

Some thoughts on resetting the roles and functions of Shari'ah committees of Islamic banks in Malaysia

Islamic banks
in Malaysia

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Mansor Isa
University of Malaya, Kuala Lumpur, Malaysia
Siew-Peng Lee
Universiti Tunku Abdul Rahman, Selangor, Malaysia
Obiyathulla Ismath Bacha
INCEIF University, Kuala Lumpur, Malaysia, and
Rubi Ahmad
University of Malaya, Kuala Lumpur, Malaysia

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Abstract

Purpose – The purpose of this study is to understand and evaluate the roles and functions of the Shari'ah committee (SC) of Islamic banks (IBs) in Malaysia and to recommend a resetting of the scope of responsibilities to enable the SC to effectively respond to current market needs.

Design/methodology/approach – A Likert-type survey questionnaire was developed and distributed to all available SC members through e-mails and online surveys as well as self-administered questionnaires. At the end of the survey, 87 useable questionnaires were collected from 161 SC members, representing a 54% response rate.

Findings – This study finds that most SC members have the necessary Shari'ah qualification, and they are mostly academics with doctoral degrees. However, there is a noticeable lack of diversity in the composition of experts in the committees. Respondents indicate that their main functions are to ensure Shari'ah compliance of bank operations and product offerings. This is of course consistent with their stated functions as outlined in the Bank Negara Malaysia's Shari'ah Governance Policy Document (BNM, 2019). The study finds that SCs are not involved in product development, nor responsible for financial performance. Respondents indicate three ways to enhance the role of SCs: improving banking knowledge of the members, more engagement with the board of directors (BoDs) and broadening the functions of SCs.

Practical implications – This study highlights two policy implications. First, there is a strategic need for IBs to consider having a diversity of expertise in the SCs while maintaining the Shari'ah experts as core members. Second, this study recommends a reset of the scope of duties of the SC to include three new areas: risk management, product development and financial performance.

Originality/value – This study evaluates the current functions of the SC of IBs in Malaysia and provides suggestions for improvement in the composition of the committee and in the scope of duties of SCs based on contemporary needs.

Keywords Islamic banks, Shari'ah committee, Shari'ah compliance, Malaysia

Paper type Research paper

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Introduction

The Islamic Financial Services Act (IFSA) (2013) of Malaysia called for all Islamic financial institutions (IFIs) in the country to establish a Shari'ah committee (SC) to ensure the Shari'ah compliance of their operations. In September 2019, Bank Negara Malaysia issued the Shari'ah Governance Policy Document (SGPD) that refines and updates the older version, the Shari'ah Governance Framework (SGF) 2010 and 2017 to provide Shari'ah governance requirements for all IFIs. The objectives of the SGPD (2019) are to strengthen the effectiveness of Shari'ah governance implementation and reinforce a strong integration of Shari'ah considerations in the risk strategies and business of IFIs. Section 10.2 of the SGPD (2019) states "The Shari'ah committee has the responsibility to provide objective and sound advice to the IFI to ensure that its objectives and operations, activities, business and affairs are in compliance with Shari'ah." With the rapid growth of Islamic banking and finance, the question of Islamic banks' (IBs) compliance with Islamic law is bound to rise. In this context, the SC plays a principal role in assuring all stakeholders of the Islamic authenticity of the banks' operations.

This study is motivated by two factors. The first motivation is the lack of growth in Islamic banking in the country. Although Islamic banking in Malaysia has been operating for more than 4 decades, its market share is less than a third of the aggregate asset size of the banking sector. This tends to indicate that IBs are facing an uphill battle competing against the conventional banks (CBs) in the country. Hence, this paper would like to propose that the SC be empowered with a broader task that includes product development and innovation that are not only Shari'ah compliant but also attractive to Muslim and non-Muslim consumers. The second motivation is that there is a noticeable departure from profit-loss sharing principles in IBs' operations. There are two trends in this departure. One, that IBs have deviated from their original intention of upholding the Islamic way of doing business based on interest-free and profit-loss sharing contracts (see for example [Cevik and Charap, 2011](#); [Anuar et al., 2014](#); [Hamza, 2016](#)). Two, that current IBs' practices are merely a replication of conventional banking with cosmetic modification to disguise their interest-rate dependence (see for example [Chong and Liu, 2009](#); [Khan, 2010](#); [Anuar et al., 2014](#); [Ariff, 2015](#); [Sukmana and Ibrahim, 2017](#)).

Since SC members are eminent scholars in Shari'ah, the SC should be the best mechanism empowered to address the above criticisms. However, their current scope of duties as stipulated in SGPD (2019) does not incorporate these responsibilities, thus limiting their ability to contribute to the overall development of Islamic banking. Therefore, this study proposes, amongst others, that the SC's roles and functions be broadened to include new areas such as risk management, new product development and responsibility for financial performance. To achieve these, there would be an obvious need for rigorous training and upskilling of the Shari'ah-qualified members to equip them with the necessary knowledge to effectively perform the expanded terms of reference. This study also proposes that IBs should consider appointing relevant non-Shari'ah experts into the SC.

This study adopted a survey approach, designed to achieve two key objectives. The first objective is to examine the current scope of functions of the SC, in particular the involvement of SC members in Shari'ah compliance, bank operations, risk management, product development and financial performance. The second objective is to recommend new areas to be incorporated into the roles and functions of the SC. The survey helps to provide a useful insight as to whether it is necessary to expand the SC's current roles and responsibilities to all stakeholders. These objectives are based on the need for further improvement of SCs to meet the challenges of the next phase of growth of IBs. The initial, easy phase of growth is over. Now IBs have to compete directly with CBs for market share. So, there is a need for SCs to be better prepared and hence, the current proposals.

Unlike previous studies, which tend to include non-SC members in their sample, all the respondents in this study are current SC members of IBs operating in Malaysia. Further, the

sample is larger than most of the previous studies, leading to more reliable results. The questionnaire is structured in a way that facilitates analysis and interpretation. The main body of the questionnaire consists of Likert-type statements on possible roles and functions of SCs, and respondents are asked to state their disagreement or agreement with each statement.

This study contributes to the existing literature by providing evidence on the consistencies between the actual and stipulated functions and roles of the SC of IBs in Malaysia. The stipulated roles are those stated in [SGPD \(2019\)](#). The study also provides a discussion on corporate financial and governance theories underlying the functions and roles of SCs. The information gathered in this study can form a basis for policy recommendations to expand the functions of SCs to, for instance, include oversight on the overall performance of IBs.

Literature review

Theoretical foundation of the roles of Shari'ah committees

Ensuring that IBs' practices are completely consistent with Shari'ah principles is not only in the best interest of the shareholders (as per [Jensen and Meckling's \(1976\)](#) agency theory) but also consistent with the interests of all stakeholders (as per [Freeman's \(1994\)](#) stakeholder theory). For example, shareholders expect profitability, employees expect fair treatment, while borrowers and depositors expect efficiency and competitive costs and returns. In a modern corporate framework, there exists information asymmetry between management and owners, and this presents an opportunity for management to act for their private benefits at the expense of the owners.

Although the establishment of the SC is a compulsory requirement, the SC is also part of the management and should therefore act in the best interest of shareholders and all other stakeholders. Muslim stakeholders in particular, in addition to having the common business expectation, also expect IBs to be Shari'ah compliant in all respects of their operations (as per the legitimacy theory, [Haridan et al., 2018](#)), including for example, office decoration and customer services. All the three theories mentioned herein provide the theoretical underpinnings of the importance of the roles played by the SC.

Being business entities, IBs also need to fulfil the business expectations of their stakeholders, such as value maximization for their shareholders, efficiency and competitiveness for their customers as well as growth and stability for the economy. In a dual banking system such as in Malaysia, merely being Shari'ah compliant may not be adequate to compete against CBs; IBs must be appealing to all consumers, Muslims and non-Muslims alike. Therefore, the SC must be proficient not only in Shari'ah but also in the business aspects of IBs. Traditionally, the board of directors (BoDs) and management are responsible to create value, growth and stability. But these are also directly related to the performance of SCs. The SCs now become an extension of the management, and therefore product development, financial performance and risk management should be incorporated into their functions. For example, many IBs are no longer in favour of profit-loss sharing modes of project financing although these are supposedly completely Shari'ah compliant and therefore should be preferred to debt-based finance (see for example an excellent discussion on this issue in [Sukmana and Ibrahim, 2017](#)).

Based on the above discussion, this study proposes that SCs should play a dual role of ensuring Shari'ah compliance of banks' operations and also assisting in banks' business viability and growth. Currently, the focus of the SC as stipulated in [SGPD \(2019\)](#) is solely for Shari'ah compliance. The failure to empower SCs with a broader scope of duties to enhance the business objectives is an agency cost that has not been given much prominence in the literature. In order for the SC to perform functions that are consistent with the demands of the

agency, stakeholder and legitimacy theories, this study proposes a revision in the functions and roles of the SC.

Related studies on Shari'ah committees

SC members are basically religious scholars who are held in high esteem in Muslim communities; hence, their endorsement of an IB's products gives confidence to stakeholders on the Shari'ah legitimacy of the bank's operations and transactions. DeLorenzo (2007) states that the SC assists in the end-to-end development of Islamic banking products, from their conception until their market launching. El-Khelaifi (2002) and Garas and Pierce (2010) state that SCs have an economic impact on IBs through their roles in approving and certifying new products. Lewis (2005) states that the SC carries out due diligence on behalf of customers who do not have full information on the financial products offered to them and also who do not have the knowledge to assess the products' Shari'ah compliance. By assuming the responsibility for Shari'ah compliance of an IB, the SC positions itself to be directly representing the religious interests of Muslim consumers (Karim, 2001).

One of the earlier debates on the functions and roles of the SC is whether they have supervisory power or simply advisory capacity. Having supervisory roles means that the SC has the authority to impose its decisions on the operations of IBs, but with advisory capacity, the committee's role is to simply give advice. The earlier studies that look into the roles of the SC include Hassan (2001), Garas and Pierce (2010) and Mokni *et al.* (2014). Hassan (2001) uses the terms "guiding" and "controlling" in describing the functions of the SC, both of which tend to imply supervisory capacities. On the other hand, Garas and Pierce (2010) categorize the SC's roles as "supervisory" and "consulting", which implies that SCs are involved in both supervisory and advisory roles. Similarly, Mokni *et al.* (2014), studying the Middle East and North African (MENA) region, provide a list of duties of the SC that encompasses both supervisory and advisory functions.

The literature seems to suggest that the SC plays both supervisory and advisory roles. The supervisory roles are in matters such as reviewing transactions to ensure Shari'ah compliance, certification of financial products, reviewing contracts, agreements and company policies, providing compliance ruling on new products, approving the allocation of net income of depositors and shareholders and participation in the implementation of related fatwas. On the other hand, advisory roles include finding compliant solutions for financial products, providing guidance in the distribution of Shari'ah non-compliant income for charitable purposes, conducting training for management and discussing zakat computation and distribution. In Malaysia, IFSA (2013) was introduced to provide the legal framework of IFIs, particularly in the aspect of Shari'ah compliance (Laldin and Furqani, 2018). Sections 28 and 32 of the Act set out the duties of IFIs and the SC. For example, Section 28(3) requires that any form of Shari'ah non-compliance should be promptly reported to Bank Negara Malaysia. This implies that SCs' decisions on Shari'ah compliance are supervisory in nature.

In the local scene, there are several articles focussing on the roles and functions of the SC, including Hassan *et al.* (2010), Hasan (2011), Hasan (2014), Haridan *et al.* (2018) and Naysary *et al.* (2020). Hassan *et al.* (2010) employ semi-structured face-to-face interviews on the roles and competencies of SCs. The study concluded that the lack of experience, information or knowledge on the practical aspect of the Islamic banking business may impede effective supervision by SCs. The implication is that SC members need to improve their competencies. Hasan (2011) conducts a questionnaire survey on Shari'ah governance practices on 31 samples from Gulf Cooperation Council (GCC) countries, Malaysia and the United Kingdom (GCC 13, Malaysia 17, UK 1). Hasan (2014), in a follow-up study, conducts semi-structured interviews with 14 SC members in various institutions: one from London, two from Dubai and 11 from Kuala Lumpur. In a similar vein, Haridan *et al.* (2018) conduct semi-structured

interviews with 14 key persons (including 6 SC members) in two full-fledged Malaysian IBs to investigate the roles and functions of their SCs. The respondents of these studies seem to indicate that the local SCs play both advisory and supervisory roles. The specific functions include conducting training, giving advice, reviewing and approving products, and endorsing Shari'ah compliance policies and procedures. The authors voice their concern on the issue of weak Shari'ah governance because the SC seems to delegate the review process to the internal compliance unit. The dependence of the compliance review process on bank internal officers may represent a possible compromise on the independence of the SC. Another important point raised in the local studies is the lack of diversified expertise of the SC. All authors agree that local SC members are well-qualified in Shari'ah, but the SC needs to include experts in other fields such as economics, banking and finance. In a recent study, [Naysary et al. \(2020\)](#) find there have been significant improvements in Shari'ah governance practices in local IBs in the last decade. However, their results also indicate that many SC members have insufficient knowledge of both conventional and Islamic banking and finance.

The importance of the roles and functions of the SC goes beyond providing assurance of the compliance of IBs' operations. Empirical studies relating to SCs and bank performance seem to indicate a positive relationship between them. Therefore, strengthening the roles and functions of SCs would have a positive impact on enhancing the financial performance of IBs. Studies that look into the relationship between IBs' performance and SCs include [Mollah and Zaman \(2015\)](#), [Frag et al. \(2018\)](#) and [Isa and Lee \(2020\)](#). [Frag et al. \(2018\)](#) study 90 IBs from various countries over the years 2006–2014, while [Mollah and Zaman \(2015\)](#) use international data from 25 countries over the period 2005–2011. [Isa and Lee \(2020\)](#) focus exclusively on IBs in Malaysia. All three studies conclude that effective SCs contribute to better banks' financial performance.

Research methodology

A self-administered survey questionnaire was developed for this study. The questions were developed based on the information available on the roles and functions of SCs as described in [SGF \(2010\)](#) and [SGF \(2017\)](#), [1] and based on issues discussed in previous studies. In addition, several meetings were held with a few SC members to obtain direct information on their roles and functions. The questionnaire is divided into three parts. The first part gathers information about the respondent's personal profile. The second part focusses on the roles and functions of SCs. Respondents are provided with a list of statements, and they are asked to state their agreement or disagreement on a five-point Likert scale. The statements are designed to cover five areas of duties of the SC; these are Shari'ah compliance, banking operations, risk management, new product development and financial performance. The first two areas are traditional areas of duties of SCs, while the last three are new areas suggested as extensions of the scope of duties.

The selection of the three new areas is based on previous literature such as [El-Khelaifi \(2002\)](#), [Garas and Pierce \(2010\)](#), [Mollah and Zaman \(2015\)](#), [Frag et al. \(2018\)](#), [Haridan et al. \(2018\)](#) and [Isa and Lee \(2020\)](#). These areas are deemed important to strengthen the SC in order to be able to help IBs compete in the market. Risk management refers to operational risk, which is a matter of great importance for banks' survival and profitability. The SC must understand the impact of their decisions on operational risk. Regarding product development, [Haridan et al. \(2018\)](#) state that before the SC endorses a product, a review of the product cycle should be undertaken; therefore, knowledge of the new product is essential. Knowledge of financial performance is necessary for SC members to understand the impact of their decisions on financial performance.

The survey statements are not listed in any particular order, the aim being that respondents evaluate each statement independently of the rest. The third part of the

questionnaire contains one open-ended question asking for respondents' opinions on ways to make the SC more effective. A pre-test was conducted with several SC members to ensure the clarity and validity of the questions before they were distributed to respondents.

The survey was conducted over a six-month period, from January until June 2019. The target respondents were all SC members of IBs in Malaysia. The list of SC members was obtained from the website of each bank, and the information was cross-checked against the central bank's web information. At the beginning of the survey, there were a total of 161 SC members in all types of IBs in the country. The survey was conducted online and via e-mails and by distribution of hard copies. After repeated reminders, a total of 87 useable questionnaires were collected, giving a response rate of 54%. The reliability test indicates that the survey questions meet the standard set by [Nunnally and Bernstein \(1994\)](#).

Results

Descriptive profile of respondents

The first part of the questionnaire covers the demographic profile of respondents. The results are presented in [Table 1](#). From a total of 87 respondents, 70% are from commercial banks, 20% from investment banks and close to 10% are from development financial institutions. With respect to gender, 60% of the respondents are males. As for the age of the respondents, 53% are between the age of 40 and 50 years. Another distinct feature of the respondents is that they tend to sit on more than one committee. The data show that more than two-thirds of the members have multiple memberships of different SCs, that is, in addition to being an SC member in IBs, they are also a member of an SC in other IFIs.

Competency of Shari'ah committee members

In terms of the highest academic qualifications, [Table 2](#) shows that a remarkably high percentage (85%) of the respondents have a doctoral degree. This means that the SC members are highly qualified people. This is not entirely surprising given that 90% of them are from the academic background. One drawback with SCs being dominated by academicians is the possible lack of industry and market experience.

| Items | Frequency | Percentage (%) |
|--|-----------|----------------|
| <i>Type of bank</i> | | |
| Commercial banks | 61 | 70.1 |
| Investment banks | 18 | 20.7 |
| Development financial institutions | 8 | 9.2 |
| <i>Gender</i> | | |
| Male | 52 | 59.8 |
| Female | 35 | 40.2 |
| <i>Age</i> | | |
| 30–39.9 years | 9 | 10.3 |
| 40–49.9 years | 46 | 52.9 |
| 50 years and above | 32 | 36.8 |
| <i>Member of how many Shari'ah committees?</i> | | |
| One | 27 | 31.0 |
| Two | 40 | 46.0 |
| Three | 20 | 23.0 |

Table 1.
Descriptive profile
of respondents

Source(s): Authors' own (based on survey results)

In terms of their academic specialization, the largest group of respondents specialize in the Shari'ah domain; more than half of them are in *uṣūl al-fiqh* (the science of source methodology in Islamic jurisprudence) and/or in *mu'āmalāt* (transactions). This high percentage is to be expected because the main function of the SC requires members to be knowledgeable in Shari'ah rulings. A smaller percentage of the members possess other qualifications; these are law (20%), finance and accounting (18%) and economics (12%). The respondents also indicate that some of the members specialize in more than one area. In terms of experience in being an SC member, a great majority of the respondents have more than five years of experience. This lends additional credibility to their performance.

The results on academic qualifications need further deliberation. The fact that the majority of SC members specialize in Shari'ah is a clear testimony that qualified people are being appointed to the committee. Additionally, the results indicate the presence of non-Shari'ah expertise, but these are few and secondary in nature. As it has been argued earlier, it is important for SCs to have members in non-Shari'ah specializations such as banking, finance and economics so that the functions of SCs can be expanded to include business aspects of Islamic banking operations. In fact, the appointment of non-Shari'ah experts is allowed by the [SGPD \(2019\) \[2\]](#). The composition of SCs could potentially be one area to be investigated by IBs in order to enhance the roles and functions of SCs. In this conjunction, [Hasan \(2014\)](#) reports that most of his respondents agree to have a multidisciplinary SC. In a recent study, [Naysary et al. \(2020\)](#) find that diversity in SC members' background increased the quality of their decisions. In the meantime, current SC members should be encouraged to acquire knowledge in other related areas such as banking, finance, economics and others which are material in discharging their mandate.

Analysis of the current roles and functions of the Shari'ah committee

As mentioned earlier, this study chooses to focus on five aspects of the SC's function to be surveyed. These are (1) Shari'ah compliance, (2) banking operations, (3) risk management, (4) new product development and (5) bank's financial performance. It is expected that the

| Items | Frequency | Percentage (%) |
|---|-----------|----------------|
| <i>Highest academic qualification</i> | | |
| Bachelor's degree | 5 | 5.8 |
| Master's degree | 8 | 9.2 |
| PhD degree | 74 | 85.0 |
| <i>Nature of occupation</i> | | |
| Academician | 78 | 89.7 |
| Shari'ah practitioner | 9 | 10.3 |
| <i>Academic Specialization (can answer more than one)</i> | | |
| Shari'ah (<i>Uṣūl al fiqh</i>) | 48 | 55.2 |
| Shari'ah (<i>Mu'āmalāt</i>) | 44 | 50.6 |
| Law | 17 | 19.5 |
| Finance, banking and accounting | 16 | 18.4 |
| Economics | 10 | 11.5 |
| <i>Number of years as Shari'ah committee member</i> | | |
| Less than 5 years | 12 | 13.8 |
| 5–9.9 years | 40 | 46.0 |
| 10–14.9 years | 29 | 33.3 |
| 15–19.9 years | 6 | 6.9 |

Source(s): Authors' own (Based on survey results)

Table 2.
Quality of Shari'ah
committee members

Shari'ah compliance aspect will be fully agreed by respondents, as this is their expressed function. It is also expected that the banking operations function will be a major function of the SC as the members work together with the Shari'ah secretariat and relevant management team to develop and endorse Shari'ah-compliance policies and administrative procedures including the review of all legal documentation. Aspects (3), (4) and (5) are new areas that this study would like to propose be included as their formal functions to enhance the functions and roles of the SC. The purpose of including these aspects in the survey is to examine the extent to which they are currently involved. If these are not within their current scope of duties, a low score is expected. The results are shown in [Table 3](#).

Panel A of [Table 3](#) lists the statements related to the Shari'ah-compliance function of the SC along with response frequencies. As shown in the table, this function shows an average score of 4.73, which represents a very strong agreement from respondents. The first statement is just to confirm their mandatory function as stated by [SGPD \(2019\)](#). The next two statements which unambiguously state the core function of the SC show a very high score of 4.83. In fact, all the six statements in this group garnered very high scores, which indicate strong agreement from respondents.

Panel B of [Table 3](#) shows that the mean score on four questions relating to banking operations is 4.63, reflecting a very high agreement amongst respondents on this function. Additionally, there are great consistencies in the responses to each statement, the scores ranging from 4.51 to 4.77. This means that the SC is also involved in discussing matters related to banking operations. However, based on the open-ended responses, a significant number of respondents suggest that the SC members should have a deeper understanding of Islamic banking operations. Respondents make the observation that there are SC members who are not able to comprehend the issues at hand due to their limited understanding. This matter is also clearly highlighted by [Haridan et al. \(2018\)](#). Since the respondents themselves realize the need to have a deeper understanding of Islamic banking operations, perhaps IBs should provide the necessary training programmes to their SC members.

Panels C, D and E of [Table 3](#) are areas not explicitly mentioned in [SGPD \(2019\)](#). This study purposely includes these areas in the survey to know exactly whether SCs are involved in these functions. The scores suggest some tendency for SCs to be involved in risk management issues. However, for the development of new products and financial performance, the majority of respondents indicate that SCs are not really involved in these two areas. The results confirmed our expectation on the committees' non-involvement in these areas.

Should the Shari'ah committee functions be expanded?

It has been argued earlier that the functions of the SC need to be broadened to cover areas in risk management, new products and financial performance. This survey includes two statements on the general feeling of the SC members on whether or not their functions should be expanded to include financial performance and risk management. The results of the survey are shown in [Table 4](#). The mean scores are 3.10 and 2.93, respectively. This means that respondents are more or less equally divided between agreeing and not agreeing to broaden their functions to cover financial performance and risk management of the banks. The survey includes one statement asking respondents' perception on the ability of Islamic banking products to compete with CBs, to which the response rate is very high at 4.21 mean score. The response indicates overwhelmingly that respondents are quite confident in the existing Islamic banking products.

How can the Shari'ah committee be made more effective in their roles and functions?

The last part of the survey includes an open-ended question that asks respondents for ideas to make the SC more effective in their roles and functions. Interestingly, almost 90% of the

| No | Questions | Responses frequency | | | | | Mean Score |
|--|--|---------------------|----|----|----|----|------------|
| | | 1 | 2 | 3 | 4 | 5 | |
| <i>Panel A: Shari'ah compliance</i> | | | | | | | |
| 1 | Adhering strictly to the guidelines of the Shari'ah Governance of the Central Bank | 0 | 0 | 0 | 12 | 75 | 4.862 |
| 2 | Issuing Shari'ah-compliant ruling on new products | 0 | 0 | 3 | 9 | 75 | 4.828 |
| 3 | Advising Board and management on Shari'ah matters | 0 | 0 | 3 | 9 | 75 | 4.828 |
| 4 | Advising on the Shari'ah compliance of bank operations | 0 | 0 | 2 | 16 | 69 | 4.770 |
| 5 | Assessing work carried out by Shari'ah audit and Shari'ah review units | 2 | 0 | 3 | 18 | 64 | 4.632 |
| 6 | Finding solutions to non-compliant transactions | 0 | 1 | 2 | 28 | 56 | 4.598 |
| | <i>Average score</i> | | | | | | 4.731 |
| <i>Panel B: Banking operations</i> | | | | | | | |
| 7 | Advising on the Shari'ah compliance of bank operations | 0 | 0 | 2 | 16 | 69 | 4.770 |
| 8 | Endorsing and validating documentation on products and services | 2 | 1 | 6 | 6 | 72 | 4.667 |
| 9 | Endorsing and validating internal policies | 0 | 0 | 5 | 26 | 56 | 4.586 |
| 10 | Endorsing and validating marketing brochures | 1 | 3 | 7 | 16 | 60 | 4.506 |
| | <i>Average score</i> | | | | | | 4.632 |
| <i>Panel C: Risk management</i> | | | | | | | |
| 11 | Discussing reports from the bank's risk committee | 6 | 7 | 20 | 29 | 25 | 3.690 |
| 12 | Advising banks on handling operation risks | 6 | 13 | 24 | 30 | 14 | 3.379 |
| 13 | Advising banks on banks' risk tolerance | 13 | 19 | 20 | 18 | 17 | 3.081 |
| 14 | Advising banks on credit risks | 19 | 17 | 40 | 8 | 3 | 2.529 |
| | <i>Average score</i> | | | | | | 3.170 |
| <i>Panel D: New product development</i> | | | | | | | |
| 15 | Participating in the creation of new products | 3 | 13 | 26 | 34 | 11 | 3.425 |
| 16 | Assessing the viability of new products | 18 | 36 | 4 | 19 | 10 | 2.621 |
| 17 | Modifying products to improve profitability | 16 | 27 | 21 | 21 | 2 | 2.609 |
| 18 | Fine-tuning existing products to make them more marketable | 13 | 39 | 15 | 12 | 8 | 2.575 |
| | <i>Average score</i> | | | | | | 2.807 |
| <i>Panel E: Financial performance</i> | | | | | | | |
| 19 | Discussing the charges for banks products and services | 3 | 9 | 21 | 30 | 24 | 3.724 |
| 20 | Analysing banks' profit and loss performance | 27 | 21 | 20 | 14 | 5 | 2.414 |
| 21 | Analysing banks' turnover or sales | 17 | 35 | 29 | 5 | 1 | 2.287 |
| 22 | Analysing returns to shareholders | 34 | 26 | 15 | 10 | 2 | 2.081 |
| | <i>Average score</i> | | | | | | 2.626 |
| <p>Note(s): Responses 1 = Strongly disagree; 2 = Disagree; 3 = Neither agree or disagree; 4 = Agree; and 5 = Strongly agree</p> <p>Source(s): Authors' own (Based on survey results)</p> | | | | | | | |

Table 3.
Functions of Shari'ah committee

respondents answered the question. All the comments made are analysed and clustered according to three categories: (1) improvement of banking knowledge, (2) engagement with management and BoDs, and (3) broadening the roles of the SC. The results are presented in Table 5 along with the frequencies, that is, the number of respondents mentioning the issue.

The topmost answer is found to be the need for SC members to be given exposure and training on banking operations and that members should have a deeper understanding of Islamic banking. There is, therefore, a general awareness amongst SC members that they need to have sufficient knowledge of banking operations in order to provide a more effective service to banks. Related comments include a suggestion that the SC should also include

members with non-Shari'ah expertise. These comments are consistent with the earlier assertion made that the SC should have some diversity in expertise to have a more balanced discussion and decision-making.

The next oft-mentioned idea is that the SC should have more active engagement with the BoDs and management. Several respondents recommended that there should be a BoD representation in the SC and others mentioned that the SC should be represented in the BoD [3]. Several respondents mention that the functions of the SC should be broadened to include involvement in risk management, product innovation and financial performance. There are two additional interesting remarks. First, there is a suggestion that a Shari'ah department be formed in the bank, and second, another suggestion that the performance of SC members be regularly assessed. This is interesting because the Shari'ah department would simplify the functions of the SC, so that they are able to focus on major issues and not be involved in the detailed operations of the bank. As for the second suggestion, performance appraisal would effectively elevate the performance of SCs [4].

Discussion of the results

In sum, the survey results indicate that the main function of the SC is all things related to ensuring Shari'ah compliance, both in banking operations and in the nature of banking products. Additionally, the SC members have to be knowledgeable in banking operations in order to appropriately discharge their fiduciary duties. Respondents are rather ambivalent regarding their involvement in risk management. However, respondents are very clear in

| No | Questions | 1 | 2 | 3 | 4 | 5 | Mean Score |
|----|---|---|----|----|----|----|------------|
| 1 | The functions of SCs should be broadened to include assessing banks' risk-taking capacity | 4 | 20 | 35 | 19 | 9 | 3.103 |
| 2 | The functions of SCs should be broadened to include evaluating banks' financial performance | 7 | 31 | 23 | 13 | 13 | 2.931 |
| 3 | I am confident that the current products of IBs are able to compete with those of CBs | 0 | 2 | 12 | 39 | 34 | 4.207 |

Table 4.
SC perception of IBs and the scope of SC functions

Note(s): Responses 1 = Strongly disagree; 2 = Disagree; 3 = Neither agree or disagree; 4 = Agree; and 5 = Strongly agree

Source(s): Authors' own (Based on survey results)

| | Frequency |
|--|-----------|
| <i>Improvement of banking knowledge</i> | |
| 1. Need to have more exposure and training on banking operations | 27 |
| 2. Members of the SC should also have non-Shari'ah banking-related expertise | 11 |
| 3. Members need to have a deeper understanding of Islamic banking | 6 |
| <i>Engagement with BoDs and management</i> | |
| 4. SC should have engagement with BoDs and management | 13 |
| 5. Must have a Board representation in the SC | 2 |
| 6. Must have SC representation in the Board | 2 |
| <i>Broadening the roles of the SC</i> | |
| 7. Should get involved in the risk management committee | 8 |
| 8. Broaden SC roles to include product innovation and financial analysis | 2 |

Table 5.
How can the SC be made more effective in their roles and functions?

Source(s): Authors' own (Based on survey results)

their response indicating that their functions do not involve product development and financial performance. Herein lies the proposition of this study. The SC's functions need to be broadened to include not only Shari'ah compliance but also risk management, product development and financial performance.

To remain relevant and sustainable in the market, IBs must demonstrate innovativeness and independence from CBs. This unfortunately has not been the case, particularly in Malaysia, as argued by some authors, such as [Chong and Liu \(2009\)](#). [The Global Islamic Finance Report \(2015\)](#) boldly states: "A primary objective of IBs innovation has been developing new financial products for the Islamic financial services industry, which replicates economic effects of the conventional products in a Shari'ah-compliant way" (p. 142). The report concludes that "Islamic retail banking has seen the least innovation in the last 5–10 years" (p. 151).

To the majority of bank customers, their concern is the efficiency of service and competitiveness of costs and returns. For IBs to be able to compete with CBs in a dual-banking system like Malaysia, their financial services must be at par with CBs. Herein lie the major issues. One of the main criticisms levelled at IBs are that both services and rates are not competitive. Although Islamic banking has been propagated as being interest-free and based on profit–loss sharing, these elements do not seem to have translated into better services to customers. This may be the reason why the market share of IBs remains substantially behind CBs despite the many government incentives and support. This survey takes a look at one element that distinguishes IBs from CBs, i.e. the Shari'ah governance that is crucial in giving the Islamic identity to IBs. The results of this survey indicate that the SC carry their expressed function faithfully. However, SCs should be given a broader scope of function to enable them to be more involved in the business aspects of banking operations, particularly in risk management, product development and innovation, and financial performance.

In terms of risk management, studies such as [Shafique et al. \(2013\)](#) and [Elgharbawy \(2020\)](#) find that the operational risks of IBs are quite similar to CBs. Risk management is permissible in Islam and is in congruence with the objectives of Islamic law (*maqāsid al-Shari'ah*), especially with respect to the preservation of wealth. One may argue that, theoretically, IBs should carry more risks by virtue of profit–loss sharing between banks and customers. But currently, IBs are moving away from profit–loss sharing to more debt-based instruments. Since SC members are experts in Islamic banking products, they are best qualified to advise banks on the related risk policies. Sound risk management may help IBs reduce their exposure to risks and enhance their ability to compete in the market. The suggestion is in line with [Abedifar et al. \(2013\)](#) and [Mollah and Zaman \(2015\)](#) who mention that SCs should be involved in risk management.

Another main criticism of IBs is in terms of product development and innovation. [Chong and Liu \(2009\)](#), for example, suggest that IBs are interest-based as opposed to interest-free, while other authors say that IBs' services are mere replication of CBs. IBs need to offer unique services that are distinctively Islamic. It is felt that SCs are the best avenues for this function due to the presence of the combined expertise in the SC. This role is deemed important because IBs have to be creative and innovative in new product offerings for their long-term sustainability and performance. This is also in line with [Fayyad \(2004\)](#) who argues that Shari'ah scholars have the responsibility to improve financial contracts and products to enhance the Islamic finance industry.

In terms of financial performance, the results of this survey indicate that respondents generally disagree that financial performance is related to SC functions. However, based on the agency theory and the stakeholder theory, the SC should discharge their duties to the best of their ability to fulfil the interest of shareholders as well as other stakeholders. It is important, therefore, for the SC to understand how their decisions on new products, for example, would influence sales and profits and hence firms' value.

Conclusion and recommendations

The purpose of this study is to understand and evaluate the roles and functions of the SC of IBs in Malaysia and to recommend a resetting of the scope of responsibilities to enable the SC to effectively respond to current market needs. Information was collected via a self-administered questionnaire that was sent to all available SC members, and 87 useable questionnaires were obtained from a total of 161 respondents. The survey finds that a great majority of SC members are academics having a doctoral degree in Shari'ah-related specializations and having a substantial amount of experience serving the SCs. However, there is a noticeable lack of diversity in non-Shari'ah expertise in the SC.

The survey finds that the main function of the SC is to ensure Shari'ah compliance in the operation and product offering of IBs. This is of course consistent with their stated functions as outlined in [SGPD \(2019\)](#). This study also finds that SCs are marginally involved in the risk management of the banks. Respondents indicate that they are not really involved in product development and financial performance. In fact, they are rather ambivalent as to whether risk management, product development and innovation, and financial performance should become additional functions of the SCs. In the open-ended question, respondents indicate three ways to enhance the roles of SCs. These are: improving the members' banking knowledge, increasing engagement with management and the BoDs and broadening the functions of SCs to include risk management and product innovation.

This study makes the following policy recommendations to IBs and the central bank. First, there is a strategic need for IBs to consider having a diversity of expertise in SCs while maintaining the Shari'ah experts as core members. A proper mix of expertise would allow SCs to handle a wider scope of functions. In fact, having a diversity of expertise is currently permissible by [SGPD \(2019\)](#) [5]. Second, three important areas that can contribute to the enhanced growth of IBs are not currently included in the roles and functions of SCs. These are risk management, product development and financial performance. It is suggested that these three areas be incorporated into the formal terms of reference of the SC. This would enable SCs to play a bigger role in the development of IBs, not only to fulfil the Islamic market segment but also to provide a viable banking alternative to the general public.

From this study, it is obvious that the current focus of the SC is strictly on Shari'ah compliance. Such a strict focus on compliance may have diverted attention away from the bigger picture of the impact of Islamic banking on society and the attainment of *maqasid al-Shari'ah*. *Maqasid al-Shari'ah* requires Islamic banking to be risk-sharing, not debt-based. Yet, the Malaysian Islamic banking experience over the last 40 years has been one of replication and imitation of conventional banking products, operations and processes. As a result, the outcomes of Islamic banking have been the same as that of conventional banking, leading to the increased build up in debt and escalated systemic risks. The focus of SCs should be geared towards the promotion of Shari'ah-compliant products based on risk sharing and the strengthening of the Shari'ah culture in their respective institutions. For the IBs to embark into more risk-sharing instruments requires high creativity and innovation from SC members and support from other stakeholders, including customers, investors and regulators.

Taken together, it is believed that the relegation of SCs to only Shari'ah oversight may have led to this state of affairs. Enabling SCs to initiate and undertake product development, for example, could have steered the industry away from mere replication of conventional debt-based products. As such, this study proposes to reset the SC functions by broadening its scope and encouraging diversity in its skills set. This should go a long way in rejuvenating Islamic banking in Malaysia. Future studies may extend the issues investigated in this paper and focus on exploring, for example, the effectiveness and independence of SCs when carrying out their duties and their contribution to strengthening IBs governance and accountability.

Notes

1. These two documents were referred to because the development of the questionnaire was done well before the issuance of [SGPD \(2019\)](#). However, in writing the paper, [SGPD \(2019\)](#) is referred to.
2. Section 12.1(c) of the [SGPD \(2019\)](#) states that the SC should consist of either a Shari'ah-qualified person or an expert who possesses skills, knowledge and experience relevant to support the roles and responsibilities of the SC.
3. As this survey was conducted before the publication of [SGPD \(2019\)](#), these comments may have been fulfilled to some extent by the SGPD (for example, see Section 12.10 of the SGPD).
4. [SGPD \(2019\)](#) also mentions this requirement in Section 9.6.
5. This recommendation arises from our survey results. However, one may argue that non-Shari'ah experts will not be able to contribute to Shari'ah matters and that if the SC needs non-Shari'ah inputs, these can be sought from the bank's experts. This point was indeed raised by one of the anonymous referees. As argued earlier, our proposal to include relevant non-Shari'ah experts is to enhance the roles and functions of the SC to better equip IBs to effectively compete in the open market. In this respect, SCs cannot just depend on the guidance provided by internal staff for there are likely to be conflicts of interest that may result in serious agency issues.

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About the authors

Mansor Isa was a Professor of Finance at the Faculty of Business and Accountancy, Universiti Malaya, Kuala Lumpur, Malaysia. He holds a PhD in Finance from the University of Pittsburgh, USA.

Siew-Peng Lee is an Assistant Professor of Finance at the Faculty of Accountancy and Management, Universiti Tunku Abdul Rahman, Malaysia. Siew-Peng Lee is the corresponding author and can be contacted at: leesp@utar.edu.my

Obiyathulla Ismath Bacha is a Professor of Finance at the Graduate Studies Department of the INCEIF University, Kuala Lumpur, Malaysia.

Rubi Ahmad is a Professor of Banking at the Faculty of Business and Economics, Universiti Malaya. She holds a PhD (Banking) from Monash University, Australia.