



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Shariah Governance Exposure Draft

Applicable to:

1. Licensed Islamic banks
2. Licensed takaful operators and professional retakaful operators
3. Licensed banks and licensed investment banks approved to carry on Islamic banking business
4. Prescribed institutions approved to carry on Islamic banking business or Islamic financial business
5. Shariah committee members

This Exposure Draft sets out the Bank's proposed regulatory requirements on Shariah governance for Islamic financial institutions.

The proposals seek to strengthen the effectiveness of Shariah governance implementation within Islamic financial institutions, primarily through enhanced oversight accountability over Shariah governance and improvements to the quality of internal control functions. These proposals have taken into consideration findings from the Shariah Governance Survey that was conducted in April 2016 and the feedback received on the Shariah Governance Discussion Paper issued on 15 November 2016.

The Bank invites written feedback on the proposed regulatory requirements, including suggestions on areas to be clarified and alternative proposals that the Bank should consider. The written feedback should be supported by a clear rationale, accompanying evidence or practical examples, where appropriate, to facilitate greater understanding of its context.

Responses must be submitted to the Bank by 11 December 2017 to–

Pengarah
Jabatan Perbankan Islam dan Takaful
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur
Email: shariahgovernance@bnm.gov.my

Electronic submission is encouraged. Submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

In the course of preparing your feedback, you may direct any queries to the following officers at 03-26988044–

- i. Nurul Izza Idris (ext: 8118)
- ii. Mohd Amirul Mukminin Mansor (ext: 7754)
- iii. Nurmastuji Abdul Malek (ext: 8523)
- iv. Nurlida Jasmin Ismail (ext: 7595)
- v. Abdul Hamid Akbar Ali (ext: 347530)

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PART A OVERVIEW

1 Introduction

- 1.1 Shariah governance is integral to Islamic financial system stability. The institutionalisation of a sound Shariah governance framework strengthens public confidence in the aims, management and business operations of the Islamic financial institutions.
- 1.2 The Shariah Governance Framework for Islamic Financial Institutions introduced in 2011 played a critical role in supporting the robust and orderly development of the Islamic finance industry in Malaysia. This is in line with the regulatory objective of promoting end-to-end Shariah compliance. Nevertheless, the growing scale and complexity of Islamic financial business as well as recent policy developments in the area of governance, compliance and risk management have necessitated further enhancements to be made to the existing framework.
- 1.3 Key enhancements in this policy document are intended to reinforce a closer integration of Shariah governance considerations in the business and risk strategies of each Islamic financial institution. This will further clarify the oversight accountability of the board and all other key organs involved in the implementation of Shariah governance. The reshaping of the composition and role of Shariah committee is intended to strengthen the quality of Shariah decisions or advice that informs the decision-making by those leading Islamic financial institutions.

2 Applicability

- 2.1 This policy document is applicable to Islamic financial institutions as defined in paragraph 5.2.

3 Legal provisions

- 3.1 This policy document is issued pursuant to—
(a) sections 29(2), 57(1) and 155 of the Islamic Financial Services Act 2013 (IFSA); and
(b) sections 33E, 41 and 116 of the Development Financial Institutions Act 2002 (DFIA).
- 3.2 The guidance in this policy document is issued pursuant to section 277 of the IFSA and section 126 of the DFIA.

4 Effective date

- 4.1 This policy document comes into effect one (1) year after its date of publication, subject to the transitional arrangements set out in Part H.

5 Interpretation

5.1 The terms and expressions used in this policy document shall have the same meanings assigned to them in the Financial Services Act 2013 (FSA), IFSA and DFIA, as the case may be, unless otherwise defined in this policy document.

5.2 For purposes of this policy document–

“**S**” denotes a standard, an obligation, a requirement, specification, direction, condition and any interpretative, supplemental and transitional provisions that must be complied with. Non-compliance may result in enforcement action;

“**G**” denotes guidance which may consist of statements or information intended to promote common understanding and advice or recommendations that are encouraged to be adopted;

“**active politician**” refers to an individual who is a member of any national or state legislative body, or who is an office bearer of, or holds any similar office or position in a political party;

“**affiliate**”, in relation to an entity, refers to any corporation that controls, is controlled by, or is under common control with, the entity;

“**board**” refers to the board of directors of an Islamic financial institution;

“**control functions**” refer to the definition provided in the policy document on *Corporate Governance* issued by the Bank;

“**Islamic financial institution**” (IFI) refers to–

- (a) licensed Islamic banks;
- (b) licensed takaful operators and professional retakaful operators;
- (c) licensed banks and licensed investment banks approved under section 15(1)(a) of the FSA to carry on Islamic banking business; and
- (d) prescribed institutions approved under section 33B(1) of the DFIA to carry on Islamic banking business or Islamic financial business;

“**senior management**” refers to the chief executive officer and senior officers of the IFI;

“**senior officers**” refer to a person, other than the chief executive officer or a director, having authority and responsibility for planning, directing or controlling the activities of an authorized person or a financial holding company including the chief operating officer, members of decision-making committees and other persons performing key functions such as risk management, compliance, internal audit or other functions as may be specified by the Bank under section 57 of the IFSA, but shall not include a member of a Shariah committee;

“**Shariah non-compliance risk**” means the risk of legal or regulatory sanctions, financial loss or non-financial implications including reputational damage, which an IFI may suffer arising from the failure to comply with the rulings of the Shariah Advisory Council of Bank Negara Malaysia (SAC), standards on Shariah matters issued by the Bank pursuant to section 29(1) of the IFSA and section 33E(1) of the DFIA or decisions or advice of the Shariah committee that are consistent with the rulings of the SAC.

6 Related legal instruments and policy documents

- 6.1 This policy document must be read together with–
- (a) other relevant legal instruments and policy documents that have been issued by the Bank, in particular–
 - (i) *Corporate Governance*;
 - (ii) *Fit and Proper Criteria*;
 - (iii) *Compliance*;
 - (iv) *Risk Governance*;
 - (v) *Operational Risk*;
 - (vi) *Guidelines on Internal Audit Function of Licensed Institutions*;
 - (vii) *Financial Reporting for Islamic Banking Institutions*;
 - (viii) *Guidelines on Financial Reporting for Development Financial Institutions*; and
 - (ix) *Financial Reporting for Takaful Operators*.
 - (b) FSA, IFSA and DFIA, in particular section 56 of the FSA, sections 65 and 66 of the IFSA and sections 5 and 5A of the DFIA; and
 - (c) Manual Rujukan Institusi Kewangan Islam kepada Majlis Penasihat Syariah.

7 Policy documents superseded

- 7.1 This policy document supersedes the following policy documents:
- (a) *Shariah Governance Framework for Islamic Financial Institutions* issued on 22 October 2010;
 - (b) Paragraph 10.4 of *Financial Reporting for Islamic Banking Institutions* issued on 5 February 2016;
 - (c) Paragraph 10.4 of *Guidelines on Financial Reporting for Development Financial Institutions* issued on 24 December 2016; and
 - (d) Paragraph 12.5 of *Financial Reporting for Takaful Operators* issued on 28 January 2015.

PART B THE BOARD

8 Key responsibilities

- S** 8.1 As part of the board's responsibility to promote the sustainable growth and financial soundness of an IFI, the board has the overall responsibility to institutionalise a robust Shariah governance framework that is commensurate with the size, complexity and nature of the IFI's business. The board's oversight accountability over Shariah governance must reflect the integration of Shariah governance considerations within the business and risk strategies of the IFI. In fulfilling this role, the board must–
- (a) approve policies relating to governance structure and reporting arrangements, Shariah non-compliance risk management and other areas that are material to the effective implementation of Shariah governance within the IFI;
 - (b) oversee the implementation of rulings of the SAC and decision or advice of the Shariah committee within all business and functional lines, including any business or risk implications arising from such implementation;
 - (c) oversee the implementation of internal control environment to prevent Shariah non-compliance and any rectification measures to resolve incidences or circumstances that may result or has resulted in Shariah non-compliance¹;
 - (d) oversee the performance of senior management and other officers entrusted to implement Shariah governance framework such that the board is satisfied that the measures of their performance is aligned with Shariah governance objectives; and
 - (e) promote a sound corporate culture which reflects the importance of adhering to Shariah requirements in product development and marketing, strategy formulation, business operations, risk management practices and other aspects that promote end-to-end compliance with Shariah.
- S** 8.2 A director must continuously develop and strengthen his understanding on Islamic finance and the relevant Shariah governance policies to fulfil his responsibility to the IFI.

9 Interaction with Shariah committee

- S** 9.1 The board must have due regard to any decision or advice of the Shariah committee on any Shariah issue relating to the operations, business, affair or activity of the IFI. This duty requires the board to–
- (a) give sufficient attention to the facts, rationale and basis for any decision or advice of the Shariah committee before arriving at its own decision;
 - (b) give fair consideration to the implications of implementing any decision

¹ This requirement in addition to section 28(3) of the IFSA and section 33D(3) of the DFIA on the obligation imposed on IFIs to report Shariah non-compliance and a plan on the rectification of such non-compliance.

- or advice of the Shariah committee;
- (c) take reasonable steps to resolve any differences in views between the board and the Shariah committee; and
- (d) maintain a record of any differences between a decision of the board and a decision of the Shariah committee in accordance with paragraph 9.2.

- S** 9.2 Paragraph 9.1(d) refers to a situation where the Shariah committee holds a stricter view on a Shariah matter relative to a published ruling of the SAC and the board seeks to apply the ruling of the SAC. Where such a situation arises, the board must document the justifications for the decision and inform the Bank no later than fourteen (14) days from the date that such decision was made.
- S** 9.3 The board must take reasonable steps to ensure that the Shariah committee is free from any undue influence that may hamper the Shariah committee from exercising its professional objectivity in deliberating issues brought before them.

Question 1: Conflict of decisions

- (i) Please describe any challenges that you foresee in implementing the requirements in paragraph 9.1, 9.2 and 9.3;
- (ii) Please describe any unintended implications of replacing the current prohibition on the board from setting aside or modifying the decision or advice of the Shariah committee without its consent with paragraph 9.1 and 9.2;
- (iii) Please describe situations or circumstances that may require the Shariah committee to make a decision that is stricter from the rulings of the SAC and how this matter is currently being addressed at each institution; and
- (iv) Please provide any alternative proposals to manage the differences in views between the board and the Shariah committee without jeopardising the integrity of Shariah requirements.

- S** 9.4 The board must establish a written policy to identify, assess and manage any conflict of interest arising from any additional activities or services performed by the Shariah committee for the IFI. This shall include policies relating to the involvement of a Shariah committee member in the provision of consultancy services to any clients of the IFI, with or without remuneration.
- S** 9.5 The board must establish effective communication with the Shariah committee on all matters relating to Shariah requirements, Shariah governance or Shariah non-compliance risks to enable both parties to effectively discharge respective responsibilities under the Shariah governance framework. The board must regularly review the quality and frequency of its engagement with the Shariah committee.
- S** 9.6 The board must allocate sufficient resources for the continuous development of skills and expertise of the Shariah committee. This shall include allocating

adequate budget, having in place development plans for Shariah committee members and regularly updating such plans to ensure that each member possesses the requisite knowledge and skills to fulfil his responsibilities.

- S** 9.7 The board must establish a formal process to assess, at minimum annually, the performance and effectiveness of the Shariah committee and every individual Shariah committee member. The assessment must consider the competence, knowledge and contribution of each Shariah committee member to the overall functioning of the Shariah committee.
- S** 9.8 The board must approve the remuneration policy for the Shariah committee that is commensurate with the accountabilities, duties and responsibilities of the Shariah committee.
- S** 9.9 In the event that the board delegates any of its responsibility to the Shariah committee, the board must remain accountable for any ensuing implications arising from the delegated responsibility.

PART C SHARIAH COMMITTEE

10 Key responsibilities

- S** 10.1 The Shariah committee must have a charter that sets out the mandate, responsibilities and procedures of the Shariah committee including matters reserved for its decision or advice.
- S** 10.2 The Shariah committee has the responsibility to provide objective and sound advice to the IFI to ensure that its aims and operations, business, affairs and activities are in compliance with Shariah. This includes–
- (a) providing a decision or advice to the IFI on the application of any ruling of the SAC or standards on Shariah matters that are applicable to the operations, business, affairs and activities of the IFI;
 - (b) providing decision or advice on matters which require a reference to be made to the SAC;
 - (c) providing a decision or advice on the operations, business, affairs and activities of the IFI which may trigger a Shariah non-compliance event;
 - (d) deliberating and affirming a Shariah non-compliant finding by any person or function; and
 - (e) endorsing a rectification measure to address a Shariah non-compliance event.
- S** 10.3 The Shariah committee shall be accountable for the quality, accuracy and soundness of its own decision or advice.
- S** 10.4 The Shariah committee must establish a robust methodology to guide its decision-making process. The Shariah committee must take into account relevant business and risk practices in arriving at a decision.

Question 2: Robust methodology or decision-making process

Please describe the existing methodology applied by the Shariah committee in arriving at a decision.

- S** 10.5 Where the Shariah committee has reason to believe that any Shariah issue or matter may affect the safety and soundness of the IFI, the Shariah committee must immediately update the board on such matter.
- S** 10.6 In cases where the Shariah committee is not able to arrive at a decision or advice, the IFI shall make reference to the SAC for a ruling in accordance with Manual Rujukan Institusi Kewangan Islam kepada Majlis Penasihat Syariah. Any request for a ruling or advice shall be communicated through the Secretariat of the SAC as provided in **Appendix 1**.
- S** 10.7 The Shariah committee must provide a record of its decision or advice, which at minimum must include the rationale and basis, in the following circumstances–
- (a) when a reference is made to the SAC for a ruling;

- (b) when an IFI submits an application for product approval to the Bank; or
 - (c) when an IFI submits a rectification plan to the Bank to address a Shariah non-compliance event.
- S** 10.8 In the event that the Shariah committee delegates any of its responsibility to any person or function, the Shariah committee must remain accountable for any ensuing implications arising from the delegated responsibility.
- S** 10.9 A Shariah Committee member must be objective in its character and judgment, and free from associations or circumstances that may impair the exercise of his professional objectivity. In fulfilling his responsibility, a Shariah committee member must ensure that his judgment in arriving at a Shariah decision or advice is not affected by his involvement in the IFI's management or business operations.
- S** 10.10 A Shariah committee member must ensure consistency in providing his views and must not act in a manner that would undermine the rulings of the SAC or any decision of the Shariah committee that they represent.
- S** 10.11 Every individual Shariah committee member must disclose to the board the nature and extent of his interest that constitutes or give rise to a conflict of interest upon the appointment or reappointment of the Shariah committee member.
- S** 10.12 A Shariah committee member must continuously develop a reasonable understanding of the business and operations of the IFI and keep abreast with relevant market and regulatory developments. The chairman of the Shariah committee must lead efforts to address the Shariah committee's developmental needs.

11 Shariah committee meetings

- S** 11.1 The chairman of the Shariah committee, in leading the Shariah committee is responsible for the effective functioning of the Shariah committee. In fulfilling this role, the chairman of the Shariah committee must–
 - (a) ensure appropriate procedures are in place to govern the Shariah committee's deliberations and proceedings;
 - (b) act as a direct liaison between the board and Shariah committee to foster greater understanding between both organs;
 - (c) ensure that Shariah decisions or advice are made on a sound and well-informed basis, including based on a robust decision-making methodology which ensures that all business, operations and risk implications are considered by the Shariah committee;
 - (d) encourage healthy discussion, participation, contribution, and ensure that dissenting views can be freely expressed and discussed; and
 - (e) ensure sufficient records of the discussion leading to formulation of Shariah committee's decision or advice are maintained.
- S** 11.2 At minimum, an IFI must hold its Shariah committee meetings at least once in every two (2) months and the meeting must be held within 60 days of the last

preceding meeting at all times.

- S** 11.3 A Shariah committee member must devote sufficient time to prepare for and attend Shariah committee meetings.
- S** 11.4 A Shariah committee member must attend at least 75% of the Shariah committee meetings held in each financial year, and must not appoint another person to attend or participate in Shariah committee meetings on his behalf.
- S** 11.5 An IFI must ensure that attendance of members at a Shariah committee meeting, by way other than physical presence, remains the exception rather than the norm, and is subject to appropriate safeguards to preserve the confidentiality of deliberations.
- S** 11.6 An IFI shall disclose the number of Shariah committee meetings held during the financial year as well as the attendance of every Shariah committee member in the IFI's annual report.
- S** 11.7 In respect of the quorum for Shariah committee meetings, the IFI must require that the majority of Shariah qualified members to be present during each meeting.
- S** 11.8 The IFI shall ensure that any decision of the Shariah committee must be made on the basis of simple majority.

Question 3: Voting rights

Please provide views on whether equal voting rights for all Shariah committee members (including members without qualification in Shariah) will affect the perceived quality of any decisions by the Shariah committee.

- S** 11.9 Where an IFI has been approved by the Bank pursuant to paragraph 13.4 to have a minimum of three (3) Shariah committee members, the IFI shall ensure that the two (2) Shariah qualified members must be present in all Shariah committee meetings.
- S** 11.10 In relation to paragraph 10.9, any Shariah committee member who is directly involved in the day-to-day management of any matter brought before the Shariah committee must abstain himself from voting on that particular matter.
- S** 11.11 In discharging its advisory function on Shariah governance, the IFI must ensure that the Shariah committee have access to all information required or needed by the Shariah committee and must ensure that the information provided is timely, accurate, comprehensive and clear.
- S** 11.12 The IFI must provide the Shariah committee with access to advice from third party experts on any matter deliberated by the Shariah committee as and when required, and the cost of such advice shall be borne by the IFI.
- S** 11.13 In relation to paragraphs 11.11 and 11.12, any party with the knowledge or

awareness of a Shariah committee's request or access being declined, denied or withheld from any relevant information by any officer or employee of the IFI must inform of the same to the board. The board shall take appropriate action to rectify the situation.

For avoidance of doubt, reference to "any party" in this paragraph also includes any Shariah committee member.

- S** 11.14 While the board or senior management may provide useful insights on any business, technical or operational matters discussed during a Shariah committee meeting, the board and senior management must not be present during voting or decision-making by the Shariah committee.
- S** 11.15 The Shariah committee must ensure that clear and accurate minutes of Shariah committee meetings are maintained to record the decisions or advice of the Shariah committee, including the key deliberations, rationale for each decision or advice made, any significant concerns and dissenting views.

12 Appointments and removal

- S** 12.1 Subject to section 31 of the IFSA, an IFI shall only appoint or reappoint a person to be its Shariah committee member if the person—
 - (a) is a Muslim individual;
 - (b) have been assessed to have met the requirements specified in the policy document on *Fit and Proper Criteria* on a continuous basis; and
 - (c) is Shariah qualified person or Islamic finance practitioner.
- S** 12.2 In determining a Shariah qualified person under paragraph 12.1(c), an IFI must assess whether the person fulfil the following:
 - (a) holds, at minimum, a bachelor's degree in Shariah, which includes study in *Usul Fiqh* (the origin of Islamic law) or *Fiqh Muamalat* (Islamic transaction/commercial law) from a reputable university;
 - (b) have a strong knowledge in Shariah with reasonable Islamic finance knowledge of the relevant industry; and
 - (c) able to demonstrate strong proficiency and knowledge in written and verbal Arabic, and have good understanding in the preferred language of the IFI, either Bahasa Malaysia or the English language.
- S** 12.3 In determining an Islamic finance practitioner under paragraph 12.1(c), an IFI must assess whether the person fulfil the following:
 - (a) qualified in banking, accounting, finance, takaful, actuary, risk, legal, treasury, audit or other areas related to Islamic finance;
 - (b) have at least ten (10) years of experience in his own area of expertise; and
 - (c) have a reasonable Islamic finance knowledge of the relevant industry.

Question 4: Islamic finance practitioner

Please provide your views on whether the proposed criteria on Islamic finance practitioner in paragraph 12.3 is appropriate, taking into account the stature, duties and responsibilities of the Shariah committee.

- S** 12.4 Pursuant to section 33(1)(c) of the IFSA, a person is disqualified from being appointed or reappointed, accepting any appointment or reappointment or holding office as a Shariah committee member of an IFI if–
- (a) he is an undischarged bankrupt, has suspended payments or has compounded with his creditors whether in or outside Malaysia;
 - (b) a charge for criminal offence relating to dishonesty or fraud under any written law or the law of any country, territory or place outside Malaysia, has been proven against him; or
 - (c) under any law relating to prevention of crime, drug trafficking or immigration–
 - (i) an order for detention, supervision or deportation has been made against that person; or
 - (ii) any form of restriction or supervision by bond or otherwise, has been imposed on him.

Where any criminal proceeding is pending in any court for any offence referred to in paragraph 12.4(b) against a Shariah committee member of an IFI, such person shall not—

- (a) act in such capacity, hold any other office or act in any other capacity, in that institution; or
- (b) be concerned with, take part or engage in, any manner, whether directly or indirectly, in any activity, affairs or business of, or in relation to, that institution,

except as may be permitted by the board of directors of the institution subject to such conditions as may be specified by the Bank.

For the purposes of this paragraph, “criminal proceedings” shall be deemed to be pending from the date that the accused person is first charged in court for the offence until the date of the final conclusion of the proceedings, whether in the court of original jurisdiction or, in the event of any appeal by any party, in the court of final appellate jurisdiction.

- S** 12.5 A Shariah committee member or his immediate family member must not–
- (a) be an employee of the IFI during the tenure of his appointment or within the last two (2) years of his proposed appointment as a Shariah committee member;
 - (b) be a substantial shareholder, executive director or senior officer of the IFI or any of its affiliates; or
 - (c) have a significant business or other contractual relationship with the IFI or any affiliates within the last two (2) years.

For the purpose of paragraph 12.5(c), the board must clearly defines what constitutes a “significant business or other contractual relationship”, taking into

account the nature, size and complexity of the IFI's operations.

Question 5: Independent criteria for Shariah committee

Please describe any concerns or challenges to meet the proposed criteria in paragraph 12.5(a) to (c) or any alternative proposals to strengthen the independence of the Shariah committee.

- S** 12.6 A Shariah committee member must not have competing time commitments that impair his ability to discharge his duties effectively. In respect of multiple appointments, Shariah committee member is required to manage his commitments effectively, observe professional objectivity and confidentiality in carrying out his duties.
- S** 12.7 A Shariah committee member must not accept any appointment in more than one licensed Islamic bank (including development financial institutions) and one licensed takaful operator.
- S** 12.8 A Shariah committee member must not be an active politician.
- S** 12.9 A Shariah committee member must immediately disclose to the board any circumstances that may affect his ability to meet the minimum requirements under paragraphs 12.1 to 12.8.
- G** 12.10 The board is encouraged to appoint Shariah Committee members as a board member. The Shariah committee members appointed will foster closer integration of Shariah governance consideration within the business and risk strategy of the IFI.

Question 6: Integration between the board and Shariah committee

In your view, what would bring about better integration between the board and Shariah committee—

- a) mandatory appointment of at least one (1) Shariah committee member as a director;
- b) requirement to include at least one (1) Shariah committee member as a permanent invitee to board meetings; or
- c) joint meetings between the board and Shariah committee?

- S** 12.11 The board must establish and regularly review succession plans for the Shariah committee members. Such a process must involve assessment of candidates against the minimum requirements set out in paragraphs 12.1 to 12.8.
- S** 12.12 The board must establish a rigorous process for the appointment, reappointment and removal of Shariah committee members. Such a process must involve the assessment of candidates against the minimum requirements set out in paragraphs 12.1 to 12.8.
- S** 12.13 An IFI must submit an application in writing to the Bank for the purposes of

appointment and reappointment of Shariah committee members and chairman of the Shariah committee at least three (3) months before it expects a proposed candidate to assume his responsibilities. In the case of reappointment, the application must be submitted three (3) months prior to the expiry of the Shariah committee member's existing tenure. All applications shall be made using the form enclosed in **Appendix 2**.

- S** 12.14 An IFI must not make an application to the Bank to appoint or reappoint a Shariah committee member or chairman of the Shariah committee unless the IFI is wholly satisfied, based on its objective assessment, that the candidate meets the minimum requirements set out in paragraphs 12.1 to 12.8, can perform his expected roles and responsibilities and will be able to meaningfully contribute to the Shariah committee.
- S** 12.15 A chairman of the Shariah committee must be a Shariah qualified person with reasonable knowledge of the Islamic finance industry.
- S** 12.16 A Shariah committee member whose tenure has expired and is being proposed for reappointment must immediately cease to hold office and act in such capacity, including by participating in any Shariah committee meetings or holding himself out as a Shariah committee member of the IFI.

13 Composition

- S** 13.1 An IFI shall ensure that Shariah committee must be of a sufficient size that–
(a) reflects the business needs of the IFI or the financial group; and
(b) enables a conducive environment for sound deliberation of Shariah matters.
- S** 13.2 An IFI must ensure that its Shariah committee, at minimum, must comprise of at least five (5) Shariah committee members that include at least one (1) Islamic finance practitioner.
- S** 13.3 An IFI must ensure that a majority of its Shariah committee members are Shariah qualified persons.
- S** 13.4 Notwithstanding paragraph 13.2 and subject to the Bank's approval, an IFI with smaller or less complex operation must demonstrate with strong justifications that a minimum of three (3) Shariah committee members is proportionate to meet the IFI's business needs.

Question 7: Alternative arrangement for small and less complex IFIs

Please describe any challenges that you foresee in implementing the requirement in paragraph 13.4 or alternative proposals you may have for smaller and less complex IFIs.

- S** 13.5 An IFI approved pursuant to paragraph 13.4 to have a minimum of three (3) Shariah committee members must ensure that one (1) of its member is an

Islamic finance practitioner.

- G** 13.6 Where there is more than one IFI within a financial group, one of the IFI may submit application to the Bank for its approval to establish a single Shariah committee to serve the entire financial group.

14 Secretariat to the Shariah committee

- S** 14.1 The IFI shall appoint a secretariat to serve the Shariah committee. The secretariat has the responsibility to provide operational support for effective functioning of the Shariah committee, which includes–
- (a) coordinating communications and disseminating information among the Shariah committee, the board and senior management;
 - (b) performing in-depth research and studies on Shariah issues;
 - (c) providing day-to-day advice to relevant parties on Shariah matters based on the rulings and decisions or advice of the SAC and Shariah committee;
 - (d) ensuring proper deliberation and dissemination of decisions of the Shariah committee within the IFI; and
 - (e) undertaking administrative and secretarial functions to support the Shariah committee.
- S** 14.2 The secretariat must consist of employees of the IFI who collectively have adequate qualifications in Shariah.
- S** 14.3 The Shariah committee must be given adequate time to deliberate all Shariah matters. In this regard, the secretariat has the responsibility to plan and coordinate Shariah committee meetings in a manner that promotes sound decision-making by the Shariah committee.

PART D SENIOR MANAGEMENT

15 Key responsibilities

- S** 15.1 Senior management of an IFI has responsibility over the day-to-day management of the IFI. This includes ensuring that the IFI's operations, business, affairs and activities comply with Shariah at all times. In fulfilling this responsibility, 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 Shariah non-compliance risks, including the accountability of the senior officer leading a Shariah department or unit;
 - (b) implement effective Shariah governance policies, procedures and practices in accordance with the direction given by the board;
 - (c) implement the rulings of the SAC and the decision or advice of the Shariah committee with due regard by the board;
 - (d) implement an effective communication policy that supports a sound understanding of Shariah matters across the IFI;
 - (e) conduct regular assessment to evaluate the quality of operational support provided to the Shariah committee and address any inadequacies arising thereof; and
 - (f) report to the board and Shariah committee on a timely basis any potential or actual Shariah non-compliance events.
- S** 15.2 Each member of senior management of an IFI must continuously develop and strengthen his understanding of Islamic finance and the relevant Shariah governance policies to fulfill his responsibility.

PART E CONTROL FUNCTIONS

16 Control functions under Shariah governance

- G** 16.1 The effective management of Shariah non-compliance risks is dependent substantially on–
- (a) a comprehensive and integrated approach to enterprise-wide risk management, which integrates risks arising from Shariah non-compliances alongside other risks such as credit, market, operational and liquidity; and
 - (b) the effective integration of control functions under Shariah governance and oversight arrangement of the risk management, compliance and internal audit at the entity-level and group-level.
- S** 16.2 The IFI must ensure that the oversight and management of the overall Shariah non-compliance risks is structured in a way that the senior officers entrusted with control functions under Shariah governance are able to exercise clear accountability over Shariah non-compliance risks.
- S** 16.3 In the event that the IFI is relying on group-wide arrangements to perform such control functions, the IFI must ensure that the oversight and management of the Shariah non-compliance risk is integrated with the existing control functions at the entity-level and group-level.
- S** 16.4 The IFI must ensure effective management of Shariah non-compliance risks which requires the following functions to be performed on a continuous basis:
- (a) Shariah risk management;
 - (b) Shariah review; and
 - (c) Shariah audit.
- S** 16.5 Senior officers undertaking control functions under Shariah governance shall have direct and unimpeded access to the Shariah committee for effective performance of such control functions.
- S** 16.6 While it is common for the control functions to work closely with individual business units, the control functions must be sufficiently independent of the business lines and must not be involved in revenue generation activities.
- S** 16.7 The control functions must have access to all business lines that are exposed to Shariah non-compliance risk to perform its functions.

17 Shariah risk management

- G** 17.1 Shariah risk management refers to a function that systematically identify, measure, monitor and report Shariah non-compliance risks to prevent any Shariah non-compliances.
- S** 17.2 The Shariah risk management function, at minimum, must–
- (a) integrate Shariah non-compliance risk considerations with enterprise-

- wide risk management;
- (b) identify material and emerging Shariah non-compliance risks in the business operations and activities of the IFI;
- (c) assess the Shariah non-compliance risks and measure the potential impact of the risk exposures to the IFI;
- (d) establish appropriate risk mitigation measures;
- (e) monitor the risk-taking activities and align the Shariah non-compliance risk exposures with the board-approved risk appetite and risk limits;
- (f) report to the board, Shariah committee and senior management on the Shariah non-compliance risk exposures, including but not limited to proposing appropriate risk-mitigating actions; and
- (g) influence or challenge decisions that may give rise to material Shariah non-compliance risks.

- S** 17.3 The senior officer principally accountable and responsible for risk management shall be responsible for Shariah risk management which forms part of the IFI's integrated risk management framework.
- S** 17.4 The IFI shall ensure that its risk officers who perform the Shariah risk management must have the requisite knowledge and experience on relevant Shariah matters.

18 Shariah review

- G** 18.1 Shariah review refers to a function that conducts regular assessment on the compliance of the operations, business, affairs and activities of the IFI with Shariah requirements.
- S** 18.2 The Shariah review function, at minimum, must–
- (a) identify, assess and monitor the compliance of the IFI's business operations and activities with Shariah;
 - (b) report to the board, Shariah committee and senior management regularly on Shariah non-compliance issues and findings;
 - (c) inform and provide updates to the board, Shariah committee and senior management on the latest developments in legal and regulatory requirements in Islamic finance, especially in relation to issuance of the SAC rulings; and
 - (d) ensure adequate training and guidance are provided to the officers of an IFI on relevant Shariah requirements governing the IFI's operations, business, affair and activity.
- S** 18.3 The senior officer principally accountable and responsible for compliance shall be responsible for Shariah review which forms part of the IFI's overall compliance responsibilities in ensuring sound management of compliance risk.
- S** 18.4 The IFI shall ensure that officers qualified to undertake compliance function responsibilities, with relevant knowledge of the Shariah requirements applicable to Islamic financial business must perform the Shariah review.
- G** 18.5 Pursuant to paragraph 18.4, officers qualified to perform compliance function

responsibilities may include officers with Shariah qualification.

19 Shariah audit

- G** 19.1 Shariah audit refers to a function that provides an independent assessment on the quality and effectiveness of the IFI's internal control, risk management systems, governance processes as well as the overall compliance of the IFI's operations, business, affairs and activities with Shariah.
- S** 19.2 The Shariah audit function, at 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;
 - (c) establish a clear documented audit programs that provide guidance to the internal auditors in gathering information, auditing procedures and audit assessment; and
 - (d) communicate results to the board and Shariah committee through an audit report, detailing the audit findings and recommendations for rectification measures, as well as the auditee's responses and action plans.
- S** 19.3 The senior officer principally accountable and responsible for internal audit shall be responsible for Shariah audit which forms part of the overall internal audit function in an IFI.
- S** 19.4 The IFI must ensure that its internal auditors who perform the Shariah audit must be qualified to perform internal audit and have adequate knowledge on Shariah requirements applicable to Islamic financial business.
- G** 19.5 The board may appoint any person to conduct an independent external Shariah audit on the operations, business, affair and activity of the IFI to provide objective assurance on the effectiveness of Shariah governance implementation within the IFI.
- G** 19.6 In the event the Bank deems appropriate for the purposes of compliance with Shariah by an IFI, the Bank may require the IFI to appoint any person approved under section 37 of the IFSA to conduct an independent audit on Shariah compliance by the IFI.

Question 8: Management of Shariah non-compliance risks

Please describe any concerns or challenges that you foresee in implementing the requirements in Part E.

PART F SHARIAH COMPLIANCE CULTURE AND REMUNERATION

20 Shariah compliance culture

- G** 20.1 Shariah compliance culture refers to the way in which an IFI promotes, adopts and implements the behaviour of compliance with Shariah in its aims and operations, business, affairs and activities. This includes adopting an appropriate ‘tone from the top’ to regularly communicate the importance of adherence to Shariah requirements and the integration of Shariah governance consideration in the business and risk strategies, internal policies and conduct of the IFI.
- S** 20.2 The board, together with the senior management, shall have the responsibility to advocate, adopt and implement a sound Shariah compliance culture across all business and functional lines including product development and marketing, internal controls, business operations and market conduct.
- S** 20.3 The board must ensure effective communication policy is in place to advocate effective implementation of Shariah governance.

21 Remuneration

- S** 21.1 The board must ensure that the remuneration policy and performance measures for senior officers responsible for ensuring Shariah compliance reinforces a risk culture that is in line with Shariah governance objectives.

PART G TRANSPARENCY AND DISCLOSURES

22 Disclosures by the board

- S** 22.1 The board must clearly articulate in the Directors' Report its oversight accountability for Shariah governance implementation and the IFI's overall compliance with Shariah.

23 Disclosures by the Shariah committee

- S** 23.1 The Shariah committee shall disclose information in the IFI's annual report on its—
- (a) responsibilities relating to Shariah governance; and
 - (b) opinion on the state of the IFI's compliance with Shariah.
- S** 23.2 For the purposes of paragraph 23.1, the Shariah committee shall not disclose any information in the IFI's annual report which is false, misleading, inaccurate or incomplete.
- S** 23.3 In relation to paragraph 23.1, the disclosure must be signed by not less than two (2) Shariah committee members.
- S** 23.4 In relation to paragraph 23.1(b), an IFI must develop a written policy that is endorsed by the Shariah committee and approved by the board to ensure effective and structured processes are undertaken by the Shariah committee in deriving its opinion on the state of the IFI's compliance with Shariah.
- G** 23.5 In relation to paragraph 23.4, an IFI may consider to include the following aspects in its written policy to form an opinion on the state of the IFI's compliance with Shariah:
- (a) planning, including the determination of materiality;
 - (b) obtaining evidence;
 - (c) consultation;
 - (d) formation of opinion; and
 - (e) the manner in which the opinion is to be published.
- S** 23.6 The Shariah committee's opinion on the state of an IFI's compliance with Shariah shall be expressed either—
- (a) where nothing has come to the Shariah committee's attention that causes the Shariah committee to believe that the operations, business, affairs and activities of the IFI involve any material Shariah non-compliance; or
 - (b) the overall operations, business, affairs and activities of the IFI are in compliance with Shariah but it has come to the Shariah committee's attention that a material Shariah non-compliance event(s) has occurred and has been or in the process of being rectified.
- S** 23.7 In relation to paragraph 23.6(b), the Shariah committee's disclosure must include the nature, status and measures undertaken to address the material

Shariah non-compliance events reported.

Question 9: Information on material Shariah non-compliance events

- (i) While any Shariah non-compliance is considered an offence under IFSA and must be reported to the Bank in accordance with section 28 of the IFSA, please provide your views on whether it is appropriate to adopt the concept of materiality in the disclosure of Shariah non-compliance events; and
- (ii) Please explain the existing factors that you currently use within your respective institution to determine the materiality of information to be disclosed under the Shariah Committee's Report (in particular, those relating to Shariah non-compliance events).

PART H TRANSITIONAL ARRANGEMENTS

- S** 24.1 All IFIs have until the following dates to comply with the specific requirements set out below:

Requirement	Effective date
Composition of the Shariah committee ²	[1 January 2021]

² As required under paragraph 13.2 and 13.4.

APPENDIX 1 SECRETARIAT OF THE SAC

1. Any reference or request for ruling or 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

APPENDIX 2 APPLICATION FORM FOR APPOINTMENT OF SHARIAH COMMITTEE MEMBER

PERMOHONAN PELANTIKAN ANGGOTA JAWATANKUASA SYARIAH

APPLICATION TO APPOINT SHARIAH COMMITTEE MEMBER

ARAHAN

Borang BNM/JKS 1 ini hendaklah diisi oleh calon yang dicadangkan oleh institusi sebagai anggota Jawatankuasa Syariah. Sila gunakan kertas tambahan sekiranya ruang yang disediakan tidak mencukupi. Pastikan **setiap muka surat** termasuk kertas tambahan yang digunakan ditandatangani dan pastikan **segala maklumat terdahulu dan semasa** yang dikehendaki dalam borang ini diisi dengan lengkap. Nyatakan "Tiada" atau "Tidak Berkenaan" sekiranya maklumat tersebut tidak berkenaan bagi calon.

Borang yang lengkap hendaklah dihantar ke alamat seperti di bawah:

INSTRUCTION

*This form BNM/JKS 1 should be completed by the candidate proposed by the institution as Shariah committee member. If the space allocated is not sufficient, additional paper may be attached. Please initial **on each page**, including on the additional papers used and provide **all past and current information** as required in this form. Indicate "Nil" or "Not Applicable" if the items are not relevant to the candidate.*

The completed form should be sent to the address below:

**Pengarah
Jabatan Perbankan Islam dan Takaful
Bank Negara Malaysia
Jalan Dato' Onn
50480 Kuala Lumpur**

NAMA INSTITUSI YANG MEMOHON
(Name of Applicant Institution)

--

Sila tandakan (✓) pada petak yang berkenaan
(Please tick (✓) in the relevant box)

Pelantikan baru (*New appointment*)

Pelantikan semula (*Reappointment*)

Tarikh tamat pelantikan: _____
(Expiry date of current appointment)

Sila lampirkan
gambar berukuran
pasport

(Please attach
passport-sized
photo)

A. BUTIR-BUTIR PERIBADI
(Personal Particulars)

1. NAMA (<i>Name</i>)

2. NO. KAD PENGENALAN (<i>NRIC No.</i>)	3. NO. PASPORT (<i>Passport No.</i>)

4. KEWARGANEGARAAN (<i>Nationality</i>)	5. STATUS PERKAHWINAN (<i>Marital Status</i>)

6. ALAMAT KEDIAMAN SEKARANG (<i>Current Residential Address</i>)

7. NO. TELEFON (<i>Contact No.</i>)
<ul style="list-style-type: none"> • Kediaman (<i>Residential</i>): • Pejabat (<i>Office</i>): • Telefon Bimbit (<i>Mobile</i>): • No. Faksimile (<i>Fax No.</i>):

8. JAWATAN SEKARANG (*Current Designation/Post*)

--

9. NAMA & ALAMAT MAJIKAN SEKARANG
(*Name & Address of Current Employer*)

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10. E-MEL
(*E-mail*)

--

11. LAMAN WEB PERIBADI
(*Personal Website or Blog*)

--

12. BAHASA PERHUBUNGAN (*Language of Communication*)

--

B. KELAYAKAN DAN PENGALAMAN (Qualification and Experience)

13. KELAYAKAN AKADEMIK DAN IKHTISAS (Academic and Professional Qualification)			
KELULUSAN (Qualification)	TAHUN (Year)	NEGARA (Country)	INSTITUSI PENGAJIAN / BADAN PROFESSIONAL (Institution of Learning / Professional Body)

14. PENGKHUSUSAN BIDANG (Field of Expertise)	
<input type="checkbox"/>	Syariah (Shariah)*
<input type="checkbox"/>	Pengajian Islam selain Syariah (Islamic Studies other than Shariah)
<input type="checkbox"/>	Perundangan (Legal)
<input type="checkbox"/>	Kewangan (Finance)
<input type="checkbox"/>	Perakaunan (Accounting)
<input type="checkbox"/>	Lain-lain (Other): _____
<p>* Individu yang berpengetahuan dan pakar, dengan pengkhususan dalam bidang Syariah termasuk <i>Usul Fiqh</i> dan <i>Fiqh Muamalat</i>, dan mempunyai kemampuan yang baik dalam penulisan dan pertuturan Bahasa Arab.</p> <p>(A person who is learned and expert, with specialisation in Shariah including <i>Usul Fiqh</i> and <i>Fiqh Muamalat</i>, and also has strong capability in written and verbal Arabic.)</p>	

15. PENGALAMAN BEKERJA (<i>Working Experience</i>)				
TEMPOH (<i>Period</i>)		JAWATAN (<i>Position</i>)	NAMA ORGANISASI (<i>Name of Organisation</i>)	TANGGUNGJAWAB UTAMA (<i>Main Responsibility</i>)
Dari (<i>From</i>)	Hingga (<i>Until</i>)			

16. MAKLUMAT SEBAGAI PENASIHAT SYARIAH BAGI SEMUA INSTITUSI & ORGANISASI (<i>Information as Shariah Advisor of All Institutions & Organisations</i>)*		
TEMPOH (<i>Period</i>)		ORGANISASI (<i>organisation</i>)
Dari (<i>From</i>)	Hingga (<i>Until</i>)	

* Merangkumi semua institusi di bawah dan di luar kawal seliaan Bank Negara Malaysia.
(*Includes all institutions within and beyond Bank Negara Malaysia's purview.*)

17. KEHADIRAN PROGRAM SHARIAH LEADERSHIP EDUCATION (SLE) (Attendance to SLE Program)	
Tarikh (Date)	MODUL (Module)

18. PENGLIBATAN DALAM KURSUS/SEMINAR/PERSIDANGAN KEWANGAN ISLAM DALAM 2 TAHUN TERKINI (Involvement in Islamic Finance Course/Seminar/Conference in 2 Recent Years)	
Tarikh (Date)	TAJUK (Title)

19. PENULISAN, KAJIAN DAN KERTAS KERJA (Writings, Research and Paperwork)	
Tarikh (Date)	TAJUK (Title)

C. PENGAKUAN DAN PENGESAHAN CALON (Declaration and Confirmation of Candidate)

20. PENGAKUAN (Declaration)

Sila nyatakan sama ada anda pernah dicadangkan / dilantik / diluluskan pelantikan oleh Bank Negara Malaysia sebagai seorang anggota Jawatankuasa Syariah di mana-mana institusi yang dikawal selia oleh Bank Negara Malaysia di bawah undang-undang berikut dalam tempoh tiga (3) bulan lepas:

- (i) Akta Perkhidmatan Kewangan Islam 2013; dan
- (ii) Akta Institusi Kewangan Pembangunan 2002.

Please indicate if you have been nominated / appointed / approved for the appointment by Bank Negara Malaysia as a Shariah Committee member of any institution regulated and supervised by Bank Negara Malaysia under the following laws in the past three (3) months:

- (i) Islamic Financial Services Act 2013; and*
- (ii) Development Financial Institutions Act 2002.*

Ya (Yes)

Tidak (No)

Jika jawapan anda adalah "Ya", sila nyatakan institusi tersebut.
(If the answer is "Yes", please indicate the institution(s) concerned.)

Institusi (Institution): _____

Saya mengaku bahawa:

I declare that:

- (a) saya BUKAN seorang bankrap yang belum dilepaskan, tidak pernah menggantung pembayaran atau telah menyelesaikan pembayaran dengan pemiutang saya sama ada di dalam atau di luar Malaysia;

am NOT an undischarged bankrupt, have not suspended any payments or has not been compounded with my creditors, whether within or outside Malaysia;

Ya (Yes)

Tidak (No)

- (b) TIDAK PERNAH dibuktikan terhadap saya sebarang pertuduhan bagi suatu kesalahan jenayah yang berhubungan dengan ketidakjujuran atau fraud di bawah mana-mana undang-undang bertulis atau undang-undang mana-mana negara, wilayah atau tempat di luar Malaysia; dan

I HAVE NOT been charged with any criminal offence relating to dishonesty or fraud under any written law or the law of any country, territory or place outside Malaysia where such charge has been proven against me; and

Ya (Yes)

Tidak (No)

- (c) TIDAK PERNAH dikenakan ke atas saya suatu perintah tahanan, pengawasan, pengusiran, atau apa-apa bentuk sekatan atau pengawasan melalui bon atau selainnya, di bawah mana-mana undang-undang yang berhubungan dengan pencegahan jenayah, penganjuran dadah, atau imigresen.

NO order of detention, supervision or deportation has been made against me, and NO form of restriction or supervision by bond or otherwise has been imposed on me under any law relating to prevention of crime, drug trafficking, or immigration.

Ya (Yes)

Tidak (No)

21. PENGESAHAN (Confirmation)

Saya dengan ini mengesahkan bahawa semua maklumat yang dikemukakan di atas adalah benar dan lengkap.

I hereby confirm that all the information given above is true and complete.

.....
Tandatangan (Signature)

Nama Penuh (Name in Full):

Tarikh (Date):