

[Exposure Draft (AGEB 3/2023) of the]
AAOIFI Governance Standard (GS) __
Shari'ah Supervisory Board: Appointment and Composition

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[ED of] AAOIFI Governance Standard (GS) ____ “Shari’ah Supervisory Board: Appointment and Composition” is set out in paragraphs 1-26.

Where the context so requires, the use of the masculine gender shall include the feminine gender and the singular shall include the plural and vice versa and the word “person” shall include any institution, corporation, firm, partnership, body corporate or other forms of association. The table of contents and headings do not form part of the text of the standard and are for the purpose of convenience and ease of understanding and may, at times, help in the interpretation of text only.

Preface

- PR1 This standard is one of the outcomes of a comprehensive Shari’ah governance framework project aimed to establish the guiding principles and rules, as well as, best practices for a sound and effective Shari’ah governance framework for Islamic financial institutions (IFIs / the institutions).
- PR2 One of the unique organs of the Shari’ah governance framework is the Shari’ah supervisory board (SSB). The SSB, by fulfilling its mandate of overseeing the institution’s compliance with Shari’ah principles and rules, secures the trust and confidence of stakeholders of the institution, including customers, investors and regulatory and supervisory authorities (RSAs).
- PR3 To ensure that SSB fulfils its mandate in an appropriate manner, with due competence, adequate resources, independence and objectivity, a standardised framework for the SSB’s composition and appointment criteria and relevant procedures and controls to ensure implementation of such criteria must be benchmarked against best governance practices. This is expected to allow the involvement of qualified Shari’ah scholars (and preferably experts in related fields) with diverse backgrounds, independent standing and adequate resources in the decision-making process.
- PR4 This standard describes certain requirements related to principle 6 “Shari’ah supervisory board (SSB)” as prescribed by [ED of] GS ____ “Shari’ah Governance Framework”.
- PR5 This standard, along with [ED of] GS ____ “Shari’ah Supervisory Board: Review and Report”, supersedes GS 1 “Shari’ah Supervisory Board: Appointment, Composition and Report” and GS 2 “Shari’ah Review”.

Introduction

Overview

- IN1 This standard aims to prescribe the principles of Shari’ah governance framework in respect of the appointment and composition of Shari’ah supervisory board (SSB) of an Islamic financial institution (IFI / the institution) enabling the establishment of an independent, competent and adequately resourced SSB. In order to achieve these objectives, this standard specifies the appointment procedures, the composition requirements for the SSB, the fit and proper criteria for the SSB members and other significant requirements.

Rationale(s) for issuing this standard

- IN2 The AAOIFI Governance and Ethics Board (AGEB / the board) decided to revise certain AAOIFI Governance Standards (GSs) including GS 1 “Shari’ah Supervisory Board: Appointment, Composition and Report”, as a part of the comprehensive Shari’ah governance framework project. This decision, inter alia, was based on the premise that these standards had been issued over two decades ago, and hence, needed significant improvements to address the current needs and challenges of the industry, taking into account that the global Islamic finance industry, as well as, the global best practices of governance and Shari’ah governance have significantly evolved and matured.
- IN3 Considering the significance of SSB’s report and its close linkage with the SSB’s review process, the board decided to split GS 1 “Shari’ah Supervisory Board: Appointment, Composition and Report” into two separate standards¹ including this standard.

Significant changes from the previous standard

- IN4 This standard, along with [ED of] GS ____ “Shari’ah Supervisory Board: Review and Report”, supersedes GS 1 “Shari’ah Supervisory Board: Appointment, Composition and Report” and GS 2 “Shari’ah Review”. This standard improves upon the previous standard GS 1 “Shari’ah Supervisory Board: Appointment, Composition and Report” by:
- prescribing improved and more comprehensive guidance in areas relating to appointment and composition of SSBs, such as fit and proper criteria for SSB members, as well as, the disqualification criteria and procedure;
 - clarifying the preference with regard to the appointment of SSB advisors (being technical experts) in addition to the SSB members, and defining their respective fit and proper criteria;
 - addressing certain earlier unaddressed issues (or issues addressed elsewhere in other relevant AAOIFI GSs) relating to the independence and objectivity of SSB members, insofar as related to the appointment and composition of SSB; and
 - aligning and moving the requirements related to the SSB’s report and SSB’s review process to the new [ED of] GS ____ “Shari’ah Supervisory Board: Review and Report” which includes the combined requirements related to the review and report in a better aligned and improved manner.

¹ [ED of] GS ____ “Shari’ah Supervisory Board: Appointment and Composition” and [ED of] GS ____ “Shari’ah Supervisory Board: Review and Report”

[Exposure Draft (AGEB 3/2023) of the]

AAOIFI Governance Standard (GS) ____

Shari’ah Supervisory Board: Appointment and Composition

Objective of the standard

1. The objective of this standard is to prescribe the governance principles applicable in respect of the appointment and composition of the Shari’ah supervisory board (SSB) of an Islamic financial institution (IFI / the institution) enabling the establishment of an independent, competent and adequately resourced SSB.

Scope

2. This standard applies to all IFIs, including Islamic windows, across all sectors. Regulatory and supervisory authorities (RSAs) may choose to apply this standard to other institutions in their jurisdictions as appropriate. This standard shall also be applied insofar as practicable by the institutions other than IFIs adopting AAOIFI governance standards (GSs), including social finance institutions.
3. This standard shall also apply to all other institutions (including Waqf and other social finance institutions) following AAOIFI GSs and to the SSBs established for Sukuk and other structures, as and to the extent, required by the relevant AAOIFI GSs.

Relationship with other standard(s)

4. This standard shall be read, understood and applied in conjunction with [ED of] GS ____ “Shari’ah Governance Framework”, [ED of] GS ____ “Shari’ah Supervisory Board: Review and Report”, [ED of] GS ____ “Shari’ah Supervisory Board: Functions and Operations” and GS 5 “Independence of Shari’ah Supervisory Board”.

Definitions

5. For the purpose of interpreting and applying this standard, the following short definitions are relevant:
 - a. Islamic financial institutions (IFIs / the institutions)² – are financial institutions that operate in line with Shari’ah principles and rules performing banking, insurance / Takaful, capital markets and similar activities and include the stand-alone branches, divisions and windows of conventional financial institutions that offer products and services in line with Shari’ah principles and rules;
 - b. Shari’ah principles and rules³ – comprise “the Shari’ah principles and rules defined by the following hierarchy, as appropriate:

² AAOIFI GS 12 “Sukuk Governance”

³ AAOIFI FAS 40 “Financial Reporting for Islamic Finance Windows”

- i. the Shari’ah standards issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
 - ii. the regulations issued by the respective jurisdiction’s regulator insofar as these entail the regulatory Shari’ah requirements;
 - iii. the rulings of the central Shari’ah board for the respective jurisdiction [if there is one];
 - iv. the requirements of the applicable financial accounting standards (FASs) as issued by AAOIFI insofar as these entail Shari’ah related requirements; and
 - v. the approvals and rulings given by the Shari’ah supervisory board of the institution”;
- c. Shari’ah supervisory board (SSB) – is an independent body of specialised jurists in Fiqh Al-Muamalat (Islamic commercial jurisprudence). In addition, the SSB may preferably include advisors (referred to as “SSB advisors”) who are experts in areas such as finance, economics, accounting or law, and have reasonable knowledge of Shari’ah principles and rules. The SSB is entrusted with the duty of reviewing and supervising the activities of an institution in order to ensure that it operates in compliance with Shari’ah principles and rules. The Fatwas and rulings (related to Shari’ah matters) of the SSB are binding on the institution; and
- d. Those charged with governance (TCWG)⁴ – in line with the International Ethics Standards Board for Accountants (IESBA) pronouncement, are “the person(s) or organisation(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, TCWG may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager”.

Composition of SSB

6. An institution shall have in place an independent, competent, empowered and adequately resourced SSB.

Minimum number of members

7. Each institution shall have an SSB consisting of at least three Shari’ah scholars specialised in Fiqh Al-Muamalat (Islamic commercial jurisprudence).

SSB advisors

8. For SSBs consisting of more than three members, professionals who are experts in related fields (e.g., finance, banking, accounting, economics, law) may preferably also be appointed as SSB advisors.

⁴ [ED of] AAOIFI GS __ “Syndicated Financing”

9. Institutions are strongly encouraged to appoint SSB advisors, as this will improve the understanding of the SSB of the broader picture, provide diversified exposure and enable the SSB to discharge its functions and duties more effectively.
10. Where an institution appoints an SSB advisor(s), they shall be subject to all the relevant provisions of this standard related to the members of SSB, insofar as suitable, in addition to the matters specifically related to SSB advisors.

Diverse expertise and exposure

11. The composition of an SSB shall preferably reflect diverse expertise and exposure, including representation from different schools of thought in the country, representation of different fields of expertise, knowledge and experience relevant to Islamic finance industry, as well as, both senior and junior scholars.

Appointment of SSB

Appointing authority, remuneration fixation and reporting line

12. SSB members shall be approved by the shareholders of the institution in their general meeting at the recommendation of TCWG.
13. SSB shall refer to TCWG for any administrative matters. However, it shall be completely independent in its function as the SSB.
14. Shareholders may periodically authorise TCWG to fix the remuneration of the SSB members.

Appointment of a temporary SSB by the RSA

15. The RSA, at its discretion, may appoint a temporary SSB if the institution fails to appoint an SSB within the time stipulated by the RSA. The cost of such an appointment shall be borne by the institution.

Appointment contracts for SSB members and the term of appointment

16. The appointment of the SSB members shall be made formally in writing by way of a contract for service for a minimum term of three years but no longer than five years.

Competence and capability considerations for appointment

17. An institution shall ensure that members of the SSB demonstrate the competence and ability to understand the technical requirements of the business, the inherent risks therein and the management processes required to conduct its operations effectively, with due regard to the interests of all stakeholders. In assessing the competence and capability of a person, all relevant factors should be considered, including, but not limited to, whether the person:
 - a. has demonstrated, through qualifications and experience, the capacity to successfully undertake the responsibilities of the position;
 - b. is mentally fit to perform their duties;
 - c. has sound knowledge of the business; and

- d. can allocate sufficient time and attention to the institution, taking into account their existing SSB memberships with other organisations, employment or other time commitments.

Fit and proper criteria for SSB members

- 18. The institution shall consider the following criteria when assessing the fitness and propriety of individual Shari'ah scholars to serve as members of the SSB:
 - a. Muslim individuals;
 - b. well-versed in Fiqh and Usul-al-Fiqh;
 - c. Shari'ah-related (preferably Fiqh-related) academic qualification (equivalent of a master's degree or above) from a recognised educational institution;
 - d. suitable practical experience or research and academic experience (at least 10 years) in the area of Fiqh Al-Muamalat;
 - e. suitable practical experience or research and academic experience in the fields of Islamic finance, economics, banking, law, business or other relevant fields;
 - f. good command of Arabic and common business language(s) in the jurisdiction;
 - g. reasonable understanding of economics, law, banking, finance and / or related fields;
 - h. demonstrable interest in and commitment to the field of Islamic banking and finance, and not having anomalous opinions in contradiction of the well-established contemporary scholarly consensus as contained in the Shari'ah principles and rules (as defined in this standard);
 - i. good understanding of legal and regulatory framework of the jurisdiction related to the financial sector;
 - j. good character, reputation and market recognition;
 - k. ability to devote sufficient time; and
 - l. independent and free from conflict of interest.

Fit and proper criteria for SSB advisors

- 19. The following criteria shall be considered when assessing the fitness and propriety of individuals to serve as SSB advisors:
 - a. Muslim individuals;
 - b. basic understanding of Shari'ah principles and rules and, preferably, an appropriate understanding of Fiqh Al-Muamalat as applicable to Islamic banking and finance;
 - c. well-versed and holds a high standing in their respective field of expertise;
 - d. suitable academic (master's degree or above) and / or professional qualification;

- e. suitable practical experience or research and academic experience in the relevant technical field(s) such as economics, law, banking, finance and / or related fields (preferably 15 years, but not less than 10 years);
- f. good understanding of legal and regulatory framework of the jurisdiction related to the financial sector;
- g. good command of common business language(s) in the jurisdiction;
- h. demonstrable interest in and commitment to the field of Islamic banking and finance;
- i. good character, reputation and market recognition;
- j. ability to devote sufficient time; and
- k. independent and free from conflict of interest.

Ethical considerations for appointment as an SSB member

20. Honesty, integrity and fairness are some of the key components of good character. In determining a person's character and to guide the criteria to be applied before appointing someone to serve on an SSB, the institution shall put in place a transparent process that considers all the appropriate factors, including, but not limited to, whether the person:
- a. has been convicted of a criminal offence, particularly an offence relating to dishonesty, fraud or financial crime;
 - b. has been the subject of any adverse findings or any settlement in civil proceedings, particularly in connection with banking or other financial business, misconduct, fraud or any business in which the person is a controlling shareholder or has a controlling interest or exercises significant influence has been investigated and disciplined or suspended by a regulatory or professional body, a court or tribunal, whether publicly or privately;
 - c. has been the owner, manager or director of a company, partnership or other organisation that has been refused registration, authorisation, membership or a licence to conduct trade, business or a profession or has had that registration, authorisation, membership or licence revoked, withdrawn or terminated, resulting in the person being refused the right to carry on a trade, business or profession requiring such a licence, registration or other authorisation;
 - d. has been a director, partner or otherwise involved in the management of a business that has gone into receivership, insolvency or compulsory liquidation while the person was connected with that organisation or within a reasonably short period (e.g., one year) after the person's departure from the institution;
 - e. has been dismissed, asked to resign or resigned from employment or from a position of trust, fiduciary appointment or similar position because of questions about honesty and integrity;

- f. has ever been disqualified from acting as a director or serving in a managerial capacity because of a wrongdoing;
- g. has not been fair, truthful and forthcoming in dealings with customers, superiors, auditors and / or regulatory authorities in the past and / or has been the subject of any justified complaint relating to regulated activities; or
- h. demonstrates unwillingness to comply with the requirements and standards of the regulatory system and other legal, regulatory or professional requirements and standards.

Disqualification of an SSB member

21. An SSB member may be disqualified if he:
 - a. ceases to be a person of good character and reputation, no longer holding a position of respect among peers;
 - b. fails to attend the minimum number of meetings in a year without a reasonable excuse;
 - c. is associated with any unethical or illegal activity, including contravening any of the requirements and standards of the financial, banking or corporate regulatory system;
 - d. is convicted of any criminal offence, including financial impropriety or moral turpitude (except misdemeanours);
 - e. is dismissed in the capacity of employee or director from any institution or company on the grounds of fraud, misrepresentation or breach of trust;
 - f. breaches the maximum limit of global / local SSB memberships as / if specified by the respective RSA; or
 - g. misuses confidential and privileged information about the institution or its clients obtained as a result of his position (e.g., for personal benefit or in a manner that is detrimental to the competitive interests of the institution in the marketplace).
22. The need for maintaining objectivity and independence of the SSB also requires that the removal, dismissal or rotation of SSB members is performed in an independent, transparent and objective manner. Accordingly, the RSA shall ensure that adequate controls are established so that such a process is free from any bias.
23. The dismissal of a member of the SSB shall require a recommendation by TCWG and be subject to the approval of the shareholders in a general meeting. It shall also be subject to the RSA's approval unless otherwise specified by the RSA.
24. The institution shall notify the relevant RSA of any resignation or removal of an SSB member as and when it happens or when action is contemplated / initiated, whichever is earlier, stating the reasons.

Effective date

25. This standard shall be effective on or after 1 July 2025. Earlier application is encouraged.

Amendments to other standards

26. This standard, along with [ED of] GS ____ “Shari’ah Supervisory Board: Review and Report”, supersedes GS 1 “Shari’ah Supervisory Board: Appointment, Composition and Report” and GS 2 “Shari’ah Review”.

Appendices

Appendix A: Adoption of the standard

This standard was presented for the approval in the AAOIFI Governance and Ethics Board's meeting No. _____ held on _____ H, corresponding to _____ and was duly approved.

Members of the board

1. Mr. Farrukh Raza (chairman)
2. Dr. Walid Hegazy (deputy chairman)
3. Dr. Abdulbari Mashal
4. Mr. Abdullah AlMoqbel
5. Dr. Abozer Magzoub
6. Dr. Ahmet AlBayrak
7. Dr. Ali Sartawi
8. Mr. Ebrahim Sidat
9. Ms. Ibtihal Al-Shamali
10. Dr. Mohammad Kabir Hassan
11. Mr. Moosa Khoory
12. Mr. Muzammil Kasbati
13. Mr. Sohaib Umar
14. Mr. Wael Merza
15. Dr. Zahid ur Rehman Khokher

Reservation

The standard was approved unanimously.

Working group members

1. Dr. Walid Hegazy (chairman)
2. Dr. Abdulbari Mashal
3. Mr. Abdulla Al-Mogbel
4. Mr. Ebrahim Sidat
5. Mr. Farrukh Raza
6. Mr. Firas Hamdan
7. Mr. Sohaib Umar

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Ms. Zahra Jassim (AAOIFI)
3. Ms. Alyaa Adel (AAOIFI)
4. Mr. Farhan Noor (AAOIFI)
5. Ms. Merjan Abid (Consultant-researcher)

Appendix B: Basis for conclusions

BC1 [To be updated later]

Appendix C: Brief history of the preparation of the standard

- H1 AAOIFI and Islamic Financial Services Board (IFSB) agreed to collaborate and cater to the growing needs of the global Islamic finance industry, in various areas of mutual interest. One of the significant collaboration efforts was in the area of standardisation and harmonisation of Shari’ah governance practices across the globe. The institutions collaborated to issue the exposure draft of “IFSB-AAOIFI Revised Shari’ah Governance Framework for Institutions Offering Islamic Financial Services” on 16 Ramadan 1444H, corresponding to 7 April 2022 after completing the due process.
- H2 Based on extensive feedback received from stakeholders and considering the mandates of each organisation, both the institutions mutually agreed to separately review and, where necessary, issue relevant guidance / standards on Shari’ah governance within their respective areas of focus.
- H3 AAOIFI Governance and Ethics Board (AGEB / the board) in its 32nd meeting on 12 Safar 1445H, corresponding to 28 August 2023, via video conferencing, approved the formation of a working group and the initiation of the development process of exposure drafts of six individual governance standards, primarily containing the requirements of the joint exposure draft, which were not covered elsewhere in the existing governance standards.
- H4 Following the board's approval, two working group meetings were held to discuss the draft standards on 25 Rabi’ II 1445H, corresponding to 9 November 2023 and 2 Jumada I 1445H, corresponding to 16 November 2023, respectively. The members of the working group agreed on conceptual issues and recommended the draft standards for the approval of AGEB.
- H5 AGEB held its 34th meeting on 13-14 Jumada I 1445H, corresponding to 27-28 November 2023 in Bahrain, and approved the issuance of exposure drafts of six governance standards, including this standard. The board directed the secretariat to incorporate the necessary changes in light of the comments of the AGEB members and the discussions during the meeting. The board further approved a fast-track due process for finalisation and issuance of these standards duly taking into account the effort and stakeholders’ feedback already incorporated in these standards.
- H6 After incorporating the board’s comments and necessary changes, this exposure draft was issued on 12 Jumada II 1445H, corresponding to 25 December 2023.