[Exposure Draft (AGEB 3 / 2022) v6.0 of the]

AAOIFI Governance Standard (GS) ___

Institutional Framework for the Implementation of Ethics

Contents

AAOIFI Governance Standard (GS) __ "Institutional Framework for the Implementation of Ethics" is set out in paragraph 1-9.

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. This standard shall be read in conjunction with "AAOIFI Code of Ethics for Islamic Finance Professionals" and other relevant governance standards.

Preface

PR1 Ethics is about achieving and maintaining Adl in all activities while pursuing Ihsaan[1]. This is an obligatory tenet of faith in Islam. It is also a core value proposition of, as well as, a driving force behind, Islamic finance. As a result, there are heightened expectations from the general public that the Islamic finance industry should conduct itself in an ethical manner that reinforces its integrity.

PR2 To facilitate Islamic finance professionals[2] in understanding the ethical requirements and expectations of them, the AAOIFI Governance and Ethics Board (AGEB) issued the AAOIFI Code of Ethics for Islamic Finance Professionals on 26 December 2019. The code is intended for adoption by both institutions[3] and professionals. This governance standard aims to facilitate institutions in their implementation of the code and the broader ethics function.

PR3 This standard primarily addresses how Islamic financial institutions (IFIs) can institutionalise ethical conduct so that their stakeholders embrace and hold themselves, and each other, accountable to higher standards.

BC1 This standard does not require a one-size-fits-all approach for its implementation. Rather, it expects the institutions to customise the framework according to the nature of their respective operations, size and structure.

[1] See AAOIFI ethical paradigm mentioned in paragraphs 12 and 13 of AAOIFI Code of Ethics for Islamic Finance Professionals

[2] See paragraph 2 of AAOIFI Code of Ethics for Islamic Finance Professionals for the definition of Islamic finance professionals

[3] See paragraph 2 of this standard

Introduction

Overview

IN1 This standard specifies a framework for institutionalising ethical conduct. The standard's principle-based guidance aims to ensure that institutions build a framework that is flexible and able to accommodate their specific needs and requirements based on the availability of resources and their unique circumstances.

IN2 This standard requires institutions to develop and implement a framework for the implementation of ethics by incorporating the principles and components mentioned in this standard.

Rationale for this standard

IN3 The rationale behind the development of the standard includes the following:

a. to remind the directors and the top management of an institution, as well as the regulators, of their responsibility to institutionalise ethical conduct as per their respective mandates and capacities;

b. to guide institutions on how to best institutionalise ethical conduct;

c. to mandate the adoption of the AAOIFI Code of Ethics for Islamic Finance Professionals (referred to as AAOIFI Code of Ethics) and provide an implementation mechanism for it; and

d. to improve the trust quotient of various stakeholders in the values and practices of IFIs and the Islamic finance industry.

Acknowledgement

IN4 In the conceptualisation and development of this standard the following main documents were referred:

a. §8B2.1, Chapter 8, Guidelines Manual (2021), United States Sentencing Commission[4]; and

b. Principles and Practices of High-Quality Ethics and Compliance Programs (2016), Ethics and Compliance Initiative (ECI).

IN5 Unless explicitly stated otherwise, AAOIFI does not endorse any specific standard or document issued by a third party.

[4] https://guidelines.ussc.gov/gl/%C2%A78B2.1 (last accessed on 19 October 2022)

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Institutional Framework for the Implementation of Ethics

Objectives of the standard

1. This standard provides guidance to institutions on how to:

   a. institutionalise ethical conduct;

   b. fulfil its fiduciary responsibilities towards stakeholders;

   c. promote an ethical culture within the institution to foster ethical conduct;

   d. reduce the likelihood of systematic ethics violations, and detect and respond to any such violation in a timely and effective manner; and

   e. safeguard the Islamic finance industry and its market players from potential reputational risk resulting from systemic ethics failures.

Scope

2. This standard shall apply to Islamic financial institutions (IFIs) including Islamic social finance institutions (such as Waqf, Zakah and Qard-based microfinance institutions) (collectively referred to as institutions).

3. The standard mandates the adoption of the relevant AAOIFI Code of Ethics[5] and recommends compliance with the relevant AAOIFI [ED of] governance standard (GS) [6].

Definitions

4. For clarity in interpreting this standard and in the context of this standard specifically, the following short definitions are applicable:

   a. institutional framework (for the implementation of ethics) – refers to the governance and control mechanisms developed and / or implemented by an institution to integrate ethics into the routine functions and behaviours of its internal stakeholders as they carry out their respective responsibilities; and

   b. internal stakeholders – include the board of directors, Shari'ah supervisory board (SSB), senior management particularly, chief executive officer (CEO), management and staff of the respective institution. In the case of outsourcing of different

[5] See AAOIFI Code of Ethics for Islamic Finance Professionals
[6] See [ED of] GS____ "Shari'ah Decision Making"

business functions to third parties, the third parties shall also be viewed as internal stakeholders[7].

Part A: Principles of the institutional framework

5. An institution shall develop the institutional framework based on, at a minimum, the following principles:

   a. commitment to ethics at all levels;

      [Explanation: The defining objective of this principle is to create or strengthen self-accountability, peer pressure and social pressure for the internal stakeholders, and then to ensure that those expectations are met]

   b. formalisation of ethics requirements and expectations;

      [Explanation: The defining objective of this principle is to clearly establish what is mandatory and what is encouraged or recommended for an institution and its internal stakeholders in terms of ethics, as well as, the approach and the policies that must be undertaken and implemented]

   c. sustained investment of human, financial and technological resources in ethics;

      [Explanation: The defining objective of this principle is to ensure sustained and adequate allocation of resources to the ethics function. It also entails granting sufficient authority to respective human resources to justify this principle]

   d. supporting internal stakeholders to understand, own and practice ethics while encouraging others to do the same;

   e. nurturing an organisational culture which encourages and incentivises ethical conduct and discourages and penalises unethical behaviour; and

   f. periodic improvement of the institutional framework.

Part B: Components of the institutional framework

6. An institution shall develop an institutional framework comprising, at a minimum, of the following components:

   a. code of ethics: an institution shall adopt the relevant AAOIFI Code of Ethics[8], to which it may add additional ethical requirements that are not inconsistent with the AAOIFI Code of Ethics;

[7] Including Takaful agents, BancaTakaful agents and call center agents.
[8] See AAOIFI Code of Ethics for Islamic Finance Professionals

b. board ethics committee: an institution shall establish a board ethics committee, which could either be a dedicated committee or an existing board committee to which the function may be assigned (such as the governance committee or the risk committee or the audit committee);

c. ethics risk assessment: an institution shall periodically conduct an ethics risk assessment to evaluate the effectiveness and impact of its institutional framework. Subsequently, a comprehensive improvement plan shall be developed and implemented to address any shortcomings identified;

d. ethics capacity building programme: an institution shall provide ethics training and awareness through various means and measures of capacity building to all internal stakeholders on a periodic basis in order for them to properly understand, own and implement ethics requirements in their respective work areas;

e. self-declaration: an institution shall require relevant internal stakeholders to provide periodic self-declarations of compliance with the requirements of the relevant AAOIFI Code of Ethics[9] and other applicable organisational policies and procedures;

f. ethics incentive and disciplinary mechanism: an institution shall integrate evaluation of ethical conduct into its performance appraisal system to significantly influence compensation, promotion and other benefits of internal stakeholders, as well as, a disciplinary mechanism to deal with those responsible for ethics violations based on the severity of the violation; and

g. ethics violation reporting mechanism: an institution shall establish an ethics hotline that allows internal stakeholders to anonymously report ethics violations without the fear of retaliation.

Proportional application and outsourcing

7. An institution shall consider how best to uphold and advance the principles mentioned in paragraph 5, as well as, to develop and implement the components referred to in paragraph 6, based on the nature of its operations, size and structure.

8. An institution may decide to outsource all the components of the institutional framework. The decision to outsource shall be made with the approval of the board ethics committee and only after conducting due diligence on the risks posed by third-parties, taking into account ethical considerations such as integrity, privacy, confidentiality and security.

Effective date

9. This standard shall be effective on or after 01 July 2024. Earlier application is encouraged.

[9] See AAOIFI Code of Ethics for Islamic Finance Professionals

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. Mohammad 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 and team

1. Mr. Sohaib Umar (chairman)
2. Dr. Ahmet Coskun
3. Mr. Abdulla Al Khaledy

4. Mr. Almir Colan
5. Mr. Ashraf Gomma Ali
6. Mr. Azeem Pirani
7. Mr. Hondamir Nustrat
8. Ms. Ibtihal Al-Shamali
9. Sheikh Irshad Ahmad Aijaz
10. Dr. Mohammad Kabir Hassan
11. Dr. Mohammad Omar Farooq
12. Mr. Muhammad Nadeem Aslam
13. Mr. Moosa Khoory

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Ms. Zahra Jassim (AAOIFI)
3. Ms. Alyaa Adel (AAOIFI)

Project lead

1. Mr. Farhan Noor (AAOIFI)

Appendix B: Description of a model institutional framework (for the implementation of ethics)

B1. An institution shall consider how to best uphold and advance the principles of the institutional framework based on the nature of its operations, size and structure.

Principle 1: Commitment to ethics at all levels

B2. An institution shall:

a. embed and nurture ethics as a core value;

b. demonstrate commitment to ethics; and

c. give voice and visibility to ethics.

Embed and nurture ethics as a core value

B3. An institution shall prioritise ethics as its core value by giving it precedence in all matters such as those involving strategic planning, business development, policy making, relationship management, decision-making, and culture-building. The objective is to fully embed ethics into every aspect of the institution's activities and operations.

Demonstrate commitment to ethics

B4. An institution shall demonstrate its commitment to upholding and advancing the principles of the institutional framework outlined in paragraph 5. Such a demonstration shall be:

a. made publicly and privately;

b. through speech, writing and conduct;

c. on an ongoing basis with periodic reemphasis;

d. based on a comprehensive plan; and

e. carried out by all stakeholders individually and collectively.

B5. An institution is encouraged to support and participate in industry initiatives that adopt and implement better ethical conduct.

Give voice and visibility to ethics

B6. An institution shall give ethics a voice, visibility and a significant role in decision-making[10] at every level. This may be achieved through initiatives and activities such as:

a. giving ethics due consideration in the boardroom and in senior management decision-making;

[10] Also see paragraph 19 of "AAOIFI Code of Ethics for Islamic Finance Professionals"

b. creating an environment where employees feel free to speak up and act on ethical issues;

c. making ethics an important criterion for professional success, growth and recognition for all employees, particularly the CEO and other members of the senior management; and

d. allowing ethics to be one of the deciding factors when competing objectives such as revenue, profitability, reputation and market share are present.

Principle 2: Formalisation of ethics requirements and expectations

B7. The primary basis for the formalisation of ethics requirements and expectations will be Shari'ah principles and rules, international best practices and internal ethics risk assessments. Accordingly, an institution shall:

a. adopt the AAOIFI Code of Ethics;

b. develop and / or update organisational policies and procedures with due consideration to ethics; and

c. conduct ethics risk assessment.

Adopt AAOIFI Code of Ethics

B8. An institution shall adopt the AAOIFI Code of Ethics and, if necessary, provide supplementary implementation guidelines.

B9. An institution shall ensure that all internal stakeholders have access to the AAOIFI Code of Ethics in their preferred language / mother tongue.

B10. An institution shall make the AAOIFI Code of Ethics accessible to all internal stakeholders at all times through different electronic and non-electronic platforms;

Develop or update organisational policies and procedures with due consideration to ethics

B11. An institution shall ensure that its organisational policies and procedures are developed to prevent, detect and mitigate risks or threats to the requirements of ethical conduct.

B12. An institution shall develop the organisational policies and procedures to promote ethical conduct at all levels and across all functions.

Conduct ethics risk assessment

B13. An institution shall conduct an ethics risk assessment to identify gaps or deficiencies in areas such as strategy and operations (including designing, sales and implementation of products and services) that have an impact on the ethical conduct of individuals within the institution and its overall culture. The objective is to utilise the findings to continually improve and strengthen the institutional framework. Such an exercise shall be conducted periodically, in a systematic and comprehensive manner.

B14. After identifying material risks to ethical conduct, an institution shall develop and implement an improvement plan to eliminate or minimise those risks.

Principle 3: Sustained allocation of resources (human and financial) for ethics

B15. An institution shall:

a. establish ethics committees;

b. specify the roles, responsibilities and authority of the ethics personnel; and

c. allocate adequate financial resources.

Establish ethics committees

B16. An institution shall establish a board ethics committee – which could be a dedicated committee, or an existing committee assigned with the additional function. An institution shall also consider establishing a management ethics committee – which could be a dedicated committee or department, or an existing committee or department assigned with the additional function.

B17. The board ethics committee shall fulfil, at a minimum, the following responsibilities:

a. provide guidance to the board on ethics-related concerns such as fraud, conflict of interest, confidentiality and transparency;

b. handle claims of ethics violations against members of the board of directors, members of the SSB and the senior management;

c. manage self-declarations of all board members attesting to their compliance with the relevant AAOIFI Code of Ethics[11];

d. authorise the CEO to establish the management's ethics committee and appoint its chairperson;

e. decide whether to appoint a full-time ethics officer to manage the institutional framework or assign the role to an existing employee on a part-time basis;

f. approve the institutional framework as presented by the management;

g. oversee and supervise the activities of the management's ethics committee (if it exists) in fulfilling its responsibilities; and

h. periodically review the effectiveness of the institutional framework in fulfilling its objectives.

[11] See AAOIFI Code of Ethics for Islamic Finance Professionals

B18. After receiving official authorisation from the board of directors, the CEO shall establish a management ethics committee. Such a committee shall comprise, at a minimum, of the following members:

a. chairperson, who shall be appointed by the board ethics committee;

b. members of senior management such as the heads of finance, human resources, Shari'ah compliance and operations;

c. ethics officer, who shall serve as the committee's secretary; and

d. employee(s) from the middle management.

B19. The management ethics committee shall fulfil, at a minimum, the following responsibilities:

a. develop and implement the institutional framework based on the principles in paragraph 5 and the components listed in paragraph 6;

b. allocate adequate resources towards the development and implementation of the institutional framework;

c. investigate allegations of ethics violations against internal stakeholders (except those involving the members of the SSB and the senior management which is the mandate of the board ethics committee). The committee shall have the authority to conduct investigations, render judgments, and penalise those who violate ethical standards;

d. manage self-declarations of internal stakeholders attesting to their compliance with the relevant AAOIFI Code of Ethics[12] and the other applicable organisational policies and procedures;

e. conduct an ethics risk assessment and recommend strategies to mitigate the identified risks or threats to ethics;

f. liaise with the human resources, training or communications department for the conduct of ethics training and other capacity building initiatives and activities for all internal stakeholders;

g. give recognition to middle and lower management employees for their ethical conduct; and

h. produce and publish an ethics report (as a section of the institution's annual report) detailing the extent to which the requirements of this standard have been implemented.

[12] See AAOIFI Code of Ethics for Islamic Finance Professionals

B20. An institution should, where possible, include at least one female professional in its ethics committees at the board and the management levels.

Define roles, responsibilities and authority of the ethics personnel

B21. An institution shall create ethics positions, with the aim to instil a sense of responsibility and accountability for ethics among employees. These positions shall include:

a. ethics officer; and

b. ethics champions.

B22. An institution shall determine the appropriate job titles for the ethics positions.

B23. The authority and responsibility of an ethics officer shall include:

a. overseeing and managing the day-to-day implementation of the institutional framework including assisting the respective board and management ethics committees in carrying out their responsibilities; and

b. investigating all types of claims of ethics violations against internal stakeholders, as well as, those of others, as applicable, when delegated by the respective ethics committees.

B24. An institution may either appoint a full-time ethics officer to manage the implementation of the institutional framework or assign the role to an existing employee on a part-time basis.

B25. An institution shall have ethics champions, preferably from each business function. The authority and responsibility of ethics champions shall include:

a. engaging with other employees on matters involving ethics with the objective to extend support and guidance in an informal manner; and

b. raising ethics awareness within their respective business functions.

B26. Ethics champions shall generally be expected to perform the functions related to ethics, in addition to their day-to-day responsibilities.

Allocate adequate financial resources

B27. An institution shall ensure that adequate financial resources are allocated for the development and implementation of its institutional framework to enable it to be run efficiently, effectively and sustainably.

Principle 4: Supporting internal stakeholders to understand, own and practice ethics while encouraging external stakeholders to do the same

B28. An institution shall:

a. conduct ethics training for all its internal stakeholders;

b. raise ethics consciousness and awareness; and

c. require periodic self-declarations from relevant internal stakeholders.

Conduct ethics training

B29. An institution shall conduct periodic ethics training for all internal stakeholders.

B30. An institution should conduct ethics orientation or sensitising sessions for the benefit of suppliers, customers and other stakeholders, where possible, as a part of its corporate social responsibility (CSR) activities. One of the objectives for such initiative is to protect an institution from potential risks or threats to ethics posed by the ecosystem in which it operates.

Raise ethics consciousness and awareness

B31. An institution shall alert its internal stakeholders on relevant policy revisions, send reminders on various ethical requirements and expectations, and inspire them to pursue Ihsaan[13]. This can be achieved through different communication channels including email, newsletters, circulars, special events, and audio-visual content. Such systematic, targeted and ongoing interventions are intended to raise the ethical consciousness and awareness of internal stakeholders.

Require periodic self-declarations from relevant internal stakeholders

B32. An institution shall require relevant internal stakeholders to complete and submit, on a periodic basis, self-declaration forms confirming their compliance with the AAOIFI Code of Ethics and other applicable organisational policies and procedures.

Principle 5: Nurturing an organisational culture which encourages and incentivises ethical conduct, and discourages and penalises unethical behaviour

B33. An institution shall consider how to best uphold and advance this principle based on the nature of its operations, size and structure. Accordingly, an institution shall establish a robust:

a. ethics incentive and disciplinary mechanism; and

b. ethics violation reporting means and mechanism.

[13] The term "Ihsaan" has been defined in paragraph 10(e) of the AAOIFI Code of Ethics for Islamic Finance Professionals as the "concept of striving for excellence in ethics", where excellence is achieved when something is done in a manner which in given resources, constraints and circumstances cannot be done better.

Establish a robust ethics incentive and disciplinary mechanism

B34. An institution shall incentivise internal stakeholders to become ethics role models. These incentives shall include:

a. integrating the evaluation of ethical conduct into the performance appraisal system to significantly influence the compensation, promotion and other benefits of internal stakeholders; and

b. recognising and rewarding internal stakeholders who have repeatedly demonstrated exemplary ethical conduct.

B35. An institution shall have a zero-tolerance policy for material ethics violations and have a robust disciplinary mechanism to properly address such violations.

Establish robust ethics violation reporting means and mechanism

B36. An institution shall build a robust system to provide internal stakeholders appropriate means and mechanism to report instances of ethics violation to the management ethics committee.

B37. An institution shall develop a policy on whistleblowing. Specifically, the policy shall protect those who disclose ethics violations in good faith and in accordance with proper reporting protocols[14].

B38. An institution shall respond to all reported ethics violations in the following manner:

a. where the reported ethics violation is against a member of the board of directors, the SSB or senior management, it shall be addressed by the board ethics committee. Otherwise, the report shall be addressed by the management ethics committee; and

b. where the reported ethics violation involves a member of the board or the management ethics committee, that member will be requested to recuse himself from the case. He shall neither participate in the investigation nor be privy to case-related information until the matter is decided. If he is found guilty of material ethics violation, he shall resign from the committee.

Principle 6: Periodic improvement of the institutional framework

B39. An institution shall:

a. carry out a comprehensive review of its institutional framework for implementation of ethics on a periodic basis; and

b. publish an annual ethics report.

[14] See "violation-escalation protocol" explained in paragraph 20 of the AAOIFI Code of Ethics for Islamic Finance Professionals

Carry out a comprehensive review of the institutional framework

B40. An institution shall periodically carry out a comprehensive review of the effectiveness of its institutional framework in meeting its objectives. Strict confidentiality shall be ensured during the review process.

B41. An institution shall prepare a review report that includes a comprehensive improvement plan to address all the shortcomings in its institutional framework. The report shall be shared with the board ethics committee.

Publish an annual ethics report

B42. An institution shall prepare an ethics report (as a section of its annual report) detailing the extent to which the requirements of this standard have been implemented in conjunction with the requirements of the relevant AAOIFI Code of Ethics[15].

[15] See AAOIFI Code of Ethics for Islamic Finance Professionals

Appendix C: Basis of conclusion

Rationale for the standard

BC1 The board debated the necessity for developing this standard. It was argued that the subject matter of the standard is neutral and generic from the Shari'ah and corporate governance perspectives, and as such, there was no need for AAOIFI to intervene in an area which is well covered by conventional corporate governance standards.

BC2 A few options were tabled, and subsequent discussions held, the summary of which is as follows:

a. AAOIFI does not develop this standard: In this scenario, the institutions may either develop their own frameworks for the implementation of ethics or adopt / adapt any third-party solutions. The board realised, however, that the importance of an AAOIFI standard cannot be ignored. The existence of an AAOIFI standard creates moral pressure or even a legal obligation (in jurisdictions where AAOIFI governance standards are mandatory) to adopt the standard. Moreover, and upon investigation, it was found that third-party solutions were context-heavy, not wholly relevant to institutions, and no single solution addressed all of the board's key concerns;

b. AAOIFI develops a guideline for the implementation of ethics and classifies it as an ethics guideline as opposed to a governance standard: Taking into consideration that a guideline does not create a legal obligation and is only optionally referenced, the board noted that this approach would fail for the same reasons as stated in item 'a' above. It was also noted that given the document discusses governance controls to ensure ethical conduct and not values, it is a governance standard and not an ethics standard or guideline, and thus should be classified as such; or

c. AAOIFI develops this as a governance standard: In this scenario, the board would summarise the main principles and components of the institutional framework for the implementation of ethics in accordance with international best practices, but within the context of Islamic finance. It was argued that only a conceptual framework would be provided to institutions, allowing them to fill in the details themselves based on the nature of their operations, size and structure.

BC3 The board selected the third option for reasons mentioned in paragraph IN3 of this standard.

Mandatory adoption of the AAOIFI Code of Ethics

BC4 The board debated the adoption of the AAOIFI Code of Ethics by the institutions as a mandatory or optional requirement. Some members believed that institutions already have their own codes of ethics and also adopt codes issued by the local regulator and / or other relevant entities. Therefore, mandating these institutions to adopt yet another code would be costly and unnecessary.

BC5 A few options were tabled, and subsequent discussions held, the summary of which is as follows:

a. institutions may voluntarily adopt the AAOIFI Code of Ethics: In this scenario, the institutions are effectively permitted to disregard the AAOIFI Code of Ethics in favour of any other code. The board argued that as this standard was specifically developed to complement the conceptual framework of the AAOIFI Code of Ethics, it will be unable to fulfil its promise if the AAOIFI Code of Ethics is replaced by another code. In addition, institutions in general lack a code comparable to the relevant AAOIFI Code of Ethics[16] and allowing the use of any other code might fundamentally lower the ethics bar;

b. institutions are only required to confirm that their codes comply with the AAOIFI Code of Ethics and meet all its requirements: Although not stated explicitly, the board realised that this option virtually mandates the adoption of the AAOIFI Code of Ethics. In addition, they contended that such an exercise would be more costly and time-consuming than simply adopting the AAOIFI Code of Ethics; or

c. institutions must adopt the AAOIFI Code of Ethics as their primary code: In this scenario, an institution's primary code of ethics would be the AAOIFI Code of Ethics, to which it may add additional ethical requirements and / or supplement its implementation by producing guidelines, explanations, and / or examples.

BC6 The board selected the third option and decided that institutions must adopt the AAOIFI Code of Ethics to avoid a scenario in which an institution, in good faith, invests heavily in the development of an institutional framework for the implementation of ethics, but where the code of ethics being implemented is deficient or even non-compliant with some Shari'ah principles or rules. In such a situation, the initiative may become ineffective and even damaging for the institution and the Islamic finance industry in general.

CEO's role in the institutional framework for implementation of ethics

BC7 The board debated the CEO's role in the institutional framework and whether he should serve on the management ethics committee, and if so, be its chairman or a member.

BC8 A couple of options were tabled, and subsequent discussions held, the summary of which is as follows:

a. the CEO should not serve on the management ethics committee: The board considered how the CEO's presence in the committee could intimidate some committee members, creating an atmosphere that would not be conducive to open and frank conversations about important ethical issues. In addition, there is the potential for a conflict of interest in which the CEO may end up self-reviewing various ethics violations, such as mis-selling, which is often a direct outcome of his

[16] See AAOIFI Code of Ethics for Islamic Finance Professionals

sales policy. It was thought that, in such a case, the CEO would overlook the violation's root cause or downplay his involvement; or

b. the CEO should serve on the management ethics committee as either its chairman or a member: The board recognised that the CEO's membership would raise the value and effectiveness of the committee. Given that the CEO would have participated in crucial discussions on a variety of issues and understood their context, content, implications and expectations, it is also expected that the CEO will make timely and courageous decisions in relation to ethics.

BC9 The board selected the second option. It was unanimously agreed that the management ethics committee would not produce the desired results without the active participation of the CEO in designing, developing and implementing the institutional framework. The board stated that the CEO will be held accountable for ethics and as a result has the right to influence committee discussions and decisions as he sees fit, which may not be achievable from outside the committee.

BC10 On the matter of chairmanship, the board left it at the discretion of the institution's board to appoint the CEO or another member as the chairman of the management ethics committee.

Middle management employees as members of the management ethics committee

BC11 The board debated on the membership of middle management and lower management employees in the management ethics committee. The main concern was whether confidentiality could be maintained about substantive ethical issues and other sensitive information.

BC12 It was determined that a middle management employee, and not a lower management employee, should be a member of the committee, with the expectation that such an employee will notify the committee about ethical issues and / or violations occurring at the operational level. The board feared losing access to such information if middle management employees are not appointed to the committee.

Cost of implementing and managing the institutional framework

BC13 The board discussed the importance of minimising the cost for institutions of implementing the institutional framework. At the same time, it was agreed that this would not be done at the expense of the framework's overall objective and quality. Among the flexibilities accorded on this front are the following:

a. institutions may tailor-design and customise the institutional framework as they deem fit based on the nature of their operations, size, structure and unique circumstances, as long as the principles are upheld, and the basic components are in place;

b. rather than appointing a full-time ethics officer to manage the institutional framework, institutions may assign the role to an existing employee on a part-time basis;

c. not mandating the establishment of the management ethics committee; and

d. institutions may outsource the development and implementation of the institutional framework to competent third-parties to realise cost savings.

Appendix D: Brief history of the preparation of the standard

H1 The working group held two meetings on 7 and 9 Rajab 1443H, corresponding to 8 and 10 February 2022, via video conferencing. The members discussed the preliminary study and agreed on conceptual issues. The study was approved to be presented to the board.

H2 AGEB held its 24th meeting on 29-30 Rajab 1443H, corresponding to 2-3 March 2022 via video conferencing and approved the preliminary study.

H3 Following the approval of the board, the working group held a meeting to discuss the first version of the exposure draft. The meeting was held on 8 Shawwal 1443H, corresponding to 9 May 2022. AGEB held its 25th meeting on 16-17 Shawwal 14443H, corresponding to 17-18 May 2022 via video conferencing to discuss the progress of the working group and agreed on the way forward.

H4 The working group held three additional meetings to discuss the exposure draft. The meetings were held on 9 Muharram 1444H, corresponding to 7 August 2022, 12 Muharram 1444H, corresponding to 10 August 2022 and 4 Safar 1444H, corresponding to 31 August 2022 via video conferencing. The working group approved the exposure draft and recommended it to be presented to the board.

H5 AGEB held its 27th meeting on 10-11 Safar 1444H, corresponding to 6-7 September 2022 at the Participation Banks Association of Turkiye (TKBB) head office in Istanbul, Republic of Turkiye and directed the secretariat to make the necessary changes and approved the exposure draft. After the due process, the exposure draft was issued on 28 Jumada I 1444H, corresponding to 22 December 2022.