

## Study on the Awareness and Adoption of *Shari'ah* Governance Framework 2010 by the Islamic Financial Institutions in Malaysia

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**Abstract:** The Central Bank of Malaysia (hereinafter referred to as Central Bank) has introduced the guideline on *Shari'ah* Governance Framework for Islamic Financial Institutions (hereinafter referred to as SGF 2010) in October 2010 to have proper *Shari'ah* governance. The SGF 2010 has been circulated to all IFIs under the Central Bank jurisdictions to ensure the SGF 2010 is adopted accordingly. The effective date for adoption was on 1<sup>st</sup> January 2011, giving the IFIs six months to comply with. Within such period, the IFIs need to confirm that they have met all the requirements and are operating in accordance with it. Thus, this article investigates the awareness by the IFIs on the objectives of SGF 2010, perception on the applicability of SGF 2010 and level of adoption of SGF 2010 by the IFIs. This is done through the collection of data and information by distributing the questionnaire to the respondents who involved in IFIs' industries such as the management of the IFIs, be it Islamic banks and Takaful institutions, *Shari'ah* Committee and *Shari'ah* Officers. Most of the data in this study were collected and analyzed using the Statistical Package for Social Sciences (SPSS) software version 16.0 and Microsoft Excel. Additional descriptive analysis is used to determine the number of frequencies and percentages. The findings and analysis show that the awareness amongst the respondents on the objectives of SGF 2010, their perception on the applicability of SGF 2010 and the level of adoption of SGF 2010 by the IFIs are very good and positive.

**Key words:** *Shari'ah* governance, SGF 2010, Central Bank, *Shari'ah* Committee, *Shari'ah* Officers, Islamic banks.

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### INTRODUCTION

*Shari'ah* governance is the Islamic mechanism of corporate governance. It places God in the apex of its structure, stipulating that the corporations can only carry out their activities in accordance with the commandments of God and the interest of the stakeholders of the corporations would come next. The stakeholders of the *Shari'ah* governance are not only shareholders but they include the employers or the staff of the corporations, customers, regulators, inventors and the society at large. This makes it distinguishable from the conventional corporate governance structures as the latter's only objective is to work for the benefit of the shareholders and in a few exceptional instances for the society. Another difference is conventional corporate governance standards fundamentally aspire to deal with the severance of ownership and management by ensuring that action of the management are kept in line with the interests of shareholders and stakeholders (Aziz, 2009).

To have a proper *Shari'ah* governance practice, the Central Bank of Malaysia (hereinafter referred to as Central Bank) has introduced the guidelines on *Shari'ah* Governance Framework for Islamic Financial Institutions (hereinafter referred to as SGF 2010) in October 2010. The objectives of the SGF 2010 are:

- i) To set out the expectations of the Bank on an IFI's *Shari'ah* governance structures, processes and arrangements to ensure that all its operations and business activities are in accordance with *Shari'ah*;
- ii) To provide a comprehensive guidance to the board, *Shari'ah* Committee and management of the IFIs in discharging its duties in matters relating to *Shari'ah*; and
- iii) To outline the functions relating to *Shari'ah* review, *Shari'ah* audit, *Shari'ah* risk management and *Shari'ah* research. (*Shari'ah* Governance, 2010).

The Central Bank in October 2010 has circulated the SGF 2010 to all IFIs under its jurisdictions to ensure the SGF 2010 is adopted accordingly by the IFIs in Malaysia. The effective date for adoption was on 1<sup>st</sup> January 2011, giving the Islamic financial institution six months to comply with the framework. Within such period, the

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IFIs need to confirm that they have met all the requirements and are operating in accordance with it. The implementation of this SGF 2010 will promote stakeholders' confidence and the integrity of the Islamic financial institutions besides reducing *Shari'ah* non-compliance risks and will contribute to the maintaining financial stability for future. (*Financial Stability*, 2009).

After more than one year starting from its effective date for adoption by the IFIs, it is therefore timely to look into i) the awareness by the IFIs on the objectives of SGF 2010, ii) perception on the applicability of SGF 2010 and iii) level of adoption of SGF 2010 by the IFIs.

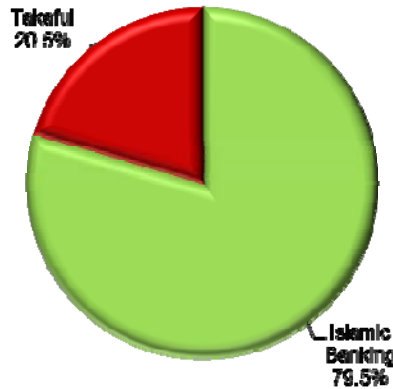
**Research Methodology:**

The collection of data has been carried out through using a set of questionnaire containing the information on the following:

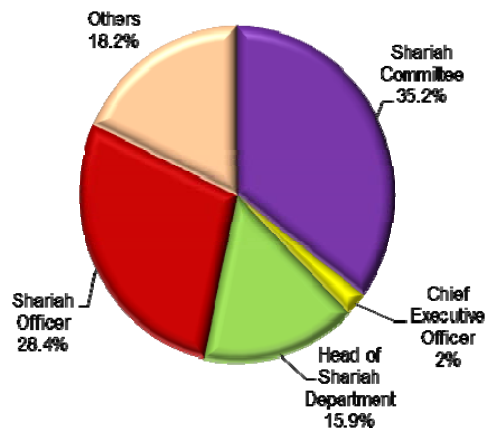
- i) profile of the respondents
- ii) awareness by the IFIs on the objectives of SGF 2010,
- i) perception on the applicability of SGF 2010 and
- ii) level of adoption of SGF 2010 by the IFIs.

To do that, the collection of data and information from the respondents who involved in IFIs' industries such as the management of the IFIs, be it Islamic banks and Takaful institutions, *Shari'ah* Committee and *Shari'ah* Officers is necessary. This is because they are the stakeholders in the implementation of SGF 2010. Most of the data in this study were collected and analyzed using the Statistical Package for Social Sciences (SPSS) software version 16.0 and Microsoft Excel. Additional descriptive analysis is used to determine the number of frequencies and percentages.

A total of 88 respondents have contributed to the research. This is to obtain a percentage from the sample. The following Charts (Chart 1.1 – 1.4) and Table 1.1 illustrate on the information of respondents' profile.



**Chart 1.1:** Respondents' distribution based on institution.



**Chart 1.2:** Respondents' distribution based on position.

From Chart 1.1, it indicates that out of 88 respondents, 79.5% of them are from Islamic banks while the rest 20.5% are from Takaful institutions. The numbers of respondents from Islamic banks are more due to the fact that Malaysia has more Islamic banks compared to the Takaful institutions. As of today, the numbers of Islamic banks are thirty-eight and Takaful institutions are twelve. (Rusni, 2011). The respondents consist of *Shari'ah* Committee (35.2%), *Shari'ah* Officer (28.4%), Head of *Shari'ah* Department (15.9%), Chief Executive Officer (2.0%) and other positions (18.2%) as mentioned in Chart 1.2.

For the genders and age groups of the respondents, they are shown in Chart 1.3 and Chart 1.4 respectively.

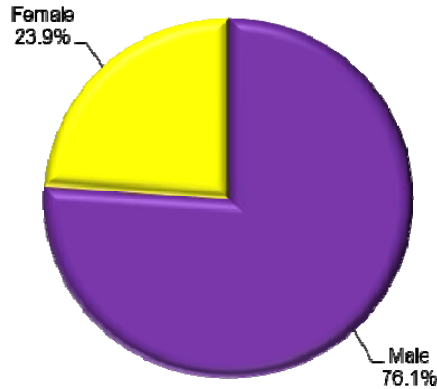


Chart 1.3: Respondents' distribution based on gender.

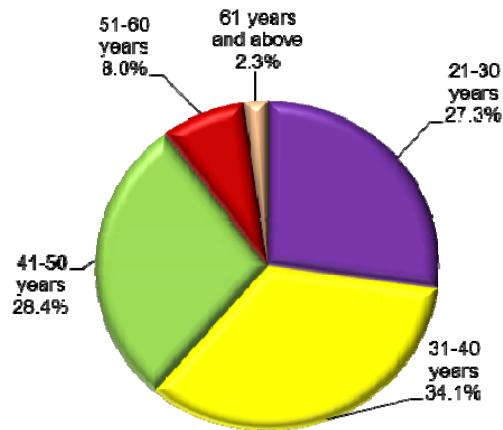


Chart 1.4: Respondents' distribution based on age group.

Chart 1.3 shows that the respondents comprise of 76.1% men and 23.9% of women as the majority of *Shari'ah* committee, Management and *Shari'ah* officers are male. Chart 1.4 shows that the majority of respondents are between 31 to 40 years old (34.1%), followed by respondents between 41 to 50 years old (28.4%) and 21 to 30 years old (27.3%). The rest are respondents in the range of 51 to 60 years old (8.0%) and above 61 years old (2.3%).

For the academic qualification of the respondents, the figure is shown in Table 1.1.

Table 1.1:

Qualification	No.	30	2	0	32
Bachelor	No.	30	2	0	32
	%	34.1%	2.3%	0.0%	36.4%
Master	No.	19	3	1	23
	%	21.6%	3.4%	1.1%	26.1%
PhD	No.	27	1	0	28
	%	30.7%	1.1%	0.0%	31.8%
Professional Courses	No.	5	0	0	5
	%	5.7%	0.0%	0.0%	5.7%
Total	No.	81	6	1	88
	%	92.0%	6.8%	1.1%	100.0%

Table 1.1 shows the distribution of respondents based on their academic qualification. It is as follows: 36.4% of respondents have Bachelor qualification, 31.8% have PhD and 26.1% have Master qualification. The rest of 5.7% possess academic qualification from Professional courses. Out of the Bachelor holders, 2 of them have professional courses certificate while 4 Master’s holders, 3 of them have professional courses certificate and 1 of them has *Shari’ah* certificate. 1 of the PhD holders has professional courses qualification certificate. It is good to find some of the respondents have professional certificate in addition to their main qualification. To make it better, it is proposed that the number of respondents with professional courses certificate need to be increased in order to enhance the professionalism in the industries.

For the respondents’ specialization, the distribution is shown in Chart 1.5.

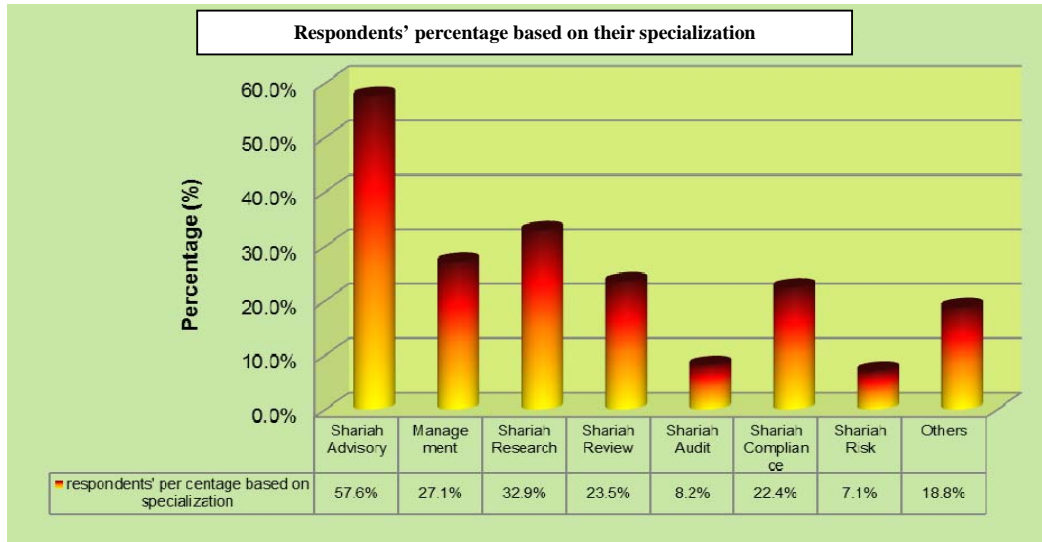


Chart 1.5:

The above Chart 1.5 indicates that 56% of the respondents are specialized in *Shari’ah* Advisory, 32.9% are on *Shari’ah* Research, 27.1% on Management, 23.5% on *Shari’ah* Review and 22.4% on *Shari’ah* Compliance. It shows also that 8.2% of the respondents have the specialization in *Shari’ah* Audit, 7.1% have in *Shari’ah* Risk and 18.8% have in other specializations.

**Awareness on the Objectives of SGF 2010:**

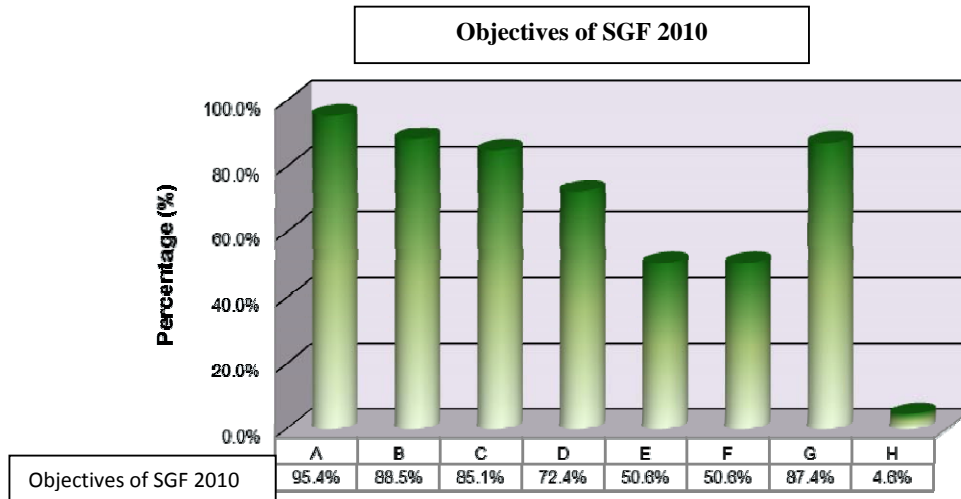
There are generally seven general objectives of SGF 2010. They are as follow:

- i) To establish a sound and robust *Shari’ah* Governance Framework
- ii) To set up accountability and responsibility of every key functionary
- iii) To ensure independence of *Shari’ah* Committee
- iv) To enhance competency and continuous knowledge
- v) To observe confidentiality of information
- vi) To maintain professional ethics and consistency of judgment
- vii) To have robust *Shari’ah* compliance function. (*Shari’ah* Governance, 2010)

To have the respondents’ knowledge and awareness on the general objectives for SGF 2010, the respondents are asked to tick in the box any of the following answers regarding the general objectives of SGF 2010. For the purpose of collection of data and analysis, each answer is given a special Code that is Code A to H.

A	To establish a sound and robust <i>Shari’ah</i> Governance Framework
B	To set up a accountability and responsibility of every key functionary
C	To ensure independence of <i>Shari’ah</i> Committee
D	To enhance competency and continuous knowledge
E	To observe confidentiality of information
F	To maintain professional ethics and consistency of judgment
G	To have robust <i>Shari’ah</i> compliance function
H	Others

For the answers, the distributions and percentage are clearly shown in the Chart 1.6.



**Chart 1.6:**

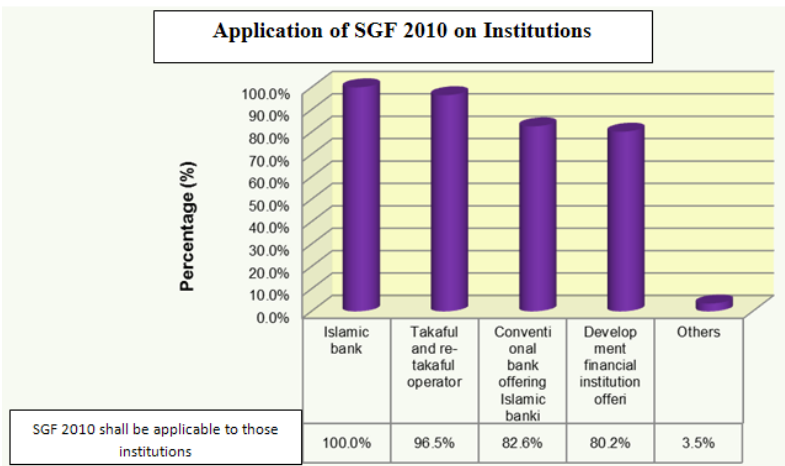
Based on the Chart 1.0, it shows that more than 85% of the respondents acknowledge that A, B, C and G are the objectives of SGF 2010. This high percentage shows that such objectives are considered of high importance from the perspective of the respondents. 72.4% of the respondents consider having a robust *Shari'ah* compliance function is important objective of SGF 2010. Meanwhile, 50.6% of the respondents are of the view that E and F are also the objectives of SGF 2010. Only 4.6% of the respondents view that there are other objectives of SGF 2010.

**Perception on the Applicability of SGF 2010:**

There are various IFIs under the jurisdiction of the Central Bank. They are subject to the applicability of SGF 2010. The following institutions are those institutions that are subject to the SGF 2010:

- i) an Islamic bank licensed under Islamic Banking Act 1983 (IBA);
- ii) a *takaful* and *retakaful* operator registered under the Takaful Act 1984 (TA);
- iii) a financial institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) that participates in the Islamic Banking Scheme; and
- iv) a development financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) that participates in the Islamic Banking Scheme. (*Shari'ah* Governance, 2010)

The perception by the respondents on the institutions subject to regulation of SGF 2010 is indicated by Chart 1.7.

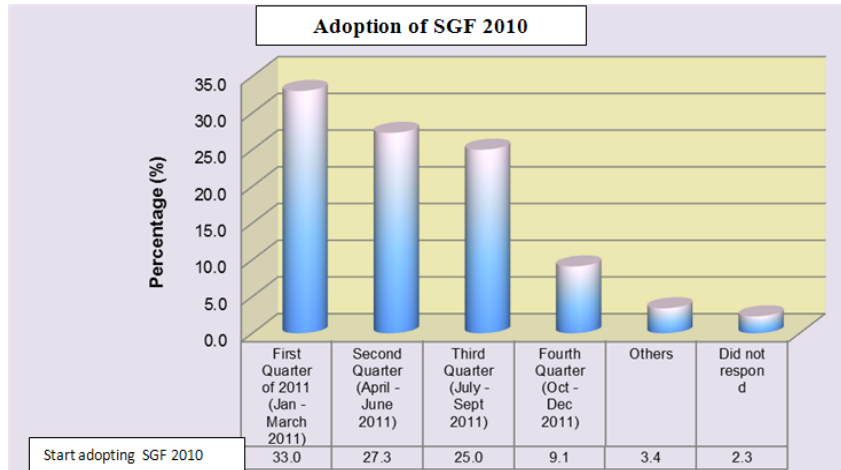


**Chart 1.7:**

On the basis of Chart 1.7, most of the respondents agree that the applicability of SGF 2010 is for the institutions those are clearly mentioned in the SGF 2010 itself. It is interesting to note that all respondents (100%) agree and acknowledge that SGF 2010 applies to the Islamic banks.

**Level of Adoption of SGF 2010:**

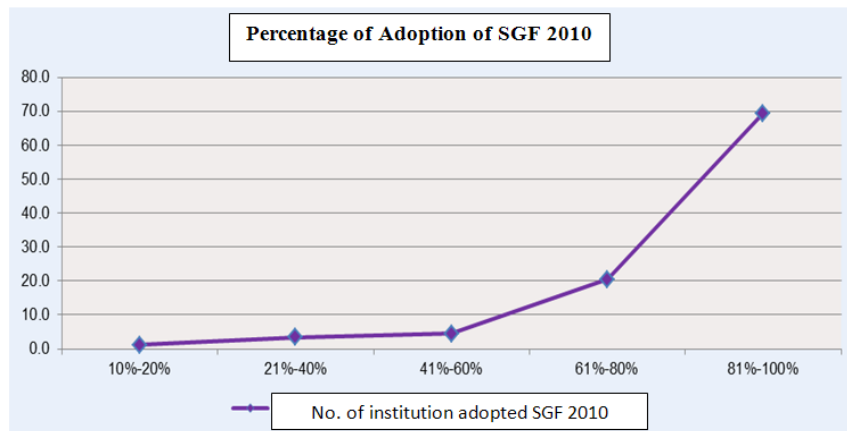
After looking into the data on the perception on the applicability of the SGF 2010 on IFIs, it is better to look into the level on adoption of the SGF 2010 by the IFIs as SGF 2010 clearly mentions that the effective date for adoption of was on 1<sup>st</sup> January 2011, giving the Islamic financial institution six months to comply with. The status of adoption of SGF 2010 for its effective date is clearly indicated in the following Chart 1.8.



**Chart 1.8:**

Chart 1.8 shows that the respondents acknowledge that 33.0% of the institutions subject to SGF 2010 have adopted the SGF 2010 on the first quarter of 2011 which is from January to March 2011 and 27.3% of them have adopted SGF 2010 on the second quarter that is from April to June 2011. The combination between the first quarter and second quarter shows that more than 70% of the institutions have adopted the SGF 2010. This is considered as a good and positive indication of the response and attitude of majority of institutions to follow the directive of the Central Bank adopting the SGF 2010 with the prescribed duration. The Chart 1.8 demonstrates also that 25% of the institutions have adopted the SGF 2010 on the third quarter of 2011 that is from July to September 2011 and 9.1% of them adopted on the fourth quarter starting from October to December 2011. The adoption of SGF 2010 after the prescribed duration by more than 37% of the institutions may be acceptable due to the fact that they are given extension of time to adopt the SGF 2010 by the Central Bank.

For the progress of adoption of SGF 2010, the following Chart 1.9 has shown it clearly.



**Chart 1.9:**

Based on Chart 1.9, it shows excellent progress as 81 – 100% of the number of institutions adopting SGF 2010. This is a very good indication of the institutions' attitude in adopting the SGF 2010. However, there are only few of them that still in 10 – 20% level adoption level. Thus, these institutions need to seriously consider to fully complying with the SGF 2010 requirement.

**Conclusion:**

It is shown from analysis and findings that the awareness amongst the respondents on the objectives of SGF 2010, their perception on the applicability of SGF 2010 and the level of adoption of SGF 2010 by the IFIs are very good and positive. This shows that the introduction of SGF 2010 has been implemented accordingly by the IFIs and well received by them. It is hoped that the implementation of this SGF 2010 will promote stakeholders' confidence and the integrity of the IFIs besides reducing *Shari'ah* non-compliance risks and will contribute towards maintaining financial stability of Malaysian Islamic Financial Industries in future.

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