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# Regulatory and Critical Governance Issues in The Contemporary Islamic Finance Industry

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## **Abstract:**

This paper examines the extent to which Shari'ah supervisory board (SSB) governance practises contribute to the issue of creative Shari'ah compliance in the contemporary Islamic finance industry. Creative Shari'ah compliance can be defined as compliance with the letter but not the objectives of Shari'ah. To gain the trust of their Muslim clients, institutions offering Islamic financial services (IIFS) normally incorporate a religious board in the form of an SSB. In theory, the SSB is there to ensure that IIFS operate within Shari'ah norms and teachings. However, concerns have been raised about the feasibility of a viable and functional Shari'ah governance culture in IIFS. Doubts relate mainly to these boards' unclear functions and legal status, lack of accountability and transparency, and conflicts of interest and lack of independence, as well as to the poor training and inadequate qualifications of SSB members.

This paper argues that the prevalence of these critical governance issues largely reduces the level of Shari'ah compliance in the Islamic finance industry. Thus, the paper recommends that regulators in Islamic and secular countries intervene and regulate Shari'ah governance in IIFS so as to ensure a sound financial system and investor confidence.

## **1.1. Introduction**

This paper examines the extent to which Shari'ah supervisory board (SSB) governance practises contribute to the issue of creative Shari'ah compliance in the contemporary Islamic finance industry. Creative Shari'ah compliance can be defined as compliance with the letter but not the objectives of Shari'ah. To gain the trust of their Mus-

lim clients, institutions offering Islamic financial services (IIFS) normally incorporate a religious board in the form of an SSB. In theory, the SSB is there to ensure that IIFS operate within Shari'ah norms and teachings. However, concerns have been raised about the feasibility of a viable and functional Shari'ah governance culture in IIFS. Doubts relate mainly to these boards' unclear functions and legal status, lack of accountability and transparency, and conflicts of interest and lack of independence, as well as to the poor training and inadequate qualifications of SSB members.

This paper argues that the prevalence of these critical governance issues largely reduces the level of Shari'ah compliance in the Islamic finance industry. Thus, the paper recommends that regulators in Islamic and secular countries intervene and regulate Shari'ah governance in IIFS so as to ensure a sound financial system and investor confidence. The paper is structured in four parts including this introduction. Part 1.2 explores definitions of SSBs in Islamic finance literature; Part 1.3 examines the impact of regulatory issues surrounding SSBs on Shari'ah compliance in the contemporary Islamic finance industry, identifying seven challenges as major factors in reducing the level of Shari'ah compliance in IIFS; and finally, Part 1.4 concludes the paper.

## **1.2. Shari'ah Supervisory Board Definition**

The literature does not provide a standard definition or name for SSBs or for Shari'ah supervision more generally<sup>(1)</sup>. SSBs have variously been called, for example, Shari'ah committees, religious committees, Shari'ah councils, and fatwa authorities<sup>(2)</sup>. However, "SSBs" seems to be the more common term in recent literature and is preferred by international standard-setting bodies such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization

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(1) Samy Nathan Garas and Chris Pierce, «Shari'a Supervision of Islamic Financial Institutions», *Journal of Financial Regulation and Compliance* 18, no. 4 (2010): p387.

(2) 'Izz al-Dīn Zighībāh «Hay'at al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah Ahammiyyathā Mu'awwiqāt 'Amalhā wa Ḥulūl Muqtaraḥah « (paper presented at the Islamic Banking Between Reality and Expectations, Dubai, UAE, 31 /5/ 2009 ), p13.

for Islamic Financial Institutions (AAOIFI)<sup>(1)</sup>.

Definitions found in the literature fall into two broad categories<sup>(2)</sup>. The first one includes definitions that focus on the functional aspect of SSBs and the objectives they seek to achieve.

The second category includes definitions stressing the nature of the body entrusted with the task of Shari'ah supervision. In this regard, al-Şālih defines SSBs as a group of jurisprudence scholars and economists who direct and supervise bank activities to ensure compliance with the provisions of Shari'ah<sup>(3)</sup>. The disparities in SSB names and definitions are a vestige of different stages of development in modern Islamic finance<sup>(4)</sup>. They also reveal the confusion over the role and function of SSBs, which may vary from one institution to another according to the legal environment in which they operate, an issue that Part 4.4 of this paper discusses in detail.

### 1.3. Regulatory Issues Surrounding Shari'ah Supervisory Boards

#### 1.3.1. The Ambiguous Role of SSBs

As discussed, the main purpose for establishing SSBs in financial institutions is to oversee the Shari'ah compliance of IIFS business activities<sup>(5)</sup>. However, there is no standard in the industry to clearly define how SSBs should perform this task. The scope of SSB work varies from one institution to another, and there is no agreement on the

(1) See: Islamic Financial Services Board (IFSB), «Guiding Principles on Shariah Governance Systems for Institutions Offering Islamic Financial Services,» IFSB,, <http://www.ifsb.org/standard/IFSB-10%20Shariah%20Governance.pdf>. accessed 29 March 2011; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), «Accounting, Auditing & Governance Standards for Islamic Financial Institutions « in Shari'a Review (Bahrain: AAOIFI, 2002).

(2) Riyāḍ Muḥammad al-Khalīfī, «al-Naẓariyyah al-Āmmah Lil-hay'āt al-Shar'iyyah « (paper presented at the Third Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, Bahrain, 5-6/10/2003), p16.

(3) Muḥammad Aḥmad al-Şālih, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maşārif al-Islāmiyyah « (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UAE, 26/4/2009), p6.

(4) al-Khalīfī, «al-Naẓariyyah al-Āmmah Lil-hay'āt al-Shar'iyyah « p16.

(5) Garas and Pierce, «Shari'a Supervision of Islamic Financial Institutions,» p388.; al-Khalīfī, «al-Naẓariyyah al-Āmmah Lil-hay'āt al-Shar'iyyah « p5.

duties of its members<sup>(1)</sup>. In fact, many institutions sign contracts with Shari'ah supervisors without specifying the nature of the work, their rights, or their duties<sup>(2)</sup>. Accordingly, while some SSBs have a proactive role in institutions, which might involve operational tasks, others might not even hold a single meeting or issue one decision during a whole year<sup>(3)</sup>. The ill-defined description of SSB roles and duties could be regarded as a bad governance practise which might contribute to weak compliance in the industry.

The vague scope of SSB function is arguably traceable, in part, to different phases of historical development in modern Islamic finance. In the early days of Islamic finance, around 1970, IIFS mainly used Shari'ah scholars as a marketing tool to promote the ideology of Islamic finance in their societies<sup>(4)</sup>. The process of issuing a fatwa to approve the permissibility of products was less formal and conducted in a non-institutional style<sup>(5)</sup>. A member of the public or a company would provide a Shari'ah scholar with a brief description of the products or the contract, and then the scholar would issue a fatwa either approving or rejecting it. In fact, until 2000, most SSB scholars at Al Rajhi Bank, one of largest Islamic banks in Saudi Arabia, reviewed the Shari'ah compli-

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(1) Wafik Grais and Matteo Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services,» World Bank Policy Research Working Paper 4054(2006) <http://ssrn.com/abstract=940711> accessed 2 December 2010; Muḥammad 'Abd al-Ḥalīm 'Umar, "A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah " (paper presented at the The Third Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, 7-8/10/2003), p17.

(2) Muḥammad Amīn 'Alī Qaṭṭān, «Hay'ah al-Raqābah al-Shar'iyyah Akhtiyār A'ḍā'iḥā Wa Ḍawābiḥā « (paper presented at the The Seventh Conference of the Shariah Boards of Islamic Financial Institutions, Bahrain, 27-28/5/2008), p11.

(3) Ahmad Muḥammad al-Sa'ad, «al-Raqābah al-Shar'iyyah WāAtharhā Fī al-Maṣārif al-Islāmiyyah» (paper presented at the TheThird International Conference on Islamic Economics, Mecca, 31/5-2/06/2005), p28.

(4) Mohd Daud Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» in *Islamic Finance: Innovation and Growth*, ed. Simon Archer and Rifaat Ahmed Abdel Karim (London: Euromoney Books and AAOIFI, 2002), p76-78; 'Umar, "A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah " p12.

(5) al-Khalīfī, «al-Nazariyyah al-'Āmmah Lil-hay'āt al-Shar'iyyah « p5.

ance of its products and contracts on a volunteer basis and sent their decision to the external auditor of the bank<sup>(1)</sup>.

The existence of various institutions offering different levels of Islamic financial service might also have contributed to uncertainty about the SSB role. While some IIFS were fully established as Islamic banks, others gradually converted their services at a later stage to those of Islamic banks, or only offer Islamic windows as an additional service to their main conventional banking<sup>(2)</sup>.

Furthermore, few regulators around the globe have recognised Shari'ah supervision as an independent profession overseen by a regulatory body.<sup>3</sup> Even where it is officially acknowledged as a profession, as in Pakistan and Bahrain, SSB members might not have a legal status that requires performing specific tasks related to their speciality<sup>(4)</sup>.

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(1) Muḥammad Anas Muṣṭafā al-Zarqā, «al-Haykal al-Sharīṭ Lil-ṣṣinā'at al-Māliyyah al-Islāmiyyah Jawānib al-Khalal wa Ṭarīq al-Iṣlāḥ « (paper presented at the Symposium on Values and Morals For Tthe Work of Economic Institutions, Kuwait 30/3/2008), p3. It is worth noting that during this time, SSBs were not responsible for ex post Shari'ah review.

(2) For a general view of the experience of converting conventional banks to Islamic banks: Ibrāhīm Muṣṭafā Muṣṭafā, «Taḳyīm Zāhirah Taḥawul al-Bunūk al-Taḳlīdiyyah Lil-maṣrifīyyat al-Islāmiyyah Dirāsah Taḥbīṭīyyah 'an Tajribah Ba'd al-Bunūk al-Su'ūdiyyah « (Master thesis, American Open University 2006).

(3) See: 'Umar, «A'māl al-Hay'āt al-Sharīyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah « p17; Abdalaziz Ibn Sṭtam al-Saud, «Siyāsah al-Jawdah al-Sharīyyah fī al-Maṣrifīyaah al-Islāmiyyah,» al-Fiqh al-Islāmī(2011) <http://www.islamfeqh.com/News/NewsItem.aspx?NewsItemID=4004> accessed 10 May 2012

(4) Malaysia is an exception with regard to recent BNM updates, see: Bank Negara Malaysia (BNM), «Shari'ah Governance Framework for Islamic Financial Institutions (BNM/RH/GL\_012\_3),» Bank Negara Malaysia, [http://www.bnm.gov.my/guidelines/05\\_shariah/02\\_Shariah\\_Governance\\_Framework\\_20101026.pdf](http://www.bnm.gov.my/guidelines/05_shariah/02_Shariah_Governance_Framework_20101026.pdf). accessed 11 December 2010; Omar Mustafa Ansari, «Roles and responsibilities of shariah advisors in Islamic banking institutions», True Banking <http://www.alhudacibe.com/AlhudaMagazine/Issue-036/article05.php>. accessed 10 May 2013

A typical list of SSB duties in an Islamic financial institution can include the following<sup>(1)</sup>:

1. Issuing fatwas to approve IIFS financial instrument products.
2. Auditing the process of applying SSB decisions through the Shari'ah internal review unit.
3. Certifying that IIFS have conducted their business according to Shari'ah by issuing an annual shareholder report.
4. Calculating the required zakāh and advising management on channelling non-Shari'ah compliant revenue towards charitable activities.
5. Approving the distribution of loss and profit between investment account holders and shareholders.
6. Educating and training IIFS staff on Shari'ah principles, responding to clients' inquiries, and increasing social awareness of Islamic finance objectives.
7. Developing new Shari'ah-compliant products and services.

Although these responsibilities are often mentioned in the literature, few SSBs perform all these tasks in practise. In fact, most SSBs are only concerned with ex ante Shari'ah review without auditing how products are actually implemented in the market<sup>(2)</sup>. Besides, some SSB

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(1) See: Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services»; Yahia Abdul-Rahman, *The Art of Islamic Banking and Finance : Tools and Techniques for Community-Based Banking* (Hoboken, N.J.: Wiley, 2010), p77; al-Şāliḥ, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah» p6; Rusni Hassan et al., *An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers* (Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance ISRA 2010), p12-18; Ibrahim Warde, *Islamic Finance in The Global Economy* (Edinburgh: Edinburgh University Press, 2000), p363-87; Zighībah «Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah Ahammiyyathā Mu'awwiqāt 'Amalhā wa Ḥulūl Muqtaraḥah» p25; Garas and Pierce, «Shari'a Supervision of Islamic Financial Institutions,» p393-94.

(2) al-Sa'ād, «al-Raqābah al-Shar'iyyah WāAtharhā Fī al-Maṣārif al-Islāmiyyah,» p19; Hussain Gulzar Rammal, «The Importance Of Shari'ah Supervision In Islamic Financial Institutions,» *Corporate Ownership and Control Journal* 3, no. 3 (2006); 'AbdAllāh Furayḥ al-Bahlāl, «al-Raqābah al-Shar'iyyah Fī al-Bunūk al-Su'ūdiyyah» (Master thesis Imam University, Higher Institute of Justice, 2003), P141.

members are still debating whether some of these duties, such as developing products, should be included amongst their responsibilities<sup>(1)</sup>.

This overload of duties suggests that SSB functions have been shaped without an appreciation of the current framework of global financial markets, which legally requires IIFS to assign certain tasks to "Approved Persons".<sup>(2)</sup> It seems that the ambitious goal of ensuring Shari'ah compliance has even led some SSB members to overlook the political systems of most countries. This assumption can be supported by the following three examples.

First, it was suggested that SSBs can play a vital role in controlling financial offences in IIFS, because financial crimes, such as fraud, manipulation, and insider dealing, are prohibited under the rule of Shari'ah. Therefore, ensuring Shari'ah compliance should theoretically prevent such illegal activities from occurring. However, it is unlikely that SSB members would have the necessary expertise and resources or the legal authorisation to undertake such a task<sup>(3)</sup>.

Secondly, as a solution to weak Shari'ah compliance at a micro level, it has been suggested that the Shari'ah compliance officer should be appointed as a branch manager<sup>(4)</sup>. Similarly, the Malaysian Central Bank recommends the appointment of an SSB chairman as a non-executive director on the IIFS board<sup>(5)</sup>. The Faisal Islamic Bank in Cyprus did so, arguing that it would enable the SSB to communicate effectively

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(1) Garas and Pierce, «Shari'a Supervision of Islamic Financial Institutions,» p394; Abdulbari Mashal, «al-'Affāq al-Mustaqbaliyyah Lil-rriqābah al-Shar'iyyah Ru'yah Lil-taṭwīr « (paper presented at the About The Future of Islamic Finance: Exploring The Opportunities of Tomorrow, Kuala Lumpur, 25-27/10/2010), p11.

(2) See for example: Financial Conduct Authority (FCA), «What is an approved person?,» FCA, <http://www.fca.org.uk/firms/being-regulated/approved/approved-persons>. accessed 4 April 2014

(3) Siti Faridah Abd Jabbar, «Financial crimes: Prohibition in Islam and prevention by the Shar'a Supervisory Board of Islamic financial institutions,» *Journal of Financial Crime* 17, no. 3 (2010).

(4) 'Ādil 'AbdAllāh Bāryān, «Asālīb Tafīl Dawr al-Raqābah al-Shar'iyyah Fī al-Maṣārif al-Islāmiyyah « (paper presented at the Islamic Banking Between Reality and Expectations, Dubai, UAE, 31/5- 3/6/2009), p27.

(5) Habhajan Singh, «BNM mulls 5 Shariah Advisors for Islamic Banks», *Malaysian Reserve* 25 October 2010 <http://islamicfinanceasia.blogspot.com/2010/10/bnm-mulls-5-shariah-advisors-islamic.html>. accessed 10 December 2010

with the board of directors and that it would be in a better position to ensure the Shari'ah compliance of the institution<sup>(1)</sup>. On the other hand, it is doubtful whether such an action would be tolerated in countries such as the UK, where a "Fit and Proper Test for Approved Persons" is required before an individual can register under the Financial Conduct Authority's Approved Persons regulations<sup>(2)</sup>. In addition, there is the question of whether most SSB scholars with multiple memberships would successfully pass the non-executive director independence test<sup>(3)</sup>.

In some institutions such as the Al Rajhi Bank, SSB duties involve the additional human resources function of selecting the institution's employees, particularly for key positions. Candidates for employment are assumed to support Islamic finance policies and to be willing to implement their practise<sup>(4)</sup>. Although having personnel with a proper understanding of Islamic finance principles enhances Shari'ah compliance in an institution, such a task can be achieved without the involvement of SSB members, as this might possibly threaten their disinterested auditing.

Finally, it has been suggested that SSBs should play a mediating role between IIFS and their clients<sup>(5)</sup>. For instance, Article 18 of Act 48 on the establishment of Faisal Islamic Bank of Egypt states that in the case of the parties' refusal to choose an arbitrator, or in the absence of an agreement on the choice of chairmen in an arbitral tribunal, the SSB will choose an arbitrator or chairman, and its decision will be binding. However, the Supreme Constitutional Court of Egypt ruled this article

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(1) Muḥammad Amīn 'Alī Qaṭṭān, «al-Raqābah al-Shar'iyyah al-Fa'ālah Fī al-Maṣārif al-Islāmiyyah « (paper presented at the TheThird International Conference on Islamic Economics, Mecca, 31/5-2/06/2005), p21.

(2) Michael Ainley et al., *Islamic Finance in The UK : Regulation and Challenges* (London: Financial Services Authority,, 2007), p13-14., also: Financial Services Authority, «Approved persons,» FSA,, <http://www.fsa.gov.uk/Pages/Doing/Regulated/Approved/persons/index.shtml>. accessed 24 December 2011

(3) On non-executive directors' independence, see: Christine A. Mallin, *Corporate Governance* (Oxford; New York: Oxford University Press, 2010), p174-75.

(4) Alrajhi Bank, «The Sharia Group,» <http://www.alrajhibank.com.jo/AboutUs/Pages/ShariaaGroup.aspx>. accessed 10 December 2010

(5) Qaṭṭān, «Hay'ah al-Raqābah al-Shar'iyyah Akhtiyār A'ḍā'iḥā Wa Ḍawābiḥā « p17; Qaṭṭān, «al-Raqābah al-Shar'iyyah al-Fa'ālah Fī al-Maṣārif al-Islāmiyyah « p33.



unconstitutional, as it breaches the principles of arbitration and denies a natural right of access to court<sup>(1)</sup>.

As can be seen from the diverse functions mentioned earlier, ambiguity clearly surrounds the actual duties of SSB members. The ensuring of Shari'ah compliance, which is the main purpose of establishing an SSB, has been weakened as its members are engaged in unrelated tasks which they might not be qualified to perform. To overcome such confusion, Shari'ah supervision should first be recognised as an independent profession<sup>(2)</sup>. Like lawyers and accountants, its members should act within a framework that defines their role and responsibilities. In the case where an IIFS is operating within a jurisdiction which does not facilitate Islamic finance compliance or where regulation is passive, SSB members can form a professional association that standardises its supervisors' contracts with financial institutions. Alternatively, it is possible to state SSB functions in an institution's articles of association<sup>(3)</sup>. In addition, SSB functions ought to be categorised according to the level of Shari'ah-compliant activities that their home institution conducts. The SSBs in Islamic banks, for example, tend to have a greater role than their counterparts in conventional banks which only offer Islamic windows. Stakeholders should be made aware of this discrepancy, which might affect the institution's degree of compliance.

### ***1.3.2. SSBs' Lack of Legal Status***

A related but separate issue affecting the Shari'ah compliance of IIFS is the SSBs' lack of legal status. In some countries, there is no legal basis for establishing an SSB in Islamic finance institutions. Even where there are legal provisions, it is not clear whether SSB decisions are deemed mandatory or merely advisory. This section investigates the legal position of SSBs and its impact on the Shari'ah compliance of institutions.

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(1) The Supreme Constitutional Court of Egypt ,Case No. 13 of year 15 6408(1994).

(2) 'Umar, «A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah « p17.

(3) See generally, Rafel Mahmood, «Islamic Governance, Capital Structure, and Equity Finance: Examining the Possibilities of American Financial Shari'ah Boards,» International Journal of Legal Information 37, no. 1 (2009). Garas and Pierce, «Shari'ah Supervision of Islamic Financial Institutions,» p389.

An SSB can draw its legal authority from different sources. In countries such as Malaysia,<sup>1</sup> Pakistan,<sup>2</sup> UAE,<sup>3</sup> Kuwait,<sup>4</sup> Jordan,<sup>5</sup> and Lebanon,<sup>6</sup> national regulations require establishing an SSB before granting Islamic financial services. In addition, IIFS articles of association might include provisions for setting up an SSB and defining its power. A lower ground of SSB authority can be based on the terms of the contract signed between the board of directors, on behalf of shareholders, and the SSB, where rights are awarded to review IIFS business.

However, some Shari'ah scholars offer a different perspective for legitimatising SSB power.<sup>8</sup> According to them, the authority of the SSB stems from the Islamic notion of *ḥisbah*, where individual Muslims have a duty to command right behaviour and forbid wrongdoing to keep society in line with the teachings of Islam. Accordingly, SSB members have a natural duty to ensure that IIFS activities are conducted within Shari'ah.<sup>9</sup> However, the nature of SSB work does not suit the concept

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(1) Bank Negara Malaysia (BNM), «Shari'ah Governance Framework for Islamic Financial Institutions (BNM/RH/GL\_012\_3)».

(2) State Bank of Pakistan, «Instructions for Shariah Compliance In Islamic Banking Institutions,» State Bank of Pakistan <http://www.sbp.org.pk/ibd/2008/Annex-c2-1.pdf>. accessed 25 January .Section A

(3) «Federal Law No-(6) of 1985 concerning Islamic Banks and Financial Institutions and Investment Companies,» Central Bank of United Arab Emirates <http://www.centralbank.ae/pdf/LawNo6-1985-IslaminBanks.pdf>. accessed 10 November 2011, Article 6

(4) «CBK Law No. (32) of 1968,» CBK [http://www.cbk.gov.kw/www/law\\_iii.html#ch3\\_10](http://www.cbk.gov.kw/www/law_iii.html#ch3_10). accessed 8 September 2011, Article 93

(5) «Law No. 28 of 2000,» Jordan central bank [http://www.cbj.gov.jo/pages.php?menu\\_id=123&local\\_type=0&local\\_id=0&local\\_details=0&local\\_details1=0&localsite\\_branchname=CBJ](http://www.cbj.gov.jo/pages.php?menu_id=123&local_type=0&local_id=0&local_details=0&local_details1=0&localsite_branchname=CBJ). accessed 11 September 2011, Article 58

(6) «Law No 575 dated February 11, 2004 The Establishment of Islamic Banks in Lebanon,» Banque du Liban [http://www.bdl.gov.lb/circ/lawpdf/Law575\\_en.pdf](http://www.bdl.gov.lb/circ/lawpdf/Law575_en.pdf). accessed 24 September 2011 , Article 9

7) Garas and Pierce, «Shari'a Supervision of Islamic Financial Institutions,» p389.

8 'AbdAllāh Mabruk al-Najjār, «Muftariqāt al-Mas'ūliyyah fī Niṭāq al-Raqābah al-Shar'iyyah 'alā al-Mu'assasāt al-Māliyyah « (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UEA, 26/4/2009), p13-14.

9 al-Khalīfī, «al-Nazariyyah al-Āmmah Lil-hay'āt al-Shar'iyyah « p14; Zighībah «Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah Ahammiyyathā Mu'awwiqāt 'Amalā wa Ḥulūl Muqtarahah « p37.

of ḥisbah. This is because SSB members are appointed and paid privately to ensure the Shari'ah compliance of the institution, whereas muḥtasib (a person conducting ḥisbah) is more concerned with public matters and is usually appointed and paid by the state<sup>(1)</sup>. Besides, in modern states, ḥisbah in Islamic countries is restricted to moral issues and antisocial behaviour<sup>(2)</sup>.

Even where legal grounds are found for establishing an SSB, though, it is not clear whether SSB judgments have an advisory nature or a mandatory one<sup>(3)</sup>. If they are merely advisory, then the primary motivation for setting up SSBs—that is, ensuring Shari'ah compliance—has not been achieved. The role of SSBs is narrowed to that of a marketing tool, as the boards' decisions are only enforced at the IIFS administration's pleasure. Countering this situation, the AAOIFI Shari'ah governance standard states that SSB pronouncements shall be binding and fully implemented<sup>(4)</sup>. Nevertheless, even where such a standard is adopted, or where regulators or IIFS articles of association have stipulated the mandatory nature of SSB decisions, these measures are insufficient to ensure compliance with Shari'ah, because SSBs only issue fatwas on cases brought to them by IIFS management<sup>(5)</sup>. In other words, if directors think the SSB will not approve a particular transaction, they can avoid the issue simply by not referring the matter to the Shari'ah board.

(1) al-Najjār, «Muftariqāt al-Mas'ūliyyah fī Niṭāq al-Raqābah al-Shar'iyyah 'alā al-Mu'assasāt al-Māliyyah « p13-27.

(2) For more about ḥisbah see: M. A. Cook, *Commanding Right and Forbidding Wrong in Islamic Thought* (Cambridge, UK; New York: Cambridge University Press, 2000).

(3) Hassan et al., *An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers* p54.

(4) Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), « No. 1 - Shari'a Supervisory Board: Appointment, Composition and Report.,» in AAOIFI Governance Standard for Islamic Financial Institutions (Bahrain: AAOIFI, 1999) Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p81.

(5) 'Umar, «A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah « p11; 'Abd al-Razzāq Raḥīm al-Hītī, «Athar al-Raqābah al-Shar'iyyah 'alā Ail-tizām al-Maṣārif al-Islāmiyyah bi-al-'Aḥkāmī al-Shar'iyyah « (paper presented at the Islamic Banking Between Reality and Expectations, Dubai, UAE, 31/5/2009 - 3/6/2009), p19; 'Abd al-Mun'im Muḥammad al-Ṭayyib, «Taḥqīm al-Raqābah al-Shar'iyyah fī Ḍil al-Niẓām al-Maṣrifī al-Islāmī al-Shāmil» (ibid.31/5-3/6/2009), p26.

This helps explain why some regulators and academic researchers have suggested appointing one of the SSB members as a non-executive director on the board of the financial institution<sup>(1)</sup>. However, it is unlikely that Shari'ah scholars, with their multiple memberships in SSBs in different institutions, would successfully fulfil the independence requirements for a position as either an executive or non-executive director<sup>(2)</sup>.

In addition, designating SSB decisions as mandatory may raise concerns amongst regulators over their impact on the financial institution's operations<sup>(3)</sup>. Although researchers such as Aldohni<sup>4</sup> have argued that forming a Shari'ah board in a UK corporate structure is not legally problematic, since the Companies Act 2006 is elastic with regard to a two-tier board structure<sup>(5)</sup>, they overlook the legal issues arising from the Financial Conduct Authority (FCA) requirements for persons to be appointed on such a board. The "Fit and Proper Test for Approved Persons", mentioned above, considers competence and capability factors, among other things<sup>(6)</sup>. It expects that a person appointed for a directorial position has sufficient relevant experience, a condition which might not be met by most SSB members, who tend to lack financial and banking experience.

Rider<sup>(7)</sup> notes that SSB members in most common law countries can

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(1) Singh, «BNM mulls 5 Shariah Advisors for Islamic Banks.»

(2) Ainley et al., *Islamic Finance in The UK : Regulation and Challenges*, p13-14.

(3) Abdul-Rahman, *The Art of Islamic Banking and Finance : Tools and Techniques for Community-Based Banking*, p79; 'Aṭīyyah Fayyāq, "al-Raqābah al-Shar'iyyah Wa al-Taḥaddiyāt al-Mu'āshirah " (paper presented at the TheThird International Conference on Islamic Economics, Mecca, 31/5-2/6/2005), p40.

(4) Abdul Karim Aldohni, «Islamic Banking Challenges Modern Corporate Governance:The Dilemma of The Shari'a Supervisory Board,» *Company Lawyer* 29, no. 5 (2008): p157; Paul L. Davies, *Introduction to Company Law* (Oxford: Oxford University Press, 2010), p195.

(5) Aldohni, «Islamic Banking Challenges Modern Corporate Governance:The Dilemma of The Shari'a Supervisory Board,» p157; Davies, *Introduction to Company Law*, p195.

(6) See: Financial Conduct Authority (FCA), «What is an approved person?»; «The Fit and Proper test for Approved Persons,» FCA, <http://media.fshandbook.info/content/FCA/FIT.pdf>. accessed 4 April 2014

(7) Barry Rider, «Corporate Governance of Institutions Offering Islamic Financial Services,» in *Islamic Finance: Law and Practice*, ed. Craig Nethercott and David Eisenberg (Oxford: Oxford University Press, 2012), p168

be regarded as shadow directors<sup>(1)</sup> if the board of directors regularly acts on SSB advice. This designation means that SSB members are subject to same legal duties as directors, and in some situations, they can be held accountable for misconduct and negligence in the general management of the company. Rider continues, however, that issuing SSB advice in a professional capacity is not alone sufficient to deem SSB members shadow directors. Additional factors are taken into account to determine whether a person is a shadow director; for example, he must be in a dominant position and not appointed to a particular post within the structure of the company<sup>(2)</sup>. Notably, although Jamieson and Hughes<sup>(3)</sup> note that English law remains unsettled on the identification of shadow directors, SSB members might meet the criterion of being in a dominant position in situations where the management of a fully flagged Islamic bank needs *ex ante* or *ex post* approval of SSB members to engage in business contracts.

Currently, the FCA considers the SSB's role merely advisory<sup>(4)</sup>. This characterisation can seriously reduce the level of Shari'ah compliance in institutions, since IIFS management has no compulsion to enforce SSB decisions regarding compliance in its products and services. For an SSB to ensure Shari'ah compliance, it must be involved in decisions that affect the operational aspect of the financial institution<sup>(5)</sup>.

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(1) A shadow director is defined as "a person in accordance with whose directions or instructions the directors of the company are accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity)". See: United Kingdom, «Company Directors Disqualification Act 1986,» The National Archives, [http://www.legislation.gov.uk/ukpga/1986/46/pdfs/ukpga\\_19860046\\_en.pdf](http://www.legislation.gov.uk/ukpga/1986/46/pdfs/ukpga_19860046_en.pdf). accessed 10 May 2013 Chapter 46 Section 22.

(2) Rider notes that recent court decisions show a more flexible position over what constitutes a shadow director. See: Rider, «Corporate Governance of Institutions Offering Islamic Financial Services,» p168.

(3) Neil Jamieson and Kelly Hughes, «The Identification of Shadow Directors under English law: what guidance might Buzzle provide?,» *Butterworths Journal of International Banking and Financial law*. 27, no. 6 (2012): p366.

(4) See: Zulkifli Hasan, «Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK,» *Kyoto Bulletin of Islamic Area Studies on Islamic Finance* 3, no. 2 (2010): p110.

(5) Ezry Fahmy, «Shari'ah Scholars as an Independent Director: A Proposal», *Shirkah* <http://www.scribd.com/doc/50058751/3/Comprehend-the-position-of-Independent-director-and-Shari%E2%80%99ah-Scholars>. accessed 10 May 2011

The AAOIFI standard states that Shari'ah supervisors are "entrusted with the duty of directing, reviewing and supervising the activities related to Islamic finance to ensure they are in compliance with Shari'ah rules and principles. The views of the Shari'ah advisor shall be binding in the specific area of supervision".<sup>(1)</sup> In short, an SSB cannot ensure true Shari'ah compliance unless its decision is deemed mandatory and is enforced in practise.

Accordingly, in terms of the real function of SSBs, a legal status needs to be considered for SSB members, who currently hold a unique position somewhere between being external auditors and non-executive directors<sup>(2)</sup>. Indeed, recognising Shari'ah supervision as an independent profession would help to shape the legal standing of SSB members. Nevertheless, the weight of Shari'ah board pronouncements against IIFS management's decisions and the consequences of breaching SSB pronouncements need to be addressed by regulators<sup>(3)</sup>, or at least be stated in the IIFS articles of association. Currently, some of IIFS personnel do not comply with SSB decisions unless those de-

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(1) Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), « No. 1 - Shari'a Supervisory Board: Appointment, Composition and Report..»

(2) Interestingly, while English literature in the area seems to indicate the resemblance of SSB members' roles to those of non-executive directors, most Arabic literature highlights the similarity of SSBs to external auditors. Compare Aldohni, «Islamic Banking Challenges Modern Corporate Governance: The Dilemma of The Shari'a Supervisory Board.»; Ainley et al., *Islamic Finance in The UK : Regulation and Challenges*; Fahmy, "Shari'ah Scholars as an Independent Director: A Proposal," p16; Rodney Wilson, "Regulatory Challenges Posed by Islamic Capital Market Products and Services," *Journal of Islamic Banking and Finance* 24[2], no. 2 (2007); Husain Hamed Hassan, "al-'Alāqah Bayn al-Hay'āt al-Shar'iyyah wa al-murāji'īn al-khārijīyyīn " (paper presented at the The First Conference for Shari'a Supervisory Boards, Bahrain, 9/10/2001); al-Zarqā, "al-Haykal al-Shar'ī Lil-ṣṣinā'at al-Māliyyah al-Islāmiyyah Jawānib al-Khalal wa Ṭarīq al-Iṣlāḥ "; Mohamad Akram Laldin, "Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah" (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UEA, 26/4/2009).

(3) For example, Article 17 from the Yemeni act on Islamic banks states that SSB decisions on the compliance of bank instruments are to be binding on the institution. The SSB shall issue an annual report on the bank's adherence to Shari'ah and to SSB instructions, and this report must be distributed to shareholders. Yemen, « Act 21(1996) as amended by Act 16 (2009) on Islamic Banks in Yemen,» Central Bank of Yemen,, [http://www.centralbank.gov.ye/App\\_upload/Islamic\\_Pank\\_low\\_Ar\\_Upd.pdf](http://www.centralbank.gov.ye/App_upload/Islamic_Pank_low_Ar_Upd.pdf). accessed 8 July 2011

isions are authorised by the directors of the financial institution<sup>(1)</sup>. In other words, an IIFS charter should include a default clause which identifies the relationship between the board of directors and the SSB, as well as the applicable procedure for addressing a conflict between the two boards.

Moreover, conflict between the two bodies can be further reduced if a financial institution's articles of association characterise it as an entity that fully complies with Shari'ah ruling<sup>(2)</sup>. In Saudi Arabia, where there is no framework for Shari'ah governance in the financial sector<sup>(3)</sup>, Al Rajhi Bank has clarified its policy towards the power of the SSB: it regards SSB decisions as obligatory for the departments and management of the institution. Executive directors on all levels are responsible for implementing SSB resolutions. Any violation of SSB pronouncement while offering products or services, without seeking prior authorisation from the board, is firmly prohibited, and all culpable are disciplined<sup>(4)</sup>. Such steps seem to be more visible than involvement from regulators, particularly in non-Islamic countries.

### ***1.3.3. SSBs' Lack of Accountability***

Accountability in a general sense has deep roots in Islam<sup>(5)</sup>, as all individuals are accountable to God for their actions. People's destiny in the hereafter is determined according to their deeds in this world. The word *ḥisāb* (account) is mentioned at least eight times in the Quran<sup>(6)</sup>, which states that on the Day of Judgment, Allah will show each person

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(1) al-Ṭayyib, «Taqyīm al-Raqābah al-Shar'iyyah fī Zīl al-Niẓām al-Maṣrifī al-Islāmī al-Shāmil,» p28. al-Sa'ad, «al-Raqābah al-Shar'iyyah WāAtharhā Fī al-Maṣārif al-Islāmiyyah,» p17.

(2) Mahmood, «Islamic Governance, Capital Structure, and Equity Finance: Examining the Possibilities of American Financial Shari'ah Boards.»

(3) Hasan, «Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK,» p97.

(4) Alrajhi Bank, «The Sharia Group».

(5) Mervyn K Lewis, «Accountability and Islam,» Fourth International Conference on Accounting and Finance(2006) <http://www.unisa.edu.au/commerce/docs/Accountability%20and%20Islam.pdf> accessed 25 July 2011

(6) Ibid.

his account, where all good and bad actions are recorded<sup>(1)</sup>. In theory, Muslims cannot separate their life into religious and secular aspects, since all their economic, political, religious, and social activities are bound up with the teachings of Shari'ah<sup>(2)</sup>.

However, one of the factors affecting compliance in the Islamic finance industry is the lack of accountability for SSB members. Surprisingly, such an essential body in the institution, with great power over the direction of the market, is exempt from scrutiny and liability<sup>(3)</sup>. Islamic finance regulations and standards, such as those of the AAOIFI, completely disregard this issue. Even in countries with an advanced Shari'ah governance framework, such as Malaysia and Pakistan, SSB accountability is poorly addressed<sup>(4)</sup>. Their frameworks do mention procedures for dismissing SSB members, but not in the context of accountability<sup>(5)</sup>.

Arguably, SSB liability is overlooked for two main reasons, the first of which is the lack of legal status amongst SSBs. As discussed earlier, in most countries, Shari'ah board members have no legal standing in financial institutions, making it difficult to hold them liable for actions

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(1) The Quran, in verses 54:52-53, states that "All that they do is noted in [their] Books [of Deeds]: Every matter small and great is on record". Similarly, verses 99:7-8 have, "Then shall anyone who has done an atom's weight of good, see it! And anyone who has done an atom's weight of evil, shall see it". Abdullah Yusuf Ali, *The Holy Qur'an: Text, Translation and Commentary* (Brentwood, Md.: Amana Corp., 1983).

(2) Zafar Iqbal and Mervyn Lewis, *An Islamic Perspective on Governance* (Cheltenham, U.K.; Northampton, Mass.: Edward Elgar, 2009), p257.

(3) Chris Wright, «The Shariah Scholar Cartel,» *Asiamoney*, <http://www.chriswright-media.com/asiamoney-sep06-shariahscholars/>. accessed 20 April 2011; Aldohni, «Islamic Banking Challenges Modern Corporate Governance: The Dilemma of The Shari'a Supervisory Board,» p159.

(4) As stand on 31 August 2011.

(5) Muḥammad 'Abd al-Ghaffār al-Sharīf, «al-Raqābah al-Shar'iyyah 'Alā al-Mu'assasāt al-Tamwīliyyah al-Islāmiyyah» (paper presented at the The Third International Conference on Islamic Economics, Mecca, Mecca, 31/5-2/6/2005), p16-17; al-Yāshiy al-Ṣādiq Fidād, «al-Raqābah al-Shar'iyyah Wa Dawruhā Fī Ḍabṭ A'māl al-Maṣārif al-Islāmiyyah» (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UAE, 26/4/2009), p21. However, unlike Pakistan, the BNM Shari'ah Governance Framework for Islamic Financial Institutions at least alludes to the accountability of SSB members. See: Bank Negara Malaysia (BNM), «Shari'ah Governance Framework for Islamic Financial Institutions (BNM/RH/GL\_012\_3)» p11.



over which they have no legal power. Even where SSBs are officially recognised, there is no legislation detailing their liability and incriminating their wrongdoing<sup>(1)</sup>. The second reason which might prove an obstacle to SSB accountability is that SSB members are usually highly respected in society; they are perceived as guardians of Shari'ah who fear no one but Allah<sup>(2)</sup>. Although there is no infallibility for Shari'ah scholars in Islam<sup>(3)</sup>, some ordinary Muslims seem to see criticism of Shari'ah scholars as criticism directed towards Islam itself<sup>(4)</sup>.

Nonetheless, historically, scholars have debated whether a mujtahd (a person who practises ijtihād) is liable for ijtihād<sup>(5)</sup>. The majority position is that the mujtahd is not liable for any mistakes in his fatwas since he issues rulings to the best of his ability<sup>(6)</sup>. The grounds for this position is the ḥadīth of the Prophet which states that when the ruler performs ijtihād and reaches the right conclusion, he will be rewarded twice, but if he makes an error, he will be rewarded just once for mak-

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(1) Sulaymān Na'im al-Rā'ī, «Athar Hay'āt al-Fatwā wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah « (paper presented at the Islamic Financial Institutions: Reality Features and Future Prospects, UAE, 15-17/5/2005), p370; Bāryān, «Asālib Taf'tīl Dawr al-Raqābah al-Shar'iyyah Fī al-Maṣārif al-Islāmiyyah « p24.

(2) For a general description of the role of the Shari'ah scholar, see: Joseph A Kechichian, «The Role of the Ulama in the Politics of an Islamic State: The Case of Saudi Arabia,» International Journal of Middle East Studies 18, no. 1 (1986): p55.; Meir Hatina, Guardians of Faith in Modern Times : `Ulama in The Middle East (Boston: Brill, 2009).

(3) Charles P. Trumbull, «Islamic Arbitration: A New Path for Interpreting Islamic Legal Contracts,» Vanderbilt Law Review 59, no. 2 (2006): p627.

(4) Aly Khorshid, «Shariah Board Accountability,» Academy UK, <http://www.academyuk.org/publications/view.aspx?id=19>. accessed 10 December 2010

(5) According to Wael B. Hallaq, ijtihād "is the maximum effort expended by the jurist to master and apply the principles and rules of usul al- fiqh (legal theory) for the purpose of discovering God's law." Wael B. Hallaq, «Was the Gate of Ijtihad Closed?,» International Journal of Middle East Studies 16, no. 1 (1984).

(6) al-Najjār, «Muftariqāt al-Mas'ūliyyah fī Niṭāq al-Raqābah al-Shar'iyyah 'alā al-Mu'asasāt al-Māliyyah « p38-39; 'Abd al-Sattār al-Khuwaylidī, «al-Ākhtiṣāṣ al-Qānūnī Wa al-Ḥimāyah al-Jinā'iyyah Lil-hay'āt al-Shar'iyyah « (paper presented at the Third Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, 5-6/10/2003), p8-9; Fidād, «al-Raqābah al-Shar'iyyah Wa Dawruhā Fī Ḍabṭ A'māl al-Maṣārif al-Islāmiyyah,» p22.

ing the *ijtihād*<sup>(1)</sup>. The only exceptions to this position occur when a definitive principle has been breached or when an individual has issued a fatwa without having the competence to do so<sup>(2)</sup>.

However, this section is not primarily concerned with the classical discussion of scholarly liability in this context, but rather with the harm that arises from an SSB's failure to fulfil its duties—for example, declaring a financial institution Shari'ah compliant without carrying out a sufficient review, deliberately failing to report violations of Shari'ah in a product or service, not holding SSB meetings, or allowing frequent absences in meetings. Such negligence might cause a great deal of damage to stakeholders and increase the risk profile of institutions, which is unlawful in Shari'ah teaching<sup>(3)</sup>.

Indeed, increasing SSB accountability should enhance the quality of Shari'ah compliance in the institution. This is because Shari'ah board members would ideally scrutinise IIFS activities closely to avoid risking any legal responsibility. Currently, SSBs are not liable for any damage arising from their remissness; they lose nothing from circumventing Islamic finance restrictions<sup>(4)</sup>. The worst-case scenario for its members is termination of their contract, which is unlikely as it might cause further damage to the institution. In *Investment Dar v Blom Development Bank*,<sup>(5)</sup> the claimant argued in its legal defence that the contract in question was not Shari'ah-compliant, despite the fact that it had been

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(1) Rushdi Siddiqui, «A Sharia Scholar's Place on The Board,» Gulf News, <http://gulf-news.com/business/features/a-sharia-scholar-s-place-on-the-board-1.625445>. accessed 30 October 2010

(2) 'Abd āl-Ḥamid al-Ba'īt, «al-Raqābah al-Shar'iyyah al-Fa'ālah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah « (paper presented at the TheThird International Conference on Islamic Economics, Umm Al Qura University, Mecca, 31/5-02/06/2005), p39. Some jurists have stated that in case, the scholar was incompetent, IIFS may take the responsibility for not conducting due diligence. See al-Najjār, «Muftariḍāt al-Mas'ūliyyah fī Niṭāq al-Raqābah al-Shar'iyyah 'alā al-Mu'assasāt al-Māliyyah « p38-39.

(3) Qaṭṭān, «al-Raqābah al-Shar'iyyah al-Fa'ālah Fī al-Maṣārif al-Islāmiyyah « p23-25.

(4) Lahem al-Nasser, «Waḍ' al-Maṣrifīyyah al-Islāmiyyah Murbik Wa Naḥn Biḥājah ilā Wilādah Jadīdah «, Islamic Finance and Investment 01/09/2010 [http://www.almasrifiah.com/2010/09/01/article\\_438969.html](http://www.almasrifiah.com/2010/09/01/article_438969.html). accessed 1 November 2010

(5) *Investment Dar Co KSCC v Blom Developments Bank Sal*, [2009] EWHC 3545 (Ch) (2009).

approved by its own Shari'ah board. The SSB of Investment Dar did not announce its resignation or sue the company to protest the challenge to its credibility. It merely issued a majority statement backing up its old ruling and asking the company not to use SSB decisions in further litigation<sup>(1)</sup>. If SSBs were held accountable for such incidents, we would have seen a stronger reaction.

An additional accountability issue requiring clarification is whether the responsibility for ensuring Shari'ah compliance lies with the SSB or with the management of the IIFS. While some researchers suggest that ensuring Shari'ah compliance is the responsibility of the SSB<sup>(2)</sup>, others suggest that it is the responsibility of IIFS executive directors, and that SSB responsibility ends with forming Shari'ah opinion on the compliance of proposals for products or services without concern for their actual implementation<sup>(3)</sup>. The AAOIFI standard seems to support the latter stance<sup>(4)</sup>. Such a position is understandable if one assumes that the AAOIFI considers the SSB's role as merely an advisory one, with no impact on the operational aspect. However, as discussed earlier, AAOIFI standards also state that Shari'ah supervisors are "entrusted with the duty of directing, reviewing and supervising the activities re-

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- (1) Shaheen Pasha, «Investment Dar gets Sharia Board blow to Blom Case,» Arabian Business, <http://www.arabianbusiness.com/investment-dar-gets-sharia-board-blow-blom-case-282707.html>. accessed 14 July 2011; al-Nasser, «Waḍ' al-Maṣrifīyyah al-Islāmiyyah Murbik Wa Naḥn Biḥājah ilā Wilādah Jadīdah «.
  - (2) For example, Yūsuf 'AbdAllāh al-Shabīlī, «al-Raqābah al-Sharīyyah 'Alā al-Maṣārif:Ḍawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Maṣārif» (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UAE, 26/4/2009), p22; Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p76.
  - (3) 'Abd al-Ḥaḳ Ḥamīsh, «Hay'ah al-Fatwā Wa al-Raqābah al-Sharīyyah Fī al-Maṣārif al-Islāmiyyah « (paper presented at the Islamic Financial Institutions: Reality Features and Future Prospects, UAE, 15/5/2005), p339; Nidal Alsayyed, «Shari'ah Board, The Task of Fatwa, and Ijtihad in Islamic Economics, and Finance,» MPRA Paper(2009) <http://mpr.a.ub.uni-muenchen.de/20204/> accessed 22 October 2010
  - (4) Ahmad Muḥī al-dīn Ahmad, «Ḥudūd al-Hay'āt al-Sharīyyah Wa Idārāt al-Mu'assasāt al-Māliyyah al-Islāmiyyah Fī al-Tāakud min al-Āltizām Biāl'Aḥkām al-Sharīyyah « (paper presented at the Third Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, Bahrain, 5-6/10/2003), p17. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), « No. 1 - Shari'a Supervisory Board: Appointment, Composition and Report...»

lated to Islamic finance to ensure they are in compliance with Shari'ah rules and principles. The views of the Shari'ah adviser shall be binding in the specific area of supervision"<sup>(1)</sup>. Consequently, it is not safe to leave SSB members holding such power without sharing responsibility for their actions. Nonetheless, Al-Khalifī and other researchers argue that ensuring Shari'ah compliance is not only a duty of the SSB, but also the collective responsibility of stakeholders<sup>(2)</sup>.

Finally, when discussing SSB members' accountability, it is often argued that Shari'ah scholars are held accountable to God<sup>(3)</sup>. These 'ulamā' or scholars are assumed to be the most trusted people, who would never compromise or hide the truth. The Quran states, "It is only those who have knowledge among His slaves that fear Allah"<sup>(4)</sup>. Iqbal and Lewis<sup>(5)</sup> note that Islam regards some governance problems, such as corruption, as ethical issues which can be resolved by enhancing internal strength rather than by applying external legal forces. In contrast, the majority of Western scholars seem to deem corruption to be the result of bad governance, rather than focusing on its moral dimension. The authors suggest that Islamic countries can improve their governance practise by implementing mechanisms and reform strategies currently applied in the Western model<sup>(6)</sup>.

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(1) « No. 1 - Shari'a Supervisory Board: Appointment, Composition and Report..»

(2) al-Khalifī, «al-Nazariyyah al-'Āmmah Lil-hay'āt al-Shar'iyyah « p21; al-Hītī, «Athar al-Raqābah al-Shar'iyyah 'alā Ail-tizām al-Maşārif al-Islāmiyyah bi-al-'Aḥkāmī al-Shar'iyyah « p14; 'Ādil 'AbdAllāh Bāryān, «Asālīb Taf'īl Dawr al-Raqābah al-Shar'iyyah Fī al-Maşārif al-Islāmiyyah « (ibid.31/5- 3/6/2009), p47.

(3) Aldohni, «Islamic Banking Challenges Modern Corporate Governance:The Dilemma of The Shari'a Supervisory Board,» p158; Wright, «The Shariah Scholar Cartel».

(4) Taqi al-Din Hilali and Muhammad Muhsin Khan, «The Noble Quran,» Muslim Directory, <http://quran.com/35/28>. accessed 7 August 2011. Ibn Kathir commented on this verse: "Only those who have knowledge truly fear Him as He should be feared, because the more they know about the Almighty, All-Powerful, All-Knowing Who has the most perfect attributes and is described with the most beautiful Names, the more they will fear Him." Ismail ibn Umar Ibn Kathir, «Tafsir Ibn Kathir « Darus-salam, [http://www.qtafsir.com/index.php?option=com\\_content&task=view&id=1906&Itemid=](http://www.qtafsir.com/index.php?option=com_content&task=view&id=1906&Itemid=). accessed 8 August 2011

(5) Iqbal and Lewis, An Islamic Perspective on Governance, p306-12.

(6) Ibid.

Nevertheless, no matter how high the ethical standards of any individual, there will always be exceptions<sup>(1)</sup>. As Hirschman emphasises<sup>(2)</sup>,

Under any economic, social, or political system, individuals, business firms, and organizations in general are subject to lapses from efficient, rational, law-abiding, virtuous, or otherwise functional behaviour. No matter how well a society's basic institutions are devised, failures of some actors to live up to the behaviour which is expected of them are bound to occur<sup>(3)</sup>.

Therefore, extra measures must be taken to protect the public interest. There are many examples cited in early Islamic history where rulers were subjected to accountability by the Prophet and the first four Caliphs, despite being regarded as role models in their time and for future Muslim generations. In particular, the second Caliph Umar Ibn Al-Khattab (ruled 634–644 CE) held some of his governors to public accountability, regardless of their status as prominent and pious Companions of the Prophet Muhammad<sup>(4)</sup>.

Accordingly, subjecting SSB members to accountability should not be perceived as showing less respect to Shari'ah scholars or doubting their credibility, but rather dealing professionally with an essential group in the industry and adding a layer of protection for public interest. This is particularly important if the IIFS is operating in a global market where the local reputation of the Shari'ah board members' reliability may not be sufficient to allay stockholder suspicions over the SSB's lack of accountability.

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(1) Historically, these individuals are known as *ulama-e soo* (vicious scholars or hypocrite scholars) who would circumvent the teaching of Shari'ah in order to protect their interests or the rulers' interest or to provide justification for their wrongdoing. See Moinuddin Ahmed, *Ulama : the Boon and Bane of Islamic Society* (New Delhi: Kitab Bhavan, 1990), p77; Ghazzali, *The Book of Knowledge*; Ihya'ulum al-din. , trans. Nabih Amin Faris, 2nd ed. (Lahore: S.M. Ashraf, 1966), Section VI.

(2) Albert O. Hirschman, *Exit, Voice, and Loyalty; Responses to Decline in Firms, Organizations, and States* (Cambridge, Mass.: Harvard University Press, 1970), p1.

(3) *Ibid.*

(4) See, for example, the stories of Caliph Umar with the following Companions: Saad Bin Waqas, Khalid Bin Waleed, Said ibn Aamir, and Amr ibn al-Aas. See Mian Usman, «The Islamic Concept of Leadership,» Allvoices, Inc, <http://www.allvoices.com/contributed-news/4804200-the-islamic-concept-of-leadership>. accessed 9 August 2011; Badr 'Abd al-Ḥamīd Hmīṣah, «Muḥāsabah al-Wulāh « Ṣayd al-Fawā'id <http://www.saa'id.net/Doat/hamesabadr/205.htm>. accessed 9 August 2011

### **1.3.4. SSBs' Lack of Transparency**

One of the main criticisms directed at IIFS is their general lack of transparency, particularly in relation to Shari'ah governance. Although transparency is regarded as an essential element of modern corporate governance<sup>(1)</sup>, it does not seem to be common practise among Islamic financial institutions, which operate in a less transparent environment than do conventional financial institutions<sup>(2)</sup>.

Wilson<sup>(3)</sup> notes that regulators and official bodies in Muslim countries tend to deal with Islamic finance issues as a sensitive subject and do not expose them to public view. This is because the governors of central banks are careful not be seen taking action which violates Shari'ah principles<sup>(4)</sup>. In addition, severe competition in the industry might block the disclosure of details of innovative Islamic financial products. The reliability of the transaction is not based on the level of transparency and disclosure, but rather on people's acceptance and trust of the Shari'ah scholar who has approved the product<sup>(5)</sup>.

Furthermore, the subject has received little attention in the AAOIFI standards and guidelines<sup>(6)</sup>. For instance, AAOIFI's recommendations for the contents of an SSB annual report are superficial and disregard the disclosure of important information. Neither does the standard promote revealing key information about IIFS Shari'ah board members, such as membership duration, procedures for selection and reappoint-

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(1) Benjamin E. Hermalin and Michael S. Weisbach, «Transparency and Corporate Governance,» (2007) [http://www.law.yale.edu/documents/pdf/cbl/HW\\_mkts\\_v5.pdf](http://www.law.yale.edu/documents/pdf/cbl/HW_mkts_v5.pdf) accessed 28 August 2011

(2) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services»; Wafica Ali Ghoul, «Shariah Scholars and Islamic Finance: Towards a more Objective and Independent Shariah-Compliance Certification of Islamic Financial Products,» *Review of Islamic Economics* 12, no. 2 (2008): p88; Alsayyed, «Shari'ah Board, The Task of Fatwa, and Ijtihad in Islamic Economics, and Finance».

(3) Wilson, «Regulatory Challenges Posed by Islamic Capital Market Products and Services,» p20.

(4) *Ibid.*

(5) Alsayyed, «Shari'ah Board, The Task of Fatwa, and Ijtihad in Islamic Economics, and Finance».

(6) Khorshid, «Shariah Board Accountability».

ment, or qualifications and professional background<sup>(1)</sup>. Moreover, as with members of a board of directors, SSB members' financial rewards and their work affiliations with other financial institutions (including the number of SSBs they serve) should be revealed<sup>(2)</sup>.

Most importantly, stakeholders should be made aware of the SSB's duties, the legal power of its decisions (whether binding or advisory in nature), and the process of Shari'ah supervision and decision-making. Some IIFS are advertised as completely under the supervision of the Shari'ah board, while their SSB in practise only conducts ex ante Shari'ah review<sup>(3)</sup>. Other institutions claim to have an internal Shari'ah review unit while, in fact, they only have one officer responsible for auditing its branches<sup>(4)</sup>. Besides, it is important to disclose how SSBs collect their data. Most SSBs state that a sample of IIFS transactions has been examined without saying when or revealing how much this sample represents the IIFS business operations<sup>(5)</sup>.

Another important point is that IIFS should disclose the disposal of non-Shari'ah compliant income<sup>(6)</sup>. Shareholders need to know how much of the IIFS operations this income represents, and whether it was correctly distributed. Many SSB reports state that IIFS operations were fully Shari'ah compliant without referring to the percentage of non-Shari'ah compliant earnings that must inevitably be generated in practise<sup>(7)</sup>. The following indices that I have compiled compare Shari'ah

(1) Alsayyed, «Shari'ah Board, The Task of Fatwa, and Ijtihad in Islamic Economics, and Finance».

(2) Fidād, «al-Raqābah al-Shar'iyyah Wa Dawruhā Fī Ḍabṭ A'māl al-Maṣārif al-Islāmiyyah,» p19.

(3) al-Hītī, «Athar al-Raqābah al-Shar'iyyah 'alā Ail-tizām al-Maṣārif al-Islāmiyyah bi-al-'Aḥkāmī al-Shar'iyyah « p21-25.

(4) 'Ādil 'AbdAllāh Bāryān, «Asālīb Taf'īl Dawr al-Raqābah al-Shar'iyyah Fī al-Maṣārif al-Islāmiyyah « (ibid.31/5- 3/6/2009), p35.

(5) al-Sa'ad, «al-Raqābah al-Shar'iyyah WāAtharhā Fī al-Maṣārif al-Islāmiyyah,» p15-19; al-Ṭayyib, «Taḳīm al-Raqābah al-Shar'iyyah fī Ḍīl al-Niḳām al-Maṣrif al-Islāmī al-Shāmil,» p27; 'Abd al-Razzāq Raḥīm al-Hītī, «Athar al-Raqābah al-Shar'iyyah 'alā Ail-tizām al-Maṣārif al-Islāmiyyah bi-al-'Aḥkāmī al-Shar'iyyah « (ibid.31/5/2009 - 3/6/2009), p21.

(6) Muḥammad 'Alī Yūsuf Ahmad, «Dawr al-Suluṭāt al-Riḳābiyyah Fī al-Riḳābah 'Alā al-Mu'assasāt al-Māliyyah al-Islāmiyyah « (paper presented at the The 2nd Conference of Islamic Financial Services., Tripoli-Libya, 27-28/4/2010), p19.

(7) Ahmad al-Islāmbūlī, «Dawr al-Hay'āt al-Shar'iyyah Fī Ḍabṭ A'māl al-Mu'assasāt al-Māliyyah al-Islāmiyyah « (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UAE, 26/4/2009), p19.

### supervision disclosure in 12 Saudi bank<sup>s(1)</sup> along with nine UK banks<sup>(2)</sup>

- (1) Source of date: information posted on the websites and annual reports of the following banks: Alrajhi Bank, «The Sharia Group»; «Annual Report 2010,» Alrajhi Bank, <http://www.alrajhibank.com.sa/en/media-centre/reports/Documents/annual-report2010-en.pdf>. accessed 28 August 2011; Bank Albilad, «Sharia Board,» <http://www.bankalbilad.com/ar/shariah.asp>, <http://www.bankalbilad.com/en/shariah.asp>. accessed 28 August 2011; «Financial Statements for 2010,» <http://www.bankalbilad.com/en/BILAD31-12-2010.pdf>. accessed 28 August 2011; Alinma Bank, «Shariah Board,» [http://www.alinma.com/wps/portal/alinma/ut/p/c5/04\\_SB8K8xLLM9MSSzPy8xBz9CP0os3hzf-2cLDy93A0t3d1c3A093xd3\\_yBfl29TA\\_3g1Dz9gmxHRQA7laOC/](http://www.alinma.com/wps/portal/alinma/ut/p/c5/04_SB8K8xLLM9MSSzPy8xBz9CP0os3hzf-2cLDy93A0t3d1c3A093xd3_yBfl29TA_3g1Dz9gmxHRQA7laOC/). accessed 28 August 2011; «Annual Report 2010,» Alinma Bank, [http://www.alinma.com/wps/wcm/connect/512dd680467a8afb930ebb690642abc77/Alinm\\_annual\\_report\\_2010\\_eng%28may22%29+22.5.11.pdf?MOD=AJPERES&CACHEID=512dd680467a8afb930ebb690642abc7](http://www.alinma.com/wps/wcm/connect/512dd680467a8afb930ebb690642abc77/Alinm_annual_report_2010_eng%28may22%29+22.5.11.pdf?MOD=AJPERES&CACHEID=512dd680467a8afb930ebb690642abc7). accessed 28 August 2011; Bank AlJazira (BAJ), «Corporate Profile,» <http://www.baj.com.sa/about-us.aspx?page=corporate-profile&id=139>. accessed 28 August 2011; «Annual Report,» <http://www.baj.com.sa/pdf/Baj%20Annual%20Report%20English.pdf>. accessed 28 August 2011; The National Commercial Bank, «Annual Report « [http://www.alahli.com/en-US/About%20Us/News\\_Reports/Documents/Reports%202010/NCB%20AR10%20English.pdf](http://www.alahli.com/en-US/About%20Us/News_Reports/Documents/Reports%202010/NCB%20AR10%20English.pdf). accessed 28 August 2011; «The NCB Shariah Board « <http://www.alahli.com/ar-SA/About%20Us/ibd/Pages/TheNCBShariahBoard.aspx>. accessed 28 August 2011; Saudi Hollandi Bank (SHB), «Shari'ah Board Members,» <http://shb.com.sa/en/about/AboutSHB/ShariahBoardmembers.aspx>. accessed 28 August 2011; Saudi Hollandi Bank (SHB), «Annual Report « [http://www.shb.com.sa/PDF/SHB%20Annual%20Report%202010\\_English.pdf](http://www.shb.com.sa/PDF/SHB%20Annual%20Report%202010_English.pdf). accessed 28 August 2011; SAMBA, «Islamic Products,» Samba Bank, [http://www.samba.com/ENGLISH/CONSUMER/HTML/CONSISLAMICPRODUCTS\\_01\\_01\\_en.html](http://www.samba.com/ENGLISH/CONSUMER/HTML/CONSISLAMICPRODUCTS_01_01_en.html). accessed 28 August 2011; «Annual Reports,» Samba Bank, [http://www.samba.com/English/Common/HTML/abtSambaFReports\\_01\\_01\\_en.html](http://www.samba.com/English/Common/HTML/abtSambaFReports_01_01_en.html). accessed 28 August 2011; Riyad Bank, «Islamic Banking « <http://www.riyadbank.com/English/PersonalBanking/IslamicBanking.html>. accessed 28 August 2011; «Annual Report,» Riyad Bank, <http://www.riyadbank.com/PDF/reports/annualreports/en/2010/AnnualReport2010.pdf>. accessed 28 August 2011; Bank Saudi Fransi (BSF), «Islamic Finance « <http://www.alfransi.com.sa/en/article/corporate-services/corporate-banking/islamic-finance.html>. accessed 28 August 2011; «Annual Report,» <http://www.alfransi.com.sa/en/general/download/file/1369>. accessed 28 August 2011; Arab National Bank (ANB), «Islamic Banking Division Profile,» [http://www.anb.com.sa/about\\_islamic.asp](http://www.anb.com.sa/about_islamic.asp). accessed 28 August 2011; «Annual Report,» [http://www.anb.com.sa/pdf/Reports/2010/ANB\\_English\\_review.pdf](http://www.anb.com.sa/pdf/Reports/2010/ANB_English_review.pdf). accessed 28 August 2011; SABB, «Shariah Committee,» SABB Bank, [http://www.sabb.com/1/2/sabb-en/about-us/profile/sahariah\\_advisory\\_committee](http://www.sabb.com/1/2/sabb-en/about-us/profile/sahariah_advisory_committee). accessed 28 August 2011; «Annual Report,» SABB Bank [http://www.sabb.com/1/PA\\_1\\_083Q9FJ08A002FBP5S0000000/content/SABB/en/about\\_us/attachments/annual\\_reports/sabb\\_annual\\_report\\_2010\\_en.pdf](http://www.sabb.com/1/PA_1_083Q9FJ08A002FBP5S0000000/content/SABB/en/about_us/attachments/annual_reports/sabb_annual_report_2010_en.pdf). accessed 28 August 2011; The Saudi Investment Bank (SAIB), «Islamic Banking,» <http://www.saib.com.sa/english/islamic.aspx>. accessed 28 August 2011; «Financial Statements,» <http://www.saib.com.sa/Docs/Financial%20Statements%202010%20English.pdf>. accessed 28 August 2011
- (2) Source of data: information posted on the websites and annual reports of the following banks: Islamic Bank of Britain (IBB), «Sharia Supervisory Committee,» <http://www.islamic-bank.com/sharia-finance/sharia-supervisory-committee/>. accessed 28 August 2011; Islamic Bank of Britain IIBI, «Annual Report and Financial Statements « <http://www.islamic-bank.com/GetAsset.aspx?id=fAAzADkANgB8AHwAVABYAHUAZQB8AHwAMAB8AA2>. accessed 28 August 2011; Ahli United Bank (UK) (AUB), «Our Sharia-h Board « [www.iibu.com/shariaa\\_board/sboard.aspx](http://www.iibu.com/shariaa_board/sboard.aspx). accessed 28 August 2011; «Annual Report,» [http://www.ahliunited.com/pdfs/ar/AUB\\_AnnualReport\\_2010.pdf](http://www.ahliunited.com/pdfs/ar/AUB_AnnualReport_2010.pdf). accessed 28 August 2011; HSBC Amanah, «Shariah Supervision,» <http://www.hsbcamanah.com/amanah/about-amanah/islamic-banking/shariah-supervision>. accessed 28 August 2011; United National Bank, «Islamic Products,» <http://www.unbankltd.com/islamic-products/>. accessed 28 August 2011; ABC International Bank plc (ABCIB), «Shariah Compliance,» ABCIB, [http://www.alburaq.co.uk/shariah\\_compliance.asp](http://www.alburaq.co.uk/shariah_compliance.asp). accessed 28 August 2011; Lloyds TSB, «Islamic Business Bank Account,» <http://www.lloydsbsbusiness.com/accounts/islamic.asp>. accessed 28 August 2011; European Islamic Investment Bank plc's (EIIB), «Sharia Board,» EIIB, [http://www.eiib.co.uk/html/sharia\\_board.asp](http://www.eiib.co.uk/html/sharia_board.asp). accessed 28 August 2011; «Annual Report « EIIB, <http://www.eiib.co.uk/documents/EIIBAnnualReport2010Final.pdf>. accessed 28 August 2011; QIB(UK), «Our People « QIB Bank(UK) <http://www.qib-uk.com/html/our-people.asp>. accessed 28 August 2011; Gatehouse Bank, «Shariah Supervisory Board,» <http://www.gatehousebank.com/about-us/shariah-supervisory-board/>. accessed 28 August 2011; «Annual Report,» [http://www.gatehousebank.com/common/documents/annual-reports/Gatehouse\\_Bank\\_Annual\\_Report\\_2009.pdf](http://www.gatehousebank.com/common/documents/annual-reports/Gatehouse_Bank_Annual_Report_2009.pdf). accessed 28 August 2011



offering Islamic financial services (see Table 1 and Table 2). They show the average disclosure and the desirable disclosure in the following areas: SSB composition, Shari'ah scholars' professional background, affiliation with other SSBs, SSB members' financial rewards, the SSB annual report to shareholders, the publication of fatwas or decisions, SSB duties, SSB decision power (binding or advisory), supervision processes, and selection procedures (by shareholders, the board of directors, or banking management).

As the average results of the two countries show, a transparency culture in banks offering Islamic financial services seems to be more prevalent in the UK than in Saudi, although the UK is a secular country with minority Muslim population and Saudi is an Islamic country. IIFS in the UK are in a better position with regard to disclosing Shari'ah scholars' membership in other SSBs. These countries' political systems might have influenced this outcome, since unlike the absolute monarchy in Saudi<sup>(1)</sup>, the democratic system of the UK promotes transparency. Besides, professional banking practises were established a long time ago in the UK, and modern corporate governance originated in the West<sup>(2)</sup>. Nevertheless, the disclosure of SSB remuneration appears to be a sensitive subject in both countries, to the extent that it has never been revealed. Lastly, the indices show that, despite the benefits of publishing SSB fatwas, such as educating the public about Islamic finance and engaging stakeholders in overseeing IIFS compliance with SSB rulings<sup>(3)</sup>, very few financial institutions have taken the incentive to publish the decisions of their SSB.

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(1) See generally, Khaled Hussainey and Ali Al-Nodel, «Corporate Governance Online Reporting by Saudi Listed Companies,» in *Corporate governance in less developed and emerging economies*, ed. Matthew Tsamenyi and Shazad Uddin (Bingley: Emerald Jai, 2008), p42

(2) Randall Morck and Lloyd Steier, *The Global History of Corporate Governance : an Introduction* (Cambridge, Mass.: National Bureau of Economic Research, 2005).

(3) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services»; Khalid Howladar, «Shari'ah Risk: Understanding Recent Compliance Issues in Islamic Finance,» Moody's, [http://eng.assaif.org/content/download/7643/43051/file/MDYs\\_ShariahRisk\\_KHowladar.pdf](http://eng.assaif.org/content/download/7643/43051/file/MDYs_ShariahRisk_KHowladar.pdf). accessed 17 October 2010

Shariah Governance disclosure Indexes in UK banks

Source: banks websites and Annual Reports

UK BANKS	SSB composition	Professional Background	Affiliation with other SSB	SSB financial rewards	SSB annual Report	Fatwas	SSB duties	power	Supervision Process	Selection Procedure
IBB	1	1	1	0	1	1	1	1	1	0
AUB UK	1	1	1	0	0	0	1	1	1	0
HSBC Amanah	1	1	1	0	0	0	1	1	1	0
UNB	1	1	0	0	0	0	0	0	1	0
Alburaq	1	1	1	0	0	1	1	0	1	0
Lloyds TSB-	1	1	0	0	0	0	0	0	0	0
EII	1	1	1	0	1	0	1	1	1	1
QIB (UK) plc	1	0	0	0	0	0	0	0	0	0
Gatehouse Bank	1	1	1	0	1	0	1	1	1	1
Average disclosure	1.00	0.89	0.67	0.00	0.33	0.22	0.67	0.56	0.78	0.22
Desirable disclosure	1	1	1	1	1	1	1	1	1	1

Numbers are binary, 1 being disclosure and 0 being non-disclosure.

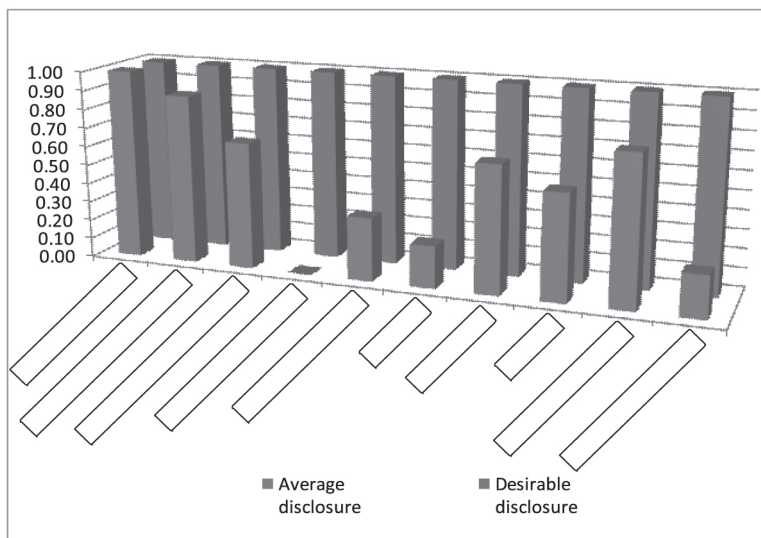


Table 1. Shari ‘ah Governance Disclosure Indexes in UK Banks

Shariah Governance disclosure Indexes in KSA banks

Source: banks websites and Annual Reports

KSA BANKS	SSB composition	Professional Background	Affiliation with other SSB	SSB financial rewards	SSB annual Report	Fatwas	SSB duties	power	Supevision Process	Selection Procedure
ALRAJHI	1	0	0	0	0	1	1	1	1	1
ALBILAD	1	1	0	0	0	1	1	1	1	0
ALINMA	1	1	0	0	0	0	1	1	1	1
BAJ	1	0	0	0	1	0	1	1	1	0
NCB	1	0	0	0	0	0	1	0	1	0
SHB	1	1	0	0	0	0	0	0	0	0
SAMBA	1	0	0	0	0	0	0	0	0	0
RIYAD	1	0	0	0	0	0	1	0	0	0
ALFRANSI	1	0	0	0	0	0	0	1	0	0
ANB	1	0	0	0	0	0	1	0	1	0
SABB	1	1	0	0	0	0	1	0	0	0
SAIB	0	0	0	0	0	0	0	0	0	0
Average disclosure	0.92	0.33	0.00	0.00	0.08	0.17	0.67	0.42	0.50	0.17
Desirable disclosure	1	1	1	1	1	1	1	1	1	1

Numbers are binary, 1 being disclosure and 0 being non-disclosure.

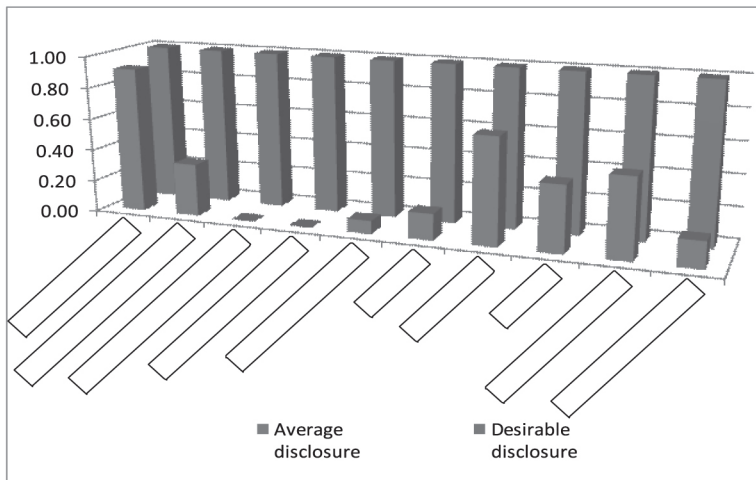


Table 2. Shari ‘ah Governance Disclosure Indexes in KSA Banks

### **1.3.5. The Lack of Independence of SSBs**

Independence, according to Oxford Dictionary of English, is the state of being “free from outside control; not subject to another’s authority”.<sup>1</sup> Any factor that compromises the independence of fiduciaries (such as directors, agents, and external auditors) will affect their judgment, reliability and public confidence<sup>(2)</sup>. However, the standard of independence and acting in a good faith as a fiduciary duty can vary from one profession to another<sup>(3)</sup>. Contemporary Islamic finance literature seems to offer a similar but less strict mindset posed in guidelines and codes issued by accounting and auditing regulatory and professional bodies<sup>(4)</sup>. Al-Khalīfī, for example, defines the independent authority of SSBs as a way of exercising their functions impartially and in complete freedom. They should not be influenced by any kind of pressure, whether from IIFS management or shareholders, that may negatively affect their decisions<sup>(5)</sup>.

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(1) Angus Stevenson, «Oxford Dictionary of English,» Oxford University Press, [http://www.oxfordreference.com/views/BOOK\\_SEARCH.html?book=t140](http://www.oxfordreference.com/views/BOOK_SEARCH.html?book=t140). accessed 1 November 2011

(2) Zabihollah Rezaee, *Corporate Governance and Ethics* (Hoboken, NJ: John Wiley & Sons, 2009), p270.

(3) See generally: Gerard M. D. Bean, *Fiduciary Obligations and Joint Ventures :The Collaborative Fiduciary Relationship* (Oxford; New York, N.Y.: Clarendon Press, 1995), p27-35; Robert A. Pearce, John Stevens, and Warren Barr, *The Law of Trusts and Equitable Obligations* (Oxford; New York: Oxford University Press, 2010), p909-15; Martha Bruce, *Rights and Duties of Directors* (London: Tolley Publishing Co Ltd, 2002), p42-49.

(4) Most guidelines and codes issued by regulatory and professional bodies highlight two notions of auditor independence: independence in fact (or mind) and independence in appearance. The former requires auditors to have a state of mind that is not influenced by any factors which may affect professional judgment. An auditor must be able to perform the task with honesty, impartiality and “professional scepticism.” The latter requires auditors to avoid any significant facts or situations that might result in a reasonable conclusion on the part of an informed third party that the auditor’s honesty, impartiality, or “professional scepticism” has been affected. Christiane Strohm, *United States and European Union Auditor Independence Regulation: Implications for Regulators and Auditing Practice* (Wiesbaden: Deutscher Universitäts-Verlag, 2006), p18.

(5) al-Khalīfī, «al-Nazāriyyah al-‘Āmmah Lil-hay’at al-Shar’iyyah « p26.

Al-Shabīlī<sup>(1)</sup> outlines three elements of SSB independence. The first is employment independence: the external Shari'ah supervisor should not be an employee of the IIFS, but should be appointed from outside the IIFS staff. In addition, the level of the internal Shari'ah department in the IIFS structure should be sufficient to accomplish its responsibilities. It should not be lower than the level of the internal audit unit, which should report directly to the SSB, not to the management of the bank. The second element is financial independence, which is achieved when an SSB member's fee is not determined by the number of products or contracts he has approved, but according to the effort he has made in conducting such a job. In the case of internal Shari'ah auditors, financial independence is achieved by ensuring that their remuneration is not linked with the content of their reports. The third element is independence in appointment and dismissal. The SSB member must be appointed by the highest authority in the IIFS, which is the annual general meeting (AGM) of shareholders. The internal Shari'ah auditor can be appointed and dismissed by an administrative decision, subject to the approval of the SSB.

In theory, Shari'ah Board members have an obligation to provide an impartial report on any breach of Islamic law that takes place within an Islamic financial institution. However, the existence of two boards in the IIFS structure, with the board of directors having a superior power over an SSB, may cause a serious conflict of interest. The fact that the IIFS board or management can appoint, dismiss, or fix the remuneration of the SSB member leaves the door open for IIFS management to use such leverage to influence Shari'ah board judgments. For instance, the board of directors may try to pressure the SSB to issue a fatwa approving a certain product or service to maximise the IIFS profit, regardless of its compliance with Shari'ah principles. Or they might threaten SSB members with termination of their contracts to prevent them from reporting non-Shari'ah compliant activities, which is likely to shake stakeholders' confidence<sup>(2)</sup>.

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(1) al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Mašārif: Dawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Mašārif,» p20.

(2) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services»; Siti Faridah Abd Jabbar, «The Sharia Supervisory Board of Islamic Financial Institutions: A Case for Governance,» The Company Lawyer 30, no. 8 (2009): p244; Abdul-Rahman, The Art of Islamic Banking and Finance : Tools and Techniques for Community-Based Banking, p79.

In the context of Shari'ah supervision, five factors can possibly compromise SSB independence<sup>(1)</sup>, namely, the approach to appointments, high remuneration, the provision of credit facilities to SSB members, ownership of shares in the IIFS, and the holding of an executive position.

### ***1.3.5.1. The Approach to Appointments***

The Islamic finance industry has no standard practise for appointing Shari'ah advisors. Generally, SSB members are appointed either directly by the IIFS board of directors or management, or else in the annual general meeting of shareholders. It is not clear which method is the most popular in the industry. According to a study conducted by Bahjat<sup>(2)</sup> on sixteen Islamic institutions, only seven SSBs have ever

- (1) External auditors' independence, to which some Islamic finance literatures make reference (HH Hassan, «al-elaqah beyn alhey'eat alesher'eyh w alemraj'eyen alekharejyen» Accounting and Auditing Organization for Islamic Financial Institutions AAOIF), can be compromised by several threats. The Ethical Standards issued by The Auditing Practices Board (APB) in addition to The International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants identify six general threats: self-interest, self-review, advocacy, familiarity or trust, management, and intimidation. The threat of self-interest is found when an auditor hesitates to act independently because it may endanger his interests (for example, shares in the audited institution). The threat of self-review occurs when an auditor provides a non-auditing service to be incorporated in the financial statement. The threat of advocacy appears when an auditor plays the role of an advocate to an audited company which requires him to adopt a position in support of that taken by the management. The threat of familiarity or trust can emerge when an auditor does not sufficiently question the point of view of the audited company. A common example is where a close personal relationship has developed with the staff of the audited entity. Moreover, a management threat can occur when an auditor makes a decision on behalf of the administration of the audited financial institution. This usually takes place when an audited entity asks the audit firm to provide non-audit services that will influence judgments made by the management. Finally, the intimidation threat occurs when the performance of an auditor is affected by fear or menaces. This could be the situation when an auditor deals with aggressive and controlling management. See: Brenda Porter, David J. Hatherly, and Jon Simon, *Principles of External Auditing* (Chichester, England: John Wiley, 2008), p104-06.
- (2) Muḥammad Fu'ād Bahjat, «Naḥw Mi'yār Lil-rriqābah al-Shar'iyyah Fī al-Bunūk al-Islāmiyyah,» *Journal of King Abdulaziz University: Islamic Economics* 3, no. 2 (1994). Cited in Fayṣal 'Abd al-'Azīz Farāḥ, «al-Raqābah al-Shar'iyyah al-Wāqī' Wa al-Mithāl « (paper presented at the TheThird International Conference on Islamic Economics, Mecca, 31/5-2/06/2005), p26.

been appointed at an AGM. Five were appointed by a board of directors, and it was not clear which method was used for appointing the members of the remaining four SSBs. In another study, Hussain Hamed Hassan<sup>(1)</sup>, a prominent international Shari'ah scholar, suggests that 89% of the SSBs in IIFS are appointed by a board of directors and 11% are appointed at an AGM.

The first method, appointment by the board of directors, is associated with two issues. First, the board may use its leverage to influence SSB decisions. Given that the board usually represents big shareholders in an institution, such pressure is likely to be used to protect any financial interests. The danger is greater in cases where there is only a single Shari'ah advisor in the institution. The second issue is the lack of objectivity in selecting SSB members. This is because board members tend to choose scholars with whom they have personal or friendly relationships<sup>(2)</sup>. Such familiarity can be an impediment for SSBs when endeavouring to perform their task in a professional manner<sup>(3)</sup>.

Although appointing SSBs in the shareholders' AGM is thought to boost SSB independence<sup>(4)</sup>, and although it represents the current practise supported by AAOIFI standards, this method is also not without its flaws. This is because the board of directors recommends the appointment of certain individuals at general meetings, and these recommendations are usually approved without objection<sup>(5)</sup>. Board recommendations tend to be influenced by management views. Therefore, it is unlikely to assume that IIFS management will have no power over the selection of SSBs appointed in an AGM.

Furthermore, even where shareholders directly make the selections, the decisions of the AGM can be influenced by a few individuals who con-

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(1) Hassan, «al-'Alāqah Bayn al-Hay'āt al-Shar'iyyah wa al-murāji'īn al-khārijīyyīn» p9.

(2) Qaṭṭān, «Hay'ah al-Raqabah al-Shar'iyyah Akhtiyār A'ḍā'ihā Wa Ḍawābiḥā» p20.

(3) 'Abd al-Majīd Maḥmūd al-Ṣalāḥīn, «Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Wa Dawruhā Fī al-Maṣrifīyyah al-Islāmiyyah» (paper presented at the Islamic Financial Institutions: Reality Features and Future Prospects, UAE, 15-17/5/2005), p257.

(4) Hassan et al., An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers p55.

(5) Alsayyed, «Shari'ah Board, The Task of Fatwa, and Ijtihad in Islamic Economics, and Finance».

trol the majority of a company's shares<sup>(1)</sup>. This might be the case in both private and government companies which become publicly traded in the stock market. For example, Al Rajhi Bank, the largest Saudi Islamic bank and the second biggest Islamic bank in the world, was listed in the Saudi stock market in 1988<sup>(2)</sup>. However, the Al Rajhi family holds a majority share in the company, and family members occupy six out of the 11 seats on the board of directors. These include the chairman of the board and his son, who is the Chief Executive Officer (CEO). In this example, the CEO will likely have a major influence on his father, as well as on the rest of the family members on the board. Therefore, it is unrealistic to claim that selecting SSB members in the AGM, which is the norm in Al Rajhi Bank, is sufficient to provide autonomy for SSB members<sup>(3)</sup>.

Another criticism directed at this method is that it prevents investment account holders from participating in the selection of SSBs<sup>(4)</sup>. Unlike conventional banks, investment account holders in Islamic finance are affected by SSB selections because they share profit and risk with the institution. Therefore, they should be involved in the process of SSB appointment.

To avoid such limitations, some experts have suggested that a regulatory body oversee the selection of SSB members in the AGM<sup>(5)</sup>. This would provide another layer to protect SSB independence from the board of directors' influence. It would also ensure greater objectivity in selecting SSB members. Such a practise is already applied in the

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(1) Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p79 n13; al-Hitī, «Athar al-Raqābah al-Shar'iyyah 'alā Ail-tizām al-Mašārif al-Islāmiyyah bi-al-'Aḥkāmi al-Shar'iyyah « p32.

(2) Alrajhi Bank, «About Us,» <http://www.alrajhibank.com.sa/AboutUs/Pages/default.aspx>. accessed 18 April 2011

(3) The board members' names as they appeared on the bank website on 18/04/2011, *ibid*.

(4) Qaṭṭān, «Hay'ah al-Raqābah al-Shar'iyyah Akhtiyār A'ḍā'ihā Wa Ḍawābiḥā « p10; 'Abd al-Hādī Ḥabṭūr, «Hay'āt Riqābiyyah Shar'iyyah fī al-Mašārif al-IslāmiyyahTa' mal k « Muassasāt Khayriyyat « Dūn Ṣifah Qānūniyyah «, al-Āqṭišādiyyah, 20 June 2010 [http://www.aleqt.com/2010/06/20/article\\_408864.html](http://www.aleqt.com/2010/06/20/article_408864.html). accessed 20 October 2010

(5) al-Ṣalāḥīn, «Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Wa Dawruhā Fī al-Maṣrifīyyah al-Islāmiyyah « p258; Ṭah Muḥammad Fāris, «Ḍawābiḥ Wa Āliyyāt Akhtiyār A'ḍā' Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah « (paper presented at the Islamic Banking Between Reality and Expectations, Dubai, UAE, 31/5- 3/6/2009), p48-51.



United Arab Emirates (UAE)<sup>(1)</sup> as well as in Malaysia,<sup>(2)</sup> where Islamic banks are required to submit the names of SSB candidates to a supreme Shari'ah board for final approval. However, this mechanism cannot be applied at the present time in countries such as Saudi Arabia, owing to the absence of regulations of Islamic finance, or in countries such as the UK, where a secular system is applied and the regulator will not interfere in a religious matter<sup>(3)</sup>.

Another suggestion is to refer the issue of SSB member selection to an international body funded by charity, which would comprise globally recognised scholars capable of assessing the competence of potential candidates<sup>(4)</sup>. However, it is questionable whether financial institutions would voluntarily adhere to the control of such a body. Unless it were backed by central banks, it could be problematic for a cross-border financial institution to operate in countries with different approaches towards Islamic finance.

### **1.3.5.2. High Remuneration**

Classical Islamic scholars have always stressed the importance of the independence of the muftī (a scholar who provides a Shari'ah answer) from the mustaftī (an individual who asks the question)<sup>(5)</sup>. Initially, classical fiqh jurists debated whether it was permissible for the muftī to receive payment from individuals in exchange for answering a religious question<sup>(6)</sup>. Proponents of prohibiting this remuneration argue

(1) «Federal Law No-(6) of 1985 concerning Islamic Banks and Financial Institutions and Investment Companies». Article 6. See also: al-Ṣalāḥīn, «Hay'at al-Fatwā Wa al-Riqābah al-Shar'iyyah Wa Dawruhā Fī al-Maṣrifīyyah al-Islāmiyyah « p258; Qaṭṭān, «Hay'ah al-Raqābah al-Shar'iyyah Akhtiyār A'ḍā'ihā Wa Ḍawābiḥā « p10.

(2) Bank Negara Malaysia (BNM), «Shari'ah Governance Framework for Islamic Financial Institutions (BNM/RH/GL\_012\_3)» p29.

(3) Ainley et al., *Islamic Finance in The UK : Regulation and Challenges*, p13.

(4) Laldin, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah,» p10.

(5) Bāryān, «Asālīb Tafīl Dawr al-Raqābah al-Shar'iyyah Fī al-Maṣārif al-Islāmiyyah « p26-30.

(6) While it is allowed within the Maliki, Shafi'i and minority Hanbali schools of thought, it is not lawful under the Hanafi and mainstream Hanbali schools of thought. See: al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Maṣārif:Ḍawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Maṣārif,» p8-9; Fāris, «Ḍawābiḥ Wa Āliyyāt Akhtiyār A'ḍā' Hay'at al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah « p31-34.

that allowing such a practise would endanger the scholar's autonomy, since the Shari'ah ruling may not be in favour of the individual. Consequently, as with judges and governors, the remuneration of scholars who provide a fatwa for the public should be paid by the Islamic state like any other public servant.

However, it is unlikely that this debate applies to the current nature of SSB work. There is a major difference between answering general questions from the public, as discussed in the classical literature, and between ensuring Shari'ah compliance in a private financial institution. The latter is an unprecedented situation for Shari'ah scholars. It takes greater effort and more time, requiring scholars to review product documents and develop an understanding of complex financial instruments. Hence, most contemporary jurists hold the view that it is religiously lawful for Shari'ah scholars to accept remuneration in exchange for time and effort provided to ensure Shari'ah compliance<sup>(1)</sup>.

Nevertheless, the phenomenon of employing a "private scholar" in financial institutions has not gone without criticism from some official scholars appointed by the state<sup>(2)</sup>. They have argued that such a practise has negatively resulted in a so-called "fatwa shopping" situation, where some SSB members use jurisprudential ruses to offer resolutions that are tailored to suit the desires of the IIFS, although doing so could undermine the spirit of Islamic finance<sup>(3)</sup>. In the eyes of these critics, banks are using their clients' money to pay a high remuneration to SSB members in exchange for rulings with doubtful religious validity.

It is probably the reports of high remuneration paid to some of the most popular Shari'ah supervisors in the industry that provoked criti-

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(1) al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Maṣārif: Dawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Maṣārif,» p9; Fāris, «Dawābiḥ Wa Āliyyāt Akhtiyār A'ḍā' Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah « p32; Laldīn, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah,» p10; Ḥamzah 'Abd al-Karīm Ḥammād, al-Raqābah al-Shar'iyyah Fī al-Maṣārif al-Islāmiyyah (Amman: Alinvaais, 2006), p120.

(2) Warde, Islamic Finance in The Global Economy, p227-28.

(3) Ibid.

cism on this issue. With no standard practise in IIFS,<sup>(1)</sup> it seems to be important to address who should determine SSB remuneration and how it should be calculated. According to a study conducted by Abumouamer<sup>(2)</sup>, for 75% of IIFS in the industry, SSB remuneration is decided by shareholders in their AGM; the board of directors determines it for 15.6%, and IIFS management fixes it for 9.4%. The calculation method varies from one IIFS to another. Some IIFS pay an annual or a monthly fee according to a set number of board meetings. Others pay a percentage of the bank's overall profit<sup>(3)</sup>. The latter is the case with Faisal Islamic Bank of Egypt, where SSB and board of directors remuneration is fixed in the annual budget to be between 5% and 10% of actual profit<sup>(4)</sup>. However, such a practise can severely endanger SSB independence and raise a serious conflict of interest. This is because the higher the profit, the higher remuneration SSB members receive. For instance, if this method were followed by Al Rajhi Bank, which made SR 6,767 million in net profit in 2009,5 assuming that the total number of board of directors and SSB members is 15, with their remuneration set at 8% of the actual profit, each member would receive about SR 36 million.

A related discussion in this regard is whether a Shari'ah supervisor can receive a percentage of the revenue from a product approved by the SSB. Some scholars argue this is religiously prohibited, as it may cast suspicions over the validity of the fatwa<sup>(6)</sup>. This is because IIFS use SSB judgment as a testimony endorsing the product in question as

(1) Laldin, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah,» p9.

(2) Faris Mahmoud Abumouamer, «An Analysis of the Role and Function of the Shariah Control in Islamic Banks» (PhD thesis, University of Wales, College of Cardiff, 1989), p266. Compare with Faraḥ, «al-Raqābah al-Shar'iyyah al-Wāqī' Wa al-Mithāl « p33.

(3) Laldin, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah,» p9.

(4) al-Ṣalāḥīn, «Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Wa Dawruhā Fī al-Maṣrifīyyah al-Islāmiyyah « p264; al-Islāmbūlī, «Dawr al-Hay'āt al-Shar'iyyah Fī Ḍabṭ A'māl al-Mu'asasāt al-Māliyyah al-Islāmiyyah « p7.

(5) Alrajhi Bank, «2009 Annual Report,» Alrajhi Bank, <http://www.alrajhibank.com.sa/reports/Pages/default.aspx>. accessed 10 March 2011

(6) al-Ṣālīḥ, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah « p18. Yūsuf 'AbdAllāh al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Maṣārif: Dawābiḥā Wa Aḥkāmhā Wa Dawrhā fī Ḍabṭ 'Amal al-Maṣārif» (ibid.), p9-10.

Shari'ah compliant, and Islamic law does not accept testimony when a witness directly benefits from it. Given that SSBs are only paid when a product is approved, the more products they approve, the more profit they will make. However, Al-Shabīlī makes one exception,<sup>(1)</sup> where the product is the innovation of a Shari'ah advisor. He argues that since Shari'ah also protects intellectual property, these advisors have the right to receive a percentage of the profit, provided that the product is approved by other SSB members.

To limit the threat of high remuneration, Bahjat<sup>(2)</sup> suggests issuing guidelines for the SSB fee, which would take into account the effort of the task and the average income in the country. Abumouamer<sup>(3)</sup> suggests that SSB remuneration should be set by an international body such as the General Council for Islamic Banks and Financial Institutions. Such measures would help to standardise the SSB fee and protect the independence of its members.

### **1.3.5.3. Credit Facility**

Another important issue that should be addressed is whether SSB members can receive credit facilities from the IIFS for which they are reviewing products. Apart from IIFS in Syria<sup>(4)</sup> and Qatar, to a limited extent, there are no restrictions on SSB members engaging in such relationships, despite the threat to Shari'ah supervisors' independence. In Qatar<sup>(5)</sup>, the Central Bank only restricts SSB members from receiving credit facilities for commercial use, but not for personal use. If the regulator is using such controls to enhance Shari'ah supervisors' inde-

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(1) «al-Raqābah al-Shar'iyyah 'Alā al-Maṣārif: Ḍawābiḥā Wa Aḥkāmḥā Wa Dawrhā fī Ḍabṭ 'Amal al-Maṣārif,» p9-10.

(2) Bahjat, «Naḥw Mi'yār Lil-rriqābah al-Shar'iyyah Fī al-Bunūk al-Islāmiyyah.» Cited in Faraḥ, «al-Raqābah al-Shar'iyyah al-Wāqī' Wa al-Mithāl « p26.

(3) Abumouamer, «An Analysis of the Role and Function of the Shariah Control in Islamic Banks,» p266. Compare with Faraḥ, «al-Raqābah al-Shar'iyyah al-Wāqī' Wa al-Mithāl « p33.

(4) Monetary and Credit Council [MCC], «Admission Rules of SSB of Islamic Banks Operating in The Syrian Arab Republic 404, MN, B4,» <http://www.banquecentrale.gov.sy/mone-poli-ar/cmcc/cmcc-0292-ar.pdf>. accessed 09/09/2011

(5) Qatar Central Bank (QCB), «Instructions to Banks,» Qatar Central Bank, Eleventh Edition, March, [http://www.qcb.gov.qa/English/Legislation/Documents/instructions-Mar09\\_Eng/SEVEN.pdf](http://www.qcb.gov.qa/English/Legislation/Documents/instructions-Mar09_Eng/SEVEN.pdf). accessed 29 April 2011

pendence, the prohibition ought to be extended to credit facilities for both personal and commercial purposes<sup>(1)</sup>.

#### **1.3.5.4. Ownership of Shares in IIFS**

In contemporary Islamic finance literature, SSB members are sometimes compared to external auditors. However, while the latter's financial investment in the audited entity is strictly prohibited and is seen as a threat to auditor's independence,<sup>(2)</sup> not all Shari'ah scholars see SSB's investment from the same perspective<sup>(3)</sup>. Some scholars believe that it is religiously permissible for SSB members to own a small share in the institution (for example, less than 5%) if it is permissible by law. Such a percentage is not considered a large enough investment to endanger the independence of the SSB's judgment<sup>(4)</sup>. Moreover, it is argued that members should not be prevented from investing in an entity, as they are more aware than anyone else of its level of compliance. Shari'ah scholars' piety and ethical standards should avert the effect of any conflict of interest<sup>(5)</sup>. However, others argue that since an SSB report is a testimony which certifies the compliance of IIFS, its members should be banned from any action which may call its credibility into question<sup>(6)</sup>.

(1) Hasan, «Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK,» p100.

(2) See: Strohm, United States and European Union Auditor Independence Regulation: Implications for Regulators and Auditing Practice, p18.

(3) al-Şālih, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maşārif al-Islāmiyyah « p17; Yūsuf 'AbdAllāh al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Maşārif: Ḍawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Maşārif» (ibid.), p10.

(4) Muḥammad Aḥmad al-Şālih, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maşārif al-Islāmiyyah « (ibid.), p17; Yūsuf 'AbdAllāh al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Maşārif: Ḍawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Maşārif» (ibid.), p10.

(5) Qaṭṭān, «al-Raqābah al-Shar'iyyah al-Fa'ālah Fī al-Maşārif al-Islāmiyyah « p21.

(6) Ahmad 'AbdAllāh Ibn Ḥumayd, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maşārif al-Islāmiyyah» (paper presented at the 19th session of the Islamic Fiqh Academy, Sharjah, UAE, 26/9/2009), p6; Yūsuf 'AbdAllāh al-Shabīlī, «al-Raqābah al-Shar'iyyah 'Alā al-Maşārif: Ḍawābiḥā Wa Aḥkāmā Wa Dawrhā fī Ḍabṭ 'Amal al-Maşārif» (ibid.26/4/2009), p10; 'Abd āl-Ḥamid al-Ba'īt, «Astiql-āliyyat al-Hay'ah al-Shar'iyyah Fī al-Mu'assasāt al-Māliyyah al-Islāmiyyah « (paper presented at the The 2nd Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, 29-30/10/2002), p30.

The decision of the International Islamic Fiqh Academy is in favour of the latter restriction<sup>(1)</sup>. Nevertheless, regulations are generally silent on this matter. This might be because of the unclear role and legal status of SSB members, which this paper has already discussed.

### ***1.3.5.5. Working in an Executive Position***

A Shari'ah supervisor's independence can be compromised if he takes on an executive role in the IIFS, since working in such a post may require him to take a supportive view of management's actions and decisions. For instance, the Dubai Islamic Bank (DIB), one of the largest Islamic financial institutions in the United Arab Emirates, has an SSB which serves as an external Shari'ah auditor, as well as an internal Shari'ah unit, which acts as an internal auditor. The issue is that the same scholar, Hussain Hamed Hassan, chairs both the DIB's external SSB and the internal Shari'ah unit based at the bank<sup>(2)</sup>. Moreover, Mohamed Abdulhakim Zoeir, who is a member of the SSB and its secretary, has also been appointed by the board of directors as an internal Shari'ah auditor<sup>(3)</sup>. In this situation, there is a potential conflict of interest, since two of the SSB members work as an external auditor and employee on the payroll of the bank. Surprisingly, when this issue was raised before the head of DIB's Shari'ah Coordination Department, he argued that it presented no threat to SSB members' independence, since they are protected by the general assembly of shareholders<sup>(4)</sup>. It does not seem to be a matter for concern that the head of the external SSB is at the same time the head of the body which oversees the implementation of SSB decisions. Nevertheless, Qatar Financial Centre rules clearly prohibit the appointing of SSB members in executive

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(1) al-Yāashyi al-Şādiq Fidād, «Ta'arūḍ al-Maşāliḥ Fī A'māl Hay'āt al-Riqābah al-Shar'iyyah» (paper presented at the The 8th Conference of Shari'ah Supervisory Boards of Islamic Financial Institutions, Bahrain, Bahrain, 18-19/5/2009), p16-17.

(2) Ghoul, «Shariah Scholars and Islamic Finance: Towards a more Objective and Independent Shariah-Compliance Certification of Islamic Financial Products,» p93.

(3) Dubai Islamic Bank (DIB), «Hay'ah al-Fatwā Wa al-Raqābah al-Shar'iyyah» «DIB,, <http://www.dib.ae/ar/shariaboard.htm>. accessed 29 April 2011; al-Islāmbūlī, «Dawr al-Hay'āt al-Shar'iyyah Fī Ḍabṭ A'māl al-Mu'asasāt al-Māliyyah al-Islāmiyyah» «p23.

(4) Ghoul, «Shariah Scholars and Islamic Finance: Towards a more Objective and Independent Shariah-Compliance Certification of Islamic Financial Products,» p94.

positions<sup>(1)</sup>. This is also the position adopted by the Financial Conduct Authority, as can be indirectly understood from its standard for directors known as the “Fit and Proper Test for Approved Persons”<sup>(2)</sup>.

Considering these five roadblocks to SSB independence, scholars have made a couple of recommendations to enhance SSB autonomy. One suggestion by Grais and Pellegrini<sup>(3)</sup> is to apply a mandatory rotation for SSBs. It has been argued that an enduring relationship between the Shari’ah board and IIFS management can weaken the objectivity of its auditing. Thus, if a mandatory rotation were imposed to intercept such a relationship, the IIFS executive would not have the leverage of terminating SSB tenure to influence its decisions. However, apart from its cost,<sup>(4)</sup> Summer argues that application of such a measure to external auditors would undercut inducements to develop a reputation for integrity.<sup>(5)</sup> Moreover, it might result in insufficient reviewing of Shari’ah compliance during the transitional period, and it might also cause inconsistent implementation of Islamic finance within the same institution. To overcome the last two criticisms, Grais and Pellegrini<sup>(6)</sup> suggest a partial compulsory rotation of SSB members rather than of the whole board. Such a solution would ensure greater independence for Shari’ah supervisors and maintain the quality of Shari’ah auditing as the remaining members would assure consistency in board resolutions.

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(1) Qatar Financial Centre Regulatory Authority (QFC), «Islamic Finance Rulebook (ISFI),» Qatar Financial Centre (QFC), [http://www.complinet.com/net\\_file\\_store/new\\_rulebooks/q/f/QFCRA\\_1935.pdf](http://www.complinet.com/net_file_store/new_rulebooks/q/f/QFCRA_1935.pdf). accessed 29 April 2011; Hasan, «Regulatory Framework of Shari’ah Governance System in Malaysia, GCC Countries and the UK,» p101.

(2) Ainley et al., *Islamic Finance in The UK : Regulation and Challenges*, p13-14. See also, Financial Conduct Authority (FCA), «What is an approved person?»; «The Fit and Proper test for Approved Persons».

(3) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering IslamicFinancial Services».

(4) Miles B. Gietzmann and Pradyot K. Sen, «Improving Auditor Independence Through Selective Mandatory Rotation,» *International Journal of Auditing* 6, no. 2 (2002).

(5) Martin Summer, «Does Mandatory Rotation Enhance Auditor Independence,» *Zeitschrift für Wirtschafts- und Sozialwissenschaften* 118, no. 3 (1998). cited in Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering IslamicFinancial Services».

(6) «Corporate Governance and Shariah Compliance in Institutions Offering IslamicFinancial Services».

Clarifying the SSB's role in the IIFS articles of association can also help to improve SSB autonomy. These articles should include provisions that clearly state the need for SSB independence and its power to access records and information required to ensure Shari'ah compliance. In addition, they should state the Shari'ah board's position in the institutional structure and the IIFS policy for appointing, dismissing, and fixing remuneration of SSB members.<sup>(1)</sup>

In terms of fiscal autonomy, it has been suggested that SSBs should have their own independent budget approved by shareholders at the AGM. It should be sufficient to meet the SSB's needs for research, software, and expertise. SSBs should be able to spend their budget without the interference of the IIFS board of directors and management<sup>(2)</sup>.

Admittedly, some of the suggested solutions are not always applicable—for example, where the IIFS operates within a secular environment or where regulators have a passive attitude towards Islamic finance. In this case, shareholders ought to modify IIFS articles of association to enhance SSB independence, as this might be the only legally enforceable solution.

Regulators as well as IIFS ought to play a proactive role in ensuring the autonomy of SSBs.<sup>(3)</sup> First, they should assert SSB independence in their rules and guidelines, as is the case in Kuwait's regulation of IIFS.<sup>(4)</sup> Second, they should task the IIFS management with ensuring Shari'ah board independence and preventing any conflict of interest. The Qatar Financial Centre, for example, currently takes such measures.<sup>(5)</sup> Third, to avoid the influence of a few individuals during the

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(1) Ibid.; al-Khalīfī, «al-Naẓariyyah al-Āmmah Lil-hay'at al-Shar'iyyah» p28-31.

(2) Ibn Ḥumayd, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabṭ a'māl al-Maṣārif al-Islāmiyyah,» p7.

(3) Notably, although the Islamic financial market in Syria is relatively new, regulators have addressed a lot of independent threats in this section. See: Monetary and Credit Council [MCC], «Admission Rules of SSB of Islamic Banks Operating in The Syrian Arab Republic 404, MN, B4».

(4) 'Abd āl-Ḥamid al-Ba'ī, «al-Qawānīn Wa al-Tashrī'āt al-Maṣrifīyyah al-Islāmiyyah Dirāsāt Muqāranah» (paper presented at the The 7th Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, Bahrain, 27/5/2008), p58.

(5) Qatar Financial Centre Regulatory Authority (QFC), «Islamic Finance Rulebook (ISFI)» p13 section 6.1.5.



SSB's appointment in the AGM, IIFS should submit SSB candidates to a regulatory body for final approval, as do regulators in Malaysia, UAE, and Syria.<sup>(1)</sup>

A vital question for regulators is whether SSBs should be subject to the same strict independence requirements as auditors or independent directors are.<sup>(2)</sup> SSB members are not outsiders, like auditors who are only concerned with ex post auditing. Neither are they part of the board of directors, like non-executive directors. There have not been any reports of a crisis due to a lack of SSB independence and conflicts of interest. However, the Islamic finance market is relatively new. Regulators should learn from auditing industry crises and start acting before scandals such as those faced by Enron, Tyco International, and WorldCom<sup>(3)</sup> occur. It is true that SSB members are generally well-regarded Shari'ah intellectuals with a high ethical standard.<sup>(4)</sup> Nevertheless, they are human and they are not infallible. If Islamic finance leaders are serious about competing on a global level, they should note that the local reputation of a scholar's integrity may not be sufficient to allay market suspicions over SSB conflicts of interest and lack of independence.

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(1) al-Khalīfī, «al-Naẓariyyah al-Āmmah Lil-hay'āt al-Shar'iyyah» « p33; Abdul-Rahman, *The Art of Islamic Banking and Finance : Tools and Techniques for Community-Based Banking*, p79; al-Ṣalāḥīn, "Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Wa Dawruhā Fī al-Maṣrifīyyah al-Islāmiyyah " p258-59; Qaṭṭān, "Hay'ah al-Raqābah al-Shar'iyyah Akhtiyār A'dā'iḥā Wa Ḍawābiḥā "; Monetary and Credit Council [MCC], "Admission Rules of SSB of Islamic Banks Operating in The Syrian Arab Republic 404, MN, B4" Art 3-5.

(2) On non-executive directors' independence, see: Mallin, *Corporate Governance*, p174-75.

(3) See generally about Enron, Tyco International, and other crises: Thomas Clarke, *International Corporate Governance : a Comparative Approach* (London: Routledge, 2007), p14-16.

(4) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services». *Fidāḍ*, «Ta'āruḍ al-Maṣāliḥ Fī A'māl Hay'āt al-Riqābah al-Shar'iyyah» « p11. It is worth pointing out that 75% of the respondents in a study conducted in Malaysia in 2009, believe that the independence of the SSB is not affected by remuneration. The fact that Shari'ah supervisors are generally full-time academics could be the reason for such findings: See Hassan et al., *An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers* p48.

### **1.3.6. Conflicts of Interest**

The growth of the Islamic financial industry has outstripped the number of qualified Shari'ah supervisors,<sup>(1)</sup> resulting in the same Shari'ah scholar holding appointments at many different institutions.<sup>(2)</sup> A 2011 study conducted by Ünal<sup>(3)</sup> shows that the top 20 Shari'ah scholars each sit on 14 to 85 board positions in the Islamic finance industry. The top 10 Shari'ah scholars hold 450 SSB positions, which represent 39.44% of available positions in the world. Table 3 lists the top 10 SSB members worldwide. The second column shows the total number of board positions which each scholar holds in Islamic finance institutions. The third column represents the total number of positions that each scholar holds, including their membership in financial institutions, standard-setting organisations, national regulatory bodies, foundations, unions, and Shari'ah consulting firms.

Although membership on multiple boards can give SSB members greater independence than they would have if serving just one institution, it raises concerns about breaching the confidentiality of IIFS. This risk arises because the role of SSBs is to ensure Shari'ah compliance of a financial institution, so its members have access to all institutional records and sensitive information. To mitigate the risk of accidental or deliberate leaks of confidential information, IIFS management might try to conceal information from the SSB, which would affect the process of securing Shari'ah compliance in the institution.<sup>(4)</sup>

The potential abuse of sensitive information is a second concern related to SSB conflicts of interest. Because IIFS directors often discuss the details of any potential deals or investments to ensure their Shari'ah compliance prior to their disclosure in the market, SSB members could theoretically use that information to their personal financial

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(1) Ghoul, «Shariah Scholars and Islamic Finance: Towards a more Objective and Independent Shariah-Compliance Certification of Islamic Financial Products,» p92.

(2) Siti Faridah Abd Jabbar, «International - The Shari'a Supervisory Board: a Potential Problem in Islamic Finance,» *The Company lawyer* 29, no. 1 (2008): p30.

(3) Murat Ünal «The Small World of Islamic Finance; Shariah Scholars and Governance - A Network Analytic Perspective,» *Funds@Work*, [http://www.funds-at-work.com/fileadmin/downloads/Sharia-Network\\_by\\_Funds\\_at\\_Work\\_AG.pdf.pdf](http://www.funds-at-work.com/fileadmin/downloads/Sharia-Network_by_Funds_at_Work_AG.pdf.pdf). accessed 5 February 2011

(4) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering IslamicFinancial Services».

advantage, especially when no regulations prevent SSB members and their relatives from investing in the company.<sup>(1)</sup>

A third issue that results from multiple SSB membership is the creation of a “fatwa shopping” phenomenon, where SSB members are hand-picked for their ability to provide a fatwa that suits the financial institution, regardless of its conflict with the spirit of Islamic law. The more lenient a Shari’ah scholar is, the more his name appears on SSBs and the more he is sought after in the industry.<sup>(2)</sup> This has led some Shari’ah scholars to compete on the basis of their leniency, not on the quality of their supervision.

Multiple membership in SSBs raises a fourth problem of granting a small group of people a considerable amount of power over the direction of the industry. As mentioned, Ünal’s 2011 study of SSB networks showed that almost 40% of Shari’ah board positions in the world are held by the top 10 scholars; moreover, the top 100 scholars sit on nearly 84% of the SSBs around the globe.<sup>(3)</sup> This concentration of power is potentially very dangerous, since it places the future of the industry in the hands of an international Shari’ah cartel.<sup>(4)</sup> This situation may hinder the industry’s jurisprudential growth by closing the door for junior scholars to join the industry.

A fifth concern is that membership on multiple SSBs can create a Shari’ah compliance risk. Multiple membership places a Shari’ah scholar under great pressure from different institutions to review contracts and sign off on documents. To cope with such tasks, SSB members spend less time ensuring Shari’ah compliance so that they can

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(1) Abd Jabbar, «The Sharia Supervisory Board of Islamic Financial Institutions: A Case for Governance,» p244; Fidād, «Ta’arūḍ al-Maṣāliḥ Fī A’māl Hay’at al-Riqābah al-Shar’iyyah « p17; Mūsā Ādam ‘Tsā, «Ta’arūḍ al-Maṣāliḥ Fī A’māl Hay’at al-Riqābah al-Shar’iyyah» (paper presented at the The 8th Conference of Shari’a Supervisory Boards of Islamic Financial Institutions, Bahrain, 18/5/2009), p25.

(2) Abdulbari Mashal, «Dawr al-Ma’āyir al-Shar’iyyah Wa al-Muḥāsabiyyah Fī Tanẓīm al-Maṣrifīyyah al-Islāmiyyah « (paper presented at the The 2nd Conference of Islamic Financial Services, Tripoli-Libya, 27-28/4/2010), p7.

(3) Ünal «The Small World of Islamic Finance; Shariah Scholars and Governance - A Network Analytic Perspective».

(4) Wright, «The Shariah Scholar Cartel».

deliver their approval quickly.<sup>(1)</sup> This raises concerns over the quality of Shari'ah auditing and can lead to huge liability for the audited entity and its investors. Lahem Al-Nasser,<sup>(2)</sup> an expert in Islamic finance and the head of an Islamic banking advisory institution, questions the ability of SSB members with numerous board memberships in different countries to provide adequate Shari'ah review, given the complexity of financial instruments and the amount of time usually spent in SSB meetings. In fact, the duration of an SSB meeting is not sufficient to read the documents presented, let alone to carefully check and understand all the details and structure of a proposed product. He recalls an incident where an SSB member approved 72 sukūks (Islamic bonds) in a single meeting, notwithstanding their complexity and controversial validity in the industry.<sup>(3)</sup> Another researcher reports that some SSB scholars rely on the approval of other members of the board when ratifying products, rather than making an independent judgment.<sup>(4)</sup>

Multiple membership on SSBs further jeopardizes Shari'ah compliance because famous SSB members serve on numerous boards in different countries where various schools of thoughts are followed. SSB members sometimes dispute the religious permissibility of a product, and since decisions are made by a majority vote, Shari'ah scholars might end up with conflicting views prohibiting a product on one board and approving it on another.<sup>(5)</sup> This inconsistency might confuse investors and shake their trust in the scholar.<sup>(6)</sup>

In the face of these criticisms, a few justifications have been offered for multiple memberships on SSBs. The Islamic finance literature has long cited the shortage of Shari'ah scholars when rationalising multiple memberships.<sup>(7)</sup> However, it is questionable whether there is a

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(1) Siddiqi, «A Sharia Scholar's Place on The Board»; Howladar, «Shari'ah Risk: Understanding Recent Compliance Issues in Islamic Finance».

(2) al-Nasser, «Waḍ' al-Maṣrifīyah al-Islāmiyyah Murbiḳ Wa Naḥn Biḥājah ilā Wilādah Jadīdah «.

(3) Ibid.

(4) Zighṭbah «Hay'āt al-Fatwā Wa al-Riqābah al-Shar'īyyah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah Ahammiyyathā Mu'awwiqāt 'Amalhā wa Ḥulūl Muqtaraḥah « p27.

(5) Qaṭṭān, «al-Raqābah al-Shar'īyyah al-Fa'ālah Fī al-Maṣārif al-Islāmiyyah « p15.

(6) Ibid.

(7) Zulkifli Hasan, «Demystifying The Myth Of Shortage Of Shari'ah Scholars», Global Islamic Finance Magazine. accessed

real lack of qualified scholars, or whether that is mainly an excuse for financial institutions to appoint certain SSB members. Zulkifli Hasan<sup>(1)</sup> suggests that this supposed shortage is simply a myth, noting that despite the establishment of modern Islamic finance more than 30 years ago and the organisation of hundreds of conferences, workshops, and seminars, the same excuse is being used. He argues that there are numerous qualified Shari'ah scholars who could be employed in the industry.<sup>(2)</sup> Professor Mohammad Akram Laldin,<sup>(3)</sup> a renowned SSB member and the director of the International Shari'ah Research Academy for Islamic Finance (ISRA), shares the same firm belief that the market does not lack for Shari'ah supervisors. Rather, Laldin contends that there is a sufficient number of proficient scholars for SSBs, but the industry has not given them the opportunity to sit on SSBs.<sup>(4)</sup>

The claim of a shortage of Shari'ah scholars is further discredited by the existence of many higher academic institutions which offer specialised education in Islamic law. These institutions are spread across the world, and thousands of students graduate from them every year. Saudi Arabia, for example, has nine universities with a special college for Shari'ah law and Islamic studies<sup>(5)</sup>. Egypt has the renowned Al Azhar University, where around 1,500 students graduate with a BA from Shari'ah colleges every year, along with 300 Masters graduates and 30 PhDs.<sup>(6)</sup> In Malaysia, there is the International Centre for Education in Islamic Finance (INCEIF), which along with other top universities in Syria, Jordan, UAE, Kuwait, Qatar, Morocco, Algeria, Pakistan, India, and Indonesia offers special courses in Islamic jurisprudence.<sup>(7)</sup> Accordingly, it seems safe to assume that there are many underutilised Shari'ah specialists who could meet the demands of the Islamic finance industry.

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(1) Ibid.

(2) Ibid.

(3) Ibid.

(4) Ibid.

(5) Khālid al-Mashūh, «Taṭwīr Kuliyyāt al-Sharī'ah « Alwatan, <http://www.alwatan.com.sa/Articles/Detail.aspx?ArticleId=2887>. accessed 10 July 2011

(6) Khorshid, «Shariah Board Accountability».

(7) Hasan, «Demystifying The Myth Of Shortage Of Shari'ah Scholars.»

However, this assumption might not be completely accurate, as not all Shari'ah graduates may be able to function properly on an SSB. In the words of one of the top 10 SSB members, Hussain Hamid Hassan, "Graduating from a Shari'ah college is not enough by itself".<sup>(1)</sup> This is because the standard curriculum in these academic institutions is not directed at producing professionals in Islamic finance, but rather general specialists in Shari'ah law, of which Islamic finance is one complex part. Moreover, classes on Islamic finance often focus on the simple structures found in classical jurisprudence, creating a disconnection between the curricula taught in these universities and the financial instruments and vehicles used in the market.<sup>(2)</sup> In short, a Shari'ah graduate may not necessarily be able to assess whether or not a particular financial product is Shari'ah compliant, because issuing such a judgment requires not only knowledge of Islamic jurisprudence, but also an understanding of the actual implementation of the product in the financial industry.

Nevertheless, this situation does not justify the domination of SSBs by just a few scholars. The majority of the top SSB members were full-time academics at one point, and some still are. They share the responsibility with the industry for not partnering with academic institutions to teach the next generation of SSB members. In addition, Shari'ah graduates' lack of competence in this domain could be overcome in the short term through intensive courses and training programmes. In the long term, the focus should be on improving the quality of the education offered in Shari'ah colleges to meet the needs of the modern Islamic finance industry. Malaysia has taken the initiative in this area by allocating the sum of 700 million ringgits for three established trusts devoted to Islamic finance education and training.<sup>(3)</sup> These trusts include INCEIF, with a fund of 500 million ringgits, and ISRA, which was

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(1) Siddiqi, «A Sharia Scholar's Place on The Board».

(2) Quṭb al-Rīṣūnī, «Naḥw Tāhīl Ajtihādī Li'Aḍā' Hay'ah al-Fatwā bi-al-Maṣārīf al-Islāmiyyah» (paper presented at the Islamic Banking Between Reality and Expectations, Dubai, UAE, 31/5 - 3/6/2009), p16-17.

(3) Mushtak Parker, «Islamic Banking Special Supplement: Shariah Governance a Challenge to Islamic Banking,» Arab News, <http://archive.arabnews.com/?page=9&section=0&article=127292&d=11&m=10&y=2009>. accessed 15 October 2010; Bank Negara Malaysia (BNM), «Shariah Scholarship Award,» Bank Negara Malaysia, <http://www.bnm.gov.my/index.php?ch=200&pg=618&ac=529>. accessed 20 May 2011

allocated 100 million ringgits. 100 million ringgits were also provided to the Malaysia Central Bank Shari'ah Development Fund, which is intended to increase the number of qualified Shari'ah scholars and is open to citizens of all countries.<sup>(1)</sup>

In this regard, it is worth pointing out the different attitudes of Malaysian SSB members towards regulation and reform, compared with their peers in the GCC countries.<sup>(2)</sup> While the former acknowledge some of the issues arising from multiple SSB membership and have supported a governance reform, top SSB members in the Gulf seem to deny the existence of a real conflict of interests,<sup>(3)</sup> and they firmly disagree with the idea of restricting Shari'ah scholars to one supervisory board. They further justify the multiplicity of SSB memberships by comparing themselves to lawyers and accountants,<sup>(4)</sup> notwithstanding the fact that SSB members do not adhere to a code of practise similar to that which governs these two professions.

Popular SSB members further justify their multiple memberships by presenting themselves as lifesavers of the Islamic finance industry, citing as pretexts their experience and the exaggerated risk of handing SSBs over to young scholars.<sup>(5)</sup> In fact, one top SSB member goes as

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(1) Parker, «Islamic Banking Special Supplement: Shariah Governance a Challenge to Islamic Banking»; Bank Negara Malaysia (BNM), «Shariah Scholarship Award».

(2) This is the position of top SSB members in the Islamic finance industry, like Nizam Yaquby, Mohamed Al Qari, and Hussain Hamid Hassan. Needless to say, there are some GGC scholars who have called for limiting SSB membership numbers and agree with the Malaysian approach.

(3) It is interesting to see that Al Qari rejects concerns over conflicts of interest but in the same interview recalls an incident where he was advising two banks which were separately developing versions of the same product for nine months. See Wright, «The Shariah Scholar Cartel».

(4) Frederik Richter, «Top Islamic Finance Scholars Oppose Reform Effort,» Reuters, <http://www.reuters.com/article/2010/12/01/islamicfinance-scholars-idUSLDE6B015920101201>. accessed 3 December 2010; Siddiqui, «A Sharia Scholar's Place on The Board»; Wright, «The Shariah Scholar Cartel»; Dana El Baltaji and Haris Anwar, «Shariah Scholar on More Than 50 Boards Opposes Limit Plan: Islamic Finance,» Bloomberg, <http://www.bloomberg.com/news/2010-11-23/shariah-scholar-on-more-than-50-boards-opposes-limit-plan-islamic-finance.html>. accessed 25 November 2010

(5) Khorshid, «Shariah Board Accountability»; Siddiqui, «A Sharia Scholar's Place on The Board».

far as faulting those who believe that Shari'ah graduates from an appropriate educational background, given current curricula, could meet the demands of the industry.<sup>(1)</sup> These behaviours call into question the credibility of claims that there is a shortage of Shari'ah scholars and suggest that the real issues are rather those of bad governance practises and the old guard trying to protect their private interests.

Perhaps the first solution that comes to mind when addressing the issue of conflicts of interest is to limit the number of SSB positions a Shari'ah scholar can hold, as regulators in Malaysia and Pakistan already do. However, although this measure could overcome concerns about confidentiality, it could also preclude the creation of a professional market for Shari'ah auditors by reducing the financial attraction towards the profession. Moreover, it could build a mutually beneficial relationship between SSB members and the audited entity, thus affecting auditor independence.<sup>(2)</sup> Nonetheless, restricting the number of Shari'ah supervisory positions per individual would facilitate the appointment of a new generation of Shari'ah scholars and combat the domination of SSB membership. In a country where there is a real shortage of Shari'ah scholars, regulators could deal with the numbers involved in board membership on a case-by-case basis, according to the performance of the individual applicant, the category of the financial institution they are involved with, and the status of the scholar within the board (chairman vs. member).

However, focusing on board membership numbers would not give regulators the full picture.<sup>(3)</sup> Regulators should consider various factors when addressing this issue, for instance, the size of the financial institution where a scholar sits on the SSB, the category of the financial work (banking or insurance),<sup>(4)</sup> the scholar's standing within the SSB

(1) Wright, «The Shariah Scholar Cartel»; El Baltaji and Anwar, «Shariah Scholar on More Than 50 Boards Opposes Limit Plan: Islamic Finance».

(2) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services».

(3) Ünal «The Small World of Islamic Finance; Shariah Scholars and Governance - A Network Analytic Perspective».

(4) In Malaysia, an SSB member cannot be appointed as a member of another SSB in the same industry. The banking and takaful (Islamic insurance) industries are considered different industries. See: Bank Negara Malaysia (BNM), «Shari'ah Governance Framework for Islamic Financial Institutions (BNM/RH/GL\_012\_3)» p20.



(chairman or member), and the ease of the scholar's access to other powerful scholars in the industry, which can affect their perspective and influence. This last point can be illustrated with the case of Mohamed Ali Al-Tashkeri; although he generally only holds four positions, he is ranked as number 15 in terms of his ability to quickly access highly ranked SSB members in the industry. Another example is Ahmad Ali Abdulla, who is ranked as number 36 in terms of total board membership, but as number 19 when taking into account his close connection with other powerful Shari'ah scholars in the industry who share board membership with him<sup>(1)</sup>.

To fully understand the potential conflicts of interest facing an SSB member, regulators should also pay attention to his presence in standard-setting organisations, as well as in national and international regulatory bodies, and how this affects his membership on Shari'ah supervisory boards in IIFS. For instance, Ünal's 2011 study showed that the 12 most active scholars in the AAOIFI sit on 38.9% of the available boards in Islamic finance institutions. Moreover, they collectively hold 71.17% of the positions in standard-setting organisations, governmental units and consulting companies.<sup>(2)</sup> This domination raises a serious concern about regulatory independence<sup>(3)</sup>: how can we be assured that standards and frameworks introduced by these entities follow public interests and are not affected by regulatory capture?<sup>(4)</sup> Accordingly, it is no wonder that the AAOIFI has so far failed to clearly address this issue and that its scholars have always objected to strict governance reforms.<sup>(5)</sup>

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(1) Ünal «The Small World of Islamic Finance; Shariah Scholars and Governance - A Network Analytic Perspective».

(2) Ibid.

(3) Alsayyed, «Shari'ah Board, The Task of Fatwa, and Ijtihad in Islamic Economics, and Finance».

(4) Regulatory capture occurs when a regulatory body, created to protect the public's interest, ultimately takes an action benefitting the industry which it is assumed to be regulating, rather than the public. See: Ernesto Dal Bó, "Regulatory Capture: A Review," Oxford Review of Economic Policy 22, no. 2 (2006).

(5) See: Richter, «Top Islamic Finance Scholars Oppose Reform Effort».

Another possible remedy for conflicts of interest is to issue a professional code of conduct for Shari'ah supervisors.<sup>(1)</sup> Such guidelines should adequately address the way in which SSB members act when faced with a conflict of interest. The AAOIFI code of ethics for accountants and auditors of IFIs ignores this issue and instead directs its attention to general Islamic ethics, quoting Shari'ah provisions, which makes it difficult to enforce in secular countries. In this case, regulators may extend the code for external auditors to include Shari'ah supervisors.<sup>(2)</sup> Nevertheless, the code should be overseen by a regulatory body and incorporate penalties for the violation of its duties. SSBs could then refer to this body with any concerns over conflict of duties.<sup>(3)</sup>

Finally, investing in contemporary Islamic finance education and incentive training programmes for potential SSB members should pay off and reduce the demand on "superstar" SSB members. Malaysia has the lead in this regard, with many academic institutions and funds dedicated to promoting Islamic finance. These include the INCEIF, Bank Negara, Shari'ah Research Grants, and the Association for Islamic Finance Advancement (AIFA).<sup>(4)</sup> By 2020, Malaysia aims to attract 55,000 local and 28,000 international students to its Islamic finance courses.<sup>(5)</sup> In the UK, the Islamic Finance Council UK, in association with the Securities and Investment Institute and Islamic Banking and Islamic Insurance, has introduced special courses designed to train a

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(1) Fidād, «Ta'arūḍ al-Maṣāliḥ Fī A'māl Hay'āt al-Riqābah al-Shar'iyyah» p17; Ṭsā, «Ta'arūḍ al-Maṣāliḥ Fī A'māl Hay'āt al-Riqābah al-Shar'iyyah,» p22-23.

(2) Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services».

(3) 'Abd al-Sattār 'Alī al-Qaṭṭān «Madā Ta'arūḍ al-Maṣāliḥ Fī A'māl Hay'āt al-Riqābah al-Shar'iyyah» (paper presented at the The 8th Conference of Shari'a Supervisory Boards of Islamic Financial Institutions, Bahrain, 18-19/5/2009), p12-13.

(4) Bank Negara Malaysia (BNM), «Shariah Scholarship Award»; The International Centre for Education in Islamic Finance (INCEIF), INCEIF,, <http://www.inceif.org/home/papers>. accessed 30 May 2011; The Association for Islamic Finance Advancement (AIFA), AIFA,, <http://aifa-i.org/>. accessed 30 May 2011

(5) Emmy AbdulAlim, «Malaysia Seeks to be Global Educational Hub,» The Islamic Globe, [http://www.theislamicglobe.com/index.php?option=com\\_content&view=article&id=282:malaysia-seeks-to-be-global-educational-hub&catid=17:survey&Itemid=74](http://www.theislamicglobe.com/index.php?option=com_content&view=article&id=282:malaysia-seeks-to-be-global-educational-hub&catid=17:survey&Itemid=74). accessed 23 May 2011

potential Shari'ah supervisor.<sup>(1)</sup> In addition, the universities of Durham, Reading, and Bangor are amongst those academic institutions offering postgraduate courses in Islamic finance across the UK.<sup>(2)</sup>

### **1.3.7. Lack of Competence**

SSB work has a religious nature, as its decision is regarded as fatwa (religious legal opinion). Therefore, its members must fulfil the ethical, educational, and technical requirements of qualified Shari'ah scholars. As far as ethics are concerned, apart from being Muslim, scholars must meet the requirements of 'adālah (upright character).<sup>(3)</sup> This includes uprightness in religion, honesty, truthfulness, and good manners.<sup>(4)</sup>

From the scholarly point of view, an SSB member must be classified as mujtahd, which includes being very well versed in Shari'ah in general, with particular expertise in Islamic commercial law. He should be fluent in classical Arabic to be able to deal directly with Shari'ah sources. He should also have a sufficient understanding of uṣūl al-fiqh (the principles of Islamic jurisprudence), maqāṣid al-sharī'ah (the objectives of Islamic law), and al-siyāsah al-sharīyyah (Shari'ah-based policy or politics).<sup>(5)</sup>

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(1) The Islamic Finance Council UK (IFC), IFC., <http://www.islamicfinancecounciluk.com/>. accessed 23 May 2011; Institute of Islamic Banking and Islamic Insurance (IIBI), «About Us,» IIBI., <http://www.islamic-banking.com/about.aspx>. accessed 23 May 2011; Hasan, «Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK.»

(2) Harriet Swain, «Islamic Finance Gives Universities a Bonus», The Guardian, 28 July 2009 <http://www.guardian.co.uk/education/2009/jul/28/business-schools-islamic-finance>. accessed 23 May 2011

(3) Mohammad Hashim Kamali, Principles of Islamic Jurisprudence, Third ed. (Cambridge, UK: Islamic Texts Society, 2003), p468.

(4) al-Khalīfī, «al-Naẓariyyah al-'Āmmah Lil-hay'āt al-Sharīyyah « p85-62; al-Shabīlī, «al-Raqābah al-Sharīyyah 'Alā al-Maṣārif:Ḍawābiḥā Wa Aḥkāmḥā Wa Dawrhā fī Ḍabṭ 'Amal al-Maṣārif,» p15-18.

(5) Fāris, «Ḍawābiḥ Wa Āliyyāt Akhtiyār A'ḍā' Hay'āt al-Fatwā Wa al-Riqābah al-Sharīyyah Fī al-Mu'asasāt al-Māliyyah « p13-20,p 40-41; Yusuf Talal DeLorenzo, «Shari'ah Supervision in Modern Islamic Finance,» <http://www.nzibo.com/IB2/Shari'ahsupervision.pdf>. accessed 8 February 2011; Qaṭṭān, «Hay'ah al-Raqābah al-Sharīyyah Akhtiyār A'ḍā'ihā Wa Ḍawābiḥā « p4-5.

From a technical perspective, scholars must be familiar with modern banking, business, and legal practises.<sup>(1)</sup> This is crucial to avoiding any disconnection between the theoretical concepts of Islamic finance and its implementation in the market. A recent survey of Shari'ah advisors, Shari'ah bank officers, and regulators in Malaysia showed that 83% of respondents agreed on the necessity for legal expertise on SSBs. In addition, 63% of participants voiced fair support that business qualifications should be required from SSB members, while 17% firmly supported such a proposal.<sup>(2)</sup>

English proficiency is another vital skill for SSB members, because contracts, forms, and agreements are frequently in English. Since most SSB members are not fluent in English, a translated version is usually provided. However, a poor translation makes it difficult for scholars to understand the actual terms of the agreement, which consequently affects the soundness of their judgment.<sup>(3)</sup> Furthermore, communication skills and the ability to work on a team in a multi-disciplinary environment are essential for SSB members, particularly when working with different departments in financial institutions to develop new products.<sup>(4)</sup>

In practise, an ideal scholar of this sort is very hard to find; few Shari'ah scholars meet all of these requirements, particularly in the technical realm. Most SSB members lack financial, economic, and legal

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(1) Ghoul, «Shariah Scholars and Islamic Finance: Towards a more Objective and Independent Shariah-Compliance Certification of Islamic Financial Products,» p90; Khālid al-Muzaynī, «Tarshīd al-'Amal Fī al-Hāāt al-Shar'iyyah Lil-mu'assasāti al-Māliyyah al-Islāmiyyah» (paper presented at the Islamic Banking Between Reality and Expectations, Dubai, UAE, 31/5 - 3/6/2009), p12; Ahmad al-Ḍuwayḥī, «Ḍawābiḥ al-Ijtihād fī al-Mu'āmalāt al-Māliyyat al-Islāmiyyah» (paper presented at the Islamic Financial Institutions: Reality Features and Future Prospects, Dubai, UAE, 15-17/5/2005), p91.

(2) Hassan et al., An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers p46.

(3) Ibn Ḥumayd, «Dawr al-Raqābah al-Shar'iyyah Fī Ḍabḥ a'māl al-Maṣārif al-Islāmiyyah,» p9; Qaṭṭān, «Hay'ah al-Raqābah al-Shar'iyyah Akhtiyār A'dā'ihā Wa Ḍawābiḥā « p18.

(4) DeLorenzo, «Shari'ah Supervision in Modern Islamic Finance» p401; Hassan et al., An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers p56-57.

backgrounds, which hinders their ability to express a sound Shari'ah view on complex modern financial practises.<sup>(1)</sup>

Perspective is another issue affecting SSB members' competence. Shari'ah scholars and bankers see from different standpoints.<sup>(2)</sup> While the former focus on the Shari'ah compliance of contracts, the latter aim to maximise profit in the most efficient way. This difference in mindset has resulted in Shari'ah scholars proposing inefficient structures for contracts and products, thus creating a serious issue for financial institutions operating in a competitive environment.

Furthermore, scholars' limited exposure to international financial practise poses a Shari'ah risk to financial institutions. This risk can occur when SSB members approve a product or contract before knowing its real implementation in the market, then revise their decision when they see the product implemented. For example, the renowned scholar 'AbdAllāh Sulimān al-Manī' recanted his authorisation of *ṣukūk al-ijārah* issued by the Bahraini government when he learned that possession of the underlying assets was not entirely conveyed to the lessor in the manner stated in *ijārah* (leasing) contracts in Islamic commercial law.<sup>(3)</sup> Such incidents can profoundly damage the reputation and financial position of the institution. A number of financial institutions have exacerbated this problem by taking advantage of SSBs' financial and commercial naiveté, either by not revealing all the required information or by presenting it in a way that guarantees SSB approval despite the fact the presentation does not reflect the product's actual implementation in the market.<sup>(4)</sup> This might help explain the inconsistent decisions of different SSBs in the industry concerning the same products.

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(1) Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p78; Abdul-Rahman, *The Art of Islamic Banking and Finance : Tools and Techniques for Community-Based Banking*, p79.

(2) Hassan et al., *An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers* p4-5.

(3) Mahmoud Amin El-Gamal, *Islamic Finance : Law, Economics, and Practice* (Cambridge UK: Cambridge University Press, 2006), p23.

(4) Siti Faridah Abd Jabbar, «The Governance of Shari'a Advisers of Islamic Financial Institutions: The Practice in Malaysia,» *The Company Lawyer* 30, no. 10 (2009): p313; Zighībah "Hay'āt al-Fatwā Wa al-Riqābah al-Shar'iyyah Fī al-Mu'asasāt al-Māliyyah al-Islāmiyyah Ahammiyyathā Mu'awwiqāt 'Amalhā wa Ḥulūl Muqtaraḥah " p24.

The first step in resolving the competence issue would be to establish specific standards for professionals working in Shari'ah supervision. Currently, there are no standards or regulations, not even an IIFS article of association which stipulates detailed qualifications and technical experience for SSB members.<sup>(1)</sup> AAOIFI and Malaysian standards, for example, do not require a specific degree or qualification to show that an individual has the expertise to do the job, but only require SSB members to be expert in fiqh al-mu'āmalāt (Islamic commercial law) or even Shari'ah law in general.<sup>(2)</sup> This might be because, in the early days of modern Islamic finance, financial institutions did not select SSB members based on their qualification for the task, but rather according to their reputation, which incentivised people to buy the IFI's products.<sup>(3)</sup>

Seeking the final approval of central banks in Malaysia and Pakistan before appointing SSB members might reduce the risk of recruiting unqualified people. However, for Shari'ah supervision to be regarded as a serious profession, like being a lawyer or accountant, individuals who wish to work on SSBs should obtain precise educational and technical qualifications designed for the task, and a governing body should be enabled by regulators to licence qualified Shari'ah professionals to work in the industry.<sup>(4)</sup>

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(1) 'Umar, «A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah» « p12-13; Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p76-78; Hassan et al., An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers p7.

(2) The Pakistani requirements seem to be more specific in this regard; see: Aznan Hasan, «Optimal Shari'ah Governance in Islamic Finance,» BNM, [http://www.bnm.gov.my/microsites/giff2007/pdf/frf/04\\_01.pdf](http://www.bnm.gov.my/microsites/giff2007/pdf/frf/04_01.pdf). accessed 17 October 2010

(3) Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p76-78; 'Umar, «A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah» « p12.

(4) «A'māl al-Hay'āt al-Shar'iyyah Bayn al-lāstishāriyyah al-Fardiyyah Wa al-Mihniyyah al-Mu'assasiyyah» « p12-13; Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services». Regulators in Malaysia are in the process of setting up a professional body which will carry out a similar function. See: Khalid Qayum and Soraya Permatasari, «Shariah Experts Push for Certification of Islamic Scholars,» Bloomberg <http://www.bloomberg.com/news/2010-08-31/shariah-experts-prepare-first-certification-of-scholars-islamic-finance.html>. accessed 15 October 2010

As an immediate solution to this issue, some IIFS have taken certain measures. In the Sudan, for example, the legal department in the Islamic Co-operative Development Bank joins the SSB in the process of structuring contracts.<sup>(1)</sup> Other financial institutions, such as the Agricultural Bank of Sudan, have appointed lawyers, accountants, and economists to their SSBs.<sup>(2)</sup> The AAOIFI standard allows the SSB appointment of one person who is not a specialist in Islamic commercial law. However, while some argue that such experts should be given full membership on the board to ensure their objectivity and independence during SSB deliberations,<sup>(3)</sup> others have criticised the right of non-Shari'ah qualified scholars to vote on Shari'ah-related issues.<sup>(4)</sup> In addition, members of cross-disciplinary SSBs might find it difficult to reconcile different perspectives, posing the risk of communication failure between board members<sup>(5)</sup>.

A final related question is whether SSB selection is currently based merely on qualifications to fulfil the task or on additional considerations as well. A recent survey conducted in Malaysia showed that new SSB members are mostly appointed as a result of suggestions from present members of the board.<sup>6</sup> This raises the question of whether regulators should play a role in ensuring a more objective method for recruiting new Shari'ah scholars, taking steps to prevent SSBs from being dominated by a small circle of Shari'ah supervisors.

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(1) The Higher Sharia Supervisory Board for Banks & Financial institutions (HSSB), *Nash'at Wata'awwur Wataqwīm Hāāt al-Riqābah al-Shar'iyyah fī al-Jihāz al-Maṣrifī al-Sūdānī* 1ed. (Khartoum: Central Bank of Sudan, 2006), p23.

(2) *Ibid.*, p29.

(3) Bakar, «The Shari'a Supervisory Board and Issues of Shari'a Rulings and their Harmonisation in Islamic Banking and Finance,» p78.

(4) al-Islāmbūlī, «Dawr al-Hay'āt al-Shar'iyyah Fī Ḍabṭ A'māl al-Mu'asasāt al-Māliyyah al-Islāmiyyah « p7; Hassan, «al-'Alāqah Bayn al-Hay'āt al-Shar'iyyah wa al-murāji'īn al-khārijīyyīn « p10-11.

5 Grais and Pellegrini, «Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services».

6 Hassan et al., *An Analysis of the Role and Competency of the Shari'ah Committees (SCs) of Islamic Banks and Financial Service Providers* p50; Ünal "The Small World of Islamic Finance; Shariah Scholars and Governance - A Network Analytic Perspective".

## **1.4. Conclusion**

This paper has aimed to gauge the extent to which Shari'ah supervisory board governance practises contribute to the issue of creative Shari'ah compliance in the contemporary Islamic finance industry. In particular, seven issues have been identified as main factors responsible for reducing the level of Shari'ah compliance in IIFS. These issues are the SSBs' unclear functions and legal status, lack of accountability and transparency, and conflicts of interest and lack of independence, as well as the poor training and inadequate qualifications of SSB members.

The paper has proposed several suggestions to confront these challenges. For one, Shari'ah supervision should be recognised as an independent profession. Like lawyers and accountants, its members should act within a framework that defines their legal status, role, and responsibilities. In cases where an IIFS is operating within a jurisdiction which does not favour Islamic finance or where regulators are passive, SSB members can take a proactive role in regulating Shari'ah governance by working across SSBs to standardise their own contracts with financial institutions

Emphasising accountability and transparency in SSBs should not be perceived as showing less respect to Shari'ah scholars or doubting their credibility, but rather as dealing professionally with an essential group in the industry and adding a layer of protection to public interests. This is particularly important if IIFS are operating in a global market where the local reputation of Shari'ah board members may not be sufficient to allay stockholders' suspicions over their reliability or SSBs' lack of accountability and transparency.

A vital point of this paper is to stress that in order to maintain sound financial systems and investor confidence, regulators in Islamic and secular countries have to recognise the need for their involvement in regulating Shari'ah governance in IIFS. In other words, a solid Islamic financial market cannot be established unless Shari'ah governance is regulated.



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