

**THE CORPORATE GOVERNANCE OF MULTIPLE *SHARIA'* BOARD
DIRECTORSHIP PRACTICE UNDER THE CENTRALISED APPROACH: A
CASE STUDY OF QISMUT+3 SOUTH EAST ASIA DIVISIONAL MEMBERS
OF MALAYSIA AND INDONESIA**

BY

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**Thesis Submitted in Fulfilment of the Requirements for the Degree of
Doctor of Philosophy at Trinity College Dublin**

School of Law

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2018

DECLARATION

I declare that this thesis has not been submitted as an exercise for a degree at this or any other university and it is entirely my own work.

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Abd Hakim Abd Razak

SUMMARY

This thesis examines the corporate governance framework for the Islamic financial institutions ('IFIs') vis-à-vis the multiple *Sharia'* board directorship practice in 2 key Islamic banking jurisdictions, namely Malaysia and Indonesia. It considers the current issues and future challenges, which the Islamic banking regulators may encounter in developing a sound corporate governance structure for the IFIs that accommodates a methodical application of the practice. The thesis explores the practicability of this practice from both the industrial and *Sharia'* law contexts and scrutinises the existing legislative and corporate governance frameworks that govern the practice at both the international and national-level. The research findings from the jurisdictions studied will enable the thesis to provide an empirical insight into the practicability of the centralised approach to the corporate governance of IFIs within the QISMUT+3 region vis-à-vis the multiple *Sharia'* board directorship practice in formulating a sound corporate governance framework for the Islamic banking industry

Since the availability of data and information on the corporate governance framework that governs the multiple *Sharia'* board directorship practice remains limited, the primary data for this research was mainly sourced from semi-structured interviews conducted with two officials from the Islamic banking and *Takaful* Department at the Central Bank of Malaysia (Malaysia) and two officials from the *Sharia'* Banking Department at the Otoritas Jasa Keuangan (Indonesia), who hold the responsibilities to develop and propose the relevant improvements to the existing legislation and corporate governance framework for the IFIs within the two targeted countries. These interviews took place between August and December 2016 at the respondents' offices and lasted between 60 – 90 minutes. Here, the researcher employed two methods of data collection, namely note-taking and audio recording. The semi-structured interview did not employ any transcription or translation services but was conducted in the English language. In addition to the 'fit and proper' criteria for *Sharia'* board directorship within these countries, which require the members to demonstrate reasonable proficiency in the English language, the researcher also possesses professional competency in both the Malay and Indonesian languages to aid the participants in understanding and answering the interview questions. The entire interview session was recorded in a digital form in order to capture a detailed and accurate transcription of the interview. Each of the respondents received a similar set of interview questions that correspond to the research questions of the thesis. Since there is only a small number of respondents involved, the

employment of this method was sufficient and appropriate to satisfy the objectives of the thesis.

The research findings from the semi-structured interview reveal several points of considerable importance in relation to the multiple *Sharia'* board directorship practice. The analysis of the research findings indicates that the repercussions of the continuous application of the practice towards the sustainability of the Islamic banking industry remains obscure within the study of the IFI's corporate governance framework. Although Malaysia and Indonesia represent good examples of countries, which adopted the centralised approach to the corporate governance of the IFIs – renowned for its certainty and standardised *Sharia'* rulings, the findings also demonstrate that the existing regulation and corporate governance policies of the practice within these countries remain in need of significant enhancement before the IFIs can truly extract and establish the beneficial attributes of the practice. The thesis finds that the presence of a disciplined corporate governance framework for the IFIs can lead to a productive application of the practice. Accordingly, the thesis offers several recommendations, which include, regulating the conducts and business practices of the *Sharia'* board members and IFI's employees; educating the current pool of *Sharia'* scholars; improving disclosure requirements of multiple *Sharia'* board directorships; and maintaining flexibility in regulating the multiple *Sharia'* board directorship practice.

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LIST OF ACRONYMS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ADIB	Abu Dhabi Islamic Bank
AITAB	<i>Al-Ijarah Thumma Al-Bai</i>
ARCIFI	Arbitration Centre for Islamic Banks and Financial Institutions
ASA	Australian Shareholders' Association
ASAS	Association of <i>Sharia'</i> Advisors in Islamic Finance
BAFIA	Banking and Financial Institutions Act 1989
BaFin	Federal Financial Services Supervisory Authority
BAMUI	<i>Badan Arbitrasi Muamalat Indonesia</i> (Indonesian <i>Muamalat</i> Arbitration Body)
BASYARNAS	<i>Badan Arbitrase Sharia' Nasional</i> (National <i>Sharia'</i> Arbitration Body)
BBA	<i>Bai Bithaman Ajil</i>
BCBS	Basel Committee for Banking Supervision
BIMB	Bank Islam Malaysia Berhad
BIS	Bank for International Settlements
BMI	Bank Muamalat Indonesia
BNM/GPS1	Guidelines on the Governance of <i>Sharia'</i> Committee for the Islamic Financial Institutions
BOD	Board of Directors
CAGR	Compound Annual Growth Rate
CBM	Central Bank of Malaysia
CBMA	Central Bank of Malaysia Act 2009
CDO	Collateralised Debt Obligation
CDS	Credit Derivative Swap
CEO	Chief Executive Officer
CFA	Chartered Financial Analyst
CGCCIIU	Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013
CGRCI	Corporate Governance Requirements for Credit Institutions 2015
CGRIU	Corporate Governance Requirements for Insurance Undertakings 2015
CIBAFI	General Council for Islamic Banks and Financial Institutions
CIPA	Certified Islamic Professional Accountant

CMDA	Capital Market Development Authority Act
CMSAC	Capital Market <i>Sharia'</i> Advisory Council
CRD	Capital Requirements Directives
CRR	Capital Requirements Regulation
CSAA	Certified <i>Sharia'</i> Advisor and Auditor Programme
DIMIA	Depository Institution Management Interlocks Act
DOJ	Department of Justice
DSN	Dewan <i>Sharia'</i> Nasional (National <i>Sharia'</i> Board)
EBA	European Banking Authority
EBF	European Banking Federation
EC	European Commission
ECB	European Central Bank
ESMA	European Securities and Markets Authority
FBF	French Banking Federation
FCA	Financial Conduct Authority
FOREX	Foreign Exchange
FSA	Financial Services Authority
FTC	Federal Trade Commission
GCC	Gulf Cooperation Council
GCGC	German Corporate Governance Code
GSIB	Global Systemically Important Banks
HSA	Higher <i>Sharia'</i> Authority
HSSB	Higher <i>Sharia'</i> Supervisory Board
IASB	International Accounting Standards Board
IBA	Islamic Banking Act 1983
IBFIM	Islamic Banking and Finance Institute Malaysia
ICD	Islamic Corporation for the Development of the Private Sector
IDB	Islamic Development Bank
IFAAS	Islamic Finance Advisory and Assurance Services
IFI	Islamic Financial Institution
IFSA	Islamic Financial Services Act 2013

IFSB	Islamic Financial Services Board
IIBI	Institute of Islamic Banking and Insurance
IICRCA	International Islamic Centre for Reconciliation and Commercial Arbitration
IIFA	International Islamic <i>Fiqh</i> Academy
IIFM	International Islamic Financial Market
IILM	International Islamic Liquidity Management
IIRA	Islamic International Rating Agency
IMF	International Monetary Fund
INCIEC	Islamic Corporate for the Insurance of Investment and Export Credit
INID	Islamic Negotiable Instrument of Deposit
IRTI	Islamic Research and Training Institute
ISAD	Internal <i>Sharia'</i> Audit Department
ISCD	Internal <i>Sharia'</i> Compliance Department
ITFC	International Islamic Trade Finance Corporation
KMC	Knowledge Management Centre
LMC	Liquidity Management Centre
LPI	Late Payment Interest
LSIs	Less Significant Institutions
LUTH	Lembaga Urusan Tabung Haji
MCKK	Malay College Kuala Kangsar
MUI	<i>Majlis Ulama'</i> Indonesia (Indonesia Council of <i>Sharia'</i> Scholars)
MWL	Muslim World League
NACD	National Association of Corporate Directors
NBFI	Non-Bank Financial Institutions
NCA	National Competent Authority
NED	Non-Executive Director
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
OIC	Organisation of Islamic Co-operation
OJK	Otoritas Jasa Keuangan (Financial Services Authority of Indonesia)
p.b.u.h.	Peace Be Upon Him

p.b.u.t.	Peace Be Upon Them
PRA	Prudential Regulation Authority
PRISM	Probability Risk and Impact System
SAC	<i>Sharia'</i> Advisory Council
SAF	<i>Sharia'</i> Advisory Forum
SBP	State Bank of Pakistan
SCA	Securities Commission Act 1993
SCM	Securities Commission of Malaysia
SCO	<i>Sharia'</i> Compliance Officer
SGF	<i>Shariah</i> Governance Framework for Islamic Financial Institutions 2011
SIs	Significant Institutions
SLEP	<i>Sharia'</i> Leaders Education Programme
SRI	Socially Responsible Investment
SSB	<i>Sharia'</i> Supervisory Board
SSM	Single Supervisory Mechanism
TA	<i>Takaful</i> Act 1984
TASIS	<i>Taqwa</i> Advisory and <i>Sharia'</i> Investment Solutions
YDPA	Yang di-Pertuan Agong

PUBLICATIONS RELATED TO THE STUDY

Part of this thesis have been published or submitted for review as:

- (a) Abd Razak, Abd Hakim, 'Multiple *Sharia*' Board Directorships Practice in Islamic Banking: An Assessment from the *Maslahah* (Public Interest) Perspective', Quarterly Review of Economics and Finance (Under Review)
- (b) Abd Razak, Abd Hakim, 'Multiple *Sharia*' Board Directorship Practice from the Western Corporate Governance Lens of Directorial Fiduciary Duties to the Company', King Abdul Aziz Journal of Islamic Economics (Under Review)
- (c) Abd Razak, Abd Hakim, 'Centralisation of Corporate Governance Framework for Islamic Financial Institutions – Is It a Worthy Cause?' ISRA International Journal of Islamic Finance (2018)
- (d) Abd Razak, Abd Hakim, 'The Fundamentals of Islamic Banking and Finance: A Prologue' (2015) 2 European Journal of Islamic Finance

ACKNOWLEDGEMENT

All praise be to God, the Lord of the Worlds. The Beneficent, the Merciful. Master of the Day of Judgment. Thee do we serve and Thee do we beseech for help. Keep us on the right path. The path of those whom Thou hast bestowed favours. Not (the path) of those upon whom Thy wrath is brought down, nor of those who go astray.

Surah Al-Fatihah (The Opening) 1: 1-7

My utmost praise and thanks to God for his blessing and for granting me patience and endurance throughout the course of completing this thesis.

I would like to express my sincere gratitude and heartfelt thanks to my distinguished supervisor, Professor Blanaid Clarke, whose extraordinary guidance, supervision, and encouragement, have inspired the completion of this thesis. My deepest appreciation is also due to my examiners, Professor Rodney Wilson and Professor Neville Cox for the wealth of knowledge and experience they brought to my viva and my thesis, and also Professor Liz Heffernan and Professor Alexander Schuster for their valuable guidance, intellectual discourse and encouragement throughout the course of this study.

My special thanks go to Mrs. Nurul Izza Idris and Mrs. Nurlida of the Islamic Banking and *Takaful* Department at the Central Bank of Malaysia and Mr. Nyimas Rohmah, Mr. Cecep Maskanul Hakim and Mr. Aulia Fadly of the *Sharia'* Banking Department at the Otoritas Jsa Keuangan Indonesia for their participation and wonderful cooperation in sharing their professional views in the semi-structured interview sessions.

Finally, and most of all, I wish to thank my family, especially my beloved wife and children, for their endurance, love, and understanding, which have greatly helped in transforming the unwanted pressure that always 'befriended' any doctoral students, into a much-needed motivation in completing the thesis. My heartfelt gratitude also goes to the Malaysian Council of Trust for the People (MARA) and the Arthur Cox Postgraduate Bursarie for providing me with the crucial financial support throughout my research journey and everyone, who has contributed to the successful accomplishment of this thesis.

I owe you a million thanks.

DEDICATION

To My Dear Parents and In-Laws:

Faizah Omar

Abd Razak Abd Jalil

Siti Kholijah Abdul Razak

Yusoff Awang Kechik

To My Beloved Wife:

Siti Fatimah Yusoff

To My Dearest Children:

Ahmad Hatem Akhtar

Ahmad Ehan Halif

*"Glory be to Thee! Of knowledge we have none, save what Thou hast taught us:
surely, Thou art the knowing, the Wise."*

(Surah Al-Baqarah 2: 32)

CHAPTER 1: INTRODUCTION

1.0 Background

In recent years, the subject of corporate governance of the Islamic financial institutions ('IFIs') has received considerable attention from industry practitioners, academic researchers, and other stakeholders. The resilience displayed by the IFIs during the 2008 financial crisis propelled further interest into the principles and corporate governance practices underlying the operation of the IFIs. However, it is worthy to note that the collapses and failures of several high-profile IFIs around the globe such as the Islamic Bank of South Africa in 1997, Ihlas Finance House of Turkey in 2001, Bank Islam Malaysia Berhad in 2005, and Dubai Islamic Bank between 2004 and 2007, among other instances, have also raised a substantial need for an improved corporate governance framework that is both holistic and practical in ensuring the sustainability of the Islamic banking industry in the years to come.

In this ever-growing sector, there exists a promising and fast-developing Islamic banking market known as the "QISMUT+3 region", which mainly comprises nine countries, namely Qatar, Indonesia, Saudi Arabia, Malaysia, United Arab Emirates, and Turkey, together with Bahrain, Kuwait, and Pakistan. As the total Islamic banking assets held by this region is estimated to reach US\$ 1.8 trillion by 2020, in addition to its convenient access to a strong 252 billion potential consumers¹, it is sensible to argue that the development of legislative and corporate governance framework for the IFIs within the QISMUT+3 will mould the direction and future of the global Islamic banking industry.

As much as the implementation of prudent corporate governance policies can benefit the growth of the industry, the application of contentious corporate practices can also inflict detrimental consequences that can, in turn, hinder its promising progress. Among these practices, the thesis has opted to focus on the practice of multiple *Sharia'* board directorate, which refers to the situation, where an IFI's *Sharia'* board member occupies an additional one or more *Sharia'* board directorates in another IFIs – creating a corporate link between the banks that can attract a host of benefits as well as disadvantages. The application of the practice, which had first started as a short-term initiative to address the shortage of qualified and experienced IFI's *Sharia'* board

¹ Ernst & Young, *World Islamic Banking Competitiveness Report 2016* (New Realities: New Opportunities, 2016), p. 18; Ernst & Young, *World Islamic Banking Competitiveness Report 2013-14* (The Transition Begins, 2013)

members in the early inception of the industry in the 1970s, has since become an issue that subjects the *Sharia'* scholars engaging in the practice to fiery criticisms from the industry practitioners, academic researchers, *Sharia'* scholars, and other stakeholders, who describe the practice as a threat to the scholars' professional commitment and impartiality as the gatekeeper to the *Sharia'* compliance assurance of the industry.

The top 50 *Sharia'* scholars command a significant 73 per cent share of the available 1142 *Sharia'* board positions worldwide, which also include those available within the Islamic banking standard-setting agencies such as the Islamic Financial Services Board ('IFSB') and the Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI')². This infers that each scholar is holding an average of 16 positions presenting a reasonable cause for concern on the potential effects of the practice towards the long-term sustainability of the overall industry. This includes a number of significant concerns such as conflict of interests, time commitments, confidentiality, and more importantly, the compliance of the stated practice with the *Sharia'* law. The latter can present a peculiar situation if the practice is not founded on any valid principles of the *Sharia'* law and yet is practised by the *Sharia'* scholars, who owe both the banks and the religion of Islam, a great responsibility in assuring stakeholders that *Sharia'* compliance assurance does not stop at the financial products and services offered by the banks, but also include the conducts and practices of the *Sharia'* scholars as the custodians to *Sharia'* compliance. These concerns provide the impetus to the commencement of the thesis.

Be that as it may, there is a dearth of empirical research conducted on the issues surrounding the practice of multiple *Sharia'* board directorate, which has rendered the determination of the practicability of the practice to the industry challenging. At the moment, the available empirical research on the topic is either largely statistical and expository in approach³ or constitutes only a small segment in research theses that deal with the subject of corporate governance for the IFIs⁴. With this in mind, it is important to

² Murat Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective* (19 January, 2011); International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016* (2016), p. 28-29, 32.

³ Unal; Murat Unal, *Sharia Scholars in the GCC - A Network Analytic Perspective* (1 September, 2009); Parvez Ahmed, 'Corporate Governance and Ethics of Islamic Financial Institutions' (2014) 10 *Journal of Islamic Economics, Banking and Finance*, p. 39.

⁴ Zulkifli Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK' (DPhil Thesis, Durham University 2011); Shakir Ullah, 'Fatwa Repositioning: The Hidden Struggle for Sharia' Compliance within Islamic Financial Institutions' (DPhil Thesis, University of Southampton 2012);

provide empirical research that fills this gap and scrutinises the legality and practicability of the practice from both the *Sharia*' law and industrial perspectives. This thesis attempts to fulfil this need and to provide the industry with practical policy recommendations and other inputs for the development of sound corporate governance frameworks for the IFIs.

1.1 Statement of Problem

In the day-to-day operations of an IFI, the *Sharia*' board, which comprises a group of learned men and women in the diverse fields of *Sharia*' law, serves as a specialised organ that assists the IFI in *Sharia*'-specific matters such as, *inter alia*, the issuance of *Fatwas* (*Sharia*' opinions) related to its financial products, services, and business conducts, and the determination of banking risks specific to the Islamic banking industry. Indeed, its practicability as a check-and-balance mechanism for the *Sharia*' compliance assurance of the IFI's financial products, services, and business conducts serves as a unique feature that differentiates the IFIs from the other financial institutions, or from the industrial scale, the Islamic banking than the Western banking industry.

However, the unique existence of the *Sharia*' board in an IFI's corporate governance system does not necessarily grant the IFI an automatic '*Sharia*'-compliant' status. The different approach to the corporate governance of IFIs and the diversity of *Fatwas* across the various jurisdictions owing to the variation in *Urf* (customary practices) and the individual country's inclination to the different schools of Islamic jurisprudence in structuring their legal and corporate governance policies for the IFIs, have rendered the notion of *Sharia*' compliance in Islamic banking and its corporate governance paradigms as an indeterminable and complex subject matter.

To highlight, Malaysia and Indonesia subscribe to the Shafie school of Islamic jurisprudence – renowned for its liberal interpretation of the *Sharia*' law, and they adopt the centralised approach to the corporate governance of the IFIs, which mandates the IFIs to adhere to the *Fatwas* issued by a centralised *Sharia*' board at the central bank-level. Qatar and Saudi Arabia subscribe to the Hanbali school – renowned for its strict interpretation of the *Sharia*' law, and they adopt the non-centralised and passive approach, which does not subject the IFIs to any superior authority and allows the IFIs to develop their own corporate governance structures. Kuwait, United Arab Emirates,

Hussain G Rammal, 'Corporate Governance in the Islamic Banking System in Pakistan: The Role of the Shariah Supervisory Boards' (DPhil Thesis, University of Adelaide 2010)

and Bahrain subscribe to the Maliki school – also renowned for its strict interpretation of the *Sharia*' law, and they adopt the non-centralised and reactive approach, which allows the central bank or financial services authority to intervene in common issues governing the banking industry such as the criteria determination of the 'fit-and-proper' test for the board of directors ('BOD') and employees, liquidity requirements, and adequacy of capital. Finally, Pakistan and Turkey subscribe to the Hanafi school – renowned for its strict and methodical interpretation of the *Sharia*' law, but they adopt a centralised and non-centralised approach to the corporate governance of the IFIs respectively. In other words, the presence of these variable factors has not only created a regulatory gap and confusion for the industry players and other stakeholders regarding the actual *Sharia*' compliance status of an Islamic financial product or corporate practice of an IFI, but it also provides a crucial call for the existing Islamic banking scholarship to develop a mutual understanding and appreciation of the pluralistic approaches to the corporate governance of the IFIs.

Accordingly, the thesis does not view their presence as a valid and strong excuse to render any attempts to scrutinise the *Sharia*' compliance and practicability of the multiple *Sharia*' board directorship practice to the sustainability of the Islamic banking industry as unnecessary. In fact, their presence can supply the thesis with a multitude of constructive data, which in turn, can assist the thesis to find a common ground between the various jurisdictions and their school of thought orientation in scrutinising the multiple *Sharia*' board directorship practice from both the *Sharia*' law and corporate governance perspective.

In view of the diverse and distinct approaches to the corporate governance of the IFIs within the QISMUT+3 region, the thesis attempts to examine the socio-legal significance of the multiple *Sharia*' board directorate practice and analyse the practicability of the centralised approach implemented in Malaysia and Indonesia. The research findings from these countries not only provide a valuable insight into the various *Sharia*' and corporate governance issues surrounding the application of the practice, but they also offer a fair assessment of the viability of the centralised approach, which can benefit new and emerging Islamic banking markets such as Oman, Nigeria, Bangladesh, United Kingdom, South Africa, China, and Luxembourg⁵.

⁵ Shabana M Hasan and Muhammad Mahbubi Ali, 'Africa and East Asia: The Emerging Markets of Islamic Finance' in Marjan Muhammad (ed), *ISRA Islamic Finance Space* (4 edn, ISRA Consultancy Sdn Bhd 2015), p. 15-16; Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2014* (2014), p. 10, 19; George Osbourne, 'London Can Lead the World as an Islamic Finance Hub' *Financial Times* (28

1.2 Research Aim and Objectives

The thesis aims to gain a better understanding of the multiple *Sharia'* board directorship practice in the Islamic banking industry with a specific focus on two of the nine countries that comprise the QISMUT+3 region namely Malaysia and Indonesia. It explores, *inter alia*, the application of this practice from both the industrial and *Sharia'* law contexts and scrutinises the existing legislative and corporate governance frameworks that govern its application at both the international and national-level through the lens of the Islamic banking regulators of these countries and available documents. The research findings from these jurisdictions will enable the thesis to provide an empirical insight into the practicability of the centralised approach to the corporate governance of IFIs within the QISMUT+3 in the context of the multiple *Sharia'* board directorship practice in formulating a sound corporate governance framework for the Islamic banking industry. Accordingly, the objectives of the thesis are:

- (a) To study the general practice of multiple *Sharia'* board directorships.
- (b) To examine the different regulatory approaches on the multiple *Sharia'* board directorship practice of the two countries studied.
- (c) To investigate the presence of periodical assessment and time commitment policy vis-à-vis *Sharia'* board members with multiple *Sharia'* board directorships.
- (d) To investigate the presence of disclosure requirements in relation to the occupation of *Sharia'* board directorships by *Sharia'* scholars.
- (e) To assess the structure and significance of remuneration policy in respect of *Sharia'* board directorships.
- (f) To investigate the presence of awareness or training programmes for *Sharia'* scholars on the laws, regulations, and business practices relating to the practice of multiple *Sharia'* board directorships.
- (g) To investigate the perception of the central bank or financial regulator of the subjected countries on the practice of multiple *Sharia'* board directorships.

October 2013) <<http://www.ft.com/cms/s/0/42766334-3fc2-11e3-a890-00144feabdc0.html#axzz3MXdX9YwS>> accessed 28 August 2017; The Economist, 'Luxembourg as a Financial Centre: Administering Instead of Hiding' *The Economist* (11 October 2014) <<http://www.economist.com/news/finance-and-economics/21623755-little-country-more-its-repertoire-tax-breaks-administering-instead>> accessed 23 August 2017.

1.3 Research Questions

The thesis aims to address and answer the following research questions formulated from the aim and objectives of the study:

- (a) What is the Islamic banking system?
- (b) What are the differences between the Islamic corporate governance system and the Western corporate governance system?
- (c) What are the different models of Islamic corporate governance system adopted by IFIs?
- (d) What are the causal factors of multiple *Sharia'* board directorship practice across the IFIs?
- (e) How does *Sharia'* law view the application of the aforementioned practice?
- (f) What are the regulatory approaches to the aforementioned practice within the countries that have adopted the centralised approach to the corporate governance of the IFIs?
- (g) What is the extent of the disclosure practice of the IFIs in relation to multiple *Sharia'* board directorships held by their *Sharia'* board members?

1.4 Thesis Statement

This research is an exploratory and empirical study of the corporate governance framework for the IFIs in relation to the practice of multiple *Sharia'* board directorships in Malaysia and Indonesia. The findings indicate that not only do similarities exist, but there are also several significant differences among the Islamic banking regulators in governing the multiple *Sharia'* board directorship practice, even within the countries, which adopted the centralised approach to the corporate governance of IFIs. Although both Malaysia and Indonesia subscribe to the *Shafie* school, one of the four major schools of thought in Islamic jurisprudence, the differences in *Sharia'* opinions among the *Sharia'* scholars in these countries, which have been confirmed and respected, have indirectly contributed to the shaping of the existing regulatory landscape and corporate governance policies for the IFIs in these countries. A proper consolidation of these differences can provide a pragmatic example to the other QISMUT+3 member states in governing the practice in question and ensuring that the industry can extract an optimum range of benefits from the application of this practice.

1.5 Significance of Research

In view of the lack of comprehensive research on the practice of multiple *Sharia'* board directorships, it is submitted that it is crucial for the thesis to conduct a methodical examination of the different approaches to the corporate governance of IFIs, especially those in countries adopting the centralised approach, namely Malaysia and Indonesia. This can provide the industry with useful insights into the guiding principles, frameworks, and best practices in the regulation of the multiple *Sharia'* board directorship practice. The findings of the thesis will provide valuable understanding of the variant perspectives of the Central Bank of Malaysia ('CBM') and the Otoritas Jasa Keuangan ('OJK') in relation to the practice and enable a practical assessment of their respective approaches to the corporate governance of the IFIs in regulating the application of the practice⁶. Accordingly, the findings of this thesis will explore and highlight the following aspects:

- (a) The design and dynamics of the corporate governance policies for the IFIs within the QISMUT+3 region with a specific focus on those in Malaysia and Indonesia;
- (b) The fundamental differences between the centralised and non-centralised approaches to the corporate governance of IFIs;
- (c) The conceptual issues of the multiple *Sharia'* board directorship practice from both the *Sharia'* law and Islamic banking contexts;
- (d) The regulatory and corporate governance approaches to the multiple *Sharia'* board directorate practice in Malaysia and Indonesia;
- (e) The role of and strategy undertaken by the CBM and the OJK in regulating the IFI's *Sharia'* board members with multiple *Sharia'* board directorships within and outside of their respective countries.

1.6 Scope of Research

As the QISMUT+3 region comprises nine countries with divergent legal systems, school of Islamic jurisprudence orientations, and approaches to the corporate governance of IFIs, the execution of a comprehensive examination of all nine countries is impractical given the limited time and research funding of this thesis. Accordingly, this researcher has chosen to limit its scope of research to the corporate governance framework for the IFIs in Malaysia and Indonesia. Although there exists another member state of the

⁶ The significance of the CBM and OJK in shaping the corporate governance framework for the IFIs in their respective jurisdictions is discussed in chapter 6.

QISMUT+3 region, namely Pakistan, which has adopted a similar approach to the corporate governance of the IFIs, the thesis has opted to exclude Pakistan due to its different school of Islamic jurisprudence orientation, namely the Hanafi school. This filtration exercise is crucial in ensuring that the scope and research outcome remain confined to the legislative and corporate governance issues encountered by the QISMUT+3 member states that operate within the Shafie school environment in relation to the multiple *Sharia'* board directorship practice. The findings of this thesis can advance substantial understanding into these challenges and generate constructive outputs in improving the corporate governance structure for IFIs within and beyond the QISMUT+3 region.

1.7 Structure of the Thesis

The thesis consists of seven chapters. The first chapter outlines the whole research direction and the essence of this research, which comprises the background of the research, objectives, scope, research questions, significance, and the statement of problems. Chapter 2 discusses the theoretical foundations of the Islamic banking system. This includes the history and emergence of the Islamic banking concept, the underlying principles and basic financial instruments of Islamic banking, and the inter-relationship and challenges in balancing the distinct interest of the *Sharia'* law and the IFIs. Chapter 3 provides a comprehensive analysis of the theoretical context of corporate governance from the *Sharia'* law perspectives. It explains the origin of the corporate governance concept in Islam and analyses its framework and models within the Islamic banking environment. It also provides a brief analysis of the compatibility of the centralised approach to the corporate governance of IFIs vis-à-vis the Islamic jurisprudential concept of *Ikhtilaf Fi Al-Fuqaha* (the differences of opinions between the *Sharia'* scholars), which remains a sensitive issue within both the Islamic banking and *Sharia'* law contexts.

The subsequent two chapters explore the multiple *Sharia'* board directorship practice from two distinct angles. Chapter 4 discusses the fundamental principles and issues of the practice from the western legislative perspective. The chapter also highlights the regulatory approaches pertinent to the practice as implemented in several western jurisdictions. Chapter 5 then provides a comprehensive analysis of the practice from the *Sharia'* law and Islamic corporate governance perspectives. It explores and discusses the emergence of the practice in the Islamic banking industry, the varying *Sharia'* issues surrounding the practice, and the regulatory approaches to the practice as

recommended by the two-leading standard-setting agencies in Islamic banking, namely the AAOIFI and the IFSB.

Chapter 6 begins by explaining the research methodology, research design, and the methods of mining and analyzing data utilised in this research. Since the thesis employed a case study approach as a research strategy, this chapter explains the justifications and suitability of this approach in exploring and analyzing the corporate governance framework of IFIs in relation to the practice of multiple *Sharia'* board directorships within the two targeted jurisdictions. Then, the chapter will proceed with the analysis of the semi-structured interview sessions conducted with the CBM and the OJK respectively. Finally, chapter 7 will conclude the research by summarizing the key findings and providing specific policy recommendations in enhancing and improving the existing corporate governance framework for the IFIs in relation to this practice. It will also highlight the research limitations and the contribution of the research to the existing scholarship on Islamic corporate governance.

CHAPTER 2: UNDERSTANDING ISLAMIC BANKING AND THE *MAQASID AS-SHARIA'* (OBJECTIVES OF THE *SHARIA'* LAW)

2.0 Introduction

Prior to the devastating global financial crisis in 2008, the inter-relationship between religion and finance carried little to no relevancy¹; this is partly due to the separation of religion from politics, economics, and governmental administration in modern capitalism. The crisis, however, exposed the frailties of the current financial system and triggered a “public outrage over the excesses and support for more conservative and ethical finance”². In truth, the concept of finance possesses a semantic affinity to religion, especially within the teachings of the three branches of Abrahamic faith, namely Judaism, Christianity, and Islam, which share a collective set of near identical philosophies on finance³ (see **Figure 1**):

JUDAISM	CHRISTIANITY	ISLAM
<p>Exodus 22: 25-27</p> <p><i>"25. When you lend money to any of my people, to the poor among you, you shall not be to him as a creditor, nor shall you impose upon him any interest.</i></p> <p><i>26. If you take your neighbour's garment as a</i></p>	<p>Luke 6: 34-35</p> <p><i>"34. And if ye lend to them of whom ye hope to receive, what thank have ye? For sinners also lend to sinners, to receive as much again".</i></p> <p><i>35. But love ye your enemies, and do good, and lend, hoping for nothing again; and</i></p>	<p>Ali Imran 3: 130</p> <p><i>"130. O ye who believe! Devour not usury, doubled and multiplied; but fear God; that ye may (really) prosper".</i></p> <p>Al-Nisa' 4: 161</p> <p><i>"161. That they took usury, though they were forbidden;</i></p>

¹ The involvement of religious elements and perspectives in trade was viewed as unnecessary by the traders in the early 18th century. See Richard Henry Tawney, *Religion and the Rise of Capitalism* (Transaction Publishers 1998), p. 192.

² Usman Hayat, 'Islamic Finance is Growing Fast but Faces the Form-Versus-Substance Debate' CFA Institute, 29 March 2013 <<https://meic.cfainstitute.org/2013/03/29/islamic-finance-is-growing-fast-but-faces-the-form-versus-substance-debate/>> accessed 22 September 2017. Also see Rasem N Kayed and M Kabir Hassan, 'The Global Financial Crisis and Islamic Finance' (2011) 53 *Thunderbird International Business Review* 551, p. 556-558.

³ Islam recognised these religions as the offspring of the Abrahamic faith, else known as the *Samawi* (originated from heaven) religions based on their respective holy scriptures, which came directly from God through the medium of His prophets. See Yatimah Sarmani and Mohd Tajudin Linggal, *Teori Kaunseling Al-Ghazali* (PTS Publications & Distributors Sdn. Bhd 2008), p. 12. Also see Francis E Peters, *The Children of Abraham: Judaism, Christianity, Islam: A New Edition* (Princeton University Press 2010), p. xi.

<p><i>pledge (collateral), you shall return to him by nightfall.</i></p> <p><i>27. For that is his only covering; it is his garment for his skin. In what shall he sleep? And it shall come to pass, that if he cries unto Me, I will hear it, for I am compassionate".</i></p> <p>Deuteronomy 23: 19-20</p> <p><i>"19. You shall not charge interest on loans to your brother (Israelites); interest on money, interest on provisions, interest on anything that is lent.</i></p> <p><i>20. On loans to a foreigner you may charge interest, but on loans to your brother (Israelites) you may not charge interest"⁴.</i></p>	<p><i>your reward shall be great, and ye shall be the children of the Highest: for he is kind unto the unthankful and to the evil"⁵.</i></p>	<p><i>and that they devoured men's substance wrongfully; - We have prepared for those among them who reject faith a grievous punishment".</i></p>
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Figure 1: Prohibition of Interest in Judaism, Christianity and Islam

Fascinatingly, a similar concept of finance also existed within the secular teachings of Aristotle and Plato, who regarded money as sterile⁶ and the ‘making of money from

⁴ Robert Carroll and Stephen Prickett, *The Bible: Authorized King James Version* (Oxford University Press 2008)

⁵ Ibid. Additionally, St Thomas Aquinas in his *Summa Theologica* wrote, “To take usury for money lent is unjust in itself, because this is to sell what does not exist, and this evidently leads to inequality which is contrary to justice.” See Thomas Aquinas, *Summa Theologica* (Fathers of the English Dominican Province tr, Christian Classics of Westminster 1981), II-II, question 78, article one. Also see Yahia Abdul-Rahman, *The Art of Islamic Banking and Finance: Tools and Techniques for Community-Based Banking*, vol 504 (John Wiley & Sons 2009), p. 26.

⁶ Aristotle opined interest as despicable and unnatural because an instrument of exchange such as money can generate and give unnatural birth to itself. See Joel Kaye, *Economy and Nature in the Fourteenth Century: Money, Market Exchange, and the Emergence of Scientific Thought* (published in New York, Cambridge University Press 1998), p. 66, 122-123. The Islamic economics ethos also disagrees to the concept of earning profit from a medium of exchange without bearing any risks. See Abu Umar Faruq

money' as unnatural and problematic⁷. In recent decades, the application of religious laws and principles to finance is not a new concept. This was evidenced by the introduction of the DJ Dharma Index in 2008 for Hindu Banking⁸; the launch of Stoxx Europe Christian Index in 2010 for Christian Banking⁹, and the formation of investment companies such as the Roman Catholics Ave Maria Rising Dividend and Aquinas Investment Company, to name a few¹⁰.

Likewise, the method of finance and banking promoted by Islam places a similar emphasis on the importance for mankind to enforce the rule of God in *Muammalat* (financial transactions). This requires a meticulous derivation of *Sharia'* rulings from the various sources of Islamic law, primarily the *Holy Quran* and the *Sunnah*¹¹ in ensuring a strict adherence and compliance of any financial products, services, and business practices with the stated rulings. Thus, this gives those responsible for the interpretation of the *Sharia'* rulings – the *Ulama'* (common *Sharia'* scholar), *Mufti* (official *Sharia'* scholar of a state), *Imam* (leader for formal prayers), *Ustadz* (male religious teacher) and *Ustazah* (female religious teacher) a decisive role in determining what is permissible and

Ahmad and M Kabir Hassan, 'The Time Value of Money Concept in Islamic Finance' (2006) 23 American Journal of Islamic Social Sciences 66, p. 84.

⁷ In his *Leges*, Plato wrote, "No one shall [...] lend at interest, since it is permissible for the borrower to refuse entirely to pay back either interest or principal". Robert P. Maloney, 'Usury in Greek, Roman and Rabbinic Thought' (1971) 27 *Traditio* 79, p. 79-109. Also see Maria-Gaia Soana, 'The Relationship Between Corporate Social Performance and Corporate Financial Performance in the Banking Sector' (2011) 104 *Journal of Business Ethics* 133

⁸ In 2008, a grass-roots level movement for Hindu banking was introduced in India with the Dow Jones Indexes launching the DJ Dharma Index, which methodology was based upon the Hindu, Jain, and Buddhist principles. Notwithstanding the decommissioning of the Index, the idea of setting up a Hindu banking is now known. CPI Financial, *School of Thought* (CPI Financial 2013)

⁹ In recent years, there has appeared an increasing proposal to promote Christianity-compliance financing within Christian-majority countries such as the G-20. For example, the formation of the Stoxx Europe Christian Index in 2010, which consists of representatives from the Vatican City to screen shares drawn from the Stoxx Europe 600 Index – comprising 533 European companies that only derive revenues from sources approved 'according to the values and principles of Christianity' such as BP, HSBS, Nestle, Vodafone, Royal Dutch Shell, and GlaxoSmithKline among others. The listing rule only allows entities, which do not profit from illegal and immoral businesses such as, *inter alia*, weapons manufacturing, gambling, pornography, tobacco and birth control. See *ibid*.

¹⁰ Emil Boasson, Vigdis Boasson and Joseph Cheng, 'Investment Principles and Strategies of Faith-based Funds' (2006) 32 *Managerial Finance* 837, p. 840. Also see Shakir Ullah, Dima Jamali and Ian A Harwood, 'Socially Responsible Investment: Insights from Shari'a Departments in Islamic Financial Institutions' (2014) 23 *Business Ethics: A European Review* 218, p. 221.

¹¹ *Sunnah* refers to the way of life of the Prophet Muhammad (p.b.u.h.).

what is not. In one *Hadith*¹², Abdullah Bin Umar narrated that the Prophet Muhammad (p.b.u.h.)¹³ said:

*“Surely! Every one of you is a guardian and is responsible for his charges; the Imam (ruler) of the people is a guardian and is responsible for his subjects; a man is the guardian of his family (household) and is responsible for his subjects; a woman is the guardian of her husband’s home and of the children and is responsible for them; and the slave of a man is a guardian of his master’s property and is responsible for it. Surely, every one of you is a guardian and responsible for his charges”*¹⁴.

In matters relating to business and financial transactions, Islam ordains a high degree of accountability by the *Sharia*’ boards of IFIs since they serve as the gatekeepers to the *Sharia*’-compliant accreditation of IFIs’ financial products, services, and business practices. However, prioritising the rule of God over the IFI’s interest is easier said than done. In recent years, there have appeared a handful of substantial concerns as well as criticisms of the *Sharia*’ compliance of a number of the financial products and practices in the Islamic banking market including, the similarities and the pegging of the IFIs’ profit rates with the interest rates of the interest-based banking system¹⁵, the IFI’s profit

¹² *Hadith* refers to a collection of report on anything attributable to the Prophet Muhammad (p.b.u.h.) such as his sayings, doings, rulings, characteristics, and manners. There exist many collections of *Hadith* compiled by various *Sharia*’ scholars, but the following seven collections are the most commonly used in interpreting the *Sharia*’ law, namely the *Sahih Al-Bukhari*, *Sahih Muslim*, *Sunan Ibn Majah*, *Sunan Abu Dawud*, *Jami’at Tirmidhi*, *Sunan Al-Nasa’i*, and *Musnad Ahmad*. *Abdur Rahman I Doi, Shariah: The Islamic Law (A.S. Noordeen 2011)*, p. 54.

¹³ It is customary for Muslims to put ‘peace be upon him’ after naming any prophets of God acknowledged by all three branches of Abrahamic faiths as a mark of respect – “*Surely God and His angels bless the Prophet Muhammad (p.b.u.h.); O you who believe! Call for (Divine) blessings on him and salute him with a (becoming) salutation*” (*Surah Al-Ahzab 33:56*) of Abdullah Yusuf Ali, *The Holy Qur’an: Original Arabic Text with English Translation & Commentary* (Saba Islamic Media, Kuala Lumpur 2000)

¹⁴ This *Hadith* is *Sahih*. See Vol. 9, Book 89, *Hadith 252* of Mil Al-Bukhari and MM Khan, *Translation of Sahih Bukhari* (published in Los Angeles, University of Southern California 2012)

¹⁵ M. Ariff and S.A. Rosly, ‘Islamic Banking in Malaysia: Unchartered Waters’ (2011) 6 *Asian Economic Policy Review* 301, p. 301-319; Feisal Khan, ‘How ‘Islamic’ is Islamic Banking?’ (2010) 76 *Journal of Economic Behavior & Organization* 805; M.R. Zaman and H. Movassaghi, ‘Interest-Free Islamic Banking: Ideals and Reality’ (2002) 14 *International Journal of Finance* 2428. Also see Beng Soon Chong and Ming-Hua Liu, ‘Islamic Banking: Interest-Free or Interest-Based?’ (2009) 17 *Pacific-Basin Finance Journal* 125; Khairul Anuar, Shamsheer Mohamad and Mohamed Eskandar Shah Shah, ‘Are Deposit and Investment Accounts in Islamic Banks in Malaysia Interest Free?’ (2014) 27 *Journal of King Abdul Aziz University: Islamic Economics* 27, p. 35, 38.

maximization objective vis-à-vis the objective of Islamic banking¹⁶, *Fatwa-shopping*¹⁷, and also the occupation of multiple *Sharia'* board directorships – the last one forms the central focus of this thesis. Hence, it is arguable that the continuance of these practices, or rather, the lack of a proper justification and address from both the *Sharia'* law and regulatory perspective can constitute an unwelcome sign of discord with the *Sharia'* compliance guarantee. This risks confusing stakeholders and marring the image of IFIs as a working embodiment of the rule of God in finance.

For these reasons, this chapter will seek to discuss and scrutinise the fundamental concepts and distinguishing traits of the Islamic financial concepts as compared to its Western banking counterpart in conveying a basic understanding of the modus operandi of the Islamic banking system. It begins with a detailed explanation of the historical background of Islamic banking and its fundamental elements, followed by a brief introduction of its common financial instruments, and scrutinisation of the profit maximisation and profit-and-risk sharing concepts underlining the operation of IFIs today.

2.1 Historical Perspective

In general, it is arguable that the modern concept of Islamic banking first emerged in 1963 when the Mit Ghamr Savings Bank of Egypt, a financial institution that initially started as a microfinancing institution, introduced *Sharia'*-compliant financial products and services, which operated on a profit-and-loss sharing basis¹⁸. This provided the

¹⁶ Humayon Dar and Talha Ahmad Azami, *Global Islamic Finance Report (GIFR) 2011* (BMB Islamic UK Limited, 2011), p. 35; Masudul Alam Choudhury, 'What is the Scope of Islamic Economics and Finance?' (2006) 2 *Journal of Islamic Economics and Finance*, p. 1-42. Also see Zulkifli Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System' (2014) 7 *International Journal of Islamic and Middle Eastern Finance and Management* 3, p. 7-14; Mark Tutton, 'Recession Sparks Interest in Islamic Finance' CNN, 27 August 2009 <<http://edition.cnn.com/2009/BUSINESS/08/25/islamic.finance/>> accessed 22 September 2017

¹⁷ *Fatwa-shopping* refers to the practice, in which an IFI 'fishes' for *Sharia'* scholars, who can issue a *Fatwa* favourable to its offered products, services, and business practices. Although there has yet to appear any concrete evidences to point out the actual occurrence of the practice, the findings of several empirical research have suggested that the practice has a higher chance to occur in countries with inadequate Islamic banking regulations and corporate governance framework. See Ullah, p. 90-92; Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK', p. 111; International Shari'ah Research Academy for Islamic Finance, *ISRA Bulletin*, vol 14 (ISRA ed, ISRA 2013). Also see Al-Hanifer Muhammad, 'Sheikh Nizam Yacubi Refutes Harshly the Claim of Fatwa-Shopping' <http://www.aleqt.com/2010/04/04/article_373863.html> accessed 20 September 2017; Khan, p. 817-818.

¹⁸ Later renamed as Nasser Social Bank (Bank Nasser Al Ijtmaai). It was started by Dr. Ahmad Al Naggar, a German-educated Egyptian, who had sought for a solution to assist the poor farmers in his village in

necessary push for the Islamic banking concept to gain both attention and momentum worldwide¹⁹. Malaysia followed shortly after with the establishment of the Lembaga Urusan Tabung Haji (LUTH) in 1969. The latter was the first institution that utilised the *Sharia'* principles in its fund management operations for Muslims going on pilgrimage and it was considered the first of its kind in the world²⁰. By December 1973, the Islamic Development Bank ('IDB') was incorporated in Jeddah, Saudi Arabia pursuant to the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries to further assist in fostering the economic development and social progress of Muslim countries in adherence to the *Sharia'* law. This landmark agreement marked the first collective effort by Muslim countries to promote Islamic banking²¹. The following year, King Faisal of Saudi Arabia pledged to initiate a banking system that adheres to the tenets of *Sharia'* law and ethics in a bid to bridge the gap between the Islamic concept of banking with the 600-years-old conventional banking system. This progressive development led to the emergence of several Islamic banks in the Middle East including the Dubai Islamic Bank in 1975, the Faisal Islamic Bank of Sudan and Egypt in 1977, and the Bahrain Islamic Bank in 1979²². Along with Malaysia, Indonesia, and Turkey, the Gulf Cooperation Council ('GCC), which consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates, is now home to several renowned financial powerhouses, including the Deutsche Bank, Citi, UBS, and Barclays, which have already

financing their purchase of seeds, farm animals for ploughing, cattle, animal feedstock, simple pumps and even living subsistence. See Abdul-Rahman, p. 192-193. However, there also exist evidences that interest-free financial transaction had existed in the Muslim world several decades earlier such as the Anjuman Mowodul Ikhwan and the Anjuman Imdad-e-Bahmi Qardh Bila Sud of Hyderabad, India. See Bala Shanmugam and Zahari Zaha Rina, *A Primer on Islamic Finance* (Elizabeth Collins ed, Research Foundation of CFA Institute 2009), p. 3.

¹⁹ Ibid., p. 192.

²⁰ The Tabung Haji of Malaysia is not a financial institution *per se*. It serves as an institution of savings to assist the Muslims in fulfilling their religious obligation of *Hajj*, or pilgrimage to Mecca. It invests the customers' deposit in *Sharia'*-compliant industries and provides profits return to further add to the financial costs of performing the *Hajj* in Saudi Arabia. See Mohd Shuhaimi Bin Haji Ishak, 'Tabung Haji as an Islamic Financial Institution for Sustainable Economic Development' (2011) 17 International Proceedings of Economics Development & Research, p. 236-240.

²¹ The IDB comprises 5 entities, namely the IDB itself; the Islamic Research and Training Institute ('IRTI'); the Islamic Corporation for the Insurance of Investment and Export Credit ('INCIEC'); the Islamic Corporation for the Development of the Private Sector ('ICD'); and the International Islamic Trade Finance Corporation ('ITFC'). See Islamic Development Bank, *Islamic Development Bank Group in Brief* (2013)

²² Mohamed Ariff, 'Islamic Banking' (1988) 2 Asian - Pacific Economic Literature 48, p. 48-49. Also see Ahmad Tajudin, Azrul Azwar, 'Overview of Islamic Finance - Islamic Finance Course: Structure & Instruments' <<http://www.bankislam.com.my/en/Documents/shariah/OverviewOfIslamicFinance-13122010.pdf>> accessed 22 September 2017, p. 16.

begun to offer their own *Sharia*-compliant products and services²³. With a combined banking customers' population of 252 million, it is suggested that these regions will be the main thrust for Islamic banking expansion in the many years to come.

Since its emergence in the 1970's, the global Islamic banking market has grown steadily at 15-20% per annum while global *Sharia*-compliant assets are forecasted to grow from over US\$ 2.7 trillion in 2017 and is further expected to cross the US\$ 5.3 trillion mark by 2020²⁴ (see **Figure 2**).

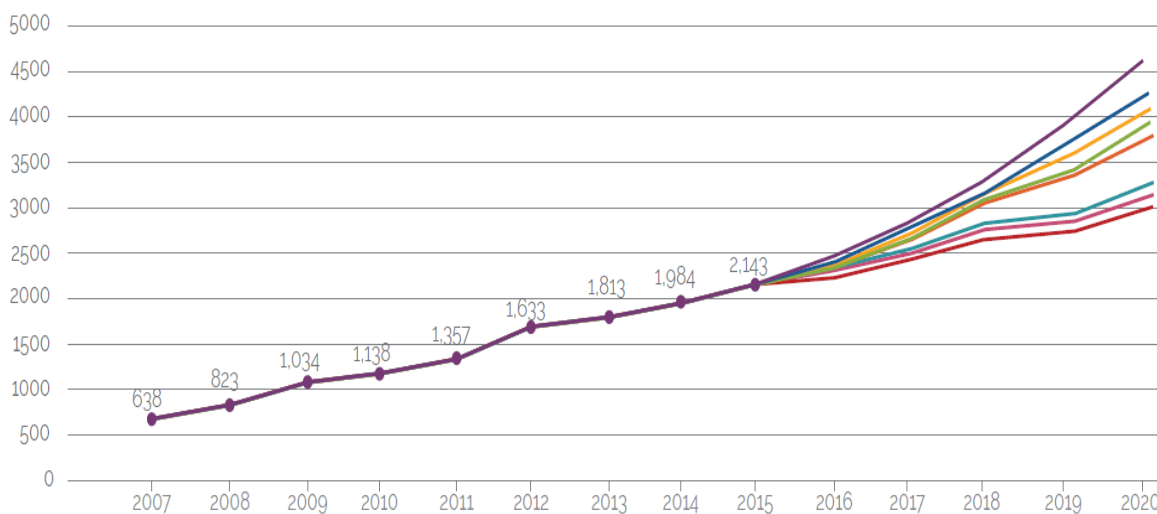


Figure 2: Future Growth of the Islamic Banking Industry 2016 - 2020²⁵

Yet, despite all these remarkable figures, Islamic banking faces mounting challenges to remain firm to the true Islamic principles while expanding globally. The IFIs shoulder crucial roles and responsibilities not only to serve the financial needs of the various stakeholders, but also to give proper consideration to the legitimacy of their operations from a *Sharia*' law point-of-view²⁶. As much as this should be the case, the industry is unable to offer an absolute and comprehensive guarantee on the consistency, uniformity, and strict adherence of the financial products, services, and business practices of the

²³ Yousef Gamal El-Din, 'Ethical Banking to Take Over: Abu Dhabi Islamic Bank CEO' CNBC, 29 April 2014 <<http://www.cnbc.com/id/101624169>> accessed 22 September 2017

²⁴ Humayon Dar, Sofiza Azmi and Bushra Shafique, *Global Islamic Finance Report (GIFR) 2016* (Gerlach Press, 2016), p. 41-42.

²⁵ Ibid, p. 41.

²⁶ Dar and Azami, p. 44.

IFIs with *Sharia'* law²⁷. Furthermore, a certain segment of Islamic banking practitioners have also questioned the authenticity and *Sharia'*-compliance of certain Islamic financial products such as *Bai Al-Inah* (sale and buy-back contract) and *Murabahah* (mark-up sale contract) which mirror the interest-based lending and borrowing products of the Western banking industry²⁸.

2.2 The Concept of Banking in Islam

2.2.1 Introduction

Generally, banking institutions exist to fulfil the financial needs of society. Analogous to a knife, which can be used either for permissible matters such as slaughtering an animal for its meat, or forbidden ones such as homicide, the relevance of banks in the society remains arguable according to the perspectives and opinions that differ from one society to another. Prior to the introduction of the Islamic banking concept, Muslims encountered considerable difficulties in making use of the diverse banking facilities available around the world. The obstacle gradually eased with the advent of Islamic banking, which offers an alternative banking concept guided by the *Sharia'* law that draws a dividing line between permissible and non-permissible financial activities. It is a banking concept that

²⁷ Refer to the controversial permissibility of *Bai Al Inah* (sale and buy-back contract) and organized *Tawarruq* (tri-partite sale) in certain jurisdictions despite being ruled out by the *Hanafi*, *Maliki* and *Hanbali'*s schools of thought. *Bai Al Inah* is a sale and buy back product, in which the bank would purchase an asset from the client on a cash basis and then immediately resell the asset to the customer at a marked-up price on a deferred payment basis. It involves two contracts, which must be independent and executed separately from each other. Scholars have argued that it can serve as a back door to *Riba'*, which the *Sharia'* law forbids because the banks may take an advantage of the customers' desperate plea for cash and further subjugate them to debt. Also, it can serve as a juristic ruse or stratagem to legalise *Riba'*. *Tawarruq* on the other hand is more acceptable to the scholars as it involves a third party and does not constitute a clear ruse to the prohibition of *Riba'*. See *ibid*, p. 44. Also see Rininta Nurrachmi, Hamida Mohamed and Nawalin Nazah, 'Dispute Between Bank and Customer in Bai Bithaman Ajil (BBA). Case in Malaysia' [2013] Munich Personal RePEc Archive Paper, p. 11-14; Said Mikail and Mahamd Arifin, 'A Critical Study on Shari'ah Compliant and Shari'ah-Based Products in Islamic Banking Institutions' (2013) 3 Journal of Islamic and Human Advanced Research 169 جھار, p. 168-189; Ibn Taymiyyah, *Majmu' Al-Fatawa* (37 Vols) ('Abd Al-Rahman Ibn Muhammad Ibn Qasim ed, published in Rabat, Maktabat Al-Ma 'arif 1981)

²⁸ Azrul Azwar, p. 40; Amir Shaharuddin, 'Maslahah-Mafsadah Approach in Assessing the Shari'ah Compliance of Islamic Banking Products' (2010) 1 International Journal of Business and Social Science 129, p. 129; Rodney Wilson, *Islamic Finance in Europe* (RSCAS PP 2007/02, 2007), p. 10; Muhammad Taqi Usmani, 'Sukuk and Their Contemporary Applications' (AAOIFI Shari'a Council Meeting, Manama, 2007), p. 2-14; Ibrahim Warde, *Islamic Finance in the Global Economy* (Edinburgh University Press 2010), p. 240; A Ahmed, 'Contemporary Practices of Islamic Financing Techniques' (1993) 1 Islamic Economic Studies 15

satisfies the divine law in both form and spirit, and has thus served as a gateway for Muslims to finally enter the formal world of finance²⁹.

An Islamic bank may be defined as a financial institution that officially and practically abides by the precepts of *Sharia'* law, which prescribes the guidelines for the inception of socially-responsible economic activities³⁰. It encapsulates a banking practice that transcends the doctrine of separation of powers between the religion and the state³¹. In other words, its objective, mission and vision are all dictated by the *Sharia'* law, which encompasses the Holy Quran, the *Sunnah* and the secondary sources of *Sharia'* law such as *Ijtihad* (independent reasoning), *Ijma'* (consensus of scholars), *Maslahah* (public interest), *Istihsan* (juristic preference), *Amal Ahl Al-Madinah* (the practices of the people of Madinah, Saudi Arabia), *'Urf* (customary practices), *Al-Istishab* (presumption of continuity), *Qawl Al-Sahabi* (opinions of the Prophet's companions), *Shar' Man Qablana* (earlier scriptures such as the Torah, Psalms and the Holy Bible), and *Sadd Al-Dzariah* (prohibiting a lawful mean that leads to an unlawful end)³².

2.2.2 The Principles of *Muammalat* (Commerce) in Islamic Banking

Islamic banking is a unique financial concept distinct from those underlying the conventional banking system. The latter is predominantly based on man-made principles and independent of any religious doctrines while the former premises its operations on a set of strict religious standards derived from the *Sharia'* law, namely the prohibition of the receipt and payment of interest; and avoidance of uncertainty, speculative instruments, and deception in trade, which are explained in detail as follows:

²⁹ Ibn Al-Ukhuwwa and Reuben Levy, *The Ma'ālim Al-Gurba Fī Aḥkam Al-Hisba of Ḍiyā'Al-Dīn Muḥammad Ibn Muḥammad Al-Qurashī Al-Shāfi-ī, Known as Ibn Al-Ukhuwwa* (Cambridge University Press 1938). Also see H. Askari, Z. Iqbal and A. Mirakhor, *Introduction to Islamic Economics: Theory and Application* (Wiley 2014), p. 94.

³⁰ Warde; Abdussalam Mahmoud Abu-Tapanjeh, 'Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles' (2009) 20 *Critical Perspectives on Accounting* 556, p. 556-567.

³¹ Abdul-Rahman, 79-80.

³² Doi, p. 21-85; Wahbah Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)* (Abdul Karim Zaidan ed, Muhammad Amar Adly tr, Pustaka Al-Ehsan, Selangor 2013), p. 131-265. Also see Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence* (Islamic Texts Society Cambridge, UK 2003); W.B. Hallaq, *An Introduction to Islamic Law* (Cambridge University Press 2009)

2.2.2.1 The Doctrine of *Mubah* (Permissibility) of All Matters

Islam recognises the inseparable bond between mankind and monetary transactions and encourages the former to engage in various legitimate and diverse commercial activities. Since *Sharia'* law does not provide any specific ruling against transacting with a bank, the *Sharia'* doctrine of *Mubah* (permissibility) that renders every beneficial matter as permissible, has since applied. It provides that engaging in financial activities with a bank is permissible so long as it can benefit the consumer and society and it functions within the permissible perimeter of *Sharia'* law (see **Figure 3**). This corresponds with the majority *Sharia'* opinions within the four schools of Islamic jurisprudence, namely the Hanafi, Maliki, Shafie, and Hanbali, which concur on the permissibility of financial transaction so long as it is *Tayyib* (good or beneficial) based on several provisions of the *Holy Quran* that render the act of entering into such transactions as *Fadl Allah* (the bounties and excellence of God)³³.

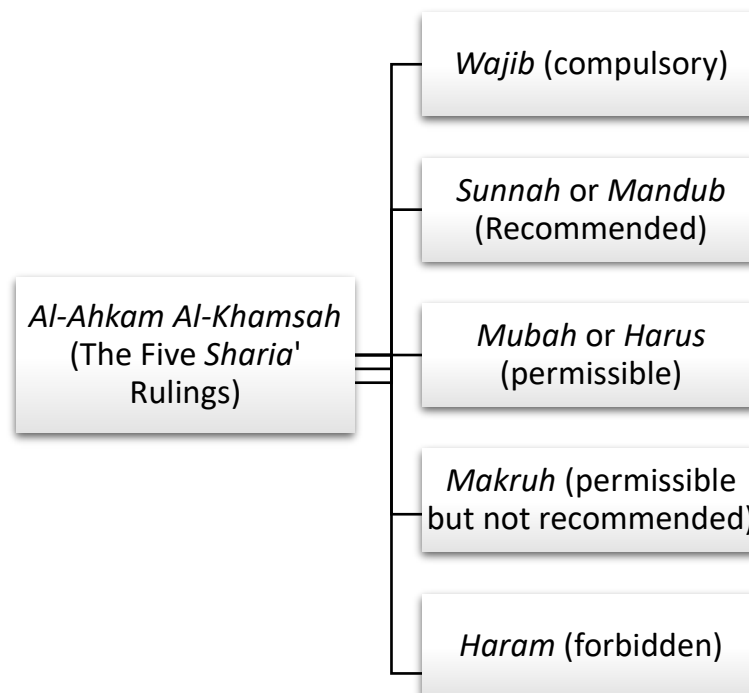


Figure 3: Permissible Perimeter of Matters under *Sharia'* Law

³³ "It is God who has subjected the sea to you, that ships may sail through it by His command, that ye may seek of His bounty, and that ye may be grateful. And He has subjected to you, as from Him, all that is in the heavens and on earth: Behold, in that are Signs indeed for those who reflect" (Surah Al-Jatsiyah 45:12-13), "O ye who believe! Make not unlawful the good things which God hath made lawful for you, but commit no excess: for God loveth not those given to excess" (Surah Al-Ma'idah 5:87); "O ye who believe! Eat of the good things that We have provided for you, and be grateful to God, if it is Him ye worship" (Surah Al-Baqarah 2:172). See Ali. Also see Doi, p. 348-349.

Correspondingly, Sheikh Yusuf Al-Qardawi, a prominent *Sharia'* scholar, had also issued a *Fatwa* that not only permits a Muslim to engage in financial activities but also to be employed by the IFIs³⁴. To the Islamic banking industry, this *Sharia'* ruling can boost the demands for *Sharia'*-compliant financial instruments in meeting the growing consumers' needs for financial products and services that fulfil both their material and religious demands³⁵. Interestingly, a small number of *Sharia'* scholars from the *Hanafi's* school have provided a dissenting view to the doctrine of *Mubah* by interpreting it in a reverse manner³⁶. In contrast to viewing the permissibility of matters in the absence of a prohibitory provision under *Sharia'* law, they argue that a matter is only permissible if there exists firm evidence of its permissibility within the sources of *Sharia'* law, primarily the Holy Quran and the *Sunnah*. Since the banks indulge in a number of *Haram* or questionable practices that contradict the tenets of *Fiqh Al-Muammalat* (Islamic commercial law) such as: the prohibition regarding the payment and receipt of *Riba'* (interest or usury); *Gharar* (uncertainty); *Maysir* (gambling or speculative nature), and investment in unethical subject areas such as alcohol, prostitution, drugs, pollution, firearms and weapons of mass destruction, there exists an equally logical argument that *Sharia'* law remains to discourage Muslims from engaging in any financial activity with the banks, regardless of their nature³⁷. This assertion corresponds to a *Hadith* from the Prophet Muhammad (p.b.u.h.), who curses those who indulge in *Riba'*, namely those

³⁴ Basri Ibrahim, *The Fatwa Method of Al-Qardawi in Dealing with Current Issues* (Mohd Puzhi Usop and Azani Ismail eds, Al-Hidayah Publication 2011), p. 199-200. The *Haiah Kibar Al-Ulama* of Saudi Arabia had also issued a similar *Fatwa* on the permissibility to transact with financial institutions. The same stance was also adopted by the Malaysian National *Fatwa* Council. See Keputusan Muzakarah Jawatankuasa Fatwa Majlis Kebangsaan Bagi Hal-Ehwal Ugama Islam Malaysia (The Decision of the Muzakarah of the National Fatwa Council for Islamic Affairs in Malaysia), p. 63; Muhammad Uthman Syabir, 'Al-Mu'amalat Al-Maliyyah Al-Mu'asarah Fi Al-Fiqh Al-Islami' TTP: Dar al-Nafa'is, p. 326; Muzakarah Jawatankuasa Fatwa Majlis Kebangsaan Bagi Hal Ehwal Ugama Islam Kali Ke-32, 10-11 Jun 1993

³⁵ Zaharuddin Muhammad, 'Hukum Bermuamalat dengan Sumber yang Haram (Ruling on Transacting in Forbidden Source)' (2010) 3 Jurnal Muamalat 77, p. 104; Muhammad Baqir Al-Sadr, *Iqtisaduna (Our Economics)* (published in Beirut, Dir al-Ta'aruf 1982)

³⁶ The presence of this stance in the Hanafi school was reaffirmed by Imam Zakariyya, a *Hanafi* scholar in a brief interview with this researcher in Lucan Mosque, Dublin, Ireland. See Imam Zakariyya, *The Position of Mubah in Hanafi School of Thought* (2014). Also see Jalal al-Din Al-Suyuti, *Al-Ashbah Wa Al-Naza'ir (Similarities in the Branches of Law)* (Dar al-Kutub al-'Ilmiyyah 1983)

³⁷ "... help ye one another in righteousness and piety, but help ye not one another in sin and rancour; fear God: for God is strict in punishment" (Surah Al-Ma'idah 5:2) of Ali

who give and receive *Riba'*, together with those who record and witness the forbidden transaction³⁸.

2.2.2.2 Syubhah (Doubtful Matters) – The In-Between of Halal (Permissible) and Haram (Impermissible)

Apart from engaging in the financial activities that *Sharia'* law has already ruled as *Haram*, the banks could also have engaged in the subject matters, which lie between the realms of *Halal* and *Haram* – known as *Syubhah* (doubtful). To simply demonstrate, a bank may enter a loan agreement to finance a customer's purchase of a shop lot. Under *Sharia'* law, this type of agreement is *Mubah* based on the presumption of conducting a business affair, of which the profits are pivotal for the continuity of mankind's livelihood. However, if this permissibility is maneuvered to conduct non-*Sharia'* compliant business activities such as prostitution or drug manufacturing, any profit derived therefrom is deemed as *Haram*. Furthermore, if the same profit is applied to pay the loan, it will cause the bank's pool of funds to contain a mixture of *Halal* and *Haram* income; thus, rendering any future transaction with the bank as a doubtful affair. In the same way, this religious insecurity will not only affect the Islamic banking customers, but also the employees, who are employed and paid by the bank³⁹.

Accordingly, this complexity originated from the division of *Sharia'* opinions among the *Sharia'* scholars concerning the actual position of *Syubhah* matters under *Sharia'* law. While several have opined that *Syubhah* bears a resemblance to *Mubah*, others have

³⁸ Ibn Mas'ud narrated, "*The Prophet Muhammad (p.b.u.h.) cursed the one who consumed Riba', and the one who charged it, those who witnessed it, and the one who recorded it*". This *Hadith* is Hasan. See Vol. 1, Book 12, *Hadith* 1206 of Abu'Isa Al-Tirmidhi, *Sunan Al-Tirmidhi* (Dar Al-Fikr Library 1986). Also see Vol. 3, Book 34, *Hadith* 299 of Z Hamidy and others, *Shahih Bukhari Volume I-IV* (Darel Fajr Publishing House 2002)

³⁹ Having an employment with the bank was regarded as a matter of *Syubhah* or abetment with doubtful matters in financial dealings. Note that *Syubhah* must be differentiated with *Haram*. Egyptian *Sharia'* scholars have agreed to allow the Muslims to work with the bank in the absence of any viable alternative, whereas prominent *Sharia'* jurist such as Sheikh Yusuf Al-Qardawi deemed that only the employment with an Islamic bank ought to be considered as permissible. However, the absence or lack of alternative in profession bears little relevancy in nowadays context since the banking profession is chosen because of its lure of lucrative payment as compared to the other profession. However, in the event of *Darurah* or dire strait, the *Sharia'* law allows one to deal with the banks but with caution. Sheikh Ali Jum'ah, *Contemporary Fatwa* (1st edn, Berlian Publications Sdn Bhd 2008). Also see Vol. 1, Book 12, *Hadith* 1206 of Al-Tirmidhi

deemed it to lie somewhere between *Makruh* and *Haram*⁴⁰. The former group of *Sharia'* scholars based their justification on the absence of any *Sharia'* sources that have prescribed *Syubhah* as *Halal* or *Haram*, and on a *Hadith* narrated by Salman Al-Farisi, which illustrated a receptive and flexible stance taken by the Prophet Muhammad (p.b.u.h.) towards the 'grey matters' in the *Sharia'* law⁴¹:

*"The Messenger of God (p.b.u.h.) was asked about ghee, cheese and wild donkeys. He said: 'The Halal is which God has made lawful in His book, and the Haram is that which He has forbidden and that which He kept silent about is permitted as a favour to you'"*⁴².

On the other hand, the latter group of *Sharia'* scholars, have justified their circumspect stance based on another *Hadith* by the Prophet Muhammad (p.b.u.h.), which reminded mankind to avoid engaging in doubtful matters of which they have limited or no knowledge.

"Both lawful (Halal) and unlawful things (Haram) are evident but in between them there are doubtful things and most people have no knowledge about them. So he, who saves himself from these doubtful things, saves his religion and his honour (i.e. keeps them blameless). And he who indulges in these doubtful things is like a shepherd who pastures (his animals) near the Hima (private pasture) of someone else and at any moment he is liable to get in it. (O people!) Beware! Every king has a Hima and the Hima of God on the earth is what He declared unlawful (Haram). Beware in the body there is

⁴⁰ For example, Imam Ibn Daqeeq Al Eid defined *Syubhah* as "doubtful deeds ... any matter supported by conflicting evidence from the Holy Quran and the Sunnah, and could carry more than one meaning, and it is devout to avoid". See Yahya Al-Nawawi, *Al-Majmoo Sharh Al-Muhadhib* (Dar Al-Fikr 1997). This view is also supported by Imam Al-Suyuti, who believed that the public should avoid matters of doubtful nature and "whoever does that is described as devout and conservative in his religion." Also see Al-Suyuti.

⁴¹ Also known as Salman the Persian. Prior to his conversion to Islam, he was a devout Christian, who always frequented the Christian monasteries but was later led to the Holy Prophet whom he heard as a man of strict honesty. He earned the nickname of '*Al-Farisi*' due to his suggestion during the war of *Tabuk* between the Muslim and the allied coalition of Arab and Jews armies, namely the application of the Persian defensive strategy of digging a broad ditch, or a moat, around the position defended – this tactic had eventually enabled the Muslim to emerge victorious in the war. See Dwight M Donaldson, 'Salman the Persian' 19 *The Muslim World* 338

⁴² This *Hadith* is *Hasan*. See Vol. 1, Book 29, *Hadith* 3367 of Muhammad Tufail Ansari, *Sunan Ibn Majah*, vol 5 (Kazi Publications 1996)

*a piece of flesh if it becomes sound and healthy, the whole body becomes sound and healthy but if it gets spoilt, the whole body gets spoilt and that is the heart*⁴³.

In addition, Imam Al-Qurtubi in his interpretation of the *Halal* and *Haram* matters in *Sharia'* law suggested that *Haram* comprises six elements – one which includes *Syubhah*⁴⁴. Also, Sheikh Abdul Rahman As-Sa'di opined that whatever leads to doubtful matter is, in itself, detested⁴⁵. This view is supported by Sheikh Yusuf Al-Qardawi, a prominent *Sharia'* jurist, who suggested that it is devout for the public “to avoid these doubtful deeds so as not to be dragged into resembling what is known to be *Haram*”⁴⁶.

Having properly considered the above scholarly opinions, it is arguable that the uncertain attribute of *Syubhah* neither confers on it a better legitimacy than *Makruh* nor stigmatizes it as *Haram*. As much the abstinence from engaging in *Syubhah* matters can serve as a measure to prevent persons from drawing themselves into the territory of *Haram* matters, the increasing importance of banking in modern life has led to a gradual shift to the *Syubhah* status of the banking industry to *Mubah* due to the genuine reliance on its financial products and services.

2.2.2.3 Prohibition of *Riba'* (The Receipt or Payment of Interest)

In contrast to the Western banking system, which operates and involves the receipt and payment of interest or usury, the second principle of *Muammalat* demands that IFIs ensure their financial products, services and transactions comply with the *Sharia'* law prohibition of *Riba'*. The term *Riba'* originates from an Arabic word that refers to an

⁴³ This *Hadith* is *Sahih* and also compiled by Bukhari and Muslim. See Book 16, *Hadith* 1511 of Al-Hafiz Ibn Hajar Al-Asqalani, *Bulugh Al-Maram Min Adillat Al-Ahkam (Attainment of the Objective according to Evidence of the Ordinances)* (Darussalam 2002)

⁴⁴ The six elements are *Riba'* (interest), sacred, *Suht* (bad), fraud, contempt and *Syubhah*. See Abu Abdullah Muhammad Al-Qurtubi, *Tafseer Al-Qurtubi* (Dar Al-Kutub Al-Imiyyah 2007). Also see Ibn Kathir, *Tafsir Ibn Kathir* (Safiur-Rahman Al-Mubarakpuri tr, 2nd (July 2003) edn, Dar-us-Salam 2003)

⁴⁵ Abdul Rahman As-Sa'di, *Al-Qawaid Wa-Usul Al-Jami'ah Wa-Furooq Wa-Taqseem Al-Badi'ah An-Naafi'ah (The Basic Rulings and Principles of Fiqh - The Beneficial, Eloquent Classifications and Differentiations)* (Sheikh Muhammad Ibn Saalih Al-Uthaimeen ed, Abu Abdullah Al-Amreeki tr, 2006), Principle 2, p. 2.

⁴⁶ Yusuf Al-Qardawi, *The Lawful and the Prohibited in Islam (Al-Halal Wal-Haram Fil Islam)* (Kamal El-Helbawy, M Moinuddin Siddiqui and Syed Shukry trs, published in Kuwait, Al Faisal Press 1995), p. 28.

excess, expansion, extra or addition⁴⁷. In technical terms, it refers to an unjustified excess above and over the capital that occurs either in a loan transaction or an exchange of commodities. There also exists a definition of *Riba'* from the Islamic jurisprudential perspective, which refers to any increase over the original wealth without trading⁴⁸.

Fascinatingly, the Islamic rigid stance of *Riba'* is not a new concept – St Thomas Aquinas in his *Summa Theologica* (Summary of Theology) suggested that the Christians also shared an identical view to Islam with respect to the prohibition of interest⁴⁹. This has also garnered significant support from modern economists, such as the 1988 Nobel Prize winner of economic science, Maurice Allais, who argued that the adjustment of the rate of interest to 0 percent (which incidentally coincides with the express prohibition of *Riba'* in Islam) constitutes an integral structural reform initiative in addressing future economic crisis⁵⁰.

In the Western banking system, money is as tradeable as any other commodity. In contrast, the Islamic banking system views money only as a medium of exchange and nothing more – as more would amount to an unjustified enrichment⁵¹. From the *Sharia'* law perspective, money possesses no intrinsic value as it cannot directly satisfy the needs of mankind. This is in marked contrast to a commodity which mankind can consume and benefit from immediately⁵². Additionally, this simple view of money not only aims to prevent avaricious parties from exploiting those in a weak bargaining position,

⁴⁷ Emad H Khalil, 'An Overview of the Sharia' Prohibition of Riba'' in Abdulkader Thomas (ed), *Interest in Islamic Economics: Understanding Riba'* (Routledge 2006), p. 54; Raghil Al-Isfahani, *Al-Mufradat Fi Gharib Al-Qur'an* (published in Beirut, Dar Al-Ma'rifa 1961), p. 186-187.

⁴⁸ Bahgat Al-Sharif, *Law and Practice of Profit-Sharing in Islamic Banking with Particular Reference to Mudarabah and Murabahah* (University of Exeter Press 1990), p. 33.

⁴⁹ Aquinas, II-II, question 78, article one.

⁵⁰ Another proposed structural reform initiative is the revision of tax rate to about 2 per cent, which also coincides with the requirement of *Zakat* (alms payment) of about 2.5 per cent to all Muslims, who has enjoyed and pass the minimum net worth of their basic needs. See Yusuf Al-Qardawi, *Fiqh Az-Zakat: A Comparative Study* (published in London, Dar Al-Tawwa Ltd 1999). Also see Kayed and Hassan, p. 556.

⁵¹ Mahmoud A El-Gamal, 'Islamic Bank Corporate Governance and Regulation: A Call for Mutualization' [2005] Rice University; P. Mills and J. Presley, *Islamic Finance: Theory and Practice* (Palgrave Macmillan UK 1999), p. 109.

⁵² John Hendry, 'Ethics in Finance: Why is It Such a Problem?' *The European Financial Review*, 20 October 2015 <<http://www.europeanfinancialreview.com/?p=4904>> accessed 22 September 2017; Tariqullah Khan, 'Time Value of Money in Islamic Finance' 7 April 2013 <<https://www.slideshare.net/tariqullahkhan/time-value-of-money-18351420>> accessed 22 September 2017; Ahmad and Hassan; Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, vol 20 (Brill 2002)

but also renders any form of gain or profit earned through speculative or overly-risky transactions illegal due to their uncertain and unpredictable nature⁵³.

In Islamic banking, *Sharia'* law prohibits IFIs from utilising money as a medium to profit from money-lending businesses such as an ordinary loan product through the charging of a specified amount of interest because it asks the borrower to pay more than the amount initially borrowed. The amount of interest can also increase if the borrower fails to submit the loan payment within the specified time frame in accordance with the loan contract. This strict prohibition against *Riba'* has influenced the way Islamic banking operates and requires IFIs to improvise their approach to financial business and devise *Sharia'*-compliant financial products and services⁵⁴.

Interestingly, *Sharia'* law not only imposes the prohibition of *Riba'* on IFIs, but also on their customers as well. For example, the IFI's customers cannot enrich themselves from engaging in simple financial products such as savings accounts, which would typically guarantee the customers a small percentage of return on their deposits, because this return, regardless of its small amount, constitutes *Riba'*. Under the Islamic banking system, IFIs can only guarantee their customers' deposits; not a guaranteed rate of return⁵⁵.

2.2.2.3.1 Classification of *Riba'* – *Riba' An-Nasihah* and *Riba' Al-Fadl*

As a rule, *Riba'* exists in two forms, namely *Riba' An-Nasihah* and *Riba' Al-Fadl*. The former, which is also known as *Riba' Al-Qurudh* and *Riba' Al-Jahiliyya*, refers to the mark-up charged on any loans in exchange for an additional time for repayment. In the

⁵³ Frank E. Vogel and L Samuel III, *Islamic Law and Finance: Religion, Risk, and Return* (Kluwer Law International 1998), p. 71-95; Nabil A Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law* (published in London, 2nd edn, Graham and Trotman 1992), p. 11-43; El-Gamal, p. 14.

⁵⁴ Philip Gerrard and J Barton Cunningham, 'Islamic Banking: A Study in Singapore' (1997) 15 *International Journal of Bank Marketing* 204, p. 205; Abdullah Saeed, *Islamic Banking and Interest: A Study of the Prohibition of Riba and Its Contemporary Interpretation*, vol 2 (Brill 1996), p. 17-49. This chapter will explain several common Islamic financial instruments in the current Islamic banking market in providing prospective readers with a better understanding of their distinguishing features.

⁵⁵ The IFIs can grant dividends on the deposits provided these are construed in the light of a *Hibah* (gift), which the *Sharia'* law deems as a voluntary gift instead of a mandatory and guaranteed rate of returns. See El-Gamal, p. 2; CPI Financial, 'Socially Inept' in *Islamic Business & Finance, Issue 83* (CPI Financial 2014) <<http://www.cpifinancial.net/flipbooks/IBF/2014/83/#1/z>> accessed 12 September 2017, p. 83. Also see Shaharuddin, p. 130.

modern context, this is commonly known as delayed payment interest⁵⁶. On the other hand, *Riba' Al-Fadl* refers to any mark-up in a loan repayment, or excessive mark-up in the sale and purchase of goods⁵⁷, which can also include the practice of exchanging goods of different types, natures and qualities⁵⁸. For example, the additional payment made by the debtor to the creditor in the exchange of commodities of the same kind, or the exchange of low quality commodities for better ones⁵⁹.

The prohibition of *Riba' Al-Fadl* began when the Prophet Muhammad (p.b.u.h.) forbade Muslims from engaging in the unequal exchange of six commodities, namely gold, silver, barley, wheat, dates, and salt, either qualitatively or quantitatively. These commodities served as the main mediums of exchange in business transactions amongst Arabs in ancient times and any unequal exchange will amount to *Riba' Al-Fadl*⁶⁰. For instance, an exchange of 1 kilogram of Egyptian wheat with 2 kilograms of Syrian wheat is a clear example of *Riba' Al-Fadl* as it involves the exchange of commodities of the same nature at different weight. This amounts to a clear contravention of the *Sharia'* prohibition of *Riba' Al-Fadl* as illustrated in the *Hadith* narrated by Ubadah Ibn As-Samit, in which the Prophet Muhammad (p.b.u.h.) said:

“Gold is to be paid for with gold, raw and coined, silver with silver, raw and coined (in equal weight), wheat with wheat in equal measure, barley with barley in equal measure, dates with dates in equal measure, salt by salt with equal measure; if anyone gives more or asks more, he has dealt in usury. But there is no harm in selling gold for silver and silver (for gold), in unequal weight, payment being made on the spot. Do not sell them if they are to be paid later. There is no harm in selling wheat for barley and barley (for

⁵⁶ Kabir Hassan and Mervyn Lewis, *Handbook of Islamic Banking* (Edward Elgar Publishing 2007), p. 43; Angelo M Venardos, *Islamic Banking & Finance in South-East Asia: Its Development & Future* (1st edn, World Scientific Publishing Co. Pte. Ltd. 2005), p. 73.

⁵⁷ Muhammad Ayub, *Understanding Islamic Finance* (John Wiley & Sons Ltd 2007), p. 50; Noor Mohammed, 'Principles of Islamic Contract Law' *The Journal of Law and Religion* 115, p. 119. Also see Shanmugam and Zaha Rina, p. 20.

⁵⁸ Abdul-Rahman, p. 42. Also see Md Abdul Awwal Sarker, 'Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm' *1 International Journal of Islamic Financial Services* 12, p. 1-2.

⁵⁹ H. Visser, *Islamic Finance: Principles and Practice* (2nd edn, Edward Elgar Publishing Ltd 2013), p. 39; Ayub, p. 53.

⁶⁰ Visser, p. 39; A.S. Thomas, *Interest in Islamic Economics: Understanding Riba* (Routledge 2006), p. 58.

wheat) in unequal measure, payment being made on the spot. If the payment is to be made later, then do not sell them⁶¹.

However, this *Hadith* also infers that *Sharia'* law allows the unequal exchange of the commodities of the same group for those of a different group such as gold for silver or 2 kilograms of Egyptian wheat for 1 kilogram of Syrian barley if the transaction is made on the spot⁶². At the same time, this does not infer that *Sharia'* law construes *Riba'* only in the light of any amount of excesses in gold, silver, barley, wheat, dates and salt. The Hanafi school and Ibn Rushd (Averroes), a renowned Muslim jurist, philosopher and physician, construed *Riba'* in a broader term and expanded its traditional perimeter; from any excess in monetary mediums (gold and silver) and common barter commodities (barley, wheat, dates, and salt) to any excess in anything measurable by weight or volume. This outlook provides a more expansive and equitable sphere to the rationale behind the *Sharia'* law prohibition of *Riba'* by insisting on the need for parties to strike a balance between the ratio of benefits received and the value ratio of the monetary mediums or barter commodities remitted. In this manner, it is understandable that *Sharia'* law prohibits *Riba'* in order to ensure there is equity in any transaction or exchange.

"It is thus apparent from the Law (the Sharia' law) that what is targeted by the prohibition of Riba' is the excessive inequity (ghubn fahish) that it entails. In this regard, equity in transactions is achieved through equality. Since the attainment of such equality in trading different products is difficult, property values are determined in monetary terms (with the dirham and the dinar). For non-fungibles (properties not measured by weight and volume), justice can be determined by means of proportionality. What I mean is this: the ratio of 1 item's value to its kind should be equal to the ratio of the other item's value to its kind. For example, if a person sells a horse in exchange for clothes, justice is attained by making the ratio of the price of the horse to other horses the same as the ratio of the value of the clothes to other clothes. Thus, if the [monetary] value of the horse is 50, the value of the clothes [for which it is exchanged] should be 50. [If each piece of the clothing

⁶¹ This *Hadith* is *Sahih*. See Book 22, *Hadith* 3343 of Abu Dawud and Sulayman Ibn Al-Ashcath, *Sunan Abi Daud* (published in Beirut, Al-Maktabah Al-Ashàriyyah 1952). Also see Vol. 5, Book 44, *Hadith* 4564 of Ahmad An-Nasa'i, *Sunan An-Nasa'i* (published in Beirut, Dar Al-Kutub Al-Ilmiyyah 1991)

⁶² Abdul-Rahman, p. 107; Mahmoud A. El-Gamal, *Islamic Finance : Law, Economics, and Practice* (Cambridge University Press 2006), p. 51.

has a monetary value of 5], then the horse should be exchanged for 10 pieces of clothes”⁶³.

2.2.2.3.2 Divergent Views of *Riba'*

Notwithstanding the above *Sharia'* law provisions, there actually exists divided opinions among *Sharia'* jurists concerning the practical application of the *Riba'* prohibition. On one hand, the traditional *Sharia'* scholars argued that the prohibition is extensive and demand a total prohibition of the payment and receipt of interest regardless of its amount⁶⁴. This deduction is consistent with the following provisions of the Holy Quran⁶⁵ and *Hadith* of the Prophet Muhammad (p.b.u.h.):

“That which ye lay out for increase through the property of (other) people, will have no increase with God: but that which ye lay out for charity, seeking the Countenance of God, (will increase): it is these who will get a recompense multiplied”.

(*Surah Al-Rum* 30: 39)

“O ye who believe! Devour not usury, doubled and multiplied; but fear God; that ye may (really) prosper”.

(*Surah Ali Imran* 3: 130)

“Those who devour usury will not stand except as stand one whom the Evil One by his touch hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are companions of the Fire: they will abide therein (forever)”.

(*Surah Al-Baqarah* 2: 275)

⁶³ A Ibn Rushd, *Bidayat Al-Mujtahid Wa Nihayat Al-Muqtasid (The Distinguished Jurist's Primer)* (Imran Ahsan Khan Nyazee tr, published in Reading, Garnet Publishing 1996), p. 184.

⁶⁴ In 1965, the Islamic Researches Academy in Cairo issued a *Fatwa* that places a complete ban on *Riba'*. Later, the *Fiqh* Academy of the Organisation of Islamic Conference ('OIC') followed with a similar stance and condemned all interest-bearing transactions as void. See Fuad Al-Omar and Mohammed Abdel-Haq, *Islamic Banking: Theory, Practice and Challenges* (Zed Books 1996), p. 8. Also see Ayub, p. 44; El-Gamal, p. 145; Khalil, p. 53.

⁶⁵ The prohibition of *Riba'* or usury is also stipulated in the Holy Bible, e.g. Deuteronomy 23: 19; Exodus 22: 25; Proverbs 14: 31; Proverbs 28: 8; Psalms 15: 1; 2, 5; Nehemiah 5: 7; Ezekiel 18:8-9; and Ezekiel 22: 12. See Carroll and Prickett

“That they took usury, though they were forbidden; and that they devoured men's substance wrongfully; - We have prepared for those among them who reject faith a grievous punishment”.

(Surah An-Nisa' 4: 161)

“God will deprive usury of all blessing, but will give increase for deeds of charity”.

(Surah Al-Baqarah 2: 276)

“O ye who believe! Fear God, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from God and His Messenger: but if ye turn back, ye shall have your capital sums: deal not unjustly, and ye shall not be dealt with unjustly”.

(Surah Al-Baqarah 2: 278-279)

Ibn Mas'ud stated that:

“The Messenger of God (p.b.u.h.) cursed the one who consumed Riba', and the one who charged it, those who witnessed it, and the one who recorded it”⁶⁶.

Additionally, *Sharia'* jurists such as Ibn Rushd opined that *Riba'* not only causes wealth to circulate around the hands of a few, but also widens the wealth gap between the rich and the poor⁶⁷. From the banking context, the charging of *Riba'* by financial institutions amounts to an exploitation of society's need for credit that can lead to excessive injustice. *Sharia'* law also considers that the financier in a particular transaction possess no right to enjoy a guaranteed profit unless they share the same risk as the borrower⁶⁸. This reiterated the stance taken by previous *Sharia'* jurists such as Imam Razi, who propounded that *Sharia'* law reckons the payment of something definite such as interest

⁶⁶ This *Hadith* is *Hasan*. See Vol. 1, Book 12, *Hadith* 1206 of Al-Tirmidhi. Also see An-Nasa'i Imam Al-Nawawi, *Riyadhus Saliheen* (Dar-us-Salam 1999)

⁶⁷ Ingo Karsten, 'Islam and Financial Intermediation' [1982] IMF Staff Papers 108, p. 111. Also see Visser, p. 38.

⁶⁸ Bank Negara Malaysia, *Financial Stability and Payment Systems Report 2013* (2013), p. 87; Askari, Iqbal and Mirakhor, p. 190.

against something uncertain such as the borrower's ability to make profit and repay the loan as *Haram*⁶⁹.

On the other hand, contemporary *Sharia'* jurists such as Ali Al-Khafif and Rafiq Al-Misri preferred to view interest or usury in the context of 'excessive interest' and considered the consumption of a small amount as admissible. Thus, for example in a deferred payment sale, the buyer would be allowed to enjoy an immediate possession of the goods in exchange of a small amount of 'compensation'⁷⁰. This is evident from the practice of *Murabahah* (mark-up sale contract) in Islamic banking, which is viewed by scholars as a permissible financial instrument, and the mark-up amount is deemed as a fair profit towards the financier⁷¹. In addition, there also exists a *Fatwa* issued in 1989 by Sheikh Mohammed Sayed Tantawi, a prominent Egyptian *Sharia'* jurist, which decreed the interest charged and received by the non-IFIs in Egypt as permissible⁷².

Nevertheless, the ban on interest does not infer that profit maximisation is never on the agenda of the IFIs. The Islamic concept of banking is akin to any legitimate business activities that attempt to maximise value for its shareholders⁷³. In fact, *Sharia'* law recognises the concept of time value for money. However, it only sanctions the generation of profit from a genuine and fair transaction that balances the interest and risk of the contracting parties instead of a static loan contract. For instance, a bank cannot profit from the business of providing loans but it can do so via other alternatives such as a lease or hire purchase contract, in which the rate of return increases as the lease prolongs. Alternately, the bank can also opt to apply a safekeeping charge to

⁶⁹ "While the earning of profit is uncertain, the payment of interest is predetermined and certain. The profit may or may not be realised. Hence, there is no doubt that the payment of something definite in return for something uncertain inflicts a wrong (*Haram*)". See Al-Omar and Abdel-Haq, p. 9.

⁷⁰ Saeed, p. 79; Nico P Swartz, 'The Prohibition of Usury (Riba') A Moral-Ethical Perspective of Islamic Financial and Banking Law: A Comparative Study Between the Islamic and the Conventional Model' (1970) 17 International Journal of Mechanical and Materials Engineering Latifa M Algaoud and Mervyn K Lewis, 'Islamic Critique of Conventional Financing' in M Kabir Hassan and Mervyn K Lewis (eds), *Handbook of Islamic Banking* (Edward Elgar Publishing Ltd 2007) Martin Lewison, 'Conflicts of Interest? The Ethics of Usury' (1999) 22 Journal of Business Ethics 327

⁷¹ Mikail and Arifin, p. 169-185. Also see Thorsten Beck, Asli Demirgüç-Kunt and Ouarda Merrouche, 'Islamic vs. Conventional Banking: Business Model, Efficiency and Stability' (2013) 37 Journal of Banking & Finance 433, p. 435.

⁷² Emmy Abdul Alim, *Global Leaders in Islamic Finance: Industry Milestones and Reflections* (John Wiley & Sons 2013)

⁷³ N. Alam and S.A.R. Rizvi, *Islamic Banking: Growth, Stability and Inclusion* (Springer International Publishing 2016), p. 123; Dar and Azami, p. 35.

savings accounts instead of paying interest to the depositors, which provides a legitimate alternative for the bank to generate profits – the ancient Islamic bank in Libya, Qasr Al-Haj, had introduced this practice in the 13th century for the pilgrims who stored their valuable goods with the bank whilst they went to perform the *Hajj*. Uniquely, the bank did not charge any interest for its storage service apart from imposing a ‘safekeeping fee’ amounting to one-fourth of the total value of the goods stored and it donated these fees to the Islamic education institutions around the area. Although this method may appear impractical in the modern banking context due to the high number of employees and complexities of the financial products and services, it provides an interesting insight into the origin of Islamic banking operation. Of course, a low or zero interest rate will lead to reduced earnings for the banks. Yet, the implementation of this policy has also profited banks in different ways. In the United Arab Emirates, the Abu Dhabi Islamic Bank has registered a profit increase of 8.7 per cent in the second quarter of 2017 despite its low interest rates thanks to its fee-based products such as card, wealth management, transactional banking, and *Sharia*-compliant insurance⁷⁴. This can substantiate the contention that the *Sharia*’ law prohibition on *Riba*’ will not automatically inflict losses to the banks.

Above all, the wisdom behind the prohibition of *Riba*’ is to eliminate any form of exploitation and the practice of unjust enrichment. According to the laws in *Fiqh Al-Muammalat*, a valid commercial agreement requires the presence of three elements, namely risk (*Ghurm*), work and effort (*Ikhtiar*) and liability (*Daman*)⁷⁵. In a *Riba*’-based financing, one or more of these elements are missing, which renders such a contract invalid under *Sharia*’ law. To illustrate, in an ordinary loan contract, the bank enjoys a guaranteed return and profit on the loan it disburses without the need to share any risk with the borrower. The bank also possesses the right to sell the collateral or hold the guarantor liable in the event of default by the borrower. Across the table, the borrower does not enjoy such a guarantee in respect of either his ability to pay or to generate profit

⁷⁴ Mahmoud Kassem, ‘Abu Dhabi Islamic Bank Says Second Quarter Profit Rises 8.7 Per Cent’ *The National*, 23 July 2017 <<https://www.thenational.ae/business/abu-dhabi-islamic-bank-says-second-quarter-profit-rises-8-7-per-cent-1.613500>> accessed 22 September 2017. Also see Laura Noonan, ‘Germany’s Big Banks Profit from Low Interest Rates’ *Financial Times* (26 July 2017) <<https://www-ft-com.elib.tcd.ie/content/9afeaa18-707c-11e7-aca6-c6bd07df1a3c>> accessed 1 August 2017; Matthew Amlot, ‘Economic Recovery Spurring Solid Growth for Gulf Banks, says S&P’ <<http://www.cpifinancial.net/news/post/28322/economic-recovery-spurring-solid-growth-for-gulf-banks-says-s-p>> accessed 22 September 2017

⁷⁵ Bank Negara Malaysia, p. 87; M.H. Kamali and A.K. Abdullah, *Islamic Finance: Issues in Sukuk and Proposals for Reform* (Kube Publishing Limited 2014), p. 16.

from the loan, and yet the contract obliges him to pay an extra amount in addition to the loan. Therefore, the Islamic banking system aspires to rectify this injustice by requiring all parties to equally share the risks in developing a win-win situation between the bank and its customers.

2.2.2.4 *Gharar* (Uncertainty)

The prohibition of *Riba'* has counterparts in other religions, but the third principle of *Muammalat* is solely exclusive to Islam⁷⁶, namely the prohibition of *Gharar*. It refers to an Arabic word that connotes “*uncertainty over the existence of the subject matter of sale*”⁷⁷. *Sharia'* jurists such as Al-Babarti defined it as “*...when the subject matter is unknown*”⁷⁸, whereas Ibn Taymiyyah and Al-Sarakhsi viewed it as “*...unknown consequences*”⁷⁹ and “*...when the consequences are concealed*”⁸⁰ respectively. For example, *Sharia'* law considers the sale of birds or fish before they are caught as void due to the uncertainty of the type, quantity, quality, and the prospect of a successful catch. Another example is the sale and purchase of a female camel and her unborn calf, which *Sharia'* law renders as forbidden due to concerns over the deliverability of the unborn calf and its probability of life⁸¹.

⁷⁶ Ibrahim Warde, a noted author on Islamic Finance, added that the concept of *Gharar* should be interpreted in the context of the problems created by asymmetrical information such as that exemplified in the lemon market theory, namely the unfair advantage enjoyed by the seller, who possesses a better information about the quality of the sale goods in contrast to the buyers, who are less informed. This was similar to the financial crisis, in which the better-informed investment banks had reportedly sold ‘toxic assets’ to the less informed pension funds, which gravely affected the entire financial market. See Hayat Also see Serpil Kahraman Akdogu and Mehmet Umutlu, ‘The Link Between Financial System and Economics: Functions of the Financial System, Financial Crises, and Policy Implications’ (2014) 5 International Journal of Financial Research, p. 55, 64.

⁷⁷ M Ibn Abidin, *Radd Al-Muhtar (The Answer to the Baffled)* (published in Quetta, Maktabah Majididiyyah 1982), p. 4; Doi

⁷⁸ Muhammad bin Ali Al-Shawkani, *Fath Al-Qadir* (published in Beirut, Dar al-Ma’rifah 1994), p. 5.

⁷⁹ Taymiyyah, p. 3.

⁸⁰ MA Al-Sarakhsi, *Kitab Al-Mabsut Li-Shams Al-Din Al-Sarakhsi* (published in Beirut, Dar Al-Ma’refah 1993), p. 13. Professor Mustafa Al-Zarqa, a prominent Syrian *Sharia'* jurist, opined *Gharar* as “*the sale of probable items whose existence or characteristics are not certain, the risky nature of which makes the transaction akin to gambling*”. See El-Gamal, p. 58.

⁸¹ Ibn Umar reported that the pagan Arabs used to divulge in the practice of *Bai Habal Al-Habala*, namely the sale and purchase over a she-camel and her unborn calf, which provided a cause for the arbitrary increase in the sale price. Since there is neither certainty over the existence of the calf nor any means to guarantee it free from any bodily deformation, the *Sharia'* law prohibits this type of transaction due to its

From the Islamic banking context, *Gharar* connotes an excessive risk or uncertainty in financial transactions⁸². In simple words, *Sharia'* law bans *Gharar* because it deprives the parties to the commercial transaction of the knowledge of the counter-value offered therein (such as, the price, deliverability, quality, and existence of goods and services) which *Sharia'* law has decreed should be fixed and reduced to writing to minimise the risk of uncertainty⁸³. This corresponds with the following provisions of the Holy Quran and the *Sunnah*:

“O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing, let a scribe write down faithfully as between the parties: let not the scribe refuse to write: as God has taught him, so let him write. Let him who incurs the liability dictate, but let him fear his Lord God, and not diminish aught of what he owes. If the party liable is mentally deficient, or weak, or unable himself to dictate, let his guardian dictate faithfully, and get two witnesses, out of your own men, and if there are not two men, then a man and two women, such as ye choose, for witnesses, so that if one of them errs, the other can remind her. The witnesses should not refuse when they are called on (for evidence). Disdain not to reduce to writing (your contract) for a future period, whether it be small or big: it is more just In the sight of God, more suitable as evidence, and more convenient to prevent doubts among yourselves but if it be a transaction which ye carry out on the spot among yourselves, there is no blame on you if ye reduce it not to writing. But take witness whenever ye make a commercial contract; and let neither scribe nor witness suffer harm. If ye do (such harm), it would be wickedness in you. So fear God; for it is God that teaches you. And God is well acquainted with all things”.

(*Surah Al-Baqarah* 2: 282)

excessive degree of *Gharar*. In the presence of modern equipment such as the ultrasound scanning device, it is arguable that the *Sharia'* law may ordain *Bai Al-Habala* as a permissible transaction. See Yousef Khalifa Al-Yousef, 'Speculative Capital: An Islamic View' (6th International Conference on Islamic Economics and Finance, Jakarta, 21-24 November 2005), p. 81; Mahmoud A El-Gamal, 'An Economic Explication of the Prohibition of *Gharar* in Classical Islamic Jurisprudence' (2001) 8 *Islamic Economic Studies* 29, p. 2; Abdul-Rahim Al-Saati, 'The Permissible *Gharar* (Risk) in Classical Islamic Jurisprudence' (2003) 16 *Islamic Economics (Journal of King Abdul Aziz)* 3, p. 13.

⁸² Visser, p. 52; Jeremy Harding, 'Fatwa Shopping' LRB Blog, 8 December 2009 <<http://www.lrb.co.uk/blog/2009/12/08/jeremy-harding/fatwa-shopping/>> accessed 22 September 2017

⁸³ S Archer and RA Karim, 'Introduction to Islamic Finance' in *Islamic Finance, Innovation and Growth* (published in London, Euromoney Books 2002) p. 3. Also see Omar Salah, 'Islamic Finance: The Impact of the AAOIFI Resolution on Equity-Based Sukuk Structures' (2010) 4 *Law and Financial Markets Review* 507

Abu Hurairah stated that:

“Prophet Muhammad (p.b.u.h.) prohibited sale that is based on Hasah⁸⁴ and Gharar (uncertain sale)”⁸⁵.

In mitigating injustice and potential disputes, *Sharia'* law not only mandates that contracting parties reduce all the terms and conditions of the contract in writing, but it also requires that these appear comprehensible to the average customer. A customer with a legal or business background may understand such a document with ease, but this may not be the case for the average customer particularly in light of the lengthy nature and complexity of modern contracts, business and juristic jargon, and small print⁸⁶.

In principle, there are two forms of *Gharar*, namely *Gharar Fahish* (major *Gharar*) and *Gharar Yasir* (minor *Gharar*). From the perspective of Ibn Rushd, *Gharar Fahish* refers to an excessive uncertainty, which can exist in the following situations:

- (a) Uncertainty over the subject matter of the contract;
- (b) Uncertainty as to the sale or purchase price;
- (c) Uncertainty as to the existence of the subject matter of the contract or ability of the seller to deliver it; and
- (d) Uncertainty as to the condition of the subject matter of the contract⁸⁷.

Examples of *Gharar Fahish* include the sale of fruits before their ripening (*Mukhabarah*), the obligation to purchase a commodity as soon as the buyer touches the commodity (*Mulasamah*), sale by throwing a commodity towards a buyer (*Munabazah*), conditional sale, the sale of goods before obtaining possession, and the sale of non-existent matters

⁸⁴ *Hasah* refers to a pre-Islamic practice of selling an object chosen or determined by the throwing of a pebble. For example, the buyer throws a pebble or stone to a group of boxes with the names of the object written on each of them and the one it lands in will be the object of sale. Alternatively, it can also refer to a sale of land according to the distance of a pebble thrown. See A Nehad and A Khanfar, 'A Critical Analysis of the Concept of Gharar in Islamic Financial Contracts : Different Perspective' (2016) 37 Journal of Economic Cooperation and Development, p. 12; B. Jokisch, *Islamic Imperial Law: Harun-Al-Rashid's Codification Project* (Walter De Gruyter 2007), p. 133.

⁸⁵ This *Hadith* is *Sahih*. See Vol. 5, Book 44, *Hadith* 4522 of An-Nasa'i. Also see Vol. 3, Book 12, *Hadith* 2194 of Ansari

⁸⁶ Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2013* (2013), p. 118; R. Wilson, *Legal, Regulatory and Governance Issues in Islamic Finance* (Edinburgh University Press 2012), p. 145.

⁸⁷ Vogel and Samuel III, p. 91; Ibn Rushd

such as a genie in a bottle⁸⁸. On the other hand, *Gharar Yasir* refers to the presence of uncertainty of a slight nature such as: the monthly lease of a house, of which the days can either be 30 or 31, or 28 or 29 in February; or the sale and purchase of wrapped items, or simply a restaurant menu without the detailed price of every dish. Indeed, *Gharar* is difficult to avoid in our daily transaction. *Imam Al-Shatibi* explained this complication noting “to remove all *Gharar* from contracts is difficult to achieve, besides, it narrows the scope of transactions”⁸⁹. However, the majority of *Sharia'* jurists conclude that *Sharia'* law has only sought to prohibit *Gharar Fahish*⁹⁰ due to its inherent uncertainty and impairment of the validity of the contract as compared to *Gharar Yasir*⁹¹ whose impact remains minimal and hard to assess quantitatively.

2.2.2.5 Maysir (Gambling or Speculation)

The fourth principle of *Muammalat* necessitates the avoidance of *Maysir* – translated as gambling or the speculative nature of transaction. It denotes an attempt to predict the future outcome of an event, or the undertaking of an excessively risky transaction, or conceding to a game of chance without sufficient knowledge⁹². *Sharia'* law prohibits such a practice because not only does it lack the analysis or interpretation of the relevant information, which mimics a similar attribute to *Gharar*, but it also constitutes an attempt to amass wealth without any productive effort. This contradicts the teaching of the

⁸⁸ Erwandi Tarmizi, *Haram Wealth in Contemporary Muamalah* (5th edn, P.T. Berkas Mulia Insani 2017), p. 220-222; Rifaat Ahmed Abdel Karim and Simon Archer, *Islamic Finance: The New Regulatory Challenge* (John Wiley & Sons 2013)

⁸⁹ Al-Saati, p. 9.

⁹⁰ *Ibid.*, p. 10-14. Also see Filippo di Mauro and others, *Islamic Finance in Europe* (2013), p. 14.

⁹¹ *Gharar Yasir* will not invalidate a contract if it satisfies the following conditions: its degree is slight or trivial; the contract is concluded unilaterally; and there exists a genuine public need of the transaction or contract, such as *Bai Al-Salam* and *Bai Al-Istisna*, which have played a pivotal role in the agricultural financing and manufacturing respectively; or the rounding adjustment of small amount of money such as 3 cents to 5 cents. See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition* (Bank Negara Malaysia 2010), p. 218. Also see H Visser, *Islamic Finance: Aims, Claims and the Realities of the Market Place* (Arab Financial Forum 2012), p. 26, Algaoud and Lewis, p. 38.

⁹² Natalie Schoon, *Islamic Banking and Finance* (Spiramus Press Ltd 2009), p. 133; HSFA Jabbar, 'Islamic Finance: Fundamental Principles and Key Financial Institutions' (2009) 30 *Company Lawyer* 23, p. 4; Algaoud and Lewis, p. 38.

Prophet Muhammad (p.b.u.h.), who underlined the importance of proactive reasoning before leaving nature to its work⁹³.

"They ask thee concerning wine and gambling. Say: "In them is great sin, and some profit, for men; but the sin is greater than the profit".

(Surah Al-Baqarah 2: 219)

In theory, there exists a similarity between *Maysir* and *Gharar* in the sense that *Maysir* is an active act upon the prohibited *Gharar Fahish* or excessive uncertainty. For instance, the pre-Islamic practice of *Bai Al-Munabazah* (sale by throwing a commodity towards a buyer) involved a high degree of uncertainty since the buyer could not perform a proper assessment of the quality of commodities thrown to him. Also, the customary practice of the sale deemed the contract as conclusive once the buyer touched the commodity. Then again, pre-Islamic society remained willing to gamble on such a risky transaction due to the hope of acquiring valuable commodities from the seller. Likewise, this would also apply to investment instruments such as a trading transaction in the stock market and foreign exchange market ('FOREX'). Although a proper utilisation of modern financial software can to some extent mitigate the risks of these transactions, the unpredictable nature of world economics such as the devastating 1997 and 2008 global financial crisis have only proven that the two prohibited elements remain the biggest obstacles to the financial community.

⁹³ *It was narrated that Prophet Muhammad (p.b.u.h.) once asked a Bedouin, who left his camel untied, "Why do not you tie your camel?" the Bedouin answered, "I put my trust in God". The Prophet then said, "Tie up your camel first then put your trust in God", Hadith 2517 of Al-Tirmidhi. Also see Rafe Haneef and Abbas Mirakhor, 'Islamic Finance: Legal and Institutional Challenges' (2014) 6 ISRA International Journal of Islamic Finance 115, p. 124-125; Jabbar, p. 4.*

Nevertheless, the prohibition on *Maysir* does not infer that *Sharia'* law proscribes the taking of risk in investment endeavours. In truth, Islam encourages people to engage in investment activities and extract profits therefrom, provided a proper assessment of the accompanying risks have taken place beforehand. For example, *Sharia'* law allows risk-taking in entrepreneurship or any investment instrument which are susceptible to the risk of natural disasters and calamities. This is the case for example in several Islamic banking products such as *Mudarabah* (profit-sharing contract), *Musharakah* (partnership contract), and *Takaful* (Islamic insurance). Of course, this would require the IFIs to perform a comprehensive analysis of the variant risks, which do not only encompass the generic risks such as credit, market, liquidity and operational risks, but also those that are specifically unique to the IFIs' risk profile such as the rate of return, *Sharia'* non-compliance, displaced commercial, and equity investment risks (see **Figure 4**).

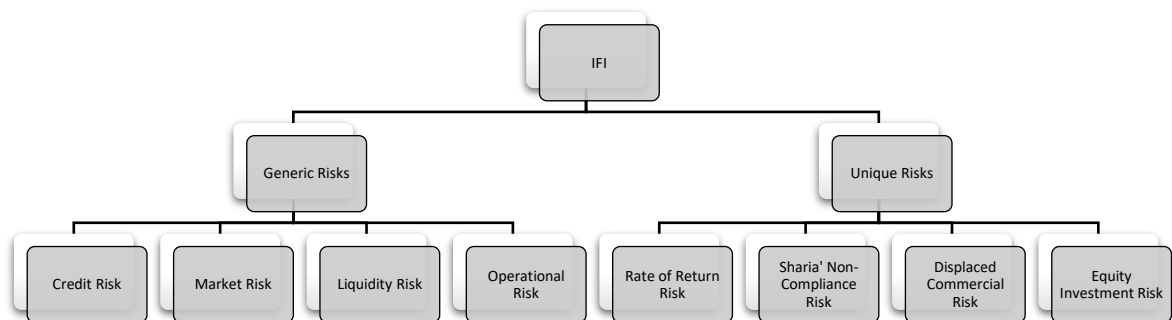


Figure 4: Risk Portfolio of IFIs

In addition, *Sharia'* law also obliges IFIs to link their financial products and services to tangible underlying assets to ensure that the IFIs remain connected to the real economy⁹⁴. From the Islamic banking perspective, both the IFIs and the customers can only obtain a return on their investment from the investment process or the leasing process of a tangible asset, which treats the return as the genuine measure of the value of the investment activities⁹⁵. An immediate example is a *Sukuk* – a certificate of equal value held in trust for the *Sukuk* holders that represents the undivided shares related to

⁹⁴ di Mauro and others, p. 9-11, 37. Also see Austrade, *Islamic Finance* (The Australian Trade Commission (Austrade) 2010), p. 7-9.

⁹⁵ Abdul-Rahman, p. 258.

an actual ownership of tangible assets or usufruct, or the ownership of assets related to a specific investment project⁹⁶.

2.2.2.6 Socially Responsible Investment

Fifthly, the principle of *Muammalat* emphasises the socio-economic aspects of economic activities that benefit society at large (*Tahqiq Al-Khidmah Al-Ijtima'iyah*); which bears a similarity to the Western concept of socially responsible investment ('SRI')⁹⁷. Inspired by the *Sharia'* law injunction of 'human accountability before God', the Islamic banking concept coaxes the investors to seek legitimate and practical avenues to invest their funds in order to create a sustainable economic environment that can improve the quality of life and ease the burden of the needy⁹⁸.

"What God has bestowed on His Messenger (and taken away) from the people⁹⁹ of the townships, - belongs to God, - to His Messenger and to kindred and orphans, the needy and the wayfarer; in order that it may not (merely) make a circuit between the wealthy among you. So take what the Messenger assigns to you, and deny yourselves that which he withholds from you. And fear God; for God is strict in punishment".

(*Surah Al-Hasyr* 59: 7)

To this end, *Sharia'* law ordains for the IFIs to strike a balance between the interest of the shareholders and those of the society to which they belong in promoting a banking business that not only aims to maximise the shareholders' value, but also to benefit

⁹⁶ *Sukuk* is akin to the conventional asset-backed securities transaction, which includes the sale of tangible assets and generates returns and risk associated therewith. See di Mauro and others, 17-18; Abbas Mirakhor and Iqbal Zaidi, 'Profit-and-Loss Sharing Contracts in Islamic Finance' [2007] Handbook of Islamic Banking, p. 53-54.

⁹⁷ Reza Zain Jaufeerally, 'Islamic Banking and Responsible Investment: Is a Fusion Possible?' in Wim Vandekerckhove and others (eds), *Responsible Investment in Times of Turmoil* (Springer Science & Business Media 2012), p. 151; Wafica Ghouil and Paul Karam, 'MRI and SRI Mutual Funds: A Comparison of Christian, Islamic (Morally Responsible Investing), and Socially Responsible Investing (SRI) Mutual Funds' (2007) 16 *The Journal of Investing* 96, p. 60-62.

⁹⁸ World Bank and Islamic Development Bank, *Global Report on Islamic Finance 2016: A Catalyst for Shared Prosperity?* (World Bank Publications, 2017), p. 125; Salma Sairally, 'Evaluating the 'Social Responsibility' of Islamic Finance: Learning from the Experiences of Socially Responsible Investment Funds' (2007) 1 *Advances in Islamic Economics and Finance* 279, p. 280.

⁹⁹ The people of the townships: the townships were the Jewish settlements around *Madinah*, of the *Banu Nadir*, and possibly of other tribes. See *Ibid.*, p. 183.

society¹⁰⁰. This would require the IFIs to channel their business portfolios in industries that can produce great benefits to society including telecommunication, technology, engineering, health care, construction, transportation, and education, and to refrain from investing in those of questionable ethics or which produce harmful outcomes such as tobacco, alcohol, pork processing, gambling, prostitution, pornography, firearms, and weapons of mass destruction¹⁰¹. In simple words, the concept of Islamic banking emphasises the need to blend banking services with social welfare in creating a mutual economic relationship that seeks both to generate benefits for the IFIs and also to appreciate and advance the social values of the community.

"They ask thee concerning wine and gambling. Say: "In them is great sin, and some profit, for men; but the sin is greater than the profit".

(Surah Al-Baqarah 2: 219)

"O ye who believe! Intoxicants and gambling, (dedication of) stones, and (divination by) arrows, are an abomination, - of Satan's handwork: eschew such (abomination), that ye may prosper. Satan's plan is (but) to excite enmity and hatred between you, with intoxicants and gambling, and hinder you from the remembrance of God, and from prayer: will ye not then abstain?"

(Surah Al-Ma'idah 5: 90-91)

¹⁰⁰ Accounting, Auditing, and Governance Standards as at December 2015, p. 953. Also see World Bank and Islamic Development Bank, p. 125.

¹⁰¹ Several IFIs in the Middle East such as the Abu Dhabi Islamic Bank, Sharjah Islamic Bank, and Al Hilal Bank have even designed their customers' bank cards to reject the purchases of illicit items such as, *inter alia*, alcohol, pork, and tobacco. Although several IFIs have started to allow customers to purchase tobacco due to the differences in *Sharia'* opinions concerning its prohibition, the purchases of the other illicit items remain prohibited. Nonetheless, it is arguable that the concept of a *Sharia'*-compliant credit card can further boost the prospect of the Islamic banking industry as a viable and ethical banking alternative. See Nada Al-Taher, 'Islamic Banks Allow Tobacco Purchase Now' Gulf News, 6 August 2014 <<http://gulfnews.com/news/uae/general/islamic-banks-allow-tobacco-purchase-now-1.1367888>> accessed 22 September 2017. Also see Anil Bhojru, 'Barclays' Customers Won't "Have an Issue" Using Cards in Bars and Clubs - ADIB' Arabian Business, 8 April 2014 <<http://www.arabianbusiness.com/barclays-customers-won-t-have-issue-using-cards-in-bars-clubs-adib-545552.html>> accessed 17 September 2017

Correspondingly, several IFIs in the Middle East have begun to bring this notion to reality. For example, the Bank Al-Bilad of Saudi Arabia launched a new branch in Riyadh that provides banking facilities to people with sight, hearing and other physical disabilities¹⁰². In the United Arab Emirates, the Abu Dhabi Islamic Bank ('ADIB') had donated a new mosque to the local Fujairah community as part of its corporate social responsibility activities, which also include the provision of residences for the Imam and *Muazzin* (the caller of prayer)¹⁰³. Similarly, the Noor Islamic Bank of the United Arab Emirates offered bank services through the post office to capture the 50 per cent of the country's population and low-paid workers with no access to a formal banking account¹⁰⁴. Likewise, the Bangladeshi Grameen Bank's microfinance project has also demonstrated the feasibility of Islamic banking as an effective tool to alleviate poverty¹⁰⁵.

2.2.2.7 Avoidance of *Hilah* (Tricks) in Trade

Sixthly, the principle of *Muammalat* prohibits the application of *Hilah* (tricks or deceptions), which includes the elements of fraud, misrepresentation, and juristic ruse. For example, a debtor cannot present a gift to his or her creditor before the settlement

¹⁰² Zawya, 'Al-Bilad Bank Opens Branch for Disabled' *Zawya* (Riyadh, 26 July 2014) <http://www.zawya.com/story/AlBilad_Bank_opens_branch_for_disabled-ZAWYA20140726045522/?lok=045500140726&&zawyaemailmarketing> accessed 1 January 2017

¹⁰³ Jessica Combes, 'ADIB Recognised for CSR Initiatives from UN Global Compact Subsidiary' <<http://cpifinancial.net/news/post/42363/adib-recognised-for-csr-initiatives-from-un-global-compact-subsidiary>> accessed 22 September 2017; Matthew Amlot, 'ADIB Gifts New Mosque in Fujairah' <<http://www.cpifinancial.net/news/post/28919/adib-gifts-new-mosque-in-fujairah>> accessed 22 September 2017

¹⁰⁴ Shanmugam, p. 95.

¹⁰⁵ Several critics have argued that the Islamic microfinance concept, particularly the one implemented in Bangladesh, could not serve as an effective mechanism in alleviating poverty because it will encourage over-indebtedness due to multiple borrowings, which will continue to trap the society in poverty. However, a recent finding by the World Bank has proven these criticisms as baseless – Islamic microfinance had in fact increased the personal expenditure, household assets, labour supply, children's education and benefited women more than men. See *The Economist*, 'Microfinance in Bangladesh: Rehabilitation and Attack' *The Economist* (19 April 2014) <<http://www.economist.com/news/finance-and-economics/21600993-biggest-study-so-far-finds-microcredit-helps-poor-after>> accessed 15 August 2017; Abbas Mirakhor and Zamir Iqbal, 'Qard Hasan Microfinance' [2007] *New Horizon*, p. 18-20. A similar effort was also undertaken by the Akhuwat, an Islamic microfinance institution in Pakistan, which had implemented the financing method of *Qard Al-Hasan* (benevolent loan) and recorded an extremely high recovery rate. It utilised the mosques as the place to operate its microfinancing business and had since grown steadily. See Akhuwat, 'History' (2017) <<http://www.akhuwat.org.pk/History.asp>> accessed 21 September 2017 Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2013*, p. 142-143.

of debt as it serves as an excuse to delay the repayment and justify the implementation of *Riba'*. Another example is the maneuver of a sale contract to bypass the *Sharia'* law prohibition of *Riba'*. In principle, *Sharia'* law condemns all types of fraud¹⁰⁶. It legitimises any profit attained in business "...so long as it stays within the rules of the game, and engage in open and free competition without deception or fraud"¹⁰⁷. This corresponds with the following provisions of the Holy Quran and the *Sunnah*:

"Woe to those that deal in fraud, - Those, who when they have to receive by measure from men, exact full measure, But when they have to give by measure or weight to men, give less than due. Do they not think that they will be called to account? – On a Mighty Day, A Day when (all) mankind will stand before the Lord of the Worlds?"

(*Surah Al-Mutaffifin* 83: 1-6)

In one *Hadith*, Abdullah reported that Prophet Muhammad (p.b.u.h.) mentioned:

*"It is obligatory for you to tell the truth, for truth leads to virtue and virtue leads to Paradise, and the man who continues to speak the truth and endeavours to tell the truth is eventually recorded as truthful with God, and beware of telling of a lie for telling of a lie leads to obscenity and obscenity leads to Hell-Fire, and the person who keeps telling lies and endeavours to tell a lie is recorded as a liar with God"*¹⁰⁸.

In another *Hadith*, the Holy Prophet (p.b.u.h.) was also quoted as saying:

*"When two people trade, they have the choice (to proceed with or cancel the transaction), so if they are honest and clarify (e.g. the defects in their merchandise) their trade will be blessed, but if they lie and conceal (defects) there will be no blessing in their trade"*¹⁰⁹.

¹⁰⁶ *"Woe to those that deal in fraud. Those who, when they have to receive by measure from men, exact full measure, but when they have to give by measure or weight to men, give less than due. Do they not think that they will be called to account?"* See (*Surah Al-Mutaffifin* 83: 1-4) of Ali

¹⁰⁷ Milton Friedman, 'The Social Responsibility of Business is to Increase Its Profits' in WaltherCh Zimmerli, Markus Holzinger and Klaus Richter (eds), *Corporate Ethics and Corporate Governance* (Springer Berlin Heidelberg 2007) <http://dx.doi.org/10.1007/978-3-540-70818-6_14> accessed 24 July 2014, p. 63. Also see Aishath Muneeza and others, 'Hilah in the Islamic Banking Instruments in Malaysia [2011] 1 MLJ liv' (2011) 1 Malaysian Law Journal

¹⁰⁸ This *Hadith* is *Sahih*. See Book 32, *Hadith* 6309 of Imam Abul Hussain Muslim Ibn Al-Hajjaj, *Sahih Muslim* (7 Vol. Set) (Hafiz Abu Tahir and Zubair Ali Zai eds, Nasiruddin Al-Khattab tr, published in Riyadh, 1st edn, Darussalam Riyadh 2007). Also see Vol. 4, Book 1, *Hadith* 1971 of Al-Tirmidhi

¹⁰⁹ This *Hadith* is *Sahih*. See Al-Bukhari and Khan

In general, there is a mixture of scholarly views among the four schools of Islamic jurisprudence regarding the issue of *Hilah*. The *Maliki* and *Hanbali*'s schools opined all *Hilah* as *Haram*, while the *Hanafi* and *Shafie* opined it as permissible in the absence of any fraudulent intention to deprive the rights of the society or demean the reputation of Islam¹¹⁰. However, several *Sharia'* scholars have expressed their concerns over the application of *Hilah* in Islamic banking. For instance, the issue of *Hilah* is evident in *Bai Al-Inah* (sale and buy back contract), an Islamic financial instrument only permissible in two countries, namely Malaysia and Brunei¹¹¹. In this instrument, the bank would purchase an asset from the client on a cash basis and then immediately resell the asset to the customer at a marked-up price on a deferred payment basis. The *Hanafi*, *Maliki*, and *Hanbali* schools identify *Bai Al-Inah* as a stratagem to circumvent the prohibition of *Riba'*-based financing by providing IFIs with a 'back door' to *Riba'* since its main intention is more to obtain the cash than the commodity itself¹¹². Moreover, this instrument is also susceptible to manipulation by the banks to take advantage of the customers' plea for cash and subsequently to subjugate them to debt¹¹³. However, the Malaysian and Brunei *Sharia'* scholars, who subscribe to the *Shafie* school, rebutted the stance of the *Hanafi*, *Maliki* and *Hanbali* schools, and argue that the motive of the parties cannot serve as a strong factor in declaring *Bai Al-Inah* impermissible¹¹⁴.

¹¹⁰ Muneeza and others, p. 5. Also see Dallah Al-Baraka, *Al-Fatawa Al-Syar'iyah li Al-Majmu'ah Al-Barakah Al-Masrifiyah (Collective Sharia' Decisions of the Al-Baraka)* (Al-Barakah Banking Group, Riyadh, 2007)

¹¹¹ Tita Nursyamsiah and Saim Kayadibi, 'Application of Bay 'Al-'Inah in Islamic Banking and Finance: From the Viewpoint of Siyasa Shar 'iyah' (3rd Annual World Conference on Riba' - The Multifaceted Global Crises of Riba': Resilience, Response & Reform, Kuala Lumpur, 26-27 November 2012), p. 123; Shahrudin, p. 129.

¹¹² There exists a substantial concern that *Hilah* can serve as a camouflage to validate *Riba'*-based transactions. In this regard, the Malaysian *Sharia'* scholars have warned the IFIs to strengthen and enhance their operational and documentation processes to comply with the perimeters set for the utilisation of *Bai Al-Inah*. See Asyraf Wajdi Dusuki, 'Commodity Murabahah Programme (CMP): An Innovative Approach to Liquidity Management' (2007) 3 *Journal of Islamic Economics, Banking and Finance* 1, p. 10. Also see Wan Jemizan Wan Deraman, 'Inah and Tawarruq' *Utusan Malaysia* (Kuala Lumpur, Malaysia, 21 July 2010) Religion <http://www.utusan.com.my/utusan/info.asp?y=2010&dt=0721&pub=Utusan_Malaysia&sec=Bicara_Agama&pg=ba_02.htm> accessed 8 September 2017; As-Sa'di, principle 2, p. 5.

¹¹³ Nurrachmi, Mohamed and Nazah, p. 12. Also see Mikail and Arifin, p. 185.

¹¹⁴ The Malaysian *Sharia'* Advisory Council ('SAC') has legalised the application of *Hilah* instruments such as *Bai Al-Inah* provided it fulfils the following conditions to avoid any abuse from unscrupulous parties – the instrument must consist of two clear and separate contracts, which must not contain any specific condition to repurchase the asset; the parties must conclude both contracts at different times; the conclusion of the contracts must follow a particular sequence, namely the parties must completely execute the first sale contract before the second sale contract; and there must exist a transfer of

Admittedly, these conflicting views on *Hilah* can cause confusion to stakeholders, especially the customers, who want to believe that Islamic banking can provide a unique and practical solution to the pursuit of a banking alternative, which conforms to the religious and moral principles advocated by the prophets of ancient – Abraham, Jesus, and Muhammad, peace be upon them ('p.b.u.t.). With the permissibility of *Bai Al-Inah* and several other controversial instruments, the stakeholders could conceive a negative perception of the prospect and viability of Islamic banking, which may arguably exhibit a lot more in common with the Western banking system. Then again, it remains academically fascinating to observe whether the permissibility of these controversial instruments in addition to the other issues face by the industry, can serve to advance or impede its progress in the years to come.

2.2.2.8 Justice and Fairness in Trade

The final principle of *Muammalat* advocates the notion of justice, balance and fairness in trade (*Al-'Adlu Wa At-Tawazun*). The prominent *Sharia'* scholar Ibn Taymiyyah considered justice as an integral outcome of the Islamic monotheism that integrates both Muslims and non-Muslims. He described justice as a noble notion that applies to every matter and everyone regardless of their faiths. Interestingly, he even argued that "...injustice is absolutely not permissible irrespective of whether it is to a Muslim or a non-Muslim or even to an unjust person"¹¹⁵.

Islam recognizes that God owns the dominion of the heaven and earth, and whatever mankind possesses is nothing but a trust from God. As the vicegerent of God on this earth, the *Holy Quran* reminded mankind of the obligation to administer justice always, even if it may jeopardise the life, financial status or reputation of the parties involved. In Islamic jurisprudence, this exercise of justice is known as *Su Isti'mal Al-Haq*. According to Al-Khafif, a renowned *Hanafi* scholar, the administration of justice or the exercise of one's right may by itself be valid and lawful, but it may also cause harm or damage to the others¹¹⁶. Undoubtedly, the *Sharia'* law does not view the concept of justice as a

ownership of the asset and a valid possession of the asset. See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 109-113. Also see Taymiyyah.

¹¹⁵ See Taymiyyah. Also see M Chapra and Robert Whaples, 'Islamic Economics: What It Is and How It Developed' (EH Net Encyclopedia, edited by Robert Whaples) <<http://eh.net/encyclopedia/islamic-economics-what-it-is-and-how-it-developed/>> accessed 22 September 2017 Kayed and Hassan

¹¹⁶ Ida Madieha Abdul Ghani, 'Some Thoughts on the Interface Between Copyright and Competition Policy: The Malaysian Perspective' (2003) 2 Common Law Journal, p. 33. Also see Ali Al-Khafif, *Al-*

matter of choice, but a divine obligation deeply rooted in the teachings of the Holy Quran and *Sunnah*.

“Say: “My Lord hath commanded justice; and that ye set your whole selves (to Him) at every time and place of prayer, and call upon Him, making your devotion sincere as in His sight: such as He created you in the beginning, so shall ye return”.

(*Surah Al-A’raf* 7: 29)

“God commands justice, the doing of good, and liberality to kith and kin, and He forbids all shameful deeds, and injustice and rebellion: He instructs you, that ye may receive admonition”.

(*Surah An-Nahl* 16: 90)

“O ye who believe! stand out firmly for God, as witnesses to fair dealing, and let not the hatred of others to you make you swerve to wrong and depart from justice. Be just: that is next to piety: and fear God. For God is well-acquainted with all that ye do”.

(*Surah Al-Ma’idah* 5: 8)

“O ye who believe! Stand out firmly for justice, as witnesses to God, even as against yourselves, or your parents, or your kin, and whether it be (against) rich or poor: for God can best protect both. Follow not the lusts (of your hearts), lest ye swerve, and if ye distort (justice) or decline to do justice, verily God is well-acquainted with all that ye do”.

(*Surah Al-Nisa’* 4: 135)

As far as its application to commercial trade is concerned, the manifestations of justice are exemplified in practices such as: transparency in measurement, price, and quality of commodities; mutual consensus in trade agreement; free-will; impartiality; and generosity towards the customers.

The importance of justice in Islamic commercial trade was illustrated in the following provisions of the Holy Quran and *Hadith*, which highlighted the Prophet Muhammad (p.b.u.h.)’s advice to the merchants to practice generosity and avoid *Talaqqi Al-Rukban*, a practice where city merchants stop incoming caravans outside the city and purchase the goods at unusually low prices before selling them to the city dwellers at higher prices – abusing the caravan owner’s lack of knowledge of the market price and inflating the

Milkiyyah Fi Al-Syariah Al-Islamiyyah (Ownership in Islamic Law) (published in Cairo, Dar Al-Fikr Al-Arabi 1966), p. 101.

prices of goods in the city¹¹⁷. This transaction, however, is allowed if the seller has the option to terminate the contract if they find themselves unfairly treated after learning the real market value of their goods.

“O ye who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will: nor kill (or destroy) yourselves: for verily God hath been to you Most Merciful!”

(*Surah An-Nisa*’ 4: 29)

Jabir bin Abdullah reported that Prophet Muhammad (p.b.u.h.) mentioned:

“May God have mercy on the person who is lenient when he sells, lenient when he buys, and lenient when he demands his payment (debt)”¹¹⁸.

Uthman bin ‘Affan stated that Prophet Muhammad (p.b.u.h.) said:

“God will admit to Paradise a man who was lenient when he sold and when he bought”¹¹⁹.

Abdullah bin Tawus narrated from Ibn Abbas that Prophet Muhammad (p.b.u.h.) said:

“Do not go to meet the caravans on the way (for buying their goods without letting them know the market price); a town dweller should not sell the goods of a desert dweller on behalf of the latter.” I asked Ibn Abbas, ‘What does he mean by not selling the goods of a desert dweller by a town dweller?’ He said, ‘He should not become his broker’¹²⁰.

From the Islamic banking context, the application of justice is evident in several Islamic financial contracts such as the *Mudarabah* and *Musharakah*, which, *inter alia*, apply the concept of profit-and-loss sharing and require contracts to disclose important information such as the profit-and-loss margin, the contribution ratio of each party and risk

¹¹⁷ H. Kureshi and M. Hayat, *Contracts and Deals in Islamic Finance: A Users Guide to Cash Flows, Balance Sheets, and Capital Structures* (Wiley 2014), p. 6; Wahbah Al-Zuhaili, *Fiqh and Islamic Laws*, vol IV (Mohd Akhir Haji Yaacob et al tr, Dewan Bahasa dan Pustaka 1995), p. 240.

¹¹⁸ This *Hadith* is *Sahih*. See Vol. 3, Book 12, *Hadith* 2203 of Ansari

¹¹⁹ This *Hadith* is *Sahih*. See Vol. 3, Book 12, *Hadith* 2202 of ibid

¹²⁰ This *Hadith* is *Sahih*. See Vol. 3, Book 34, *Hadith* 367 of Hamidy and others. Also see Vol. 5, Book 44, *Hadith* 4501 of An-Nasa’i; Book 10, *Hadith* 3620 of Ibn Al-Hajjaj; Book 31, *Hadith* 97 of M Anas, *Muwatta Imam Malik—The First Formulation of Islamic Law* (Aisha Bewley tr, published in London, Kegan Paul International 1989)

management policies¹²¹. Since the disclosure of information and transparency in contracts constitutes the most vital characteristic of Islamic banking¹²², it is imperative for all the staff and officers to possess adequate knowledge of the tenets underlying the IFI's financial products and services in relaying the correct and accurate information to stakeholders and ensuring the attainment of a good understanding of anything to which they are about to subscribe¹²³.

2.3 Basic Islamic Financial Instruments

2.3.1 *Murabahah*

Murabahah is derived from the Arabic word of '*ribh*', which means extra, addition, or profit¹²⁴. Commonly referred to as a mark-up sale contract or cost-plus financing, *Murabahah* is also known as '*Al-Murabahah Li Al-Amir Bi Al-Shira*' (*Murabahah* to Purchase Order), or *Bai Bithaman Ajil* ('BBA') or *Bai Muajjal* in the South East Asian countries such as Malaysia, Brunei and Indonesia¹²⁵. From a business perspective, it is a sale-and-purchase transaction based on a cost-plus-profit basis that gives the buyer the option to submit the payment in either a bullet or instalment form. This infers that *Murabahah* can exist in two forms, namely a cash *Murabahah* and a credit *Murabahah*. In Islamic banking, it refers to a sale and purchase contract between an IFI and a customer, where the IFI purchases an asset on behalf of the customer and sells it to the

¹²¹ Bank Negara Malaysia, *Guidelines on Musharakah and Mudharabah Contracts for Islamic Banking Institutions* (Bank Negara Malaysia 2007), p. 14; Ayub, p. 27.

¹²² Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services, p. 4-6. Also see Ullah, Jamali and Harwood, p. 219.

¹²³ From this researcher's personal observation of three Malaysian non-IFIs offering Islamic financial products and services ('Islamic windows'), it was surprising to note that some of the customers preferred to engage with the bank's security guards, sweepers, and window cleaners for a quick chat on the application procedures, product information and its differences from the Western banking products than obtaining them from the information counters or officers of the banks. Although several reasons could have motivated this unusual practice, it is arguable that the IFI should not only provide the relevant training on the *Sharia*' principles of Islamic banking to its professional staffs, but also aspire to include its non-professional ones, who must receive sufficient exposure to the basic theory of Islamic banking and the relevant procedures in accommodating 'unusual' customer needs.

¹²⁴ Ayub, p. 215.

¹²⁵ S. Haron and N.W. Azmi, *Islamic Finance Banking System* (McGraw-Hill 2009), p. 141; Muneeza and others, p. 2.

same party at an agreed mark-up price¹²⁶. To illustrate, an IFI purchases a commodity for US\$ 1,000 and later resells it to a buyer at US\$ 1,400. Here, the US\$ 1,400 constitutes the *Murabahah* price and the US\$ 400 constitutes the *ribh* or profit for the IFI. There also exists a specific condition under *Sharia'* law that requires the IFI or the selling party to disclose the actual cost of the asset and the profit it would gain from the sale of the asset to the buyer¹²⁷.

As much as the modern application of *Murabahah* has received recognition from the majority of *Sharia'* scholars, there also exist several considerable concerns in relation to its structure and compliance with *Sharia'* law such as its potential application as a form of *Hilah* to circumvent the *Sharia'* prohibition of *Riba'* by manoeuvring the purchase of assets¹²⁸. It is arguable that these conflicts of opinions may have occurred because of the evolving nature and complex structure of *Murabahah* such as, *inter alia*, the presence of *Wa'd* (promise) on the part of the customer to purchase the asset from the IFI, the benchmarking of its mark-up profit with the market interest rates, and the acquisition of asset by the IFI, which do not exist in the classical *Murabahah* structure¹²⁹. Accordingly, it can serve as a permissible instrument under the *Sharia'* law if the IFI can prove that it has a solid interest to acquire the asset, a physical possession of the asset, and the willingness to bear the risks associated with it¹³⁰. However, most IFIs have encountered extreme difficulty to fulfil these conditions given the fact that their interest in the *Murabahah* contract only extend as far as providing financial assistance to the customers. As this would imply that the actual intention of the IFIs is merely to extend financial

¹²⁶ B.A. Oshodi, *An Integral Approach to Development Economics: Islamic Finance in an African Context* (Taylor & Francis 2016), p. 162; Habib Ahmed, *Product Development in Islamic Banks* (Edinburgh University Press 2011); Saiful Azhar Rosly, *Critical Issues on Islamic Banking and Financial Markets: Islamic Economics, Banking and Finance, Investments, Takaful and Financial Planning* (Dinamas Publishing 2005), p. 87-88.

¹²⁷ Bank Negara Malaysia, *Murabahah* (Bank Negara Malaysia 2013), p. 9; Necmeddin Guney, 'Murabahah Financing Revisited: The Contemporary Debate on Its Use in Islamic Banks' (2015) 23 *Intellectual Discourse* 495, p. 497; Abu Zayd, *Bay Al-Murabahah Wa Tatbiqatuhu Al-Mu'asirah Fi Al-Masarif Al-Islamiyyah* (published in Beirut, Dar Al-Fikr 2004), p. 37. Also see Ayub, p. 213.

¹²⁸ Bank Negara Malaysia, *Murabahah*, p. 4; Guney, p. 501. Also see Beck, Demirgüç-Kunt and Merrouche, p. 435.

¹²⁹ Only the determination of the asset price according to its original cost originates from the classical *Murabahah* structure. See Zayd, p. 498-499. Also see *ibid*, p. 239-243; S.B. Sairally, 'Murabahah Financing: Some Controversial Issues' (2002) 12 *Review of Islamic Economics* 73, p. 74; El-Gamal, 'Islamic Bank Corporate Governance and Regulation: A Call for Mutualization', p. 3.

¹³⁰ Shari'a Standards for Islamic Financial Institutions, p. 521-532; Khan, p. 809; Sairally, p. 81. Also see Azrul Azwar, p. 12; Chong and Liu, p. 129; Ahmed

assistance and profit from the interest payment, most *Murabahah* instrument would appear as nothing more than a façade to justify *Riba*'.

Since *Murabahah* mimics the standard debt contract commonly offered under the Western banking system, it is clearly understandable why its application has challenged the contention that the Islamic banking system can act as a viable alternative to the interest-based financial system. It must be clear, however, that *Sharia*' law allows *Murabahah* as long as it functions as a credit sale to the customer and not a loan to finance the customer's needs¹³¹. Notwithstanding these uncertainties, *Murabahah* remains the most common financing instrument used by IFIs in Malaysia, Indonesia, Bahrain, Pakistan, Sudan, Djibouti, Kenya, Kuwait, Nigeria, and Turkey¹³².

2.3.2 *Mudarabah*

Commonly referred to as a profit-sharing contract, *Mudarabah* is a partnership contract between the *Rabb Al-Mal* (capital provider) and a *Mudharib* (a skilled entrepreneur) under which the former will provide a capital injection to the latter, who will contribute his labour and expertise to a project authorised by *Sharia*' law and agreed by both parties¹³³. In other words, instead of focusing on the creditworthiness of the customer to repay the capital, the IFI will focus on the productivity prospect of the entrepreneurship in approving the *Mudarabah* contract. As the capital provider, the *Rabb Al-Mal* does not participate or intervene in the management and operation of the entrepreneurship project¹³⁴.

Both parties will share the profits in accordance with the terms of the *Mudarabah* agreement with the *Rabb Al-Mal* solely responsible for any financial losses incurred in

¹³¹ Ayub; Sairally

¹³² International Monetary Fund, *Multi-Country Report: Ensuring Financial Stability in Countries with Islamic Banking - Case Studies - Press Release; Staff Report* (IMF Country Report No 17/145 June 2017, 2017), p. 13, 20, 28, 36, 43, 51, 60, 67, 75, 84. Also see Bernardo Vizcaino, 'Islamic Finance Body AAOIFI Seeks to Update Guidance on Murabaha Contracts' Thomson Reuters, 6 March 2017 <<http://www.reuters.com/article/infosys-ceo-succession-idUSL2N1L40L6>> accessed 16 August 2017; International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2017* (2017), p. 28; Thomson Reuters, *Innovation in Islamic Liquidity Management 2017: Transforming Islamic Finance Business* (2017), p. 31.

¹³³ El-Gamal, p. 120; Ayub, p. 322; Usmani, *An Introduction to Islamic Finance*, p. 13.

¹³⁴ M. Bellalah, *Islamic Banking and Finance* (Cambridge Scholars Publisher 2013), p. 33; Usmani, *An Introduction to Islamic Finance*, p. 13.

the entrepreneurship endeavour unless the losses are caused by the *Mudharib's* misconduct, negligence or breach of any contractual provision¹³⁵. An example of the application of *Mudarabah* facility in Islamic banking is the *Mudarabah*-based investment account. Here, the customer will act as the capital provider whereas the IFI will act as the entrepreneur, who will invest the customers' fund in *Sharia'*-compliant activities. In the event of financial losses, the customer remains solely responsible unless there exist sufficient evidences that prove the IFI was negligent in the management of its customer's fund, at which point the IFI is penalised and not compensated for the labour it has already expended¹³⁶.

2.3.3 *Musharakah*

In Arabic, *Musharakah* means 'sharing' or 'to unite for a particular cause'¹³⁷. In contrast to *Mudarabah*, in which one party provides the capital injection while the other acts as the entrepreneur, *Musharakah* requires all the parties to contribute to the cause of the business venture¹³⁸. It allows the parties to pool their resources in a specific investment project and share any resulting profits and losses; a trait, which bears a similarity with *Mudarabah*¹³⁹. Although *Musharakah* does not enjoy the same popularity as the other Islamic financing contracts, it remains one of the most authentic financing models of the *Sharia'* after *Mudarabah*¹⁴⁰. In Islamic banking, it can take the form of a contract between the IFI and the customer to contribute capital to an enterprise, whether existing or new, or to own a real estate or moveable asset, either on a temporary or permanent basis.

¹³⁵ Ayub, p. 308; Siti Faridah Abd Jabbar, 'Sharia-Compliant Financial Instruments: Principles and Practice' (2009) 30 *Company Lawyer* 176; Usmani, *An Introduction to Islamic Finance*, p. 13.

¹³⁶ Dar and Azami, p. 43. Also see Ayub, p. 308.

¹³⁷ M. Khan and M. Bhatti, *Developments in Islamic Banking: The Case of Pakistan* (Palgrave Macmillan UK 2008), p. 48; Usmani, *An Introduction to Islamic Finance*, p. 17.

¹³⁸ The AAOIFI defines *Musharakah* as "an agreement between two or more parties to combine their assets, labour or liabilities for the purpose of making a profit". See Shari'a Standards for Islamic Financial Institutions, p. 203. Also see Usmani, *An Introduction to Islamic Finance*, p. 13; Ayub, p. 307.

¹³⁹ H.A. Dar and J.R. Presley, 'Lack of Profit Loss Sharing in Islamic Banking: Management and Control Imbalances' (2000) 2 *International Journal of Islamic Financial Services* 3; S Cevik and J Charap, *The Behaviour of Conventional and Islamic Bank Deposit Returns in Malaysia and Turkey* (IMF Working Papers, 2011); Usmani, *An Introduction to Islamic Finance*, p. 13. Also see Chong and Liu, p. 129.

¹⁴⁰ M. Hussain, A. Shahmoradi and R. Turk, *An Overview of Islamic Finance* (International Monetary Fund 2015), p. 7; Abu Umar Faruq Ahmad, *Theory and Practice of Modern Islamic Finance: The Case Analysis from Australia* (Brown Walker Press 2010), p. 187.

Profits are shared according to the ratio stipulated in the contract, while losses are shared in proportion to each partner's share of capital¹⁴¹. It is also commonly referred to as a partnership or joint venture contract¹⁴².

2.3.4 *Ijarah*

In Arabic, *Ijarah* means 'to give something on rent'¹⁴³. It involves two parties, namely the *Mujir* (the lessor) and the *Mustajir* (the lessee)¹⁴⁴. In an Islamic banking context, an *Ijarah* contract refers to an agreement made by a financial institution offering Islamic financial products and services to lease to a customer an asset specified by the customer for an agreed period against specified instalments of lease rental. Simply put, it is the lease of an asset by the IFI to the customer at an agreed rental charge plus the profit with the ownership of the asset remaining in the hands of the IFI¹⁴⁵. The *Ijarah* contract is slightly different to the lease contract offered by a western financial institution in the sense that the leased asset must comply with *Sharia'* law and only be utilised for *Sharia'*-compliant purposes¹⁴⁶. For example, the lease of a premise to conduct gambling, drugs-manufacturing, or prostitution is prohibited from *Ijarah*. Currently, *Ijarah* is mostly applied in the hire purchase of vehicles known as *Al-Ijarah Thumma Al-Bai* ('AITAB'), or *Al-Ijarah Muntahia Bi-Tamleek* or *Al-Ijarah Wa Al-Iqtina* as it is known in the Middle East, which resembles the hire purchase instrument in western banks. It comprises the combination

¹⁴¹ Erdem Oz and others, *Shariah Non-Compliance Risk in the Banking Sector: Impact on Capital Adequacy Framework of Islamic Banks* (IFSB Working Paper Series, March 2016, WP-05/03/2016, 2016), p. 38-39; Ayub, p. 312, 316; Usmani, *An Introduction to Islamic Finance*

¹⁴² Askari, Iqbal and Mirakhor, p. 192; Usmani, *An Introduction to Islamic Finance*, p. 15.

¹⁴³ Asyraf Wajdi Dusuki, *Islamic Financial System: Principles & Operations* (International Shari'ah Research Academy for Islamic Finance (ISRA) 2011), p. 233; Usmani, *An Introduction to Islamic Finance*, p. 109.

¹⁴⁴ C.L.E.C. Limited and Corporation Essvale, *Business Knowledge It in Islamic Finance* (Essvale Corporation 2010), p. 66; Brian Kettell, *Islamic Finance in a Nutshell: A Guide for Non-Specialists* (John Wiley & Sons 2010), p. 54-55.

¹⁴⁵ Shanmugam and Zaha Rina, p. 20; Ayub, p. 130, 279; Wahbah Zuhaili, *Al-Fiqh Al-Islami Wa-Adillatuhu (Financial Transactions in Islamic Jurisprudence)* (Mahmoud Amin El-Gamal tr, published in Damascus, Dar Al-Fikr 2003), p. 386-387.

¹⁴⁶ Maha-Hanaan Balala, *Islamic Finance and Law: Theory and Practice in a Globalized World*, vol 5 (IB Tauris 2010), p. 29; M Fahim Khan and Mario Porzio, *Islamic Banking and Finance in the European Union: A Challenge Studies in Islamic Finance* (Edward Elgar Publishing 2010), p. 97; Kettell, p. 55.

of an *Ijarah* contract with an *Al-Bai* (purchase) contract, where the lessee will enter an *Al-Bai* contract to purchase the asset from the lessor at an agreed price¹⁴⁷.

2.3.5 *Istisna*

An *Istisna* contract refers to an agreement to sell to or buy from a customer a non-existent commodity, which is to be manufactured according to the buyer's specification and delivered on a specified future date at a predetermined selling price¹⁴⁸. Here, the IFI operates as the financier between the seller or manufacturer and the buyer or customer. For example, the IFI provides finance to an aircraft manufacturer for the construction of aircraft for a specific airline company. In *Istisna*, the parties will agree on the price of the commodity, its specification, and the place of delivery in advance¹⁴⁹. However, the delivery time of the commodity is not fixed in advance and can vary according to circumstances – though the buyer can opt to set a maximum date of delivery in the *Istisna* contract¹⁵⁰. Similar to the other Islamic financing instruments, the buyer can opt to submit the payment in advance or after the delivery of the commodity¹⁵¹.

As far as the right to cancel the *Istisna* contract is concerned, the parties can opt to cancel the contract at any time before the manufacturing process of the commodity begins¹⁵². However, there are two juristic opinions pertaining to this right. On one hand, *Imam* Abu Hanifah, the founder of the Hanafi school, opined that the buyer can exercise *Khiyar Ur-Ru'yah* (an option to see) and decide whether to accept or reject the manufactured commodity¹⁵³. On the other hand, *Imam* Abu Yusuf and the majority of the *Sharia'* jurists of the Ottoman empire argued that the buyer cannot terminate the *Istisna*

¹⁴⁷ Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 3; Shanmugam and Zaha Rina, p. 20, 33-34.

¹⁴⁸ Dusuki, *Islamic Financial System: Principles & Operations*, p. 207; Khan and Porzio, p. 53; Chong and Liu, p. 129.

¹⁴⁹ Article 389 of *Al-Majalla Al-Ahkam Al-Adaliyyah* (The Majelle); Ayub, p. 263; Usmani, *An Introduction to Islamic Finance*, p. 135.

¹⁵⁰ Jaquir Iqbal, *Islamic Finance Management* (Global Vision Publishing House 2009), p. 92; Ibn Abidin; Usmani, *An Introduction to Islamic Finance*, p. 138.

¹⁵¹ Article 391 of *Al-Majalla Al-Ahkam Al-Adaliyyah* (The Majelle); El-Gamal, p. 90.

¹⁵² Iqbal, p. 92; Usmani, *An Introduction to Islamic Finance*, p. 89.

¹⁵³ A. Khorshid, *Euromoney Encyclopedia of Islamic Finance* (Euromoney Books 2009), p. 17; Usmani, *An Introduction to Islamic Finance*, p. 137.

if the commodity conforms to the specifications initially agreed between the buyer and the manufacturer because it can inflict substantial financial damages on the manufacturer, who has utilised all his time and resources to prepare the specified commodity. This latter opinion has since served as the preferred legal stance between the four schools of Islamic jurisprudence¹⁵⁴.

Historically, the application of *Istisna* existed in the Muslim community due to specific financing needs in areas such as manual work, leather products, shoes and carpentry. Later, it grew into a major financing method that renders it possible to meet the financing needs of major infrastructure and industrial projects¹⁵⁵. Together with *Salam*, *Istisna* is an exception to the general *Sharia'* rule that insists on the existence of the subject matter at the time of the contract on the juristic grounds of *Maslahah* (public interest) and the common need of society¹⁵⁶.

2.3.6 Salam

Similar to *Istisna*, *Salam* is a future contract between the seller and the buyer in respect of the supply of a commodity, which will be delivered at a future date¹⁵⁷. It is often applied in the agricultural sector, where the bank advances money for various inputs to receive a share in the crop, which it then sells for profit¹⁵⁸. During the time of Prophet Muhammad (p.b.u.h.), *Salam* was used to assist farmers who required finance to grow their crops and feed their families up to the time of harvest¹⁵⁹.

In contrast to *Istisna*, the time of delivery of the commodity constitutes an essential part of a *Salam* contract¹⁶⁰. The buyer must also submit the full payment in advance before the delivery of the commodity to avoid from turning the transaction in a sale of a debt

¹⁵⁴ Khorshid, p. 17; Usmani, *An Introduction to Islamic Finance*, p. 137.

¹⁵⁵ Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 21-23; Ayub, p. 262.

¹⁵⁶ Khan and Porzio, p. 53; Usmani, *An Introduction to Islamic Finance*, p. 135-136.

¹⁵⁷ K. Ullah and W. Al-Karaghoul, *Understanding Islamic Financial Services: Theory and Practice* (Kogan Page Publishers 2017), p. 38; Chong and Liu, p. 129.

¹⁵⁸ Ahmad, p. 305; SM Hasanuzzaman, *Islam and Business Ethics* (Institute of Islamic Banking and Insurance 2003), p. 443-444.

¹⁵⁹ Usmani, *An Introduction to Islamic Finance*, p. 129; El-Gamal, p. 82.

¹⁶⁰ Usmani, *An Introduction to Islamic Finance*, p. 136; Ayub, p. 255.

against debt, which *Sharia*' law has expressly forbidden¹⁶¹. As much as *Salam* benefits the seller, who will receive the full payment of the commodity in advance, it also benefits the buyer, who can obtain the commodity at a lower price than the price in spot sales¹⁶². It is necessary that the quality of the assets intended to be purchased and its date of delivery are fully specified leaving no ambiguity which might lead to dispute¹⁶³. This requirement corresponds with a *Hadith* narrated by Ibn Abbas, in which the Prophet Muhammad (p.b.u.h.) stated, "*Whoever pays in advance the price of a thing to be delivered later should pay it for a specified measure at specified weight for a specified period*"¹⁶⁴.

2.3.7 **Sukuk**

Originated from the Arabic word of *Sakk*, which means 'certificate' or 'order of payment', *Sukuk* represents a holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such an asset. In the Middle Ages, Muslims used these certificates to represent their financial obligations in trade and other commercial activities. Similar to modern cheques, the *Sakk* represents a written vow comprising the order, date, name of issuer, and the sum that the merchants must pay¹⁶⁵. In modern days, *Sukuk* indicates, "...*investment instruments, which allocate the capital by floating certificates, as an evidence of capital ownership, on the basis of shares of equal value, registered in the name of the owner, as joint*

¹⁶¹ *Imam* Malik opined that the seller can grant a grace period of two to three days to the buyer before submitting a full payment of the commodity. However, this concession should not form part of the *Salam* contract. See Abu-Muhammad Abd-Allah Ibn-Qudamah, *Kitab Al-Mughni (The Enricher)* (published in Beirut, Dar Al-Kitab Al-Arabi 1983). Also see Ayub, p. 241; Usmani, *An Introduction to Islamic Finance*, p. 129, 136; Rosly, p. 139.

¹⁶² Ayub, p. 242; Usmani, *An Introduction to Islamic Finance*, p. 129, 131-132.

¹⁶³ Ayub, p. 255; Usmani, *An Introduction to Islamic Finance*, p. 130.

¹⁶⁴ This *Hadith* is *Sahih*. See Book 35, *Hadith* 3 of Al-Bukhari and Khan. Also see Book 44, *Hadith* 168 of An-Nasa'i

¹⁶⁵ M. Ariff, M. Iqbal and S. Mohamad, *The Islamic Debt Market for Sukuk Securities: The Theory and Practice of Profit Sharing Investment* (Edward Elgar Publishing, Incorporated 2012), p. 50; A Saeed and O Salah, 'Development of Sukuk: Pragmatic and Idealist Approaches to Sukuk Structures' (2014) 29 *Journal of International Banking Law and Regulation* 41, p. 46.

owners of shares in venture capital or whatever shape it may take, in proportion to ... each one's share therein"¹⁶⁶.

To generate liquidity, *Sukuk* can be sold or purchased in the secondary market. In contrast to conventional bonds, which pay interest based on ownership of debts, the *Sukuk* holder is entitled to the profits based on their ownership of real underlying assets¹⁶⁷. In other words, *Sukuk* emphasizes the need for a direct relationship between the profit return and the real economy. It is akin to the asset-backed bonds that exist in the Western financial system with a slight difference in the assets utilised – the underlying asset in *Sukuk* cannot be used for activities that do not comply with *Sharia'* law such as, *inter alia*, prostitution, gambling, firearms or drugs manufacturing, pork processing, and intoxicated drinks¹⁶⁸.

2.4 *Maqasid As-Sharia'* v Profit Objective

2.4.1 Introduction to the *Maqasid As-Sharia'*

Undeniably, mankind stands as one of God's wonderful creations that surpasses even the likes of *Malaikah* (angels), *Syaitans* (Satan), and *Djinns* (Genie). The Holy Bible has approved this contention in *Genesis* 1: 26-27, which remind mankind of their value in the eyes of God.

"And God said, let Us make man in Our image, after our likeness...so God created man in His Own image..."

(*Genesis* 1: 26-27)

The Holy Quran further explains that the angels and God's other creations initially opposed the creation of mankind for fear that it would bring nothing but chaos and destruction in return.

¹⁶⁶ Resolutions and Recommendations of the Council of the Islamic Fiqh Academy 1985-2000, p. 61-61.

¹⁶⁷ V. Efendić, F. Hadz'ić and H. Izhar, *Critical Issues and Challenges in Islamic Economics and Finance Development* (Springer International Publishing 2017), p. 9; Shanmugam and Zaha Rina, p. 47.

¹⁶⁸ Michael JT McMillen, 'Asset Securitization Sukuk and Islamic Capital Markets: Structural Issues in These Formative Years' (2007) 25 *Wisconsin International Law Journal*, p. 707; Michael JT McMillen, 'Contractual Enforceability Issues: Sukuk and Capital Markets Development' (2007) 7 *Chicago Journal of International Law*, p. 427-429; SR Vishwanath and Sabahuddin Azmi, 'An Overview of Islamic Sukuk Bonds' (2009) 14 *The Journal of Structured Finance* 58, p. 58-59.

"Behold, thy Lord said to the angels: "I will create a vicegerent on earth." They said: "Wilt Thou place therein one who will make mischief therein and shed blood? - whilst we do celebrate Thy praises and glorify Thy holy (name)?" He said: "I know what ye know not".

(Surah Al-Baqarah 2: 30)

The greatness of mankind was displayed in the Holy Quran when God commanded the angels to prostrate themselves before Adam, the first of mankind¹⁶⁹.

"Behold, Thy Lord said to the angels: "I am about to create man from clay: When I have fashioned Him (in due proportion) and breathed into Him of My spirit, fall ye down in obeisance unto Him." So the angels prostrated themselves, all of them together: Not so Iblis: He was haughty, and became one of those who reject Faith. (God) said: "O Iblis! What prevents thee from prostrating thyself to one whom I have created with My hands? Art thou haughty? Or art thou one of the high (and mighty) ones?" (Iblis) said: "I am better than He: Thou createdst me from fire, and Him thou createdst from clay." (God) said: "Then get thee out from here: for thou art rejected, accursed. And My curse shall be on Thee till the Day of Judgment".

(Surah Al-Sad 38: 71-78)

Accordingly, Muslims believe that God has appointed mankind as his vicegerent on this earth and provided them with a set of comprehensive guidance to govern their conduct and inter-relationship with one another. Everything on this earth has its own purpose. For example, the birds decorate the skies with their wings; horses, camels, and elephants provide the means of transportation; while cows, sheep, chicken and alike provide mankind with meats and the source of energy. Likewise, the same applies to mankind itself, who plays an important role as the vicegerent of God. From the Islamic perspective, this is where the *Maqasid As-Sharia'* plays the role as the beacon of light in every aspect of mankind's life, prescribing precisely the perimeters as ordained by God in the Holy Quran.

¹⁶⁹ Al-Tabari, *The History of Al-Tabari Vol. 1: General Introduction and from the Creation to the Flood*, vol 1 (SUNY Press 1989), p. 257-265. Also see C. Çakmak, *Islam: A Worldwide Encyclopedia [4 volumes]* (ABC-CLIO 2017), p. 45.

“Does man think that he will be left uncontrolled, (without purpose)? Was he not a drop of sperm emitted (in lowly form)? Then did he become a leech-like clot; then did (God) make and fashion (him) in due proportion”.

(Surah Al-Qiyamah 75: 36-38)

“Verily, this is My way, leading straight: follow it: follow not (other) paths: they will scatter you about from His (great) path: thus doth He command you. that ye may be righteous”.

(Surah Al-An'am 6: 153)

According to Imam Al-Ghazali, there exist two divisions of *Maqasid As-Sharia'*, namely the *Dunyawi* (the material world), and the *Deen* and *Akhira* (the religion and the Hereafter)¹⁷⁰. These consolidate as a set of principles that aim to protect the five important aspects of life, namely the *Al-Din* (Islamic religion), *Al-Nafs* (the soul), *Al-'Aql* (intellect), *Al-Nasl* (posterity), and *Al-Mal* (property)¹⁷¹. Imam Al-Qarafi also mentioned that some jurists added *Al-'Ird* (honour) to the *Maqasid As-Sharia'*¹⁷². Imam Al-Shatibi viewed these principles as a path “to free man from the grip of his own whims and fancy, so that he may be the servant of God by choice, as he is one without it”¹⁷³. Imam Al-Ghazali further opined that the safeguarding of these five elements promotes the *Sharia'* law maxim of *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil) that ultimately serves to benefit the public interest¹⁷⁴.

¹⁷⁰ Asyraf Wajdi Dusuki and Abdulazeem Abozaid, 'A Critical Appraisal on the Challenges of Realizing Maqasid Al-Shariaah in Islamic Banking and Finance' (2007) 15 International Journal of Economics, Management and Accounting. Also see Sharifah Hayaati Syed Ismail Al-Qudsy, Asmak Ab Rahman and Mohd Izani Bin Mohd Zain, 'Efektif Governan dan Pelaksanaannya dalam Pentadbiran Islam (Effective Governance and Its Implementation in Islamic Administration)' (2008) 16 Jurnal Syariah.

¹⁷¹ Muḥammad al-Ṭāhir Ibn 'Āshūr, *Treatise on Maqasid Al-Shariah* (The International Institute of Islamic Thought (IIIT) and Islamic Book Trust (South East Asia Publisher) 2006), p. 473. Also see Mustafa Omar Mohammad and Syahidawati Shahwan, 'The Objective of Islamic Economic and Islamic Banking in Light of Maqasid Al-Shariah: A Critical Review' (2013) 13 Middle-East Journal of Scientific Research 75, p. 79.

¹⁷² Ibid., p. 118.

¹⁷³ Wahbah Zuhaili, *Al-Wajiz Fi Ushuli Al-Fiqh* (Darl Al-Fikr 1995)

¹⁷⁴ Atieq Amjadallah Alfie, 'Studi Interpretatif Nilai-Nilai Islam dalam Pengungkapan Laporan Tahunan Lembaga Keuangan Syariah' (2013) 8 AKSES (Journal of Business and Economy) 177

2.4.2 The Role of *Maqasid As-Sharia'* in Islamic Banking

In regard to Islamic banking, the *Maqasid As-Sharia'* has undoubtedly a crucial role to play in modern financial transactions as the dividing line between what *Sharia'* law ordains as permissible and impermissible. It is akin to the pillars of a building, without which the latter will collapse to ruin and destruction. Amidst the increasing call from financial practitioners and scholars for the formation of an ethical banking concept, especially following the devastating effects of the 2008 financial crisis, the Islamic banking industry has shown great promise as a competent and better alternative to the conventional banking system¹⁷⁵. With its prohibition of the payment and receipt of interest, uncertainty and the non-engagement with industries of questionable ethics, Islamic banking may already provide the sought-after blueprint of an ideal banking system.

Importantly, the *Maqasid As-Sharia'* not only serves as a crucial element in providing cohesiveness and clarity to Islamic banking stakeholders, but it also injects the necessary boost to the reputation of the industry itself as a viable banking alternative that complies with the tenets of the *Sharia'* law¹⁷⁶. Since *Sharia'* compliance is a distinctive characteristic of Islamic banking and a major point of attraction for consumers, stakeholders have become more conscious and demanding of the need to align their financial arrangements with the laws and principles of *Sharia'* law¹⁷⁷. Failure to cater to this demand on the part of the IFI or even the occurrence of any non-*Sharia'* compliance

¹⁷⁵ The majority of Islamic financial scholars and practitioners believed that a crisis of failed morality as a result of greed, exploitation, and corruption in the financial sector had triggered the global financial meltdown in 2008. See Kayed and Hassan, p. 555. Also see Muhammad Ayub, 'Islamic Finance Must Turn to the Roots - Theme to be Pondered in Aftermath of the Current Global Crisis' <<http://www.islamicfinance.de/files/IFIs%20must%20turn%20to%20the%20roots.pdf>> accessed 22 September 2017, p. 3; Tutton; Swartz, p. 409-430; Gamal El-Din; Samathri Kariyawasam, 'Corporate Collapses-To What Extent does Failure to Follow Corporate Governance Contribute' (23rd Anniversary Convention, Sri Lanka, 2011), p. 181; Deutsche Welle English, *Islamic Banking as an Ethical Alternative* (YouTube 2012).

¹⁷⁶ Malaysia International Islamic Financial Centre (MIFC), *Shariah Compliance in All Matters. The Priority of a Robust Islamic Finance Ecosystem* (2014), p. 5. Also see Sayd Farook and Mohammad Farooq, 'Shariah Governance for Islamic Finance: Challenges and Pragmatic Solutions' (2013) 5 ISRA International Journal of Islamic Finance, p. 150.

¹⁷⁷ Wafik Grais and Matteo Pellegrini, *Corporate Governance and Stakeholders' Financial Interests in Institutions Offering Islamic Financial Services* (WPS4053, 2006), p. 2; M Umer Chapra and Habib Ahmed, *Corporate Governance in Islamic Financial Institutions* (Occasional Paper No 6, Jeddah, IRTI/IDB, 2002), p. 23, 74; Karim Ginena, 'Shari 'ah Risk and Corporate Governance of Islamic Banks' (2014) 14 Corporate Governance 86, p. 88; Nasser M. Suleiman, 'Corporate Governance in Islamic Banks' (2000) 22 Journal of the Budapest University of Economic Sciences and Public Administration 98, p. 3.

events could lead customers to withdraw their deposits or switch banks¹⁷⁸. A field interview conducted by Chapra and Ahmed¹⁷⁹ in 2001 to study, *inter alia*, the customers' reaction to non-*Sharia'* compliance by an IFI, highlighted a high prospect of bank runs with 130 out of the 153 customers (85.6 per cent) in Bahrain, 109 out of 165 (66.8 per cent) in Bangladesh, and 141 out of 150 (94.6 per cent) in Sudan, indicating their willingness to withdraw their deposits and move to another bank if their IFI failed to comply with *Sharia'* law in conducting its business¹⁸⁰. Similarly, in Pakistan, the withdrawal risk triggered by the same cause remains significant with research indicating that IFI customers had displayed the willingness to sacrifice higher returns and convenience for the sake of *Sharia'* compliance¹⁸¹.

2.4.3 The Islamic Concept of *Tahsil Al-Ribh* (Attainment of Profit or Profit Maximisation)

As a balancing scale between promoting the well-being of the society on one hand, and adhering to the divine commandments, on the other, the *Maqasid As-Sharia'* serves to promote a financial system that not only complies with *Sharia'* law, but also functions as a means for customers to generate profits from a wide array of *Sharia'*-approved financial instruments, which are confined to *Murabahah*, *Mudarabah*, *Musarakah*, *Ijarah*, *Salam*, *Istisna*, *Sukuk*, or a hybrid of any of these Islamic financial instruments. Indeed, Islam recognises the importance of wealth for the continuity of life and strongly urges mankind to mutually prosper through the legal means outlined by *Sharia'* law¹⁸². In fact, the

¹⁷⁸ Other triggering factors which may exhort the customers to withdraw their funds from the IFIs are the mismanagement of the depositors' fund, *Sharia'* non-compliance issue, and bad reputation of the services offered. See Habib Ahmed, 'Withdrawal Risk in Islamic Banks, Market Discipline and Bank Stability' (International Conference on Islamic Banking: Risk Management, Regulation and Supervision, Jakarta, September 30 - October 2), p. 460-465. Also see Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 6; Franklin Allen and Douglas Gale, 'Optimal Financial Crises' (1998) 53 *The Journal of Finance* 1245, p. 1245; Gerrard and Cunningham, p. 205.

¹⁷⁹ Chapra and Ahmed

¹⁸⁰ *Ibid*, p. 109, 120.

¹⁸¹ Kun-ho Lee and Shakir Ullah, 'Customers' Attitude Toward Islamic Banking in Pakistan' (2011) 4 *International Journal of Islamic and Middle Eastern Finance and Management* 131, p. 137.

¹⁸² "And when the Prayer is finished, then may ye disperse through the land, and seek of the bounty of God: and celebrate the praises of God often (and without stint): that ye may prosper" (*Surah Al-Jumu'ah* 62:10) of Ali

Prophet Muhammad (p.b.u.h.) himself had served as a tradesman; a profession also adopted by his companions and the subsequent *Sharia'* jurists such as the third Caliph Uthman Bin Affan and Imam Abu Hanifa, the founder of the Hanafi school of Islamic jurisprudence¹⁸³.

By the same token, the idea of profit maximization also received a strong support from influential *Sharia'* jurists such as Ibn Khaldun¹⁸⁴, who opined that mankind enjoys the right to profit from mutual trades; and Al-Sayyid Sabiq¹⁸⁵ and Imam Al-Syarbini¹⁸⁶, who both opined that *Sharia'* law allows the accumulation of wealth from trading transactions when both contracting parties have reached an agreement. In the modern context, the International Islamic *Fiqh* Academy ('IIFA')¹⁸⁷, a ruling body under the auspices of the Organisation of Islamic Cooperation ('OIC'), also issued a corresponding *Fatwa* that affirms the above stance on profit maximisation if it conforms with the perimeters allowed by *Sharia'* law such as the avoidance of *Riba'*, *Gharar*, and *Maysir* in business transaction; the promotion of SRI; and adherence to other ethics in *Muammalat*¹⁸⁸. Although *Sharia'* law abstains from prescribing a specific maximum profit margin and allows a trader to accumulate as much profit as possible, it highly encourages the trader to apply the customary ethics in *Muammalat* such as generosity and leniency in trade¹⁸⁹.

¹⁸³ Nicholas H.D. Foster, 'Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law' (2010) 11 European Business Organization Law Review (EBOR) 3, p. 26.

¹⁸⁴ Ibn Khaldun (Abdul Rahman bin Muhammad bin Khaldun Al-Hadrami), *Al-Muqaddimah (The Introduction)* (Dewan Bahasa dan Pustaka 1995), p. 467.

¹⁸⁵ Al-Sayyid Sabiq, *Fiqh Al-Sunna (The Jurisprudence of Tradition)*, vol 3 (Maktabat Al-Qahira 1994), p. 147.

¹⁸⁶ Al-Syarbini Muhammad Al-Khatib, *Al-Iqna' Fi Had Al-Fadz Bi Abi Suja' (The Persuasion: Understanding the Text of Abi Suja)*, vol 2 (Maktabah Wa Matba'ah Sulaiman Mar'ei 1995), p. 142.

¹⁸⁷ The International Islamic Fiqh Academy, (2017) <<http://www.fiqhacademy.org.sa/>> accessed 22 September 2017

¹⁸⁸ The IIFA's *Sharia'* resolution is not binding on the OIC member states. Yet, it is very persuasive, especially within the Islamic banking fraternity since the IIFA commands a wider respect than the other two standard-setting bodies, namely the AAOIFI and the IFSB. See The Maximum Profit Margin for Traders. Also see Habhajan Singh, 'Fiqh Academy Must Make Thorough Study of Issues' *The Malaysian Reserve* (Kuala Lumpur, 3 November 2009) Islamic Finance <<http://aibim.com/content/view/2142/105/>> accessed 18 June 2017

¹⁸⁹ From a common understanding, many would believe that generosity and leniency in trade will hinder the accumulation of wealth. On the contrary, the Muslims believe that generosity or leniency in business will only invite blessings from God and prosper the business based on the provisions in the *Holy Quran* such as, *inter alia*, "God is never unjust in the least degree: if there is any good (done), He doubleth it, and

Above all, *Sharia'* law advises mankind to observe moderation in their pursuit of profit whilst striving to maximise the holistic good of society¹⁹⁰ as opposed to focusing on enriching themselves¹⁹¹.

2.4.4 Islamic Legal Maxims of Risk and Profit – Al-Ghunm Bil Ghurm and Al-Kharaj Bi-Dhaman

As the rule of thumb in *Fiqh Al-Muammalat*, *Sharia'* law mandates that the return of profit is only justifiable when it results from the active participation and fair undertaking of risks between the contracting parties. This mandatory correlation between the risk and profit return is captured in the Islamic legal maxim of *Al Ghunm Bil Ghurm* (no risk, no return) and *Al Kharaj Bi-Dhaman* (the right to return is justifiable by assuming the risk of loss)¹⁹², and also reflected in the famous *Al-Majelle Al-Ahkam Al-Adliyah*, a codification of the *Hanafi's* school commercial law that was adopted by Syria and Jordan until 1949 and 1970 respectively¹⁹³. In simple terms, these maxims postulate that the entitlement to profits would depend on the outcome of the entrepreneurial endeavours and the agreed risk sharing between the contracting parties rather than on a pre-determined interest rate.

In these legal maxims, *Sharia'* law provides a distinction between the profit or 'rate of return from capital' and the interest in the sense that the return of profit is only justifiable if it flows naturally from the outcome of the business endeavours between the contracting

giveth from His own presence a great reward" (Surah An-Nisa' 4: 40); and "He that doeth good shall have ten times as much to his credit..." (Suran Al-An'am 6:160) of Ali

¹⁹⁰ Baker Ahmad Alserhan, *The Principles of Islamic Marketing* (Gower Publishing, Ltd. 2011), p. 11-12. Also see Shanmugam and Zaha Rina, p. 76-77.

¹⁹¹ Zubair Hasan, 'Theory of Profit: The Islamic Viewpoint' (1983) 1 *Journal of Research in Islamic Economics* 1, p. 8-12. Also see Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System', p. 7-14.

¹⁹² Bank Negara Malaysia, *Financial Stability and Payment Systems Report 2013*, p. 87. Also see M Fahim Khan, 'Fiqh Foundations of the Theory of Islamic Economics: A Survey of Selected Contemporary Writings on Economics Relevant Subjects of Fiqh' (Theoretical Foundations of Islamic Economics, Islamabad, 25-27 March 2000), p. 69; Saiful Azhar Rosly and Mohammad Ashadi Mohd Zaini, 'Risk-Return Analysis of Islamic Banks' Investment Deposits and Shareholders' Fund' (2008) 34 *Managerial Finance* 695, p. 296.

¹⁹³ To illustrate, article 85 of the *Al-Majelle* states "the benefit of a thing is a return for the liability for loss arising from that thing"; article 87, "the detriment is a return for the benefit"; and article 88, "the burden is in proportion to the benefit and the benefit in proportion to the burden". See *Al-Majalla Al-Ahkam Al-Adaliyyah* (The Majelle); William M Ballantyne, *Essays and Addresses on Arab Laws* (Routledge 2011), p. 129-130.

parties¹⁹⁴. Since an IFI cannot generate profit from the practice of lending money, it must revisit its business strategy for suitable alternatives that can allow it to maximise the shareholders and other stakeholders' value within the permissible ambit of *Sharia'* law. For example, under the *Mudarabah* instrument¹⁹⁵, the bank acts as a *Rabb Al-Mal* (financier) to provide the capital injection to a *Mudharib* (entrepreneur) of an approved business venture. Whilst the *Rabb Al-Mal* solely bears the financial risk, the *Mudharib* will bear all risks associated with the execution and operation of the entrepreneurship.

Although the ultimate control over the entrepreneurial activity lies with the *Mudharib*, the *Rabb Al-Mal* has a major say in important investment decisions such as the period for investment, location, type of project, commingling of funds and participation of other investors¹⁹⁶. In *Mudarabah*, both the *Rabb Al-Mal* and the *Mudharib* will share the profits at a predetermined ratio while any financial losses is borne solely by the *Rabb Al-Mal* unless it can prove any negligence or breach of any contractual provision by the *Mudharib*¹⁹⁷. With this in mind, the *Rabb Al-Mal* or the IFI can justify its acquisition of profits as it has already fulfilled its part of the bargain by undertaking its share of the risk within the entrepreneurship endeavour, namely the financial risk. In addition, since the IFI can filter incoming applications for *Mudarabah* financing, it can mitigate its risk exposures, thus ensuring a viable business environment with a higher degree of profitability that also complies with this *Sharia'* law maxim. Alternatively, another Islamic banking instruments such as *Musharakah* also fulfils the maxim, in which the contracting parties will share an equal ratio of the profits and financial losses resulting from the venture, thus levelling the IFI's risk exposure with its investors.

¹⁹⁴ Shanmugam and Zaha Rina, p. 3. Also see Hussain G Rammal, 'The Importance of Shari'ah Supervision in Islamic Financial Institutions' (2006) 3 Corporate Ownership and Control, p. 204-205.

¹⁹⁵ An example of *Mudarabah*-based instrument that the IFI can offer is a *Mudarabah*-current account product. In contrast to the ordinary Islamic savings account in which the payment of dividends depends on the IFI's discretion, customers with a *Mudarabah*-current account enjoy a share of the profits generated based on a pre-determined ratio agreed when opening the current account. See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 26-27. Also see Shaharuddin, p. 130.

¹⁹⁶ Beck, Demirgüç-Kunt and Merrouche, p. 435. Also see Shariah Standard on Mudarabah BNM/RG/GL 012-4, p. 5.

¹⁹⁷ Shariah Standard on Mudarabah BNM/RG/GL 012-4, p. 14.

2.4.5 Challenges in Balancing the *Maqasid As-Sharia'* and Profit Objective

Similar to the Western banking institutions, IFIs operate as commercial institutions with an interest in generating profits from their diverse financial products and services. As the IFIs are not charitable organisations, it would appear challenging to balance the need to adhere to the *Maqasid As-Sharia'*, on one hand, and the maximisation of profit, on the other. The common preference of the latter has often caused theological difficulty to the IFI's *Sharia'* advisors in promoting the socio-economic functions of the IFIs, especially when their profit maximisation endeavours indulge elements deemed *Makruh* or *Haram* under the *Sharia'* law¹⁹⁸.

Consequently, the prevalence of the profit maximisation ideology within the IFI's objectives has provoked criticisms from *Sharia'* scholars, industry practitioners and Islamic banking enthusiasts, who had questioned the low application of the *Maqasid As-Sharia'* in the IFIs' actual practices. For instance, Saleem¹⁹⁹ complained that the IFIs did not practise what they preached with interest being charged but disguised behind the Islamic veil. Ariff and Rosly²⁰⁰, Bacha²⁰¹, and Zaman and Movassaghi²⁰² claimed the products offered by the IFIs bear close resemblance to those of the Western financial

¹⁹⁸ An Islamic banker was quoted stating, "As far as (my bank) is concerned, we are very committed to the development of the Islamic financial market. It is a means to enhance our shareholders' value. From an institutional perspective, we do not see Islamic banking either as a religious requirement or a social need. We see it more in terms of how we might enhance shareholders' value". See M Parker, 'Tsunami Tragedy Exposes CSR Failure' *Islamic Banker* 108, p. 108-109. Also, several empirical researches have pointed out that the profit maximisation ideology remains rooted deep within the IFI's business agenda to the extent that it can contradict the interest of the *Maqasid As-Sharia'*. See Choudhury, p. 1-42. Also see Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System', p. 7-14; Tutton

¹⁹⁹ Muhammad Saleem, *Islamic Banking-A \$300 Billion Deception: Observations and Arguments on Riba (interest Or Usury), Islamic Banking Practices, Venture Capital and Enlightenment* (Xlibris Corp 2006). Also see Tawfique Al-Mubarak and Noor Mohammad Osmani, 'Applications of Maqasid Al-Shari'ah and Maslahah in Islamic Banking Practices: An Analysis' (International Seminar on Islamic Finance, Kouchi, 4-6 October 2010), p. 10-13; Emirates 24/7, 'Islamic Banks Should be Named 'Ethical Banks'' *Emirates 24/7* (United Arab Emirates, 9 December 2013) <<http://www.emirates247.com/business/economy-finance/islamic-banks-should-be-named-ethical-banks-2013-12-09-1.530641>> accessed 3 September 2017.

²⁰⁰ Ariff and Rosly, p. 301-319. Also see Khan; Zaman and Movassaghi

²⁰¹ Obiyathulla Ismath Bacha, 'The Islamic Inter Bank Money Market and a Dual Banking System: the Malaysian Experience' (2008) 1 *International Journal of Islamic and Middle Eastern Finance and Management* 210

²⁰² Zaman and Movassaghi

institutions. Hasan²⁰³ argued that there was a lack of integration of the *Maqasid As-Sharia'* in modern Islamic banking products and services. Finally, Dusuki²⁰⁴ reiterated the importance of realising the *Maqasid As-Sharia'* within the IFI's financial operations as a key differentiator between the Islamic and Western banking system²⁰⁵.

It is arguable that these criticisms bear a certain degree of truth. There actually exist several controversial practices within the Islamic banking industry, which have since raised considerable doubts of the 'Islamicity' of the existing financial products and services in today's market further substantiating the claim of 'hair-splitting' differences between the Islamic and the Western banking products and services. For example, there is a lack of difference between the profits rates of IFIs and the interest rates of the Western financial institutions²⁰⁶. Additionally, Anuar et al²⁰⁷ discovered that there exists a significant link between these rates with the fluctuation of the interest rates of the Western financial institutions influencing the profit rates of the IFIs, thus raising doubts of the profit-and-loss sharing paradigm of Islamic banking.

In another example, the majority of the *Mudarabah*-based equity financing (partnership), which encapsulate the *Sharia'* requirement of profit-and-risk sharing, was practised as *Murabahah*-based debt financing (mark-up sale) since the latter enabled the IFIs to generate quick profits²⁰⁸. Another example is *Bai Al-Inah*, in which a commodity is purchased and immediately sold at a marked-up price for profit. For example, a vendor sold a computer to a purchaser for US\$ 5,500 on a deferred payment basis. The purchaser then sold it back to the vendor for US\$ 5,000 cash. Here, although the purchaser has obtained US\$ 5,000 in cash, he is still obliged to pay US\$ 5,500 to the

²⁰³ Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System', p. 4.

²⁰⁴ Dusuki and Abozaid, p. 144-165.

²⁰⁵ "...the realisation of *Maqasid As-Sharia'*, should be equally looked into especially in structuring a financial product. Otherwise, Islamic banks are just an exercise of semantics; their functions and operations are no different from conventional banks, except in their use of euphemisms to disguise interest and circumvent the many *Sharia'* prohibitions". See *ibid*, p. 144.

²⁰⁶ Chong and Liu

²⁰⁷ Anuar, Mohamad and Shah, p. 35.

²⁰⁸ *Murabahah* is the most common mode of financing preferred by the IFIs today, accounting to 90 per cent of the total Islamic financing as its mark-up concept enables the IFIs to generate quick profits. See Vizcaino; International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2017*, p. 28; Thomson Reuters, p. 31; Shoaib Ghias, 'Translation of 'Murawwaja Islāmī Baynkārī awr Jamhūr 'Ulamā kay Mawqaf kā Khulāṣa' - A Collective Fatwa Against Islamic Banking' [2012] Wiley & Sons, p. 9.

vendor on a deferred basis. Apparently, it is arguable that the main motive behind *Bai Al-Inah* is to obtain a quick cash instead of extracting the usufruct from the purchased commodity. In other words, *Bai Al-Inah* can operate as a stratagem that provides a 'back door' for the IFIs to circumvent the *Sharia'* law prohibition of *Riba'* through the manipulation of sale and purchase methods.

Then again, it is interesting to note that industry practitioners have perceived the presence of these 'modern' products as necessary and pivotal to enable the Islamic banking industry to stand in parallel to, and compete with the more established Western banking system²⁰⁹. In the same vein, this argument is flawed as a means of justifying any indiscriminate departure from the crucial principles of *Maqasid As-Sharia'*. The mere cosmetics and masquerading of Western banking products as Islamic banking products even prompted Pakistani *Sharia'* scholars to issue a *Fatwa* in 2009 that declared Islamic banking as *Haram*, or unconstitutional according to the tenets of *Sharia'* law, though ²¹⁰.

2.5 Conclusion

This chapter has attempted to explain the conceptual dimension and theoretical framework of Islamic banking from the *Sharia'* law perspectives by referring to the principles of *Muammalat*, which are derived from both the primary and secondary sources of *Sharia'* law. Contrary to the conventional banks, IFIs' operations must be based on the *Maqasid As-Sharia'*, which are identified as the prohibition of *Riba'*, *Gharar*, *Maysir*, *Hilah*, and the promotion of ethical business practices such as justice, fairness and transparency. The 2008 global financial crisis has created an urgent-yet-unique

²⁰⁹ John Foster, 'How Sharia-Compliant is Islamic Banking?' BBC News, 11 December 2009 <<http://news.bbc.co.uk/2/hi/business/8401421.stm>> accessed 22 September 2017

²¹⁰ Ghias, p. 4-20. It is worth noting that Islamic banking constitutes a portion of a larger and emerging sector called the *Halal* industry, which also comprises other lines of business such as logistics, pharmaceutical, and production of foods among many others. The global *Halal* economy is expected to hit US\$ 2.3 trillion by 2017-end and top US\$ 3.7 trillion by 2019. As the various *Halal* businesses would continuously demanding capital injections, it can provide the IFIs with an ideal platform to offer their financial resources in critical areas such as microfinance, and small and medium enterprise (SME'). Since the *Halal* industry epitomizes its business sphere as the embodiment of *Sharia'* compliance in both form and substance, it serves all the more reason for Islamic banking to retain its competitiveness whilst remaining true to the *Sharia'* principles to boost the stakeholders' confidence in the viability of the entire industry. See Trade Arabia, 'Global Halal Industry Grows 8pc to Hit US\$2.3 Trillion' Trade Arabia, 25 June 2017 <http://www.tradearabia.com/news/MISC_326749.html> accessed 16 August 2017 Sophie Morlin-Yron, 'Makeup, Meds and Sports Wear: Why Halal Has Become Big Business' CNN, 29 August 2016 <<http://edition.cnn.com/2016/08/29/world/halal-industry/index.html>> accessed 21 September 2017

awareness among banking consumers of the need for an alternative to complement the Western banking system, which had since suffered from a crisis of failed morality²¹¹. Meanwhile, the Islamic banking system, which is identified as a viable banking alternative²¹², has long focused on the concept of a banking institution not only as a medium to generate profit, but also as a tool to integrate and prioritise the *Maslahah* (public interest) and ethical values in banking practices. In reality, however, Islamic banking is not yet deserving of such an accolade, at least amidst the presence of several highlighted controversial products and practices within the industry. In addition, empirical research has shown that conflicting opinions between Islam's four major schools of thought may have contributed to the inconsistency of *Sharia'* rulings with regards to Islamic banking products such as, *inter alia*, *Bai Al-Inah*, *Tawarruq*, and *Murabahah*²¹³.

To summarise, this chapter provides a comprehensive literature overview of the concept of banking from an Islamic perspective, particularly its application to IFIs' practices. An understanding of Islamic banking is essential in order to inform the reader of the corresponding issues that will be discussed in the subsequent chapters. Chapter 3 will further explore the conceptual and foundational dimensions of corporate governance under the *Sharia'* law and highlight its differences and diversities vis-à-vis the Western corporate governance system.

²¹¹ Hendry; Kayed and Hassan, p. 555. Also see Ayub, 'Islamic Finance Must Turn to the Roots - Theme to be Pondered in Aftermath of the Current Global Crisis', p. 3; Tutton; Swartz, p. 409-430; Gamal El-Din; Kariyawasam, p. 181; English

²¹² In 2009, the Vatican City declared their recognition of Islamic Finance as one of the alternatives to global financial crisis and Pope Benedict XVI urged financial experts to study the Islamic banking model. See Lorenzo Totaro, 'Vatican Says Islamic Finance May Help Western Banks in Crisis' Bloomberg, 4 March 2009 <<http://www.cimer.org.au/documents/vatican.pdf>> accessed 17 September 2017

²¹³ Dusuki, 'Commodity Murabahah Programme (CMP): An Innovative Approach to Liquidity Management', p. 10. Also see Wan Deraman, . There also exists many other Islamic schools of jurisprudence apart from the major four such as *Zahiri*, *Awza'e*, *Zaydee*, *Laythee*, *Thawree*, *Jareeri*, etc. In fact, no less than 19 schools had appeared between the 1st and the 4th century. However, the majority of *Sharia'* jurists in modern times regarded the four major schools as the *Muktabar* (officially recognised or popular) ones because of their better documentation and more established *Sharia'* legal methodologies, procedures, and *Sharia' Hukm* (*Sharia'* ruling). See A.S. Al-Mansur, *Kedudukan Mazhab Dalam Syari'at Islam (The Position of Mazhab According to the Islamic Principles)* (Pustaka Al Husna 1984), p. 82-84. Also see Muhammad Saed Abdul-Rahman, *Islam: Questions And Answers-Schools of Thought, Religions and Sects* (MSA Publication Limited 2003); Ibn Hajar' Asqalani, *Tahdib Al-Tahdib* (published in Beirut, Dar Al-Kutub Al-Ilmiyya)

CHAPTER 3: THE ISLAMIC CORPORATE GOVERNANCE FRAMEWORK¹

3.0 Introduction

Corporate governance forms an indispensable element in the structure of any corporation. For an important institution such as a bank, a strong corporate governance framework serves as a crucial feature in maintaining the public's trust in the institution as a guardian and intermediary for the safekeeping of money and the rewarding of investment. Gradually, the concept of corporate governance has developed and begun to attract renewed attention from policymakers around the world, particularly after a series of landmark corporate failures over the last few decades. These failures included the collapse of Barings Bank in 1995, Enron, Arthur Andersen and WorldCom in 2002, Merrill Lynch, Bear Stearns and Lehmann Brothers in 2008, and the subsequent inability of major banks such as the Royal Bank of Scotland and Lloyds Banking Group to sustain themselves without government support².

As soon as the sub-prime mortgage crisis in the United States of America triggered the global financial crisis in 2008, the after-effects swiftly reached the European continent and started to take its toll on several high-profile European financial institutions. In the United Kingdom, the crisis severely hit Northern Rock and prompted the government to nationalise the bank in February 2008³. In Germany, the IKB Deutsche Industriebank became the first financial institution in the country to be rescued by a government-led bailout⁴. Sachsen LB followed suit when it was bailed out by Landesbank Baden-

¹ A major segment of this chapter was presented at the 10th International Conference on Islamic Economics and Finance on the 22-25th March 2015 in Doha, Qatar and the Islamic Finance and Law Conference 2015 on the 14-15th May 2015 in University College Dublin, Ireland.

² Kariyawasam, p. 178-181; Jerry W Markham, *A Financial History of the United States: From Enron-Era Scandals to the Subprime Crisis (2004-2006); From the Subprime Crisis to the Great Recession (2006-2009)* (Routledge 2015); John C. Coffee, 'What Went Wrong? An Initial Inquiry Into the Causes of the 2008 Financial Crisis' (2009) 9 *Journal of Corporate Law Studies* 1, p. 10; Paul H Dembinski and others, *Enron and World Finance: A Case Study in Ethics* (Springer 2006), p. 19, 143.

³ Hyun Song Shin, 'Reflections on Northern Rock: The Bank Run that Heralded the Global Financial Crisis' (2009) 23 *The Journal of Economic Perspectives* 101, p. 101-102; Jane Croft and Chris Giles, 'Fury over Rock Nationalisation' *Financial Times* (17 February 2008) <<http://www.ft.com/intl/cms/s/0/9ba3c422-dd6e-11dc-ad7e-0000779fd2ac.html#axzz3ZMHmBKdc>> accessed 28 August 2017; United Nations, *Corporate Governance in the Wake of the Financial Crisis: Selected International Views* (United Nations Conference on Trade and Development, 2010), p. 57.

⁴ Grant Kirkpatrick, 'Corporate Governance Lessons from the Financial Crisis' (2009) 2009 *OECD Journal: Financial Market Trends*, p. 81; Ivar Simensen, 'On Europe: IKB Bail-out Faces Criticism' *Financial Times* (3 August 2007) <<http://www.ft.com/intl/cms/s/0/38cad06-41e1-11dc-8328-0000779fd2ac.html#axzz3ZMHmBKdc>> accessed 15 September 2017; United Nations, p. 57, 71.

Wurttemberg, a public-sector bank⁵. In France, the crisis prompted BNP Paribas to halt withdrawals from its three investment funds after witnessing their share price plunged by almost 20 per cent in less than two weeks⁶.

Since then, the global financial crisis had exposed the Western banking industry to concerns from economists regarding its business strategies, solvency, image, reputation, and public relations⁷. In the United States, the credit crunch has brought a crisis of reputation to its banking industry with banking institutions performing worse than pharmaceutical companies, oil and gas companies, airlines, media outlets, and telecommunication firms in terms of reputation with the public⁸. Similarly, in Europe, the Eurozone sovereign debt crisis severely affected public confidence in European financial institutions⁹. After the 2008 financial crisis, the banking industry ranked as the least trusted industry globally as a result of having a poor reputation for illegal and unethical

⁵ Kirkpatrick, p. 81; Ivar Simensen, 'Sachsen LB is Bailed out as Credit Crunch Fallout Widens' *Financial Times* (Frankfurt, 18 August 2007) <<http://www.ft.com/intl/cms/s/0/9e6e71ac-4d22-11dc-a51d-0000779fd2ac.html#axzz3ZMHmBKdc>> accessed 14 September 2017; United Nations, p. 71.

⁶ Banks' shares have drastically dropped around the globe. Between January – December 2008, the banks in the US recorded losses of US\$ 423.7 billion in market value, followed by the UK at US\$ 307.1 billion. See Gert Wehinger, 'Lessons from the Financial Market Turmoil: Challenges Ahead for the Financial Industry and Policy Makers' [2008] *Financial Market Trends*, p. 4. Also see Shin, p. 102; Sebastian Boyd, 'BNP Paribas Freezes Funds as Loan Losses Roil Markets' *Bloomberg*, 10 August 2007 <<https://www.bloomberg.com/news/articles/2007-08-09/bnp-paribas-freezes-funds-as-loan-losses-roil-markets>> accessed 22 September 2017; Thomson Reuters, 'BNP Freezes \$2.2 Billion of Funds Over Subprime' Thomson Reuters, 9 August 2007 <<http://www.cnbc.com/id/20188987>> accessed 18 September 2017; CNN, 'Timeline: Banking Crisis' CNN, 16 October 2008 <http://edition.cnn.com/2008/BUSINESS/09/30/us.bailout.timeline/index.html?eref=rss_latest> accessed 22 September 2017

⁷ Rita Kottasz and Roger Bennett, 'Managing the Reputation of the Banking Industry After the Global Financial Crisis: Implications of Public Anger, Processing Depth and Retroactive Memory Interference for Public Recall of Events' [2014] *Journal of Marketing Communications* 1, p. 2. Also see Deloitte, *2014 Global Survey on Reputation Risk* (Deloitte, 2014), p. 13.

⁸ Heather Landy, 'American Banker's 2013 Survey of Bank Reputation' *American Banker* <http://www.americanbanker.com/magazine/123_7/american-bankers-2013-survey-of-bank-reputations-1060105-1.html?zkPrintable=1&nopagination=1> accessed 22 September 2017. Also see Cherie J Owen, 'Board Games: Germany's Monopoly on the Two-Tier System of Corporate Governance and Why the Post-Enron United States Would Benefit from Its Adoption' (2003) 22 *Penn St Int'l L Rev* 167, p. 167.

⁹ Emma Dunkley, 'Banks Fight to Repair Damage to Brands After Financial Crisis' *Financial Times* (27 May 2015) <<https://www.ft.com/content/bf47c4b4-ef22-11e4-87dc-00144feab7de>> accessed 17 September 2017; Erkki Liikanen, 'Europe Without Banks? The Future of Financial Sector' Keynote Speech, Alpbach Financial Market Symposium, Alpbach, 28 August 2014 <<http://www.bis.org/review/r140905a.pdf>> accessed 22 September 2017. Also see Ipsos Public Affairs, 'Reputation Snapshot for the Banking Industry' Ipsos Public Affairs <<https://www.ipsos.com/ipsos-mori/en-uk/reputation-snapshot-banking-industry>> accessed 22 September 2017, p. 4.

behaviour¹⁰. This lack of trust and public confidence prompted the financial service community to look at the concept of ethical banking, with Islamic banking touted by economists and finance experts as a suitable alternative¹¹. By 2016 and 2017, global trust in the banking industry has significantly improved but it remains the least trusted industry compared to energy, food and beverages, and technology industry¹².

However, Islamic banking is not a perfect alternative. In fact, there have been examples of corporate failures in high-profile IFIs within the last two decades including the collapse of the Islamic Bank of South Africa in 1997¹³; the demise of the Ihlas Finance House in Turkey in 2001¹⁴; the commercial losses of Bank Islam Malaysia Berhad in 2005¹⁵; and the various fraudulent cases that led to losses in the Dubai Islamic Bank between 2004 and 2007¹⁶. Additionally, the 2008 global financial meltdown affected several other IFIs

¹⁰ Edelman, *Edelman Trust Barometer Financial Services Industry Results* (2014), p. 13. Also see Hendry

¹¹ Kayed and Hassan; Lucy Williamson, 'Islamic Banks 'Better in Crisis'' BBC News, 2 March 2009 <<http://news.bbc.co.uk/2/hi/asia-pacific/7918129.stm>> accessed 21 September 2017. Also see Hussien Alasrag, 'Global Financial Crisis and Islamic Finance' [2010] Munich Personal RePEc Archive Paper, p. 3-4.

¹² Edelman, *2017 Edelman Trust Barometer Financial Services* (2017), p. 22, 23, 32, 33. It is worth noting that the global trust in banking industry also varies according to jurisdictions and other factors. For example, trust in banking industry in the UK and US is influenced by Brexit and the presidential election respectively.

¹³ The Islamic Bank of South Africa suffered from a lack of regulatory supervision, weak risk management, numerous loans to insiders, unsound management, and also a debt of between R50 – R70 million (US\$ 47 – 65 million). See Charles C Okeahalam, 'The Political Economy of Bank Failure and Supervision in the Republic of South Africa' (1998) 3 *African Journal of Political Science* 29, p. 37-38.

¹⁴ Ihlas Finance, the largest IFI in Turkey, was forced to cease operation due to financial distress and weak corporate governance framework. See Humayon Dar and Talha Ahmad Azami, *Global Islamic Finance Report (GIFR) 2012* (BMB Islamic UK Limited, 2012), p. 111; Salman Syed Ali, 'Financial Distress and Bank Failure: Lessons from Closure of Ihlas Finans in Turkey' (2007) 14 *Islamic Economic Studies*, p. 8-9.

¹⁵ The Malaysian maiden Islamic bank encountered losses totalling to US\$ 142 million in 2005 due to unsound corporate governance practices, namely inappropriate composition of its *Sharia'* board; with none of its members familiar with the banking operations, as well as a lack of sound and proper credit and debt collection policies. See Parker Mushtak, 'Scandal Hit Bank Islam Malaysia Declares Huge Losses' Arab News, 19 December 2005 <<http://www.arabnews.com/node/277580>> accessed 21 September 2017; MalaysiaKini, 'Bank Islam Losses Due to 'Weak Credit Control'' 10 July 2006 <<http://www.malaysiakini.com/news/53659>> accessed 22 September 2017

¹⁶ The Dubai Islamic Bank lost nearly US\$ 501 million due to fraud cases involving two of its former executives, who were arrested along with another 7, with analysts citing weak internal controls. See Colin Simpson, 'Dh1.8 Billion Fraud Trial That Rocked Business' The National, 1 May 2011 <<https://www.thenational.ae/uae/dh1-8-billion-fraud-trial-that-rocked-business-1.577778>> accessed 17 September 2017; Simeon Kerr, 'Seven Charged Over Alleged \$501m Dubai Fraud' Financial Times, 10 March 2009 <<https://www.ft.com/content/ba68bdaa-0cd3-11de-a555-0000779fd2ac>> accessed 22

such as the Kuwait Finance House, Al-Rajhi Bank, Al-Hilal Bank, and the Noor Islamic Bank of the United Arab Emirates, which prompted a bailout from the Emirate of Abu Dhabi when the crisis began affecting the Dubai government¹⁷.

However, these cases only represented a small fraction of the larger Islamic banking industry that had remained unaffected by the financial crisis. This resilience was due to two crucial ingredients of the Islamic banking system¹⁸. First, the strong foundation of Islamic banking that prohibits, *inter alia*, the involvement of IFIs in interest-bearing and speculative financial instruments. For instance, the IFIs could not hold assets such as a credit derivative swap ('CDS') or collateralised debt obligation ('CDO') because such assets do not comply with *Sharia'* law. Second, the unique feature of the Islamic corporate governance system, which this chapter will explain, shielded the majority of the IFIs from the aftermath of the financial crisis in 2008¹⁹.

In brief, this chapter focuses on examining the concept of corporate governance under the *Sharia'* law and its distinguishing features from the Western corporate governance concept based on their respective theological, ideological and corporate culture orientations. Accordingly, the chapter is divided into three segments. The first will explain the philosophy of Islamic corporate governance, particularly the influence of *Tawheed* (Islamic monotheism or unity of God), and the institution of *Hisbah* in the formulation of modern Islamic corporate governance. The second will look at the Islamic corporate governance framework of the IFIs and analyse the divergent roles played by each corporate organ in ensuring an optimum level of *Sharia'* compliance. Finally, the third will explain the comparative features of the different Islamic corporate governance

September 2017. Also see Michelle Walton, 'Can a Financial Crisis Occur Under the Rules of Islamic Finance' (2011) 15 RPOS 499Z: Honors Thesis, December 2, p. 17-22.

¹⁷ Walton Dana El Baltaji and Soraya Permatasari, 'Dubai Crisis Prompts Sukuk Holders to Seek Asset Rights: Islamic Finance' Bloomberg, 13 July 2010 <<http://www.bloomberg.com/news/2010-07-13/dubai-crisis-prompts-sukuk-holders-to-seek-asset-rights-islamic-finance.html>> accessed 22 September 2017

¹⁸ Sabur Mollah and others, 'The Governance, Risk-Taking, and Performance of Islamic Banks' (2017) 51 Journal of Financial Services Research 195, p. 198; Habib Ahmed, 'Financial Crisis, Risks and Lessons for Islamic Finance' (2009) 1 ISRA International Journal of Islamic Finance 7, p. 18.

¹⁹ Kayed and Hassan; Mollah Sabur and Karim Wares, 'Does Corporate Governance Model of Interest-free Banks Provide Better Protection Against Financial Crisis? Empirical Investigation on Corporate Governance Perspectives of the Interest-Free Banks Globally' (8th International Conference on Islamic Economics and Finance, Doha, 19-21 December 2011), p. 3-4. Also see Adel Ahmed, 'Global Financial Crisis: An Islamic Finance Perspective' (2010) 3 International Journal of Islamic and Middle Eastern Finance and Management 306, p. 307.

models adopted by the IFIs around the world, namely the international standards system, the centralised system, and the de-centralised system.

3.1 Epistemology of Islamic Corporate Governance

3.1.1 Definition of Islamic Corporate Governance

In the presence of different corporate governance models around the world²⁰, it is impractical to confine corporate governance to a single definition. From a terminological perspective, corporate governance originates from a combination of the Latin word of '*corporatus*' (a group of people authorised by the law to act as a single entity) and the Greek word of '*kubernan*' (to steer)²¹. Technically, it points to the way an organisation is administered, controlled, and directed. In the context of a company, corporate governance refers to the exercise of control by shareholders over the company's managers in order to ensure that their actions and decisions reflect the objectives and interests of the shareholders²². According to the Organisation for Economic Co-operation and Development ('OECD'), corporate governance is further understood as:

²⁰ There exist a number of corporate governance models, including the Anglo-Saxon model, German model, Latin model, Confucian model, Japanese model, and Islamic model. For the purpose of this study, the term 'Western corporate governance' will refer to the Anglo-Saxon and the German corporate governance models due to their predominant application in the Western world. See Esfandiar Malekian and Abbas Ali Daryaei, 'Islamic Values Forward into Better Corporate Governance Systems' (International Conference on Business and Economic Research, Kuala Lumpur, 26-28 November), p. 4-6. Also see T. Clarke and D. Branson, *The SAGE Handbook of Corporate Governance* (SAGE Publications 2012), p. 392-393.

²¹ See the definition of 'govern' in T.H. Hoad (ed), *The Concise Oxford Dictionary of English Etymology* (Oxford University Press 2003). Also see A.L. Dempsey, *Evolutions in Corporate Governance: Towards an Ethical Framework for Business Conduct* (Greenleaf Publishing Limited 2013), p. 10; S. Perera, *Corporate Ownership and Control: Corporate Governance and Economic Development in Sri Lanka* (World Scientific Pub. 2011), p. 27; A.S. Hornby and J. Turnbull, *Oxford Advanced Learner's Dictionary* (Oxford University Press 2010)

²² Luc Laeven and Lev Ratnovski, 'Corporate Governance Alone Won't Prevent the Next Banking Crisis' World Economic Forum, 25 July 2014 <<https://www.weforum.org/agenda/2014/07/corporate-governance-banks-financial-stability/>> accessed 20 September 2017; Shuangge Wen, *Shareholder Primacy and Corporate Governance: Legal Aspects, Practices and Future Directions* (Routledge 2013), p. 216; Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance*, vol 1 (Gee 1992), p. 15.

“A set of relationship between a company’s management, its board, its shareholders and other stakeholders (through which) the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”²³.

From the banking aspect, the Basel Committee for Banking Supervision (‘BCBS’) has defined corporate governance as *“the manner in which the business affairs of individual institutions are governed by their board of directors (‘BOD’) and senior management affecting how a bank sets its corporate objective, daily business, interest of the stakeholder, to align corporate activities in a safe and sound manner and to comply with the laws and regulations, and to protect the interest of depositors”²⁴*. Here, it is arguable that the scope of corporate governance from the financial industry context covers a more diversified group of stakeholders such as the employees, depositors, suppliers, customers, supervisors, government, and the society.

From the Islamic banking viewpoint, there is no precise definition of corporate governance – at least prior to the introduction of the IFSB guidelines. Based on these guidelines, the scope of Islamic corporate governance differs from the Western corporate governance in the sense that the Islamic version stresses the attainment of a specific objective, which not only mandates the safeguarding of the stakeholders’ interest, but also an overall compliance of the IFI’s products and operations with the fundamental precepts of *Sharia’* law.

According to the IFSB-3, Islamic corporate governance is defined as *“a set of relationship between a company’s management, its BOD, its shareholders and other stakeholders that provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”*. It continues to explain that this system must encompass *“a set of organisational arrangements whereby the actions of the management of IFI are aligned, as far as possible, with the interest of its stakeholders; provision of proper incentives for the organs of governance such as the BOD, Sharia’ board and management to pursue objectives that are in the interest of the stakeholders and facilitate effective monitoring,*

²³ Organisation for Economic Co-operation Development, *OECD Principles of Corporate Governance 2004* (OECD Publishing 2004). Also see G. Aras and D. Crowther, *Global Perspectives on Corporate Governance and CSR* (Taylor & Francis 2016), p. 164.

²⁴ Principles for Enhancing Corporate Governance, p. 5-6. Also see Zeti Akhtar Aziz, ‘Special Address’ (2nd Seminar for Central Banks and Monetary Agencies on AAOIFI’s Accounting Standards, Kuala Lumpur, 29 May 2002) <http://www.bnm.gov.my/index.php?ch=en_speech&pg=en_speech&ac=124&lang=en> accessed 22 September 2017

*thereby encouraging IFI to use resources more efficiently; and compliance with Islamic Sharia' rules and principles*²⁵. Then, IFSB-10 moves to distinguish the concept of Islamic corporate governance from the Western corporate governance by highlighting the unique aspect of *Sharia'* compliance of Islamic banking – “*the set of institutional and organisational arrangements through which an IFI ensures that there is an effective independent oversight of Sharia' compliance*”²⁶.

Comparatively, both the OECD and BCBS provide broad-yet-clear perspectives of corporate governance in their terms while the IFSB narrows the context to fit the specificities of Islamic banking. However, the definition of corporate governance offered by the IFSB remains in need of a significant upgrade to reflect both the universal and specific nature of Islamic banking. Islamic banking is not a financial system that merely seeks to ensure the compliance of all financial products, services, and operations of the IFIs with the tenets of the *Sharia'* law. It is also one that aspires to advance the socio-economic status of the society without prejudice to the non-Muslims community. Although the ‘compliance with the *Sharia'* law’ is the only difference in the Islamic version of corporate governance, the lack of universality element in the IFSB’s interpretation of corporate governance can lead non-Muslims to perceive Islamic banking as a system exclusive to the Muslims only – thus belittling its actual concept of an ethical and universal financial system.

In this regard, the thesis offers an improved definition of the Islamic concept of corporate governance, which will refine the scope of its current objectives to include a broader concept of societal accountability that befit the universal and egalitarian nature of Islam – “*a set of policies' arrangements that dictates how an IFI is managed, operated and controlled through governance structures that: guarantee transparency and full compliance of the IFI's objectives and business interest with the rules of Sharia' law; protects the best interest of all stakeholders; and promotes financial activities that improve the socio-economic status within society regardless of religious-orientation*”.

²⁵ Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 27. Although the *Sharia'* board is also known as the *Sharia'* Council, *Sharia'* Supervisory Board, *Sharia'* Control Committee, *Sharia'* Council and Religious Committee, *Sharia'* Controller, and the *Sharia'* Control Board, this thesis prefers to use the term *Sharia'* board for the purpose of consistency. See Rihab Grassa, ‘Shariah Supervisory System in Islamic Financial Institutions New Issues and Challenges: A Comparative Analysis between Southeast Asia Models and GCC Models’ (2013) 29 Humanomics 333, p. 344.

²⁶ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 2.

3.1.2 Origin of Islamic Corporate Governance – the Institution of *Hisbah*

As notes, prior to the last two decades, the concept of corporate governance was relatively new to the Islamic banking industry. In fact, there neither exists a specific Arabic phrase that connotes the term ‘corporate governance’ nor a literature that could point to the exact origin of corporate governance in Islam²⁷. However, it is arguable that the concept of corporate governance is evident within the *Sharia*’ legal principle of *Siyasa Al-Sharia*’, which refers to the act of governing the subject necessary to the community such as, *inter alia*, security, market regulation, taxes, and public security, in accordance with the *Sharia*’ law²⁸. This principle conforms with several Quranic verses which stress the need for good governance and constructive collaboration between the authorities such as the state or a company, and the subjects such as the shareholders or other stakeholders, otherwise known as *Hisbah*.

“Let there arise out of you a band of people inviting to all that is good, enjoining what is right, and forbidding what is wrong: They are the ones to attain felicity”.

(*Surah Ali Imran* 3: 104)

“The believers, men and women, are protectors one of another: They enjoin what is just, and forbid what is evil...”

(*Surah At-Taubah* 9: 71)

“...Help ye one another in righteousness and piety, but help ye not one another in sin and rancour: fear God: for God is strict in punishment”.

(*Surah Al-Ma’idah* 5: 2)

In general, *Hisbah* refers to the practice of a group of individuals, who invite the public to do good deeds and avoid the forbidden matters as set down by the *Sharia*’ law²⁹.

²⁷ Abu-Tapanjeh, p. 561. Also see Mervyn K Lewis, ‘Islamic Corporate Governance’ (2005) 9 Review of Islamic Economics 5, p. 5.

²⁸ Asifa Quraishi-Landes, ‘The Sharia Problem with Sharia Legislation’ (2015) 41 Ohio Northern University Law Review 545, p. 550-552; Al-Qudsy, Rahman and Zain, p. 470.

²⁹ The prominent *Sharia*’ jurist, Ibn Al-Qayyim Al-Jawziya had stressed the religious value of good governance from his perspective as, “God sent His message and His Books to lead people with justice ... Therefore, if a just leadership is established, through any means, then therein is the Way of God”. See Ibn Qayyim Al-Jawziyah, *’Ilam Al-Muwaqqi’in ’An Rabb Al-Alamin (Informing the Drafters of Legal Documents About the Lord of All Beings)* (Muhammad ibn Abd Bakr tr, Al-Maktabah Al-’Ilmiyyah 1991). Also see Sami Hamarneh, ‘Origin and Functions of the *Hisbah* System in Islam and its Impact on the Health Professions’ (1964) 48 Sudhoffs Archiv für Geschichte der Medizin und der Naturwissenschaften 157 Ibn Taimiyyah,

Accordingly, the Prophet Muhammad (p.b.u.h.) was himself the first *Muhtasib* (enforcement officer), who initiated the practice of *Hisbah* in the history of Islam³⁰. This corresponds to the following *Hadith* narrated by Abu Hurairah:

*The Messenger of God (p.b.u.h.) passed by a pile of food. He put his fingers in it and felt wetness. He said, "O owner of the food! What is this?" He replied, "It was rained upon O Messenger of God." He said, "Why not put it on top of the food so people can see it?" Then he said, "Whoever cheats, he is not one of us"*³¹.

In simple words, *Hisbah* involves the practice of surveillance by the *Muhtasibs* in enforcing the implementation of *Sharia'* law and Islamic ethical values in all aspects of the community's daily conduct. This would include prayer, fasting, municipal administration, and fair-market practices³². In the latter, the *Muhtasib* is responsible to inspect the *bazaar* (daily market) and ensure the *Sharia'* compliance of the business transactions executed therein such as ensuring the use of proper weight and measures, promoting a free-market economy and fair-trading rules, and preventing frauds, illegal contracts and the hoarding of necessities³³. Additionally, it is also important to note that *Hisbah* cannot be executed arbitrarily and in disregard of the rights of the general public such as the right to privacy or the right to property, on the pretext of preventing the occurrence of *Sharia'* non-compliant events³⁴.

Al-Hisbah Fil Islam (Hisbah in Islam) (Dar Al-Kutub Al-Arabiyyah, Cairo 1967) Nicola Ziadeh, *Al-Hisbah Wa'l Muhtasib Fi'l Islam (Public Duties of the Muhtasib in Islam)* (Catholic Press 1963)

³⁰ Bassam Abu Al-Foul and Mohamed Soliman, 'The Economic Role of the State in the Classical Islamic Literature: The Views of Ibn Taimiyah' (2006) 15 *Digest of Middle East Studies* 1, p. 8; Zulfaqar Mamat, 'Institusi Hisbah dan Peranannya dalam Mengawal Kegiatan Ekonomi Negara Islam (The Institution of Hisbah and Its Role in the Governance of Economic Activities in an Islamic Country)' [2010] *Jurnal Muamalat* 113, p. 115.

³¹ This *Hadith* is *Sahih*. See Vol. 3, Book 12, *Hadith* 1315 of Al-Tirmidhi

³² Fauzan Saleh, 'The Institution of Hisbah: Its Roles in Nurturing Fair and Just Economic System in Islam' (National Conference on Islamic Economics 2009, Kuala Lumpur, February 10-11), p. 3. Also see Al-Foul and Soliman, p. 8.

³³ In this situation, the *Muhtasib* is also referred to as *Sahib Al-Suq* (market supervisor) or *Al-Amil fi Al-Suq* (market officer). See Abu-Tapanjeh, p. 563; Taimiyyah, p. 12-15. Also see Mamat, p. 118-131.

³⁴ The limited nature of the *Muhtasib's* authority was highlighted in an incident during the reign of Umar Al-Khattab, when the caliph demolished a house to expose and humiliate the members of the household, who were consuming *Khamr* (intoxicated drinks). However, they argued that Umar's actions were far more erroneous than what they had committed based on the Quranic injunctions that forbid a Muslim from entering a house without the owner's permission. Upon realising his mistake, Umar immediately regretted his hasty decision and asked for their forgiveness. See A.M. `Aqqad, *`Abqariyyat `Umar (The*

Soon, the practice of *Hisbah* was followed and enforced by the many companions of the Prophet Muhammad (p.b.u.h.) such as the first and second caliphs of Islam – Caliph Abu Bakr As-Siddiq and Umar Al-Khattab respectively³⁵. The latter was particularly renowned for personally patrolling the streets for the purposes of obtaining a better picture of the condition of his people and preventing crimes³⁶. Inadvertently, Umar's practice extended the application of *Hisbah* to include the prevention of criminal offences leading to the formation of the first police institution in Islam and the development of *Fiqh Al-Jinayat* (Islamic criminal law).

Moreover, the appointment of a *Muhtasib* was not limited to men but had also included women such as Sayyidah Ash Shifa' and Samra' binti Nuhaik Al-Asadiyah, who were both appointed as *Muhtasibs* by Umar in Madinah³⁷. By the early of the Abbasides period (750 CE onwards), *Hisbah* underwent a unique development under Caliph Abu Jaafar Al-Mansur as a result of the establishment of a special office entrusted with the sole objective of aligning the public's daily conducts in accordance with the Quranic injunction of *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil)³⁸.

Relatively, the exemplary leadership of Umar Al-Khattab highlighted the gravity of responsibilities of a *Muhtasib*. During one of his night patrols, he encountered a woman, who was cooking while her children were weeping beside her. Umar asked the reason for their weeping and the woman replied that they were hungry and she was only boiling water in the pot to raise false hopes; hoping the children would fall asleep. Although she was suffering great hardship, the woman did not blame the caliph but said that only God would decide whether the caliph was accountable for the people's sufferings. Hearing

Genius of Umar) (Dar Al-Ma'arif 1976), p. 140. Also see (*Surah Al-Hujraat* 49:12), (*Surah Al-Baqarah* 2:189), and (*Surah An-Nur* 24:7) of Ali

³⁵ Ali bin Hasan Al-Qarni, *Al-Hisbah Fi'l Madi Wa'l Hadir (Hisbah in the Past and Present)*, vol 2 (published in Riyadh, Maktabah Al-Rushd, Riyadh 1994), p. 499-521; Taimiyyah

³⁶ Musthafa Murad, *Kisah Hidup Umar Ibn Khattab (The Life Story of Umar Ibn Khattab)* (published in Jakarta, Dar Al-Fajr 2007), p. 11-12; Muhammad Hashim Kamali, 'Siyasah Al-Shariyah (The Policies of Islamic Government)' (1989) 1 IIUM Law Journal 139

³⁷ Mamat, p. 115; 'Athiyah Musthafa Mushrifah, *Al-Qadha Fi Al-Islam (The Jurisdiction of Islam)* (published in Beirut, Dar Ash-Sharq Al-Ausat 1966), p. 181.

³⁸ This office was segregated from the rest of the government's offices to ensure its independency from the influence of politicians. See Mamat, p. 115. Also see Lewis, p. 17; Abdul Azim Islahi, 'Works on Market Supervision and Shar'iyah Governance (al-hisbah wa al-siyasah al-shar'iyah) by the Sixteenth Century Scholars' [2006] The University Library of Munich, p. 2.

this, Umar immediately went to the *Baitul-Mal* (treasury), took a bag of flour, rushed to her house and started the fire. When the food was prepared and the children fell asleep after eating it, Umar went home and frequently uttered the woman's sentence, "Only God would decide the accountability of Umar towards his people". Another narration reported that Umar's concept of responsibility in *Hisbah* was so vast that he had said, "If there dies an animal because of starvation within the boundaries of an Islamic state, I will have to be answerable to God. If there dies a camel helplessly on the bank of the Euphrates, I fear that God will question me for that"³⁹. Hence, the above connotes the enormous responsibilities of a *Muhtasib*, who is not only accountable to the society, but also to the Almighty God.

As far as its relevancy to Islamic banking is concerned, *Hisbah* serves as an integral check-and-balance mechanism for the banking industry, especially in cognisance of the paramount importance placed by the industry on *Sharia'* compliance in the IFIs' financial activities. In modern Islamic banking practices, the role of *Hisbah* is assumed by the *Sharia'* board, whose duties include, *inter alia*, the supervision of the IFI's financial activities in ensuring their full compliance with the *Sharia'* law⁴⁰. Nonetheless, it is arguable that the responsibilities of a *Muhtasib* do not suit a supervisory body such as the *Sharia'* board as in most circumstances, the *Hisbah* institution normally lies under the jurisdiction of the state rather than the IFIs. With the *Muhtasibs* being paid by the state, which also remains independent from any direct connection with the industry, this approach can prevent the *Sharia'* board members from behaving in a manner inconsistent with the spirit of the *Sharia'* law and the interests of the stakeholders.

There are also concerns over the issue of potential bias of the *Muhtasibs* towards the state. However, the Holy Quran and the *Sunnah* rebutted any such presumption and emphasised that the chief objective of *Hisbah*, namely the *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil), is to prevent the exploitation of power by the state and the misconduct of the *Muhtasibs* before the people. Further, Sheikh Muhammad Abduh, a prominent Egyptian *Sharia'* jurist, asserted that *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* is a mandatory obligation for all Muslims to treat

³⁹ Aqeel Ahmad Qureshi and Mehmood Sultan Khokhar, 'Islamic Concept of Support and Financial Care' (2012) 7 Dialogue 36, p. 46; Saeed M Mohtsham, 'Vision and Visionary Leadership An Islamic Perspective' (2007) 3 International Review of Business Research Papers 248, p. 258-259. Also see Ibn Sa'd, *Al-Tabaqāt Al-Kubrā*, vol 3 (published in Beirut, Dar Sadir 1988), p. 305.

⁴⁰ Governance Standard for Islamic Financial Institutions. Also see Ahmed Muhammad Abd Al-Aziz Najjar and others, *One Hundred Questions & One Hundred Answers Concerning Islamic Banks* (International Association of Islamic Banks, Jeddah 1980)

everyone alike regardless of their social standings in the community⁴¹. This corroborates the following *Hadith* described by Abu Sa'id Al-Khudri:

“The Prophet Muhammad (p.b.u.h.) said, ‘The best Jihad (effort) in the path of God is speaking a word of justice (even) to an oppressive ruler’⁴².

Hence, in the attempt to promote a better transparency in the practice of *Hisbah* within the IFIs, the banking industry may want to consider the formation of a specific *Hisbah* institution dedicated to Islamic banking, which is placed under the state's jurisdiction or an independent body that possesses industrial links with the key players of the Islamic banking industry. The latter players would include predominantly the AAOIFI and the IFSB described later in this chapter⁴³. Accordingly, the proposed institution will not only provide the market players with an independent authority for the issuance of Islamic banking *Fatwas* (*Sharia'* opinions), but it will also serve as a platform to harmonise at a global level the differences in *Sharia'* opinions among the different schools of Islamic jurisprudence *via* a systematic collection and clarification of ambiguous Islamic banking *Fatwas* (*Sharia'* opinions). Eventually, this will assist in mitigating potential *Sharia'* non-compliance risks and market confusion as a result of the diversity of *Sharia'* opinions in *Sharia'* law. A later part of this chapter will discuss the benefits, roles and functions of such an institution to the development of the Islamic banking industry⁴⁴.

3.1.3 Islamic Corporate Governance v. Western Corporate Governance

3.1.3.1 Theoretical Foundations

From a general perspective, there are three features that can distinguish the Western corporate governance system, which is represented by the dominant Anglo-Saxon⁴⁵ and

⁴¹ T.M. Asy-Syawi, *Syura Bukan Demokrasi (Shura ain't Democracy)* (Gema Insani Press 1997), p. 88; Rashid Rida and Ibrahim Shams Al-Din, *Tafsir Al-Qur'an Al-Hakim*, vol IV (Ibrahim Shams Al-Din ed, published in Beirut, Dar Al-Kutub Al-'Ilmiyya 1999)

⁴² This *Hadith* is *Sahih*. See Book 38, *Hadith* 4330 of Dawud and Ibn Al-Ashcath. Narrated as *Hasan* in Vol. 4, Book 7, *Hadith* 2174 of Al-Tirmidhi

⁴³ See discussion on the AAOIFI and the IFSB at p. 115-124.

⁴⁴ See discussion on *Ikhtilaf Fi Al-Fuqaha* at p. 134-148.

⁴⁵ Although the Anglo-Saxon model is predominantly practised in the United States, Ireland and the United Kingdom, it is also adopted by other countries such as Canada, Australia, New Zealand, South Africa and the majority of South East Asia countries such as Malaysia, Philippines, and Singapore. See A.C. Fernando, *Corporate Governance: Principles, Policies and Practices* (Pearson Education 2009), p. 54;

the German models⁴⁶, from the Islamic corporate governance system. The first differentiating factor lies in the theoretical foundation that has played an important role in the existence of both of these systems. While agency theory and stakeholder's theory formed the foundation of the Western corporate governance system, the Islamic corporate governance system grounded itself on a stewardship theory model⁴⁷. According to the agency theory, which is based on the rationale that a person will always choose a decision that optimises his or her economic interest, the Anglo-Saxon corporate governance model concentrates more on profit maximisation and the protection of shareholders' rights and interests than on the interests of other stakeholders⁴⁸. As the agent of the shareholders, the BOD is responsible to preserve and enhance the shareholders' wealth by engaging in business activities deemed beneficial to the shareholders and acting as a mediating authority that synchronises the management's decisions and conducts with shareholders' profit-maximisation ambition⁴⁹. In other words, the corporate governance approach advocated by the Anglo-Saxon model is narrow in its scope as it might be said to ignore the influence of the external environment within which the company exists that can also influence its success.

On the other hand, the stakeholder theory places a significant emphasis on the objectives and interests of the other stakeholders such as the employees, creditors, suppliers, community, and the environment and calls on the company to consolidate them in its

Zulkifli Hasan, 'Corporate Governance: Western and Islamic Perspectives' (2009) 5 *International Review of Business Research Papers* 277, p. 5-6; Y. Luo, *Global Dimensions of Corporate Governance* (Blackwell Pub. 2007), p. 36.

⁴⁶ On the other hand, the German model, which is also known as the Continental European model, is adopted by the majority of European countries such as Germany, Holland, Greece, and to an extent, France. See Marilyn Ong Siew Ai, *Corporate Governance In Islamic Banking And Financial Institutions: Islamization Trend and Issues* (FEB Working Paper Series No 1008, 2010), p. 15; Fernando, p. 54.

⁴⁷ Zafar Iqbal and Mervyn Lewis, *An Islamic Perspective on Governance* (Edward Elgar Publishing 2009), p. 272; Maliah Sulaiman, Norakma Abd Majid and Noraini Mohd Arifin, 'Corporate Governance of Islamic Financial Institutions in Malaysia' (2015) 8 *Asian Journal of Business and Accounting* 65, p. 74.

⁴⁸ Andrew West, 'Corporate Governance Convergence and Moral Relativism' (2009) 17 *Corporate Governance: An International Review* 107, p. 110; Perera, p. 28.

⁴⁹ R. Muller and D.B.A.M.B.A.P. Ralf Muller, *Governance and Governmentality for Projects: Enablers, Practices, and Consequences* (Taylor & Francis 2016), p. 27-28; S. Boubaker, B.D. Nguyen and K. Nguyen, *Corporate Governance: Recent Developments and New Trends* (Springer Berlin Heidelberg 2012), p. 417; Luh Luh Lan and Loizos Heracleous, 'Rethinking Agency Theory: The View from Law' (2010) 35 *Academy of Management Review* 294, p. 297, 298; M Blair and L Stout, 'Corporate Accountability: Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 *Washington Law Review* 403, p. 404.

decision-making and future planning⁵⁰. Proponents of stakeholder theory claim that a company's activities have direct and indirect effects on the external environment within which it operates, thus rendering the company responsible to a wider audience than its shareholders⁵¹. Accordingly, the BOD and the management team must ensure that the corporate governance structure of the company reflects its commitment to safeguard and enhance interests of a wider constituents of stakeholders⁵². The theory does not change the roles and functions of the BOD but merely expands them, which now must respond to the needs and interests of the other stakeholders⁵³. Likewise, the essence of the theory does not necessarily call for directors to abandon or leave the pursuit of shareholders' profit maximisation in limbo as it remains possible for directors to satisfy the interests of a wider stakeholder constituents whilst striving to maximise shareholders' value at the same time⁵⁴.

By comparison, the stewardship theory, which underlines the foundation of the Islamic corporate governance system, regards the IFI's management, namely the BOD and the *Sharia'* board, as stewards, who shoulder the responsibility to lead the IFI towards achieving the business goals of the company that correspond to the tenets of the *Sharia'* law⁵⁵. From this perspective, it is reasonable to suggest that the Islamic corporate

⁵⁰ R.E. Freeman and others, *Stakeholder Theory: The State of the Art* (Cambridge University Press 2010), p. 170; Silvia Ayuso, Miguel Angel Rodriguez and Roberto Garcia, *Responsible Corporate Governance: Towards a Stakeholder Board of Directors?* (IESE Business School, University of Navarra, Working Paper WP No 701 July 2007, 2007), p. 2; Dante Mendes Aldrighi, 'Corporate Governance in Germany: An Assessment of the Convergence Hypothesis' (2000) 30 *Estudos Econômicos* 51, p. 71. Also see West, p. 108.

⁵¹ Wan Fauziah Wan Yusoff and Idris Adamu Alhaji, 'Insight of Corporate Governance Theories' (2012) 1 *Journal of Business & Management* 52, p. 55; Eva Jansson, 'The Stakeholder Model: The Influence of the Ownership and Governance Structures' (2005) 56 *Journal of Business Ethics* 1, p. 5. Also see A.C. Fernando, *Business Environment* (Pearson 2011), p. 279.

⁵² For example, the BOD can consider appointing a representative of non-shareholder stakeholders as a director or creating a committee comprises mainly of stakeholder representatives dedicated to corporate social responsibility. See A. Klettner, *Corporate Governance Regulation: The Changing Roles and Responsibilities of Boards of Directors* (Taylor & Francis 2016), p. 49; Lan and Heracleous, p. 298; Ayuso, Rodriguez and Garcia, p. 4; J Kaler, 'Evaluating Stakeholder Theory' (2006) 69 *Journal of Business Ethics* 249, p. 256.

⁵³ Klettner, p. 49; S Marshall and I Ramsay, 'Stakeholders and Directors' Duties: Law, Theory and Evidence' (2012) 35 *University of New South Wales Law Journal* 291, p. 295.

⁵⁴ Ayuso, Rodriguez and Garcia, p. 4; Kaler, p. 256.

⁵⁵ Ahcene Lahsasna, *Introduction to Fatwa, Shariah Supervision & Governance in Islamic Finance* (CERT Publications 2011), p. 9; Maria Bhatti and Ishaq Bhatti, 'Development in Legal Issues of Corporate Governance in Islamic Finance' (2009) 25 *Journal of Economic and Administrative Sciences* 67 Lahsasna, p. 72-73. Also see "O ye wo believe! Obey God, and obey the Messenger, and those charged with authority

governance system shares similarities with the German model in the sense that both cater to a much larger audience comprising both shareholders and other stakeholders such as the general public and the environment⁵⁶. This altruistic approach corresponds to the *Sharia'* principle of *Maqasid As-Sharia'*, which calls for companies to refrain from placing too much emphasis on the profit-maximisation of their shareholders neglecting the rights and interests of other stakeholders such as those of the God, the religion, and the society⁵⁷. Instead, companies must seek to strike a balance between the shareholders and stakeholders' interests and ensure that everyone involved in the business operations and endeavours of the companies can perform their responsibilities to their best abilities. Ultimately, Muslims believe that this staunch corporate probity not only enhances the company's goodwill as a socially responsible entity, but also invites the blessings of God that will pave the way to the company's success, both in this world and the Hereafter⁵⁸.

3.1.3.2 Corporate Culture – Collectivism v. Individualism

The second feature that differentiates Islamic corporate governance from the Western model rests within their respective corporate culture or emphasis. In the Anglo-Saxon model, the generation of profits and the maximisation of the shareholders' interests serve as the primary objectives of the company and hold primacy over the interests of other

among you. If you differ in anything among yourselves, refer it to God and His Messenger, if ye do believe in God and the Last Day: that is best, and most suitable for final determination" (Surah Al-Nisa' 4:59) of Ali

⁵⁶ Accounting, Auditing, and Governance Standards as at December 2015, p. 949; Shamsheer Mohamad, Zulkarnain Muhamad Sori and Mohamed Eskandar Shah, 'Shariah Governance: Effectiveness of Shariah Committees in Islamic Banks in Malaysia' Mohamed Eskandar, Shariah Governance: Effectiveness of Shariah Committees in Islamic Banks in Malaysia (January 25, 2015), p. 2-3; Malik M. Hafeez, 'An Analysis of Corporate Governance in Islamic and Western Perspectives' (2013) 2 International Journal of Business, Economics and Law, p. 98-100. Also see Maliah Sulaiman, Norakma Abd Majid and Noraini Mohd Ariffin, 'Corporate Governance of Islamic Financial Institutions in Malaysia' (8th International Conference on Islamic Economics and Finance, Doha, 19-21 December 2011), p. 6.

⁵⁷ *"So he who gives (in charity) and fears (God), and (in all sincerity) testifies to the best – We will indeed make smooth for him the path to Bliss. But he who is a greedy miser and thinks himself sufficient, and gives the lie to the best – We will indeed make smooth for him the path to misery; Nor will his wealth profit him when he falls headlong (into the Pit)" (Surah Al-Layl 92:5-11) of Ali.*

⁵⁸ *"... And for those who fear God, He (ever) prepares a way out. And He provides for him (or her) from (sources) he never could imagine. And if anyone puts his trust in God, sufficient is (God) for him" (Surah Al-Talaq 65:2-3) of ibid. Also see Al-Jawziyah*

stakeholders⁵⁹. By contrast, the German model treats the interests of every stakeholder as equal and as significant as those of the shareholders due to their intrinsic values and substantial influence on the performance and sustainability of the company. To put it simply, the German model places a profound focus on the collective interest of a wider range of stakeholders and tends to foster a more societal influence than the Anglo-Saxon model⁶⁰.

An agency problem arises when the stakeholders' interests clash with those of the company's shareholders and its management causing a 'whom-do-you-protect first' dilemma for the management⁶¹. Since the publication of Berle and Means' seminal text *The Modern Corporation and Private Property* in 1932⁶², corporate governance scholars and economists have viewed the Anglo-Saxon model as a weak corporate governance system because it does not effectively address the agency problem. This is the case even in the presence of several attempts to reconcile the interests of the shareholders with those of the stakeholders, because the eventual goal of a company which adopts the Anglo-Saxon model remains the maximisation of the shareholder's wealth⁶³. By contrast, the German model provides a better and more equitable alternative that balances the interests of the shareholders with those of the stakeholders⁶⁴. This is due to the fact that stakeholder theory not only mandates the company's management to maximise the value of the company as a whole by taking into account the interests of a

⁵⁹ Frederick V Perry, 'The Corporate Governance of Islamic Banks: A Better Way of Doing Business' (2010) 19 Mich St U Coll LJ Int'l L 251, p. 256. Also see Lucian Cernat, 'The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?' (2004) 11 Journal of European Public Policy 147, p. 150; Iqbal and Lewis, p. 272.

⁶⁰ Eric Engle and Tetiana Danyliuk, 'Emulating the German Two-tier Board and Worker Participation in U.S. Law: A Stakeholder Theory of the Firm' (2015) 45 Golden Gate University Law Review 69, p. 99; Karim and Archer, chapter 21. Also see Christine A. Mallin, *Corporate Governance* (published in Oxford, 2nd edn, Oxford University Press 2007), p. 16.

⁶¹ Douglas A Bosse and Robert A Phillips, 'Agency Theory and Bounded Self-interest' (2016) 41 Academy of Management Review 276, p. 276; Perry, p. 256.

⁶² Adolf A Berle and Gardiner C Means, *The Modern Corporation and Private Property* (published in New York, Commerce Clearing House 1932)

⁶³ Jonathan R Macey and Geoffrey P Miller, 'Universal Banks are not the Answer to America's Corporate Governance "Problem": A Look at Germany, Japan and the U.S.' in Joel M. Stern and Donald H. Chew Jr. (eds), *The Revolution in Corporate Finance*, vol 4 (Blackwell Publishing 2004). Also see Ronald Philip Dore, *Stock Market Capitalism: Welfare Capitalism: Japan and Germany versus the Anglo-Saxons* (Oxford University Press 2000), p. 71-94; Hampel Committee, *Committee on Corporate Governance (Final Report)* (January 1998 edn, The Committee on Corporate Governance and Gee Publishing Ltd 1998), p. 12.

⁶⁴ Mallin, p. 16; Engle and Danyliuk, p. 100.

wider range of constituents such as the general public, but it also allows these stakeholders to participate in corporate decisions⁶⁵.

On the other hand, the Islamic corporate governance system seeks to promote the alignment of the economic interest of the company, its shareholders, and the other stakeholders with the principles of the *Sharia'* law⁶⁶. In the Islamic banking environment, the system calls for the IFIs to place the interest of the stakeholders on the same footing as those of the shareholders with *Sharia'* law acting as the fulcrum that bridges the two⁶⁷. In fact, it is important to note that Islamic banking neither aims to provide a direct financing competitor to the Western banking system, nor to serve as a financing tool for the IFIs to generate profit; rather, it aspires to function as a society-oriented financing proposition⁶⁸ (see **Figure 5**).

<i>Characteristics of Vision, Mission, and Objective (VMO)</i>	<i>IFIs</i>	<i>Non-IFIs</i>
<i>Foundation</i>	<i>Tawheed</i> ⁶⁹	Secularism
<i>Motivation</i>	Worldly and hereafter	Worldly

⁶⁵ Zamir Iqbal and Abbas Mirakhor, 'Stakeholders Model of Governance in Islamic Economic System' (2004) 11 *Islamic Economic Studies*, p. 46, Silvia Ayuso, Miguel Angel Rodriguez and Roberto Garcia, *Maximising Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance* (IESE Business School, University of Navarra, Working Paper WP No 67 January 2007, 2007), p. 3; Antonio Argondana, 'The Stakeholder Theory and the Common Good' (1998) 17 *Journal of Business Ethics* 1093, p. 1097.

⁶⁶ Accounting, Auditing, and Governance Standards as at December 2015, p. 953; Mohammed Alsanosi, 'The Concept of Corporate Governance in Sharia' (2009) 20 *European Business Law Review* 343, p. 346-347. Also see Abu-Tapanjeh, p. 561-562.

⁶⁷ "O mankind! Verily We have created you from a single (pair) of a male and a female, and have made you into nations and tribes, that you may know each other. Verily, the most honoured of you in the sight of God is the most righteous" (Surah Al-Hujurat 49:13) of Ali

⁶⁸ Thomson Reuters and Dubai Chamber of Commerce and Industry, *GIES 2013 Review: Steps Forward for Growth* (Dubai Islamic Economy Development Centre, Dubai, 2013), p. 58; Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System', p. 7-14.

⁶⁹ See discussion on *Tawheed* at p. 86-91.

<i>Orientation</i>	Profit maximisation, financial growth, continuity, and divine blessings	Profit maximisation, financial growth, and continuity
<i>Business Ethos</i>	Business as part of faith	Business as a material need
<i>Strategic Management</i>	VMO of the organisation is closely related to the concept of 'mankind as vicegerent of God'	VMO of the organisation is based on material interest <i>per se</i> .
<i>Operation Management</i>	Every process, input and output is guaranteed <i>Sharia'</i> -compliant. Promoting productivity within the perimeters of <i>Sharia'</i> law.	No <i>Sharia'</i> compliant guarantee for every process, input and output. Promoting productivity only within the perimeters of self-serving interest.
<i>Financial Management</i>	<i>Sharia'</i> compliant guarantee in every financial process, input and output.	No <i>Sharia'</i> compliant guarantee in every financial process, input and output.
<i>Marketing Management</i>	Marketing initiative is only done for <i>Sharia'</i> -compliant financial products.	Marketing initiative includes <i>Sharia'</i> non-compliant financial products.

Figure 5: Comparison of VMOs Between IFIs and Non-IFIs⁷⁰

As noted earlier, it is widely known that *Sharia'* law prohibits the IFIs from engaging in any financial activities involving *Riba'*, *Gharar*, *Maysir*, or unethical subject matters and business practices such as, *inter alia*, prostitution, alcoholic beverages, pork processing, pornography, firearm's manufacturing, entertainment, *Hilah*, excessive uncertainty, fraud,

⁷⁰ Modified. See Muhammad Ismail Yusanto and Muhammad Karebet Widjajakusuma, *Menggagas Bisnis Islami (Upholding Business the Islamic Way)* (Gema Insani 2002), p. 22-23. Also see Irawan Febianto, 'Shariah Compliant Model of Business Entities' (2011) 1 World Journal of Social Science 130, p. 10.

mistake and misrepresentation⁷¹. In the same manner, *Sharia'* law also imposes a moral responsibility on the IFIs by decreeing *Zakat* (alms payment) as mandatory in ensuring that society can also benefit from their presence⁷². Essentially, *Zakat*, which the *Holy Quran* has mentioned as many as 32 times (in isolation) and 26 times (enjoined with the obligation for prayer), constitutes one of the five important attributes of Islam⁷³.

Linguistically, *Zakat* is an Arabic word that connotes 'growth' or 'purification'⁷⁴. Technically, it refers to 'a right to wealth (or a part of wealth)' as specified by *Sharia'* law for the advantage of certain beneficiaries⁷⁵. Accordingly, it requires qualified individuals and companies such as the IFIs to surrender a specified portion of their wealth to the *Baitul Mal* (the treasury or the equivalent of an Inland Revenue department)⁷⁶. Subsequently, the *Baitul Mal* will distribute the funds to the seven groups of society specified by *Sharia'* law as the appropriate beneficiaries, namely the poor; the needy; the *Amil* (the person appointed by the *Baitul Mal* to collect the *Zakat*); the *Muallaf* (the person who recently embraced the Islamic faith); those who are in great debt; those who work in the path of God; and the wayfarers⁷⁷.

⁷¹ See discussion on these elements in Chapter 2.

⁷² "And be steadfast in prayer; give *Zakat*; and bow down your heads with those who bow down (in worship)" (*Surah Al-Baqarah* 2:43); "Of their goods, take alms, that so thou mightest purify and sanctify them: and pray on their behalf..." (*Surah Al-Taubah* 9:103) of Ali

⁷³ The remaining four attributes of Islam are the *Kalimah Tauheed* (testifying that there is no God but the One God, and the Prophet Muhammad (p.b.u.h.) is His Messenger); *Salah* (prayer), fasting during the holy month of Ramadhan; and *Hajj* (pilgrimage to Mecca, Saudi Arabia).

⁷⁴ Muhammad Ibn 'Ali Al-Shawkani, *Nayl Al-Awtar (Attainment of the Objective)*, vol 2 (published in Beirut, Dar al-Fikr 1983), p. 169; Al-Qardawi. Also see "And those in whose wealth there is a fixed portion" (*Surah Al-Maarij* 70:24) of Ali

⁷⁵ "And in their wealth and possessions (was remembered) the right of the needy, him who asked, and him who (for some reason) was prevented (from asking)" (*Surah Al-Dhariyat* 51:19) of Ali. Also see Abd al-Rahman al Jaziri, *Al-Fiqh Ala Mazahib Al-Arba'ah (Islamic Jurisprudence According to the Four Schools of Thought)*, vol 2 (published in Cairo, Maktabah al-Tijariyah al-Kubra 1991), p. 435.

⁷⁶ It is important to note that *Zakat* is only compulsory on companies and qualified individuals once their net earnings or profits have reached the determined *Nisab* (a certain value as determined by the state's Islamic affairs department). The deductible percentage for *Zakat* is 2.5 per cent on the personal savings or income, 10 per cent on agricultural produce, and 20 per cent on the produce of mines or mineral wealth. See Al-Qardawi, p. 556.

⁷⁷ (*Surah At-Taubah* 9:60) of Ali.

Although *Sharia'* law does not prohibit the accumulation of wealth by individuals and companies⁷⁸, it recognises the possibility of the creation of an economic disparity between the rich and the poor because of the quest for profit maximisation⁷⁹. In other words, there will emerge two groups of different economic capacity, namely the 'admired' (the rich), and the 'admirer' (the poor). According to Sheikh Ali Al-Jarjawi, these two groups will remain separated by hatred and jealousy that will eventually lead to catastrophic consequences such as theft, rape, corruption, and murder⁸⁰. From the *Sharia'* law perspective, Imam Al-Ghazali emphasised that wealth is merely a trust from God and if one fails to utilise it according to the manner prescribed by the Holy Quran and the *Sunnah* such as to alleviate the hardship of the poor or the needy, the person will not receive any share of the pleasures accorded in the Hereafter⁸¹. Therefore, the system of *Zakat* not only serves as a bridging mechanism that balances this economic disparity, but also as a medium to express one's gratitude to God⁸² and purify one's earnings from a religious standpoint⁸³.

At the same time, it also important to note that the obligation of *Zakat* does not aim to 'spoon-feed' the poor while they remain idle and dependent on the contributions from the rich. In fact, according to Ibn Al-Humam, the actual aim of *Zakat* is to relieve the poor without impoverishing the rich in order to transform the former from being the recipients

⁷⁸ "And when the Prayer is finished, then may ye dispersed through the land, and seek of the bounty of God: and celebrate the praises of God often (and without stint): that ye may prosper" (Surah Al-Jumu'ah 62:10). Also see (Surah Al-A'raf 7:32) of ibid

⁷⁹ Abu Sa'eed noted that the Prophet Muhammad (p.b.u.h.) said, "The poor (Muhajirin) will enter the Paradise before the rich among them by five hundred years interval". This Hadith is Sahih. See Book 36, Hadith 48 of Al-Tirmidhi. Also see Book 81, Hadith 136 of Hamidy and others

⁸⁰ From the Islamic perspective, there are two forms of envy. On one hand, there is the acceptable *Ghibtah*, or envy without malice, and on the other, the prohibited *Hasad*, or envy with malice. See Ali Ahmad al Jurjawi, *Hikmah al-Tasyri'wa Falsafatuhu (The Beauty of Islam and Its Philosophy)* (Harlis Kurniawan ed, published in Jakarta, Gema Insani 2006), p. 183-186.

⁸¹ Imam Muhammad Al-Ghazali, *Ihya Ulumuddin (Inner Dimensions of Islamic Worship)* (Fazlul AHM Karim tr, printed in India, 16th Impression edn, Islamic Book Service (P) Ltd 2015), p. 57. Also see Saeed

⁸² "The parable of those who spend their substance in the way of God is that of a grain of corn: it groweth seven ears, and each ear has a hundred grains. God giveth manifold increase to whom He pleaseth: and God careth for all and He knoweth all things" (Surah Al-Baqarah 2:261) of Ali. Also see Book 45, Hadith 90 of Ibn Al-Hajjaj

⁸³ Nur Barizah Abu Bakar and AbdulRahim Abdul Rahman, 'A Comparative Study of Zakah and Modern Taxation' (2007) 20 Journal of King Abdul Aziz University: Islamic Economics 25, p. 34. Also see R Ticehurst and H Roberts, 'The Responsibility of Wealth - Should Rich People Give Away Their Money?' Lexology, 6 November 2015 <<http://www.lexology.com/library/detail.aspx?g=2d8eab24-05db-41a1-9ba0-9fc517100dff>> accessed 19 September 2017

of *Zakat* to the givers of *Zakat* themselves in the future⁸⁴. Indeed, the realisation of this objective was highlighted during the reign of Caliph Umar Abdul Aziz, where there was a surplus in the *Baitul Mal* due to the absence of eligible *Zakat* recipients⁸⁵.

As far as Islamic banking is concerned, it is interesting to note that the concept of *Zakat* has since contributed to the development of IFI's micro-financing instruments such as *Qard Al-Hasan* (interest-free loan)⁸⁶ and the provision of education grants in the industry's bid to uphold the notion of 'profiting-responsibly' as lauded by *Sharia'* law⁸⁷. For instance, the Jordan Islamic Bank established a specific fund, which provided *Qard Al-Hasan* service to more than 33,000 beneficiaries for justified social purposes such as education, medical treatment, and marriage⁸⁸. Likewise, the Jeddah-based IDB has also contributed to the development of scholarships in the fields of Islamic banking, especially Islamic microfinance, in its 56-member countries in the form of research scholarships, technical assistance programmes, and disaster reliefs⁸⁹. Furthermore, since *Sharia'* law only imposes the extraction of *Zakat* from *Sharia'*-compliant incomes or profits, which correspond to the business nature of the IFIs that upholds the principles of *Maqasid Al-Sharia'*⁹⁰, the whole concept of *Zakat* constitutes another unique feature that distinguishes the Islamic from the Western corporate governance system.

⁸⁴ Al-Qardawi, vol. 1, p. 59.

⁸⁵ A.A. Hakam, *Umar bin Abdul Aziz: Peribadi Zuhud Penegak Keadilan (Umar bin Abdul Aziz: The Humble and Just)* (Alam Raya 2009), p. 59. Also see Al-Qardawi, vol. 2, p. 46.

⁸⁶ *Qard Al-Hasan* is a combination of the Arabic words of *Qard*, which means 'loan' or 'to cut', and *Hasan*, which means 'kind' or 'gratitude'. It is also called as a benevolent loan since the lender does not expect any return from the borrower. See Ahmad and Hassan, p. 68.

⁸⁷ "Who is he that will loan to God a beautiful loan, which God will double unto his credit and multiply many times? It is God that giveth (you) want or plenty, and to Him shall you return" (Surah Al-Baqarah 2:245) of Ali. Also see Habib Ahmed, 'Financial Inclusion and Islamic Finance: Organisational Formats, Products, Outreach, and Sustainability' in Z. Iqbal and A. Mirakhor (eds), *Economic Development and Islamic Finance* (World Bank Publications 2013) <<http://books.google.com.my/books?id=EZpVAAAAQBAJ>>, p. 212-213; Al-Qardawi, vol. 2, p. 560.

⁸⁸ Jordan Islamic Bank, *The Thirty Fifth Annual Report 2013* (2013), p. 22; Jordan Islamic Bank, *Second Report on the Social Responsibility 2013* (2013), p. 28.

⁸⁹ Islamic Development Bank, p. 10-16. Also see Hassan and Lewis, p. 281-282.

⁹⁰ It is difficult to implement the concept of *Zakat* within the Western banking environment due to the presence of *Sharia'* non-compliant elements such as, *inter alia*, *Riba'*, *Gharar*, and *Maysir*. This postulation is based on a *Hadith* narrated by Abu Hurairah that the Prophet Muhammad (p.b.u.h.) said, "O you people! Indeed God is *Tayyib* (good) and he does not accept but what is good". This *Hadith* is Sahih. See Book 47, *Hadith* 3257 of Al-Tirmidhi

3.1.3.3 Ideological Views – *Tawheed* v. Secularism

The third feature that differentiates Islamic corporate governance from the Western model lies in its ideological view. While the concept of Western corporate governance stemmed from socially derived ‘secular humanist’ values⁹¹, Islamic corporate governance concept took its shape from the ethical principles that are rooted deep within the teachings of Islam – specifically the governance of human’s inter-relationship with one another, and most importantly, with God, in every matter⁹². Above all, the primary objective of Islamic corporate governance is to serve God and uphold his commands in line with the injunctions of the Holy Quran and the *Sunnah*⁹³.

⁹¹ Alsanosi, p. 347. Also see Lewis, p. 14.

⁹² Muhammad Al-Sayyid Yusuf, *Tafsir Ekonomi Islam: Konsep Ekonomi Al-Quran (Interpretation of Islamic Economics: The Quranic Economic Concept)* (Abu Ezzat Al-Mubarak ed, Murtadho Ridwan tr, published in Johor Bahru, Perniagaan Jahabersa 2008), p. 110-113, 175-183; Choudhary Slahudin, ‘OECD Principles and the Islamic Perspective on Corporate Governance’ (2008) 12 Review of Islamic Economics 29, p. 37.

⁹³ “... *Help ye one another in righteousness and piety, but help ye not one another in sin and rancour: fear God: for God is strict in punishment*”. See (Surah Al-Ma’idah 5:2) of Ali. In one *Hadith*, Anas bin Malik narrated: “*The Prophet Muhammad (p.b.u.h.) said, ‘Support your brother whether he was unjust or the victim of injustice.’ He was asked, ‘O Messenger of God! We know about helping him when he suffers injustice, but what about helping him when he commits injustice?’ He said, ‘Prevent and stop him from committing injustice, and this represents giving support to him’*”. This *Hadith* is *Sahih* from Al-Bukhari. See Kathir, p. 1253-1254.

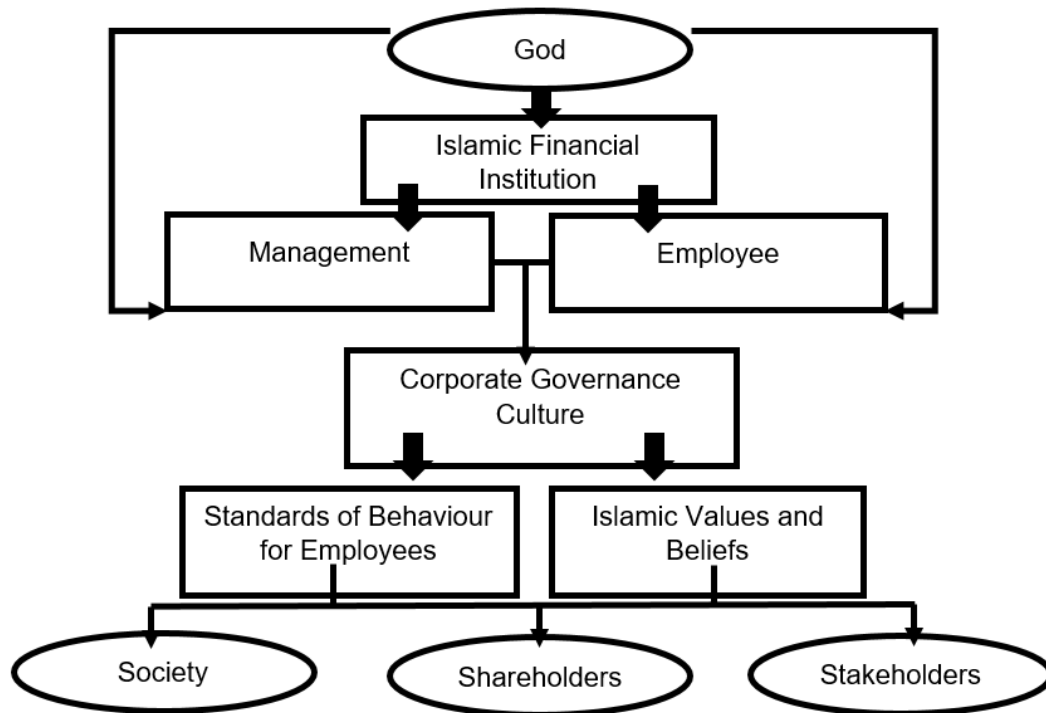


Figure 6: *Tawheed* as the Apex of Islamic Corporate Governance System

In principle, the Islamic corporate governance system differs from its Western counterparts in the sense that companies, in this case the IFIs, owe a duty to uphold the commandments of God before anything else (see **Figure 6**)⁹⁴. This is in contrast to the Western corporate governance concepts such as the Anglo-Saxon and the German models, which do not incorporate any religious sentiments or consciences within their respective corporate governance frameworks. However, this does not automatically imply that the Islamic corporate governance system neglects the interest of the company, shareholders and the other stakeholders as *Sharia'* law also guarantees the protection of these groups' financial objectives. This is portrayed by a number of Islamic banking products such as the application of *Mudarabah* in current or savings account products, and the Islamic Negotiable Instrument of Deposit ('INID'), where the IFI as the *Mudharib*, is obliged to maximise the value of the shareholders' investments as long as it

⁹⁴ Aishath Muneeza and Rusni Hassan, 'Shari'ah Corporate Governance: The Need for a Special Governance Code' (2014) 14 International Journal of Business in Society, p. 121; Abu-Tapanjeh, p. 565; Abdul Rahim Abdul Rahman, 'Issues in Corporate Accountability and Governance: An Islamic Perspective' (1998) 15 American Journal of Islamic Social Sciences 55

materialises within the permissible parameter of *Fiqh Al-Muammalat* (Islamic commercial law)⁹⁵.

In the Islamic corporate governance system, the most important stakeholder of the Islamic banking industry is Islam itself⁹⁶. If industry players such as the IFIs fail to comply with the strict rules of *Sharia'* law, it is submitted that the Islamic banking concept is merely an attempt by banking institutions to exploit the image of Islam as a brilliant marketing scheme in order to profit from the 252 billion Muslim population worldwide. Since the 'Islamic' label of the IFI is undeniably influential in the Muslim communities, it remains subject to exploitation by the banks as a strategic leveraging tool to settle a bank's position as an ideal Islamic bank within a particular community⁹⁷. This brings negative repercussions that not only can damage the credibility of the IFIs and the global Islamic banking market, but also the reputation of Islam as a whole. Hence, it is important to note that the *Sharia'* compliance element serves as a crucial ingredient of the Islamic corporate governance system in justifying the 'Islamic' prefix attached to the IFIs that further distinguishes Islamic banking from the Western banking system.

In essence, the core of Islamic corporate governance rests on the precept of *Tawheed*; a fundamental concept from which everything else radiates in Islam – from the *Sharia'* principles to everyday conducts⁹⁸. From the theoretical point-of-view, the precept of *Tawheed* comprises three cardinal principles, namely *Aqidah* (faith), *Sharia'* (Islamic law), and *Akhlaq* (ethics). It constitutes "... a man's commitment to God, the focus of all his reverence and gratitude, the only source of value. What God desires for man become

⁹⁵ See discussion on *Tahsil Al-Ribh* at p. 57-59. Also see Shariah Standard on Mudarabah BNM/RG/GL 012-4, p. 7; Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 24-27; Abdul-Rahman, p. 59.

⁹⁶ Mohammad Murray Hunter, 'Towards an Islamic Business Model: A Tawhid Approach' (2012) 2 International Journal of Business and Technopreneurship 121, p. 126-129; Rahmatina Kasri, 'Corporate Governance: Conventional vs. Islamic Perspective' [2009] Islamic Perspective, p. 7.

⁹⁷ Bernardo Vizcaino, 'Islamic Banks Rebranding in Bid to Go Global' Trade Arabia, 2 July 2014 <http://www.tradearabia.com/news/REAL_261263.html> accessed 21 September 2017; Guidelines on Corporate Governance for Licensed Islamic Banks (GP1-i) BNM/RH/GL 002-1, p. 8-9; Shawn Wang, 'War and Peace in International Islamic Finance' Wharton Research Scholars, Wharton School, University of Pennsylvania, May 2010 <http://repository.upenn.edu/cgi/viewcontent.cgi?article=1136&context=wharton_research_scholars> accessed 21 September 2017, p. 18.

⁹⁸ John L Eposito and Dalia Mogahed, *Who Speaks for Islam - What a Billion Muslims Really Think* (Gallup Press 2007), p. 11; Hasan, 'Corporate Governance: Western and Islamic Perspectives', p. 283.

*the value for him, the end of all human endeavour*⁹⁹. On the other hand, from the practical point-of-view, it necessitates one believing that God always sees all of his acts and conducts and that nothing on this earth will ever escape the attention of God¹⁰⁰. In brief, the concept of *Tawheed* asserts that every conduct must comply with the *Sharia'* law and also is accompanied by the belief that God is ever watching¹⁰¹.

Accordingly, the first principle (*Aqidah*) requires every Muslim to believe in the concept of the oneness of God, who possesses the sole command over everything that exists within and between the realms of the heaven and the earth¹⁰². Subsequently, Islam postulates that God had chosen mankind, out of all His creations, to become His vicegerent on earth¹⁰³. Thus, God had reminded mankind that they shall be accountable to Him in the hereafter for all of their deeds¹⁰⁴. This would include every aspect of a human's life – from a person's relationship with their own family to their relationship with society. From this point, it is obvious that the notion of “*accountability to God that precedes everything in this world*” is paramount in Islamic corporate governance.

The second (*Sharia'*) and third (*Akhlaq*) principles respectively direct the company to ensure that the nature and operations of its affairs adhere to the principles and ethics of the *Sharia'* law. This mandate corresponds to the opinions of prominent Islamic scholars

⁹⁹ Gillian Rice, 'Islamic Ethics and the Implications for Business' (1999) 18 *Journal of business ethics* 345
Hasan, 'Corporate Governance: Western and Islamic Perspectives'; Hunter, p. 125.

¹⁰⁰ This concept is known as *Al-Ihsan* in *Sharia'* law. See 'Ali ibn Muhammad Jurjani, *al-Sayyid al-Sharif, Kitab Al-Ta'rifat* (Maktabat Lubnan 1978), p. 12.

¹⁰¹ Izzaty Ulya Munirah Abd Aziz, Ahmad Irdha Mokhtar and Zulkefli Aini, 'Ihsan Dalam Pengurusan Organisasi Islam (Ihsan in the Administration of Islamic Organisation)' (The Seminar Proceeding of Islamic Management: Towards the Strengthening of the Ummah, Bangi, Selangor), p. 3-4; Al-'Allamah Musthafa Muhammad, *Terjemahan Jawahir Al-Bukhari (The Translation of Jawahir Al-Bukhari)* (Muhammad Zuhri tr, published in Indonesia, Raja Murah Al-Qana'ah 1979), p. 39-40.

¹⁰² (*Surah As-Sajadah* 32:4-5) of Ali

¹⁰³ "Behold, Thy Lord said to the angels: "I will create a vicegerent on earth." They said: "Wilt Thou place therein one who will make mischief therein and shed blood? - whilst we do celebrate Thy praises and glorify Thy holy (name)?" He said: "I know what ye know not..." See (*Surah Al-Baqarah* 2: 30-33) of *ibid*

¹⁰⁴ "And We have fastened every man's (deeds) to his neck: On the Day of Judgment, We shall bring out for him a scroll, which he will see spread open. (It will be said to him) Read thine (own) record: Sufficient is thy soul this day to make out an account against thee". See (*Surah Al-Isra'* 17:13-14) of *ibid*.

such as Hasan Al-Basri¹⁰⁵, Umar Abd Aziz¹⁰⁶, Imam Al-Syafie¹⁰⁷, and Yusuf Al-Qardawi¹⁰⁸ on the essential connection between faith and actual practice. It can be summarised as “*the harmonisation of faith and conviction that is implanted in the heart, and realised through action rather than mere outward expressions*”¹⁰⁹. Additionally, Ibn Al-Uthaymeen, a prominent Sunni scholar, opined that mankind must learn to appreciate and implement a set of 77 acts of faith as ordained by the *Sharia'* law in understanding the complete concept of *Tawheed*¹¹⁰. Accordingly, it is arguable that a major part of these acts have already been amalgamated into the Islamic corporate governance system and practiced in Islamic banking – for example, the prohibition of *Riba'*, *Gharar*, *Maysir*, and *Hilah*, among others, in financial transaction¹¹¹; the implementation of *Zakat*¹¹², *SRI*¹¹³, *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar*¹¹⁴; and the promotion of *Sharia'*-compliant practices among the IFI's employees and customers¹¹⁵.

¹⁰⁵ Ibn Taymiyyah, *Kitab Al-Iman: Book of Faith* (Dar Al-Kutub Al-'Ilmiyyah 1983), p. 251. Also see Hunter, p. 126.

¹⁰⁶ Al-Khalidi, *Fi Zilal Al-Iman* (published in Damsyiq, Dar Al-Qalam 1994), p. 26.

¹⁰⁷ *Ibid*, p. 24.

¹⁰⁸ Yusuf Al-Qaradawi, *Iman dan Kehidupan (Iman and Life)* (published in Selangor, Dewan Pustaka Fajar 1985), p. 25. Also see Hasan Al-Ayyub, *Tabsit Al-'Aqa'id Al-Islamiyyah* (published in Cairo, Dar Al-Tawzi wa Al-Nasyr wa Al-Islamiyyah 1994), p. 17.

¹⁰⁹ The parable of the actual Islamic faith is mentioned by God in the Holy Quran as “*For, believers are those who, when God is mentioned, feel a tremor in their hearts, and when they hear His Signs rehearsed, find the faith strengthened, and put (all) their trust in their Lord; who establish regular prayers and spend (freely) out of the gifts We have given them for sustenance; such in truth are the believers: they have grades of dignity with their Lord, and forgiveness, and generous sustenance*”. See (Surah Al-Anfal 8:2-4) of Ali

¹¹⁰ According to Imam Muhammad Al-Baihaqi, there are 77 acts of faith as ordained by the *Sharia'* law – the highest rank of the faith is the belief in the One God, and the lowest is the removal of pebbles, stones, thorns, sticks or anything that may harm another God's being, from the road. See Muhammad Al-Uthaymeen, *Fatawa Al-Aqidah (The Collection of Fatwas on Aqidah)* (published in Beirut, Dar Al-Jil 1993), p. 136-138. Also see Book 1, *Hadith* 60 of Ibn Al-Hajjaj

¹¹¹ See discussion on these elements in Chapter 2.

¹¹² See discussion on *Zakat* at p. 83-85.

¹¹³ Amlot, 'ADIB Gifts New Mosque in Fujairah'; Sairally, p. 280.

¹¹⁴ See p. 75-76.

¹¹⁵ Accounting, Auditing, and Governance Standards as at December 2015, p. 915. For example, the Bank Islam Malaysia Berhad regards the Muslims' five-compulsory-prayers-a-day as a paramount element of their Islamic corporate governance structure. This is evident in a number of its corporate practices such as the implementation of Islamic dress code to all employees; the airing of *Adhan* (call for prayer); temporary suspension of banking transaction during prayer's time; the provision of prayers' room for

Given these points, the concept of *Tawheed* serves as an integral element in the Islamic corporate governance framework as it places equal importance on the IFI's financial structure and aspects such as the *Sharia'* compliance of the IFI's financial products, services, and business conducts. In fact, compliance with *Sharia'* law constitutes a significant part of the vital elements of an efficient Islamic corporate governance framework as prescribed by the IFSB-3, namely:

- (a) The actions of the IFI's management must be aligned with the interests of stakeholders;
- (b) Proper incentives must be provided to the organs of governance such as the BOD, the management, and the *Sharia'* Board to pursue objectives that are in the interests of stakeholders; and
- (c) There must be compliance with the principles of *Sharia'* law¹¹⁶.

Nonetheless, it is also observed that contrary to this ideal framework, there remains a substantial concern that the IFIs have yet to realise the complete application of the above fundamental Islamic corporate governance principles, particularly the compliance of the financial products and services with the principles of the *Sharia'* law. For example, there has been a continuous utilisation of controversial Islamic financial products such as the *Murabahah*-based debt financing¹¹⁷, *Bai Al-Inah*¹¹⁸, and *Tawarruq*¹¹⁹ in certain jurisdictions, which fails to reflect the above-mentioned values that urge the alignment of the IFI's financial products and services with the requirements and interests of both *Sharia'* law and the stakeholders. Hence, these issues present a complex future challenge to researchers and scholars in determining the actual foundation on which the current Islamic corporate governance system rests.

employees and customers; opportunities for employees to engage in additional spiritual activities, *e.g.* religious seminars, *Iftar* (breaking of fast), Friday prayer and *Tarawikh* (night prayer during the Ramadhan). These practices are also exercised in Malaysia by the other IFIs such as Bank Muammalat, Bank Kerjasama Rakyat, and Tabung Haji.

¹¹⁶ Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 27.

¹¹⁷ See footnote 208 in Chapter 2. Also see Anuar, Mohamad and Shah, p. 28-31.

¹¹⁸ Nursyamsiah and Kayadibi, p. 123; Shahrudin, p. 129. Also see footnote 27 and 40 in Chapter 2.

¹¹⁹ See footnote 27 in Chapter 2. Also see Islamic Development Bank and Islamic Financial Services Board, *Islamic Financial Services Industry Development: Ten-Year Framework and Strategies - A Mid-Term Review* (2014), p. 30.

3.2 Islamic Corporate Governance Framework in Islamic Banking

3.2.1 The Principle of *Shura* (Collectiveness) in *Sharia*' Law

Basically, the term *Shura* originated from the Arabic word of *Shawara*, which means 'to advise' or 'to consult'¹²⁰. Accordingly, when a matter requires the making of a decision that both involves and affects the interest of the public, the Islamic concept of justice necessitates the implementation of *Shura* as a guiding principle. This corresponds to the following provisions of the Holy Quran:

"... and consult them (the people) in affairs (of moment). Then, when thou hast taken a decision put thy trust in God. For God loves those who put their trust (in Him)".

(Surah Ali Imran 3: 159)

"And those who respond to their Lord and keep up prayer, and their rule is to take counsel among themselves, and who spend out of what We have given them".

(Surah As-Shura 42: 38)

Generally, Muslims believe that the Prophet Muhammad (p.b.u.h.) never consulted anyone – not even his companions, in the determination of religious matters because of his direct connection with God¹²¹. Of course, there exist numerous instances that highlighted the adoption of *Shura* by the Prophet (p.b.u.h.) in non-religious matters. According to Al-Razi¹²² and Al-Qurtubi¹²³, the practice of *Shura* does not aim to favour the human intellect over the divine revelation, but to teach humanity of the concept of

¹²⁰ Hans Wehr, *A Dictionary of Modern Written Arabic* (J Milton Cowan ed, published in Beirut, 4th edn, Harassowitz Verlag 1979), p. 574-575; Muhammad Nazeer Ka Ka Khel, 'The Conceptual and Institutional Development of *Shura* in Early Islam' (1980) 19 *Islamic Studies* 271, p. 279. Also see Md Golam Mohiuddin and Mohammad Muzahidul Islam, 'Decision Making Style in Islam: A Study of Superiority of *Shura* (Participative Management) and Examples from Early Era of Islam' (2016) 8 *European Journal of Business and Management* 79, p. 79.

¹²¹ Ahmad Raysūnī, *Al-Shura: The Qur'anic Principle of Consultation* (Nancy Roberts tr, The International Institute of Islamic Thought (IIIT) 2011), p. 5, 17-18; Khadija Katja Wöhler-Khalfallah, 'Democracy Concepts of the Fundamentalist Parties of Algeria and Tunisia—Claim and Reality' (2007) 1 *International Journal of Conflict and Violence (IJCV)* 76, p. 80.

¹²² Fakr Al-Din M Al-Razi, *Al-Tafsir Al-Kabir (The Large Commentary)*, vol 3 (published in Beirut, Dar Al-Kutub Al-'Ilmiyyah 1990), p. 79-80.

¹²³ Abu'Abdallah Al-Qurtubi, *Al-Jami 'Li-Ahkam Al-Qur'an (The Compendium of Legal Rulings of the Quran)* (published in Beirut, Dar Al-Kutub Al-'Ilmiyya 2004), p. 191-194.

unity and the importance of consultation in administrative issues, *i.e.* the significance and wisdom of collective decisions over those made individually.

For example, during the battle of *Badr Al-Qubra* (2H/624 C.E.) and Uhud (3H/625 C.E.), the Prophet (p.b.u.h.) consulted his companions on the proper discourse that should be taken against the *Quraish* armies¹²⁴. Similarly, the Prophet (p.b.u.h.) accepted the suggestion of Salman Al-Farisi to construct trenches around the Madinah city in the battle of Khandaq, and sought counsel from his companions when his wife, 'Aisha, was falsely accused of indecency¹²⁵. After the demise of Prophet Muhammad (p.b.u.h.), Muslims continued this act of democracy by introducing an open dialogue session that was implemented in the first discussion to elect a successor to the Prophet (p.b.u.h.) – of which the majority of Muslims elected Abu Bakr As-Siddiq as the first caliph of Islam¹²⁶. By the time of Umar Al-Khattab, a consultative council already existed to function as a proper medium to discuss the appointment of the subsequent caliph¹²⁷.

Indeed, Islam regards the act of decision-making as a trust from God and *Shura* as an important system that ensures the observation of this divine obligation in protecting the rights of all parties involved. From another perspective, *Shura* also prevents the subjugation of society's rights at the hands of a certain group of people, particularly those who are entrusted with public authority¹²⁸. Although *Shura* operates as a socially driven mechanism, the majority of *Sharia'* scholars opine that its decisions are not binding on

¹²⁴ Taqiuddin An-Nabahani, *The Ruling System in Islam* (5th edn, Khilafah Publications 1996), p. 238; Al-Khaldi, *Nizam Al-Shura Fil Islam (The Administration of Shura in Islam)* (published in Amman, Maktabat Al-Risala Al-Haditha 1986), p. 25-28.

¹²⁵ An-Nabahani, p. 52; Fatih Osman, 'Islam in a Modern State: Democracy and the Concept of Shura' [1997] Center for Muslim-Christian Understanding History and International Affairs, Edmund A Walsh School of Foreign Service, Georgetown University, Washington DC, p. 11; Ibn Taymiyyah, *Al-Siyasah Al-Shariyah (The Politics of Sharia' Law)* (published in Beirut, Dar Al-Marifah 1967); E. Cotran, A.O. Sherif and U.L.C.I.M.E. Law, *Democracy: The Rule of Law and Islam* (Springer Netherlands 1999), p. 458-459.

¹²⁶ Asy-Syawi, p. 103. Also see 'Abd Al-Nasir Tawfiq Al-Attar, 'Al-Ta'rif Bi Al-Ijtihad Al-Jama'i' (Conference on Al-Ijtihad Al-Jama'i fi Al-A'lam Al-Islami, Al-Ain, 1996), p. 8.

¹²⁷ There were six candidates named by Umar Al-Khattab as his potential successor, namely Uthman, 'Ali, Talhah, Az-Zubayr, Sa'id, and Abdur-Rahman bin 'Awf. See Kathir; Abu'l-Hasan Ali Ibn Muhammad Ibn Habib Al-Basri Al-Mawardi, *Al-Ahkam Al-Sultaniyyah (The Laws of Islamic Governance)* (Asadullah Yate tr, Ta-Ha Publishers Ltd 1996), p. 13.

¹²⁸ Muzaffar A Shaikh, 'Ethics of Decision Making in Islamic and Western Environments' (1988) 5 American Journal of Islamic Social Sciences 115; J.W. Meri, *Medieval Islamic Civilization: An Encyclopedia* (Taylor & Francis 2005), p. 171-172.

the ruler or a particular authority, unless the parties form a covenant to implement a binding decision¹²⁹.

However, *Sharia'* scholars such as Sheikh Yusuf Al-Qardawi, Muhammad Salim Al-'Awwa, and Taha Jabir Al-'Alwani, disagreed with this opinion and contended that the outcome of *Shura* should bind the parties since the decision is resolved through a majority vote¹³⁰. Additionally, *Sharia* scholars such as Ibn Taymiyyah and Sheikh Muhammad Abduh regarded *Shura* as an obligation rather than an option¹³¹, especially in matters that involve the rights and interests of stakeholders at large¹³². In other words, a non-binding *Shura* decision can make a mockery of the entire *Shura* process. This corroborates with the view of Ibn 'Atiyya, a distinguished Andalusian Quranic commentator, who proposed that if those in power fail to consult those who possess a better knowledge and conscience of God such as the *Sharia'* scholars or pious people, they should be dismissed from their respective positions¹³³.

As far as the application of *Shura* in Islamic banking is concerned, the practice of binding *Shura* decisions has been implemented at the national level in several countries by the central *Sharia'* boards such as the Higher *Sharia'* Supervisory Board ('HSSB') of the Central Bank of Sudan¹³⁴; the *Sharia'* Advisory Council ('SAC') of the CBM (Malaysia)¹³⁵; the Higher *Sharia'* Authority ('HSA') of the United Arab Emirates¹³⁶; and the *Fatwa* Board

¹²⁹ Amir Shaharuddin and others, *Fatwas on Islamic Capital Markets: A Comparative Study Between Malaysia and Gulf Co-operation Council (GCC) Countries - Research Paper (No:40/2012)* (International Shari'ah Research Academy for Islamic Finance (ISRA) 2012), p. 7; Aznan Hasan, 'An Introduction to Collective Ijtihad: Concept and Application' (2003) 20 *American Journal of Islamic Social Sciences* 26, p. 37-38.

¹³⁰ Yusuf Al-Qaradawi, 'Shura is Compatible with the Essence of Democracy' (Islamopedia Online, Fatwa, 27 June 2011) <<http://www.islamopediaonline.org/fatwa/yusuf-al-qaradawi-shura-compatible-essence-democracy>> accessed 22 September 2017. Also see An-Nabahani, p. 249-250.

¹³¹ Muhammad Umer Chapra, *Islam and the Economic Challenge* (Islamic Foundation Leicester 1992), p. 242-243; Hasan, 'Corporate Governance: Western and Islamic Perspectives', p. 284.

¹³² (*Surah Ali Imran* 3: 159), (*Surah As-Shura* 42: 38) of Ali

¹³³ Osman, p. 11; Abd Al-Haqq Ibn Ghalib Ibn Atiyya, *Al-Muharrar Al-Wajiz (The Compendious Record)*, vol 3 (published in Fez, Ministry of Awqaf and Islamic Affairs 1997), p. 280-281.

¹³⁴ Section 21 (1) of The Banking Business (Organisation) Act 2003

¹³⁵ Section 55 and 57 of the Central Bank of Malaysia Act 2009 (Act 701)

¹³⁶ Article 5 of Federal Law No - (6) of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies

of the Ministry of *Awqaf* and Islamic Affairs of Kuwait¹³⁷. Moreover, the legislators in a number of these jurisdictions have moved even further in legislating statutory provisions that render the decisions of these institutions binding not only on the IFIs, but also on the parliament and the judiciary. For example, Article 230 (1) of the Constitution of Pakistan mandates that the Islamic Council, a special body formed by the legislator in ensuring the compliance of the Pakistani laws with the *Sharia'* law, can question the legality of any bills tabled in the Parliament if it contradicts the principles of *Sharia'* law. Further, the decision of the Islamic Council will bind both the Parliament and the President¹³⁸. Likewise, section 57 of the Central Bank of Malaysia Act 2009 ('CBMA 2009') mandates that *Sharia'* rulings issued by the SAC will bind both the IFIs and the court or arbitrator¹³⁹.

Since 'banking and mercantile matter', which includes Islamic banking, rests within the jurisdiction of the civil courts¹⁴⁰, this *Shuratic* approach in Malaysia can function as a prudent legal policy in guaranteeing the *Sharia'* compliance of the IFIs' financial products, services, and operations, especially considering the fact that the civil court judges are only trained in common law matters as opposed to the members of the SAC, who are more exposed to technical banking issues from the *Sharia'* law angle. In the same context, this binding *Shuratic* policy also gives rise to a significant legal concern that the vast powers of the SAC may have encroached into the judicial power exclusive to the judiciary. Accordingly, it is crucial for the Malaysian legislature to consider amending its Federal Constitution in granting the country's *Sharia'* courts the authority to preside over Islamic banking matters – a step that will ultimately restore this peculiar legal imbalance.

On a different note, it is also essential to comprehend that the practice of *Shura* does not automatically guarantee a positive outcome. This can be exemplified by the collective decision taken by the *Shura* council during the battle of *Uhud* (3H/624 C.E.), which inflicted great losses to the Muslim armies. Similarly, a decision concluded by the majority participants in a *Shura* may not necessarily represent the finest outcome for everyone in the community¹⁴¹. Nonetheless, *Sharia'* scholars such as Sheikh Ahmed Rida and

¹³⁷ Article 93 of Law No. 32 of the Year 1968 Concerning Currency, The Central Bank of Kuwait and the Organisation of Banking Business. Also see Hennie Van Greuning and Zamir Iqbal, *Risk Analysis for Islamic Banks* (World Bank Publications 2008), p. 192.

¹³⁸ Article 230 (3) of The Constitution of Pakistan

¹³⁹ Central Bank of Malaysia Act 2009 (Act 701)

¹⁴⁰ Ninth Schedule of Federal Constitution of Malaysia

¹⁴¹ "And if you follow most of those on the earth, they will lead you astray from the path of God; they follow nothing but conjecture and they only lie" (Surah Al-An'am 6: 116); "...They believe therein; but those

Ibrahim Sham Al-Din¹⁴² pointed out that as long as the decision of the majority conforms to the rules and principles of the *Sharia'* law, it is more trustworthy and will advance the best interests of the community¹⁴³. Further, *Shura* also shares traits similar to the Western concept of democracy in the sense that both agree a collective consideration is more comprehensive, more accurate, and more likely to lead to a fair and sound result for the social good than one reached by a minority or an individual¹⁴⁴. Even so, *Sharia'* law affirms this rationale with a caveat.

In order to guarantee that the decisions taken by the majority fulfil both *Sharia'* law and the public interest, the concept of *Shura* in Islam necessitates the decision-makers be those of *Ulu Al-Amr Minkum* (people who are elected and entrusted with authority by the public)¹⁴⁵. Further, the Islamic governmental concept of *Al-Bay'a* demands a bilateral relationship between those who hold the authority (the ruler or government) and those subjected to that authority (the public). On one hand, the ruling entity is responsible for guaranteeing and preserving the supremacy of the *Sharia'* law and the best interests of the community. On the other hand, the public is obliged to support the ruler and obey his commands as long as these comply with the *Sharia'* law¹⁴⁶.

In short, although *Shura* cannot provide a satisfactory outcome for every party in a discussion, its role as a platform of conscience remains relevant, especially to a

of the Sects that reject it, - the Fire will be their promised meeting place. Be not then in doubt thereon: for it is the Truth from your Lord: yet many among men do not believe!" (Surah Hud 11:17); *"And We have explained to men in this Quran every kind of similitude: yet the greater part of men refuse except with ingratitude!"* (Surah Al-Isra' 17:89); *"And truly before them, many of the ancients went astray"* (Surah Al-Saffat 37: 71) of Ali

¹⁴² Rida and Al-Din

¹⁴³ *"O ye who believe! Obey God, obey the Messenger, and those charged with authority amongst you. If you differ in anything among yourselves, refer it to God and His Messenger, if you do believe in God and the Last Day: that is best, and most suitable for final determination"* (Surah An-Nisa' 4:59) of Ali

¹⁴⁴ Sadek Jawad Sulaiman, 'Democracy and Shura' in C Kurzman (ed), *Liberal Islam: A Sourcebook* (published in New York, Oxford University Press 1998), p. 98; John L Esposito and John O Voll, *Islam and Democracy* (Oxford University Press 2001); Sana Tahzeeb, 'A Comparative Study of Islam and Modern Democratic Ideals' (2014) 2 *Journal of Islamic Studies* 47, p. 51.

¹⁴⁵ Osman, p. 12; M. Al-'Allāf, *Mirror of Realization: God is a Percept, the Universe is a Concept* (M. Al-Allaf 2003), p. 276.

¹⁴⁶ Abu Ya'la and Muhammad Ibn Al-Husayn Al-Farra, 'Al-Mu'tamadfi Usul Al-Din (The Approved Matter According to the Principles of Religion)' in Yusuf Ibish (ed), *Nusus Al-Fikr Al-Siyasi Al-Islami (The Constitutional Thought in the Islamic Studies)* (Dar Al-Tali'a 1966), p. 224; Tasha Solomon, 'Law and Theory: Pre-modern and Contemporary Development of Islamic Discourse on Rebellion' (2016) 3 *Journal of Mason Graduate Research* 128, p. 132. Also see (Surah An-Nisa' 4: 59) of Ali

developing industry such as Islamic banking. Truly, the situation has become more challenging with the existence of the different schools of jurisprudence in Islam, whose variant opinions can prove difficult to reconcile. As much as the difference in opinions between these schools has served as the crux of the Islamic legal system, it can also create inconsistency in deciding technical *Sharia'* issues in Islamic banking that can subsequently destabilise the industry¹⁴⁷. A latter part of this chapter will discuss and scrutinise the much-debated issue of *Al-Ikhtilaf Fi Al-Fuqaha* (the differences of opinions between *Sharia'* scholars) within the Islamic banking industry, which remains the *raison d'être* of the different approaches to the corporate governance of IFIs. Be that as it may, it is arguable that the differences of opinions in the *Sharia'* law must not be viewed as a limitation but rather a source of potential strength – when harnessed through a proper medium. All in all, since *Sharia'* law aims to promote a mutual understanding without favouring the opinions of an *Imam* or a particular school of Islamic jurisprudence over the other¹⁴⁸, the exercise of *Shura* can serve as an ideal platform in bridging the variant opinions between the different stakeholders within the Islamic banking industry.

3.2.2 Guardian to *Sharia'* Compliance – the *Sharia'* Board

According to the landmark English case of *Salomon v Salomon*¹⁴⁹, a company is a separate legal entity that has the right to sue or be sued in its own right. However, a company remains dependant on the mobility of human beings as its organs and limbs in its day-to-day operations. In most jurisdictions, the legislation requires companies to form a board of directors (“BOD”), which is appointed by the shareholders and entrusted with responsibility to spearhead the company’s business operation and resources¹⁵⁰. Collectively, the BOD is a team comprising the company’s executives charged with a set of advisory and oversight responsibilities that include the approval of business strategies;

¹⁴⁷ Parker Mushtak, ‘Shariah Governance in Islamic Finance Industry’ Arab News, 22 March 2010 <<http://www.arabnews.com/node/340237>> accessed 19 September 2017; Deloitte, *The Deloitte Islamic Finance Leaders Survey in the Middle East Benchmarking Practices* (2010), p. 11, 13.

¹⁴⁸ “Those who hearken to their Lord, and establish regular prayer, who (conduct) their affairs by mutual consultation; who spend out what We bestow on them for sustenance” (*Surah Al-Shura* 42: 38). Also see Raysūnī, p. 4; Hamza Ates, ‘Towards a Distinctive Model? Reconciling the Views of Contemporary Muslim Thinkers on an Ideal State for Muslim Societies’ (2003) 31 *Religion, State & Society* 347, p. 359.

¹⁴⁹ *Salomon v Salomon* [1897] AC 22 (HL)

¹⁵⁰ B. Hannigan, *Company Law* (OUP Oxford 2012), p. 105; D. Larcker and B. Tayan, *The Duties and Liabilities of the Board of Directors* (Pearson Education 2011)

protection of shareholders' rights and interest; designation of executives' compensation packages; risk management; and the protection of the company's assets and reputation¹⁵¹.

While the Western banking system depends on the BOD to make strategic decisions, the Islamic banking system requires the formation of a special board in addition to the BOD, namely the *Sharia'* board, which not only gives credibility and satisfies the ethical expectation of the IFI's customers, but also functions as a specialised body that deals with *Sharia'*-specific matters such as *Sharia'* compliance and the identification of banking risks specific to *Sharia'* law. In definition, a *Sharia'* board is defined as "*an independent body of specialised jurists (in Sharia' law) which is entrusted with the duty of directing, reviewing and supervising the activities of the Islamic financial institutions in order to ensure that they are in compliance with Islamic Sharia' rules and principles through the Fatwas, and rulings which are binding on the Islamic financial institution*"¹⁵².

As far as the Islamic banking industry is concerned, IFIs are either recommended or legally obliged by the statutory laws, their articles of association, the central bank's guidelines or the AAOIFI or the IFSB *Sharia'* governance standards to provide a viable and comprehensive *Sharia'* compliance mechanism in guaranteeing the compliance of their financial products, services, and business operations with *Sharia'* law. More often than not, this would necessitate the formation of a *Sharia'* board at the IFI-level. However, the realisation of *Shura* application in Islamic banking can also be achieved through the acquisition of *Sharia'* advisory services from a *Sharia'* advisory firm, or alternately, a *Sharia'* scholar, whose expertise lies in the areas of *Fiqh Al-Muammalat*¹⁵³.

¹⁵¹ The appointment of a *Sharia'* board member can be made through either a direct appointment from the IFI's shareholders as practised in Bahrain, Kuwait, Oman, Sudan, and the United Arab Emirates, or by the Islamic banking regulators such as the central bank or the financial services authority as practised in Malaysia and Indonesia respectively. See International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 24; A. Dignam and J. Lowry, *Company Law* (Oxford University Press 2014), p. 330-338, 584; Hannigan, p. 159-259. Also see Shamsul Nahar Abdullah, 'Board Structure and Ownership in Malaysia: The Case of Distressed Listed Companies' (2006) 6 Corporate Governance: The international journal of business in society 582

¹⁵² Abdurrahman Raden Aji Haqqi, 'Shariah Governance in Islamic Financial Institution: An Appraisal' (2014) 11 US-China Law Review 112, p. 119.

¹⁵³ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 8. Also see Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 7. In certain jurisdictions, the regulatory framework allows for the appointment of an individual *Sharia'* scholar, whom shall have the sole authority to perform the Islamic corporate governance function of the IFI concerned. Though this can be justified by the cost factor, it will undoubtedly put the IFI at a disadvantage

From the Islamic corporate governance perspective, the implementation of *Shura* is commonly represented by a two-tier board structure; a feature similar to the German corporate governance model¹⁵⁴. The first tier comprises the BOD and the *Sharia'* board. The BOD is responsible for a number of general responsibilities such as to decide on policies that best represent the shareholders' interests, to provide counsel to the Chief Executive Officer ('CEO'), to provide strategic alternatives in assisting the top management, and to monitor the implementation of the IFI's policies¹⁵⁵. The *Sharia'* board serves to advise and assist the BOD in a wide range of corporate functions, particularly the *Sharia'* compliance of the IFI's financial operations¹⁵⁶.

In the second tier, a *Hay'at Al-Raqabah Al-Shar'iyah* or an independent *Sharia'* board, which is normally formed at the central bank-level, is added into the fray as a higher layer of governing authority ensuring a more consistent and comprehensive implementation of the *Sharia'* compliance framework and Islamic banking standards across all IFIs in the country (see **Figure 7**)¹⁵⁷. Uniquely, there also exists a three-tier board structure as the one implemented in Pakistan in the country's bid to promote a more comprehensive and rigorous *Sharia'* compliance processes. Apart from the formation of the *Sharia'* board at both the central bank and the IFI-level, the State Bank of Pakistan also mandates the performance of an independent and objective assessment of the IFI's operations with *Sharia'* law by an external *Sharia'* audit firm or a

in terms of collective wisdom as compared to the other IFIs, which implemented the practice of *Shura* through the formation of a group of *Sharia'* scholars. See *ibid*, p. 8.

¹⁵⁴ In Germany, the German Stock Corporation Act (*Aktiengesetz*) requires a publicly traded company to form a two-tier board structure comprising the management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*). See §30 of *Aktiengesetz* (Stock Corporation Act). Also see Perry, p. 16.

¹⁵⁵ H. Elasrag and C.S.I.P. Platform, *Corporate Governance in Islamic Financial Institutions* (Createspace Independent Publishers 2014), p. 109-115; Samy Nathan and Vincent Ribière, 'From Knowledge to Wisdom: The Case of Corporate Governance in Islamic Banking' (2007) 37 *Vine* 471, p. 475-476. Also see Kevin Hendry and Geoffrey C Kiel, 'The Role of the Board in Firm Strategy: Integrating Agency and Organisational Control Perspectives' (2004) 12 *Corporate Governance: An International Review* 500, p. 504.

¹⁵⁶ This is in contrast with the German corporate governance system, which comprises a supervisory board of external directors along with a separate management BOD. Although the former has the authority to elect the latter, it has limited influence when it comes to the decision-making over the company's policies. See Elasrag and Platform, p. 88; Cally Jordan, 'Cadbury Twenty Years On' (2013) 58 *Villanova Law Review*, p. 15-21.

¹⁵⁷ A.M.E.T. Ahmed and W. Grais, *Islamic Finance and Economic Development: Risk, Regulation, and Corporate Governance* (Wiley 2014), p. 145-181; Grassa, p. 339.

firm with the capacity to conduct *Sharia'* audit¹⁵⁸. Additionally, several countries in the GCC such as Bahrain, Kuwait, United Arab Emirates, and Qatar do own a national *Sharia'* board but it does not exercise any supervisory function on the *Sharia'* compliance practices at the IFI-level¹⁵⁹. The following sections will explain extensively the diverse functions of a *Sharia'* board and also the roles expected of the BOD in the IFI's *Sharia'* compliance assurance process in providing a comprehensive understanding of the IFI's corporate governance framework.

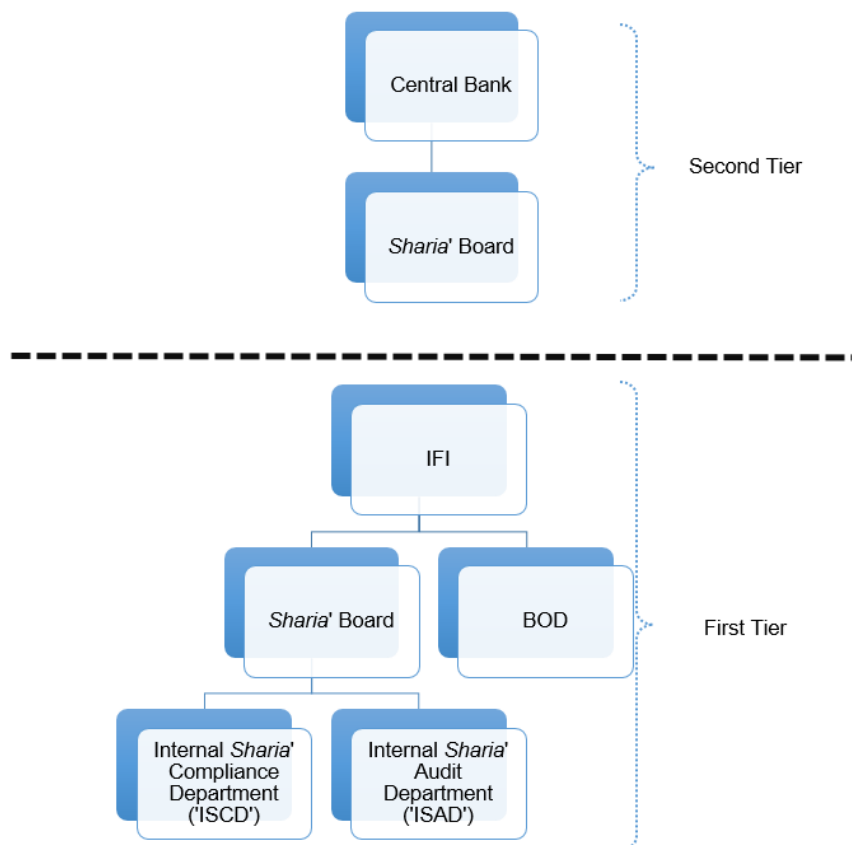


Figure 7: Two-Tier Board Structure in Islamic Corporate Governance

¹⁵⁸ Shari'ah Governance Framework for Islamic Banking Institutions, April 2014, p. 7-8. Also see Ahmed and Grais; Shamshad Akhtar, 'Shariah Compliant Corporate Governance' (The Annual Corporate Governance Conference, Dubai, 27 November 2006), p. 4.

¹⁵⁹ Grassa, p. 341; Aznan Hasan, 'Optimal Shariah Governance in Islamic Finance' (2007) 4 Islamic Finance News 7

3.2.2.1 Role of the *Sharia'* Board in *Sharia'* Compliance Assurance

From a general perspective, it may appear that the *Sharia'* board only holds a limited set of responsibilities to the IFI such as issuing Islamic banking *Fatwas*, advising the IFI on the application of *Sharia'* rulings in modern banking business, and setting policies for Islamic financial products and transactions¹⁶⁰. In reality, as the gatekeeper to *Sharia'* compliance for the IFI's entire operations, the *Sharia'* board is entrusted with a wider range of responsibilities that include the provision of advisory services to the BOD on all *Sharia'* compliance issues; participation in product development and structuring activities; review and approval of matters related to *Sharia'* law; issuance of *Fatwa*; *Sharia'* auditing; issuance of an annual certification of *Sharia'* compliance; *Sharia'* compliance assurance of the IFI's financial activities in equities, *Sukuk* and other business avenues; computation of *Zakat*; and even the promotion of *Sharia'*-compliant practices among employees and customers such as the provision of prayer rooms, airing of *Adhan* (call for prayer), and organising religious talks¹⁶¹. This would also include the drafting and revision of *inter alia*, contractual terms and conditions, product manuals, marketing advertisements, sales illustrations and brochures used to describe the bank's products and services¹⁶².

Correspondingly, the *Sharia'* board is also assisted by the ISCD and ISAD¹⁶³. The ISCD is responsible for the dissemination and monitoring of the Islamic banking *Fatwas* issued to the IFI's key units and the monitoring of the implementation of the *Sharia'* rulings issued. In addition, the ISAD is responsible for the examination of *Sharia'* compliance fulfilment in all aspects of the IFI's business operations¹⁶⁴. However, the *Sharia'* board

¹⁶⁰ Muneeza and Hassan, p. 124; Shahrudin, p. 129.

¹⁶¹ Matthias Casper, *Sharia Boards and Sharia Compliance in the Context of European Corporate Governance* (Working Papers of the Center for Religion and Modernity, Available at SSRN 2179412, 2012), p. 6; Dusuki, *Islamic Financial System: Principles & Operations*; Sabur and Wares, p. 3-4.

¹⁶² Section 20 of the Guidelines on the Governance of *Sharia'* Committee for the Islamic Financial Institutions (BNM/GPS 1). See Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/005-6

¹⁶³ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 3. Additionally, Islamic banking standard-setting agencies such as the AAOIFI have strongly recommended for the IFIs to establish an ISCD to assist the *Sharia'* board in the implementation of *Sharia'* rulings and assurance of *Sharia'* compliance in all of the IFI's financial operations. See A Al Dareer, *Shari'a Supervisory Boards: establishment, objectives and reality* (Faisal Islamic Bank 2001)

¹⁶⁴ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 8. Also see A Faddad, 'Shari'a Supervision and Its Role in Controlling the Works of Islamic

of certain IFIs such as the Al-Baraka Islamic Investment Bank of Bahrain has opted to perform the task of *Sharia'* audit themselves instead of relying on the ISAD or procuring external auditing services from the audit firms¹⁶⁵.

Apart from providing advisory services to the BOD, the *Sharia'* board is also responsible for the tasks of assisting the CEO, the IFI's management, and other staff and personnel in all *Sharia'* issues pertaining to Islamic banking through the provision of guidance, advice, and proper training on *Fiqh Al-Muammalat*¹⁶⁶. In several jurisdictions, particularly those adopting the centralised Islamic corporate governance system, the legislation not only requires the IFI's *Sharia'* board to ensure the IFI's compliance with the *Fatwas*, policies, and guidelines related to *Sharia'* compliance issued by the central *Sharia'* board, but also to consult the central *Sharia'* board on *Sharia'* matters that it cannot solve¹⁶⁷.

For instance, in Malaysia, section 55 (2) of the CBMA 2009 stipulates that an IFI may refer to the SAC¹⁶⁸ to ascertain that its financial operations do not involve any element which contravene the *Sharia'* law. Since the CBMA 2009 deems compliance with the SAC's rulings as an essential part of *Sharia'* compliance, it is arguable that the failure of an IFI's *Sharia'* board to consult the SAC in *Sharia'* matters that it could not resolve would constitute a *Sharia'* non-compliant event¹⁶⁹. Undoubtedly, this is an important matter that the IFIs cannot afford to ignore, especially in the presence of statutory legislations such as the Malaysia's Islamic Financial Services Act 2013 ('IFSA 2013') and Pakistan's *Shari'ah* Governance Framework for Islamic Banking Institutions, which hold not only the IFI and its *Sharia'* board accountable for *Sharia'* non-compliance event or negligence,

Banks: Its Importance, Requirements, and Techniques' (Proceedings of Nineteenth International Fiqh Conference, UAE, 2009)

¹⁶⁵ Nonetheless, since the *Sharia'* board forms part of the IFI's operational bodies, which are employed and paid by the IFI itself, it is arguable that this practice can create a potential conflict of interest that will jeopardise the impartiality aspect of the *Sharia'* board. See Rodney Wilson, *Islamic Financial Markets* (Routledge 2012), p. 13; Ali Adnan Ibrahim, 'The Rise of Customary Businesses in International Financial Markets: An Introduction to Islamic Finance and the Challenges of International Integration' (2011) 23 American University International Law Review 661, p. 687.

¹⁶⁶ Muneeza and Hassan, p. 124. Also see Mohd Nazri Chik, 'Shariah Audit: Shariah Perspective' (International Shariah Audit Conference, Kuala Lumpur, 9 May 2011), p. 8.

¹⁶⁷ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 2. Also see Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 34-35.

¹⁶⁸ For discussions on the SAC, see p. 289-295.

¹⁶⁹ Section 28 (2) of Islamic Financial Services Act 2013 (Act 759)

but the BOD as well¹⁷⁰. Since the BOD does not generally comprise members who are conversant in the field of *Fiqh Al-Muammalat*, its liability for the occurrence of *Sharia'* non-compliance event also presents a fascinating angle on the liability concept of the BOD in Islamic banking, which is explained in the following section. Nonetheless, it is also important to note that in most jurisdictions, the *Sharia'* board and the BOD remain immune from liability for the occurrence of any *Sharia'* non-compliance event or negligence due to either a weak *Sharia'* compliance framework or the absence of proper Islamic banking statutory legislations¹⁷¹.

3.2.2.2 Qualification of a *Sharia'* Board Member

Since the key function of the *Sharia'* board involves the supervision and alignment of the IFI's business and operations with the principles of *Fiqh Al-Muammalat*, it has to ensure that its members fulfil a set of general and specific criteria and qualifications necessary to assist the BOD and the IFI's management in the delicate task of *Sharia'* compliance assurance¹⁷². In general, a *Sharia'* board comprises a minimum number of three *Sharia'* scholars with a balance of scholars of different length of experience and different nationalities. Ideally these scholars should have received training in the juridical science of the different schools of Islamic jurisprudence¹⁷³. However, it is arguable that this minimum number of *Sharia'* board members will not suffice to accommodate the growing volume and complexities of modern Islamic banking business, especially in the case of

¹⁷⁰ Shari'ah Governance Framework for Islamic Banking Institutions, April 2014, p. 3; Simon Archer and Madzlan Mohamad Hussain, 'Islamic Finance Stability, Resilience, and Regulatory Issues' in *Islamic Finance for Asia: Development, Prospects, and Inclusive Growth* (Asian Development Bank and Islamic Financial Services Board 2015), p. 28, 31.

¹⁷¹ Bernardo Vizcaino, 'Independent Entity Needed for Sharia Supervision - Kuwait Central Bank' Thomson Reuters, 11 February 2014 <<http://uk.reuters.com/article/islamic-finance-scholars/independent-entity-needed-for-sharia-supervision-kuwait-c-bank-idUKL5N0LG02Z20140211>> accessed 20 September 2017; Emily Samra, 'Corporate Governance in Islamic Financial Institutions' [2016] University of Chicago Law School International Immersion Program Papers, p. 9. Also see Shamsher. Mohamad and Zulkarnain Muhamad Sori, 'Effectiveness of Shariah Committee in the Malaysian Islamic Financial Institutions: The Practical Perspective' Middle East Insights, Islamic Finance Special 2, 13 July 2016 <https://mei.nus.edu.sg/themes/site_themes/agile_records/images/uploads/Download_Insight_IFS_2_Shamsher_and_Zulkarnain.pdf> accessed 22 September 2017, p. 2.

¹⁷² Muneeza and Hassan, p. 124. Also see Chik, p. 8.

¹⁷³ Shari'a Standards for Islamic Financial Institutions, p. 510; K. Ginena and A. Hamid, *Foundations of Shariah Governance of Islamic Banks* (Wiley 2015), p. 289; Samy Nathan Garas, 'The Control of the Shari'a Supervisory Board in the Islamic Financial Institutions' (2012) 5 International Journal of Islamic and Middle Eastern Finance and Management 8

large IFIs¹⁷⁴. This argument also proves relevant in meeting the management's need for consultation and also in accommodating the circumstances of absent *Sharia'* scholars in light of the contentious practice of multiple *Sharia'* board directorships in the industry.

In essence, a *Sharia'* board member is required to be a Muslim and possesses a complete legal capacity that consists of 'Aql (intellect), *Baligh* (reached the age of puberty), *Rushd* (ability to exercise discretionary reasoning), and 'Adl (fair and just)¹⁷⁵. He or she may not necessarily be an Arab as persons of different national backgrounds can apply for the candidature¹⁷⁶. On the other hand, he or she must also possess knowledge in the Holy Quran and the *Sunnah*, *Usul Al-Fiqh*, *Ijma'*, *Maqasid As-Sharia'*, *Qawaid Al-Fiqhiyyah* (general principles of *Fiqh*), *Khilaf fi Arba'in Madzhab Al-Islami* (differences of opinions between the four schools of Islamic jurisprudence), and the specialisation in the detailed areas of *Fiqh Al-Muammalat*¹⁷⁷. This requirement corresponds with the following provision in the *Holy Quran*, which expounds the essential need for competency in a profession – "... *Are those equal, those who know and those who do not know? It is those who are endowed with understanding that receive admonition*"¹⁷⁸.

Accordingly, candidates must possess extensive knowledge in these areas since the *Sharia'* board engages in a wide range of matters under the *Sharia'* law of transaction, e.g. *Uqud Tamlikat* (contract of ownership), *Uqud Tawsiqat* (contract of guarantee), *Uqud Itlaqat* (general contract), *Uqud Ishtirak* (contract of partnership), *Uqud Taqyidat* (contract of restriction), *Uqud Isqatat* (contract of waiver), and *Uqud Hifz* (contract of

¹⁷⁴ F Abu Me'mer, 'The Impact of Shari'a Supervision and Its Independence on Islamic Bank Transactions' Also see Garas

¹⁷⁵ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 30. Also see Title 2: General Obligations and Governance of Islamic Banking Regulatory Framework of the Central Bank of Oman, p. 13.

¹⁷⁶ This is based on a *Hadith*, which was extracted from the final sermon of Prophet Muhammad (p.b.u.h.), "All mankind is from Adam and Eve, an Arab has no superiority over a non-Arab nor a non-Arab has any superiority over an Arab; also a White has no superiority over a Black nor a Black has any superiority over a White except by piety and righteousness". See Muhammad AbdulRaoof, *Prophet Muhammad (PBUH) A Blessing For Mankind* (published in Riyadh, 3rd edn, International Islamic Publishing House 1999), p. 18. Also see Vol. 3, Book 21, *Hadith* 1706 of Al-Tirmidhi

¹⁷⁷ Muhamad Sori Zulkarnain, Mohamad Shamsheer and Mohamed Eskandar Shah, 'Shariah Governance Practices in Malaysian Islamic Financial Institutions' <<https://ssrn.com/abstract=2579174> or <http://dx.doi.org/10.2139/ssrn.2579174> > accessed 21 September 2017, p. 9-10; Al-Qattan and Abdul Sattar, 'Towards a Systematic Model of A Policy for Shari'a Supervisory Board and Their Commitment Letter' (Proceedings of the 6th Annual Conference of AAOIFI, Bahrain, January 2007), p. 26.

¹⁷⁸ (*Surah Al-Zumar* 39:9) of Ali

deposit)¹⁷⁹. In terms of language capacity, a *Sharia'* board member must possess not just proficiency in written and spoken Arabic, but also in English or another international language, which can improve the communication channel between the IFI and its variant stakeholders¹⁸⁰.

Additionally, the *Sharia'* board may include experts from critical disciplines such as law, accounting, banking, and finance, who must also possess reasonable knowledge in *Fiqh Al-Muammalat*¹⁸¹. For instance, in Malaysia, the Central Bank of Malaysia appointed a former Chief Justice as a member of its SAC¹⁸². In fact, this healthy mixture of *Sharia'* scholars and industry experts from the stated critical disciplines can already be seen in the composition of *Sharia'* boards in various IFIs across the globe. In Pakistan, the State Bank of Pakistan ('SBP') imposes a strict qualification guideline pertaining to the appointment of a *Sharia'* board member. First, the candidate is expected to possess a minimum of second class bachelor's degree in either economics or *Fiqh*; or a postgraduate degree in either Islamic jurisprudence or any *Sharia'* law studies with sufficient exposure to banking and finance. Second, he or she must also have a minimum experience of either four years in the issuance of *Fatwas*, or five years in research and development activities related to Islamic banking¹⁸³.

¹⁷⁹ Al-Zuhaili. Also see Mohd Daud Bakar, 'The Shari'a Supervisory Board and Issues of Shari'a Rulings and Their Harmonisation in Islamic Banking and Finance' in Rifaat Ahmed Abdel Karim and Simon Archer (eds), *Islamic Finance: Innovation and Growth* (Euromoney Books 2002), p. 74-89.

¹⁸⁰ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 30. Also see Marjan Muhammad and Muhammad Mahbubi Ali, 'Who Can Exercise Ijtihad in Islamic Financial Matters?' (2014) 7 ISRA Bloomberg Bulletin, p. 1-3; Aznan Hasan and Ruslan Sabirzyanov, 'Optimal Shari'ah Governance Model in Islamic Finance Regulation' (2015) 3 International Journal of Education and Research 243, p. 254.

¹⁸¹ The fit and proper criteria in countries such as Bahrain, United Arab Emirates, and Kuwait necessitate the IFI's *Sharia'* board members to possess the knowledge in *Fiqh Al-Muammalat* and the ability to grasp financial concepts, while Pakistan requires the possession of at least 3 years' experience in *Fatwa* issuance processes. See Younes Soualhi, 'Models of Shariah Governance Across Jurisdictions' in International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters (eds), *Islamic Commercial Law Report 2016* (ISRA & Thomson Reuters 2016), p. 24; Accounting, Auditing, and Governance Standards as at December 2015, p. 886; Blake Goud and others, 'Session Two: Shariah Governance and Templatisation of Islamic Finance Products' (GIES Roundtable Series 1: Ethical & Islamic Finance, Dubai, 22 September 2014), p. 15; Bashar H Malkawi, 'Shari'ah Board in the Governance Structure of Islamic Financial Institutions' (2013) 61 American Journal of Comparative Law 539, p. 559.

¹⁸² Bank Negara Malaysia, 'Shariah Advisory Council of the Bank' (*Bank Negara Malaysia*, 2017) <http://www.bnm.gov.my/index.php?ch=en_about&pg=en_thebank&ac=439&lang=en> accessed 21 September 2017

¹⁸³ Fit and Proper Criteria for Shariah Advisors of IBIs (Revised Vide IBD Circular 2 of 2007)

By the same token, it is arguable that the above model of the *Sharia'* board, which comprises members of different areas of expertise, serves as an innovative approach in harmonising the knowledge gap between two different groups of *Sharia'* scholars. On one hand, there are 'scholars of the text', who specialises in the 'text sciences' such as Quranic exigencies, *Hadith* sciences, and *Usul Al-Fiqh*. On the other hand, there are 'scholars of the context', who are conversant in the 'context sciences' such as business, accounting, and law¹⁸⁴.

Accordingly, the alliance of both sets of *Sharia'* scholars will benefit the IFI's overall *Sharia'* compliance assurance processes and result in the construction of better quality *Fatwas* that are both *Sharia'*-compliant and practical from the modern banking perspective. All in all, it is important to note that the IFSB strongly recommended that IFIs ensure that the majority of *Sharia'* board members have received formal education and exposure in the diverse areas of the *Sharia'* law. This *Sharia'* board's composition formula can help to regulate the influence of non-*Sharia'* law experts and limits their dominance in ensuring the prevalence of the rules of *Sharia'* law in the *Sharia'* board's decision-making process¹⁸⁵.

Although the thesis will not discuss the reputational aspect of a *Sharia'* board member in detail, it is also important to note that in certain jurisdictions, the law requires the *Sharia'* board members to satisfy a set of reputational and integrity requirements in portraying the *Sharia'* board as a credible source of *Sharia'* compliance for the IFIs¹⁸⁶. For example, in Oman, Malaysia, Nigeria, and Indonesia, among others, unethical or immoral activities such as arrogance, poor personal hygiene, consumption or addiction to intoxicated drinks, and ignorance of the daily prayers, can cast reasonable doubts on a *Sharia'* board member's credibility to exercise *Sharia'* compliance function that can serve as a strong ground for board disqualification and dismissal¹⁸⁷. Since the conduct

¹⁸⁴ Tariq Ramadan, *Radical Reform: Islamic Ethics and Liberation* (Oxford University Press, USA 2008), p. 129; Aasim I. Padela, 'Islamic Bioethics: Between Sacred Law, Lived Experiences, and State Authority' (2013) 34 *Theoretical Medicine and Bioethics* 65, p. 71.

¹⁸⁵ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 30; Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 30. Also see Bakar, p. 77-78.

¹⁸⁶ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 30; di Mauro and others; Racha Ghayad, 'Corporate Governance and the Global Performance of Islamic Banks' (2008) 24 *Humanomics* 207, p. 214.

¹⁸⁷ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 30-31; Article 2.2.3.5 of the General Obligations and Governance of the Islamic Banking Regulatory Framework of the Central Bank of Oman; Peraturan Bank Indonesia Nomor 11/23/PBI/2009 Tentang Bank Pembiayaan

of a *Sharia'* board member can affect the reputation and integrity of the IFI, it is only correct that an important task such as *Sharia'* compliance assurance be restricted only to those who are known for their scholarship, knowledge, righteousness and fear of God¹⁸⁸.

3.2.2.3 Role of the BOD and the IFI's Management in *Sharia'* Compliance Assurance

Although the responsibility of *Sharia'* compliance assurance mainly rests with the *Sharia'* board, it does not necessarily infer that the BOD and the IFI's management share no part in promoting a sound *Sharia'*-compliant framework within the IFI's business operations. Regardless of the absence of clear statutory provisions in most countries to enforce the BOD's accountability for *Sharia'* non-compliance events, the BOD remains the ultimate decision-making authority, which shares a parallel responsibility with the *Sharia'* board to play an active role in guaranteeing the IFI's *Sharia'* compliance by taking into account the comprehensive interest of other stakeholders instead of focusing solely on the interest of the IFI's shareholders¹⁸⁹. This includes: the approval of *Sharia'*-related policies on Islamic banking; the provision of proper training in improving employees' understanding of *Sharia'* compliance and the ability to communicate their *Sharia'* concerns¹⁹⁰; the appointment of a competent *Sharia'* board; and respecting the autonomy of the *Sharia'* board¹⁹¹.

In comparison with the other key Islamic banking markets, Malaysia has taken a step ahead in holding the BOD accountable for the IFI's *Sharia'* compliance by introducing

Rakyat Syariah (Bank Indonesia Regulation No. 11/23/PBI/2009 Concerning Islamic Bank Financing), p. 18; Guidelines on Shariah Governance for Non-Interest Financial Institutions in Nigeria, p. 4.

¹⁸⁸ See Resolution N'104 (7/11) of Fatwa of the Council of the Islamic Fiqh Academy 1985-2000

¹⁸⁹ Accounting, Auditing, and Governance Standards as at December 2015, p. 951, 955; Archer and Hussain, p. 28, 31; Masudul Alam Choudhury and Mohammad Ziaul Hoque, *An Advanced Exposition of Islamic Economics and Finance*, vol 25 (Edwin Mellen Pr 2004), p. 57-58, 85-88; Ginena.

¹⁹⁰ Accounting, Auditing, and Governance Standards as at December 2015, p. 915; AL Janahi, 'Islamic Banking, Concept, Practice and Future' [1995] Manama: Bahrain Islamic Bank

¹⁹¹ This would include, among other, the recognition of the *Sharia'* board's independence in making its own decisions, and abstaining from influencing any of its resolutions. See Section III of the Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3 Also see Malaysia International Islamic Financial Centre (MIFC); Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3

specific statutory provisions and guidelines. This is illustrated by section IV of the *Shariah Governance Framework for Islamic Financial Institutions 2011* ('SGF 2011'), which places equal responsibilities for *Sharia'* compliance assurance on both the *Sharia'* board and the BOD. In other words, it requires the BOD and the IFI's management to possess a reasonable understanding of the principles of *Sharia'* law and its application in Islamic banking¹⁹². In the IFSA 2013, the CEO and senior officers of the IFI are also held accountable for the IFI's *Sharia'* compliance assurance¹⁹³. Interestingly, the failure to ensure *Sharia'* compliance will, upon conviction, render these corporate officials subject to imprisonment for a term not exceeding 8 years or to a fine not exceeding 25 million Malaysian Ringgit (approximately US\$ 5.8 million) or to both¹⁹⁴. Thus, these statutory provisions re-emphasise the notion of *Sharia'* compliance assurance as a collective accountability of all the corporate organs of the IFI such as the CEO, BOD, *Sharia'* board, and the employees. Further, it stresses the fact that the law does not treat the *Sharia'* board member any differently than the director when it comes to the performance of their respective duties, even if their category of duties differs from one another, *i.e.* the responsibility to assure the IFI's *Sharia'* compliance for the *Sharia'* board member, and the overall compliance for the directors. Both sets of board member must exercise the same level of care and due diligence to the IFI.

As the BOD often requires the advice of the *Sharia'* board, especially in relation to *Sharia'* compliance matters, a concern arises as to the appropriate recourse of action in the event of differences of opinions between the two check-and-balance corporate organs. This is a critical issue and some countries such as Malaysia have already introduced statutory provisions that hold the *Sharia'* board accountable for the occurrence of *Sharia'* non-compliance events. Since the BOD remains the ultimate decision-making authority for the IFI's general business policy¹⁹⁵, there is a concern about the legal implication of

¹⁹² *Shariah Governance Framework for Islamic Financial Institutions* BNM/RH/GL_012_3, p. 17-18. Also see *Fit and Proper Criteria* BNM/RH/GL 018-5, p. 1; Ahcene Lahsasna, *Shariah Aspects in Business and Finance* (published in Kuala Lumpur, The International Centre for Education in Islamic Finance (INCEIF) 2010)

¹⁹³ Section 29 (3) of Islamic Financial Services Act 2013 (Act 759). However, it must be noted that the Malaysian IFSA 2013 is the first legislation of its kind that expressly impose liability on the *Sharia'* board, BOD, CEO and relevant officers for *Sharia'* non-compliance events. See Andrew Jones and Sandy Hendry, 'Malaysia Legislates Jail for Shariah Scholars Over Insurer, Bank Breaches' *Insurance Journal* (San Diego, 23 August 2013) <<http://www.insurancejournal.com/news/international/2013/08/23/302671.htm>> accessed 16 September 2017

¹⁹⁴ Section 28 and 29 of Islamic Financial Services Act 2013 (Act 759)

¹⁹⁵ Casper, p. 9; Archer and Hussain, p. 28, 31.

a *Sharia'* decision 'altered' by the BOD which it considers not to be advancing the best interest of the IFI. In such a situation, will the law consider that the *Sharia'* board has discharged its obligations satisfactorily or will the *Sharia'* board remain liable for the occurrence of any *Sharia'* non-compliance event as a result of an alteration by the BOD?

Additionally, since the primary responsibility for ensuring the maximisation of shareholders' value rests with the BOD and a number of its decisions may involve contentious *Sharia'* compliance issues such as the status of investment in FOREX, stock exchange, and *Sukuk*, it is arguable that the differences in the VMOs between the BOD and the *Sharia'* board can threaten the IFI's credibility as a *Sharia'*-compliant banking institution. For this reason, the IFSB-10 has recommended that IFIs have in place an appropriate and transparent guideline for resolving any differences between the BOD and the *Sharia'* board¹⁹⁶.

Comparatively, the processes are more straight-forward in countries that have adopted a centralised Islamic corporate governance approach due to the presence of a national *Sharia'* board, which often serves as the final authority in resolving any disputes between the IFI's BOD and its *Sharia'* board. For instance, in Pakistan and Nigeria, the BOD and the *Sharia'* board can present their disputes and arguments before the national *Sharia'* board, which will ultimately issue a final decision of the case¹⁹⁷. Similarly, Malaysia has taken a proactive approach in mitigating this internal dispute by recommending the IFI to consider appointing at least one *Sharia'* board member on the BOD to serve as a 'bridge' between the two corporate organs¹⁹⁸. Since the decision of the *Sharia'* board binds the BOD in Malaysia, the appointment of a *Sharia'* board member as a director on the BOD can serve as a strategic initiative fostering a greater understanding and appreciation of the *Sharia'* decisions made by the *Sharia'* board¹⁹⁹. Nonetheless, as the

¹⁹⁶ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 15. Also see Hawkamah Institute for Corporate Governance, *Policy Brief on Corporate Governance for Islamic Banks and Financial Institutions in the Middle East and North Africa Region* (2011), p. 8.

¹⁹⁷ Shari'ah Governance Framework for Islamic Banking Institutions, April 2014, p. 8. Also see Guidelines on Shariah Governance for Non-Interest Financial Institutions in Nigeria, p. 9.

¹⁹⁸ Principle 2, section II of Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 10. Also see Soualhi, p. 23.

¹⁹⁹ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 10. Also see Ahcene Lahsasna, 'Shariah Governance in the Islamic Financial Institution: Issues and Challenges' (5th International Conference on Business and Economic Research Proceeding, Kuching, 24-25 March 2014), p. 706.

dispute resolution processes may differ from one jurisdiction to another and also depend on the adopted Islamic corporate governance framework of each country, the conflict of opinions between the BOD and the *Sharia'* board presents another crucial area that could benefit from better clarification from the relevant authorities.

3.2.3 *Modus Operandi* of Islamic Corporate Governance in IFIs

In the last 15 years, the IFSB had developed three Guiding Principles to assist in strengthening the corporate governance structures and processes of the IFIs and promoting soundness and stability to the global Islamic banking industry²⁰⁰. However, it is also important to remember that the term 'Islamic corporate governance' and its operational processes have not been properly defined in any of the existing IFSB standards. Since Islamic corporate governance from the Islamic banking context refers to the way an IFI is directed, governed and controlled, it is crucial to understand how the system functions within an IFI's operational environment. As a basis of this discussion, reference will be made to the IFSB-10, which presents a comprehensive and practical depiction of the common procedures that take place in the Islamic corporate governance system of the IFIs (see **Figure 8**).

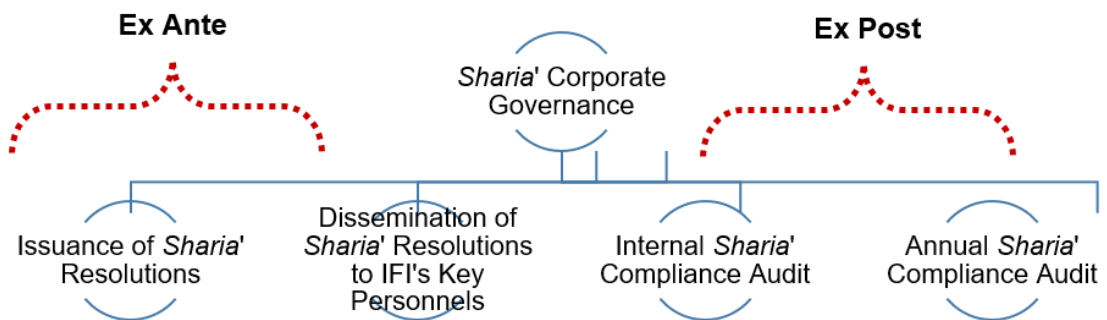


Figure 8: Key Processes in Islamic Corporate Governance²⁰¹

²⁰⁰ These include the Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds) (IFSB-3); Guiding Principles on Governance for Islamic Collective Investment Schemes (IFSB-6); and Guiding Principles on Governance for *Takaful* (Islamic Insurance) Undertakings (IFSB-8). See Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 1.

²⁰¹ Modified. See *ibid*, p. 2-4.

The first process is the issuance of *Fatwas* by the *Sharia'* board on *Sharia'*-related issues relevant to the IFI's line of business. As this process is an intellectual and technical effort, it involves rigorous deliberations among the *Sharia'* board members in endorsing the IFI's financial products, services, and business conducts and ensuring their fulfilment and compliance with all of the *Sharia'* law principles relating to *Fiqh al-Muammalat*²⁰². Once the *Sharia'* board has issued a *Fatwa*, it becomes a *Hukm Al-Sharia'* (*Sharia'* ruling) that binds the IFI²⁰³. Since it involves delicate *Sharia'* law procedures, it is imperative that all *Sharia'* board members be present during the process. Depending on the policy of a country's supervisory authority, the *Sharia'* board may be required to disclose and publish its *Fatwas* and *Sharia'* decision-making processes, their application to the IFI's financial operations, and any relevant internal policies pertaining to *Sharia'* compliance assurance²⁰⁴. This policy would not only provide essential information to stakeholders concerning the IFI's ability to achieve both its financial and *Sharia'*-related objectives, but also educate them on the *Sharia'* compliance processes that occurred within the IFI and further enhance their confidence in the credibility of *Fatwas* issued by the *Sharia'* board²⁰⁵.

However, recent studies such as Hasan²⁰⁶ highlighted a weak disclosure practice by the IFIs in the GCC, Malaysia, and United Kingdom, with only 10 per cent of the 80 IFIs' research participants having published their *Sharia'* boards' *Fatwas* pertaining to the Islamic financial products and services offered. This finding is consistent with research

²⁰² Several empirical studies have pointed out that IFIs' *Sharia'* board had also interacted with the stakeholders before any decision is taken. Nonetheless, there has yet to be any concrete evidence regarding the stakeholders' participation in the IFI's decision-making processes based on this researcher's observation of several IFI's annual reports. See Hasan, 'Corporate Governance: Western and Islamic Perspectives', p. 284-285. Also see Muneeza and Hassan, p. 124.

²⁰³ Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 12. However, this binding legal effect is also subjected to the individual country's legal and regulatory framework. See Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 2.

²⁰⁴ Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 11. Also see Mohamad and Sori, p. 3-4; Grassa, p. 146.

²⁰⁵ Wafik Grais and Matteo Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services* (WPS4054, 2006), p. 8-9. Also see Humayon Dar and Talha Ahmad Azami, *Global Islamic Finance Report (GIFR) 2013* (BMB Islamic UK Limited, 2013), p. 119.

²⁰⁶ Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK', p. 290.

by Unal²⁰⁷ revealing a substantial dearth of information within the disclosure practice of the IFIs, which rarely includes the *Sharia'* board's justifications pertaining to the permissibility or impermissibility of an Islamic banking instrument. Correspondingly, it suggests that the minimal publication and disclosure of the *Fatwas* and the *Sharia'* decision-making processes within the industry necessitates significant attention from both the industry's regulators and the IFIs themselves in improving consumer awareness of the essential *Sharia'* law principles that underline the IFIs' services²⁰⁸.

The second process involves the dissemination of the issued *Fatwas* to the IFI's key personnel such as the accounting, legal, business, risk, audit and other relevant departments that are responsible for the bank's *Sharia'*-compliant operations. This role would normally be undertaken by either a *Sharia'* compliance officer ('SCO') or the ISCD, both of which must be independent from the other business units and departments²⁰⁹. Accordingly, they will provide the monitoring and assurance of the day-to-day compliance of the IFI's operations with the *Fatwas*, and the revision of contracts and agreements with customers according to the IFI's *Sharia'* compliance policy²¹⁰.

Similar to the Western corporate governance system, the function of an audit is also crucial in the Islamic corporate governance system as it measures the financial integrity of the entire company²¹¹. For this reason, the third process involves an internal *Sharia'* compliance audit to determine the fulfilment of the *Sharia'* compliance aspect within the IFI's operations which corresponds to Principle 3.2 of the IFSB-3²¹². This includes the examination of financial contracts and agreements, IFI's policies, financial products and services, memorandum and articles of association, financial statements, circulars, and

²⁰⁷ Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*, p. 6-7.

²⁰⁸ For example, the BNM's SAC had published several compilations of *Sharia'* resolutions with detailed *Sharia'* explanations. See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*. Also see Van Greuning and Iqbal, p. 216.

²⁰⁹ See p. 101.

²¹⁰ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 8. Also see Faddad

²¹¹ L Krishnan, 'The Role of Auditors in the Context of Corporate Governance' (2010) 3 *Current Law Journal*, p. 2; Pricewaterhouse Coopers, *Shariah Audit: Industry Insights* (2011), p. 8-9.

²¹² "IFI shall comply with the *Sharia'* rules and principles as expressed in the rulings of the IFI's *Sharia'* scholars. The IFI shall make these rulings available to the public". See Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 12.

reports²¹³. Similar to the second process, this function can also be executed by either a *Sharia'* compliance officer or the ISAD, who will verify the fulfilment of the *Sharia'* compliance aspect within the IFI's operations and report any incident of *Sharia'* non-compliance directly to the *Sharia'* board. The subsequent investigation findings must then be presented to both the IFI's Audit Committee and the *Sharia'* board.

Finally, the fourth process involves an annual *Sharia'* compliance audit by the *Sharia'* board to verify the IFI's overall fulfilment of the principles of *Maqasid As-Sharia'* within the financial year²¹⁴. Subsequently, the findings are presented in two sets of reports, namely a general statement of compliance that is included in the IFI's annual report, and a detailed report on the *Sharia'* compliance work undertaken by the IFI, which is specifically disclosed to the relevant regulatory authorities²¹⁵. However, it is also important to note that empirical studies such as that conducted by Maali²¹⁶ discovered that these reports may not necessarily represent a transparent indication of the IFI's compliance with the *Sharia'* law. This was evidenced from the analysis of annual reports of 29 IFIs across 16 countries in which the IFIs did not disclose their policies and course of action on defaulting customers²¹⁷. In other words, the finding suggests that the IFIs are only keen to disclose matters that can enhance their 'Islamic' image and not those that can attract negative criticisms from the stakeholders²¹⁸. Hence, this presents another critical challenge for the industry's regulators and the IFIs in assuring

²¹³ Lahsasna, *Introduction to Fatwa, Shariah Supervision & Governance in Islamic Finance*, p. 247; Mohd Zamerey Abdul Razak and Nurmaezah Omar, 'Audit Syariah Dalam Institusi Kewangan Islamic di Malaysia (Sharia Audit in Islamic Financial Institution in Malaysia)' (2008) 1 *Jurnal Muamalat* 135, p. 140-141.

²¹⁴ Muneeza and Hassan, p. 124. Also see Michael E Murphy, 'Assuring Responsible Risk Management in Banking: The Corporate Governance Dimension' (2011) 36 *Del J Corp L* 121, p. 135-136.

²¹⁵ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 3-4; Accounting, Auditing, and Governance Standards as at December 2015; Nawal Kasim, Sheila Nu Nu Htay and Syed Ahmed Salman, 'Conceptual Framework for Shari'ah Corporate Governance with Special Focus on Islamic Capital Market in Malaysia' (2013) 4 *International Journal of Trade, Economics & Finance* 336, p. 337.

²¹⁶ Bassam Maali, Peter Casson and Christopher Napier, 'Social Reporting by Islamic Banks' (2006) 42 *Abacus* 266, p. 286.

²¹⁷ In the event of default, it is common for banks, including the IFIs, to impose a penalty in the form of late-payment interest ('LPI'). Since this is an addition towards the principal sum, it constitutes *Riba'*, which is the *Sharia'* law forbids. In Malaysia, the BNM's SAC declared that the LPI is permissible based upon the principles of *Gharamah* (fine or penalty) and *Ta'widh* (compensation). See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 129-131.

²¹⁸ Maali, Casson and Napier, p. 286.

stakeholders that the notion of transparency is maintained and reflected in the annual reports.

3.3 Islamic Corporate Governance Models

3.3.1. An International Standard System

Although there are a number of international standard-setting organisations for the Islamic banking industry such as the General Council for Islamic Banks and Financial Institutions ('CIBAFI'); the International Islamic Financial Market ('IIFM'); the Islamic International Rating Agency ('IIRA'); the Liquidity Management Centre ('LMC'); the International Islamic Centre for Reconciliation and Commercial Arbitration ('IICRCA'); the International Islamic Liquidity Management ('IILM'); the Arbitration Centre for Islamic Banks and Financial Institutions ('ARCIFI'); the Bank for International Settlements ('BIS'); and the International Monetary Fund ('IMF')²¹⁹, there are only two prominent organisations that have continued to improve the industry's Islamic corporate governance standards and guidelines, namely the AAOIFI, which is domiciled in Bahrain, and the IFSB, which is headquartered in Kuala Lumpur, Malaysia²²⁰.

Additionally, there also exist organisations such as the *Fiqh* Academy of the OIC, the *Fiqh* Academy of the Muslim World League ('MWL'), the Al-Azhar Seminary, the *Dar Al-Ifta* (the Egyptian Office of the Mufti), and the General's Presidency of *Ifta* of Saudi Arabia, which provide *Fatwas* on Islamic banking and finance matters from time to time²²¹. However, since the expertise of these organisations are more specific to common public issues such as marriage, divorce, *faraid* (inheritance), custody of children, *wasiah* (wills), ethical issues, and customary practices, this chapter will primarily focus on the AAOIFI

²¹⁹ Islamic Development Bank (ed), *39 Years in the Service of Development* (Islamic Development Bank 2013), p. 11. Also see Kureshi and Hayat, p. 169; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*, p. 2.

²²⁰ Muhamed Zulkhibri Abdul Majid and Reza Ghazal, 'Comparative Analysis of Islamic Banking Supervision and Regulation Development' (2012) 6 *Money and Economy* 50, p. 119; Dian Kartika Rahajeng, 'Sharia Governance: Sharia Supervisory Board Model of Islamic Banking and Finance in Indonesia' Available at SSRN 2366722: <http://ssrncom/abstract=2366722> or <http://dxdoiorg/102139/ssrn2366722>. Also see Shanmugam and Zaha Rina

²²¹ Mohammad Akram Laldin and Hafas Furqani, 'Shariah Scholars, Ijtihad and Decision Making in Islamic Finance' (2015) 5 *Journal of Islamic Business and Management* 37, p. 38; Muhammad Khalid Masud, Brinkley Messick and David S Powers, *Islamic Legal Interpretation: Muftis and their Fatwas* (Harvard University Press 1996), p. 4-32, 286-296.

and the IFSB given their specific focus on the fields of Islamic banking and Islamic corporate governance.

3.3.1.1 The Accounting and Auditing Organisation for Islamic Financial Institution

Since its establishment in Algiers on 26 February 1990, this non-profit organisation has become an important standard-setting organisation for the Islamic banking industry. Its membership is comprised of central banks, IFIs, *Takaful* firms, investment firms, and auditing firms²²². To date, it has issued 94 standards covering auditing, accounting, Islamic corporate governance, ethical and *Sharia'* issues in Islamic banking²²³. These include seven Islamic corporate governance standards for the IFIs, namely the *Sharia'* Supervisory Board: Appointment, Composition and Report (No.1); *Sharia'* Review (No. 2); Internal *Sharia'* Review (No. 3); Audit and Governance Committee for IFIs (No. 4); Independence of *Sharia'* Supervisory Board (No. 5); Statement of Governance Principles for IFIs (No. 6) and Corporate Social Responsibility, Conduct, and Disclosure for IFIs (No. 7)²²⁴.

The primary aim of the AAOIFI is to coordinate the variant concepts and applications of *Sharia'* law, particularly *Fiqh Al-Muammalat*, in financial transactions through the development of common and universally acceptable Islamic banking standards. Although the AAOIFI standards have improved the corporate governance structure of the IFIs, there are a number of contentious issues, which remain unaddressed and have resulted in the increasing uncertainty surrounding the structure of the IFI's *Sharia'* board and the role of its members. These include issues such as the multiple *Sharia'* board directorship practices across the other IFIs, an opaque understanding of *Sharia'* rulings, the irregularity of *Sharia'* rulings, the outsourcing of *Sharia'* compliance function to *Sharia'* advisory firms, and the shortage of banking-literate *Sharia'* scholars. From the legal

²²² Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Institutional Membership' (AAOIFI, 2017) <<http://aaoifi.com/structure/?lang=en#>> accessed 22 September 2017

²²³ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'About AAOIFI' (AAOIFI, 2017) <<http://aaoifi.com/about-aaofii/?lang=en>> accessed 18 September 2017

²²⁴ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Issued Standards' (2017) <<http://aaoifi.com/issued-standards-3/?lang=en>> accessed 18 September 2017. Also see Abu Me'mer; Garas

perspective, it is arguable that these loopholes are attributable to several significant factors.

The first issue is the non-binding status of the AAOIFI's *Sharia'* and corporate governance standards. Although the standards are comprehensive in terms of their scope and the integration of the variant opinions of the major schools of Islamic jurisprudence, they are not legally binding on the IFIs. In fact, the adoption of these standards remains voluntary in most countries²²⁵. Whilst the adoption of the AAOIFI's *Sharia'* standards have become part of mandatory regulatory requirement and *Sharia'* guidelines in Bahrain, Oman, Pakistan, Sudan, Syria, Malaysia and Indonesia; and voluntary in countries such as Brunei, United Arab Emirates, France, Jordan, Kuwait, Lebanon, Saudi Arabia, Qatar, South Africa, and United Kingdom, among others, the adoption of its corporate governance standards remains voluntary²²⁶. Nonetheless, it is also important to note the growing shift towards the adoption of these standards within new and emerging markets such as Oman, Morocco, Nigeria, and Bangladesh, which presents an early and promising indication of greater harmonisation of cross-border Islamic banking standards in the near future²²⁷.

In the same light, it is also arguable that the legal status of the AAOIFI's Islamic banking standards has not received much discussion and analysis from *Sharia'* scholars and industry practitioners. The legal position of *Fatwa* under *Sharia'* law as merely a non-binding explanation of a *Sharia'* issue may have influenced such a view²²⁸. Furthermore,

²²⁵ Islamic Development Bank and Islamic Financial Services Board, p. 31; Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2014*, p. 57. Further, in Bangladesh, none of the IFIs complied with the AAOIFI's *Sharia'* Standards because none of them has any audit or governance committee. See EVP Mahmood Ahmed and Maksuda Khatun, 'The Compliance with Shariah Governance System of AAOIFI: A Study on Islamic Banks Bangladesh' (2013) 9 *Journal of Islamic Economics, Banking and Finance*.

²²⁶ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Adoption of AAOIFI Standards' (AAOIFI, 2017) <<http://aaoifi.com/adoption-of-aaoifi-standards/?lang=en>> accessed 17 September 2017. Also see Khairul Nizam, 'Discussions on AAOIFI Governance Standards' (AAOIFI - World Bank Annual Conference on Islamic Banking and Finance, Manama, Bahrain, 7 December 2015), p. 15; Islamic Development Bank and Islamic Financial Services Board, p. 31; Said Bourheraqua, 'The Concept and Practices of Standardisation in Islamic Finance' in International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters (eds), *Islamic Commercial Law Report 2016* (ISRA & Thomson Reuters 2016), p. 50.

²²⁷ Thomson Reuters, *Islamic Finance Development Report 2014* (2014), p. 8, 117.

²²⁸ M. Rohe and G. Goldbloom, *Islamic Law in Past and Present* (Brill 2014), p. 94; P. Bearman and P.R. Peters, *The Ashgate Research Companion to Islamic Law* (Ashgate Publishing Limited 2014); p. 93; Shaharuddin and others, p. 7. Also see Musthofa bin Sa'ad Al-Ruhaibaniy, *Mathâlib Ûli An-Nuhâ fî Syarh Ghâyah Al-Muntahâ*, vol 6 (Hanafi Fiqh, Al-Maktab Al-Islami 1994), p. 437.

the *Muktabar* (officially recognised or popular) opinion of the major schools of Islamic jurisprudence allows the diversity of *Fatwas* to exist in matters that do not constitute an *Usul* (fundamental principle) under *Sharia'* law²²⁹. For example, the *Ibadat*²³⁰ constitutes part of an *Usul*. If a Muslim changes any element of the *Ibadat*, for instance, performing the *Fajr* (morning) prayer in the afternoon, or the *Hajj* at other places than Mecca, Saudi Arabia, it amounts to a *Bida'ah*, or diversity in *Usul*, which the *Sharia'* law forbids.

By contrast *Sharia'* scholars do not consider Islamic banking as a form of *Usul*, but rather as *Furu'* (a subdivision of *Fiqh*), which permits the existence of diversity of opinions²³¹. At this point, it is hardly surprising that several *Sharia'* scholars contend that the attempt to standardise and unify the divergent Islamic banking standards is baseless and unnecessary because it defeats the spirit of *Ijtihad* (independent reasoning) under *Sharia'* law, which permits flexibility in interpreting *Fatwas* based on one's legal, political, and socioeconomic circumstances²³². In fact, the notion of diversity of opinions in *Sharia'* law has received a great support from a number of prominent *Sharia'* scholars, including the caliph Umar bin Abdul Aziz, who opined that it provides mankind with a wider range of perspectives and solutions to a *Sharia'* issue²³³.

As an example, the Islamic banking products of *Bai Al-Inah* and *Tawarruq* were declared impermissible by the IFIs' *Sharia'* boards within the majority of the GCC countries based on the contention that they provided a 'back door' to circumvent the *Sharia'* law prohibition of *Riba*²³⁴. However, the *Sharia'* scholars in Malaysia have decided to legalise them based on the concept of *Maslahah* (public interest), which refers to the need for,

²²⁹ Doi, p. 85; Saadan Man and Abdul Karim Ali, 'Ikhtilaf Fiqhi di Kalangan Aliran Syafi'iyah dan Salafiyah di Malaysia: Analisis Retrospektif Terhadap Faktor Pencetus (Ikhtilaf Fiqh Among the Shafi'iyah and Salafiyah in Malaysia: Retrospective Analysis of the Triggering Factor)' (2005) 2 *Jurnal Fiqh*, p. 78.

²³⁰ See footnote 73 in Chapter 3.

²³¹ Doi, p. 85. Also see Al-Dahabi, *Siyar A'lam Al-Nubala (The Lives of Noble Figures)* (Muassasah Al-Risalah 1984), vol. 8, p. 98.

²³² Rahmat Hakim, 'Harmonization of Shariah Rulings in Islamic Finance: An Analysis' (2013) 7 *Ijtihad*, p. 272; K. Hassan and M. Mahlknecht, *Islamic Capital Markets: Products and Strategies* (Wiley 2011), p. 314, 328. Also see *ibid*, p. 327.

²³³ Ibn Abd Al-Barr and Yusuf Ibn Abd Allah, *Jami' Bayan Al-Ilm Wa Fadlih (The Comprehensive Exposition of Knowledge and Its Excellence)*, vol 2 (published in Riyadh, Dar Ibn Al-Jawzi Lil Nashr Wa Al-Tawzi 1994), vol. 2, p. 902. Also see chapter 52 (*Ikhtilaful Fuqaha*) of Abdullah Al-Darimi, *Sunan Al-Darimi* (published in Beirut, Darul Basyair 2013)

²³⁴ M.K. Hassan, *Handbook of Empirical Research on Islam and Economic Life* (Edward Elgar Publishing 2016), p. 288; Shahrudin, p. 129. Also see p. 41 and 62-63.

and reliance upon, such products in the modern Muslim community²³⁵. Accordingly, the SAC of the Securities Commission of Malaysia has issued an affirmative *Fatwa* to decree the application of these contentious products as *Harus* or permissible based on the rationale that they can further advance the development of financial products in the Malaysian Islamic banking market²³⁶. Although this opinion received heavy criticism from the *Sharia'* scholars of the GCC, the entire episode demonstrates the diversity of opinions accorded by the *Sharia'* law – which never asserts a *Fatwa* as binding.

Nonetheless, it must also be acknowledged that the policy of the AAOIFI can confuse stakeholders. On one hand, the voluntary nature of the AAOIFI's Islamic banking standards appears to be consistent with the recognition of the diversity of opinions under *Sharia'* law. On the other hand, it promulgates that IFIs must adhere to the *Fatwas* issued by their respective *Sharia'* boards. This is evidenced from Point 6/1 of the AAOIFI's *Sharia'* standards No. 29 (Stipulations and Ethics of *Fatwa* in the Institutional Framework), which stipulates:

*“The institution is obliged to follow the Fatwa once it is issued regardless of whether it meets the satisfaction of the management or not. This obligation holds true when the Fatwa entails enforcement or prohibition of a certain act. When the Fatwa entails permissibility of the act in question, the institution has the right to refrain from following it, if it believes that for practical needs it has to do so. In this case, however, rejection of the board Fatwa should be reported to the General Assembly of the institution”*²³⁷.

Although the adoption of the AAOIFI accounting and *Sharia'* standards can promote uniformity in accounting and contract documentation practices, their non-binding status poses a challenge to the entire Islamic banking industry. Additionally, as the diversity of *Fatwas* provides the IFIs with the flexibility to select suitable *Fatwas* that complement the

²³⁵ Amir Shahrudin, 'The Bay' al-'Inah Controversy in Malaysian Islamic Banking' (2012) 26 Arab Law Quarterly 499, p. 6; Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 109; Shofian Ahmad and Samsinar Sulaiman, 'Penggunaan Hiyal dalam Produk Bay al-Inah dan Bay al-Tawarruq oleh Institusi Kewangan di Malaysia (The Application of Hiyal in Bay al-Inah and Bay Al-Tawarruq Products by Islamic Financial Institutions in Malaysia)' in Md Yazid Ahmad, Anwar Fakhri Omar and Mohammad Zaini Yahaya (eds), *Isu Syariah & Undang-Undang (Sharia & Law Issue)* (Universiti Kebangsaan Malaysia 2014) <<http://ukmsyariah.org/terbitan/index.php/isusyariah20/>> , p. 43.

²³⁶ Resolutions of the Securities Commission Shariah Advisory Council, Second Edition, p. 24. Also see Zulkifli Hasan, 'Legal Thoughts of Madhhab Al-Shafi'i in the Implementation of Islamic Banking in Malaysia' (International Seminar on Legal Thought of Madhhab Shafi'i), p. 16.

²³⁷ Shari'a Standards for Islamic Financial Institutions, p. 510.

business and legal climate of their respective countries, the AAOIFI's call for a binding *Fatwa* also acts against the classical understanding of *Fatwa* as a non-binding *Sharia'* opinion²³⁸. However, it is also arguable that the AAOIFI's call for a binding *Fatwa* can provide a fitting solution in regulating the malpractice of *Talfiq* (combination of different *Fatwas* to create a new *Fatwa*)²³⁹ and *Fatwa*-shopping, which neglects the integrity and consistency of the variant schools of Islamic jurisprudence²⁴⁰. This corresponds to point 6/3 and 6/4 of similar *Sharia'* standards which stipulates:

*“The institution should not follow the Fatwas of other Sharia' Advisory Boards except with permission of its own Board. The institution should not demand Fatwa according to a specific Mazhab (sect) of Fiqh even if it is the official sect in its host country, or the sect that official Fatwa bodies adhere to. However, attention should be given to situations where the legal or judiciary system in the country observes a specific sect, and the issue in question may be taken to the courts in the future”*²⁴¹.

From the Islamic banking perspective, *Fatwa*-shopping refers to the practice of seeking favourable *Sharia'* opinions from a *Sharia'* scholar or *Sharia'* consultancy firm that suit the IFI's business and financial interests²⁴². This objective, according to Ibn Qayyim, constitutes a juristic ruse as it seeks the mere permissibility of a matter rather than implementing the truth²⁴³. However, Sheikh Nizam Yacuby, a prominent *Sharia'* jurist and *Sharia'* board member of the AAOIFI, has dismissed the allegation of *Fatwa*-shopping practices within the industry as a negative campaign to halt its growth²⁴⁴.

²³⁸ Shahrudin and others, p. 7-8. Also see Al-Ruhaibaniy, p. 437.

²³⁹ Wahbah Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)* (published in Damascus, Dar al-Fikr 1996), vol. 2, p. 1143. Also see Hallaq Wael, *A History of Islamic Legal Theories: An Introduction to Sunni Usul Al-Fiqh* (Cambridge University Press 1999), p. 207-215.

²⁴⁰ Shahrudin and others, p. 8; Foster

²⁴¹ Shari'a Standards for Islamic Financial Institutions, p. 510.

²⁴² Rodney Wilson, *The Development of Islamic Finance in the GCC* (Working Paper, Kuwait Programme on Development, Governance and Globalisation in the Gulf States, May 2009, 2009), p. 8. Also see Ethica Institute of Islamic Finance (ed), *Fiqh or Fiction* (March 2011 edn, CPI Financial 2011), p. 21.

²⁴³ Ibn Qayyim Al-Jawziyya, *Al-Turuq Al-Hukmiyya Fi Al-Siyasa Al-Shar'iyya (Methods of Judgment in a Sharia-Oriented Policy)* (Abd Al-Hamid Al-Askari tr, Matba'a Muhammadiyya 1961)

²⁴⁴ Muhammad

However, several empirical studies exist which have pointed out the presence of the practice within the industry. For instance, Ullah²⁴⁵ discovered that several IFIs' managements were interested in the concept of *Fatwa*-shopping and the lure of having lenient *Sharia'* advisors. This can be exemplified by the controversial Goldman Sachs's US\$ 2 billion *Sukuk* programme in 2011 which was the subject of massive criticism from *Sharia'* scholars and industry analysts worldwide, who were not only sceptical about the programme's compliance with *Sharia'* law, but also the nature of the bank's appointment of the *Sharia'* scholars whom the bank 'expected' to approve the *Sukuk* issuance²⁴⁶. Although a small number of the *Sharia'* scholars appointed claimed that they were unaware of their appointment or the existence of the programme, the case had not only proven the presence of *Fatwa*-shopping incidents in the industry, but also its leveraging potential as a short-cut mechanism for the banks to obtain favourable *Fatwas*²⁴⁷.

The AAOIFI's Islamic banking standard has prohibited IFIs from adopting the *Fatwas* of other IFIs' *Sharia'* boards or demanding *Fatwas* that subscribed to a specific Islamic school of jurisprudence²⁴⁸. This is in recognition of the potential repercussions that can jeopardise the reputation of both the IFIs and the industry in the event a *Fatwa* is incorrect, vague or overly complicated, or reversed when no longer subscribed to by the IFIs' *Sharia'* board members²⁴⁹. Although this thesis does not aim to reflect upon the issue of *Fatwa*-shopping in great detail, this researcher opines that the concept of a binding Islamic banking standard possesses its own merits as it can regulate the stated

²⁴⁵ Ullah, p. 90-92.

²⁴⁶ Goldman Sachs already has the reputation of a controversial financial entity, which unwavering pursuit of profit has come at the price of its reputation with many considering its role in the European sovereign debt crisis, amongst other controversies, as a solid ground to view it as an unethical banking institution. See Brand Finance, *Brand Finance Banking 500* (Brand Finance 2012)

²⁴⁷ Thomson Reuters, 'SocGen Avoiding Goldman Missteps with \$300 mln Sukuk Plan' Chicago Tribune, 11 September 2013 <<http://www.reuters.com/article/societegenerale-sukuk/corrected-socgen-avoiding-goldman-missteps-with-300-mln-sukuk-plan-idUSL6N0G01IS20130911>> accessed 16 September 2017; Thomson Reuters, 'Debate Rages over Western Role in Islamic Finance' Thomson Reuters, 23 February 2012 <<http://www.reuters.com/article/islamicfinance-west/refile-debate-rages-over-western-role-in-islamic-finance-idUSL5E8DN45E20120223>> accessed 17 September 2017

²⁴⁸ Shari'a Standards for Islamic Financial Institutions, p. 510.

²⁴⁹ If a *Sharia'* board negligently issues a *Fatwa* without due consideration and is found to be mistaken, it can be subjected to liability for any losses suffered by the financial institution as a result thereof. See Ginena. Also see Gulf African Bank, 'The Role of the Shari'ah Supervisory Boards and Shari'ah Coordinators' (2nd East and Central African Islamic Finance Conference) Securities Commission Malaysia, *Malaysian Islamic Capital Market*, vol 5 (Securities Commission Malaysia 2010) Shaykh Yusuf Talal DeLorenzo, 'Shari'ah Compliance Risk' (2006) 7 Chi J Int'l L 397 Shanmugam and Zaha Rina

controversial practices and create a strong regulatory environment for the global Islamic banking industry.

A second to address is the limited access to the AAOIFI's Islamic banking standards. At the time of this writing (August 2017), the AAOIFI standards are only accessible through an online purchase or hardcopy subscriptions²⁵⁰. This may be justified in a number of ways such as the desire to preserve the authenticity of the standards. In recent years, concerns arose over the mass circulation of these standards on the Internet although the AAOIFI was not known to have published such contents on its website or elsewhere on the Internet²⁵¹. Even more worrying, a number of these standards could have been either inaccurate or outdated failing to incorporate the latest amendments crucial to the formation of an improved corporate governance framework for the IFIs. Such unauthorised dissemination of the AAOIFI's standards would not only confuse stakeholders if the misrepresented contents were cited in academic journals, industrial reports, or applied in any review processes of the industry²⁵², but it also risked damaging the reputation of the AAOIFI as a reputable standard-setting body and harmonisation intermediary for the global Islamic banking industry²⁵³.

Contrary to the IFSB, which provides free and unrestricted access to all of its published Islamic banking standards and guidelines, it is arguable that the AAOIFI's 'close' policy not only discourages stakeholders from understanding and providing constructive feedback to the existing standards, but it also prevents further dissemination of the standards for progressive purposes²⁵⁴. This point is worth mentioning since the AAOIFI has progressed in the past two decades from a mere accounting and auditing

²⁵⁰ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Online Store' (AAOIFI, 2017) <<http://aaoifi.com/shop/?lang=en>> accessed 18 July 2017. Also see Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Online Standards' (AAOIFI, 2017) <<http://aaoifi.com/standard/accounting-standards/?lang=en>> accessed 18 July 2017

²⁵¹ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'AAOIFI Shari'a Standards Book - Fabricated Copy' <<http://50.56.110.28/en/news/aaoifi-sharia-standards-book-fabricated-copy.html>> accessed 22 September 2017

²⁵² CPI Financial, 'Socially Inept'

²⁵³ Further, several *Sharia'* scholars opined that the AAOIFI standards have several credibility issues due to the lack of review and were approved by the same *Sharia'* scholars, who served on numerous IFI's *Sharia'* boards in various jurisdictions. See Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System'

²⁵⁴ Bernardo Vizcaino, 'AAOIFI's Perestroika' in Bernardo Vizcaino (ed), *Opalesque Islamic Finance Intelligence*, vol 14 (15 December 2010 edn, Opalesque 2010), p. 3-5.

organisation that was relatively unknown except to those who were directly involved with the industry to an important Islamic banking standard-setting body as it is known today.

With the AAOIFI already making significant contributions to the development of Islamic corporate governance and producing a code of business ethics for the Islamic banking industry, the standard-setting agency should consider revising the restrictive publication policy for its standards, especially considering the ubiquitous nature of the Internet access in this globalised world, where transparency is lauded²⁵⁵. Although the price tag of US\$ 70 for a combination of both the AAOIFI's *Sharia'* and its accounting, auditing, and governance standards will not present any financial difficulty to the IFIs, it is also arguable that the same policy can impede the AAOIFI's long-standing harmonisation effort, particularly when the Islamic banking standards of the other standard-setting agencies such as the IFSB remain accessible for free online²⁵⁶.

Furthermore, in the context of the competitive ambitions of the following countries aspiring to become the Islamic banking hub for their respective regions, for example, the United States, United Kingdom and Luxembourg for the Western region²⁵⁷; Malaysia, Indonesia, Singapore, and Brunei for the South East Asian region²⁵⁸; Bahrain, Saudi Arabia, Qatar, and the United Arab Emirates for the Middle East region; and Senegal, Nigeria, South Africa and Tanzania for the African region²⁵⁹, the AAOIFI has undoubtedly an important role to undertake in coordinating this healthy competition. Correspondingly, it is also suggested that the AAOIFI should consider rotating its Manama-based headquarters after a specified period to locations across the globe, particularly in key

²⁵⁵ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Online Standards'

²⁵⁶ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Online Store'; Islamic Financial Services Board (IFSB), 'Published Standards' (IFSB, 2017) <<http://www.ifsb.org/published.php>> accessed 18 August 2017

²⁵⁷ Osbourne, ; The Economist, 'Luxembourg as a Financial Centre: Administering Instead of Hiding'.

²⁵⁸ Yvonne Tuah, 'Islamic Finance: The Unconventional but Nascent Financial System' Borneo Post Online, 5 March 2017 <<http://www.theborneopost.com/2017/03/05/islamic-finance-the-unconventional-but-nascent-financial-system/>> accessed 21 September 2017; Andrew Wood, 'Asia: Malaysia Aims to Be Hub for Its Region' Financial Times, 5 May 2009 <<https://www.ft.com/content/8d8102aa-3836-11de-9211-00144feabdc0>> accessed 17 September 2017; PricewaterhouseCoopers, *Malaysia, Asia's Islamic Finance Hub* (PricewaterhouseCoopers ed, PricewaterhouseCoopers 2008)

²⁵⁹ Rose Skelton, 'Senegal Seeks to Become West African Hub for Islamic Finance' *Bloomberg* (14 March 2013) <<https://www.bloomberg.com/news/articles/2013-03-14/senegal-plans-to-become-west-african-hub-for-islamic-finance-1->> accessed 21 September 2017; Javier Blas, 'Africa Embraces Islamic Finance' Financial Times, 16 December 2013 <<https://www.ft.com/content/54e5beb6-5750-11e3-9624-00144feabdc0>> accessed 18 September 2017

countries such as the United Kingdom, the United States of America, and those within the QISMUT region. This rotation would not only assist in promoting consistency and cross-border harmonisation of the divergent *Sharia'* opinions *vis-à-vis* Islamic banking within these regions, which undoubtedly comprise divergent consumers with different schools of Islamic jurisprudence orientation, but would also promote the AAOIFI as an important standard-setting institution in promoting a healthy and competitive environment for these would-be Islamic banking hubs.

3.3.1.2 The Islamic Financial Services Board

Another renowned standard-setting agency for the industry is the Kuala Lumpur-based IFSB, which has operated since March 2003. Unlike the AAOIFI, the IFSB does not issue any *Fatwas* on Islamic banking. Instead, it plays an important role in ensuring the soundness and stability of the Islamic banking market through its efforts in developing and harmonising *Sharia'* governance standards around the globe²⁶⁰. Its many objectives include: introducing various *Sharia'* standards and recommending them for adoption; providing guidelines to the IFIs on effective *Sharia'* supervisory and regulatory mechanisms; promoting cooperation among other standard-setting organisations and member countries; facilitating research, training and talent development programs; and maintaining a database of the IFIs, *Sharia'* scholars and industry experts²⁶¹. To date, the IFSB has issued 27 standards, guiding principles, and technical notes for the Islamic banking industry²⁶².

²⁶⁰ Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 11; Malkawi, p. 552; Islamic Development Bank and Islamic Financial Services Board, p. 122.

²⁶¹ Islamic Financial Services Board, 'Objectives' (IFSB, 2017) <<http://ifsb.org/objectif.php>> accessed 18 July 2017; Ginena and Hamid, p. 268.

²⁶² These include the Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Takaful Institutions and Islamic Mutual Funds] (IFSB-3), Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services [Excluding Takaful Institutions and Islamic Mutual Funds] (IFSB-5), Guiding Principles on *Sharia'* Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), Revised Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services [Excluding Takaful Institutions and Islamic Collective Investment Schemes] (IFSB-16), and Core Principles for Islamic Finance Regulations (IFSB-17). See Islamic Financial Services Board (IFSB), 'Published Standards'

Similar to the AAOIFI, the adoption of the IFSB standards and guiding principles for the IFIs is also voluntary in most countries²⁶³ – another circumstance that will continue to encourage divergent opinions in the industry. In a study by the Islamic Development Bank ('IDB') in 2014, only 15 per cent of the regulatory authorities in IFSB member countries reported full compliance with the IFSB standards, followed by 42 per cent that reported partial compliance²⁶⁴. However, a recent finding by the IFSB has also observed a considerable progress in the adoption of the IFSB standards among member countries with 33 per cent (11 out of 36) of the regulatory and supervisory authorities surveyed in 2016 fully complied with all the IFSB standards – an increase of 1 per cent from those surveyed in 2015²⁶⁵.

At the same time, it is equally important to note that the implementation of Islamic banking standards must also be examined against critical factors such as the overall market share of Islamic banking of a country, and the beneficial impact of a partial implementation of the said standards²⁶⁶. For instance, a relatively insignificant market share in certain countries such as Mongolia (Financial Regulatory Commission), Vietnam (State Securities Commission), or Japan (Financial Services Agency) may influence the financial regulators by suggesting the implementation of Islamic banking standards as meaningless²⁶⁷. Likewise, it is also worth mentioning that the full implementation of the IFSB standards may not necessarily serve as an effective mechanism to coordinate the developing Islamic banking market as compared to a partial implementation which can also benefit a country's Islamic banking industry in the sense that it allows the country to modify and improvise the standards to suit its legal system, orientation of school of Islamic jurisprudence, and business environment as its global Islamic banking market share progresses.

²⁶³ Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2017* (2017), p. 51; Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2016* (2016), p. 58.

²⁶⁴ Islamic Development Bank and Islamic Financial Services Board, p. 34. Also see Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2014*

²⁶⁵ Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2017*, p. 52. In 2015, full compliance with all the IFSB standards stood at 32 per cent (12 out of 39) regulatory and supervisory authorities surveyed. See Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2016*, p. 60.

²⁶⁶ Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2014*, p. 97. Also see *ibid*, p. 35.

²⁶⁷ *Ibid*, p. 98.

3.3.2 A Centralised System

3.3.2.1 The National *Sharia'* Board

From an historical perspective, the idea of centralisation of *Fatwa* in *Sharia'* law was first mooted during the reign of Caliph Harun Al-Rashid circa 790 CE, where the Caliph proposed the full implementation of *Imam* Malik's *Al-Muwatta'*; a concise collection of famous and credible *Hadiths* from a trusted chain of narrators²⁶⁸. Although the *Imam* refused this proposal out of his respect for the opinions of other *Sharia'* scholars, it marked the first attempt by an Islamic state to systemise the divergent *Fatwas* between the various schools of Islamic jurisprudence. Likewise, the proposal of Abdullah Ibn Muqaffa, a Persian Islamic thinker, to compile all the *Fiqh* opinions and grant them a binding status, and the famous *Al-Majelle*, a codification of the *Fatwas* on *Fiqh Al-Muammalat* issued by *Imam* Hanafi, the founder of the Hanafi school of Islamic jurisprudence, also exemplify the early initiatives of *Fatwa* standardisation in the Islamic history²⁶⁹.

As far as Islamic banking is concerned, the idea of a national *Sharia'* board was mooted in 1993 during the 8th session of the Council of the Islamic Fiqh Academy, where the formation of a supreme *Sharia'* board was proposed as a means to assist in the harmonisation of Islamic banking *Fatwas*, standards and practices between IFIs around the world²⁷⁰. Apart from serving as the sole authority for any *Sharia'* issues related to Islamic banking, the idea of a national *Sharia'* board was also advocated as a means to accommodate a number of issues which are only specific to the *Sharia'* law system such as *Al-Ikhtilaf Fi Al-Fuqaha* (the differences of opinions between *Sharia'* scholars).

²⁶⁸ M. Al-Azami, *Sejarah Teks Al-Quran dari Wahyu Sampai Kompilasi: Kajian Perbandingan dengan Perjanjian Lama dan Perjanjian Baru (History of the Quranic Texts from Their Revelation to Compilation: A Comparative Study of the Old and New Testament)* (Gema Insani 2005), p. 106-108; Ahmad bin Ali Ibn Hajar Asqalani, *Fath Al-Bari Bi Syarh Al-Bukhari*, vol 9 (Dar Al-Fikr 1994), vol. 9, p. 20. Also see Muhammad Ibn Sa'd, *Al-Tabaqat Al-Kubra (The Book of Major Classes)* (Dar Al-Kutub Al-Ilmiyya 1997), p. 440.

²⁶⁹ Ibn Al-Muqaffa, *Athar Ibn Al-Muqaffa (Effects of Ibn Al-Muqaffa)* (published in Beirut, Dar Al-Maktabah Al-Hayah 1966), p. 353; Zafarul Islam, 'Origin and Development of Fatawa Compilation in Medieval India' (1996) 12 *Studies in History* 223, p. 230; Abdul Sattar Abdul Kareem Abu Ghudda, 'The Codification of Resolutions of Fiqh Academies and Standard-Setting Organisations' in International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters (eds), *Islamic Commercial Law Report 2016* (ISRA & Thomson Reuters 2016), p. 82.

²⁷⁰ Fatwa of the Council of the Islamic Fiqh Academy 1985-2000, p. 165-169.

Due to the existence of the different schools of Islamic jurisprudence²⁷¹, it is not an uncommon situation that an Islamic financial instrument approved in one country is not approved in another²⁷². This is attributable to the different *Sharia'* opinions of the different IFIs' *Sharia'* boards across the jurisdictions as a result of the variant school of thought orientation among the *Sharia'* board members. For example, the interpretation of the *Sharia'* law is liberal in Malaysia and Egypt, intermediate in the United Arab Emirates, but strict in Saudi Arabia and Kuwait²⁷³. In fact, these differences not only occur between the major schools of Islamic jurisprudence, but also within a school itself. In other words, the variation of opinions can even occur in a country that only subscribes to the principles and teachings of a single school. On a global scale, the centralisation of *Fatwas* and standards in Islamic banking remains a sensitive issue as it involves balancing the traditional and modern understanding of *Al-Ikhtilaf Fi Al-Fuqaha* on one hand, and creating a symmetry platform of understanding that addresses the specific concern of the global Islamic banking industry on the other. The final section of this chapter will specifically explain the issue of *Al-Ikhtilaf Fi Al-Fuqaha* within the context of the Islamic corporate governance system of the Islamic banking industry.

Certainly, the differences of *Sharia'* opinions in the industry has confused both Muslims and non-Muslim stakeholders alike. Accordingly, a crucial need exists for the Islamic banking market players to agree on a common platform to mitigate the risk of inconsistency of *Fatwas* within and between jurisdictions. Arguably, the formation of a centralised *Sharia'* board at the national level can help to consolidate and resolve these differences through the implementation and enforcement of uniformed *Sharia'* decisions. This will benefit the IFIs within a country through reliance on a consistent set of Islamic banking *Fatwas* and standards and it will also enhance and expedite cross-border

²⁷¹ See discussion on *Hilah* at p. 40-42. Also see I. Warde, *Islamic Finance in the Global Economy* (2nd edn, Edinburgh University Press 2014), p. 31; Abdulrahman Baamir and Ilias Bantekas, 'Saudi law as Lex Arbitri: Evaluation of Saudi Arbitration Law and Judicial Practice' (2009) 25 *Arbitration International* 239, p. 264.

²⁷² See *Bai Al-Inah* in Nursyamsiah and Kayadibi, p. 123; D.V. Abdullah and K. Chee, *Islamic Finance: Why It Makes Sense (For You) — Understanding its Principles and Practices* (2nd edn, Marshall Cavendish International (Asia) Private Limited 2013), p. 202. Also see H. Elasrag, *Principals of the Islamic finance* (Createspace Independent Publishing Platform 2017), p. 101; Perry

²⁷³ Gordon Platt, 'Cover Story: Profits with Principles' in Joseph Giarraputo (ed), *Global Finance* (July/August 2006 edn, Joseph Giarraputo 2006) <<http://www.gfmag.com/magazine/julyaugust-2006/cover-story-profits-with-principles->> accessed 15 October 2014; Perry, p. 271.

transactions between the IFIs across jurisdictions²⁷⁴. Nonetheless, there remain several key challenges that demand immediate attention from the industry regulators before the harmonisation effort of Islamic banking *Fatwa* and standards can be achieved. These include, the conflict of laws between jurisdictions, the conflict of *Sharia'* opinions between the various schools of thought, and the formation of a competent dispute resolution mechanism for Islamic banking cases as an alternative to the civil court, which may not possess sufficient expertise to try such cases.

In contrast with the decentralised Islamic corporate governance system, the *Sharia'* decision of a national *Sharia'* board binds all the IFIs in the country. In the United Arab Emirates, for instance, article 5 of the Federal Law No. (6) of 1985²⁷⁵ requires the Higher *Sharia'* Authority to act as the final authority on *Sharia'* matters related to Islamic banking and its decisions bind all the IFIs in the kingdom. Likewise, in Malaysia, section 58 of the CBMA 2009 stipulates that in the event of conflict between the *Sharia'* rulings issued by the *Sharia'* board of an IFI and the SAC, the latter's rulings shall prevail²⁷⁶. Furthermore, section III of the SGF 2011 not only mandates the BOD to implement the *Fatwas* of the IFI's *Sharia'* board, but also prohibits the BOD from altering the *Fatwas* without the *Sharia'* board's consent²⁷⁷.

At the moment, there is a growing number of countries that have either adopted or are in the process of opting for a national *Sharia'* board to act as the apex of *Sharia'* decisions for their respective Islamic banking markets. These countries include Sudan (the High *Sharia'* Supervisory Board), Malaysia (the SAC of CBM), Pakistan (*Sharia'* Board of the State Bank of Pakistan), the United Arab Emirates (HSA), Bahrain (National *Sharia'* Board of the Central Bank of Bahrain), Oman (*Sharia'* Supervisory Authority of the Central Bank of Oman), Nigeria (*Sharia'* Council of the Central Bank of Nigeria),

²⁷⁴ STA Law Firm Ltd, 'Clash of Jurisdictions: Applicability of Islamic Finance Principles under English Law' Lexology, 4 August 2016 <<http://www.lexology.com/library/detail.aspx?g=ceb68949-cc02-4176-ae65-e5296286a24c>> accessed 19 September 2017; Goud and others, p. 16.

²⁷⁵ Federal Law No - (6) of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies

²⁷⁶ Section 58 of Central Bank of Malaysia Act 2009 (Act 701). The position of the SAC as the Malaysia's highest authority on Islamic banking issues is further strengthened by the recently introduced IFSA 2013, which stipulates that the IFIs shall be deemed as *Sharia'*-compliant only when it complies with the rulings of the SAC. See section 28 of Islamic Financial Services Act 2013 (Act 759)

²⁷⁷ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 15.

Bangladesh (Central *Sharia'* Board for Islamic Banks of Bangladesh)²⁷⁸ and prospectively Morocco²⁷⁹. Although their names vary from one country to the other, this *Sharia'* board serves towards a single purpose, namely to act as the highest *Sharia'* authority in the country.

Among these countries, the Malaysian centralised governance system presents the most unique framework as it involves two national *Sharia'* boards that regulate the diverse Malaysian Islamic banking market. The SAC of the CBM is responsible for the supervision of the general Islamic banking and *Takaful* activities in the country. In addition, another SAC is formed under the Securities Commission of Malaysia to supervise and regulate all *Sharia'* issues relating to Islamic capital market²⁸⁰. This framework was followed by the Maldives, which also formed an independent Capital Market *Sharia'* Advisory Council ('CMSAC') in December 2013 pursuant to its Capital Market Development Authority Act ('CMDA')²⁸¹.

3.3.3 A Decentralised System

3.3.3.1 *Sharia'* Board of Islamic Financial Institution

Although Islamic banking had started as early as 1963 with the formation of IFIs such as the Mit Ghamr Savings Bank, the Nasser Social Bank of Egypt, and the Dubai Islamic Bank, the formal institution of the *Sharia'* board was not present within the IFI's corporate governance structure, at least until 1976, as it did not constitute a requirement for the

²⁷⁸ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 26-28. Also see Thomson Reuters, *Islamic Finance Development Report 2014*, p. 109.

²⁷⁹ Morocco has proposed to phase out the requirement of *Sharia'* board for the IFIs in the country in favour of a national *Sharia'* board, which shall act as the sole authority for Islamic banking matters. Since a *Sharia'* board at the IFI-level remains an important organ to the IFI in overseeing its day-to-day *Sharia'* compliance operations, it is arguable that the reliance on a single '*Sharia'* board model' can decelerate the progress of the country's Islamic banking industry. See Thomson Reuters, *Islamic Finance Development Report 2016* (Islamic Corporate for the Development of the Private Sector, Jeddah, 2016), p. 6, 97; Soualhi, p. 23; Islamic Development Bank, *Islamic Development Bank Group in Brief*, p. 29. Also see Bernardo Vizaino, 'Oman Sets Up Central Sharia Board in Move to Boost Islamic Finance' Thomson Reuters, 8 October 2014 <<http://www.reuters.com/article/oman-islam-financing/oman-sets-up-central-sharia-board-in-move-to-boost-islamic-finance-idUSL6N0S305J20141008>> accessed 21 September 2017

²⁸⁰ Resolution of the SC's SAC 2nd Edition, p. 4.

²⁸¹ Thomson Reuters, *Islamic Finance Development Report 2014*, p. 102, 113; Capital Market Development Authority, *Maldives Capital Market Strategic Plan 2015-2019* (2015), p. 15.

overall functioning of the IFIs²⁸². The establishment of the Faisal Islamic Bank of Egypt that year marked the first leap in the development of a unique and systematic corporate governance system for the industry that was soon followed by several IFIs around the globe such as the Jordan Islamic Bank, the Faisal Islamic Bank of Sudan, the Kuwait Finance House, and the Bank Islam Malaysia Berhad²⁸³.

In contrast to the centralised Islamic corporate governance system, an IFI operating in a decentralised system relies on the advices and *Fatwas* of its own *Sharia'* board and also considers those issued by the *Sharia'* boards of other IFIs. At present, several countries have adopted the decentralised system, namely, *inter alia*, Kuwait, Qatar, Jordan, Singapore, and the United Kingdom²⁸⁴. Comparatively, the system allows flexibility to the IFI and the management team in terms of the adoption of Islamic banking *Fatwas* due to its regulatory structure, which does not mandate the IFI to follow a set of specified *Fatwas*²⁸⁵. In simple terms, its corporate governance structure is internally driven and more IFIs-specific. It grants more freedom to the IFIs to adopt *Fatwas* that immediately suit their legal and business environment than the centralised system. However, this accommodating governance structure also presents a crucial question about the actual roles and scope of authority of the *Sharia'* board within the IFI – whether the *Sharia'* board has an executive function in enforcing the implementation of its *Sharia'* decisions or whether its function is merely restricted to an advisory one.

This latter issue highlights the significant regulatory challenges that the industry faces, which can appear even more challenging for new and emerging markets operating in non-Islamic legal environment such as the United Kingdom, United States of America,

²⁸² Tahreem Noor Khan, 'Enhancing Islamic Financial Brand: Shari'ah Board Theoretical Conceptual Framework' (2015) 3 Journal of Islamic Banking and Finance 62, p. 62; Hassan and Mahlkecht, p. 312.

²⁸³ Monzer Kahf, 'Strategic Trends in the Islamic Banking and Finance Movement' (Harvard Forum on Islamic Finance and Banking, Boston, 6-7 April 2002), p. 4; L. Napoleoni, *Rogue Economics* (Seven Stories Press 2011), p. 290.

²⁸⁴ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 31; Hichem Hamza, 'Sharia Governance in Islamic Banks: Effectiveness and Supervision Model' (2013) 6 International Journal of Islamic and Middle Eastern Finance and Management 226, p. 231; Rusni Hassan and others, *A Comparative Analysis of Shari'ah Governance in Islamic Banking Institutions Across Jurisdictions (No:50/2013)* (International Shari'ah Research Academy for Islamic Finance (ISRA) 2013), p. 1. Also see Van Greuning and Iqbal, p. 188.

²⁸⁵ Soualhi, p. 25; Shaharuddin and others, p. 7; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*

China, Turkey, and Luxembourg²⁸⁶. For example, in the United Kingdom, an IFI must demonstrate that its *Sharia'* board only plays an advisory role and does not interfere with the management of the IFI²⁸⁷. Likewise, in the United States of America, the role of the *Sharia'* board in a financial institution including for example its interaction with its management must be precisely determined²⁸⁸.

Notwithstanding the above concern, it is arguable that given the robust development of more sophisticated and competitive Islamic financial products to meet the growing complexities of stakeholders' needs, IFI's *Sharia'* board members have become more involved in product development processes that could lead to a more executive role. Under this circumstance, the role of a *Sharia'* board member will more likely resemble that of an Executive Director than a Non-Executive Director. In fact, the evolving nature of the functions and roles of the IFIs' *Sharia'* boards will also subject the contentious practice of multiple *Sharia'* board directorships to scrutiny due to significant conflicts of interest and *Sharia'* compliance issues²⁸⁹, a subject which the thesis will scrutinise in detail in the subsequent chapters.

Additionally, in a corporate governance environment that traditionally grants a maximum weight to the decisions of the BOD, the *Fatwas* issued by the IFI's *Sharia'* board will also remain subject to the BOD's evaluation in respect of their viability and compatibility with the interest of the shareholders or stakeholders. Since the Western corporate governance approaches concentrate on corporate decisions that best serve the interest of the stated parties, it is arguable that the Western concept of 'in the best interest' of the shareholders and stakeholders may not necessarily conform to the principles of the *Maqasid As-Sharia'* grounded within the Islamic corporate governance system. Moreover, given the strong influence of the IFIs' 'Islamic' brand in attracting potential

²⁸⁶ Islamic Financial Services Board, 'The Islamic Financial Services Board: Setting Standards for Islamic Finance' The IAASB Consultative Advisory Group Meeting, 7-8 March 2017, New York <<https://www.iaasb.org/system/files/meetings/files/IFSB-IAASB-CAG-Presentation.pdf>> accessed 22 September 2017; Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2014*, p. 10, 19.

²⁸⁷ Michael Ainley and others, *Islamic Finance in the UK: Regulation and Challenges* (Financial Services Authority, November, 2007), p. 13. Also see Casper, p. 9.

²⁸⁸ Todd J Schmid, 'Real Shariah Risk: Why the United States Cannot Afford to Miss the Islamic Finance Moment, The' [2013] U Ill L Rev 1293, p. 1332.

²⁸⁹ Ainley and others, p. 13; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*, p. 10; Wilson, *The Development of Islamic Finance in the GCC*, p. 10.

investments from the diverse consumers' market, there is also a concern that the absence of a statutory provision that grants the *Sharia'* board's *Fatwas* a binding legal effect will allow the BOD to modify them and pursue doubtful or *Sharia'* non-compliant objectives.

3.3.3.2 *Sharia'* Advisory Firms

In the last two decades, *Sharia'* advisory firms have become an important source of consultation for IFIs as a result of the industry's shortage of *Sharia'* scholars possessing expertise in the vast field of *Fiqh Al-Muammalat*. To a certain extent, the formation of a *Sharia'* board at the IFI-level was neither considered necessary nor practical. However, the common practice of IFIs consulting *Sharia'* advisory firms for *Sharia'* compliance assurance gradually evolved into a global trend. The practice, which started in Kuwait in 2003, escalated beyond Qatar and Saudi Arabia in order to meet IFIs' continuous demands for *Sharia'*-compliance advisory as the global Islamic banking industry expanded.

A *Sharia'* advisory firm is an independent organisation that provides IFIs with consultation and advisory services pertaining to any *Sharia'* compliance issues. Apart from endorsing the financial products and services offered by the IFIs, it also provides *Sharia'* review and audit services; akin to those offered by any public audit firms²⁹⁰. Moreover, there are also several *Sharia'* advisory firms such as the Islamic banking and Finance Institute of Malaysia ('IBFIM'), the Minhaj Advisory and the Islamic Finance Advisory and Assurance Services ('IFAAS') that have begun offering the IFIs unique services such as talent development programs for banking professionals and the formation of knowledge management centres ('KMCs') in facilitating further research and innovation of Islamic banking products²⁹¹.

In addition, it is worth noting that not every IFI can afford the services of an in-house *Sharia'* board due to common business challenges such as a deficiency in working

²⁹⁰ Ginena and Hamid, p. 363; A Mashal, 'Shari'a Consulting Firms and Shari'a Supervisory Boards: Restrictions and Techniques' (Proceedings of Seventh Annual Conference of AAOIFI, Bahrain); Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 3-4. Also see Abdul Razak and Omar, p.137-138.

²⁹¹ For instance, the Kuala Lumpur-based IBFIM currently possesses over 23,000 book collections on *Sharia'* law, Islamic banking, and finance, which are available in Arabic, Malay, and English. See Islamic Banking and Finance Institute of Malaysia (IBFIM), 'Knowledge Management Centre' (IBFIM, 2017) <<http://www.ibfim.com/index.php?p=kmc&c=index>> accessed 26 August 2017

capital, the small size of the business operation, and the shortage of qualified and experienced *Sharia'* scholars in the industry. For example, the Australia-based Iskan Finance has neither a *Sharia'* advisor nor a *Sharia'* board²⁹². Instead, it modelled its Islamic financial products based on the advice and *Fatwas* of leading *Sharia'* scholars from the Al-Azhar Seminary in Egypt²⁹³. Further, as the regulatory framework of a decentralised Islamic corporate governance system does not mandate the formation of a *Sharia'* board at the IFI-level, the services of *Sharia'* advisory firms are also preferred by non-IFIs that offer limited Islamic banking products which are based on simple *Muammalat* principles such as *Wadiah*, *Mudarabah*, *Musharakah*, *Ijarah*, and *Takaful*²⁹⁴.

At present, a number of renowned *Sharia'* advisory firms offer consultation services on *Sharia'* issues pertinent to Islamic banking. These include the Shariyah Review Bureau, the Institute of Islamic Banking and Insurance ('IIBI'), Yasaar Limited, Minhaj Advisory, IBFIM, the Association of *Sharia'* Advisors in Islamic Finance ('ASAS'), Failaka, Taqwa Advisory and *Sharia'* Investment Solutions ('TASIS'), IFAAS, Israa Capital and Amanie Advisors. Although the advisory services of these firms cannot be compared to that of an in-house *Sharia'* board at the IFI-level²⁹⁵, the increasing cost of maintaining a proper panel on a *Sharia'* board plays a significant factor in influencing the IFIs to consider opting for these alternative mediums which provide a preferable *Sharia'* consultancy service in terms of time and cost efficiency²⁹⁶.

²⁹² Iskan Finance is an Islamic financial institution established in 2001, which aims to meet the home financing needs of the Australian Muslim community. See Abu Umar Faruq Ahmad and AB Rafique Ahmad, 'Islamic Microfinance: The Evidence from Australia' (2009) 25 *Humanomics* 217, p. 227-228; Ahmad, p. 177.

²⁹³ Rammal, 'The Importance of Shari'ah Supervision in Islamic Financial Institutions'. Also see note 2 of Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 1.

²⁹⁴ Ginena and Hamid, p. 363; Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 8.

²⁹⁵ Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 1.

²⁹⁶ In a decentralised governance system, where the IFI's *Sharia'* board members are not restricted in terms of the number of *Sharia'* board positions they may hold within the other IFIs, the *Sharia'* board's efficiency may considerably be affected or arguably less efficient considering the busy schedule of these scholars due to their occupancy of too many positions. See Thomson Reuters, 'Islamic Finance Outsources Scholars' Supervision to Grow' Thomson Reuters, 3 November 2010 <<http://www.reuters.com/article/2010/11/03/islamicfinance-scholars-idUSLDE69H1PG20101103>> accessed 17 September 2017

However, the majority of these advisory firms also comprise *Sharia'* scholars who are themselves *Sharia'* board members of the IFIs. From a sound corporate governance perspective, the occupancy of multiple *Sharia'* board positions can present a number of challenging issues such as a potential conflict of interest, time management, and confidentiality concerns due to the roles and scope of duties owed by the IFI's *Sharia'* board members which include the handling of sensitive and confidential information of the IFI²⁹⁷. On one hand, it is arguable that the industry can profit from the vast knowledge and experience of these scholars as it expands. In fact, the composition of a diverse range of *Sharia'* board members from the different IFIs advising the firms' *Sharia'* board assures a better collective *Sharia'* decision that incorporates practical views from the different jurisdictions and schools of Islamic jurisprudence.

On the other hand, it is arguable that the regulatory and supervisory authorities should introduce a specific statutory provision regulating the participation of the IFIs' *Sharia'* board members in *Sharia'* advisory firms. In fact, the growing complexities of the industry – from innovative and sophisticated Islamic financial products to the bureaucratic compliance requirements of local legislations – demand specific attention from *Sharia'* board members. If a *Sharia'* board member occupies too many *Sharia'* board positions, it can pose serious question for his or her ability to provide the IFI with prudent and quality *Sharia'* advice.

Hence, it is submitted that the introduction of *Sharia'* advisory certifications such as the Certified *Sharia'* Advisor and Auditor Programme ('CSAA') and the *Shariah* Professionals Programme for Islamic Capital Market by the AAOIFI and the Securities Commission of Malaysia respectively can reduce the *Sharia'* advisory firms' over-reliance on the IFIs' *Sharia'* board members. This could lead to a significant development in the area of *Sharia'* advisory firms, where the increasing number of individuals equally competent in the fields of *Fiqh Al-Muammalat* in the industry can reduce dependency on the IFIs' *Sharia'* board members as *Sharia'* advisory firms' advisors²⁹⁸.

²⁹⁷ Rushdi Siddiqui, 'A Sharia Scholar's Place on the Board' *Gulf News* (United Arab Emirates, 12 May 2010) Business Feature 36 <<http://gulfnews.com/business/sectors/features/a-sharia-scholar-s-place-on-the-board-1.625445>> accessed 13 September 2017, p. 36-37; Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 15. Also see Anjuli Davies and Mirna Sleiman, "'Rock Star' Scholars a Risk for Islamic Finance' Thomson Reuters, 29 February 2012 <<http://www.reuters.com/article/2012/02/29/finance-islamic-scholars-idUSL5E8DG31N20120229>> accessed 22 September 2017

²⁹⁸ At the time of writing (August 2017), the AAOIFI's CSAA program is undergoing a major overhauling process. See Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Certified Sharia' Advisor and Auditor (CSAA)' (AAOIFI, 2017) <<http://aaoifi.com/certification/certified-sharia>

3.3.4 *Ikhtilaf Fi Al-Fuqaha* (Differences of Opinions Between *Sharia'* Scholars) *Vis-à-Vis* a Centralised Islamic Corporate Governance System

There are contentious debates among *Sharia'* scholars and industry practitioners on the repercussions of a centralised governance system on the overall development of the global Islamic banking industry²⁹⁹. In addition to the divergence of opinions between the different schools of Islamic jurisprudence, the presence of variable factors such as legal systems, languages and understanding of the *Fiqh*, and '*Urf* (customary practices) renders it difficult for the industry to agree on a standardised Islamic corporate governance model. Accordingly, these factors have contributed to the differences of *Sharia'* law interpretation among *Sharia'* scholars – also commonly referred to as *Al-Ikhtilaf Fi Al-Fuqaha*.

Basically, *Al-Ikhtilaf Fi Al-Fuqaha* is a common phenomenon in the science of Islamic jurisprudence which had occurred since the time of the companions of the Prophet Muhammad's (p.b.u.h.) due to the absence of clear laws in the Holy Quran and the *Sunnah* pertaining to specific *Sharia'* issues such as the actual time of *Lailatul Qadr* (Night of Power or the night the Holy Quran was revealed). Such an absence also arises in respect of the practice of multiple *Sharia'* board directorships. According to the *Muktabar* opinion among *Sharia'* scholars, an event of *Ikhtilaf* allows them to interpret a *Sharia'* issue according to a set of Islamic jurisprudential methodologies that vary from one school of Islamic jurisprudence to another³⁰⁰. Additionally, the methodologies will also differ according to several variable factors recognised by the *Sharia'* law including: the reception of *Sharia'* scholars to the validity of an argument; the conditions of

adviser-and-auditor-csaa/?lang=en> accessed 3 September 2017. Also see Securities Commission of Malaysia, 'Shariah Professionals Programme for Islamic Capital Market' (*Securities Commission of Malaysia*, 2017) <<http://www.sidc.com.my/professional-learning-development-solutions/training-programmes/shariah-professionals-programme/overview>> accessed 7 August 2017

²⁹⁹ Mumtaz Hussain, Asghar Shahmoradi and Rima Turk, *An Overview of Islamic Finance* (IMF Working Paper, WP/15/120, June 2015, 2015), p. 23; Bloomberg, 'IFC Discuss Central Shariah Board' November 2014 <<http://www.ukifc.com/ifc-discuss-central-shariah-boards/>> accessed 22 September 2017; Hassan and Mahlkecht, p. 314, 328. Also see Akhtar, p. 3.

³⁰⁰ Lahsasna, 'Shariah Governance in the Islamic Financial Institution: Issues and Challenges', p. 703. Also see Abou Ishaq Ibrahim Ibn Musa Al-Shatibi, *Kitab Al-I'tisam*, vol 2 (Mohammed Mahdi Al-Sharif tr, Dar Al-Kutub Al-Ilmiyyah 2012), p. 191.

accepting a *Hadith* or its narrators; interpretative methodology; jurisdiction, culture, and ‘*Urf*³⁰¹.

Khilaf is an Arabic word that connotes a difference of matter³⁰². Technically, it refers to the difference of opinions among *Sharia'* scholars or the different schools of Islamic jurisprudence pertaining to *Al-Ahkam Al-Furu'iyah* (the *Sharia'* rulings on matters that evolved out of the expansion of *Fiqh*) as opposed to that of *Usul Al-Ahkam* (the primary sources of *Sharia'* law)³⁰³.

In other words, *Al-Ikhtilaf Fi Al-Fuqaha* can occur in every aspect of *Sharia'* law other than those considered as integral to the *Ibadat* (performance of the Islamic belief, namely the declaration of faith, mandatory prayers, fasting, almsgiving, and pilgrimage). Examples of these include: the recitation of *Qunut* (additional supplication) during the *Fajr* (morning) prayer; the holding of a staff by *Khatib* (the person who delivers the Friday sermon); methods of ablution; and the provision of *Tahlil* (special prayer after one's death). Any *Ikhtilaf* in these practices does not render their performances voidable or invalid because such a difference in opinion only involves a variation in methods or technique; not the principles or foundations of the *Ibadat*.

The caliph Umar bin Abdul Aziz and prominent *Sharia'* scholars such as Imam Ahmad, Imam Al-Shatibi, Sheikh Wahbah Mustafa Az-Zuhaili, Ibn Abd Al-Barr, and Ibn Hajar opined that the diversity of opinions in *Fiqh* presents mankind with a wider range of solutions to their problems³⁰⁴. Apparently, this opinion corresponds to the following *Hadith*, which remains a subject of continuous debate among the *Sharia'* scholars:

³⁰¹ Mohd. Hapiz Mahaiyadin and Md. Yunus Abd Aziz, 'Kekangan-Kekangan Eksklusif Terhadap Proses Realisasi Usul Fiqh Sebagai Metode Ijtihad (The Exclusive Obstacles Towards the Realisation Process of Usul Fiqh as An Ijtihad Method)' (National Seminar of Usul Fiqh, Kajang, 15-16 December 2004), p. 83-94. Also see Muhammad Salam Madkur, *Manahij Al-Ijtihad Fi Al-Islam Fi Al-Ahkam Al-Fiqhiyyah Wa Al-'Aqa'idhiyyah* (Jami'ah Al-Kuwayt 1973)

³⁰² Ibn Manzur and Muhammad Ibn Al-Mukarram, *Lisan Al-'Arab (The Arabic Speech) (15 Vols)*, vol 9 (published in Beirut, Dar Al-Sadir 1955), p. 9. Also see Muhammad Khalid Masud, 'Ikhtilaf Al-Fuqaha: Diversity in Fiqh as a Social Construction' in Zainah Anwar (ed), *Wanted: Equality and Justice in the Muslim Family* (Musawah 2009), p. 65.

³⁰³ Saadan Man, 'The Development of Ikhtilaf and Its Impact on Muslim Community in Contemporary Malaysia' (2008) 16 *Jurnal Syariah*, p. 503; Thoha JF Al-Ulwany, *Adab Al-Ikhtilaf Fi Al-Islam (The Etiquette of Ikhtilaf in Islam)* (Abu Fahmi tr, Gema Insani Press 1991), p. 30; J. Gallagher and E.D. Patterson, *Debating the War of Ideas* (Palgrave Macmillan, New York 2009), p. 46.

³⁰⁴ Al-Barr and Ibn Abd Allah, p. 902. Also see Majlis Ugama Islam Singapura, 'Managing Differences of Opinions (Fiqh Ikhtilaf)' Friday Sermon, 21 November 2014

“*The diversity among the Muslims is a blessing*”³⁰⁵.

However, there also exists a section of *Sharia'* scholars including Imam Al-Nawawi, Imam Al-Suyuti, Sheikh Al-Albani, and Sheikh Zakaria Al-Ansori, who dispute the authenticity of this *Hadith* based on the contention that its origin and *Sanad* (the early chain of narrators) could not be traced in any of the studies on the sciences of *Hadith*³⁰⁶. Further, Ibn Hazm, a prominent scholar of the Zahiri's school of Islamic jurisprudence, opined that it was unreasonable to associate blessings with diversity – especially when uniformity, in general, indicates a strength³⁰⁷.

On the other hand, Imam Al-Nawawi opined that although the elements of diversity and uniformity contradict one another, several verses in the Holy Quran proved the ability of both elements to coexist³⁰⁸. For instance (*Surah Al-Anfal 28:73*) stipulates, “*And of His mercy He has made for you the night and the day, that you may rest therein, and that you may seek of His grace, and that you may give thanks*”. Although the night connotes a mercy from God, the day does not infer a punishment. In other words, what may appear as a contradiction between opposing elements does not necessarily invoke negative consequences.

As far as the diversity of *Sharia'* opinions in Islamic banking is concerned, the modern *Sharia'* jurists and industrial experts opined that not only does it enrich *Sharia'* law by providing society with various solutions and alternatives to a wide range of issues, but it also encourages further innovation of Islamic financial products and services in enabling

<<http://www.muis.gov.sg/officeofthemufti/documents/E14Nov21%20-%20Fiqh%20Ikhtilaf.pdf>>
accessed 22 September 2017

³⁰⁵ Reported in Al-Nawawi's commentary of the book of *Waqf* in Sahih Muslim. See Muhyi Al-Din Al-Nawawi, *Al-Minhaj Fi Sharh Sahih Muslim Ibn Al-Hajjaj* (published in Beirut, Dar Al-Ma'rifah 1996), p. 91. Also see Muhammad Al-Zuhaily, *Asbab Ikhtilaf Al-Fuqaha (The Reasonings Behind the Differences of Opinions Among Sharia' Scholars)* (published in Damascus, Dar Al-Maktabi 1999), p. 12; Al-Barr and Ibn Abd Allah, p. 901.

³⁰⁶ Muhammad Nashiruddin Al-Albani, *Silsilah Hadits Dha'if dan Maudhu' (The Origin of Weak and Invented Hadith)* (published in Jakarta, Gema Insani Press, Depok 1995), p. 57.

³⁰⁷ “*And obey God and His Apostle and do not quarrel for then you will be weak in hearts and your power will depart, and be patient...*” (*Surah Al-Anfal 8:46*) of Ali. Also see Abu Hasan Al-Amidi, *Al-Ihkam Fi Usul Al-Ahkam (The Ruling on the Origin of the Sources of Sharia' Law)* (published in Beirut, Dar Al-Kutub Al-'Arabiyyah 1985), p. 64.

³⁰⁸ Imam Al-Nawawi and Y Syarif, *Sahih Muslim Bi Syarhi Al-Nawawi (Commentary of Sahih Muslim by Imam Al-Nawawi)* (published in Beirut, Daar Ihya'Al-Turath Al-Arabi 1992)

the industry to compete with its Western counterparts³⁰⁹. For example, *Bai Al-Inah*, *Wa'ad* (promise), *Bai Bithaman Ajil*, *Tawarruq*, and *Sukuk* are part of the by-products of the financial innovations in the industry that have benefited from this diversity.

Dr. Mohamed Ali Al-Qari, a prominent Islamic banking scholar and IFI *Sharia'* board member, opined that the adoption of a centralised Islamic corporate governance system would undermine the versatility and egalitarian nature of *Sharia'* law³¹⁰. It is arguable that his opinion corresponds to the following provisions of the Holy Quran and the *Sunnah*:

“...God intends every facility for you. He does not want to put you in difficulties...”

(*Surah Al-Baqarah* 2: 185)

“...God doth not wish to place you in a difficulty, but to make you clean, and to complete His favour to you, that ye may be grateful...”

(*Surah Al-Ma'idah* 5: 6)

'Aishah reported:

“Whenever the Prophet Muhammad (p.b.u.h.) was given a choice between two matters, he would (always) choose the easiest as long as it was not sinful to do so; but if it was sinful, he was most strict in avoiding it”³¹¹.

Sharia' scholars have also argued that the centralisation of Islamic banking *Fatwas* can serve against the principle of *Ijtihad* in *Sharia'* law, which allows the scholars to interpret the *Sharia'* rulings based on circumstance that can differ according to the presence of variable factors such as legal, political or socio-economic conditions³¹². Consequently,

³⁰⁹ S. Alamad, *Financial Innovation and Engineering in Islamic Finance* (Springer International Publishing 2017), p. 127; Dar and Azami, *Global Islamic Finance Report (GIFR) 2011*, p. 24. Also see Nursyamsiah and Kayadibi, p. 123.

³¹⁰ However, he also noted that in the absence of consistency and predictability of *Fatwas*, the Islamic banking industry “will have no hope of meeting international standards and growing beyond its niche status”. See Mushtak, ‘Shariah Governance in Islamic Finance Industry’. Also see Ehsan Waquar, ‘Discussion Board’ in Bernardo Vizcaino (ed), *Opalesque Islamic Finance Intelligence*, vol 1 (28 July 2009 edn, Opalesque 2009) accessed 14 January 2014

³¹¹ This *Hadith* is *Sahih*. See Book 1, *Hadith* 641 of Al-Nawawi

³¹² S. Shabbar, *Ijtihad and Renewal* (International Institute of Islamic Thought 2017), p. 87-88; M. Malik, *Foundations of Islamic Governance: A Southeast Asian Perspective* (Taylor & Francis 2016), p. 4; Tayyab Ahmed, ‘Islamic Finance Ijtihad in the Information Age: Quo Vadis?’ (8th International Conference on Islamic Economics and Finance, Doha, Qatar, 19-21 December 2011), p. 10; Shaharuddin, ‘Maslahah-Mafsadah Approach in Assessing the Shari’ah Compliance of Islamic Banking Products’, p. 129.

any standardisation effort can lead to an anachronistic circumstance called *Insidad Bab Al-Ijtihad* (the closing of the gate of *Ijtihad*), which prohibits or discourages creativity and flexibility in the determination of a new *Sharia' Hukm* – transforming the industry into a rigid financial regime that remains obsolete regardless of the significance of the above variable factors³¹³.

In addition, the major schools of Islamic jurisprudence acknowledge and permit the diversity of *Sharia'* opinions in matters that are not related to *Ibadat*³¹⁴. As banking and financial matters do not constitute a form of *Ibadat*, it is arguable that any effort to standardise *Fatwas* in *Muammalat* presents an unnecessary move which not only deprives society from applying *Fatwas* that fit their legal, economic, and socio-political circumstances, but also defeats the purpose of *Maqasid As-Sharia'*, namely the preservation of the public interest³¹⁵. Moreover, the CIBAFI had also reported that out of a set of 6,000 *Fatwas* issued by the IFIs worldwide, inconsistent *Fatwas* across the globe only accounted for 10 per cent or approximately 600 *Fatwas*³¹⁶. In other words, there exists strong evidence to indicate the existence of a near consensus among the *Sharia'* scholars on a majority of *Sharia'* issues in Islamic banking.

On the other hand, it is also arguable that Islamic banking matters can also lie within the category of *Ibadat*. This postulation is deducible from the final sermon of the Prophet Muhammad (p.b.u.h.), which explained the inter-relationship of *Muammalat* and *Ibadat*. In his final sermon, the Prophet (p.b.u.h.) called for Muslims to free themselves from the influence and negative effects of *Riba*³¹⁷. In other words, it also inferred that if a Muslim engages in financial transactions that provide a 'back-door' to *Riba*, or those contended by the *Sharia'* scholars as *Haram*, that person's *Ibadat* is arguably incomplete, or worse

³¹³ Hassan and Mahlkecht, p. 327; Jamal Abbas Zaidi, 'Sharia' Harmonization, Regulation and Supervision' (AAOIFI-World Bank Islamic Banking and Finance, Manama, 10-11 November 2008). Also see Joseph Schacht, *An Introduction to Islamic Law* (Oxford University Press 1967), p. 70-72; Bourheraqua, p. 50.

³¹⁴ See p. 116-117.

³¹⁵ Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 232-233; Hassan and Mahlkecht, p. 314, 328. Also see Al-Mubarak and Osmani, p. 6-13.

³¹⁶ Z. Hasan, *Shari'ah Governance in Islamic Banks* (Edinburgh University Press 2012), p. 92; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*, p. 8. Also see Sharmilla Devi, 'Experts: Scholars and Harmony in Short Supply' *Financial Times* (17 June 2008) <<http://www.ft.com/cms/s/0/4b67288c-3c0f-11dd-9cb2-0000779fd2ac.html#axzz3IZOjBKc0>> accessed 14 September 2017

³¹⁷ Anis Ahmad, *The Farewell Sermon of the Holy Prophet Muhammad* (Da'wah Academy of the International Islamic University Islamabad 1996)

– void. Similarly, it is also arguable that the diversity of the Islamic banking *Fatwas* around the globe confuses stakeholders about the actual *Sharia'* compliance status of an Islamic financial product or service. Thus, the proposal to centralise the Islamic banking *Fatwas* can provide a working solution in mitigating the risk of controversy or the irregularity of *Fatwas* as a result of the diversity of *Sharia'* opinions.

Accordingly, a decentralised corporate governance system can provide IFIs with greater flexibility in adopting *Fatwas* and policies that best fit their respective business environments and legal systems. It can also allow the IFIs the freedom to create financial products and services that not only conform to a country's market appetite, but are also unrestrained by the *Sharia'* rulings of a particular school of Islamic jurisprudence. This is exemplified in the United Kingdom where the then Financial Services Authority ('FSA') granted the IFIs the freedom to adopt any Islamic corporate governance model or the *Sharia'* rulings of any schools of Islamic jurisprudence as it did not regard *Sharia'* compliance as an issue for it but rather as an issue for the IFIs themselves³¹⁸. Nonetheless, as the IFIs' business involves the act of receiving and lending money, these activities fell within the definition of a credit institution under the EU Banking Consolidation Directive³¹⁹. Thus, they remain subject to similar authorisation requirements as their Western counterparts such as the 'fit-and-proper test' of the BOD members and employees, liquidity requirements, and adequacy of capital³²⁰.

Despite the flexibility offered by the decentralised corporate governance system, it also exhibits several significant weaknesses, which can threaten the stability and goodwill of the global Islamic banking industry. First, although this system grants every IFI the autonomy to choose Islamic banking *Fatwas* that suit both their legal environment and

³¹⁸ Frederick V Perry and Scheherazade S Rehman, 'Globalization of Islamic Finance: Myth or Reality?' (2011) 1 International Journal of Humanities and Social Science 107, p. 112-113; Wilson, *The Development of Islamic Finance in the GCC*, p. 30; Lahsasna, 'Shariah Governance in the Islamic Financial Institution: Issues and Challenges', p. 697-699; Ahmed Belouafi and Abdelkader Chachi, 'Islamic Finance in the United Kingdom: Factors Behind Its Development and Growth' (2014) 22 Islamic Economic Studies 37, p. 57-58. The FSA was replaced in April 2013 with 2 new regulators, namely the Financial Conduct Authority ('FCA') and the Prudential Regulation Authority ('PRA'). See Brooke Masters, 'FSA to Give Way to 'Twin Peaks' System' *Financial Times* (London, 2 April 2013) <<https://www.ft.com/content/32ebdd78-97bf-11e2-97e0-00144feabdc0>> accessed 18 September 2017

³¹⁹ Article 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 Relating to the Taking Up and Pursuit of the Business of Credit Institution (recast)

³²⁰ Accounting, Auditing, and Governance Standards as at December 2015, p. 955; Revised Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services [excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes], p. 12-16. Also see Ainley and others, p. 12.

business interests, it is arguable that such freedom can lead to uncertainty and confusion among stakeholders such as the investors and customers. This might arise in respect of the actual *Sharia'* compliance status of the IFIs' products and services due to the difference in the *Sharia'* rulings adopted by the IFIs, which may differ from one IFI to another³²¹. Simply put, a product approved by an IFI's *Sharia'* board may not necessarily be approved as an underlying model for another IFI's product. In chapter 2, this concern was highlighted by the controversial Islamic financial instrument of *Bai Al-Inah*, which has impeded the consolidation of Islamic banking standards at both the national and international levels.

This contention corresponds to the recent finding by Shaharuddin that out of the *Fatwas* issued by the regulatory bodies in the GCC and Malaysia, these Islamic banking powerhouses only reached a consensus in respect of two Islamic financial products, namely *Musharakah Mutanaqisah* (diminishing partnership) and asset securitisation³²². Furthermore, there also exists a 100 per cent difference in *Fatwas* on *Bai Al-Inah*³²³, *Bai Al-Ma'dum* (sale and purchase contract over non-existent commodity), *Dha' Wa Ta'ajjal* (the writing off of part of the debt by the creditor when the debtor settles the balance of his debt earlier than the maturity date), future contracts, and *Ujrah* (fee) for *Kafalah* (guarantees); with a 60 per cent and 40 per cent difference on *Bay Al-Wafa* (sale with a right in the seller to repurchase the commodity by refunding the purchase price) and *Bay Al-Dayn* (sale of debt) respectively³²⁴. By and large, these findings demonstrate the absence of uniformity in the Islamic banking *Fatwas* adopted by the IFIs within these key Islamic banking markets.

Indeed, the bindingness and non-bindingness of Islamic banking *Fatwas* have attracted a significant concern from the West, especially from countries with a growing base of Muslim populations such as the United States, Canada, and the United Kingdom, which

³²¹ Thomson Reuters, 'Malaysian Bank Merger to Disrupt Islamic Finance' CNBC, 17 July 2014 <<https://www.cnbc.com/2014/07/17/malaysian-bank-merger-to-disrupt-islamic-finance.html#>> accessed 21 September 2017; Goud and others, p. 13-14.

³²² The research collected data from six entities comprising three regulatory bodies and three IFIs, namely the SAC of the Securities Commission of Malaysia; the AAOIFI; the International Islamic *Fiqh* Academy; Kuwait Finance House; Dallah Al-Baraka; and Dubai Islamic Bank. See Shaharuddin and others, p. 31.

³²³ Also see discussion on *Bai Al-Inah* at p. 17, 41-42, and 117-118.

³²⁴ Shaharuddin and others, p. 10, 31.

project promising prospects for the development of Islamic banking markets³²⁵. For example, the UK's Financial Conduct Authority ('FCA') abstains from interfering with the IFIs' *Fatwa* issuance processes or the suitability of their *Sharia'* board members but it demands the IFIs ensure that the stakeholders understand the *Sharia'* compliance basis underlying an Islamic financial product or service³²⁶. As the diversity of *Sharia'* opinions remains a regular feature of the *Sharia'* legal system, it presents yet another layer of complications for the financial regulators such as the FCA in ensuring the consistency and predictability of *Fatwas* in the UK's Islamic banking industry. Arguably, a centralised corporate governance approach could provide a viable solution that can assist Western bankers, investors, and customers in understanding the concept of Islamic banking better.

Secondly, in the absence of a national *Sharia'* board or strong legislation that grants a statutory binding effect on the Islamic banking *Fatwas*, the IFI's BOD retains the right to refuse any decisions taken by the *Sharia'* board deemed as counter-productive or interfering with the IFI's profit-oriented VMO. According to a study by Dawud³²⁷, there exists a 50-50 division among the IFIs with regards to the legal status of *Sharia'* rulings issued by their *Sharia'* boards due to imprecise regulatory frameworks. Since as noted earlier neither the AAOIFI nor the IFSB's *Sharia'* standards are binding on the IFIs, the BOD remains the ultimate decision-making authority that possesses the prerogative to implement or refuse the *Fatwas* of the IFI's *Sharia'* board. In the worse scenario, the BOD could even leverage its authoritative position and alter the *Fatwas* to accommodate its interests. This is not surprising considering the fact that in most jurisdictions, the appointment of the IFI's *Sharia'* board members are made by the BOD³²⁸. Alternately,

³²⁵ Schmid, p. 1319; Thomson Reuters, *Canada Islamic Finance Outlook 2016* (Toronto Financial Services Alliance, Toronto, 2016), p. 20; T. Alrifai, *Islamic Finance and the New Financial System: An Ethical Approach to Preventing Future Financial Crises* (Wiley, Singapore 2015)

³²⁶ Ginena and Hamid, p. 121; Financial Conduct Authority, 'Ensuring the UK Remains Open for Business - Requirements for Foreign-Owned Firms' 13 November 2013 <<https://www.fca.org.uk/news/speeches/ensuring-uk-remains-open-business-%E2%80%93-requirements-foreign-owned-firms>> accessed 20 September 2017. Also see Agnelio M. P. Chicava Pita, 'Some Issues to Consider when Regulating Islamic Banking Business in Secular Countries' (2014) 2 *Journal of Islamic Banking and Finance* 389, p. 396; Ainley and others, p. 11.

³²⁷ Here, approximately 50 per cent of the IFIs considered the *Sharia'* rulings issued by their *Sharia'* board as binding, while the remaining 50 per cent was a mixture of those who viewed the rulings as merely advisory and those who failed to respond. See H Daoud, 'Shari 'a Control in Islamic Banks' [1996] *International Institute of Islamic Thoughts*, Herndon, VA, p. 43. Also see Casper, p. 5.

³²⁸ C.A. Mallin, *Handbook on Corporate Governance in Financial Institutions* (Edward Elgar Publishing 2016), p. 269; Ginena and Hamid, p. 276; di Mauro and others, p. 48. Also see Nurhastuty Wardhany and Shaista Arshad, 'The Role of Shariah Board in Islamic Banks: A Case Study of Malaysia, Indonesia and

the concern over job security or contract renewals of their *Sharia'* board directorships can also turn a *Sharia'* board into a silent and weak *Sharia'* board³²⁹.

Thirdly, the absence of centralised and standardized *Fatwas* and corporate governance standards can expose the industry to a growing list of *Sharia'* non-compliance risks including the multiple *Sharia'* board directorship practice. Since the occupation of multiple *Sharia'* board positions inflicts additional burdens and strains on the *Sharia'* board members, it is arguable that the practice can impair their *Sharia'* governance oversight and hinder the provision of an effective *Sharia'* compliance supervision over the IFI's financial operations³³⁰. In contrast to the decentralised Islamic corporate governance system, which does not impose a restriction on the *Sharia'* board members in respect of the number of board directorship they may hold³³¹, a number of countries, which adopted the centralised Islamic corporate governance system such as Malaysia and Sudan have begun to prohibit the practice of multiple *Sharia'* board directorships to ensure that the IFI's *Sharia'* board members will only dedicate their time and attention to the affairs of their main employer³³².

Additionally, the presence of several factors such as the strong influence of the secular laws towards the governing legislation for Islamic banking in most countries and the lack of dedicated Islamic banking legislations and a structured Islamic corporate governance

Brunei Darussalam' (2nd ISRA Colloquium "Islamic Finance in a Challenging Economy: Moving Forward", Kuala Lumpur, November 27), p. 5; Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/012-1, p. 3; S Gooden, 'Participation of Stakeholders in the Corporate Governance of Islamic Financial Institutions' [2001] *New Horizon* 12, p. 12-15.

³²⁹ A.J. Ali, *Business Ethics in Islam* (Edward Elgar 2014), p. 109; Lahsasna, 'Shariah Governance in the Islamic Financial Institution: Issues and Challenges', p. 699. Also see Hamza, p. 229.

³³⁰ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28-29; Thomson Reuters, *Islamic Finance Development Report 2016*, p. 100; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 179. Also see Renée Birgit Adams and Daniel Ferreira, 'Regulatory Pressure and Bank Directors' Incentives to Attend Board Meetings' (2012) 12 *International Review of Finance* 227, p. 228, 231; Pornsit Jiraporn and others, 'Too Busy to Show Up? An Analysis of Directors' Absences' (2009) 49 *The Quarterly Review of Economics and Finance* 1159, p. 1160.

³³¹ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 25; Hasan and Sabirzyanov, p. 251; Thomson Reuters, 'Islamic Finance Outsources Scholars' Supervision to Grow'

³³² International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28-29; Islamic Development Bank, *Islamic Development Bank Group in Brief*, p. 29. Also see Thomson Reuters, *Islamic Finance Development Report 2014*, p. 113; Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 7.

framework in key jurisdictions such as Saudi Arabia, Qatar, United Arab Emirates, and Iran remain the focal challenges that continue to contribute towards the instability of the global Islamic banking industry³³³. This corresponds to the Global Islamic Finance Report in 2016, which highlighted this concern and discovered that 77 per cent of 2,170 respondents in 43 countries, comprising academicians and professionals in the financial services industry favoured the establishment of a centralised *Sharia'* board, with 71 per cent of them viewed the central bank responsible to set and maintain this board³³⁴. This is similar to the industry report by Deloitte in 2010, which highlighted this concern and discovered that 57 per cent of the executives, practitioners, and policy-makers of the Islamic banking industry in the Middle East had displayed preferences towards the adoption of a centralised Islamic corporate governance system over the decentralised. This was attributed to the latter's weaknesses in regulating the inconsistencies of Islamic banking *Fatwas*, conflict of interest issues, and also the practice of *Sharia'* arbitrage, or the re-engineering of an interest-bearing financial instrument into one that closely resembles a *Sharia'*-compliant financial instrument (see **Figure 9**)³³⁵.

³³³ Majid and Ghazal. Also see Deloitte, p. 12; Hasan and Sabirzyanov, p. 245.

³³⁴ Dar, Azmi and Shafique, p. 103-113.

³³⁵ A good example of *Sharia'* arbitrage financial instruments is *Takaful*, which critics have argued as one that comprises the prohibited element of *Gharar*. See Hussain, Shahmoradi and Turk, p. 23; Deloitte, p. 13; Mahmoud El-Gamal, 'Incoherent Pietism and Sharia Arbitrage' *Financial Times* (23 May 2007) <http://www.ft.com/cms/s/0/97adbfcf-08ca-11dc-b11e-000b5df10621.html?ft_site=falcon&desktop=true#axzz4asqfOGTy> accessed 29 August 2017.

Which of the following two common Sharia'a supervisory models do you think is better for industry growth?

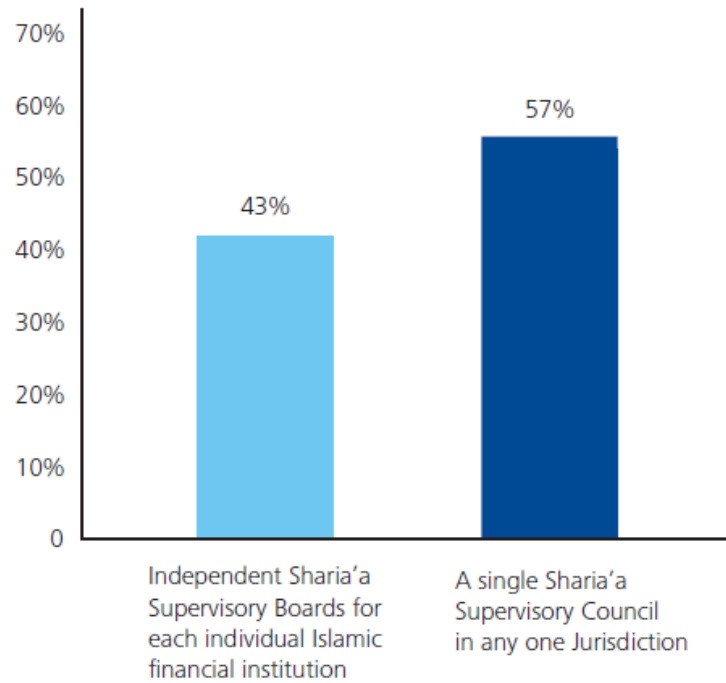


Figure 9: Opinion Survey Between a Single *Sharia'* Supervisory Council and an Independent *Sharia'* Supervisory Boards for the IFI³³⁶

As much as the IFSB recognises the different *Sharia'* viewpoints within the industry given the varying nature of the legal systems and '*Urf* of the respective countries, it also acknowledges the importance for the industry to establish a suitable platform to enhance understanding and resolve the ongoing differences that can contribute to the destabilization of the entire industry³³⁷. Accordingly, it is arguable that a centralised Islamic corporate governance system provides a universal and more comprehensive platform for the exercise of a systematic *Ijtihad* instead of an 'arbitrary opinion-making' environment represented by a decentralised system³³⁸. This contention is based on the following rationale.

³³⁶ Deloitte

³³⁷ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 1. Also see Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 11.

³³⁸ Bourheraqua, p. 50; Muḥammad Ṭāhirulqādrī, *Ijtihad (Meanings, Application & Scope)* (Minhaj-ul-Quran Publications 2007).

First, although the national *Sharia'* board serves as the highest *Sharia'* authority for the IFIs in a country, its presence does not infer that the *Sharia'* board at the individual IFI-level loses its authority to issue *Fatwas* on Islamic financial products and services. On the contrary, the regulatory framework within the centralised Islamic corporate governance system allows the IFI's *Sharia'* board to issue *Fatwas* on newly-invented financial instruments and the *Sharia'* compliance assurance of the IFI's overall financial operations³³⁹. In other words, the national *Sharia'* board merely functions as a mediation platform to promote consistency and uniformity in the adoption of Islamic banking *Fatwas* and corporate governance standards between the two different levels of *Sharia'* boards. The IFI's *Sharia'* board continues to enjoy the prerogative to develop suitable *Fatwas* that correspond to the guidelines issued by the national *Sharia'* board³⁴⁰.

Accordingly, this requirement is reflected in the policies of several countries that have since adopted the centralised Islamic corporate governance system which mandate the establishment of an in-house *Sharia'* board in all IFIs. For example, in the United Arab Emirates, Article 6 of the Federal Law No. (6) of 1985 requires the formation of an in-house *Sharia'* board in all IFIs in the kingdom, whose duties shall include the alignment of the IFI's financial operations with *Sharia'* law³⁴¹. In Malaysia, the IFSA 2013 not only mandates the formation of a similar institution³⁴² but it also allows banks, which possess more than one entity licensed to conduct Islamic banking business, to establish a single *Sharia'* board to supervise the overall *Sharia'* compliance of the bank's financial activities³⁴³. It is arguable that such an approach can assist in liberalising the local Islamic banking market as well as mitigating the prospect of market confusion caused

³³⁹ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 34-35. Also see Shaharuddin and others, p. 8.

³⁴⁰ Mohammad Akram Laldin and Hafas Furqani, 'Standardisation in Islamic Finance: Moving Towards Harmonisation' in Marjan Muhammad (ed), *ISRA Islamic Finance Space* (4 edn, ISRA Consultancy Sdn Bhd 2015), p. 6-10; Goud and others, p. 13.

³⁴¹ The said article stipulates "*The respective articles and memorandum of association of each Islamic bank, financial institution and investment company should clearly stipulate that a Sharia' Supervision Authority shall be formed of minimum three members to render their transactions and practices accordant with the principles and provisions of Islamic Sharia' law*". See Article (6) of Federal Law No - (6) of 1985 Regarding Islamic Banks, Financial Institutions and Investment Companies

³⁴² Section 30 of Islamic Financial Services Act 2013 (Act 759)

³⁴³ *Ibid*. This policy is a positive improvement to the repealed Takaful Act 1984 and superseded BNM Guidelines on the Governance of *Sharia'* Committee that required a separate *Sharia'* board to be formed if the banking group conducts Takaful business. See Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 9.

by the presence of variable factors such as '*Urf* and school of thought orientation, thus increasing stakeholders' confidence and advancing industry's effort to standardize Islamic banking *Fatwas* across borders³⁴⁴.

Secondly, a centralised Islamic corporate governance system does not necessarily infer the singularisation of the variant *Sharia'* opinions for every Islamic financial product and service in the market. In fact, the centralisation policy administered in countries such as Malaysia and Pakistan suggests that the scope for flexibility remains. For example, in the last ten years, Malaysia had welcomed three international IFIs into its Islamic banking market, namely the Al-Rajhi Bank, Kuwait Finance House, and the Asian Finance Bank. Although the IFSA 2013 mandates that the IFIs must adhere to the *Fatwas* issued by the SAC, the law also recognises the *Fatwas* of the different schools of Islamic jurisprudence and grants a certain degree of flexibility to the international IFIs to adopt *Fatwas* issued by their respective *Sharia'* boards, which are subjected to the SAC's prior approval³⁴⁵.

For instance, the SAC allowed the Al-Rajhi Bank to offer an Islamic financial scheme based on the *Musharakah Mutanaqisah* principle (diminishing partnership) in lieu of the BBA, and to offer deposit accounts based on the *Qard* (loan) and *Mudarabah* principle instead of *Wadiah* (safekeeping) – which are akin to the Islamic banking principles commonly adopted by the IFIs in the GCC region³⁴⁶. Similarly, in Pakistan, its Islamic banking industry, which mainly subscribes to the opinions of the Hanafi's school, has also implemented a liberal approach in the adoption of Islamic banking *Fatwas* from the other schools of Islamic jurisprudence. For instance, the SBP's *Sharia'* Advisory Forum ('SAF') had already approved a number of the AAOIFI's Islamic banking standards, which comprise a combination of *Sharia'* opinions from the different schools of Islamic jurisprudence after evaluating their practicability from the context of the country's regulatory framework and public interest. These include the *Sharia'* Standard No. 03 (Defaults in Payment by a Debtor), No. 08 (*Murabahah* to the Purchase Order), No. 09 (*Ijarah* and *Ijarah Muntahia Bittamleek*) and No.13 (*Mudarabah*)³⁴⁷. Based on the above

³⁴⁴ Bloomberg; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 95. Also see Akhtar, p. 3.

³⁴⁵ Principle 1.8 of Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 8. Also see Rusni Hassan, Agus Triyanta and Adnan Yusoff, 'Shariah Compliance Process in Malaysian Islamic Banking [2011] 5 MLJ lxxx' (2011) 5 Malaysian Law Journal, p. 94.

³⁴⁶ Hassan and Mahlkecht, p. 331. Also see Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*, p. 43, 101-102.

³⁴⁷ Dar and Azami, *Global Islamic Finance Report (GIFR) 2012*, p. 117-119.

examples from Malaysia and Pakistan, it is arguable that the 'harmonisation' of the Islamic banking *Fatwas* and corporate governance standards can also serve as a fitting theme to the concept of a centralised Islamic corporate governance system.

Thirdly, although the reliance on a single *Sharia'* board can risk compromising an IFI's overall *Sharia'* compliance processes, a national *Sharia'* board can arguably benefit the IFI through the provision of the necessary standards and templates of Islamic financial products for the IFI to use. This manages the uncertainty issue that arises from the complexity of certain financial instruments as well as lowering their issuance cost by reducing the need to create them *de novo*³⁴⁸. At the same time, its presence can also alleviate the roles and responsibilities of the *Sharia'* boards at the IFI-level. As a result, *Sharia'* boards can concentrate on other aspects of *Sharia'* compliance such as the development of an internal *Sharia'* compliance framework, internal *Sharia'* compliance monitoring, product innovation, and the provision of *Sharia'* trainings to employees. Thus, the centralised Islamic corporate governance system warrants a comprehensive *Sharia'* compliance assurance at both the national and IFI-level.

Finally, although the GCC had considered the idea of a national *Sharia'* board in harmonising the differences of *Sharia'* opinions as unnecessary; taking into account the fact that the governing law of most of the countries within the region is *Sharia'* law³⁴⁹, it is arguable that the adoption of a centralised Islamic corporate governance system can assist in accommodating prospective investors to the market, especially those unfamiliar with the concepts and principles of Islamic banking. This is because it provides a more structured and comprehensive Islamic corporate governance framework as compared to the decentralised Islamic corporate governance system. This was recently demonstrated by Oman – the last nation among the GCC to introduce Islamic banking. It has begun to benefit from its newly adopted centralised Islamic corporate governance

³⁴⁸ Goud and others, p. 15; Bank Negara Malaysia, *Financial Stability and Payment Systems Report 2007* (2007), p. 58.

³⁴⁹ This can also be explained by the absence of a written constitution in countries such as Saudi Arabia, which relies totally on the provisions of the Holy Quran and the *Sunnah*. See A.Y. Baamir, *Shari'a Law in Commercial and Banking Arbitration: Law and Practice in Saudi Arabia* (Taylor & Francis 2016), p. 14; Zulkifli Hasan, 'Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK' (2010) 3 Kyoto Bulletin of Islamic Area Studies 82, p. 106-107. Also see William F Pepper, 'Foreign Capital Investment in Member States of the Gulf Cooperation Council Considerations, Issues and Concerns for Investors' (1992) 7 Arab Law Quarterly 33

approach³⁵⁰. Not only has the system accelerated the growth of Islamic financial products and services in the country, it has also reduced the overall operational costs for *Sharia'* compliance of all its IFIs³⁵¹. Adding to the fact that Oman had only adopted a corporate governance framework for its Islamic banking market in the third-quarter of 2014, its rapid development and quick learning from advanced Islamic banking markets caught the industry by surprise by outperforming established market players such as the United Arab Emirates and Maldives in terms of the strength of its overall Islamic corporate governance framework (see **Figure 10**). Further, the performance of the top five countries apart from Kuwait – Bahrain, Malaysia, Pakistan, and Sudan, reemphasises the fact that the centralised Islamic corporate governance approach represents a stable and viable corporate governance framework for the Islamic banking system.

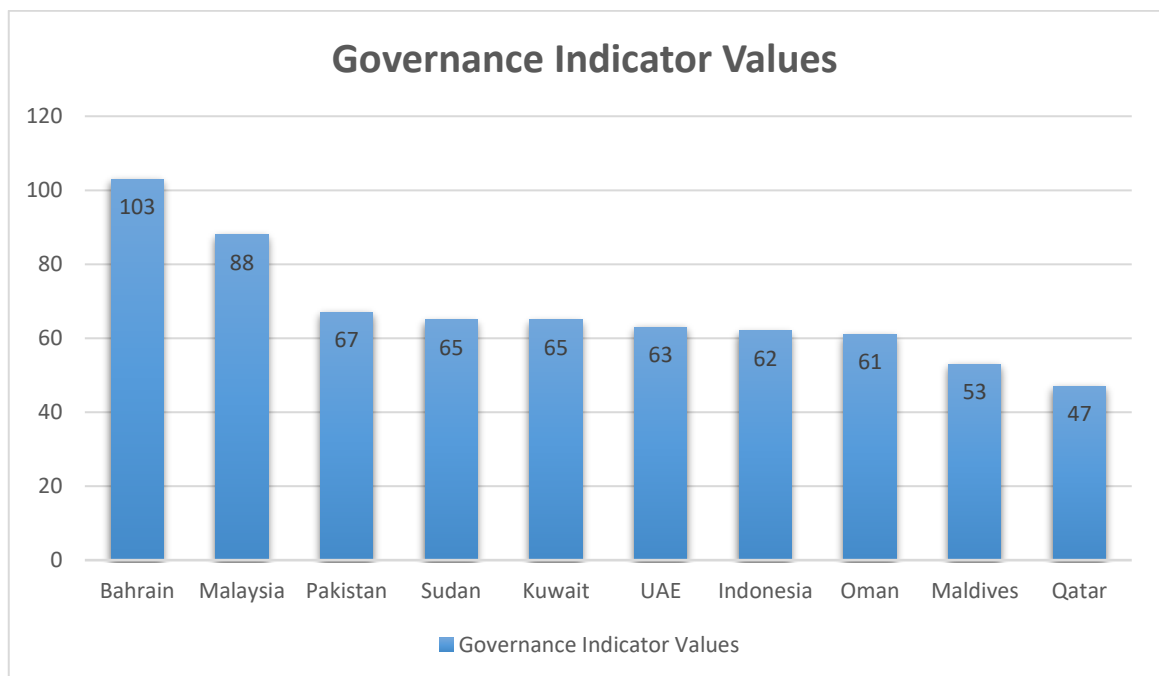


Figure 10: Ranking of Countries According to the Standards of Good Practice in Islamic Banking with Regards to Regulations, Corporate Governance, and *Sharia'* Governance (2016)³⁵²

³⁵⁰ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 95, 102; Soualhi, p. 23. Also see Thomson Reuters, *Oman Islamic Finance Report 2015: Building on a Strong Start* (Islamic Research Training Institute, Jeddah, 2015), p. 113; Vizaino

³⁵¹ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 97; Vizaino. Also see Thomson Reuters and Dubai Chamber of Commerce and Industry, p. 152.

³⁵² Modified. The Governance Indicator Values ranges from 0 to 103. See Thomson Reuters, *Islamic Finance Development Report 2016*, p. 94-96.

3.4 Conclusion

The Islamic corporate governance system differs from its Western counterparts in the sense that its purpose lies in upholding the principle of *Maqasid As-Sharia'* throughout the IFI's financial operations. However, in recent years, the inconsistency of Islamic banking *Fatwas* and standards have caused confusion among consumers and subjected the industry to heavy scrutiny from *Sharia'* scholars and banking practitioners³⁵³. The AAOIFI and the IFSB acknowledged the differing viewpoints among the IFIs' *Sharia'* boards, given the diverse legal systems across jurisdictions where they operate³⁵⁴. However, the growing list of pressing issues such as the independence of the *Sharia'* board, conflict of laws and schools of Islamic jurisprudence, education and qualification of the IFI's *Sharia'* board members, non-standardised *Sharia'* rulings and guidelines, and *Fatwa*-shopping; have all but necessitated the reformulation and rethinking of the effectiveness of the whole Islamic corporate governance concept in fulfilling its fundamental objective of ensuring *Sharia'* compliance. In the next chapter, the thesis will specifically assess the practice of multiple directorships from the western context of directors' fiduciary duty of loyalty (encompassing the duty to act in the best interest of the company and the duty to avoid conflict of interest) and the regulatory approaches of several western countries in respect of the practice. These would provide a helpful practical platform in appreciating the corresponding issues commonly associated with the practice from the *Sharia'* law lens, which would be dealt with in chapter 5.

³⁵³ T. Harrison and H. Estelami, *The Routledge Companion to Financial Services Marketing* (Taylor & Francis, London 2014), p. 407; Lateef Kayode Adeyemo and Kamil Koyejo Oloso, 'Islamic Banking and Finance Today: Issues and Implications' (2013) 4 *Islamic and Civilisational Renewal*, p. 432; Deloitte, p. 11.

³⁵⁴ {Islamic Financial Services Board (IFSB), 2009 #94}

CHAPTER 4: THE PRACTICE OF MULTIPLE DIRECTORSHIPS IN GLOBAL ISLAMIC BANKING INDUSTRY

4.0 Introduction

In our modern life, it is not uncommon for an individual to undertake multiple jobs or responsibilities at the same time – either in a personal, social or professional capacity. This is due to the presence of several enabling factors such as the availability of time, the ability to multitask, contractual obligations, or simply due to personal passion. For instance, a research student who undertakes a part-time job; a politician who normally handles two or more designations – one in his political party and another in the government's cabinet; or even a man who practices polygamous matrimonial relationship, illustrate such a phenomenon in our modern world.

A layman who engages in the practice of undertaking multiple obligations in either his personal or professional life may not encounter too much bother. However, the engagement in such a practice by an important figure such as a prime minister, or a board director, who play a decisive role in their profession, may give raise to several questionable issues from the governance perspective. In the previous chapter, the thesis demonstrated the differentiating characteristics of the Western and the Islamic corporate governance systems. At the same time, it is vital to note that both systems witness controversial practices such as interlocking directorships, or in the case of the Islamic banking industry, multiple *Sharia'* board directorships by the IFI's *Sharia'* board members.

During the inception of the Islamic banking industry in the 1970s, it was uncommon to hear of a *Sharia'* scholar occupying multiple *Sharia'* board directorships across IFIs. However, it began to evolve into a common practice considering the limited collective number of IFIs around the globe and the absence of a formal *Sharia'* compliance organ in the form of a *Sharia'* board within most of the IFIs' corporate governance structure at that time³⁵⁵. As the global demands for Islamic financial products and services increased, so did the number of IFIs. Nonetheless, the robust development of Islamic banking dwarfed the collective supply of *Sharia'* scholars with the necessary knowledge and practical experience in the *Sharia'* law and banking respectively to serve as the IFI's *Sharia'* board members, which created a *Masyaqqah* (a severe or difficult situation) that

³⁵⁵ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28-30, 32; Hussien Elasrag, 'Corporate Governance in Islamic Finance' [2014] Munich Personal RePEc Archive Paper, p. 50. Also see Kahf, p. 4; Napoleoni, p. 290.

prompted the IFIs to share similar *Sharia'* scholars as their advisors for *Sharia'* compliance processes³⁵⁶.

As at 2016, there are approximately 1068 *Sharia'* scholars around the world, who occupy *Sharia'* board directorships across 46 countries³⁵⁷. 75 per cent of these directorships are concentrated in ten countries, spanning across the Southeast Asia, the GCC, and South Asia³⁵⁸. Out of this number, 27 per cent (285) have 2-4 *Sharia'* board directorships while 8 per cent (87) have 5 or more *Sharia'* board directorships (see **Figure 11**).

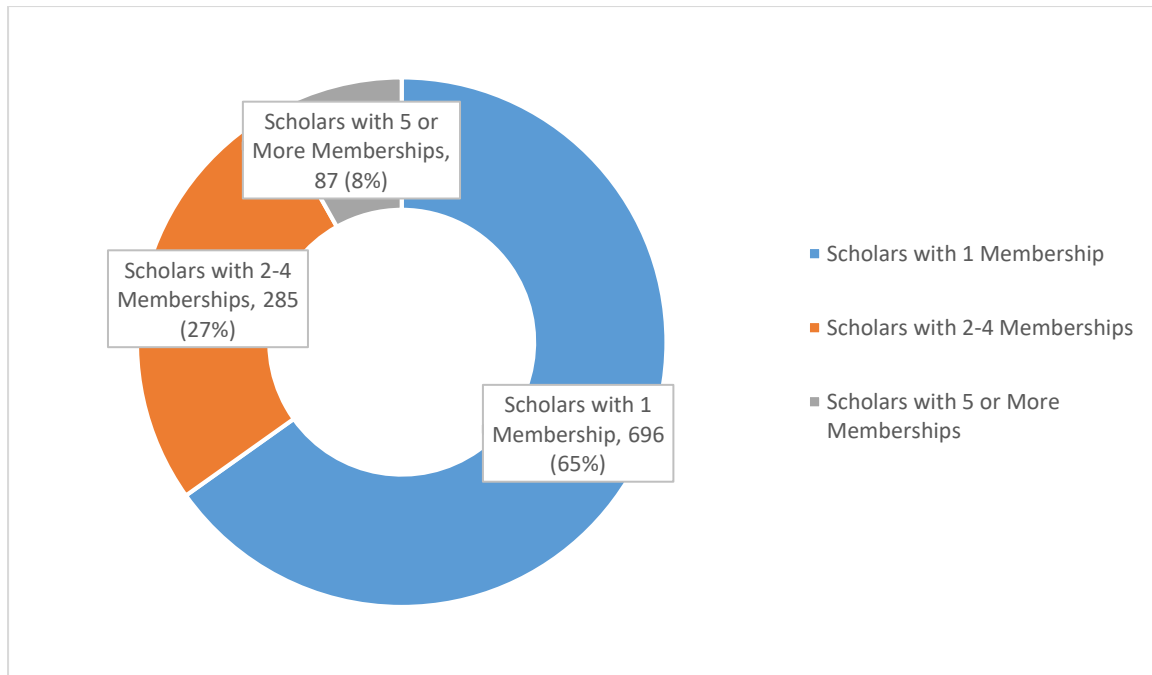


Figure 11: *Sharia'* Board Directorships of *Sharia'* Scholars Globally (2016)³⁵⁹

³⁵⁶ Majid and Ghazal, p. 149; Also see the *Fiqh* method of *Dharurah Tabihu Al-Makhzurat* (necessity permits the forbidden) in Al-Sheikh Zayn Al-Din bin Ibrahim bin Muhammad Ibn Nujaym, *Al-Ashbah Wa Al-Nazair 'Ala Mazhab Abi Hanifah Al-Nu'man (Similarities in the Branches of Law According to the Hanafi School)* (1st edn, Dar Al-Kutub Al-Ilmiyyah 1999), p. 73; Ali Ahmad Al-Nadwi, *Al-Qawa'id Al-Fiqhiyyah (The Method of Fiqh)* (published in Damascus, 4th edn, Dar Al-Qalam 1998), p. 308; Al-Suyuti, p. 168-169.

³⁵⁷ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 6, 9, 95, 96, 100; *ibid*, p. 29.

³⁵⁸ Example of countries with *Sharia'* scholars serving on multiple IFIs' *Sharia'* boards include Malaysia, Indonesia, Pakistan, Bangladesh, Qatar, Saudi Arabia, United Arab Emirates, Bahrain, and Kuwait. See Thomson Reuters, *Islamic Finance Development Report 2016*, p. 102; International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 29. Also see Thomson Reuters, *Islamic Finance Development Report 2014*, p. 102, 113.

³⁵⁹ Modified. See Thomson Reuters, *Islamic Finance Development Report 2016*, p. 94.

It is also important to note that the top 50 *Sharia'* scholars based on the number of their *Sharia'* boards directorships; and not their seniority, command a significant 73 per cent share and the top three scholars are serving 40 per cent of the available 1142 *Sharia'* board directorships worldwide³⁶⁰, which also include those within Islamic banking standard-setting agencies such as the IFSB and the AAOIFI. The fact that it hypothesises an average of 16 *Sharia'* board directorships per scholar not only indicates a high concentration risk of *Sharia'* board directorships within the industry, but also presents a reasonable cause for concern in respect of the ability of the IFI's *Sharia'* boards to manage the *Sharia'* due diligence and review process. The concerns behind the practice revolve around several substantial issues such as conflict of interest, time commitment, confidentiality and more importantly, the compliance of the stated practice with *Sharia'* law³⁶¹. If the application of the practice was unfounded on any valid principle of *Sharia'* law and yet was practised by *Sharia'* scholars, it could jeopardise the stability and reputation of the industry as the scholars owe both the IFIs and the religion of Islam, a great responsibility in assuring stakeholders that *Sharia'* compliance does not stop at the financial products and services offered, but includes the conducts and practices of those safeguarding IFI's *Sharia'* compliance assurance.

³⁶⁰ The top ten *Sharia'* scholars commands a 76 per cent share of the *Sharia'* board directorships across 652 IFIs. See International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28-29, 32; Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*. A comprehensive list of *Sharia'* scholars based on the number of their *Sharia'* board directorships is available for a premium at Thomson Reuters On Demand service.

³⁶¹ Mirna Sleiman and Bernardo Viszaino, 'Dubai Plans Central Islamic Finance Regulatory Board' Thomson Reuters, 27 February 2013 <<http://uk.reuters.com/article/2013/02/27/islamicfinance-dubai-idUKL6NOBR6DV20130227>> accessed 19 September 2017; Majid and Ghazal; Wilson, *The Development of Islamic Finance in the GCC*, p. 10.

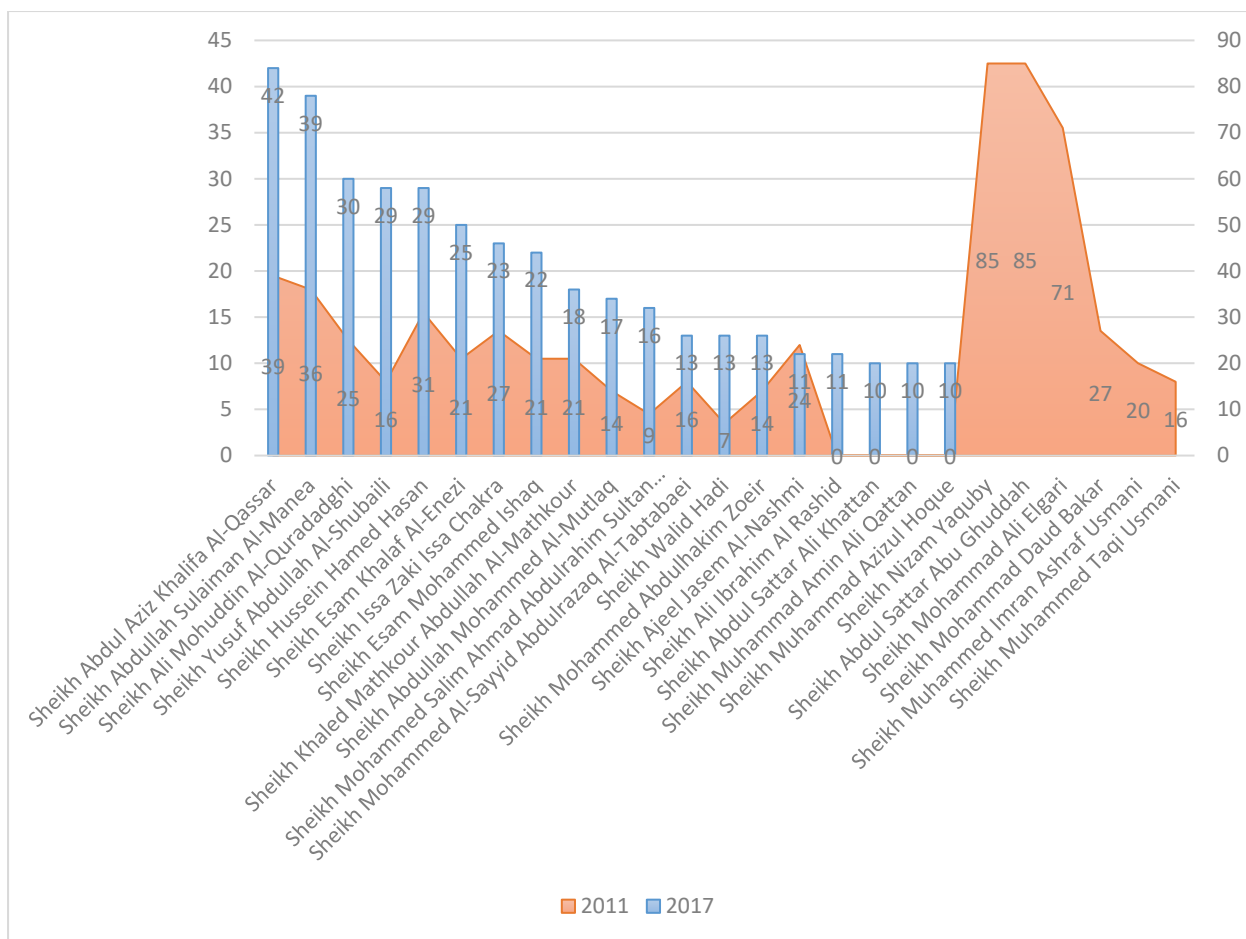


Figure 12: Top 25 *Sharia'* Scholars and Their *Sharia'* Board Directorships (2017)³⁶²

The above figure illustrates and compares the top 25 *Sharia'* scholars and their *Sharia'* board directorships across the globe between 2011 and 2017 by integrating the data provided by Unal³⁶³, which provides the first empirical statistic on the multiple *Sharia'* board directorships practice, with a recent data obtained from Thomson Reuters (see **Figure 12**). It is both surprising and academically interesting to note that not much has changed since 2011. Although this thesis could not obtain the data on several *Sharia'* scholars and their *Sharia'* board directorships, namely Sheikh Ali Ibrahim Al Rashid, Sheikh Abdul Sattar Ali Khattan, Sheikh Muhammad Amin Ali Qattan, and Sheikh

³⁶² Modified. See Thomson Reuters, 'Top Sharia Scholars by Number of Boards' Thomson Reuters On Demand (Purchased Data) <<https://financial.thomsonreuters.com/en/products/infrastructure/trading-infrastructure/on-demand-financial-market-reports.html>> accessed 10 September 2017. Also see International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28; Thomson Reuters, *Islamic Finance Development Report 2015* (2015), p. 129-130; Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*, p. 4.

³⁶³ Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*, p. 4.

Muhammad Azizul Hoque for their directorships in 2011, and the top three *Sharia'* scholars (Sheikh Nizam Yaquby, Sheikh Abdul Sattar Abu Ghuddah, and Sheikh Mohammad Ali Elgari) for their directorships in 2017, the data on the other *Sharia'* scholars displays a slight variation in the number of directorships held by the scholars. Eleven *Sharia'* scholars remain to hold more than 15 *Sharia'* board directorships; eight holds more than ten directorships; and those held by the remaining six popular *Sharia'* scholars remain unknown³⁶⁴. The fact that the majority of these scholars are GCC nationals suggests that the multiple *Sharia'* board directorships practice is either permissible or unregulated within the GCC region.

At the time of writing (September 2017), there has yet to exist a specific data that could trace and illustrate the inclination or declination rate of *Sharia'* scholars with 5 or more *Sharia'* board directorships in the last 3 years. The only available data on this was provided by the Thomson Reuters' Islamic Finance Development Report 2014 and 2015, which suggest a slight increase in the number between 2013 and 2014 across key Islamic banking markets except Malaysia and Sudan who have begun to prohibit *Sharia'* scholars from engaging in multiple *Sharia'* board directorship practice (see **Figure 13**)³⁶⁵. From the data, it is also evident that the numbers of *Sharia'* scholars with 5 or more *Sharia'* board directorships are especially high in GCC countries which may have adopted a non-restrictive policy towards the application of the practice³⁶⁶.

³⁶⁴ This researcher performed a quick independent search on the Internet to find information about these six *Sharia'* scholars and discovered that some of them remain to hold a significant number of *Sharia'* board directorships across various IFIs. For example, Sheikh Nizam Yaquby holds more than ten *Sharia'* board directorships in IFIs such as Bahrain Islamic Bank, Bank Al Khair, Ibdar Bank, Ithmaar Bank, Khaleeji Commercial Bank, Mashreq Al Islami, Arab Finance House, Abu Dhabi Islamic Bank, Bank ABC Islamic, Bank Audi, and Attijari Al Islami. Interestingly, Sheikh Nizam Yaquby's name has also been spelt differently such as Nidham, Netham, and Yacuby, among others, which may explain why Thomson Reuters could not capture the data on these *Sharia'* scholars.

³⁶⁵ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 31; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 112-113; Islamic Development Bank, *Islamic Development Bank Group in Brief*, p. 29; Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 7.

³⁶⁶ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 102; Thomson Reuters, *Islamic Finance Development Report 2015*, p. 141; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 114.

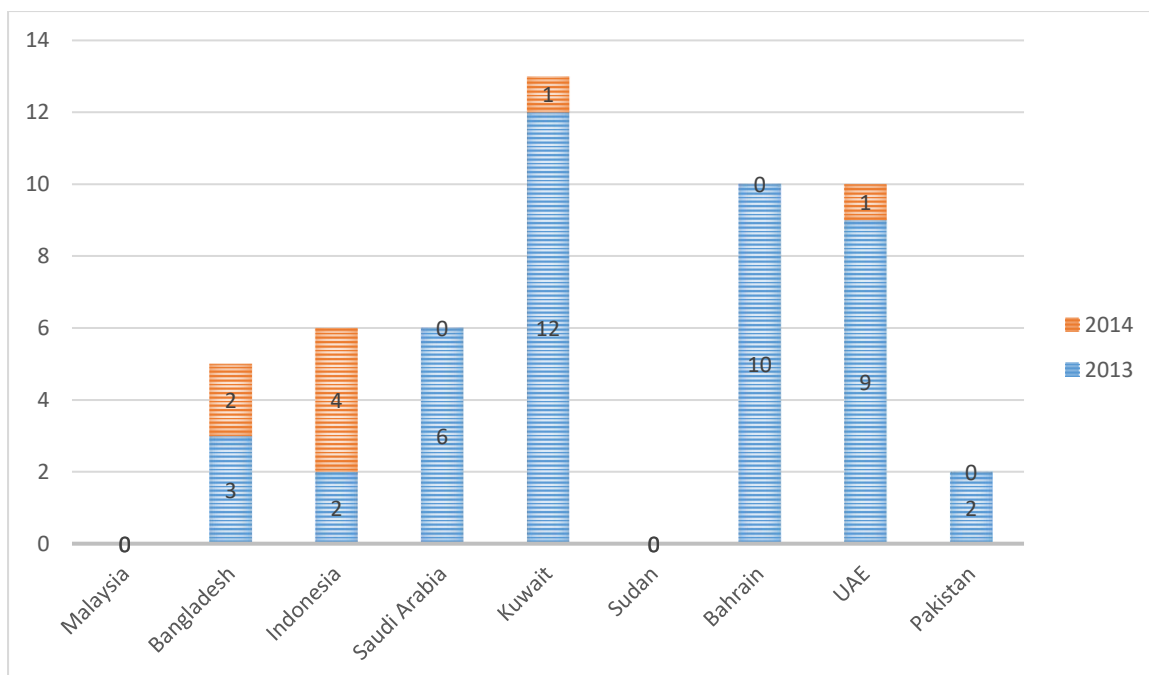


Figure 13: Number of *Sharia'* Scholars of Top Islamic Banking Markets with Five or More *Sharia'* Board Directorships (2013-2014)³⁶⁷

Similar to non-executive directors ('NEDs'), the majority of *Sharia'* board members are appointed on a part-time basis and their scope of work is more in the nature of a consultancy than that of an executive director³⁶⁸. Apart from holding *Sharia'* board directorships elsewhere, many of them also hold academic and other professional positions across various universities and organisations. Likewise, *Sharia'* board members enjoy the right to challenge the BOD's decision should it contradict the tenets of *Sharia'* law. As noted earlier, in recent years, the roles of *Sharia'* board members have begun to evolve and become more complex and more involved with the engineering and development of Islamic financial products in order to accommodate divergent consumer needs and demands. This renders it likely that the landscape of the Islamic corporate governance structure for IFIs may experience a transformative process in the future.

Although the BOD remains the ultimate decision-making authority of the IFI, it cannot afford to ignore the advice of the *Sharia'* board in matters concerning the *Sharia'* compliance of Islamic financial products, services, and related business decisions, which

³⁶⁷ Modified. See International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 30; Thomson Reuters, *Islamic Finance Development Report 2015*, p. 140; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 114.

³⁶⁸ Mohd Daud Bakar, *Shariah Minds in Islamic Finance* (Amanie Media Sdn Bhd 2016), p. 268; L. Roach, *Company Law Concentrate* (Oxford University Press 2014), p. 111. Also see J. Marson and K. Ferris, *Business Law* (Oxford University Press 2015), p. 388.

serves as a crucial determinant to the integrity of the IFI's *Sharia'* compliance assurance³⁶⁹. Regardless, the evolving roles of the *Sharia'* board members translates into more corporate responsibilities, more active involvement with the IFI's affairs, and an increased share of the corresponding risks and stress. As this would demand more attention and time commitment from *Sharia'* board members, now more than ever, the presence of external commitments at other IFIs can plausibly prejudice the performance of their fiduciary responsibilities to the extent that it can endanger the IFI's *Sharia'* compliance assurance processes.

In recent years, the interest in, and awareness of, the conceptual framework of the IFI's corporate governance systems have intensified and yet surprisingly, the practice of multiple *Sharia'* board directorships, which had become evident in the last two decades, has failed to attract a substantial interest and scrutiny from academicians and industry practitioners – rendering an examination of its practicability to the industry and its *Sharia'* compliance status a worthy research subject. At the same time, the thesis also acknowledges the fact that the uncertain *Sharia'* compliance status of the practice renders it a subject of *Ikhtilaf* (differences of opinions) among the four major schools of Islamic jurisprudence³⁷⁰. Even so, *Sharia'* law also does not forbid any research on the subject if the purpose is to search for the truth³⁷¹.

Accordingly, this chapter will examine the pros and cons of the practice and the corresponding issues surrounding its application through the lens of the western context of directors' fiduciary duties. It will also examine the regulatory approaches to the practice in selected Western jurisdictions, namely the European Union, the United Kingdom, Ireland, the United States of America, and Germany to provide a comparative analysis *vis-à-vis* the Islamic concept of *Fardh Ain-Fardh Kifayah* perspective (mandatory obligation-conditional obligation), *Ijtihad*, *Amanah* (trust), and *Maslahah Al-Mursalah* (public interest), and the regulatory approaches of the AAOIFI and the IFSB, which are dealt separately in chapter 5.

³⁶⁹ See p. 95 and 98.

³⁷⁰ For a detailed discussion on *Ikhtilaf*, see p. 128-141.

³⁷¹ Nasrul Hisyam Nor Muhamad, 'Pemakaian Prinsip Hibah Dalam Sistem Kewangan Islam Di Malaysia: Tumpuan Kepada Industri Perbankan Islam Dan Takaful (The Application of Hibah in the Malaysian Islamic Banking System: A Focus Towards the Islamic Banking and Takaful Industry)' (2010) 52 Sains Humanika, p. 79. Also see Al-Suyuti

4.1 Overlapping Benefits and Risks of Multiple Directorships

The multiple directorship practice has its proponents and detractors. From an industrial perspective, the practice can overcome the shortage of highly qualified and experienced directors which can occur even in the largest of industries. This appeared to be the case for the Islamic banking industry between the early 1970's and the late 1990's which experienced a shortage of qualified *Sharia'* scholars with substantial experience and exposure to banking operations crucial to the business of IFIs³⁷². Through serving on the BODs or the *Sharia'* boards of other IFIs or companies, the practice enables *Sharia'* board members to acquire additional knowledge, experience, and the opportunity to develop external skills that can enhance the overall effectiveness of the *Sharia'* board and the IFI as a whole³⁷³. This gives the IFIs access to the necessary expertise in critical areas that it may lack including for example matters concerning stocks, bonds, mergers and acquisitions, and *Sharia'* compliance, all of which definitely call for expert counsel and skill. Likewise, the critical experience gained in handling the divergent corporate issues which arise at these IFIs or companies can benefit others, especially the IFIs that lack adequate experience in navigating the public markets³⁷⁴.

As the interlocking *Sharia'* board members become more acquainted with the patterns of corporate issues experienced by other IFIs, they can facilitate faster learning across

³⁷² A.J. Ali, *Handbook of Research on Islamic Business Ethics* (Edward Elgar Publishing Limited 2015), p. 252; Richard C. Morais, 'Don't Call It Interest' Forbes <<http://www.forbes.com/forbes/2007/0723/122.html>> accessed 22 September 2017. Also see Ben Marlow, 'Overboarding is Corporate Governance Gone Mad' The Telegraph, 29 April 2017 <<http://www.telegraph.co.uk/business/2017/04/29/overboarding-corporate-governance-gone-mad/>> accessed 28 July 2017 (*"[B]ig banks ... say it is painfully difficult for them to find people willing to deal with the dizzying complexities and regulations that has been piled on to financial institutions since the financial crisis*).

³⁷³ Laura Field, Michelle Lowry and Anahit Mkrtchyan, 'Are Busy Boards Detrimental?' (2013) 109 *Journal of Financial Economics* 63, p. 64; Brian L. Connelly and Erik J. Van Slyke, 'The Power and Peril of Board Interlocks' (2012) 55 *Business Horizons* 403, p. 403-405; Benjamin M Gerber, 'Enabling Interlock Benefits while Preventing Anticompetitive Harm: Toward an Optimal Definition of Competitors under Section 8 of the Clayton Act' (2007) 24 *Yale Journal on Regulation* 107, p. 115; Pamela R. Haunschild and Christine M. Beckman, 'When Do Interlocks Matter?: Alternate Sources of Information and Interlock Influence' (1998) 43 *Administrative Science Quarterly* 815, p. 817, 823, 839.

³⁷⁴ Field, Lowry and Mkrtchyan, p. 64; Ira C Harris and Katsuhiko Shimizu, 'Too Busy to Serve? An Examination of the Influence of Overboarded Directors' (2004) 41 *Journal of Management Studies* 775, p. 792; Haunschild and Beckman, p. 817, 823, 839; Edward J Zajac and James D Westphal, 'Director Reputation, CEO-Board Power, and the Dynamics of Board Interlocks' (1996) 41 *Administrative Science Quarterly* 507, p. 511; Gerald F. Davis, 'Agents without Principles? The Spread of the Poison Pill through the Intercorporate Network' (1991) 36 *Administrative Science Quarterly* 583, p. 591.

the board enabling the IFI to formulate a better risk management framework³⁷⁵. In other words, the diversity of knowledge and experience that they gain will enable the IFI to learn from the success and failures of other IFIs as well as supplementing it with a better access to the current market strategies, policies, and beneficial corporate governance practices³⁷⁶. It might be argued that restricting the practice may pressure the IFIs to accept less qualified and less experienced *Sharia'* scholars or to resort to external *Sharia'* advisory services, which in turn, can increase the IFI's operational costs³⁷⁷.

On a different point, the diversity of experience and skills gained by interlocking *Sharia'* board members serves as a certification of their abilities, develops their reputations as monitoring specialists, and increases their prospect of receiving offers for additional *Sharia'* board seats from other IFIs³⁷⁸. Additionally, it is also arguable that the practice not only enhances the reputation of the IFIs and the *Sharia'* scholars, but also the universities at which most of the top *Sharia'* scholars with multiple *Sharia'* board directorships work.

For the Islamic banking industry, the practice exhibits the potential to encourage transparency across the Islamic banking market through the interchange of critical information between the IFIs as a result of the sharing of similar *Sharia'* board members³⁷⁹. In other words, the decision of an IFI's *Sharia'* board can influence the

³⁷⁵ Connelly and Van Slyke, p. 406-407; Harris and Shimizu, p. 792; Andrew Nathanson and Joel Payne, 'The Perils of Multiple Directorships' [2011] Annual Review of Civil Litigation, p. 76.

³⁷⁶ Connelly and Van Slyke, p. 404; Harris and Shimizu, p. 792.

³⁷⁷ Luca Enriques and Dirk Zetzsche, *Quack Corporate Governance, Round III? Bank Board Regulation Under the New European Capital Requirement Directive* (ECGI Working Paper Series in Law, Working Paper No 249/2014, October 2014, 2014); Siddiqui, ; Dana El Baltaji and Haris Anwar, 'Shariah Scholar on More Than 50 Boards Opposes Limit Plan: Islamic Finance' Bloomberg, 23 November 2010 <<http://www.bloomberg.com/news/articles/2010-11-23/shariah-scholar-on-more-than-50-boards-opposes-limit-plan-islamic-finance>> accessed 22 September 2017

³⁷⁸ Bradley W Benson and others, 'Do Busy Directors and CEOs Shirk Their Responsibilities? Evidence from Mergers and Acquisitions' (2015) 55 *The Quarterly Review of Economics and Finance* 1, p. 3; Stephen P Ferris, Murali Jagannathan and Adam C Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58 *The Journal of Finance* 1087, p. 1098; Mark S Mizruchi, 'What do Interlocks do? An Analysis, Critique, and Assessment of Research on Interlocking Directorates' (1996) 22 *Annual Review of Sociology* 271, p. 277. Also see Eliezer M Fich and Anil Shivdasani, 'Are Busy Boards Effective Monitors?' (2006) 61 *The Journal of Finance* 689, p. 690; Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301, p. 315.

³⁷⁹ Azhar Abdul Rahman and Abdullah Awadh Bukair, 'The Influence of the Shariah Supervision Board on Corporate Social Responsibility Disclosure by Islamic Banks of Gulf Co-Operation Council Countries' (2013) 6 *Asian Journal of Business and Accounting*, p. 76; Connelly and Van Slyke, p. 404; Hafiza Aishah Hashim

decision-making processes of other IFIs' *Sharia'* boards, thus encouraging uniformity and predictability of *Sharia'* decisions within a particular Islamic banking market. It can also facilitate the propagation of international standards and best Islamic business practices, which would take longer to accomplish or even be unachievable otherwise. Apart from assisting in mitigating *Sharia'* structural risk, namely the risk of losing asset value due to the differences between the variant *Sharia'* compliance views of an Islamic financial product or service, the practice can also reduce the gap in irregular Islamic banking *Fatwas* between the various schools of Islamic jurisprudence³⁸⁰.

Additionally, the practice also provides an IFI with the opportunity to cooperate with other IFIs and companies and develop important networks with suppliers and customers. This can assist in lowering the transaction costs between the IFIs and suppliers, which in turn enhances the IFI's market value and also its ability to thrive on the market³⁸¹. Likewise, it is also arguable that these benefits may even entice poorly performed or near insolvent IFIs to appoint *Sharia'* scholars, who already sit on several IFIs' *Sharia'* boards to improve their market performance or secure better access to funds; although their frailties may render any ambitious attempt to recruit these interlocking *Sharia'* scholars difficult³⁸².

In the financial sector, the interlocking directorship practice can function as a marketing tool for the financial institutions to attract deposits and secure reliable customers for loans³⁸³. For the IFIs, having top *Sharia'* figures on the *Sharia'* board can play a significant role in attracting potential customers, especially the pious ones, due to the

and Mohd Shaari Abdul Rahman, 'Multiple Board Appointments: Are Directors Effective' (2003) 2 International Journal of Business and Social Science, p. 138.

³⁸⁰ For instance, the ambiguous *Sharia'* compliance and acceptance status of *Tawarruq* (tri-partite sale) and the repurchase of *Ijarah Sukuk* (Islamic bond based upon a sale and leaseback approach) can create serious structural risk to the Islamic banking industry. See Muhammad Nejatullah Siddiqi, 'Islamic Economics: Where From, Where To?' (2014) 27 Journal of King Abdul Aziz University: Islamic Economics 109, p. 114; Van Greuning and Iqbal

³⁸¹ Jayati Sarkar and Subrata Sarkar, 'Multiple Board Appointments and Firm Performance in Emerging Economies: Evidence from India' (2009) 17 Pacific-Basin Finance Journal 271, p. 272; Tod Perry and Urs Peyer, 'Board Seat Accumulation by Executives: A Shareholder's Perspective' (2005) 60 The Journal of Finance 2083, p. 2121; Thomas Koenig, Robisrt Gogel and John Sonquist, 'Models of the Significance of Interlocking Corporate Directorates' (1979) 38 American Journal of Economics and Sociology 173, p. 177.

³⁸² Fich and Shivdasani, p. 710.

³⁸³ Vladimir Petersen, 'Interlocking Directorates in the European Union: An Argument for Their Restriction' (2016) 6 European Business Law Review, p. 12; Peter C. Dooley, 'The Interlocking Directorate' (1969) [American Economic Association] 59 The American Economic Review 314, p. 318.

popularity enjoyed by these scholars within the pious segment of the market³⁸⁴. Interestingly, it can also serve as a strategic surveillance tool for the IFIs, where the interlocking *Sharia'* board members can learn and observe the operation of other IFIs and provide a valuable input on the creditworthiness of a prospective client – thus mitigating the risk of lending to distressed borrowers³⁸⁵. This, indirectly, can indicate the presence of a strong commitment to *Sharia'* compliance assurance on the part of the interlocking *Sharia'* board members in upholding *Sharia'* principles in the IFI's business operations; thus, preserving the best interest of stakeholders.

As much as multiple directorships can engineer a positive performance on the market value of a financial institution³⁸⁶, the practice can lead to the concentration of corporate powers in the hands of a few board members. From the Islamic banking perspective, this can translate into the acquisition of extraordinary powers by certain *Sharia'* scholars. Alternately, the interlocking relationship can also serve as a mechanism to preserve an 'old-boy network', which can result in the BOD, *Sharia'* board, or the management team comprising members, who share a similar alma mater background³⁸⁷. Admittedly, the notion of working together with other people with whom one is comfortable – especially with those, who share the same level of knowledge and working attitude – bears its own rationale and practicality. Nonetheless, as much as the relationship can foster a greater

³⁸⁴ Nathan Berg, Mohamed El-Komi and Jeong-Yoo Kim, 'Market Segmentation and Non-Uniform Shariah Standards in Islamic Finance' [2016] *Journal of Economic Behavior & Organization*, p. 4; Christophe J Godlewski, Rima Turk and Laurent Weill, *Do the Type of Sukuk and Choice of Shari'a Scholar Matter?* (IMF Working Paper, WP/14/147, 2014), p. 4, 7, 10, 13. Also see Ghassan F Abu Alsoud and Mohammad Khairi Al-Sheikh Abdallah, 'Customer Awareness and Satisfaction of Islamic Retail Products in Kuwait' (2013) 4 *Research Journal of Finance and Accounting* 36, p. 42, 49; Farah Amaline Md Nawj, Ahmad Shukri Yazid and Mustafa Omar Mohammed, 'A Critical Literature Review for Islamic Banks Selection Criteria in Malaysia' (2013) 6 *International Business Research* 143, p. 148.

³⁸⁵ Connelly and Van Slyke, p. 406-407; Harris and Shimizu, p. 792; Hashim and Abdul Rahman, p. 138. Also see Dooley, p. 317-318.

³⁸⁶ Mike W Peng and others, 'Board Interlocks and Corporate Performance Among Firms Listed Abroad' (2015) 21 *Journal of Management History* 257, p. 264-265, 276; Harris and Shimizu, p. 791. Also see Nai H Lamb, 'Does the Number of Interlocking Directors Influence a Firm's Financial Performance? An Exploratory Meta-Analysis' (2017) 17 *American Journal of Management* 47, p. 48-49.

³⁸⁷ Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors* (The Department of Trade and Industry (DIT) London 2003). In Malaysia, the Malay College Kuala Kangsar ('MCKK'), a premier boys-only boarding school in the country, possesses an extensive professional network based on alma mater; influencing over 22 public companies with a combined market capitalisation of RM 336.3 billion, which constituted around 20 per cent of the market capitalisation of Bursa Malaysia companies. See Richard Whitley, 'The City and Industry: The Directors of Large Companies, Their Characteristics and Connections' in Philip Stanworth and Anthony Giddens (eds), *Elites and Power in British Society* (Cambridge University Press 1974)

level of trust and aid teamwork within the IFI's working environment, it does not automatically render an interlocking *Sharia'* board member more capable in executing their fiduciary responsibilities as complacency remains a risk that can even occur within a relationship built on the greatest amount of trust³⁸⁸. Additionally, this 'friendship' can also make room for the development of a blind trust between the co-workers that can further lead to bias and fraud³⁸⁹.

Likewise, it is arguable that the practice can also raise considerable concerns over the monitoring abilities of interlocking *Sharia'* board members. As much as the busyness of *Sharia'* scholars can reflect their professional qualities³⁹⁰, the tedious nature of the responsibilities that emanate from occupying multiple *Sharia'* board directorships, which demand attentive time commitment and dedication from the scholars, can decrease their service quality and hinder the effective execution of their fiduciary responsibilities to each of the IFIs represented. The question of time commitment of interlocking *Sharia'* board members has often served as a crucial issue in evaluating the multiple *Sharia'* board directorship practice. The more board directorships a *Sharia'* board member possesses, the more it can create additional burdens that can reduce their ability to exercise their *Sharia'* compliance monitoring function³⁹¹. Since it also translates into less time spent at each of the IFIs represented, the practice limits the *Sharia'* board members' ability to provide useful advice and good counsel and it increases the odds of their unavailability at critical moments. This in turn increases the IFI's overall risk profile³⁹².

³⁸⁸ See (*Surah Al-Baqarah* 2:82) of Ali

³⁸⁹ NK Chidambaran, Simi Kedia and Nagpurnanand R Prabhala, 'CEO-Director Connections and Corporate Fraud: Not Just Whether You are Connected but How' [2012] Fordham University Schools of Business Research Paper, p. 3, 41; Fich and Shivdasani, p. 691. Also see Mark S. Beasley, 'An Empirical Analysis of the Relation between the Board of Director Composition and Financial Statement Fraud' (1996) 71 *The Accounting Review* 443, p. 445.

³⁹⁰ Field, Lowry and Mkrtychyan, p. 64; Fama and Jensen

³⁹¹ Sarkar and Sarkar, p. 279; Fich and Shivdasani, p. 689-692; John K Wells, 'Multiple Directorships: The Fiduciary Duties and Conflicts of Interest That Arise When One Individual Serves More Than One Corporation, 33 *J. Marshall L. Rev.* 561 (2000)' (2000) 33 *The John Marshall Law Review* 2, p. 578; John E. Core, Robert W. Holthausen and David F. Larcker, 'Corporate Governance, Chief Executive Officer Compensation, and Firm Performance' (1999) 51 *Journal of Financial Economics* 371, p. 383, 388; Beasley, p. 461. Conversely, it is worthy to note that less directorships also cannot guarantee a better monitoring performance. See Jeremy C Kress, *Board to Death: How Busy Directors Could Cause the Next Financial Crisis* (Ross School of Business Working Paper No 1370, June 2017, 2017), p. 4; Joanne Li and James S Ang, 'Quantity Versus Quality of Directors' Time: The Effectiveness of Directors and Number of Outside Directorships' (2000) 26 *Managerial Finance* 1, p. 17.

³⁹² Elizabeth Cooper and Hatice Uzun, 'Directors with a Full Plate: The Impact of Busy Directors on Bank Risk' (2012) 38 *Managerial Finance* 571, p. 583; Harris and Shimizu, p. 777. Also see Geoffrey C Kiel and

A financial crisis can provide a good opportunity for the interlocking directors to display and utilise their experience, skills and connections in navigating the company through difficult times, but there is also a high chance for the directors to become exhausted due to the higher frequency and greater length of meeting, which in turn, can negate their ability to act as effective monitors and advisors for the company. The drawbacks could be especially severe for large and complex financial institutions, which would require directors to dedicate more time and attention.

During the global financial crisis in 2008, the multiple directorships of several of Bear Stearns' directors had provoked questions about the ability of the interlocking directors to oversee complex affairs of the company³⁹³. Similarly, in the Wells Fargo's fraudulent accounts scandal in late 2016, where it lost US\$ 25 billion when its employees opened as many as 3.5 million fake customer accounts to meet aggressive cross-selling target, their directors failed to respond to red flags regarding sales practices violations as they were busy attending to their other professional commitments³⁹⁴. Nine out of 13 of its independent directors served on at least three public company boards, stretching their corporate obligations to the extent that they rarely met as a full board or in their committees – in fact, they were outperformed by their peer banks in terms of the number of board and committee meetings conducted between 2012 and 2015³⁹⁵. Eventually, these excessive commitments left the directors with little time to respond to the

Gavin J Nicholson, 'Multiple Directorships and Corporate Performance in Australian Listed Companies' (2006) 14 *Corporate Governance: An International Review* 530, p. 531, where the Australian Shareholders' Association ('ASA') suggested that owing a commitment to more than five corporate board at one time can harm the interests of shareholders.

³⁹³ Zachary A Goldfarb, 'SEC to Examine Boards' Role in Financial Crisis' *Washington Post*, 20 February 2009 <<http://www.washingtonpost.com/wp-dyn/content/article/2009/02/19/AR2009021903172.html>> accessed 22 September 2017. Also see D. Chandler and W.B. Werther, *Strategic Corporate Social Responsibility: Stakeholders, Globalization, and Sustainable Value Creation* (SAGE Publications 2013); J. Gillespie and D. Zweig, *Money for Nothing: How CEOs and Boards Enrich Themselves While Bankrupting America* (Free Press 2010), p. 49.

³⁹⁴ Ben McLannahan, 'Wells Fargo Reveals Millions of More Unauthorised Accounts' *Financial Times*, 1 September 2017 <<https://www.ft.com/content/5476e7ca-8e60-11e7-9084-d0c17942ba93>> accessed 22 September 2017; Ben Dipietro, 'Crisis of the Week: Fake Accounts Scandal Rocks Wells Fargo' *The Wall Street Journal*, 19 September 2016 <<https://blogs.wsj.com/riskandcompliance/2016/09/19/crisis-of-the-week-fake-accounts-scandal-rocks-wells-fargo/>> accessed 22 September 2017

³⁹⁵ Kress, p. 23, 25; Gillian Tan, 'Does Wells Fargo's Board Need a Refresh?' *Bloomberg*, 1 September 2017 <<https://www.bloomberg.com/gadfly/articles/2016-11-16/wells-fargo-s-damage-control-could-include-a-board-fix>> accessed 1 September 2017. Also see Dan Freed, 'Exclusive: Four Large Wells Fargo Shareholders Want More Action From Board' *Reuters*, 16 November 2016 <<http://www.reuters.com/article/us-wellsfargo-accounts-board-exclusive/exclusive-four-large-wells-fargo-shareholders-want-more-action-from-board-idUSKBN13A297>> accessed 22 September 2017

company's sales practices issues or monitor its operations, which continued to operate with a substandard risk management infrastructure.

In contrast, the case of PNC provides an interesting insight of how a less busy board could benefit the corporate governance structure of large financial companies. The PNC was among the most resilient banks during the global financial crisis in 2008³⁹⁶. Its directors were among the least busy of all US bank boards – 12 of its 17 directors only served on PNC's board or the board of one other company and met more frequently than Wells Fargo's directors³⁹⁷. The relatively minimal outside commitments enabled its directors to dedicate more time and attention to monitor the company's management and contribute to its strategic decisions, which proved crucial in fortifying the company to withstand the financial crisis. These examples do not infer that the multiple directorship practice renders a company more susceptible to the negative effects of financial crisis but they prove a crucial and practical point – a board with less outside commitments is more likely able to contribute to productive monitoring and decision-making to a company than a board with many outside commitments.

Additionally, it is also arguable that the practice of multiple *Sharia'* board directorships can precipitate an anti-competitive effect to the Islamic banking economy as a whole. To illustrate, an interlocking *Sharia'* board member also performs the function of a liaison officer between the IFIs, who will seek to promote a universal and common *Sharia'* decision across the IFIs' *Sharia'* boards. Additionally, it is important to note that the application of the practice, especially in an expanding but small market such as Islamic banking can forestall the development of constructive competition within the industry, which can not only render the IFIs less competitive, but also the entire industry stagnant.

Moreover, there also exists empirical research that supports the presence of a negative correlation between the number of board directorships a person possesses and his or her attendance at board meetings, *i.e.* the more board directorships the person possesses, the more likely they are to skip board meetings³⁹⁸. Of course, absenteeism

³⁹⁶ T.W. Koch and S.S. MacDonald, *Bank Management* (Cengage Learning 2014), p. 68; Roben Farzad, 'A Bank CEO Thrives Far from Wall Street' Bloomberg, 26 October 2012 <<https://www.bloomberg.com/news/articles/2012-10-26/a-bank-ceo-thrives-far-from-wall-street>> accessed 3 September 2017; C.W.L. Hill and G.R. Jones, *Strategic Management Cases: An Integrated Approach* (Cengage Learning 2012), p. 50.

³⁹⁷ Kress, p. 30-31.

³⁹⁸ Bill B Francis, Iftexhar Hasan and Qiang Wu, *Do Corporate Boards Affect Firm Performance? New Evidence from the Financial Crisis* (Bank of Finland Research Discussion Paper 112012, 2012), p. 28;

from meetings does not necessarily infer that interlocking *Sharia'* board members are shirking from their fiduciary responsibilities. After all, it is the quality of their time spent that matters the most to the IFI; not the quantity. However, it is arguable that these multiple commitments can overstretch the *Sharia'* board members' commitment and deter them from acclimatising themselves with the working culture and the nature of problems of each of the IFIs represented. As a result, this can have a negative effect on the IFI's reputation and market value³⁹⁹. All in all, these arguments suggest that there exists a physical limitation as to the numbers of board directorships a *Sharia'* board member can represent at a time.

4.2 Multiple Directorships from Western Corporate Governance Perspective

While it is common to refer to the BOD as a single entity, it is also worth noting that the board consists a blend of members with a different range of qualifications, knowledge, expertise, and even individual agendas, which can differ from the objectives of the company and its stakeholders. When a company enters a business transaction with another company, it creates a corporate relationship that links the company with one another. Similarly, when a company's director occupies board directorships in other companies, a corporate link is established between the companies, which not only attracts a host of benefits, but also accompanying risks and complications that can further influence the interest, stability, and reputation of the companies⁴⁰⁰.

In general, the concerns over the practicability of the interlocking directorship practice are not new. In fact, it had been part of a global debate in the Western corporate governance world as early as the Industrial Revolution in the 19th century⁴⁰¹. Since then,

Jiraporn and others, p. 1160, 1162. Also see Renée B. Adams and Daniel Ferreira, 'Do Directors Perform for Pay?' (2008) 46 *Journal of Accounting and Economics* 154, p. 161.

³⁹⁹ Antonio Falato, Dalida Kadyrzhanova and Ugur Lel, 'Distracted Directors: Does Board Busyness Hurt Shareholder Value?' (2014) 113 *Journal of Financial Economics* 404, p. 407; Li and Ang, p. 3.

⁴⁰⁰ Mizruchi, p. 271; Kees van Veen and Jan Kratzer, 'National and International Interlocking Directorates within Europe: Corporate Networks within and Among Fifteen European Countries' (2011) 40 *Economy and Society* 1, p. 2; Phillip H Phan, Soo Hoon Lee and Siang Chi Lau, 'The Performance Impact of Interlocking Directorates: The Case of Singapore' *Journal of Managerial Issues* 338

⁴⁰¹ Ngonidzashe Chiranga and Oscar Chiwira, 'The Impact of Multiple Directorships on Performance for Companies Listed on the Johannesburg Stock Exchange' (8th Annual London Business Research Conference, London, 8-9 July 2013); Ferris, Jagannathan and Pritchard; Pornsit Jiraporn, Young Sang Kim

the practice has given rise to significant issues concerning its potentially harmful effects on both the companies and the directors including conflicts of interest, time management deficiencies, and the transmission of confidential information⁴⁰². The OECD observed that the occupation of too many board directorships can impede the performance of the BOD members⁴⁰³. Accordingly, the following paragraphs will consider the interlocking directorship practice from the Western corporate governance perspective discussing the fiduciary roles owed by the interlocking directors to the company, followed by a comparative assessment of the current regulatory approaches adopted in selected Western jurisdictions, namely the United Kingdom, Ireland, Germany, and the United States of America.

4.2.1 The Fiduciary Roles of Directors in a Company

In assessing the legal implication of interlocking directorate, it is essential to understand the legal status and corporate roles that a director assumes in the company. Since the landmark case of *Salomon v Salomon*⁴⁰⁴, the court has recognised a company as a legal entity that cannot act on its own; it requires the assistance of human beings, namely the directors, to act on its behalf in matters regarding the management of its funds, properties and overall operations⁴⁰⁵. From an anatomical perspective, the directors owe a crucial role akin to the brain, without which a human being is as good as dead.

Accordingly, there is more than one analogy to capture the quintessence of a director's functions. In principle, a director can operate in a tripartite capacity comparable to that

and Wallace N Davidson, 'Multiple Directorships and Corporate Diversification' (2008) 15 Journal of Empirical Finance 418; Sarkar and Sarkar; Fich and Shivdasani

⁴⁰² Sleiman and Viszaino; Majid and Ghazal; Wilson, *The Development of Islamic Finance in the GCC*, p. 10.

⁴⁰³ Point E.3, Principle VI of Organisation for Economic Co-operation Development (OECD), *The G20/OECD Principles of Corporate Governance* (OECD Publishing 2015)

⁴⁰⁴ *Salomon v Salomon*

⁴⁰⁵ See *Ferguson v Wilson* [1866] LR 2 Ch App 77, 89-90, where Cairns LJ stated, "*The company cannot act in its own person ... it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent*". Also see Paula J Dalley, 'Shareholder (and Director) Fiduciary Duties and Shareholder Activism' (2007) 8 Hous Bus & Tax LJ 301, p. 303; The City Law School, *Company Law in Practice* (Oxford University Press 2015), p. 86.

of an agent, a trustee, or an employee of the company⁴⁰⁶. Additionally, a director can also occupy a role that amalgamates the characteristics of all three stated capacities, which imposes an even more concentrated combination of corporate responsibilities and potential liabilities on the director. For the purpose of this thesis, the following discussion will only analyse the context of the directors' fiduciary roles in the capacity of an agent and trustee due to their relevance to the overall theme of the thesis.

In the context of an agency relationship, the common law courts had recognised a director as an agent of the company on whose behalf the director acts. This follows Cairns LJ in *Ferguson v Wilson*⁴⁰⁷, who opined that a director acted in a capacity similar to an agent in an agent-principal relationship:

*“What is the position of the directors of a public company? They are merely agents of a company. The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent. Wherever an agent is liable those directors would be liable; where the liability would attach to the principal, and the principal only, the liability is the liability of the company”*⁴⁰⁸.

Previously, the question of whether a director operates in the capacity of an agent of the company or that of the shareholders had attracted significant debate. Since shareholders appoint and empower directors with the necessary authority to direct and manage the affairs of the company, it follows that a director owes a duty to promote the best interest of the shareholders⁴⁰⁹. However, this view has presented a crucial question over the sovereign interest of the company, which the directors must uphold at all times. As likely as it is for the interests of both shareholders and the company to harmonise on any particular point, there is also a possibility that these interests will differ with one

⁴⁰⁶ Randy J Holland, 'Delaware Directors' Fiduciary Duties: The Focus on Loyalty' (2008) 11 U Pa J Bus L 675, p. 679; Tamar Frankel, 'Fiduciary Law' (1983) 71 California Law Review 795, p. 805. Also see *Charitable Corp. v Sutton* (1742) 2 ATK 400 26 Eng Rep 642, 406.

⁴⁰⁷ *Ferguson v Wilson*

⁴⁰⁸ *Ibid*, 89. Also see *Charitable Corp. v Sutton*, 405.

⁴⁰⁹ *Charitable Corp. v Sutton*, 405. Also see *Parke v Daily News Ltd* [1962] Ch 927, 963.

another⁴¹⁰. In *Dawson International Plc v Coats Platon Plc*⁴¹¹, Lord Cullen reiterated the view of the court in *Percival v Wright*⁴¹² and opined that a director only answers to one master, namely the company⁴¹³. This view supporting the notion of directors as agents of the company is consistent with judicial stances in common law countries such as the United Kingdom⁴¹⁴, Ireland⁴¹⁵, and Canada⁴¹⁶ all of which emphasise the interests of the company over that of its shareholders or directors⁴¹⁷.

A director can also serve as a trustee of the company and thus owe a responsibility to manage and safeguard its assets and interest. As early as 1742, the Lord Chancellor in *Charitable Corporation v Sutton*⁴¹⁸ held that a director serves as both an agent and a trustee, and owes the company a duty to act with “*fidelity and reasonable diligence*”⁴¹⁹. This view is consistent with that expressed by Lord Cranworth in *Aberdeen Rail Co. v Blaikie Bros*⁴²⁰, who opined that a director shares similar responsibility to that of a trustee in the sense that he cannot devise “*any contract for his own benefit in relation to the affairs of the company*”⁴²¹. Likewise, Jessel M.R. in *Re Forest of Dean Coal Mining Co.*⁴²²

⁴¹⁰ John Quinn, *The Duty to Act in the Interests of the Company: Simply a Duty to Increase Shareholder Wealth?* (UCD Working Papers in Law, Criminology & Socio-Legal Studies (Research Paper No 07/2015), 2015), p. 17-18. The potential divergence between the shareholders’ and the company’s interest was recognised in *Re BSB Holdings Ltd* [1996] BCLC 155; *Dawson International Plc v Coats Platon Plc* [1989] BCLC 233, and *Re Wellfab Engineers* [1990] BCLC 833

⁴¹¹ *Dawson International Plc v Coats Platon Plc*

⁴¹² *Percival v Wright* [1902] 2 Ch 421

⁴¹³ *Dawson International Plc v Coats Platon Plc*, 243. Also see *Peskin v Anderson* [2000] 2 BCLC 1

⁴¹⁴ *Hutton v West Cork Railway* (1883) 23 Ch D 654; *Re Smith & Fawcett Ltd* [1942] Ch 304

⁴¹⁵ *Re Frederick Inns Ltd* [1994] 1 ILRM 387, 396; *Bloxham (in Liquidation) v The Irish Stock Exchange Ltd* [2014] IEHC 93. Also see *G & S Doherty Ltd v Doherty* (19 June 1969, unreported), 42; *Irish Press Plc v Ingersoll Irish Publications Ltd* (15 December 1993, unreported), 77.

⁴¹⁶ *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 SCR 461, 481.

⁴¹⁷ *Re BSB Holdings Ltd*, 249.

⁴¹⁸ *Charitable Corp. v Sutton*

⁴¹⁹ *Ibid*, 406 and 645. Also see Holland, p. 683.

⁴²⁰ *Aberdeen Rail Co v Blaikie Brothers* [1843-60] All ER 249

⁴²¹ *Ibid*, 251; Nathaniel Lindley Baron Lindley and John Campbell Lorimer, *A Treatise on the Law of Partnership* (published in London, Sweet and Maxwell 1905), p. 364. Also see Carsten Gerner-Beuerle, Philipp Paech and Edmund Philipp Schuster, *Study on Directors’ Duties and Liability* (European Commission DG Markt, London, April 2013, 2013), p. 42.

⁴²² *Re Forest of Dean Coal Mining Co.* [1878] 10 Ch D 450 (Chancery Division)

also postulated that “...directors are called trustees. They are no doubt trustees of assets which have come into their hands, or which are under their control...”⁴²³. In other words, the directors fall within the ambit of ‘trustees of the company’ as long as they are dealing with the company’s property.

Indeed, it appears that such a deduction carries its own logic as a director has control over the funds and properties of the company and remains subject to liability for any misappropriation of the above sources⁴²⁴. Even so, it is also arguable that a director may not strictly fit into the framework of a trustee in the legal sense because there are several differences in the form and role of a director as opposed to that of a typical trustee⁴²⁵. For example, a director does not hold the legal and beneficial title of the company’s assets, whereas a trustee normally bears such a title⁴²⁶. In terms of the utilisation of the company’s assets, the preservation of such assets remains the paramount duty of a trustee⁴²⁷. The general rule is a trustee cannot afford to undertake a ‘business gamble’ by risking the company’s assets for a particular business endeavour since it requires the trustee to accept the possibility of loss to the assets; a circumstance that contradicts the primary duty of a trustee⁴²⁸. Of course, there are times when a trustee must make investment decision, which necessitates them to assume a certain degree of risk but this must be exercised with great caution⁴²⁹. In other words, the trustee may only assume risks that suit the objectives of the trust and capable to advance the beneficiary interests,

⁴²³ Ibid, 453. Also see *Percival v Wright; Peskin v Anderson*; P.L. Davies, S. Worthington and E. Micheler, *Gower and Davies' Principles of Modern Company Law* (Sweet & Maxwell 2012), p. 571.

⁴²⁴ *Bodell v General Gas & Electric Corp.* (1926) 132 A 442

⁴²⁵ *Re City Equitable Fire Insurance Co. Ltd* [1925] 1 Ch 407, 426. Also see *Bray v Ford* [1896] AC 44, 51.

⁴²⁶ B.G. Pettet, *Company Law* (Longman 2001), p. 178; Darren Skinner, ‘Unlocking the Interlocks: Common Law Fiduciary Duties and the Phenomenon of Interlocking Corporate Directorates in the Commonwealth Caribbean’ (1994) 3 J Transnat'l L & Pol'y 53, p. 61.

⁴²⁷ J. Finlay, *Trusts Law Essentials* (Edinburgh University Press 2012), p. 62; C.P. Cline, *The Law of Trustee Investments* (American Bar Association 2009), p. 32. Also see Paul L. Davies and Klaus J. Hopt, *Boards in Europe—Accountability and Convergence* (ECGI Law Working Paper No 205/2013, April 2013, 2013), p. 40.

⁴²⁸ A. Keay, *Directors' Duties* (Jordan Publishing 2009), p. 18-21; James J Fishman, ‘Standards of Conduct for Directors of Nonprofit Corporations’ (1987) 7 Pace Law Review 389, p. 402.

⁴²⁹ A.R. Keay, *The Corporate Objective* (Edward Elgar Publishing Limited 2011), p. 156; Cline, p. 32. Also see B. Longstreth, *Modern Investment Management and the Prudent Man Rule* (Oxford University Press 1987), p. 207.

i.e. the investment not only could secure a reasonable return, but also assure the safety of the capital.

On the contrary, a director can afford to risk the company's assets, which forms part of their corporate duties, by applying prudential business acumen provided that it rests within the director's scope of authorities and responsibilities⁴³⁰. Nevertheless, the fiduciary nature of the relationship between the director and the company shows that a director also functions as a trustee of the company to a certain extent. For instance, a director cannot engage in a business or transaction that may conflict with the interest of the company, or make secret profits without the authorisation or ratification of the company⁴³¹. Regardless of the various references used by the courts when referring to the fiduciary roles of the directors; whether as an agent, trustee, or employee of the company, it is arguable that such expressions provide neither an absolute nor exhaustive interpretation of the roles assumed by the directors in the company, but merely a useful reference in discussing the circumstances when their functions and liabilities coincide with the principles that govern these roles⁴³².

4.2.1.1 The Fiduciary Duty of Loyalty

In principle, directors owe an individual duty of loyalty to the company and its shareholders⁴³³. Since the directors derive their authority to act and make decisions on corporate matters from the company's shareholders, there lies a duty of allegiance or loyalty to the company, which falls under the fiduciary duty category⁴³⁴. In the corporate environment, the duty of loyalty forbids directors and officers alike from abusing "*their*

⁴³⁰ Deirdre Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' (2011) 33 Dublin ULJ 116, p. 145; J. Rush and M. Ottley, *Business Law* (Thomson 2006), p. 246; Skinner, p. 61; John H Farrar, 'Corporate Governance, Business Judgment and the Professionalism of Directors' (1993) 6 Corp & Bus LJ 1, p. 25. Also see Davies and Hopt, p. 39; Fishman, p. 402.

⁴³¹ *Re Allied Business and Financial Consultants Ltd; O'Donnell v Shanahan & Or* [2009] 2 BCLC 666, 667. Also see Brenda Hannigan, 'Reconfiguring the No Conflict Rule: Judicial Strictures, a Statutory Restatement and the Opportunistic Director' (2011) 23 Singapore Academy of Law Journal 714, p. 736.

⁴³² David Kershaw, *The Path of Fiduciary Law* (LSE Law, Society and Economy Working Papers 6/2011, 2011), p. 25. Also see *Imperial Hydropathic Hotel Company v Hampson* (1882) 23 Ch D 1

⁴³³ Engle and Danyliuk, p. 90-91; Thomas Clarke, *International Corporate Governance: A Comparative Approach* (Routledge 2007), p. 36; Skinner, p. 64.

⁴³⁴ Dalley, p. 303-304; Bernard S Black, 'The Principal Fiduciary Duties of Board of Directors' (Third Asian Roundtable on Corporate Governance, Singapore, 4 April 2001), p. 2. Also see Lori McMillan, 'The Business Judgment Rule as an Immunity Doctrine' (2012) 4 William & Mary Business Law Review 521, p. 531.

*position of trust and confidence to further their private interest*⁴³⁵. It originates from the viewpoint that without the restraining force of the law, a person in whom trust is placed may be inclined to take advantage of their positions⁴³⁶.

When directors occupy multiple directorships, questions may arise not only as to their ability to meet and balance the accompanying risks and liabilities but also as to their loyalty. Although there are laws permitting directors to engage in such a practice, a layman may argue that such an authorisation may have transcended both the common logic and biblical injunction, which stipulates a person or a servant cannot serve two or more masters at the same time because it can affect their impartiality – potentially leading to disloyalty and breach of trust⁴³⁷. Accordingly, an examination of the western fiduciary concept of the duty of loyalty can assist in bridging the understanding gap between the law and the laymen of the multiple directorship practice. Hence, the following paragraphs examine the fiduciary duty of the directors, and particularly the two sub-duties, namely the duty to act bona fide and in the best interests of the company, and the duty to avoid conflicts of interest.

4.2.1.1.1 Duty to Act Bona Fide and in the Best Interests of the Company

The first duty concerns the requirement for directors to ensure that their actions and decisions serve the best interests of the company. Although no specific definition of this duty exists, the OECD has defined it generally as “*the duty of a board member to act on an informed basis in decisions with respect to the company...requiring the board member to approach the affairs of the company in the same way that a ‘prudent man’*”

⁴³⁵ *Guth v Loft* 5 A 2d 503, 510. Also see *Schoon v Smith* 953 A 2d 196, 206.

⁴³⁶ C.A. Hill and others, *Research Handbook on the Economics of Corporate Law* (Edward Elgar 2012), p. 135; DE McLay, ‘Multiple Directorates and Loss of Corporate Opportunity: Bases and Remedies’ (1980) 10 *Victoria U Wellington L Rev* 429, p. 436. Also see *Keech v Sandford* (1726) Sel Cas T King 61, 62; *Bray v Ford*, 51.

⁴³⁷ “*No one can serve two masters. Either he will hate the one and love the other, or he will be devoted to one and despise the other*” (Matthew 6:24) of Carroll and Prickett. Also see Skinner, p. 53; L Brandeis, ‘Breaking the Money Trusts’ [1913] *Harpers Weekly*, p. 13. Likewise, the *Sharia*’ law also prohibits the undertaking of allegiance to two or more parties as illustrated in the case of Sayeed Ibn Musayyeb, whom the Caliph Abdul Malik flogged and made to wear a dress of disgrace for refusing to swear allegiance to his two sons – Walid and Sulaiman. See Al-Ghazali, p. 90.

would approach his own affairs...⁴³⁸. Simply put, it ordains the directors to utilise their authority, which includes “*the calling of meetings, electing new board members, allotting, and transferring and forfeiting shares*”, for none other than the company itself. Failure to do so will subject the directors to a claim for breach of trust⁴³⁹.

However, ‘the best interest of the company’ appears to be a subjective and vague phrase as both shareholders and directors may have different views as to what serves the best interests of the company. On one hand, the agency theory, which views the relationship between a director and the shareholders as one between an agent and a principal, calls for the directors to adhere to the shareholders’ instructions and maximise their returns⁴⁴⁰. Here, the proponents of the shareholders primacy view shareholders as the main residual claimant of the company’s income stream and deserving of primacy over other stakeholders⁴⁴¹. On the other hand, the fact that directors are more engaged and better acquainted with the operations of the company than anyone else bestows upon them an equally strong claim to exercise an unfettered judgment as to what would serve in the best interests of the company⁴⁴². Compelling directors to pursue exclusively the interests of the shareholders without considering this commercial reality can present an overly restrictive stance that will not benefit the company in the long run. After all, the

⁴³⁸ Organisation for Economic Co-operation Development (OECD), *Experiences from the Regional Corporate Governance Roundtables* (2003), p. 88. Also see Organisation for Economic Co-operation Development (OECD), *The G20/OECD Principles of Corporate Governance*, p. 52.

⁴³⁹ Kershaw, p. 52; Nathaniel Lindley Baron Lindley and Samuel Dickinson, *A Treatise on the Law of Partnership: Including Its Application to Companies* (Callaghan 1878), p. 9. Also see *Dorchester Finance v Stebbing* [1989] BCLC 498, 501, where Foster J postulated that “*a director must exercise any power vested in him as such, honestly, in good faith and in the interest of the company...*”

⁴⁴⁰ D Fischel, ‘The Corporate Governance Movement’ (1992) 35 *Vanderbilt Law Review* 1259. Also see Eugene F Fama and Michael C Jensen, ‘Agency Problems and Residual Claims’ (1983) 26 *Journal of Law and Economics* 327; Michael C Jensen and William H Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305

⁴⁴¹ R. Blanpain and others, *Rethinking Corporate Governance: From Shareholder Value to Stakeholder Value* (Wolters Kluwer 2011), p. 331-332; Michael C Jensen and D Chew, *A Theory of the Firm: Governance, Residual Claims and Organizational Forms* (Harvard University Press 2000); C. Coffee, Jr, ‘The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications’ (1999) 93 *Northwestern University Law Review* 641; Eugene F Fama and Michael C Jensen, ‘Organizational Forms and Investment Decisions’ (1985) 14 *Journal of Financial Economics* 101, p. 102-103.

⁴⁴² See *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91, 103, where Arden LJ stipulated that “*the fundamental duty to which a director is subject ... is the duty to act in what he in good faith considers to be the best interest of his company*”. Also see *Re Smith & Fawcett Ltd*. In the U.S., the U.S. District Court held that the directors did not breach their fiduciary duties when they rejected a rival bid in favour of a less lucrative one, which they believed provided a better protection for the employees. See *Norfolk Southern Corp. v Conrail Inc.* 1997 US Dist LEXIS 978

shareholders' ownership of the shares does not necessarily infer an ownership of the company⁴⁴³.

At the same time, it is imperative that there is a clear perceptual line of demarcation that elucidates the practical boundaries within which directors may exercise independent business judgment. As much as it is prudent for directors to be mindful of their actions, they cannot afford to worry about liability for every decision they made as it would pressurise them to take a less-risky approach in everything, which in turn, could stifle the company's growth⁴⁴⁴. In the US, the courts developed the 'business judgment' rule in the early of 19th century. Its effect is that the courts will not hold directors liable for negligence for their erroneous business judgment made in good faith unless substantial evidence exists that can prove their irrationality from a prudent business perspective⁴⁴⁵. Whenever an allegation arises of a breach by directors of their fiduciary duties, the burden of proof rests on the claimant, who must demonstrate the presence of bad faith, conflict of interest, or gross negligence. Failure to do so will prompt the courts to respect the directors' business judgment. If the claimant manages to establish these elements, however, the burden of proof will shift to the directors, who must prove that their business judgment was fair and served the best interests of the company⁴⁴⁶.

In the UK and the majority of EU jurisdictions, however, the application of the business judgment rule remains inexplicit⁴⁴⁷. Regardless, the courts in these jurisdictions have demonstrated a willingness to recognise the essence of the rule by abstaining from second-guessing the directors' business judgment in the absence of bad faith, self-

⁴⁴³ M. Moore and M. Petrin, *Corporate Governance: Law, Regulation and Theory* (Macmillan Education UK 2017), p. 78; Lan and Heracleous, p. 301; Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288, p. 290. In *Macaura v Northern Assurance Co* [1925] AC 619 (House of Lords), the House of Lords stated that '*it is not the shareholders but the company that owns the corporate assets, and the concept of a share serves somewhat different functions*'.

⁴⁴⁴ McMillan, p. 527; H. Anderson, *Directors' Personal Liability for Corporate Fault: A Comparative Analysis* (Kluwer Law International 2008), p. 107-108.

⁴⁴⁵ Gerner-Beuerle, Paech and Schuster, p. 115; Engle and Danyliuk, p. 95-96. Also see Lynn A Stout, 'The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance' (2003) 152 *University of Pennsylvania Law Review* 667, p. 693; *Smith v Van Gorkom* 488 A2d 858

⁴⁴⁶ McMillan, p. 529-530; Gerner-Beuerle, Paech and Schuster, p. 115.

⁴⁴⁷ Adina Ponta and Radu N Catana, 'The Business Judgment Rule and Its Reception in European Countries' (2015) 4 *The Macrotheme Review* 125, p. 136-137; Davies and Hopt, p. 39. Also see Enriques and Zetsche

interest or gross negligence⁴⁴⁸. In *Charitable Corp. v Sutton*⁴⁴⁹, the Lord Chancellor stipulated that the courts will abstain from interfering in the directors' prerogative to interpret matters that best serve the company's interest, even if such decisions attracted negative consequences⁴⁵⁰, once the directors had acted for 'proper purpose' and within the confine of authority delegated to them by the company⁴⁵¹. Here, the courts opined that the act of interfering, predetermining, or even holding directors guilty of a breach of fiduciary duties in matters that the courts neither possess better knowledge of, nor are familiar with, would constitute an injustice⁴⁵².

Similarly, in *Howard Smith Ltd v Ampol Petroleum Ltd and Others*⁴⁵³, the UK Court of Appeal reaffirmed the view that it would be improper "*to substitute [the Court's] opinion for that of the management, or indeed to question the correctness of the management's decision ... if bona fide arrived at*"⁴⁵⁴. Then again, the UK courts have also displayed a readiness to interfere in the directors' decision whenever they act *ultra vires* the authority prescribed by the company or are unable to address the question of whether their acts and decisions have served the best interest of the company. Here, the courts will provide their own interpretation of the directors' decision based on whether an honest and knowledgeable man in the position of a director would have reasonably believed that such actions or decisions serve the best interests of the company⁴⁵⁵.

⁴⁴⁸ *Re City Equitable Fire Insurance Co. Ltd*, at 425. Also see Gerner-Beuerle, Paech and Schuster, p. 116.

⁴⁴⁹ *Charitable Corp. v Sutton*

⁴⁵⁰ See *ibid*, 405, where the Lord Chancellor wrote, "...where acts are executed within their authority...it is by no means just in a judge, after bad consequences have arisen from such executions of their power, to say that they foresaw at the time what must necessarily happen; and therefore were guilty of breach of trust".

⁴⁵¹ Holland, p. 681. Also see *Re W & M Roith Ltd* [1967] 1 WLR 432. In this case, a director and controlling shareholder of a company entered into a service agreement, which provided the director's wife with a pension upon the director's death. Although the court agreed that the director had acted honestly, the contract was not binding as the parties failed to clarify how the contract can benefit the company.

⁴⁵² *Charitable Corp. v Sutton*, 405. Also see Holland, p. 681.

⁴⁵³ *Howard Smith Ltd v Ampol Petroleum Ltd and Others* [1974] AC 821

⁴⁵⁴ *Ibid*, at 832. Also see Dillon J in *Devlin v Slough Estates Ltd and Others* [1983] BCLC 497 at 504, who stipulated, "*The court does not interfere with the business judgment of directors in the absence of allegations of mala fides*".

⁴⁵⁵ *Item Software (UK) Ltd v Fassihi*, 104; *Charterbridge Corp. Ltd v Lloyds Bank Ltd* [1970] Ch 62, 74. Also see the Canadian case of *Teck Corporation Ltd v Millar* (1972) DLR (3d) 288, where the court held that the directors can use their powers to defeat the majority stakeholders in fighting off a takeover if they considered it reasonable in the interest of the company.

In the case of interlocking directorships, the fulfilment of this duty depends on the factual circumstances of each case. As much as the occupation of multiple directorships can trigger significant concerns over the interlocking directors' ability to provide sound and prudent business decisions for the company, the fact that the practice also offers various benefits in improving the business efficacy of the company may well be considered as an act done in the best interest of the company. However, the interlocking directors can only realise this within a certain limit or perimeter. While there is no magic number to the number of board directorships a director can possess at a given time⁴⁵⁶, it is sensible to speculate that excessive board directorships can overstretch the directors and render them too busy to balance the conflicting interest of each of the companies they represent⁴⁵⁷. In such a scenario, the directors may have no other plausible recourse but to cease or limit their board directorships to ensure a fair and equal attention to the affairs of the companies represented without subjugating the interest of one below the other⁴⁵⁸.

4.2.1.1.2 Duty to Avoid Conflict of Interest

Another fiduciary duty owed by the directors to the company is the duty to avoid conflict of interest. In essence, the duty, which originated from the 18th century case of *Keech v Sandford*⁴⁵⁹ and later formed an integral component of directorial duties in *Aberdeen Railway Co v Blaikie Bros*⁴⁶⁰, posits that a director cannot secretly profit from his or her

⁴⁵⁶ Anil Shivdasani and David Yermack, 'CEO Involvement in the Selection of New Board Members: An Empirical Analysis' (1999) 54 *The Journal of Finance* 1829, p. 1847. See Ferris, Jagannathan and Pritchard, p. 1094, where the occupation of three or more board directorships can render a director too busy; Core, Holthausen and Larcker, p. 380-381. Also see Council of Institutional Investors, 'Core Policies, General Principles, Positions & Explanatory Notes' <http://www.ecgi.org/codes/documents/cii_corp_gov_pol.pdf> accessed 22 September 2017, p. 5, which limits a director's board directorships to a maximum of two boards.

⁴⁵⁷ A BOD with 50 per cent (or more) of its directors holding three or more board directorships in other companies implies a busy BOD. See Fich and Shivdasani, p. 695, 698. Also see *Moody v Cox and Hatt* [1917] 2 Ch 71, 81; *Commonwealth Bank of Australia v Smith* (1991) 102 ALR 453

⁴⁵⁸ See Higgs, p. 8, 55, which recommended the BOD to consider against appointing directorial candidates, who have taken on more than one non-executive directorship in public-listed companies, or the chairpersonship of such companies.

⁴⁵⁹ *Keech v Sandford*, 62. The duty of loyalty postulates the viewpoint that without the restraining force of the law, a person in whom trust is placed may be inclined to take advantage of their positions. Also see *Bray v Ford*, 51, where Lord Herschell postulated that a fiduciary "... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict".

⁴⁶⁰ *Aberdeen Rail Co v Blaikie Brothers*

official positions and must refrain from engaging in self-dealing transactions that can jeopardise the interests of the company⁴⁶¹. In this case, Lord Cranworth stated:

*“A corporate body can only act by its agents, and it is, of course the duty of those agents to act as the best to promote the interest of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound to protect. So strictly is the principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into”*⁴⁶².

In general, the duty to avoid conflicts of interest, which has become a statutory duty in most European countries⁴⁶³, places the onus on the trustee to disclose all the material facts to the beneficiary in the instance his or her interests conflict with those of the beneficiary⁴⁶⁴. Since a director can operate in a trustee-like fiduciary position, the same principle also binds a director⁴⁶⁵. However, following *Regal (Hastings) Ltd v Gulliver*⁴⁶⁶, the interpretation of the duty took a different twist. Here, the House of Lords postulated that a director cannot engage in a position of conflict with the fiduciary responsibilities owed to the company even in the absence of either mala fide or losses to the company⁴⁶⁷. In other words, a director cannot take advantage of his or her fiduciary position to earn

⁴⁶¹ *Schoon v Smith*, 206; *Skinner*, p. 68. Also see *Bray v Ford*, 51; *Guth v Loft*, 510.

⁴⁶² *Aberdeen Rail Co v Blaikie Brothers*, 471-472; *Guth v Loft*, 510. Also see *Camden Land Co v Lewis* 101 Me 78 (1905), p. 97; *New Zealand Netherlands Society "Oranje" Inc. v Kuys* [1973] 2 NZLR 163, 166, where Lord Wilberforce stipulated, “*The obligation not to profit from a position of trust, or, as it is sometimes relevant to put it, not to allow a conflict to arise between duty and interest, is one of strictness*”.

⁴⁶³ Gerner-Beuerle, Paech and Schuster, p. 30-42; PK Andersen and DK Balshoj, *Directors' Conflict of Interest: A Contribution to European Convergence* (Nordic & European Company Law, LSN Research Paper Series, No 14-13, 2013), p. 63. Also see Davies and Hopt, p. 42.

⁴⁶⁴ *Thomson v Eastwood* [1877] 2 AC 215, at 236.

⁴⁶⁵ *In Re The French Protestant Hospital* [1951] Ch 567, 510. Also see Davies, Worthington and Micheler, p. 571.

⁴⁶⁶ *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134

⁴⁶⁷ The test formulated by Lord MacMillan requires the plaintiff company to prove two issues, namely, first, that the director's action was done in relation to the affairs of the company, in the course of the director's duties, and in utilisation of the opportunities and knowledge as the company's directors, and second, that the action resulted in a profit to the director. See Michael Christie, 'The Director's Fiduciary Duty Not to Compete' (1992) 55 *The Modern Law Review* 506, p. 508; McLay, p. 37; *Regal (Hastings) Ltd v Gulliver*, 153.

profits; even if the actions taken were necessary for the company and executed in good faith⁴⁶⁸.

In determining the ambit of the duty within the context of interlocking directorships, the common law took the approach of assessing the fiduciary duties owed by the directors to the company. The case of *London & Mashonaland Exploration Co. Ltd v New Mashonaland Exploration Co. Ltd*⁴⁶⁹ highlighted the early stance of the English courts regarding the practice of interlocking directorships. The court declined to prevent a director from holding multiple directorships, even at a competitor company. According to Chitty J, the absence of a specific provision in the company's articles of association to compel a director to dedicate part or a whole part of his or her time solely for the company, or one that prohibits the director from serving as a director in another company provided strong grounds for the courts to abstain from restricting the practice⁴⁷⁰. Additionally, in the absence of any claim for breach of confidential information instituted against the interlocking director or evidence of sufficient damage to the company as a result of the application of the practice, the position remains that a director can serve on the BOD of other companies.

Forty years later, a similar stance was evident in the case of *Bell v Lever Bros*⁴⁷¹, where Lord Blanesburgh reaffirmed the principle in *London & Mashonaland* and added that not only could a director serve on the board of a rival company, but he or she could also engage in a competing business against the company in the absence of a specific provision in the company's articles of association to prohibit the practice or a situation

⁴⁶⁸ *Regal (Hastings) Ltd v Gulliver*, 144. This stance was also followed in subsequent cases such as, *inter alia*, *Bayley & Associates Pty Ltd v DBR Australia Pty Ltd* [2013] FCA 1341; *The Board of Trustees of the Sabah Foundation & Ors v Datuk Syed Kechik Bin Syed Mohamed & Anor* [1999] 6 MLJ 497; *G.E. Smith Ltd v Smith* [1952] NZLR 470; *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295; *Zwicker v Stanbury* [1953] 2 SCR 438; *Hawrelak v City of Edmonton* (1975) 54 DLR (3d) 45

⁴⁶⁹ *London & Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165

⁴⁷⁰ "[Even] assuming that Lord Mayo had been duly elected chairman and director of the plaintiff company, there was nothing in the articles which required him to give any part of his time, much less the whole of his time, to the business of the company, or which prohibited him from acting as a director of another company; neither was there any contract, express or implied, to give his personal services to the plaintiff company and to another company. No case had been made out that Lord Mayo was about to disclose to the defendant company any information that he had obtained confidentially in his character as chairman: the analogy sought to be drawn by the plaintiff company's counsel between the present case and partnerships was incomplete: no sufficient damage had been shown, and no case had been made for an injunction: the application was wholly unprecedented, and must be dismissed with costs". See *ibid*. Also see Christie, p. 509.

⁴⁷¹ *Bell v Lever Bros* [1932] AC 161

where the director has an interest in any contracts into which the company enters⁴⁷². In other words, the strict ‘no conflict’ rule expressed in *Aberdeen Railway* cannot serve as a strong foundation to prohibit a director from engaging in such a practice. Interestingly, the New Zealand court in *Berlei Hestia (N.Z.) Ltd. v Fernyhough*⁴⁷³ presented a fiscal argument to the strict approach of *Aberdeen Railway*. Mahon J propounded that a strict rule prohibiting directors from holding offices in two or more companies, is only applicable in the presence of sufficient proof, which highlights an actual crystallisation of profit-making, or an abuse of confidential information by the director⁴⁷⁴.

However, these legal decisions may suffer from several weaknesses. First, it is arguable that the courts may have treated the fiduciary responsibilities of the directors lightly in comparison to other classes of fiduciaries such as an agent, an employee or a trustee. In the capacity of an agent, for instance, Scrutton LJ in the case of *Fullwood v Herley*⁴⁷⁵ postulated that even if a director engages in the interlocking directorship practice in good faith and does not own a direct interest in either company, the director remains forbidden from such a practice unless each company has approved the director’s multiple board employments⁴⁷⁶. This is consistent with the modern approach postulated by Millett J in *Bristol and West Building Society v Mothew*⁴⁷⁷, which reemphasised the strict fiduciary rule that forbids directors from holding multiple offices⁴⁷⁸. In fact, Lord Blanesburgh

⁴⁷² See *ibid*, 195, where Lord Blanesburgh restricted the application of the strict ‘no conflict rule’ in *Aberdeen Railway* to “... a company’s contracts in which, on the other side of the table, a director is interested and with reference to which the company’s regulations are silent. The [rule] ... is not addressed to a director’s own contracts with outsiders in which the company has no financial interest at all”.

⁴⁷³ *Berlei Hestia (N.Z.) Ltd v Fernyhough* [1980] 2 NZLR 150

⁴⁷⁴ *Ibid*, 161.

⁴⁷⁵ *Fullwood v Herley* [1928] 1 KB 498. Also see *Ferguson v Wilson*

⁴⁷⁶ “No agent who has accepted an employment from one principal can in law accept an engagement inconsistent with his duty to the first principal from a second principal, unless he makes the fullest disclosure to each principal of his interest, and obtains the consent of each principal to the double employment”. See *Fullwood v Herley*, 502. Also see Andrew Griffiths, ‘Interlocking Directorships and the Danger of Self-Dealing: The Duties of Directors with a Conflict of Interest’ (1999) 280 *International Company and Commercial Law Review*, p. 2.

⁴⁷⁷ *Bristol and West Building Society v Mothew* [1998] Ch 1 18

⁴⁷⁸ “...fiduciary who acts for two principals with potentially competing interest without the informed consent of both is in breach of the obligation of undivided loyalty; he puts himself in a position where his duty to one principal may conflict with his duty to the other”. See *ibid*, 18. Also see *Clark Boyce v Mouat* [1994] 1 AC 428

himself in *Bell v Lever Bros* admitted that serving two masters is a practice “...as impossible today as it ever was”⁴⁷⁹.

Similarly, in the capacity of a trustee, the case of *Re Thomson*⁴⁸⁰ reiterated and applied the dicta of the *Aberdeen Railway's* case, which restrains a trustee in his personal capacity from engaging in a transaction or practice that can jeopardise the beneficiaries' interests⁴⁸¹. Here, Clauson J provided an opposing sentiment to those in *London & Mashonaland* and *Bell v Lever Bros* by holding that a trustee “...by starting such a [competitive] business ... would have been entering engagements which would conflict, or certainly possibly might conflict with the interest of the beneficiaries ...”⁴⁸². This remains the position in the instance of an employee as set out in the case of *Hivac v Park Royal Scientific Instruments Ltd*⁴⁸³. The court in this case determined that the company, as the employer, could restrain its employees, including the directors, from utilising their spare time to work for rival companies despite the absence of specific provisions in their contracts of employment demanding exclusive service and commitment to the main company⁴⁸⁴. Since the interlocking directors occupy a powerful fiduciary position across the companies they represent and also draw considerable collective remuneration from their multiple directorships⁴⁸⁵, it is only correct to subject them to fiduciary liabilities of stricter standards.

Second, it is arguable that the proof of profit-making on the part of the interlocking directors only constitutes one facet of the fundamental rule of equity, while the other facet insists that directors abstain from placing themselves in a situation that can cause their duties and personal interests to conflict with one another – collectively referred to

⁴⁷⁹ *Bell v Lever Bros*, 172.

⁴⁸⁰ *Re Thomson* [1930] 1 Ch 203

⁴⁸¹ *Ibid*, 214-215.

⁴⁸² *Ibid*, 216.

⁴⁸³ *Hivac v Park Royal Scientific Instruments Ltd* [1946] 1 Ch 169. This case involved two employees, who worked in their spare time for a direct competitor of their employer, of which they were held to be liable for breaching their duties of fidelity.

⁴⁸⁴ *Ibid*, 171. Also see *Atlas Organic Fertilizers (Pty) Ltd. v Pikkewyn Ghwano (Pty) Ltd* [1981] 2 SA 173, where, the South African court had limited the practice of interlocking directorate for the NEDs only.

⁴⁸⁵ Petersen, p. 12-13; Paula Clancy, Nat O'Connor and Kevin Dillon, *Mapping the Golden Circle* (TASC Dublin, 2010), p. 29. Also see Nial Friel and others, 'Interlocking Directorates in Irish Companies Using a Latent Space Model for Bipartite Networks' (2016) 113 Proceedings of the National Academy of Sciences 6629; Mizruchi, p. 277.

as the 'no-conflict-no-profit rules'⁴⁸⁶. Whilst profit-making can render the interlocking directors accountable for a breach of their fiduciary duties, the directors can also be taken to account in a similar fashion for misusing their positions as the directors of the company⁴⁸⁷. In fact, breach of fiduciary duties can occur when a director simply serves on the BOD of another company, particularly when these companies stand in competition with one another – even in the absence of losses to the first company or sufficient evidence to suggest an abuse of confidential information by the director⁴⁸⁸. Since their exposure to the confidential information of these companies would substantially increase, the interlocking directors could well be in breach of their duty of confidentiality. Practicing impartiality in dealing with sensitive information brings its own practical challenges in light of the often-unclear dividing line between what is sensitive and what is not⁴⁸⁹. Additionally, the 'no-conflict-no-profit rules' do not only correspond with the earlier court rulings in cases such as *Parker v McKenna*⁴⁹⁰, *North West Transportation Co. Ltd. v Beatty*⁴⁹¹, *Transvaal Lands Co. v New Belgium (Transvaal) Land & Development Co*⁴⁹², *Industrial Development Consultants Ltd v Cooley*⁴⁹³, and the *Aberdeen Railway* case, but also the recent ones such as *Bhullar v Bhullar*⁴⁹⁴ and

⁴⁸⁶ See *Boardman v Phipps* [1967] 2 AC 46, 123, where Lord Upjohn stipulated that “a person in a fiduciary position must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict”.

⁴⁸⁷ *Abbey Glen Property Corporation v Stumborg* (1976) 65 DLR 3d 325. Also see *Cook v Deeds* [1916] 1 AC 554, 563, where Lord Buckmaster LC postulated that “...men [and women] who assume the complete control of a company’s business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and while ostensibly acting for the company, direct in their own favour business which should properly belong to the company they represent”.

⁴⁸⁸ See *Atlas Organic Fertilizers (Pty) Ltd. v Pikkewyn Ghwano (Pty) Ltd.* [1981] 2 S.A. 173, at 198. (“...It is impossible for one to advance the conflicting interest of two actively competing businesses as managing director of both...”).

⁴⁸⁹ See *Hivac v Park Royal Scientific Instruments Ltd*, 173, where Lord Greene MR stipulated that “To say that people in these circumstances can, so to speak, make a division in their minds between what is confidential and what is not, and be quite careful while they are working for the defendants to keep the confidential information locked up in some secret compartment of their minds theoretically may be all very well, but from a practical point of view has a certain unreality”.

⁴⁹⁰ *Parker v McKenna* (1874) LR 10 Ch 96, 124-125.

⁴⁹¹ *North West Transportation Co Ltd v Beatty* [1887] 12 AC 589 [1887] 12 AC 589

⁴⁹² *Transvaal Lands Co v New Belgium (Transvaal) Land & Development Co* [1914] 2 Ch 488

⁴⁹³ *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443

⁴⁹⁴ *Bhullar v Bhullar* [2003] EWCA Civ 424; [2003] 2 BCLC 241

*Quarter Master UK Ltd (in liquidation) v Pyke*⁴⁹⁵, which treated the mere possibility of a conflict as a sufficient reason to prohibit a fiduciary from placing him or herself in such a situation; even if it neither attracts benefits nor incurs losses to the company.

Third, it is arguable that the mere reliance on an actual crystallisation of profit-making on the part of the interlocking directors seems unpersuasive in ruling out the strict 'no conflict' rule. As much as the rule measures the presence of any monetary or material benefits gained by the interlocking directors, it would also consider circumstances where the benefits or detriments arising from the practice present themselves in non-physical or unquantifiable forms⁴⁹⁶. For instance, an interlocking director, who may lack a financial self-interest, cannot escape the fact that he or she remains connected to individuals, who could have an incentive to exert their influence to achieve personal or extraneous objectives⁴⁹⁷. In the Islamic banking setting, the findings of several pieces of empirical research such as Ullah⁴⁹⁸ and Zulkifli⁴⁹⁹ have suggested that a *Sharia'* board member or scholar can become a subject of interest for certain IFIs to provide a 'fast-track' *Sharia'* compliance authorisation for their Islamic banking products and services which may have comprised contentious or prohibited elements under *Sharia'* law; a malpractice described earlier as *Fatwa-shopping* or 'fishing' for favourable *Fatwas*⁵⁰⁰. Accordingly, this may have persuaded the earlier courts to devise a sure-preventive mechanism in the form of a strict 'no conflict' rule that not only deters a director from engaging in the practice, but also guarantees the preservation of the best interest of the beneficiaries, namely the companies⁵⁰¹.

⁴⁹⁵ *Quarter Master UK Ltd (in liq) v Pyke* [2004] EWHC 1815 Ch; [2005] 1 BCLC 245

⁴⁹⁶ Holland, p. 687. Also see *Aronson v Lewis* 473 A 2d 805, 812.

⁴⁹⁷ *Cede & Co v Technicolor Inc.* 634 A 2d 345, 362.

⁴⁹⁸ Ullah, p. 90-92.

⁴⁹⁹ Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK', p. 111

⁵⁰⁰ Ahmed; Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds], p. 25; N Hosen, 'Online Fatwa in Indonesia: From Fatwa Shopping to Googling a Kiai' in Greg Fealy and Sally White (eds), *Expressing Islam: Religious Life and Politics in Indonesia* (Institute of Southeast Asian Studies 2008), p. 159-172. Also see footnote 17 in Chapter 2 and p. 120-121 in Chapter 3.

⁵⁰¹ *Benson v Heathorn* [1842] 1 Y & CCC 326. Also see *Michoud v Girod* 4 How 503, 554, 11 L Ed 1076, 1099 (1846), p. 45, where Wayne J postulated, "*The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity In this conflict of interest, the law wisely interposes. It acts not on the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the*

Fourth, the multiple directorship practice has its own practicalities from a business perspective but this fact by itself could not serve as a strong ground to relax the fiduciary responsibilities owed by the interlocking directors to their respective companies. Indeed, the justification that the directors do not necessarily owe the company “100 per cent of their energies, times, efforts and cumulative talents...”⁵⁰² or are not bound to give continuous attention to the affairs of the company provide a sound argument for the proponents of interlocking directorships⁵⁰³. In fact, it is arguable that the quality of their time at the boards matters more than the collective amount of time they can spend at each of the boards represented. However, the unpredictability of human nature presents a reasonably worrying element in suggesting that the directors as human beings, cannot escape the temptation to sacrifice their fiduciary duties for self-interest objectives⁵⁰⁴. Serving on multiple boards, in addition, involves competing demands that can jeopardise the decision-making and board monitoring quality of the interlocking directors⁵⁰⁵. For the IFIs, *Sharia'* board members with the skills and years of experience in banking under their belts remain a scarcity within the Islamic banking industry and the time and effort they spend on their other *Sharia'* board directorships will only reduce the individual professional commitment owed to each of the IFIs' *Sharia'* boards represented.

In mitigating the risk of the exploitation of fiduciary positions by interlocking directors, most legislation or articles of association have already moved to restrict them from voting or participating in the board's discussion on matters, in which their interests stands in

probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty!”

⁵⁰² Pearlie Koh, ‘Once a Director, Always a Fiduciary?’ (2003) 62 The Cambridge Law Journal 403, p. 409; Pat K Chew, ‘Competing Interests in the Corporate Opportunity Doctrine’ (1989) 67 North Carolina Law Review 435, p. 448.

⁵⁰³ “...A director is not bound to give continuous attention to the affairs of his company. His duties may be performed at periodical board meetings and committee meetings. Although he ought to attend whenever he is reasonably able to do so, he is not bound to attend all meetings...”. See *Re City Equitable Fire Insurance Co. Ltd*, 429.

⁵⁰⁴ *Bray v Ford*, 51.

⁵⁰⁵ Luke C.D. Stein and Hong Zhao, ‘Distracted Directors’ Working Paper, WP Carey School of Business, Arizona State University, August 2016 <<https://wpcarey.asu.edu/sites/default/files/workingpaper1hongzhaolukesteinasu.pdf>> accessed 1 August 2017, p. 11, 13, 29; Connelly and Van Slyke, p. 407; Dan Segal, ‘Board Reputation and Financial Reporting Quality’ [2011] Research Collection School of Accountancy, p. 7-8, 14; Falato, Kadyrzhanova and Lel; Fich and Shivdasani, p. 722. Also see Core, Holthausen and Larcker

conflict with those of the company⁵⁰⁶. Adding to these firewalls are often requirements for the directors to acquire special authorisation from either the BOD or the shareholders in the general meeting before undertaking other directorships, especially ones in a competitor company, and the insertion of an anti-competition clause in the directors' contract of service to prevent them from serving on the BOD of competitor companies, either perpetually or temporarily, which remains applicable even after their resignation. The corporate governance framework of the Islamic banking industry contains similar requirements for *Sharia'* board members to declare any conflict of interest in the performance of their fiduciary responsibilities to the IFI and abstain from participating in the relevant decision-making process⁵⁰⁷.

Correlatively, the issue of conflict of interest presents two different contexts of arguments in the case of multiple *Sharia'* board directorships. On one hand, the presumption of conflict of interest would surface the moment a *Sharia'* board member serves on the *Sharia'* board of another IFI, especially one in direct competition with the primary IFI. In contrast to interlocking directors, who could utilise their positions for example to shape the price and contractual conditions for their benefit to the detriment of the shareholders, interlocking *Sharia'* board members stand in a position where they can shape the Islamic banking *Fatwas* and Islamic financial instruments to suit the interest of the IFIs, which may conflict with the interests of *Sharia'* law. On the other hand, the inability of interlocking *Sharia'* board members to exert a major influence on the commercial aspect of the IFI's business operations, which remains vested in the BOD, renders conflict of interest a remote risk. In countries that have adopted the centralised approach to corporate governance of the IFIs, the *Sharia'* board can only compel the BOD to adhere to the Islamic banking *Fatwas* issued by the national *Sharia'* board due to its mandatory status and importance in determining the IFI's *Sharia'* compliance⁵⁰⁸.

It is submitted that the presence of the firewalls mentioned above would suffice in mitigating the risk of conflict of interest without the immediate need to resort to prescribing a specific limit to the number of *Sharia'* board directorships. At the same time,

⁵⁰⁶ Davies and Hopt, p. 24, 41, 43; Rosalind Nicholson, 'Authorising Multiple Directorships in Unrelated Companies: Table A to the Rescue?' (2011) 9 *Journal of International Banking and Financial Law* 534; Edward Brown, 'A Case of Split Loyalty? Multiple Directorships and Conflicts of Interest Under the Companies Act 2006' (2010) 10 *Journal of International Banking and Financial Law* 584. Also see Black

⁵⁰⁷ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 16. Also see Core Principles for Islamic Finance Regulation (Banking Segment), p. 48-49.

⁵⁰⁸ See p. 109 and 127-128.

it is prudent to note that the increasing complexities of the Islamic banking industry have also contributed to the expansion in the scope of responsibilities of the *Sharia'* board members, which may include non-*Sharia'* matters in the future. The formulation of the above firewalls further substantiates the claim that the roles of the *Sharia'* board members are gradually transitioning from those of the NEDs to those of the executive directors⁵⁰⁹. In the absence of a clear dividing line between a conflicting and non-conflicting situation in prohibiting or allowing multiple directorships, it is essential for the court to consider the factual circumstances surrounding a claim of breach of fiduciary duties by the interlocking directors. This, however, only constitutes one facet in assessing the practice from the *Sharia'* law perspective. Of course, this thesis does not intend to suggest the civil court judges need to familiarise themselves with the theoretical and practical aspects of *Sharia'* law, which would require, even for a trained *Sharia'* scholar, years to comprehend⁵¹⁰. Nonetheless, as the context of *Sharia'* compliance encompasses both the financial and operational aspects of the IFI, which correspondingly would give rise to disputes that necessitate the ascertainment of the *Sharia'* issues involved, the suggestion that the courts should consider assessing an Islamic banking dispute through the eyeglasses of *Sharia'* law by appointing Islamic banking experts to give their opinions to the court or creating a special court consisting of judges with knowledge and expertise in *Sharia'* law, especially *Fiqh Al-Muamalat*, are worth considering in mitigating the risk of judicial incongruity in Islamic banking-related litigations.

4.3 Regulatory Approaches to Interlocking Directorships in Western Jurisdictions

4.3.1 Europe

In response to the global financial crisis in 2008, the European Commission ('EC') began to enhance and tighten its existing legal framework in order to address the loopholes in

⁵⁰⁹ Most legislations or articles of association do not prohibit the NEDs from occupying other directorships. See Simon Witney, 'Corporate Opportunities Law and the Non-Executive Director' (2016) 16 *Journal of Corporate Law Studies* 145, p. 159. Also see Code B.3.2 and B.3.3 of The UK Corporate Governance Code (September 2014), p. 12.

⁵¹⁰ See *Arab Malaysian Merchant Bank v Silver Concept* [2005] 5 MLJ 210 (High Court) at 217, where Suriyadi J stipulated that "not every presiding judge is a Muslim, and even if so, may not be sufficiently equipped to deal with matters, which Ulama' take years to comprehend".

the corporate governance principles governing the financial sector, which it claimed had suffered from a 'lack of genuine effectiveness'⁵¹¹. In 2014, the EC introduced the Capital Requirements Directives IV ('CRD IV')⁵¹², a legislative package that supercedes any voluntary 'comply or explain' principle used by EU member countries in their domestic corporate governance codes⁵¹³. As far as the interlocking directorship practice is concerned, the CRD IV stipulates that a director, who is involved in the financial sector, can only hold one executive directorship with two non-executive directorships, or a maximum of four non-executive directorships⁵¹⁴. Furthermore, it also stresses that directors with multiple directorships must demonstrate their ability to dedicate sufficient time to the companies represented in fulfilling their fiduciary functions at those companies⁵¹⁵.

This approach to the interlocking directorship practice is restrictive and could dilute the quality of the board by rendering it difficult for financial institutions to recruit highly qualified and experienced directors, whom are likely to hold multiple directorships, due

⁵¹¹ This includes the broad nature of the existing principles, the uncertain roles and responsibilities within both the financial institution and the supervisory authority and the non-binding nature of the principles. See European Commission, *Green Paper: Corporate Governance in Financial Institutions and Remuneration Policies* (2 June 2010, COM (2010) 284 Final, 2010), p. 5-6. Also see Max Barrett, 'The End of "Comply or Explain"? Corporate Governance in the United Kingdom and Ireland and the Impact of CRD IV' (2012) 27 *Journal of International Banking Law and Regulation* 4

⁵¹² The CRD IV comprises the Capital Requirements Directive ('CRD') 2013/36/EU and Capital Requirements Regulation ('CRR') 575/2013. See Directive 2013/36/EU of the European Parliament and of the Council OJ L 176/385

⁵¹³ A 'comply or explain' corporate governance principle requires the companies to state whether they apply a corporate governance code, specify if they comply with its provisions, and in the case of non-compliance, explain the reason for such a choice. See Massimo Belcredi and Guido A Ferrarini, *The European Corporate Governance Framework: Issues and Perspectives* (ECGI Law Working Paper No 214/2013, May 2013, 2013), p. 18. Also see Financial Reporting Council (FRC), *Comply or Explain: 20th Anniversary of the UK Corporate Governance Code* (2012)

⁵¹⁴ Article 91 of CRD IV, p. 385. Article 91 (4) further stipulates that certain multiple directorships shall count as one, namely executive or non-executive directorships held within the same group, or those held in institutions which are members of the same institutional scheme, or undertakings (including non-financial entities) in which the institution holds a qualifying holding.

⁵¹⁵ *Ibid*, p. 344, 379, 385-386,

to significant time commitment expected of them⁵¹⁶. For example, Enriques⁵¹⁷ argues that the CRD IV might have focused too much on reducing directors' busyness and ignored the functionality of interlocking directors to the financial industry. He contends that the limitation on directorships cannot guarantee a better time commitment from directors considering the lack of conclusive evidence linking the practice to banks' performance and risk-taking behaviour. Whilst these arguments are sound, leaving the practice unrestricted is also lacking in prudence. With due respect, the limit on directorships by the CRD IV should not merely be viewed as a limitation to a directors' freedom or a downgrade to their knowledge and experience. A regulated approach to the practice is better than an unregulated approach because it could eliminate the risk of having over-committed directors on a company's board and improve their monitoring capability. Some have already occupied key positions in committees such as risk committee and audit committee, which are critical to a company's risk management framework and thus, requiring directors to commit substantial amount of time and attention to its operations.

At the same time, the CRD IV does provide a room for flexibility by allowing the central banks or relevant supervisory authorities of EU member states to permit directors to hold one additional non-executive directorship, subject to a regular notification of such authorisation to the European Banking Authority ('EBA')⁵¹⁸. Additionally, the European Securities and Markets Authority ('ESMA') and EBA recommend for financial institutions to conduct a reassessment on the sufficient time commitment of directors whenever they

⁵¹⁶ Royal Bank of Scotland (RBS), *Annual Report and Accounts 2016: Creating a Simple, Safe, Customer-Focused Bank* (2016), p. 458 ("The Group will be required to recruit new independent directors and senior members of management to sit on the boards of directors and board committees ... and there may be a limited pool of competent candidates ..."). Also see Royal Bank of Scotland (RBS), *Annual Report and Accounts 2015: Building a Strong, Simple, Fair Bank* (2015), p. 48 ("non-executive director recruitment remains challenging for a number of reasons, including the significant time commitment expected ..."); Barclays PLC, *Annual Report 2014: Helping People Achieve Their Ambitions - in the Right Way* (2014), p. 119 ("...the introduction of the Individual Accountabilities Regime ... may also reduce the attractiveness of the financial services industry to high calibre candidates ...")

⁵¹⁷ Enriques and Zetzsche, p. 21-22.

⁵¹⁸ Article 91 (6) of CRD IV, p. 385; article 9 (2) of Directive 2014/65/EU of the European Parliament and of the Council OJ L 173/349. Also see Prudential Regulation Authority (PRA), *Strengthening Capital Standards: Implementing CRD IV* (Consultation Paper, CP5/13, August 2013, 2013), p. 17; Central Bank of Ireland, 'Implementation of Competent Authority Discretions and Options in CRD IV and CRR' <<https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/credit-institutions/regulatory-requirements/gns-4-4-3-2-implementation-of-competent-authority-discretions-and-options-in-crd-iv-and-crr.pdf?sfvrsn=0>> accessed 31 August 2017, p. 32, 54.

take on an additional directorship⁵¹⁹. It is prudent to argue that as much as this reassessment exercise enables a better understanding of an interlocking director's ability to fulfil their professional responsibilities, it might also impose a heavy monitoring responsibility on the EBA and the competent authorities by overloading them with files or letters each time any director takes an additional directorship. As alternatives, the European Banking Federation ('EBF') recommends for directorships held for non-commercial purposes to be excluded from this reassessment exercise as these are less subject to a 'crisis' situation that would require a higher level of commitment from directors⁵²⁰, whilst the French Banking Federation ('FBF') recommends for the reassessment exercise to be made only in cases where the number of directorships is high⁵²¹.

Although it is arguable that the CRD IV does not cover the full spectrum of the interlocking directorship practice, it still exemplifies a promising legislative development within the EU, which not only recognises the prospective benefits offered by the practice such as lowering cross-border operational costs, harmonising the multiplicity of corporate governance codes within the EU, and easing needless red tapes⁵²², but it also recognises the perimeters within which the practice can viably operate and attract the most benefits for companies.

⁵¹⁹ This reassessment exercise would include directorships held by directors in companies that do not pursue commercial objectives. See European Securities and Markets Authority (ESMA) and European Banking Authority (EBA), *Joint ESMA and EBA Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders under Directive 2013/36/EU and Directive 2014/65/EU* (Consultation Paper, ESMA/2016/1529, 28 October 2016, 2016), p. 23, 28. Also see Federation Bancaire Francaise (FBF), 'ECB Draft Guide to Fit and Proper Assessments: FBF Response' 20 January 2017 <<http://fbf.fr/fr/files/AJRHK6/FBF-Comments-Draft-ECB-guide-fit-proper-20012017.pdf>> accessed 7 August 2017

⁵²⁰ Examples on entities that do not pursue commercial objectives include charities; other not-for-profit organisations; and companies set up for the sole purpose of managing the private economic interests of members of the management body provided they do not require day-to-day management by the member of the management body. See European Banking Federation (EBF), *EBF Response to Consultation Paper on Joint ESMA and EBA Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders under Directive 2013/36/EU and Directive 2014/65/EU* (EBF 025444, 27 January 2017, 2017), p. 4, 6, 8. Also see European Securities and Markets Authority (ESMA) and European Banking Authority (EBA), p. 23, 27, 28, 30.

⁵²¹ Federation Bancaire Francaise (FBF)

⁵²² Barrett, p. 11.

4.3.2 United Kingdom

The UK Corporate Governance Code⁵²³, which applies to all UK listed companies (including listed credit institutions) offers a rather less stringent approach to the practice of interlocking directorships. Although its provisions are not as detailed as the CRD IV and do not cover the full spectrum of the interlocking directorship practice, its ‘comply or explain’ approach renders it an important benchmark of good corporate governance practice among companies across the world⁵²⁴. Arguably, the drafters may have accepted the benefits of recruiting interlocking directors who can contribute significant added values to the companies. As of now, the Code only prohibits full-time directors from undertaking more than one non-executive directorship in an FTSE 100 company or the chairmanship of such a company⁵²⁵ though it also acknowledges the multiple directorship practice as an element that could affect a director’s independence to act and make impartial judgement⁵²⁶.

Nonetheless, the Code places an equal emphasis for all directors to allocate sufficient time in meeting the fiduciary obligations expected of them including the need to be available in the event of crisis – the directors’ individual contribution and time commitment will be subject to evaluation by the BOD every year⁵²⁷. Their letters of appointment will prescribe the expected time commitment and directors with any outside commitments must disclose the relevant details such as the time involved and remuneration received to the BOD, who in turn, must disclose this information together with a statement explaining whether the interlocking directors will retain such earnings in the remuneration report⁵²⁸. Although the NEDs can have multiple directorships, the

⁵²³ Financial Reporting Council (FRC), ‘The UK Corporate Governance Code’ April 2016 <<https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf>> accessed 6 September 2017

⁵²⁴ Barrett, p. 3. Also see P. Davies and others, *Corporate Boards in European Law: A Comparative Analysis* (OUP Oxford 2013), p. 732.

⁵²⁵ Principle B.3.3 of Financial Reporting Council (FRC), ‘The UK Corporate Governance Code’. Also see Higgs, p. 83; Benson and others, p. 1.

⁵²⁶ Principle B.1.1 of Financial Reporting Council (FRC), ‘The UK Corporate Governance Code’

⁵²⁷ Principle B.3, B.3.1, B.3.2 and B.6 of *ibid*. Also see David Walker, *A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations* (26 November 2009, 2009), p. 14, 121, 179, where it recommends NEDs to reduce taking additional directorships and increase their time commitment. It further recommends major banks to require NEDs to commit a minimum of 30 to 36 days, which must be indicated in their letters of appointment.

⁵²⁸ Principle B.3.2 and D.1.2 of Financial Reporting Council (FRC), ‘The UK Corporate Governance Code’

Code seems to have provided a sound corporate governance framework that not only acknowledges the abilities of some directors to multitask effectively, but also ensures the application of the practice would not jeopardise the best interests of companies and their shareholders.

Additionally, certain provisions exist relevant to the practice of interlocking directorships in the UK Companies Act 2006. Section 175 stipulates that a director owes a duty to avoid a situation, in which his interest can conflict with that of the company⁵²⁹. Although this duty arises in circumstances such as the exploitation of property, information or opportunity; regardless of whether the company could take advantage of such situations, it is arguable that the duty, which bears close resemblance to the strict 'no conflict' rule established in the *Aberdeen Railway's* case, can also apply to interlocking directorship cases⁵³⁰ where there are legitimate concerns over the potential occurrence of conflict of interests between the interlocking directors and the companies they represent. Moreover, section 176, which imposes a duty on the director not to accept benefits from third parties by reason of his or her directorship, further supports the fundamental rule of equity that forbids a director from misusing his or her fiduciary positions for personal benefits⁵³¹.

4.3.3 Ireland

Across the Irish Sea, the Irish Companies Act 2014 regulates the interlocking directorship practice in respect of Irish registered companies. According to section 142 (1), a director cannot occupy more than 25 directorships in the BODs of private companies limited by shares, or 25 directorships in the BODs of one or more private companies limited by shares and one or more companies of other type, which is capable of being wound up under the Act. However, the interlocking directorship practice within the financial sector falls under the purview of the Central Bank of Ireland, which had introduced a new corporate governance code in 2015 entitled the Corporate Governance Requirements for Credit Institutions 2015 ('CGRCI')⁵³². The introduction of the Code

⁵²⁹ Section 175 of Companies Act 2006

⁵³⁰ Section 175 (7) of *ibid.* Also see Nicholson

⁵³¹ *Abbey Glen Property Corporation v Stumborg*. Also see *Keech v Sandford*, 62.

⁵³² The Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013 ('CGCCIU') has been split into two versions to provide for requirements for Credit Institutions and Insurance Undertakings separately; the first is the CGRCI, while the second is the Corporate Governance Requirements for Insurance Undertakings 2015 ('CGRIU'). See Central Bank of Ireland, 'Codes' (2017) <<https://www.centralbank.ie/regulation/how-we-regulate/codes>> accessed 10 September 2017. Also

signified the country's departure from the 'comply or explain' approach favoured by the UK Corporate Governance Code, at least for the credit institutions, in favour of a mandatory approach that prescribes legal sanctions for any breach of its provisions, which the drafters may have viewed as a better way to promote good corporate governance practices⁵³³.

Indeed, the CGRCI may well have possessed all the trademarks of a comprehensive corporate governance framework on the practice of interlocking directorships. In fact, its arrival corresponded with the 2010 recommendation of TASC, a local think-tank organisation, which had generated a detailed report that studied the interlocking directorship practice in Ireland involving 40 companies including financial institutions such as the Central Bank of Ireland, AIB, Irish Life and Permanent, and the Anglo-Irish Bank. The report recommended, among other, the introduction of a specific restriction in the number of board directorships a director can hold in providing a better regulation of the interlocking directorship practice and improving the Republic's corporate governance system⁵³⁴.

The Central Bank of Ireland divided regulated institutions into four categories, namely, low, medium-low, medium-high, and high impact institutions⁵³⁵. This follows the Probability Risk and Impact System ('PRISM') – the Central Bank's risk-based framework, which enables a more systematic assessment of the risks that occur within the financial firms it regulates⁵³⁶. For low, medium-low, and medium-high impact institutions, the number of directorships is limited to five in the financial sector and eight

see paragraph 5.1 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015' <<https://www.centralbank.ie/docs/default-source/Regulation/codes/gns-4-1-7-corgovreq-credinstits2015.pdf?sfvrsn=4>> accessed 1 September 2017

⁵³³ Barrett, p. 5. Also see Clancy, O'Connor and Dillon, p. 48, 51.

⁵³⁴ Clancy, O'Connor and Dillon, p. 49. This included, *inter alia*, a revision of the Companies (Amendment) (No.2) Act 1999, which had previously capped the maximum number of directorships a director can hold at a high 25. See section 45 of Companies (Amendment) (No.2) Act 1999

⁵³⁵ Central Bank of Ireland, 'PRISM Explained: How the Central Bank of Ireland is Implementing Risk-Based Regulation' April 2016 <<https://www.centralbank.ie/docs/default-source/Regulation/supervision/prism/gns-4-1-2-2-5-prism-explained-feb-2016.pdf?sfvrsn=2>> accessed 1 September 2017. Also see paragraph 2 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'

⁵³⁶ Central Bank of Ireland, 'PRISM Explained: How the Central Bank of Ireland is Implementing Risk-Based Regulation'

in the non-financial sector⁵³⁷; both which shall include directorships held outside of Ireland⁵³⁸ but exclude those held within the same group such as in parent-subsidary companies, and those held on a voluntary and pro bono basis⁵³⁹. Then again, the director must disclose such information and ensure that the directorships do not interfere with the fulfilment of his or her fiduciary responsibilities as a director of a company⁵⁴⁰. Also, in the event of a potential conflict of interest as a result of the director's multiple directorships, the CGRCI stipulates that the director must abstain from participating in any discussion or decision-making event⁵⁴¹.

In cognisance of the CRD IV, which empowers the financial authorities to authorise the directors to hold additional board directorships⁵⁴², the Central Bank of Ireland allows the directors of the aforementioned category of institutions to hold directorships above the circumscribed perimeters of the CGRCI⁵⁴³. At the same time, the central bank also recognises the gravity of crucial factors such as the nature of the directorships and time commitments that can render holding anything more than the prescribed limit as a challenging feat⁵⁴⁴. For instance, the central bank may grant an exception if the institution can either prove that it only seeks to benefit from the underlying experience and expertise of the director, which appointment will not involve a lot of obligations, or that it possesses a less complex and small operation size⁵⁴⁵. Though the institution must provide a detailed rationale in the event it decides to appoint a director, who has already held the maximum number of directorships allowed, and explain why it considers the

⁵³⁷ Paragraph 7.8 and 7.9 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'

⁵³⁸ Paragraph 7.8 and 7.9 of *ibid*

⁵³⁹ Paragraph 7.8 and 7.10 of *ibid*

⁵⁴⁰ This information will depend on the facts of each case. See Section 7.10 of *ibid*. Also see paragraph 7.6 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015 - Frequently Asked Questions' December 2016 <<https://www.centralbank.ie/docs/default-source/Regulation/how-we-regulate/codes/corgov-req---credit-institutions-faq.pdf?sfvrsn=4>> accessed 1 September 2017

⁵⁴¹ Section 7.13 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'

⁵⁴² Article 91 (6) of CRD IV

⁵⁴³ Section 7.8 and 7.9 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'

⁵⁴⁴ Section 7.8 and 7.9 of *ibid*

⁵⁴⁵ Benson and others, p. 3; Rüdiger Fahlenbrach, Angie Low and René M. Stulz, 'Why do Firms Appoint CEOs as Outside Directors?' (2010) 97 *Journal of Financial Economics* 12

director's concurrent directorships will not affect his or her time commitment to the institution⁵⁴⁶, it is equally important to note that the central bank intends to adopt a cautious approach in exercising this power on a case by case basis, which would include a meticulous assessment of factors such as time commitment, conflicts of interest, current roles, and the director's ability to perform his or her corporate functions⁵⁴⁷.

On the other hand, the directorship limit for high impact financial institutions is three in the financial sector and five in the non-financial sector, irrespective of whether they are executive or non-executive in nature⁵⁴⁸. Similar to the low, medium-low and medium-high impact financial institutions, this limitation shall include directorships held outside of Ireland and exclude those held within the same group⁵⁴⁹. However, the CGRCI imposes an absolute limit on the directors of high impact financial institutions as it does not allow them to occupy an additional directorship above the circumscribed perimeter – even if it is held on a pro bono basis⁵⁵⁰. From these criteria, it is arguable that Ireland may already have possessed one of the most comprehensive corporate governance frameworks on the interlocking directorate practice among the other member states of the EU.

At the same time, it is important to note that the implementation of the Single Supervisory Mechanism ('SSM') on 4 November 2014 has created a new system of banking supervision comprising the European Central Bank ('ECB') and the national competent authorities ('NCA') of participating EU countries⁵⁵¹. The NCA for Ireland is the Central

⁵⁴⁶ Paragraph 7.8 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'

⁵⁴⁷ Paragraph 3.10 of Central Bank of Ireland, 'Consultation on Competent Authority Discretions and Options in CRD IV and CRR' Consultation Paper CP 74, September 2013 <<https://www.centralbank.ie/docs/default-source/publications/Consultation-Papers/cp74/consultation-on-competent-authority-discretions-and-options-in-crdiv-and-crr---cp-74--pdf-version.pdf?sfvrsn=4>> accessed 22 September 2017; paragraph 22.1 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015 - Frequently Asked Questions'

⁵⁴⁸ Paragraph 7.8 and 7.9 (Additional Obligations on High Impact Designated Credit Institutions) of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'. Also see paragraph 21.2 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015 - Frequently Asked Questions'

⁵⁴⁹ Paragraph 7.8 and 7.9 of (Additional Obligations on High Impact Designated Credit Institutions) of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015'

⁵⁵⁰ Paragraph 7.8 of (Additional Obligations on High Impact Designated Credit Institutions) of *ibid*; paragraph 6.17 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015 - Frequently Asked Questions'

⁵⁵¹ European Central Bank (ECB), 'Single Supervisory Mechanism' (2017) <<https://www.bankingsupervision.europa.eu/about/thessm/html/index.en.html>> accessed 1 September

Bank of Ireland. Credit institutions in the EU have been categorised into two categories, namely 'significant institutions' ('SIs'), which fall under the direct supervision of the ECB, and 'less significant institutions' ('LSIs'), which fall under the supervision of the NCA⁵⁵². As of 1st April 2017, there are five Irish banks categorised as SIs out of a total of 124 SIs supervised by the ECB⁵⁵³. According to the European Union (Capital Requirements) Regulations 2014 (S.I. No. 158 of 2014), which transposed the CRD IV into a national law, directors of significant institutions must adhere to the limit on directorships provided under the CRD IV, *i.e.* they can only hold one executive directorship with two non-executive directorships, or a maximum of four non-executive directorships instead of a maximum of three and five for financial and non-financial directorships respectively provided under the CGRCI 2015⁵⁵⁴. However, this restriction excludes any directorships held in organisations that do not pursue commercial objectives⁵⁵⁵.

2017. Also see Central Bank of Ireland, 'PRISM Explained: How the Central Bank of Ireland is Implementing Risk-Based Regulation', p. 8.

⁵⁵² Financial institutions qualify as SIs if they fulfil at least one of these criteria, namely size (total value of assets exceeds €30 billion); economic importance for the specific country or the EU economy as a whole; cross-border activities; evident request or receipt of funding from the European Stability Mechanism or the European Financial Stability Facility. See European Central Bank (ECB); European Central Bank (ECB), 'What Makes a Bank Significant?' (2017) <<https://www.bankingsupervision.europa.eu/banking/list/criteria/html/index.en.html>> accessed 1 September 2017. Also see article 6 (6) and (7) of Council Regulation (EU) No 1024/2013 of 15 October 2013 Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions [2013] OJL 287/63

⁵⁵³ These are the Allied Irish Banks, Citibank, Permanent TSB, Bank of Ireland, and Ulster Bank. See European Central Bank (ECB), 'List of Supervised Entities' 1 April 2017 <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/list_of_supervised_entities_201704.en.pdf?cf307b8bc923b7869e40e0efffeb712> accessed 1 September 2017. Also see International Monetary Fund (IMF), 'Ireland Financial Sector Assessment Program: Technical Note - Financial Safety Net, Bank Resolution, and Crisis Management' IMF Country Report No 16/313, September 2016 <<https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Ireland-Financial-Sector-Assessment-Program-Technical-Note-Financial-Safety-Net-Bank-44306>> accessed 2 September 2017, p. 7.

⁵⁵⁴ Regulation 79 (7) of Ireland, 'European Union (Capital Requirements) Regulations 2014 (S.I. No. 158 of 2014)' <<http://www.irishstatutebook.ie/eli/2014/si/158/made/en/pdf>> accessed 2 September 2017. Also see appendix 2 of Central Bank of Ireland, 'Corporate Governance Requirements for Credit Institutions 2015 - Frequently Asked Questions'; Central Bank of Ireland, 'Implementation of Competent Authority Discretions and Options in CRD IV and CRR', p. 32.

⁵⁵⁵ Regulation 78 (9) of Ireland

4.3.4 Germany

Similar to the regulatory approach in Ireland, Germany has also opted to prescribe a limitation on board directorships by way of statutory regulation and corporate governance codification⁵⁵⁶. According to the German Stock Corporation Act 1965 ('*Aktiengesetz*'), a NED cannot hold more than ten supervisory board directorships in companies that are required by law to form a supervisory board⁵⁵⁷. It is further stipulated that the director can serve on either the supervisory board or the management board but cannot serve on both boards simultaneously in order to maintain the independence of these boards⁵⁵⁸. The German Corporate Governance Code 2015 ('GCGC') stipulates that an executive director cannot accept more than three directorships in the supervisory boards of other listed companies in a bid to ensure directors can devote reasonable attention to their supervisory responsibilities⁵⁵⁹. Both the directors of the management and supervisory boards must disclose any conflict of interest to the supervisory board⁵⁶⁰. Also, the Code only allows a maximum of two former directors of the management board to serve on the company's supervisory board⁵⁶¹.

From a legal perspective, the GCGC does not possess the same parliamentary legitimacy as the *Aktiengesetz* because it was issued by a Standing Corporate Governance Committee; hence, the code carries no legal binding effect⁵⁶². The adoption of the code resembles that of the 'comply or explain' approach adopted in the UK and

⁵⁵⁶ France also adopts a similar way of governance. See article L225-21 of Code de Commerce (Commercial Code), which restricts the number of a director's board directorship to a maximum number of five.

⁵⁵⁷ Section 100 (2) (1) of *Aktiengesetz* (Stock Corporation Act). Additionally, the companies can enlist further interlocking directorship restrictions and requirements in their respective articles of association

⁵⁵⁸ Section 105 (1) of *ibid.* Also see Engle and Danyliuk, p. 107; Davies and Hopt, p. 10, 16; Enrico Prinz, *Corporate Governance and the Uncertain Role of Interlocking Directorates: Director Networks in Germany and Their Impact on Financial Performance* (Université de Bourgogne-CREGO EA7317 Centre de recherches en gestion des organisations, 2006), p. 12.

⁵⁵⁹ Para 5.4.1 and 5.4.5 of Regierungskommission, *Deutscher Corporate Governance Kodex (German Corporate Governance Code)* (as amended on May 5 2015, 2015). Also see section 25d of Banking Act (Gesetz über das Kreditwesen)

⁵⁶⁰ Para 4.3.3 and 5.5.2 of Regierungskommission

⁵⁶¹ Para 5.4.2 of *ibid.*

⁵⁶² *Ibid.*, p. 2; J.J. du Plessis and others, *German Corporate Governance in International and European Context* (Springer Berlin Heidelberg 2012), p. 46.

elsewhere in Europe⁵⁶³. Accordingly, the *Aktiengesetz* explicitly states that companies must provide a declaration of their compliance with the GCGC or a disclosure statement and explanation for non-compliance on an annual basis⁵⁶⁴. Furthermore, German corporate law treats the annual declaration or disclosure of the ‘comply or explain’ approach adopted by companies very seriously and states that any incorrect information or false declarations can result in serious legal repercussions towards the members of the management board and the supervisory board⁵⁶⁵.

Similar to Ireland, Germany also participates in the SSM, where the ECB is mainly responsible for the supervision of SIs while the NCA holds the responsibility to supervise LSIs⁵⁶⁶. The role of NCA for Germany is jointly performed by the Federal Financial Services Supervisory Authority (BaFin) and the Deutsche Bundesbank⁵⁶⁷. As of 1st April 2017, there are 21 German banks categorised as SIs and among them is the Deutsche Bank, which is included in the Financial Stability Board list of Global Systemically Important Banks (‘G-SIBs’) for 2016⁵⁶⁸. The same limit on directorships applies to

⁵⁶³ Organisation for Economic Co-operation Development (OECD), *OECD Corporate Governance Factbook* (OECD 2017), p. 22; Davies and Hopt, p. 24.

⁵⁶⁴ Section 161 of *Regierungskommission*; J.J. du Plessis, A. Hargovan and M. Bagaric, *Principles of Contemporary Corporate Governance* (Cambridge University Press 2010), p. 346. In contrast, the code also grants a flexibility to companies to deviate without the need of a proper disclosure where the provision deviated contains the term “should”. See *Regierungskommission*, p. 2.

⁵⁶⁵ Organisation for Economic Co-operation Development (OECD), *OECD Corporate Governance Factbook*, p. 22; du Plessis and others, p. 47.

⁵⁶⁶ European Central Bank (ECB), ‘Single Supervisory Mechanism’. Also see Federal Financial Supervisory Authority (BaFin), ‘Single Supervisory Mechanism’ (22 March 2016) <https://www.bafin.de/EN/Aufsicht/BankenFinanzdienstleister/EUBankenaufsicht/SSM/ssm_node_en.html> accessed 2 September 2017

⁵⁶⁷ Deutsche Bundesbank, ‘Single Supervisory Mechanism’ <https://www.bundesbank.de/Navigation/EN/Tasks/Banking_supervision/Objective/eu_supervision.html> accessed 2 September 2017; International Monetary Fund (IMF), ‘Germany Financial Sector Assessment Program: Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision’ IMF Country Report No 16/196, June 2016 <<http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Germany-Financial-Sector-Assessment-Program-Detailed-Assessment-of-Observance-on-the-Basel-44020>> accessed 2 September 2017, p. 18.

⁵⁶⁸ GSIBs comprises a group of 30 financial institutions, whose failures might trigger a financial crisis. The Deutsche Bank is the only German bank in the group, boasting a total assets value above €1 trillion. See European Central Bank (ECB), ‘List of Supervised Entities’; Financial Stability Board, ‘2016 List of Global Systemically Important Banks (G-SIBs)’ 21 November 2016 <<http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf>> accessed 2 September 2017. Also see Federal Financial Supervisory Authority (BaFin); International Monetary Fund (IMF), ‘Germany Financial Sector Assessment Program: Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision’, p. 18.

directors from both the management board and the supervisory board, namely one management board directorship and two supervisory board directorships, or four supervisory board directorships⁵⁶⁹. Additionally, this restriction excludes any directorships held in organisations that do not pursue commercial objectives⁵⁷⁰.

4.3.5 United States

The United States regulates the practice of interlocking directorship through two principal statutes and two sets of listing rules, namely the Clayton Act and the Depository Institution Management Interlocks Act ('DIMIA'), and the New York Stock Exchange ('NYSE') Listed Company Manual and the NASDAQ Stock Market Rules respectively. For companies publicly listed under the NYSE and NASDAQ, the BOD must comprise a majority of 'independent director', which excludes, *inter alia*, directors who engage in the interlocking directorship practice⁵⁷¹. Additionally, both the NYSE and the NASDAQ rules consider a resigned interlocking director to be 'non-independent' up until a period of three years after the cessation of his or her employment as an executive of a company⁵⁷².

Under the DIMIA, which applies to management officials of a depository institution or a depository holding company, an officer or a director cannot serve on the BOD of two or more unaffiliated financial institutions having offices in the same city or town⁵⁷³, or when one of the institution holds a total asset exceeding US\$2.5 billion and the other institution

⁵⁶⁹ Section 25c (2) and 25d (3) of 'Banking Act (Gesetz über das Kreditwesen)' July 2014 <https://www.bundesbank.de/Redaktion/EN/Downloads/Tasks/Banking_supervision/Acts_Regulations_Guidelines/banking_act.pdf?__blob=publicationFile> accessed 2 September 2017. Also see Thomas Paul, Sven H Schneider and Jan L Steffen, 'Germany' in Jan Putnis (ed), *The Banking Regulation Review* (8 edn, The Law Reviews 2017) <<http://thelawreviews.co.uk/edition/the-banking-regulation-review-edition-8/1143933/germany>> , p. 178.

⁵⁷⁰ Section 25c (2) and 25d (3) of , 'Banking Act (Gesetz über das Kreditwesen)'.

⁵⁷¹ Section 303A.02 of New York Stock Exchange Listed Company Manual; section 5605 (a) (2) of NASDAQ Stock Market Rules. Also see Michal Barzuza and Quinn Curtis, 'Board Interlocks and Outside Directors' Protection' (217) 46 *The Journal of Legal Studies* 129; Katherine M Brown, 'New Demands, Better Boards: Rethinking Director Compensation in an Era of Heightened Corporate Governance' (2007) 82 *New York University Law Review* 1102, p. 1110.

⁵⁷² Section 303A.02 (b) (iv) of New York Stock Exchange Listed Company Manual; section 5605 (a) (2) [e] of NASDAQ Stock Market Rules

⁵⁷³ This is generally designated by the Office of Management and Budget. See section 3202 of Depository Institution Management Interlocks Act 12 U.S.C.. Also see M.L. Fein, *Banking and Financial Services: A Regulatory Guide to the Convergence of Banking, Securities, and Insurance in the United States* (Wolters Kluwer Law & Business 2006), chapter 21, p. 93.

holding a total asset exceeding US\$1.5 billion⁵⁷⁴. The restriction applies to interlocking directorship practices within the banking institutions and also those of non-banking financial institutions⁵⁷⁵. Likewise, the Clayton Act also contains a similar prohibition on the directors from serving on the BOD of two or more commercial companies that compete with one another by virtue of their business nature and location of operation⁵⁷⁶. Nonetheless, the Clayton Act only applies to companies other than banking institutions, banking associations, and trust companies⁵⁷⁷, which own capital, surplus, and undivided profits exceeding US\$10 million; a threshold that varies according to the annual adjustments made by the Federal Trade Commission ('FTC') based on the change in the gross national product⁵⁷⁸. It excludes entities such as start-up companies; private foundations; not-for-profit entities; companies, which products differ from one another⁵⁷⁹; and any directorial interlocks between parents and wholly-owned subsidiaries or those between suppliers and distributors in recognition of the fact that these companies operate as a single entity⁵⁸⁰. Further, the Clayton Act not only bars individuals from engaging in the practice, but also prohibits companies from designating their directors,

⁵⁷⁴ Section 3203 of Depository Institution Management Interlocks Act 12 U.S.C.. The Federal Reserve System can adjust the asset size to allow for inflation or market changes.

⁵⁷⁵ Section 3201 of *ibid*

⁵⁷⁶ Section 8 (15 U.S.C. § 19) of Clayton Act 15 U.S.C.

⁵⁷⁷ These entities are covered by the DIMIA. See *BankAmerica Corp. v United States* 462 US 122 (1983); J.M. Jacobson and American Bar Association. Section of Antitrust Law, *Antitrust Law Developments (sixth)* (Section of Antitrust Law, ABA 2007), p. 428. Also see *BankAmerica Corp. v United States*, 128.

⁵⁷⁸ Section 8 (§ 19 (a) (1) (b)) of Clayton Act 15 U.S.C.. Also see Federal Trade Commission, 'FTC Announces New Thresholds for Clayton Act Antitrust Reviews for 2015' Annual Update on Thresholds for Premerger Notification Filings and Interlocking Directorates, January 15 2015 <<https://www.ftc.gov/news-events/press-releases/2015/01/ftc-announces-new-thresholds-clayton-act-antitrust-reviews-2015>> accessed 22 September 2017.

⁵⁷⁹ See *American Bakeries Co v Gourmet Bakers Inc* 515 F Supp 977 (D Md 1981), where the District Court held that two companies; one, selling freshly baked goods to retail bakeries, while the other selling dough and mixes to retail bakeries, did not sufficiently meet the requirement of a competitor within the meaning of the Clayton Act. Also see Andrew C. Finch, Samir K. Ranade and Jacqueline P. Rubin, 'Interlocking Directorates: Re-examining Section 8 of the Clayton Act' (2010) 24 *Insights: The Corporate & Securities Law Advisor* 8, p. 10.

⁵⁸⁰ *Las Vegas Sun Inc v Summa Corp* 610 F2d 614 (9th Cir 1979). Also see *Copperweld Corp v Independence Tube Corp* 467 US 752 (1984)

who serve as their agents, onto the boards of companies they are targeting in a takeover attempt⁵⁸¹.

Additionally, the Act does not prohibit the practice if either of the companies represented by the interlocking directors only possesses competitive sales of less than US\$1 million⁵⁸². However, this does not infer that the companies below the stated thresholds can be complacent and ignorant of the significant need for internal due diligence processes in mitigating the corresponding risk within their respective corporate environment, especially if the relationship between the interlocking companies exhibits the potential to exceed this threshold in later years. The FTC's investigation of the overlapping directorial relationships between Apple and Google in 2009 exemplifies the argument that companies, which did not compete with one another at an earlier point, could become competitors in the future⁵⁸³. In this case, both Apple and Google had shared two directors, namely Eric Schmidt, who was the CEO of Google, and Arthur Levinson, a former CEO of Genentech, a biotechnology company⁵⁸⁴. During this time, both companies had collaborated to integrate the various Google technologies such as its search engine and Google Maps into Apple's iPhone. A couple of months after Apple launched the iPhone, Google unveiled its smartphone in November 2007, setting both companies on a collision course that transformed them into major competitors in the smartphone market⁵⁸⁵. This interlocking relationship, which triggered unfair and anti-

⁵⁸¹ See *Square D v Schneider S.A., SQD Acquisition Co* 760 F Supp 362 (SDNY 1991), where the District Court held that section 8 can also include entities apart from a director or an officer as long as the entities possess a form of business relationship with the acquiring company.

⁵⁸² Section 8 (§ 19 (a) (2) (a)) of Clayton Act 15 U.S.C.; Federal Trade Commission

⁵⁸³ Deborah L Feinstein, 'The Forward-Looking Nature of Merger Analysis' (Advanced Antitrust US, San Francisco); Miguel Helft and Brad Stone, 'Board Ties at Apple and Google Are Scrutinised' *New York Times*, 4 May 2009 <http://www.nytimes.com/2009/05/05/technology/companies/05apple.html?_r=0> accessed 21 September 2017

⁵⁸⁴ Sara Kehaulani Goo, 'Google Chief Schmidt Joins Apple as Director' *Washington Post*, 30 August 2006 <<http://www.washingtonpost.com/wp-dyn/content/article/2006/08/29/AR2006082901011.html>> accessed 22 September 2017. Also see Clifford Chance, 'Don't Get Tangled Up with Interlocking Directorates' [2013] *Corporate Compliance Insights*

⁵⁸⁵ The software features of these smartphones were also in competition with one another. For example, Google's Chrome and YouTube competed with Apple's Safari and iTunes. See Henry Blodget, 'Hey, Apple, Google Chrome is Kicking Safari's Ass' *Business Insider*, 4 May 2010 <<http://www.businessinsider.com/google-chrome-apple-safari-2010-5?IR=T&r=US&IR=T>> accessed 22 September 2017; Brad Stone, 'Google Chief Gives Up Board Seat at Apple' *The New York Times* (San Francisco, August 3, 2009) <<http://www.nytimes.com/2009/08/04/technology/companies/04apple.html>> accessed 21 September 2017; Steve Lohr and Claire Cain Miller, 'Scrutinizing Google's Reign' *The New York Times* (18 September

competition concerns from the FTC, had prompted both Mr. Schmidt and Mr. Levinson to resign from Apple and Google in 2009⁵⁸⁶.

Although the interlocking directorship prohibition under the Clayton Act attracts strict liability, the principal remedy sought by the federal enforcement agencies such as the Department of Justice ('DOJ') and the FTC often involves the elimination of the interlocking relationship through an injunctive relief application to the court securing the resignation of the interlocking directors rather than monetary fines or criminal prosecutions⁵⁸⁷. This suggests that the violation of the interlocking directorship prohibition only results in a rather mild legal sanction in comparison to the violation of other antitrust laws in the US and does little in mitigating the risk of anti-competitive behaviours between companies sharing similar directors⁵⁸⁸. Then again, a large number of public traded firms in the country have lately begun to limit the number of board directorships a director can hold⁵⁸⁹; which indeed highlights the feasibility of the law

2011) <<http://www.nytimes.com/2011/09/19/technology/googles-to-face-congressional-antitrust-hearing.html>> accessed 16 September 2017

⁵⁸⁶ Jessica E Vascellaro and Yukari Iwatani Kane, 'Schmidt Resigns His Seat on Apple's Board' *The Wall Street Journal*, 4 August 2009 <<https://www.wsj.com/articles/SB124930285423801287>> accessed 22 September 2017; Alexei Oreskovic, 'Levinson Quits Google Board, Appeasing FTC' Thomson Reuters, 12 October 2009 <<http://www.reuters.com/article/google-idCNN1212942920091012>> accessed 22 September 2017

⁵⁸⁷ Michael E Jacobs, 'Combating Anticompetitive Interlocks: Section 8 of the Clayton Act as a Template for Small and Emerging Economies' (2014) 37 *Fordham International Law Journal* 643, p. 674. Also see Finch, Ranade and Rubin, p. 8.

⁵⁸⁸ John G. Fingley, Joe Tringali and Michael Naughton, 'Federal Trade Commission Inquires into Interlocking Boards' *Harvard Law School Forum on Corporate Governance and Financial Regulation*, 15 May 2009 <<http://corpgov.law.harvard.edu/2009/05/15/federal-trade-commission-inquires-into-interlocking-boards/>> accessed 21 September 2017. Also see R. Miller, *Business Law Today, Comprehensive: Text and Cases: Diverse, Ethical, Online, and Global Environment* (Cengage Learning 2014), p. 891.

⁵⁸⁹ In a survey conducted by the Spencer and Stuart Board Index on S&P 500 boards between May 2015 to May 2016, 370 boards have limited their directors' ability to hold multiple directorships. Out of this, 305 boards have set a numerical limit on the number of directorships applicable to all directors – 15 have cap additional directorships at two; 110 at three; 122 at four, and 58 at five or six. The remaining 125 boards did not specify any limit but required the directors to notify the CEO in advance of accepting an invitation to join the BOD of other companies. See Spencer Stuart, 'Spencer Stuart Board Index 2016' <<https://www.spencerstuart.com/~media/pdf%20files/research%20and%20insight%20pdfs/spencer-stuart-us-board-index-2016.pdf>> accessed 3 September 2017, p. 15. Also see Benson and others, p. 1; C. Padgett, *Corporate Governance: Theory and Practice* (Palgrave Macmillan 2011); John A. Byrne, 'Listen Up: The National Association of Corporate Directors' New Guidelines Won't Tolerate Inattentive, Passive, Uninformed Board Members' *Business Week* (25 November 1996) 100 <<http://www.businessweek.com/1996/48/b35039.htm>> accessed 14 June 2017; National Association of Corporate Directors, 'Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies' National Association of Corporate Directors, 16 October 2008

despite its lax legal sanctions. Interestingly, it is arguable that such a flexibility can also provide the necessary support to new and emerging economic sectors such as Islamic banking⁵⁹⁰, which would require the services of interlocking *Sharia'* board members with proficiency in both the *Sharia'* law and banking in navigating the intricacies and technicalities of the banking industry – this issue, of course, will be dealt with in detail in the next chapter, which attempts to scrutinise the multiple *Sharia'* board directorship practice from both the *Sharia'* law and Islamic banking industry perspectives.

4.4 Conclusion

This chapter has discussed the theoretical and regulatory framework of the multiple board directorship practice from the western corporate governance perspective. As much as the practice brings various advantages to companies, it is prudent to note that the practice could also distract the directors and reduce their monitoring capability, which may jeopardise the board's ability to respond to nascent risks more effectively and thus affect a company's sustainability in the future. Although the multiple board directorship practice was not a major cause to the collapse of big financial institutions during the global financial crisis in 2008, the example of Wells Fargo's fraudulent accounts scandal and PNC's resilience during the market crash, suggest the significance of directors with less outside board commitments, especially those serving large and complex financial institution in the effort to preserve the safety and soundness of the financial system. The next chapter will discuss the theoretical and regulatory framework of the multiple *Sharia'* board directorship practice from the *Sharia'* law and Islamic corporate governance perspectives through a detailed scrutinisation of the concept of *Ijtihad* (independent reasoning), *Maslahah Al-Mursalah* (public interest), *Amanah* (trust), regulatory approaches of the AAOIFI and the IFSB, and common issues associated with the practice.

<http://www.ecgi.org/codes/documents/nacd_key_agreed_principles_16oct2008_en.pdf> accessed 22 September 2017, p. 7.

⁵⁹⁰ Apart from Islamic banking, the *Halal* industry also comprises the production and manufacturing of *Sharia'*-compliant products and services such as, *inter alia*, food retailing, restaurant chains, logistics and shipping, personal care products, drugs and vaccines. See Nazar Hussain and others, 'Global Halal Food Market and Opportunities for Pakistan' (2014) 2 International Journal of Education and Research, p. 4; Jacobs, p. 670; Ernst & Young, *World Islamic Banking Competitiveness Report 2012-2013* (Growing Beyond: DNA of Successful Transformation, 2012), op. cit; Dar and Azami, *Global Islamic Finance Report (GIFR) 2013*, p. 37.

CHAPTER 5: MULTIPLE *SHARIA'* BOARD DIRECTORSHIPS PRACTICE: THE *SHARIA'* LAW AND ISLAMIC CORPORATE GOVERNANCE PERSPECTIVES¹

5.0 Introduction

As much as the subject of interlocking directorship has attracted substantial attention and discussions within the Western corporate governance hemisphere², the practice, which only became noticeable in Islamic banking in the last two decades, remains a '*terra incognita*' in the Islamic corporate governance world. In fact, there remains a dearth of references, discussions, case law or empirical research dealing with the subject of interlocking directorates or multiple *Sharia'* board directorships; neither within the vast nor specific field of the *Sharia'* law such as *Fiqh Al-Muammalat* (Islamic law of commerce).³This renders the study of this subject challenging.

Indeed, there exists plenty of factors that can explain why the *Sharia'* scholars may agree to occupy multiple *Sharia'* board appointments. Similar to the benefits offered by the interlocking directorships practised in the Western corporate world, the practice yields attractive advantages to *Sharia'* scholars such as, *inter alia*, the opportunity for career advancement, improved social connections and access to sensitive information, a portal to reputation enhancement – and even *Fi Sabilillah* (for the sake of God)⁴. Apart from providing the IFIs with a valuable access to the network of highly experienced *Sharia'* scholars', which in turn, can assist the IFIs in recruiting additional or new *Sharia'* board members⁵, the practice also bestows the IFIs with credible sources that can strengthen

¹ A major segment of this chapter was presented at the International Conference on Islamic Leadership and Management 2016 on 6th August 2016 in Bandar Seri Begawan, Brunei Darussalam.

² Chiranga and Chiwira; Ferris, Jagannathan and Pritchard; Jiraporn, Kim and Davidson; Sarkar and Sarkar; Fich and Shivdasani

³ To date, the only empirical research ever conducted on the multiple *Sharia'* board directorship practice in Islamic banking was by Dr. Murat Unal in 2011. See Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*

⁴ Hassan and Lewis, p. 139; Mizruchi, p. 277; Fich and Shivdasani, p. 690; Ferris, Jagannathan and Pritchard, p. 1089; Fama and Jensen, 'Separation of Ownership and Control', p. 315.

⁵ Companies can utilise the networking contacts of the interlocking directors already serving on their BODs to recruit new directors. See Gerald F Davis, 'The Significance of Board Interlocks for Corporate Governance' (1996) 4 *Corporate Governance: An International Review* 154, p. 157; Christine Shropshire, 'The Role of the Interlocking Director and Board Receptivity in the Diffusion of Practices' (2010) 35 *Academy of Management Review* 246, p. 249.

the IFIs' *Sharia'* compliance framework through the acquisition of vital information from the other IFIs such as their business practices, market strategy, new Islamic financial products and services, and also Islamic banking *Fatwas* (*Sharia'* opinions)⁶. These can not only assist in the standardisation of *Sharia'* rulings on Islamic banking between the countries, but also save the time and costs customarily involved in exercising *Sharia'* compliance diligence, especially in one that involves complex Islamic banking products and services incorporating modern financial jargon and significant conjoint paperwork⁷.

As much as the occupation of multiple *Sharia'* board directorships can promote the achievement of these benefits, it is also arguable that these attractive perks not only entice the existing *Sharia'* scholars, but also the aspiring ones, in obtaining or retaining these positions for an objective peripheral to *Sharia'* compliance – to the extent that it can jeopardise the impartiality of the interlocking scholars and lead to the subjugation of the *Sharia'* compliance objective to one oriented by money and other worldly benefits⁸. At the same time, the appointment of *Sharia'* scholars with multiple *Sharia'* board directorships does not necessarily guarantee optimal *Sharia'* compliance monitoring of an IFI as it also broaches the crucial question of *quis custodiet ipsos custodiet* (who will guard the guardians themselves?), which if transposed to an Islamic corporate governance context means asking how one can ensure that the interlocking scholars can fulfil their fiduciary responsibilities without subordinating the interests of one IFI to that of another?⁹

Regardless of the reputation, the wealth of knowledge, and the experience that a scholar serving on multiple *Sharia'* boards can bring to an IFI, it can also interfere with the scholar's time commitment and attention to each and every IFI represented; thus, endangering the interests of both the shareholders and stakeholders at large. This is especially so in the case of top *Sharia'* scholars, who are often sought-after by the IFIs due to their social reputation which can serve as an effective marketing tool to enhance stakeholders' confidence and the IFIs' goodwill¹⁰. Correspondingly, the number of

⁶ Connelly and Van Slyke, p. 404-405; Harris and Shimizu, p. 792.

⁷ Farook and Farooq; International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 29.

⁸ Hassan and Lewis, p. 141.

⁹ Jean Dermine, 'Bank Corporate Governance, Beyond the Global Banking Crisis' (2013) 22 *Financial Markets, Institutions & Instruments* 259, p. 268.

¹⁰ Asa Fitch, 'Islamic Finance Industry Needs More Experts' *The National* (United Arab Emirates, 12 April 2011) <<https://www.thenational.ae/business/islamic-finance-industry-needs-more-experts-1.432713>>

distractions that increases along with the number of *Sharia'* board's representation can significantly affect the monitoring intensity of a scholar¹¹. Moreover, several pieces of empirical research on the subject have discovered that the accumulation of board directorships presented additional constraints to directors, or in this case, the *Sharia'* board members, from acting as effective monitors to the IFIs¹². In the event a *Sharia'* compliance problem occurs, interlocking *Sharia'* board members will not only have to prepare themselves to devote a huge amount of time in resolving the conflict, but also the prospect of forsaking their fiduciary obligations to other IFIs. Since the *Sharia'* board serves as a *Sharia'* compliance monitor of the IFI's financial operations, it is arguable that the multiple *Sharia'* board directorship practice can not only cause significant difficulties to the *Sharia'* scholars in fulfilling their fiduciary obligations to the IFI, but can also lead to an overly-committed *Sharia'* board if it comprises a substantial number of interlocking *Sharia'* scholars – which can translate into the IFI experiencing a decline in the quality of its corporate governance oversight¹³.

In this regard, it is important to realise that *Sharia'* law does not prescribe a specific figure as to the number of *Sharia'* board directorships an IFI's *Sharia'* scholar can hold at one time¹⁴. There has yet to emerge any case law, reports, or news coverage that provide sufficient evidence of the occurrence of mismanagement or malpractices by interlocking *Sharia'* scholars as a result of the application of the practice¹⁵. Likewise, there neither exists a specific *Fatwa* nor any empirical researches that has analysed the legality of the practice from the *Sharia'* law perspective. Nonetheless, these uncertainties cannot serve as valid excuses to hold any attempts to scrutinise the *Sharia'* compliance of the practice

accessed 1 September 2017; Siddiqui, ; Michael JT McMillen, 'Islamic Capital Markets: Developments and Issues' (2006) 1 *Capital Markets Law Journal* 136, p. 140; E Zighaba, *The Boards of Fatwa and Shari'a Supervision in Islamic Financial Institutions: Their Importance, Restrictions, and Recommended Solutions* (Prentice-Hall 2009)

¹¹ Fich and Shivdasani, p. 692.

¹² Ibid, p. 722. Also see Samy Nathan Garas, 'The Conflicts of Interest Inside the Shari'a Supervisory Board' (2012) 5 *International Journal of Islamic and Middle Eastern Finance and Management* 88; Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System'; Sleiman and Vizaino

¹³ Fich and Shivdasani, p. 722. Also see Wilson, *The Development of Islamic Finance in the GCC*, p. 10; Sleiman and Vizaino

¹⁴ IFI's *Sharia'* scholars, who occupy more than three *Sharia'* board directorships can fall into the definition of busy directors. See Ferris, Jagannathan and Pritchard, p. 1094.

¹⁵ Siddiqui, , p. 36.

and its consequential effects to the development and stability of the global Islamic banking industry as unnecessary.

Additionally, it is arguable that the legal and ethical status of the practice under *Sharia'* law transcend the realms of *Halal* (permissible) and *Haram* (forbidden) due to the absence of definite sources that can neither suggest the practice as *Sharia'*-compliant nor *Sharia'* non-compliant. As a result, the determination of its status may comprise areas that remain understudied and unaccounted for within the Islamic corporate governance sphere. Hence, this chapter will attempt to scrutinise the practice from several relevant *Sharia'* law doctrines, namely: the *Sharia' Hukum* (*Sharia'* ruling) of *Fardh Ain* (mandatory obligation) and *Fardh Kifayah* (collective obligation), which neither judge a matter as right nor wrong but rather differentiate on the basis of what is right and what is the rightest¹⁶; *Ijtihad* (independent reasoning); *Maslahah Al-Mursalah* (public interest) and *Amanah* (trust). Since the practice remains a subject of *Ikhtilaf* (difference of opinions) under the *Sharia'* law, it is arguable that this method can serve as the best way to assess a delicate issue such as the multiple *Sharia'* board directorship practice. Additionally, the chapter will also explore several common issues associated with the practice such as the shortage of *Sharia'* scholars, attendance of *Sharia'* scholars in meetings, solicitation of *Sharia'* board directorships, and the remuneration of *Sharia'* scholar in providing a different dimensional analysis of the practice from the *Sharia'* law lens.

5.1 The 'Fardh Ain (Mandatory Obligation) and Fardh Kifayah' (Collective Obligation) Argument

In the last 10 years, the subject of multiple *Sharia'* board directorships has developed into a controversial topic in Islamic banking. From a potential conflict of interest issue to the scholar's ability in executing his or her fiduciary responsibilities to the IFI, the practice has placed the integrity of the *Sharia'* board as an effective *Sharia'*-compliant filtration mechanism under serious scrutiny from other *Sharia'* scholars, industry critics and fellow members of the academia. The crucial question, therefore, does not only revolve around the issue of the IFI's responsibility in regulating the practice among its *Sharia'* board's

¹⁶ Imam Suyuti opined that *Ikhtilaf* is between what is right and what is rightest; not what is right against what is wrong. See Sheikh Jum'ah Amin Abdul Aziz, *Fahmul-Islam Fi Dzilali Al-Usul Al-'Isyrin* (published in Alexandria, Dar Al-Da'wah 1990). Also see the discussions on *Fardh Ain* and *Fardh Kifayah* in *As-Sa'di*

members, but also the fulfilment of due diligence by interlocking *Sharia'* board members to their respective IFIs.

Then again, *Sharia'* law does not contain any clear ruling that permits or forbids such a practice. In the absence of an explicit *Sharia'* ruling, the practice of multiple *Sharia'* board directorships remains one of *Zanniy* (speculative) and hence open to *Ikhtilaf* (difference of opinions). In other words, this inconclusive circumstance has rendered the stated practice as permissible according to the doctrine of *Mubah* as long as it is *Tayyib* (good or beneficial) towards the industry¹⁷. On the other hand, it is arguable that the practice of multiple *Sharia'* board directorships may have also originated from the legal status of *Ijtihad* (independent reasoning) under *Sharia'* law itself. This renders it imperative for the thesis to scrutinise the views and perspectives of *Sharia'* law in regard to *Ijtihad* in providing a comprehensive assessment of the practice in discussion.

Accordingly, *Sharia'* law regards *Ijtihad* as a *Fardh Kifayah*¹⁸. Contrary to *Fardh Ain* that mandates the performance of an obligation on every member of the society¹⁹, *Fardh Kifayah* is a collective duty, of which the fulfilment by a sufficient number of individuals excuses the other individuals from performing it. Consequently, if the society fails to find a member, who can perform a *Fardh Kifayah* obligation, the *Sharia'* law will hold every member of the community accountable to the God in the Hereafter²⁰. For example, if a person dies but not a single member of the community can administer his funeral

¹⁷ (*Surah Al-Ma'idah* 5:87) of Ali. Also see discussion on *Mubah* at p. 18-20.

¹⁸ Ibrahim, p. 11; Mohamed A Abdelaal, 'Taqlid v. Ijtihad: The Rise of Taqlid as the Secondary Judicial Approach in Islamic Jurisprudence' (2012) 14 *The Journal of Islamic Jurisprudence* 151, p. 170. Also see Aznan Hasan, 'An Introduction to Collective Ijtihad (Ijtihad Jama'i): Concept and Applications' (2003) 20 *The American Journal of Islamic Social Sciences*, p. 28.

¹⁹ Examples of *Fardh Ain* are, *inter alia*, the five daily prayers; fasting during the holy month of *Ramadhan*; *Zakat*; *Hajj*; obedience to parents; and seeking knowledge. See Abdus Salaam Al-Barjis, 'Treading the Path of Knowledge' (Islamic lecture, Birmingham, 1996) <<http://www.salafipublications.com/sps/downloads/pdf/SCL020007.pdf>> accessed 22 September 2017, p. 2. Also see Yusuf al Qardawi, *As-Shahwatul Islamiyah Ru'yatu Nuqadiyatu min al-Daakhili (The Rise of Islam According to Scholar's Discussion)* (Julizar Firmansyah ed, published in Jakarta, 1st edn, Gema Insani Press 1998), p. 72.

²⁰ M.H. Daud, *Konsep Fardhu Kifayah (The Concept of Fard Kifayah)* (Jabatan Kemajuan Islam Malaysia (JAKIM) 2000); Amir A. Rahman, *Pengantar Tamadun Islam (Preface to Islamic Civilisation)* (published in Kuala Lumpur, Dewan Bahasa dan Pustaka 1991)

according to the appropriate rites under the *Sharia'* law, the liability shall rest with every member of the society²¹.

However, it is observed that the *Sharia'* position of *Ijtihad* can actually vary from one circumstance to the other. In other words, the presence of specific factors in a particular circumstance can influence the *Hukm* of *Ijtihad*, which in turn, can vary between *Fardh Kifayah*, *Fardh Ain*, *Mandub*, or *Haram*²². To illustrate, an *Ijtihad* becomes a *Fardh Ain* when a *Sharia'* scholar needs to decide on a personal issue; the *Hukm* which will only apply to him, or when there exists no other scholar, who can issue the *Hukm* of a particular issue apart from himself²³.

On the other hand, an *Ijtihad* becomes a *Fardh Kifayah* when there exists a number of equally competent scholars, who can decide the *Hukm* of a particular *Sharia'* issue. Here, the assumption of the responsibility of *Ijtihad* by a scholar will absolve the other scholars from a similar undertaking. However, if none of the scholars are willing to undertake the *Ijtihad*, the onus will rest on every scholar in the community. This deduction corresponds with the opinion of both the contemporary and traditional *Sharia'* scholars such as, *inter alia*, Sheikh Dr. Yusuf Al-Qardawi and Imam Al-Suyuti, who opined that if a society or a country fails to find a competent *Sharia'* scholar to exercise *Ijtihad* and issue *Fatwa* correspondence, the legal position of *Ijtihad* will evolve from a *Fardh Kifayah* to a *Fardh Ain*²⁴. In other words, what was then an optional obligation will now transform into a mandatory one.

From a different angle, an *Ijtihad* can also become *Mandub* if the *Ijtihad* seeks to decide the *Hukm* of a foreseeable issue that has yet to occur. Finally, an *Ijtihad* becomes *Haram* if applied to matters that have already reached the status of *Qat'i* (definitive) under *Sharia'* law²⁵. As the *Sharia'* position of *Ijtihad* fluctuates according to the different

²¹ Other examples of *Fardh Kifayah* include feeding the poor; attending the congregational prayers; and paying the sick a visit.

²² See the discussion on *Al-Ahkam Al-Khamsah* at p. 18-20 in Chapter 2.

²³ Al-Qurtubi, p. 216; As-Sa'di

²⁴ Ibrahim, p. 11; Hasan, 'An Introduction to Collective Ijtihad: Concept and Application', p. 28. Also see Jalal al-Din Suyuti, *Kitab Al-Radd 'Ala Man Akhlada Ila Al-Ard Wa-Jahila Anna Al-Ijtihad Fi Kull 'Asr Fardh (Refutation of Those Who Cling to the Earth and Ignore That Scholarly Striving is a Religious Obligation in Every Age)* (published in Beirut, Dar Al-Kutub Al-'Ilmiyyah 1983); As-Sa'di

²⁵ Muhammad Sayyid Tantawi, *Konsep Ijtihad dalam Hukum Syarak (Al-Ijtihad fil Ahkam Al-Syariah)* (Safri Mahayedini tr, 2nd edn, Institut Terjemahan Negara Malaysia 2009), p. 13; M. Kamrava, *The New Voices of Islam: Rethinking Politics and Modernity : a Reader* (University of California Press 2006), p. 79.

features of each case, it presents a tricky issue in determining the actual *Hukm* of the multiple *Sharia'* board directorship practice in question. Hence, the thesis will examine the factors set out below from both the present Islamic banking practices and the *Sharia'* law context in suggesting a reasonable *Hukm* of the occupation of multiple *Sharia'* board directorships within the industry.

5.2 The Self-Burdening Effort of *Ijtihad* (Independent Reasoning)

“And before thee also the messengers We sent were men, to whom We granted inspiration: if ye realise this not, ask of those who possess the Message (i.e. the *Sharia'* scholars)”.

(*Surah Al-Nahl* 16:43)

In general, *Ijtihad* forms an integral component of the Islamic banking industry in cognisance of its proximity to the *Fatwa* issuance processes of an IFI. It allows the IFI's *Sharia'* board to issue *Fatwas* that either legitimise or illegitimise a financial product or service as one that adheres or infringes the precepts of the *Sharia'* law. Linguistically, *Ijtihad* originates from the Arabic root word of *jahada*, which carries two distinct meanings²⁶. On one hand, it refers to *juhd*, which means “an effort or an exercise to arrive at one's own judgment”²⁷. On the other, Ibn Mandzur, a prominent North African Arab lexicographer of the Arabic language, referred to it as ‘a difficulty or hardship’²⁸.

Although these meanings contradict one another, Raghīb Al-Isfahani, an 11th century *Sharia'* scholar of Quranic exegesis and Arabic language, had combined the two contradictory terms and introduced an interesting and prudent technical definition of *Ijtihad* – “a self-burdening effort that involves the exhaustion of energy and intellect for a specific purpose”²⁹. *Sharia'* scholars such as Imam Al-Ghazali and Al-Baidawi construed it as the complete exertion of effort by a *Sharia'* jurist in obtaining religious rulings³⁰.

²⁶ M. Khadduri, *War and Peace in the Law of Islam* (Lawbook Exchange Ltd 2010), p. 55.

²⁷ Doi, p. 78.

²⁸ Ibn Manzur and Muhammad Ibn Al-Mukarram, *Lisan Al-'Arab (The Arabic Speech) (15 Vols)*, vol 2 (published in Beirut, Dar Ehia Al-Tourath 1999), p. 395.

²⁹ Yusuf Al-Qaradawi, *Fiqh Jihad* (PTS Islamika 2009), p. 4. Also see Doi, p. 78.

³⁰ Al-Ghazali and Muhammad Abu Hamid, *Al-Mustasfa* (Dar al-Kutub Al-'Ilmiyyah 1992), p. 350. Also see Nasiruddin Al-Baidawi, *Minhaj Al-Wusul Ila 'Ilm Al-Usul*, vol 3 (Matba'ah Muhammad Ali Sabih n.d.), p. 191.

Imam Al-Zarkashi, on the other hand, opined that *Ijtihad* involves the application of a series of methods in extracting the relevant justification from the sources of *Sharia'* law that will lead to the realisation of a *Sharia'* ruling, which can either constitute one of *Qat'i* (definitive) or *Zanni* (speculative)³¹.

Alternately, it is arguable that *Ijtihad* constitutes an intellectual process that not only demands an optimum effort from the jurist, but also the exhaustion of all possible mental and material faculties in arriving at a prudent *Sharia'* ruling – to the extent that he or she could not pursue the issue any further. In reality, *Ijtihad* is akin to the practice used by the civil law judges in extracting reasoning or justification from the existing legislations. Thus, it is arguable that *Ijtihad* connotes the act of being earnest and meticulous in one's conduct, which is not confined to the religion of Islam.

5.2.1 Origin of *Ijtihad*

In essence, the requirement of *Ijtihad* as a juristic method in resolving a *Sharia'* law issue emerged immediately after the demise of Prophet Muhammad (p.b.u.h.). Although the Muslims believe that Prophet Muhammad (p.b.u.h.) received the Holy Quran through gradual revelations from God and his demise infers the completion of his divine mission to spread the religion of Islam, the completion or rather the cessation of the important sources of *Sharia'* law, namely the Holy Quran and the Sunnah, has also stirred unrest within the Muslim community, who began to confront new problems that involved deeper and more complex issues. Moreover, the problematical emergence of *Ikhtilaf* in *Fiqh* had also begun to develop during the reign of Umar Al-Khattab due to the migration of the learned Companions of the Prophet to regions outside of Madinah for missionary assignments³². This had substantially exposed the Muslims to a multitude of issues of divergent nature as a result of the expansive range of *Ikhtilaf*. Consequently, these disconcerting circumstances had given rise to the practice of *Ijtihad*, which not only presents the public with a feasible medium to find answers to their daily problems, but

³¹ Muhammad Ibn Yusuf al-Andalusi Abu Hayyan, *Tafsir al-Bahr al-Muhit*, vol 3 (published in Beirut, Dar al-Qutub al-'Ilmiyya 1993), p. 281; Abd al-Rahim ibn al-Hasan Isnawi, *Nihayat Al-Sul fi Sharòh Minhaj al-wusul ila ilm Al-usul lil-Qadi Nasir Al-Din Al-Badawi Al-Mutawaffa*, vol 2 (Abd Allah ibn Umar Baydawi ed, al-Tabah 1 edn, Dar al-Kutub al-'Ilmiyah 1999), vol. 2, p. 232. Also see Ṭāhirulqādrī

³² Walī Allāh Al-Dihlawī and Wali Allah Shah Dehlawi, *Al-Insaf Fi Bayan Sabab Al-Ikhtilaf (Difference of Opinions in Fiqh)* (Muhammad Abdul Wahhab tr, Ta-Ha 2003); Masud, p. 67.

also practical solutions that accord substantial consideration to the natural presence of variable factors such as social, economic, political, or cultural backgrounds³³.

5.2.2 ***Dalil (Sharia' Commandment) on Ijtihad***

Apart from the provision mentioned above, there also exists other *Dalil* that advocate the application of *Ijtihad* in resolving complex and challenging *Sharia'* issues or disputes. According to Imam As-Shafie, the following provisions of the Holy Quran provide an implied and prudent obligation on the significant role of *Ijtihad* in mankind's life³⁴:

"Those who hearken to their Lord, and establish regular prayer; who (conduct) their affairs by mutual consultation³⁵; who spend out of what we bestow on them for sustenance".

(*Surah Al-Shura* 42: 38)

"...therefore take a lesson, O you who have eyes!"

(*Surah Al-Hasyr* 59:2)

"...Wherever you go, turn your face in the direction of the Sacred Mosque, and wherever you may be, turn your faces in its direction..."

(*Surah Al-Baqarah* 2: 144)

Accordingly, he argued that the direction and location of the Sacred Mosque in Mecca, Saudi Arabia will remain unknown if one fails to exercise one's intellect. In other words, the above provision presents an indirect injunction from the Holy Quran that encourages mankind to exercise their faculty of reasoning in deriving a logical solution to the issues at hand. As much as *Sharia'* law does not provide the solution to every matter, the *Sunnah* only recommends the exercise of *Ijtihad* after due recourse to both the Holy

³³ Kamali; Mohamed Nachi, 'Thinking about Ikhtilâf: The Political Construction of Difference in the Islamic Context' (2012) 2 History of the Present 52, p. 61.

³⁴ Imam Muhammad Idris Shafi'i, *Ar-Risala Fi Usul Al-Fiqh (Treatise on the Foundations of Islamic Jurisprudence)* (Majid Khadduri tr, 2nd edn, The Islamic Texts Society 1961), p. 295-303.

³⁵ According to the Muslims' beliefs, *Ijtihad* presents an ideal way, in which a man should conduct their affairs, so that, on one hand, he may not become too egotistical, and on the other, he may not lightly abandon the responsibilities bestowed upon him as a personality whose development counts in the sight of God. This principle was applied to its fullest extent by the Prophet Muhammad (p.b.u.h.) in both of his private and public life, and was fully acted upon by the early caliphates of Islam. Modern representative government is an attempt – by no means perfect – to apply this principle in state affairs. See Ali

Quran and *Sunnah* fails to provide a feasible solution³⁶. This is exemplified in the following *Hadith*, where the Prophet Muhammad (p.b.u.h.) asked Muadh bin Jabal a series of questions before dispatching him to Yemen:

*“How will you judge when the occasion of deciding a case arises?” He replied, “I shall judge in accordance to the book of God (Holy Quran).” The Prophet asked, “If you do not find any solution in the book of God?” He replied, “I will refer to the Sunnah of the Prophet.” The Prophet asked, “If you do not find any solution in neither of them?” He replied, “I shall exercise *Ijtihad* to my best effort in forming my own reasoning within the limits of both the book of God and Sunnah of His Prophet.” Then, the Prophet patted him on the breast and said, “Praise be to God, who has granted wisdom to the messenger of His messenger”³⁷.*

In a similar *Hadith*, Maimun bin Mahran stated that whenever Abu Bakar As-Siddiq, the first caliph, encountered a dispute, he would always refer to the Holy Quran and the *Sunnah*. If he could not find a *Dalil* in either of them, he would assemble the *Sharia'* scholars and ask for their collective opinions³⁸. Umar Al-Khattab had also adopted a similar approach and urged the application of *Qiyas* (analogical deduction) in *Ijtihad* in ensuring that its outcome stays within the ambit of *Sharia'* law teachings³⁹.

5.2.3 Application and Limitation of *Ijtihad*

In regard to the application of *Ijtihad*, the majority of *Sharia'* scholars from the four major schools of Islamic jurisprudence have agreed to restrict the application of *Ijtihad* to non-*Ibadat* matters such as *Muammalat*, ablution, the signs of Judgment Day, and the following perimeters. First, when there exists *Zanni* (speculative) textual rulings in the Holy Quran and *Sunnah* due to the presence of different *Dalalah* (meaning) or *Riwayah* (transmission), the scholars can execute *Ijtihad* to determine the correct interpretation

³⁶ Muhammad Ibn Idris Al-Shafi'i, *Al-Umm* (published in Beirut, Dar al-Ma'rifah 1990), vol. 7, p. 272; Doi

³⁷ This *Hadith* is *Da'if* (Al-Albani). See Book 25, *Hadith* 22 of Dawud and Ibn Al-Ashcath. Also see Vol. 3 of *Al-Tirmidhi*; *Al-Jawziyah*

³⁸ This was also narrated by Ad Darimi and Al Baihaqi, and Al Hafiz Ibnu Hajar stated that the chain of narration is *Sahih*. See *Al-Jawziyah*, vol. 1, p. 64-65. Also see Ibn Hajar and Ahmad Ibn Ali, *Fath-Al-Bari* (Dar Al-Marifah 1985); Sulayman ibn Ahmad Al-Tabarani, *Al-Mu`jam Al-Saghir* (Suyuti al and others eds, al-Tab`ah 2 edn, Dar al-Fikr 1981)

³⁹ *Al-Jawziyah*, vol. 1. p. 85; Saim Kayadibi, 'Ijtihad by Ra'y: The Main Source of Inspiration Behind Istihsan' (2007) 24 *American Journal of Islamic Social Sciences* 73, p. 76, 78.

that harmonises with the objectives and higher purposes of *Sharia'* law. Second, when there is no *Nass* (clear injunction) or *Ijma* pertaining to the *Sharia'* ruling of a particular issue. However, the application of *Ijtihad* in this circumstance must employ the principles of *Maqasid As-Sharia'* as the guiding factor; this is known as *Ijtihad Bi Al-Rai* (*Ijtihad* founded in opinion). Third, when the existing rules of *Fiqh* cannot serve the higher objectives of *Sharia'* law after considering the influence of variable factors such as social, economic, political, or cultural backgrounds⁴⁰.

On the other hand, *Sharia'* law does not permit the application of *Ijtihad* on *Ibadat*-related matters because both the Holy Quran and *Sunnah* had since provided clear injunctions over a diverse range of issues related to *Ibadat*, which have reached the level of *Qat'i* within the teachings of the four major schools⁴¹. For example, there already exists strong *Dalil* within these primary sources of *Sharia'* law that support the determination of matters such as the existence of God, the truth of His prophets, and the authenticity of the Holy Quran⁴². Further, Sheikh Waliullah Dehlavi, a prominent 18th century Muslim writer, opined that the exercise of *Ijtihad* must not contradict the religious stance and opinions of the four major schools to avoid the emergence of a new school of jurisprudence, which could confuse the public and lead to the misinterpretation of *Sharia'* law as a whole⁴³. Altogether, these limitations serve to restrict the *Ijtihad* of the modern *Sharia'* scholars to an established set of jurisprudential disciplines instead of one of arbitrary.

5.2.4 Qualification to Practice *Ijtihad*

Since interpreting *Sharia'* law demands an in-depth understanding of vast areas of *Fiqh*, the majority of *Sharia'* scholars such as Ibn Al-Humam and Sheikh Wahbah Al-Zuhaili, resolved that only a scholar who has reached the qualification of a *Mujtahid* can issue a *Fatwa*⁴⁴. This infers that the members of the public and those who merely possess

⁴⁰ Muhammad Hashim Kamali, 'Source, Nature and Objectives of Shari'ah' (1989) 33 *Islamic Quarterly* 215, p. 225.

⁴¹ *Ibid*, p. 225; Kamrava, p. 79.

⁴² Doi, p. 78. "And if you are in doubt as to that which We have revealed to Our servant, then produce a chapter like it and call on your witnesses besides God if you are truthful. But if you do (it) not and never shall you do (it), then be on your guard against the fire of which men and stones are the fuel; it is prepared for the unbelievers". See (*Surah Al-Baqarah* 2:23-24) of Ali. Also see Tantawi, p. 3.

⁴³ Tāhirulqādrī, p. 35.

⁴⁴ Ibn Al-Humam, 'Al-Tahrir Fi Usul Al-Fiqh (Liberalisation in the Principles of Jurisprudence)' in Muhammad Amir Amir Badishah (ed), *Taysir Al-Tahrir* (published in Cairo, Mustafa Al-Babi Al-Halabi n.d.),

intermediary knowledge of the *Sharia'* law such as the *Imams* (head of local community mosque) and religious teachers cannot exercise *Ijtihad* in their personal capacity. However, *Sharia'* scholars such as Jalaluddin Al-Mahalli opined that it would suffice if a *Mufti* or *Ulama* possesses adequate knowledge of the religious stance of his own school and is able to evaluate its divergent views⁴⁵. Moreover, *Imam* Al-Shawkani argued that limiting the exercise of *Ijtihad* only to those who fulfil the criteria of a *Mujtahid* will serve as a counter-productive condition, which could lead to the delinquency and failure of the *Fatwa* institution itself⁴⁶.

As for the general public or those who do not possess the adequate capacity to practice *Ijtihad*, Ibn Taymiyyah proposed the application of *Taqlid*, or the adoption of the *Ijtihad* of those who qualified as a *Sharia'* scholar or *Mujtahid*⁴⁷. In one way, *Taqlid* functions as a counter-measure that prevents a person from engaging in the turbulence of thought between the different schools of Islamic jurisprudence. On the other, it counterbalances the prospect of confusion and destruction of a person's faith through the adoption of the teachings of a specific school, which presents a more convenient discourse⁴⁸.

In general, *Sharia'* law is silent on the qualifications required of a *Mujtahid*. *Sharia'* scholars such as Uthman Ibn Khurrazadh suggested the following subjective but rigid criteria of a *Mujtahid*, "*The person associated to Hadith is in need of five qualities, and if one of them is lost then it is considered a deficiency; he is in need of a good mind, piety, precision, proficiency in this field, as well as being well known for his trustworthiness*"⁴⁹. However, other *Sharia'* scholars such as Imam Al-Ghazali, Al-Shatibi, Al-Baidawi, and

vol. 3, p. 341. Also see Al-Zuhaili; Umar Sulaiman Al-Asyqar, *Tarikh Al-Fiqh Al-Islami* (published in Amman, Dar Al-Nafais 1991), p. 11-17.

⁴⁵ Jalaluddin Al-Mahalli, *Jam' Al-Jawamir*, vol 2 (Dar Ihya Al-Kutub Al-Arabiyah n.d.), p. 425.

⁴⁶ Muhammad Ibn 'Ali Al-Shawkani, *Irshad Al-Fuhul Ila Tahkik Al-Hak Minal Ilmu Usul (Guidance for the Luminaries to Achieving the Truth in the Sciences of the Principles of Law)* (1 ed. edn, Dar Al-Kutub Al-Ilmiyah 1999), p. 270.

⁴⁷ Zainal Abidin, 'Corak Pemikiran dan Metode Ijtihad Ibn Taymiyyah (Pattern of Thought and Ijtihad Method of Ibn Taymiyyah)' [2010] Millah Edisi Khusus, p. 39; Greg Fealy and Greg Barton, *Nahdlatul Ulama, Traditional Islam and Modernity in Indonesia* (Monash Asia Inst 1996). Also see Al-Jawziyah, vol. 2, p. 188.

⁴⁸ Ridzwan Ahmad, 'Liberalism in Fiqh Madzhab Shafie Understanding: Reality and Phenomena in Malaysia' (2007) 4 Jurnal Fiqh 119; Mahyuddin Abu Bakar and Azman Md Zain, 'Konsep Bertaklid Dalam Islam (The Concept of Taqlid in Islam)' (2005) 6 Jurnal Pengajian Umum Asia Tenggara 71, p. 75.

⁴⁹ Shaykh Bakr Aboo Zayd, Shaykh Muhammad Bin Saalih and Bin Al-Uthaymeen, *The Etiquette of Seeking Knowledge* (published in Birmingham, Al-Hidaayah Publications 2000), p. 40.

Al-Amidi suggested that a competent *Mujtahid* must satisfy a set of two criteria. According to Imam Al-Ghazali, a *Mujtahid* must exhibit not only a satisfactory proficiency in the sources of *Sharia'* law such as the Holy Quran, *Sunnah*, and *Ijma'*, among other sources, but also the ability to utilise them according to their hierarchy of authority in generating a firm *Fatwa* to a particular *Sharia'* issue⁵⁰. Additionally, the scholar must also possess the cardinal virtues of fairness and impartiality, which Al-Ghazali had prescribed as a precondition that renders a *Fatwa* as obligatory on the society. In a similar context, if a *Mujtahid* does not possess such virtues, the society can opt to either adopt or omit his *Fatwas*.

Likewise, Imam Al-Shatibi prescribed that a *Mujtahid* must possess a detailed understanding of the objectives and structure of *Hukm* (legal rule) of *Sharia'* law and the ability to decide and issue a *Fatwa* accordingly⁵¹. Al-Baidawi and Al-Amidi, on the other hand, demanded that a *Mujtahid* must be a *mukallaf* (free from undue influence) and knowledgeable of the sources of *Hukm* and its divisions under *Sharia'* law such as *Hukm Taklifi* (prescriptive law) and *Wad'ei* (descriptive law)⁵². Although the scholars differ in regard to the knowledge and skills required of a *Mujtahid*, it is arguable that their descriptions correspond to the following common traits of a qualified *Sharia'* scholar:

- (a) Well versed in the study of the Holy Quran. He or she must possess the knowledge in the area of *Asbab Al-Nuzul* or the justifications behind the revelation of the verses and chapters of the Holy Quran;
- (b) Well versed in the study of the *Sunnah*. He or she must master the sciences of *Hadith* and be able to comprehend the distinction between the various classification of *Hadith* such as *Marfu'* (attributed to the Prophet Muhammad (p.b.u.h.)), *Mawquf* (attributed to a Companion), *Maqtu* (attributed to a successor of the Companion), *Mutawattir* (successive), *Mashur* (well-known), *Sahih* (authentic), *Hasan* (good), *Daif* (weak), and *Qudsi* (a direct quotation of God's words);
- (c) Knowledge of *Ijma*, *Qiyas*, and other secondary sources of *Sharia'* law such as *Istihsan* (juristic preference), *Maslahah Mursalah* (public interest), *Sadd Al-Dzariah*

⁵⁰ Al-Ghazali and Abu Hamid, p. 102.

⁵¹ A Al-Shatibi, *Al-Muwafaqat Fi Usul Ash-Shariah (4 volumes)* (published in Cairo, Al-Maktabah Al-Tawfiqiyah 2003), p. 105-106.

⁵² Al-Amidi, p. 139. Also see Abd Al-Rahman Ibn Al-Hasan Al-Isnawi, *Al-Tamhid Fi Al-Takhrij Al-Furu' 'Ala Al-Usul (Introduction to the Derivation of Branches From the Original Sources)* (3rd edn, Muassasat Al-Risalah 1984), p. 526.

(prohibition of lawful means that can lead to unlawful ends), *Qawl Al-Sahabi* (opinion of the Prophet's Companions), *Shar Man Qablana* (earlier scriptures), *Urf* (customary practices), and *Istishab* (presumption of continuity)⁵³.

5.2.5 *Ijtihad* in Islamic Banking *Vis-à-Vis* Multiple *Sharia'* Board Directorships

5.2.5.1 Attendance of *Sharia'* Scholars in Meetings

In contrast to the exercise of *Ijtihad* in determining the *Sharia'*-compliant status of common subjects such as food and drinks, *Ijtihad* in Islamic banking possesses its own controlling mechanism and *modus operandi* in determining the accuracy of the solution suggested to a particular *Sharia'* issue. In the past few decades, the process of *Ijtihad* in the industry has encountered various developments. Previously, it was common for individual *Muftis* and *Sharia'* scholars to perform *Ijtihad* on *Fiqh Al-Muamalat* issues relative to the small size of the industry. However, as the industry becomes more developed and sophisticated to accommodate the increasing complexities of the customers' demands, which vary from one region to another, most IFIs have already established an *Ijtihad* mechanism that issues Islamic banking *Fatwas* according to the majority decision of the *Sharia'* scholars in a *Shura* council established at the IFI level; else known as the *Sharia'* board.

Although this method can guarantee a better selection of *Sharia'* decisions reached by the *Sharia'* board members due to the 'collective wisdom' offered by the *Shura* system, it is reasonable to argue that the multiple *Sharia'* board directorship practice has also raised a cause for concern of the quality and integrity of Islamic banking *Fatwas*, especially those issued by independent *Sharia'* scholars with interlocking *Sharia'* board directorships or an Islamic bank's *Sharia'* board with the majority of its members holding multiple *Sharia'* board directorships, considering the limited length of time they can allocate to the affairs of each IFI represented. Interlocking *Sharia'* board members, undoubtedly, can offer the IFIs persons with complementary skills and the ability to work well with the Chief Operating Officer ('CEO') and the IFI's management. At the same

⁵³ Doi, p. 79; Lahsasna, *Introduction to Fatwa, Shariah Supervision & Governance in Islamic Finance*, p. 37-65. Additionally, Imam Al-Ghazali had also added the element of 'justice or fairness' to these general requirements of *Ijtihad*. See Al-Ghazali and Abu Hamid, p. 102. Also see Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, vol. 2, p. 1044.

time, a well-functioning *Sharia'* board does not merely require the *Sharia'* board members to turn up for the *Sharia'* board meetings, but also to devote sufficient time and attention to the IFI's affairs. This may appear unrealistic to those with interlocking *Sharia'* board positions, whose time commitment to the affairs of each IFI decreases as the number of their interlocking board positions increases⁵⁴.

While there has yet to exist any empirical research on the correlation between multiple *Sharia'* board directorship practice and the *Sharia'* scholars' attendance at the *Sharia'* board meetings, it is practical to argue that multiple *Sharia'* board appointments also translates into additional corporate responsibilities, which can inflict substantial fatigue and stress on the scholars, thus casting doubt on their fitness to attend and perform at meetings⁵⁵. Also, the occupation of too many *Sharia'* board directorships may bore the *Sharia'* scholars and contribute to a lower attendance rate that can further lead to a deficit in the *Sharia'* compliance reviewing process⁵⁶. Although a minimal absenteeism of *Sharia'* scholars may not render a *Sharia'* board meeting unproductive, the unavailability of a few, especially the interlocking ones with vast industrial experience, can leave the *Sharia'* board short of critical inputs and perspectives that can contribute to better *Sharia'* decisions. The employment of video-conferencing technology can provide a useful virtual platform for an effective *Sharia'* board meeting, which can also smooth the way for those impeded by travel distance, time, cost, and even external corporate commitments⁵⁷. However, facilitating complex discussions and debates without meeting participants sitting in the same room can prove a challenge as face-to-face meetings inspire more social contacts, encourages greater challenge between the participants, and a better attention to the meeting agenda than a virtual meeting, which renders the

⁵⁴ Adams and Ferreira, p. 228, 231; Jiraporn and others, p. 1160.

⁵⁵ Sarkar and Sarkar, p. 279; Fich and Shivdasani, p. 689-692; Wells, p. 578; Core, Holthausen and Larcker, p. 383, 388; Beasley, p. 461.

⁵⁶ Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System'; Sumaira Jan and Mohi-ud-Din Sangmi, 'The Role of Board of Directors in Corporate Governance' (2016) 2 Imperial Journal of Interdisciplinary Research 707, p. 709.

⁵⁷ Jon Martin Denstadli, Tom Erik Julsrud and Randi Johanne Hjorthol, 'Videoconferencing as a Mode of Communication: A Comparative Study of the Use of Videoconferencing and Face-to-Face Meetings' (2012) 26 Journal of Business and Technical Communication 65, p. 77, 78, 80, 84, 86; Lisa M Fairfax, 'Virtual Shareholder Meetings Reconsidered' (2010) 40 Seton Hall Law Review, p. 1390; Michael D Goldman and Eileen M Filliben, 'Corporate Governance: Current Trends and Likely Developments for the Twenty-first Century' (2000) 25 Delaware Journal of Corporate Law 683, p. 695.

video-conferencing medium more suited to an emergency situation or one that does not involve pressing and complex *Sharia'* issues⁵⁸.

From the perspective of the industry's standard-setting agencies, the AAOIFI does not provide a clear and direct code of conduct to monitor the *Sharia'* scholars' attendance in meetings. In fact, it is important to state here that no specific code of conduct exists to govern the *Sharia'* scholars in the industry. Be that as it may, the AAOIFI emphasises the importance of deriving income from *Halal* means in its Accounting, Auditing and Governance Standards, which calls for the IFI's employees to respect the working hours and honour all their obligations to the IFI except in exceptional circumstances. Even in such circumstances, the employees must seek to rectify any dereliction of their duties⁵⁹. Likewise, the Standards also urge employees to abstain from working for other employers if it would prejudice the employees' working commitment at the IFI⁶⁰.

Although the *Sharia'* board members operate on the same foundation as the non-executive directors ('NEDs'), making it incorrect to consider them as 'employees' of the IFI⁶¹, they owe the duty to abstain from engaging in matters that can impair the performance of their fiduciary obligations to the IFI⁶². In fact, it is arguable that as far as this duty is concerned, there is no distinction between the executive and NEDs⁶³. Indeed, trust is the cornerstone upon which the IFIs operate but the principle does not infer that *Sharia'* board members should enjoy an automatic and absolute trust and the prerogative to act according to their own unwritten rules. In other words, the absence of a specific code of conduct for *Sharia'* scholars or technical wording in the existing corporate governance standards that subject them to these professional working principles cannot serve as valid excuses to allow *Sharia'* scholars to shirk their fiduciary responsibilities.

⁵⁸ Denstadli, Julsrud and Hjorthol, p. 78; Fairfax, p. 1381.

⁵⁹ 6/2/2 of Accounting, Auditing, and Governance Standards as at December 2015, p. 1037. Also see (*Surah Al-Baqarah* 2:172-173); (*Surah An-Nahl* 16:114) of Ali

⁶⁰ 6/2/7 of Accounting, Auditing, and Governance Standards as at December 2015, p. 1038.

⁶¹ "*Sharia' board members should not be employees of the same IFI*", article 4, Governance Standard No. (5): Independence of *Shari'a* Supervisory Board of *ibid*, p. 940. It is also worth noted that Bank Altadamon of Sudan treats its *Sharia'* board members as employees and specifies their monthly salaries. See Abdul Majeed Mahmoud Al-Salaheen and Ammar Aldhala'een, 'The Role of Shari'a Fatwa and Supervisory Board in the Islamic Banks' (2013) 5 International Journal of Academic Research, p. 76-77.

⁶² "*SSBs should avoid potential and actual situations that impair their ability to make objective professional judgments*", article 4, Governance Standard No. (5): Independence of *Shari'a* Supervisory Board of Accounting, Auditing, and Governance Standards as at December 2015, p. 940.

⁶³ *Dorchester Finance v Stebbing*

With the roles and responsibilities of the *Sharia'* board members becoming more complex in tandem with the growing complexities of modern Islamic financial businesses, it is arguable that the introduction of a specific code of conduct for the *Sharia'* board members would not only ensure a disciplined and comprehensive working structure at the IFI, but also assure stakeholders of the upholding of *Sharia'* compliance in both the IFI's financial products and its business practices.

In a similar fashion, the IFSB has also stopped short of providing a clear provision on a similar issue. The IFSB-10 has divided absenteeism cases into two categories, namely 'absent with apology' and 'absent without apology'⁶⁴. However, in the absence of a list of admissible excuses, these terms can lend a vague picture and create a scepticism of the IFSB's treatment toward absenteeism cases that involve the *Sharia'* board members, who may have skipped the meeting because of their commitments at other IFIs⁶⁵. Since the best way to analyse the quality of the *Sharia'* board is by studying its characteristics associated with good corporate governance practices, which also include an excellent participation and engagement of the *Sharia'* scholars in the *Sharia'* board meetings, it is arguable that prescribing such loose terms can create doubts over the fitness of scholars, especially those with multiple *Sharia'* board directorships, in providing an optimum-level of *Sharia'* compliance assurance of the IFI's financial products, services and business conducts. This raises further questions on the effectiveness of the Islamic corporate governance system for IFIs.

Indeed, attendance at *Sharia'* board meetings not only provides scholars with a focal platform to obtain new information and participate in the IFI's *Sharia'* decision-making processes, but also functions as a yardstick to measure the fulfilment of their *Sharia'* compliance monitoring responsibility⁶⁶. Failure of an interlocking *Sharia'* board member to appear before the *Sharia'* board meeting, can also amount to a breach of fiduciary and religious duty; after all, an overworked *Sharia'* board member or a *Sharia'* board with most of its members holding external *Sharia'* board directorships can jeopardise the

⁶⁴ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 26.

⁶⁵ Ibid, p. 26.

⁶⁶ Adams and Ferreira, p. 227; Francis, Hasan and Wu, p. 26. Also see Amedeo Pugliese, Gavin Nicholson and Pieter-Jan Bezemer, 'An Observational Analysis of the Impact of Board Dynamics and Directors' Participation on Perceived Board Effectiveness' (2015) 26 British Journal of Management 1, p. 2.

Ijtihad process of the IFI, thus threatening not only the integrity and quality of the Islamic banking *Fatwas* issued, but also the reputation of the industry as a whole⁶⁷.

These arguments do not suggest that *Sharia'* board members with multiple *Sharia'* board directorships would shirk from attending to their corporate duties but it is sensible to contemplate that the multiple *Sharia'* board directorship practice paves the way for one to do so. Analogous to a double-edge sword, it bestows upon the scholars vast industrial information, networks, and experience. At the same time, it also decreases the scholars' time commitment to each of the IFIs represented. Without emphatic monitoring disciplines from both sides, namely, the industry regulators such as the IFSB, AAOIFI, and the central banks on one hand, and the IFIs on the other, it is arguable that the multiple *Sharia'* board directorships benefits only the scholars themselves.

5.2.5.2 Solicitation of Multiple *Sharia'* Board Directorships

In addition to the self-burdening effort of *Ijtihad*, which necessitates the *Sharia'* board members exhausting their efforts, time, and attention in administering the IFI's *Sharia'* affairs, it is also prudent to consider the significance of several *Sharia'* law provisions that explore the question of soliciting for a leadership position, or in the context of this thesis, asking for additional *Sharia'* board directorships. While it is common for the IFI's shareholders or the BOD to hold the authority to appoint the *Sharia'* board members⁶⁸, the vast professional connections and influence of these scholars across the numerous IFIs' *Sharia'* boards can also create a distinct opportunity that can act in the scholars' favours, *i.e.* enabling them to obtain additional *Sharia'* board directorships.

On one hand, there are several *Sharia'* law provisions to suggest that Islam regards the pursuit of a *Sharia'* board directorship as an *Ibadat* when one possesses the necessary qualification justifying this pursuit⁶⁹. Here, it becomes a *Fardh Ain* if the person possesses a critical knowledge, expertise, or leadership skill, which remains scarce in

⁶⁷ "O ye who believe! Fulfil (all) obligations..." (Surah Al-Ma'idah 5:1) of Ali

⁶⁸ Accounting, Auditing, and Governance Standards as at December 2015, p. 885; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*; Van Greuning and Iqbal, p. 189.

⁶⁹ Syaraf al-Haq al-'Azhim Abadi, *Aunul Ma'bud 'Ala Syarh Sunan Abu Dawud*, vol 3 (published in Beirut, Dar Ibn Hazm 2005), p. 404.

the Islamic banking industry⁷⁰, or a *Fardh Kifayah* if there already exists a number of equally competent candidates for the position⁷¹. This presents a sensible inference since *Sharia'* law views one's knowledge and expertise as the trust from God and ordains their employment only within the permissible perimeters⁷². Also, the pursuit will neither deprive the person from receiving any remuneration from the employer nor reduce his or her deeds from the eyesight of God⁷³.

Similarly, in one *Hadith*, Uthman Ibn Abul'as stated that he approached the Prophet Muhammad (p.b.u.h.) and asked, "O Messenger of God! Appoint me the leader of the tribe in prayer". He said, "You are their leader, but you should follow on who is the weakest of them: and appoint a Muadzin who does not charge for the calling of Adhan"⁷⁴. This authority substantiates the argument that *Sharia'* law neither condemns nor decrees the pursuit as *Makruh* (permissible but not recommended)⁷⁵. In the same light, the Quranic verse of "Our Lord! Grant unto us wives and offspring, who will be the comfort of our eyes, and make us the leader of the righteous"⁷⁶, which often constitutes a common supplication in the Muslim prayers, further reinforces the proposition that *Sharia'* law allows this pursuit if it can protect the *Maslahah* of the community and promote the *Sharia'* principle of *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil)⁷⁷.

⁷⁰ Al-Qurtubi suggested that the *Sharia'* law renders it as *Fardh Ain* for a highly-qualified *Sharia'* scholar not only to administer the *Sharia'* affairs of the government or an important financial institution such as an Islamic bank, but also to request to occupy this crucial position in the absence of *Sharia'* scholars of equal competence and qualifications. See Al-Qurtubi, p. 216. Also see *Hadith* 1, Book 3 of Hamidy and others

⁷¹ Ibrahim, p. 11; As-Sa'di

⁷² "Surely those who conceal the clear proofs and the guidance that We revealed after We made it clear in the Book for men, they are whom God shall curse, and those who curse shall curse them (too)" (*Surah Al-Baqarah* 2:159) of Ali

⁷³ *Fatwa* No. 8949 of 'Al-Lajnah Ad-Daa'imah lil-Buhooth Al-'Ilmiyyah Wal-Iftaa' (The Permanent Committee for Islamic Research and Fatwa)' <<http://www.alifta.com/>> accessed 19 September 2017

⁷⁴ This *Hadith* is *Sahih*. See *Hadith* 531, Book 3 of Dawud and Ibn Al-Ashcath. Also see No. 8365 of Sulaiman bin Ahmad Al-Tabarani, *Al-Mu'jam Al-Kabeer* (Maktabat Al-'Ulum wa Al-Hikam 1983)

⁷⁵ Al-Mawardi, p. 113-114.

⁷⁶ (*Surah Al-Furqan* 25:74) of Ali. Also see al-Sayyid al Ash-Shan'ani and Imam Muhammad bin Ismail al Kahlani, *Subulus Salam* (Ahmad Bin Sulaiman tr, published in Riyadh, Maktabah Al-Rushd 2005), p. 100-116.

⁷⁷ Abd-al-Aziz Ibn-Baz, *Majmu'at Fatawa Ibn Baz (Fatwa Collection of Ibn Baz)* (published in Riyadh, Dar Al-Watan 1995), vol. 7, p. 232.

On the other hand, *Sharia'* law also contains several authorities of equal significance to suggest that it is *Haram* or *Makruh* for one to demand a leadership position⁷⁸. For instance, in one *Hadith*, Abu Musa recounted:

*“Two men from my tribe and I entered upon the Prophet Muhammad (p.b.u.h.). One of the two men said to the Prophet, “O Messenger of God! Appoint me as a governor,” and so did the second. The Prophet said, “We do not assign the authority of ruling to those who ask for it, nor to those who are keen to have it”*⁷⁹.

In another *Hadith*, Abdur-Rahman bin Samura narrated:

*“The Prophet Muhammad (p.b.u.h.) said, “O Abdur-Rahman bin Samura! Do not seek to occupy a leadership position, because if you are given authority for it, then you will be held responsible for it, but if you are given it without asking for it, then you will be helped in it (by God) ...”*⁸⁰

Indeed, the pursuit of multiple *Sharia'* board directorships presents two distinct possibilities – it can either serve to benefit or to damage the operations and outlook of both the IFI and the industry. It serves as a benefit if the interlocking *Sharia'* board members hold the necessary competencies that would provide added values to the IFI's *Sharia'* board and also demonstrate an exceptional degree of diligence and professionalism in balancing the competing interests of the other IFIs represented. Conversely, it would inflict a great deal of harm if they fail to allocate sufficient time and attention to the affairs of these IFIs and only concern themselves with the advancement of their personal career interests.

Certainly, the *Sharia'* board consists of knowledgeable men and women, who would adhere to the teachings and rules of *Sharia'* law and would not occupy additional *Sharia'* board directorships unless they saw themselves fit to shoulder the risks and liabilities that these commitments entail⁸¹. A diligent and fair manoeuvre of these obligations will gain these scholars the trust of stakeholders and great rewards in the hereafter⁸².

⁷⁸ Muhammad Abd Al-Qadir Abu Faris, *Al-Nizam Al-Siyasi fi Al-Islam (The Political System in Islam)* (published in Jordan, Dar Al-Furqan 1988), p. 190. Also see Al-Mawardi, p. 113.

⁷⁹ This *Hadith* is *Sahih*. See *Hadith* 13, Book 93 of Al-Bukhari and Khan. Also see *Hadith* 9, Book 25 of Dawud and Ibn Al-Ashcath

⁸⁰ This *Hadith* is *Sahih*. See *Hadith* 2, Book 83 of Al-Bukhari and Khan. Also see Al-Nawawi, vol. 2, p. 469.

⁸¹ Asqalani, vol. 8, p. 217.

⁸² *“7 are (the persons) whom God would protect with His shade on the Day of Judgment when there would be no shade but that of Him: a just ruler; a youth who grew up in the worship of God; a person whose*

However, it is arguable that the shouldering of a great number of corporate commitments carries with it great responsibilities, which demand both physical and mental hard works. This is especially the case considering the nature of *Ijtihad*, which encompasses a chain of physical and mental processes in arriving at judgments through the utilisation of the utmost intellectual inquiry⁸³ – from the interpretation of the injunctions in the Holy Quran and the assessment of the authenticity of the *Hadith* to the implementation of the variant secondary sources of Sharia' law to a present-day *Sharia'* issue.

As much as a diligent and fair fulfilment of these obligations will gain these scholars the trust of stakeholders and great rewards in the hereafter, a careless and arbitrary assumption of multiple *Sharia'* board directorships will yield nothing short of superfluous risks and liabilities that can tarnish the goodwill of the IFI and the entire industry – and even turn into a matter of regret in the hereafter. In one *Hadith*, Abu Hurairah recounted that the Prophet Muhammad (p.b.u.h.) stated, “*You people will be keen to have the authority of ruling which will be a thing of regret for you on the Day of Resurrection. What an excellent wet nurse it is, and yet what a bad weaning one it is*”⁸⁴. In another *Hadith*, Abu Zhar narrated that he asked the Prophet, “*O Prophet of God, will you not appoint me to a public office?*” He stroked my shoulder with his hand and said, “*Abu Zhar, you are weak and authority is a trust, and on the Day of Judgment it is a cause of humiliation and repentance except for one who fulfils its obligations and (properly) discharges the duties attended thereon*”⁸⁵.

Although the last part of the second *Hadith* provides an exception to the dissuasion against soliciting for a leadership position, the exception also demonstrates that only few can honour and discharge the obligations the position would entail. In fact, this rationale, together with the fear of God and the humiliation that awaits one in the hereafter for

heart is attached to the mosque; two person who love and meet and depart from one another for the sake of God; a man who refuses the call of a charming woman of noble birth for illicit intercourse with her and says, “I fear God”; a person who give charity and conceals it (to such an extent) that the left hand does not know what the right hand has given; and a person who remembered God in privacy and his eyes shed tears”. This Hadith is Sahih. See Hadith 54, Book 10 of Al-Bukhari and Khan. Also see Al-Nawawi, vol. 12, p. 211.

⁸³ The IFSB-10 stresses that the presence of factors such as undue influence; duress; the possession of familial or close ties with the IFIs, its related companies or its officers; and multiple *Sharia'* board appointments, if left ungoverned, can impair the *Sharia'* scholars' ability in delivering an independent judgment. See Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 15-16; Doi, p. 78.

⁸⁴ This *Hadith* is *Sahih*. See *Hadith* 12, Book 93 of Al-Bukhari and Khan

⁸⁵ This *Hadith* is *Sahih*. See *Hadith* 19, Book 33 of Ibn Al-Hajjaj

failing to discharge one's leadership obligations had convinced the Companions and *Sharia'* scholars of the older generation such as Abdullah Ibn Umar, Imam Al-Mahalli and Imam Abu Hanifah, the founder of the Hanafi school, to decline their appointments to occupy leadership positions – even when the request came from the Caliph himself⁸⁶. Alternatively, the same rationale can also justify the current multiple *Sharia'* board directorship patterns, which are heavily centred around 25 *Sharia'* scholars⁸⁷ renowned for their expert *Sharia'* law and industrial knowledge, experience, and extraordinary dedication to the pursuit of knowledge. A fine example of this was Sheikh Mohammed Nizam Yaquby, who was reported to prefer spending his leisure time poring over 2, 000 ancient Islamic manuscripts among his valuable private collection of 50,000 volumes⁸⁸.

Given these points, it is clear that the solicitation of additional *Sharia'* board directorships cannot serve as an automatic ground to infer failures on the part of the interlocking *Sharia'* board members in fulfilling and honouring their multiple corporate responsibilities⁸⁹. *Sharia'* law only discourages the pursuit of *Sharia'* board directorships if it is only driven by the ambition to obtain the perks and fringe benefits on offer instead of the desire to contribute in promoting an ethical banking solution to society and invoke the pleasure of God.

At the same time, *Sharia'* law also hypothesises that with great powers and positions comes great challenges and tribulations in variant forms. The noble approach taken by Imam Abu Hanifah should serve as a reminder to those with multiple *Sharia'* board directorships of the essential need to remain diligent, independent, and above all, God-

⁸⁶ Imam Abu Hanifah refused his appointment as the national supreme judge because he feared the government would control and abuse his *Fatwa*. Due to his persistent refusal, the Caliph had subjected Imam Abu Hanifah to imprisonment and forbade him from issuing any *Fatwas* or even engage with the public. Muhammad Al-Bazzazi Al-Kardari, *Manaqib Al-Imam Al-Azam Abu Hanifa (Biography of Imam Abu Hanifa)*, vol 2 (published in Beirut, Dar Al-Kitab Al-Arabi 1981), p. 15; Muwaffaq A Al-Makki, *Manaqib Al-Abu Hanifah (Biography of Abu Hanifah)*, vol 1 (published in Beirut, Dar Al-Kitab Al-Arabi 1981), p. 215; Khatib Al-Baghdadi, *Tarikh Al-Baghdad (History of Baghdad)*, vol 13 (Dar Al-Kutub Al-Ilmiyyah 1931), p. 328. Also see Ahmad Muhammad Al-Sawi, *Hashiyah Al-Sawi*, vol 1 (Matba'ah Mustaf Al-Halabi 1941), p. 4; Al-Ghazali, p. 80.

⁸⁷ Thomson Reuters, 'Top Sharia Scholars by Number of Boards'. Also see International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28; Thomson Reuters, *Islamic Finance Development Report 2015*, p. 129-130; Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*, p. 4.

⁸⁸ Mohammed Abbas, 'Holy Man Joins Jet Set as Islamic Finance Booms' *Reuters* (Manama, 5 February 2008) <<http://www.reuters.com/article/us-islamic-summit-scholar/holy-man-joins-jet-set-as-islamic-finance-booms-idUSL059423620080205>> accessed 29 August 2017

⁸⁹ No. 7146-7147, *Kitab Al-Ahkam* of Asqalani

fearing in treading the risky path of *Sharia'* board directorships, which responsibilities are allegorised by Imam Al-Nawawi as signing on behalf of the God⁹⁰. Naturally, a God-fearing approach should indicate hesitancy or restraint on the part of *Sharia'* scholars before any *Sharia'* board appointment offers. Soliciting for additional *Sharia'* board directorships or an arbitrary acceptance of multiple *Sharia'* board appointments can suggest the absence of the 'God-fearing' factor in Islamic banking that can further stigmatise the industry as one which has truly abandoned its fundamental values.

5.3 Shortage of *Sharia'* Scholars *Vis-à-Vis Maslahah Al-Mursalah* (Public Interest)

5.3.1 Emergence of Multiple *Sharia'* Board Directorship Practice

In general, there are hundreds or thousands of *Sharia'* scholars around the globe who possess expertise in the divergent fields of *Sharia'* law. However, as Islamic banking comprises multidisciplinary fields such as business, accounting, and legal sciences, only a small number of these scholars possess fundamental knowledge in *Fiqh al-Muammalat* – an area of crucial importance to the Islamic banking industry, in addition to a strong experience and exposure to a vast array of Islamic financial products and services⁹¹. Without the necessary knowledge and experience, the *Sharia'* law discourages and even renders it *Haram* (forbidden) for a *Sharia'* scholar to engage in a position that requires him or her to issue *Fatwas*⁹².

During its inception in the early 1970's, Islamic banking suffered from a shortage of *Sharia'* scholars with strong expertise in the fields of *Sharia'* law and finance. In fact, this remained the case until the late 1990's when only 20 per cent of *Sharia'* scholars around the globe possessed knowledge in banking and finance, and English language literacy⁹³. As the global industry experienced a rapid increase in the number of IFIs, the usual

⁹⁰ Al-Nawawi, p. 73. Also see Ibrahim, p. 13.

⁹¹ Bakar, *Shariah Minds in Islamic Finance*, p. 169; Farhan Bokhari, 'Skills Shortages Still Hamper Islamic Finance' *Financial Times* (London (UK), 3 July 2008) <<http://www.ft.com/intl/cms/s/0/510d4d46-488c-11dd-a851-000077b07658.html#axzz3ev7e9oSn>> accessed 17 September 2017

⁹² Ahmad Ali Taha Rayyan, *Dawabit Al-Ijtihad Wa Al-Fatwa (The Principle of Ijtihad and Fatwa)* (published in Cairo, Jabhah Ulama Al-Azhar 1994), p. 77-78. Also see As-Sa'di, which stipulates that whatever leads to the establishment of a *Haram* matter is itself prohibited.

⁹³ Ali, *Handbook of Research on Islamic Business Ethics*, p. 252; C. Morais; Abdul-Rahman, p. 63.

output supplies of qualified *Sharia'* scholars could not meet the demands of the corresponding increase in the number of IFIs' *Sharia'* boards – which also proves that the lack of highly qualified and experienced personnel can occur even in a large industry such as Islamic banking. In fact, this dearth of qualified personnel also involved those, who belonged to the bottom chain of the employment pyramid of the IFIs – 50 per cent of the IFIs in the GCC ('Gulf Cooperation Council') found it difficult to hire graduates for entry-level positions and nearly 23 per cent struggled to hire candidates for mid-level roles⁹⁴. Consequently, this created a *Masyaqqah* (a severe or difficult situation) that prompted the IFIs to share similar *Sharia'* scholars to serve on their *Sharia'* boards⁹⁵.

Karim and Archer noted: "*In those early days, there were few scholars with knowledge in finance and banking. The handful scholars that had published on related subjects were without practical experience, having had no exposure whatsoever to modern banks and financial markets. In many cases, banks retained scholars based solely on their reputation as authors and authorities on Islamic subjects in general; not as experts or authors of works on finance or related subjects*"⁹⁶.

Although this difficulty compelled the IFIs to appoint academics as their *Sharia'* board members, the decision to do so eventually proven advantageous to the interests of both the IFIs and the industry. The wealthy research experience and academic creativity of the academics in question not only provided the IFIs with a valuable access to the relevant knowledge, ideas, and important networks⁹⁷, but it also led to the transformation of a religious-based financial concept into the real financial practice it is known as today. Moreover, the *Fiqh* method of *Al-Masyaqqatul Tajlib At-Taisir* (hardship begets facility)⁹⁸ lent further support to the practice of sharing similar *Sharia'* scholars amongst IFIs and provided the industry with an emphatic solution to the shortages of qualified and

⁹⁴ Bakar, *Shariah Minds in Islamic Finance*, p. 169; Cleofe Maceda, 'Islamic Finance Talent Gap to Reach 8,000 Plus' *Gulf News* (United Arab Emirates, 24 March 2014) <<http://gulfnews.com/business/sectors/general/islamic-finance-talent-gap-to-reach-8-000-plus-1.1308317>> accessed 17 September 2017

⁹⁵ Majid and Ghazal, p. 149. Also see the *Fiqh* method of *Dharurah Tabihu Al-Makhzurat* (necessity permits the forbidden), Ibn Nujaym, p. 73; Al-Nadwi, p. 308; Al-Suyuti, p. 168-169.

⁹⁶ See Karim and Archer. Also see Farook and Farooq; Abdul-Rahman, p. 63.

⁹⁷ Davies and Hopt, p. 20; Field, Lowry and Mkrtychyan, p. 64; Craig A Peterson and James Philpot, 'Roles of Academic Directors on US Fortune 500 Boards' (2009) 9 *Corporate Governance: The International Journal of Business in Society* 202, p. 204.

⁹⁸ Al-Nadwi, p. 302; Al-Suyuti, p. 157. Also see As-Sa'di

competent *Sharia'* scholars at that time. Since this complication can threaten the *Sharia'* compliance assurance processes of the IFIs, it is only practical for the industry to allow a certain degree of flexibility to *Sharia'* scholars to occupy a reasonable number of *Sharia'* board directorships.

Similarly, the lengthy period of formal *Sharia'* trainings, which generally consumed 15 years, has also granted an indirect exclusivity to the current batch of senior *Sharia'* scholars such as Sheikh Mohammed Nizam Yaquby, Sheikh Abdul Sattar Abu Ghuddah, Sheikh Mohammad Ali Elgari and Sheikh Mohammad Daud Bakar, to name a few, who sit on the *Sharia'* boards of top IFIs around the world, due to their vast experience in *Muammalat* and banking practices. Although it is also arguable that during their early years, most of these senior scholars possessed limited or no industrial experience at all, their years of service across multiple IFIs' *Sharia'* boards have not only improved their experience greatly, but also rendered them an integral component in nowadays IFI's *Sharia'* compliance assurance.

5.3.2 Shortage of *Sharia'* Scholars

While the contention that the industry faced an acute shortage of *Sharia'* scholars to justify the multiple *Sharia'* board directorship practice held substantial ground during the early years of Islamic banking, it may not serve as a convincing excuse nowadays. For instance, it is arguable that the shortage of competent *Sharia'* scholars within the industry is difficult to explain especially in light of the exceptional interest shown by both academic researchers and prospective students around the globe in the last two decades in Islamic banking studies⁹⁹. In fact, as at 2016, there were 823 Islamic banking education providers worldwide: 76 per cent accounted for Islamic finance courses, which subjects include *Zakat*, *Sukuk* financing and capital markets, jurisprudence, actuarial practices, Islamic trade and corporate finance, and the remaining 24 per cent accounted for degree courses, which include both undergraduate and postgraduate Islamic banking programs (see **Figure 14**)¹⁰⁰.

⁹⁹ Siddiqui,

¹⁰⁰ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 89; Thomson Reuters, *Islamic Finance Development Report 2015*, p. 116-119. Also see Yurizk, *Global Islamic Finance Education 2013 Special Report* (Yurizk, 2013), p. 14, 31.

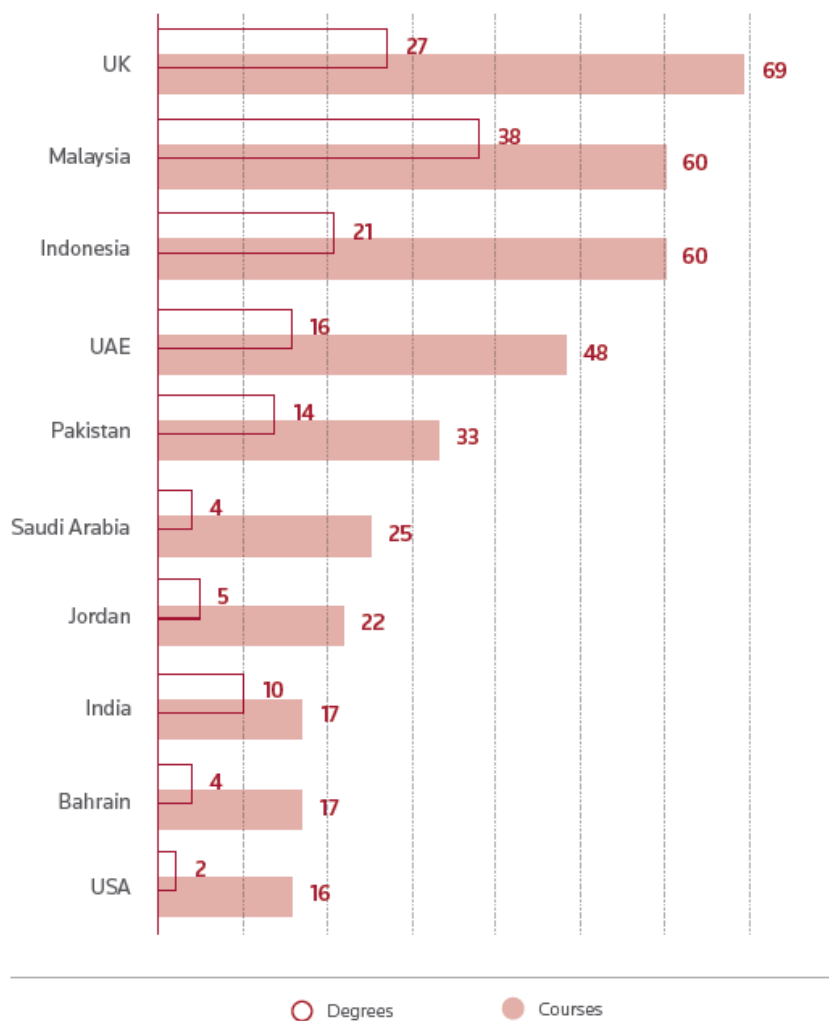


Figure 14: Segregation of Organisations Offering Islamic Banking Courses within the Top 10 Countries as at 2016¹⁰¹

In reality, the industry boasts a sufficient number of competent and up-and-coming *Sharia'* scholars, who not only possess academic qualifications in industry-relevant areas such as *Sharia'* law, Islamic accounting, Islamic management, and Islamic banking and finance¹⁰², but also hold academic positions across various renowned universities – a career path similar to most leading and senior *Sharia'* scholars of the industry (see **Figure 15**). In fact, the number of *Sharia'* scholars commanding strong knowledge of both *Sharia'* law and finance has increased steadily in tandem with the gradual development of Islamic banking degree programs offered by universities and

¹⁰¹ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 89.

¹⁰² Ibid, p. 86; Thomson Reuters, *Islamic Finance Development Report 2015*, p. 116-119; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 75.

higher learning institutions around the world¹⁰³. Although the majority of the first generation of *Sharia'* scholars, who hold multiple *Sharia'* board directorships across the IFIs, are at the end of their career by now¹⁰⁴, it remains arguable that only a few of the up-and-coming *Sharia'* scholars can obtain the opportunity to serve on the IFIs' *Sharia'* boards as certain IFIs prefer to appoint top *Sharia'* scholars on their *Sharia'* boards, who bring more added value to the IFIs in terms of reputation and credibility. This results in a concentration of *Sharia'* board directorships amongst a certain group of senior scholars¹⁰⁵.

Name of <i>Sharia'</i> Scholar	Academic Qualification	Institutions Taught	Number of Directorships Held
Sheikh Dr. Abdul Sattar Abu Ghuddah	Ph.D. (Al-Azhar University)	Imam Al-Da'awa Institute (SA), Religious Institute (KWT) and Kuwait University (KWT)	85*
Sheikh Nizam Yaquby	Ph.D. (University of Wales)	Independent <i>Sharia'</i> Law Instructor in Bahrain	85*
Sheikh Professor Ali Elgari	Ph.D. (University of Berkeley)	King Abdul Aziz University (KSA)	71*
Sheikh Dr. Abdul Aziz Khalifa Al-Qassar	Ph.D. (Al-Azhar University)	Kuwait University (KWT)	42

¹⁰³ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 89. Also see Devi,

¹⁰⁴ Islamicbanker, 'The Scholars Network Analysis' (Last Updated 9 September 2017, 2017) <<https://www.islamicbanker.com/scholars>> accessed 11 September 2017; Siddiqui,

¹⁰⁵ This can lead to a lower demand for unknown *Sharia'* scholars as the IFIs favour prominent and well-known figures to increase the marketability of their Islamic financial products and services. See Fitch, ; Siddiqui, . Also see The Star Online, 'Islamic Finance Industry Faces Shortage of 56,000 Professionals' Bernama, 4 November 2015 <<http://www.thestar.com.my/business/business-news/2015/11/04/islamic-finance-industry-faces-shortage-of-56000-professionals/>> accessed 22 September 2017

Sheikh Professor Ali Mohiuddin Al-Quradadghi	Ph.D. (Al-Azhar University)	Qatar University (QA)	30
Sheikh Dr. Yusuf Bin Abdullah Al-Shubaili	Ph.D. (Imam Mohammad Bin Saud Islamic University)	Imam Bin Mohammad Saud (KSA)	29
Sheikh Dr. Mohd Daud Bakar	Ph.D. (University of St. Andrews)	International Islamic University (MAS)	27*
Sheikh Dr. Esam Khalaf Al-Enezi	Ph.D. (University of Jordan)	Kuwait University (KWT)	25
Sheikh Dr. Issa Zaki Issa Chakra	Ph.D. (Islamic University of Madinah Al-Munawwarah)	College of Basic Education, Public Authority for Applied Education and Training (KWT)	23
Sheikh Esam Mohammed Ishaq	Bachelor's Degree (McGill University)	Independent <i>Sharia'</i> Law Instructor in Bahrain	22
Sheikh Mohammed Imran Ashraf Usmani	Ph.D. (University of Karachi)	Jamia Dar Al-Uloom (PK)	20*
Sheikh Khaled Mathkour Abdullah Al-Mathkour	Ph.D. (Al-Azhar University)	Kuwait University (KWT)	18
Sheikh Professor Abdullah Bin Mohamed Al-Mutlaq	Ph.D. (Imam Mohammad Bin Saud Islamic University)	Imam Bin Mohammad Saud University (KSA)	17

Sheikh Dr. Mohammad Abdul Rahim Sultan Al Olama	Ph.D. (Umm Al Qura University)	United Arab Emirates University (UAE)	16
Sheikh Muhammad Taqi Usmani	LL.B. (Karachi University)	Jamia Dar Al-Uloom (PK)	16*
Sheikh Dr. Mohammad Al-Sayyid Abdulrazaq Al-Tabtabaei	Ph.D. (Imam Mohammad Bin Saud Islamic University)	Kuwait University (KWT)	13
Sheikh Dr. Mohammed Abdulhakim Mohammed Zoeir	Ph.D. (Al-Azhar University)	Emirates Institute for Banking and Financial Studies (UAE)	13
Sheikh Dr. Ajeel Jasem Al-Nashmi	Ph.D. (Al-Azhar University)	Kuwait University (KWT)	11
Sheikh Dr. Ali Ibrahim Al Rashid	Ph.D. (Cairo University)	Kuwait University (KWT)	11
Sheikh Dr. Muhammad Amin Ali Qattan	Ph.D. (University of Birmingham)	Kuwait University (KWT)	10
*Directorships held in 2011. Data on latest directorships is unavailable.			

Figure 15: List of *Sharia'* Scholars by Number of *Sharia'* Board Directorships, Their Qualifications and Academic Appointments¹⁰⁶

By the same token, this concentration also expounds its own rationale. In contrast to other *Sharia'* scholars in the industry, most of the top scholars exhibited pragmatic working experience that transcended those of the young scholars, which justified their occupation of influential *Sharia'* board positions across a diverse range of domestic and international IFIs. As much as this argument does not seek to undermine the

¹⁰⁶ Modified. See Thomson Reuters, 'Top Sharia Scholars by Number of Boards'; Islamicbanker; Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*, p. 4.

qualifications and experience of the other *Sharia'* scholars, it is submitted that the diversified nature of modern *Sharia'* board responsibilities has further compelled IFIs to appoint the candidates with the best combination of academic qualifications and experience to serve on their *Sharia'* boards.

For example, Sheikh Mohammed Nizam Yaquby, a prominent *Sharia'* jurist, who remains one of the few elite *Sharia'* scholars with over 50 *Sharia'* board directorships across both IFIs and Islamic banking standard-setting organisations such as the AAOIFI and the International Islamic *Fiqh* Academy, is also a member of the *Sharia'* judiciary of Bahrain and continues to dispense occasional *Sharia'* rulings on Islamic family law issues¹⁰⁷. Similarly, Sheikh Muhammad Taqi Usmani, who sits on the *Sharia'* boards of several IFIs and that of the AAOIFI, is a retired judge of the Federal *Sharia'* Court and the *Sharia'* Appellate Bench of the Supreme Court of Pakistan¹⁰⁸.

Further, there are also several other *Sharia'* scholars with influential positions in the judicial service such as Sheikh Abdullah Bin Sulaiman Al-Manea, who served as the Deputy President of the Makkah Al-Mukarramah Courts and a judge of the Court of Cassation¹⁰⁹, and Sheikh Professor Abdullah Bin Mohamed Al-Mutlaq, who served as a member of the Supreme Judiciary Committee of Saudi Arabia¹¹⁰. Indeed, the possession of strong judicial skills and experience undoubtedly enhances a *Sharia'* scholar's competency, especially in the capacity of an IFI's *Sharia'* board member, which demands

¹⁰⁷ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Shari'ah Board Members' (AAOIFI, 2017) <<http://aaoifi.com/members-2/?lang=en>> accessed 15 September 2017; Abbas, . Also see Islamicbanker; Islamicbanker, 'Sheikh Nizam Mohammed Yaquby' (*Last Updated 18 September 2017*, 2017) <<https://www.islamicbanker.com/scholars/sheikh-nizam-mohammed-saleh-yaquby>> accessed 22 September 2017

¹⁰⁸ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Shari'ah Board Members'; Visser, p. 127. Also see Islamicbanker, 'The Scholars Network Analysis'

¹⁰⁹ Saudi Arabia British Bank (SABB), 'SABB Shariah Committee' (2017) <<http://www.sabb.com/en/about-sabb/about/shariah-committee/>> accessed 15 September 2017. Also see Bloomberg, 'Executive Profile - Abdullah Bin Sulaiman Al-Manea' (*Bloomberg Business*) <<http://www.bloomberg.com/research/stocks/people/person.asp?personId=78820071&ticker=ATC:AB&previousCapId=36070207&previousTitle=SABB%2520TAKAFUL>> accessed 16 September 2017; Islamicbanker, 'The Scholars Network Analysis'

¹¹⁰ Saudi Arabia British Bank (SABB). Also see Bloomberg, 'Executive Profile - Abdullah Bin Muhammad Al-Mutlaq' (*Bloomberg Business*) <<http://www.bloomberg.com/research/stocks/people/person.asp?personId=49687806&capId=36070207&previousCapId=36070207&previousTitle=SABB%2520TAKAFUL>> accessed 14 September 2017; Islamicbanker, 'The Scholars Network Analysis'

the issuance of *Fatwas* for Islamic banking products and services – skills that remains a scarcity among most of the young *Sharia'* scholars today¹¹¹.

Apart from the possession of the necessary academic qualifications, skills, and experience, these senior *Sharia'* scholars have not only exhibited exceptional talents and dedication in the study of *Sharia'* law, but also a comprehensive knowledge of multidisciplinary sciences relevant to the industry such as law, accounting, economics, and finance. These qualities render them indispensable to the developing Islamic banking industry. For instance, a prominent *Sharia'* scholar Sheikh Mohammed Nizam Yaquby who commenced studying religious texts at the tender age of ten, began teaching in *Sharia'* law subjects at 16, and received guidance in the study of classical *Sharia'* law from prominent *Sharia'* scholars such as Sheikh Abdulla Al-Farisi, Sheikh Yusuf Al-Siddiqi, Sheikh Muhammed Saleh Al-Abasi, and Sheikh Muhammed Yasin Al-Fadani¹¹². These traits correspond with Al-Dhahabi, a *Hadith* expert and Islamic historian, who provided a detailed list of qualities a *Sharia'* scholar should possess:

*“Trustworthiness is a portion of the religion, and precision is included in proficiency; so what a scholar really need, is to be: fearful of God, intelligent, grammatical, a linguist, righteous, modest, Salafee (follower of the path of the righteous), and it is sufficient enough for him to write 200 volumes and to gather 500 reliable compilations (books), and not to become fatigued by seeking knowledge till death, with sincerity and humility – otherwise, let him not trouble himself”*¹¹³.

As far as academic qualifications are concerned, Sheikh Mohammed Nizam possesses a bachelor's degree in economics and comparative religions; a Master's degree in finance; and a Ph.D. degree in *Sharia'* law. Having served as a visiting lecturer at the Harvard University, he also exhibits an impressive professional linguistic proficiency in four languages, namely English, Arabic, Urdu and Farsi. Likewise, the same qualities

¹¹¹ Thomson Reuters, *Islamic Finance Development Report 2014*, p. 77. Also see Connelly and Van Slyke, p. 404-405.

¹¹² Al Rayan Bank, 'Sheikh Nizam Muhammed Saleh Yaqoobi' (*Al Rayan Bank*, 2017) <<https://www.alrayanbank.co.uk/useful-info-tools/islamic-finance/sharia-compliance/sheikh-nizam-muhammed-saleh-yaqoobi/>> accessed 15 September 2017. Also see Thomson Reuters Zawya, 'Sheikh Dr Nizam Mohamed Saleh Abdul Rahman Yaquby' (*Thomson Reuters Zawya*, 2014) <<http://www.zawya.com/officers/biography/20080218080912/>> accessed 7 January 2014; Brian Kettell, *Introduction to Islamic Banking and Finance*, vol 1 (John Wiley & Sons 2011), p. 28; Abbas,

¹¹³ Zayd, Saalih and Al-Uthaymeen, p. 40.

also apply to the other senior *Sharia'* scholars, who have displayed similar exceptional academic achievements and strong working experience throughout their career span.

The seniority of these interlocking *Sharia'* board members also provides them with another advantage over other *Sharia'* scholars – their reputation. Interestingly, reputation has played and continues to play a significant role in the appointment of directors. In Victorian times, companies preferred to appoint nobles on the BOD paying a fee based on their social standings rather than their business acumen in order to boost the companies' goodwill in the market¹¹⁴. In those times, having a member of the aristocrats on the BOD often symbolised the business acumen and credibility of the companies. Lord Millett acknowledged “... *(the director's) function was merely to lend his name, and with it an aura of respectability, to the business ... Investors were supposed to trust in his honesty, not in his ability: and his only duty was not to make off with the company's money*”¹¹⁵.

In a similar vein, the significance of *Sharia'* scholars' seniority has existed in the classical teachings of *Sharia'* law for centuries. In simple terms, a senior *Sharia'* scholar earns more respect and enjoys a significant reputation within society as compared to junior scholars. In fact, several provisions in *Sharia'* law have even highlighted the crucial role played by senior *Sharia'* scholars in the modern world. For instance, 'Abdullah bin 'Amr recounted that the Prophet Muhammad (p.b.u.h.) said: “*God will not deprive you of knowledge after he has given it to you, but it will be taken away through the death of the religious learned men with their knowledge. Then, there will remain ignorant people, who when consulted, give verdicts according to their opinions, whereby they mislead others and go astray*”¹¹⁶.

¹¹⁴ AJ Boyle, 'Company Law and the Non-Executive Director—The USA and Britain Compared' (1978) 27 International and Comparative Law Quarterly 487, p. 499. Also see Alex Rubner, *The Ensnared Shareholder* (1st edn, Macmillan 1965), p. 73-74.

¹¹⁵ Lord Millett, 'Directors' Duties in the Context of Complex International Finance' Cayman Island One Day Seminar <<https://www.insol.org/Cayman%20Islands/Papers/Tab%205%20Directors%20duties.pdf>> accessed 22 September 2017. Also see *Re Brazilian Rubber Plantations & Estates Limited* [1911] 1 Ch 425 (Chancery Division), where one of the four directors of the company had agreed to join its BOD upon seeing the names of the others, whom he considered as good men.

¹¹⁶ This Hadith is *Sahih*. See Book 96, Hadith 38; Book 3, Hadith 42 of Al-Bukhari and Khan. Also see Book 47, Hadith 22 of Ibn Al-Hajjaj. Also see a *Hadith* narrated by 'Abdullah Ibn Mas'ud, in which the Prophet Muhammad (p.b.u.h) said, “*In the end of time, there will come a people young in years, foolish in minds, reciting the Holy Quran, which will not go beyond their throats, uttering sayings from the best of creatures, going through the religion as an arrow goes through the target...*”. This *Hadith* is *Sahih*. See *Hadith* 31,

Accordingly, this argument does not suggest that Islam condones the appointment of young scholars as *Sharia'* board members or advisors. By no means is it intended to alienate or undermine the credibility and ability of young scholars to lead. However, industry must also pay sufficient consideration to significant events that have occurred throughout the history of Islamic civilisation pertaining to the delicate issue surrounding junior scholar's appointment in important societal position such as the *Sharia'* board. Histories are lessons and they ring with truth. For example, Muslim historians suggested that the policy of substituting senior and prominent *Sharia'* figures with young and inexperienced officials on major administrative tasks and affairs was a causal factor to the fall of the Umayyad dynasty (circa 750 CE). The ascension of Caliph Hisham of the Umayyad at the young age of 11 with no experience in managing the administration of the dynasty's affairs which was said to have contributed to the beginning of its decline may have influenced this view¹¹⁷. Also, this is consistent with the opinion of Ali Abi Talib, the fourth caliph of Islam, who postulated that the appointment of young and inexperienced officials in governmental affairs can contribute to the downfall of the government¹¹⁸. At the same time, industry must also be aware that the appointment of *Sharia'* board members from a stagnant pool of top *Sharia'* scholars will also ignore equally or more talented candidates languishing in the growing pool of Islamic banking professionals and graduates, who could inject a more vibrant and fresh perspective to an IFI's *Sharia'* board. Further, this preferential appointment would also foreclose the opportunities for young and up-coming *Sharia'* scholars to gain experience as *Sharia'* board members¹¹⁹ – a critical experience they desperately need to progress in this career paths.

Book 33 of Al-Tirmidhi; *Hadith* 137, Book 37 of An-Nasa'i; *Hadith* 173, Book 1 of Ansari; *Hadith* 172, Book 42 of Dawud and Ibn Al-Ashcath

¹¹⁷ Peter C Scales, *The Fall of the Caliphate of Córdoba: Berbers and Andalusis in Conflict*, vol 9 (Brill 1993), p. 23, 38; M.Z.M. Ali, *Tradisi Intelektual Andalusia Pengaruh Disiplin Al-Quran (Andalusian Intellectual Tradition Influenced by The Holy Quran Discipline)* (Penerbit Universiti Sains Malaysia 2016)

¹¹⁸ Muhammad Shirazi, *If Islam Were to be Established in Iraq* (Z. Olyabek tr, published in London, 2nd edn, Fountain Books 2003), p. 53. Also see a *Hadith* narrated by Abu Hurairah, in which the Prophet Muhammad (p.b.u.h) said: *“There will come to the people years of treachery, when a liar is believed and the truthful person is proclaimed a liar, and the deceitful person is entrusted and honest person is accused of being untrustworthy, and the Ruwaibidah will speak.”* It was asked: *‘Who are the Ruwaibidah?’* He said: *‘The insignificant person who speaks on the public affairs’*. As-Sindee opined the *Ruwaibidah* as ‘a person with little knowledge’. This *Hadith* is *Hasan*. See Vol. 1, Book 36, *Hadith* 4036 of Ansari. Also see Zayd, Saalih and Al-Uthaymeen

¹¹⁹ Dr. Mohammad Akram Laldin of ISRA opined that the industry is not experiencing a shortage of scholars but rather potential *Sharia'* advisors were not given a fair opportunity to serve on the *Sharia'* board since the majority of IFIs favour prominent and well-known figures for the purpose of increasing

By and large, the above arguments suggest that the industry does not actually suffer from a shortage of *Sharia'* scholars, but rather the dearth of those with extraordinary quality, dedication, and competent literacy in the multidisciplinary sciences relevant to Islamic banking. In fact, as the practice of multiple *Sharia'* board directorships also improves their business contacts and provides *Sharia'* scholars with valuable knowledge and information on the different style and skills of management, it is arguable that the practice actually enriches the quality of these interlocking *Sharia'* board members.

Given these points, it is reasonable to argue that the actual issue does not hinge on the quantitative aspect, but rather on the qualitative aspect of these interlocking *Sharia'* board members, which reciprocally, dictates the quality and credibility of the Islamic banking *Fatwas* issued by the IFI's *Sharia'* board. Indeed, the outstanding and all-round qualities displayed by the top *Sharia'* scholars have to date, served as a firm excuse to justify their occupation of multiple IFIs' *Sharia'* boards' directorships. In fact, Al-Qurtubi suggested that *Sharia'* law renders it as *Fardh Ain* for a highly-qualified *Sharia'* scholar not only to administer the *Sharia'* affairs of the government or an important financial institution such as an Islamic bank, but also to request to occupy these crucial positions in the absence of those of equal competence and qualifications¹²⁰. At the same time, however, the question remains whether this measurement can continue to serve as a strong and justifiable excuse, especially in light of the increasing number of up-and-coming *Sharia'* scholars worldwide. Without proper justification, the practice of multiple *Sharia'* board directorships could reflect one grounded on cronyism instead of the dearth of quality and experienced *Sharia'* scholars in the industry.

5.3.3 *Maslahah Al-Mursalah* in Multiple *Sharia'* Board Directorships

5.3.3.1 Definition and Contextual Application of *Maslahah Al-Mursalah*

Accordingly, it is submitted that there is a reasonable probability that the shortage of *Sharia'* scholars within the industry had created an excusatory need known as *Maslahah Al-Mursalah*, which obliged the IFIs to share similar scholars on their *Sharia'* boards in order to ensure the *Sharia'* compliance-guarantee status of their financial products and

the marketability of financial products and services. This view was also shared by Sheikh Hussein Hamid Hassan. See Siddiqui, ; McLay, p. 429. Also see Hasan and Sabirzyanov, p. 253.

¹²⁰ Al-Qurtubi, p. 216. Also see *Hadith* 1, Book 3 of Hamidy and others

services¹²¹. The term '*Maslahah*' originates from the Arabic root word of '*saluha*', which refers to goodness or the act of bringing benefits and preventing losses or destruction¹²². Its derivatives such as '*muslihun*' and '*salihin*', both which refer to piousness, also appear in numerous verses in the Holy Quran¹²³. From a *Sharia*' law standpoint, *Maslahah* belongs to the secondary sources of *Sharia*' legal methodology beneath the primary sources, namely the *Holy Quran* and the *Sunnah*.

In technical terms, Imam Shatibi defined the *Maslahah* as "*all concerns that promote the subsistence of human life, the completion of man's livelihood and the acquisition of all his physical and intellectual qualities, which are required for him*"¹²⁴. Imam Izzuddin Abdul Aziz bin Abdul Salam opined that all the principles and teachings of the *Sharia*' constitute a *Maslahah* because they operate based on *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil)¹²⁵. Imam Al-Ghazali formulated it as "*the act of extracting benefits and preventing losses or harms to mankind in preserving the Maqasid As-Sharia' (objectives of the Islamic religion)*"¹²⁶. Ibn Al-Qayyim viewed *Maslahah* as an explicit example of God's justice, mercy and blessings to mankind¹²⁷. Modern Islamic jurists and economists such as Muhammad Abduh, Rashid Rida, Ibn Ashur, and Muhammad Sa'id Ramadhan Al-Buti also recognised its position as a valid source of *Sharia*' law because it supports the notion of Islam as a religion that preserves the human welfare¹²⁸.

¹²¹ Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 236; Al-Mawardi, p. 114. Also see (Surah Yusuf 12:55-56) of Ali

¹²² Its antonym is '*Mafsadah*', which refers to a harmful or destructive outcome. See Al-Ghazali and Abu Hamid, p. 139; Ab. Latif Muda and Rosmawati Ali, *Pengantar Usul Fiqh (Preface to Usul Fiqh)* (published in Kuala Lumpur, 2nd edn, Pustaka Salam 2012), p. 78; Al-Qaradawi, *The Lawful and the Prohibited in Islam (Al-Halal Wal-Haram Fil Islam)*

¹²³ See (Surah Ali Imran 3:114) of Ali

¹²⁴ Al-Shatibi, vol. 2, p. 6, 15, 37. Also see Muhammad Said Ramadan Al-Buti, *Dawabit Al-Maslahah Fi Al-Shari'ah Al-Islamiyyah (The Principle of Maslahah in Islamic Law)* (published in Beirut, Muassasah Risalah 1982), p. 23.

¹²⁵ Imam Izzuddin (577 – 660 AH) is a famous Islamic scholar of the Shafie school, who specialised in the area of *Fiqh*, *Usul Al-Fiqh*, *Tafseer*, and Arabic literature studies. See Izzu al-Din Abd al Salam, *Qawaid Al-Ahkam Fi Masalih Al-Anam (The Method of Law in Public Interest)*, vol 1 (published in Beirut, Dar al-Ma'rifah 2000), p. 9; Alfie

¹²⁶ Al-Ghazali and Abu Hamid, p. 286. Also see p. 53-55.

¹²⁷ Al-Jawziyah, vol. 1, p. 14; Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 237-238.

¹²⁸ Al-Buti, p. 23; Rashid Rida, *Yusr Al-Islam Wa Usul At-Tashri' Al-'Am (The Conveniences of Islam and General Principles in the Sharia')* (Maktabah Nahdat Misr 1956), p. 79; Rashid Rida, *Al-Khilafah Wa Al-*

Accordingly, the above standpoints suggest that the quintessence of *Maslahah* concentrates on harmonising the public interest with the objective of the Lawgiver, who does not fashion the Islamic religion as a cause of hardship but a mean of benefit to mankind¹²⁹. This is exemplified by the anointment of the Prophet Muhammad (p.b.u.h.) as the Last Messenger, which the *Holy Quran* clearly stipulated as “a mercy for all creatures”¹³⁰. In other words, the *Holy Quran* asserted that the Lawgiver not only allows mankind to employ a reasonable degree of their reasoning in fulfilling the objective of the *Sharia'*, but also provides them with the means to do so in the form of *Maslahah*¹³¹.

In practice, the issue of *Maslahah* arises when a matter does not have a precedent in either the Holy Quran or the *Sunnah* but it requires a solution to allow mankind to preserve the *Maqasid As-Sharia'*¹³². This involves the issuance of a *Sharia' Hukm* that either authorises a matter or a practice because of its benefits to the general public (*Maslahah Al-Mursalah*), or prohibits it because of its detrimental consequences (*Maslahah Al-Mufsadah*). *Maslahah*, which is a by-product of *Ijtihad*, emerged when the Muslims, especially the Companions, who succeeded Prophet Muhammad (p.b.u.h.) in the administration of the Muslims' affairs, encountered problems in new situations and issues that were without precedent in *Sharia'* law. This prompted the Companions to base their *Ijtihad* on the premise of *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil), which gave birth to a new *Sharia'* legal methodology – the *Maslahah*. For instance, the first Caliph Abu Bakar As-Siddiq initiated

Imamah Al-'Uzma (The Caliphates and Distinguished Imams) (published in Cairo, Maktabah Al-Manar 1923), p. 94

¹²⁹ “...He has chosen you, and has imposed no difficulties on you in religion...” (Surah Al-Hajj 22:78); “He intends for you ease, and He does not want to make things difficult for you” (Surah Al-Baqarah 2:219) of Ali. Also see Ibn Musa Al-Shatibi, p. 307-312.

¹³⁰ “We sent thee not, but as a mercy for all creatures” (Surah Al-Anbiya' 21:107) of Ali

¹³¹ Abu Burda narrated that, “The Prophet Muhammad (p.b.u.h.) sent Muadh and Abu Musa to Yemen telling them, ‘Treat the people with ease and don’t be hard on them, give them glad tidings and don’t fill them with aversion, and love each other, and don’t differ’”. This Hadith is Sahih. See Hadith 244, Book 56 of Al-Bukhari and Khan. Also see a Hadith narrated by Abu Hurairah, “The Prophet Muhammad said, ‘Religion is very easy and whoever overburdens himself in his religion will not be able to continue in that way...’”, vol. 1, Hajar and Ibn Ali, p. 102; Abdul Wahab Khallaf, *Masadir Al-Tashri Al-Islami Fi Ma La Nassa Fih (The Origins of Islamic Legislation in the Absence of Textual References)* (published in Cairo, Dar Al-Kutub Al-Arabi 1954), p. 75.

¹³² Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 232-233; Zakariyya Barri, *Usul Al-Fiqh Al-Islami (Islamic Jurisprudence)* (published in Cairo, Dar Al-Nahdan Al-Arabiyyah 1982), p. 135; Al-Zarqa', *Al-Madkhal Al-Fiqhi Al-Am (Introduction to the Basics of Islamic Jurisprudence)*, vol 1 (published in Beirut, Dar Al-Fiqh 1968), p. 68.

the effort to collect and collate the scattered verses of the *Holy Quran* in the bid to prevent confusion among the Muslims and the fabrication of the verses by irresponsible parties¹³³; the second Caliph Umar bin Al-Khattab increased the punishment for drunkards from 40 to 80 lashes¹³⁴; and the third Caliph Uthman bin Affan completed the compilation of the scattered verses into a single *Mushaf* (collection) known as the *Holy Quran* today – all, which the Prophet Muhammad had never done before¹³⁵.

5.3.3.2 *Maslahah Al-Mursalah* in the Four Major Schools of Islamic Jurisprudence

Among the four main schools of Islamic jurisprudence, three of them exhibit an accommodating approach to the use of *Maslahah* in extracting a *Sharia' Hukm*. The Hanafi school does not explicitly accept *Maslahah* as one of its legal methodologies but its recognition of *Urf* (customary practices) and *Istihsan* (juristic preference), and its adoption of *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* as the foundation to its *Sharia'* legal methodology, which give strong consideration to the *Maslahah* of the public, suggest the significant influence of *Maslahah* in the school's legal paradigm¹³⁶. For example, the Hanafi had argued that the family of the Prophet Muhammad (p.b.u.h.) could receive *Sadaqah* (donation) as a mean to ease their hardships; even in the presence of a number of *Hadiths*, in which the Prophet expressly forbade his family from receiving any *Sadaqah*¹³⁷. There also exists a *Fatwa* from the school that allowed

¹³³ Abdul Wahab Khallaf, *Usul Al-Fiqh* (published in Cairo, Dar Al-Hadith 2003), p. 95; Jalal Al-Din Al-Suyuti, *Al-Hawi Li Al-Fatawi (The Collected Legal Decisions)* (published in Beirut, Dar Al-Jil 1992), p. 80.

¹³⁴ Sheikh Dr. Muhammad Salim Al-Awwa argued that the increasing number of those who committed the forbidden act had prompted the Caliph to rationalise and readjust the initial punishment in fulfilling the aim of the *Maqasid As-Sharia'*. See Al-Buti, p. 355; Muhammad Salim Al-Awwa, *Fi Usul Al-Nizam Al-Jinai' Al-Islami (The Origin of Administration of Crime in Islam)* (published in Cairo, Dar Al-Ma'arif 1979), p. 132.

¹³⁵ Abu Abdillah Badr Al-Din Muhammad Abdullah Al-Zarkashi, *Al-Burhan Fi Ulum Al-Quran*, vol 1 (Dar Al-Hadith 2006), p. 166; Khizr Muazzam Khan, 'Juristic Classification of Islamic Law' (1983) 6 Hous J Int'l L 23, p. 26; Al-Buti, p. 362. Also see "We have, without doubt, sent down the Message; and We will assuredly guard it (from corruption)" (Surah Al-Hijr 15:9) of Ali

¹³⁶ *Istihsan* involves the process of exercising personal opinion to avoid any rigidity and unfairness that may result from the literal enforcement of the *Sharia'* law. See Al-Buti, p. 395; Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, vol. 2, p. 775; Doi, p. 81.

¹³⁷ "Sadaqah to the family of Muhammad is not Halal. It is only people's impurities" See Book 58, *Hadith* 13 of Anas; *Hadith* 2609 of An-Nasa'i; Mustafa Zaid, *Al-Maslahat Fi At-Tasyri' Al-Islami (Maslahah in the Principles of Islam)* (published in Cairo, Dar Al-Fikr Al-Arabi 1964), p. 46. Also see "And know that out of

Muslims to kill the animals and burn their meats together with the booty of wars which they cannot carry, in order to prevent their enemies from benefiting from them¹³⁸.

Among the three schools, the Maliki is the most receptive to the use of *Maslahah*, followed by the Hanbali¹³⁹. The Maliki opined that *Maslahah* can serve as a logical deduction to understand the contextual application and perimeters of the primary *Sharia'* law sources in mankind's life¹⁴⁰. Although *Maslahah* operates as an independent source to *Sharia'* law, it is important to note that both the Maliki and Hanbali only warrant its use if the situation arises as one of *Darurah*, in which the application of *Maslahah* can ease the difficulty encountered in preserving the interest of the society¹⁴¹.

For instance, the Maliki opined that the Quranic provision, which stipulates "...mother should breast-feed their babies for a period of two years"¹⁴² does not carry any implied obligation on the Muslims as the practice, in actual, varies according to the *Urf*¹⁴³. The Maliki also allows the *Bay'ah* (formal acknowledgement of a leader) of a less suitable person as a prime minister or a leader, even in the presence of another who holds a better qualification and experience, in order to maintain the stability of the state and avoid strife within the society¹⁴⁴. These suggest that *Maslahah* also functions as a form of *Rukhsah* (leniency) granted by the Lawgiver to mankind as a mean to ease their hardships in recognition of their differences in customary practices.

all the booty that ye may acquire (in war), a fifth is assigned to God, - and to the Messenger, and to near relatives, orphans, the needy, and the wayfarer..." (Surah Al-Anfal 8:41) of Ali

¹³⁸ Zaid, p. 46.

¹³⁹ Al-Shawkani, *Irshad Al-Fuhul Ila Tahkik Al-Hak Minal Ilmu Usul (Guidance for the Luminaries to Achieving the Truth in the Sciences of the Principles of Law)*, p. 403.

¹⁴⁰ This differs from the *Sharia'* legal methodology of *Qiyas*, which only utilises specific texts from the primary *Sharia'* law sources in deducing a *Sharia' Hukm*. See Nasrun Rusli, *Konsep Ijtihad Al-Syaukani (The Ijtihad Concept of Al-Syaukani)* (Logos 1999), p. 33. Also see Doi, p. 70.

¹⁴¹ Al-Shawkani, *Irshad Al-Fuhul Ila Tahkik Al-Hak Minal Ilmu Usul (Guidance for the Luminaries to Achieving the Truth in the Sciences of the Principles of Law)*, p. 403; Ibn Musa Al-Shatibi, p. 307-312; Zaid, p. 60; Al-Amidi, p. 394. Also see (Surah Al-Hajj 22:78) of Ali

¹⁴² (Surah Al-Baqarah 2:233) of Ali

¹⁴³ Al-Buti, p. 353-360. Also see Al-Suyuti, p. 60-61.

¹⁴⁴ Ibn Musa Al-Shatibi, p. 363. Also see Anas

In the case of Hanbali, it is important to note that *Maslahah* does not belong to any of the school's adopted *Sharia'* legal methodologies¹⁴⁵. Instead, it gained ground as one of the school's recognised legal methodologies as a result of the absence of a specific ruling from its founder, Imam Ahmad bin Hanbal, who neither mandated nor rejected its application in the derivation of a *Sharia' Hukm*¹⁴⁶. Nonetheless, there exists a number of *Fatwas* from Imam Ahmad, which demonstrated the significant influence of *Maslahah* in the school's legal methodology. Examples include the banishment of criminals to a secluded county to preserve the peace and harmony in society, and the permission to withhold the distribution of an inheritance to beneficiaries in the presence of reasonable evidences to suggest that they would utilise the money for unlawful purposes¹⁴⁷.

Prominent jurists from the Hanbali school, such as Al-Tufi, introduced a more liberal approach to *Maslahah* by recognising the use of the human intellect in determining its scope of application and they accorded a significant priority to the application of *Maslahah* over the textual sources in the issuance of a *Sharia' Hukm*¹⁴⁸. Although this method had indeed attracted criticisms from the majority of *Sharia'* jurists in the 14th century because it differed from the accepted *Sharia'* legal methodologies of the *Muktabar* (officially recognised or popular) schools, Al-Tufi propounded a sound argument, which proved valuable especially to the *Sharia'* issues in modern times, by restricting the application of *Maslahah* to matters pertaining to *Muammalat* (financial transactions) or the interrelationship between mankind and not *Ibadat* (act of worship)¹⁴⁹.

The *Shafie'* school, however, remains hesitant as to the practicability of *Maslahah* as a credible source of *Sharia'* law in deducing a *Sharia' Hukm* because it includes anything that concerns the public interest, which can serve as an overly wide excuse and become a 'safe harbour' for irresponsible parties to pursue their personal interest and even justify

¹⁴⁵ The Hanbali commonly adopts five *Sharia'* legal methodologies, namely the Holy Quran, *Sunnah*, *Ijma'*, *Qawl Al-Sahabi*, and *Hadith Mursal* (*Hadith* with incomplete or broken chain of narration). See Lahsasna, *Introduction to Fatwa, Shariah Supervision & Governance in Islamic Finance*, p. 93-94; Al-Jawziyah, vol. 1, p. 29-32.

¹⁴⁶ Al-Buti, p. 369.

¹⁴⁷ Ibn Qayyim, *Al-Thuruq Al-Hukmiyyah Fi'l-Siyasah Al-Shar'iyyah* (Al-Mu'assasah al-'Arabiyyah 1961), p. 14, 222, 226; Ibn-Qudamah; Abdallah Abd Al-Muhsin Al-Turki, *Usul Madhab Al-Imam Ahmad (The Origin of the School of Imam Ahmad)* (published in Riyadh, Maktabah Al-Riyadh Al-Hadithah 1977), p. 425.

¹⁴⁸ Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, p. 817; Zaid, p. 206-240.

¹⁴⁹ Al-Shatibi, vol. 2, p. 222. Also see Man, p. 503.

their wrongdoings¹⁵⁰. The school opined that the *Maslahah* cannot exist outside the perimeters of *Sharia'* law because its existing legal methodology, which relies on the *Holy Quran, Sunnah, Ijma'*, and *Qiyas*, can already meet the need to preserve the *Maslahah* of mankind¹⁵¹. In other words, the Shafie took a cautious approach by preferring to eliminate the risk of losing public confidence in the administration of *Sharia'* law as a result of the exploitation of *Maslahah* than the very act of utilising the same methodological instrument to deduce a *Sharia' Hukm* – an approach that resembles the *Sharia'* legal maxim of *Al-Amal Bil-Makruf Wa-Nahi 'Anil Munkar* (the enjoinder of better good and forbidding evil), which ultimately serves to benefit the public interest¹⁵². This does not infer that the school disregards the significance of *Masyaqqah* in a particular *Sharia'* issue; it simply emphasises the need to establish the causes, which led to such extreme circumstances before it can take a *Rukhsah* (lenient) approach¹⁵³.

However, there are several *Sharia' Hukms* from the Shafie school that have embraced the principal constituents of *Maslahah* such as the existence of a *Fatwa*, which permits the annihilation of animals or plants within an enemy's territory with the intention of weakening the opposition¹⁵⁴. In fact, it is even arguable that the Shafie shares a similar methodological view of *Maslahah* with the Maliki, *i.e.* both recognise the ground of *Maslahah* if it complies with the Holy Quran and the *Sunnah*¹⁵⁵. Additionally, the successive generation of scholars from the Shafie school such as Imam Al-Ghazali refined the perimeters of *Maslahah* and concluded that the school can resort to its use in deriving a *Sharia' Hukm* if it can satisfy three conditions, namely *Darurah, Qat'iyah*

¹⁵⁰ For instance, the *Munafiqun* (hypocrites) had often manipulated *Maslahah* as an excuse to avoid participating in the wars to defend the religion of Islam by citing exhaustion and personal desires to protect oneself from hostilities and destructions. See Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 233, 236; Shaharuddin, 'Maslahah-Mafsadah Approach in Assessing the Shari'ah Compliance of Islamic Banking Products', p. 130. The Zahiri, Shia, and certain Maliki scholar such as Ibn Al-Najib also rejected the use of *Maslahah*. See Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, vol. 2, p. 758.

¹⁵¹ "Does man think that he will be left uncontrolled (without purpose)?" (*Surah Al-Qiyamah 75:36*) of Ali. Also see Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, vol. 2, p. 761; Hussein Hamid Hassan, *Nadzariyah Al-Maslahah Fi Al-Fiqh Al-Islami* (Maktabah Mutanabbi 1981), p. 311.

¹⁵² Alfie; Zaid, p. 20. Also see Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 232.

¹⁵³ The Shafie recognised the presence of *Masyaqqah* in cognisance of a *Fatwa* from Imam Al-Shafie, namely, *Iza Dhaqal Amru Ittisa'* (when a matter is constricted, the *Hukm* is wide). See Al-Suyuti, p. 162; Ibn Nujaym, p. 89.

¹⁵⁴ Al-Suyuti, p. 60-61. Also see Hassan, p. 311.

¹⁵⁵ Al-Buti

(absolute certainty) and *Kuliyyah* (universality)¹⁵⁶. The absence of any of these conditions will render the use of *Maslahah* invalid. To illustrate this, a *Darurah* situation which prompted the passengers of a sinking boat to throw a fellow passenger overboard for the sake of saving the life of the other passengers, is not considered as one done out of *Maslahah* because it lacked universality and only benefited a certain group of people¹⁵⁷.

From the above explanations, it is deducible that the current stance on the validity of *Maslahah* as a *Sharia'* legal methodology lies between the rigid approach of the Shafie and Hanafi, which only recognise its validity if its application stays within the perimeters of the *Holy Quran* and the *Sunnah*, and the open approach of Maliki and Hanbali, which prefers to adopt it directly as long as it does not contradict the objectives of *Sharia'* law. Nonetheless, it is arguable that the concept of *Maslahah* bears a strong resemblance to the western jurisprudential concept of utilitarianism in the sense that both agree to the application of reasoning and logics as the main references in determining the permissibility of a certain practice or issue, as long as it brings benefits to the greatest number of people. The only differences lie in their respective religious or moral trajectory where the *Maslahah* mandates that any decision must not breach the perimeters allowed by *Sharia'* law¹⁵⁸.

5.3.3.3 *Maslahah Al-Mursalah* and Multiple *Sharia'* Board Directorships

Applying the aforementioned stance in the context of multiple *Sharia'* board directorships, it is arguable that only the Maliki and Hanbali; or in the geographical terms, the countries that subscribe to the teachings and principles of these schools, would accept the use of *Maslahah* to justify the practice. This standpoint can be illustrated by the fact that the practice is accepted and prevalent in Qatar (Hanbali), Saudi Arabia (Hanbali), and United

¹⁵⁶ Al-Ghazali and Abu Hamid; Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, vol. 2, p. 767; Muhammad Mustafa Shalabi, *Usul Al-Fiqh Al-Islami (Islamic Jurisprudence)* (published in Beirut, Dar Al-Nahdah Al-Arabiyyah 1986), p. 289.

¹⁵⁷ Al-Ghazali and Abu Hamid, p. 296-297.

¹⁵⁸ H. Said Agil Husin Al-Munawar, 'Konsep Al-Maslahah Sebagai Salah Satu Sumber Perundangan Islam (The Concept of Maslahah as One of the Sources of Islamic Law)' 18 & 19 *Islamiyyat* 59, p. 60-63. Also see Khallaf, *Masadir Al-Tashri Al-Islami Fi Ma La Nassa Fih (The Origins of Islamic Legislation in the Absence of Textual References)*, p. 76.

Arab Emirates (Maliki), but impermissible or restricted in Malaysia (Shafie) and Pakistan (Hanafi)¹⁵⁹. Fascinatingly, Sudan, which subscribes to the Maliki school, also shares a similar restrictive policy as Malaysia and Pakistan, and has begun prohibiting the practice of multiple *Sharia'* board directorships in order to ensure an optimum devotion of time and attention by *Sharia'* board members to the affairs of IFIs¹⁶⁰. This implies the existence of a substantial concern within a fraction of the Maliki school as to the adversarial aspect of *Maslahah*, namely *Maslahah Al-Mufsadah*, which could give rise to the beginning of a more restrictive approach to *Maslahah* in the Maliki school.

Regardless, the above explanations not only prove a strong presence of qualified and competent *Sharia'* scholars in the Islamic banking industry, but also render it practical to argue that the shortage of *Sharia'* scholars could not longer serve as a valid and practical *Masyaqqah* in justifying the *Maslahah* of the multiple *Sharia'* board directorship practice¹⁶¹. In fact, it is arguable that the possession of extraordinary banking experience or vast business contacts by the interlocking *Sharia'* board members only add an extra choice and do not constitute a mandatory requirement to the qualification criteria of an IFI's *Sharia'* board member¹⁶². Moreover, the absence of a binding and uniform Islamic banking set of legal and corporate governance standards at the international level, which occurs as a result of the divergence in *Sharia'* opinions, legal methodologies, and *Urf* between the different schools of Islamic jurisprudence¹⁶³, has further contributed to the variation in legal standards and regulatory policies on the legal position of the practice between countries¹⁶⁴.

¹⁵⁹ Hasan, 'Optimal Shariah Governance in Islamic Finance', p. 15.

¹⁶⁰ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 100-102; Islamic Development Bank, *Islamic Development Bank Group in Brief*, p. 29. Also see Thomson Reuters, *Islamic Finance Development Report 2014*, p. 113; Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 7.

¹⁶¹ cf the *Fiqh* method of *Al-Dharurah Taqdiru Bi-Qadriha* (Necessity is Determined According to Its Degree), which stipulates that when the reason for the severity ceases to exist, what is permitted shall revert to its original rulings. See Al-Suyuti, p. 170; Muda and Ali, p. 402-403.

¹⁶² Al-Mawardi, p. 15.

¹⁶³ Lahsasna, 'Shariah Governance in the Islamic Financial Institution: Issues and Challenges', p. 703. Also see Ibn Musa Al-Shatibi, p. 191.

¹⁶⁴ Imam Al-Shafie opined that the application of *Maslahah* can lead to uncertainty and lack of uniformity in the *Sharia'* law. See Muhammad Ibn Idris Al-Shafi'i, *Al-Umm*, vol 6 (Matba'ah Al-Kubra Al-Amiriyah 1908), p. 273.

Indeed, *Maslahah* serves as an integral legal basis for *Sharia'* scholars in arriving at a *Sharia' Hukm*, particularly in matters, where the *Holy Quran* and the *Sunnah* have abstained from prescribing a specific directive. Then again, considering the uncertain *Sharia'* compliance status of multiple *Sharia'* board directorships, a continual reliance on *Maslahah* as the basis to uphold the practice can expose the industry to the possible risk of *Sharia'* non-compliance. Surely, a *Maslahah* that leads to chaos and destruction does not represent the actual concept of *Maslahah* as envisioned by *Sharia'* law but presents a *Mafsadah* (harmful or destructive outcome), whose avoidance constitutes a *Maslahah* in itself¹⁶⁵.

In fact, a specific *Fatwa* does not yet exist on the legal status of the practice or even an *Ijtihad* from any non-Islamic banking *Sharia'* scholars that can offer an independent and credible evaluation of the *Sharia'* compliance status of the practice in question and its inherent risk. This dilemma took a dubious turn when the *Sharia'* scholars who engage in the practice themselves stressed that restricting the practice would not only expose the industry to the risk of appointing less qualified candidates for the IFI's *Sharia'* board, but also would curb the growth of the US\$ 2 trillion Islamic banking market¹⁶⁶. Certainly, these assertions and the ostensible absence of any serious repercussions to the industry since its inception more than 30 years ago because of this practice can neither serve as a credible justification nor render the practice *Sharia'*-compliant.

In fact, as much as *Ikhtilaf* amongst the different school of Islamic jurisprudence serves as a form of blessing to the Muslim community in the sense that it allows and recognises the differences of *Sharia'* opinions as a result of the differences in the *Urf* and legal systems between the countries¹⁶⁷, it is equally crucial for a proper *Ijtihad* on the legal status of the multiple *Sharia'* board directorship practice to exist in an attempt to regulate this practice. This could begin by setting certain preconditions to its exercise – this could include restricting the practice only to the circumstances that benefit the public interest; not those of an individual or a particular group of *Sharia'* scholars. The interlocking *Sharia'* board members could definitely employ their vast knowledge and experience to

¹⁶⁵ Al-Jawziyah; 'Abd Al-Rahman Al-Suyuti, *Ashbah Wa Al-Nazair Fi Qawaid Wa Furu Fiqh Al-Syafi (Similarities in the Branches of Law According to the Syafi Fiqh Method)*, vol 1 (M Muhammad Tamir and H Ashur Hafiz eds, published in Cairo, Dar Al-Salam 2004), p. 64.

¹⁶⁶ Ernst & Young, *World Islamic Banking Competitiveness Report 2016*, p. 18. Also see Enriques and Zetzsche; Siddiqui, ; El Baltaji and Anwar

¹⁶⁷ Reported in Al-Nawawi's commentary of the book of *Waqf* in Sahih Muslim. See Al-Nawawi, p. 91. Also see Al-Zuhaily, p. 12; Al-Barr and Ibn Abd Allah, p. 901.

good use for the benefit of the IFIs. At the same time, in order to avoid any bias, it is equally critical for the practice in question to procure strong grounds of legitimacy under the *Sharia'* law through a collective *Ijtihad* – a methodical process of *Fiqh* in arriving at a comprehensive and more convincing assessment, as opposed to the personal opinions of those who engage in the practice themselves.

5.4 Fulfilment of *Amanah* (Trust) Amidst Multiple Obligations

5.4.1 Concept of *Amanah* in *Sharia'* Law

“...truly the best of men for thee to employ is the (man) who is strong and trustworthy.”

(*Surah Al-Qasas* 28: 26)

Undoubtedly, the doctrine of trust functions as a crucial foundation that underlines the different types of relationship in mankind's life: from one that sustains the personal relationship between mankind to one governing business transactions such as those involving important monetary institutions such as banks. The structure of trust not only depends on one's cultural background, but also varies according to one's religion and moral beliefs. In the Western culture and norms, it begins as a positive expectation that the other party will exercise honesty and due diligence thereby reducing the fear that one's interests may be threatened¹⁶⁸. In the East, it flows in the opposite manner – trust only exists once a person has proven his trustworthiness. In other words, trust in business exists almost instantaneously in the West while in the East, one must earn the trust and confidence of the people before commencing any business.

In this context, the concept of trust founded in the East bears a resemblance to the doctrine of *Amanah*, where Islam restricts its designation only to the rightful individuals, who satisfy a certain set of criteria such as bearing a good intention; *baligh* (reaches the age of majority); *aqil* (sound mind); and *mukallaf*¹⁶⁹. Contrary to both the Eastern and Western concept of trust, which do not subscribe to a particular religious doctrine, Islam

¹⁶⁸ David De Cremer, 'Understanding Trust in China and the West' Harvard Business Review <<https://hbr.org/2015/02/understanding-trust-in-china-and-the-west>> accessed 22 September 2017. Also see Harry G Barkema and others, 'West Meets East: New Concepts and Theories' (2015) 58 Academy of Management Journal, p. 463.

¹⁶⁹ Ibnu Mas'ud and Zainal Abidin, *Fiqh Madzhab Syafi'i* (*Fiqh of Shafie School of Islamic Jurisprudence*) (published in Bandung, CV Pustaka Setia 2007), p. 28. Also see P.D.A. Kharofa, *Transaksi dalam Perundangan Islam* (*Transaction in Sharia' Law*) (Itnm 2007), p. 112.

regards *Amanah* as a trust from God that emanates from the doctrine of *Tawheed* and emphasises the allegiance of mankind to God in every aspect. In other words, the term 'God' serves as an important source of both aspiration and sanction of *Amanah* in the Islamic teachings.

"O ye who believe! Betray not the trust of God and the Messenger, nor misappropriate knowingly things entrusted to you".

(*Surah Al-Anfal* 8: 27)

"...therefore fear not men, but fear Me, and sell not my Words for a miserable price. If any do fail to judge by (the light of) what God hath revealed, they are (not better than) the Unbelievers".

(*Surah Al-Ma'idah* 5: 44)

Further, *Sharia'* law also views *Amanah* as an integral trait that differentiates a Muslim and a hypocrite. In a *Hadith* narrated by Abu Hurairah, the Prophet Muhammad (p.b.u.h.) said:

*"The signs of a hypocrite are three. First, whenever he speaks, he tells a lie. Second, whenever he promises, he breaks it. Third, whenever he is entrusted with a matter, he breaches it"*¹⁷⁰.

Additionally, the fulfilment of *Amanah* also encourages the development of *Tsiqah*, or the feeling of trust to the leadership of a leader, which further cultivates the essential attributes of respect, obedience and loyalty¹⁷¹ – without which, leadership serves no purpose but leads to failure and ruin¹⁷². In Islamic banking, *Tsiqah* of the customers emanates from both the success of the IFIs in introducing *Sharia'*-compliant financial instruments, which fulfil the objective and interest of both the *Maqasid As-Sharia'* and the society, and from the conduct of their employees that reflect a comprehensive obedience to the fundamental teachings of *Sharia'* law. Hence, Islam treats any allegations that question *Tsiqah* to a leadership as a serious matter unless they are supported by strong evidence. In the context of multiple *Sharia'* board directorships, any

¹⁷⁰ This *Hadith* is *Sahih*. See *Hadith* 26, Book 2 of Al-Bukhari and Khan; *Hadith* 117, Book 1 of Ibn Al-Hajjaj

¹⁷¹ *"But no, by God! They do not believe (in reality) until they make you a judge of that which has become a matter of disagreement among them, and then do not find any straightness in their hearts as to what you have decided and submit with entire submission"* (*Surah An-Nisa* 4:64) of Ali

¹⁷² *"Obedience and a gentle word (was proper); but when the affair becomes settled, then if they remain true to God it would certainly be better for them"* (*Surah Muhammad* 47:21) of ibid

discussions that question the ability of the *Sharia'* scholars in fulfilling their corporate responsibilities amidst multiple directorships must be engaged in a tactful manner so as to avoid leading the public to lose confidence in the credibility and leadership of the *Sharia'* scholars.

5.4.2 ***Amanah* in Occupation**

Relatively, Islam regards an occupation as an *Amanah* from God, regardless of whether it is a high-profile one such as a company's CEO or one deemed humble such as a garbage collector¹⁷³. Likewise, this injunction also applies to the occupations of *Sharia'* scholars as a *Mufti*, *Ulama*, academic professor, and religious teacher; or in the current context as an IFI's *Sharia'* board member. The *Holy Quran* further equates those who work or labour for the sake of their spouse and children through *Halal* means with those who fight or sacrifice in the path of God known as *Jihad*¹⁷⁴. This noble effort, according to Sheikh Yusuf Al-Qardawi, belongs to another category of *Jihad* called *Jihad Al-Madani* (civil *Jihad*)¹⁷⁵. Of course, it is important to note that the term *Jihad* does not involve any act of terrorism such as suicide bombings or beheadings of captives, which actions have since distorted the actual interpretation of *Jihad* in Islam.

Additionally, Islam classified a *Halal* occupation as a noble profession. Caliph Umar Al-Khattab once stated that he preferred dying on his saddle while seeking the bounties of God than fighting in the *Jihad*¹⁷⁶. In another *Hadith*, the Prophet also mentioned that the

¹⁷³ "And say: "Work (righteousness): soon will God observe your work, and His Messenger, and the believers: soon will ye be brought back to the Knower of what is hidden and what is open: then will He show you the truth of all that ye did"" (Surah Al-Tawbah 9:105) of ibid. Also see Mohamed Sharif Mustaffa and Roslee Ahmad, 'Bimbingan Kerjaya Menurut Perspektif Islam (Career Guidance According to the Islamic Perspective)' (2002) 8 Jurnal Pendidikan Universiti Teknologi Malaysia, p. 67.

¹⁷⁴ "...He knoweth that there may be (some) among you in ill-health; other travelling through the land, seeking of God's bounty; yet others fighting in God's cause..." (Surah Al-Muzzammil 73:20) of Ali. Also see *Hadith* 213, Book 56 of Hamidy and others; *Hadith* 53, Book 15 of Dawud and Ibn Al-Ashcath; *Hadith* 5, Book 45 of Ibn Al-Hajjaj

¹⁷⁵ Ibrahim, p. 306-314. This echoes the views of the Prophet Muhammad (p.b.u.h.), who provided a different perspective to *Jihad* to include working with the intention to provide sustenance to oneself and one's family. See Al-Tabarani, vol. 2, p. 148.

¹⁷⁶ Muhammad Ibn Hassan Al-Shaybani, *Al-Iktisab Fi Al-Rizq Al-Mustatab (Earning Desired Income)* (published in Cairo, Matba'ah Al-Anwar 1938), p. 16.

act of seeking a *Halal* job is a *Fardh* after *Fardh*¹⁷⁷. Although the *Hadith* has stopped short of identifying the type of *Fardh* the Prophet Muhammad (p.b.u.h.) had referred to, it is arguable that ‘a *Fardh* after *Fardh*’ refers to one that is not mandatory, yet highly recommended – namely *Fardh Kifayah* since it is the second *Fardh* commended by Islam.

From the *Sharia*’ law perspective, *Amanah* in an occupational environment demands employees perform their working obligations with due diligence for the sake of obtaining the pleasure of God. Since the employment contract involves mutual promises to perform a set of obligations in exchange for a specific compensation between an employer and an employee, Islam treats the situation of an employee who fails to fulfil his obligations in a proper manner but readily accept his monthly salary as a breach of *Amanah*, which renders him accountable to God in the Hereafter. Likewise, it is considered that an employee who undertakes his obligations with total dedication and integrity will not only earn the confidence of his employer, colleagues, and customers, but also a great reward in the Hereafter.

5.4.3 *Amanah* in the Capacity of *Sharia*’ Board Members

As far as the authoritative capacity of the IFI’s *Sharia*’ board members is concerned, *Sharia*’ law regards the power to make decision and issue relevant *Fatwas* as an *Amanah* from both God and society, which obliges scholars to make decisions that are both *Sharia*’-compliant and society-oriented¹⁷⁸. According to Imam Al-Ghazali, Islam requires the individuals in whom this trust is bestowed to observe the following ethics in ensuring the *Amanah* is upheld at all times. These include:

- (a) Remembrance of God at all times;
- (b) To undertake the responsibility in good faith and free will;
- (c) To exercise truthfulness and justice;
- (d) To implement *Shura* and promote the spirit of collective decision-making;
- (e) To ensure compliance with the principles of *Sharia*’ law;
- (f) To avoid uncertainty in every matter; and

¹⁷⁷ Abu-Bakr Al-Bayhaqi, *Al-Sunan Al-Kubra* (published in Beirut, 1994). Also see, “And say: Work, so God will see your work and (so will) His Apostle and the believers; and you shall be brought back to the Knower of the Unseen and the Seen, then He will inform you of what you did” (Surah Al-Taubah 9:105) of Ali

¹⁷⁸ “...nor misappropriate knowingly things entrusted to you”. See (Surah Al-Anfal 8:27) of Ali

(g) To exercise keen consciousness in avoiding mistakes¹⁷⁹.

In Islamic banking, *Amanah* serves as the most valuable trait for the Islamic banks¹⁸⁰. As much as Islam regards the IFIs as business entities that shoulder the people's trust in managing their funds in a *Sharia'*-compliant manner, it also demands everyone at the IFI – from the bottom to the top executive level, to perform their job responsibilities with the utmost integrity. Over time, the fulfilment of *Amanah* via repeated satisfactory interactions between the IFIs and their consumers will morph into a positive reputation and translate into a higher profitability for both the IFIs and industry. Moreover, since the most important stakeholder of Islamic banking is Islam itself, *Amanah* in the IFI's business practices remains a significant issue and must not be taken lightly, especially in view of the occurrence of several breaches of *Amanah* involving IFIs in the last two decades. These include the fraudulent 'pyramid scheme' of the Egyptian Al-Rayyan Islamic Investment Co. in 1987¹⁸¹; the embezzlement of Dubai Islamic Bank in 1997 and 2007; and the financial losses of Bank Islam Malaysia Berhad in 2005, all of which had a negative impact on the global reputation of the Islamic banking industry¹⁸². In fact, according to Dr. Y. V. Reddy, the former Governor of the Reserve Bank of India, the depreciation of trust was also a global dilemma that has since plagued the entire financial services industry, particularly the banking sector¹⁸³.

Although the commission of these breaches of *Amanah* did not involve members of the *Sharia'* boards, this does not mean they will not commit similar misconducts in the future. In fact, Ibn Al-Arabi, a prominent historical Arabic scholar, opined that the betrayal of trust can even occur within the context of religious duties; which infers that a 'religious' label does not necessarily guarantee the fulfilment of *Amanah*¹⁸⁴. In addition, as much as the IFI's *Sharia'* board comprises *Sharia'* scholars exhibiting an exceptional

¹⁷⁹ Al-Ghazali. Also see Lewis, p. 16.

¹⁸⁰ Accounting, Auditing, and Governance Standards as at December 2015, p. 951. Also see Kerry Close, 'Almost Nobody Trusts Financial Institutions' Money, 14 April 2016 <<http://time.com/money/4293845/trust-financial-institutions-study/>> accessed 22 September 2017

¹⁸¹ Reinhard Klarmann, 'Islamic Finance in Egypt' [2007] Islamic Finance News; Ahmed and Grais

¹⁸² See p. 67-68.

¹⁸³ Y. V. Reddy, 'Society, Economic Policies, and the Financial Sector' Per Jacobsson Foundation Lecture, 24 June 2012, Switzerland <<http://www.bis.org/events/agm2012/sp120624.pdf>> accessed 21 September 2017

¹⁸⁴ See Ibn Al-Kalbi in Al-Qurtubi

competency in *Fiqh Al-Muammalat*, and also a high standard of trustworthiness that corresponds to their deep understanding of the *Halal* and *Haram* realms of *Sharia'* law, Islam also advocates against the practice of placing an arbitrary trust in religious scholars without utilising the reasoning faculties granted by God beforehand – which according to Islam, had attributed to the misinterpretation of the actual teachings of the Abrahamic religions such as those occurred in Judaism and Christianity¹⁸⁵.

“They take their priests and their anchorites to be their Lords in derogation of God, and (they take as their Lord) Christ the son of Mary; yet they were commanded to worship but one God. There is no God but Him. Praise and glory to Him: (far is He) from having the partners they associate (with Him)”.

(*Surah At-Taubah* 9: 31)

Sheikh Dr. Hussein Hamid Hassan, a prominent *Sharia'* scholar, contended that there has not been a case or proven evidence to suggest the occurrence of a breach of *Amanah* by an IFIs' *Sharia'* board members throughout the entire 30 years-history of the Islamic banking industry¹⁸⁶. He also notes that the *Sharia'* board comprises men and women of faith guided by the above *Sharia'* morale and ethics, who will refrain from dishonouring the trust of God. As the IFI's *Sharia'* board operates as a collective decision-making institution, he suggests it may appear preposterous to suggest that the *Sharia'* scholars, who have obtained a deep understanding of *Sharia'* law, are willing to forsake their knowledge of the *Halal-Haram* matters and overlook the punishments awaiting those who commit breach of *Amanah* in favour of wealth and worldly materials.

There is an element of truth in this viewpoint but it overlooks the fact that a total reliance on moral and good religious principles as the ultimate fulcrum regulating the conduct of *Sharia'* scholars will not render them immune from committing fraudulent or non-*Sharia'* compliant practices¹⁸⁷. In the past, men and women of faith have always shown a frequent reluctance to shoulder the burden of leadership for fear of breaching the trusts

¹⁸⁵ *“The Jews call 'Uzair a son of God, and the Christians call Christ the son of God. That is a saying from their mouth; (in this) they but imitate what the unbelievers of old used to say. God's curse be on them: How they are deluded away from the truth!”*, see (*Surah At-Taubah* 9:30) of Ali. Also see *Hadith* 3211, Book 47 of Moh Zuhri, *Tarjamah Sunan Al-Tirmidzi* (published in Kuala Lumpur, Victory Agencie 1993); Taymiyyah, *Majmu' Al-Fatawa* (37 Vols), vol. 7, p. 71.

¹⁸⁶ Siddiqui, , p. 36.

¹⁸⁷ *“...Therefore, justify not yourselves: He knows best who it is that guards against evil”*. See (*Surah Al-Najm* 53:32) of Ali. Also see Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System'

of both the public and God¹⁸⁸. Furthermore, it is arguable that the multiple *Sharia'* board directorship practice can also present a critical risk to the stakeholders' *Tsiqah* of the industry, where a well-connected *Sharia'* scholar; usually the senior scholar, can wield considerable powers to influence the decisions of the *Sharia'* board due to their possession of unique information or professional connections, thus jeopardising the integrity and credibility of the IFI's businesses¹⁸⁹.

Although Islam advocates *Tsiqah* to the *Sharia'* scholars in recognition of their knowledge and understanding of the delicate rules and principles of *Sharia'* law, it also prohibits the exercise of arbitrary *Tsiqah* to those in positions of leadership – even if the leader is a renowned figure¹⁹⁰. Moreover, all the Imams, who founded the four major schools of Islamic jurisprudence, had unanimously warned the members of the public and even the *Sharia'* scholars, against the practice of arbitrary obedience in matters of which they possess little or no knowledge¹⁹¹. Imam Shafie, for instance, had particularly stressed the supremacy of the Holy Quran and the *Sunnah* of the Prophet Muhammad (p.b.u.h.) against the practices and sayings of the *Sharia'* scholars, especially if these contradict the main sources of *Sharia'* law¹⁹².

During the time of the Prophet Muhammad (p.b.u.h.) and the four *Ar-Rashidin* caliphates, total *Tsiqah* was common within Arabian society. Further, the proximity of the society's era with that of the Prophet's and also the absence of any schools of Islamic jurisprudence or variations in religious practices, which suited the non-sophisticated nature of society at that time as compared to the present day, had even rendered 'arbitrary' *Tsiqah* a feasible practice to a large extent¹⁹³. Additionally, it is also worth noting that the practice of arbitrary *Tsiqah* has exhibited its own infallibility as it had contributed to the downfall of both the Abbasides dynasty and the city of Baghdad to the

¹⁸⁸ See discussion on *Amanah* at p. 40-41, 84, 93, 218 and 243-244. Also see *Hadith* 12, Book 93 of Al-Bukhari and Khan; *Hadith* 19, Book 33 of Ibn Al-Hajjaj

¹⁸⁹ Davis, p. 157.

¹⁹⁰ "Nay! They say: 'We found our fathers following a certain religion, and we do guide ourselves by their footsteps'". See (Surah Al-Zukhruf 43:22) of Ali

¹⁹¹ Al-Jawziyah, vol. 2, p. 200.

¹⁹² Ibnu Katsir, *Al-Bidayah Wa An-Nihayah (The Beginning and The End)* (Abu Ihsan Al-atsari tr, Darul Haq 2004), vol. 5, p. 276; Al-Dahabi, vol. 5, p. 35. Also see Al-Nawawi, p. 63.

¹⁹³ Ibn Badran Al-Dimasq, *Al-Madhkal Ila Madhab Al-Imam Ahmad Bin Hanbal (Introduction to the Madhab of Imam Al-Ahmad Bin Hanbal)* (Dar Ihya' Al-Turath Al-Arabi 1920), p. 193; R. Mottahedeh, *Loyalty and Leadership in An Early Islamic Society* (I. B. Tauris 2001), p. 7-8.

Hulagu dynasty circa 1258¹⁹⁴. With the advent of Islamic banking, which propagates the application of *Sharia*-compliant financial instruments, it is arguable that there is a need for stakeholders to revisit their *Tsiqah* to the IFIs, especially in light of several alarming cases involving the exploitation of the image of Islam by irresponsible parties to profit from the stakeholders' trust of the industry¹⁹⁵.

Similarly, in the common law, honesty in the exercise of power cannot protect a director against a claim for breach of duty¹⁹⁶. In the same way as there is no financial institution that is too big to fail; similarly, there is no *Sharia*' scholar who is too virtuous to fault. Arbitrary and unsubstantiated claims of virtue can serve as a manipulation tool for unscrupulous parties to prey on the 'Islamic' label of the IFIs and Islamic banking. After all, religion can convince the public that the notion of honesty, fairness, justice, and compliance with the rules of God will always gain prevalence over all others when the reality brings an entirely different picture. For example, the phrase of 'by God' or 'God wills it' in the Western society, or '*Wallahi*' or '*Wabillahi*' in the Islamic society had functioned as an effective term to convince society that a cause would serve the interest of God and the religion¹⁹⁷. Hence, there arises a need for society to utilise their intellectual capacity in drawing a distinction between a rightful and a wrongful conduct instead of placing an unyielding trust or absolute reliance on the 'religious label' of a person or company. In fact, *Sharia*' law also stipulates that the call to remain vigilant at

¹⁹⁴ Wan Kamal Mujani, 'Political History of Mamluk (648-922H/1250-1517AD): An Observation Based on Primary and Secondary Sources' (2010) 2 International Journal of West Asian Studies, p. 38; Bakar and Zain, p. 74.

¹⁹⁵ Pakistan Today, "Interest-Free Investment' Scam by Muftis Steals Billions' Pakistan Today, 19 July 2013 <<http://www.pakistantoday.com.pk/2013/07/19/national/interest-free-investment-scam-by-muftis-steals-billions/>> accessed 19 September 2017. Also see H. Cisse and others, *The World Bank Legal Review, Volume 5: Fostering Development through Opportunity, Inclusion, and Equity* (World Bank Publications 2013), p. 128.

¹⁹⁶ Skinner, p. 64.

¹⁹⁷ In Malaysia, these phrases are common in the oath-taking text of official governmental ceremony such as the coronation of the King or the appointment of the Prime Minister and the Chief Ministers. Ironically, the embroilment of Prime Minister Najib Razak in numerous controversies, most recently, the discovery of RM2.3 billion in his personal account, the actual purpose of the debt-ridden 1MDB, and his continuous evasion in answering these issues in the Parliament suggest a serious breach of his previous oath, which further supplement the argument that the phrases of '*Wallahi*' or '*Wabillahi*' can serve as a manipulative tool. See Nazri Muslim and Ahmad Hidayat Buang, 'Islam dalam Perlembagaan Persekutuan dari Perspektif Hubungan Etnik di Malaysia (Islam in the Federal Constitution from the Perspective of Ethnic Relation in Malaysia)' (2012) 20 Jurnal Kemanusiaan, p. 122; Tom Wright and Bradley Hope, '1MDB Scandal: Deposits in Malaysian Leader Najib's Accounts Said to Top \$1 Billion' The Wall Street Journal, 1 March 2016 <<http://www.wsj.com/articles/deposits-in-malaysian-leaders-accounts-said-to-top-1-billion-1456790588>> accessed 19 September 2017

all times constitutes a collective responsibility, which involves society and the other stakeholders of the industry such as the regulatory authorities, investors, and the IFI's professionals.

“...Verily never will God change the condition of a people until they change it themselves (with their own souls) ...”

(*Surah Ar-Ra'd* 13: 11)

Nonetheless, the interlocking *Sharia'* board members should also deserve a reasonable degree of trust from the stakeholders. Since *Sharia'* compliance forms the fundamental backbone of IFIs' business operations, it is arguable that there has already existed a firm Islamic corporate governance framework within most IFIs to ensure an optimum level of compliance with *Sharia'* law. The presence of regulatory authorities at the federal level such as the central bank has also provided a realistic assurance to the industry's stakeholders that the preservation of both their religious and financial interests remain the priority interests for the IFIs. In the event the practice causes the collective *Sharia'* decisions of the IFI's *Sharia'* board to contradict *Sharia'* law or becomes controversial, the presence of a national *Fatwa* council can provide a viable 'check-and-balance' platform in resolving the contradictory *Fatwas*.

5.4.4 Fulfilment of *Amanah* in Multiple *Sharia'* Board Directorships

In relation to the theme of this thesis, the issue of whether interlocking *Sharia'* board members can fulfil the *Amanah* entrusted to them amidst their multiple *Sharia'* board commitments, presents an intriguing debate among practitioners and *Sharia'* scholars alike. Whenever a *Sharia'* scholar holds more than one IFI's *Sharia'* board directorship, it triggers a perplexing question as to the scholar's time management ability in discharging his or her professional duties. For example, two *Sharia'* board directorships will reduce the scholar's time and focus to 50 per cent, three positions to 33 per cent, four positions to 25 per cent, five positions to 20 per cent, ten positions to 10 per cent, and 16 positions to a mere 6 per cent. Interlocking *Sharia'* board members, who hold academia appointments, could project an even lower percentage in the time and focus commitment to the IFI's affairs depending on the number of *Sharia'* board directorships they have undertaken¹⁹⁸.

¹⁹⁸ Sheikh Yusuf Talal de Lorenzo, a prominent *Sharia'* scholar in the United States, reminded those who serve on multiple *Sharia'* boards while at the same time hold obligation to other institution, particularly

Notably, the latest empirical research on the practice discovered that the top 50 *Sharia'* advisors held multiple *Sharia'* board directorships across 73 per cent of the IFIs across the globe, which equals to approximately 834 *Sharia'* board positions¹⁹⁹. In other words, the fact that each scholar held an average of 16 *Sharia'* board directorships highlights a serious concentration risk in the most critical function of an IFI, namely the *Sharia'* compliance certification of its financial products and services²⁰⁰. Since the scope of duties and responsibilities of *Sharia'* scholars involve, among others, the issuance of Islamic banking *Fatwas*, which requires a rigorous deliberation of all the *Sharia'* issues involved and a detailed scrutiny of legal documents²⁰¹, the undertaking of even a small number of *Sharia'* board directorships can place an onerous set of responsibilities on scholars. This can jeopardise their existing corporate responsibilities and also the integrity of *Fatwas* issued by them. Moreover, the discovery that *Sharia'* board members can only spend a limited time at the IFIs due to reasons such as, *inter alia*, the consultancy nature of their directorship and the lack of a permanent office at the IFI further suggest the practice can hinder them from providing an intensive monitoring to the IFI's *Sharia'* compliance assurance processes²⁰².

In light of the unregulated nature of multiple *Sharia'* board directorships in the majority of key Islamic banking markets, it is high time for the industry to start paying attention to the professional workloads of the *Sharia'* board members, especially those occupying multiple *Sharia'* board positions. Not only does the subject determine the scholar's ability to exercise a sound judgment that best satisfy the material and spiritual interest of stakeholders, its proper analysis can also provide a general idea of the saturation point of *Sharia'* board directorships before this renders the interlocking *Sharia'* board members

academicians, to be very careful and to balance their time and diligence in carrying out their responsibilities effectively. See Siddiqui, . Also see Wilson, *The Development of Islamic Finance in the GCC*, p. 10.

¹⁹⁹ International Shari'ah Research Academy for Islamic Finance (ISRA) and Thomson Reuters, *Islamic Commercial Law Report 2016*, p. 28-29, 32; Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*

²⁰⁰ Sayd Farook and Mohammad Omar Farooq, 'Shariah Governance, Expertise and Profession: Educational Challenges in Islamic Finance' (2013) 5 ISRA International Journal of Islamic Finance 137; Farook and Farooq; Unal, *Sharia Scholars in the GCC - A Network Analytic Perspective*

²⁰¹ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10)

²⁰² Pakistan is the only country that requires IFIs to have at least one resident *Sharia'* scholar to provide day-to-day advice to the IFI. The scholar cannot serve on the *Sharia'* board of other IFIs. See Thomson Reuters, *Islamic Finance Development Report 2015*, p. 141; Hassan, Triyanta and Yusoff, p. 96.

ineffective in performing their fiduciary duties. Hence, the following arguments will attempt to scrutinise the *Sharia'* law perspective of *Amanah* in providing a general assessment of the status quo of *Amanah* and its fulfilment within the practical context of multiple *Sharia'* board directorships.

The proponents of the practice have argued that the assumption of multiple *Sharia'* board positions can enable the interlocking *Sharia'* board members to share and spread their knowledge across the various IFIs' *Sharia'* boards, which fulfil the *Amanah* of God to reveal His knowledge to anyone who wants it²⁰³. This corresponds to the following verse of the *Holy Quran*:

“Surely those who conceal the clear proofs and the guidance that We revealed after We made it clear in the Book for men, they are whom God shall curse, and those who curse shall curse them (too)”.

(Surah Al-Baqarah 2: 159)

In addition, proponents have also relied on another Quranic verse, which gives the impression that multiple *Sharia'* board positions will not hinder the interlocking *Sharia'* board members from fulfilling their *Amanah* to God since “He does not place a burden on a person greater than what he or she can bear”²⁰⁴. In other words, it appears as if the verse guarantees that interlocking *Sharia'* board members will remain capable of fulfilling their multiple corporate responsibilities regardless of the number of *Sharia'* board positions they possess. Moreover, proponents have also argued that the possession of multiple *Sharia'* board directorships will not hinder the *Sharia'* board members from receiving a reward in the Hereafter, even if they erred in their judgment as the *Sharia'* law regards the assumption of these positions as a *Fardh Kifayah*, which already attracted a reward in itself²⁰⁵. This corresponds to a *Hadith*, where Abu Hurairah narrated that the Prophet Muhammad (p.b.u.h) said:

²⁰³ Siddiqui, , p. 36. See (*Surah Ali Imran* 3:187) of Ali.

²⁰⁴ “*On no soul doth God places a burden greater than it can bear ...*” (*Surah Al-Baqarah* 2:286) of Ali

²⁰⁵ Ibrahim, p. 11.

“If a judge (Sharia’ scholar) passes a judgment and strives to reach the right conclusion and gets it right, he is entitled to 2 rewards. (On the other hand) If he strives to reach the right conclusion but gets it wrong, he is entitled to 1 reward”²⁰⁶.

From a different perspective, it is arguable that the *Sharia’* law injunction of seeking for occupation as a ‘*Fardh* after *Fardh*’ can also justify the current multiple *Sharia’* board directorship phenomenon. Indeed, *Sharia’* board members differ in terms of their workloads on the *Sharia’* boards; some are busy while some have more time at their disposal, which renders the assumption of additional *Sharia’* board positions a practical way to contribute and earn as much expertise, knowledge, and even remuneration as possible. It is also arguable that there exist several provisions in *Sharia’* law which can persuade *Sharia’* scholars to share and extend their knowledge and expertise to other parties such as the IFIs, whenever possible²⁰⁷. In addition, the lack of an in-house office for the *Sharia’* board members in most IFIs due the scholars’ advisory function, which does not require a daily attendance, further entices them to seek a practical way to occupy their time – this can include seeking additional *Sharia’* board directorships in other IFIs²⁰⁸.

Conversely, it is also pertinent to consider several *Sharia’* law provisions that place an onerous degree of responsibilities on *Sharia’* board members in the exercise of their duties as the *Mujtahids* of the IFIs. A *Sharia’* scholar, regardless of his or her exceptional prowess of knowledge, experience, expertise and academic qualification, must only issue a *Fatwa* when he or she is in a calm and stable state – both physically and mentally²⁰⁹. With the nature of *Sharia’* board responsibilities embracing a substantial involvement in recent years that translates into a more intensive engagement with the IFIs’ decision-making and *Sharia’* compliance processes, *Sharia’* board members will find their professional roles and commitment becoming increasingly more demanding. For example, the time-consuming process of *Fatwa* issuance²¹⁰, the possibility of delays

²⁰⁶ This *Hadith* is *Sahih*. See Vol. 6, Book 49, *Hadith* 5383 of An-Nasa’i. Also see Vol. 3, Book 13, *Hadith* 1326 of Al-Tirmidhi

²⁰⁷ “...You shall certainly make it clear to men and you shall not hide it...” (*Surah Ali Imran* 3:187) of Ali. In a *Hadith* narrated by Thawban, the Prophet Muhammad (p.b.u.h) said, “No person should lead others in prayer, then supplicate only for himself and not for them. If he does that, he has betrayed them”. This *Hadith* is *Hasan*. See *Hadith* 923, Vol. 1, Book 5 of Ansari

²⁰⁸ Hassan, Triyanta and Yusoff, p. 96.

²⁰⁹ Ibrahim, p. 15. Also see Abu Faris

²¹⁰ From the experience of the *Sharia’* Advisory Council (‘SAC’) of the CBM, the resolution of a *Sharia’* issue can consume up to a period of three months, and even longer depending on the complexity of the *Sharia’*

in-between the processes, and an increase in the number of board meetings present a list of non-exhaustive factors that can tire the *Sharia'* board members²¹¹. The ability of a *Sharia'* board member to execute his or her fiduciary functions including meeting deadlines and effectively representing the IFI in local and international fora serve as an important aspect in measuring his or her work and performance as a functional member of the IFI's *Sharia'* board²¹². If a single *Sharia'* board position can already tire a *Sharia'* scholar, it is arguable that the assumption of additional and excessive *Sharia'* board positions can jeopardise the entire *Fatwa* issuance processes and compromise the integrity of Islamic banking *Fatwas* across the IFIs.

The *Sharia'* law position on the multiple *Sharia'* board directorship practice can also vary on a case-by-case basis. A mere reliance on the *Hadith* that rewards interlocking *Sharia'* board members, even if they erred in their judgment, cannot serve as an automatic defence to justify the multiple *Sharia'* board directorship practice. Nor does it lead to a better understanding and appreciation of the *Sharia'* law perspective of the practice among stakeholders, especially the industry's western counterparts. In fact, an indiscriminate application of the *Hadith* without due consideration to the rigid criteria that qualifies a *Sharia'* scholar to serve on the IFI's *Sharia'* board can develop into a misjudgement in justifying the scholar's conduct even if it contradicts the tenets and spirits of *Sharia'* law. This can subsequently expose the industry to future attempts to redefine and reconstruct the industry in the name of 'progress' and 'modernisation'.

As much as the assumption of additional *Sharia'* board directorships can become a *Fardh Ain* for highly qualified *Sharia'* scholars²¹³, it is arguable that the assumption of too many directorships can render it as a *Haram* practice, even for seasoned and experienced ones. Although the material factors such as the physical and mental energy, the nature of *Sharia'* board responsibilities, and the time at disposal, differ from one *Sharia'* scholar to another, it remains arguable that the numbers of such outstanding scholars, who can perfectly balance their time and professional commitment between the multiple *Sharia'* boards represented, are too few. Fascinatingly, the nature of multiple

issue involved. The *Fatwa* issuance process of new Islamic Banking products can also take a long period of time due to the absence of a *Sharia'* resolution on the product. See Hassan, Triyanta and Yusoff, p. 89-90.

²¹¹ Shahazuri Ibn Al-Salah, *Adab Al-Mufti Wa Al-Mustafti (Etiquette of the Mufti and the Mustafti)* (Maktabah Al-Ulum Wa Al-Hikam 2002), p. 113.

²¹² Siddiqui, ; El-Gamal, p. 11.

²¹³ Al-Qurtubi, p. 216. Also see *Hadith* 1, Book 3 of Hamidy and others

Sharia' board directorship practice bears a similitude to the practice of polygamy in Islam, in which the *Sharia'* law recommends a cautious approach when treading with a position that demands one to deliver fairness and justice to all.

"If ye fear that ye shall not be able to deal justly with the orphans, marry women of your choice, two or three or four; but if ye fear that ye shall not be able to deal justly (with them), then only one, or (a captive) that your right hands possess, that will be more suitable, to prevent you from doing injustice".

(*Surah An-Nisa' 4: 3*)

In other words, the permission to engage in a polygamous marriage in Islam presents a sound argument to suggest that *Sharia'* law allows a *Sharia'* board member to hold multiple *Sharia'* board directorships as it recognises the variation in the nature of *Sharia'* board functions, energy, and time at disposal, which differ from one scholar to the other. However, *Sharia'* law also cautions against holding too many responsibilities as the failure to balance the interests of the parties involved will result in injustice and a breach of *Amanah*, which amounts to a grave sin under the *Sharia'* law²¹⁴.

On the same note, Imam Al-Shatibi argued that a *Sharia'* scholar shares a similar set of responsibilities to that of a prophet, which coincides with the *Hadith*, "*Verily the pious (scholars) are heirs to the prophet*"²¹⁵. Accordingly, this implies that scholars inherit the prophet's responsibilities of providing the community with the *Sharia'* rulings and counsels when needed. However, it is also worth pondering the fact that shouldering the responsibilities of a prophet is not a task to be taken lightly as it not only demands the possession of *Sharia'* knowledge and qualifications of the highest eminence, but also spiritual qualities, which transcend that of a layman. Due to this heavy responsibility, it is not uncommon even for a *Sharia'* scholar of the highest calibre to resist occupying the position that demands the issuance of *Fatwas*, or engaging in its processes and procedures due to their fear of committing injustice and breaching the *Amanah* of God²¹⁶. Perhaps, it is not that *Sharia'* law forbids a *Sharia'* scholar from holding multiple *Sharia'*

²¹⁴ "...If any person is so false, he shall, on the Day of Judgment, restore what he misappropriated; then shall every soul receive its due, - whatever it earned, - and none shall be dealt with unjustly" (*Surah Ali Imran 3:161*) of Ali

²¹⁵ Al-Shatibi, p. 244, 595; Al-Mawardi, p. 10.

²¹⁶ Doi, p. 17. Also see a *Hadith* narrated by Abu Hurairah, in which the Prophet Muhammad (p.b.u.h) said, "*God, the Most High says, 'I make a third (party) with two partners as long as one of them does not cheat the other, but when he cheats him, I depart from them'*". This *Hadith* is *Daif*. See Book 23, *Hadith 58* of Dawud and Ibn Al-Ashcath

board directorships, but rather the occupation of too many, which suggests a lack of fear of God and the burden of His *Amanah* – this of course, is not a fitting image of a *Sharia'* scholar as one who is pious and fearful of God.

“We did indeed offer the trust to the heavens and the earth and the mountains; but they refused to undertake it, being afraid thereof: but man undertook it; - he was indeed unjust and foolish”

(*Surah Al-Ahzab* 33:72)

5.4.5 Remuneration of *Sharia'* Scholars

The issue of executive remuneration has long attracted attention in the western countries, especially following the 2008 global financial crisis. In the banking sector, excessive and poorly structured remuneration packages cultivated a 'greedy' culture within the banks encouraging them to take more risks leading to terrible losses during the crisis as exemplified by Bear Stearns²¹⁷ and Merrill Lynch²¹⁸. In the United Kingdom, the government is still facing persistent calls from various stakeholders to regulate the executives' remuneration structure and to promote a better channel for stakeholders to engage in its governance ensuring that businesses are run not only for the benefit of the shareholders but also for the benefit of the staff and other stakeholders as well²¹⁹.

²¹⁷ In 2006, its top five executives had earned an average of US\$ 28 million. See Organisation for Economic Co-operation Development (OECD), *Corporate Governance and the Financial Crisis: Key Findings and Main Messages* (OECD, June 2009, 2009), p. 17; Lucian A Bebchuk, Alma Cohen and Holger Spamann, 'The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008' (2010) 27 *Yale J on Reg* 257, p. 273.

²¹⁸ Before its publicly assisted merger with Bank of America, Merrill Lynch paid out US\$ 4-5 billion in bonuses despite suffering around US\$ 15 billion in losses. See Organisation for Economic Co-operation Development (OECD), *Corporate Governance and the Financial Crisis: Key Findings and Main Messages*, p. 18. Also see Jean Jinghan Chen and others, 'Financial Crisis and Executive Remuneration in Banking Industry – An Analysis of Five British Banks' (2011) 21 *Applied Financial Economics* 1779, which scrutinised the lucrative remuneration packages for the executives of 5 banks (Northern Rock, Royal Bank of Scotland, Halifax Bank of Scotland, Lloyds TSB and Bradford & Bingley) in the United Kingdom despite the banks' poor performance.

²¹⁹ Energy & Industrial Strategy Department for Business, 'Corporate Governance Reform: The Government Response to the Green Paper Consultation' August 2017 <<https://www.gov.uk/government/consultations/corporate-governance-reform>> accessed 15 September 2017. Also see Patrick Jenkins and Sarah Gordon, 'May Told to Toughen Line on Executive Excess' *Financial Times*, 24 January 2017 <<https://www-ft-com.elib.tcd.ie/content/a138fc74-e186-11e6-9645-c9357a75844a>> accessed 20 September 2017; BBC, 'Executive Pay: Companies Told to Justify Rates'

From the Islamic banking context, the receipt of remuneration in itself is never an issue in Islam as there are ample provisions in the *Sharia'* law that allow and encourage Muslims to seek for 'God's bounties' so long it is done within the allowed perimeters²²⁰. Accordingly, it is arguable that the receipt of an 'excessive' remuneration package is not a problem if the recipient has conducted himself or herself and performed the occupation according to the tenets of *Sharia'* law. However, it can become a significant issue if the nature of the occupation is a religious one such as those of the *Sharia'* board members who issue Islamic banking *Fatwas* for the IFIs²²¹. Since the multiple *Sharia'* board directorship practice entitles the *Sharia'* board members to additional remunerations, it is arguable that the practice may have contradicted the *Sharia'* law injunctions, which not only dissuade the scholars from having an affection for the worldly wealth but also from capitalising on *Amanah* as a source of profit. In a *Hadith* narrated by Ali Bin Abi Talib, the Prophet Muhammad (p.b.u.h.) said:

*"When my Ummah (the Muslims) does 15 things, the afflictions will occur in it." It was said, "What are they O Messenger of God?" He said, "When the country's money are distributed preferentially; when Amanah becomes a source of profit; when Zakat becomes a fine (debt); when a man obeys his wife but disobeys his mother; when voices are raised in the mosque; when the most despicable of the people becomes the leader; when the most honoured man is feared because of his evil; when people drunk intoxicants everywhere; when men wore silk; when people idolised the artists; when music is available everywhere; and when a generation curses its predecessors. When that occurs, anticipate a red wind, collapsing the earth, and transformation"*²²².

Indeed, the receipt of remuneration from the IFIs by *Sharia'* board members cannot serve as an automatic ground to suggest the presence of a serious risk to *Sharia'* compliance. In fact, it is akin to the payment of a salary by the State to its Prime Minister and his or

BBC News Magazine, 29 November 2016 <<http://www.bbc.com/news/business-38138815>> accessed 22 September 2017

²²⁰ See (*Surah Al-Jumu'ah* 62:10) of Ali. Also see (*Surah Al-Baqarah* 2:198); (*Surah Al-Naba'* 78:11) of ibid

²²¹ A similar issue is also apparent in Christianity, where the motivation to receive fees on part of certain priests may deviate them from the path of God and lead them to a similar path that have been the downfall of many priests. See L.W. Countryman, *Living on the Border of the Holy: Renewing the Priesthood of All* (Church Publishing Incorporated 1999), p. 187; Elise Harris, 'Pope Francis: Turning Churches into 'Businesses' is a Scandal' Catholic News Agency, 21 November 2014 <<http://www.catholicnewsagency.com/news/pope-francis-turning-churches-into-businesses-is-a-scandal-33377/>> accessed 20 September 2017

²²² This *Hadith* is *Daif*. See *Hadith* 53, Book 33 of Zuhri

her ministers for their leadership and service. In addition, the previous caliphs of Islam such as Abu Bakar As-Siddiq and the other governors during the reign of the Four Caliphates also received payment for their services. The *Holy Quran* further contains several provisions, which commend the effort of earning a livelihood²²³. In a *Hadith* narrated by Abdullah bin As-Sa'di, the Prophet Muhammad (p.b.u.h) recommended Muslims accept their salaries even if they prefer their salaries to be donated to the charity, "...Take it and keep it in your possession and then give it in charity. Take whatever comes to you of this money if you are not keen to have it and not asking for it; otherwise (if it does not come to you) do not seek to have it yourself"²²⁴.

In modern corporate practices, it is common for the IFIs to pay the private auditing companies for their review and auditing services of the IFIs' operations, financial flows, and annual reports. As the payment constitutes a compensation for these professional services, it appears unfair to deem the receipt of such a payment a ground to suggest the auditing companies have compromised their integrity and impartiality in delivering a fair assessment of their clients' business operations. In a different setting, it is akin to labelling the receipt of a salary by university lecturers as an incentive to pass their students at all costs for the sake of protecting their central source of income. In the absence of concrete evidence, this inference remains a wild generalisation that is unjustified and misrepresents the Islamic notion of trust. This corresponds with the methods of *Fiqh* in *Sharia'* law such as *Al-Asal Bira'atu Zimmah* (the original *Hukm* of an individual is his freedom from any offence and allegation), *Al-Bayyinah Ala Mad'ie Wal-Yamin Ala Min Inkar* (evidence must be furnished by the prosecution and only after, the accused can be asked to defend himself), and *Al-Yaqin La Yazulu Bil-Sha'* (the presumption of innocence cannot be defeated by vague evidences), which absolves an accused person of guilt until proven otherwise²²⁵. Hence, it appears unfair to treat every

²²³ "And among His signs is the sleep that ye take by night, and by day, and the quest that ye (make for livelihood) out of His bounty: verily in that are signs for those who hearken" (Surah Al-Rum 30:23) of Ali. Also see (Surah An-Naba 78:11); (Surah Al-Isra 17:12); (Surah Al-Qasas 28:73); (Surah Al-Mukminun 23:61) of ibid

²²⁴ This *Hadith* is *Sahih*. See *Hadith 27*, Book 93 of Al-Bukhari and Khan

²²⁵ Al-Suyuti, p. 65. Also see Zaharuddin Abd Rahman, 'Mestikah Iman dan Ilmu Mereka Telah Dibeli? (Has Their Faith and Knowledge Been Compromised?)' <<http://zaharuddin.net/senarai-lengkap-artikel/3/1004-mestikah-iman-dan-ilmu-mereka-telah-dibeli-.html>> accessed 22 September 2017

Sharia' board member, who receives salaries from the IFIs as persons substituting their religion and integrity for worldly wealth and benefits²²⁶.

Nonetheless, it is equally important to note that throughout the history of Islamic civilisation, *Sharia'* scholars had always sought to avoid any political or personal ties with the governing authorities such as the government for the sake of retaining their impartiality in issuing a *Sharia' Hukm*²²⁷. This discipline serves as a crucial element to convince stakeholders that the scholars will always owe their allegiance to stakeholders and will protect their rights and interests and uphold the objectives of the *Maqasid As-Sharia'*. In a *Hadith* narrated by Ibn Abbas, the Prophet Muhammad (p.b.u.h) said, "*Whoever resided in the deserts will become ignorant, whoever devoted himself to the chase will become unmindful, and whoever frequented the doors of the rulers will be led astray*"²²⁸.

In another *Hadith* attributed by Imam Al-Ghazali to the Prophet Muhammad (p.b.u.h), the Prophet said, "*So long the learned men do not mix with the rulers, they become guardians of trust of the Prophet for the servants of God; when they mix with them, they commit treachery, be careful of them and keep away from them*"²²⁹. Imam Ghazali further propounded that a *Sharia'* scholar, who harbours great pleasure in wealth and authoritative position will only contribute to the downfall of rulers and society²³⁰. This parallels a *Hadith* narrated by Ibn Kaab Bin Malik Al-Ansari from his father, in which the Prophet stated that a religion destroyed by mankind's desire for wealth and honour is more destructive than a situation, where two wolves roam free among the sheep²³¹.

²²⁶ "O ye who believe! Let not some men among you look down on others: it may be that the (latter) are better than the (former): nor let some women look down on others: it may be that the (latter) are better than the (former): nor defame nor be sarcastic to each other, nor call each other by (offensive) nicknames: Ill-seeming is a name connoting wickedness, (to be used of one) after he has believed: and those who do not desist are (indeed) doing wrong" (Surah Al-Hujurat 49:11) of Ali

²²⁷ Asy-Syawī, p. 448.

²²⁸ This *Hadith* is Hasan. See *Hadith* 99, Book 33 of Al-Tirmidhi. Also see Al-Ghazali, p. 79.

²²⁹ Al-Ghazali, p. 89.

²³⁰ Ibid; Asy-Syawī, p. 448. The Malays refer to mankind as '*manusia*' – a combination of the Arabic words of '*Ma*' (what) and '*Nasiya*' (to forget), which infers mankind as nothing but an entity created by God that tends to forget. See Wehr, p. 963. Also see, "*Has it not occur to Man for a long period of time that he was nothing – (not even) mentioned? Verily We created Man from a drop of mingled sperm in order to try him...*" (Surah Al-Insan 76:1-2) of Ali

²³¹ This *Hadith* is Hasan. See *Hadith* 73, Book 36 of Al-Tirmidhi

Indeed, the above self-restraint neither obliges *Sharia'* board members to abstain from engaging in any form of relationship with the IFIs, nor does it forbid them from receiving remuneration in exchange for their *Sharia'* advisory services. In fact, if every *Sharia'* scholar adopted an evasive policy to every *Sharia'* board appointment, it is arguable that the approach would not only contravene the *Sharia'* law's commendation of *Ijtihad* as a *Fardh Kifayah*, but also would lead to industry suffering from a dearth of critical minds to administer the *Sharia'* compliance assurance of the financial products and services impeding its promising growth.

However, the receipt of remuneration from the IFIs can also trigger a concern over a potential conflict of interest and independence issue between *Sharia'* board members and the IFIs to whom they owe a duty of loyalty²³². The difficulty in finding qualified and highly experienced *Sharia'* scholars, who only serve a single IFI, can trigger a 'remuneration tug-of-war' between the IFIs leading to the enticement of *Sharia'* scholars with lucrative remuneration packages²³³. The stewardship theory, which formed the backbone of the Islamic corporate governance structure of IFI, demands that *Sharia'* board members act as the stewards of the IFIs in ensuring a precise alignment of the interests of all stakeholders with the *Sharia'* law and principles²³⁴. It also necessitates *Sharia'* board members delivering an unbiased *Sharia'* opinion on the IFIs' financial products and services, a task which requires the use of their judgment. As much as a remuneration package can motivate them to act in a manner consistent with stakeholders' interests, it can also serve as a double-edged sword enticing them to compromise these interests in pursuit of more financial gains²³⁵. For instance, an IFI that remunerates its *Sharia'* board members on the basis of a fixed percentage of its net profit may incentivise them to hasten product approval to increase the IFI's marketability and

²³² Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*, p. 10; Wilson, *The Development of Islamic Finance in the GCC*, p. 10. Also see Sleiman and Vizcaino

²³³ Vizcaino, 'AAOIFI's Perestroika', p. 4-5. Also see Abdul-Rahman, p. 79; Mizruchi, p. 277.

²³⁴ Bhatti and Bhatti; Lahsasna, *Introduction to Fatwa, Shariah Supervision & Governance in Islamic Finance*, p. 9, 72-73. Also see "O ye who believe! Obey God, and obey the Messenger, and those charged with authority among you. If you differ in anything among yourselves, refer it to God and His Messenger, if ye do believe in God and the Last Day: that is best, and most suitable for final determination" (Surah Al-Nisa' 4:59) of Ali

²³⁵ Ali, *Handbook of Research on Islamic Business Ethics*, p. 252; Van Greuning and Iqbal, p. 189; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*

profits and in turn to increase their own remuneration²³⁶. If this compromises the *Sharia'* compliance assurance of the IFI's financial product and services, it can paint a negative picture of the *Sharia'* board member's independence from the IFI.

At the same time, the Prophet's warning of the coming of a time when the traits of trust and honesty will dissipate from mankind's heart also provides a rational cause for concern of the multiple *Sharia'* board directorship practice, which as noted remains unregulated in the majority of the key regions of the Islamic banking markets²³⁷. The Prophet had also warned of the emergence of Muslims, who would misuse their knowledge of the *Sharia'* law to deceive the people in pursuit of financial gain. In a *Hadith* narrated by Abu Hurairah, the Prophet Muhammad (p.b.u.h) said, "*In the end of time, there shall come men who will swindle the world with religion, deceiving the people in soft skins of sheep, their tongues are sweeter than sugar and their hearts are the hearts of wolves. God the Almighty says, "Is it me you try to delude or is it against me whom you conspire? By Me, I swear to send upon these people, among them, a Fitnah (tribulation) that leaves them (even their scholars) utterly devoid of reason"*²³⁸.

Although these *Sharia'* law provisions steer clear of impeaching the integrity of the interlocking *Sharia'* board members or even classifying them in the same mould as those, who would sell out their religion for the sake of personal expediency, there has already emerged several significant cases that highlight the exploitation of the religious label of 'Islam' as a marketing strategy to promote certain products, which further substantiates

²³⁶ Al-Salaheen and Aldhala'een, p. 76-77.

²³⁷ Huzaifah bin Al-Yaman said, "*The Prophet Muhammad (p.b.u.h) had related to us, 2 prophetic narrations, one of which I have seen fulfilled and I am waiting for the fulfilment of the other. The Prophet Muhammad (p.b.u.h) told us that virtue of honesty descended in the roots of men's hearts and then they learned it from the Holy Quran and the Sunnah. The Prophet further told us how that honesty is taken away. He said, "Man will go to his sleep during which the honesty will be taken away from his heart and only its trace will remain in his heart like the trace of a dark spot, then the man will go to sleep, during which the honesty will decrease further still, so that its trace will resemble the trace of blister as when as ember is dropped on one's foot which would make it swell, and one would see it swollen but there would be nothing inside. People would be carrying out their trade but hardly will there be a trustworthy person. It will be said, "In such and such tribe, there is an honest man," and later it will be said about some man, "What a wise, polite, and strong man he is!", though he will not even have faith equal to a mustard seed in his heart". Indeed, there came upon me a time I did not mind dealing with anyone of you, for is he was a Muslim, his religion would compel him to pay me what is due to me, and if he was a Christian, the official would compel him to pay me what is due to me, but today I do not deal except with such and such person". This Hadith is Sahih. See Hadith 37, Book 92 of Hamidy and others. Also see Nur al-Din Al-Haythami, *Majma' Al-Zawa'id Wa Manba' Al-Fawa'id* (published in Beirut, Dar Al-Kitab Al-'Arabi 1982); *Hadith 274*, Book 1 of Ibn Al-Hajjaj*

²³⁸ This *Hadith* is *Daif*. See *Hadith 102*, Book 36 of Al-Tirmidhi

the Prophet's warning. These include the sale of drinking water, raisins, and dates, among others, which are often enchanted with the incantations from the *Holy Quran* and claimed to possess a supernatural ability that can improve one's behaviour, beauty, and even marital relationship²³⁹. Certain manufacturers even claim that their products bear similarities to the ones consumed by the Prophet Muhammad (p.b.u.h) during his time leading to a significant increase in the price of these products over ordinary ones²⁴⁰.

By contrast, *Sharia'* board members may have undertaken the multiple *Sharia'* board appointments for far nobler purposes such as upholding the principles of *Sharia'* law in *Muammalat* or addressing the acute shortage of qualified and experienced *Sharia'* scholars in the industry. At the same time, they may want to consider a *Hadith* narrated by Ibn Abbas, in which the Prophet Muhammad (p.b.u.h) had cautioned that a *Sharia'* scholar, who treads the religious path with the view to profit from his or her knowledge, even if they intended well and swore to abstain from anything that could compromise their religious commitment, will only find their intention futile²⁴¹.

Despite its weak chain of narration, it is arguable that this *Hadith* provides a relevant argument against the proponents of the multiple *Sharia'* board directorship practice, especially in light of the lucrative and promising nature of the global Islamic banking industry. The significance of the *Hadith* is also worth pondering in consideration of the interests of consumers who would be loath to see the day when *Sharia'* scholars become nothing more than a *Sharia'*-compliant 'rubber stamp' tool for the IFIs to advance their worldly interest at the expense of the consumers' interest for financial products and services that satisfy their spiritual commitment. It is further argued that a *Sharia'* scholar,

²³⁹ Tarmizi Abdul Rahim, 'Jangan Perdagang Al-Quran (Don't Commercialise the Holy Quran)' *Utusan Malaysia* (11 March 2015) <<http://www.utusan.com.my/rencana/jangan-perdagang-al-quran-1.68075>> accessed 15 September 2017

²⁴⁰ 'Khuatir Trend Agama Jadi Jenama (Concern Over the Trend that Changes the Religion into a Brand)' *Sinar Harian* (27 September 2015) <<http://www.sinarharian.com.my/nasional/khuatir-trend-agama-jadi-jenama-1.434159>> accessed 27 August 2017; Sharilfuddin Saari, 'Kismis Doa, Air Jampi Ubah Anak Jadi Mengarut (Absurdity of Enchanted Raisins and Healing Water)' *Utusan Malaysia* (Perlis, 27 February 2015) <<http://www.utusan.com.my/rencana/kismis-doa-air-jampi-ubah-anak-jadi-mengarut-1.64099>> accessed 17 September 2017. Also see Keputusan Muzakarah Jawatankuasa Fatwa Majlis Kebangsaan Bagi Hal-Ehwal Ugama Islam Malaysia (The Decision of the Muzakarah of the National Fatwa Council for Islamic Affairs in Malaysia), p. 13.

²⁴¹ "There will be some people among my Ummah (nation) who will gain knowledge of the religion, and they recite the Holy Quran, and will say: "We come to the rulers so that we may have some share of their worldly wealth, and we will make sure that our religious commitment is not affected," but that will not be the case. Just as nothing can be harvested from Qatad (a thorny plant) except thorns, nothing can be gained from being close to the rulers except (sins)". This *Hadith* is *Daif*. See Book 1, *Hadith* 264 of Ansari. Also see Al-Ghazali, p. 84.

who pursues multiple *Sharia'* board positions to advance personal financial gain, will only jeopardise his or her understanding of *Sharia'* law and compromise the integrity and credibility of *Fatwas* in the industry²⁴².

Given these points, it is high time for both the industry regulators and the IFIs to re-examine the remuneration packages of *Sharia'* board members, especially in light of the unregulated nature of multiple *Sharia'* board directorship worldwide. For a start, the IFI may want to consider balancing the information asymmetry with its stakeholders by enhancing their access to crucial information through the publication of the minutes of *Sharia'* board meetings, all the *Fatwas* issued by the *Sharia'* board, and the remuneration structure of its *Sharia'* board members thus providing greater transparency in respect of its Islamic corporate governance framework²⁴³. The industry regulators may also want to consider placing the IFI's *Sharia'* board under the jurisdiction of the state, which will become the sole authority responsible for remunerating *Sharia'* board members. This could help to mitigate the risk of undue influence, *Talfiq* (combination of different *Fatwas* to create a new *Fatwa*) and the practice of *Fatwa*-shopping in ensuring *Sharia'* board members' independence²⁴⁴.

At the same time, it is also pertinent for the practice of multiple *Sharia'* board that financial regulators and industry practitioners, particularly the *Sharia'* board members, adopt a pro-active approach in upholding the notion of *Amanah*, which dictates the reputation and the trust of society in both the IFIs and the global Islamic banking industry as a whole. In addition, the recent increase in consumers' trust towards the financial services industry²⁴⁵ also renders it relevant to revisit the concept of *Tsiqah* towards the *Sharia'* scholars, which must also advance systematically to ensure the stability of the Islamic banking industry in the long run. Indeed, reputation is hard to build but easy to ruin. An

²⁴² Imam Sufyan At-Thawri, the founder of the *Thawri's* school of Islamic jurisprudence mentioned, "*I was blessed with the understanding of the Holy Quran, and when I upturned the money purse, the understanding was taken away from me*". See Mohammad Ibn Ibrahim Ibn Jama'ah and Muhammad Hashim Nadawi, *Tadhkirat Al-Sami' Wa Al-Mutakallim Fi Adab Al-'Ilm Wal-Muta'allim* (published in Beirut, Dar Kutub Al-Ilmiyyah 2006), p. 19. Also see Hasan, 'In Search of the Perceptions of the Shari'ah Scholars on Shari'ah Governance System'

²⁴³ Murat Unal, 'Moving Beyond Shariah Governance towards a More Sustainable Financial System' (2013) 10 Islamic Finance News

²⁴⁴ Zuhaili, *Usul Al-Fiqh Al-Islami (The Origin of Islamic Jurisprudence)*, vol. 2, p. 1143; Shaharuddin and others, p. 8; Foster

²⁴⁵ Edelman, *2017 Edelman Trust Barometer Financial Services*, p. 22, 23, 32, 33; Edelman, *Edelman Trust Barometer Financial Services Industry Results*, p. 9.

option to prohibit or limit the number of *Sharia'* board directorships a *Sharia'* scholar holds may not suit the industry's current dearth of qualified and highly experienced *Sharia'* scholar but if such a measure can preserve the *Amanah* and the consumers' trust of the industry, it is a suggestion worth considering.

5.5 Regulatory Approaches to Multiple *Sharia'* Board Directorships in Islamic Banking

5.5.1 The AAOIFI

The AAOIFI has issued seven Islamic corporate governance standards²⁴⁶. While there are no specific provisions on the practice of multiple *Sharia'* board directorships in any of these standards, they contain several relevant provisions, which suggests that the continuance of the practice can disharmonise the Islamic corporate governance framework of an IFI. For instance, the Governance Standard (No. 5) stresses that *Sharia'* scholars should not serve as an employee of the IFI and must abstain from accepting any fees from any external parties as it can impair the scholars' independence²⁴⁷. Another standard, although inapplicable to *Sharia'* board members due to their status as non-employees, also emphasises that engaging in multiple employments can prejudice the rights and interest of the IFI²⁴⁸. Additionally, as the *Sharia'* board members are also the holders of the stakeholders' *Amanah*, they owe a duty to enhance the confidence and trust of stakeholders, which are vital to the sustainability of the IFI's business²⁴⁹.

Although these would suggest that the AAOIFI holds a sceptical stance of the practice, the standards appear inadequate to regulate the practice, especially in light of the increasing volume of IFIs' business transactions, which demands an optimum attention

²⁴⁶ These are the Shari'ah Supervisory Board: Appointment, Composition and Report (No. 1); Shari'ah Review (No. 2); Internal Shari'ah Review (No. 3); Audit and Governance Committee for Islamic Financial Institutions (No. 4); Independence of Shari'ah Supervisory Board (No. 5); Statement of Governance Principles for Islamic Financial Institutions (No. 6); and Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions (No. 7). See Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Issued Standards' (2016) <<http://aaoifi.com/issued-standards-2/?lang=en>> accessed 20 April 2016. Also see Abu Me'mer; Garas, 'The Control of the Shari'a Supervisory Board in the Islamic Financial Institutions'

²⁴⁷ Accounting, Auditing, and Governance Standards as at December 2015, p. 940, 943.

²⁴⁸ Ibid, p. 1038.

²⁴⁹ Article 4/1, Governance Standard No. (6): Statement on Governance Principles for Islamic Financial Institutions of ibid, p. 951

from *Sharia'* board members in meeting the continuous needs of the management for *Sharia'* consultation²⁵⁰. Indeed, the AAOIFI has acknowledged that a long association with IFIs can lead to a close relationship, which can further threaten the independence of *Sharia'* board members. However, the non-binding nature of the AAOIFI's *Sharia'* and governance standards presents a critical lacuna that leaves *Sharia'* board members free to hold on to their *Sharia'* board positions beyond the AAOIFI's recommendations for the IFIs to rotate their *Sharia'* board members every five years in preserving their independence²⁵¹.

On a positive note, the AAOIFI has taken a proactive approach in balancing the number of its high-profile *Sharia'* board members such as Sheikh Muhammad Taqi Usmani, Sheikh Dr Abdel Sattar Abu Ghuddah, Sheikh Nizam Yacuby, Sheikh Dr Hussein Hamid Hassan, and Sheikh Dr Mohamed Ali Al-Qari, with young and upcoming scholars such as, *inter alia*, Sheikh Dr Essam Khalaf Al Enezi and Sheikh Dr Hamed Hassan Merah, which will definitely provide the industry with reliable and competent future scholars²⁵². Be that as it may, the AAOIFI may also want to consider a more disciplined approach to the practice of multiple *Sharia'* board directorship in question, especially when 17 of its *Sharia'* scholars populating over an astronomical 750 *Sharia'* boards across numerous Islamic banks and *Takaful* (Islamic insurance) institutions, which presents another genuine cause for concern as to the transparency and practicability of the AAOIFI's governance standards²⁵³. Without a proper and enforceable corporate governance provision addressing the practice, the AAOIFI not only risks the trust and confidence of the stakeholders, but also its position as the leading gatekeeper to the industry's Islamic corporate governance and *Sharia'* compliance assurance.

²⁵⁰ Garas, 'The Control of the Shari'a Supervisory Board in the Islamic Financial Institutions'; M Zoair, 'The Role of Sharia' Supervision in the Development of Banking Transactions' [1996] Islamic Economic Magazine 43; Abu Me'mer

²⁵¹ Accounting, Auditing, and Governance Standards as at December 2015, p. 944. Also see Vizcaino, 'AAOIFI's Perestroika', p. 3.

²⁵² Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Shari'ah Board Members'

²⁵³ Ibid; Unal, 'Moving Beyond Shariah Governance towards a More Sustainable Financial System'

5.5.2 The IFSB

The IFSB, on the other hand, has formulated direct but limited provisions to regulate the practice. While the IFSB instructs *Sharia'* scholars to ensure a sufficient allocation of time and attention to the affairs of the IFI²⁵⁴, Principle 1.1 of the IFSB-10 suggests that the IFSB actually recognises the presence of such a practice in the industry:

“An IFI should be fully aware of the possibility of, among other things; ensuring that the Sharia' board is more focused, with more time spent on each assignment and conflicts of interest adequately managed, which may imply that its members should not serve more than a limited number of clients, hiring and nurturing young members of the Sharia' board with promising potential, to expand the talent pool in the profession; engaging other professionals, such as lawyers accountants and economists, to assist and advise the Sharia' board, especially on legal and financial issues”²⁵⁵.

This is because the IFSB acknowledges the fact that the senior and more experienced *Sharia'* scholars would also owe external commitments to institutions such as the IFIs or a central *Sharia'* advisory board due to their reputation and extensive industrial experience²⁵⁶. It notes that although these commitments can threaten the scholars' attention and time commitment to the IFI, they can provide an efficient learning platform for the young *Sharia'* scholars, who can dedicate more time to study, scrutinise, and offer a fresh perspective to the *Sharia'* issues and proposals presented for the *Sharia'* board deliberation, which can further facilitate the innovation of new Islamic banking products²⁵⁷. Then again, the IFSB also cautions *Sharia'* board members against serving on too many *Sharia'* boards and requires the IFIs to develop internal guidelines to address the competing time commitments faced when *Sharia'* scholars serve on multiple *Sharia'* boards²⁵⁸.

²⁵⁴ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 7, 16.

²⁵⁵ Ibid, p. 9.

²⁵⁶ Ibid, p. 8.

²⁵⁷ Ibid, p. 8. Also see Thomson Reuters, 'Islamic Finance Outsources Scholars' Supervision to Grow'

²⁵⁸ Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10), p. 7, 9, 16.

5.6 Conclusion

In the final analysis, this chapter discovers that the practice of multiple *Sharia'* board directorships attracts three different *Sharia' Hukm*. In the first instance, the *Hukm* is *Fardh Ain* or *Wajib* (mandatory) for the *Sharia'* scholars to occupy and even request to occupy multiple *Sharia'* board positions if he or she possesses the knowledge, expertise or skills that the industry remains in critical need of²⁵⁹. In the second instance, the *Hukm* for scholars, who possess the necessary qualifications and requested to occupy these positions remains debatable between *Mubah* or *Harus* (permissible) – propounded by Al-Qurtubi, Al-Suyuti, and Al-Qardawi²⁶⁰, and *Makruh* (permissible but not recommended) – based on the *Hadith* narrated by Abdur-Rahman bin Samura²⁶¹. In the third instance, the *Hukm* can end up as *Haram* (forbidden) if the scholars assume too many *Sharia'* board positions to the extent that it prejudices the performance of their fiduciary responsibilities and endangers the interests of the IFIs they represented.

As a result, it is both difficult and challenging for the industry to determine the actual legal and compliance status of the practice with the *Sharia'* law. Although this chapter observes that the practice in question exhibits a number of critical issues that can run counter to the principles of *Sharia'* law, it neither seeks to criticise nor criminalise interlocking *Sharia'* board members because the absence of a specific *Fatwa* on this practice renders it as a subject of *Al-Ikhtilaf Fi Al-Fuqaha* (disagreement between *Sharia'* scholars), which occurs as a result of the presence of variable factors such as the different schools of Islamic jurisprudence, legal systems and understanding of the *Fiqh* and *Urf* (customary practices) across the key Islamic banking markets.

In a similar juncture, given the uncertain compliance status of this practice with *Sharia'* law, it is imperative that the industry adopts a cautious approach and considers the need to explore a proper corporate governance framework that takes into account the theoretical and practical *Sharia'* issues concerning the application of the practice as discussed in this chapter. This measure will provide greater transparency of the *Sharia'* compliance status of the practice and assure stakeholders of the preserved alignment

²⁵⁹ Ibrahim, p. 11; Hasan, 'An Introduction to Collective Ijtihad: Concept and Application', p. 28; Al-Qurtubi, p. 216; *Hadith* 1, Book 3 of Hamidy and others. Also see Suyuti

²⁶⁰ "(Joseph) said: "Set me over the store-houses of the land: I will indeed guard them, as one that knows (their importance)". See (*Surah Yusuf* 12:55) of Ali. Also see Al-Qurtubi, p. 216. Also see *Hadith* 1, Book 3 of Hamidy and others

²⁶¹ This *Hadith* is *Sahih*. See *Hadith* 2, Book 83 of Al-Bukhari and Khan. Also see Al-Nawawi, vol. 2, p. 469.

between the industry's economic interest and *Sharia'* law. Without a proper corporate governance approach to the issues highlighted, it is arguable that continuing to engage in the practice of multiple *Sharia'* board directorships registers an inclination towards *Syubhah* (doubtful) matters, which prominent *Sharia'* jurists such as Al-Qurtubi, As-Sa'di, and Al-Qardawi had strongly called for Muslims, especially the devout ones such as the *Sharia'* scholars, to avoid as it can be “*dragged into resembling what is known as Haram*”²⁶².

In the next chapter, this thesis will set forth the research methodology and research design utilised for this research and explain the data mining and analysis methods. Subsequently, it will also present the analysis of the data obtained from the case studies conducted involving the Central Bank of Malaysia and Otoritas Jasa Keuangan of Indonesia. In summary, the chapter illustrates the overall research processes and analysis of the findings to demonstrate the quality and originality of the research.

²⁶² Al-Qurtubi; As-Sa'di, Principle 2, p. 2; Al-Qaradawi, *The Lawful and the Prohibited in Islam (Al-Halal Wal-Haram Fil Islam)*, p. 28. Also see the *Hadith*, in which the Prophet Muhammad (p.b.u.h) said, “*Both lawful (Halal) and unlawful things (Haram) are evident but in between them there are doubtful things and most people have no knowledge about them. So he, who saves himself from these doubtful things, saves his religion and his honour (i.e. keeps them blameless). And he who indulges in these doubtful things is like a shepherd who pastures (his animals) near the Hima (private pasture) of someone else and at any moment he is liable to get in it. (O people!) Beware! Every king has a Hima and the Hima of God on the earth is what He declared unlawful (Haram)...*”. This *Hadith* is *Sahih*. See Book 16, *Hadith* 1511 of Al-Asqalani

CHAPTER 6: ANALYSIS OF CASE STUDIES

6.0 Introduction

The selection of an appropriate research methodology is a prerequisite for good quality research. In the context of doctoral research, it projects the originality of a study that seeks to conduct empirical work in subject areas never attempted before, or to introduce substantial evidence or new interpretations to old or existing issues¹. In ensuring the originality and quality of the research, this researcher has decided to adopt the qualitative methodology that employs the comparative method. It involves the application of both a descriptive and a comparative analysis to a specific research area and assists in identifying a viable and practical explanation and solution to specific legal issues already encountered in other jurisdictions². More importantly, the utilisation of the comparative method is recognised by policymakers around the world for enhancing the development of the law³.

This researcher submits that this research represents an original contribution to the study of the multiple *Sharia'* board directorship practice within the Islamic banking industry. With empirical work conducted in different countries, this study can introduce substantial new evidence and findings on corporate governance policy governing the IFIs in these jurisdictions in relation to the multiple *Sharia'* board directorship practice. This has the potential to benefit the key stakeholders within the industry such as the legislators, Islamic banking regulators and the IFIs in enhancing and improving their respective Islamic corporate governance frameworks. This chapter explains the research methodology utilised by this researcher and elaborates on the research design, data collection, and the case-by-case findings. This analysis will comprise an industrial and regulatory insight into the Islamic banking industry of the targeted countries and the stance taken by their respective Islamic banking regulator in respect of the multiple *Sharia'* board directorship practice; the latter, which constitutes a crucial method of

¹ D. Watkins and M. Burton, *Research Methods in Law* (Taylor & Francis 2013), p. 38; Estelle Phillips and Derek Pugh, *How to Get a PhD: A Handbook for Students and Their Supervisors* (McGraw-Hill Education (UK) 2010), p. 40-41, 67.

² Terry C Hutchinson, *Researching and Writing in Law* (Lawbook Co./Thomson Reuters 2010), p. 106. Also see Norman K. Denzin and Yvonna S. Lincoln, 'Introduction: Entering the Fields of Qualitative Research' in NK Denzin and YS Lincoln (eds), *Handbook of Qualitative Research* (SAGE Publications 1994), p. 3-4.

³ Jonathan Hill, Konrad Zweigert and Hein Kötz, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 *Oxford Journal of Legal Studies*, p. 102; Konrad Zweigert and Kotz Hein, *Introduction to Comparative Law* (3rd edn, Oxford University Press 1998), p. 34.

obtaining factual inputs of the current regulatory framework of the practice in countries adopting the centralised approach to the corporate governance of IFIs.

6.1 Research Methodology

As noted above, this thesis employs the qualitative methodology based on a comparative case study approach, which suits its attempt to study a specific social or legal phenomenon involving the application of complex *Sharia'* rules and principles in contemporary areas such as the corporate governance of the IFIs⁴. A case study is defined as “*the in-depth study of instances of a phenomenon in its natural context and from the perspective of the participants involved in the phenomenon*” or one that aims to “... *illuminate a decision or set of decisions: why they were taken, how they were implemented, and with what result*”⁵. From the perspective of legal research, the case study approach is useful in investigating a specific event or phenomenon that involves a population or jurisdiction, which can subsequently lead to a better understanding of a larger group of cases⁶.

As the central theme of this thesis aims to scrutinise the practice of multiple *Sharia'* board directorships from both the *Sharia'* law and the legislative perspective, the employment of the case study approach can form a basis for the development and discovery of more general theories concerning the application of this practice and even practical improvements that can benefit future research⁷. Moreover, in the absence of empirical research on the practice in question, the employment of the case study approach can yield descriptive and explanatory insights and serve as a practical platform prior to the

⁴ A. Bryman, *Social Research Methods* (Oxford University Press 2015), p. 60; JW Creswell, *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches* (2nd edn, SAGE Publications 2003), p. 15; Jill Hussey and Roger Hussey, *Business Research* (Palgrave 1997), p. 66; Robert E Stake, *The Art of Case Study Research* (Sage Publications 1995), p. 8-9.

⁵ Robert K Yin, *Case Study Research: Design and Methods* (5th edn, Sage Publications 2013), p. 13, 17; Robert E Stake, ‘Qualitative Case Studies’ in NK Denzin and YS Lincoln (eds), *The SAGE Handbook of Qualitative Research* (3rd edn, SAGE Publications 2005), p. 443, 445; Alexander L George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Mit Press 2005), p. 75; MD Gall and JP Gall, *Educational Research: An Introduction* (6th edn, Longman 1996), p. 545.

⁶ Stake, ‘Qualitative Case Studies’, p. 445-447. Also see Isidora Djuric, ‘The Role of Case Study Method in Management Research’ (2010) 5 Serbian Journal of Management 175, p. 177.

⁷ Earl R. Babbie, *The Practice of Social Research* (12th edn, Wadsworth Cengage 2010), p. 309. Also see Yin, p. 18; Robert K Yin, ‘The Case Study Crisis: Some Answers’ (1981) 26 Administrative Science Quarterly 58

execution of a large-scale investigation in the future on the legislative and corporate governance framework governing the IFIs in relation to the practice of multiple *Sharia'* board directorship such as those within the QISMUT+3 region⁸.

The case study approach comprises three categories, namely exploratory, descriptive, and explanatory as well as a hybrid of any of these categories⁹. In brief, an exploratory approach seeks to explore a specific phenomenon of interest to the researcher; a descriptive approach seeks to describe the phenomenon as it naturally occurs; and an explanatory approach seeks to examine and scrutinise the phenomenon¹⁰. The research questions of the thesis focuses on the 'what' and 'how' aspects of the multiple *Sharia'* board directorship practice from both the *Sharia'* law and the legislative and corporate governance frameworks governing the IFIs within the targeted jurisdictions, a focus which justifies the use of the case study method¹¹. As a result, this researcher has chosen to adopt the exploratory case study approach in exploring and advancing the understanding in these areas, especially in light of the limited empirical research conducted on the practice¹². The adoption of this approach can also provide an instrumental insight into the legislative pattern and perceptives of the Islamic banking regulators within these countries in relation to the practice, which can benefit other countries, especially the newcomers to Islamic banking, in designing the corporate governance policy for the IFIs in their respective countries.

⁸ Bryman, p. 60; Babbie, p. 309; Linda G. Morra and Amy C Friedlander, *Case Study Evaluations* (World Bank Operations Evaluation Department, 1999), p. 10.

⁹ Nerida Hyett, Amanda Kenny and Dr Virginia Dickson-Swift, 'Methodology or Method? A Critical Review of Qualitative Case Study Reports' (2014) 9 *International Journal of Qualitative Studies on Health and Well-being*, p. 2; Stake, *The Art of Case Study Research*; Zaidah Zainal, 'Case Study as a Research Method' (2007) 9 *Journal of Humanity*, p. 4; C Mariano, 'Case Study: The Method' in P Munhall and C Oiler (eds), *Nursing Research: A Qualitative Perspective* (2nd edn, Jones and Bartlett Publishers 2000), p. 311-337.

¹⁰ Yin, *Case Study Research: Design and Methods*, p. 10; David E Gray, *Doing Research in the Real World* (Sage Publications 2014), p. 36; Zainal, p. 3; Arch G Woodside and Elizabeth J Wilson, 'Case Study Research Methods for Theory Building' (2003) 18 *Journal of Business & Industrial Marketing* 493, p. 502.

¹¹ MD Myers, *Qualitative Research in Business and Management* (SAGE Publications 2009); J Mouton, *How to Succeed in Your Master's and Doctoral Studies: A South African Guide and Resource Book* (Van Schaick Publishers 2001)

¹² Gray, p. 36, 57; SB Merriam, *Qualitative Research: A Guide to Design and Implementation* (2nd edn, Jossey-Bass 2009); David Silverman, *Doing Qualitative Research: A Practical Handbook* (SAGE Publications 2004)

6.2 Research Design

There are two research designs in a case study approach, namely the single case design and the multiple case design¹³. The single case design is suitable if the research aims to test a specific, unique, or rare theory and determine whether its propositions are correct or whether alternative explanations can provide a better or more relevant explanation¹⁴. In simple terms, a single case design is particularly useful in confirming, challenging or extending a specific theory. Additionally, this design is also advantageous in conducting revelatory studies of a phenomenon or situation, which other researchers could not access in the past, and longitudinal studies that observe a single case and its corresponding changes by stages or time intervals¹⁵.

On the other hand, the employment of the multiple case design is practical when the research aims to explore and compare the differences in a specific phenomenon between countries or industries¹⁶. Like the primary data, the availability of secondary data on the multiple *Sharia'* board directorship practice remains a scarcity within the existing empirical work on the corporate governance of IFIs in the Islamic banking industry. Given the limited empirical research on the practice, this design can provide a more robust finding that can add further complexity and richness to the study of the corporate governance framework of the IFI vis-à-vis the practice¹⁷. Therefore, this thesis will apply the multiple case design to achieve its objectives and to compare the corporate governance policy governing the IFIs of two countries of the QISMUT+3 region, namely Malaysia and Indonesia in relation to the practice of multiple *Sharia'* board directorship¹⁸.

¹³ Yin, *Case Study Research: Design and Methods*, p. 19; Chad Perry, 'Processes of a Case Study Methodology for Postgraduate Research in Marketing' (1998) 32 *European Journal of Marketing* 785, p. 792.

¹⁴ Yin, *Case Study Research: Design and Methods*, p. 47.

¹⁵ *Ibid*, p. 49.

¹⁶ *Ibid*, p. 57; Babbie, p. 311; Bent Flyvbjerg, 'Five Misunderstandings about Case-study Research' (2006) 12 *Qualitative Inquiry* 219; Stake, *The Art of Case Study Research*, p. 12. Also see C.C. Ragin, *The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies* (University of California Press 2014), p. 5-6.

¹⁷ Yin, *Case Study Research: Design and Methods*, p. 53; Perry, p. 792; Stake, *The Art of Case Study Research*; Robert E Herriott and William A Firestone, 'Multisite Qualitative Policy Research: Optimizing Description and Generalizability' (1983) 12 *Educational Researcher* 14, p. 12, 14-19.

¹⁸ Comparative case study design comprises three divisions, namely 'many countries', 'few countries', and 'single country'. See Landman Todd, *Issues and Methods in Comparative Politics: An Introduction* (3rd edn, Routledge 2008). Also see Stake, 'Qualitative Case Studies', p. 444; Arend Lijphart, 'Comparative Politics and the Comparative Method' [1971] 63 *American Political Science Review*, p. 683-684.

While the QISMUT+3 region comprises nine countries, in view of the extensive time and resources that a multiple case design can consume¹⁹, the constraints of time and funding for postgraduate research, and the complex and multifaceted features of these countries, it is submitted that it is reasonable and appropriate for the thesis to concentrate on the two selected countries. The findings not only provide comprehensive information on the corporate governance policy in relation to the multiple *Sharia'* board directorship practice, which can serve as the best means to translate any differences in these policies between the QISMUT+3 member states, but they can also set a useful foundation for any prospective research attempting to study the corporate governance framework of IFIs in the QISMUT+3 region in the future²⁰.

6.3 Data Mining Methods

6.3.1 Semi-Structured Interview

The interview method has always served as an effective data collection strategy in conducting empirical research in social studies²¹. It plays a crucial role in promoting the robustness of case study research and it enables the researcher to appreciate and understand the divergent perspectives of the target groups concerning the subject of interest of the thesis²². As this study focuses on analysing and understanding the legislative and corporate governance framework of the subject countries in regard to the multiple *Sharia'* board directorship practice, the employment of this method assists in the generation of important data about the present legislative and corporate governance

¹⁹ Yin, *Case Study Research: Design and Methods*, p. 53. Also see David Collier, 'The Comparative Method' in AW Finifter (ed), *Political Science: The State of the Discipline II* (American Political Science Association 1993), p. 106-107; Woodside and Wilson, p. 493.

²⁰ Perry, p. 793; Collier, p. 105.

²¹ Babbie, p. 274; Kathleen M Blee and Verta Taylor, 'Semi-Structured Interviewing in Social Movement Research' in B Klandermans and S Staggenborg (eds), *Methods of Social Movement Research* (University of Minnesota Press 2002), p. 105; SB Merriam, *Qualitative Research in Practice: Examples for Discussion and Analysis* (Jossey-Bass 2002)

²² Brendan O'Dwyer, 'Qualitative Data Analysis: Illuminating a Process for Transforming a 'Messy' but 'Attractive' 'Nuisance'' in C Humphrey and B Lee (eds), *The Real Life Guide to Accounting Research: A Behind-the-scenes View of Using Qualitative Research Methods* (published in Amsterdam, Elsevier 2004), p. 392; D.E.W. Marginson, 'The Case Study, the Interview and the Issue: A Personal Reflection' in C Humphrey and B Lee (eds), *The Real Life Guide to Accounting Research: A Behind-the-scenes View of Using Qualitative Research Methods* (published in Amsterdam, Elsevier 2004), p. 325. Interviews also serves as "a conversation with purpose". See Catherine Marshall and Gretchen B Rossman, *Designing Qualitative Research* (Sage Publications 2014), p. 101.

policy of the Islamic banking regulators in these countries and their perception of the practice in question, as well as in the gathering of expert knowledge that can provide valuable insights into any future initiatives these regulators could undertake in relation to this practice.

There are two types of interview design commonly utilised in this area of study, namely the structured and the semi-structured interview²³. As part of the qualitative research strategy to explore the research questions, this thesis adopts the semi-structured interview design because of its flexibility in allowing the researcher to modify the sequence of the questions in the interview guide and to propose additional ones based on the interactions and responses received from the respondents during the interview²⁴. Its flexible design provides a greater opportunity for the researcher to “...*tap into (the) realities beyond the interviews’ contexts*” in contrast to a structured interview²⁵.

In this thesis, the researcher conducted face-to-face interviews with the key officials or heads of department at the central bank-level, who are responsible for developing and proposing relevant improvements to the existing legislation and corporate governance framework for the IFIs within the two targeted countries. In addition to the limited empirical research conducted on the compatibility and practicability of the multiple *Sharia'* board directorship practice from both the *Sharia'* law and industrial perspective, it is imperative to note that in most other justifications, scrutinisation of the practice were provided by the *Sharia'* scholars who have engaged in the practice themselves²⁶. As these viewpoints may be one-sided and biased, this thesis has selected the central banks of the targeted countries, which act as the regulators for the Islamic banking industry in the countries concerned, as its main point of reference in order to obtain their inside perspectives in understanding the functional features of the corporate governance policies of the IFIs within the countries that have adopted the centralised approach in relation to the practice in question.

Accordingly, the interviews involved two officials from the Islamic banking and *Takaful* Department at the Central Bank of Malaysia (Malaysia) and two officials from the *Sharia'*

²³ Blee and Taylor, p. 92; C Robson, *Real World Research* (2nd edn, Blackwell 2002)

²⁴ Bryman, p. 201. Also see Blee and Taylor, p. 93.

²⁵ Bryman, p. 201; Helen Irvine and Michael Gaffikin, 'Getting in, Getting on and Getting out: Reflections on a Qualitative Research Project' (2006) 19 *Accounting, Auditing & Accountability Journal* 115, p. 126.

²⁶ Bakar, *Shariah Minds in Islamic Finance*; Siddiqui,

Banking Department at the Otoritas Jasa Keuangan (Indonesia). These interviews took place between August and December 2016 at the respondents' offices and lasted between 60 – 90 minutes each. This researcher employed two methods of data collection, namely note-taking and audio recording. No transcription or translation services were employed as the semi-structured interview was conducted in the English language. In addition to the 'fit and proper' criteria for *Sharia*' board directorship within these countries, which requires members to demonstrate a reasonable proficiency in the English language, this researcher also possesses professional competency in both the Malay and Indonesian languages sufficient to aid the participants in understanding and answering the interview questions. The entire interview session was recorded in a digital form to capture a detailed and accurate transcription of the interview²⁷. Each of the respondents received a similar set of interview questions that corresponded to the research questions of the thesis. Since there is only a small number of respondents involved, the employment of this method is sufficient and appropriate to satisfy the objectives of the thesis.

6.3.2 Interview Design

The semi-structured interview comprises four types, namely the oral history interview, life history interview, focus group interview, and key informant interview²⁸. In designing the interview questions, this researcher employed the key informant interview approach, which involved selecting the respondents based on their respective position, role and the willingness to respond²⁹. With this in mind, the study has selected the key officials or heads of the relevant department at the central bank-level or Islamic banking regulator-level due to their inside knowledge and significant role in developing the corporate governance framework for the IFIs within their respective countries.

Based on the research questions formulated, the semi-structured interview comprises 23 questions segregated into seven parts. These involve a mixture of both the open-ended and close-ended questions that correspond to the research objectives of the

²⁷ U. Sekaran and R.J. Bougie, *Research Methods For Business: A Skill Building Approach* (Wiley 2016), p. 119; SA Merriam, 'Conducting Effective Interview' in *Case Study Research in Education* (published in San Francisco, 1st edn, Jossey-Bass 1988), p. 71-86.

²⁸ Bryman, p. 201; Blee and Taylor, p. 105.

²⁹ Blee and Taylor, p. 105; Michael Quinn Patton, *How to Use Qualitative Methods in Evaluation* (Sage 1987).

thesis (see **Figure 16**). The open-ended questions are useful in allowing the respondents to answer in their own terms, which can provide the study with the prospect of obtaining unusual and unique responses that the researcher may not have considered and enable access to new perspectives and ideas in areas unknown or of limited knowledge to the researcher³⁰. This also puts the respondents at ease and allows for an optimal interviewing environment. This researcher also applied probing or follow-up questions, which forms the major part of the prepared interview protocol, to encourage the participants to elaborate on their responses whenever necessary³¹.

At the same time, the presence of close-ended questions is equally crucial in ensuring that the entire interview session remains within a reasonable time frame in cognisance of the subjective nature of the open-ended questions, which may consume more time and cause the respondents to talk longer than necessary to the extent they deviate from the actual research objectives of the thesis³². Also, the close-ended questions could allow the researcher to confirm and validate certain corporate governance issues and provide an option to the respondents to elaborate on their answers.

Research Objectives	Questions
i. To study the general Islamic corporate governance framework on the practice of multiple <i>Sharia'</i> board directorship.	Q1 – Q6
ii. To examine the different regulatory approaches of subjected countries to the practice of multiple <i>Sharia'</i> board directorship.	Q7 – 11

³⁰ Bryman, p. 244; Babbie, p. 256. Also see RC Bogdan and SK Biklen, *Qualitative Research for Education: An Introduction to Theories and Methods* (4th edn, Pearson Education Group 2003); KG Esterberg, *Qualitative Methods in Social Research* (McGraw-Hill 2002)

³¹ Yin, *Case Study Research: Design and Methods*, p. 107; NK Denzin and YS Lincoln, *The Landscape of Qualitative Research: Theories and Issues* (2nd edn, Sage Publications 2003)

³² Bryman, p. 244; Babbie, p. 260.

iii. To investigate the presence of periodical assessment and time commitment policy vis-à-vis the IFI's <i>Sharia'</i> scholars with multiple <i>Sharia'</i> board directorship.	Q12 – 15
iv. To investigate the presence of disclosure requirement in relation to the number of <i>Sharia'</i> board directorships held by the <i>Sharia'</i> scholars.	Q16 – 17
v. To assess the structure and significance of remuneration policy to the <i>Sharia'</i> scholars.	Q18 – 20
vi. To investigate the presence of awareness or training programme for the <i>Sharia'</i> scholars on the laws, regulations, and business practices relating to the practice of multiple <i>Sharia'</i> board directorship.	Q21 – 22
vii. To investigate the perception of the central bank or financial regulator of the subjected countries on the practice of multiple <i>Sharia'</i> board directorship.	Q23

Figure 16: Link Between the Interview Questions and Research Objectives

6.4 Analysis of Data

6.4.1 Analysis of the Semi-Structured Interview

In interpreting the data collected from the semi-structured interviews, this researcher employed several research analysis processes including transcribing and transferring the written and digital data of the interview to the computer, scanning and extracting the relevant responses of the interview participants from the data, pattern identification, and identifying the substantial themes in the recorded responses. The analysis of this data

involved coding and categorising done according to a specific format on the computer³³. Following the sequence of the research questions, the study coded and categorised the respondents' feedbacks in six categories, namely the general Islamic corporate governance framework of the multiple *Sharia'* board directorship practice, the regulatory approach to the practice, the auditing and assessment of the time commitment of the *Sharia'* board members, the disclosure requirement of multiple *Sharia'* board directorships, the remuneration structure of the *Sharia'* board members, and the awareness programme on the practice. From this coding, this researcher summarised the given responses and developed a theme for each of the interview questions.

6.5 The QISMUT+3 Region

Despite constituting a mere 1 per cent of the global financial industry with its operations mostly concentrated in regions with a high percentage of Muslim population such as the South-East Asia and the GCC³⁴, the Islamic banking industry is experiencing tremendous growth around the globe. Accordingly, this thesis has chosen to analyse the legislative stance and perspectives of the Islamic banking regulators within the targeted jurisdictions, namely Malaysia and Indonesia concerning the practice of multiple *Sharia'* board directorship within an emerging and fast-developing Islamic banking market, collectively known as the QISMUT+3 region. This region has lately emerged as the industry's stronghold with a promising 5-year Compound Annual Growth Rate ('CAGR') of 14 per cent and an estimated total Islamic banking asset that will reach US\$ 1.8 trillion by 2020 (see **Figure 17**)³⁵. The region not only has a fast-growing customer base for Islamic financial services – serving two-third of the 38 million customers across the globe, but it also provides convenient access to a strong 252 billion potential banking customers³⁶. Apart from its significance as the economic gateway to the Islamic banking industry, the QISMUT+3 region also serves as the headquarters to important Islamic

³³ Blee and Taylor, p. 111.

³⁴ Humayon Dar and Talha Ahmad Azami, *Global Islamic Finance Report (GIFR) 2015* (BMB Islamic UK Limited, 2015), p. 9-10; Jeddah Chamber of Commerce & Industry, *Saudi Arabia - Islamic Finance Report* (November 2015, 2015), p. 3.

³⁵ Ernst & Young, *World Islamic Banking Competitiveness Report 2016*, p. 18.

³⁶ Ernst & Young, *World Islamic Banking Competitiveness Report 2013-14*

financial structure and standard-setting organisations such as the AAOIFI, IFSB, and many others (see **Figure 18**).

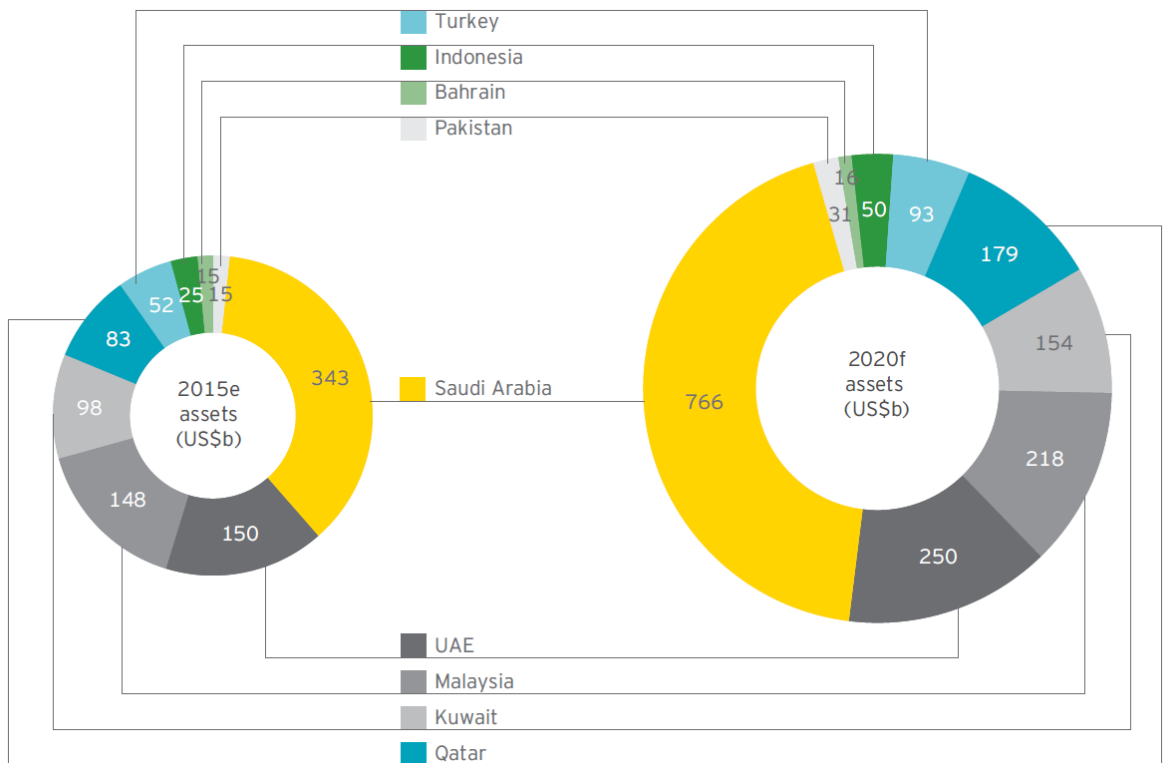
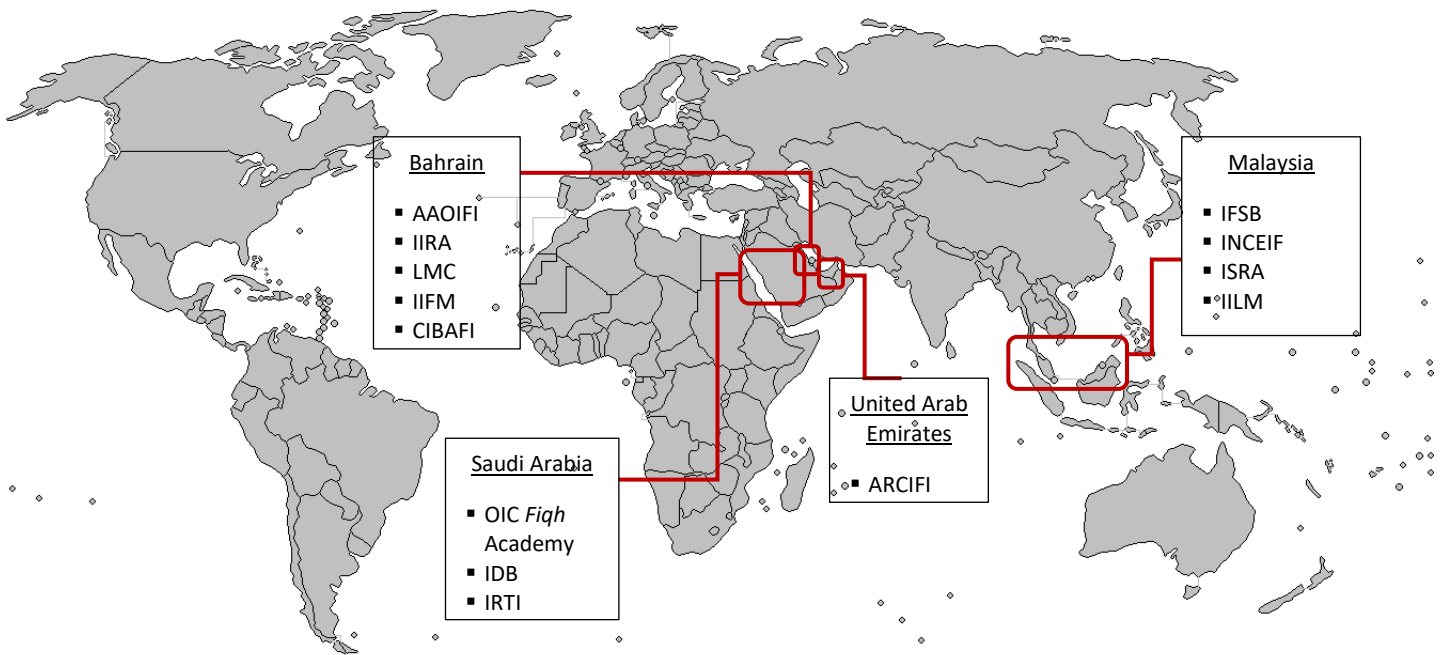


Figure 17: Estimated Total Islamic Banking Assets of the QISMUT+3 Countries between 2015 - 2020³⁷

³⁷ Ernst & Young, *World Islamic Banking Competitiveness Report 2016*, p. 18.



IFSB	International Financial Services Board
INCEIF	International Centre for Education in Islamic Finance
ISRA	International <i>Sharia'</i> Research Academy for Islamic Finance
IILM	International Islamic Liquidity Management Corporation
ARCIFI	Arbitration and Reconciliation Centre for Islamic Finance
IDB	Islamic Development Bank
IRTI	Islamic Research and Training Institute
AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
IIRA	International Islamic Ratings Agency
LMC	Liquidity Management Centre
IIFM	International Islamic Financial Market
CIBAFI	General Council for Islamic Banks and Financial Institutions

Figure 18: Islamic Financial Infrastructure and Standard-Setting Organisations within the QISMUT+3 Region

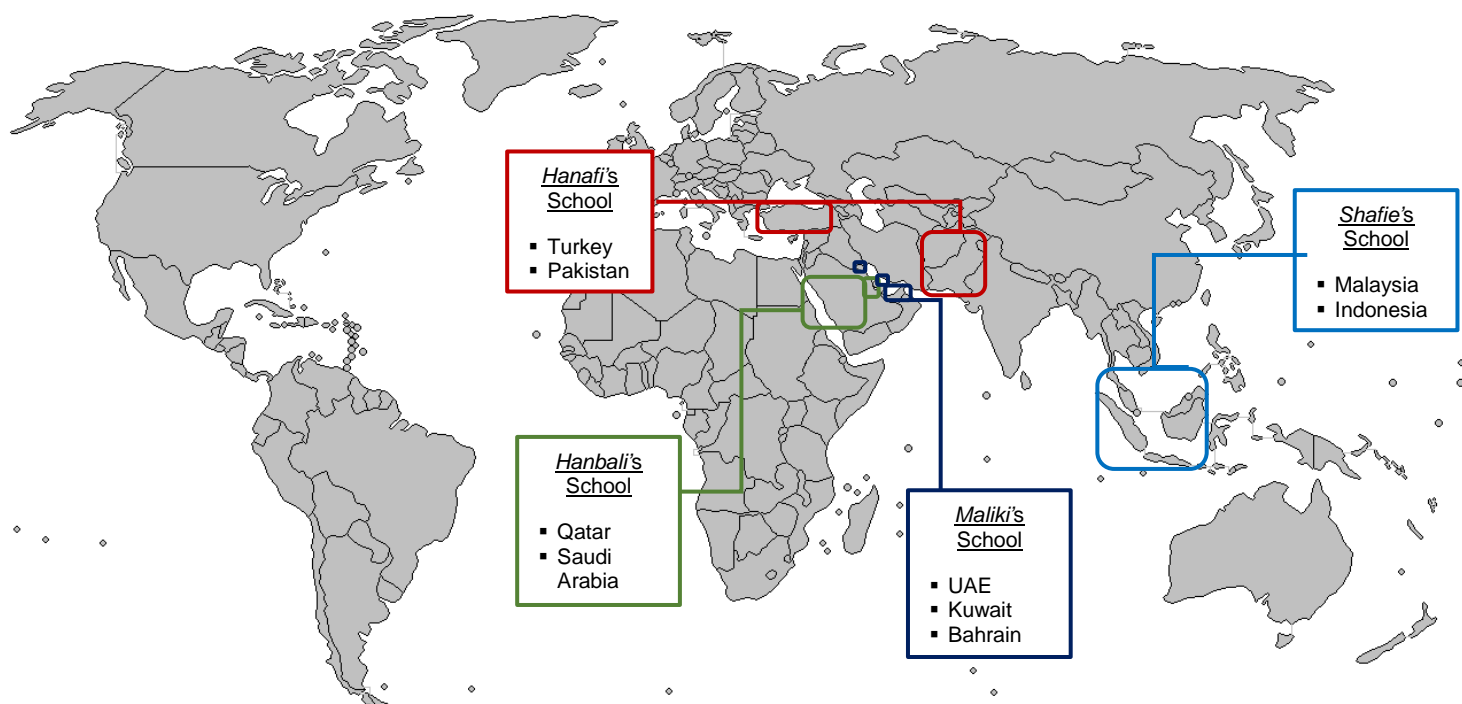


Figure 19: Division of Islamic Jurisprudential Schools within the QISMUT+3 Region

The thesis has chosen to concentrate its research scope on Malaysia and Indonesia due to the specific pivotal factors exhibited by these jurisdictions. On one hand, Malaysia is widely known as the leader of the Islamic banking market in the Asia Pacific region and it has since become one of the most progressive Islamic banking industry player within the QISMUT+3 region³⁸. On the other, Indonesia is the home to the largest Muslim population in the world and the fact that the Islamic banking industry has yet to fully exploit the Republic's dense Muslim population resources, and transform the country into a strong force in the global Islamic banking arena renders the Republic as a pragmatic selection³⁹.

Their respective shares in the global Islamic banking market, their promising potential to thrive and dictate the industry in the future, and this researcher's proficiency in the Malay and Indonesian languages certainly provide excellent grounds for the study to select these countries as its research subjects. In addition, the study also found that the unique pattern of the school of Islamic jurisprudence adopted by the two jurisdictions can

³⁸ Ibid, p. 11, 15.

³⁹ Dar and Azami, *Global Islamic Finance Report (GIFR) 2015*, p. 50, 52; Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), *Indonesia Islamic Finance Report: Prospects for Exponential Growth* (2016), p. 8, 13, 16, 43; Rifki Ismail, 'Islamic Banking in Indonesia: Lessons Learned' (Annual Meeting on Trade and Development, United Nations of Conferences on Trade and Development, Geneva, 6-8 April 2011), p. 4.

provide an interesting and valuable input into the research subject of this thesis (see **Figure 19**). Since it is common for the different schools of Islamic jurisprudence to differ in matters that belong to the non-*Ibadat* category⁴⁰ – and the multiple *Sharia*' board directorship practice is arguably a non-*Ibadat* matter, it is reasonable to anticipate that the stance on the practice will also differ between the schools. Accordingly, the concentration on both Malaysia and Indonesia, which subscribes to the *Shafie* school, renowned for its flexibility and lenient stance amongst the four major schools of Islamic jurisprudence not only presents an intriguing and constructive research outcome of the corporate governance framework to the multiple *Sharia*' board directorship practice within the *Shafie* school-oriented countries, but also benefits future research that attempts to scrutinise the same subject from the remaining three schools' settings⁴¹.

6.5.1 Case I (Malaysia)

6.5.1.1 Introduction

Malaysia ranks as the leading Islamic banking market in the Asia Pacific region and constitutes approximately 17 per cent of the total Islamic banking assets within the QISMUT+3 region⁴². The concept of Islamic banking first started in Malaysia in 1969 following the establishment of the Lembaga Urusan Tabung Haji ('LUTH'), a financial institution that focused on offering a saving and investment services to assist Muslims in gathering sufficient funds to perform the *Hajj* (pilgrimage) in Mecca, Saudi Arabia, which constitutes one of the five fundamental attributes of Islam⁴³. In 1983, the country

⁴⁰ See discussion *Ikhtilaf Fi Al-Fuqaha* at p. 134-148.

⁴¹ It is pertinent to note that *Imam* Shafie, the founder of the Shafie school of thought, was the first *Imam* to systemise the fundamental principles of *Fiqh* from the Hanafi and Maliki schools; this is reflected in his book called *Al-Risalah*. See Abu Ameenah Bilal Philips, *The Evolution of Fiqh (Islamic Law & The Mazhab)* (published in Kuala Lumpur, Percetakan Zafar Sdn Bhd 2002), p. 81.

⁴² Ernst & Young, *World Islamic Banking Competitiveness Report 2016*, p. 11, 15; Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2016*, p. 8.

⁴³ In Malaysia, it has become a common practice for parents to open-up a savings account with the LUTH for their children from the time they were born in providing them with the necessary funds to perform the *Hajj* in the future. The LUTH has since generated great returns from their *Sharia*'-compliant investment portfolios such as, *inter alia*, palm oil plantation and real estate projects. It had also established a number of on-site health and welfare service centres in Jeddah, Makkah, Madinah and Mina to assist the pilgrims during the *Hajj* season. See Sulaiman Abdullah Saif Al Nasser, Datin and Dr Joriah Muhammed, 'Introduction to History of Islamic Banking in Malaysia' (2013) 29 *Humanomics* 80, p. 82; Ishak, p. 236-240; Abdul-Rahman, p. 194; Joni Tamkin B Borhan, 'Tabung Haji as an Islamic Financial

introduced the Islamic Banking Act 1983 ('IBA') that allows the IFIs to co-exist and operate side-by-side with their non-IFI counterparts. This was soon followed by the establishment of the Bank Islam Malaysia Berhad ('BIMB') and Syarikat *Takaful* Malaysia in 1983 and 1985, the country's first Islamic bank and *Takaful* (Islamic insurance) operator respectively⁴⁴. After nearly two decades of operations, the BIMB has proven itself as the country's most successful IFI – boasting an expanding network of 80 branches with approximately 1, 200 employees⁴⁵. The emergence of these pioneering IFIs also led to the formation of the first *Sharia'* board to advise the IFI's management on the *Sharia'* issues related to financial services. Ten years later, the CBM introduced the *Skim Perbankan Tanpa Faedah* (Interest-Free Banking Scheme) and the concept of the Islamic banking window, which allows non-IFIs to offer Islamic financial products and services providing healthy competition to the other IFIs and stimulating the growth of the Malaysian Islamic banking market⁴⁶.

As the number of the non-IFIs with Islamic windows increased, a genuine call came for the financial regulators to streamline and harmonise the Islamic banking activities in the country, especially those involving the interpretations of the *Sharia'* law related to financial services. This led to the creation of two *Sharia'* Advisory Councils ('SAC') under both the CBM and the Securities Commission of Malaysia ('SCM') to cater for the divergent Islamic financial industry. On one hand, the CBM had established its SAC⁴⁷ in May 1997 pursuant to the Banking and Financial Institutions Act 1989 ('BAFIA') to act as the highest decision-making authority on Islamic banking and *Takaful* businesses⁴⁸. On the other hand, in July 1996 pursuant to the Securities Commission Act 1993, the

Institution: An Analysis of Its Contribution in The Economic Development in Malaysia, 1969-1990' (2001) 75 *Islamic Culture* 49. Also see footnote 73 in Chapter 3.

⁴⁴ Bank Islam Malaysia Berhad, 'History' (*Bank Islam Malaysia Berhad*, 2017) <<http://www.bankislam.com.my/home/corporate-info/about-us/corporate-profile/>> accessed 15 September 2017. Also see PricewaterhouseCoopers, p. 15.

⁴⁵ M. Iqbal and P. Molyneux, *Thirty Years of Islamic Banking: History, Performance and Prospects* (Palgrave Macmillan UK 2016), p. 45.

⁴⁶ Malaysia has also developed an Islamic debt securities market in 1990, an Islamic Interbank Money Market in 1994, and an Islamic equity market in 1995. See Bank Negara Malaysia, *Guidelines on "Skim Perbankan Islam"* (Bank Negara Malaysia 2012); di Mauro and others, p. 57; Mohd Roslan Mohd Nor and others, 'Historical Development of Islamic Institutions: A Case of Malaysian Government' (2012) 6 *African Journal of Business Management* 2766, p. 2769; Venardos, p. 155.

⁴⁷ For the purpose of this thesis, the term 'SAC' shall only refer to the CBM's SAC.

⁴⁸ Bank Negara Malaysia, 'Shariah Advisory Council of the Bank'

SCM had established its own SAC, which acts as the sole authority on the *Sharia*' compliance issues pertaining to the Islamic capital market⁴⁹.

On October 1999, the merger of Bank Bumiputera Malaysia Berhad and the Bank of Commerce Malaysia Berhad led to the formation of the Bank Muammalat Malaysia Berhad, which became the second full-fledged Islamic bank in the country and a direct competitor to the BIMB⁵⁰. Five years later, the Kuwait Finance House, Al Rajhi Banking & Investment Corporation, and the Asian Finance Bank Berhad became the first three foreign full-fledged IFIs to join the Malaysian Islamic banking market as a result of the financial liberalisation policy implemented by the Malaysian government in 2004⁵¹. Soon, the Malaysian financial market began to welcome the admission of IFIs such as the Unicorn International Islamic Bank, First Islamic Investment Bank Ltd⁵², and Deutsche Bank AG, which provided greater competition to the local IFIs and spurred the growth of the Malaysian Islamic banking industry⁵³. Currently, Malaysia boasts more than 20 IFIs offering Islamic financial services.

6.5.1.2 Regulatory Overview

Malaysia adopts a pro-active approach to the corporate governance structure of its IFIs by emphasising the formation of a comprehensive regulatory framework as the key foundation in developing and strengthening its existing corporate governance system for the Islamic banking industry⁵⁴. There are already several substantial legislations and internal guidelines introduced by the Malaysian parliament and the CBM respectively to support the local Islamic banking market such as the Islamic Banking Act 1983 ('IBA

⁴⁹ Resolution of the SC's SAC 2nd Edition, p. 2; PricewaterhouseCoopers, p. 55.

⁵⁰ Nasser, Datin and Muhammed, p. 83; Mohd Najib Mansor, 'Islamic Banking and Financial Institutions in Malaysia: Current Developments' (2009) 5 *Journal of International Studies* 109, p. 115.

⁵¹ Ruzian Markom and Norilawati Ismail, 'The Development of Islamic Banking Laws in Malaysia: An Overview' [2009] *Jurnal Undang-Undang*, p. 196-197; Ricardo Baba, 'Islamic Financial Centres' in Kabir Hassan and Mervyn Lewis (eds), *Handbook of Islamic Banking* (Edward Elgar Publishing 2007), p. 393.

⁵² Owned by the PT. Bank Muammalat Indonesia.

⁵³ Markom and Ismail, p. 197; Hamin S Ahmad Mokhtar, Naziruddin Abdullah and S Musa Alhabshi, 'Technical and Cost Efficiency of Islamic Banking in Malaysia' (2007) 11 *Review of Islamic Economics* 5, p. 10-11.

⁵⁴ Hasan, 'Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK', p. 84; Majid and Ghazal

1983')⁵⁵, *Takaful Act 1984* ('TA 1984')⁵⁶, the Banking and Financial Institutions Act 1984 ('BAFIA 1984')⁵⁷, Securities Commission Act 1993 ('SCA 1993'), Central Bank of Malaysia Act 2009 ('CBMA 2009'), and the Islamic Financial Services Act 2013 ('IFSA 2013')⁵⁸. The robust regulatory framework and the presence of sound legislation and corporate governance guidelines for the local Islamic banking sector have positioned the country at the forefront of the global Islamic banking industry.

In the same vein, the introduction of the IFSA 2013 has boosted the legislative requirements in upholding financial stability and *Sharia'* compliance in the Malaysian Islamic banking market. It imposes a duty on the IFIs and other financial institutions offering Islamic financial services to ensure that their financial operations comply with *Sharia'* law and obliges their BODs to pay due regard to the decisions issued by their respective *Sharia'* boards and the SAC⁵⁹. The CBM, through its SAC, is also empowered with the prerogative to set standards on any *Sharia'*-related issue, which includes the identification of the duties of the IFI's BOD, senior management, and the *Sharia'* board toward *Sharia'* compliance; the issuance of fit and proper criteria for the *Sharia'* board members and the grounds for their disqualification; the setting of a framework for internal *Sharia'* compliance functions; and any other matters related to *Sharia'* compliance⁶⁰. It is also important to note that the advice or rulings of the SAC binds the CEO, BOD, *Sharia'* board and senior management of these financial institutions⁶¹.

⁵⁵ Repealed by the IFSA 2013.

⁵⁶ Repealed by the IFSA 2013.

⁵⁷ Repealed by the Financial Services Act 2013.

⁵⁸ Bank Negara Malaysia, 'Legislation' (*Bank Negara Malaysia*, 2017) <http://www.bnm.gov.my/index.php?ch=en_legislation&lang=en> accessed 22 September 2017; Bank Negara Malaysia, 'Banking & Islamic Banking' (*Bank Negara Malaysia*, 2017) <http://www.bnm.gov.my/index.php?ch=en_policy&pg=en_policy_banking> accessed 22 September 2017

⁵⁹ Malaysia International Islamic Financial Centre (MIFC)

⁶⁰ Ginena Islamic Financial Services Act 2013 (Act 759) Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3

⁶¹ Section 29 of the Islamic Financial Services Act 2013 (Act 759)

6.5.1.3 Corporate Governance Structure for Islamic Banking

The Malaysian Islamic corporate governance model adopts a two-tier board structure. The first tier comprises the formation of a *Sharia'* committee at the financial institution-level in accordance with section 51 of the CBMA 2009⁶², section 30 of the IFSA 2013⁶³ and the *Sharia'* Governance Framework of Islamic Financial Institutions 2011 ('SGF 2011') issued by the CBM⁶⁴, which render the formation of a *Sharia'* committee a prerequisite in the granting of the necessary licence for these institutions to carry out Islamic banking business⁶⁵. The *Sharia'* committee acts as the guardian to the *Sharia'* compliance guarantee of the Islamic financial products and services in the market and provides the necessary counsels to the BOD and the management in discharging their respective roles and responsibilities in their day-to-day operations including a *Sharia'* compliance review, a *Sharia'* audit, risk management and industrial research⁶⁶ (see **Figure 20**).

⁶² Previously under section 3 (5) of Islamic Banking Act 1983. See Islamic Banking Act 1983 (Act 276) (repealed)

⁶³ Previously under section 124 of Banking and Financial Institutions Act 1989. See Banking and Financial Institutions Act 1989 (Act 372) (repealed)

⁶⁴ Formerly known as the Guidelines on the Governance of *Shariah* Committee for the Islamic Financial Institutions (BNM/GPS1). See Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/005-6

⁶⁵ Schedule 5 of the Islamic Financial Services Act 2013. See Islamic Financial Services Act 2013 (Act 759); Section 5 (a) and (b) of the Islamic Banking Act 1983. Also see Islamic Banking Act 1983 (Act 276) (repealed)

⁶⁶ The BOD can appoint at least 1 member of the *Sharia'* committee to serve as a 'bridge' in harmonising and calibrating any divergent viewpoints between the BOD and the *Sharia'* committee. See Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 10. Also see Bernama, 'New Syariah Governance Framework to Boost Progress of Islamic Finance' *Sin Chew Daily* (Kuala Lumpur, 14 February 2011) <<http://www.mysinchew.com/node/53180>> accessed 11 September 2017; Hassan, Triyanta and Yusoff

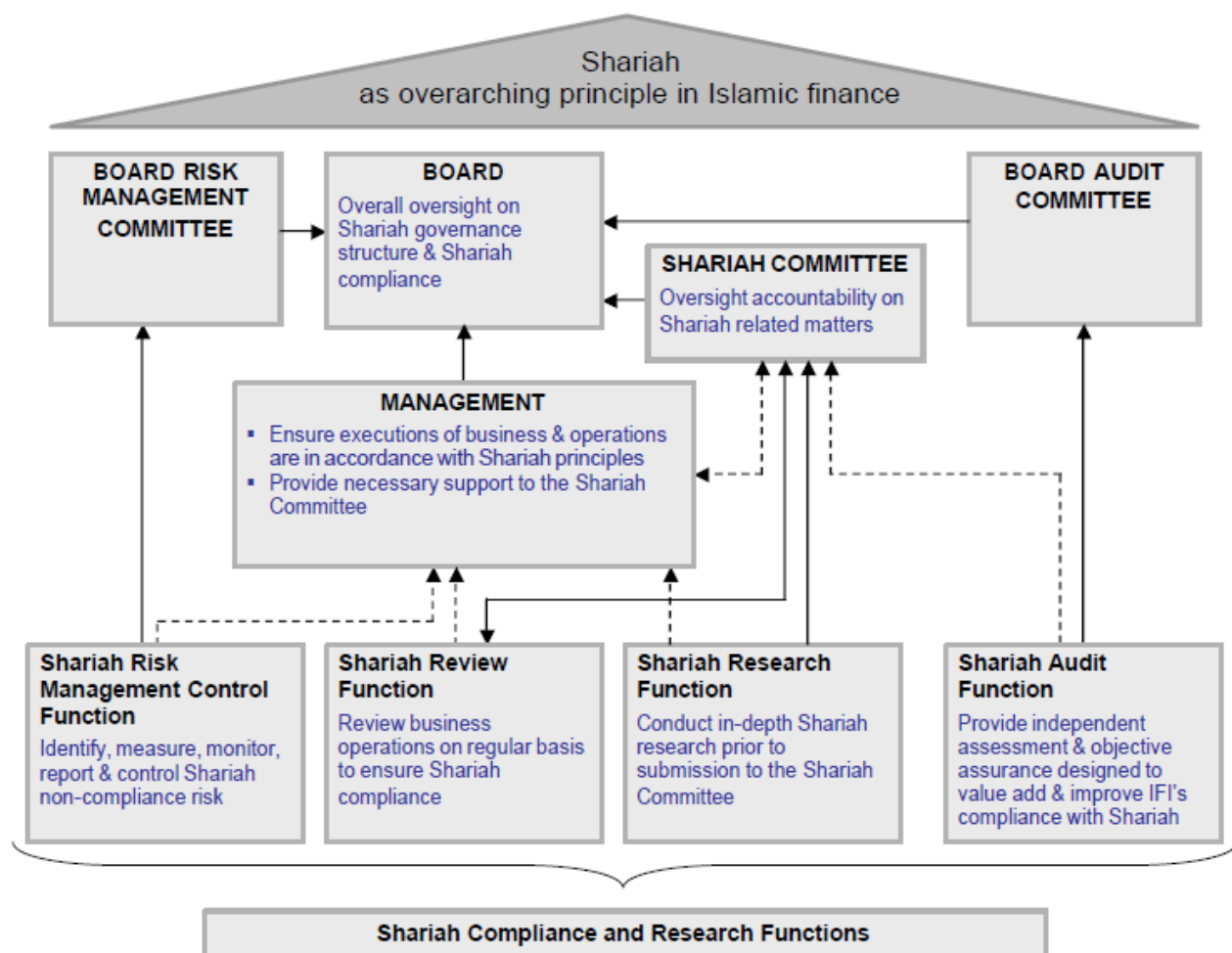


Figure 20: CBM's *Shariah* Governance Framework model for Islamic Financial Institutions – *Shariah* Governance Framework 2011⁶⁷

The *Sharia'* committee must comprise a minimum number of five members⁶⁸, who must demonstrate an acceptable reputation, character, and integrity, as well as satisfying a set of fit and proper criteria set by the CBM⁶⁹. In terms of their appointments, the CBM allows every IFI to nominate their own candidates and these appointments become

⁶⁷ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3

⁶⁸ This represents an increase from the minimum number of three members stipulated in the superseded BNM/GPS1. See Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/005-6, p. 4.

⁶⁹ A *Sharia'* committee member must profess the religion of Islam, hold a bachelor's degree in *Sharia'* law, and demonstrate a strong proficiency and knowledge in written and verbal Arabic, Malay and the English languages. See Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 10, 17, 30; Fit and Proper Criteria BNM/RH/GL 018-5, p. 12. Also see p. 103-107 and 210-213.

official upon the receipt of written approval from the CBM⁷⁰. Likewise, the reappointment of any *Sharia'* board members must adhere to a similar set of procedures⁷¹. The duration of the appointment remains unclear as the CBMA 2009, IFSA 2013, and the SGF 2011 have not prescribed a specific term for the appointment and the number of renewals although a relevant provision on these could be found in the superseded Guidelines on the Governance of *Sharia'* Committee for the Islamic Financial Institutions ('BNM/GPS1'), which had fixed the duration of appointment for the *Sharia'* board directorship at two years with a renewal option of an additional two years⁷².

The second tier of the board comprises the CBM's SAC, which is responsible for issuing *Fatwas* and resolutions for the Malaysian Islamic banking and *Takaful* (Islamic insurance) market; except for the Islamic capital market⁷³. The establishment of the SAC in May 1997 as a centralised supervisory and governing body signals the CBM's commitment to promoting certainty in the Malaysian Islamic banking market through a standardised implementation of the *Fatwas* and *Sharia'* resolutions in all Islamic banking and *Takaful*-related issues⁷⁴. In addition to the significant legislation of the CBMA 2009 and the IFSA 2013, the appointment of the SAC's members by the Yang di-Pertuan Agong ('YDPA')⁷⁵, the Malaysian monarch, have also enhance the CBM's mandates in promoting monetary and financial stability in the local Islamic banking market. It is important to note that prior to the CBMA 2009, the SAC members were appointed by the

⁷⁰ Section 31 of the Islamic Financial Services Act 2013 (Act 759); Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 29.

⁷¹ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 16, 29.

⁷² Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/005-6, p. 3. Also see Wardhany and Arshad, p. 8.

⁷³ Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance - Second Edition*. The Securities Commission of Malaysia has its own SAC and *Sharia'* resolutions for the Islamic capital market. See Section 316A of the Capital Market and Services Act 2007; Capital Market and Services Act 2007 (Act 671). Also see Simon Archer, Rifaat Ahmed Abdel Karim and Gopala Krishnan Sundaram, 'Evolution of Shariah Standards and Guidelines for AAOIFI, IFSB and Bank Negara Malaysia' in *Islamic Commercial Law Report 2016* (ISRA & Thomson Reuters 2016), p. 54-55; Hassan, Triyanta and Yusoff

⁷⁴ Section 16B (1) of the Central Bank of Malaysia Act 1958 (Act 519) (repealed). Also see Mohammad Akram Laldin and Hafas Furqani, 'Standardisation and Harmonisation of Islamic Financial Practices: The Approach of the Central Bank of Malaysia' in *Islamic Commercial Law Report 2016* (ISRA & Thomson Reuters 2016), p. 56.

⁷⁵ "The Yang di-Pertuan Agong may, on the advice of the Minister after consultation with the Bank [CBM], appoint ... as members of the Shariah Advisory Council". See section 53 of the Central Bank of Malaysia Act 2009 (Act 701), p. 50. Additionally, the YDPA also appoints the CBM's Governor and its BOD.

Minister of Finance⁷⁶. The appointment to the SAC's office by the YDPA signals the intention of the legislature to elevate the standard and significance of the SAC; akin to those of the civil court judges, who are appointed through the same procedures, which empowers the SAC to act as the sole authoritative body for the ascertainment of all Islamic banking issues in the country⁷⁷.

It is also worthy to note that the IFSA 2013 is the first of its kind, which contains a specific provision that expressly hold the IFI accountable for any *Sharia'* non-compliance incidence in its financial operations. Uniquely, the legislation further states specifically that *Sharia'* compliance is not only the responsibility of the *Sharia'* board, but also that of the CEO's, BOD's, and senior officers' – all whom are subjected to the same penal provision, which can render them liable to imprisonment for a term not exceeding eight years or to a fine not exceeding 25 million Malaysian Ringgit or both⁷⁸. Although actual conviction may appear unlikely due to several mitigating factors such as the statutory definition of *Sharia'* compliance itself, which simply demands that the IFI gives effect to the *Sharia'* rulings of the SAC⁷⁹; or the grace period of 30 days granted to the IFI to submit its rectification plan to the CBM in the event of *Sharia'* non-compliance, the stance taken by the Malaysian government is indeed highly commendable and exemplary in its boosting of the reputation of its Islamic banking industry.

6.5.1.4 Regulatory Issues

Malaysia exhibits a unique and more sophisticated Islamic corporate governance framework than the rest of the key Islamic banking markets due to its mixed legislative system that comprises both *Sharia'* law and the common law; the latter being the surviving legacy of the British colonialism of the country between 1786 - 1957⁸⁰. The

⁷⁶ "The Syariah Advisory Council shall consist of such members as may be appointed by the Minister [of Finance] ...". See section 16B (2) of the Central Bank of Malaysia Act 1958 (Act 519) (repealed)

⁷⁷ Section 28 of the IFSA 2013 further reinforces the authority of the SAC by stipulating that an IFI is deemed as a *Sharia'*-compliant financial institution only when it complies with the *Sharia'* rulings of the SAC. See Islamic Financial Services Act 2013 (Act 759)

⁷⁸ Section 28 and 29 of *ibid*

⁷⁹ Section 28 (2) and 29 (1) (b) of the *ibid*

⁸⁰ Ramlah Adam, *Kemelut Politik Semenanjung Tanah Melayu (The Political Struggle of the Malay Peninsular)* (Universiti Malaya Publication 1998). Also see Carolina López, 'The British Presence in the Malay World: A Meeting of Civilizational Traditions' (2001) 19 *Sari* 3; Ahmad Fauzi Abdul Hamid, 'Malay

common law principles apply to almost all matters with the civil court holding an extensive jurisdiction by virtue of List I – Federal List, which provides a comprehensive list of matters that fall under the purview of the civil court. In contrast, *Sharia'* law has a limited application by virtue of List II – State List, which only allows the *Sharia'* Court to try cases pertaining to family, inheritance, and minor criminal offences under *Sharia'* law⁸¹. Although the civil court has remained the platform for the adjudication of Islamic banking cases in the country since 1985⁸² due to the fact that Islamic banking matters correspond with the definition of “banking, moneylending, pawnbrokers, and control of credit” in List I – Federal List, the Malaysian judiciary, in cooperation with the CBM, has established a *Muammalat* Court in the commercial division of the High Court in an effort to provide a proper adjudication channel for Islamic banking cases due to their distinct principles and operation⁸³.

Additionally, the Malaysian Islamic corporate governance structure is also unique as the *Sharia'* resolutions of the SAC not only bind both the IFIs and non-IFIs that offer Islamic financial products and services in the country, but they also bind the civil court and the arbitrator, who must refer to the SAC for its advice and counsel in proceedings involving the ascertainment of any *Sharia'* matters related to Islamic financial products, services

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⁸¹ Ninth Schedule of Federal Constitution of Malaysia. Additionally, the country's constitutional arrangement bestows supremacy to its common law-based Federal Constitution. See article 4 of *ibid*. Also see Para. 3 of *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors (Koperasi Seri Kota Bukit Cheraka Bhd, third party)* [2008] 5 MLJ 631 Malaysian Law Journal (High Court (Kuala Lumpur)); Rusni Hassan, 'Championing the Development of Islamic Banking Law in Malaysia: Legal Issues and Remedies' [2006] Shariah Law Reports Articles 1, p. 7.

⁸² *Tinta Press v Bank Islam Malaysia Berhad* [1986] 1 MLJ 474 (Court of Appeal) was the first reported Islamic banking case in Malaysia. Since then, the civil courts had tried many Islamic banking cases. See Apnizan Abdullah and Hakimah Yaacob, 'The Trend of Legal Suits Involving Islamic Financial Transactions in Malaysia: Evidence From the Reported Cases' [2012] ISRA Research Paper; Zulkifli Hasan and Mehmet Asutay, 'An Analysis of the Courts' Decisions on Islamic Finance Disputes' (2011) 3 ISRA International Journal of Islamic Finance 41

⁸³ Practice Direction No. I/2003. The initiation of the *Muammalat* Court has since displayed a positive result in the disposal of Islamic banking cases with 7, 787 disposals of cases out of 7, 849 registered cases between 2003 and 2013. See Federal Court of Malaysia, *The Malaysian Judiciary Yearbook 2013* (Zainun J. Ali ed, Percetakan Nasional Malaysia Berhad 2013), p. 84; Umar Aimhanosi Oseni and Abu Umar Faruq Ahmad, 'Dispute Resolution in Islamic Finance: A Case Analysis of Malaysia' (8th International Conference on Islamic Economics and Finance, Doha, 19-21 December 2011), p. 6; Hasan, 'Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK', p. 84-85; Ahmad Hidayat Buang, 'Islamic Contracts in a Secular Court Setting? Lessons from Malaysia' (2007) 21 Arab Law Quarterly 317, p. 319.

and banking practices⁸⁴. Since *Tinta Press* in 1985⁸⁵, a critical concern had emerged in respect of the civil court's capability to adjudicate the *Sharia'* issues of Islamic banking cases in which the interpretation and application of *Sharia'* law and principles of finance necessitate the possession of knowledge and skills in both *Sharia'* law and its *Fiqh* (jurisprudential) methods – a condition diametrically opposed to the civil court judges' knowledge and expertise⁸⁶.

Prior to the introduction of the CBMA 2009, the court enjoyed the prerogative to opt to refer any *Sharia'* matters related to Islamic banking to the SAC⁸⁷. In *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation*⁸⁸, the Court of Appeal held that the principles and procedures of the conventional or non-Islamic banking system should also apply to Islamic banking. This decision gradually contributed to the *raison d'être* of a specific body to advise the court of *Sharia'*-related issues involved in Islamic banking cases. The call for the legislation of a mandatory reference to the SAC intensified in 2009 when High Court judge Abdul Wahab Patail J in *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & 2 Ors*⁸⁹ delivered a contentious judgment, in which his lordship ruled the *Bai Bithaman Ajil* ('BBA'), or the deferred payment sale, an invalid Islamic financing facility because it not only resembled an interest-bearing loan, which violated the principles of *Fiqh Al-Muamalat* (Islamic law of commerce), but also because it was unacceptable

⁸⁴ Section 56 and 57 of Central Bank of Malaysia Act 2009 (Act 701). In Pakistan, the *Sharia'* Federal Court acts as the highest authority on Islamic banking matters despite of the presence of a central *Sharia'* board at the State Bank of Pakistan, the country's central bank. See Hasan, 'Regulatory Framework of Shari'ah Governance System in Malaysia, GCC Countries and the UK', p. 84. Also see Abdul-Rahman, p. 79.

⁸⁵ In *Tinta Press*, the civil court interpreted the *Ijarah* financing facility from the perspective of a lease contract under the English law. See Abdul Karim Aldohni, *The Legal and Regulatory Aspects of Islamic Banking: A Comparative Look at the United Kingdom and Malaysia* (Routledge 2011), p. 205-206; Buang, p. 326; Siti Nurul Aziera Moharani and Aminuddin Mustaffa, 'Role of the Syariah Advisory Council (SAC) in Dispute Resolution Process: Perspective on Recent Case Development' (2012) 6 Malaysian Law Journal

⁸⁶ Suriyadi J in *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd [2005] 5 MLJ 210* opined that "not every presiding judge is a Muslim, and even if so, may not be sufficiently equipped to deal with matters, which Ulama' take years to comprehend". See Ruzian Markom and Noor Inayah Yaakub, 'Litigation as Dispute Resolution Mechanism in Islamic Finance: Malaysian Experience' (2015) 40 European Journal of Law and Economics 565, p. 580; Adnan Trakic, 'Dispute Resolution of Islamic Banking Cases in Malaysia with Reference to Muamalat Division of the High Court and the Shariah Advisory Council [2013] 3 MLJ lxvii' 3 Malaysian Law Journal. Also see *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Sdn Bhd [2003] 2 MLJ 408* (Court of Appeal (Kuala Lumpur))

⁸⁷ Markom and Yaakub, p. 567, 577.

⁸⁸ *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Sdn Bhd*

⁸⁹ *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & 2 Ors [2009] 1 CLJ 419*

to all four major schools of Islamic jurisprudence⁹⁰. Here, his lordship had taken it upon himself to rule the BBA contract as invalid due to its sole acceptability by the Shafie school⁹¹, which his lordship deemed as contradictory to the definition of 'Islamic banking business' in the now-repealed IBA 1983⁹². This ruling stirred an uneasiness among the IFIs as due to its binding effect it formed a strong judicial precedent that could jeopardise all recovery actions against defaulters undertaking similar Islamic financing facility, who could exploit this contentious precedent in order to avoid their respective financial obligations. In fact, there were several cases that had followed the precedent set in the *Arab Malaysian Finance Bhd* case such as *Malayan Banking Bhd v Marilyn Ho Siok Lin*⁹³, *Malayan Banking Bhd v Ya'kup Oje & Anor*⁹⁴, *Fadzilah v Malayan Banking*⁹⁵, *Arab Malaysian Merchant Bank v Foreswood Industries*⁹⁶, and *Arab Malaysian Merchant Bank v Silver Concept*⁹⁷.

Theoretically, the judgment of Abdul Wahab Patail J in *Arab Malaysian Finance Bhd* has its own rationale as the beliefs and practices of an Islamic jurisprudential school do not necessarily represent those of the other schools or the religion of Islam in general. With due respect, however, this verdict had failed to consider the significance of the other elements available in *Usul Al-Fiqh* such as *Maslahah Al-Mursalah* or *Urf*, which can lend legitimacy to a specific matter or practice – even if it does not receive the acknowledgment of the other schools of Islamic jurisprudence. In truth, it was never mandatory for an Islamic financing facility to obtain the approval of all the four schools.

⁹⁰ The judge departed from the precedent cases such as *BIMB v Adnan Omar* [1994] 3 CLJ 735 and *Haji Nik Mahmud v BIMB* [1996] 4 MLJ 295, which recognised the validity of BBA contract as a financing facility.

⁹¹ See *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & 2 Ors*, where Abdul Wahab Patail J stated “...If a facility is to be offered as Islamic to Muslims generally, regardless of their Mazhab [school], then the test to be applied by a civil court must logically be that there is no element not approved by the religion of Islam under the interpretation of any of the recognised Mazhabs. That it is acceptable to one Mazhab is not sufficient to say it is acceptable in the religion of Islam when it is not accepted by the other Mazhabs”.

⁹² The IBA 1983 defines an 'Islamic banking business' as “banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam”. See section 2 of Islamic Banking Act 1983 (Act 276) (repealed)

⁹³ *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 3 CLJ 796

⁹⁴ *Malayan Banking Bhd v Ya'kup Oje & Anor* [2007] 5 CLJ 311

⁹⁵ *Fadzilah v Malayan Banking* 1 LNS 536

⁹⁶ *Arab Malaysian Merchant Bank v Foreswood Industries* [2007] 1 LNS 539

⁹⁷ *Arab Malaysian Merchant Bank v Silver Concept* [2008] 9 CLJ 522, [2008] 6 MLJ 295

Each school is entitled to its own opinions and any differences in the *Sharia'* opinions between the schools does not render one less Islamic than the other. In other words, the fact that the BBA is only recognised by the Shafie school cannot serve as a justifiable ground to hold this Islamic financing facility invalid⁹⁸.

Accordingly, the court in *Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor*⁹⁹ overturned the ruling in *Arab Malaysian Finance Bhd* and held that judges in civil courts should not take it upon themselves to decide matters of compliance with *Sharia'* law. Instead, they should leave its deliberation in the hands of those holding proper qualifications in the field of Islamic jurisprudence¹⁰⁰. Since it is unrealistic for the civil court judges to familiarise themselves with *Sharia'* law due to its impracticability in the civil court, the provision of a statutory obligation for the court to refer all *Sharia'*-related issues in Islamic banking cases to the SAC grants the court direct access to a group of qualified and competent *Sharia'* experts who can enhance the court's ability to deal with complex *Sharia'* issues in these cases, and also seeks to prevent a problematical situation, in which the transactions entered into by contracting parties complied with *Sharia'* law but the judgment issued by the court did not¹⁰¹.

At the same time, it is arguable that the mandatory obligation imposed by the law on the court can amount to an encroachment or usurpation of the court's independence and authority. However, the cases of *Mohd Alias bin Ibrahim v RHB Bank Bhd & Anor*¹⁰² and *Tan Sri Abdul Khalid Ibrahim v Bank Islam (M) Bhd*¹⁰³ upheld section 56 and 57 of the CBMA 2009 as valid federal laws. These provisions do not interfere with the court's independence as the SAC's role is only limited to the ascertainment of the *Sharia'* issues involved within the financial dispute and does not infer that the SAC was performing a judicial or quasi-judicial role. In other words, the provisions do not impose a binding obligation on the court to adopt the SAC's counsel and allows the judges, to a certain

⁹⁸ Suraya Ismail and Wan Anisah Endut, 'Bai Bithaman Ajil Home Financing in Malaysia: An Evaluation' (2015) 3 International Journal of Education and Research, p. 648; Guney, p. 498-499. Also see Raus Sharif JCA in *Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor* [2009] 6 MLJ 839

⁹⁹ *Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor*

¹⁰⁰ *Bank Muamalat Malaysia Bhd v Kong Sun Enterprise Sdn Bhd & Ors* [2012] 10 MLJ 665

¹⁰¹ Archer and Hussain, p. 31; Abdul-Rahman, p. 81; Engku Rabiah Adawiah Engku Ali, 'Constraints and Opportunities in Harmonisation of Civil Law and Shariah in the Islamic Financial Services Industry [2008] MLJ 4' [2008] Malaysian Law Journal

¹⁰² *Mohd Alias bin Ibrahim v RHB Bank Bhd & Anor* [2011] 3 MLJ 26

¹⁰³ *Tan Sri Abdul Khalid Ibrahim v Bank Islam (M) Bhd* [2012] 3 MLJ 269

degree, to exercise their own understanding and perception of the entire *Sharia'* concept involved in ensuring a fair outcome that balances the application of *Sharia'* law with the interest of the disputing parties¹⁰⁴.

6.5.1.5 Regulatory Policies of Multiple *Sharia'* Board Directorship

In light of the two-tiered board structure of the Malaysian corporate governance framework for IFIs, it is important to understand the regulatory policies of the multiple *Sharia'* board directorship practices on a 'tier-to-tier' basis. At the first tier (IFI-level), the SGF 2011 provides that an IFI cannot appoint a *Sharia'* scholar, who has already occupied a directorship position on the *Sharia'* board of another IFI unless this position is held in an IFI that operates in a different industry¹⁰⁵. Here, the CBM segregates the IFIs' line of business into two categories, namely the 'Islamic banking business' and the '*Takaful* business'¹⁰⁶, and it prohibits a *Sharia'* board member of an IFI that engages in either the 'Islamic banking business' or the '*Takaful* business' from occupying any additional *Sharia'* board position in the *Sharia'* board of other IFI, which operates in a similar line of business.

Additionally, the division of the 'Islamic banking business' and the '*Takaful* business' also implies that Malaysia recognises the multiple *Sharia'* board directorship practice and allows a *Sharia'* board member to occupy a maximum of two *Sharia'* board directorships if one of the position is in an opposite line of business to the other. This translates into one position in any IFI that operates in the Islamic banking industry, and another position in any IFI operating in the *Takaful* (Islamic insurance) industry¹⁰⁷. For example, a *Sharia'* board member of Bank Islam Malaysia Berhad cannot serve on the *Sharia'* board of Bank Muamalat Berhad as both operate in the Islamic banking business. However, he or she could serve on the *Sharia'* board of Syarikat *Takaful* Malaysia Berhad, which

¹⁰⁴ Archer and Hussain, p. 31.

¹⁰⁵ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 20, 32; Hasan and Sabirzyanov, p. 246.

¹⁰⁶ Islamic Financial Services Act 2013 (Act 759), p. 26, 36.

¹⁰⁷ Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/012-1, p. 6-7.

operates in a different line of business than Bank Islam¹⁰⁸. Such a restriction aims to preserve the confidentiality of sensitive information, prevent any potential conflicts of interest between the IFIs and ensure that the *Sharia'* board members can commit an optimum level of time, focus and dedication to the IFIs' affairs¹⁰⁹.

At the second tier (central bank-level), however, there is no provision in either the IFSA 2013 or the CBMA 2009 to address the issue of multiple *Sharia'* board directorship by members of the SAC. This lacuna is surprising considering the presence of a specific provision in the repealed CBMA 1958, which barred the members of the SAC from serving on the *Sharia'* board of any financial institution in the country, whether remunerated or not, without the written approval of the CBM¹¹⁰. It is even ironic to learn that the CBMA 2009 requires the CBM Governor and Deputy Governor to devote the whole of their professional time to the central bank and bars them from occupying any other office or employment, whether remunerated or not,¹¹¹ but neglects to impose a similar degree of professional dedication on the SAC's members.

In a similar vein, the IFSA 2013, CBMA 2009 and the SGF 2011 have stopped short of addressing the issue of extraterritorial *Sharia'* board directorships held by the IFI's *Sharia'* board and SAC members. The limitation imposed by the Malaysia statutes and the CBM's guidelines could not prevent a *Sharia'* board member from occupying additional *Sharia'* board directorships outside the country and Sheikh Mohammad Daud Bakar, Sheikh Mohamad Akram Laldin, and Sheikh Aznan Hasan are among the country's prominent scholars who hold extraterritorial *Sharia'* board directorships¹¹².

¹⁰⁸ For a comprehensive list of licensed IFIs and *Takaful* companies in Malaysia, see Bank Negara Malaysia, 'List of Licensed Financial Institutions' (*Bank Negara Malaysia*, 2017) accessed 1 July 2017

¹⁰⁹ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 19-20, 32; Bernama, . Also see section 16B (6) of the repealed Central Bank of Malaysia Act 1958 (Act 519) (repealed)

¹¹⁰ Sec. 16 (B) (6) of Central Bank of Malaysia Act 1958 (Act 519) (repealed); Guidelines on the Governance of Shariah Committee for the Islamic Financial Institutions BNM/RH/GL/012-1, p. 6. Also see Hasan and Sabirzyanov, p. 246; Dauda Momodu, 'Legal Framework for Islamic Banking and Finance in Nigeria' (2013) 1 Electronic Journal of Islamic and Middle Eastern Law 160; Rusni Hassan and others, 'A Comparative Analysis of Shari'ah Governance in Islamic Banking Institutions Across Jurisdictions' (2013) 50 ISRA Research Paper 1. In Pakistan, the member of the *Sharia'* board of the State Bank of Pakistan, the country's central bank, can serve as a *Sharia'* board member of any IFI in the country. However, this is limited to 1 *Sharia'* board directorship only. See Hasan, 'Optimal Shariah Governance in Islamic Finance', p. 15.

¹¹¹ Section 15 (8) of Central Bank of Malaysia Act 2009 (Act 701). Also see section 9 (3) of Central Bank of Malaysia Act 1958 (Act 519) (repealed)

¹¹² Bank Negara Malaysia, 'Shariah Advisory Council of the Bank'. Also see Unal, 'Moving Beyond Shariah Governance towards a More Sustainable Financial System'; Vizcaino, 'AAOIFI's Perestroika', p. 5.

Hence, it is arguable that the Malaysian corporate governance approach for its Islamic banking industry remains far from a perfect policy in respect of multiple *Sharia'* board directorship practices as it does not include any extraterritorial directorships held by the scholars within its perimeter and it renders of little significance the relevant provisions requiring the scholars to dedicate their time and commitment to the IFI's affairs.

6.5.2 Case II (Indonesia)

6.5.2.1 Introduction

As the global Muslim population stands at approximately 1.65 billion, it is worthwhile noting that Indonesia has the largest Muslim population in the world with 202.9 million constituting 87.2 per cent of its total population¹¹³. This provides an enormous potential audience and a conducive environment for Islamic banking to thrive in the Republic. Within the QISMUT+3 region, Indonesia constitutes 3 per cent of the region's total Islamic banking assets¹¹⁴. The Republic's Islamic banking assets grow at an average of 33.2 per cent¹¹⁵. As at 2016, the Indonesian Islamic banking landscape comprises 13 full-fledged IFIs, 24 Islamic banking windows that offer Islamic banking products and services, and more than 160 Islamic rural banks that provide savings and investment products to the community in areas with difficult access to financial services¹¹⁶.

¹¹³ Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 199; Otoritas Jasa Keuangan (OJK), *Indonesian Financial Services Sector Master Plan 2015-2019* (1st edn, OJK 2016), p. 15.

¹¹⁴ Ernst & Young, *World Islamic Banking Competitiveness Report 2016*, p. 15.

¹¹⁵ Otoritas Jasa Keuangan, 'Roadmap of Indonesian Islamic Banking 2015-2019' (OJK International Conference on Islamic Finance, Jakarta, 12 November 2015); Otoritas Jasa Keuangan (OJK), *Roadmap Perbankan Syariah Indonesia 2015-2019 (Roadmap of Indonesian Sharia Banking 2015-2019)* (Departemen Perbankan Syariah, OJK, 2015), p. 1.

¹¹⁶ The majority of Indonesia's Islamic financial products and services focused on community-based initiatives, which had since witnessed the development of rural IFIs, retail *Sukuk* (Islamic bonds), and *Hajj* (pilgrimage) funds. See Otoritas Jasa Keuangan (OJK), 'Perbankan Syariah dan Kelembagaannya (Sharia Banking and Its Constitution)' (OJK, 2017) <<http://www.ojk.go.id/id/kanal/syariah/tentang-syariah/Pages/PBS-dan-Kelembagaan.aspx>> accessed 21 September 2017; Bernardo Vizcaino, 'Indonesia Eyes Islamic Finance Incentives in Industry Road Map' Thomson Reuters, 18 August 2014 <<http://www.reuters.com/article/indonesia-islamicfunds/indonesia-eyes-islamic-finance-incentives-in-industry-road-map-idUSL5N0QO09220140818>> accessed 18 September 2017; Wardhany and Arshad, p. 9.

Until the late 1980s, the government under President Suharto had displayed a cautious approach toward Islamic banking and perceived it as a radical Islamic movement that could threaten the stability of the Republic¹¹⁷. However, this strict stance had begun to soften when the President approved a policy package called PAKTO'88 that liberalised the Indonesian banking business and also launched the first meeting of the *Ikatan Cendekiawan Muslim Indonesia* (Association of Indonesian Muslim Intellectuals) in 1990, which paved the way for the emergence of several district-based Islamic banking initiatives and the subsequent exploration of the prospect of Islamic banking in the Republic¹¹⁸.

In November 1991, Bank Muamalat Indonesia ('BMI'), the republic's first IFI emerged with an initial capital of US\$8.5 million as a result of a comprehensive working project conducted a year before by the *Majlis Ulama' Indonesia* ('MUI'), which is the Indonesia Council of *Sharia'* Scholars¹¹⁹. It is fascinating to note that the initial proposal to establish the first IFI in Indonesia had once appeared amusing to certain critics, who branded BMI as *Bank Mustahil Indonesia* – translated as Indonesia's Impossible Bank¹²⁰. In the same year, three Islamic rural banks were launched and opened in two regions. Following the introduction of the Republic of Indonesia Laws No. 10 in 1998, which separated the Islamic banking and the Western banking system, the Republic witnessed the birth of its second IFI, namely the Bank Syariah Mandiri in 1999, followed in subsequent years by several other IFIs including Bank IFI, Bank Niaga, Bank BTN, Bank Mega, Bank Bukopin,

¹¹⁷ Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 31; Shofwan Al Banna Choiruzzad, 'The Central Bank in the Development of Islamic Economy Project in Indonesia: Role, Motivations and Moderating Effect' (2012) 25 *Ritsumeikan Annual Review of International Studies* 87, p. 89.

¹¹⁸ Indonesia had begun experimenting the viability of Islamic banking in the 80s through the establishment of *Bait At-Tamwil* Salman ITB, an Islamic investment institution, in Bandung and the Ridho Gusti cooperative institution, in Jakarta – both, which operated on a limited scale. See Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 31; Otoritas Jasa Keuangan (OJK), 'Sejarah Perbankan Islam (The History of Islamic Banking)' (OJK, 2017) <<http://www.ojk.go.id/id/kanal/syariah/tentang-syariah/Pages/Sejarah-Perbankan-Syariah.aspx>> accessed 17 September 2017; Shofwan Al Banna Choiruzzad and Bhakti Eko Nugroho, 'Indonesia's Islamic Economy Project and the Islamic Scholars' (2013) 17 *Procedia Environmental Sciences* 957; Nur Yasin, *Hukum Ekonomi Islam (Jurisprudence of Islamic Economics)* (UIN Malang Press 2009), p. 105.

¹¹⁹ Bank Muamalat Indonesia, 'Company Profile of Bank Muamalat' (2017) <<http://www.bankmuamalat.co.id/en/company-profile-of-bank-muamalat>> accessed 16 September 2017. Also see A.M. Venardos, *Islamic Banking & Finance in South-East Asia: Its Development & Future* (3rd edn, World Scientific 2012), p. 146; Warde, p. 223.

¹²⁰ Choiruzzad, p. 93; K.S. Nathan and M.H. Kamali, *Islam in Southeast Asia: Political, Social and Strategic Challenges for the 21st Century* (1st edn, Institute of Southeast Asian Studies 2005), p. 76.

BPD Jabar, and BPD Aceh¹²¹. In contrast with other Muslim-majority countries such as Pakistan and the Middle East, or its neighbour, Malaysia, the development of IFIs in Indonesia was indeed moving at a slow pace¹²².

During the Asian financial crisis in 1997, Indonesia suffered the worst devaluation of its local currency, with the Indonesian Rupiah experiencing a 75 per cent decline in the exchange rate of the Rupiah relative to the U.S. dollar¹²³. In addition to the devastating aftermath of the crisis, which remains noticeable throughout the Republic until today, confidence in the banking sector has continued to remain low amongst stakeholders, especially the public, who remain unconvinced of the prospect of Islamic banking as a workable banking solution to improve society's economic well-being¹²⁴.

By the same token, Indonesia's Islamic banking assets in 2016 only accounted for less than five per cent of its total domestic banking assets and stood at approximately US\$ 20.8 billion of the Indonesian total banking assets of US\$ 449.5 billion¹²⁵. This lack of market penetration is largely due to Indonesia's scattered population across its massive 5 million kilometre territory with Islamic banking penetration poor in remote areas such as the Sulawesi, Riau, East Kalimantan, Gorontalo, West Sumatra and West

¹²¹ Otoritas Jasa Keuangan (OJK), 'Perbankan Syariah dan Kelembagaannya (Sharia Banking and Its Constitution)'; Acep Rohendi, 'Sistem Perbankan Indonesia Pasca Undang-Undang Perbankan Syariah (The Indonesian Banking System Post the Syariah Banking Laws)' (2010) 9 *Wawasan TRIDHARMA*, p. 25; Muhammad Arifin and Bismar Nasution, 'The Dynamics Study of Regulations on Syariah Banking Indonesia' (2015) 5 *International Journal of Humanities and Social Science* 237, p. 238-239; Siti Rochmah Ika and Norhayati Abdullah, 'A Comparative Study of Financial Performance of Islamic Banks and Conventional Banks in Indonesia' (2011) 2 *International Journal of Business and Social Science*, p. 200.

¹²² Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 30; A.A. Hossain, *Central Banking and Monetary Policy in Muslim-Majority Countries* (Edward Elgar Publishing 2015), p. 146.

¹²³ Thailand was the second worse at 48 per cent, followed by South Korea at 47 per cent, and Malaysia and the Philippines at 36 per cent respectively. See Abdul-Rahman, p. 109.

¹²⁴ Vizcaino, 'Indonesia Eyes Islamic Finance Incentives in Industry Road Map'; Mutiara Dwi Sari, Zakaria Bahari and Zahri Hamad, 'What's Up with Islamic Banking in Indonesia' (2014) 10 *Journal of Islamic Economics, Banking and Finance* 139, p. 146.

¹²⁵ Islamic Financial Services Board, *Islamic Financial Services Industry Stability Report 2016*, p. 8; Otoritas Jasa Keuangan; Otoritas Jasa Keuangan (OJK), *Roadmap Perbankan Syariah Indonesia 2015-2019 (Roadmap of Indonesian Sharia Banking 2015-2019)*, p. 3. Also see Indonesia Investments, 'Islamic Finance in Indonesia: Sharia Banking is Large Untapped Potential' 7 November 2014 <<http://www.indonesia-investments.com/news/todays-headlines/islamic-finance-in-indonesia-sharia-banking-is-large-untapped-potential/item2592>> accessed 22 September 2017; Sari, Bahari and Hamad, p. 145-146.

Papua¹²⁶. Nonetheless, the various initiatives implemented by the government under President Joko Widodo to enhance the financial inclusion efforts in Indonesia have served as a strong base to argue that the Republic possesses significant potential for growth in Islamic banking¹²⁷.

6.5.2.2 Regulatory Overview

Although the BMI is the first IFI in Indonesia, it is important to note that a proper legislative and corporate governance framework for IFIs in the Republic did not exist until 1998. When the BMI started its operation in 1991, Islamic banking had yet to receive significant attention from the legislators due to uncertainty over its practicability. The only relevant legislation that accommodated the BMI's operation as an IFI, namely the Republic of Indonesia Laws No. 7/1992 Concerning Banking, had merely allowed Indonesian banks to operate on the principle of profit-sharing, which forms the quintessence of Islamic banking, without specifying the operational framework of an IFI and the type of business that it could perform¹²⁸.

However, in 1998, the government introduced the Republic of Indonesia Laws No. 10/1998, which distinguished the Islamic banking system from the Western banking system in complementing Laws No. 7/1992¹²⁹. This significant amendment paved a

¹²⁶ Meri Indri Hapsari, Noven Suprayogi and Salahuddin Rizal, 'Strategy in Overcoming market Saturation of Islamic Banking in Indonesia' (2016) [2016] 2 Australasian Journal of Islamic Finance and Business, p. 4; Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 48, 95; Otoritas Jasa Keuangan (OJK), *Roadmap Perbankan Syariah Indonesia 2015-2019 (Roadmap of Indonesian Sharia Banking 2015-2019)*, p. 3.

¹²⁷ These initiatives include improving financial literacy, adding public finance facilities, mapping of financial information, provision of supportive regulation and policy, upgrading intermediation or distribution facility, and enhancing customer protection. See Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 98.

¹²⁸ Undang-Undang Republik Indonesia Nomor 7 Tahun 1992 Tentang Perbankan (Republic of Indonesia Laws No. 7/1992 Concerning Banking). Also see Otoritas Jasa Keuangan (OJK), 'Perbankan Syariah dan Kelembagaannya (Sharia Banking and Its Constitution)'; M. Zainuddin Alanshori, 'Perkembangan, Tantangan, dan Peluang Bank Syariah (The Development, Challenges and Opportunities of Syariah Bank)' (2016) 1 Jurnal Ekonomi Syariah (Journal of Sharia Economics) 127, p. 133-134.

¹²⁹ The terminology of a commercial bank then changed to, "*Commercial bank is a bank which based its activities on conventional and/or Sharia' principles in doing so provides services in payment transactions*". See article 1 of Undang-Undang Republik Indonesia Nomor 7 Tahun 1992 Tentang Perbankan Sebagaimana Telah Diubah Dengan Undang-Undang Nomor 10 Tahun 1998 (Republic of Indonesia Laws No. 7/1992 Concerning Banking as Amended by Laws No. 10/1998). Also see Arifin and Nasution, p. 238-239; Ascarya, *Akad dan Produk Bank Syariah (Contract and Sharia Bank Product)* (Raja Grafindo Persada 2007), p. 41; Deasy Wulandari and Ari Subagio, 'Consumer Decision Making in Conventional Banks and

strong legal basis for the expansion and development of a decent legislative and corporate governance framework for the IFIs in the Republic including the Republic of Indonesia Laws No. 21/2008 Concerning Islamic Banking, the Bank Indonesia Regulation No. 11/3/PBI/2009 Concerning Islamic Banks, No. 11/10//PBI/2009 Concerning Islamic Windows, No. 11/23/PBI/2009 Concerning Islamic Bank Financing, No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Banks and Islamic Windows, and the Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS.

6.5.2.3 Corporate Governance Structure for Islamic Banking

Similar to Malaysia, Indonesia also adopts a pro-active approach to its corporate governance framework for IFIs and implements a two-tier board structure comprising a national *Sharia'* board at the federal level, known as the *Dewan Sharia' Nasional* ('DSN'), which was formed in 1997 by the MUI¹³⁰, and the *Sharia'* boards at the IFI-level¹³¹. The DSN undertakes the responsibility as the sole issuer of Islamic banking *Fatwas* in the Republic pursuant to Regulation No. 11/3/PBI/2009, which obliges the IFI's *Sharia'* board to adopt the Islamic banking *Fatwas* issued by the DSN and to seek its counsel regarding any new financial products and services of the IFI that are not covered by the existing *Fatwas*¹³².

Additionally, the *Fatwas* issued by the DSN, which plays a central role in the *Sharia'* compliance assurance of the IFI's financial products and services, are also regularly adopted by the Bank Indonesia, the Republic's central bank, in supervising, licensing

Islamic Bank based on Quality of Service Perception' (2015) 211 *Procedia - Social and Behavioral Sciences* 471, p. 473.

¹³⁰ The DSN has since made significant contributions to the progress of Islamic Banking in Indonesia, which include, among other, the publication of collective Islamic banking *Fatwas* issued through its cooperation with the MUI, and the initiation of a certification programme for existing and aspiring IFI's *Sharia'* scholars. Perry, p. 272; Bank Indonesia, *Sharia' Banking Development Report 2012* (2012), p. 51.

¹³¹ In Indonesia, the *Dewan Pengawas Sharia'* is also known as the *Sharia'* Supervisory Board ('SSB'). However, the thesis has chosen to use the term *Sharia'* board in referring to the SSB to ensure the consistency of wording.

¹³² Article 35 of Bank Pembiayaan Rakyat Syariah. Also see Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 36, 84; Majid and Ghazal; Perry, p. 272; Grais and Pellegrini, *Corporate Governance and Stakeholders' Financial Interests in Institutions Offering Islamic Financial Services*, p. 11.

and issuing regulations for Islamic banking¹³³. However, on the 1st January 2014, Bank Indonesia transferred its powers to the Otoritas Jasa Keuangan ('OJK') – translated as the Indonesia Financial Services Authority, which is now responsible for supervising and administering the development of Islamic banking in the Republic and marked the Republic's change from an institutionalised administrative and supervisory approach to one modelled on an integration approach¹³⁴. Nonetheless, Bank Indonesia remains responsible for the development of monetary and macroprudential policy and the supervision of the monetary, payment, and financial systems¹³⁵. In addition, the banking regulations issued by Bank Indonesia remain applicable provided that they neither conflict with the existing regulations nor were replaced by the new ones issued by the OJK¹³⁶.

In relation to the appointment of *Sharia'* board members, the Bank Indonesia Regulation No. 11/3/PBI/2009 requires an IFI to nominate suitable candidates for its *Sharia'* board

¹³³ Malaysia International Islamic Financial Centre (MIFC) Bank Negara Malaysia, *Financial Stability and Payment Systems Report 2013*; Wardhany and Arshad, p. 11. Also see Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS, p. 15.

¹³⁴ This transition of powers from the central bank to a financial services authority mirrors the integrated supervision approach as implemented in countries such as, *inter alia*, the UK (Financial Services Authority), Australia (Australian Prudential Regulatory Authority), and Japan (Japan Financial Services Authority). See Undang-Undang Republic Indonesia Nomor 21 Tahun 2011 Tentang Otoritas Jasa Keuangan (Republic of Indonesia Laws No. 21/2011 Concerning Financial Services Authority). Also see Rebecca Simmonds, 'IFN Country Analysis - Indonesia: Islamic Finance in Indonesia' *Islamic Finance News*, Vol 11, Issue 10, 12 March 2014 <https://www.islamicfinancenews.com/login?redirect_to=https://www.islamicfinancenews.com/ifn-country-analysis/indonesia> accessed 12 September 2017; Islamic Research and Training Institute (IRTI), Thomson Reuters and General Council for Islamic Banks and Financial Institutions (CIBAFI), p. 40-41; Otoritas Jasa Keuangan (OJK), 'Sejarah Perbankan Islam (The History of Islamic Banking)'; Hasbi Hasan, 'Efektivitas Pengawasan Otoritas Jasa Keuangan terhadap Lembaga Perbankan Syariah (Effectiveness Control of Financial Services Authority on Sharia Banking Institutions)' (2012) 9 *Jurnal Legislasi Indonesia* 373, p. 374. Effective 1st January 2013, the OJK had also inherited the supervision of the capital market and Non-Bank Financial Institutions ('NBFi') from the Republic's Ministry of Finance. See A. Nasution, *Macroeconomic Policies in Indonesia: Indonesia Economy Since the Asian Financial Crisis of 1997* (Taylor & Francis 2014), p. 83.

¹³⁵ Bank Indonesia, 'Memahami Tugas BI Pasca Terbentuknya OJK, Mengerti Kiat Pemanduan Museum (Understanding the Roles of BI Post-OJK, Understanding the Museum's Objectives)' *Museum Bank Indonesia*, 24 February 2014 <http://www.bi.go.id/id/tentang-bi/museum/info/berita-kehusus/Pages/Berita_ToT.aspx> accessed 22 September 2017; Bank Indonesia, 'Bank Indonesia Transferring Regulation and Supervision of Banks to Financial Services Authority' Joint Press Release No 15/56/DKom, 31 December 2013 <http://www.bi.go.id/en/ruang-media/siaran-pers/Pages/SP_155613_DKom.aspx> accessed 19 September 2017

¹³⁶ Yanny M Suryaretina, 'Indonesia' in Jan Putnis (ed), *The Banking Regulation Review* (8th edn, The Law Reviews 2017); Muhamad Irfan Sukarna, 'Indonesia's Islamic Finance Development and Risk Management Framework & Infrastructure' (COMCEC Meeting, Ankara, 16 October 2014)

directorship to Bank Indonesia for approval. This board must consist of a minimum of two *Sharia'* scholars or a maximum of 50 per cent of the IFI's BOD directorships¹³⁷. In addition, the candidates must obtain satisfactory recommendations from both the IFI's remuneration and nomination committee, and the MUI¹³⁸. Upon the approval of the Bank Indonesia, the *Sharia'* board directorship is official subject to the conclusion of a formal agreement and the issuance of a formal appointment from the IFI's shareholders¹³⁹. Likewise, any termination of service or withdrawal from the *Sharia'* board directorship must also obtain the approval of Bank Indonesia and must be reported within 10 days of such termination or withdrawal from service.

In the same vein, Bank Indonesia emphasises that the nominated candidate must possess satisfactory knowledge in *Fiqh Al-Muammalat* at the very least, and significant industrial experience in banking and finance¹⁴⁰. In addition, the candidate must satisfy the other fit-and-proper criteria set by Bank Indonesia such as the possession of a good character and moral values; the ability to comply with the laws and rules related to Islamic banking and other prevailing legislation; a high commitment to develop a sound and sustainable Islamic banking environment; and a good credit history¹⁴¹. Although the actual duration of the *Sharia'* board directorship remains unknown due to the lack of disclosure of such information from the IFIs in Indonesia, the Bank Indonesia Regulation No. 11/33/PBI/2009 stipulated that the duration is similar to the duration of service of the

¹³⁷ Article 36 of Bank Pembiayaan Rakyat Syariah; A Syukron, 'Good Corporate Governance di Bank Syariah (Good Corporate Governance in Sharia Bank)' (2013) 3 Jurnal Ekonomi dan Hukum Islam, p. 74.

¹³⁸ Article 37 of Bank Pembiayaan Rakyat Syariah; Article 45 of Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows). Also see Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS, p. 14.

¹³⁹ Article 37 of Bank Pembiayaan Rakyat Syariah. Also see Wardhany and Arshad, p. 10; Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS, p. 14.

¹⁴⁰ Article 34 of Bank Pembiayaan Rakyat Syariah. Also see Nikmah Rahmawati, 'Peran dan Fungsi Dewan Pengawas Syariah (Shari'a Supervisory Board) dalam Perbankan Syariah di Indonesia (Role and Function of the Sharia Supervisory Board in Sharia' Banking in Indonesia)' (2014) 1 Jurnal Ekonomi Syaria'ah & Bisnis Islam 75, p. 83; Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*, p. 31.

¹⁴¹ The candidate for a *Sharia'* board directorship must also prove that he or she has not occupied any *Sharia'* board directorships within the period of five years before his or her nomination. See article 34 of Bank Pembiayaan Rakyat Syariah. Also see Wardhany and Arshad, p. 10; Otoritas Jasa Keuangan (OJK), 'Perbankan Syariah dan Kelembagaannya (Sharia Banking and Its Constitution)'

BOD, namely four years¹⁴². In the event a *Sharia'* board member fails to execute his or her responsibilities causing the IFI to lose its Islamic banking licence from Bank Indonesia, he or she is liable to a sanction that disqualifies him or her from serving as a *Sharia'* board member in any IFI in the Republic for a maximum period of ten years after the date of the withdrawal of the licence¹⁴³.

6.5.2.4 Regulatory Issues

Similar to Malaysia, the Indonesian legal system is also pluralistic and comprises a mixture of several laws, namely the Dutch civil law, *Sharia'* law and customary law¹⁴⁴. Its judicial framework comprises four court structures, namely the civil court, Religious Court, administrative court, and military court¹⁴⁵. Since Islamic banking comprises elements common to both civil law and *Sharia'* law, the Indonesian legal system accords a parallel jurisdiction to both the civil court and the Religious Court to adjudicate Islamic banking cases.

In the early years of Islamic banking in the Republic, there was also confusion as to the competency of the civil court to try Islamic banking disputes in cognisance of the limited jurisdiction enjoyed by the Religious Court, which can only try cases relating to marriage,

¹⁴² Article 45 (2) of Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows); Wardhany and Arshad, p. 14.

¹⁴³ This includes the failure to advise the BOD of the matters decided by the *Sharia'* board; failure to evaluate and ensure the *Sharia'* compliance of the IFI's products and operations; failure to monitor and ensure the development of the IFI's products complies with the *Fatwas* issued by the DSN; failure to conduct a periodical review of the *Sharia'* compliance fulfilment of the IFI's financial operation; and failure to issue an annual report of the *Sharia'* board's activities and monitoring outcome. See Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS, p. 19. Also see Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows)

¹⁴⁴ I. IBP, *Indonesia Criminal Justice System Laws, Regulations and Procedures Handbook Volume 1 Strategic Information and Regulations* (International Business Publications, USA 2015), p. 64; Karen Mills, 'Indonesia' in Michael Pryles (ed), *Dispute Resolution in Asia* (Kluwer Law International 2002), p. 155.

¹⁴⁵ Mark E Cammack and R Michael Feener, 'The Islamic Legal System in Indonesia' (2012) 21 Pacific Rim Law & Policy Journal, p. 27; Julio C Colon, 'Choice of Law and Islamic Finance' (2010) 46 Texas International Law Journal 411, p. 420.

probate, wills, and endowments¹⁴⁶. The emergence of BMI and Islamic rural banks, which brought the prospect of a new challenge for the Indonesian judicial system, together with growing concerns over the competency of the civil court, prompted the MUI to form the *Badan Arbitrase Sharia' Nasional* ('BASYARNAS'), translated as the National *Sharia'* Arbitration Body, in 1993 providing the industry with an alternative dispute resolution forum to resolve *Muammalat* disputes¹⁴⁷.

Later, the Indonesian lawmakers decided to enhance the jurisdiction of the Religious Court to reflect the government's serious commitment in developing a practical legal framework for the Republic's growing Islamic banking industry by introducing the Republic of Indonesia Laws No. 3/2006, which amended Laws No. 7/1989 Concerning Religious Court and expanded the Religious Court's jurisdiction to include Islamic banking¹⁴⁸. In 2008, Laws No. 21/2008 Concerning Islamic Banking further consolidated the jurisdiction of the Religious Court, which has now gained the necessary competency to try a diverse range of Islamic banking subjects including *Sharia'*-compliant banking, finance, microfinance institutions, *Takaful*, re*Takaful*, fund management, pawn brokerage, pension funds, and other *Sharia'*-compliant businesses¹⁴⁹.

However, Law No. 21/2008 has painted a blurred picture of the actual intention of the legislators as it does not grant an exclusive jurisdiction to the Religious Court. In fact,

¹⁴⁶ Article 49 of Undang-Undang Republic Indonesia Nomor 7 Tahun 1989 Tentang Peradilan Agama (Republic of Indonesia Laws No. 7/1989 Concerning Religious Court). Also see International Monetary Fund, p. 30; M.J. Moser, *Arbitration in Asia* (2nd edn, JurisNet 2008), p. 296.

¹⁴⁷ Previously, *BASYARNAS* was known as *Badan Arbitrasi Muammalat Indonesia* ('BAMUI'), translated as the Indonesian Muammalat Arbitration Body. See R. Ismal, *Islamic Banking in Indonesia: New Perspectives on Monetary and Financial Issues* (Wiley 2013). Also see MBA Drs. Zainul Arifin, *Dasar-dasar Manajemen Bank Syariah (Management Policies of Sharia' Bank)* (Pustaka Alvabet 2012), p. 261.

¹⁴⁸ Undang-Undang Republik Indonesia Nomor 3 Tahun 2006 Tentang Perubahan Atas Undang-Undang Nomor 7 Tahun 1989 Tentang Peradilan Agama (Republic of Indonesia Laws No. 3/2006 Concerning Amendment of Laws No. 7/1989 Concerning Religious Court). Also see Undang-Undang Republik Indonesia Nomor 50 Tahun 2009 Tentang Perubahan Kedua Atas Undang-Undang Nomor 7 Tahun 1989 Tentang Peradilan Agama (Republic of Indonesia Laws No. 50/2009 Concerning Second Amendment of Laws No. 7/1989 Concerning Religious Court), which is a second amendment to Laws No. 3/2006 but does not provide any specific changes to the jurisdiction of the Religious Court.

¹⁴⁹ Article 55 of Undang-Undang Republik Indonesia Nomor 21 Tahun 2008 Tentang Perbankan Syariah (Republic of Indonesia Laws No. 21/2008 Concerning Islamic Banking); article 49 of Undang-Undang Republik Indonesia Nomor 3 Tahun 2006 Tentang Perubahan Atas Undang-Undang Nomor 7 Tahun 1989 Tentang Peradilan Agama (Republic of Indonesia Laws No. 3/2006 Concerning Amendment of Laws No. 7/1989 Concerning Religious Court). Also see Cammack and Feener, p. 29; Abdul Rasyid, 'Settlements of Islamic Banking Disputes in Indonesia: Opportunities and Challenges' (International Conference on Mediation in the Asia Pacific: Constraints and Challenges, Kuala Lumpur, 2008); A. Salim, *Contemporary Islamic Law in Indonesia: Shari'ah and Legal Pluralism* (Edinburgh University Press 2015)

referral to the Religious Court is not mandatory as the disputing parties, even if they are Muslims, still enjoy their rights to choices of law and choices of forum. While the Religious Court can try Islamic banking cases, the statute also allows the disputing parties to settle their disputes via alternative legal means such as banking mediation, BASYARNAS, and the civil court¹⁵⁰. At the same time, it is also important to note that the statute strictly mandates the application of *Sharia'* law principles in resolving an Islamic banking dispute – creating a *contradicto in terminis* (opposite meaning), which begs the big question of whether the civil court possesses the necessary expertise to adjudicate a matter that involves issues outside of its field of expertise¹⁵¹. This issue surfaced in the case of *H. Effendi bin Rajab & Drs. Fitri Effendi binti Munir v Bank Bukopin Syariah & Ors*¹⁵², where the plaintiff, who lost the case at the civil court, had exploited this loophole and brought the case to the Religious Court for another hearing. Of course, the presence of the Supreme Court as the ultimate decision-maker can address any competency dispute between the two courts¹⁵³, *i.e.* the Supreme Court will decide on the appropriate court to try the dispute in question. However, it does little to address “the elephant in the room”, namely the competency of the civil court to try Islamic banking cases should the Supreme Court choose the civil court over the Religious Court. While the requirement to apply *Sharia'* law principles in resolving an Islamic banking dispute will not trouble BASYARNAS, given the competency of its arbitrators in *Sharia'* law, it is arguable that the same cannot be said of the civil court.

¹⁵⁰ “*In the event the parties have agreed to settle their disputes using means other than the one mentioned in paragraph (1), the dispute resolution shall be executed according to the said agreement*”. See article 55 (2) of Undang-Undang Republik Indonesia Nomor 21 Tahun 2008 Tentang Perbankan Syariah (Republic of Indonesia Laws No. 21/2008 Concerning Islamic Banking). This provision corresponds with Undang-Undang Republik Indonesia Nomor 30 Tahun 1999 Tentang Arbitrase dan Alternatif Penyelesaian Sengketa (Republic of Indonesia Laws No. 30/1999 Concerning Arbitration and Alternative Dispute Resolution). Also see *H. Effendi bin Rajab & Drs. Fitri Effendi binti Munir v Bank Bukopin Syariah & Ors* No 284/PdgG/2006/PABkt, where the High Religious Court held that the Religious Court could not preside over the case due to the presence of a key clause in the *Murabahah* contract indicating the agreement of both parties to refer any ensuing dispute to BASYARNAS, then known as BAMUI.

¹⁵¹ “*Settlement of disputes as considered in paragraph (2) must not contradict the Sharia' principles*”. See article 55 (3) of Undang-Undang Republik Indonesia Nomor 21 Tahun 2008 Tentang Perbankan Syariah (Republic of Indonesia Laws No. 21/2008 Concerning Islamic Banking)

¹⁵² *H. Effendi bin Rajab & Drs. Fitri Effendi binti Munir v Bank Bukopin Syariah & Ors*

¹⁵³ Alexandra Gerungan, Lia Alizia and Rudy Andreas Sitorus, ‘Indonesia’ in Michael Madden (ed), *Litigation & Dispute Resolution* (4th edn, Global Legal Group 2015), p. 152; Abdul Rasyid and Zuhuda Sonny, ‘Legal Reform on the Dispute Resolution Mechanism in Islamic Banking and Finance in Indonesia: Issues and Challenges’ (8th International Conference on Islamic Economics and Finance, Doha, 19-21 December 2011), p. 6.

Although the civil court's application of legal principles that do not contradict *Sharia'* law to an Islamic banking dispute is acceptable¹⁵⁴, the process would still necessitate the civil court judges possessing a comprehensive knowledge of *Sharia'* law and familiarity with its diverse *Fiqh* methods; a criterion that most definitely exceeds the requirements for typical civil law judges. Moreover, allowing the civil court judges to interpret and decide on the *Sharia'* issues involved in an Islamic banking dispute can lead not only to an awkward and improper application of *Sharia'* law, but can also give rise to a distorted understanding of the Islamic banking concept as a whole; a repeat of the Malaysian controversial civil court's rulings of *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation* and *Arab Malaysian Finance Bhd*. As the jurisdiction of both the civil and Religious Court are clearly distinct from one another by virtue of Law No. 48/2009 Concerning Judicial Jurisdiction¹⁵⁵, the adoption of a hesitant approach by the civil court to adjudicating matters that rest beyond its competence could jeopardise stakeholders' confidence in the capability of the Indonesian judicial system in determining Islamic banking disputes. Additionally, the legislators should also consider deleting the competence given to the civil court in article 55 (2), in order to provide legal certainty to the Republic's Islamic banking dispute resolution framework.

6.5.2.5 Regulatory Policies of Multiple *Sharia'* Board Directorships

Although substantial studies exist that highlight the regulatory stance of the multiple *Sharia'* board directorship practices in Indonesia, there has yet to emerge any empirical research, which scrutinises the practicability and adequacy of the Republic's policy in regulating this practice¹⁵⁶. A detailed research of these studies discovered a plain and

¹⁵⁴ See article 55 (3) of Undang-Undang Republik Indonesia Nomor 21 Tahun 2008 Tentang Perbankan Syariah (Republic of Indonesia Laws No. 21/2008 Concerning Islamic Banking)

¹⁵⁵ Undang-Undang Republik Indonesia Nomor 48 Tahun 2009 Tentang Kekuasaan Kehakiman (Republic of Indonesia Laws No. 48/2009 Concerning Judicial Jurisdiction)

¹⁵⁶ cf Mahmudi, 'Mekanisme Pengawasan Dewan Pengawas Syariah di BPRS Ikhsanul Amal Gombang Kebumen dan BPRS Bumi Artha Sampang Cilacap (Supervision Mechanism of the Sharia Supervisory Board in BPRS Ikhsanul Amal Gombang Kebumen dan BPRS Bumi Artha Sampang Cilacap)' (Master's Thesis, IAIN Purwokerto 2015), p. 22, 25, 32; IW Rochaeli, 'Fungsi dan Peranan Dewan Pengawasan Syariah di Unit Usaha Syariah PT. Bank "X" Dikaitkan dengan Pelaksanaan Good Corporate Governance (GCG) (Function and Role of the Syariah Supervisory Board in PT. Bank "X" in Relation to the Implementation of Good Corporate Governance (GCC))' (Master's Thesis, Universitas Indonesia 2011), p. 48; Ahmad Faozan, 'Implementasi Good Corporate Governance dan Peran Dewan Pengawas Syariah di Bank Syariah (Implementation of Good Corporate Governance and the Role of the Sharia Board in Sharia Bank)' (2013) 7 Jurnal Ekonomi Islam, p. 10.

repetitive reference to the existing regulatory policy of the practice without the accompaniment of analytical exploration of its practicability or any other corresponding issues. This discovery suggests that empirical work, which explores the relationship between the practice and the promotion and development of a healthy IFI's corporate governance environment, remain largely unexplored.

In principle, an IFI's *Sharia'* board member in Indonesia can hold a maximum of four *Sharia'* board directorships across the IFIs, including any *Sharia'* board directorships held in the DSN¹⁵⁷. It is important to note the rarity of a full-time or part-time *Sharia'* board appointment as the majority of the Indonesian IFIs prefer to appoint their *Sharia'* board members on a consultancy basis, which only requires them to provide counsel to the IFIs once a month or upon request¹⁵⁸. This extra 'legroom', in addition to the slow Islamic banking penetration in the Republic, which arguably justifies the following, has provided an opportunity for the existing batch of IFI's *Sharia'* board members to multitask and occupy additional *Sharia'* board directorships, with several prominent *Sharia'* scholars such as Sheikh Dr. Muhammad Syafi'i Antonio also occupying *Sharia'* board positions outside of Indonesia.

6.6 Comparative Review of the Case Studies

6.6.1 General Islamic Corporate Governance Framework on Multiple *Sharia'* Board Directorships

This section comprises six questions. The case study generated these questions to examine the views, existing regulatory framework, and challenges encountered by the central banks or Islamic banking regulators in Malaysia and Indonesia in regulating the

¹⁵⁷ Article 36 of Bank Pembiayaan Rakyat Syariah; article 47 and 51 of Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows); Kumpulan Fatwa Dewan Syariah Nasional - Majelis Ulama Indonesia (DSN-MUI) 2000 - 2007 (Collection of the Fatwa of the National Sharia Board - Council of Sharia Scholars Indonesia (DSN-MUI) 2000 - 2007), p. 11. Also see Faozan, p. 10.

¹⁵⁸ NEP Saleh and MF Kamarudin, 'Sustainability of Islamic Micro Finance Institutions (IMFIs)' (2013) 1 Universal Journal of Accounting and Finance 70, p. 72; Usamah Usamah, 'Peran Kompetensi dan Model Pengorganisasian Dewan Pengawas Syariah terhadap Pembiayaan Berbasis bagi Hasil pada Perbankan Syariah di Indonesia (Role of Competency and Organisational Model of the Syariah Supervisory Board toward the Financing Basis of the Syariah Banking in Indonesia)' (Master's Thesis, Universitas Diponegoro 2010); Rifaat Ahmed Abdel Karim, 'The Independence of Religious and External Auditors: The Case of Islamic Banks' (1990) 3 Accounting, Auditing & Accountability Journal

multiple *Sharia'* board directorship practice within their respective Islamic banking industry. From these introductory questions, the interview findings affirm that the dearth of qualified *Sharia'* scholars with the critical expertise in *Fiqh Al-Muammalat* and substantial experience in banking and finance remains a prevalent factor, which continues to influence both the CBM and OJK in permitting the IFI's *Sharia'* board members to engage in the multiple *Sharia'* board directorship practice. The findings on Indonesia specifically provides a valuable insight into the extent of the shortage of competent *Sharia'* scholars in the Republic, where the OJK stated that the lack of technical knowledge and sufficient exposure to the Islamic banking operations is a major deficiency among the IFIs' *Sharia'* board members in Indonesia. The majority of *Sharia'* scholars it interviewed for *Sharia'* board candidacies had not met the threshold for appointment. For example, the OJK referred to an unnamed engineering graduate, who currently serves as a *Sharia'* board member of an IFI in a different district as faring better than another *Sharia'* board candidate it had interviewed, due to his experience and exposure to an IFI's operations and working environment. The interviews highlighted the crucial importance of possessing technical knowledge of, and exposure to, banking operations for IFI's *Sharia'* board directorship appointments, and one might speculate that the corporate governance landscape for the IFIs in countries adopting the centralised approach will experience an interesting twist in the future, where the possession of the stated technical banking experience will take precedence over a formal academic qualification in *Sharia'* law. The latter will remain necessary but not compulsory due to the presence of the national *Sharia'* board as the highest *Fatwa*-making authority in the country. Instead of issuing Islamic banking *Fatwas*, the role of the IFI's *Sharia'* board will become more concentrated on the technical aspect of Islamic banking operations, where its presence and then-more-viable counsels are beneficial and better appreciated by the BOD.

In terms of the awareness of any repercussions of the practice, both countries confirmed the presence of a specific corporate governance policy within their respective jurisdictions, drafted according to the IFSB standards, governing the IFIs and the conduct of the *Sharia'* board members, which allows their occupation of multiple *Sharia'* board directorships¹⁵⁹. Both countries admitted that the practice can jeopardise the

¹⁵⁹ On one hand, the CBM refers to the existing SGF 2011 but has already begun to revise this standard, which will take on a new form some time in 2019-2020. On the other, the OJK refers to the Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Banks and Islamic Windows, and the Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS.

dedication and time commitment of *Sharia'* board members toward the IFI's corporate governance and *Sharia'* compliance processes. However, the CBM and OJK insisted that the implementation of a binding and rigid corporate governance regime, which outlines the criteria for the appointment and reappointment of a candidate to the IFI's *Sharia'* board, could enable them to assess, prior to approving their appointment or reappointment, the suitability of the nominated candidates for *Sharia'* board directorships and determine the candidates' capability, especially those with multiple *Sharia'* board directorships, in executing their respective professional responsibilities.

At the same time, the interviews identified a considerable divergence in the challenges encountered by the two countries in regulating the conduct of the IFI's *Sharia'* board members. On one hand, the CBM did not indicate the occurrence of any misconduct and it contended that its corporate governance framework is comprehensive in its regulation of the conduct of the IFI's *Sharia'* board members. On the other, the OJK highlighted the occurrence of several dubious practices such as the inclusion of *Sharia'* board members who did not attend the *Sharia'* board meetings in the list of those who had ratified the IFI's *Sharia'* board *Fatwas* or *Sharia'* decisions. Since the IFIs adopt the *Shuratic* (collective) approach in issuing any Islamic banking *Fatwas*, the OJK opined that both the multiple *Sharia'* board directorship practice and the falsification of the *Sharia'* board members' attendance could lead to fraudulent misconduct and made a mockery of the entire *Sharia'* compliance processes, which could further compromise the integrity of the *Fatwas* issued by the IFIs and lower the confidence of stakeholders in the prospect of Islamic banking in the Republic.

The interview findings on Indonesia also reveal new data on the practicability of the existing corporate governance framework for the IFIs implemented in the Republic. The presence of integrated bodies, namely the OJK, which supervises, inspects, and administers the operations of the IFIs, and the DSN-MUI, which issues the Islamic banking *Fatwas* and designs the certification program that every candidate must undergo in fulfilling the requirement for *Sharia'* board directorship, appears to have contributed to a lack of consistency, or incongruence within the Republic's corporate governance framework for the IFIs. The OJK indicated during their interviews that there is no structured coordination between them and the DSN-MUI in relation to the actual qualification and competency desired of an IFI's *Sharia'* board member with the DSN-MUI's certification programme overlooking an essential condition other than the possession of knowledge and skills in *Sharia'* law, namely exposure to the critical aspects of Islamic banking operations, which the OJK lamented as a missing component

in the programme. This lack of coordination between the OJK and the DSN-MUI has also occurred in the nomination of candidates for *Sharia'* board directorship, where the OJK revealed during their interviews that they have dismissed several 'television celebrities' candidates nominated by the DSN-MUI due to their lack of the necessary knowledge, experience and skills in *Fiqh Al-Muammalat* and the operational aspect of an IFI. Although the OJK retains the final authority in deciding the appointment or replacement of *Sharia'* board members, the lack of standardisation and harmonisation in the certification and appointment criteria of the *Sharia'* board directorship creates a perennial conflict between these important Islamic banking authorities.

6.6.2 Regulatory Approach to Multiple *Sharia'* Board Directorships

This section comprises five questions, which aim to ascertain the presence of any statutory provisions or regulatory tolerance that allows an IFI's *Sharia'* board member to hold additional *Sharia'* board directorships within and outside the two countries; the regulators' attitude to *Sharia'* board members with extraterritorial *Sharia'* board positions, and the presence of any punitive measures against *Sharia'* board members who breach the corporate governance code, policy, or guideline for the IFIs in their respective countries.

While both Malaysia and Indonesia have specific provisions within their respective corporate governance codes to fix the maximum number of *Sharia'* board directorships an IFI's *Sharia'* board member can hold, the interviews uncovered two novel points that can contribute to existing scholarship on the corporate governance framework of the IFIs. First, the number of *Sharia'* board positions that an IFI's *Sharia'* board member in Malaysia can hold is three instead of the two positions often cited in most academic works on the subject¹⁶⁰. This translates into a maximum of one directorship in an IFI, one in a *Takaful* institution, and one in a developmental financial institution. Second, a foreign *Sharia'* board member cannot hold any *Sharia'* board directorships in Indonesia, with the OJK citing the failed attempt of CIMB Niaga Indonesia to appoint Sheikh Dr. Mohammad Daud Bakar on its *Sharia'* board as a factual example. Such a closed-door policy does not exist in Malaysia.

¹⁶⁰ For example, see Hasan and Sabirzyanov, p. 252; Wilson, *The Development of Islamic Finance in the GCC*, p. 9-10; MS Malik, Ali Malik and Waqas Mustafa, 'Controversies That Make Islamic Banking Controversial: An Analysis of Issues and Challenges' (2011) 2 American Journal of Social and Management Sciences 41, p. 43.

While the corporate governance codes for the IFIs of the two countries have abstained from specifying any exceptional circumstances to allow the occupation of *Sharia'* board directorship above the prescribed limit, the interviews also revealed that both countries have refrained from extending the scope of their regulation of the multiple *Sharia'* board directorship practice to include any extraterritorial *Sharia'* board positions held by the *Sharia'* board members for the following reasons. In the case of Malaysia, the CBM maintained that its periodical assessment of the individual performance of the IFIs' *Sharia'* board members can provide a substantial insight in determining their capability to hold additional *Sharia'* board positions, which further allows the CBM to determine the appropriate corrective measures to take whenever taking on these directorships compromises the *Sharia'* board members' fiduciary responsibilities to their respective IFIs. On the other hand, the OJK highlighted that it is unnecessary to regulate extraterritorial *Sharia'* board directorships due to the small number of Indonesian *Sharia'* board members with extraterritorial *Sharia'* board positions. Additionally, both the CBM and OJK indicated the absence of any plan to introduce a specific policy to address extraterritorial *Sharia'* board directorships.

In relation to punitive measures against the IFI's *Sharia'* board members for breaches of the corporate governance codes, the Islamic corporate governance frameworks for the IFIs of both Malaysia and Indonesia have prescribed specific punitive measures against such a misconduct with Malaysia possessing the strictest system. From one perspective, it is arguable that the introduction of these punitive measures complies with the precept of equality and justice for all promulgated by Islam as it subjects the *Sharia'* board members to a similar set of expectations and liability as applies to the BOD and senior management of the IFI¹⁶¹. At the same time, it is equally important to note that *Sharia'* scholars earn a great deal of trust and respect in Muslim-majority countries like Malaysia and Indonesia, where the act of convicting them, even in the presence of sufficient evidence, can attract a mixed reception from the community. A negative reception, for instance can lead to a serious deterioration in stakeholders' trust of Islamic banking and even aggravate the existing situation as was experienced by Indonesia where the

¹⁶¹ "O ye who believe! Stand out firmly for God, as witnesses to fair dealing, and let not the hatred of others to you make you swerve to wrong and depart from justice. Be just: that is next to piety: and fear God. For God is well-acquainted with all that ye do" (Surah Al-Maidah 5:8) of Ali. In a Hadith narrated from 'Aishah, the Prophet Muhammad (p.b.u.h) said, "By God, if Fatimah the daughter of Muhammad (my daughter) were to steal, I would cut off her hand". This Hadith is Sahih. See Vol. 3, Book 20, Hadith 2547 of Ansari

public's confidence in the banking sector is already low¹⁶². As much as it is a novel approach that can revolutionise the corporate governance landscape of the Islamic banking industry, the sensitivity of punitive sanctions makes it essential that Islamic banking regulators tread with great care in order to avoid the stakeholders, especially the public, perceiving the industry as a disguised agenda to destroy the Islamic faith by 'imprisoning' *Sharia'* scholars¹⁶³.

6.6.3 Auditing of *Sharia'* Board Members

Among its other roles, an IFI's *Sharia'* board performs the role of an internal auditor for the IFI, in evaluating the *Sharia'* compliance of its subjects including the BOD and the IFI's management team. At the same time, the performance of the *Sharia'* board is also subject to audit and scrutiny from the country's Islamic banking regulators in the central banks or the financial services authorities. The auditing of the performance of the *Sharia'* board and its members forms an integral component of a good Islamic corporate governance framework that enables both the Islamic banking regulators and the IFIs to identify any weaknesses in their current frameworks and to devise the appropriate resolutions. This section comprises four questions, which attempt to ascertain the presence and execution of this auditing practice by the CBM and OJK in respect of the IFI's *Sharia'* board members and to compare the effectiveness of the Islamic corporate governance system implemented between the two countries.

There are specific requirements within the Malaysian and Indonesian Islamic banking corporate governance codes mandating the IFIs to perform periodical self-audits or reviews of their *Sharia'* board members. The Malaysian risk-based supervisory approach requires the CBM to conduct its own assessment of the effectiveness of the IFI's *Sharia'*

¹⁶² Vizcaino, 'Indonesia Eyes Islamic Finance Incentives in Industry Road Map'; Sari, Bahari and Hamad, p. 146. Also see Komaruddin Bagja Arjawinangun, 'Habib Novel: Ulama Ditangkap, Ahok Sampai Sekarang Tidak Ditahan (Habib Novel: Ulama is Imprisoned, Ahok Remains Undetained)' Sindonewscom, 31 March 2017 <<https://metro.sindonews.com/read/1193247/170/habib-novel-ulama-ditangkap-ahok-sampai-sekarang-tidak-ditahan-1490967744>> accessed 18 September 2017

¹⁶³ Throughout the history of Islamic civilisation, numerous *Sharia'* scholars had faced imprisonment due to political reasons, which did not bode well with the Muslim community. These had included renowned figures such as *Imam Abu Hanifa*, *Imam Shafie*, and *Imam Ahmad Ibn Hanbal*. See A. Sayeed, *Women and the Transmission of Religious Knowledge in Islam* (Cambridge University Press 2013), p. 139; A.S. Ahmed, *Discovering Islam: Making Sense of Muslim History and Society* (Taylor & Francis 2002). Also see K.E. Shienbaum and J. Hasan, *Beyond Jihad: Critical Voices from Inside Islam* (Academica Press 2006), p. 200.

board members in performing their fiduciary responsibilities¹⁶⁴, in addition to the self-audits performed by the respective IFIs¹⁶⁵. The Indonesian situation differs slightly in that the OJK performs its evaluation of *Sharia'* board members based on self-assessment reports prepared by the IFIs¹⁶⁶. Additionally, both the CBM and OJK indicated during their interviews that their respective evaluations will also heed the number of external board directorships held by the IFI's *Sharia'* board members elsewhere.

The corporate governance codes for the IFIs of both countries also contain specific provisions, which require *Sharia'* board members to dedicate sufficient time and attention in discharging their fiduciary duties to the IFIs. Since the *Sharia'* board members in both countries are appointed on a part-time basis, the fulfilment of this mandatory requirement is likely manifested through the compulsory provisions within the countries' corporate governance codes that require the *Sharia'* board to conduct meetings above a specified threshold, namely a minimum of one meeting every two months for Malaysia¹⁶⁷, and a minimum of one meeting every month for Indonesia¹⁶⁸, which projects the IFIs in the Republic to conduct the most *Sharia'* board meetings with a minimum of 12 meetings a year in contrast to its neighbour with a minimum of 6 meetings.

Although both countries treat absenteeism cases strictly, the interviews reveal that both the CBM and OJK recognise the attendance of *Sharia'* board members via the utilisation of technological means such as video or telephone conferencing. In the same vein, it is interesting to note that the CBM treats any absence from a *Sharia'* board meeting facilitated via technological means as similar to any absenteeism from a physical meeting, which can subject any truant *Sharia'* board member to disqualification from the

¹⁶⁴ Fit and Proper Criteria BNM/RH/GL_018-5, p. 5; Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 18.

¹⁶⁵ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 18.

¹⁶⁶ Article 3 of Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows). Also see Circulars to All Islamic Public Bank and Islamic Windows in Indonesia No. 12/13/DPbS, p. 19-25.

¹⁶⁷ Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 36.

¹⁶⁸ See Article 48 and 49 of Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows)

Sharia' board directorship if his or her attendances at meetings fall below the 75 per cent threshold¹⁶⁹.

Finally, the interviews also reveal that the absence of a specific provision in the laws and corporate governance policy for the IFIs in both countries leads to the emergence of an unhealthy practice, where several *Sharia'* board members have dominated or occupied their directorships for a long time. The study supports and favours the OJK's recommendation for the introduction of a two-term limit, comprising four years a term, which promotes the professional independence of *Sharia'* board members, as well as providing the younger generation of *Sharia'* scholars with a better opportunity to learn and gain the essential practical experience in serving the industry in the future.

6.6.4 Disclosure of Multiple *Sharia'* Board Directorships

Accuracy, transparency, and disclosure contribute to the concept of accountability that serves as a prerequisite for a good Islamic corporate governance system. It requires the IFIs to disclose accurate and true information to their stakeholders in compliance with the provision in the *Holy Quran* that stresses the importance of transparency in any business engagement¹⁷⁰. Accordingly, this section comprises two questions, which aim to explore any regulations that require the IFIs to disclose the number of *Sharia'* board directorships held by their *Sharia'* board members and the remunerations received therefrom.

Although Indonesia is the only country of the two, which requires the IFIs to disclose the number of board directorships held by their *Sharia'* board members, the interviews reveal that this disclosure does not include information on the remuneration received by the *Sharia'* board members from their external board directorships. This omission defies the *Sharia'* governance disclosure recommended by the IFSB in its IFSB-4, which requires the IFIs to disclose the remuneration received by the *Sharia'* board members in advancing the concept of fairness and transparency in the IFIs' business practices¹⁷¹.

¹⁶⁹ See Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 31, 36. Also see section 19 (6) of Central Bank of Malaysia Act 2009 (Act 701)

¹⁷⁰ See (*Surah Al-Baqarah* 2:282) of Ali. Also see Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds)

¹⁷¹ Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services (excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds), p. 28.

Since the multiple *Sharia'* board directorship practice induces considerable questions on the time commitment and remuneration received by the interlocking *Sharia'* board members, a proper disclosure of this information can improve the stakeholders' access to crucial information and provide better transparency of the IFI's corporate governance framework boosting stakeholders' confidence in the roles played by the *Sharia'* board. It is submitted that the absence or lack of disclosure on this information in Malaysia and Indonesia respectively could be attributed to their lack of significance to stakeholders or to the absence of empirical research to prove their significance.

6.6.5 Remuneration of Interlocking *Sharia'* Board Members

The remuneration of the *Sharia'* board members remains a controversial issue in discussing the independence of the *Sharia'* board. Since *Sharia'* board members receive a specific amount of remuneration from the IFIs, there is a considerable ground to argue that the *Sharia'* board members could legitimise dubious financial operations or compromise the principles of the *Sharia'* law to preserve their *Sharia'* board directorships. This section comprises three questions, which aim to understand the professional views of the CBM and the OJK in exploring the correlation between the remuneration of *Sharia'* board members and the multiple *Sharia'* board directorship practice.

The interviews reveal a significant difference in the remuneration policy of the IFIs' *Sharia'* board members in the two countries. While the SGF 2011 mandates the IFIs in Malaysia to remunerate their *Sharia'* board members¹⁷², the remuneration policy in Indonesia applies a different approach, which does not compel the IFIs to remunerate their *Sharia'* board members. In other words, a *Sharia'* board directorship in the Republic can exist in two unique forms, namely the remunerated and non-remunerated ones.

Although the receipt of remuneration by the IFIs' *Sharia'* board members remains a subject of *Ikhtilaf* (difference of opinions) amongst the different schools of Islamic jurisprudence, the CBM indicated that the practice as a fair and professional business norm in appreciation of their time and service, even if it materialises from their occupation of multiple *Sharia'* board directorships. The OJK shared a similar view to the CBM on the rationale for remunerating *Sharia'* board members but cautioned against the receipt of remuneration from multiple *Sharia'* board directorships, which could trigger a potential

¹⁷² Shariah Governance Framework for Islamic Financial Institutions BNM/RH/GL_012_3, p. 11.

conflict of interest and independence issue of the *Sharia'* board members¹⁷³. While the CBM embraces a liberal policy stance on this issue, the OJK advocates the limitation of the number of *Sharia'* board directorships as a prudent approach in ensuring that the collective amount of remuneration received by an interlocking *Sharia'* board member stays within a moderate and reasonable perimeter.

The interviews also attempted to explore the perspectives of both the CBM and OJK on the practicability of multiple *Sharia'* board directorships without remuneration in offering an alternative paradigm to the existing application of the practice. While both the CBM and OJK acknowledged the religious sentiment of a segment of stakeholders, who viewed *Sharia'* board members as trustees of God and who ought to distant themselves from any elements that could undermine their credibility and 'God-fearing' reputation such as the receipt of multiple remuneration packages, the interviews reveal that the Indonesian legislation and corporate governance policies for the IFIs are more accommodating to this sentiment, allowing the *Sharia'* board members to opt out of receiving any remuneration for their multiple *Sharia'* board services and treating them as a contribution in *Fi Sabilillah* (for the sake of God). Although the concept of multiple *Sharia'* board directorship without remuneration remains a foreign and unexplored subject within the universe of Islamic corporate governance study, it is submitted that Islamic banking regulators may want to consider introducing a specific guideline that provides *Sharia'* board members the option to opt out of receiving any remuneration for their *Sharia'* board service in accommodating this religious sentiment.

6.6.6 Awareness Programme

The provision of the necessary training or awareness programmes for IFI's *Sharia'* board members is crucial in improving the competence of the *Sharia'* board. Accordingly, this section comprises two questions, which attempt to investigate the presence of competent training programme offered by the CBM and OJK and measure their adequacy in educating and exposing IFI's *Sharia'* board members to the corporate governance issues surrounding the multiple *Sharia'* board directorship practice.

¹⁷³ The PBI 11/33/2009 contains a provision, which prohibits the *Sharia'* board members from manipulating their positions to advance their personal interest. See article 51 of Peraturan Bank Indonesia Nomor 11/33/PBI/2009 Tentang Pelaksanaan Good Corporate Governance Bagi Bank Umum Syariah dan Unit Usaha Syariah (Bank Indonesia Regulation No. 11/33/PBI/2009 Concerning the Implementation of Good Corporate Governance for Islamic Bank and Islamic Windows)

While the interviews reveal that IFIs' *Sharia'* board members have to participate in a specific training programme organised by the CBM in the form of the *Sharia'* Leaders Education Programme ('SLEP'), *Sharia'* board members in Indonesia must undergo a certification programme developed by an external institution, namely the MUI. Although the participation of the IFI's *Sharia'* board members is compulsory for both the SLEP and MUI certification programme, there is a significant difference in the constituents and practicability of these training programmes between the two countries.

On one hand, the SLEP has portrayed itself as a comprehensive training programme as it not only trains the IFI's *Sharia'* board members on the crucial *Sharia'* compliance issues, but it also exposes them to the applicable laws, professional ethics, and codes of conduct within modern Islamic banking practices, which includes considerable exposure to the multiple *Sharia'* board directorship practice. On the other hand, the OJK highlighted during the interview that the MUI certification programme requires a significant upgrade as it places too much emphasis on the *Sharia'* aspects of Islamic banking and neglects to expose the IFI's *Sharia'* board members to its practical and financial aspects, which bear an equal, if not, greater importance to the functional operation of the IFIs. This researcher fully supports this recommendation as both the theoretical and practical aspects of Islamic banking are critical, without which, the *Sharia'* law can render it as *Makruh* (permissible but not recommended) or even *Haram* (forbidden) for a *Sharia'* scholar to engage in such an important position as a *Sharia'* board member which involves, *inter alia*, the scrutinisation of technical financial documents and business proposals¹⁷⁴.

6.6.7 Additional Insights

This section provides an overview of the additional insights offered by the CBM and OJK in relation to any aspect relevant to the multiple *Sharia'* board directorship practice, which can enhance the outcome of this study. As much as the practice exhibits its own advantages and disadvantages, the interviews reveal that the repercussion and continuance of the practice with respect to the sustainability of the Islamic banking industry in the long-term remain largely unknown, if not, under-researched – even in countries such as Malaysia with the most progressive and comprehensive Islamic corporate governance frameworks for IFIs. Indeed, the shortage of qualified and highly

¹⁷⁴ Rayyan, p. 77-78. Also see p. 252.

experienced *Sharia'* scholars in the fields of *Fiqh Al-Muammalat* and the financial operations of banks, together with the prospect of instilling greater certainty and uniformity of *Sharia'* rulings across the interlocking jurisdictions have provided the *raison d'être* for the continuous application of the practice. However, it is equally crucial to note that the industry cannot extract the positive features of the practice without addressing the various issues highlighted above in respect of its governance.

In the same vein, it is submitted that the course of action recommended by the OJK exhibits several practical merits worth considering. The introduction of a systematic and comprehensive certification programme that encompasses a fundamental exposure to both the theoretical and practical aspects of Islamic banking can provide the industry with a steady reservoir of quality IFI's *Sharia'* board members, who can in turn, contribute to the uniformity and standardisation of Islamic banking *Fatwas* across the *Sharia'* boards they represent. In ensuring the independence of the IFI's *Sharia'* board, the introduction of a rotation system that limits the length of a *Sharia'* board directorship to a maximum of two terms, comprising three to four years a term, can serve as a viable initiative in enhancing the transparency, efficiency, accountability and professionalism of the IFI's *Sharia'* compliance endeavours.

6.7 Conclusion

The next chapter concludes this thesis by summarising the major findings of the case studies. It will highlight the limitations encountered by this researcher in framing the design of this research. The chapter will then identify the current challenges to the governance of multiple *Sharia'* board directorship practice in countries adopting the centralised approach to the corporate governance of IFIs and suggest several key areas for future research and practical recommendations, which would benefit various stakeholders of the industry, particularly policy makers in strengthening the corporate governance framework for Islamic banking markets in their respective countries.

CHAPTER 7: CONCLUSION

7.0 Introduction

This chapter provides a brief discussion of the research findings and offers several practical recommendations to enhance the existing corporate governance structures of the Islamic banking system. Based on the analysis of the semi-structured interviews, the following sub-section contextualises how the research findings answer the research questions formulated in this thesis and it outlines the contribution of this thesis to existing scholarship in the studies of the corporate governance for the IFIs in particular, and Islamic banking in general. From this analysis, the chapter will identify the issues and weaknesses of the centralised approach to the corporate governance of IFIs implemented in both Malaysia and Indonesia in regulating the multiple *Sharia'* board directorship practice. Then, the chapter will offer several practical policy recommendations for the Islamic banking regulators, policy makers, IFIs, industry practitioners, and the other stakeholders to consider in strengthening the existing corporate governance framework for the Islamic banking industry in the future.

7.1 Summary of Key Findings

The findings of this thesis provide a unique and significant added value to the study of Islamic corporate governance. As discussed in the previous chapters, the Islamic banking industry has experienced progressive growth over the last three decades and continues to display promising growth potential, especially in Muslims-populated countries spanning across the Middle East, Africa, and Asia regions. Despite this rapid growth, the thesis has revealed that the existing corporate governance framework for IFIs, even within the rapid growth market of the QISMUT+3 region, remains fragile and in need of continuous refinement from both the holistic and practical perspectives.

The centralised approach in relation to the practice of multiple *Sharia'* board directorship is promising as a practical corporate governance model for the IFIs. It not only promotes certainty in the Islamic banking industry by bridging the differences in *Sharia'* rulings between countries, but it also enables the IFIs to operate in a more efficient and systematic framework. However, the adoption of this corporate governance model does not necessarily render the IFIs more *Sharia'*-compliant as the analysis of the case studies indicates that the structure of the corporate governance policies for the IFIs within the countries adopting the centralised approach leaves plenty of open questions.

In other words, the viability of these policies and the actual virtues of permitting or restricting the multiple *Sharia'* board directorship practice in advancing the Islamic banking industry remain indeterminate – due in part to the lack of empirical research conducted in this area.

Accordingly, this thesis is the first of its kind to analyse the practicability of the corporate governance approach implemented by the Islamic banking regulators in Malaysia and Indonesia in relation to the practice of multiple *Sharia'* board directorship. The research findings have managed to identify the following gaps and issues that remain unaddressed within the existing empirical research on multiple *Sharia'* board directorship:

(a) Shortage of *Sharia'* Scholars for IFI's *Sharia'* Board Directorship

The research findings confirm that the dearth of qualified *Sharia'* scholars for IFI's *Sharia'* board directorships remain a strong *Maslahah* ground to justify the multiple *Sharia'* board directorship practice; a condition that persists even within progressive Islamic banking markets such as Malaysia and Indonesia, with the latter boasting the largest Muslim population, and probably the largest reservoir of *Sharia'* scholars in the world. Although Malaysia and Indonesia have adopted a restricted approach to the practice, their corporate governance policies for IFIs continue to allow *Sharia'* board members to hold additional *Sharia'* board directorships up to a prescribed limit. Accordingly, it is submitted that such a flexibility is in accordance with the *Fiqh* method of *Al-Masyaqqatul Tajlib Al-Taisir*¹ having considering the experience of the CBM and OJK in finding suitable candidates with proficiency in both *Sharia'* law and the practical aspects in banking and financial operations for the IFI's *Sharia'* board directorship, which created a *Masyaqqah*² in their respective Islamic banking markets.

(b) Lack of Coordination between Islamic Banking Regulator and *Fatwa* Issuer

In contrast to Malaysia, which gives the authority to regulate and issue *Fatwas* to a centralised authority, namely the CBM, it is submitted that the segregation, or rather the

¹ See p. 151-152 and 223.

² See p. 151-152 and 223.

non-unification of these critical roles as exemplified by Indonesia and evident in the other member states of the QISMUT+3 region such as Kuwait³ and Qatar⁴, can pose a substantial risk to the structure of a country's corporate governance framework for IFIs. Indeed, this segregation of authorities can provide a pragmatic bilateral check-and-balance mechanism, *i.e.* both the Islamic banking regulator and the *Fatwa*-issuing authority can cross-check the corporate governance policies and *Fatwas* promulgated in ensuring that their application reflects the best interests of the industry. At the same time, it is also practical to argue that this separated style of governance can only benefit the market if there is strong coordination between the two authorities, especially in matters crucial to the operation of a functional corporate governance framework for the IFIs such as the 'fit-and-proper' criteria and the certification or any 'continuing professional development' programme, which can reflect the interests of both the authorities. Eventually, the lack of coordination between these authorities could create uncertainty and confusion for stakeholders as well as compromise the structural integrity of the centralised Islamic corporate governance framework.

(c) Lack of Disclosure and Transparency on *Sharia'* Board Members' Occupation of Multiple *Sharia'* Board Directorships

The disclosure of essential information, especially that related to the *Sharia'* compliance of IFI's financial products, services, and operations, has evolved into a point of much interest in modern Islamic corporate governance debates due to its significant relevance to the principle of transparency lauded by *Sharia'* law, which can serve as another significant determinant to the *Sharia'* compliance of the IFIs⁵. Although both countries adopt a similar approach to the corporate governance of IFIs, the research findings reveal that there is a lack of transparency and disclosure within their corporate governance frameworks concerning *Sharia'* board members' occupation of multiple *Sharia'* board directorships, which is consistent with the empirical research by Hasan⁶,

³ See p. 95.

⁴ See p. 100. Also see Hamza, p. 83.

⁵ "*Ye shall make it clear to the people and not conceal it*" (*Surah Ali Imran 3:187*) of Ali

⁶ Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK', p. 270-271, 298-299, 344.

Grais et al⁷, and Maali et al⁸, who discovered substantial shortcomings in the disclosure practices of the IFIs across the various jurisdictions.

(d) Unspecified Status of *Sharia'* Board Members' Occupation of Extraterritorial *Sharia'* Board Directorships

In regulating the multiple *Sharia'* board directorship practice, Malaysia and Indonesia have promulgated specific provisions within their respective corporate governance policies for IFIs. Interestingly, the research findings reveal that the occupation of extraterritorial *Sharia'* board directorships remains a grey area and has yet to attract significant attention from the Islamic banking regulators due to the small number of IFIs' *Sharia'* board members with *Sharia'* board directorships outside of their respective countries⁹.

Although both countries have installed sound 'firewalls' such as the implementation of deterrent punitive measures and periodical evaluations to entrench responsibility more generally on the *Sharia'* board members, it remains arguable that the tentative approach to the occupation of extraterritorial *Sharia'* board directorships can compromise the integrity of a disciplined Islamic corporate governance framework. Indeed, the centralised approach to the corporate governance of the IFIs adopted by these countries has demonstrated the potential to be a pragmatic corporate governance model for the industry. However, the exclusion of extraterritorial *Sharia'* board directorships from the perimeter of existing legislative and corporate governance policy in force on the multiple *Sharia'* board directorship practice not only sends a distorted signal to the market of the Islamic banking regulators' commitment to regulate the practice, but it also sets an unhealthy precedent for the new generation of *Sharia'* board members.

In addition, the fact that most of the IFIs' *Sharia'* board members in both countries are academics, who deliver lectures and conduct research in *Sharia'* law and other areas of significant relevance to the industry, can present another reasonable ground for the need

⁷ Grais and Pellegrini, *Corporate Governance and Shariah Compliance in Institutions Offering Islamic Financial Services*, p. 34.

⁸ Maali, Casson and Napier, p. 285.

⁹ Examples of renowned Malaysian and Indonesian *Sharia'* scholars with extraterritorial *Sharia'* board directorships are Sheikh Dr. Mohammad Daud Bakar (Malaysia), Sheikh Professor Dr. Mohamad Akram Laldin (Malaysia), Sheikh Dr. Aznan Hasan (Malaysia), Sheikh Cecep Maskanul Hakim (Indonesia), and Sheikh Dr. Muhammad Syafi'i Antonio.

to regulate extraterritorial directorships. Despite the absence of detailed statistics to illustrate the actual number of local academics with extraterritorial *Sharia'* board directorships, or to suggest their tendency to shirk their academic and *Sharia'* board responsibilities, the thesis is keen to argue that, with all due respect to these academics-cum-*Sharia'* board members, there are simply not enough hours in a day to run a research-based university while serving on several IFIs' *Sharia'* boards. Furthermore, the unregulated practice of extraterritorial *Sharia'* board directorships will only allow them to take on more directorships and to take on unnecessary personal responsibilities. Addressing this technical ambiguity would not only strengthen the standards around *Sharia'* board directorships, but it would also reflect the Islamic banking regulators' strong commitment to promote a disciplined corporate governance framework for the IFIs.

(e) No 'One-Size-Fits-All' Approach to the Corporate Governance of IFIs

Between the two different approaches to corporate governance of the IFIs, the centralised approach exhibits the most comprehensive corporate governance structure for the industry with its two-tier *Sharia'* board system, which serves as a dual-layered supervisory mechanism that monitors and calibrates the *Sharia'* compliance processes of the IFIs according to a set of predetermined corporate governance standards¹⁰. As the sustainability of Islamic banking also depends on the resoluteness of a country's Islamic banking regulator, the adoption of this approach by both Malaysia and Indonesia has brought a much-needed certainty to the governance of practices such as the multiple *Sharia'* board directorship, as well as providing a working experiment in studying the practicability of a disciplined corporate governance framework for the industry.

Be that as it may, the research findings reveal that the differences in policies and opinions concerning its governance infer the impracticability of a 'one-size-fits-all' approach to the corporate governance of the IFIs, which cannot disavow the substantial presence of *Urf* or the legislative, political, and social heterogeneities influencing the corporate governance framework of a jurisdiction. As much as both Malaysia and Indonesia subscribe to the Shafie school of Islamic jurisprudence, their adoption of a centralised approach does not necessarily infer that the door to *Ikhtilaf* is shut. Variations in the countries' policies and standpoints concerning the power of the Islamic banking

¹⁰ See p. 125-128.

regulators in governing the industry as illustrated by the tense relationship between the OJK and the MUI in Indonesia; the remuneration of IFI's *Sharia'* board members; the receipt of remuneration from other *Sharia'* board directorships; the non-remuneration of interlocking *Sharia'* board members; and the disclosure of *Sharia'* board directorships – all these differences suggest not only that the room to differ remains open, even among countries that subscribe to a similar school of Islamic jurisprudence, but also the impracticability of a 'one-size-fits-all' corporate governance system for the industry.

It is also worth noting that neither the AAOIFI nor the IFSB advocate a 'one-size-fits-all' approach to the corporate governance of the IFI – a flexible stance similar to the OECD¹¹. These standard-setting agencies have not mandated the adoption of their corporate governance standards and the fact that derogations from them have even occurred in countries, where their applications are mandatory for the IFIs, reflects the practical difficulty in generalising these standards across different jurisdictional settings, and also the un-readiness of the market for a rigid and uniformed corporate governance framework. In this challenging and competitive banking business that necessitates rapid response by the IFIs to changes in the global market in order to compete with their non-IFI peers, a 'one-size-fits-all' approach can create rigidity in the global Islamic banking market and raise efficiency questions – an unneeded situation, which can impede the development of innovative Islamic financial products and services, and thus the market.

As much as the research findings on Malaysia and Indonesia draw a logical hypothesis on the suitability of such a rigid framework to countries subscribing to the Shafie school due to its meticulous approach to issues concerning *Muammalat*, it is prudent to argue that the other member states of the QISMUT+3 region may prefer a different or more flexible approach to suit their respective *Urf* and school of Islamic jurisprudence-orientation. The centralised approach implemented by both Malaysia and Indonesia, by no means, is a perfect approach to the corporate governance of the IFI but its coordinated and disciplined framework can serve as a viable approach worth considering by the other member states of the QISMUT+3 region in the build-up to a sustainable Islamic corporate governance ecosystem. Of course, the centralised approach is in need of several significant improvements, especially relative to the governance of the multiple *Sharia'* board directorship practice. However, the real challenge should not be about creating a singularity in the market, but rather harmonising the various corporate governance standards and Islamic banking *Fatwas* across the different jurisdictions to

¹¹ Organisation for Economic Co-operation Development, p. 53-54.

ensure consistency across the market, something which a 'one-size-fits-all' approach cannot accommodate.

7.2 Recommendations

In principle, the thesis not only aspires to set out the relevant arguments and empirical data on the practice of multiple *Sharia'* board directorship; it also seeks to provide a viable research platform for this under-studied subject, which can benefit prospective researchers in the Islamic banking field in enhancing the structure of the Islamic corporate governance framework for the IFIs within their respective countries. Also, it is important to note the research credo of Al-Amidi, an influential 12th century *Sharia'* jurist of the Shafie school, who postulated that the research outcome and findings of those, who do not satisfy the criteria of a *Mujtahid*, remain subjected to opinions and *Fatwas* of the *Sharia'* scholars and other *Mujtahids*¹². Since this researcher had neither a formal education in the vast fields of *Sharia'* law nor satisfied the criteria of a *Mujtahid*, the outcome and findings of this research should not serve as an absolute *Hukm* of the *Sharia'* law for this right remains the prerogative of the *Sharia'* scholars.

Be that as it may, the analysis of the research findings indicates that the repercussions of the continuous application of the practice towards the sustainability of the Islamic banking industry remain obscure. Although Malaysia and Indonesia represent good examples of countries which adopted the centralised Islamic corporate governance model – renowned for its certainty and standardised *Sharia'* rulings – the findings also demonstrate that the existing regulation and corporate governance policies of the practice within these countries are in need of significant enhancement before the IFIs can truly extract and establish the beneficial attributes of the practice. A number of recommendations are made as follows:

- (a) Regulating the Conducts and Business Practices of *Sharia'* Board Members and IFI's Employees

The regulation of the professional conduct and activities of *Sharia'* scholars, or in relevance to the scope of this thesis, the IFI's *Sharia'* board members, has gained acceptance of late among industry professionals and members of academia. Since it is

¹² Al-Amidi, p. 198.

a sensitive issue within the Muslim community, who consider *Sharia'* scholars as the vicegerent of the Prophet Muhammad (p.b.u.h)¹³, it is easy to understand why a certain quarter would treat this proposal not only as an unnecessary measure given the pious status of *Sharia'* scholars, but also as a form of blasphemy against Islam.

At the same time, it is also worth reflecting on the findings of recent empirical research that identifies the potential for malpractices involving IFI's *Sharia'* board members such as *Fatwa*-shopping¹⁴ and, as deduced from the research findings of this thesis, the inclusion of *Sharia'* board members, who did not attend the *Sharia'* board meeting, in the list of those, who have attended and ratified the *Fatwas* or *Sharia'* decisions of the *Sharia'* board. Although there has yet to emerge adequate empirical research and evidence that can substantiate these inferential research findings, the call to regulate the professional conduct and activities of both *Sharia'* scholars and IFI's employees is timely and practical. This is particularly the case in this era of governance and transparency, given the increasing complexities of the *Sharia'* board members' responsibilities, which expose them to a diverse range of market-sensitive information. Of course, such a fresh initiative would require a prudent administrative approach from the Islamic banking regulators due its religious-sensitivity.

Accordingly, the research findings highlighted that the experience of the Malaysian and Indonesian Islamic corporate governance frameworks can provide a pragmatic example of a dedicated approach to the notion of *Sharia'* compliance in the industry. Although the *Sharia'* board comprises men and women who are always guided by *Sharia'* law principles, this fact alone cannot render their conduct and decision faultless. The insertion of a 'deterrent' provision in the existing Islamic banking laws and corporate governance policies of these countries have added a new dimension to the notion of *Sharia'* compliance of the IFIs by holding the CEOs, BODs, and the management teams, in addition to the *Sharia'* board members, responsible for the occurrence of any *Sharia'* non-compliance incidences. Prescribing punitive measures against the misconduct of these key officials, by no means, guarantees a fault-proof Islamic corporate governance framework. Nevertheless, the initiation of such a deterrent approach can deliver a strong signal to the market of the Islamic banking regulators' commitment to promote a robust and discipline Islamic corporate governance framework spurring further confidence in this growing industry. Additionally, the provision of trainings or seminars educating

¹³ Al-Nawawi, p. 73. Also see Ibrahim, p. 13.

¹⁴ See Ullah. Also see footnote 17 in chapter 2; p. 120-121, and p. 181 for discussions on *Fatwa*-shopping.

Sharia' board members on corporate ethics, and the introduction of a specific charter or code of conduct for *Sharia'* board members that truly actualises the notion of *Sharia'* board directorship as a profession governed by practical standards and religious ethics, a code which does not currently exist in the industry, can also serve as a pragmatic amplification of the scope of *Sharia'* compliance in the industry¹⁵.

(b) Prepping the Current Pool of *Sharia'* Scholars

Banking practices have evolved drastically and become more complex and sophisticated than they were in the last century. Crowdfunding, mobile banking, digital currencies, and green finance exemplify several innovative and modern financial products and services that have begun to gain significant traction in the financial market. These developments consequently demand that the IFI's *Sharia'* board members understand their complexities and analyse their practicability to the development of the Islamic banking market. As stakeholders' expectation becoming more demanding, *Sharia'* board members cannot afford to remain static in terms of their knowledge. The Islamic banking regulators play a pivotal role in formulating a positive environment ensuring that *Sharia'* board members remain competent and up to the mark. In other words, the stereotype of *Sharia'* board members as amateurs in the practical aspects of banking and finance must end now. They should be seen as professionals and they should be expected to perform like professionals – and this will require them to undergo a different set of specific trainings in the field. Surprisingly, the aspects of the training and industry-specific development programme for the *Sharia'* board members remain a largely unexplored area.

The findings of this research reveal that the shortage of qualified and experienced personnel in both *Sharia'* law and the practical aspects of banking operations remains a substantial issue in Malaysia and Indonesia. However, there is a rapid increase in the number of graduates with qualification in *Sharia'* law and Islamic banking around the world to address this shortcoming in the years to come¹⁶. It is submitted that the actual

¹⁵ The AAOIFI has developed two codes of ethics, namely the Code of Ethics for Accountants and Auditors of IFIs, and the Code of Ethics for the Employees of the IFIs. However, there has yet to exist a specific code of ethics for the *Sharia'* advisors of IFIs. See Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Issued Standards'

¹⁶ Thomson Reuters, *Islamic Finance Development Report 2016*, p. 86; Thomson Reuters, *Islamic Finance Development Report 2015*, p. 116-119; Thomson Reuters, *Islamic Finance Development Report 2014*, p. 75.

issue facing the industry is not the number of *Sharia'* scholars with the right qualifications, but rather the number of those with the right skills and experience in banking and finance. In Malaysia and Indonesia, only a small segment of *Sharia'* board members fits into the latter category. The majority of them is either foreign *Sharia'* scholars or qualified academics without experience in the banking sector. With the industry set to experience a rapid growth due to the increasing acceptance of the Islamic banking concept among the masses¹⁷, the empowerment of human capital in the market, especially the IFI's *Sharia'* board members, requires institutional efforts. These efforts can begin by the introduction of continuous professional development programmes that focus on both the theoretical and practical aspects of Islamic banking and adding thus to the limited reservoir of competent *Sharia'* scholars.

Certainly, the provisions of training programmes by key Islamic banking organisations such as the AAOIFI¹⁸, General Council for Islamic Banks and Financial Institutions ('CIBAFI')¹⁹, Islamic Research and Training Institute ('IRTI')²⁰, and the Association of *Sharia'* Advisors in Islamic Finance ('ASAS')²¹ have all served as a proactive step in improving the quality of the IFI's *Sharia'* board and the overall *Sharia'* compliance processes. However, most of these programs have only emphasised the concept of banking and finance from the *Sharia'* law perspective and its application in the Islamic banking industry. This can lead to the *Sharia'* board members looking at these matters from a one-sided lens and can prevent them from appreciating a financial concept from a different angle that may prove beneficial. Additionally, the creation of a pool of modern IFI's *Sharia'* board members armed with a Chartered Financial Analyst ('CFA') qualification, at least Part I of the CFA, could act as a practical beginning in improving

¹⁷ Ernst & Young, *World Islamic Banking Competitiveness Report 2016*, p. 18.

¹⁸ Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), 'Certified Sharia' Advisor and Auditor (CSAA)'

¹⁹ General Council for Islamic Banks and Financial Institutions (CIBAFI), 'CIBAFI Programs' <<http://www.cibafi.org/Programs.aspx?id=ffKvw9AJko8>> accessed 18 September 2017

²⁰ The AAOIFI offers two certification programmes for the current and prospective IFI's *Sharia'* board members, namely the Certified *Sharia'* Adviser and Auditor ('CSAA') and the Certified Islamic Professional Accountant ('CIPA'). See Islamic Research and Training Institute (IRTI), 'Training Program' <<http://www.irti.org/English/TrainingAndLearning/Pages/Training-Programs.aspx>> accessed 18 September 2017

²¹ Apart from providing the IFI's *Sharia'* board members with the opportunity to enrol in Islamic financial trainings, its programmes also enable them to earn points in building up their position as qualified and competent *Sharia'* scholars. See Association of Sharia Advisors in Islamic Finance (ASAS), <<http://asas.my/>> accessed 22 September 2017

the quality of human capital in the industry. This would not only serve to furnish them with a substantial financial expertise, but it would also stimulate a positive market reaction to the appointment of *Sharia'* board members who are conversant in the specificities of modern financial instruments.

(c) Improving Disclosure Requirements of Multiple *Sharia'* Board Directorships

Transparency, which forms part of the principles of *Fiqh Al-Muammalat*, namely the principle of justice and fairness, constitutes a key element for a sound Islamic corporate governance framework for IFIs. The disclosure of information concerning the corporate practices in the Islamic banking market has gradually improved in recent years and the IFIs have begun to disclose a wide range of information including: the *Sharia'* board activities; *Fatwa* issuance processes and its justification; treatment of *Zakat* (alms payment) and funds received from questionable sources such as late payment fees or those considered as *Sharia'* non-compliant; and corporate social responsibility²². However, the lack of disclosure about the *Sharia'* board members' occupation of other *Sharia'* board directorships as highlighted by this research finding infers a weak transparency policy that can hinder efforts to understand its contribution to the sustainability of the industry.

As much as its disclosure can serve as an indication of the *Sharia'* board members' experience and provide an accurate reflection of their roles on the *Sharia'* board, its availability can also enable stakeholders to assess the possible time pressures faced by *Sharia'* board members in assessing the extent to which the practice can impair their decision-making capabilities and the performance of fiduciary responsibilities. As their presence plays a central role in instilling awareness and enhancing the quality of transparency in the IFI's disclosure effort, it is only sensible to argue that the multiple *Sharia'* board directorship practice could impede them from allocating sufficient time to improving and promoting transparency in the IFI's operations and business practices. Additionally, this information is especially beneficial to the IFI's investors in assessing the wisdom of any investment decisions. From a different perspective, a weak disclosure requirement can contribute to the development of unethical corporate practices and a

²² Inutu Lukonga, *Islamic Finance, Consumer Protection, and Financial Stability* (IMF Working Paper, May 2015, WP/15/107, 2015), p. 23; Karim and Archer, p. 33-36.

loss of market integrity, which will jeopardise both the IFIs and also the prospects of the Islamic banking industry as a whole.

As revealed by the research findings, the weak disclosure requirements of the two countries' studies on *Sharia'* board members' occupation of other *Sharia'* board directorships deserves proper attention from the respective Islamic banking regulators. Although both the AAOIFI and the IFSB have made significant contributions in promoting transparency and market discipline through the initiation of various awareness programmes and the issuance of corporate governance standards and guidelines, the overall disclosure practices among the IFIs across the globe remain in need of significant improvements. This highlights the vital role of each country's Islamic banking regulator in developing coherent regulatory disclosure requirements and moulding a competent culture of transparency among the IFIs²³.

Accordingly, Islamic banking regulators should consider making mandatory the disclosure by IFIs of more information about their *Sharia'* board members in their annual reports and corporate websites. This could help to enhance their credibility and improve confidence in the eyes of stakeholders. This information could include their attendance records, *Sharia'* board directorships held in other IFIs, the nature of the works undertaken on behalf of these *Sharia'* boards, and the remuneration received. The latter disclosure could assist in identifying and mitigating the risk of *Fatwa*-shopping and has increasingly become a good disclosure practice mandated in several countries²⁴.

²³ See Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK', p. 266, which highlighted the substantial shortcomings of the IFIs in the GCC countries in their disclosure practices despite adopting the AAOIFI's Accounting, Auditing and Governance Standards. Cf AEA Al-Baluchi, 'The Impacts of AAOIFI Standards and Other Banks Characteristics on the Level of Voluntary Disclosure in the Annual Reports of Islamic Banks' (DPhil Thesis, University of Surrey 2006), p. 192, which highlighted the positive influence of the same AAOIFI's standards towards the disclosure practices of 34 IFIs in Bahrain, Qatar and Jordan.

²⁴ For example, Bahrain has recently proposed new disclosure requirements that would mandate the publication of remuneration paid to the IFI's *Sharia'* board members in its bid to promote a more disciplined corporate governance framework for the IFIs. See Organisation for Economic Co-operation Development (OECD), *Corporate Governance and the Financial Crisis: Key Findings and Main Messages*, p. 21; Bernardo Vizcaino, 'Bahrain to Require External Sharia Auditors for Islamic Banks' Thomson Reuters, 27 September 2016 <<http://uk.reuters.com/article/islamic-finance-bahrain/bahrain-to-require-external-sharia-auditors-for-islamic-banks-idUKL8N1C30EW>> accessed 21 September 2017

(d) Maintaining Flexibility in Regulating Multiple *Sharia'* Board Directorship Practice

While the practice of multiple *Sharia'* board directorships does not necessarily threaten the *Sharia'* board members' performance of their respective corporate responsibilities²⁵, it has undoubtedly stimulated substantial debate over the need for a structured corporate governance mechanism that regulates the number of *Sharia'* board directorships a *Sharia'* board member can hold at a time in a bid to improve their time and attention on the *Sharia'* board and to boost the IFI's *Sharia'* compliance assurance to an optimum level. Limiting it may be considered too drastic a measure considering its numerous *Maslahah* or benefits in amplifying the IFI's knowledge, expertise and experience of the market. At the same time, limiting the number of *Sharia'* board directorships remains a feasible proposition given the difficulty in ascertaining a specific time requirement for *Sharia'* board members in the legislation or corporate governance codes²⁶. On the other hand, leaving it unregulated will raise more questions over the potential occurrence of conflicts between the *Sharia'* board members' personal interests, on one hand, and the interest of the IFI and the *Sharia'* law, on the other. It will also raise questions over its practicability vis-à-vis the market's sustainability in the long term. One matter remains clear though – there is an urgent need for the industry to address the uncertainty surrounding the application of the practice and certainly, this cannot start with a passive act such as leaving the practice unregulated.

However, it is important to maintain a diplomatic stance and to abstain from instituting arbitrary limitations that can trivialise the various advantages yielded by the practice. On one hand, having interlocking *Sharia'* board members, especially prominent *Sharia'* figures, on the IFI's *Sharia'* board provides a beneficial access to a rich network of *Sharia'* scholars, who can enrich the IFI's *Sharia'* compliance experience. If the interlocking *Sharia'* board members have enjoyed the confidence of stakeholders, imposing a specific limitation on the number of *Sharia'* board directorships one can hold may appear as the least important agenda for both the IFIs and the industry. Additionally, it is also arguable that the experienced directors can appreciate and comprehend better the

²⁵ Ferris, Jagannathan and Pritchard, p. 1109.

²⁶ The National Association of Corporate Directors ('NACD') suggested "*four full 40-hour weeks of service for every board on which [the directors] serve*", while Martin Lipton and Jay W Lorsch, 'A Modest Proposal for Improved Corporate Governance' (1992) 48 *The Business Lawyer* 59 proposed 100 hours at least in a year. Although none have provided a specific explanation of the rationale behind these random figures, these propositions infer that the practical demands for the directors' time have substantially increased.

significance of transparency in modern banking practices and are more likely to encourage the IFIs to disclose more information to stakeholders²⁷.

On the other hand, it is also important to note that the tedious nature of multiple *Sharia'* board directorships can also render the application of the *Fiqh* method of *Al-Mashghul La Yushghal* (the busy cannot be made busier)²⁸ as both a practical and imperative course of action in ensuring an optimum *Sharia'* compliance operation at the IFI. Stress and burnout as a result of occupying multiple *Sharia'* board directorships can have a negative effect on the *Sharia'* board members themselves as well as on stakeholders. If left unregulated, the practice can create a circumstance of *Mafsadah* (harmful or destructive) that can harm the sustainability of both the IFIs and the industry, whose prevention *Sharia'* law would consider as a priority over the extraction of *Maslahah* due to its potential risk to the preservation of *Maqasid As-Sharia'*²⁹. Prescribing a limit on the number of *Sharia'* board directorships, after all, can both assist in creating a methodical framework for the practice to operate and also neutralise potential work-related interference by driving the *Sharia'* board members to channel their time and attention to the affairs of a finite number of IFIs widening the opportunities for the young and up-and-coming *Sharia'* scholars to the *Sharia'* advisory service, which constitute a *Maslahah* in itself³⁰. In light of the shortage of qualified and experienced *Sharia'* scholars in the industry, which has served as a continuous *Masyaqqah* over the last two decades that had pressured the top *Sharia'* scholars to assume excessive number of *Sharia'* board directorships, the introduction of a limit on *Sharia'* board directorships can also serve as

²⁷ A Abdul Rahman and A Bukair, 'The Influence of the Sharia Supervision Board on Corporate Social Responsibility Disclosure by Islamic Banks of Gulf Co-Operation Council Countries' (2013) 6 Asian Journal of Business and Accounting 65, p. 77-79; Sayd Farook, M Kabir Hassan and Roman Lanis, 'Determinants of Corporate Social Responsibility Disclosure: The Case of Islamic Banks' (2011) 2 Journal of Islamic Accounting and Business Research 114

²⁸ Ab. Latif Muda and Rosmawati Ali, *Perbahasan Kaedah-Kaedah Fiqh (The Discourse of Fiqh Methods)* (published in Kuala Lumpur, 1st edn, Pustaka Salam 2000), p. 449.

²⁹ On the authority of Abu Sa'eed Al-Khudree, it was narrated that the Prophet Muhammad (p.b.u.h.) said: "No harm shall be inflicted or reciprocated". This *Hadith* is Hasan. See *Hadith* 32 of M.D. Al-Bugha and others, *Al-Wafi: Syarah Hadis Arba'in Imam An-Nawawi* (2017). Also see the *Fiqh* method of *Al-Dharul La Yuzalu Bi-Mithlihi* (Harmful elements cannot be substituted with the like) in Muhammad Sidqi Ahmad Al-Burnu, *Al-Wajiz Fi Idah Qawaid Al-Fiqh Al-Kuliyyah* (published in Beirut, Muassasah Al-Risalah 1998), p. 259; Ahmad al-Zarqa', *Syarh Al-Qawa'id Al-Fiqhiyyah (Commentary on the Method of Fiqh)* (Dar al-Qalam 1989), p. 195-196.

³⁰ Zuhaili, *Mukhtasar Fi Usul Al-Fiqh (The Method of Usul Fiqh)*, p. 237; Mushtak, 'Shariah Governance in Islamic Finance Industry'

a supportive policy to ease the burdens they carry of religious conscience in enhancing their role as effective monitors for the IFI's *Sharia'* compliance operations.

In searching for a practical approach in regulating the practice, the research findings on the restrictive stance implemented in both Malaysia and Indonesia provide constructive raw data in formulating a prudent regulatory framework that acknowledges the yin and yang of the practice to the industry. Despite the presence of a statutory limitation on the number of *Sharia'* board directorships in these countries, it is submitted that their respective regulatory policies remain flexible and allow the IFI's *Sharia'* board members to engage in the practice within a supervised environment. Accordingly, the centralised approach to the corporate governance of the IFIs adopted by these countries, which relieves the IFIs of the task of issuing Islamic banking *Fatwas* and allows the *Sharia'* board members to focus on the *Sharia'* compliance operation of the IFIs or engage in other similar responsibilities³¹, has played a decisive role in providing a regulatory environment conducive to a pragmatic application of the multiple *Sharia'* board directorship practice. The introduction of a policy of a similar nature that encourages *Sharia'* board members to spend more quality time at their represented IFIs with an eye toward less *Sharia'* board directorships, is also worth considering.

Apart from flexibility, consistency in regulation also serves as an important attribute of a strong corporate governance framework for IFIs³². However, it has been shown that this attribute remains lacking in the governance of extraterritorial *Sharia'* board directorships in both Malaysia and Indonesia where the presence of sound 'firewalls' preventing *Sharia'* board members from shirking their corporate responsibilities and a small number of *Sharia'* board members with extraterritorial *Sharia'* board directorships were cited as the main justifications behind the countries' decision to leave the practice unregulated. With all due respect, the Islamic banking regulators should consider adopting a more diligent approach in weighing the compatibility of extraterritorial *Sharia'* board directorships with effective *Sharia'* board performance, especially in the absence of a specific legal cap on the number of extraterritorial *Sharia'* board directorships a *Sharia'* board member can hold. Apart from prescribing a specific limitation, the provision of certain exceptions to allow the occupation of foreign *Sharia'* board directorships, which can benefit the local Islamic banking industry and ease cross-border transactions

³¹ Islamic Development Bank, *39 Years in the Service of Development*, p. 29.

³² Part IV of Guiding Principles on Shari'a Governance Systems for Institutions Offering Islamic Financial Services (IFSB-10)

between IFIs, can also serve as a prudent and diplomatic approach in maintaining a fair balance of *Maslahah* brought forth by the practice³³.

7.3 Limitations

Throughout the course of writing this thesis, it cannot be denied that the researcher has experienced several research limitations. Firstly, although there exists a high number of mainstream empirical works and research available in the field of the corporate governance of the IFIs, empirical studies that scrutinise the subject of multiple *Sharia'* board directorship practice in the Islamic banking industry remain very limited or non-existent. This is explainable in part by the fact that the practice has only become a subject of interest of Islamic banking researchers in recent years³⁴. Indeed, the existence of the empirical research on the interlocking directorate practice from the western scholarship perspective has provided the thesis with ample valuable points. However, the majority of this research is premised across interdisciplinary themes such as economics, accounting, and law with little reference to the prevalence of the practice in the Islamic banking industry and to its practicability and permissibility from the *Sharia'* law perspectives. This has rendered the construction of the theological basis for this research challenging. Secondly, the researcher acknowledges the fact that the application of the case study method may not present a robust research outcome despite its suitability to the exploratory nature of this thesis due to the small number of respondents for the semi-structured interviews. However, the method allows the researcher to generate significant primary data from the Islamic banking regulators' perspective of the practice that can enhance understanding of the efficiency of the regulatory framework regulating the practice in these important Islamic banking markets.

Thirdly, the thesis limits the scope of the research by focusing on the centralised approach to the corporate governance of the IFIs vis-à-vis the multiple *Sharia'* board directorship practice implemented in Malaysia and Indonesia. In other words, the research findings cannot serve as a complete and comprehensive epitomisation of the corporate governance policies practised within the QISMUT+3 region or even one that

³³ The Islamic banking regulator can consider allowing the local *Sharia'* board members to occupy foreign *Sharia'* board directorships if the nature of the appointment will not involve a lot of obligations, or the appointing IFI has a less complex and small operation size. See p. 190.

³⁴ See Unal, *Sharia Scholars in the GCC - A Network Analytic Perspective* Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*

represents the *Sharia'* views of the four *Muktabar* schools of Islamic jurisprudence on the practice. Of course, the scope of the research remains open to further expansion in the future to include the remaining member states of the QISMUT+3 region and the perspectives of the other schools of Islamic jurisprudence. Notwithstanding these limitations, the thesis has yielded substantial information and facts on the corporate governance policies undertaken between the two countries which fulfils and answers the research objectives and research questions of the thesis as well as establishing a viable foundation for the expansion of the scope of this thesis in the future.

7.4 Suggestions for Future Research

Based on the current findings, several avenues for future research are suggested. In the last ten years, it appears that the multiple *Sharia'* board directorship practice can be justified on the ground of *Maslahah* in light of the shortage of qualified and experienced *Sharia'* scholars in the industry. At the same time, the correlation between the practice and the reputation of the industry remains a grey area. Since preserving the reputation of the industry also forms an integral component of the *Maslahah* of the Islamic banking industry, there should also be a study to explore the method of deducing a *Sharia' Hukm* in a situation, which involves the clashing of two different *Maslahah*. In relation to the theme of the current thesis, the prospective study could explore the relationship of the *Maslahah* of the multiple *Sharia'* board directorship practice with the *Maslahah* of preserving the reputation of the Islamic banking industry.

Since the pioneering studies by Unal in 2009³⁵ and 2011³⁶, the subject of multiple *Sharia'* board directorships has not attracted substantial interest from fellow researchers in the Islamic banking field with the subject discussed only briefly across several empirical studies within the Islamic corporate governance sphere³⁷. This paucity of interest is arguably associated with the absence of considerable arguments and evidences crucial to a proper analysis of the *Sharia'* compliance status and the practicability of the practice to the Islamic banking industry. To date, the latest statistics of *Sharia'* scholars, who

³⁵ Unal, *Sharia Scholars in the GCC - A Network Analytic Perspective*

³⁶ Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*

³⁷ For example, see Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK'; Ullah; Rammal, 'Corporate Governance in the Islamic Banking System in Pakistan: The Role of the Shariah Supervisory Boards'

serve on the various IFIs' *Sharia'* boards in both the domestic and global markets are either unavailable or costly to obtain, a fact which does little to benefit and substantiate any attempts to scrutinise this subject further. Accordingly, the presence of such important data could assist in the effort to approximate the numbers of IFIs' *Sharia'* board members engaging in the practice and to analyse how it would shape the Islamic corporate governance landscape of the Islamic banking industry within the QISMUT+3 region in the future.

Another fascinating area that can enhance future research on the multiple *Sharia'* board directorship practice is the potential influence female *Sharia'* board members could bring to the operation and behaviour of the *Sharia'* board members as a whole. To date, women only comprise a minority of the IFIs' *Sharia'* board directorships across the globe. It is also surprising to learn that women have yet to occupy any *Sharia'* board directorships in the IFIs in the GCC countries. Such a lack of diversity crowds out alternative voices and risks the negative effects of group think in the IFI's decision-making processes³⁸. At the same time, it is interesting to note the presence of numerous empirical research in the western corporate governance universe on the positive effects brought by female directors to the BOD³⁹. For example, part from assuring a better attendance rate of male directors, the presence of female directors in the BOD can also induce the male directors to improve their preparation for board meetings – not wanting their female counterparts to catch them 'asleep'⁴⁰. In light of Sheikh Mohd Daud Bakar's revelation of the lack of preparation for meetings of certain segment of the IFIs' *Sharia'* board members⁴¹ who came prepared, this subject presents a viable research area that

³⁸ Rihab Grassa and Hamadi Matoussi, 'Is Corporate Governance Different for Islamic Banks? A Comparative Analysis between the Gulf Cooperation Council and Southeast Asian Countries' (2014) 9 *International Journal of Business Governance and Ethics* 27, p. 42. Also see Brooke Masters, 'Barclays and What Happens When You Go After the Whistleblower' *Financial Times* (12 April 2017) <<https://www-ft-com.elib.tcd.ie/content/32c2ef9e-1df3-11e7-b7d3-163f5a7f229c>> accessed 19 September 2017

³⁹ European Women on Boards (EWoB) and Institutional Shareholder Services (ISS), 'Gender Diversity on European Boards, Realizing Europe's Potential: Progress and Challenges' April 2016 <<http://european.ewob-network.eu/wp-content/uploads/2016/04/EWoB-quant-report-WEB-spreads.pdf>> accessed 20 September 2017; Barnali Choudhury, 'New Rationales for Women on Boards' (2014) 34 *Oxford Journal of Legal Studies* 511; Renee B Adams and Daniel Ferreira, 'Women in the Boardroom and Their Impact on Governance and Performance' (2009) 94 *Journal of Financial Economics* 291; Adelina Broadbridge and others, 'Gender-Related Boardroom Dynamics: How Scandinavian Women Make and Can Make Contributions on Corporate Boards' (2006) 21 *Women in Management Review* 113

⁴⁰ Adams and Ferreira, p. 236; Choudhury, p. 527; Broadbridge and others, p. 13.

⁴¹ Bakar, *Shariah Minds in Islamic Finance*, p. 28.

would benefit future research on the multiple *Sharia'* board directorship practice, and the Islamic corporate governance system in general.

7.5 Contribution of the Research

The distinctive contributions of this study are trifold. First, the thesis is the first to scrutinise the multiple *Sharia'* board directorship practice from the *Sharia'* law perspective. Since its emergence in the early 70's, there have appeared several empirical works that studied its application in the Islamic banking industry but none have attempted to analyse its conceptual framework and practicability from a *Sharia'* law point-of-view⁴². Accordingly, this study offers a unique conceptual appraisal of the practice from both the western and Islamic contexts. On one hand, it discusses the roles and fiduciary duties owed by the directors under the common law, and explores the regulatory approaches to the interlocking directorate practice in several western jurisdictions as proxies for understanding the subject from the perspective of the western law. On the other hand, it analyses the compatibility of the practice with the *Sharia'* law through the lens of *Ijtihad*, *Amanah* and *Maslahah Al-Mursalah* providing an alternative vantage point to the application of the practice in Islamic banking.

Secondly, the study offers a comprehensive examination of the regulatory and corporate governance approaches to the multiple *Sharia'* board directorship practice implemented in 2-member countries of the QISMUT+3 region, namely Malaysia and Indonesia. This will provide substantial information that can enhance and improve the present Islamic corporate governance framework for IFIs, especially within the QISMUT+3 region.

Finally, the study highlights several critical issues in the present implementation of the centralised approach to the corporate governance of the IFIs in regulating the practice, which include the practicality of the 'shortage of *Sharia'* scholars' to justify the practice amidst the increasing number of qualified *Sharia'* scholars and Islamic banking courses worldwide; the uncertain legality of the practice from both the *Sharia'* and conventional law perspective due to the absence of a specific *Fatwa* or corporate governance policy; and the Islamic banking regulators' approach to regulating extraterritorial *Sharia'* board

⁴² See Unal, *Sharia Scholars in the GCC - A Network Analytic Perspective*; Unal, *The Small World of Islamic Finance: Shariah Scholars and Governance - A Network Analytic Perspective*; Hasan, 'Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK'; Ullah; Rammal, 'Corporate Governance in the Islamic Banking System in Pakistan: The Role of the Shariah Supervisory Boards'

directorships. Accordingly, the study proposes several policy recommendations that can serve as viable propositions for future research on similar subjects.

APPENDIX 1: SEMI-STRUCTURED INTERVIEW QUESTIONS

Each question is optional. Feel free to omit a response to any question; however, the researcher would be grateful if all questions are responded to.

Your participation in this research is greatly appreciated. All the information given will be treated in the strictest confidence.

General Instructions and Information

1. The semi-structured interview aims to understand the existing legislative and corporate governance framework of 3 of the 6 countries that comprise the QISMUT region, namely Malaysia, Indonesia, and Saudi Arabia, in regard to the interlocking directorate practice of Islamic bank's *Sharia*' board members. It will involve approximately 3 key officials/head of department at the central bank-level, who are responsible for the regulation and corporate governance framework of Islamic banks within the 3 countries; comprising 1-2 officials from the central banks of each country (Bank Negara Malaysia (Malaysia), Otoritas Jasa Keuangan (Indonesia), and Saudi Arabia Monetary Agency (Saudi Arabia)). The study can enhance the understanding on the existing legislative stance and prospective legislative changes of the interlocking directorate practice within the QISMUT region and provide valuable inputs for future research in similar areas.
2. Please be advised that this session will be recorded with a digital voice-recorder. The research will anonymise and retain the collected data, including the personal particulars of the *Sharia*' scholars, for a maximum period of 5 years after the completion of the study. The lead researcher will store all of these data in an external hard drive. Only the lead researcher, his research supervisor, and any internal or external examiners of Trinity College Dublin can access these data within the stated period.

DECLARATION:

- I am 18 years or older and am competent to provide consent.
- I have read, or had read to me, a document providing information about this research and this consent form. I have had the opportunity to ask questions and all my questions have been answered to my satisfaction and understand the

description of the research that is being provided to me.

- I agree that my data is used for academic purposes and I have no objection that my data is published in academic publications in a way that does not reveal my identity.
- I understand that if I make illicit activities known, these will be reported to appropriate authorities.
- I understand that I may stop electronic recordings at any time, and that I may at any time, even subsequent to my participation have such recordings destroyed (except in situations such as above).
- I understand that, subject to the constraints above, no recordings will be replayed in any public forum or made available to any audience other than the current researchers/research team.
- I freely and voluntarily agree to be part of this research study, though without prejudice to my legal rights.
- I understand that I may refuse to answer any question and that I may withdraw at any time without penalty.
- I understand that my participation is fully anonymous and that no personal details about me will be recorded.
- <If the research involves viewing materials via a computer monitor> I understand that if I or anyone in my family has a history of epilepsy then I am proceeding at my own risk.
- I have received a copy of this agreement.

For Office Use Only:

Date of Interview: __/__/2016

Case Number: □□□

Country: Malaysia / Indonesia / Saudi Arabia

Respondent Number: □□□

School of Law

Trinity College Dublin, Republic of Ireland

Lead Researcher E-Mail: abdrazaa@tcd.ie

Research Supervisor E-Mail: blanaid.clarke@tcd.ie

SEMI-STRUCTURED INTERVIEW QUESTIONS

General Islamic Corporate Governance Framework on Interlocking Directorate

Q1: What is your view of the interlocking directorate practice of *Sharia'* scholars across Islamic banks' *Sharia'* boards?

Q2: Is there a specific corporate governance code/policy/guideline in your country that outlines the governance of Islamic banks and in particular, the conduct of *Sharia'* board members and occupation of multiple *Sharia'* board positions in other Islamic banks?

Q3: If yes, which international benchmark was used in drafting the corporate governance code/policy/guidelines in your country?

Q4: Is the adoption of the corporate governance code/policy/guideline by Islamic banks in your country made mandatory by your country's law?

Q5: Are you aware of any failure or serious repercussion to the performance or *Sharia'* compliance framework of Islamic banks as a result of the interlocking directorate practice?

Q6: What are the challenges that your institution may have faced in regulating the conduct of Islamic banks' *Sharia'* scholars?

Regulatory Approach to Interlocking Directorate

Q7: Does the corporate governance code/policy/guideline in your country allow *Sharia'* scholars to hold multiple board positions across Islamic banks?

Q8: Are there any special circumstances in which the corporate governance code/policy/guidelines in your country may allow a *Sharia'* scholar to hold multiple *Sharia'* board memberships?

Q9: Does the corporate governance code/policy/guideline in your country cover extraterritorial board memberships held by these scholars? If no, how does your institution regulate *Sharia'* scholars with board memberships outside of your country?

Q10: Is there any future plans to introduce a specific legislation/additional provision in your country's current legislation to govern an extra-territorial interlocking directorate practice of *Sharia'* scholars?

Q11: Does the corporate governance code/policy/guideline in your country provide any punitive measures against *Sharia'* scholars for breach of the code/policy/guidelines?

Audit on *Sharia'* Scholars

Q12: Does your institution conduct any periodical assessment or evaluation of Islamic banks' *Sharia'* scholars?

Q13: If yes, does this assessment or evaluation take into account the number of board memberships held by Islamic banks' *Sharia'* scholars?

Q14: Does the corporate governance code/policy/guideline in your country mandate the *Sharia'* scholars to dedicate their time and attention to their respective Islamic bank?

Q15: How does the corporate governance code/policy/guideline in your country address the competing time commitments faced by *Sharia'* scholars with multiple *Sharia'* board positions?

Disclosure of Interlocking Directorate Positions

Q16: Does the corporate governance code/policy/guideline in your country require Islamic banks to disclose the number of board memberships that their *Sharia'* scholars held in other Islamic banks?

Q17: If yes, does this disclosure include information on the remuneration received by the Islamic bank's *Sharia'* scholars of their *Sharia'* board memberships held within and outside of the Islamic bank?

Remuneration of Interlocking *Sharia'* Scholars

Q18: Does the corporate governance code/policy/guideline in your country require the Islamic banks to remunerate their *Sharia'* scholars?

Q19: Should *Sharia'* scholars receive remuneration from their interlocking *Sharia'* board positions?

Q20: What do you think of interlocking *Sharia'* board memberships without remuneration?

Awareness Programme/Training

Q21: Does your institution provide training programs for Islamic banks' *Sharia'* scholars that expose them to the laws, regulations, and business ethics of Islamic Banking in your country?

Q22: If yes, does the training program educate Islamic banks' *Sharia'* scholars on the interlocking directorate practice?

Additional Insights

Q23: Please provide any other insights that you believe are relevant in relation to the interlocking directorate practice of *Sharia'* scholars.

**APPENDIX 2: TOP SHARIA' SCHOLARS BY NUMBER OF BOARDS AS AT
SEPTEMBER 2017**

Top Sharia Scholars by Number of Boards

Name	Number of Boards
Dr Abdulaziz Khalifa Al Qassar (Kuwait)	42
Mr Abdullah Bin Suleiman Bin Mohammed Al Manea (KSA)	39
Dr Ali Mohieddine Ali Al Quradaghi (Qatar)	30
Dr Yousef Abdullah Al Shubaily (KSA)	29
Sheikh Dr Hussein Hamed Hasan (Egypt)	29
Dr Esam Khalaf Al-Enezi (Kuwait)	25
Dr Issa Zaki Issa Chakra (Kuwait)	23
Sheikh Esam Mohammed Ishaq (Bahrain)	22
Dr Khaled Mathkour Abdullah Al-Mathkour (Kuwait)	18
Dr Abdullah Bin Mohammed Al Mutlaq	17
Sheikh Dr Mohammed Salim Ahmad Abdulrahim Sultan Al Olama	16
Dr Mohammad Al-Sayyid Abdulrazaq Al-Tabtabaei	13
Sheikh Dr Walid Bin Hadi (Qatar)	13
Dr Mohammed Abdulhakim Mohammed Zoeir (UAE)	13
Sheikh Dr Ajeel Jasem Al-Nashmi	11
Dr Ali Ibrahim Al Rashid	11
Sheikh Abdul Sattar Ali Kattan	10
Dr Muhammad Amin Ali Qattan	10
Sheikh Mohammed Azizul Hoque	10
Sheikh Dr Osama Qais Salman Al-Deraie	10

Source: Thomson Reuters



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trondemand@thomsonreuters.com

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