SHARĪ‘AH GOVERNANCE FOR ISLAMIC FINANCIAL INSTITUTIONS

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Abstract

For Islamic financial institutions to have credibility, formal procedures for Sharī‘ah governance are required; otherwise clients would have no assurance that the institution is upholding the principles of Islam in its financial dealings. This formal assurance can be provided by national law, as in the case of Iran, which enacted the Law on Interest-Free Banking of 1983, under which all banking operations had to be Sharī‘ah compliant. Malaysia passed an Islamic Banking Law the same year, but it created a dual system whereby licensed Islamic banks could compete alongside those operating conventionally. Unlike in Iran, however, Malaysia instigated a system for ongoing assurance by establishing Sharī‘ah Boards for the Central Bank and the Securities Commission with the power to deliver fatwā, and boards at the level of each Islamic bank to ensure that the financial products they offered are Sharī‘ah compliant and conform to the requirements of the centrally issued fatwā. At the other extreme, the countries of the GCC have devolved all Sharī‘ah governance to the institutional level, although many Islamic banks recognise the rulings of the Sharī‘ah Board of the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Organization of the Islamic Conference (OIC) Fiqh Academy. This paper discusses the merits of centralised versus devolved Sharī‘ah governance and considers what competences and experience Sharī‘ah

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Board members should have. The Islamic Financial Services Board has recently issued guidelines on Sharī‘ah governance. These are evaluated, including the conditions for the appointment of Sharī‘ah Board members, their mandate, procedures for the conduct of meetings, and lines of accountability and reporting.

Keywords: Sharī‘ah governance, Sharī‘ah Board members, Islamic banking law.

INTRODUCTION

If Islamic financial institutions are to be credible to their clients, they need to have a formalised system to ensure that all their activities are Sharī‘ah compliant. Exactly what constitutes an effective Sharī‘ah governance system is a matter of debate, however, and it is apparent from examining the experiences of different countries and institutions that a variety of systems are in place. This pluralistic approach has advantages, as the legal environments in which Islamic financial institutions operate differ, not only in terms of the status of Sharī‘ah, but also depending on whether the countries use common or civil law. Furthermore, client expectations of what constitutes acceptable and effective Sharī‘ah governance differ, and, as will be evident from this study, most systems currently employed are market rather than state driven. Indeed, in the realm of Islamic finance, Sharī‘ah governance has largely been privatised rather than nationalised.

The credibility of financial institutions with their clients has been highlighted by the financial crisis of 2008, when some conventional financial institutions faced a run on deposits. Many conventional financial institutions found that they had lost the confidence of other banks and, hence, they could no longer rely on the inter-bank market for funding. Merely having a Sharī‘ah Board does not, of course, provide immunity to liquidity crises or overcome the difficulties associated with the credit crunch, but it was noticeable that in many jurisdictions Islamic banks fared better than their conventional counterparts.

This was because of two factors that were positively linked to Sharī‘ah governance. Firstly, Islamic banks have to rely on depositors
rather than inter-bank borrowing for their funding, which immunised them from the credit crunch. However, their ability to continue to harness these funds depends on the depositor’s perceptions of the integrity of the Shari‘ah governance system. Secondly, Islamic banks could not hold assets that would ultimately prove toxic—for instance, credit derivative swaps or collateralised debt obligations—as such assets are not Sharī‘ah compliant, and their acquisition would not have been approved by any Sharī‘ah Board.

In other words, although the management of credit, liquidity, operational and other risks is the responsibility of the Board of Directors of an Islamic bank and not the Sharī‘ah Board, good Sharī‘ah governance prevents financial institutions from damaging themselves. In essence, this financial crisis, like others before it, was caused by human greed and uncontrolled excesses. Such behaviour has no place in Islamic finance, and it is effective Sharī‘ah governance that promotes moderation and justice in financial transactions.

THE LEGAL FRAMEWORK

Although Islamic financial institutions operate around the world in both predominately Muslim and non-Muslim countries, there are few states that have included provision for Sharī‘ah governance in their banking, insurance or capital market laws. Saudi Arabia, despite its central position in the Islamic World, has no specific legislation on Islamic finance, although adherence to Sharī‘ah is enshrined in the legal system. Under Chapter 1 of its Basic Law, it is stated that the Qur’an and the Sunnah represent the constitution of the Kingdom, and the role of Sharī‘ah governance is stressed under Article 45, which provides for the establishment of a board of religious advisors drawn from the ‘ulamā’.

The charter that established the Saudi Arabian Monetary Agency (SAMA), which serves as the Central Bank, states under Article 2 that SAMA will not pay or receive interest, but rather pay fees for its services. The Banking Control Law is silent on the question of interest and contains no reference to Sharī‘ah; and several

2 Royal Decree No. 23, 23/5/1377.
articles in the Law, notably Article 16, specifically refer to loans on which interest will presumably be charged.¹⁴ In practice, like most central banks, SAMA uses repurchase agreements (repos) for its money market operations. These, given the fixed exchange rate with the US dollar, tend to follow Federal Reserve rates. The repo rates directly influence bank lending rates, which can be viewed as *ribā*.

However the banking laws and regulations in Saudi Arabia make no explicit mention of interest. In the Consumer Credit regulations of January 2006 reference is made to both conventional borrowing and Islamic profit rates under Section 2.2.2. The terminology used, rather than interest, is ‘the annual percentage rate of charge (APR)’ that must be disclosed to clients.⁴ Section 2.3 states that, for Islamic products, documentation covering the underlying purchase and sale of goods should comply with the requirements of the bank’s Sharī’ah Committee. That marks the first-ever mention of Sharī’ah compliance in the SAMA regulations. SAMA, although it has been criticised in the past for ignoring Islamic banking (Wilson, 2002, P.143-163), has become more actively involved in recent years, and, indeed, its Deputy Governor, Dr Abdulrahman Al Hamidy, has served as chairman of the Sharī’ah Governance Working Group of the Islamic Financial Services Board (IFSB).

Across the Gulf in Iran the entire financial system has been Islamic since the enactment of the Law on Interest-Free Banking in 1983 (Central Bank of the Islamic Republic of Iran, 1983). Article 1 provides for the establishment of a monetary and credit system based on rightness and justice as delineated by Islamic jurisprudence. Article 3 provides for the acceptance of current deposits based on *qarād hasan*, whereby the clients provide the bank with an interest-free loan, and term investment deposits based on *muḍārābah*, whereby the client shares in the bank’s profits. *Muḍārābah* can also be used for financing, as specified in Article 9, and reference is also made to operational leasing and other funding methods commonly accepted as permissible under Sharī’ah. Iran’s law, however, does not cover Sharī’ah governance, as there is no provision for ongoing surveillance through the appointment of a Sharī’ah Board to ensure

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¹⁴ Royal Decree No. M/5, 22/2/1386.
that financial transactions comply with the law. Rather, this is the responsibility of the Central Bank, but the Bank itself does not have a Sharī‘ah Board. Banks themselves are still regulated under the earlier Monetary and Banking Law of 1972, which was enacted well before the Islamic Republic was founded. The seven state-owned and six private banks operating in Iran make no reference to Islamic values or Sharī‘ah-based or compliant financial products in their reports or publications. They make no reference to interest, using instead the term ‘profit rates’.

The first Islamic banking law in the Gulf Co-operation Council (GCC) was enacted by the UAE in 1985. Under Article 5 provision was made for the establishment of a Higher Sharī‘ah Authority, including fiqh scholars and legal and banking personnel, to ensure that Islamic banks, financial institutions and investment companies conduct their business in accordance with Sharī‘ah law. The proposal of having commercial lawyers and financial experts as well as fiqh scholars was subsequently adopted in Sudan, but nowhere else. In the UAE Article 5 provided that the Higher Sharī‘ah Authority should be established and approved through a cabinet decision, but this never happened, although there has been some debate since 2008 about whether such a body should be established (Henderson & Hainsworth, 2008).

In practice, it was Article 6 of the UAE Islamic banking law that was implemented. This states that each Islamic bank, financial institution and investment company should establish its own Sharī‘ah Supervisory Authority to ensure that its transactions and practices conform to Islamic law. Provision for this should be made in the articles and memorandum of association of each Islamic bank, and the Authority should consist of at least three members. This devolved system of Sharī‘ah governance was favoured in the UAE, not least because, at the time the law was passed, the Dubai Islamic Bank was the sole institution of its type, and it preferred to regulate itself as far as Sharī‘ah compliance was concerned rather than being governed from Abu Dhabi.

5 United Arab Emirates, Federal Law No. 6 of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies.
Very comprehensive legal provision for Islamic banking was introduced in Kuwait when the banking law was revised in 2003 to bring the Kuwait Finance House within the regulatory authority of the Central Bank and open the market for Islamic financial services to new entrants. Section 10 was added, with conventional banks permitted under Article 86 to apply for licenses to establish subsidiaries offering Islamic banking facilities. Under Article 93 each Islamic bank is required to appoint a Shari‘ah Board with at least three members, with appointments subject to ratification by each bank’s general assembly. Shari‘ah Boards are required to submit an annual report to the general assembly that the banks’ operations comply with Shari‘ah principles, and this report should be included in the annual financial statements. In the event of disputes between Shari‘ah Board members, the Board of Directors may refer the matter to the Fatwā Board of the Ministry of Awqaf and Islamic Affairs, which will serve as the final authority.

As knowledge of what is required for Islamic financial institutions to function effectively has increased, legislation has become much more detailed. The Indonesian legislative provision of 2008 is a good example of this for although Islamic banks account for less than two percent of deposits, there is a political commitment to Shari‘ah finance playing an increasing role in the world’s most populous Muslim country. This is driven by two factors, the first being a desire to ensure that the pious participate in the financial system rather than remain excluded from it; the second is a desire to benefit from Indonesia’s good relations with other Muslim countries through the Organization of the Islamic Conference (OIC), and in particular to capitalise on its relations with the GCC.

Under Article 32 of the Indonesian Shari‘ah Banking Act, a Shari‘ah Board must be established by each Islamic bank as well as all conventional banks offering Islamic financial services. The Shari‘ah Board members are nominated by the Indonesian Ulama Council, a state body which is in charge of all Islamic matters in the country. The nominees have to be approved by the general meeting of shareholders.

7 Act of the Republic of Indonesia, Number 21 of 2008 Concerning Shari‘a (Islamic) Banking.
of the institution which they serve. Under Clause 3 of Article 32 the mandate of the Shari‘ah Board is to give advice and recommendations to the Board of Directors of the Islamic bank or conventional bank offering Islamic financial services. Clause 4 of Article 32 states that Bank Indonesia will regulate Shari‘ah governance, which provides greater ongoing flexibility and the ability to respond more rapidly to issues as they arise than might be the case with the Ulama Council.

REGULATORY REQUIREMENTS

In most jurisdictions Shari‘ah governance has been dealt with at the regulatory level. Malaysia, for example, passed an Islamic Banking Law in 1983 which specified that banks registered under the act should not undertake operations which are not approved by the religion of Islam. However, no mechanism for Shari‘ah governance was specified in the law, and it was only in December 2004 that Bank Negara, the Central Bank of Malaysia, produced detailed guidelines on Shari‘ah governance (Bank Negara Malaysia, 2004). These guidelines provide for how members of Shari‘ah Boards should be appointed, the duties and responsibilities of the Boards and their relationship with the Islamic financial institutions they serve. The system of Shari‘ah compliance is more centralised in Malaysia than in the GCC, as only the Shari‘ah Boards of Bank Negara and the Securities Commission have the power to issue fatwā, the role of the Shari‘ah Boards of Islamic financial institutions being to serve as audit units to ensure that these fatwā are implemented with respect to the contracts offered. By contrast, in the GCC none of the central banks, SAMA or the Saudi Arabia Capital Markets Authority have their own Shari‘ah Boards.

The Bank Negara Guidelines apply to Islamic banks, takāful operators and conventional banks offering Shari‘ah compliant products. They recommend that Shari‘ah Boards should have at least three members, all of whom should have the necessary knowledge, expertise and experience in either Islamic jurisprudence or Islamic commercial law (fiqh mu‘āmalāt) (Bank Negara Malaysia, 2004, 8

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8 ACT 276 of 1983, Clause 2.
Art 12). Those appointed who fail to attend more than 75 percent of board meetings will be disqualified, as will any member who becomes bankrupt or is found guilty of any serious criminal offence (Bank Negara Malaysia, 2004, Art 16). Members of the Sharī‘ah Boards of Bank Negara and the Securities Commission cannot serve on the boards of Islamic commercial institutions and vice versa. For reasons of confidentiality Sharī‘ah Board members can only serve on one board (Bank Negara Malaysia, 2004, Art 19). All Sharī‘ah Board decisions will be recorded in a Sharī‘ah compliance manual which should be retained for future reference. Decisions should be backed with evidence from relevant Sharī‘ah jurisprudential literature. Sharī‘ah opinions should not only be provided to the Islamic financial institution but also its external auditors and legal counsel if requested. For its part, the Islamic financial institution should make available whatever documents are required to conduct its work, and provide adequate resources to facilitate the smooth running of the Sharī‘ah Board. Once the Sharī‘ah Board’s recommendations are made, the Islamic financial institution has a duty to carry them out (Bank Negara Malaysia, 2004, Art 20).

An appendix to the Bank Negara Guidelines provides an application form for those who wish to serve on Sharī‘ah Boards.9 Applicants have to provide details of their academic and professional qualifications as well as information on working experience. As those appointed are often academics in Malaysian universities, applicants are also asked to provide details of any scholarly publications, such as books, journal articles, working papers and other research in progress. If they are already serving as Sharī‘ah advisors, this must be declared. This standardised system means that Bank Negara has a database on all Sharī‘ah Board members serving in the country. While the process of appointment does not represent a formal system of accreditation, it does provide a centrally controlled vetting procedure for all those serving on the Sharī‘ah Boards of Islamic financial institutions in Malaysia. In practice it can be regarded as a system of peer review, as it is the members of the Sharī‘ah Board of Bank Negara who decide who should be approved, which obviously enhances the power and status of that body.

9 Form BNM/JKS 1.
Sudan and Pakistan also have Sharī‘ah Boards affiliated with their central banks that have the power to issue fatwās and provide definitive rulings on questions referred to them by the Sharī‘ah Boards or advisors serving Islamic financial institutions. In the case of Sudan the High Sharī‘ah Supervisory Board comprises not only fiqh scholars, but also specialists in finance. This has the merit of ensuring the fiqh scholars are aware of the financial consequences of their actions and are better informed about the often complex structures they are asked to approve. On the other hand, it could be argued that the inclusion of individuals with limited knowledge of fiqh on the High Sharī‘ah Supervisory Board dilutes the influence of Islamic jurisprudence.

The State Bank of Pakistan issued very detailed Instructions and Guidelines for Sharī‘ah compliance in Islamic banking institutions in 2008 (State Bank of Pakistan, 2008, No. 2). Part A of the Instructions provides for the appointment of Sharī‘ah advisors. Under Clauses (i) and (ii) Sharī‘ah advisors should be appointed by the Board of Directors in the case of a domestic bank, or by the management in the case of foreign Islamic banks having branches in Pakistan. Under Clause (iii) the Sharī‘ah advisors should meet ‘fit and proper’ criteria, and under Clause (iv) they should be appointed for a renewable term of three years. Clause (vii) requires that the State Bank of Pakistan be informed within 14 days if Sharī‘ah advisors are removed or resign before the end of their period of appointment, and the reasons for the termination of the appointment must be given. This clause should help safeguard the independence of Sharī‘ah advisors. Under Clause (ix) the fatwās and rulings of Sharī‘ah advisors are binding on the institution which appoints them.

Part B of the State Bank of Pakistan Instructions outlines the duties and responsibilities of Sharī‘ah advisors. The Instructions stipulate that it is the duty of the Sharī‘ah advisor to ensure that all products and services offered by Islamic financial institutions are Sharī‘ah compliant. In the case of newly approved products the Sharī‘ah advisor shall arrange a training programme for the staff involved. This should help ensure that bank staff are properly informed when advising clients and dealing with their queries. Sharī‘ah advisors should have access to all the necessary records and documents needed for their work, and they will be responsible for ensuring that any
income derived from a source which is not compliant with Shari‘ah is paid into a charity account and thereby purified. Shari‘ah advisors can also be called on to give advice to the legal team of an Islamic financial institution.

Part C of the State Bank of Pakistan’s Instructions stipulates that Shari‘ah advisors should prepare a report for inclusion in the annual financial statements of the Islamic financial institution. The report should indicate whether all the institution’s operations were Shari‘ah compliant, whether the funds allocated to the profit-and-loss-sharing muḍārahah investment accounts are fair, and if the profit-sharing ratios are appropriate. This is a useful stipulation, as it provides a measure of protection to investment muḍārahah account holders, for there is a potential conflict between their interests and those of the shareholders in an Islamic financial institution. The Board of Directors looks after the shareholders’ interests, so it is also appropriate that the investment muḍārahah account holders should have someone to champion their rights.

Part D of the State Bank of Pakistan Instructions deals with conflict resolution in Shari‘ah rulings about which Shari‘ah advisors disagree. This is dealt with in a similar manner to the Malaysian practice, as disputes should be referred to the State Bank of Pakistan’s Shari‘ah Board. They are the final authority, and their decisions are binding. This type of system encourages Shari‘ah Boards to reach consensus, as obviously there will be a reluctance to refer cases to a higher authority unless all avenues of reaching agreement are exhausted.

In the GCC the regulators do not have their own Shari‘ah Boards and, therefore, the issue of dispute resolution becomes more problematic. In Kuwait, when there is disagreement it should be referred to the Board of Directors of the Islamic financial institution. They can then refer the matter to the Shari‘ah Board of the Ministry of Awqaf and Islamic Affairs, as already indicated, for an independent but binding opinion (Aznan, 2009, P.17). The concern with this procedure is that the expertise of the Shari‘ah Board of the Ministry is related to awqāf, and not necessarily Islamic banking, Shari‘ah compliant fund management or takaful. The position is similar in Qatar, where there is also no Central Bank Shari‘ah Board, but disputes can be referred
to the Supreme Sharī‘ah Council of the Ministry of Awqaf.\textsuperscript{10} In Qatar there is also provision for the Central Bank to appoint independent Sharī‘ah scholars to resolve the issue, although this has never been used.

Both Qatar and Dubai have financial centres which function under their own laws and regulations rather than under national laws. The purpose of these centres is to attract a wide range of financial institutions to provide investment banking and asset management services rather than retail financial business for local nationals and residents, which is regulated by the central banks. The Dubai International Financial Centre has no special provision for Islamic finance, but at its inception the Qatar Financial Centre Regulatory Authority decided to draft a detailed rulebook on Islamic finance.\textsuperscript{11} The rules governing the appointment and operation of Sharī‘ah Supervisory Boards are set out in Section 6. This states that the Sharī‘ah Supervisory Board should comprise at least three members, and that those appointed should be suitably qualified and experienced. Appointments should be approved by the governing body of the Islamic financial institution, normally the Board of Directors, and Sharī‘ah Board members themselves cannot serve as directors or executive officers. This is to ensure their independence. Islamic financial institutions licensed by the Qatar Financial Centre must document their policies with regard to the appointment of Sharī‘ah Board members and provide details of their remuneration and terms of engagement. They should also supply information on the competency of those appointed and maintain records on those who serve for a minimum of six years.

The Qatar Financial Centre recognises the Sharī‘ah standards of the Bahrain-based Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). These include the requirement for each Sharī‘ah Supervisory Board to provide an annual report which will normally be included with the financial statements, a copy of which should be made available to the regulator.\textsuperscript{12} Islamic financial

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\textsuperscript{10} Qatar Financial Centre Regulatory Authority, QFC Regulatory Authority Rulebook on Islamic Finance, 27th July 2005.

\textsuperscript{11} Ibid., p. 21.

\textsuperscript{12} AAOIFI Standards on Governance, GSIFI Number 1.
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institutions regulated by the Qatar Financial Centre are also required to undertake an internal Sharī'ah review in compliance with AAOIFI standards on governance.13 This aims to ensure that the contracts and other documents made available to clients conform to the fatwās, rulings and guidelines provided by each institution’s Sharī'ah Board.

Bahrain, unlike Qatar, has a unified system of regulation, with the Central Bank responsible for all regulation, including that of Islamic financial institutions. Bahrain serves as a regional centre for Islamic finance and has 24 Islamic banks and 11 takāfīl operators with total Sharī'ah compliant assets exceeding US$10.3 billion (Central Bank of Bahrain, 2009). As the headquarters for AAOIFI, its governance standards, not surprisingly, are mandatory, including those on Sharī'ah governance. The Central Bank Rulebook simply refers to the AAOIFI governing standards, notably requiring each Islamic financial institution to appoint a Sharī'ah Board of at least three members14 and have an internal Sharī'ah audit unit.15

THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB) GUIDING PRINCIPLES ON SHARĪ'AH GOVERNANCE

The IFSB is the institution which provides guidance on the key regulatory issues pertaining to Islamic financial institutions.16 Its procedures correspond to international norms, as its members are consulted on each set of guidelines it produces and there is extensive public consultation. Work on the Guiding Principles on Sharī'ah Governance commenced in 2007, and the final draft of the Guidelines should be available by the end of 2009.17

As the earlier discussion has shown, there are wide variations in Sharī'ah governance standards across jurisdictions, largely reflecting legal and regulatory differences as well as the extent to which Islamic

13 AAOIFI Standards on Governance, GSIFI Number 3.
14 Central Bank of Bahrain Rulebook HC-1.3.15.
15 Central Bank of Bahrain Rulebook HC-1.3.16.
16 For information on the remit and functions of the IFSB see www.ifsb.org.
17 The author had the privilege of serving as a consultant to the IFSB working group on Sharī'ah governance, but the views expressed here are solely the responsibility of the author.
financial institutions have developed in particular countries. The IFSB is not in a position to impose on its members any one system of Sharī’ah governance, but its aim is to identify the key issues and, drawing on best practice, suggest possible ways in which the major concerns can be managed. Its overriding assumption is that there is no single model that should be adopted, no one-size-fits-all approach; rather, solutions appropriate to each jurisdiction should be applied on the basis of informed perceptions of their varying circumstances. Standardisation tends to stifle innovation, and in a rapidly developing and changing area such as Islamic finance, it would arguably be counterproductive to settle on a single system.

It is important to note that the IFSB’s concern is the process of Sharī’ah governance, ensuring the systems are sound, and not with the actual rulings of Sharī’ah Boards, which are matters of judgment for those serving on the Boards. In other words, it is not the substance of the fatwās that is being dealt with, but rather the conditions under which the Sharī’ah Boards work. The aim is to ensure that sound systems are in place to facilitate effective decision-making by Sharī’ah Boards, a parameter of vital importance to the reputation of Islamic financial institutions. It is also recognised that some systems may be acceptable in certain jurisdictions but not in others. It may, for example, be politically possible for regulators to have their own Sharī’ah Boards in predominately Muslim countries, but in countries where other religions have larger numbers of adherents this will not usually be the case. However, even in jurisdictions such as the United Kingdom, the Financial Services Authority (FSA), as the regulator, recognises the value of sound procedures to ensure that products marketed as Islamic are Sharī’ah compliant; otherwise, the interests of Muslim clients would not be protected (Ainley, Mashayekhi, Hicks, Rahman, & Ravalia, 2007; HM Treasury, 2008).

The four key attributes identified by the IFSB for sound and effective Sharī’ah governance are competence, independence, confidentiality and consistency. Competence implies diligence and capability and obviously relates to whether those appointed to Sharī’ah Boards are suitably qualified and have relevant experience. It is recognised, however, that for some it will be their first appointment to such a position. This implies that there should be continuing training opportunities for those serving on Sharī’ah Boards and perhaps a
system of mentoring whereby more experienced members can pass on their knowledge to newer, and usually younger, members. In other words, provision should be made for the professional development of those appointed to Sharī‘ah Boards, not least because, while many may be knowledgeable concerning *fiqh*, their understanding of the complexities of modern finance and contemporary legal contracts may be more limited. This is a lacuna that has to be filled if they are to provide informed advice. The IFSB proposes that there should be a formal process to assess both the overall effectiveness of the Sharī‘ah Boards and the contributions of their individual members. Collective effectiveness of Boards can be assessed in relation to peer performance to the extent that such information is available. Effectiveness of individuals can be measured in terms of attendance at meetings, diligence, commitment to attend training programmes and willingness to accept responsibility for duties assigned. In other words, both quantitative and qualitative measures can be used for performance evaluation.

Independence is the second attribute stressed in the IFSB Guidelines. Sharī‘ah Board members are, of course, paid by the institutions in which they serve, and this inevitably leads to criticism that they cannot be completely impartial and independent. Of course, financial auditors are in the same position and have been subject to the same criticism. An alternative would be to have the Sharī‘ah Boards paid by governments, but this is not feasible in Muslim minority countries and there would, in any case, be concerns about possible political interference. No country has adopted this approach. The IFSB Guidelines stress that apart from remuneration for work on the Sharī‘ah Board, no member or his or her relatives should receive any payment from the Islamic financial institution they serve, either as an employee or as a shareholder. Where there is a conflict of interest, the member should declare it in writing to the Islamic financial institution. Financial auditors are usually appointed for a fixed term, and then the position must rotate. There is a case for Sharī‘ah Board members serving non-renewable terms rather than serving in perpetuity, although this has not been included in the IFSB Guidelines. The counter-argument is that when Sharī‘ah Board members have extensive experience and their integrity is beyond doubt, it is desirable to retain their services.
Confidentiality is a third attribute, as those serving on Sharī‘ah Boards will have access to a wide range of information and documents that could be of commercial value to rival institutions. This is a particular issue when Sharī‘ah Board members serve several Islamic financial institutions. This is why multiple Board membership is not permitted in Malaysia. It is recognised, however, that given the shortage of Sharī‘ah scholars versed in this specialisation in the GCC, it would not be feasible to adopt such a restriction there. If confidentiality is compromised, however, an Islamic financial institution should have procedures in place to take appropriate disciplinary action to protect its interests.

Consistency is the fourth attribute stressed as desirable in the IFSB Guidelines. This applies to consistency over time by the Sharī‘ah Board of a particular Islamic financial institution, as well as consistency across different Islamic financial institutions, both within a country and internationally. Of course, Sharī‘ah Boards should be free to change their opinions if they become aware of new issues that have implications for previous judgments. The debate over the legitimacy of bai bithaman ajil (BBA) in Malaysia is an example of this, as is the controversy over tawarruq as a contract without substance and ṭuḥrūrah as a contract when fixed repurchase undertakings turn these into pure debt instruments (AAOIFI, 2008). Consistency between Islamic financial institutions within a single jurisdiction is more likely where there are national Sharī‘ah Boards. Elsewhere, the practice of scholars serving on multiple Boards might actually promote consistency, even though this can be criticised on other grounds.

18 The Court of Appeal declared on March 31st 2009 that the BBA sales contracts offered by Bank Islam Malaysia were legitimate, following a ruling by a lower court that they were not.
19 Tawarruq was ruled as not legitimate by the OIC Fiqh Academy at a meeting in Sharjah in May 2009.
As Islamic finance has spread globally, the need for international standards has become apparent, not least because Islamic banks and takāful operators based in the GCC are rapidly expanding into other jurisdictions, which raises the issue of which Shari’ah rulings should apply. As already indicated, BBA has been declared legitimate in Malaysia but is clearly unacceptable in the GCC, where murābaḥah is viewed as preferable because of its greater transparency regarding the purchase price and the mark-up. Al Rajhi Malaysia, the subsidiary of Al Rajhi Bank of Saudi Arabia, has four members on its Shari’ah Board in Kuala Lumpur, one from the Riyadh Board, and the others from Malaysia, but it is notable that the product range corresponds to those offered in Saudi Arabia, with BBA excluded.\(^\text{20}\)

There are two major bodies which provide international Shari’ah governance, the AAOIFI Shari’ah Board and the OIC Fiqh Academy. The former comprises 14 scholars representing the AAOIFI members, with each serving a four-year term.\(^\text{21}\) They have issued Shari’ah standards for most of the major Islamic contracts, which has aided convergence (AAOIFI, 2008). The OIC Fiqh Academy was inaugurated in 1988, before AAOIFI was founded, and considers a wider range of issues, most recently tawarruq, as already indicated.\(^\text{22}\)

There is no coordination between these institutions, however, and if the international Shari’ah governance infrastructure is to improve, there is a need to determine how the mandate of each institution should relate, or perhaps even for a new unified institution to be founded with the support of OIC-member states and leading industry players. Clearly much has been achieved, Shari’ah financial governance has gained increased respect and recognition, and the IFSB Guidelines should prove helpful in increasing the credibility of Shari’ah assurance processes. Numerous issues remain to be resolved, however, so there is clearly much work to do, although, ultimately, market forces will continue to be what drives the Islamic finance industry forward.

\(^{22}\) www.fiqhacademy.org.sa (Arabic only, accessed 11th June 2009).
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