

**SHARIAH RISK MANAGEMENT PRACTICES OF
ISLAMIC BANKS IN MALAYSIA**

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**MASTER IN ISLAMIC FINANCE AND BANKING
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OF ISLAMIC BANKS IN MALAYSIA**

By

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Graduate School of Business

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ABSTRACT

Shariah risk management practices are crucial for the stability and reputation of the Islamic banking industry. Thus, the purpose of this study is to determine the factors that influence Shariah risk management practices among Islamic banks in Malaysia. Islamic banking staff in the Shariah department in five (5) Islamic banks are surveyed through a questionnaire and the results are used to examine whether Shariah risk management practices is influenced by Shariah risk management process, Shariah board involvement, knowledge and expertise. Additionally, statistical method such as multiple regressions was used to test the hypothesis. This study found that Shariah risk management practices among Islamic banks in Malaysia are moderate. Other findings show that Shariah risk management practices are influenced by Shariah risk management process and expertise in both Shariah and banking operation by the employees. This explains that higher level of Shariah risk management process and expertise among staffs will lead to a higher level of Shariah risk management practices. On the other hand, two independent variables have not given much significant influence on Shariah risk management practices. Although the response rate is 86.08%, it represents beliefs, which are not necessarily translated into actions. This study makes a significant contribution to the academic understanding of Shariah governance in the context of Malaysia, which may guide policy makers, bankers, and customer. It is expected that the results of this study would give realization to the regulators to strengthen and strictly promote the Shariah compliance in all Islamic banking products and services and put a greater emphasize on Shariah risk management. In addition, it is important for the Islamic financial institutions to widen a well-organized and synchronize Shariah risk management process through understanding Shariah risk, proper identification, and assessment of the possible occurrence of the risk as well as monitoring all the products and services to control Shariah non compliance events. Lastly, the Islamic financial institution must train experts that will enhance the Shariah risk management practices through training policies in both Shariah and banking operation, proper qualification among staff and Shariah coordination in ensuring Shariah compliance to attract more customers.

Keywords: Shariah compliance, Shariah risk, Shariah risk management, Islamic banks

ABSTRAK

Amalan pengurusan risiko Shariah amat penting bagi kestabilan dan reputasi industri perbankan Islam. Oleh itu, tujuan kajian ini adalah untuk mengkaji faktor-faktor yang mempengaruhi amalan pengurusan risiko Shariah di kalangan bank-bank Islam di Malaysia. Kakitangan perbankan Islam di Jabatan Shariah lima (5) bank-bank Islam ditinjau melalui soal selidik. Seterusnya, maklumat tersebut digunakan untuk menilai sama ada amalan pengurusan risiko Shariah dipengaruhi oleh proses pengurusan risiko Shariah, penglibatan ahli lembaga Shariah, pengetahuan dan kepakaran. Selain itu, kaedah statistik termasuk regresi pelbagai telah digunakan untuk menguji hipotesis. Kajian ini mendapati bahawa tahap amalan pengurusan risiko Shariah di kalangan bank-bank Islam di Malaysia adalah sederhana. Dapatan lain, menunjukkan amalan pengurusan risiko Shariah dipengaruhi oleh proses pengurusan risiko Shariah, kepakaran dalam Shariah dan operasi perbankan oleh pekerja. Ini menerangkan bahawa apabila tahap proses pengurusan risiko Shariah dan kepakaran di kalangan kakitangan meningkat, tahap amalan pengurusan risiko Shariah juga akan meningkat. Sebaliknya, dua pembolehubah bebas didapati tidak memberi pengaruh yang besar ke atas amalan pengurusan risiko Shariah. Walaupun kadar tindak balas adalah 86.08%, itu merupakan kadar kepercayaan dan tidak semestinya diterjemah ke bentuk tindakan. Kajian ini memberi sumbangan yang amat penting kepada pemahaman akademik tadbir urus Shariah dalam konteks Malaysia yang menjadi panduan kepada pembuat dasar, bank-bank dan pelanggan. Dapatan kajian ini juga akan memberi kesedaran kepada pengawal selia untuk memperkukuh dan mengutamakan pematuhan Shariah dalam semua produk dan perkhidmatan perbankan Islam, seterusnya memberi keutamaan kepada pengurusan risiko Shariah. Di samping itu, ia adalah penting bagi institusi kewangan Islam untuk memperluas dan menyelaraskan proses pengurusan risiko Shariah melalui pemahaman tentang risiko Shariah, pengenalpastian dan pemantauan terhadap kemungkinan risiko dan memantau semua produk dan perkhidmatan untuk mengawal ketidakpatuhan Shariah. Akhir sekali, institusi kewangan Islam perlu melatih pakar-pakar yang akan meningkatkan amalan pengurusan risiko Shariah melalui dasar latihan dalam Shariah dan operasi perbankan, kelayakan yang bersesuaian di kalangan kakitangan dan penyelarasan Shariah dalam memastikan pematuhan Shariah untuk menarik lebih ramai pelanggan.

Keywords: Pematuhan Shariah, Risiko Shariah, Pengurusan Risiko Shariah, Perbankan Islam

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institution
BCBS	Basel Committee on Banking Supervision
BNM	Bank Negara Malaysia
CFA	Confirmatory Factor Analysis
DV	Dependent Variable
EFA	Exploratory Factor Analysis
GIFF	Global Islamic Finance Forum
IDB	Islamic Development Bank
IFI	Islamic Financial Institution
IFSA2013	Islamic Financial Services Act of 2013
IFSB	Islamic Financial Service Board
IFN	Islamic Finance News
IIFS	Institution offering only Islamic Financial Services
IV	Independent Variable
KFH	Kuwait Finance House
KLIFF	Kuala Lumpur Islamic Finance Forum
SB	Shariah Board
SBI	Shariah Board Involvement
SC	Shariah Compliance
SRM	Shariah Risk Management

CHAPTER ONE

Introduction

This chapter introduces the background of the global Islamic banking industry, particularly in Malaysia where this study was conducted. The chapter consists of seven parts. These parts highlight the problem statements, research questions and objectives, followed by the significance of the study, the scope of the study and definition of key terms. The chapter concludes with the explanation of the organization of the research.

1.1 Background of the Study

The Islamic banking sector has been the driving force of the global Islamic finance industry. In many Islamic countries, Islamic banking system remains as the core of financial services (Makiyan, 2008). The increasingly important role has been witnessed in connecting economies through the mobilization and channeling of funds for productive investment activities not just locally but internationally. It includes the increasing international participation in Islamic financial markets and improved cross-border activities which are based on the principles of Shariah.

The demand for Shariah-compliant products is increasing as the wealth of Muslims rises, spurred by the export-led Asian economic growth and crude oil income in the Persian Gulf. A report from the Global Islamic Finance Forum (GIFF) 2012 stated that there are currently more than 600 Islamic financial institutions worldwide that are located in more than 75 countries including Malaysia. According to Kuwait Finance House (KFH) research on Islamic finance outlook 2014, Islamic banking assets are expected to reach USD1.6 trillion by the end of 2014.

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