SHARIAH GOVERNANCE DISCLOSURE

BY ISLAMIC BANKS IN MALAYSIA

By

FATIHAH BINTI ABD RAHAMAN

Research Paper Submitted to
Othman Yeop Abdullah Graduate School of Business,
Universiti Utara Malaysia,
In Partial Fulfillment of the Requirement for the Master in Islamic Finance and Banking
PERMISSON TO USE

In presenting this research paper in partial fulfillment of the requirements for a Post Graduate degree from the Universiti Utara Malaysia (UUM), I agree that the Library of this university may make it freely available for inspection. I further agree that permission for copying this dissertation in any manner, in whole or in part, for scholarly purposes may be granted by my supervisors or in their absence, by the Dean of Othman Yeop Abdullah Graduate School of Business where I did my dissertation. It is understood that any copying or publication or use of this dissertation parts of it for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to the UUM in any scholarly use which may be made of any material in my dissertation.

Request for permission to copy or to make other use of materials in this dissertation in whole or in part should be addressed to:

Dean of Othman Yeop Abdullah Graduate School of Business
Universiti Utara Malaysia
06010 UUM Sintok
Kedah Darul Aman
ABSTRACT

Shariah governance is the utmost important division of Islamic banks to differentiate with its conventional counterpart. Although Islamic banks had been in the Malaysian banking industry for more than three decades, it is still at the stage towards comprehensive and proper framework. Besides, Islamic banks have the responsibility to ensure Shariah compliance in its overall operation. Non-compliance element will damage the confidence of the stakeholders and the perception on the purity of Islamic banking system. Thus, this study intends to scrutinize the scope of latest regulations on Shariah governance in Islamic banks, then comparing it with the international standard and to analyze its practice in compliance with the stipulated guidelines. These purposes are achieved by using qualitative method of research by applying doctrinal and legal research where the latest annual report and few regulations are referred. Besides, the descriptive and comparative study was also adopted for deep understanding. All data was taken from the Islamic banks listed under BNM and analysed it using content analysis. The practice of Shariah governance was examined by using Shariah governance disclosure ratio on the items in the SC report based on referred regulations. This study found that Malaysian regulations on Shariah governance of Islamic banking are more comprehensive rather than the international standard. However, only few Islamic banks comply with the guidelines, whilst the transition period for the compliance is almost end. Thus, it is recommended for the authorities to ensure Shariah governance disclosure been fully complied by the related Islamic banks. As the result, a proper and comprehensive Shariah governance in Islamic banks in Malaysia could be achieved.

Keywords: Malaysia, Islamic banking, Shariah governance
ABSTRAK


Kata kunci: Malaysia, Bank Islam, Tadbir-urus Shariah
ACKNOWLEDGEMENT

In the name of Allah S.W.T., the Most Compassionate and the Most Merciful. All praise to Him, Lord of the Universe and peace with blessings to His Prophet and Messenger, Muhammad S.A.W.

Firstly, I would like to express my deepest thankfulness to everyone who guide and support me directly or indirectly. The highest gratitude to my supervisors, Dr. Ahmad Khilmy bin Abdul Rahim for guiding on the management of the study, and Mr. Mohammad Azam bin Hussain for instructing me on the flow and details of the study based on his specialty in legal area. I am indebted for their valuable efforts, guidance and constructive comments that the thesis able to be completed on time. Further, I extend my gratitude to Prof Madya Dr Abu Bakar bin Hamed, the Head Facilitator of Research and Dr Nor Azlina binti Abdul Wahab, the Program Coordinator for MIFB, also the seniors for their kind assistance upon completing this study.

My utmost and genuine appreciation to my beloved parents, my heartbeat; Abdul Rahman bin Haji Abdullah and Aishah bin Haji Ahmad, for their countless prayers, unconditional love and constant encouragement, also my dearest siblings Wahida, Saniah, Karmina, Zaid, Naim and siblings in-laws for their support and motivation that gives me strength upon completing this study.

Last but not least, my gratefulness towards my supportive friends throughout the study for their kindness and assistance also for their time listening and supporting me either directly or indirectly. May Allah S.W.T. bless and repay your kindness.

Amin.
# TABLE OF CONTENTS

PERMISSION TO USE............................................................................................................i 
ABSTRACT ..............................................................................................................................ii 
ABSTRAK ...............................................................................................................................iii 
ACKNOWLEDGEMENT ...........................................................................................................iv 
TABLE OF CONTENT ...........................................................................................................v 
LIST OF TABLES ..................................................................................................................viii 
LIST OF FIGURES ................................................................................................................ix 
LIST OF ABBREVIATION ......................................................................................................x 
CHAPTER ONE: INTRODUCTION .........................................................................................1 
  1.1 Background of Study .....................................................................................................1 
  1.2 Problem Statement .......................................................................................................3 
  1.3 Research Questions ......................................................................................................7 
  1.4 Research Objectives .....................................................................................................7 
  1.5 Significance of Study ....................................................................................................8 
  1.6 Scope of the Study .......................................................................................................9 
  1.7 Structure of the Study .................................................................................................10 
  1.8 Conclusion ...................................................................................................................12 
CHAPTER TWO: LITERATURE REVIEW .............................................................................13 
  2.1 Introduction ..................................................................................................................13 
  2.2 The Concept of Corporate Governance ......................................................................13 
      2.2.1 Definition of Corporate Governance ...................................................................14 
      2.2.2 Elements of Corporate Governance ...................................................................16 
  2.3 The Concept of Islamic Corporate Governance ..........................................................17 
      2.3.1 Definition of Islamic Corporate Governance ......................................................17 
      2.3.2 Elements of Islamic Corporate Governance ......................................................19 

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.4</td>
<td>Good Governance in Islamic Perspective</td>
<td>21</td>
</tr>
<tr>
<td>2.4.1</td>
<td>Definition of Good Governance in Islamic Perspective</td>
<td>21</td>
</tr>
<tr>
<td>2.4.2</td>
<td>Elements of Good Governance in Islamic Perspective</td>
<td>24</td>
</tr>
<tr>
<td>2.5</td>
<td>The Concept of Shariah Governance</td>
<td>25</td>
</tr>
<tr>
<td>2.5.1</td>
<td>The Concept of Shariah Compliance</td>
<td>29</td>
</tr>
<tr>
<td>2.5.2</td>
<td>The Concept of Full Disclosure in Islamic Perspective</td>
<td>30</td>
</tr>
<tr>
<td>2.6</td>
<td>Shariah Governance in Islamic Banking Institution</td>
<td>34</td>
</tr>
<tr>
<td>2.6.1</td>
<td>Shariah Governance in Islamic Banking Institution in Malaysia</td>
<td>35</td>
</tr>
<tr>
<td>2.6.1.1</td>
<td>IFSA 2013</td>
<td>38</td>
</tr>
<tr>
<td>2.6.1.2</td>
<td>SGF 2011</td>
<td>40</td>
</tr>
<tr>
<td>2.6.1.3</td>
<td>GP1-i 2013</td>
<td>43</td>
</tr>
<tr>
<td>2.6.1.4</td>
<td>GP8-i 2012</td>
<td>44</td>
</tr>
<tr>
<td>2.6.2</td>
<td>Shariah Governance in Islamic Banking Institution Internationally</td>
<td>45</td>
</tr>
<tr>
<td>2.6.2.1</td>
<td>AAOIFI 2010</td>
<td>46</td>
</tr>
<tr>
<td>2.6.2.2</td>
<td>IFSB-10 2009</td>
<td>47</td>
</tr>
<tr>
<td>2.7</td>
<td>The Shariah Governance Disclosure Ratio</td>
<td>49</td>
</tr>
<tr>
<td>2.8</td>
<td>Conclusion</td>
<td>52</td>
</tr>
<tr>
<td><strong>CHAPTER THREE: RESEARCH METHODOLOGY</strong></td>
<td></td>
<td>53</td>
</tr>
<tr>
<td>3.1</td>
<td>Introduction</td>
<td>53</td>
</tr>
<tr>
<td>3.2</td>
<td>Research Design</td>
<td>53</td>
</tr>
<tr>
<td>3.3</td>
<td>Source of Data</td>
<td>55</td>
</tr>
<tr>
<td>3.4</td>
<td>Population Design</td>
<td>56</td>
</tr>
<tr>
<td>3.5</td>
<td>Data Collection Method</td>
<td>58</td>
</tr>
<tr>
<td>3.5.1</td>
<td>Developing the Shariah Governance Disclosure Ratio</td>
<td>59</td>
</tr>
<tr>
<td>3.6</td>
<td>Data Analysis and Interpretation</td>
<td>62</td>
</tr>
<tr>
<td>3.7</td>
<td>Conclusion</td>
<td>64</td>
</tr>
</tbody>
</table>
CHAPTER FOUR: ANALYSIS AND FINDING ..............................................65
4.1 Introduction ..........................................................................................65
4.2 Different Approaches of Legislations on Shariah Governance in Islamic Banks66
   4.2.1 Malaysian Legislations on Shariah Governance in Islamic Banks ..........67
   4.2.2 International Standard on Shariah Governance in Islamic Banks ........77
4.3 Comparative Analysis among Regulations on Shariah Committee’s / Supervisory Board’s Report .................................................................82
4.4 Shariah Governance Disclosure Ratio ....................................................83
4.5 Conclusion ............................................................................................87

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS ..................88
5.0 Introduction ..........................................................................................88
5.1 Research Summary and Finding ............................................................88
5.2 Penalty for Non-Compliance of Shariah Governance Disclosure ..........91
5.3 Recommendations ................................................................................92
5.4 Limitation of the Study ........................................................................94
5.5 Conclusion ............................................................................................95
References ................................................................................................97
<table>
<thead>
<tr>
<th>Table</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Corporate Governance from Islamic Perspective</td>
<td>20</td>
</tr>
<tr>
<td>3.1</td>
<td>The Lists of Islamic Banks under BNM</td>
<td>58</td>
</tr>
<tr>
<td>3.2</td>
<td>Items for Shariah Governance Disclosure Ratio Scoring</td>
<td>62</td>
</tr>
<tr>
<td>4.1</td>
<td>Example for SC’s Report</td>
<td>74</td>
</tr>
<tr>
<td>4.2</td>
<td>Example Report for SSB</td>
<td>81</td>
</tr>
<tr>
<td>4.3</td>
<td>Different Approach of SC/SSB Report</td>
<td>82</td>
</tr>
<tr>
<td>4.4</td>
<td>Shariah Governance Disclosure Ratio of Islamic Banks</td>
<td>85</td>
</tr>
</tbody>
</table>
## LIST OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.2</td>
<td>Islamic Corporate Governance</td>
<td>18</td>
</tr>
<tr>
<td>2.2</td>
<td>Shariah Governance Framework Model for IFIs</td>
<td>42</td>
</tr>
<tr>
<td>3.1</td>
<td>The Stages of Developing Shariah Governance Disclosure Ratio</td>
<td>61</td>
</tr>
<tr>
<td>4.1</td>
<td>Summary of Average Shariah Governance Disclosure Ratio on Each Items</td>
<td>86</td>
</tr>
<tr>
<td>4.2</td>
<td>Summary of Average Shariah Governance Disclosure Ratio on Each Islamic Banks</td>
<td>87</td>
</tr>
</tbody>
</table>
### LIST OF ABBREVIATION

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAOIFI</td>
<td>Accounting and Auditing of Islamic Financial Institutions</td>
</tr>
<tr>
<td>BNM</td>
<td>Bank Negara Malaysia</td>
</tr>
<tr>
<td>CBA 2009</td>
<td>Central Bank Act of Malaysia 2009</td>
</tr>
<tr>
<td>CPIFR</td>
<td>Core Principles for Islamic Finance Regulation</td>
</tr>
<tr>
<td>DFIA 2002</td>
<td>Development Financial Institutions Act 2002</td>
</tr>
<tr>
<td>FSA 2013</td>
<td>Financial Services Act 2013</td>
</tr>
<tr>
<td>FSAP</td>
<td>Financial Sector Assessment Program Malaysia</td>
</tr>
<tr>
<td>FSMP</td>
<td>Financial Sector Master Plan</td>
</tr>
<tr>
<td>GP1-i 2013</td>
<td>Guidelines on Corporate Governance for Licensed Islamic Banks 2013</td>
</tr>
<tr>
<td>IFIs</td>
<td>Islamic Financial Institutions</td>
</tr>
<tr>
<td>IFSA 2013</td>
<td>Islamic Financial Services Act 2013</td>
</tr>
<tr>
<td>IFSB</td>
<td>Islamic Financial Services Board</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
</tr>
<tr>
<td>pbuh</td>
<td>Peace Be Upon Him</td>
</tr>
<tr>
<td>SC</td>
<td>Shariah Committee</td>
</tr>
<tr>
<td>SCA 1993</td>
<td>Securities Commission Act 1993</td>
</tr>
<tr>
<td>SGF 2011</td>
<td>Shariah Governance Framework 2011</td>
</tr>
<tr>
<td>SSB</td>
<td>Shariah Supervisory Board</td>
</tr>
</tbody>
</table>
CHAPTER ONE

INTRODUCTION

1.1 Background of Study

Ironically, the exclusivity of the divine values of Islamic finance based on the Quran and Hadith being the basis of the system has significantly risen the emergence of Islamic banking and finance. Consequently, the business and economics development of Islamic finance has become the new trend in the finance and banking industry (Wardhany & Arshad, 2012). Basically, the Shariah principles are the substance of Islamic banking operations. By that fact, the comprehensive system in compliance with Shariah principles distinguishes Islamic banking from the conventional banking (Shaharuddin, 2011). Agreeably, Shariah compliance is the original foundation in having a banking system that fulfills the religious requirements for Muslims, from Islamic point of view (Elias, 2014).

In order to avoid Shariah non-compliance risk, a sound and robust Shariah governance framework is crucial with the excellent enforcement of laws.

According to Hasan (2010), for the purpose of Shariah compliance, the theoretical substance of Shariah governance needs an additional layer of governance in Islamic banks. The internal Shariah governance of Islamic banking institutions should be supported by their external counterparts to ensure that all involved parties do their duties as stipulated in Islamic law requirements. At this point, the regulations and its
The contents of the thesis is for internal user only
REFERENCES


Hancock, B. (2002). *An Introduction to Qualitative Research*. Trent Focus Group.


