

## SHARIAH COMMITTEES IN MALAYSIA: ARE ISLAMIC BANKS MEETING COMPOSITION REQUIREMENTS?

Yasin Ahmed Sulub  
IIUM Institute of Islamic Banking and Finance  
International Islamic University Malaysia, Kuala Lumpur, Malaysia  
Email: sulub.yahmed@gmail.com

Razali Haron  
IIUM Institute of Islamic Banking and Finance  
International Islamic University Malaysia, Kuala Lumpur, Malaysia  
Email: hrzali@iium.edu.my

### ABSTRACT

*Shariah compliance is fundamental to the operations of Islamic banks (IBs), ensuring that all activities conform to Islamic law (Shariah). To maintain Shariah compliance, IBs must establish a Shariah committee (SC), which plays a key role in providing guidance, oversight, and approval for Islamic banking products and services. The aim of this study is to investigate whether IBs in Malaysia effectively comply with the regulatory requirements for SC composition, with a particular focus on SC size and member qualifications. The findings reveal that, despite a few instances of non-compliance, most IBs in Malaysia have adhered to the stipulated requirements for SC composition. The conclusions of this study are beneficial to the regulators, IBs, and researchers.*

Keywords: Shariah committees, Shariah committee composition, Shariah committee size, Shariah committee qualifications

### INTRODUCTION

*Shariah Governance (SG)* is a fundamental feature that distinguishes Islamic financial institutions (IFIs) from their conventional counterparts. It ensures that all aspects of IFIs, including their operations, practices, instruments, products, and management, consistently align with *Shariah* principles (Ismail and Hassan, 2016). SG ensures that the operations and activities of IFIs strictly adhere to *Shariah* requirements by avoiding prohibited elements such as *riba* (interest), *gharar* (excessive uncertainty), *maisir* (gambling), and other non-compliant practices (Bahari and Baharudin, 2016). This mechanism delivers the religious and ethical legitimacy essential to meeting stakeholders' expectations (Karbhari et al., 2020). To uphold *Shariah* compliance, IFIs must establish a *Shariah* committee (SC)/*Shariah* board to fulfill this task (Alam, 2022; Sulub, 2024).

*Shariah* boards (or SCs), an independent body of specialized scholars in Islamic commercial jurisprudence, are entrusted with directing, reviewing, and supervising the activities of IFIs to ensure that they are *Shariah*-compliant (AAOIFI, 2015). Their presence is essential for assuring and boosting stakeholder confidence in *Shariah* compliance with all activities (Alnasser and Muhammed, 2012; Masruki et al., 2020). Hence, SCs are the most critical governance mechanism at the IFI level to safeguard *Shariah* compliance (Fatmawati et al., 2022).

Recognizing the importance of SG and the critical role of SCs, Malaysia, through the Central Bank—Bank Negara Malaysia (BNM), has introduced several key SG guidelines for IFIs over the years. These include the *Shariah* Governance Framework (SGF) of 2010, the Islamic Financial Services Act (IFSA) of 2013, and the *Shariah* Governance Policy Document (SGPD) of 2019. The latest SG guideline, the SGPD issued in 2019, superseded the SGF 2010. The SGPD is considered the most comprehensive SG framework compared to the SGF 2010 and IFSA 2013 (Kamaruddin et al., 2020).

The SGPD 2019 mandates that IFIs establish a SC to oversee *Shariah* compliance. The SGPD specifies detailed criteria regarding the qualifications, expertise, and composition of SC members, including the minimum number of members to be appointed by IFIs. Failure to meet these requirements or comply with SC directives in Malaysia could expose IFIs to legal risks (Ismail and Hassan, 2016). Thus, whether Islamic banks (IBs) in Malaysia effectively comply with the SC composition requirements stipulated in the SGPD arises.

That said, this study seeks to examine whether IBs in Malaysia meet the size and qualifications criteria of the SC as required by the SGPD 2019. To our knowledge, no prior research has investigated this issue.

The structure of this paper is as follows. The next section provides an overview of SG. The third section introduces a brief overview of SG in Malaysia. The fourth section presents the research methodology. The fifth section reports the findings and discussion. Lastly, the sixth section sets forth the conclusion and recommendations.

### SHARIAH GOVERNANCE

SG is a unique characteristic of IBs and is vital for ensuring effective compliance with *Shariah*. It provides these institutions with religious and moral legitimacy (Karbhari et al., 2020). It also enhances stakeholder confidence by assuring them that all practices and activities consistently align with the *Shariah* principles (Haron et al., 2022). *Shariah* compliance in the Islamic finance industry is strengthened by establishing a robust SG framework (Hasan, 2007; Laldin and Furqani, 2018).

IFSB-10 defines SG as: “the set of institutional and organizational arrangements through which an IIFS (institution offering Islamic Financial Services) ensures that there is effective independent oversight of *Shariah* compliance [...] (IFSB, 2009).” Moreover, IFSB-10 describes the SG system in IFIs, as shown in Table 1. IBs or any other IFI maintain standard governance mechanisms similar to conventional financial institutions but are also subject to an additional layer of governance through SG. For

instance, alongside the typical board of directors found in conventional institutions, IBs must have a *Shariah* Board/SC to certify that IB's operations are *Shariah*-compliant. In typical financial institutions, the control function involves internal and external auditors, whereas IBs have additional internal and external *Shariah* review/audit functions. Regarding the compliance function, it is recommended that IBs have an internal *Shariah* compliance unit together with the existing regulatory and financial compliance departments.

**Table 1. *Shariah* governance system in IFIs**

| Functions  | Typical financial institution                                    | Exclusive to IFIs   |
|------------|--|---|
| Governance | Board of directors   | <i>Shariah</i> Board  |
| Control    | Internal auditor<br>External auditor                             | Internal <i>Shariah</i> review/audit unit<br>External <i>Shariah</i> review |
| Compliance | Regulatory and financial compliance officers, unit or department | Internal <i>Shariah</i> compliance unit                                     |

Source: IFSB (2009)

Grassa (2013) describes SG as a system guided by *Shariah* principles and overseen by a religious board (i.e., SC) to validate that IFIs' activities comply with *Shariah* conduct and principles. Hence, the purpose of the appointment of SCs in IBs is to provide guidance and oversight, ensuring that all operations and activities strictly adhere to *Shariah* principles. As the primary mechanism at the institutional level, the SC plays a critical role in safeguarding *Shariah* compliance across the IFI.

### SHARIAH GOVERNANCE IN MALAYSIA

Recognizing the importance of SG, Malaysia has developed a comprehensive SG framework through the country's legal and regulatory framework to ensure its enforceability (Hasan, 2010; Laldin and Furqani, 2018). BNM (i.e., the regulator) has introduced extensive and detailed SG guidelines and regulations, including the *Shariah* Governance Framework (SGF) in 2010, the Islamic Financial Services Act (IFSA) in 2013, and the *Shariah* Governance Policy Document (SGPD) in 2019. These guidelines delineate the roles and responsibilities of key SG participants, including the board, SCs, management, and internal *Shariah* control functions. The SGPD 2019, which came into effect in April 2020, outlines the most recent SG guidelines issued by BNM. These guidelines define the responsibilities of main SG participants, including the board, SC, management, and internal *Shariah* control functions such as *Shariah* review, *Shariah* audit, and *Shariah* risk management.

Regarding SCs' composition, the SGPD 2019 instructs that local IFIs must ensure that the SC comprises at minimum five (5) members, with the majority being qualified scholars in *Shariah* (BNM, 2019; p .13). In the SGPD, *Shariah*-qualified scholars refer to those who hold, at minimum, a bachelor's degree in *Shariah*, which includes study in *Usul Fiqh* (principles of Islamic jurisprudence) or *Fiqh Muamalat* (Islamic transaction/commercial law), possess reasonable Islamic finance expertise, and demonstrate strong proficiency and knowledge in written and verbal Arabic, with good command in the preferred language of the IFI (BNM, 2019; p .10). For IFIs operating as an Islamic window or a foreign branch in Malaysia, they must ensure that their SC, at minimum, comprises at least three (3) members (BNM, 2019; p .13). Table 2 summarizes the SC composition requirements specified under the SGPD 2019 in terms of the minimum number of members and educational qualifications.

**Table 2. *Shariah* committee composition requirements under the SGPD 2019**

| Guideline/Regulation                                  | Number of SC members required  | Qualification requirements  | Other qualifications that can be included in the SC   |
|---|--|---|---|
| <i>Shariah</i> Governance Policy Document (SGPD) 2019 | <ul style="list-style-type: none"> <li>At least five (5).</li> <li>At least three (3) for Islamic window or a foreign branch.</li> </ul> | The majority must hold, at minimum, a bachelor's degree in <i>Shariah</i> , which includes study in <i>Usul Fiqh</i> (principles of Islamic jurisprudence) or <i>Fiqh Muamalat</i> (Islamic transaction/commercial law) and possess reasonable Islamic finance knowledge. | An expert who possesses skills, knowledge, and experience relevant to support the roles and responsibilities of the SC. |

Source: BNM (2019)

Accordingly, this study investigates whether IBs comply with the SCs' size and *Shariah* qualification requirements prescribed by the SGPD 2019. The SGPD mandates adherence to specific composition standards, and IBs are obligated to meet these requirements. As previously noted, non-compliance with these regulatory provisions could expose IBs to legal risks.

### RESEARCH METHODOLOGY

This study adopts a quantitative research approach. It analyzes the *Shariah* Governance Policy Document (SGPD 2019), with a particular focus on the SC composition requirements. Specifically, it investigates the mandated number of SC members and the *Shariah* qualifications required for these members. Data on SC composition were sourced from the annual reports of IBs and compared against the regulatory requirements presented in Table 2. The target population of this study comprises IBs operating in Malaysia. According to the BNM website, there are 17 IBs in Malaysia. Out of these, 16 IBs produced annual reports during the

study period (2020 – 2023), and they were included in the analysis. The study period, spanning from 2020 to 2023, was chosen as it represents the timeframe following the implementation of the SGPD 2019. The SGPD, issued on September 20, 2019, came into effect in April 2020. Consequently, it is expected that IBs would have complied with and implemented the guidelines by the end of the 2020 financial year.

## FINDINGS AND DISCUSSION

This study seeks to evaluate whether IBs in Malaysia adhere to the regulatory requirements for SC composition in terms of size and *Shariah* qualifications. The findings are presented in Table 3 and assessed against the following regulatory criteria established by the SGPD 2019:

1. The SC must consist of at least five (5) members. For IFIs operating as foreign branches in Malaysia, their SC must comprise at least three (3) members;
2. The majority of SC members must possess at least a bachelor's degree in *Shariah*, which includes study in Usul Fiqh (principles of Islamic jurisprudence) or Fiqh Muamalat (Islamic transaction/commercial law).

The results indicate that nearly all IBs in Malaysia have effectively complied with the regulatory requirements for SC composition as outlined in the SGPD. Most IBs met the mandated SC size and *Shariah* qualification criteria, demonstrating their commitment to meeting the guidelines stipulated by the policy. However, despite this overall compliance, instances of non-compliance were observed, as highlighted in Table 3. Two non-compliance events involving HSBC Amanah Malaysia Berhad and Public Islamic Bank Berhad were identified.

HSBC Amanah Malaysia Berhad failed to meet the second regulatory requirement, which mandates that the majority of SC members must possess, at minimum, a bachelor's degree in *Shariah*. This non-compliance persisted throughout the study period, spanning four consecutive years from 2020 to 2023. In 2020 and 2023, *Shariah*-qualified members with at least a bachelor's degree in *Shariah* constituted exactly half of the committee, while in 2021 and 2022, they represented less than half. In both scenarios, the SC did not meet the requirement for *Shariah*-qualified members to constitute the majority, resulting in non-compliance with the stipulated guidelines.

Likewise, Public Islamic Bank Berhad failed to meet the second regulatory requirement for the first three years, as *Shariah*-qualified members constituted a minority in 2020, 2021, and 2022. Nevertheless, this non-compliance was rectified in 2023, when *Shariah*-qualified members formed the majority, with three out of five committee members meeting the *Shariah* qualification criteria.

This study concludes that the vast majority of IBs in Malaysia successfully adhered to the regulatory requirements for SC composition, specifically concerning the minimum number of SC members and their *Shariah* qualifications, as outlined in the SGPD 2019. Instances of non-compliance can arise for various reasons, such as resignation, completion of tenure, or termination. The reported cases of non-compliance involving HSBC Amanah Malaysia Berhad and Public Islamic Bank Berhad may not necessarily constitute these institutions' violations of BNM's SC *Shariah* qualification requirements. SG regulations, such as the IFSA 2013, mandate that IBs obtain prior written approval from BNM for SC member appointments and re-appointments as stated in Division II Section 31 (see BNM, 2013). This approval process requires IBs to submit the candidates' names, qualifications, and other relevant details to BNM for evaluation and consent. Thus, it is unlikely that BNM was uninformed of these instances of supposed non-compliance, as each SC member's appointment must receive the regulator's approval.

It is probable that BNM approved these appointments based on alternative criteria beyond the requirement of *Shariah* degrees. For instance, the SC of HSBC Amanah Malaysia Berhad in 2020 consisted of six members, three of whom held at least a bachelor's degree in *Shariah*, meeting the basic qualification requirement. The remaining three members, however, possessed other *Shariah* qualifications, such as certificates or diplomas in Islamic law (*Shariah*) or academic degrees in closely related fields such as Islamic finance, which often involve significant study of *Shariah*, particularly *Fiqh Muamalat* (Islamic transaction/commercial law). Similarly, during 2021, 2022, and 2023, while most SC members of HSBC Amanah did not possess, at minimum, a bachelor's degree in *Shariah*, some members held certificates in *Shariah*, doctoral degrees in Islamic finance, or a combination of both. These credentials may indicate knowledge of *Shariah* and Islamic commercial law.

In the case of Public Islamic Bank Berhad, while *Shariah*-qualified members with at least a bachelor's degree in *Shariah* did not form the majority of the SC in 2020, 2021, and 2022, some members held *Shariah* qualifications such as diplomas in Islamic law. Therefore, if BNM deemed these members as *Shariah*-qualified based on their alternative credentials, the majority of the SC members at both IBs would meet the *Shariah* qualification requirements, resolving the observed instances of non-compliance.

**Table 3. *Shariah* committees' composition in Islamic banks in Malaysia for the 2020-2023 period**

| No. | Islamic Bank  | Ownership | 2020 |    | 2021 |    | 2022 |    | 2023 |    |
|-----|---|-----------|------|----|------|----|------|----|------|----|
|     |   |           | TM   | SQ | TM   | SQ | TM   | SQ | TM   | SQ |
| 1.  | Affin Islamic Bank Berhad                                   | Local     | 6    | 6  | 6    | 6  | 6    | 6  | 6    | 6  |
| 2.  | Al Rajhi Banking & Investment Corporation (Malaysia) Berhad | Foreign   | 5    | 5  | 5    | 4  | 5    | 4  | 5    | 4  |
| 3.  | Alliance Islamic Bank Berhad                                | Local     | 5    | 4  | 5    | 4  | 5    | 4  | 5    | 4  |
| 4.  | AmBank Islamic Berhad                                       | Local     | 6    | 6  | 6    | 6  | 5    | 5  | 6    | 4  |
| 5.  | Bank Islam Malaysia Berhad                                  | Local     | 6    | 6  | 5    | 4  | 5    | 4  | 6    | 5  |
| 6.  | Bank Muamalat Malaysia Berhad                               | Local     | 5    | 4  | 5    | 4  | 5    | 4  | 6    | 5  |
| 7.  | CIMB Islamic Bank Berhad                                    | Local     | 6    | 4  | 6    | 4  | 5    | 3  | 5    | 3  |
| 8.  | Hong Leong Islamic Bank Berhad                              | Local     | 5    | 5  | 5    | 5  | 5    | 5  | 5    | 5  |
| 9.  | HSBC Amanah Malaysia Berhad                                 | Foreign   | 6    | 3  | 5    | 2  | 5    | 2  | 6    | 3  |

|     |                                  |         |   |   |   |   |   |   |   |   |
|-----|----------------------------------|---------|---|---|---|---|---|---|---|---|
| 10. | Kuwait Finance House Berhad      | Foreign | 5 | 5 | 4 | 4 | 5 | 5 | 5 | 5 |
| 11. | Maybank Islamic Berhad           | Local   | 5 | 4 | 7 | 6 | 6 | 5 | 6 | 5 |
| 12. | MBSB Bank Berhad                 | Local   | 5 | 4 | 5 | 4 | 6 | 5 | 5 | 5 |
| 13. | OCBC Al-Amin Bank Berhad         | Foreign | 5 | 3 | 6 | 4 | 5 | 3 | 6 | 4 |
| 14. | Public Islamic Bank Berhad       | Local   | 5 | 2 | 5 | 2 | 5 | 2 | 5 | 3 |
| 15. | RHB Islamic Bank Berhad          | Local   | 5 | 3 | 6 | 4 | 5 | 4 | 5 | 3 |
| 16. | Standard Chartered Saadiq Berhad | Foreign | 5 | 3 | 5 | 3 | 5 | 4 | 5 | 4 |

**Notes:**

TM = Total members of SC;

SQ = Number of SC members with at least a bachelor of *Shariah* qualification.

Based on these findings, this study offers some recommendations for regulators and IBs. First, it is vital that BNM refine the *Shariah* qualification rule by clearly defining whether members with alternative *Shariah* qualifications (e.g., diplomas, certificates, or extensive practical expertise in Islamic finance) can be considered *Shariah*-qualified persons for the purposes of meeting the majority rule. Additionally, BNM may require that IBs promptly nominate a *Shariah*-qualified individual in cases where a resignation, tenure-end, or termination causes a previously *Shariah*-qualified majority SC to lose its status. This requirement would ensure that IBs take immediate action to restore the *Shariah*-qualified majority by submitting the nominee's credentials to BNM for evaluation and approval.

Second, IBs should take proactive measures to ensure that the composition of their SCs consistently meets the majority rule for *Shariah*-qualified members. This approach guarantees full compliance with regulatory requirements, mitigating exposure to potential legal risks that could result in financial losses and reputational harm.

**CONCLUSION AND RECOMMENDATIONS**

This study investigated whether IBs in Malaysia effectively comply with the regulatory requirements for SC composition, focusing on SC size and *Shariah* qualifications. The findings indicate that, while a few instances of non-compliance were observed, most IBs in Malaysia have adhered to the stipulated requirements for SC composition. The conclusions of this study carry important implications. For regulators, the study highlights the need for BNM to refine its guidelines on *Shariah* qualifications and the definition of *Shariah*-qualified persons to enhance clarity and facilitate more effective implementation. For researchers, the study provides valuable insights into the practices of SC composition among IBs following the implementation of the SGPD 2019, offering a foundation for future research. While this study focused exclusively on SC composition in terms of size and qualifications, future research should examine compliance with other guidelines stipulated in the SGPD 2019. These may include assessing whether the SC chairperson meets the *Shariah* qualification criteria, evaluating the minimum regulatory requirement for SC meetings against the actual number of meetings convened annually, analyzing the attendance rates of individual SC members compared to regulatory benchmarks, and exploring the extent of disclosure regarding SG policies and practices.

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