

## Session 4

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### Regulatory Approach to Shari'ah Governance System

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An Insight into the Exposure Draft of IFSB-10:

**GUIDING PRINCIPLES ON *SHARI'AH* GOVERNANCE SYSTEMS FOR INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES**

## Outline

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About Exposure Draft of IFSB-10

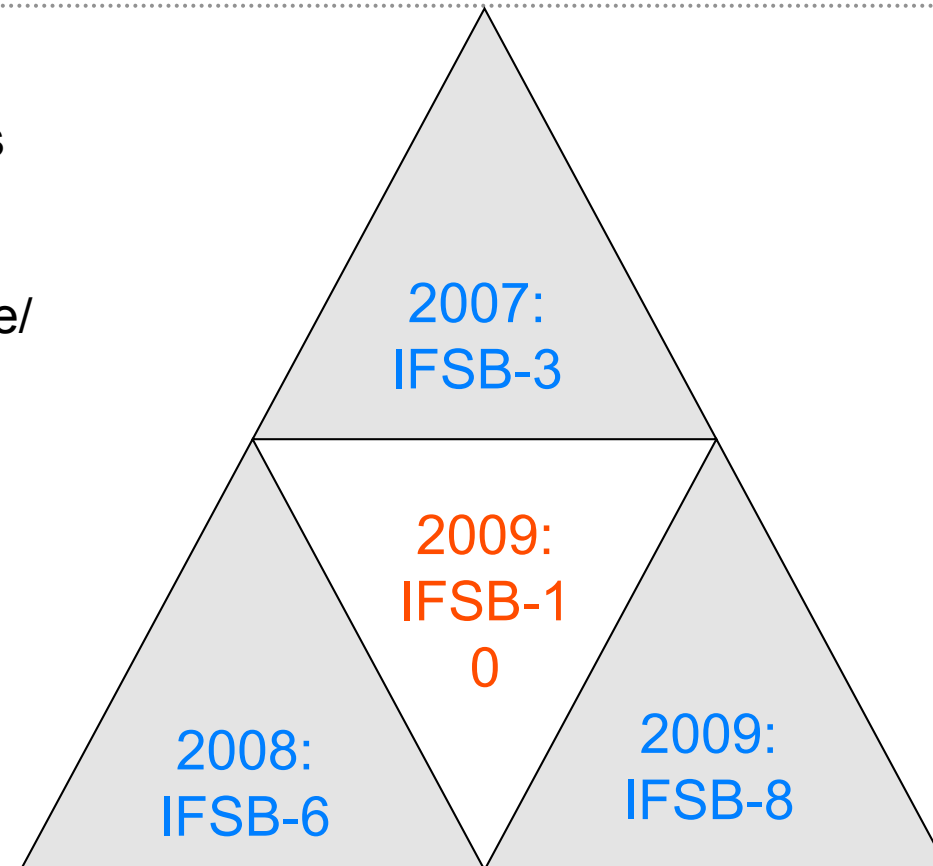
- **Background and objectives**
- **Definition and scope**
- **Insight into issues to be addressed; and**
- **Recommended best practices**

Administrative Matters

- **Due process and Timetable**

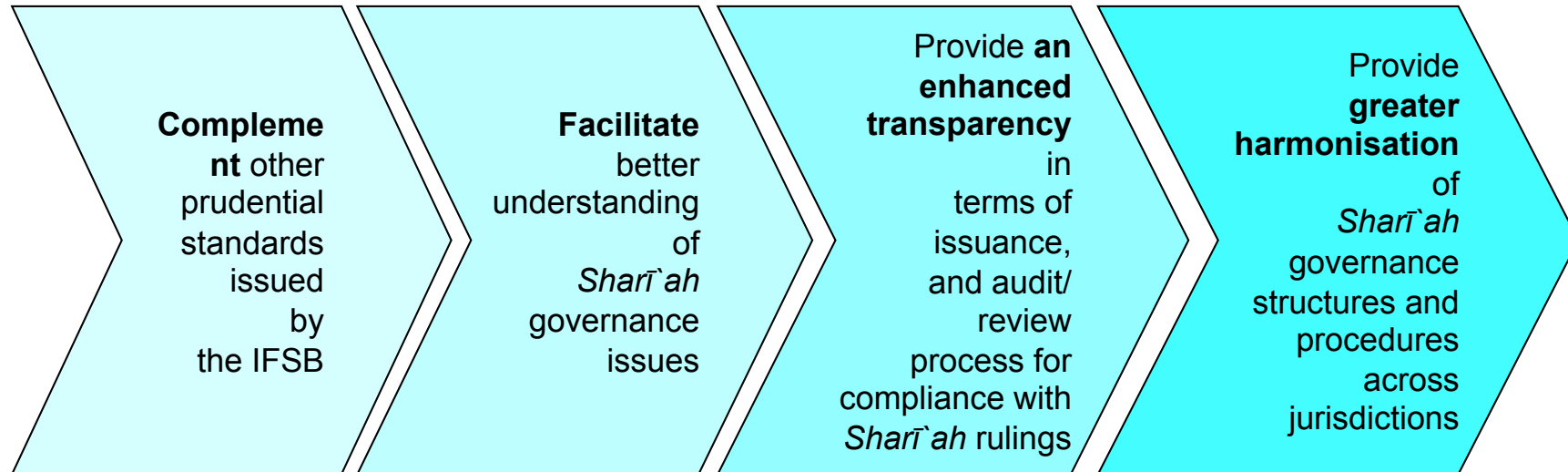
## Background of Exposure Draft of IFSB-10

- i. Guiding Principles for Governance for Institutions offering only Islamic Financial Services (**IIFS** – excluding Islamic insurance/*takāful* institutions and Islamic mutual funds);
- ii. Guiding Principles on Governance for Islamic Collective Investment Schemes;
- iii. Guiding Principles on Governance for *Takāful* (Islamic Insurance) Operations.



- iv. Guiding Principles on the *Sharī'ah* Governance System

# Objectives of the IFSB-10



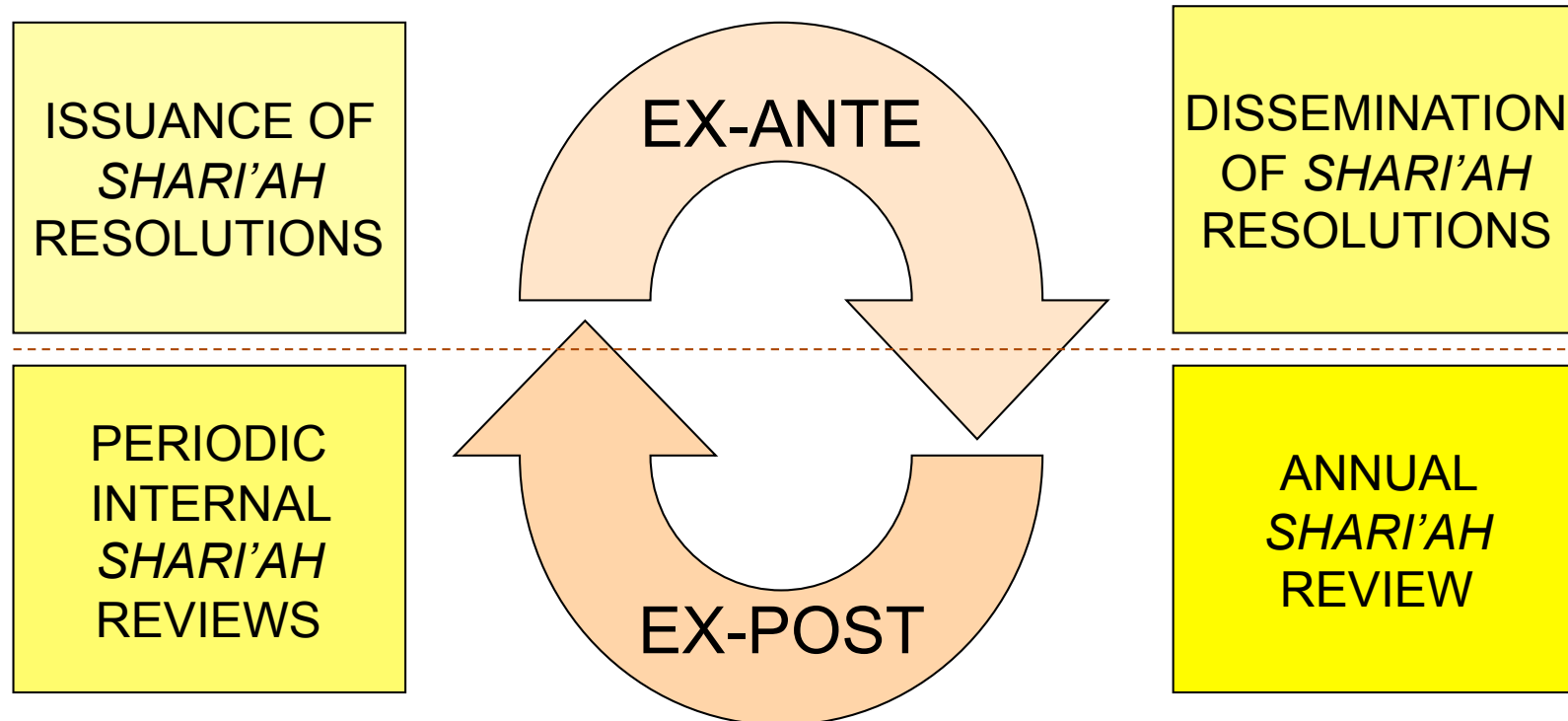
Highlighting the components of a sound *Sharī`ah* governance system

Focus on competence, independence, confidentiality and consistency of *Sharī`ah* boards

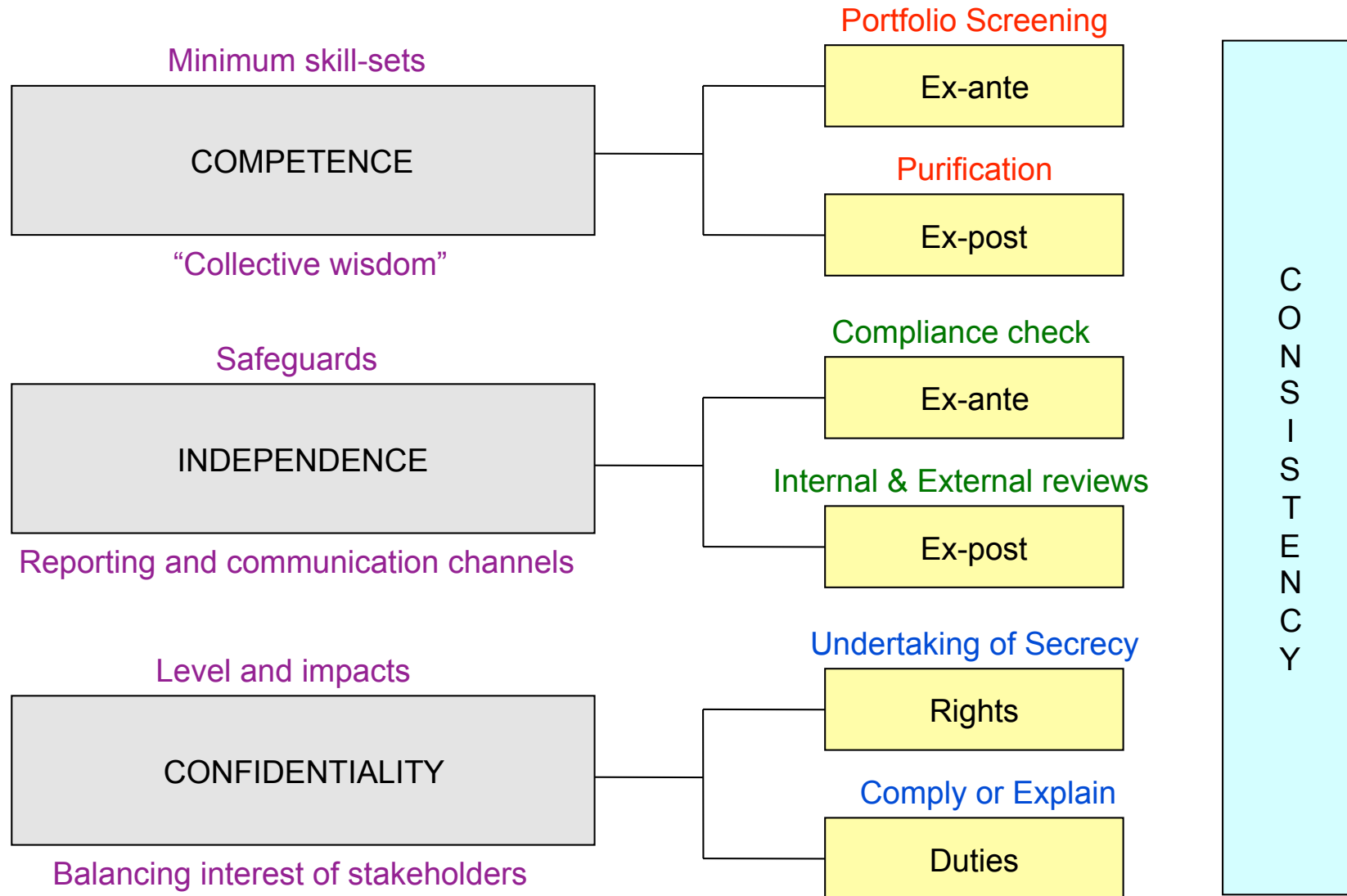
Stakeholders should satisfy themselves that an appropriate and effective *Sharī`ah* governance system is in place

# Definition and Scope of a *Sharī'ah* Governance System

“*Sharī'ah* Governance System” refers to the set of institutional and organisational arrangements through which an IIFS ensures that there is effective independent oversight of *Sharī'ah* compliance over each of the following structures and processes:



# Framing the IFSB-10



# How IFSB-10 differs from earlier IFSB Guiding Principles

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## ■ Scope

- ▶ Defining “*Sharī’ah* Governance System” and other key terminologies.
- ▶ Covers all types of IIFS including banks, collective investment schemes, fund management companies, *Takāful* undertakings and Islamic windows.
- ▶ Instead of repeating *structures and processes* that govern relationship between *Sharī’ah* Board and IIFS, the IFSB-10 focuses on four elements required for an effective *Sharī’ah* Governance System.

## ■ Structures and Processes

- ▶ Competence – Terms of Reference, “Fit & Proper” criteria, “Code of Ethics”
- ▶ Independence – Management of conflicts of interest
- ▶ Confidentiality – Authorised/unauthorised disclosures
- ▶ Consistency – Drive towards convergence

## Main Premises

### COHERENCE

The IFSB standards and guiding principles shall draw upon and complement one another, and form a coherent prudential framework. The requirements and recommendations in this document do not, in any manner, contradict or supersede the requirements and recommendations relating to the *Shari'ah* Governance System that may have been mentioned in other IFSB standards and guiding principles.

### NO SINGLE/ONE-SIZE-FITS-ALL MODEL

It is perfectly understandable that supervisory authorities may tailor the *Shari'ah* Governance System adopted by IIFS in their respective jurisdictions to suit market realities and the stage of development of their IFSI. Each model may have its pros and cons, and supervisory authorities should have a clear understanding of these and justification as to which model would suit their requirements.

### SHARING RESPONSIBILITY

The burden of ensuring a sound and effective *Shari'ah* Governance System should not be left to members of the *Shari'ah* board alone. Every stakeholder in the IFSI, including the clients, management, shareholders and the supervisory authorities, should also play a part in sharing the responsibility.

## Five Parts of IFSB-10

<b>Part I</b>	relates to the general approach to a <i>Sharī'ah</i> Governance System, whereby various <i>ex-ante</i> and <i>ex-post</i> processes considered as essential parts of good governance practices in other internationally recognised governance standards, such as the precise terms of reference for <i>Sharī'ah</i> boards, appropriate alignment of incentives, proper record-keeping, adoption of a professional code of ethics, etc., are adapted in order to strengthen the <i>Sharī'ah</i> Governance System.
<b>Part II</b>	in the area of competence, suggests various measures to ensure reasonable expertise and skill-sets in <i>Sharī'ah</i> boards, and to evaluate their performance and professional development.
<b>Part III</b>	aims at safeguarding the independence of <i>Sharī'ah</i> boards, particularly from the management of IIFS, by highlighting various issues arising from potential conflicts of interest and recommending how they should be managed.
<b>Part IV</b>	emphasises the importance of observing and preserving confidentiality by the organs of <i>Sharī'ah</i> governance.
<b>Part V</b>	focuses on improving consistency in terms of the professionalism of members of the <i>Sharī'ah</i> board, which would be crucial in enhancing their credibility and confirming their integrity through a set of best practices.

# Part I – General *Sharī'ah* Governance Approach

**Principle 1.1: The *Sharī'ah* governance structure adopted by the IIFS should be commensurate and proportionate with the size, complexity and nature of its business.**

- Sets out the *ex-ante* and *ex-post* considerations before an IIFS chooses its Shariah Governance structure

Ex-Ante	Ex-Post
<ul style="list-style-type: none"> <li>■ to appoint a reputable and credible <i>Sharī'ah</i> board;</li> <li>■ to support the <i>Sharī'ah</i> board by appointing an ISCU or an individual <i>Sharī'ah</i> officer; and</li> <li>■ for the <i>Sharī'ah</i> board to have at least three members, possibly of different nationalities, or trained in different schools of jurisprudence, and to have a mix of more experienced and less experienced members of the <i>Sharī'ah</i> board. Members of the <i>Sharī'ah</i> board should possess some exposure in the areas of commerce or finance.</li> </ul>	<ul style="list-style-type: none"> <li>■ ensuring that the <i>Sharī'ah</i> board is more focused, with more time spent on each assignment and conflicts of interest adequately managed;</li> <li>■ letting the <i>Sharī'ah</i> board mandate and delegate some of its functions to the ISCU;</li> <li>■ hiring and nurturing young members of the <i>Sharī'ah</i> board with promising potential to expand the talent pool in the profession; and</li> <li>■ engaging other professionals such as lawyers, accountants and economists to assist and advise the <i>Sharī'ah</i> board, especially on legal and financial issues.</li> </ul>

## Part I – General *Sharī'ah* Governance Approach (2)

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Principle 1.2: Each IIFS must ensure that the *Sharī'ah* board has:

- a clear terms of reference regarding its mandate and responsibility;
- well-defined operating procedures and lines of reporting; and
- good understanding of, and familiarity with, professional ethics and conduct.

- Complemented by **Appendices** on Terms of Reference, meeting procedures and basic code of ethics

## Part II – Competence

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**Principle 2.1: The IIFS shall ensure that any person mandated with overseeing the *Sharī`ah* Governance System fulfils an acceptable fit and proper criteria.**

Criteria when assessing the fitness and propriety of individuals to serve on the *Sharī`ah* board as well as officers of Internal *Sharī`ah* Compliance Unit (ISCU) and Internal *Sharī`ah* Review Unit (ISRU):

■ **Good character, i.e. honesty, integrity, fairness and reputation**

■ **Competence, diligence, capability and soundness of judgment**

## Part II – Competence (2)

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**Principle 2.2: The IIFS shall facilitate continuous professional development of persons serving on its *Sharī`ah* board, as well as its ISCU and ISRU, if any.**

**Training policies** shall be established with adequate consideration for training needs, to ensure compliance with the IIFS's operational and internal control policies and procedures, and all applicable legal and regulatory requirements to which the IIFS generally, and members of the *Sharī`ah* board and internal *Sharī`ah* officers particularly, are subject.

- *Orientation and induction program*
- *Mentoring program i.e. more experienced members of the Sharī`ah board and internal Sharī`ah officers provide guidance and tutelage to less experienced counterparts*
- *Tailor-made training on industry-specific knowledge*
- *Giving in-house training to other officers*

## Part II – Competence (3)

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**Principle 2.3: There should be a formal assessment of the effectiveness of the *Sharī'ah* board as a whole and the contribution by each member to the effectiveness of the *Sharī'ah* board.**

IIFS shall decide how the *Sharī'ah* board's performance may be evaluated and propose objective performance criteria. Such performance criteria, which allow for comparison with industry peers, should be developed together and in consultation with the *Sharī'ah* board and may include, for example, how the *Sharī'ah* board enhances long-term shareholders' value.

- Performance criteria should not be arbitrarily or unilaterally changed by the IIFS; onus should be on the IIFS, through the BOD, to justify any changes.

- *Appendix 5 recommends assessments criteria.*

## Part III – Independence

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**Principle 3.1: The *Sharī`ah* board should play a strong and independent oversight role, with adequate capability to exercise objective judgment on *Sharī`ah*-related matters. No individual or small group of individuals shall be allowed to dominate the *Sharī`ah* board’s decision making.**

- In order to uphold the integrity and credibility of the *Sharī`ah* board, its members must not only be able to exercise independent judgement without undue influence or duress, especially from the management of the IIFS, but also to be *seen* to be truly independent.
- Sets out the position deemed to be “in conflict”.

## Part III – Independence (2)

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**Principle 3.2: In order to fulfil their responsibilities, the *Sharī`ah* board should be provided with complete, adequate and timely information prior to all meetings and on an on-going basis.**

- *Sharī`ah* boards should have **separate and independent access** to the ISCU and ISRU, respectively, to check whether internal control and compliance procedures have been appropriately followed and that applicable rules and regulations to which the IIFS is subject have been complied with.
- Where the *Sharī`ah* board has its own secretariat, the **appointment and removal of members** of the secretariat should be appropriately carried out **in consultation** with the *Sharī`ah* board.
- IIFS shall have a procedure for the *Sharī`ah* board, either for each individual member or as a group, in the furtherance of their duties, to take **independent professional advice**, such as on legal, accounting, financial or valuation issues, if necessary, at the IIFS's expense.

## Part IV – Confidentiality

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**Principle 4.1: *Shari`ah* board members should ensure that internal information obtained in the course of their duties is kept confidential.**

- Examples of confidential information
- In case of leakage of confidential or market-sensitive information to inappropriate parties, IIFS should at least have appropriate risk management and control processes in place to limit the damage of such leakage
- Wherever possible, the IIFS should establish a process for taking disciplinary and/or other administrative actions against the *Shari`ah* board or its members to ensure absolute accountability and appropriate remedy.

## Part V – Consistency

**Principle 5.1: The IIFS should fully understand the legal and regulatory framework for issuance of *Sharī'ah* pronouncements/resolutions in the jurisdiction where it operates. It should ensure that its *Sharī'ah* board strictly observes the said framework and, wherever possible, promotes convergence of the *Sharī'ah* governance standards.**

Ex-Ante	Ex-Post
<ul style="list-style-type: none"> <li>■ In countries where there is a central authority issuing the <i>Sharī'ah</i> pronouncements/ resolutions, the <i>Sharī'ah</i> board at the IIFS is usually required to follow and adopt such <i>Sharī'ah</i> pronouncements/resolutions as are issued by that central <i>Sharī'ah</i> authority.</li> <li>■ If no such body, the <i>Sharī'ah</i> board should follow and adopt the <i>Sharī'ah</i> pronouncements/ resolutions issued by the OIC Fiqh Academy.</li> <li>■ Otherwise, the <i>Sharī'ah</i> board should exercise its best efforts in documenting and publishing its <i>Sharī'ah</i> pronouncements/resolutions so that they can be openly assessed by the industry's stakeholders (subject to the appropriate observance of confidentiality).</li> </ul>	<ul style="list-style-type: none"> <li>■ From time to time, members of the <i>Sharī'ah</i> board should participate in meetings of <i>ulama</i> specialised in <i>fiqh al-muamalat</i> to present and debate <i>Sharī'ah</i> pronouncements/ resolutions. They must also expect to answer questions from shareholders and the public in a general assembly or similar forum. It would be helpful if they were to produce in the annual reports a section on <i>Sharī'ah</i> compliance by the IIFS, including clarifying the process of how the <i>Sharī'ah</i> board reached its decisions.</li> <li>■ The IIFS should ensure that the <i>Sharī'ah</i> board adopts a specified process for changing, amending or revising any <i>Sharī'ah</i> pronouncements/resolutions.</li> </ul>

## The Public Consultation

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### Views seek from the public consultation:

- Adequacy of choice of terminologies and their definitions;
- Compatibility of the Guiding Principles with local *Shari'ah* Governance framework; and
- Additional recommendations of best practices to be incorporated.

## The Public Consultation (2)

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- **Exposure Draft of IFSB-10 made available for public consultation between 15/1/09 – 15/5/09**
- **Public hearing held on 5/5/09 in Singapore, attended by 60 participants. Workshop held on 4/6/09 in Abu Dhabi, attended by 40 participants.**
- **By the close of the dateline, we received written comments from 22 organisations, 3 individuals as well as the IFSB Arabic Editing Committee**
- **In general, the Exposure Draft of IFSB-10 was well received. No changes made to any of the Principles; only a few changes in the recommended best practices.**

## Due Process and Timetable

2009	DUE PROCESS
5.5.09	Public Hearing
15.5.09	End of Consultation Period
18.5.09	Working Group Meeting
24.8.09*	<i>Shari'ah</i> Committee Meeting
22-23.10.09*	Technical Committee Meeting
23.11.09*	Adoption of Standard by Council
	<b>*tentative</b>



**Thank you for your attention**

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# Q & A

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