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**ISLAMIC CORPORATE GOVERNANCE  
(CASE STUDY IN ASIA AND GCC COUNTRIES)**

**Ummu Salma Al-Azizah**

Universitas Muhammadiyah Prof. DR. HAMKA

Email: [ummusalma@uhamka.ac.id](mailto:ummusalma@uhamka.ac.id)

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*Abstract*

*In the recent years, Islamic Banking development has many contribution into the International finance. However, this followed by other industries such as capital market and also corporate. Therefore, need to understanding how is Islamic Corporate Governance should be follow by the industries. In this paper, elaborate some Islamic Corporate Governance in ASIA and GCC Countries as well as established during the year, there are: Indonesia, Malaysia and Pakistan. And from GCC are: Saudi Arabia, Dubai and Bahrain.*

*Keywords: Islamic Corporate Governance, International Finance, Industries, Capital Market*

**Abstrak**

Dalam beberapa tahun terakhir, pengembangan Perbankan Syariah memiliki banyak kontribusi kepada keuangan Internasional. Namun, ini diikuti oleh industri lain seperti pasar modal dan juga perusahaan. Oleh karena itu, perlu memahami bagaimana Corporate Governance Islam harus mengikuti oleh industri. Dalam tulisan ini, menguraikan beberapa Corporate Governance Islam di ASIA dan Negara GCC serta didirikan selama tahun ini, ada: Indonesia, Malaysia dan Pakistan. Dan dari GCC adalah: Saudi Arabia, Dubai dan Bahrain.

**Kata Kunci:** Tata Kelola Perusahaan Islam, Keuangan Internasional, Industri, Pasar Modal

## INTRODUCTION

The collapse of banking system in year 1997 and 1998 have been created in the most ASEAN countries. However, this financial crisis created mostly by the bank management, political interference, illegally, enormously excessive lending to companies and a host of other activities which is conflict between the shareholders and management. Therefore, need to developed the good corporate governance to manage and maintain the interest for both the parties.

After the collapsed of the conventional banking systems, and also the collapse of corporate worldwide, it was a huge growth of Islamic financial systems in the worldwide. Since that the time began, it is important needed of the corporate governance according to Islamic principles. It should be done directly, administer or control the systems accurately. However, there are several models of the shariah governance over the countries. In this paper, we will discuss and compare between the ASEAN GCC countries' models.

In term of Shariah Corporate Governance (SCG) models, it can be differentiate and identified as the importance and essentials of corporate

governance. There were about who make the decision, for whom, and with what resources to do. Additionally, it later governing to whom it due to the accountability. However, the most concern of this SCG with the western approach is about the contrasting regulatory framework.

The nature aspects of Islamic corporate governance is Islamic law, which are included the life, ethical, social, and to encompass criminal as well as civil jurisdiction. Some ethical principles are defined such as true, fair and justice, nature of corporate responsibilities, the priorities to society, along with some specific governance standards. Second, in term of providing the regulation of business ethics, an Islamic economic and financial principles have a direct impact to corporate practices and policies. That must be include is zakah, prohibition of riba, speculation, and starting to develop of a system of economic based on profit and loss sharing.

In this paper, we will discuss about the models of shariah corporate governance which are used by the ASEAN and GCC countries, such as Malaysia, Indonesia, Pakistan, Bahrain, UAE and Qatar. These

countries started develop and managing the shariah governance's models after their corporate collapsed and the starting point of the Islamic financial institutions.

This paper use the theoretical

## **RESULT**

According to the previous study about the shariah corporate governance in ASIA and the GCC countries, we can see that, ASIA countries usually use the interventionist and proactive model of Shariah Governance for their Islamic Financial Institutions. On the other hand, the GCC countries, their mostly use the model of minimalist.

Shariah corporate governance, in the broadest terms, is the single most important current issue for the Islamic financial institutions. The global financial system continues in the state flux and is not without further threat and stresses. Therefore, it is needed to changes the system works of infrastructure through the financial systems based on Islamic principles. At the same time, corporate governance used as a governance codes and guidelines issued over the last 20 years.

Regarding to development of Islamic financial institutions through the world, it

methodology by reviewing the existing literature related to the conceptual and framework of corporate governance of the Western and Islamic models.

is need to develop and maintain the corporate governance based on the shariah principles. As a result, shariah corporate governance is needed by the Islamic financial institutions as a legal and organizational structures that look after the internal integrity of a corporation.

This paper will be only focus on the model of shariah corporate governance in ASEAN like Malaysia, Indonesia and Pakistan and the GCC countries such as Bahrain, United Arab Emirates, Kuwait, Saudi Arabia and Qatar. In addition, many of the previous study research that focused on the model of shariah governance in GCC countries, Malaysia and United Kingdom. However, there are many of ASEAN countries that developed the model of shariah governance for the Islamic financial institutions, like Indonesia and Thailand. Therefore, the differentiate in terms of shariah corporate governance model will be more developed and introduced.

Corporate governance concerns to the

corporation and its constituents. In the conventional terminology, it is about the relationship linkage between those who supplying capital and finance to the firm and its management. Moreover, since those a legal and organizational structures of corporation integrity as an organization or institutions. It is thereby a bundle of contracts and rules under which it functions, is legitimated by legal enactment and protected by legal tenets of any government and state.

Corporate governance as an organizational concept can be derived from the words of Arrow (1974, p. 224) he wrote:

*“An organization is a group of individuals seeking to achieve some common goals, or, in different language, to maximize an objective function. Each member has objectives of his own, in general not coincident with those of the organization. Each member also has some range of decisions to make within limits set partly by the environment external to the organization and partly by the environment external to the organization and partly by the decision of member. Finally, some but not all observations about the workings of the organizations and about the external world are communicated from one member to*

*another”.*

The very first objective of corporate governance is to define and attain an objective criterion to understanding the relation between critical variables supported by policies, programs and strategic coalitions. Furthermore, there are two main systems in corporate governance, namely The anglo-saxon which is considered used in United States and United kingdom. And the second one is European models that has been used in European countries such as Italy, German, France, Spain and Greece.

### **Islamic Perspectives in Corporate Governance**

According to the Islamic Financial Services Board (IFSB), shariah governance system as defined as a set of institutional and organizational arrangements to oversee shariah compliance aspects in Islamic Financial Institutions (IFIS). However, majority of IFIS have established their own shariah board and some of them even have set up a dedicated internal shariah review unit or department to support shariah board in performing its functions (IFSB, 2008).

There is not very different between the Shariah corporate governance and conventional definition about the corporate governance. Refer to the system

which companies are directed and controlled with a purpose to meet the corporation's objective by protecting all the shareholders' interest and right. On the other hand, in the context of Islam, the interest of stakeholders will gain is from the financial return or profit maximization from the corporation. Therefore, it must be cover from the Islamic ethic and the principle of the oneness of Allah.

#### **Tawhid and shura based approach**

Tawhid is the concept of the philosophical pillars of Islamic economic. Therefore, tawhid epistemology methodology to the issue of corporate governance. According to Choudhury, Islamic corporation is "a legal entity where the principle and proportionate of the firm's shares owned by the shareholders based on equity participation and profit sharing ratios and deals with legal and organizational structures that control the internal governance of a firm with an objective to define and attain an objective criterion by way of understanding the relations between variables supported by policies, programs and strategic creation" (Choudury and Hoque, 2004: 58 and 83).

In the process of Shariah Corporate

governance, there are two main institutions involved which are shariah board and the participants constituent. Shariah board has the pivotal role to ensure that all corporation activities are in line with the shariah principles. Similarly, the shareholders can also be participate in the process of decision making and policy framework by considering the interest of all stakeholders rather than maximize their profit alone (Archer & Rifaat, 2007).

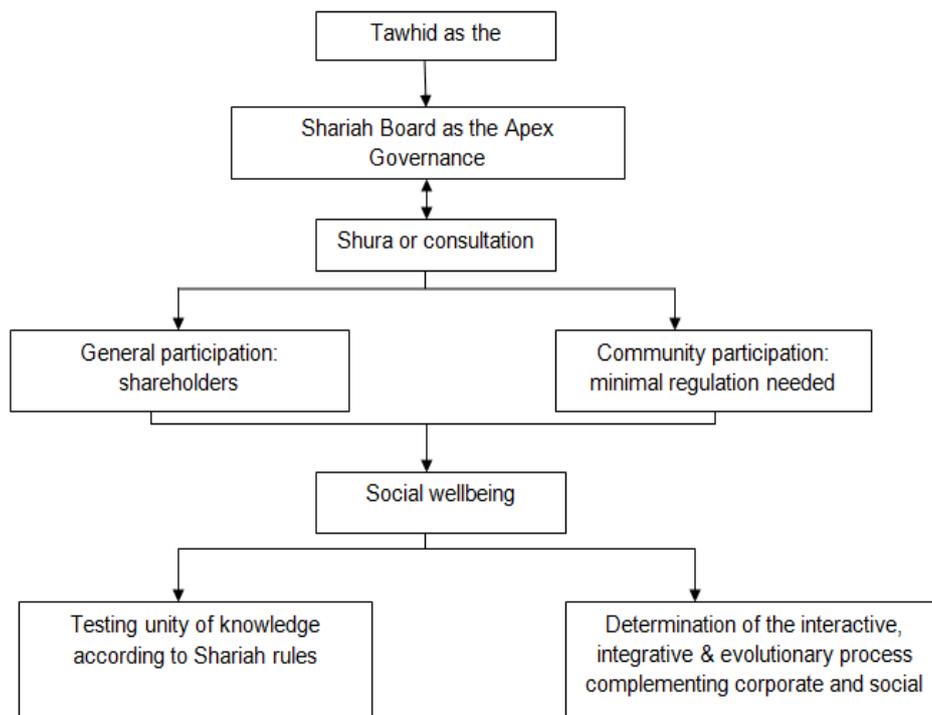
#### **Stakeholders Based Approach**

According to Chapra and Ahmed (2002: 13-20), their find that corporate governance in IFIs emphasize on the notion of equitability protecting the rights of all stakeholders irrespective of whether they hold equity or not. Additionally, the view by Iqbal and Mirakhor, where they view that the corporate governance model in Islamic economic system is a stakeholder centered model in which the governance style and structures protect the interest and rights of all stakeholders rather than the shareholders. However, the Nienhaus, (2003) states that Islamic corporate governance should be based on value oriented and promote the principle of fairness and justice with respect to all stakeholders (Chapra & Ahmad, 2002).

Shariah corporate governance based on overall business activities and the stakeholders oriented model is recorded by the two fundamental concepts of shariah principles of property rights and contractual frameworks. The board of directors acting on behalf of the shareholders to monitor and oversee overall business activities and the manager to manage the firm as a trust for all of the obligations. There is a unique criteria regarding to the shariah corporate governance and have the distinctive characteristics to compare with European and the Anglo-saxon

**These are the differences:**

Aspects	The Anglo Saxon	The European	Shariah Model
Episteme	Rationalism & rationality	Rationalism & rationality	Tawhid
Objective			
Rights & interest	To protect the interest & rights of the shareholders.	The right of community in relation of the corporation	To protect the interest and rights of all stakeholders but subject to the rules of shariah.
Corporate goal	Shareholders controlling managers for purpose of shareholders profit.	Society controlling corporation for purpose of social welfare	Acknowledge profit motive oriented but balance it with the shariah objective and principles
Nature of Management	Management dominated	Controlling shareholder dominated	Concept of vicegerency and shura
Management boards	One tier board	Two tier board	Two tier board. Shariah boards as the ultimate governance
Capital related & ownership structure	Widely dispersed ownership; dividends prioritized.	Banks and other corporations are major shareholders; dividends less prioritized	Shareholders and depositors or investment account holders.



### Shariah Governance Model

#### 1. Reactive approach

Prevalent in non-Islamic legal environment countries. Several Islamic banking licensed who issued to IFIs, the regulatory authority following the shariah governance framework. The important thing in this model is, that the IFIs make sure that their business operation and products are shariah compliant. Regulator will be react if there is any significance issue involved which may affect the industry.

#### 2. Passive approach

This model used Saudi Arabia. SAMA (Saudi Authority Monetary Agency) treats

IFIs equal to their conventional counterparts. There is no national shariah advisory board or any institutions to be the authority body in Islamic finance.

#### 3. Minimalist approach

In this model, there is an intervention on the regulatory authorities. There is also any appointments to seat together in as a shariah board from the various institutions. This approach usually used in the market to develop the shariah corporate governance.

#### 4. Pro active approach

This model has the strong faith in term of regulatory to make strong the shariah governace framework in the country. We

can see this model in Malaysia.

### 5. Interventionist approach

As a unique model, interventionist approach used exclusively in Pakistan. This type of model, allowed the third party from the institution to make the decisions according to the shariah matters.

### 2.4 Regulatory Issues

According to the positive development of shariah corporate governance, there are several issue come up. First, legal status of the shariah pronouncement. This issue cover which is the shariah rulings are binding to the IFIS, court or any other related institutions. In Malaysia, the Shariah board decisions are binding and mandatory. Second, conflict of laws. This conflict come up because of the legislative framework consisting of mixed jurisdictions and mixed legal systems used by mostly IFIS. Therefore, it is necessity for the shariah governance have legal framework to resolve this issue (Bakar, 2002).

Third, court jurisdictions. In term of the conflict that happened in IFIS, no need based on the conventional jurisdiction. However, this issue might be significant in respect to the Shariah governance system to decide Islamic finance cases. Fourth, addressing issue on differences of

Shariah resolutions. This issue will become more and more happen if there is still absence of a comprehensive set regulatory framework. This also, will lead to the problem in development of Islamic finance. Example of this issue is the differentiates of fatwa made by shariah board according to the IFIS products for every countries. The last issue is about the role of shariah board. As we know, that the shariah board has the pivotal role to regulate the IFIS transaction, products and operations. However, as strong as what it will be? Meaning that, how powerful these shariah board to control the IFIS. To answer this issue, we must to give full authority for the shariah board in term of supervise and advise to address the shariah compliance aspects of IFIS.

### **Shariah Governance in GCC Countries and ASIA**

#### Shariah Governance System Overview of GCC Region

Islamic finance has been growing rapidly in the recent years. Total volume of Shariah-compliant assets in the world was estimated at US\$1.1 trillion at the end of 2011, among which 40% of the total assets was contributed by GCC countries. During the years of 2006-2011, Islamic finance industries in GCC region have

been developing in a high speed and compounded annual growth rate was averaged at 27.7% (SESRIC, 2012).

Islamic banking industries stand for about 80% of total Islamic finance in the current development stage, but comparing to total banking assets, the share of Islamic banking assets is still much small. According to the Institute of International Finance (IIF) estimation, the total value of Islamic Banking Assets of GCC countries were amounted to US\$314 billion at the end of the year 2011, which stands for 19% of the total banking assets in this region (Deloitte, 2012).

There are three types of Shariah Governance system in terms of different standards in the current Islamic Finance world. First, Legal Authority requires IFIs to implement the AAOIFI Shariah Governance standards through legislation, such as Bahrain, Qatar, Dubai; second type is that, related Authority of Government issues guidelines or instructions towards Shariah Governance in IFIs, for example, the Central Bank of Malaysia has issued guidelines for the regulation of Shariah Committee of IFIs. The third is that government less involves in development of Islamic Institutions, for

instance, there are no specific regulation or law pertaining to Islamic Financial Sector in Saudi Arabia until now. Shariah Governance of Islamic Institutions has been developing in free-market level.

Saudi Arabia

### **Islamic finance industries overview**

Saudi Arabia is one of most important countries in the development of Islamic finance and it is the second largest country in the world regarding to total Shariah-compliance assets. Establishment of Islamic Development Bank (IDB) in 1975 in Saudi Arabia is viewed as the first step for the modern Islamic Banking industries. According to Deloitte's estimation (Deloitte, 2012), the volume of Shariah-compliant assets in Saudi Arabia was totaled to US\$94 million by the end of 2011, representing 8.2% of the total value of Islamic Finance services in the world, and counting for 26% of the overall Islamic Finance Services in GCC Region. In the banking sector, Islamic banking industries represent only 35% of the total banking assets (SESRIC, 2012). Furthermore, Islamic banking industry is the major sector among the Islamic finance in the current development stage, which indicates that the share of Islamic

Business in the total economic transaction of Saudi Arabia is relatively low.

As one of the major products in capital market, sukuk have been attracting more attention from governments and companies. There had been 25 different sukuk issued until December of 2011, which were valued at US\$17.1 billion in Saudi Arabia. General Authority of Civil Aviation issued Murabahah-structured sukuk in January 2012. It is sized at US\$4 billion which is the biggest single sukuk in Islamic finance history (Deloitte, 2012).

#### Legislation System

In Saudi Arabia, Shariah is the main source of all aspects of life, including civil law. Therefore, the Shariah court is the final court in jurisdiction system. But when it comes to commercial sector, there is a special commercial court which functions as highest court pertaining to all commercial matters including Islamic finance. The Central Bank of Saudi Arabia, which is called Saudi Arabia Monetary Agency (SAMA), was founded in 1952 by Royal Decree. The role of the SAMA includes Issuance of national currency, banks of government, management of foreign exchange reserves, service provider for commercial banks, conduction monetary policy etc.

(SAMA, 2012).

However, the Islamic Banks are not monitored by SAMA; instead, all IFIs are under the supervision of the Saudi Ministry of Commerce (Hasan, 2009). This means Islamic Banks are considered as the in nature with the commercial companies.

#### Shariah Governance Overview

Shariah governance in other GCC countries are attracted more attention, for instance, Bahrain established National Shariah Board, but in Saudi Arabia there is no such organization playing the role of final Shariah Board Authority, instead, Banking Disputes Committee (BDC) which was launched in 1987 by SAMA as a specialized institution for solving banking sector disputes (Hasan, 2009). Although there is no specific law or guidelines by government towards Islamic Finance, IFs have been growing in Saudi Arabia with a considerable speed. During the development of Islamic Financial sector, Shariah governance framework has been built by market force voluntarily and indirectly (Hasan, 2009).

#### Qatar

##### Islamic finance institutions overview

According to The Institute of International Finance (IIF) report

(Peninsula, 2012), overall Islamic banking assetsof Qatar reached to \$35billion at the end of 2011, representing 19.3% of total banking assets, and it stands for only 11% of the GCC region Islamic banking total assets (the estimated total Islamic banking assets of GCC are \$314 billion).

It is worth noting that in Feb 2011, the Central Bank of Qatar issued specific announcement asking conventional banks to terminate Islamic banking services windows before the end of 2011 (Qatar Central Bank, 2011). This means starting from the year of 2012, conventional banks are not allowed to involve Islamic deposits and operation of Islamic finance. This is a significant step in the development of Islamic Finance which ensures pure Islamic banks operation system in Islamic banking industries.

#### **Regulatory framework.**

After its independence in 1971, Qatar Authority declared legislation system would be based on Shariah, and civil law would consider Shariah as the main source of legislation. Nevertheless, regarding to commercial sector, Shariah is accepted as only one of the sources, not the primary condition of regulation (Hasan, 2009). Therefore, opposition exists between civil

law and commercial regulation. In 1975, the Qatar Monetary Agency started to intervene determining the interest rate in commercial transaction, which was later replaced by the Qatar Central Bank (QCB), which means charging interest on commercial loans in Qatar is allowed by the civil law. All the disputes relating financial sector are put under civil court.

The Qatar Financial Centre (QFC) was established in 2005 as a business and financial center to provide legal and business infrastructure for financial services. The Centre is operated by a commercial authority and a regulator – the QFC Authority and the Regulatory Authority respectively. Both don't depend on each other and also are independent from the Qatar government (Qatar Embassy, 2006).

#### **Shariah board overview**

Shariah governance framework in Qatar is regulated by Qatar Central Bank and Qatar Financial Centre respectively. The QCB issues prudential regulations, amendments and explanations pertaining to banking sector to facilitate banking business. In 2011, the QCB has released 13th edition of instructions book named "Instruction to Banks November

2011”, which contains 13 parts aimed to regulate all banks including national banks (conventional and Islamic), branches of the foreign banks operating in Qatar, Islamic Banks (Qatar Central Bank, 2011).

The QFC also issues its own regulatory rules towards all financial sectors including banking, insurance, financial market. . The QFC regulation rules include the activities of IFIs. For example, the QFC Regulatory Authority has released a rulebook to govern the activities of licensed companies involving Islamic financial industries. In this rulebook, QFC requires every authorized firms operating business in Islamic finance to establish a Shariah Supervisory Board, which should have three members at least. The rulebook also has requirement towards Shariah board members, in which it is asked Shariah members to be selected from those who have the ability to perform their functions taking into account their qualification and pervious experience. And according to the rule book, performtheir role according to every Islamic finance institution should have establish particular systems and accountable controls to make sure its operations are always Shariah-compliant.

## **Bahrain**

### **Islamic finance institutions overview**

Recently, Bahrain, hosting two major international Islamic finance organizations, namely the Accounting and Auditing Organization for Islamic Financial Institutions ('AAOIFI') and the International Islamic Financial Market ('IIFM'), has become one of the leader countries in the development of Islamic Finance Industries. At present, seven Takaful companies and two Re-Takaful companies are operating in Bahrain. In addition, sukuk market has been developing with a remarkable speed with the great sport by the Central Bank (Central Bnak of Bahrain, 2012).

Islamic banking sector has been expanding as major part of Islamic finance industry. The overall assets of Islamic banking sector reached to US\$25.4 billion by the end of August 2012 from US\$1.9 billion in the year of 2000, which stands for 13.3 of the total banking assets of this country (Central Bnak of Bahrain, 2012).

### **Regulatory framework**

Shariah is the main source of legislation since its independence in 1971. Due to its interest-based economics system, Bahrain established its own commercial related law which makes

charging interest on commercial loans permissible in business transactions. But according to Federal Law, the rate should be determined by the Bahrain Monetary Agency. The Bahrain Civil Court has stipulated a comprehended jurisdiction framework over commercial and civil matters, but Shariah related disputes are not under civil court (Hasan, 2009).

Shariah board overview.

Bahrain has established National Shariah Advisory Board of the CBB to serve and verify the Shariah compliance of its own products only as it does not have authority upon the other IFIs

All the finance sector of Bahrain, including banking, insurance and capital market, are regulated and supervised by the Central Bank of Bahrain (CBB). The Central Bank of Bahrain has issued a comprehended prudential and reporting guidelines rule books to clarify the particular concepts and the needs of Islamic insurance and banking. The rulebook towards Islamic banks includes aspects such as capital adequacy, licensing requirements, business conduct risk management, and reporting/disclosure requirements, financial crime. According to the Rule Book, the CBB requires all

banks to set up an independent Shariah board and adopt the AAOIFI's governance standards. Apart from that the CBB allows all IFIs to establish a separate function of Shariah review for a purpose of ensuring Shariah compliance. No restriction for the member of National Shariah Board to serve any financial institution, also no limitation to serve only one institution.

Likewise, the rulebook for insurance covers specific features of firms operating takaful and re-takaful business. Both rulebooks have a significant role to build the regulatory framework of Islamic finance business, which provided a comprehensive system to deal with Islamic Finance (Central Bank of Bahrain, 2012).

## **United Arab Emirates**

### **Islamic finance institutions overview**

In the UAE, Islamic banking assets grow to 20 per cent of the total banking sector in 2012 from an estimated 18 per cent in 2011, a banking expert has mentioned. The sukuk market in UAE is the second largest market in the world followed by Malaysia.

### **Regulatory framework**

As the same with other GCC countries,

Shariah is the main source of legislation in UAE , and charging interest in commercial transaction was prohibited until 1992. From the year of 1993, it is allowed to charge interest on commercial loan because it was considered as Necessity. Financial matters including banking sector are put under civil court in current legislation system.

Regarding to Islamic finance industries in UAE, Dubai was entitled a unique privilege to develop Islamic Finance across the region. The Dubai International Financial Center Law was passed in 1985, which aims to build international financial center in Dubai. The other law- the Dubai Financial Services Authority Law was passed to ensure its unique position and privilege in the development of Islamic finance. All IFIs registered under the DIFC are put under the DIFC court and the DIFC Arbitration Center and also all these institutions are regulated by DIFC law.

### **Shariah board overview**

Because of the special position of Dubai in the legislation framework in UAE, there are two Shariah governance systems in UAE, one of which is for UAE member federals except Dubai, and the other is adapted for Dubai.

Shariah governance framework in UAE except Dubai is monitored by Federal Law. Under this law, higher Shariah authority was established to supervise and Islamic institutions including banks, investment companies and financial institutions. It is governed by the Ministry of Justice and Islamic Affairs and be binding. In this article, it is required that memorandum of association should cover governance and manner of Shariah board including duties, functions, appointment and responsibilities. Another special requirement is that before the appointment, IFIs should submit proposal to Higher Shariah Authority to be approved.

Regarding to Islamic Firms registered under DIFC, they should be regulated by DIFC Services Authority and DIFC law. DIFC Services Authority has issued Rulebook for IFIs, in which it is required every IFIs to implement the AAOIFI Shariah Governance Standards. Apart from that, the Rulebook prescribes formation, conduct, appointment and operation and also requires at least three members should be included in the Shariah board.

### **Kuwait**

#### **Islamic finance institutions overview**

As one of the most important Islamic finance institutions in Kuwait, Kuwait Finance House was allowed to provide Shariah-compliant banking services by government in 1976, which was the first and only Islamic bank in Kuwait for many years. Now Kuwait Finance House became one of the leading Islamic finance institutions in global Islamic finance market, with a total asset of US\$39.59 billion by the end of third quarter in 2012 (KFH, 2012).

Regarding to the total Islamic banking assets, the share of Islamic banking assets counted for 34.4% of the total banking industry in Kuwait, which is much higher than that in other GCC countries (Deloitte, 2012).

### **Regulatory Framework**

The legislation framework of Kuwait strongly adheres to Islamic Shariah Law, in which interest is prohibited in commercial transaction. The Civil Law Code of Kuwait of 1981 prohibited charging interest on commercial loan in the business transaction and declared such practice is not permissible. But in the same year, the Kuwait Government issued a specific commercial code in order to exclude the commercial sector from the

application of the Shariah code (Hasan, 2009). Under this specific legislation, interest on loans is legally permissible.

The Central Bank of Kuwait is the sole regulator for monetary financial system in the State of Kuwait and supervises the financial institutions and matters on the organization of banking business. The judicial system of Kuwait puts the civil court to have jurisdiction over commercial matters and this includes banking and finance disputes. In regarding to Islamic banking, CBK law grants the CBK authority to regulate and control the activities of IFIs.

### **Shariah board overview**

After the legislation in 1976 allowing the establishment of Kuwait Finance House, only until the year of 2004, Kuwait government amended the law pertaining Islamic finance, which allows Islamic financial institutions to operate in the same financial environment as conventional banks and settles framework for Islamic banks including the requirement for the Islamic financial institutions to establish Shariah board (Wilson, 2009).

The amended CBK Law provides a legal basis for the regulations of the

Shariah board. Article 93 requires all Islamic Finance Institutions to establish an independent Shariah board which shall be appointed by the bank's General Assembly. The law also requires Islamic finance institutions to stipulate specified document to clarify the role, status, governance and working of the Shariah board (Hasan, 2009).

There is no Shariah board under CBK to act as the highest Shariah authority in Islamic banking and finance. To address this issue the CBK Law recognizes the Fatwa Board in the Ministry of Awqaf and Islamic Affairs as the final authority for any Shariah dispute involving Islamic banking and business. This Fatwa Board is an external body to the Central Bank of Kuwait. The CBK Law clearly provides the supremacy of Islamic law where it states that IFIS shall be subject to the provision of the CBK Law but subject to the Islamic Shariah principles. This is a strong legal proviso which placed Shariah as the supreme law in relation with Islamic banking and finance in Kuwait (Hasan, 2009).

### **Asian Shariah Governance Overview**

#### **Malaysia**

##### **Shariah governance framework**

The first phase of Islamic banking

industry was developed in Malaysia in 1983 by establishing Bank Islam Berhad and setting up the first shariah board. The central bank of Malaysia called Bank Negara Malaysia (BNM) issued Islamic Banking Law which named Islamic Banking Act (IBA). The law specified that banks registered under the act should not take operations which were not approved by the religion of Islam. Then the law was amended by new regulations in 1994. The BNM introduced a free-interest banking scheme in which conventional banks may offer Islamic banking products through their windows. The conventional banks which set up Islamic windows required to appoint selected Muslim Scholars to be member of shariah board. Next, the highest shariah authority was established in 1997 which called Shariah Advisory Commission to harmonize the interpretations among Islamic banks, conventional banks offered shariah compliant products and Takaful operators in the country.

At the start of 2011 In the newest amendment Islamic banking law recommended the framework for Shariah Governance specified by BNM in detail guidelines such as the number of Shariah Board members appointed (consist of

three members), the qualifications of the members, the duties and responsibilities of the boards, and their relationship with the Islamic Financial Institutions they serve. The framework includes functions of a risk management control, shariah review, and shariah audit function which provide an independent assessment of adequacy of all policies and procedures. The members of the Shariah Boards of Bank Negara and Securities Commission can only serve on one board. The restriction of multiple appointments of scholars is to avoid a conflict of interest and for reason of confidentiality. However, a scholar does not permitted to become a member of shariah committee in the same industries or same financial institutions.

In Malaysia's shariah governance system only the Shariah Boards of Bank Negara and Securities Commission have authority to issue fatwa on all matters regarding to shariah contracts offered. In the term of disputes cases hearing of Islamic banking institutions and costumers, the matter is under the jurisdiction of the civil court. However, the BNM act 2009 affirmed that the SAC is the sole authoritative body on shariah matters pertaining to Islamic banking and

finance. Hence, the civil court or arbitrator is mandatory to refer and consult with the SAC members before deciding verdicts or for deliberation on any shariah issues.

Indonesia

Shariah governance model and framework. Islamic banking started in Indonesia when Bank Muamalat was established in 1992 as the first bank operating in Islamic principles. It was regulated by the enactment of the Banking Act No.7/1992 and amended in 1998 to provide an opportunity to conventional banks to open Islamic windows. Next, in 1999 the National Shariah Board was formed by the Indonesian Ulama Council as an independent body recognized by the central bank of Indonesia (Bank Indonesia).

The article 32 of Indonesian Shariah Banking Act in 2008 stated that Shariah Board must be established by Takaful companies, each Islamic bank and all conventional banks offering Islamic financial products and services. The Shariah Board members are appointed by the Indonesian Ulama Council but the nominees have to be approved by general meeting of shareholders of the institution that they serve. While the internal Shariah

Supervisory Board members must be reported to Bank Indonesia and approved by the National Shariah Board.

In Indonesia's shariah governance system only the National Shariah Board formed by MUI has authority to issue fatwa on all matters regarding to products and services of Islamic financial institutions offered. So Bank Indonesia issues regulations for Islamic banking products and services complied with the fatwa issued by the NSB.

To adjudicate on disputes concerning Islamic financial matters between the institutions and costumers, the cases are handled in religious court. Nevertheless, before being judged to the religious court, the first step is the dispute case is heard by religious scholars in qualified body set up the National Shari'ah Arbitration Body by creating ad-hoc tribunal known as "Basyarnas".

### **Pakistan**

Shariah governance model and framework The State Bank of Pakistan established a Shariah Board being role as the sole authority in matter regarding to Islamic finance. The shariah governance in Pakistan is regulated by the State Bank of Pakistan' Shariah Board. In 2008 the State Bank of Pakistan (SBP) issued detail

guidelines for shariah compliance in Islamic banking institutions. The guidelines require all Islamic finance institutions to establish Shariah Advisors to hire minimum five scholars become their advisor. The Shariah Board member appointed may serve as a Shariah Advisor in more than one financial institution(difference from Malaysia's model).

### **CONCLUSION**

As we can see from the study literature before, we can conclude that shariah governance has four (4) models, such as reactive, passive, proactive and interventionist approach. Mostly in GCC countries, which are still under development in Islamic financial sector and built by market voluntary and indirectly, they use passive approach.

However, in ASEAN countries they use minimalist approach. When the Islamic financial institutions was established in the country, there is also shariah governance, therefore, the institutions still under control from the board of shariah.

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