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## I. INTRODUCTION

1. The compliance with Shariah principles is an integral feature in the Islamic banking and finance. An effective and conducive Shariah framework is imperative in assuring such compliance. It will underpin a comprehensive and wholesome development of this sector. An effective Shariah framework will harmonise the Shariah interpretations, strengthen the regulatory and supervisory oversight of the industry and will also foster and nurture a pool of competent Shariah advisers.

2. To achieve the above objectives, Bank Negara Malaysia has amended the Central Bank of Malaysia Act 1958 to enhance the role and functions of its Shariah Advisory Council for Islamic Banking and Takaful (SAC). This amendment has accorded the SAC as the sole Shariah authority in Islamic finance. As the sole Shariah authority, the SAC will be referred to by the court or arbitrator in disputes involving Shariah issues in Islamic banking, finance and takaful cases.

3. To effectively play its role, the SAC operates as an independent body. An independent SAC with high level of integrity will command public confidence and thereby will boost the industry to a greater height. There is also a crucial need to define the relationship between the SAC and Shariah bodies which act as Shariah advisers in the industry. Towards this end, the Shariah bodies in the Islamic financial institution need to be rationalised. A Shariah body in the industry which is to be known as a Shariah Committee, will play a complementary role to the SAC of Bank Negara Malaysia.

4. In light of the above, Bank Negara Malaysia has prepared the ***Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions*** or known as ***BNM/GPS 1*** that regulates the governance of Shariah Committee of an Islamic financial institution. For the development financial institutions, the ***Guidelines on the Governance of Shariah Committee*** shall be known as ***BNM/DFI/GPS 1***.

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## **II. OBJECTIVES**

5. These Guidelines aim at achieving the following:
- (a) to set out the rules, regulations and procedures in the establishment of a Shariah Committee;
  - (b) to define the role, scope of duties and responsibilities of a Shariah Committee; and
  - (c) to define relationship and working arrangement between a Shariah Committee and the SAC of Bank Negara Malaysia.

## **III. SCOPE OF APPLICATION**

6. These Guidelines shall be applicable to all Islamic financial institutions regulated and supervised by Bank Negara Malaysia. The reference to "Islamic financial institution" for the purpose of these Guidelines means:

- (a) an Islamic bank licensed under the Islamic Banking Act 1983 (IBA);
- (b) a financial institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) which participates in the Islamic Banking Scheme (BAFIA IBS bank);
- (c) a development financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) which carries on Islamic banking business or Islamic financial business; and
- (d) a takaful operator registered under the Takaful Act 1984 (TA).

## **IV. ESTABLISHMENT OF SHARIAH COMMITTEE**

7. Every Islamic financial institution is required to establish a Shariah Committee. In the case of a BAFIA IBS bank, it may establish one Shariah Committee for the banking group. However, if a takaful operator is part of that group, the takaful operator must

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establish its own separate Shariah Committee, due to the legal requirement under the TA.

## V. MEMBERSHIP OF SHARIAH COMMITTEE

### Appointment and Reappointment

8. The Board of Directors of an Islamic financial institution upon recommendation of its Nomination Committee shall appoint the members of the Shariah Committee. The appointment and reappointment of a Shariah Committee member shall obtain prior written approval of Bank Negara Malaysia. The appointment shall be valid for a renewable term of two years.

9. In approving the appointment and reappointment, Bank Negara Malaysia may impose necessary conditions it deems fit in addition to the requirements in these Guidelines. The failure to comply with any of such conditions shall nullify the approval.

### Application Procedures

10. The application for the appointment or reappointment of members of the Shariah Committee shall be submitted to Bank Negara Malaysia at least **sixty days** before the proposed date of appointment takes effect. The application shall be made in the form BNM/JKS 1 as enclosed in the Appendix.

### Qualification

11. A member of a Shariah Committee shall be an individual. A company, institution or body shall not constitute a Shariah Committee for the purpose of these Guidelines.

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12. The proposed member of the Shariah Committee shall at least either have qualification or possess necessary knowledge, expertise or experience in the following areas:

- (a) Islamic jurisprudence (*Usul al-Fiqh*); or
- (b) Islamic transaction/commercial law (*Fiqh al-Mu'amalat*).

13. It should however be noted that paper qualification on the above subjects will not be mandatory as long as the candidate has the necessary expertise or experience in the above areas.

### **Composition**

14. To ensure that the Shariah Committee would be able to function effectively, the composition of the Shariah Committee shall consist a minimum of three (3) members.

### **Secretariat**

15. In addition to the Shariah Committee, an Islamic financial institution is required to have a minimum of one officer, preferably a person with knowledge in Shariah, who will serve as the secretariat to the Shariah Committee.

### **Disqualification**

16. The members of the Shariah Committee shall be persons of acceptable reputation, character and integrity. Bank Negara Malaysia reserves the right to disqualify any member who fails to meet the requirements. In particular, any member may be disqualified due to any of the following breach of corporate governance:

- (a) he has acted in a manner which may cast doubt on his fitness to hold the position of a Shariah Committee member;

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- (b) he has failed to attend 75 per cent of meetings scheduled for Shariah Committee in a year without reasonable excuse;
- (c) he has been declared a bankrupt, or a petition under bankruptcy laws is filed against him;
- (d) he was found guilty for any serious criminal offence, or any other offence punishable with imprisonment of one year or more; or
- (e) he is subject to any order of detention, supervision, restricted residence or banishment.

17. Where upon the discovery of any fact that any member of a Shariah Committee becomes subject to any ground of disqualification or otherwise becomes unfit to hold such appointment as provided in these Guidelines and/or in the letter of approval from Bank Negara Malaysia, the Islamic financial institution shall terminate the appointment of the Shariah member.

## **Resignation and Termination**

18. An Islamic financial institution shall notify Bank Negara Malaysia of any resignation or termination of a member of the Shariah Committee within **fourteen days** of the date of resignation or termination. The notice shall state the reasons of such termination.

## **VI. RESTRICTIONS ON SHARIAH COMMITTEE**

19. The members of the Shariah Committee are subjected to the following restrictions:

- (a) In line with section 16B(6) of the Central Bank of Malaysia Act 1958, an Islamic financial institution is not allowed to appoint any member of the SAC to serve in its Shariah Committee; and

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- (b) To avoid conflict of interest and for reasons of confidentiality within the industry, an Islamic financial institution shall not appoint any member of a Shariah Committee in another Islamic financial institution of the same industry.

For this purpose, Islamic financial institutions which are regulated under the IBA, BAFIA and DFIA are classified as of the "Islamic banking industry", whilst Islamic financial institutions that are regulated under the TA are classified as of the "takaful industry". Memberships in other categories of industry are excluded from the restriction.

#### **Illustration**

- **A** is appointed as a Shariah Committee member of one Islamic financial institution in Islamic banking industry;
- **A** is still eligible to be appointed as a Shariah Committee member of another Islamic financial institution in takaful industry;
- **A** is also eligible to be a member of a Shariah body of any institution in other industries e.g. funds management.

## **VII. DUTIES AND RESPONSIBILITIES OF SHARIAH COMMITTEE**

20. All Shariah Committee members are expected to participate and engage themselves actively in deliberating Shariah issues put before them. The main duties and responsibilities of the Shariah Committee are as follows:

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**(a) To advise the Board on Shariah matters in its business operation**

The Shariah Committee shall advise the Board on Shariah matters in order to ensure that the business operations of the Islamic financial institution comply with Shariah principles at all times.

**(b) To endorse Shariah Compliance Manuals**

The Islamic financial institution shall have a Shariah Compliance Manual. The Manual must specify the manner in which a submission or request for advice be made to the Shariah Committee, the conduct of the Shariah Committee's meeting and the manner of compliance with any Shariah decision. The Manual shall be endorsed by the Shariah Committee.

**(c) To endorse and validate relevant documentations**

To ensure that the products of the Islamic financial institutions comply with Shariah principles in all aspects, the Shariah Committee must endorse the following:

- i) the terms and conditions contained in the proposal form, contract, agreement or other legal documentation used in executing the transactions; and
- ii) the product manual, marketing advertisements, sales illustrations and brochures used to describe the product.

**(d) To assist related parties on Shariah matters for advice upon request**

The related parties of the Islamic financial institution such as its legal counsel, auditor or consultant may seek advice on Shariah matters from the Shariah Committee. The Shariah Committee is expected to provide assistance to them so that compliance with Shariah principles can be assured completely.

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**(e) To advise on matters to be referred to the SAC**

The Shariah Committee must advise the Islamic financial institution to consult the SAC on any Shariah matters which have not been resolved or endorsed by the SAC.

**(f) To provide written Shariah opinion**

The Shariah Committee is required to record any opinion given. In particular, the Committee shall prepare written Shariah opinions in the following circumstances:

- i) where the Islamic financial institution make reference to the SAC for advice; or
- ii) where the Islamic financial institution submits applications to Bank Negara Malaysia for new product approval. The Shariah Committee should provide the endorsement and decision with regard to the Shariah compliance on the concept and the mechanism/structure of every new product, furnishing the relevant fiqh literature, supporting evidence and reasoning. The endorsement shall be in the form of a letter and a copy of the Shariah paper presented to the committee.

**(g) To assist the SAC on reference for advice**

The Shariah Committee must explain the Shariah issues involved and the recommendations for a decision. It must be supported by relevant Shariah jurisprudential literature from the established sources. The Shariah Committee is also expected to assist the SAC on any matters referred by the Islamic financial institution. Upon obtaining any advice of the SAC, the Shariah Committee shall ensure that all SAC's decisions are properly implemented by the Islamic financial institution.

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## VIII. DUTIES AND RESPONSIBILITIES OF ISLAMIC FINANCIAL INSTITUTIONS

21. To ensure the smooth running of the Shariah Committee, an Islamic financial institution is responsible: -

**(a) To refer all Shariah issues to the Shariah Committee**

The Islamic financial institution must refer all Shariah issues in its business operations to the Shariah Committee for advice. The submission for an advice or a decision must be made in a comprehensive manner for an effective deliberation by the Shariah Committee. This will include explaining the process involved, documents to be used and other necessary information.

**(b) To adopt the Shariah Committee's advice**

The Islamic financial institution is required to adopt and take necessary measures for implementation of Shariah Committee's advice.

**(c) To ensure that product documents be validated**

The Islamic financial institution shall obtain validation of the Shariah Committee relating to Shariah issues in all product documentations.

**(d) To have a Shariah Compliance Manual**

The Islamic financial institution shall ensure that the Shariah Compliance Manual referred to in Paragraph 20(b) is endorsed by the Shariah Committee.

**(e) To provide access to relevant documents**

The Islamic financial institution must provide necessary assistance to the Shariah Committee. The Shariah Committee must be given access to relevant records, transactions, manuals or other relevant information, as

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required by them to perform their duties. For this purpose, the Shariah Committee members are granted exemptions from the secrecy provisions under the respective legislations. Specifically for DFIs, section 119 of DFIA shall not apply to the disclosure of DFIs' customers' information or documents to the Shariah Committee members by virtue of section 120(1)(k) of DFIA.

**(f) To provide sufficient resources**

The Islamic financial institution must provide the Shariah Committee with sufficient resources, such as budget allocation, independent expert consultation, reference materials and trainings. It is also the duty of the Islamic financial institution to familiarise the Shariah Committee on its operation and business.

**(g) To remunerate the members of the Shariah Committee accordingly**

The Board shall determine the remuneration of the Shariah Committee members (through its Remuneration Committee). The remuneration shall commensurate and reflect the roles and functions of the Shariah Committee.

**IX. REPORTING STRUCTURE**

22. With regard to the reporting structure, the Shariah Committee will report functionally to the Board of Directors of the Islamic financial institution. This reporting structure reflects the status of the Shariah Committee as an independent body of the Islamic financial institution.

**X. EFFECTIVE DATE**

23. These Guidelines shall be complied with by **1 September 2005**.

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## **XI. SECRETARIAT OF THE SAC BANK NEGARA MALAYSIA**

24. Any reference or request for advice of the SAC shall be communicated through the Secretariat at Bank Negara Malaysia. All correspondence shall be directed to:

**Pengarah  
Jabatan Perbankan Islam dan Takaful  
Bank Negara Malaysia  
Jalan Dato' Onn  
50480 Kuala Lumpur  
(Attn.: Secretariat Shariah Advisory Council)**

**Tel : 03 - 2698 8044  
Fax : 03 - 2693 3826**