

[Exposure Draft (ver. 7.0) of]
Governance Standard No. 8

Central Shari'ah Board

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AAOIFI Governance Standard No. 8 “Central Shari'ah Board” is set out in paragraph 1 – 55.

Preface

- P1 With the growth and expansion of Islamic banking and finance, a central or national approach has emerged across the globe with respect to Shari'ah Boards that function at the level of the wider Islamic finance industry, advising or supervising products, practices, operations, etc.
- P2 Previously, many regulators and government authorities depended on the Shari'ah boards in individual Islamic banks and financial institutions to evaluate and decide whether their products and operations were in compliance with Shari'ah principles and precepts. To a major extent, this approach was also being followed by AAOIFI, whereby after defining the core principles of Shari'ah in form of its Shari'ah standards, AAOIFI had defined the governance principles for individual banks' Shari'ah boards only.
- P3 Nevertheless, some may argue that this approach might have given rise to conflicting rulings and eventually conflicting practices and products of Islamic banking and finance that might have confused clients and investors; and might in turn have affected the credibility of Islamic banking and finance as a whole.
- P4 Certain jurisdictions were quick to introduce a centralized approach that aimed to oversee the application of Shari'ah principles and rules relating to Fiqh al-Muamalat to the various facets of Islamic banking and finance activities across their national economies. Other countries simply followed suit. Over time, more countries do opt for the same approach by introducing central Shari'ah boards (CSBs) of their own.
- P5 Under current practices, two main models are prevalent: centralized (central regulation) and non-centralized (self-regulation). Within the centralized model, there are mainly two categories: countries that follow a single central body and countries that follow multiple central bodies.
- P6 This governance standard seeks to provide comprehensive foundations that would help define the key terms of reference and principles for such boards. It aims to provide guidance to Islamic Financial Institutions (IFIs) worldwide on this important aspect of governance, and to standardize the global regulatory practices in this respect.
- P7 This standard encourages, but not mandates, creation of central Shari'ah boards.

Introduction

Overview

- IN1 The purpose of this Governance Standard for Islamic Financial Institutions (GSIFI) is to provide guidance on the definition, scope of work, responsibilities, appointment, composition, independence, terms of reference of a central Shari'ah board (CSB) and other relevant issues. This standard aims to ensure compliance of the regulatory bodies establishing, or having established, central Shari'ah boards with Shari'ah principles and rules.
- IN2 It aims to provide framework on governance for central Shari'ah boards worldwide, and to standardize global regulatory practices in this area. It also presents, but not mandates, a country-level approach for regulating the Islamic finance industry within borders, including products, practices, operations, etc.

Rationale of this standard

- IN3 This standard aims to establish an advanced degree of harmonization and convergence in the work of Shari'ah Supervisory Boards (SSBs) of Islamic financial institutions to iron out the situations of contradiction and differences between the Fatwas, rulings, decisions, and applications by such entity-level boards, allowing consistency in products and services offered by Islamic Financial Institutions (IFIs) and the promotion of standardized practices. This will, in turn, increase the credibility of the Islamic finance industry and boost the confidence of its clients and investors in IFIs and their offerings.

AAOIFI Governance Standard No. 8 (Exposure Draft)

Central Shari'ah Board

Objective of the standard

1. The objective of this standard is to provide guidance on central Shari'ah boards (CSB / the board) in terms of appointment, composition, functioning and independence, based on best practices from Shari'ah perspectives.
2. The standard recommends and encourages formation of central Shari'ah boards to achieve greater level of harmony in the practices of Islamic banking and finance, within a jurisdiction, as well as coupled with the recommendation of adoption of AAOIFI Shari'ah standards by all such bodies, to reach a global greater level of harmony of such practices.

Scope of the standard

3. This standard applies to governance for central Shari'ah boards or similar bodies to oversee and advise in respect of Shari'ah matters to regulators and government authorities.
4. This standard does not apply to Shari'ah supervisory boards and other institution-level boards and committees as they are covered by separate standards¹.
5. Bodies similar to a central Shari'ah board which are voluntarily formed, without explicit authority by the governments or regulators, may use the provisions of this standard as guidelines for their functioning, insofar as these are applicable thereon.

Definitions

6. For the purposes of this standard, the following terms have the meanings attributed below:
 - a. Appointing authority – is a government, government authority, regulatory or self-regulatory body, or equivalent that appoints a central Shari'ah board of either type;
 - b. Central Shari'ah board – a broad-level board or similar body of specialized jurists in Fiqh al-Muamalat (Islamic commercial jurisprudence) and experts in Islamic banking, finance, law and accounting etc. providing guidance and advice on Shari'ah matters, with limited supervision, that is established in a specific country or jurisdiction for providing uniformity and harmony in the products and practices with regard to Islamic finance through Fatawa, rulings and principles applicable on a broad base rather than a single institution. It has two basic types i.e. a national Shari'ah board² and regulatory Shari'ah board³;

¹ AAOIFI GSIFI 1 and 4

² National Shari'ah board is a central Shari'ah board formed at a national level by a government or government authority having multiple regulatory regimes under its direct or indirect ambit.

³ Regulatory Shari'ah board is a central Shari'ah board formed by a regulatory or a self-regulatory or similar body for a jurisdiction having one or more industry segment(s) under its ambit as defined by the regulator.

- c. Shari’ah Supervisory board – an independent body of specialized jurists in Fiqh al-Muamalat (Islamic commercial jurisprudence). However, the Shari’ah supervisory board may include a member other than those specialized in Fiqh al-Muamalat, but who should be an expert in the field of Islamic financial institutions and with knowledge of Fiqh al-Muamalat. The Shari’ah supervisory board is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institution in order to ensure that they are in compliance with Shari’ah principles and rules. The Fatwas and rulings of the Shari’ah supervisory board shall be binding on the Islamic financial institution;
- d. Independence – is “an attitude of mind which does not allow the viewpoints and conclusions of its possessor to become reliant on or subordinate to the influences and pressures of conflicting interests. It is achieved through organizational status and in an objective way”. The principle of objectivity for this purpose, expects fairness, intellectual honesty and an attitude which is free of conflicts of interest.

Appointment, composition and dismissal

Appointment

First appointment

7. Board members for the first time constitution of a central Shari’ah board, or first time reconstitution after adoption of this standard, shall be appointed by the appointing authority, considering factors relating to composition, independence and fit and proper test prescribed by this standard.

Subsequent appointments

8. For any subsequent appointment of the central Shari’ah board, the appointing authority shall additionally take into consideration the rotation requirements, as well as, self-evaluation requirements setup in line with the requirements of this standard.

Remuneration

9. The appointing authority shall be responsible for fixing and paying the remuneration of the members duly considering the best practices, as well as, suitability of remuneration with regard to ensuring independence of individual members.
10. The remuneration payable to all members shall be equal, subject to paragraph 11. Remuneration may be setup on a retainer basis, time basis or attendance of meeting basis, or a combination thereof.
11. Additional remuneration may be paid to members performing additional functions e.g. spending additional time on additional responsibilities as chairman or vice chairman, secretarial function for the board or performing research function on the instructions of the board, according to a time based formula.

Terms of reference for appointment

12. Terms of reference of the appointment shall be defined by the appointing authority in line with the requirements of this standard duly considering the laws and regulations in force, which shall be ratified by the board in its first meeting after appointment / reappointment.
13. An appointment letter shall be issued by the appointment authority to address each and every member in person with engagement terms and terms of reference. This shall include a reference to the time commitment expected from each member with regard to the tasks of the board.

Tenure of the board's term and reappointments

14. Term of the board is recommended to be between 3 to 5 years.
15. There shall be a rotation policy carefully devised by the appointing authority which shall consider, among others, maintaining independence; continuity of the board to a reasonable extent⁴; and improved level of governance and self-evaluation⁵ of the board.

Composition and selection

Composition

16. The central Shari'ah board shall consist of a sufficient number of members to provide diversified exposure of members and to enable them to discharge their functions and duties efficiently and effectively. It shall include relevant experts to allow the board to have access to accurate and relevant advisory services whenever needed.
17. The board shall comprise Shari'ah scholar members and expert members.
18. The recommended minimum number of total members of the board, based on market factors is:
 - a. in case of a board catering to a single industry segment e.g. banking or insurance – minimum 5; and
 - b. in case of a board catering to multiple industry segments – minimum 7.
19. The majority of the members shall be the Shari'ah scholar members selected from amongst recognized Shari'ah scholars within or outside the country. They shall meet the fit and proper criteria applicable to Shari'ah scholar members.
20. The chairman, as well as, vice chairman (men) (if any) shall be selected from the Shari'ah scholar members.
21. Expert members shall inter-alia, include experts in areas of accounting, finance, law, banking and economics, among others, both from the academia and the industry / profession. They shall have a commitment to the cause of, and have considerable level of understanding of the functions of,

⁴ In other words, all the board members shall not retire / rotated at the same time so that the board functioning may have adequate level of continuity.

⁵ This includes rotation of such members whose performance, attendance or contribution is below par.

Islamic banking and finance by virtue of relevant education, research or practical experience. They shall meet the fit and proper criteria applicable to expert members.

22. For any decision to be taken there shall be a proper quorum in which a majority of Shari'ah scholars consistent with their proportion in the composition of the Shari'ah board shall be present. However, in case of Shari'ah ruling, the view of the majority of Shari'ah scholar members shall prevail.
23. Subject to the requirements of paragraph 21, the appointing authority shall ensure that a balance is struck between Shari'ah scholar members and expert members.

Diversity

24. The composition of a central Shari'ah board should preferably reflect diversity, considering Shari'ah values, in the following matters:
 - a. representation from within the country / jurisdiction and globally acclaimed scholars / experts;
 - b. representation of different schools of thoughts amongst Shari'ah scholars in the country / jurisdiction;
 - c. representation of different fields of expertise and strengths amongst the members; and
 - d. no discrimination against potential female members, solely on merit i.e. having due regard to fit and proper criteria applicable to the appointment.

Removal and termination

25. The appointing authority may decide to remove / terminate engagement of a member of the board, after providing adequate opportunity of being heard, if, and only if, :
 - a. a professional misconduct is proven against such member or if he is in breach of a principal term of reference; or
 - b. the member has not attended the minimum criteria of attending meetings as set out in the terms of reference; and
 - c. the majority of the board members, other than the member in question, agrees with the decision of such termination.

Functions of central Shari'ah board

26. The central Shari'ah boards shall focus on harmony of Islamic banking and finance practices:
 - a. globally, through adoption of AAOIFI Shari'ah standards and /or other globally accepted Shari'ah principles;

- b. locally, by providing principles, rulings, guidelines and product approvals and other functional support as prescribed in this standard, primarily considering the global practices in mind.
27. This standard encourages that all central Shari’ah boards shall have primarily advisory capacity coupled with a limited level of supervisory authority.
28. The functions of the board may be divided in three broad functions which are:
- a. advisory and Fatwa;
 - b. regulations; and
 - c. oversight and limited supervision.

Fatawa

29. Fatawa (rulings) function of central Shari’ah board is the function of the appointing authority through the following:
- a. issuing Fatwa and decisions in relation to its area of work;
 - b. approving Sukuk structures and documentation for sovereign and government Sukuk, as referred to it by the appointing authority; and / or
 - c. validating product structures, services and tools offered by IFIs, as referred to it by the appointing authority.

Advisory

30. Advisory function of central Shari’ah board is the function of supporting the regulator through the following:
- a. defining broad principles for profit and loss calculation and distribution among investment accountholders / similar stakeholders and shareholders for IFIs;
 - b. providing advisory on specific issues and matters relating to Islamic banking and finance, as referred to it by the appointing authority / regulator;
 - c. subject to its approval / acceptance, providing Shari’ah expertise to the courts of law, when requisitioned on, for any issues related to Islamic finance and banking; and
 - d. providing advisory to the regulator in the latter's efforts to resolve and settle complaints and issues raised by customers of IFIs or disputes amongst IFIs with regard to Shari’ah matters.
31. Most of the functions of a central Shari’ah board related to advisory and Fatwa are passive (reactive) in nature i.e. the board provides Fatwa or advice or guidance only when asked for it by the appointing authority or a regulator. The board shall be proactive in nature when, and only when, the following conditions are met:

- a. it concludes that a major non-compliance of Shari’ah principles and rules has occurred, which has not being taken care of by the appointing authority;
- b. a perception in market exists that such non-compliance is in knowledge of, or with the due approval of, the board; and
- c. it concludes that unless a proactive step is taken with respect to such matter, the larger stakeholders’ interest will be compromised.

Regulations

32. Regulations related function of central Shari’ah board is of an advisory nature, supporting the function of the appointing authority through the following:
- a. adopting AAOIFI and / or, if necessary, other Shari’ah standards for the jurisdiction;
 - b. providing Shari’ah consultation to the regulators, government and relevant authorities with regard to various laws, rules and regulations;
 - c. reviewing and approving regulatory body’s directives related to Islamic finance to ensure Shari’ah compliance;
 - d. approving a code of ethics for IFIs (e.g. by adopting AAOIFI codes of ethics); and
 - e. coordinating with other national Shari’ah boards, central Shari’ah boards and relevant bodies to establish uniform best practices in the areas relating to Islamic banking and finance.

Oversight and limited supervision

33. Oversight and supervision related functions of central Shari’ah board are meant for supporting the functions of the appointing authority through the following:
- a. settling any disputes between the SSBs of IFIs and the regulator;
 - b. supervising and guiding the Shari’ah compliance inspection and surveillance function of the regulator and providing Shari’ah views on the key issues brought before it; and
 - c. Holding periodic meetings with SSBs of IFIs on a need basis to discuss Fiqh issues and their solutions with regard to key Islamic banking and finance matters, specifically with reference to the direction of product innovation in the jurisdiction.

Other key functional provisions

Decisions

34. The decisions of the board shall be by majority of votes at a meeting duly constituted with the requisite quorum.

35. Dissenting opinions shall be documented and attached with the majority decisions.
36. The decisions of the board relating to advisory and Fatwa, along with the basis of conclusion, shall be compiled and published on a regular basis provided such publication and disclosure does not violate any law, rules and regulations in force in the country of jurisdiction.

Secretariat

37. In a bid to facilitate the work and functions of the board, a secretary to the board shall be appointed either from amongst the members of the board, or an officer of the appointing authority, or an individual specifically employed for this purpose; subject to the approval of the board.
38. The secretary shall:
 - a. maintain the records of the board including the record of minutes and resolutions / rulings;
 - b. be responsible for all communication with the appointing authority and other parties; and
 - c. supervise and coordinate for the research function as needed to support the functioning of the board.
39. The secretary shall be provided with, by the appointing authority, the resources and team, as may be requested for the purpose by the board.

Self-evaluation and reporting

40. The board shall conduct self-evaluation exercises from time to time, but not later than an annual basis. For this purpose the board shall develop self-evaluation criteria for individual members, as well as, for the board collectively and shall agree the same with the appointing authority beforehand. This aims to ensure that the board is able to discharge its functions and responsibilities over the period of assessment.
41. A report of annual performance of the board, along with self-evaluation, shall be prepared and submitted by the board to the appointing authority to that effect.
42. The board and appointing authority with mutual coordination may agree on all or part of the report to be made public or shared with a selected set of stakeholders, in order to enhance stakeholder confidence on the system.

Confidentiality

43. Subject to the requirements of paragraph 36, the board and board members, shall maintain confidentiality of information and documents at all times, except information and matters which are in public domain or when information or documents are requisitioned by a court of competent jurisdiction or any proceedings of regulatory nature in due process of law. For this purpose, detailed guidelines may be provided by the appointing authority, or in absence of the same, the board may itself develop such guidelines.

Responsibilities of the appointing authority

44. In addition to the responsibilities assigned under different provisions of this standard, an appointing authority shall be responsible:
- a. to provide full operational independence to the board; and
 - b. to provide all necessary resources including budget, access to information and human resources, as may be deemed necessary by the board for the purpose of performing its responsibilities.

Fit and proper criteria

45. The appointing authority shall develop separate fit and proper criteria for the Shari'ah scholar members, as well as, the expert members of the board.
46. The selection and appointment of Shari'ah scholars on the board shall be carried out in accordance with the fit and proper criteria, with due care and maintaining high level of independence and merit.
47. The broad parameters for setting up the fit and proper criteria, for both types of members are provided below.

Shari'ah scholar members

48. The fit and proper criteria for Shari'ah scholar members shall be developed considering the following key parameters:
- a. well-versed in Fiqh and Usul al Fiqh;
 - b. suitable academic qualification – traditional or contemporary (or a combination thereof);
 - c. suitable practical experience in the area of Fiqh al-Muamalat;
 - d. suitable practical experience, or research and academic experience, in the fields of Islamic finance, economics, banking, law, trade and other relevant fields;
 - e. good command of Arabic and common business language(s) in the jurisdiction;
 - f. suitable understanding of economics, law, banking, finance and related fields as per scope of the board including insurance and capital markets;
 - g. demonstrable interest and commitment to the field of Islamic banking and finance;
 - h. good standing, reputation and recognition;
 - i. dedicated and able to devote sufficient time; and
 - j. independent and free from conflict of interest.

Expert members

49. The fit and proper criteria for expert members shall be developed considering the following key parameters:
- a. basic understanding of, and firm belief in, Islamic Shari'ah, and preferably, some understanding of Fiqh al-Muamalat as applicable to Islamic banking and finance;
 - b. well-versed and having a high standing in their respective field of knowledge and experience;
 - c. suitable academic and / or professional qualification;
 - d. suitable practical experience, or research, or academic experience in the relevant technical fields;
 - e. demonstrable interest and commitment to the field of Islamic banking and finance;
 - f. good standing, reputation and recognition;
 - g. dedicated and able to devote sufficient time; and
 - h. independent and free from conflict of interest.

Independence

Considerations for selection and appointment

50. Following independence considerations shall be maintained while selecting and appointing the board members:
- a. the board shall not include directors, officers or staff members of the appointing authority or the relevant regulator (if different than the appointing authority);
 - b. the board shall not include directors, significant shareholders⁶, officers or staff members of an IFI which is subject to supervision of the appointing authority or relevant regulator;
 - c. on the first time formation of the board, the Shari'ah scholar members of the board shall not include more than one-third members from those who work as Shari'ah advisors, Shari'ah board members or in similar capacities with an IFI or are a significant shareholder of an IFI, which is subject to supervision of the appointing authority or relevant regulator, whereas, on subsequent formation of the board, no such member shall be included in the board; and
 - d. on the first time formation of the board, the expert members of the board shall not include more than one-third members from those who have significant financial dependence on either the appointing authority or the relevant regulator (if different than the appointing authority) or on an IFI or are a significant shareholder of an IFI which is subject to

⁶ To be defined e.g. having 5% of shareholding or so.

supervision of the appointing authority or relevant regulator, whereas, on subsequent formation of the board, no such member shall be included in the board.

Considerations for functioning

51. Central Shari'ah board shall develop or adopt its own independence guidelines and code of conduct.
52. This shall focus on an understanding that the board is independent in nature and deals with the appointing authority, any relevant regulator and the industry players on an independent basis. The board shall not be a part of the reporting line or internal structure of the appointing authority.
53. The individual members shall always disclose a conflict of interest whether permanent or temporary in nature and the same shall be dealt in a professional manner in line with the code of conduct developed.

Effective date

54. This standard shall be effective from 1 January 2018.

Transitional provision

55. In respect of matters prescribed by this standard related to setting up terms of reference and appointment of members, constitution, and reconstitution of central Shari'ah boards, the same shall be applicable on any such event occurring on or after the effective date.

APPENDICES

Appendix A: Adoption of the standard

This standard was presented for the approval in the AAOIFI Governance and Ethics Board's meeting no. _____ held on _____, corresponding to _____ and was duly approved.

Members of the Board

1. Dr. Ishrat Husain – Chairman
2. Sh. Esam Ishaq – Deputy Chairman
3. Dr. Abdulbari Mashal
4. Dr. Abdurrahman Habil
5. Mr. Ahmad Mishari Al Faris
6. Mr. Ebrahim Sidat
7. Mr. Fawad Laique
8. Dr. Gaffar Abdalla Ahmed Khalid
9. Dr. Hussein Said Saifan
10. Mr. Mehmet Sirin
11. Mr. Mohammad Farrukh Raza
12. Dr. Mohammad Mahdy Mohammad Radwan
13. Mr. Kazi Mohammad Mortuza Ali
14. Mr. Sohaib Umar
15. Dr. Walid Hegazy

Reservation

The standard was approved unanimously.

Working group and team

1. Mr. Ebrahim Sidat – Chairman
2. Dr. Hurriyah El-Islami
3. Mr. Mohammad Farrukh Raza

4. Dr. Walid Hegazy
5. Omar Mustafa Ansari (AAOIFI)
6. Mohammad Majd Bakir (AAOIFI)
7. Zahra Jassim ALSaraifi (AAOIFI)