set out in paragraphs 12.1 to 12.8.
- S** 12.12 The board must establish a rigorous process for the appointment, reappointment and cessation of Shariah committee members. Such process must involve assessment of candidates against the minimum requirements set out in paragraphs 12.1 to 12.8.
- S** 12.13 An IFI must submit an application in writing to the Bank for the purpose of appointment and reappointment of Shariah committee members and chairman of the Shariah committee at least three (3) months before it expects a proposed candidate to assume his responsibilities. In the case of reappointment, the application must be submitted three (3) months prior to the expiry of the Shariah committee member's tenure. All applications shall be made using the form enclosed in FI@KijangNet portal.
- S** 12.14 An IFI must not make an application to the Bank to appoint or reappoint a Shariah committee member or chairman of the Shariah committee unless the IFI is fully satisfied, based on its objective assessment, that the candidate meets the minimum requirements set out in paragraphs 12.1 to 12.8, can perform his expected roles and responsibilities and will be able to meaningfully contribute to the Shariah committee.
- S** 12.15 For the purpose of the application for reappointment and termination of the Shariah committee members and chairman of the Shariah committee, an IFI must provide justifications for the application, as well as assessment on the performance of such member to the Bank.
- S** 12.16 A Shariah committee member whose tenure has expired and is being proposed for reappointment must immediately cease to hold office and act in such capacity, including by participating in any Shariah committee meetings or holding himself out as a Shariah committee member of the IFI.

- G** 12.17 Where a Shariah committee member resigns or is disqualified pursuant to the relevant paragraphs in this policy document, sections 33(2) and 34(1) of the IFSA impose obligations on an IFI and the Shariah committee member to notify the Bank of that fact and its reason immediately or in any cases no later than fourteen (14) days of such circumstance.
- G** 12.18 Section 33(3) of the IFSA imposes an obligation on an IFI to obtain the prior written approval of the Bank before the IFI terminates a Shariah committee member.

13 Composition

- S** 13.1 An IFI shall ensure that Shariah committee must be of a sufficient size that–
(a) reflects the business needs of the IFI or the financial group; and
(b) enables a conducive environment for sound deliberation of Shariah matters.
- S** 13.2 An IFI must ensure that its Shariah committee, at minimum, comprise of at least five (5) Shariah committee members.
- S** 13.3 An IFI must ensure that–
(a) majority of its Shariah committee members are Shariah qualified persons; and
(b) the chairman of the Shariah committee must be a Shariah qualified person.
- S** 13.4 Notwithstanding paragraph 13.2, an IFI operating as an Islamic window or a foreign branch in Malaysia must ensure that its Shariah committee, at minimum, comprise at least three (3) Shariah committee members.
- G** 13.5 Where there is more than one IFI within a financial group, section 30(2) of the IFSA states that one of the IFIs may submit application to the Bank for its approval to establish a single Shariah committee to serve the entire financial group.

14 Secretariat to the Shariah committee

- S** 14.1 An IFI shall appoint a secretariat to serve the Shariah committee. The secretariat has the responsibility to provide operational support for effective functioning of the Shariah committee, which includes–
(a) coordinating communications and disseminating information among the Shariah committee, the board and senior management;
(b) performing in-depth research and studies on Shariah issues;
(c) providing day-to-day advice to relevant parties within the IFI on Shariah matters based on the rulings of the SAC and decisions or advice of the Shariah committee;
(d) ensuring proper dissemination of decisions or advice of the Shariah committee within the IFI; and

- (e) undertaking administrative and secretarial functions to support the Shariah committee.
- S** 14.2 An IFI must ensure that officers who perform the responsibilities in relation to paragraph 14.1(b) and (c) are officers with Shariah qualification.
- S** 14.3 An IFI must give the Shariah committee adequate time to deliberate all Shariah matters. In this regard, the secretariat has the responsibility to plan and coordinate Shariah committee meetings in a manner that promotes sound decision-making by the Shariah committee.

PART D SENIOR MANAGEMENT

15 Key responsibilities

- S** 15.1 The CEO, in leading senior management, has primary responsibility over the day-to-day management of the IFI. This includes ensuring that the IFI's operations, business, affairs and activities comply, at all times, with Shariah. In fulfilling this responsibility, the CEO and senior management must–
 - (a) establish a management structure and reporting arrangement that provides a clear scope of accountability between the business lines and the internal control functions that are involved in managing Shariah non-compliance risks, including the accountability of the senior officer leading a Shariah department or unit;
 - (b) implement effective Shariah governance policies, procedures and practices in accordance with the direction given by the board;
 - (c) implement the rulings of the SAC and the decision or advice of the Shariah committee with due regard by the board;
 - (d) implement an effective communication policy that supports a sound understanding of Shariah matters across the IFI;
 - (e) conduct regular assessment to evaluate the quality of operational support provided to the Shariah committee and address any inadequacies arising thereof; and
 - (f) report to the board and Shariah committee on a timely basis any potential or actual Shariah non-compliance events.
- S** 15.2 Each member of senior management of an IFI must continuously develop and strengthen his knowledge and understanding on Islamic finance, as well as keep abreast with developments that may impact Islamic financial business.

PART E CONTROL FUNCTIONS

16 Control functions under Shariah governance

- G** 16.1 The effective management of Shariah non-compliance risk is largely dependent on–
(a) a comprehensive and integrated approach to enterprise-wide risk management, which integrates risks arising from Shariah non-compliances alongside other risks such as credit, market, operational and liquidity; and
(b) the effective integration of control functions under Shariah governance and oversight arrangement of the risk management, compliance and internal audit at the entity-level and group-level.
- S** 16.2 An IFI must ensure that the oversight and management of the overall Shariah non-compliance risk is structured in a way that the senior officers entrusted with control functions under Shariah governance are able to exercise clear accountability over Shariah non-compliance risk.
- S** 16.3 An IFI must ensure effective management of Shariah non-compliance risk which requires the following functions to be performed on an ongoing basis:
(a) Shariah risk management;
(b) Shariah review; and
(c) Shariah audit.
- S** 16.4 An IFI must provide sufficient resources for the control functions, including putting in place adequate number of officers with the appropriate competencies and experience.
- S** 16.5 Senior officers undertaking control functions under Shariah governance shall have direct and unimpeded access to the Shariah committee for effective performance of such control functions.
- S** 16.6 While it is common for the control functions to work closely with individual business units, the control functions must be sufficiently independent of the business lines and must not be involved in revenue generation activities.
- S** 16.7 The control functions must have access to all business lines that are exposed to Shariah non-compliance risk to perform its functions.

17 Shariah risk management

- G** 17.1 Shariah risk management refers to a function that systematically identifies, measures, monitors and reports Shariah non-compliance risks in the operations, business, affairs and activities of the IFI.
- S** 17.2 The Shariah risk management function, at minimum, must–
(a) integrate Shariah non-compliance risk considerations with enterprise-wide risk management;

- (b) identify Shariah non-compliance risk exposures in the business operations and activities of the IFI;
 - (c) assess Shariah non-compliance risk and measure the potential impact of the risk exposures to the IFI;
 - (d) establish appropriate risk mitigation measures;
 - (e) monitor Shariah non-compliance risk exposures and effectiveness of the risk mitigation measures;
 - (f) report to the board, Shariah committee and senior management on the Shariah non-compliance risk exposures in relation to paragraph 17.2(b) to (e); and
 - (g) constructively challenge decisions that may give rise to Shariah non-compliance risks.
- S** 17.3 The senior officer principally accountable and responsible for risk management shall be responsible for Shariah risk management which forms part of the IFI's integrated risk management framework.
- S** 17.4 An IFI shall ensure that its risk officers who perform the Shariah risk management function have the requisite knowledge on Shariah requirements applicable to Islamic financial business.

18 Shariah review

- G** 18.1 Shariah review refers to a function that conducts regular assessment on the compliance of the operations, business, affairs and activities of the IFI with Shariah requirements.
- S** 18.2 The Shariah review function, at minimum, must–
 - (a) identify, assess and monitor the compliance of the IFI's business operations and activities with Shariah;
 - (b) report to the board, Shariah committee and senior management regularly on Shariah non-compliance issues and findings;
 - (c) inform and provide updates to the board, Shariah committee and senior management on the latest developments in legal and regulatory requirements in Islamic finance, especially in relation to issuance of the SAC rulings; and
 - (d) ensure adequate training and guidance are provided to the officers of an IFI on relevant Shariah requirements governing the IFI's operations, business, affairs and activities.
- S** 18.3 The senior officer principally accountable and responsible for compliance shall be responsible for Shariah review which forms part of the IFI's overall compliance responsibilities in ensuring sound management of compliance risk.
- S** 18.4 An IFI shall ensure that officers who perform the Shariah review function are qualified to undertake compliance function responsibilities and have sound understanding of relevant Shariah requirements applicable to Islamic financial business.

- G** 18.5 Pursuant to paragraph 18.4, officers qualified to perform compliance function responsibilities may include officers with Shariah qualification.

19 Shariah audit

- G** 19.1 Shariah audit refers to a function that provides an independent assessment on the quality and effectiveness of the IFI's internal control, risk management systems, governance processes as well as the overall compliance of the IFI's operations, business, affairs and activities with Shariah.
- S** 19.2 The Shariah audit function, at minimum, must–
(a) establish an audit methodology to assess the risk profile and vulnerabilities of each auditable area;
(b) generate an audit plan for the assignments to be performed;
(c) establish clear documented audit programs that provide guidance to the internal auditors in gathering information, auditing procedures and audit assessment; and
(d) communicate results to the board and Shariah committee through an audit report, detailing the audit findings and recommendations for rectification measures, as well as the auditee's responses and action plans.
- S** 19.3 The senior officer principally accountable and responsible for internal audit shall be responsible for Shariah audit which forms part of the overall internal audit function in an IFI.
- S** 19.4 An IFI must ensure that its internal auditors who perform the Shariah audit function are qualified to perform internal audit and have the requisite knowledge on Shariah requirements applicable to Islamic financial business.
- G** 19.5 The board may appoint any persons to conduct an independent external Shariah audit on the operations, business, affairs and activities of the IFI to provide objective assurance on the effectiveness of Shariah governance implementation within the IFI.
- G** 19.6 In the event that the Bank deems appropriate for the purposes of compliance with Shariah by an IFI, in line with section 37 of the IFSA, the Bank may require the IFI to appoint any persons as the Bank may approve to conduct an independent audit on Shariah compliance by the IFI.

PART F SHARIAH COMPLIANCE CULTURE AND REMUNERATION**20 Shariah compliance culture**

- G** 20.1 Shariah compliance culture refers to the way in which an IFI instils and promotes the behaviour of compliance with Shariah in its aims and operations, business, affairs and activities. This includes adopting an appropriate ‘tone from the top’ to regularly communicate the importance of adherence to Shariah requirements and the integration of Shariah governance consideration in the business and risk strategies, internal policies and conduct of the IFI.
- S** 20.2 The board must ensure that an effective communication policy is in place and implemented to advocate effective implementation of Shariah governance.

21 Remuneration

- S** 21.1 The board must ensure that the remuneration policy and performance measures for senior officers responsible for ensuring Shariah compliance reinforce a risk culture that is in line with Shariah governance objectives.

PART G TRANSPARENCY AND DISCLOSURES

22 Disclosures by the board and Shariah committee

- S** 22.1 An IFI must disclose in the annual report information on its Shariah governance policies and practices. Such disclosures must include—
(a) disclosure by the board on its oversight accountability for Shariah governance implementation and the IFI's overall compliance with Shariah; and
(b) disclosure by the Shariah committee on its—
(i) responsibilities relating to Shariah governance; and
(ii) opinion on the state of the IFI's compliance with Shariah.
- S** 22.2 For the purpose of disclosure as required in paragraph 22.1—
(a) for an IFI operating as an Islamic window, the disclosure must be prepared as part of its financial institution annual report or its financial group annual report; and
(b) for an IFI operating as a foreign branch in Malaysia, the disclosure must be submitted to the Bank.
- G** 22.3 Pursuant to paragraph 22.2(b), the IFI may publish the disclosures as required in paragraph 22.1 on its website.
- S** 22.4 An IFI must ensure that the disclosures as required in paragraph 22.1, reflect the roles, responsibilities and accountabilities of the board and Shariah committee.
- S** 22.5 For the purposes of paragraph 22.1, the board and Shariah committee shall not disclose any information in the IFI's annual report which is false, misleading, inaccurate or incomplete.
- S** 22.6 In relation to paragraph 22.1(b), the disclosure must be signed by not less than two (2) Shariah committee members.
- S** 22.7 In relation to paragraph 22.1(b)(ii), an IFI must develop a written policy that is endorsed by the Shariah committee and approved by the board to ensure effective and structured processes are undertaken by the Shariah committee in deriving its opinion on the state of the IFI's compliance with Shariah.
- G** 22.8 In relation to paragraph 22.7, an IFI may consider to include the following aspects in its written policy to form an opinion on the state of the IFI's compliance with Shariah:
(a) planning, including the determination of materiality;
(b) obtaining evidence;
(c) consultation;
(d) formation of opinion; and
(e) the manner in which the opinion is to be published.

- S** 22.9 The Shariah committee's opinion on the state of an IFI's compliance with Shariah under paragraph 22.1(b)(ii) shall be expressed as follows:
- (a) nothing has come to the Shariah committee's attention that causes the Shariah committee to believe that the operations, business, affairs and activities of the IFI involve any material Shariah non-compliances; or
 - (b) the overall operations, business, affairs and activities of the IFI are in compliance with Shariah but it has come to the Shariah committee's attention that a material Shariah non-compliance event(s) has occurred and has been or in the process of being rectified.
- S** 22.10 In relation to paragraph 22.9(b), the Shariah committee's disclosure must include the nature, status and measures undertaken to address the material Shariah non-compliance events reported.

APPENDIX 1 SECRETARIAT OF THE SAC

1. Any references or requests for ruling or advice of the SAC shall be communicated through the Secretariat at Bank Negara Malaysia. All correspondence shall be directed to:

**Pengarah
Jabatan Perbankan Islam dan Takaful
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
(Attn.: Secretariat Shariah Advisory Council)**

Tel: 03 – 2698 8044 / Fax: 03 – 2693 3826