EXPOSURE DRAFT

IFSB–AAOIFI REVISED SHARĪ‘AH GOVERNANCE FRAMEWORK FOR INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES

31 MARCH 2022

Comments on this Exposure Draft should be sent to the IFSB’s Secretariat not later than 23 June 2022 at email public_consultation@ifsb.org
ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a lengthy due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which involves, among others, the issuance of exposure drafts, holding of workshops and, where necessary, public hearings. The IFSB also conducts research and coordinates initiatives on industry-related issues, as well as organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

For more information about the IFSB, please visit www.ifsb.org.
ABOUT THE ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCIAL INSTITUTIONS (AAOIFI)

AAOIFI, established in 1991 and based in Bahrain, is the leading international not-for-profit organisation primarily responsible for development and issuance of standards for the global Islamic finance industry. It has a total of 117 standards and technical pronouncements in issue in the areas of Shari’ah, accounting, auditing, ethics and governance for international Islamic finance. It is supported by over 200 institutional members, including central banks and regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, from over 45 countries. Its standards and technical pronouncements are currently followed by all the leading Islamic financial institutions across the world and have introduced a progressive degree of harmonisation of international Islamic finance practices. AAOIFI holds various public hearing events, conferences, roundtables, workshops, seminars, webinars to promote the Islamic banking industry and standardise the practices to the best interest of the industry. These events are attended by banking and finance professionals, Shari’ah scholars, leaders of Islamic financial institutions, professionals from audit firms, academicians and stakeholders from around the world.

For more information about AAOIFI, please visit www.aaoifi.com
**TECHNICAL COMMITTEE**

**Chairperson**

H.E. Dr. Fahad Ibrahim AlShathri – Saudi Central Bank  
*(from 9 June 2021)*

Mr. Khalid Al Kharji – Central Bank of United Arab Emirates  
*(until 15 September 2020)*

Mr. Waleed Al Awadhi – Central Bank of Kuwait  
*(until 4 June 2020)*

**Deputy Chairperson**

Mr. Saud Al Busaidi – Central Bank of Oman  
*(from 9 June 2021)*

Mrs. Madelena Mohamed – Bank Negara Malaysia  
*(until 2 May 2021)*

**Members**

<table>
<thead>
<tr>
<th>Name</th>
<th>Bank/Authority</th>
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<tbody>
<tr>
<td>Dr. Gaffar A. Khalid</td>
<td>Islamic Development Bank</td>
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<tr>
<td><em>(until 14 Dec 2021)</em></td>
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<tr>
<td>Mr. Syed Faiq Najeeb</td>
<td>Islamic Development Bank</td>
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<td>Bangladesh Bank</td>
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<td>Mr. Md. Nazrul Islam</td>
<td>Bangladesh Bank</td>
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<td>Mr. Md. Rezaul Islam</td>
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<td>Ms. Maksuda Begum</td>
<td>Bangladesh Bank</td>
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<td>Ms. Rafezah Abd Rahman</td>
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<td>Mr. Deden Firman Hendarsyah</td>
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<td>Dr. Jafar Jamali</td>
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<td>Mr. Alibek Nurbekov</td>
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<td>Mr. Anuar Kaliev</td>
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<td>Dr. Ali Abusalah Elmabrok</td>
<td>Central Bank of Libya</td>
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<tr>
<td>Mrs. Madelena Mohamed</td>
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<tr>
<td>Mr. Noraizat Shik Ahmad</td>
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<td>Mrs. Sharifatul Hanizah Said Ali</td>
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<td>Mr. Mohamed Triqui</td>
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<td>Mr. Ibrahim Sani Tukur</td>
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<td>Dr. Salisu Hamisu</td>
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<td>Dr. Waziri Mohammed Galadima</td>
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<tr>
<td>Mr. Ghulam Muhammad Abbasi</td>
<td>State Bank of Pakistan</td>
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<td>Mr. Hisham Saleh Al-Mannai</td>
<td>Qatar Central Bank</td>
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<td>Dr. Sultan Alharbi</td>
<td>Saudi Central Bank</td>
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<tr>
<td>Mr. Ahmed Asery</td>
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<tr>
<td>Mr. Abdulrahman Al-Hussayen</td>
<td>Capital Market Authority, Saudi Arabia</td>
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<tr>
<td>Mr. Bader Alissa</td>
<td>Capital Market Authority, Saudi Arabia</td>
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<tr>
<td>Mrs. Sumia Amer Osman Ibrahim</td>
<td>Central Bank of Sudan</td>
</tr>
<tr>
<td>Mr. Ömer Çekin</td>
<td>Banking Regulation and Supervision Agency of Turkey</td>
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<tr>
<td>Mr. Yavuz Yeter</td>
<td>Central Bank of the Republic of Turkey</td>
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<tr>
<td>Mr. Ali Çufadar</td>
<td>Central Bank of the Republic of Turkey</td>
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<tr>
<td>Dr. Yusuf Bora Enhoş</td>
<td>Central Bank of the Republic of Turkey</td>
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<tr>
<td>Mrs. Ilic Basak Sahin</td>
<td>Capital Markets Board, Republic of Turkey</td>
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<tr>
<td>Mr. Hüseyin Ünal</td>
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<tr>
<td>Mr. Abdulaziz Saoud Al Mualla</td>
<td>Central Bank of the United Arab Emirates</td>
</tr>
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<td>(from 10 December 2020)</td>
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</tbody>
</table>

*Names in alphabetical order of the country the member’s organisation represents, except international organisations, which are listed first.*
**IFSB–AAOIFI REVISED SHARĪʻAH GOVERNANCE FRAMEWORK FOR INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES**

**Chairpersons**

Dr. Gaffar A. Khalid – Islamic Development Bank (until 14 Dec 2021)
Mr. Abdulaziz Saoud Almualla - Central Bank of the United Arab Emirates (from 15 Dec 2021)
**Mr. Sohaib Umar – Central Bank of Bahrain**

<table>
<thead>
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<th>Organization</th>
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<td>Mr. Syed Faiq Najeep</td>
<td>Islamic Development Bank</td>
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<td><strong>Mr. Ebrahim Sidat</strong></td>
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<tr>
<td>Mr. Mohammed Al-Ghfais</td>
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<td>Dr. Obaid Al Zaabi</td>
<td>Emirates Securities and Commodities Authority</td>
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<td>**Mr. Mohammad Farrukh Raza</td>
<td>Islamic Finance Advisory and Assurance Services (IFAAS)</td>
</tr>
<tr>
<td>**Dr. Abdulbari Meshal</td>
<td>Raqaba</td>
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</table>

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** nominated by AAOIFI
# IFSB-AAOIFI JOINT SHARI'AH COMMITTEE

## Chairperson
Sheikh Muhammad Taqi Al-Usmani

## Deputy Chairperson
Sheikh Esam Mohammed Ishaq

## Members*

<table>
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<th>Name</th>
<th>Role</th>
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<td>Sheikh Dr. Aznan Hasan</td>
<td>Member</td>
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<tr>
<td>Sheikh Dr. Kahlan Alkharusi</td>
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<tr>
<td>Sheikh Prof. Koutoub Moustapha Sano</td>
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<tr>
<td>Sheikh Dr. Mohammed Burhan Arbouna</td>
<td>Member</td>
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<tr>
<td>Sheikh Mufti Mohammad Najeeb Khan</td>
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<td>Sheikh Dr. Muhammad Syafii Antonio</td>
<td>Member</td>
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<tr>
<td>Sheikh Dr. Osaid Kailani</td>
<td>Member</td>
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</table>

*In alphabetical order
AAOIFI Governance and Ethics Board (AGEB)

Chairperson

Mr. Farrukh Raza – Islamic Finance Advisory and Assurance Services (IFAAS) - IFIN (Islamic fintech)

Deputy Chairperson

Dr. Walid Hegazy – Hegazy and Partners

Members*

<table>
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<tr>
<td>Dr. Abdulbari Mashal</td>
<td>Raqaba Group</td>
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<td>Mr. Abdullah Almoqbel</td>
<td>Capital Market Authority (CMA)</td>
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<tr>
<td>Mr. Abozer Magzoub Mohammed</td>
<td>Islamic Development Bank Group IsDB</td>
</tr>
<tr>
<td>Dr. Ahmet Albayrak</td>
<td>Kuveyt Turk Participation Bank</td>
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<tr>
<td>Dr. Ali Sartawi</td>
<td>Palestine Islamic Bank</td>
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<tr>
<td>Mr. Ebrahim Sidat</td>
<td>Ernst &amp; Young Ford Rhodes (Former)</td>
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<tr>
<td>Ms. Ibtihal Alshamali</td>
<td>Capital Markets Authority</td>
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<tr>
<td>Prof. Mohammad Kabir Hassan</td>
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<tr>
<td>Mr. Wael Merza</td>
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<tr>
<td>Mr. Omar Mustafa Ansari</td>
<td>Secretary-General</td>
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<tr>
<td>Ms. Zahra Jassim</td>
<td>Executive Manager</td>
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<td>Ms. Alyaa Adel</td>
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<td>Dr. Bashir Aliyu Umar</td>
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<td>Mr. Syed Faiq Najeeb</td>
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8.1 Internal Shari‘ah Audit function

8.2 Roles and responsibilities

8.3 Fit and Proper Criteria

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9.1 Independent External Shari‘ah Audit

9.2 Fit and proper criteria

Principle 10: Islamic Windows

10.1 Special Considerations for Islamic Windows

10.2 Reporting and disclosure requirements

10.3 Other requirements

Principle 11: Islamic Subsidiaries/ Affiliates

11.1 Special Considerations for Islamic Subsidiaries/ Affiliates

Principle 12: Other Considerations

12.1 Special treatment for participatory stakeholders

12.2 Shari‘ah Compliance and Fiduciary Ratings

Principle 13: Applicability to Different Sectors

13.1 Islamic Capital Market (ICM)

13.2 Islamic Microfinance Institutions / Islamic Fintech Platforms / Other Organisations working for Financial Inclusion

Principle 14: Disclosure and Transparency

14.1 ICM

14.2 Takaful

DEFINITIONS

Appendix A: SSB Report Template

1. Introduction

2. Opinion

3. Our responsibilities

4. The responsibilities of the management and the Board of Directors

5. Other significant reporting matters

6. Report approval and authentication

7. Date and place of issuance of the report

Appendix B: SSB Performance Assessment Template
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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>AAOIFI</td>
<td>Accounting and Auditing Organization for Islamic Financial Institutions</td>
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<td>CSB</td>
<td>Central Shari’ah board</td>
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<td>IAH</td>
<td>Investment account holders</td>
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<td>ICIS</td>
<td>Islamic collective investment schemes</td>
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<td>Islamic capital market</td>
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<td>Independent external Shari’ah audit</td>
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<td>Islamic Financial Services Board</td>
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<td>IFSI</td>
<td>Islamic financial services industry</td>
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<td>IIA</td>
<td>Institute of Internal Auditors</td>
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<td>IIFS</td>
<td>Institutions offering Islamic financial services</td>
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<td>ISA</td>
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<td>International Standard on Assurance Engagements</td>
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<td>ISAF</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<td>RSA</td>
<td>Regulatory and supervisory authority</td>
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<td>SCF</td>
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LIST OF GUIDING PRINCIPLES FOR SHARĪʻAH GOVERNANCE FRAMEWORK

Principle 1: Sharīʻah Governance Framework

“An IIFS must have in place a comprehensive Sharīʻah Governance Framework which encompasses a set of institutional and/or system-wide arrangements for the effective and independent oversight of Sharīʻah compliance of its products/services, processes and business operations.”

Principle 2: Role of Regulatory and Supervisory Authorities

“The Regulatory and Supervisory Authorities shall have adequate understanding of Sharīʻah non-compliance risks and accordingly ensure that the IIFS have in place an adequate and effective Sharīʻah Governance Framework and reporting mechanism.”

Principle 3: Central Sharīʻah Board

“RSAs and/or governments are strongly recommended to establish and appropriately empower Central Sharīʻah Boards in order to harmonise Islamic banking and finance practices in the jurisdiction in line with Sharīʻah principles and rules.”

Principle 4: Unique Organs of Institutional Sharīʻah Governance Framework

“An IIFS must ensure that its Sharīʻah Governance Framework includes, at a minimum, these organs of governance: (i) Sharīʻah Supervisory Board; (ii) Sharīʻah Compliance Function; (iii) Internal Sharīʻah Audit Function; (iv) Independent External Sharīʻah Audit.”

Principle 5: Role of the Board of Directors and Senior Management

“An IIFS must clearly define the roles and responsibilities of its Board of Directors, Senior Management and other organs towards upholding the Sharīʻah compliance of its activities and operations.”

Principle 6: Sharīʻah Supervisory Board

“An IIFS must have in place an independent, competent, empowered and adequately resourced Sharīʻah Supervisory Board.”

Principle 7: Sharīʻah Compliance Function

“An IIFS must have in place a Sharīʻah Compliance function that is competent, empowered and adequately resourced to discharge its duties.”
Principle 8: Internal Shari’ah Audit Function

“An IIFS must have in place an Internal Shari’ah Audit function that is competent, empowered and adequately resourced to discharge its duties.”

Principle 9: Independent External Shari’ah Audit

“An IIFS should be subject to Independent External Shari’ah Audit.”

Principle 10: Islamic Windows

“An Islamic Window of a Conventional Financial Institution must have a suitable Shari’ah Governance Framework in place to ensure effective Shari’ah compliance of its operations.”

Principle 11: Islamic Subsidiaries/Affiliates

“An Islamic Subsidiary/Affiliate of a Conventional Financial Institution must have a suitable Shari’ah Governance Framework in place to ensure effective Shari’ah compliance of its operations.”

Principle 12: Other Considerations

“An IIFS is responsible to ensure that it prudently recognizes any additional considerations or exceptional circumstances which may require it to apply proportionality and/or other considerations towards implementation of the principles of this Standard.”

Principle 13: Applicability to Different Sectors

“The provisions of this Standard may be suitably implemented using the proportionality criteria and as per the relevance for different sectors of the Islamic finance industry.”

Principle 14: Disclosure and Transparency

“An IIFS shall be transparent in its Shari’ah governance to its shareholders, customers, other relevant stakeholders and market participants.”
SECTION 1: INTRODUCTION

1.1 Background

1. A unique feature of the operations of the institutions offering Islamic financial services (IIFS) is the need to have in place a robust Shari‘ah governance system that can ensure effective and timely implementation of Shari‘ah principles and rules in all their products, services and operations. The presence of a reliable Shari‘ah governance system is crucial since compliance with Shari‘ah is the primary principle that stakeholders of an IIFS expect to see in its operations.

2. Given the extent of developments in Shari‘ah governance practices globally, the Council of the Islamic Financial Services Board (IFSB), in its 33rd meeting (held on 6 December 2018 in Jeddah, Saudi Arabia), approved the IFSB Work Plan for 2019 which included, among other things, the preparation of a new standard, Revised Guiding Principles on Shari‘ah Governance Framework for Institutions offering Islamic Financial Services (“the RSGF Standard”, or “the Standard”). The IFSB Council also approved in principle for the IFSB to collaborate with the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) to jointly develop this new revised standard on Shari‘ah governance.

3. The objective behind this collaboration is to cater to the growing needs of the global Islamic finance industry in a more efficient and effective way and to avoid duplication of efforts from the two standard-setting bodies. The AAOIFI Governance & Ethics Board, in its ninth meeting (held in Bahrain on 7–8 November 2018), approved the proposed collaboration.

4. Importantly, the Standard intends to synergise the efforts of the two Islamic standard-setting bodies to provide consistent and harmonised Shari‘ah governance guidelines for stakeholders in the Islamic financial services industry (IFSI). To this end, the new standard shall supersede the existing guidelines on Shari‘ah governance by both the IFSB and AAOIFI and will serve as an updated and comprehensive benchmark for the industry.

5. A range of Shari‘ah governance models exist in the world today which differ in terms of their unique organs of Shari‘ah governance and their responsibilities. Most jurisdictions require each IIFS to have its own Shari‘ah supervisory board (SSB), along with internal mechanisms for Shari‘ah compliance and Shari‘ah audit. Some jurisdictions add a layer of independent external Shari‘ah audit (IESA). Increasingly, a central Shari‘ah body in the form of a central Shari‘ah board (CSB) is being introduced. A small number of jurisdictions have opted for a centralised Shari‘ah oversight model without individual SSBs. While each model has its own benefits and shortcomings, there is a need to harmonise Shari‘ah governance practices and to develop a mainstream model which can be broadly adopted by both mature and upcoming Islamic finance jurisdictions.
1.2 Objectives

6. The aim of this standard is to provide a revised set of guiding principles and rules on the key components of a sound and effective Shari`ah governance framework for IIFS.

7. The specific objectives of this standard are to:
   a. improve the quality of Shari`ah governance while optimising the costs by providing comprehensive guidance on minimum and best practices for various elements of Shari`ah governance;
   b. help regulatory and supervisory authorities (RSAs) and IIFS fulfil their fiduciary responsibilities towards the various stakeholders regarding Shari`ah compliance and governance;
   c. provide greater harmonisation of Shari`ah governance structures and practices across jurisdictions, especially since there are increasing numbers of IIFS with cross-border operations;
   d. provide a higher level of transparency in Shari`ah compliance of an IIFS by standardising and streamlining the process of issuance and implementation of Shari`ah rulings and audit of the implementation of the same;
   e. enhance public confidence in the Shari`ah compliance of IIFS and reduce the reputational risk of Shari`ah non-compliance through improved Shari`ah governance structure, greater transparency and more effective accountability; and
   f. complement the other standards issued by the IFSB and AAOIFI.

1.3 Scope and Approach

8. This standard applies to IIFS (including Islamic windows) in the Islamic banking, takāful (Islamic insurance) and Islamic capital market sectors. RSAs may choose to apply this standard to other IIFS in their jurisdictions. The Standard adopts a principle-plus-rule approach that provides a comprehensive set of Shari`ah governance practices for implementing each principle.

1.4 Implementation Date and Transitional Provisions

9. To encourage consistency in implementation of IFSB and AAOIFI standards across jurisdictions, it is recommended that RSAs implement this standard in their jurisdictions effective from 1 January 2024. In the case of IESA for public interest IIFS, the standard will become effective from the period beginning on or after 1 January 2027. During this period and for all other IIFS, IESA is strongly recommended. This takes into account an adequate pre-implementation period starting from the issuance date of this standard, for the standard to be embedded into national regulations and guidelines and, where applicable, implemented into supervisory practices. The degree of implementation of the standard in a particular jurisdiction may be dependent upon, and be without prejudice to, the general legal framework of that jurisdiction.
SECTION 2: GUIDING PRINCIPLES FOR SHARĪʻAH GOVERNANCE FRAMEWORK

Principle 1: Sharī`ah Governance Framework

“An IIFS must have in place a comprehensive Sharī`ah Governance Framework which encompasses a set of institutional and/or system-wide arrangements for the effective and independent oversight of Sharī`ah compliance of its products/services, processes and business operations.”

10. For the purpose of this standard, “Sharī`ah governance framework” refers to the “set of institutional and/or system-wide arrangements through which an RSA/IIFS ensures that there is an effective and independent oversight of Sharī`ah compliance of the IIFS’s products/services, processes and business operations”. This means that there exists a type of governance system which facilitates an IIFS to put in place measures to comply with Sharī`ah principles and rules in all its activities.

11. The Sharī`ah governance framework must include arrangements to incorporate effective and independent oversight of Sharī`ah compliance of the products offered by the IIFS. This entails, among other things, having in place effective procedures to design, structure and market these products while ensuring Sharī`ah compliance at all times. Besides products, Sharī`ah governance extends to systems and processes as well as people. Other important aspects include training the concerned staff and creating an overall culture of Sharī`ah compliance. In particular, there should be no violations of Sharī`ah standards or ethical values while selling and marketing products and dealing with customers.

12. Since IIFS market themselves to be Sharī`ah-compliant, attracting, in particular, religious and/or ethically sensitive customers, it is of paramount importance that IIFS are not only Sharī`ah-compliant in their operations, dealings and transactions, but are also perceived to be Sharī`ah-compliant by their stakeholders, including the general public. A major incidence of Sharī`ah non-compliance, or repeated failures in Sharī`ah governance, can result in financial and reputational loss to the IIFS. It may also have consumer protection and risk management implications for the jurisdiction (e.g. loss of consumer confidence and/or higher operational risk due to Sharī`ah non-compliance). In a worst-case scenario, it can lead to a systemic loss of confidence in all IIFS, causing financial stability concerns. A sound Sharī`ah governance framework, on the other hand, helps an IIFS to discharge its fiduciary and other responsibilities towards its stakeholders (including the general public) and leads to enhanced stakeholder confidence in its integrity and operations.

13. The main objectives of a Sharī`ah governance framework are to:
   a. provide a structure and a system for governing all the business activities of the IIFS in order to ensure Sharī`ah compliance at all times and at all levels;
   b. enable the IIFS to be acknowledged as Sharī`ah-compliant by the stakeholders, including the general public; and
   c. protect the IIFS from financial and reputational loss on account of Sharī`ah non-compliance.
Principle 2: Role of Regulatory and Supervisory Authorities

“The Regulatory and Supervisory Authorities shall have adequate understanding of Shari’ah non-compliance risks and accordingly ensure that the IIFS have in place an adequate and effective Shari’ah Governance Framework and reporting mechanism.”

2.1 Responsibilities of Regulatory and Supervisory Authorities

14. It is the responsibility of the RSAs to ensure effective Shari’ah governance of the IIFS in their jurisdiction. RSAs are expected to play their role in establishing and overseeing a robust Shari’ah governance system.

15. RSAs must allow Shari’ah-compliant financial services to be offered only by licensed IIFS, including Islamic windows.¹ To clarify, conventional financial institutions cannot offer Shari’ah-compliant financial services except through their Islamic windows.

16. RSAs are strongly recommended to develop suitable prudential guidelines² and requirements for the implementation of Shari’ah governance mechanisms in order to manage Shari’ah non-compliance risk by IIFS. RSAs shall consider adding suitable criteria enabling adequate Shari’ah governance (including Islamic finance knowledge, qualifications and experience) to complement the standard fit and proper criteria for the management and control positions of IIFS. RSAs shall ensure that the interests of the shareholders, investment account holders (IAHs) and other fund providers of IIFS are safeguarded, so that their funds, which are meant to have been collected with a promise of Shari’ah-compliant utilisation, are not utilised, directly or indirectly, for investing in/financing of conventional financial institutions (including the conventional parents of Islamic windows and Islamic subsidiaries/affiliates) or instruments.

17. RSAs need to create regulatory capacity that is commensurate with the size of their industry by investing in their own people and systems, and by enabling effective institutional arrangements to supervise, inspect and proactively guide the IIFS in the jurisdiction regarding Shari’ah governance.

18. In jurisdictions which have more than one RSA, the respective RSAs shall coordinate to implement the Shari’ah governance framework in a consistent manner.

19. In addition to the responsibilities assigned under different provisions of this standard, the RSA shall be responsible for:
   a. developing and implementing a continuing professional development programme for the RSA staff responsible for Shari’ah guidelines development and oversight of IIFS;
   b. providing all required resources, including an adequate budget and access to information and human resources, as may be deemed necessary by RSA staff as well as the CSB, for proper discharge of their duties; and
   c. fulfilling its duties and responsibilities towards the CSB (where it exists) by providing it full operational independence.

¹ For unique requirements related to Islamic windows, see Principle 10.
² In some jurisdictions, Shari’ah-compliant finance/banking may be called by a different name, such as “alternative finance”, “non-interest banking”, “participation banking/finance”, etc.
20. Unless otherwise specified by the RSAs, jurisdictions must follow the hierarchy of Sharī‘ah principles and rules set out below:
   a. Sharī‘ah standards issued by AAOIFI and Sharī‘ah-related requirements of the applicable financial accounting standards issued by AAOIFI;
   b. regulatory Sharī‘ah requirements (if any) issued by the regulator;
   c. Sharī‘ah rulings of the CSB (if any); and
   d. Sharī‘ah rulings of the IIFS’s SSB.
Principle 3: Central Sharī‘ah Board

“RSAs and/or governments are strongly recommended to establish and appropriately empower Central Sharī‘ah Boards in order to harmonise Islamic banking and finance practices in the jurisdiction in line with Sharī‘ah principles and rules.”

21. Central Sharī‘ah boards are increasingly becoming an important part of the overall Sharī‘ah governance in a jurisdiction.

22. If there is more than one CSB in a jurisdiction, each CSB shall have a clear scope of authority. There should be coordination between the CSBs to ensure an effective mechanism for harmonisation of the standards and resolutions issued (e.g. by having common chairpersons, common memberships, a coordination committee, periodic coordination joint meetings, etc.).

3.1 Appointment, Composition and Dismissal

Appointment

23. When constituting a CSB for the first time, or when reconstituting the CSB due to the adoption of this standard, the appointing authority may appoint members by considering factors relating to composition, independence, and fit and proper criteria as prescribed by this standard. A person shall not be eligible to become a member of a CSB if they are a member of an SSB or hold a permanent position with an IIFS operating within the jurisdiction of such CSB.

Subsequent appointments

24. For any subsequent appointment of the CSB, the appointing authority (the respective government or regulator) shall additionally take into consideration rotation requirements as well as outcomes of the performance evaluation process put in place in line with the provisions of this standard for individual members and for the CSB as a whole.

Nomination committee

25. If necessary, the appointing authority shall consider the formation of a nomination committee for the purpose of nominating suitable candidates for the CSB. The nomination committee, if formed, shall have adequate terms of reference aimed at improving the transparency of the appointment process.

Remuneration

26. The appointing authority shall be responsible for fixing and paying the remuneration of the CSB members while considering best practices and the suitability of remuneration with regard to ensuring the independence of individual members.

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3 A CSB is defined as a broad-level board or a similar body of specialised jurists in fiqh al-muamalat (Islamic commercial jurisprudence) and experts in Islamic banking, finance, economics, law, accounting, etc., providing guidance and advice on Sharī‘ah matters, with limited supervision, that is established in a specific country or jurisdiction in order to provide uniformity and harmony in the products and practices with regard to Islamic finance through Sharī‘ah rulings and guidelines. The CSB’s decisions are applicable on a broader base in the jurisdiction rather than to a single institution. The term “central Sharī‘ah board” as used in this standard includes national Sharī‘ah boards.
Terms of reference for appointment

27. The terms of reference for appointment shall be defined by the appointing authority in line with the requirements of this standard, duly considering the laws and regulations in force, which shall be ratified by the CSB in its first meeting after appointment/reappointment.

Tenure of the CSB’s term and reappointments

28. The term of the CSB is recommended to be between three and five years.

29. There shall be a rotation policy carefully devised by the appointing authority which shall consider, among other things, maintaining independence, continuity of the CSB to a reasonable extent, succession planning, and improved level of governance and performance evaluation of the CSB, as well as determining a suitable cooling-off period for reappointment.

Composition

30. The CSB shall be comprised of Sharī`ah scholar members and expert members, as per guidelines provided in this standard (see section 6.2, “Fit and Proper Criteria” of Principle 6: “Sharī`ah Supervisory Board”). However, expert members cannot become a chairperson or deputy chairperson of a CSB.

31. The recommended number of total CSB members, based on market factors, is:
   a. in the case of a CSB catering to a single industry segment (e.g. banking or insurance): a minimum of five members; and
   b. in the case of a CSB catering to multiple industry segments: a minimum of seven members.

32. For any decision to be taken, there shall be a proper quorum in which a majority of Sharī`ah scholars consistent with their proportion in the composition of the CSB shall be present. However, in the case of a Sharī`ah ruling (which is a Sharī`ah matter in view of the chairperson), only the Sharī`ah scholar members can vote.

Removal and termination

33. The appointing authority may decide to remove/terminate engagement of a member of the CSB, after providing them with an adequate opportunity to be heard, if and only if:
   a. professional misconduct is proven against such a member, or if they are in breach of a principal term of reference; or
   b. the member has not attended the minimum number of meetings during the year without a legitimate reason.

3.2 Functions of the CSB

34. CSBs shall generally focus on harmonising Islamic banking and finance practices in their respective jurisdictions. This is normally done through:
   a. the adoption of AAOIFI Sharī`ah standards and/or other widely accepted Sharī`ah standards which do not conflict with AAOIFI Sharī`ah standards; and
b. the provision of principles, rulings, guidelines and other functional support to IIFS and RSAs in their respective jurisdictions as prescribed in this standard, primarily and in line with the standards of the IFSB and AAOIFI and considering global practices and local context.

35. Functions of the CSB may be divided into three broad categories:
   a. advisory and fatwa (rulings);
   b. advisory for regulations; and
   c. oversight and limited supervision.

36. The decisions of the CSB shall be by a majority of votes at a meeting duly constituted with the requisite quorum.

Advisory and fatwas

37. The advisory function of a CSB is the function of supporting the RSA through the following:
   a. providing advice on specific issues and matters relating to Islamic banking and finance, as referred to it by the RSA (e.g. defining broad principles for profit and loss calculation and distribution among IAHs);
   b. subject to its approval/acceptance, providing Shari`ah expertise to the courts of law, when requisitioned, for any issues related to Islamic banking and finance; and
   c. providing advice to the regulator to resolve and settle relevant complaints and issues raised by customers and/or other stakeholders of IIFS or disputes among IIFS with regard to Shari`ah matters.

38. The fatwa function of a CSB is the function of supporting the RSA through the following:
   a. issuing fatwas and decisions in relation to its area of work;
   b. approving sukuk structures and documentation for sovereign and government sukuk (or any other facility or instruments offered by the central bank – for example, liquidity management instruments, financier of last resort facility, deposit protection schemes, etc.), as referred to it by the RSA; and/or
   c. validating product structures and their documentation, services and tools offered by IIFS, as referred to it by the regulator.

39. Most of the functions of a CSB related to advisory and fatwa are passive (reactive) in nature; that is, the CSB provides fatwa, advice or guidance only when asked for it by the RSA. The CSB shall be proactive in nature when, and only when, the following conditions are met:
   a. it concludes that a major non-compliance with Shari`ah principles and rules has occurred, which has not been taken care of by the RSA; and
   b. it concludes that a perception in the market exists that such non-compliance is with the knowledge, or the due approval, of the CSB.

Regulations

40. The regulations-related function of a CSB is of an advisory nature (or in a capacity as per the legal framework of the respective jurisdiction) which supports the RSA through the following:
a. adopting AAOIFI Sharī`ah standards for the jurisdiction and/or setting up the Sharī`ah regulations for the jurisdiction, as applicable;
b. providing Sharī`ah consultation to the regulators, government and relevant authorities with regard to various laws, rules and regulations;
c. reviewing and approving the regulatory body’s directives related to Islamic finance to ensure Sharī`ah compliance;
d. approving a code of ethics for IIFS – for example, by adopting AAOIFI Code of Ethics for Islamic Finance Professionals (for individuals) and the IFSB Code of Conduct (at the institutional level); and
e. coordinating with other CSBs and relevant bodies to establish uniform best practices in the areas relating to Islamic banking and finance.

Oversight and limited supervision

41. The oversight and supervision-related functions of CSBs support the RSA through the following:
   a. settling any difference of opinion or disagreement between the SSBs of IIFS and the regulator;
   b. supervising and guiding the Sharī`ah compliance inspection and surveillance function of the regulator and providing Sharī`ah views on the key issues brought before it; and
   c. holding periodic meetings with the SSBs of IIFS on an as-needed basis, as determined by the CSB (but at least once a year), to discuss common concerns and developments for the industry, including fiqh issues and their solutions with regard to key Islamic banking and finance matters, specifically with reference to the direction of product innovation in the jurisdiction. The RSA shall provide/arrange the logistical support for this purpose.

Secretariat

42. In order to facilitate the work and functions of the CSB, a secretary shall be appointed from among the members of the CSB or officers of the RSA, or an individual may be specifically employed for this purpose, subject to the approval of the CSB.

43. The secretary shall:
   a. maintain the records of the CSB, including the record of minutes and resolutions/rulings;
   b. be responsible for all communication with the RSA and other parties; and
   c. supervise and coordinate the research function as needed to support the functioning of the CSB.

44. The RSA shall provide the secretary with the resources and a team as may be needed and as requested for the purpose by the CSB.
Performance assessment and reporting

45. The CSB shall conduct assessment and evaluation of its performance from time to time, but not later than on an annual basis. For this purpose, the CSB shall develop performance assessment criteria for individual members and for the CSB collectively and shall agree the same with the appointing authority beforehand. (See Appendix B for a performance assessment template.) This evaluation is to ensure that the CSB is able to discharge its functions and responsibilities over the period of assessment.

46. A report of annual performance of the CSB, along with performance assessment, shall be prepared and submitted by the CSB to the appointing authority.

47. The CSB and the appointing authority/RSA shall coordinate in order to agree on the report (or a summary thereof) to be made public, so as to enhance stakeholder confidence in the system.

Confidentiality

48. The CSB and its members shall maintain confidentiality of information and documents at all times, except regarding anything that is already in the public domain or when information or documents are requisitioned by a court of competent jurisdiction or any proceedings of a regulatory nature in the due process of law. For this purpose, detailed guidelines may be provided by the appointing authority; or, in the absence of the same, the CSB may itself develop such guidelines.
Principle 4: Unique Organs of Institutional Sharī`ah Governance Framework

“An IIFS must ensure that its Sharī`ah Governance Framework includes, at a minimum, these organs of governance: (i) Sharī`ah Supervisory Board; (ii) Sharī`ah Compliance Function; (iii) Internal Sharī`ah Audit Function; and (iv) Independent External Sharī`ah Audit.”

49. The Sharī`ah governance framework must consist, at a minimum, of the following components/organisms:
   a. a Sharī`ah supervisory board;
   b. Sharī`ah compliance function;
   c. internal Sharī`ah audit function; and
   d. independent external Sharī`ah audit.

However, an independent external Sharī`ah audit is mandatory for public interest IIFS after a period of three years from the effective date of this standard. During this period, and for all other IIFS, compliance with this principle is strongly recommended.

50. Since the start of the contemporary IFSI in the 1970s, SSBs have been the most common way to seek Sharī`ah-related guidance by the IIFS. SSBs are comprised of Sharī`ah scholars who are engaged professionally by IIFS to provide guidance and supervision, including on Sharī`ah rulings related to products, transactions, operations, etc. To guide the day-to-day operations from a Sharī`ah compliance perspective, an individual with a Sharī`ah background and knowledge is also considered necessary by most IIFS as a Sharī`ah compliance officer.

51. The Sharī`ah compliance function provides the mechanism for ensuring compliance of the IIFS’s financial arrangements, contracts and transactions with Sharī`ah principles and rules. It is an integral part of an IIFS’s governance and control structure. “Sharī`ah compliance department” – for the purpose of this standard – means a department (and includes a division, team, section or unit) entrusted with the responsibilities of Sharī`ah compliance in accordance with this standard.

52. The internal Sharī`ah audit function is part of the governance organs of an IIFS, being independent of management, with the primary objective to provide assurance to the board and the SSB in relation to the IIFS’s adherence to Sharī`ah principles and rules. Internal Sharī`ah audit assesses the adequacy and effectiveness of intended controls pertaining to adherence to Sharī`ah guidelines, whereas the Sharī`ah compliance function is an ongoing process of monitoring the IIFS’s overall activities and Sharī`ah compliance environment.

53. IESA provides an independent third-party assurance to the stakeholders of an IIFS about its compliance with Sharī`ah principles and rules. IESA has become a good-practice tradition globally and is increasingly considered essential for safeguarding the integrity, reputation

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4 Principle 6 in this standard.
5 Principle 7 in this standard.
6 Principle 8 in this standard.
7 Principle 9 in this standard.
8 In some jurisdictions it is called a “Sharī`ah supervisory committee” or a “Sharī`ah advisory committee”, or similar.
9 The word “scholar” has been preferred as a direct translation for “alim” (plural: ulama), which connotes a person who is learned and expert. In the context of the IIFS, this standard refers to a more specialised level within fiqh al-muamalat (Islamic commercial jurisprudence). Furthermore, that specialisation is dedicated towards providing expert opinions in the form of Sharī`ah pronouncements/resolutions related specifically to Islamic financial services and is usually not related directly to the general public or businesses more widely.
and sustainability of IIFS, especially those categorised as public interest entities (e.g. retail banks and *takaful* companies).
Principle 5: Role of the Board of Directors and Senior Management

“An IIFS must clearly define the roles and responsibilities of its Board of Directors, Senior Management and other organs towards upholding the Sharī‘ah compliance of its activities and operations.”

54. A comprehensive Sharī‘ah governance framework demands the creation of some new organs and the assigning of additional responsibilities to existing organs. It is important to note that Sharī‘ah compliance is the responsibility of each stakeholder of an IIFS and cannot simply be delegated to a few (e.g. the SSB).

5.1 Board of Directors

55. The board of directors (“the board”) of an IIFS has an oversight responsibility to ensure that an effective and robust Sharī‘ah compliance environment and culture exist at the IIFS. The board is responsible for establishing a good governance and control framework for the institution, for developing a strategy for compliance with Sharī‘ah principles and rules, and for oversight of the management in implementing the same and in achieving the desired objectives. The board may use any of its dedicated committees to assist for the purpose of fulfilling its responsibilities under this standard.

5.1.1 Responsibilities

56. The board has the ultimate responsibility of institutionalising a robust Sharī‘ah governance framework at the IIFS that is commensurate with the size, complexity and nature of the business (to be comparable with other governance and control functions). In fulfilling this role, the board shall:
   a. approve policies relating to governance structure and reporting arrangements, Sharī‘ah non-compliance risk management, and other areas that are material to the effective implementation of Sharī‘ah governance within the IIFS;
   b. oversee the implementation of the CSB’s rulings (if any) and decisions, rulings and guidance of the SSB within all business and functional lines, including any business or risk implications arising from such implementation;
   c. oversee the implementation of the internal control framework (including ensuring the independence of Sharī‘ah compliance and internal Sharī‘ah audit functions) to prevent systematic Sharī‘ah non-compliance and any rectification measures to resolve incidences or circumstances of Sharī‘ah non-compliance or that may result in Sharī‘ah non-compliance;
   d. oversee the performance of senior management and other officers entrusted to implement the Sharī‘ah governance framework such that the board is satisfied that the measures of their performance are aligned with Sharī‘ah governance objectives; and
   e. promote a sound corporate culture which reflects the importance of adhering to Sharī‘ah requirements in product development and marketing, strategy formulation, business operations, risk management practices and other aspects that promote end-to-end compliance with Sharī‘ah principles and rules.

These requirements also apply to the board of directors of a conventional financial institution housing an Islamic window.
57. A board member must continuously develop and strengthen their knowledge and understanding of Islamic finance, as well as keep abreast of the developments that may impact Islamic financial business, to fulfil their responsibility to the IIFS.

5.1.2 Interaction with the SSB

58. The board must have due regard for any decision or advice of the SSB on any Shari‘ah issues relating to the products, transactions, operations, processes or activities of the IIFS. This duty requires the board to:
   a. give sufficient attention to the facts, rationale and basis for any decisions or advice of the SSB before arriving at its own decision;
   b. give fair consideration to the implications of implementing any decisions or advice of the SSB;
   c. put in place a conflict resolution mechanism to deal with any differences in views between the board and the SSB; and
   d. maintain a record of deliberations between the board and the SSB in matters where differences in views exist, and their resolution.

59. The board must take reasonable steps to ensure that the SSB is free from any undue influences that may hamper its members from exercising their professional objectivity and independence in deliberating issues brought before them.

60. The board must establish a written policy to identify, assess and manage any conflicts of interest arising from any additional activities or services performed by any SSB member for the IIFS, or their other external professional commitments. This shall include policies relating to the involvement of an SSB member in the provision of consultancy services to any clients of the IIFS, with or without remuneration.

61. The board must establish effective communication with the SSB on all matters relating to Shari‘ah requirements, Shari‘ah governance and Shari‘ah non-compliance risk to enable both parties to effectively discharge their respective responsibilities under the Shari‘ah governance framework. The board must regularly review the quality and frequency of its engagement with the SSB.

62. The board must allocate sufficient resources for continuous development of skills and expertise of the SSB. This shall include allocating an adequate budget, having in place plans for the professional development of SSB members, and regularly updating such plans to ensure that each member possesses the requisite knowledge and skills to fulfil their responsibilities.

63. The board must establish a formal process to assess, at minimum annually, the performance and effectiveness of the SSB and each of its members. The assessment must consider the competence, knowledge and contribution of each member to the overall functioning of the SSB. (See Appendix B for a performance assessment template.) However, in no case shall the board or the senior management perform such an assessment, except to the extent of administrative assessment.

64. The board shall seek periodic authorisation from the shareholders to fix and review the SSB members’ remuneration.
5.2 Senior Management

65. Senior management has the responsibility to implement the Shari‘ah governance framework and to ensure that Shari‘ah compliance is embedded in the day-to-day functioning of the IIFS. The management is responsible for ensuring that the operations of the institution, particularly the financial arrangements, contracts and transactions entered into by the institution with its customers and other stakeholders and related policies and procedures, are, in substance and in their legal form, in compliance with the requirements of Shari‘ah principles and rules. The management is also responsible for the design, implementation and maintenance of appropriate internal control procedures with respect to such compliance and maintenance of relevant accounting records. It is the management’s responsibility to design and implement, with the support of the SSB and/or the Shari‘ah compliance department as appropriate, an effective continuous professional development and training programme for the board, the management and other organs of Shari‘ah governance, as well as for the employees of the IIFS.

66. The chief executive officer (CEO) or equivalent, leading the senior management, has primary responsibility for the day-to-day management of the IIFS. In fulfilling the senior management’s responsibility towards Shari‘ah compliance, the CEO and the senior management must:
   a. establish a management structure and reporting arrangement that provides a clear scope of accountability between the business lines and the internal control functions that are involved in managing Shari‘ah non-compliance risk, including the accountability of the head of the Shari‘ah compliance department or unit;
   b. implement effective Shari‘ah governance policies, procedures and practices in accordance with the direction given by the board;
   c. implement the rulings of the CSB (if any);
   d. implement the decisions, rulings and guidance of the SSB;
   e. implement an effective communication policy that supports a sound understanding of Shari‘ah matters across the IIFS;
   f. conduct regular assessment to evaluate the quality of operational support provided to the SSB and address inadequacies (if any); and
   g. report to the board, on a timely basis, any significant Shari‘ah non-compliance incidents.

67. Each member of senior management of an IIFS must continuously develop and strengthen their knowledge and understanding of Islamic finance, as well as keep abreast of the developments that may impact Islamic financial business.

68. Senior management has overall responsibility for:
   a. cooperating fully with the SSB and other organs of Shari‘ah governance to fulfil their responsibilities;
   b. providing complete and accurate information to the SSB prior to all meetings and on an ongoing basis such that it allows the SSB reasonable time to review and fully understand the information;
   c. providing the SSB, the Shari‘ah compliance function, the internal Shari‘ah audit function and independent external Shari‘ah auditors (as applicable) complete and
unhindered access to all records, transactions and information from all sources, including professional advisers and IIFS’s employees;
d. observing and implementing Sharī‘ah rulings and decisions of the SSB;
e. ensuring that Sharī‘ah guidelines and fatwas issued by the SSB are accessible at all times to those involved in the actual implementation process as well as other stakeholders;
f. ensuring that the information provided includes background or explanatory information relating to matters to be brought before the SSB. As far as possible, such information shall be presented in a manner that would assist the SSB to analyse not only the form of, but also the substance surrounding, the issues brought before them;
g. preparing a statement of compliance with Sharī‘ah principles and rules for the stakeholders, testifying that it has followed the relevant Sharī‘ah standards and rulings, implemented a sound Sharī‘ah governance system including internal controls, fulfilled all the relevant contractual obligations, complied with the relevant code of ethics, etc. A sample management report is available with AAOIFI Auditing Standard no. 6: *External Sharī‘ah Audit*;
h. promptly notifying the Sharī‘ah compliance department if a case of Sharī‘ah non-compliance comes to the management’s attention, and acting on their advice to rectify the situation;
i. ensuring that appropriate and timely disclosure is made to the stakeholders whenever the SSB departs from or revises any of its Sharī‘ah rulings;
j. ensuring that there is a continuous professional development programme for the SSB and providing adequate support and assistance in line with the requirements in paragraph 101; and
k. appointing an independent secretariat to serve the SSB, or entrusting the Sharī‘ah compliance function with this task. The secretariat has the responsibility to provide operational support for effective functioning of the SSB, which includes:
   • providing operational and administrative support to the SSB;
   • performing research and studies on Sharī‘ah issues as requested by the SSB;
   • coordinating between the SSB and the management/board; and
   • ensuring proper dissemination of decisions and rulings of the SSB within the IIFS.
Principle 6: Sharīʻah Supervisory Board

“An IIFS must have in place an independent, competent, empowered and adequately resourced Sharīʻah Supervisory Board.”

6.1 Appointment and Composition

69. Each IIFS must have a Sharīʻah supervisory board consisting of at least three Sharīʻah scholars specialised in *fiqh al-muamalat* (Islamic commercial jurisprudence). For SSBs consisting of more than three members, professionals who are experts in related fields (e.g. finance, banking, accounting, economics, law) may preferably also be appointed as members. However, the majority of the members shall always be the Sharīʻah scholars.

70. The composition of an SSB should preferably reflect diversity, including representation from different schools of thought in the country, representation of different fields of expertise, knowledge and experience relevant to Islamic finance industry, and both senior and junior scholars.

71. The SSB members shall be approved by the shareholders in their general meeting at the recommendation of the board of directors.

72. The appointment of the SSB members shall be made formally in writing by way of a contract for service for a minimum term of three years but no longer than five years.

73. A rotation policy shall be approved by the general assembly, which shall consider, among other things, maintaining independence, continuity\(^{11}\) of the SSB to a reasonable extent, succession planning and improved level of governance and performance assessment of the SSB, as well as determining a suitable cooling-off period for reappointment. In all cases, no SSB member shall serve the same IIFS (or any of its subsidiaries) for more than nine years consecutively. Such an SSB member shall be eligible for a reappointment to serve the same IIFS after a cooling-off period of at least one term. SSB members that are currently continuing for more than eight years, as of the time of the effective date of this standard, shall have two years to comply with this requirement.

74. Shareholders may periodically authorise the board to fix the remuneration of the SSB. Such remuneration shall be disclosed for each SSB member in the IIFS’s annual report.

75. The regulator, at its discretion, may appoint a temporary SSB if an IIFS fails to appoint the SSB within the stipulated time. The cost of such an appointment shall be borne by the IIFS.

76. The SSB shall refer to the board of directors for any administrative matters. However, it shall be completely independent in its function as the SSB.

6.2 Fit and Proper Criteria

77. The IIFS shall consider the following criteria when assessing the fitness and propriety of individuals to serve on the SSB as Sharīʻah scholar members:

a. Muslim individuals;

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\(^{11}\) “Continuity” means that not all SSB members retire at the same time.
b. well-versed in fiqh and usul al fiqh;
c. Sharī‘ah-related (preferably fiqh-related) academic qualification (equivalent of a master’s degree or above) from a recognised educational institution;
d. suitable practical experience or research and academic experience (at least 10 years) in the area of fiqh al-muamalat;
e. suitable practical experience, or research and academic experience, in the fields of Islamic finance, economics, banking, law, business or other relevant fields;
f. good command of Arabic and common business language(s) in the jurisdiction;
g. reasonable understanding of economics, law, banking, finance and/or related fields;
h. demonstrable interest in and commitment to the field of Islamic banking and finance, and not having anomalous opinions in contradiction of the well-established contemporary scholarly consensus as contained in the Shari‘ah principles and rules (as defined in this standard);
i. good understanding of legal and regulatory framework of the jurisdiction related to the financial sector;
j. good character, reputation and market recognition;
k. ability to devote sufficient time; and
l. independent and free from conflict of interest.

78. The following criteria shall be considered when assessing the fitness and propriety of individuals to serve on the SSB as expert members:
a. Muslim individuals;
b. basic understanding of Sharī‘ah principles and, preferably, an appropriate understanding of fiqh al-muamalat as applicable to Islamic banking and finance;
c. well-versed and having a high standing in their respective field of expertise;
d. suitable academic (master’s degree or above) and/or professional qualification;
e. suitable practical experience, or research and academic experience in the relevant technical field(s) such as economics, law, banking, finance and/or related fields (preferably 15 years, but not less than 10 years);
f. good understanding of legal and regulatory framework of the jurisdiction related to the financial sector;
g. good command of common business language(s) in the jurisdiction;
h. demonstrable interest in and commitment to the field of Islamic banking and finance;
i. good character, reputation and market recognition;
j. ability to devote sufficient time; and
k. independent and free from conflict of interest.

79. Expert members shall have a demonstrable commitment to the cause of Islamic finance and a considerable level of understanding of the functions of Islamic banking and finance by virtue of relevant education, research or practical experience.
80. IIFS are strongly encouraged to appoint expert members, as this will improve the understanding of the SSB of the broader picture, provide diversified exposure, and enable the SSB to more effectively discharge its functions and duties.

81. Honesty, integrity and fairness are some of the key components of good character. In determining a person’s character and to guide the criteria to be applied before appointing someone to serve on the SSB, the IIFS shall put in place a transparent process that considers all the appropriate factors, including, but not limited to, whether the person:
   a. has been convicted of a criminal offence, particularly an offence relating to dishonesty, fraud or financial crime;
   b. has been the subject of any adverse findings or any settlement in civil proceedings, particularly in connection with banking or other financial business, misconduct, fraud, or any business in which the person is a controlling shareholder or has a controlling interest or exercises significant influence has been investigated and disciplined or suspended by a regulatory or professional body, a court or tribunal, whether publicly or privately;
   c. has been the owner, manager or director of a company, partnership or other organisation that has been refused registration, authorisation, membership or a licence to conduct trade, business or a profession, or has had that registration, authorisation, membership or licence revoked, withdrawn or terminated, resulting in the person being refused the right to carry on a trade, business or profession requiring such a licence, registration or other authorisation;
   d. has been a director, partner or otherwise involved in the management of a business that has gone into receivership, insolvency or compulsory liquidation while the person was connected with that organisation or within a reasonably short period (e.g. one year) after the person’s departure from the institution;
   e. has been dismissed, asked to resign, or resigned from employment or from a position of trust, fiduciary appointment or similar position because of questions about honesty and integrity;
   f. has ever been disqualified from acting as a director or serving in a managerial capacity because of wrongdoing;
   g. has not been fair, truthful and forthcoming in dealings with customers, superiors, auditors and/or regulatory authorities in the past and/or has been the subject of any justified complaint relating to regulated activities; or
   h. demonstrates unwillingness to comply with the requirements and standards of the regulatory system and other legal, regulatory or professional requirements and standards.

82. The IIFS shall ensure that members of the SSB demonstrate the competence and ability to understand the technical requirements of the business, the inherent risks therein and the management processes required to conduct its operations effectively, with due regard to the interests of all stakeholders. In assessing the competence and capability of a person, all relevant factors should be considered, including, but not limited to, whether the person:
   a. has demonstrated, through qualifications and experience, the capacity to successfully undertake the responsibilities of the position;
   b. is mentally fit to perform their duties;
c. has sound knowledge of the business; and

d. can allocate sufficient time and attention to the IIFS, taking into account their existing SSB memberships with other organisations, employment or other commitments of time.

83. SSB members are expected to continuously develop themselves both in terms of Shari'ah knowledge and the understanding of business, financial, accounting, economic and legal developments relevant for the IIFS they are meant to serve. They shall agree with the management on an annual professional development programme. RSAs are encouraged to oversee that the training programme for SSB members is adequate and appropriately implemented.

6.3 Roles and Responsibilities

84. The SSB must be vested with appropriate power and authority as may be necessary to perform its duties and responsibilities effectively.

85. The SSB shall issue Shari'ah rulings which shall be binding on the IIFS.

86. The SSB must supervise the IIFS’s operations, transactions and processes to ensure compliance with Shari'ah principles and rules. Accordingly, the following shall apply:

   a. All relevant documentation for products and services, including contracts, agreements, marketing and promotional materials or other legal and operational documentation used in the IIFS’s business transactions, must be approved by the SSB.

   b. All policies and procedures relating to the IIFS must be reviewed and approved by the SSB, with regard to any Shari'ah compliance consideration.

   c. The SSB must oversee and approve the profit/loss calculation and distribution to the IAHs.

   d. The SSB must review and approve the accounting treatment of products and services with regards to Shari'ah.

   e. The SSB must review and approve the IIFS’s annual zakāh calculations on behalf of the shareholders (and participatory stakeholders, if applicable).

   f. The SSB must review the reports and observations of the Shari'ah compliance function, internal Shari'ah audit function and IESA (where applicable) and provide advice on such reports and observations.

   g. The SSB must provide their input to the annual plans of internal Shari'ah audit (to be approved by the audit committee).

   h. The SSB must specify the means of disposal of earnings that have been realised from sources or by means prohibited by Shari'ah principles and rules. The SSB must also verify the correct use of such income for appropriate charitable causes. The SSB shall take measures to systematically reduce or eliminate the occurrence of such Shari'ah non-compliant income in the future.

87. The SSB must establish a robust methodology to guide its decision-making process. The SSB must take into account relevant business realities/practices and related risks as well as consumer protection concerns in arriving at its decisions.
88. SSB members shall exercise appropriate discretion in decision making by keeping in mind both the technical aspects of Shari’ah and the objectives of Shari’ah (maqasid al Shari’ah). They shall pay attention to both the legal requirements and the ethical dimensions of their decisions.

89. If a case of Shari’ah non-compliance is identified within the IIFS, the SSB must undertake the following steps at a minimum:
   a. Take corrective action, if the correction is feasible.
   b. Take remedial action to deal with the consequences of Shari’ah non-compliance (if correction is not feasible).
   c. Take preventive measures to avoid recurrence of the same/similar issue in the future.

90. SSB members must not have competing time commitments that may impair their ability to discharge their duties effectively. In respect of multiple appointments, SSB members are required to manage their commitments effectively and to observe confidentiality in carrying out their duties.

91. SSB members are, and shall remain, individually responsible for their own work as members of the SSB (irrespective of any delegation or reliance on other members of the SSB).

92. The SSB shall be accountable for the quality, accuracy and soundness of its decisions.

93. If the SSB has reason to believe that Shari’ah non-compliant activities are being carried out in a systematic manner within the IIFS, the SSB shall inform the board of directors and suggest suitable measures to rectify the situation.

94. If Shari’ah non-compliant activities continue despite the above measures, or if the board fails to effectively address the concerns of the SSB, the SSB shall inform the relevant regulator and report such violations in its annual Shari’ah compliance report.

95. The SSB must ensure proper documentation of any opinion that it gives on Shari’ah-related issues and its basis of conclusion. These shall be maintained centrally for ready reference.

96. The SSB shall, at all times, make available all the Shari’ah rulings regarding products/services offered by the IIFS along with their bases (religious/jurisprudential evidence). The IIFS shall ensure that these rulings and their bases are made available on the IIFS’s website.

97. The SSB shall define the key elements to be evaluated while reviewing and approving a product. Such key elements shall be used as the minimum guidelines/checklist by the Shari’ah compliance function while reviewing all new products and services, before presenting the product/service document to the SSB. This checklist shall include, at a minimum, key features of the product, processes, structure, documentation (including legal contracts), risk and compliance considerations, marketing collateral and other such necessary details as required to ensure proper business understanding. The views of the head of legal shall also be included. The SSB shall advise on the Shari’ah compliance of
the proposed product/service backed by appropriate basis of conclusion (*fiqh* literature, evidence and reasoning).

98. At least one SSB member (preferably the chairperson) shall present the SSB report at the annual general meeting to the stakeholders of the IIFS and respond to their queries about the state of Sharî‘ah compliance of the IIFS.

99. The SSB shall be consulted on the appointment of the head of the Shari‘ah compliance function. It shall also be consulted on the appointment of the head of the internal Shari‘ah audit function.

100. The SSB shall be consulted by the management to evaluate and assess, on an annual basis, the performance of the head of the Shari‘ah compliance function and the head of the internal Shari‘ah audit function.

101. The SSB, led by the chairperson, should ensure the continuous professional education and training programme of the SSB members with the management’s assistance and support.

102. The SSB shall conduct an annual performance assessment. For this purpose, evaluation criteria shall be developed for individual members and for the SSB, collectively (refer to Appendix B for the SSB performance assessment template), and the same shall be agreed with the board of directors.

103. The IIFS may decide on a third-party assessment of the SSB’s performance. In this case, the IIFS must ensure that the assessment is objective, transparent and related to the accountability of the SSB, and is not misused or abused by the board of directors or senior management to unduly influence the SSB or to compromise its independence.

104. The SSB performance assessment report shall be submitted by the board of directors to the relevant regulator on an annual basis (unless otherwise specified by the regulator).

105. The SSB must adopt a specified process for changing, amending or revising any Shari‘ah rulings issued by it previously, and arrange for its dissemination to the relevant stakeholders.

106. The SSB shall cooperate and, where necessary, work in coordination with the CSB (if one exists in the jurisdiction) to achieve standardisation and harmonisation in Islamic product development.

6.4 *Charter or Terms of Reference*

107. An SSB charter (or terms of reference) must be prepared by the IIFS and be approved by the board of directors defining the scope of work for the SSB.

108. A typical charter of the SSB must include, at a minimum, the following:
   a. purpose of the charter;
   b. authorisation of the charter;
   c. membership of the SSB;
   d. composition of the SSB;
   e. chairperson – roles and responsibilities;
   f. secretary – roles and responsibilities;
g. removal and/or replacement of an SSB member;

h. authority of the SSB;

i. responsibilities of the SSB;

j. term and remuneration of SSB members;

k. meeting frequency and quorum;

l. voting and decisions;

m. amendments to the charter; and

n. relationship with the board and senior management.

6.5 **Operational Procedures for the SSB**

109. For any decision to be taken, there shall be a proper quorum in which a majority of Sharī‘ah scholars consistent with their proportion in the composition of the SSB shall be present. However, in the case of a Sharī‘ah ruling (which is a Sharī‘ah matter in view of the chairperson of the SSB), only the Sharī‘ah scholar members can vote.

110. The SSB shall meet frequently, but no less than four times a year, to fulfil its responsibility.

111. Each member of the SSB must attend at least three-fourths (75%) of the meetings during a calendar year, including through video or conference calls. They cannot appoint another person to attend on their behalf.

112. All meetings must be chaired by the SSB chairperson and, in their absence, by the vice chairperson.

113. The agenda of the SSB meetings, along with sufficient details, must be sent to the SSB members well in advance, enabling them to come prepared to the meetings. The specific timelines for submission of the agenda and related background documents must be set by the SSB itself in line with the relevant regulations (if any), but in no case less than a week before the meeting.

114. The SSB shall commit to and specify a reasonable maximum timeline, after the required information has been provided, for any and all issues presented before it for a decision. Such a timeline shall be agreed with the management as part of the operational procedures at the start of the SSB term.

115. The SSB must ensure that the minutes of its meetings have necessary details of all the decisions made and/or fatwas issued along with the detailed rationale (fiqhi or other) and difference of opinion or dissenting note, if any. Further, the minutes must be signed by all the SSB members who attended the meeting to confirm the matters addressed therein, no later than in the next meeting.

116. The secretary to the SSB shall be responsible for recording the minutes of SSB meetings. Any differences of opinion or dissenting opinions among members of the SSB shall be duly documented and referred to in the minutes.

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12 An email acceptance of the minutes from a member may be deemed as equivalent to their signature, as per the IIFS policy and if allowed by the respective regulator.
117. Any SSB approval taken through circulation must be part of the minutes of the next SSB meeting.

118. The chairperson, and in their absence the vice chairperson, is empowered to invite any relevant senior management personnel to attend the SSB meetings at the initiative of the SSB or the management.

119. The SSB is strongly encouraged to meet with the board of directors of the IIFS at least once a year to discuss issues related to Shari‘ah compliance and governance. The SSB should document its observations, concerns and suggestions for the board.

120. The SSB may develop any additional Shari‘ah-related terms of reference and procedures if not covered in this standard.

6.6 Limit on the Number of SSB Seats

121. For an SSB member who is not employed anywhere part-time or full-time, the maximum number of concurrent SSB seats globally is eight (unless the respective jurisdiction specifies a lower number, in which case the lower limit shall prevail).

122. For an SSB member who is employed part-time or full-time other than their memberships of various SSBs, the maximum number of SSB seats they can simultaneously occupy globally is four (unless the respective jurisdiction specifies a lower number, in which case the lower limit shall prevail).

123. SSB members that are currently occupying more than the maximum allowable SSB seats have two years or the end of their current SSB term, whichever is earlier, to comply with the above requirement.

124. The respective IIFS and regulators shall take appropriate measures to ensure that the individuals appointed as SSB members fulfil the limit specified.

125. It is to be noted that if a person is a member of multiple entities within a single group, each of these memberships shall be counted separately for the purpose of the above limit. The exceptions are: (i) the SSB membership of a non-operational special purpose vehicle which does not require additional time and effort from the SSB member; and (ii) the SSB membership of an asset management company which owns and manages multiple funds shall be counted as only one.

126. Regulators may allow an exception to the requirements of paragraph 125 in the case of membership of sukuk SSBs if applicable, duly considering the overall workload and responsibilities of the relevant SSB members.

6.7 SSB Report Contents

127. The SSB shall annually submit a report to the board of directors on the IIFS’s Shari‘ah compliance to be published as part of the annual report.

128. The SSB report shall at least contain the following basic elements:
   a. title;
   b. addressee;
c. opening or introductory paragraph;

d. opinion paragraph containing an expression of opinion on the compliance of the IIFS with Shari’ah principles and rules, categorised into:
   - primary opinion;
   - exceptions;
   - limitations;
   - additional opinions;

e. responsibilities paragraph describing the nature of the work performed, including:
   - hierarchy of Shari’ah principles and rules as applicable to the institution;
   - functions relied upon;
   - inherent limitations of the SSB function and its report;
   - a declaration of SSB’s independence and ethical considerations;

f. responsibilities of the management and the board of directors;

1. other significant reporting matters, including:
   - key Shari’ah non-compliance risks with weak controls;
   - significant instances of Shari’ah non-compliance, identified and later resolved;
   - key Shari’ah non-compliance issues in matters not being part of primary scope;
   - key observations on the overall governance and control mechanism;
   - key differences between Shari’ah principles and rules applicable to the parent entity and those applied by subsidiaries due to application of a different regulatory regime;

h. report approval and authentication (including dissenting opinion if any);

i. signatures of the SSB members; and

j. date and place of the report.

129. See Appendix A for a template of the SSB report.

6.8 Disqualification of an SSB Member

130. An SSB member may be disqualified if they:

a. cease to be a person of good character and reputation, no longer holding a position of respect among their peers;

b. fail to attend the minimum number of meetings in a year without a reasonable excuse;

c. are associated with any unethical or illegal activity, including contravening any of the requirements and standards of the financial, banking or corporate regulatory system;

d. are convicted of any criminal offence, including financial impropriety or moral turpitude (except misdemeanors);

e. are dismissed in the capacity of employee or director from any institution or company on the grounds of fraud, misrepresentation or breach of trust;

f. breach the maximum limit of global SSB memberships as specified in this standard or the limit of local SSB memberships if specified by the respective regulator; or

g. misuse confidential and privileged information about the IIFS or its clients obtained as a result of their position (e.g. for personal benefit or in a manner that is
The need for maintaining objectivity and independence of the SSB also requires that the removal, dismissal or rotation of SSB members is performed in an independent, transparent and objective manner. Accordingly, the regulator shall ensure that adequate controls are established so that such a process is free from any bias.

The dismissal of a member of the SSB shall require a recommendation by the board of directors and be subject to the approval of the shareholders in a general meeting. It shall also be subject to the regulator’s approval unless otherwise specified by the regulator.

The IIFS shall notify the relevant regulator of any resignation or removal of an SSB member as and when it happens or when action is contemplated/initiated, whichever is earlier, stating the reasons.

6.9 Conduct of an SSB Member

6.9.1 Independence and objectivity

The SSB shall be independent, objective, competent and appropriately empowered to carry out its responsibilities. Necessary measures shall be taken to ensure that the SSB not only works independently but is also seen to be independent by the stakeholders, including the general public.

“Independence”, for the purpose of this standard, is “an attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influences and pressures of conflicting interests. It is achieved through organisational status and objectivity.”

No individual, or group of individuals, must be allowed to dominate the SSB’s decision making.

The SSB members must be truly independent and must be able to exercise independent judgment without undue influence or pressure (including time constraints), especially from the board of directors and/or the management of the IIFS.

SSB members have a responsibility to the public which relies on the credibility and independence of the SSB while using the services of the IIFS. Clients (including IAHs), credit grantors, governments, employees, investors and others also rely on the objectivity and integrity of SSB members to ensure Shari’ah compliance with regard to the activities of the IIFS.

SSB members shall always strive to uphold fairness and equity for all the stakeholders.

The remuneration of SSB members shall not be conditional on or linked to their achieving certain results or the IIFS meeting certain financial targets.

Neither an SSB member nor any member of their immediate family (spouse and dependent children) or close family (parents, non-dependent children and siblings) can be the CEO or director or any other key management position of the IIFS or any of its related companies.
for the current or the last financial year. An SSB member cannot be an employee of the IIFS or any of its related companies in the current or the last financial year.

142. Neither an SSB member nor any member of their immediate family (spouse and dependent children) or close family (parents, non-dependent children and siblings) can be a substantial shareholder (5% or as specified by the respective jurisdiction, or 10% of the net worth of the person, whichever is lower) of the IIFS or any of its subsidiaries/affiliates on whose SSB they serve. Such shareholding shall be duly disclosed in the annual report of the IIFS.

143. Neither an SSB member nor any member of their immediate family (spouse and dependent children) or close family (parents, non-dependent children and siblings) can be a substantial shareholder (5% or as specified by the respective jurisdiction, or 10% of the net worth of the person, whichever is lower) of an organisation which the IIFS made to or received from significant payments (USD 50,000 or as specified by the respective jurisdiction) in the current or immediate past financial year.

144. Neither an SSB member of an IIFS nor any member of their immediate family (spouse and dependent children) or close family (parents, non-dependent children and siblings) can be shareholders or employees of a company that provides the same IIFS with Sharīʻah consultancy and/or Sharīʻah audit services.

145. An SSB member can be a depositor/IAH of the IIFS or seek financing facilities from the IIFS in the normal course of business. However, no special rates or preferential treatment shall be given to SSB members in such cases. All such relationships shall be disclosed in the annual report of the IIFS.

146. The SSB members shall not have any relationship with the IIFS that could possibly interfere, or be reasonably perceived to interfere, with the exercise of their independent professional judgment.

147. SSB members shall continuously assess their relationship with the IIFS to identify any situation that may, or be reasonably perceived to, impair independence. They shall promptly resolve or report to the SSB such situations in which an issue of independence impairment is present or may reasonably be inferred and agree on an action plan to resolve it.

148. When faced with a potential and/or an actual issue of independence impairment, concerned SSB members shall do the following to resolve the issue:
   a. disclose and document the issue;
   b. review the issue internally within the SSB and take necessary steps to resolve it;
   c. where there is a temporary conflict of interest, or a duty to another party, abstain from participating in the relevant discussion, decision or action; or
   d. if the issue remains unresolved, or if it is of a permanent nature, the SSB member with the issue of independence impairment must resign and the general assembly of the IIFS must be notified.

149. The principle of objectivity imposes obligations on SSB members to be fair, intellectually honest and free of any conflict of interest.
150. Objectivity is an independent mental attitude which SSB members shall maintain in performing Shari‘ah supervision. SSB members shall not subordinate their judgment on Shari‘ah supervision matters to that of others.

151. Objectivity requires an SSB to perform Shari‘ah supervision in such a manner that they have an honest belief in their work. SSBs shall avoid potential and actual situations that impair their ability to make objective and independent professional judgments.

152. The board of directors of the IIFS shall devise a satisfactory mechanism for an annual check of SSB members for independence and conflict of interest.

153. Conflict of interest may arise, for example, when an SSB member acts contrary to their obligation and to their fiduciary duty towards the IIFS, or if the SSB member exploits their position for their own personal and pecuniary benefit.

6.9.2 Handling confidential information

154. SSB members must ensure that information obtained in the course of their duties is kept confidential.

155. Any confidential or sensitive information obtained by a member of the SSB while serving an IIFS must not be used in ways that could be detrimental to that IIFS, particularly in ways that might give an advantage to its competitors.

156. The duty to observe confidentiality applies to all information with which members of the SSB are entrusted by the IIFS, or which is brought to their attention during or at any time after the carrying out of their assignment. Confidentiality obligations do not end when a member of the SSB ceases to serve an IIFS or when a matter is completed or closed. Members of the SSB must observe the same restrictions unless they have obtained express authorisation from the IIFS that relieves them from such obligation.

157. Where an SSB member has a dissenting opinion on a fatwa given by the SSB, they have the right to document the dissent as per policy, but they must not criticise such fatwa publicly or use it to inflict reputational damage on the IIFS or its SSB.

6.10 Considerations in Fatwa Issuance and Hierarchy of Shari‘ah Principles and Rules

158. While deliberating on an issue, the SSB shall hold substantive and meaningful consultations within its members and with the various stakeholders (and, if need be, with outside experts) in order to arrive at a decision or issue a fatwa.

159. In the case of new product development, SSB members shall consider the legal and regulatory aspects of the respective product and, accordingly, provide an opportunity to the head of legal and others (as deemed necessary) involved in the process to express their views.

160. SSB members shall give due consideration to the economic, societal and other aspects of the issue under discussion in order to reach a Shari‘ah ruling/fatwa which follows both the letter and the spirit of Shari‘ah.
161. SSB members shall allocate appropriate time and effort to understand fully the issues under consideration. They are expected not to compromise the rigor of the Shari‘ah ruling process due to commercial pressure or time constraints.

162. SSB members shall continuously update themselves in order to be adequately knowledgeable about the contemporary issues and latest industry trends and developments so as to provide a correct Shari‘ah ruling when a matter is presented before them.

163. An SSB member simultaneously serving two different IIFS shall not issue conflicting *fatwas* for the same product. Notwithstanding the generality of this principle, if the SSB member believes that there are legitimate reasons to issue conflicting *fatwas*, such a rationale must be documented. At the discretion of the SSB chairperson or the board of directors, the matter may be referred to the CSB of the jurisdiction through the respective regulator. The SSB member shall also communicate the fact to the other IIFS’s SSB for reconsideration of the matter in line with such rationale, if applicable, while maintaining the necessary level of confidentiality.

164. SSB members shall follow AAOIFI Shari‘ah Standard no. 29: *Stipulations and Ethics of Fatwa in the Institutional Framework* while making Shari‘ah decisions and issuing *fatwas*.

6.11 Disclosure

165. The SSB report must be published as part of the annual report and must include a paragraph containing an expression of opinion on the compliance of the IIFS with Shari‘ah principles and rules (i.e. adherence to the above-mentioned hierarchy).

166. The IIFS shall disclose the number of SSB meetings held during the year and the attendance of every SSB member in the IIFS’s annual report.

167. The IIFS must make available to the customers and the general public, through appropriate publication and communication channels (e.g. website, annual report), the SSB’s rulings of products/services approved during the year and their evidence (jurisprudential and other), and any changes to any product-specific *fatwas*.

168. The IIFS must disclose in its annual report the total remuneration paid to each of its SSB members during the year and any financing or deposit relationship with the SSB members, and whether such arrangements are on an arm’s-length basis.

169. For other disclosure-related requirements, please see Principle 14: “Disclosure and Transparency”.
Principle 7: Sharīʻah Compliance Function

“An IIFS must have in place a Sharīʻah Compliance function that is competent, empowered and adequately resourced to discharge its duties.”

7.1 Sharīʻah Compliance Function

170. The Sharīʻah compliance function is an integral part of an IIFS’s governance and control structure, facilitating the management to ensure the IIFS’s compliance with Sharīʻah principles and rules on a day-to-day basis in all its business activities, operations and transactions.

171. The Sharīʻah compliance function is a crucial part of preventive controls and is mainly concerned with ex-ante work.

172. Sharīʻah compliance is the responsibility of each individual in an IIFS within their own area of responsibility, including the board of directors and the management. The function of Sharīʻah compliance, therefore, needs to be integrated with each organ and function of the IIFS. Accordingly, “Sharīʻah compliance function” is a broad term which includes the mechanism of ensuring Sharīʻah compliance, the related controls and processes, and the establishment of a Sharīʻah compliance department (SCD).

173. As a general principle, an IIFS shall adopt objective and risk-based monitoring of material risks relating to Sharīʻah non-compliance. The risk management department of the IIFS, in close coordination with the SCD, shall document such risks and develop a robust mechanism of risk reporting and management. Such risk shall be considered as a significant subset of operational risk and be given adequate coverage in internal and regulatory risk reporting.

174. The SCD is principally a part of management and shall report to, be accountable to, and be evaluated and appraised for performance by the senior management in consultation with the SSB.

175. In order to ensure an effective Sharīʻah compliance mechanism, it is imperative that the SCD works in close coordination with, and under the active supervision of, the SSB. Accordingly, it shall establish a dotted-line reporting relationship with the SSB.

176. The SCD, despite being a part of the management of an IIFS, shall remain independent from business operations to maintain segregation of duties, neutrality of views and performance, and preserve work ethics. It shall particularly be independent of the following functions, except for providing reviews and inputs:
   a. managerial decision making;
   b. finance-related functions;
   c. legal;
   d. marketing and sales; and
   e. product development.

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13 For detailed guidance, see AAOIFI Governance Standard for Islamic Financial institutions no. 9: Sharīʻah Compliance Function.
177. The SCD shall be led by a senior, experienced Shari’ah compliance professional supported by an adequate team with relevant education and experience. The management shall appoint the head of the department in consultation with and after the due approval of the SSB.

7.2 Roles and Responsibilities

178. In the case of the IIFS not having an independent secretariat for the SSB, the SCD may perform the function of SSB secretariat, subject to the condition that such dual functionality does not result in a self-review threat. The head of the SCD can take up the additional role of the secretary to the SSB.

179. The SCD shall help the management to ensure that it has provided basic Shari’ah-related training to all its staff and in-depth training to staff in their specific areas or functions. There shall be a system of continuous training and professional development.

180. The following are the primary functions of the SCD to ensure Shari’ah compliance:
   a. review and provide Shari’ah-related input for the development of policies, processes and procedures affecting various departments in relation to new products;
   b. review business transactions before execution from time to time, on self-initiative or when referred to by the SSB, board or management;
   c. support the SSB in performing its functions, whether secretarial support or research work or implementation of its decisions throughout the IIFS;
   d. review of related documentation (e.g. marketing collateral) and communication with various outside stakeholders;
   e. develop Shari’ah compliance programmes and conduct ongoing Shari’ah compliance reviews according to a structured plan;
   f. provide assistance and input to the business side of the IIFS in their communication with outside stakeholders – for example, customers (for matters related to Shari’ah) and the regulators (for matters related to Shari’ah compliance reporting);
   g. liaise with the internal Shari’ah audit function, external auditors and independent external Shari’ah auditors;
   h. assist the management in implementing a continuous professional Shari’ah-related training and development programme;
   i. assist the management in seeking Shari’ah-related decisions from the SSB on issues and queries raised by them or any other stakeholder;
   j. assist the management in responding to customer queries or complaints about Shari’ah compliance;
   k. facilitate pre-approval formalities of business transactions through the SSB or by using powers vested in it by the SSB;\textsuperscript{14}
   l. coordinate with the SSB to provide pre-approval of deviations from standard transactions or by using the powers vested in it by the SSB;
   m. monitor and enforce internal and external Shari’ah audit reports; and

\textsuperscript{14} See section 6.3 of this standard for the roles and responsibilities of the SSB.
n. in close collaboration with the risk management department, periodically conduct a thorough exercise (or update, as relevant) of identification, analysis and evaluation of real or perceived Sharī‘ah non-compliance risk relating to products, services, processes, policies and general conduct of business (including marketing, interacting with customers, IIFS’s investments, etc.). It is recommended that a comprehensive Sharī‘ah-related risk universe is prepared for easy reference.

181. The SCD shall ensure that it receives regular management information system (MIS) reports and confirmations from the business departments relating to the Sharī‘ah compliance of key transactions and the actions taken to resolve any observations raised by the SCD on the operations, products or procedures. At a minimum, this MIS can be in the shape of a reporting checklist of key Sharī‘ah issues for various contract and transaction types, drafted by the SCD, which shall be duly filled in and submitted by the relevant business department(s) on a regular basis to ensure ongoing Sharī‘ah compliance. The purpose of this reporting is to minimise the possibility of Sharī‘ah non-compliance and rectify any such issues (where possible) during the year.

182. The SCD shall ensure that any subsequent changes in product structures, contracts or agreements after SSB approval are returned to the SSB for review and approval/endorsement before implementation.

183. The SCD shall strive to create awareness regarding the applicability of laws, rules and regulations across businesses and processes and how they translate into operational requirements for managing Sharī‘ah non-compliance risk through, for example, periodic seminars, discussion forums, circulars and working papers.

184. The SCD shall perform a regular, ongoing assessment of the state of the overall compliance with Sharī‘ah principles and rules within the IIFS focusing on areas that require special consideration. Such reviews shall be conducted with a view to further improve and strengthen the Sharī‘ah compliance function. They may include pre-approvals by the department on selected transactions (involving potential high risk of Sharī‘ah non-compliance) as well as routine, random and, if necessary, snap checks of transactions on a real-time basis.

185. The following chart, developed in line with the five key pillars of the COSO\textsuperscript{15} integrated framework, identifies the broad objectives and recommends an overall approach towards the Sharī‘ah compliance control environment.

\textsuperscript{15} Committee of Sponsoring Organizations of the Treadway Commission.
Control environment

- Setting the tone at the top - Board and senior management to demonstrate clear commitment towards Shari’ah compliance.
- Setting up the governance organs including those specific to IIFS with regard to Shari’ah compliance.
- Setting up foundations for Shari’ah compliance control consciousness.
- Control environment factors to include the values, operating style and culture, delegation of authority, technology, people, processes, etc.
- Setting up Shari’ah compliance department to achieve the overall objective of strengthening Shari’ah controls.

Risk assessment

- Risks related to Shari’ah non-compliance to be assessed, and different departments and business units to integrate their efforts for this purpose.
- Risk mitigation strategies to be developed for the identified risks through coordinated efforts.

Control activities

- Integration of Shari’ah compliance function with the overall functions, controls and processes of the IIFS.
- Definition of specific control activities - particularly the preventive controls under this Standard and a mechanism of implementation of the same.
- Detective controls to be established, partially in line with this Standard; other governance organs in line with respective governance standards to be implemented.

Information and communication

- Communication of the Shari’ah compliance considerations.
- Communication of manuals, policies, procedures, standardized documentation and Fatwas as necessary.
- Information systems and technology to play their role.

Monitoring

- Monitoring mechanism, review requirements and detective controls under this Standard.
- Detective and monitoring organs and controls under the scope of various governance standards including Shari’ah compliance, internal Shari’ah audit, independent external Shari’ah audit and consideration of compliance with Shari’ah principles and rules by the external auditor.
7.3 Fit and Proper Criteria

186. The head of the SCD shall meet the following fit and proper criteria (unless otherwise specified by the regulator):

a. be well-versed in the operations and functions of Islamic banking and/or finance, and in the relevant Shari‘ah principles and rules, and have an understanding of fiqh al-muamalat;

b. have a university degree in Shari‘ah (fiqh al-muamalat or usul al fiqh), Islamic law, Islamic finance or an equivalent academic qualification, OR have a university degree or professional qualification suitable for the position with significant additional understanding of (a) above;

c. have at least 10 years’ work experience in the area of Shari‘ah compliance, Shari‘ah advisory, internal or external Shari‘ah audit or other relevant areas; and

d. have been approved by the SSB regarding the necessary knowledge and skills in Shari‘ah principles and rules applicable to the IIFS and fiqh al-muamalat.

187. Similar (though less stringent) criteria may be applied for other resources within the SCD.

188. The management must allocate sufficient financial and human resources in line with the nature and size of the IIFS for the SCD to perform its work effectively, in consultation with the SSB. The SCD may consist of one or more human resources, depending on the nature and size of the IIFS.
Principle 8: Internal Shari'ah Audit Function

“An IIFS must have in place an Internal Shari'ah Audit function that is competent, empowered and adequately resourced to discharge its duties.”

8.1 Internal Shari'ah Audit Function

189. The internal Shari’ah audit (ISA) function is part of the governance organs of an IIFS, independent of the management, with the primary objective being to provide assurance to the board and the SSB in relation to the IIFS’s adherence to Shari’ah principles and rules.

190. The audit committee of an IIFS shall ensure that a robust and effective ISA function exists in the IIFS and remains in operation. The audit committee shall keep oversight of the overall ISA function and shall provide its input in this regard. The SSB, on the other hand, shall provide necessary input to the ISA function on an as-needed basis.

191. An IIFS shall establish an ISA function with suitable resources. The function may be established as a separate department or as a unit of internal audit function.

192. The ISA department may take the form of a unit within the internal audit department of an IIFS if and only if:
   a. the IIFS is relatively small in size and/or operates in a new market;
   b. the internal audit department has adequate capability (quantitatively as well as qualitatively) to perform the tasks of the ISA function;
   c. the head of internal audit meets the fit and proper criteria applicable to the head of ISA, or a separate individual meeting such criteria is appointed as head of ISA (even if reporting administratively to the head of internal audit); and
   d. overall operational efficiency of the function can be achieved by combining the ISA department with the internal audit department.

193. The ISA function, through the head of ISA, shall have reporting lines as follows:
   a. primary reporting to the board via the audit committee; and
   b. dotted-line reporting to the SSB (all Shari'ah issues must be dealt with by the SSB).

194. While the ISA function has dotted-line reporting to the SSB, it is expected that it will have a more direct interaction with the SSB on a regular basis. The ISA function shall share the initial draft reports and observations with the SSB for its views and conclusions regarding Shari’ah matters, as well as Shari’ah interpretation, where applicable.

195. The audit committee shall appoint the head of the ISA function with due approval of the SSB, and the approval of the respective regulator, where applicable.

196. The final draft of the ISA report shall be first shared with the SSB and after receiving its comments/observations (if any) shall be submitted to the board via the audit committee.
197. The following chart\textsuperscript{16} depicts a normal flow of reporting process\textsuperscript{17} within an IIFS for the ISA function.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{chart.png}
\caption{Normal Flow of Reporting Process within an IIFS for the ISA Function}
\end{figure}

8.2 \textit{Roles and Responsibilities}

198. The primary objective of ISA is to provide assurance to the board and the SSB, in the form of an opinion, in relation to the IIFS’s adherence to Sharī‘ah principles and rules. ISA shall provide an independent assessment on the quality and effectiveness of the IIFS’s internal Sharī‘ah controls, Sharī‘ah non-compliance risk management systems and governance processes, as well as the overall compliance of the IIFS’s business, operations and activities with Sharī‘ah principles and rules.

199. The ISA function, at a minimum, must:
   a. establish an audit methodology to assess the risk profile and vulnerabilities of each auditable area;
   b. generate an audit plan for the assignments to be performed, in consultation with the SSB and to be approved by the audit committee;
   c. establish clearly documented audit programmes that provide guidance to internal Sharī‘ah auditors in gathering information, auditing procedures and audit assessment; and
   d. communicate results to the board and the SSB through an audit report, detailing the audit findings and recommendations for rectification measures, as well as the

\textsuperscript{16} For detailed guidance, see AAOIFI’s Governance standard no. 11: \textit{Internal Sharī‘ah Audit}.

\textsuperscript{17} Stage 1: Head of ISA submits draft internal Sharī‘ah audit report to SSB for review and comments.
Stage 2: SSB provides its comments on the report and sends it back to the head of ISA.
Stage 3: Head of ISA incorporates the SSB’s comments and shares the final draft with the SSB for any final comments/observations; thereafter, the report is submitted to the audit committee.
auditee’s responses and action plans.

200. The ISA function, in addition to the primary objective, shall provide the following assurance, in the form of an opinion, to the board and the SSB as to whether:
   a. an adequate governance structure/framework is in place for proper functioning of the IIFS in line with Shari’ah principles and rules and relevant governance requirements (including those relevant to fiduciary responsibilities of the IIFS);
   b. adequate internal controls have been designed and implemented by the management of the IIFS to ensure adherence with Shari’ah principles and rules; and
   c. the management has established adequate risk assessment criteria and mechanisms to ensure compliance with Shari’ah principles and rules and to cater to the specific risks related to Islamic finance transactions.

201. The head of the ISA function shall, besides the routine tasks, perform the following:
   a. establish plans to carry out the responsibilities of the ISA;
   b. prepare an internal Shari’ah audit manual to guide the members of the ISA team; and
   c. ensure that ISA efforts are properly coordinated in an efficient and effective manner.

202. ISA shall follow a risk-based Shari’ah audit methodology in line with the global best practices, including AAOIFI Governance Standard no. 11: Internal Shari’ah Audit and the relevant global internal audit standards.

203. The head of the ISA shall be responsible for developing an ISA charter and manual, which shall be subject to periodic review and update, as appropriate. The same shall be approved by the audit committee, after due consultation with the SSB.

204. The ISA charter shall generally include:
   a. statement of purpose/objectives;
   b. high-level summary of scope and responsibilities;
   c. structure of the ISA department and the reporting lines and procedures; and
   d. reporting expectations.

205. The charter shall make it clear that ISA officers have no executive authority or responsibility for the activities they audit.

206. The head of the ISA function must have direct and regular communication with all levels of management, the SSB, the audit committee, the head of Shari’ah compliance and independent external Shari’ah auditors. No scope limitation or restriction of access to documents, reports, etc. must be placed on ISA staff.

207. ISA staff must be objective and maintain an independent attitude in performing ISA. They must reach objective conclusions based on work performed and the results thereof.
208. The ISA manual shall include, at a minimum, the following:\(^\text{18}\)
   a. the protocols of the overall ISA process;
   b. guidance on the tools and methodologies for conducting ISA;
   c. guidance in respect of the reporting mechanism, including rating criteria, if applicable;
   d. the risk matrix and the summary of relevant controls, as well as the audit programmes, as applicable; and
   e. ethical and professional compliance, including independence and quality assurance processes.

209. The ISA function shall embrace technology to improve the performance of the function. This includes the adoption of suitable Shari‘ah audit software (including for archiving of audit data) and assessment of the information technology (IT) controls relating to Shari‘ah compliance.

### 8.3 Fit and Proper Criteria

210. The person appointed as head of ISA shall:
   a. have a university degree or a professional qualification (preferably in accountancy, audit, internal audit and/or Shari‘ah audit) suitable for the position;
   b. be well-versed in the operations and functions of Islamic banking and/or finance, the relevant Shari‘ah principles and rules, as well as having an understanding of *fiqh al-muamalat*;
   c. have at least 10 years’ work experience in the area of internal Shari‘ah audit, external Shari‘ah audit, internal audit, external audit/assurance or other relevant areas;
   d. have been approved by the SSB regarding the necessary knowledge and skills in Shari‘ah principles and rules applicable to the IIFS and *fiqh al-muamalat*; and
   e. have the necessary regulatory approvals to act as such, as applicable.

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\(^{18}\) See AAOIFI Governance Standard no. 11: *Internal Shari‘ah Audit* for a detailed methodology for conducting ISA.
Principle 9: Independent External Sharī‘ah Audit

“An IIFS should be subject to Independent External Sharī‘ah Audit.”

9.1 Independent External Sharī‘ah Audit

211. The objective of IESA is to provide an annual independent assurance opinion as to the compliance of an IIFS’s financial arrangements, contracts and transactions with Sharī‘ah principles and rules for a specific period. The IESA report is to be presented to the board (via its audit committee) and thereafter to the SSB.

212. This principle is mandatory for public interest IIFS after a period of three years from the effective date of this standard. During this period and for all other IIFS, compliance with this principle is strongly recommended.

213. Sharī‘ah principles and rules for the purpose of IESA shall mean the following, in the sequence provided below (unless otherwise specified by the respective regulator):
   a. Sharī‘ah standards issued by AAOIFI and Sharī‘ah-related requirements of the applicable financial accounting standards issued by AAOIFI;
   b. regulatory Sharī‘ah requirements (if any) issued by the regulator;
   c. Sharī‘ah rulings of the CSB (if any); and
   d. Sharī‘ah rulings of the IIFS’s SSB.

214. In the case of an ambiguity identified during a compliance, audit or rating exercise, as the case may be, with regard to interpretations related to the above hierarchy, the SSB’s clarification shall prevail. If unsatisfied with the SSB’s clarification, the independent external Sharī‘ah auditor may inform the audit committee as well as engage the regulator and request to refer the matter to the CSB.

215. This section shall be read in conjunction with the International Standard on Assurance Engagements (ISAE) 3000: Assurance Engagements Other than Audits or Reviews of Historical Financial Information.

216. The requirements of ISAE 3000, unless contrary to or inconsistent with a requirement of this section, being specific in nature, or with a requirement of Sharī‘ah, shall be applicable on such engagements as may be carried out under this section. For a detailed methodology to apply, the requirements of this standard, read with ISAE 3000, AAOIFI Auditing Standard no. 6: External Sharī‘ah Audit (Independent Assurance Engagement on an Islamic Financial Institution’s Compliance with Sharī‘ah Principles and Rules), shall be applicable.

217. In addition to meeting the other professional requirements for quality control, such as International Standard on Quality Control (ISQC) 1: Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements, the independent external Sharī‘ah auditor shall ensure that it has adequate capability in terms of resources and knowledge of the criteria to fulfil the responsibilities under the engagement in a professional manner. This shall entail active involvement of Sharī‘ah expert(s) throughout the engagement. The leading Sharī‘ah expert for an engagement shall fulfil the fit and proper criteria equivalent to either an SSB member or the head of internal Sharī‘ah audit as prescribed in this standard.
218. An IESA engagement can take the form of either:
   a. a direct IESA (the preferred approach); or
   b. an attestation IESA (in cases where required by the regulators of the respective jurisdiction and where a statement of compliance with Shari'ah principles and rules is required from the management of the IIFS).

219. The underlying subject matter of a direct IESA shall be comprised of “assessing compliance of the IIFS’s financial arrangements, contracts and transactions with Shari'ah principles and rules” for a specific period.

220. Subject-matter information of an attestation IESA shall be a “statement of compliance of the IIFS’s financial arrangements, contracts and transactions with Shari'ah principles and rules” for a specific period, duly approved and issued by the management of the IIFS.

221. The following chart depicts the summarised principal procedures to be performed by the independent external Shari'ah auditor in an IESA engagement.
The IESA report shall include the following basic elements, in line with ISAE 3000:

a. title – as appropriate in line with this standard;
b. addressee (the shareholders and the participatory stakeholders of the IIFS, unless otherwise required by the respective regulator);
c. identification of:
   - the underlying subject matter;
   - the criteria applied to evaluate the underlying subject matter; and/or
   - the subject-matter information (if applicable – i.e. in the case of an attestation IESA);
d. a statement that the management of the IIFS is responsible for:
the underlying subject matter – i.e. the IIFS’s compliance with Sharī‘ah principles and rules; and/or
- the development of subject-matter information (if applicable – i.e. in the case of an attestation IESA);
e. a statement that the engagement was performed in accordance with this standard read with ISAE 3000 which requires the independent external Sharī‘ah auditor to comply with ethical requirements and to plan and perform procedures to obtain reasonable assurance about the evaluation of underlying subject matter against criteria (and the subject-matter information, if applicable);
f. a statement about the ethical principles (including AAOIFI’s code of ethics) and quality control standards applicable to the independent external Sharī‘ah auditor;
g. a summary of the independent external Sharī‘ah auditor’s procedures to obtain reasonable assurance and a statement of the independent external Sharī‘ah auditor’s belief that the evidence obtained is sufficient and appropriate to provide a basis for the independent external Sharī‘ah auditor’s opinion;
h. a statement about the involvement of subject-matter (Sharī‘ah) experts;
i. the independent external Sharī‘ah auditor’s opinion, expressed in the positive form:
- in the case of a direct engagement – on whether, in all material respects, based on suitable criteria, the IIFS meets the underlying subject matter; or
- in the case of an attestation engagement – on whether the subject-matter information presents fairly the state of affairs of the IIFS with regard to the underlying subject matter, in all material respects;
j. the date of the independent external Sharī‘ah auditor’s report, which shall be no earlier than the date on which the independent external Sharī‘ah auditor has obtained sufficient appropriate evidence on which to base the opinion;
k. the name of the independent external Sharī‘ah auditor – including the name of the firm and the engagement partner, if applicable, and the location in the jurisdiction where the independent external Sharī‘ah auditor practises;
l. the statement that a long-form report is being issued to the board; and
m. in the case of an attestation engagement – without modifying the independent external Sharī‘ah auditor’s opinion, a reference to any material non-compliance(s) of Sharī‘ah principles and rules which is/are adequately described by the management in the subject-matter information.

223. A long-form report shall be issued alongside the short-form report duly addressed to the board, primarily containing the key audit matters and observations, particularly such material observations that have been resolved through adjustment, charity reversals or other corrective measures.

224. The long-form auditors’ report for IESA to be read in conjunction with the short-form report (opinion) shall include the following suggested aspects, as a minimum:
a. objective and scope of the engagement;
b. key audit matters, including risks and observations/findings, including those related to the following:
- the overall Sharī‘ah compliance environment;
- the risks associated with Sharī‘ah non-compliance;
▪ the capacity and the quality of the risk management system to measure, manage and mitigate these risks;
▪ the level of awareness and sensitisation of the management and the board in addressing the said risks; and
▪ any other issues deemed significant by the independent external Sharī‘ah auditor;
c. management’s and the independent external Sharī‘ah auditor’s responsibilities and other important terms of engagement;
d. broad description of the procedures performed;
e. limitations with respect to the engagement involving the execution of the Sharī‘ah audit procedures;
f. detailed description of the factual findings resulting from the independent external Sharī‘ah auditor’s work identifying the gaps/issues and the recommendation to address the same; and
g. the names and qualifications of the subject-matter (Sharī‘ah) expert(s) appointed by the independent external Sharī‘ah auditor for the said engagement.

225. In making the risk assessments, the independent external Sharī‘ah auditor shall consider and test the internal controls (including governance framework, transaction-level controls, product-specific controls and other related controls) relevant to the IIFS’s compliance with Sharī‘ah principles and rules in order to design appropriate procedures, but not for the purpose of expressing an opinion on the effectiveness of such controls. The independent external Sharī‘ah auditor’s comments on internal controls shall be included in its long-form report.

226. The IESA shall review the internal Sharī‘ah audit reports, interact with the SSB as needed and make use of such other sources as necessary for the satisfactory conclusion of the audit.

227. If the independent external Sharī‘ah auditor concludes that there is/are material non-compliance(s) with Sharī‘ah principles and rules, or in the case of an attestation engagement the subject-matter information does not reflect material information, or if the independent external Sharī‘ah auditor is unable to obtain sufficient appropriate evidence to reach proper conclusions, the independent external Sharī‘ah auditor’s opinion shall be modified in the form of a qualified, adverse or disclaimer of opinion, as appropriate in the circumstances.

228. The independent external Sharī‘ah auditor’s assurance report shall contain a clear description of the reasons for the modification(s) in the report.¹⁹

9.2 Fit and Proper Criteria

229. A professional IESA firm shall be either a professional firm of accountants or a dedicated Sharī‘ah audit/advisory firm, meeting the following criteria, as a minimum:
   a. having the necessary regulatory approvals to act as such, as applicable;
   b. having the necessary auditing experience as internal/external auditor or internal/external Sharī‘ah auditor;

¹⁹ For sample IESA reports, see Appendices A and B of AAOIFI’s Auditing Standard no. 6: External Sharī‘ah Audit.
c. having been approved by the SSB regarding the necessary knowledge and understanding of Shari‘ah principles and rules applicable to the IIFS and fiqh al-muamalat and the suitability to the operations of the IIFS;
d. having adequate resources, qualitatively (in terms of knowledge base, methodology and tools) and quantitatively (in terms of the number of eligible human resources that can devote sufficient time) for the IESA assignment; and
e. maintaining compliance of the applicable professional standards, quality assurance processes and codes of ethics including, in particular, the independence and confidentiality requirements.
Principle 10: Islamic Windows

“An Islamic Window of a Conventional Financial Institution must have a suitable Sharī‘ah Governance Framework in place to ensure effective Sharī‘ah compliance of its operations.”

10.1 Special Considerations for Islamic Windows

230. “Islamic window” is defined as a part of a conventional financial institution that provides Sharī‘ah-compliant financial services under a governance framework that ensures its sanctity as a Sharī‘ah-compliant operator. Special considerations become necessary for windows, as they are not separate legal entities and are housed within a conventional financial institution.

231. As an identifiable unit within a conventional financial institution that provides a complete intermediation process, from sourcing of funds to providing financing and making investments, the Islamic window has a fiduciary responsibility towards its fund providers (primarily the shareholders of the conventional parent and the IAHs and depositors of the Islamic window) in the same way that a full-fledged Islamic financial institution does. As far as practical, the Islamic window’s funds shall be kept completely segregated on a day-end clearing basis from the conventional parent’s funds, including keeping separate accounts with the central bank and the clearing houses.

232. Islamic windows of conventional banks and other financial institutions shall follow an “institution within an institution” model, allowing maximum independence of the Islamic window to pursue its activities without unnecessary and undue interference or influence from the management of the conventional parent.

233. The Sharī‘ah governance framework of an Islamic window of a conventional financial institution shall consist of the same components/organs as any IIFS, namely:
   a. an SSB;
   b. Sharī‘ah compliance function;
   c. internal Sharī‘ah audit function; and
   d. independent external Sharī‘ah audit.

   However, the independent external Sharī‘ah audit is mandatory for public interest IIFS, including Islamic windows (if applicable) after a period of three years from the effective date of this standard. During this period and for all other IIFS, compliance with this principle is strongly recommended.

234. In addition, the CSB (in markets where it exists) has a role to play in the Sharī‘ah governance framework. The board of directors and the management also have their responsibilities20 to ensure the Sharī‘ah compliance of the Islamic window.

235. The responsibilities, fit and proper criteria and other aspects of each of the Sharī‘ah governance components of an Islamic window shall be the same as mentioned in the relevant sections of this standard, except those specified otherwise in this section.

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20 These responsibilities are the same as for an IIFS, as mentioned in this standard.
236. The respective regulators may decide, based on the size of an Islamic window and the scope of its operations, to allow outsourcing the internal Shari’ah audit function. However, the Shari’ah compliance function and the SSB function cannot be outsourced.

237. All business units and functions (including products, sales, service and marketing) must be directly managed by the Islamic window, while the control and support functions may be shared with the conventional parent provided that there are defined cost allocation and service level agreements. (See the “Other Requirements” section below.)

238. Islamic windows shall operate through dedicated Islamic-only branches and dedicated staff for these branches serving only Islamic window customers. No customer-facing staff of any function shall serve both conventional and Islamic window customers.

239. It is necessary that a licensing regime is introduced for Islamic windows with the obligation to follow the minimum regulatory requirements of capital allocation and maintenance, governance and operations.

240. It is highly recommended that the Islamic window is allowed to spinoff into a fully or partly owned subsidiary of the conventional parent if and when it reaches a certain threshold of assets and regulatory capital.

241. External auditors, as part of their review, shall certify that separate controls and systems have been maintained to ensure that there is no commingling of funds from the Islamic window to the conventional parent.

10.2 Reporting and Disclosure Requirements

242. Separate books of account shall be maintained for an Islamic window.

243. Conventional financial institutions offering Islamic financial services through an Islamic window, a branch or several branches that have separate accounts from their conventional branches, shall group those branches offering Islamic financial services together for financial reporting and shall prepare a supplementary set of accounting statements as per the standards issued by AAOIFI. These supplementary financial statements shall be published as an appendix in the notes to the financial statements of the conventional parent.

244. If the conventional parent’s accounting system is not designed to produce information for the Islamic window as required under this standard, requisite changes shall be made to the accounting system.

245. The Islamic window shall prepare a separate supplementary statement to be published in the notes to the financial statements showing in detail:
   a. the funds mobilised according to Shari’ah principles and rules and the assets financed by these funds; and
   b. the income and expenses related to the Islamic banking services offered by the Islamic window.

246. Islamic windows shall disclose in detail:
   a. whether or not and to what extent the Islamic window commingled funds related to
Islamic financial business with funds related to conventional financial business;
b. the sources and applications of funds mobilised and invested;
c. the sources of funds used to cover a deficit if it occurs;
d. any income received that is prohibited by Shari’ah and the disposition of such income in accordance with the SSB guidelines;
e. any reserves deducted from the funds mobilised according to Shari’ah principles and rules, the purpose of such reserves, and to whom these reserves shall revert in case the activities in respect of which such reserves were deducted have ceased;
f. the percentage of funds held by the Islamic window from the conventional parent and/or other conventional entities (in the form of capital allocated, deposits/investment accounts, etc.) in comparison to the total funds; and
g. any other details as mandated by the respective regulator from time to time.

247. The SSB must express an opinion in its report as to whether the Islamic window’s funds were commingled with those of the conventional parent during the reporting period.

10.3 Other Requirements

248. The ultimate responsibility of the Islamic window is with the board of directors of the conventional parent. The board is encouraged to include as an independent member (or an adviser) a person who has experience and knowledge in Islamic finance. The board shall ensure that the head of the Islamic window has adequate knowledge, qualifications and experience in Islamic banking and finance and possesses at least a basic understanding of Shari’ah principles and rules as they apply to Islamic financial products and processes. Specifically, they shall have a clear understanding of the risks specific to Islamic finance and applicable corporate and Shari’ah governance regulations. The board shall also ensure that the head of the Islamic window meets the fit and proper criteria in terms of integrity, character, market reputation and ethical conduct.

249. The head of the Islamic window shall be a senior and experienced person in the hierarchy of the organisation. They must be dedicated to the operations of the Islamic window and must not perform any tasks that are not within the scope of the Islamic window. The head shall report directly to the CEO of the conventional parent for all kinds of business and performance matters. It is important that the CEO does not delegate this responsibility to another executive, in order to maintain the organisational status accorded to the Islamic window.

250. The various functions of an Islamic window shall be organised in such a manner so as to ensure maximum independence of the Islamic window and to avoid conflict of interest with the conventional parent. This shall be achieved through the following:
a. dedicated staff for business functions such as consumer, corporate, treasury reporting to the head of the Islamic window, with dotted-line reporting to respective department heads at the conventional parent;
b. dedicated staff for other business support functions, such as products, business intelligence, marketing, customer service, HR, legal, alternative channels, reporting to the head of Islamic banking, with dotted-line reporting to respective department heads at the conventional parent;
c. dedicated staff for various control functions, including but not limited to internal audit, compliance, credit administration, financial control, risk management, etc., reporting to their respective department heads, with these functions keeping the head of the Islamic window informed in respect of their reports and observations; and

d. shared support functions (e.g. central operations, administration, etc.) with the conventional parent, provided a transparent cost allocation policy is designed and a service-level agreement is concluded with proper board and SSB approvals.

251. The core banking/IT system adopted by the Islamic window shall be capable of recognising and distinguishing the unique nature of Islamic financial contracts, terminologies, transactions and processes. The core banking/IT system must be capable of profit calculation and accounting treatment as per Sharī‘ah requirements.

252. There shall be proper systems for pool and treasury management at the Islamic window in order to fulfil the unique needs of funds segregation and profit calculations.

253. The Islamic window can receive funds from its conventional parent under a Sharī‘ah-compliant contract. However, it cannot place funds with its conventional parent, or with any other conventional financial institution, either directly or through a third party.²¹

254. The Sharī‘ah compliance function shall work independently and report to the SSB, with administrative reporting to the head of Islamic banking. The head of the Sharī‘ah compliance function shall be appointed by the head of Islamic banking in consultation with and after the due approval of the SSB.

255. The internal Sharī‘ah audit function can be an independent function within the Islamic window or part of the internal audit function of the conventional parent, provided that the staff fulfils the fit and proper criteria for the internal Sharī‘ah auditor.

256. In addition to other duties, the internal Sharī‘ah auditor shall also make an assessment as to whether the funds have been adequately segregated and that the services to and transactions with the conventional parent (if any) are Sharī‘ah-compliant and in accordance with this standard and with the relevant regulations and guidelines issued by AAOIFI, the regulator and the SSB.

257. In the takaful subsector, the takaful window operator shall give assurance that the funds of the takaful participants are properly segregated from the funds of the conventional insurance policyholders and the takaful window operator’s shareholder funds. The expression of an opinion to that effect shall be a regulatory requirement in the SSB report of the takaful window operator.

258. The same applies for windows under Islamic collective investment schemes (ICIS), which shall also ensure that appropriate systems and mechanisms for monitoring ex-ante and ex-post Sharī‘ah compliance are in place and are effective (see section 13.1). The Sharī‘ah governance system for ICIS shall cater for the following processes:

a. monitoring consistent compliance with Sharī‘ah principles and rules in its daily

²¹ An Islamic window may place funds with other Islamic windows.
operations;
b. portfolio screening to ensure its investment portfolios remain within Sharī‘ah-permissible assets/projects; and
c. purification of Sharī‘ah non-compliant income.
Principle 11: Islamic Subsidiaries/Affiliates

“An Islamic Subsidiary/Affiliate of a Conventional Financial Institution must have a suitable Sharī‘ah Governance Framework in place to ensure effective Sharī‘ah compliance of its operations.”

11.1 Special Considerations for Islamic Subsidiaries/Affiliates

259. An Islamic subsidiary or affiliate is defined as an independent legal entity and financial institution, owned partly or fully by a conventional parent, having a separate licence to provide Sharī‘ah-compliant financial services.

260. If an IIFS is owned by a conventional parent (typically a conventional financial institution), whether this ownership is 100%, majority or minority with the ability to exercise influence/control, the provisions of this standard shall apply as long as the IIFS is a separate legal entity having its own licence.

261. The Sharī‘ah governance framework of an Islamic subsidiary/affiliate shall consist of the same components/organs as any IIFS, namely:
   a. an SSB;
   b. Sharī‘ah compliance function;
   c. internal Sharī‘ah audit function; and
   d. independent external Sharī‘ah audit.
   However, an independent external Sharī‘ah audit is mandatory for public interest IIFS, including Islamic subsidiaries/affiliates (if applicable) after a period of three years from the effective date of this standard. During this period and for all other IIFS, compliance with this principle is strongly recommended.

262. Similarly, CSB (in markets where it exists) has a role to play in the Sharī‘ah governance framework of the Islamic subsidiary/affiliate. The board of directors and the management also have their responsibilities to ensure Sharī‘ah compliance of the Islamic subsidiary/affiliate.

263. The responsibilities, fit and proper criteria and other aspects of each of the Sharī‘ah governance components of an Islamic subsidiary/affiliate shall be the same as mentioned in this standard, except those specified otherwise in this section.

264. The governance and operating model of the Islamic subsidiary/affiliate shall take into consideration the interests of key stakeholders in the Islamic subsidiary/affiliate, including IAHs and minority shareholders. It shall ensure fair treatment for all.

265. The Islamic subsidiary/affiliate shall be and act as an independent organisation in all respects. The conventional parent can influence decision making at the Islamic subsidiary/affiliate at a strategic level only through board memberships and board committees, where it shall be represented in line with its shareholding percentage.

266. In order to avoid conflict of interest, the representatives of the conventional parent on the board of the Islamic subsidiary/affiliate are not allowed to vote on any issue which is, or is
reasonably perceived to be, benefiting the conventional parent at the cost of the interests of the stakeholders of the Islamic subsidiary/affiliate.

267. The board of the Islamic subsidiary/affiliate shall bear the full fiduciary responsibility towards the stakeholders, including the shareholders and the IAHs of the Islamic subsidiary/affiliate. This fiduciary responsibility cannot be transferred or delegated to the board of the conventional parent simply because of the ownership.

268. With the exception of heads of compliance, internal audit and risk management, the conventional parent cannot appoint any other members of its executive management to the board of the Islamic subsidiary/affiliate. It can, however, appoint any of its non-executive board members to the board of the Islamic subsidiary/affiliate if the regulations of the jurisdiction allow it and if the board members fulfil the relevant fit and proper criteria.

269. If a conventional parent owns a majority or 100% of an Islamic subsidiary, it can have dotted-line reporting of key business departments/functions where the conventional parent’s function heads shall have the right to certain relevant information as approved by the two boards and as per the laws of the jurisdiction but shall not have the authority to make or influence the decisions of the Islamic subsidiary. Any sharing of customer-level information between the two must not be detrimental to the long-term interests of the shareholders and IAHs of the Islamic subsidiary.

270. Any strategic or tactical attempt by the conventional parent to reduce competition from the Islamic subsidiary/affiliate (e.g. by prohibiting the Islamic subsidiary/affiliate from approaching certain categories of customers or business segments) is not allowed if it is deemed to be against the interests of the minority shareholders and/or IAHs of the Islamic subsidiary/affiliate.

271. The conventional parent and the Islamic subsidiary/affiliate can agree, for the purpose of cost saving, on a shared services arrangement on an arm’s-length basis to be approved by the boards of the two entities and the SSB of the Islamic subsidiary/affiliate. The board members representing the conventional parent shall absent themselves at the time when the board of the Islamic subsidiary/affiliate votes on the arrangement.

272. Such a shared services arrangement must take into consideration that no employee of the Islamic subsidiary/affiliate can be coerced, directly or indirectly, to work for the conventional parent, nor can the Islamic subsidiary/affiliate rent out/lease any part of its physical infrastructure or systems to the conventional parent.

273. If the Islamic subsidiary/affiliate decides to co-locate with its conventional parent, it must ensure that this arrangement does not affect its brand identity in the perception of the general public.

274. The Islamic subsidiary/affiliate can receive funds from its conventional parent under a Shari’ah-compliant contract. However, it cannot place funds with its conventional parent or with any other conventional financial institution either directly or through a third party.
Principle 12: Other Considerations

“An IIFS is responsible to ensure that it prudently recognizes any additional considerations or exceptional circumstances which may require it to apply proportionality and/or other considerations towards implementation of the principles of this Standard.”

12.1 Special Treatment for Participatory Stakeholders

275. One of the unique features of Islamic finance is the presence of risk-sharing stakeholders such as IAHs in Islamic banks and participants (or the insured) in takaful companies. According to AAOIFI Conceptual Framework for Financial Reporting (Revised 2020), participatory stakeholders have a contractual arrangement with the institution to share the profits, losses and residual interest in the net assets of the underlying asset or business.

276. Participatory stakeholders such as IAHs are considered quasi-equity as they share the majority risk of the IIFS. Hence, there is a need to have well-defined, transparent and standardised policies and practices for the overall governance of participatory stakeholders’ funds in order to ensure fair and equitable treatment to them.

277. IIFS must ensure that pool creation, pool management, and profit calculation and distribution to IAHs are in line with the relevant AAOIFI Shari‘ah, accounting and governance standards (as applicable in the jurisdiction), IFSB-3: Guiding Principles on Corporate Governance for Institutions offering Only Islamic Financial Services and under the supervision of the respective SSB. Subsequently, it must also be subject to internal audit and independent external Shari‘ah audit.

278. The IIFS must have in place a comprehensive and well-defined pool management policy for funds received from IAHs. The policy must be approved by the SSB and the board of directors. The IIFS must also establish comprehensive risk mitigation measures to safeguard and protect the interests of IAHs.

279. The policy must cover, at a minimum, the following areas with an aim to provide fair and equitable treatment to IAHs:
   a. the objectives, investment strategy, risk appetite, limits and delegation of authority for each pool;
   b. the process for pool establishment, profit-sharing ratio and weightages, and the basis thereof;
   c. policy and procedures for asset allocation and deployment of funds;
   d. the rights and obligations of the IIFS as mudarib (asset manager) or wakil (agent);
   e. the basis for allocating different types of IAHs’ funds to different pools;
   f. the basis for assigning weightages to each investment account category within a particular pool;
   g. the basis of allocation of income and direct expenses between IAHs and IIFS, including pre-set criteria to govern the same;
   h. the treatment and remuneration basis for early encashment/withdrawal of funds by IAHs;
   i. a defined mechanism for inter-pool transfer of assets, with appropriate senior-level approval and SSB’s approval;
j. policy to create reserves such as the profit equalisation reserve (PER) and investment risk reserve (IRR), and procedures for their utilisation; and
k. the responsibility of the SSB, the respective committee(s) of the board of directors and the independent directors to represent participatory stakeholders’ interests (including IAHs’ interests) regarding the governance of these funds.

280. The IIFS have a fiduciary responsibility towards their participatory stakeholders to ensure that their funds are used only in Shari’ah-compliant activities and transactions. It is therefore prohibited for IIFS to place funds with conventional financial institutions either directly or through a third party.

12.2 Shari’ah Compliance and Fiduciary Ratings

281. IIFS are encouraged to seek Shari’ah compliance and fiduciary ratings from independent rating agencies in order to enhance their level of Shari’ah compliance and reinforce the public’s confidence in the institution.
Principle 13: Applicability to Different Sectors

“The provisions of this Standard may be suitably implemented using the proportionality criteria and as per the relevance for different sectors of the Islamic finance industry.”

282. In general, the provisions of this standard are fully applicable to the banking and _takaful_ industry, and all prudentially regulated institutions offering Shari‘ah-compliant banking and _takaful_ products are required to comply.

283. However, suitable flexibility based on proportionality criteria may be provided to other sectors such as Islamic capital markets, Islamic deposit insurance, Islamic microfinance and Islamic social finance institutions.

284. It is the responsibility of the RSAs to ensure that the provisions of this standard are implemented in full, in spirit and in principle, as per suitability and relevance to the sector/institution under consideration.

13.1 Islamic Capital Market (ICM)\(^{22}\)

285. IIFS in the Islamic capital market include issuers, fund managers and market intermediaries explicitly claiming the Shari‘ah compliance of their offerings.

286. The regulator must seek to ensure that the products claimed to be Shari‘ah-compliant in the ICM have undergone a sound screening and approval process by a competent SSB.

287. For ICM, the SSB is comprised, in line with this standard, of three or more Shari‘ah scholars. However, it may also be sourced\(^ {23}\) under a service contract through an external Shari‘ah consultancy firm provided all governance and fit and proper criteria as outlined in this standard are complied with. Where a CSB exists in a jurisdiction, the ICM products must be in compliance with the CSB requirements.

288. The regulator must require marketers of products claimed to be Shari‘ah-compliant in the ICM to make appropriate disclosures should any material changes affecting the Shari‘ah compliance of the products occur.

289. The regulator must clearly specify regulatory measures and remedial actions to be undertaken in the event of a change in status from a Shari‘ah-compliant product to a Shari‘ah non-compliant product.

290. The regulator must also be transparent and consistent in its approach to dealing with matters of Shari‘ah governance in the ICM.

291. The regulator must have a mechanism in place to cooperate with other RSAs to manage cross-border activities in the ICM in the light of differing Shari‘ah interpretations or differences in the relevant Shari‘ah governance requirements.

\(^{22}\) More detailed guidelines are available in IFSB-21: *Core Principles for Islamic Finance Regulation (Islamic Capital Market Segment)*

\(^{23}\) This is normally in instances where a capital market participant is not an IIFS by nature of its majority business line; for example, in the case of _sukūk_ issuance by a telecom company or an automobile manufacturer, the issuer is not expected to house a full-time SSB and, hence, it may be sourced externally under a service contract.
13.2 Islamic Microfinance Institutions/Islamic Fintech Platforms/Other Organisations Working for Financial Inclusion²⁴

292. A sound Shari’ah governance framework is a requirement for any organisation, especially those engaged in financial services. A number of new business models have been emerging in recent years. Some are prudentially regulated (such as financial technology – or fintech – platforms, for-profit Islamic microfinance institutions or payment system operators) while others are not (e.g. charitable organisations working for financial inclusion). The common factor among these different models and businesses is their claim to be Shari’ah-compliant.

293. Considering the nature and the scale of activities of an organisation, the RSAs may allow certain exceptions to the requirements of this standard and provide appropriate regulatory flexibility.²⁵ The organisations not under prudential regulations wishing to offer Shari’ah-compliant services are encouraged to adopt the relevant and applicable principles of this standard.

294. An example of regulatory flexibility is to allow outsourcing of some of the Shari’ah governance functions to a third party. Another option for reducing the cost of operations is to allow smaller service providers to rely on a single Shari’ah adviser instead of an SSB. Alternatively, a number of such providers can collectively form an SSB and share the costs. They can also engage a Shari’ah consultancy firm to provide SSB services under a service agreement. Another option is voluntary Shari’ah services offered by Shari’ah advisers, Shari’ah advisory firms or SSBs (e.g. of Islamic banks) to smaller service providers as part of their corporate social responsibility efforts.

295. For prudentially regulated entities, while allowing selectively the above flexibilities and/or exceptions, the RSAs must also ensure that the related risks are controlled and mitigated. For example, if a single Shari’ah consultancy firm is used by multiple entities for an outsourced SSB function, appropriate measures should be put in place to ensure that confidential information from one institution is not leaked to others.

²⁴ More detailed guidelines are available in IFSB TN-3: Financial Inclusion and Islamic Finance.
²⁵ This, however, does not override any existing guidelines and/or more stringent practices as already adopted by national RSAs, particularly if the service provider is a prudentially regulated institution under a national/central Shari’ah governance framework of the jurisdiction.
Principle 14: Disclosure and Transparency

“An IIFS shall be transparent in its Sharī‘ah governance to its shareholders, customers, other relevant stakeholders and market participants.”

296. The objective of transparency in the area of Sharī‘ah governance is to provide the shareholders, customers, other relevant stakeholders and market participants with the information necessary to enable them to assess the effectiveness of the board in ensuring Sharī‘ah compliance. This applies, in particular, to the Islamic banking, Islamic capital market and *takaful* sectors. Disclosures shall be made through a formal disclosure policy of the IIFS and shall be clear, comprehensive, meaningful to users and consistent over time.27

297. IIFS shall disclose relevant and useful information that supports the key areas of Sharī‘ah governance in line with the principles contained in this standard. Such disclosure shall be proportionate to the size, complexity, structure, economic significance and risk profile of the IIFS.

298. At a minimum, and in addition to the SSB report, the IIFS shall disclose annually the following information in their stand-alone regulatory disclosure documents or in other documents (such as annual reports) with appropriate signposting:28

a. a statement on the governance arrangements, systems and controls employed by the IIFS to ensure Sharī‘ah compliance; how these meet applicable national or international standards; and, if there is less than full compliance with these standards, an explanation of the reasons for non-compliance. In countries where this standard is followed, or where national guidelines on Sharī‘ah governance in IIFS exist, a statement of compliance with these standards (and reasons for any non-compliance) shall be provided;

b. qualifications and areas of expertise of each SSB member;

c. appointment and change of members of the SSB during the financial year;

d. the total remuneration paid to each of the SSB members during the year;

e. any financing or deposit relationship with the SSB members and whether any special or preferential rates were offered;

f. any conflict of interest with respect to paragraphs 141, 142, 143 and 144;

g. the record of attendance of each SSB member at SSB meetings during the financial year;

h. disclosure of the number and nature of Sharī‘ah non-compliance29 events during the period and how these were resolved (with reference to the applicable Sharī‘ah standards), including control measures to avoid recurrence of such events; and

i. trainings that have been attended by members of the SSB during the period.

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26 “Customers” is used here to refer to depositors, IAHs and financing recipients in Islamic banking, participants in *takaful* and investors in ICIS and *sukūk*.

27 See IFSB-22: *Disclosures to Promote Transparency and Market Discipline for IIFS (Banking Segment)* for more details on these principles.

28 See IFSB-22 for more details on signposting requirements.

29 “Sharī‘ah non-compliance” refers to the failure of an IIFS to comply with, or apply, the Sharī‘ah principles and rules determined by its SSB and/or the relevant body in the jurisdiction in which the institution operates.
299. IIFS shall disclose Sharīʻah pronouncements/resolutions issued by their SSB during the last 12 months which are related to its offered products and services, along with the rationales/bases of conclusion (jurisprudential or other) supporting these pronouncements/resolutions. It is important that these Sharīʻah pronouncements/resolutions and the rationales supporting them are made in accurate, specific terms and in clear, simple and easy-to-understand language and form. An IIFS shall also make appropriate disclosure whenever its SSB departs from or revises any of its earlier Sharīʻah pronouncements/resolutions, along with the reasoning for such departure or revision.

300. Subject to national requirements, IIFS may provide disclosures detailing annual zakāh obligations of IIFS, method(s) used to determine their zakāh base and the recipients of zakāh contributions. Zakāh disclosure requirements in this standard are only applicable to zakāh obligations of the IIFS in accordance with applicable national laws and regulations. These disclosures shall include:
   a. the method used in the calculation of the zakāh base by an IIFS, where relevant;
   b. zakāh fund disbursement channels employed by the IIFS;
   c. disclosure of annual zakāh obligations of the IIFS, where relevant, according to constitutional and/or national requirements; and
   d. if zakāh has not been paid by the IIFS, in accordance with applicable national laws and regulations, then sufficient information must be disclosed by the IIFS to allow the shareholders and other investors to calculate their own zakāh obligations.

301. An IIFS shall present as part of its annual report a statement of sources and uses of charity funds, including prohibited/Sharīʻah non-compliant income and other charitable funds.

302. Additional disclosures for ICM and takaful are as follows.

14.1 ICM

Sukūk

303. Sufficient disclosures shall be made about Sharīʻah aspects of the sukūk to allow an informed judgment to be made as to the initial and ongoing Sharīʻah compliance of the sukūk. Such disclosure may include elements related to the following.

Sharīʻah scholars and the Sharīʻah review process

304. Disclosure shall identify which SSB has opined on the Sharīʻah compliance of a sukūk, the names of the Sharīʻah scholars involved, and the nature of their relationship to the originator, obligor or arranger. Sufficient information about the scholars (including their credentials and experience) shall be disclosed to allow an investor to decide the reliance they are prepared to place on them.

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30 See IFSB-19: Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Sukūk and Islamic Collective Investment Schemes) for detailed recommended disclosures for sukūk and ICIS.

31 This might include, for instance, the party that appointed the SSB.
305. If the relevant jurisdiction regulates Sharī‘ah governance or interpretation on a nationwide or market-wide level (e.g. by having a CSB or a separate SSB for capital markets), this shall be stated.

306. Disclosure shall be made of the detailed roles and responsibilities of the SSB and the Shari‘ah review process followed (including activities such as review and fatwa issuance, continuous monitoring, periodic review of the sukūk, etc.) and what documents (e.g. term sheets, summary papers, draft contracts and/or final contracts) were reviewed by the scholars. It shall also indicate whether there were related external arrangements that were not considered (e.g. external hedging arrangements).

307. If the originator, the arrangers or any other party to the sukūk arrangements is making a representation as to the Shari‘ah compliance of the sukūk, this must be clearly disclosed. The absence of such representation must also be disclosed in a clear disclaimer.

Fatwa and reasoning

308. Any fatwa relating to the sukūk (including its issuance and trading) must be part of the legal documentation of the sukūk and be disclosed in the offering document, or otherwise by making it available to prospective investors – for example, by posting it on a website accessible to them. Disclosure shall also include the rationale for the fatwa (i.e. the jurisprudential reasoning).\(^{32}\)

Underlying assets and activities

309. Any particular Shari‘ah deficiency or limitation in relation to the asset(s) or activities underlying the sukūk as well as the risks of these arising in the future shall be disclosed. For example, where a pool of underlying assets includes cash and receivable-type assets, any ratios that must be observed for the asset pool shall be disclosed, along with consequences of their breach. In addition, any underlying assets or activities that include an impermissible component that requires purification shall also be disclosed.

Tradability

310. If, in the view of the SSB opining on the sukūk, there are limitations to be observed on the tradability of the sukūk in the secondary market (e.g. trading only at par or at the outstanding amount owed on a spot basis), these limitations shall be disclosed clearly and the reasoning explained. If the limitation is such that the sukūk may not be traded or transferred in a Shari‘ah-compliant manner at negotiated prices, then the offering document for the sukūk shall bear a prominent legend stating that the sukūk may not be traded or transferred except at the par value.

Purification and compensation payments

311. It shall be disclosed whether or not there are arrangements in the sukūk contracts for purification payments to be made in respect of Shari‘ah non-compliant income arising from the sukūk. The basis on which purification payments are calculated shall also be explained.

\(^{32}\) Where an issuance has been approved by more than one set of SSBs, these disclosures shall be made for each fatwa issued.
as advised by the SSB and the entities to whom they will be made shall also be disclosed (if these are known at the time).

312. It shall be disclosed whether or not there are arrangements made in the sukūk contracts for compensation payments to be made on overdue amounts under the sukūk. If so, it shall be disclosed under what circumstances such a payment is imposed, on which party it is imposed, how it is determined and how it will be utilised.

Shari’ah and interpretation

313. It must be clearly disclosed what role (if any) Shari’ah would play in the interpretation of the sukūk contracts (whether interpretation by the parties performing the contracts or interpretation in a legal forum applying the selected governing law), and particularly in default, enforcement, amendment or restructuring. In jurisdictions where courts are not bound to apply Shari’ah in interpreting contracts, it must be stated that courts would likely apply the relevant national law rather than Shari’ah principles in interpreting the sukūk contracts, and, if this is the case, describe the possibility that the resulting interpretation may not be consistent with Shari’ah principles.

Shari’ah guidance in matters arising post-issuance

314. Disclosure shall be made of any arrangements in place to provide Shari’ah assessments or ad hoc Shari’ah determinations in extraordinary matters that may arise following the issuance of the sukūk, such as default, enforcement, amendment or restructuring. If there are no such arrangements, any potential consequences for Shari’ah-compliant investors shall be disclosed.

Ongoing disclosure

315. Periodic Shari’ah-related disclosures for sukūk shall include details of payments made in respect of purification or compensation as described in paragraphs 311 and 312 and Shari’ah-related payments made as described in paragraph 300. Any conflicts of interest relating to such payments must also be disclosed.

316. Immediate Shari’ah-related disclosures for sukūk shall include: (i) any new fatwa or confirmation relating to the sukūk; (ii) any material changes in the matters disclosed under paragraph 309 (“Underlying assets and activities”); (iii) any changes in the matters disclosed under paragraph 310 (“Tradability”); and (iv) any changes to the arrangements disclosed under paragraph 314 (“Shari’ah guidance in matters arising post-issuance”).

Islamic collective investment schemes

317. An Islamic collective investment scheme shall make sufficient disclosures about its Shari’ah governance, Shari’ah compliance and operations to allow a concerned investor to make an informed decision whether to invest or remain invested. Disclosures for special types of ICIS need to reflect their specific structures, operational considerations and risks.
Investments, Sharīʻah review and governance

318. An ICIS shall disclose in its prospectus the type(s) of Sharīʻah-compliant assets in which the fund will invest, and the process that will be used to ensure that each asset is Sharīʻah-compliant.

319. Where the asset selection process depends on an externally produced list of compliant assets or a screening methodology, the ICIS shall give details. Where the information is extensive, broad details may be given in the prospectus, together with a reference (e.g. through a URL) to more detailed information. It shall give the names and qualifications of the Sharīʻah scholars responsible for approving the methodology and, where available, the relevant fatwā. It shall also disclose any special Sharīʻah-related risks.

320. Where the ICIS maintains or employs its own SSB, it shall give the names of the Sharīʻah scholars, their qualifications, the roles and responsibilities of the SSB, and the Sharīʻah review process followed. It shall also disclose the frequency of Sharīʻah meetings, the frequency of review of the ICIS’s investments and investment methodology, circumstances where non-compliance with Sharīʻah principles or rules may occur, and the processes used to detect and control the risks of such non-compliance.

321. An ICIS shall disclose in its prospectus the processes for internal and/or external Sharīʻah audit.

322. Material changes to any of the matters set out above shall be reported in the annual and/or interim reports. A material change in investment strategy is also likely to be a matter requiring investor approval and, therefore, immediate disclosure.

323. An ICIS shall also include in its annual report a report from its SSB (if any) on the operations of the ICIS during the year, and from any external Sharīʻah auditor.

Treatment of Sharīʻah non-compliant assets or income

324. An ICIS shall explain in its prospectus the processes for review of the continuing Sharīʻah compliance of its investments, and for divestment from any asset or investment determined to be no longer compliant. It shall also state whether or not there are arrangements made for purification payments to be made in respect of Sharīʻah non-compliant income. The basis on which purification payments are made shall be described, and the entities to whom they will be made shall also be disclosed (if these are known at the time).

14.2 Takaful

325. Investment is one of the key activities in takaful that must be in line with Sharīʻah principles and rules. In addition to the disclosures specified in paragraphs 298, 299 and 300, takaful and retakaful operators shall be required to disclose the following information for each fund: (i) the adopted Sharīʻah screening methodology; (ii) any purification payments made in respect of assets or businesses that were not fully Sharīʻah-compliant; and (iii) the amount of any purification payments held by the takaful/retakaful undertaking and not yet paid.

33 For detailed guidance, see IFSB-25: Disclosures to Promote Transparency and Market Discipline for Takāful/Retakāful Undertakings.
326. *Takaful* institutions shall also ensure appropriate disclosures in respect of the following:

a. a brief about the overall *takāful* model applied and the core Shari‘ah principles and rules applicable thereto, including but not limited to the policy in respect of segregation of various *takāful* participants’ funds including investment funds, and the mutual relationship between these funds and the *takāful* entity along with significant terms and conditions applicable thereto, in line with Shari‘ah principles and rules;

b. policy in respect of *qard hasan*, its impairment, any regulatory requirements in respect of the same, along with any waiver or write-off requirements;

c. disclosures in respect of *qard hasan*, its movement (including receipts and payments, impairment and other adjustments, etc.), as well as adequate future projections about the ability or otherwise of the *takāful* funds to repay the *qard hasan* in the foreseeable future;

d. policy in respect of maintenance of regulatory reserve and solvency requirements, separately identifying the extent to which these pertain to the *takāful* participants’ funds and investment funds;

e. policy in respect of surplus and deficit determination in the *takāful* participants’ funds related to the risk sharing/underwriting business, its attribution and distribution, in line with the Shari‘ah principles and rules;

f. disclosures of various fees (e.g. *wakala*) charged and incomes/surpluses shared (e.g. *mudarabah/al-wakala bl al-istithmar* (investment agency)) under different internal contracts charged by the *takāful* entity to various *takāful* participants’ funds (including investment funds), identifying separately any surplus shared with the *takāful* entity (if so allowed/required by the respective *takāful* model/regulations);

h. disclosure of expenses and costs shared between different funds and the *takāful* entity; and

i. in those cases where the financial reporting model (due to regulatory or financial reporting regime requirements) does not account for the *takāful* participants’ funds and the *takāful* entity separately, the disclosure of all significant balances as consolidated in the financial statements attributable to the *takāful* entity and the respective funds, as well as transactions and balances among them.
## DEFINITIONS

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fatwā</strong></td>
<td>A juristic opinion given by an SSB on any matter pertinent to Shari‘ah issues, based on appropriate methodology.</td>
</tr>
<tr>
<td><strong>Independent external Shari‘ah audit (IESA)</strong></td>
<td>IESA is an independent assurance engagement to provide reasonable assurance that an IIFS complies with Shari‘ah principles and rules applicable to its financial arrangements, non-financial matters, contracts and transactions during a specific period based on a specific set of Shari‘ah principles and rules contained in the criteria.</td>
</tr>
<tr>
<td><strong>Institutions offering Islamic financial services (IIFS)</strong></td>
<td>IIFS include Islamic banks, Islamic insurance/takāful institutions, Islamic windows and Islamic collective investment schemes.</td>
</tr>
<tr>
<td><strong>Investment risk reserve (IRR)</strong></td>
<td>The amount appropriated out of the profit of investment account holders (IAHs) after allocating the muḍārib’s share of profit, in order to cushion against future investment losses for IAHs.</td>
</tr>
</tbody>
</table>
| **Islamic collective investment scheme (ICIS)** | Any structured financial scheme that, fundamentally, meets all the following criteria:  
  a. Investors have pooled their capital contributions in a fund (whether that fund is in a separate legal entity or is held pursuant to a contractual arrangement) by subscribing to units or shares of equal value. Such units or shares constitute, in effect, claims of ownership of the undivided assets of the fund (which can consist of financial or non-financial assets), and give rise to the right or obligation to share in the profits or losses derived from those assets. Whether or not the ICIS is managed by the institutions that established or sponsored it, it is financially accountable separately from those institutions (i.e. it has its own assets and liabilities profile), but excluding sukūk.  
  b. The fund is established and managed in accordance with Shari‘ah principles and rules. |
| **Islamic window** | An identifiable unit within a conventional financial institution that provides a complete intermediation process in Shari‘ah-compliant financial services from sourcing of funds to providing financing and making investments under a governance framework that ensures its sanctity as a Shari‘ah-compliant operator. |
| **Management** | For the purpose of this standard, management is an organ, or combination of organs, that manages an IIFS’s operations and resources (including human resources). Management’s functions include, inter alia, risk assessment, objective setting, planning, organising, staffing, leading or directing, and controlling an IIFS. Management includes such directors and employees who are involved in the above-mentioned functions, irrespective of their designations. It may also refer to specific departments and/or the whole organisational management collectively. |
| **Maqāṣid al-Shari‘ah** | The fundamental principles of Shari‘ah which aim to promote and protect the interests of all human beings and avert all harm that impairs their interests. |
| **Muḍārabah** | A partnership contract between the capital provider (rabb al-māl) and an entrepreneur (muḍārib) whereby the capital provider would
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>contribute capital</td>
<td>Contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless they are due to misconduct, negligence or breach of contracted terms.</td>
</tr>
<tr>
<td>Operational risk</td>
<td>The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. For takāful or retakāful undertakings, this also includes risk of loss resulting from Shari‘ah non-compliance and failure in a takāful or retakāful operator's fiduciary responsibilities.</td>
</tr>
<tr>
<td>Profit equalisation reserve (PER)</td>
<td>The amount appropriated out of the muḍārabah profits in order to maintain a certain level of return on investment for the muḍārib and unrestricted IAHs.</td>
</tr>
<tr>
<td>Qard</td>
<td>The payment of money to someone who will benefit from it provided that its equivalent is repaid. The repayment of the money is due at any point in time, even if it is deferred.</td>
</tr>
<tr>
<td>Retakāful</td>
<td>An arrangement whereby a takāful undertaking cedes a portion of its risks on the basis of treaty or facultative retakāful as a representative of participants under a takāful contract, whereby it would contribute a portion of the contribution as tabarru’ into a common fund to cover against specified loss or damage.</td>
</tr>
<tr>
<td>Retakāful operator</td>
<td>Any establishment or entity that manages a retakāful business – usually, though not necessarily, a part of the legal entity in which the participants' interests are held.</td>
</tr>
<tr>
<td>Retakāful participant</td>
<td>A party that participates in a retakāful arrangement with the retakāful operator and has the right to benefit under a retakāful contract.</td>
</tr>
<tr>
<td>Retakāful undertaking</td>
<td>An undertaking operating under the principles of takāful but in which the participants are themselves takāful undertakings and the risks shared are those of the original takāful undertakings' participants.</td>
</tr>
<tr>
<td>Self-review threat</td>
<td>For the purpose of this standard, self-review threat is the situation in which a reviewer or decision maker or arbiter reviews and provides their own opinion, view or decision in respect of a matter in which they were responsible for, or part of the team responsible for, the work that has been performed earlier in respect of such matter.</td>
</tr>
<tr>
<td>Senior management</td>
<td>For the purpose of this standard, senior management represents collectively the group of most senior members of the management (including the head of the Islamic window) who are responsible for overall decision making for the IIFS, individually or collectively.</td>
</tr>
<tr>
<td>Shari‘ah</td>
<td>The practical divine law deduced from its legitimate sources: the Qur'an, Sunnah, consensus (ijmā'), analogy (qiyās) and other approved sources of the Shari‘ah.</td>
</tr>
<tr>
<td>Shari‘ah adviser/Shari‘ah advisory firm</td>
<td>An individual or entity that provides Shari‘ah advisory services, including Shari‘ah-compliant product development, as part of their professional services.</td>
</tr>
<tr>
<td>Shari‘ah non-compliance risk</td>
<td>An operational risk resulting from non-compliance of the IIFS with Shari‘ah principles and rules.</td>
</tr>
<tr>
<td>Shari‘ah principles and rules</td>
<td>Shari‘ah principles and rules are defined by the following hierarchy:</td>
</tr>
<tr>
<td><strong>a.</strong> Sharī‘ah standards issued by AAOIFI and Sharī‘ah-related requirements of the applicable financial accounting standards issued by AAOIFI;</td>
<td><strong>Shari‘ah supervisory board (SSB)</strong></td>
</tr>
<tr>
<td><strong>b.</strong> regulatory Sharī‘ah requirements (if any) issued by the regulator;</td>
<td><strong>DIRECTORY</strong></td>
</tr>
<tr>
<td><strong>c.</strong> Sharī‘ah rulings of the CSB (if any); and</td>
<td><strong>Takāful</strong></td>
</tr>
<tr>
<td><strong>d.</strong> Sharī‘ah rulings of the IIFS’s SSB.</td>
<td><strong>Takāful operator</strong></td>
</tr>
<tr>
<td><strong>Shari‘ah supervisory board (SSB)</strong></td>
<td><strong>Takāful participant</strong></td>
</tr>
<tr>
<td><strong>DIRECTORY</strong></td>
<td><strong>Takāful undertaking</strong></td>
</tr>
<tr>
<td><strong>DIRECTORY</strong></td>
<td><strong>Takāful/retakāful window</strong></td>
</tr>
<tr>
<td><strong>DIRECTORY</strong></td>
<td><strong>Underwriting (takāful)</strong></td>
</tr>
<tr>
<td><strong>DIRECTORY</strong></td>
<td><strong>Underwriting risk (takāful)</strong></td>
</tr>
<tr>
<td><strong>DIRECTORY</strong></td>
<td><strong>Underwriting surplus or deficit (takāful)</strong></td>
</tr>
<tr>
<td><strong>DIRECTORY</strong></td>
<td><strong>Wakāla (takāful)</strong></td>
</tr>
<tr>
<td><strong>Zakāh</strong></td>
<td>An obligatory financial contribution disbursed to specified recipients that is prescribed by the Shari'ah on those who possess wealth reaching a minimum amount that is maintained in their possession for one lunar year.</td>
</tr>
</tbody>
</table>
APPENDIX A: SSB REPORT TEMPLATE

بسم الله الرحمن الرحيم

Sharī‘ah Supervisory Board’s report to the shareholders and participatory stakeholders\(^{34}\) of XYZ Institution on the state of compliance of XYZ Institution with Sharī‘ah principles and rules during the year ended 31 December 20XX

السلام عليكم ورحمة الله وبركاتك

1. Introduction

We, collectively, having been appointed by the shareholders [or other appointing authority] as the Sharī‘ah Supervisory Board (SSB) of XYZ Institution (the institution) have fulfilled our responsibilities in respect of ensuring the institution’s compliance with Sharī‘ah principles and rules, and are pleased to issue this report.

2. Opinion

Primary Opinion

Based on our (i) oversight and supervision of the institution’s affairs related to Sharī‘ah compliance, and (ii) a period specific review of the activities performed, we report that in our opinion, [except for the effect of the Exceptions and Limitations reported in the paragraphs immediately following], in all material respects the institution’s financial arrangements, contracts and transactions with its customers, other financial institutions and stakeholders for the year ended 31 December 20XX are in compliance with Sharī‘ah principles and rules.

Exceptions

[Provide exceptions, if any, including instances of material non-compliances with Sharī‘ah principles and rules, which could not be resolved/settled]

Limitations

[Provide limitations or constraints, if any, e.g. missing data, record-keeping deficiencies or missing or unreliable documents, that restrict the ability of the SSB to conclude with reasonable certainty about the state of compliance of the institution with Sharī‘ah principles and rules]

Additional Opinions

We further report that in our opinion:

a. any income earned from impermissible sources, along with any charity amounts received from customers/other stakeholders, have been adequately accounted for as impermissible income and have been paid/are earmarked for payment within the next 12 months (duly segregated

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\(^{34}\) According to AAOIFI Conceptual Framework for Financial Reporting (Revised 2020), participatory stakeholders have a contractual arrangement with the institution to share the profits, losses and residual interest in the net assets of the underlying asset or business. Primarily, they include IAHs and sukūk holders (as applicable). For takaful companies, these include participants (also called the insured).
from the institution’s own funds) by the management for the purposes and the parties approved, on a timely basis, in line with the overall policy approved by the SSB;

b. zakāh applicable on different stakeholders has been adequately computed and accounted for and/or disclosed, as appropriate, and the zakāh has been paid by the management for the purposes and the parties approved, on a timely basis, in line with the overall policy approved by the SSB;

c. the institution has complied with its fiduciary responsibilities, including in particular the profit and/or loss sharing with various participating stakeholders (including IAHs, sukuk holders, etc.) by applying just and equitable treatment to such stakeholders in line with the relevant contracts, applicable Shari’ah and accounting standards and the institution’s policies;

d. the institution has followed the principles of financial reporting, reflecting the true nature and characteristics of the transactions in line with Shari’ah principles and rules and has not committed any non-compliance with Shari’ah, in particular regarding revenue and liability recognition, profit and loss computation, determination of counterparty balances and reporting of monetary balances, among others; and

e. the institution has established an appropriate mechanism of assessment of Shari’ah non-compliance risk commensurate with the nature and size of its operations and has established necessary mitigating measures to manage such risk.

f. [For takaful windows] the funds of the takaful participants have been properly segregated from the funds of the conventional insurance policyholders.

3. Our Responsibilities

Our responsibilities in respect of the institution’s compliance with Shari’ah principles and rules include providing supervision, Shari’ah rulings on the products, services and operations of the institution, particularly regarding the design of the transactions (including approval of contracts, related documents, process flows, etc.). We are also responsible for supervising and providing our input where needed about the execution of such transactions and implementation of our decisions. We are also required to perform a period-specific review of the state of compliance of the institution with Shari’ah principles and rules.

We confirm that we have fulfilled our responsibilities in respect of the current year. We further confirm that the management of the institution has provided us all the information and support that we considered necessary for the purpose of fulfilling our responsibilities, including, in particular, those enabling us to form our opinion and to issue our report.

Sharī’ah Principles and Rules as Applicable to the Institution

The institution’s compliance with Shari’ah principles and rules denotes compliance of the institution’s financial arrangements, contracts and transactions for the year ended 31 December 20XX with Shari’ah principles and rules, as determined in line with the hierarchy provided below (or as otherwise specified by the respective regulator):

a) the Shari’ah standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and Shari’ah-related requirements of the applicable financial accounting standards issued by AAOIFI;

b) the regulatory Shari’ah requirements (if any) issued by [________________ – the regulator];

c) the Shari’ah rulings of the CSB (if any); and

d) Shari’ah rulings of the institution’s SSB [including the interpretation provided by the SSB of the requirements of (a) to (c) above, where needed].
Responsibility for the Subsidiaries [where applicable]

The scope of our report for the purpose of determining our opinion includes the subsidiary(ies) that are consolidated in the financial statements of the institution. In respect of the subsidiaries that have a different SSB or where different regulatory Sharī‘ah requirements are in place, for the purpose of forming our opinion, we have performed a review of the overall state of compliance with Sharī‘ah principles and rules. [Any differences arising due to a different regulatory Sharī‘ah requirement shall be reported under the other significant matters.]

Functions Relied Upon

For the purpose of forming our opinion and preparing this report, particularly for being able to conclude on the execution of contracts and transactions and implementation of Sharī‘ah principles and rules in day-to-day operations, we have relied extensively on the following (after due deliberation on the quality and independence of the respective functions and their reports):

a. the report of the independent external Sharī‘ah auditor (if any);

b. the report of the external auditor on the financial statements of the institution;

c. the internal Sharī‘ah audit function and its reports as relevant to the period; and

d. the Sharī‘ah compliance department’s reports and other communication to the SSB.

Inherent Limitations of the SSB Function and Its Report

The function of the SSB and, consequently, our report has certain inherent limitations which the readers of this report ought to know before forming their conclusions. These, inter alia, include:

a. The SSB’s involvement with the affairs of the institution is in an independent capacity and it has significant constraints with regard to time and resource availability. Due to this, the SSB has to place significant reliance on various functions and reports in its assessment of compliance with Sharī‘ah principles and rules in the day-to-day operations of the institution.

b. The SSB’s main function is limited to the design of contracts and transactions (including fatwa and overall approval of the documents, process flows, etc.), while the implementation of contracts and transactions is the management’s responsibility.

SSB’s Independence and Ethical Considerations

We confirm that we have complied with all ethical and independence requirements, as applicable to us, during the year/period of report, until the date of issuance of this report [except for ____________]. These requirements include those specified in [IFSB–AAOIFI RSGF/AAOIFI GS 1 and 5] and AAOIFI Code of Ethics for Islamic Finance Professionals.

4. The Responsibilities of the Management and the Board of Directors

The Responsibilities of the Board

The board of directors of the IIFS has an oversight responsibility to ensure that an effective and robust Sharī‘ah compliance environment and culture exist at the IIFS. The board is responsible for the establishment of a good governance and control framework for the institution and the development of a strategy for compliance with Sharī‘ah principles and rules, and for oversight of the management in implementing the same and in achieving the desired objectives.
Responsibilities of the Management

Management has the responsibility to implement the Shari‘ah governance framework and to ensure that Shari‘ah compliance is embedded in the day-to-day functioning of the IIFS. The management is responsible for ensuring that the financial arrangements, contracts and transactions having Shari‘ah implications, entered into by the institution with its customers and other stakeholders and related policies and procedures, are, in substance and in their legal form, in compliance with the requirements of Shari‘ah principles and rules. Management is also responsible for the design, implementation and maintenance of appropriate internal control procedures with respect to such compliance and maintenance of relevant accounting records.

5. Other Significant Reporting Matters

In connection with this report, we believe that the following matters need to be brought to the attention of the stakeholders. However, these do not impact our overall opinion regarding the state of compliance of the institution with Shari‘ah principles and rules. [To be judgmentally reported by the SSB, if applicable]

Key Shari‘ah Non-Compliance Risks with Weak Internal Controls

- 
- 

Significant Instances of Shari‘ah Non-Compliance, Identified and Later Resolved

- 
- 

Key Shari‘ah Non-Compliance Issues in Matters Not Being Part of Primary Scope [e.g. administration, culture, marketing, etc.]

- 
- 

Key Observations on the Overall Governance and Control Mechanism

- 
- 

Key Differences between Shari‘ah Principles and Rules Applicable to the Parent Entity and Those Applied by Subsidiaries Due to the Application of a Different Regulatory Regime

- 
- 

6. Report Approval and Authentication

This report is duly approved and signed by all the members of the SSB, as follows. The report has been approved unanimously except for the dissenting opinion(s) provided below.

We beg Allah the Almighty to keep us on the right path and to grant us success.
<table>
<thead>
<tr>
<th>Name</th>
<th>Designation</th>
<th>Signature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sh. ABC</td>
<td>Chairperson (Sharī‘ah scholar)</td>
<td></td>
</tr>
<tr>
<td>Sh. MNO</td>
<td>Member (Sharī‘ah scholar)</td>
<td></td>
</tr>
<tr>
<td>Sh. XYZ</td>
<td>Member (Sharī‘ah scholar)</td>
<td></td>
</tr>
<tr>
<td>Dr. ABC</td>
<td>Member (Expert)</td>
<td></td>
</tr>
<tr>
<td>Mr. XYZ</td>
<td>Member (Expert)</td>
<td></td>
</tr>
</tbody>
</table>

Dissenting opinion [if any]

I, ______________________, agree with the SSB report in all matters (as evidenced by my signature affixed above), except for dissent based on my personal opinion with respect to the following matter(s):

- __________________________________________________________________________
- __________________________________________________________________________

Signature: ______________________________

7. Date and Place of Issuance of the Report

[Date]

[City], [Country]

والسلام عليكم و رحمة الله و بركاته

In the event that the SSB detects major violations of Sharī‘ah principles and rules by the institution, the opinion paragraph may be replaced with the following:

a. Some of the contracts, transactions and dealings entered into by the institution during the year ended 20XX that we have reviewed are not in compliance with Sharī‘ah principles and rules. These are listed below:
   - Contract X: brief summary, listing of Sharī‘ah violation, rectification or resolution.
   - Transaction Y: brief summary, listing of Sharī‘ah violation, rectification or resolution.
   - Process Z: brief summary, listing of Sharī‘ah violation, rectification or resolution.

b. The allocation of profit and charging of losses relating to investment accounts does not conform to the basis that had been approved by us in accordance with Sharī‘ah principles and rules:
   - explanation of the issue
   - resolution or rectification.

On account of the above Sharī‘ah violations, we are not able to verify the Sharī‘ah compliance of the institution’s operations.
APPENDIX B: SSB PERFORMANCE ASSESSMENT TEMPLATE

The following is a template containing the minimum parameters for the assessment of an SSB’s performance. The methodology for assessment may include a combination of: (i) administrative assessment by the management; (ii) technical assessment by the peers; and (iii) technical assessment by the chairperson. Suitable weightages may be assigned to each of these components to come up with a combined score for each SSB member. The SSB’s performance as a collective body is to be assessed, as well as that of each of its members individually. This assessment is to be done with respect to four areas (others may be added if needed):

- Values & Ethics
- Leadership & Commitment
- Independence & Objectivity
- Knowledge & Learning.

Collective Assessment

<table>
<thead>
<tr>
<th>Did the SSB:</th>
<th>Values &amp; Ethics</th>
<th>Leadership &amp; Commitment</th>
<th>Independence &amp; Objectivity</th>
<th>Knowledge &amp; Learning</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. consciously strive to adhere to the letter and spirit of the Sharī’ah instead of taking a legalistic and technical approach to Sharī’ah decision making?</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. demonstrate effective organisational accountability?</td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. communicate effectively with other organs of governance, including the board, the management and the auditors?</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>d. properly identify and evaluate the organisation’s exposure to Sharī’ah non-compliance risk and reputational risk, and effectively communicate that risk information to appropriate bodies in the organisation?</td>
<td></td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>e. demonstrate independence and objectivity in its working and decision making?</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>f. promote appropriate ethics and values within the organisation?</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>g. promote continuous improvement of the organisation’s Sharī’ah control processes?</td>
<td></td>
<td></td>
<td></td>
<td>✓</td>
</tr>
</tbody>
</table>

Individual Assessment

<table>
<thead>
<tr>
<th>Did each member of the SSB:</th>
<th>Values &amp; Ethics</th>
<th>Leadership &amp; Commitment</th>
<th>Independence &amp; Objectivity</th>
<th>Knowledge &amp; Learning</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. strive to adhere to the letter and spirit of the Sharī’ah instead of relying primarily on legal and Sharī’ah stratagems?</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>b. attend at least 75% of the SSB meetings held during the past 12 months either in person or through video/conference call?</td>
<td></td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. devote sufficient time as needed in preparing for the meeting, including review of meeting papers?</td>
<td></td>
<td></td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>d. contribute, to the best of their ability, to enriching the discussion and deliberation of the issues raised in SSB meetings?</td>
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<td>e. demonstrate integrity and honesty?</td>
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<td>f. strive for continuous learning and self-improvement?</td>
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<td>g. accept responsibility with due care and diligence?</td>
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<td>h. strive to be sensitive to cultural differences?</td>
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<td>i. strive to be observant/aware of contextual factors before coming to a decision?</td>
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<td>j. demonstrate awareness of psychological tendencies and consciously try to avoid those in their decisions?</td>
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<td>k. exercise rational and logical reasoning?</td>
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<td>l. demonstrate accepting criticism in a constructive and positive manner?</td>
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<td>m. demonstrate willingness to learn from others?</td>
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<td>n. exercise independent professional judgment without being unduly influenced by others?</td>
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<td>o. demonstrate respect for others’ viewpoints while disagreeing with them?</td>
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<td>p. demonstrate the ability to change their position when presented with convincing facts contrary to their opinion?</td>
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<td>q. strive to be inquisitive (capable of asking intelligent and relevant questions)?</td>
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<td>r. maintain the confidentiality of information received during the course of their duties?</td>
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<td>s. demonstrate the spirit of teamwork and collaboration to achieve the common objectives of the SSB?</td>
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