

FAQs on IFSB 10:

Guiding Principles on Sharī'ah Governance Systems for Institutions Offering Islamic Financial Services

Q 1. What are the main objectives of this standard?

Answer: The Guiding Principles on Sharī'ah Governance System standard is expected to:

- a. complement other prudential standards issued by the IFSB by highlighting in more detail to the regulatory and supervisory authorities in particular, and the industry's other stakeholders in general, the components of a sound Sharī'ah governance system, especially with regard to the competence, independence, confidentiality and consistency of Sharī'ah boards;
- b. facilitate better understanding of Sharī'ah governance issues and how stakeholders should satisfy themselves that an appropriate and effective Sharī'ah governance system is in place;
- c. provide an enhanced degree of transparency in terms of issuance, and the audit/review process for compliance with Sharī'ah rulings; and
- d. provide greater harmonisation of the Sharī'ah governance structures and procedures across jurisdictions, especially since there are increasing numbers of IIFS with cross-border operations.

(Paragraph 2)

Q 2. Does the Sharī'ah governance system replace the existing governance, control and compliance functions within an IIFS?

Answer: The Sharī'ah governance system does not replace the existing governance, control and compliance functions within an IIFS; rather, it complements them. For instance, in addition to having the board of directors (BOD), internal and external auditors, and regulatory and financial compliance officers' units/departments, an IIFS is required to have a Sharī'ah board, an internal Sharī'ah compliance review/audit (ISRU), external Sharī'ah compliance review/audit and internal Sharī'ah compliance unit respectively (ISCU).

(Paragraph 5)

Q 3. Do the requirements and recommendations in this standard replace or supersede those relating to the Sharī'ah governance system that may have been mentioned in other IFSB standards and guiding principles?

Answer: No. The IFSB standards and guiding principles shall draw upon and complement one another, and form a coherent prudential framework. The requirements and recommendations in this document do not, in any manner, contradict or supersede those relating to the Sharī'ah governance system that may have been mentioned in other IFSB standards and guiding principles

(Paragraph 6 (i))

Q 4. What is the most suitable Sharī'ah governance structure or model that should be adopted by IIFS in various jurisdictions?

Answer: The Sharī'ah governance structure adopted by the IIFS should be commensurate and proportionate with the size, complexity and nature of its business. Accordingly, no “single model” or “one-size-fits-all” approach applies in this case. The IFSB has consistently required in its standards and guiding principles that every IIFS shall have adequate and effective access to a Sharī'ah board, which will have a clear mandate and responsibility for ensuring that the IIFS adheres to Sharī'ah rules and principles with respect to any Islamic financial products and services it offers. In this respect, it is duly acknowledged that there are various Sharī'ah governance structures and models that have been adopted in different jurisdictions where IIFS are present. It is plausible, therefore, that supervisory authorities may tailor the Sharī'ah governance system adopted by IIFS in their respective jurisdictions to suit market realities and the stage of development of their Islamic financial services industry (IFSI). Each model may have pros and cons, and supervisory authorities should have a clear understanding of these and justification as to which model would suit their requirements. In this regard, the universal wisdom of “no single model” and “no single cure”, as advocated by the internationally recognised promoter of good governance, the Organisation for Economic Co-operation and Development (OECD), is relevant.

(Paragraphs 6 (ii) and 10)

Q 5. Various jurisdictions have developed their own unique approaches to Sharī'ah governance with the ultimate aim of ensuring compliance with Sharī'ah rules and principles. What are some of the approaches that are being practised in various jurisdictions?

Answer: Supervisory authorities in certain jurisdictions, in addition to requiring a Sharī'ah board at the institutional level, also have their own Sharī'ah boards that issue standardised Sharī'ah pronouncements/resolutions. Instead of establishing a Sharī'ah board at the supervisory level, a few other supervisory authorities take the view that each IIFS should have its own Sharī'ah board with a certain minimum number of members who must meet certain “fit and proper” criteria. Another stance taken by some supervisory authorities, mainly in secular jurisdictions, involves the role of the supervisor in reducing “market deficiencies” and the need for “consumer protection”. Accordingly, these authorities require that each IIFS has a properly functioning Sharī'ah governance system in place, and will seek reassurance that this is the case. Still other supervisory authorities require IIFS to have an effective system for managing the reputational risk related to Sharī'ah compliance and permit IIFS to decide for themselves what kind of Sharī'ah governance system to adopt.

(Paragraphs 11–12)

Q 6. Keeping in view the scarcity of qualified Sharī'ah experts, why is it that in some jurisdictions, supervisory authorities prohibit members of the centralised Sharī'ah board from sitting on a Sharī'ah board of the market players, and members of a Sharī'ah board are restricted in terms of the number of such boards they can serve on?

Answer: This restriction is intended to remove or minimise any perception of conflict of interest and to maintain an appropriate firewall to manage conflicts and preserve confidentiality. It is also intended to ensure that the members of a Sharī'ah board can dedicate adequate time and effort to each IIFS they serve.

(Paragraph 13)

Q 7. What are the relevant ex-ante processes that an IIFS needs to observe at the product design/development stage?

Answer: The relevant ex-ante processes include:

- a. issuing Sharī'ah pronouncements/resolutions; and
- b. conducting compliance checks.

(Paragraph 16)

Q 8. What are the relevant ex-post processes that should be observed at the product offering stage?

Answer: The relevant ex-post processes that should be observed at the product offering stage include internal Sharī'ah review and Sharī'ah governance reporting. These processes are necessary so that the IIFS will be able to monitor the consistency of its Sharī'ah compliance and effectively manage any Sharī'ah non-compliance risk that may arise over time.

(Paragraph 18)

Q 9. What are the minimum competencies required for an officer of the internal Sharī'ah compliance unit (ISCU) or internal Sharī'ah review/audit unit (ISRU), or for an internal Sharī'ah officer?

Answer: The minimum competencies for ISCU and ISRU officers shall include, among other things: (a) adequate training in Sharī'ah; (b) possession of additional qualifications in the area of finance or other relevant areas; (c) good communication skills to enable them to liaise and work effectively with the Sharī'ah board; and (d) good organisational skills to enable them to liaise and work with other units/departments in the IIFS.

(Footnote no. 20)

Q 10. How should the Sharī'ah board be appointed?

Answer: Taking into consideration the principles of good governance, prudent risk management and professionalism, the Sharī'ah board should be appointed formally in writing and with the terms of reference clearly set out. The appointment letter, which becomes the contract for service for the members appointed to serve on the Sharī'ah board of the IIFS, is the primary document that determines the form of relationship, level of fiduciary duties, and chain of accountability between the Sharī'ah board, the IIFS and its stakeholders. As it is legally a binding contract between the two parties, at the minimum, the terms of reference, as stated in Appendix 1, should be clearly set out.

(Paragraph 21)

Q 11. What are the criteria that the BOD of an IIFS needs to consider when assessing the fitness and propriety of individuals to serve on the Sharī'ah board, as well as officers of the ISCU and ISRU?

Answer: The BOD of an IIFS should consider the following criteria when assessing the fitness and propriety of individuals to serve on the Sharī'ah board, as well as officers of the ISCU and ISRU:

- a. good character – that is, honesty, integrity, fairness and reputation; and
- b. competence, diligence, capability and soundness of judgment.

It should be noted that the above list is not exhaustive and, accordingly, the BOD should consider all other relevant matters on a case-by-case basis – in particular, aspects that are relevant to the segments of the IFSI they are in, and the jurisdiction's legal and regulatory framework.

(Paragraph 27)

Q 12. The IIFS is responsible for facilitating the continuous professional development of persons serving on its Sharī'ah board, as well as its ISCU and ISRU. In what way can the IIFS fulfil this responsibility?

Answer: The IIFS can fulfil this responsibility by providing adequate training both initially and on an ongoing basis by ensuring that members of the Sharī'ah board and internal Sharī'ah officers receive appropriate training when they are first appointed. This training should include an orientation and induction programme to ensure that incoming members of the Sharī'ah board and internal Sharī'ah officers are familiar with the IIFS's business and governance practice. It is equally important that the IIFS provide further relevant training, particularly on relevant new laws, regulations and changing commercial risks.

(Paragraphs 32–34)

Q 13. How can the IIFS assess the effectiveness of the Sharī'ah board as a whole and of the contribution by each member?

Answer: The IIFS shall specify and adopt a process for assessing the effectiveness of the Sharī'ah board as a whole, as well as the contribution by each individual member to its effectiveness, by proposing objective performance criteria. Such performance criteria, which allow for comparison with industry peers, should be developed together and in consultation with the Sharī'ah board. These performance criteria should not be arbitrarily or unilaterally changed by the IIFS.

(Paragraph 37)

Q 14. Each IIFS should conduct a formal assessment of the effectiveness of its Sharī'ah board as a whole and the contribution by each member of the Sharī'ah board. The performance assessment report should be submitted to which organs within the IIFS?

Answer: The performance assessment report should be submitted to the BOD for observation and constructive comments. Where appropriate, an IIFS shall act on the results of the performance evaluation, such as considering nominations of new members to be appointed to the Sharī'ah board or seeking the resignation of any member of the Sharī'ah board who fails to meet adequately the terms and conditions of his or her contract.

(Paragraph 39)

Q 15. What does “independence” mean when referring to the Sharī‘ah board?

Answer: “Independence of the Sharī‘ah board” means the board’s ability to exercise sound judgment after fair consideration of all relevant information and views without influence from management or inappropriate outside interests. Moreover, the Sharī‘ah board should play a strong and independent oversight role, with adequate capability to exercise objective judgment on Sharī‘ah-related matters. No individual, or group of individuals, shall be allowed to dominate the Sharī‘ah board’s decision making.

(Paragraph 40)

Q 16. What is the appropriate and transparent process for resolving any differences of opinion between the BOD and the Sharī‘ah board?

Answer: The appropriate and transparent process for resolving any differences of opinion between the BOD and the Sharī‘ah board may include having direct access to the shareholders as a “whistle-blower”. This has to be done after duly informing the supervisory authority. The supervisory authorities may be involved in this process of resolving differences, without compromising the binding nature of the pronouncements/resolutions of the Sharī‘ah board.

(Paragraph 40)

Q 17. Under what circumstances can a Sharī‘ah board be considered independent?

Answer: A Sharī‘ah board can only be deemed independent when none of its members has a blood or intimate relationship with the IIFS, its related companies or its officers that could interfere, or be reasonably perceived to interfere, with the exercise of independent judgment in the best interests of the IIFS by the Sharī‘ah board.

(Paragraph 41)

Q 18. Paragraph 42 outlines examples of relationships that would deem a member of the Sharī‘ah board or a Sharī‘ah advisory firm to be perceived as not independent. What should the IIFS do if one or more of these relationships existed and yet the IIFS wishes to consider a member of the Sharī‘ah board or Sharī‘ah advisory firm as independent?

Answer: Regardless of the existence of one or more of these relationships, if the IIFS wishes still to consider a member of the Sharī‘ah board or Sharī‘ah advisory firm as independent, it should disclose in full the nature of that relationship and bear the responsibility for explaining why the member or the firm should be considered independent. The disclosure can be made, where appropriate, to the supervisory authority, or to the public through the annual report of the IIFS.

(Paragraph 43)

Q 19. What should a member of the Sharī‘ah Board do if some of the issues raised in paragraph 42 became unavoidable, resulting in a conflict of interest?

Answer: Wherever a conflict of interest is unavoidable, the member of the Sharī‘ah board or Sharī‘ah advisory firm should declare it in writing to the IIFS. Also, they must report any such conflict in regard to members of their family, business associates or companies in which they

have an interest. Moreover, the member of the Sharī'ah board or the Sharī'ah advisory firm involved should abstain from participating in the relevant decision or action on behalf of the IIFS.

(Paragraph 44)

Q 20. Should the Sharī'ah board rely purely on the information that is provided by the management of the IIFS to make its decisions?

Answer: No. Relying purely on what is volunteered by the management is unlikely to be enough in all circumstances, and further enquiries may be required if the Sharī'ah board is to fulfil its duties and responsibilities properly. Therefore, there is the need for the Sharī'ah board to have separate and independent access to the company's senior management, as well as the ISCU and ISRU, for all the information it needs, while adhering to obligations of confidentiality.

(Paragraph 46)

Q 21. What type of information may be considered confidential?

Answer: "Confidential information" is that information received by members of the Sharī'ah board or Sharī'ah advisory firm in the course of their duties that is not public and is not authorised to be made public. This includes information received under seal, expressly marked or designated by the IIFS to be kept confidential, or relating to the deliberative processes of the IIFS.

(Paragraph 52)

Q 22. Does the confidentiality obligation on the Sharī'ah board or internal Sharī'ah officers or Sharī'ah advisory firm end when a member of the Sharī'ah board or Sharī'ah advisory firm or the internal Sharī'ah officers cease to serve an IIFS, or when a matter is completed or closed?

Answer: Confidentiality obligations do not end when a member of the Sharī'ah board or Sharī'ah advisory firm ceases to serve an IIFS, or when a matter is completed or closed. Members of the Sharī'ah board and Sharī'ah advisory firms should observe the same restrictions unless they have obtained express authorisation from the IIFS that relieves them from such an obligation.

(Paragraph 54)

Q 23. What is the meaning of "consistency" as used in this standard?

Answer: Consistency has to do with the fact that members of the Sharī'ah board should be consistent in the opinions that they provide in serving on the Sharī'ah boards of different IIFS. Consistency in this respect is related to competence and independence, as well as being a matter of professional ethics.

(Paragraph 57)

Q 24. What are the steps that can be adopted by members of the Sharī'ah boards in order to be more consistent in their decisions?

Answer: In countries where there is a central authority issuing the Sharī'ah pronouncements/resolutions, the Sharī'ah board at the IIFS is usually required to follow and adopt

such Sharī'ah pronouncements/resolutions as are issued by that central Sharī'ah authority. In jurisdictions where there is no such body, it is recommended that the Sharī'ah board follows and adopts the Sharī'ah pronouncements/resolutions issued by internationally recognised bodies that issue authoritative opinions on Sharī'ah matters. If that is not possible, the Sharī'ah board should exercise its best efforts in documenting and publishing the Sharī'ah pronouncements/resolutions issued by it so that they can be openly assessed by the industry's stakeholders.

(Paragraph 60)

Q 25. What are the suggested means through which members of the Sharī'ah board may expand their knowledge and understanding of developments in the IFSI?

Answer: Members of the Sharī'ah board, from time to time, should participate in various seminars, workshops and meetings of scholars specialised in *fiqh al-mu'amalāt* to present and debate existing and new Sharī'ah pronouncements/resolutions. Also, they should consider participating in other similar events on banking and finance, *takāful*, capital markets, etc., which may be outside their Sharī'ah domains.

(Paragraph 61)