

SHARI'AH GOVERNANCE OF ISLAMIC BANKING INDUSTRY IN SRI LANKA

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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. (ZurinaShafii 2013)

In Pakistan, Securities and Exchange Commission of Pakistan (SECP), the regulator passed the following rules regarding to *Shari'ah*Board (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 programee 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.
 - 3.

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'iyah 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.

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