SHARI’AH GOVERNANCE OF ISLAMIC BANKING INDUSTRY IN SRI LANKA

Mr. HMA. Hilmy¹ & Mr. SMM. Mazahir²

¹Lecturer (prob.), Dept. of Islamic Studies, South Eastern University of Sri Lanka, ahamedhilmy@gmail.com
²Senior Lecturer, Dept. of Islamic Studies, South Eastern University of Sri Lanka, mazahirssmm@gmail.com

Introduction

Today Islamic banks are operating in nearly all Muslim countries and many non-Muslim countries since 1970s. Unlike conventional banking industry, Islamic banking industry provides only the halal financial services for their customers because of its Shari’ah compliant system.

Therefore, the Shari’ah governance is the essence and vehicle for a comprehensive regulatory and supervisory infrastructure of Islamic banking system and it is the key feature of Islamic banking industry which distinguishes it from the conventional financial system. The overall compliance of Islamic banking and financial business is solely depending on the adequacy and efficiency of the Shari’ah governance.

To ensure that Islamic banking system is complying with the religious requirements, it is required to utilize the service of Shari’ah supervisory board (SSB). These SSB consist of number of Shari’ah scholars who conduct internal religious audit in Islamic financial Institutions and are required to approve the Shari’ah compliance of new financial products before they are launched commercially.

This study addresses the issues of accountability and governance in Islamic banking industry in Sri Lanka comparing the system of Shari’ah governance of Malaysian Islamic banking industry and investigates the roles and responsibilities of the SSB and Shari’ah advisers.

Objectives

1. The primary objective of this study is to evaluate Shari’ah governance practiced in Islamic banking industry in Sri Lanka.
2. To examine the duties and responsibilities of Shari’ah advisors of Islamic banking sector.
3. To find out the role of Central Bank of Sri Lanka in pertaining of Shari’ah Applications and governance.
4. To discover a suitable model of Shari’ah governance for Islamic financial institutions of Sri Lanka.
5. To compare the existing Sri Lankan model of Shari’ah governance with Malaysian model.

Literature Review

Most of the studies have been devoted the Shari’ah governance of the Islamic financial institutions. Because the Riba Free (RF) banks, should conduct their business keeping in mind the Shari’ah principles of Islamic Commercial Law, from their function of mobilizing fund till utilizing them in business along with distributing return to the customers.

The Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) has prepared a standard for a Shari’ah supervisory board, its composition and related aspects like rulings, report, etc. According to this standard, a Shari’ah board should be an independent body of specialized jurists in Islamic commercial jurisprudence. It may also include other experts in areas of Islamic financial institutions with knowledge of Islamic jurisprudence relating to commercial transactions. (Ayyub2007)

Some new researchers addressed that the Shari’ah governance as one of the important elements for cooperate governance.

Holder-Webb, Cohen, Nath and Wood, (2008) defined Collective Governance (CG) as the provision of effective boards, strong shareholder rights, and broad disclosures in managing a business. From the perspective of IFIs, governance specifically addresses issues pertaining to the role and conduct of the Shari’ah Supervisory Boards (SSB).
The Shari’ah audit function is defined in the framework as an independent assessment that is conducted on a periodical basis in order to improve the degree of compliance and to ensure a sound and effective internal control system for Shari’ah compliance in the institution. (ZurinaShaffi 2013)

In Pakistan, Securities and Exchange Commission of Pakistan (SECP), the regulator passed the following rules regarding to Shari’ahBoard (2012).

(1) The Commission may establish a Shari’ah Advisory Board consisting of such number of members as may be decided by the Commission.

(2) The Shari’ah Advisory Board will be responsible to formulate policies and guidelines for operation and management of Takaful business in line with Shari’ah principles.

(3) If in the opinion of the Commission different treatment for a similar operational issue is adopted by various operators, with the approval of their Shari’ah Advisor, the matter shall be resolved by the Shari’ah Advisory Board and the findings of the Shari’ah Advisory Board shall be final.

(4) The Commission may assign any other responsibility to the Shari’ah Advisory Board from time to time.

Research Methodology

The field based case study method was applied in this study and primary data was collected through the interviews with individuals and Shari’ah board members from the Sri Lankan Islamic banking sector. The interviewees were chosen based on their experience, involvement and intellect on the subject area. Additional information was sourced from the secondary resources i.e. historical documents, books, annual reports and journal/newspaperarticles.

The collected data has been analyzed by the proper qualitative analytical methods and reached the findings. A comparison was done with existing national Shari’ah governance model in Malaysia which is the hub for Islamic financial industry, in order to evaluate the new Shari’ah governance and application model for Islamic financial institutions that has been enforced by the Central Bank of Sri Lanka. This model is seen as the first step towards the implementation in Sri Lanka of the Shari’ah governance requirements put forth by the AAOIFI, the global regulatory body for Islamic financial institutions.

Findings

1. The Shari’ah governance of the Islamic banking industry in Sri Lanka is inadequate in term of competency and efficiency comparing to the Malaysian model.
2. Shari’ah board consists some foreign scholars who are very busy and member of several international institutions all over the world, like As Sheikh TaqiUsmani of Pakistan.
3. The Shari’ah boards do not consist of any PhD holders or intellectuals and learned who have very clear knowledge on Fiqh al Mu’amalat and Usul al Fiqh, in their respective bodies as full time Shari’ah advisors.
4. ACJU of Sri Lanka’s role in Islamic banking sector is not in the level of final decision maker. Even, according to the interview the ACJU also conducts seminars, organizes training programme and provide some valuable services for the Islamic finance. But it is not enough to develop the Shari’ah governance framework in the country. Sri Lanka as a non-Muslim country, the ACJU has major responsibility to conform the Islamic financial transactions in the country are Shari’ah compliant.
5. The Shari’ah board members’ relationship with the customers of the bank and the community is not in the level of expectation.
6. The training programme and the awareness programme conducted by respective Islamic banking sector or ACJU regarding the Islamic banking and finance also not sufficient.

7. Central Bank of Sri Lanka as a sole regulator of the country not consist separate division for Shari’ah governance. It may affect the following instances:

1. While providing the license for the new Islamic financial institutions they may consider only on the areas of county’s rules and regulations without the Shari’ah matters.
2. The internal Shari’ah boards of the institutions haven’t any body to overrule their decisions when different interpretations between the Shari’ah committee members occur. This let the country to the situation where standardization of Shari’ah is left.

Conclusions and Recommendations

Lack of proficiency and competency of Sri Lankan Shari’ah governance setup is also a reason for unable to operate the Islamic financial institutions successfully and effectively. However, there are some misconceptions regarding the Shari’ah governance still available. According to our study this is because of less
relationship between the customers/ public and Shari’ah scholars of the institutions and the lack of awareness programmes. So, the key strategies would basically involve educating the related parties through awareness programmes and training sessions by the Shari’ah scholars which would create close relationship between the public and Shari’ah board members.

Another criticism is regarding the Shari’ah board members’ freedom. Since the Shari’ah committee members are appointed and their allowances are paid by the banks, it is argued that the bank’s management may influence them in making proposed products legal. This misconception may influence on the growth of Islamic finance in Sri Lanka. Therefore, some major efforts are to be done to remove this misconception.

If we compare the Malaysian system it gives a better confident regarding the independency of the Shari’ah scholars. The new Shari’ah governance framework issued by Central Bank of Malaysia (Bank Negara Malaysia) provides strong foundation for the betterment of Islamic banking industry. BNM has also founded a National Shari’ah Advisory Council (NSAC). The NSAC is regarded as the most authoritative body relating to the Shari’ah issues of the Islamic banking in that country.

Hence, the new Shari’ah governance framework again emphasizes the independency matter. BNM stresses that Islamic banks must ensure that the Shari’ah committees are free from any influence which would hamper them from making objective judgment. In relation to this, re-appointment, resignation and removal of the Shari’ah committees cannot be decided at the bank’s level. It is must be approved by the National Shari’ah Advisory Council (NSAC) formed by Central Bank of Malaysia (BNM). (Amir Shaharuddin, 2011)

Therefore, the system like Malaysian banking sector is very much needed to ensure the public’s confidence on Islamic financial and the growth and development of the Islamic banking sector. However, as a non-Muslim country Sri Lanka may delay to involve this concept. It took more than a decade to provide the license for fully fledged Islamic Bank. However the total Islamic finance providers may insist CBSL to inaugurate a separate division for Islamic finance into CBSL. The All Ceylon Jam’iyyah al ‘Ulama’(ACJU) also may insist the government on this matter. ACJU as a responsible body for Shari’ah matters of the country, it has rights to ensure the Shari’ah governance of the Islamic financial institutions. And also, ACJU should consider establishing an independent National Shari’ah Council for supervising and advising the existing SSBs.

Furthermore, the ACJU and the Islamic Banking industry jointly may take effort to educate and train ‘Ulama’s of the country on Islamic finance and also the ACJU may instruct the Arabic colleges to take more care on the Subjects of Fiqh al Muamalat and Usul al Fiqh. Moreover, the highly talented Shari’ah scholars should be motivated to read Masters and PhD programmes in Islamic financial fields. It will reduce the problem of shortage of Shari’ah scholars and their competency.

References