Regulatory and Supervisory Shariah Governance of Islamic Banking System: Comparative Analysis of Malaysia and Nigeria

Muhibat Ayoni Oladimeji¹
Muhammad Ridhwan Ab. Aziz²
Khairil Faizal Khairi³

ABSTRACT

Purpose: The purpose of the study is to examine shariah governance system in terms of regulatory and supervision of Nigerian Islamic banking system for its establishment and operation. The study compares Malaysia and Nigeria in terms of their shariah governance practices. It suggests way forward for the development and smooth running of the system in Nigeria based on Malaysian experience.

Methodology: The study employs qualitative approach making use of both the in-depth field interview with shariah scholars, regulatory officers, practitioners, academicians who are directly involved in the operations of Islamic banking system in two countries Malaysia and Nigeria. And secondary source inform of documentary review is also employed.

¹ Lecturer, Crescent University Abeokuta, Ogun State. Nigeria and currently Phd. Student, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM). Corresponding author: muhibat@yahoo.com
², ³ Senior Lecturers, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM).
Findings: From the findings of this study, in terms of basic minimum things, most, but not all of the situations regarding shariah governance, in Nigeria are in line with footsteps of Malaysia. Thus, lots need to be done. The regulators should bear it in mind that in terms of shariah governance framework what they are have done are just the basic minimum required for the start, they should be prepared and ready for the comprehensive effective and efficient frameworks for the industry.

Practical Implication/ Value of the Study: The study will have policy implication to the CBN and other stakeholders in the area of Islamic banking system. Findings of this study will be a source of reference for Nigeria and other countries in formulating the similar concept of Islamic banking system because it provides gap which needs to be filled in order to make the system a success.

Keywords: Regulatory/supervisory Shariah governance, Islamic banking system, Comparative analysis, Nigeria/Malaysia.

INTRODUCTION

Islamic banks have similar functions and roles to any other ordinary commercial banks. But the objective and philosophy of the Islamic bank are the main functions that differentiate Islamic bank from conventional one. The basic objective of Islamic bank is to provide financial facilities by developing financial instruments that conform to the Islamic rules and norms of Shariah. Islamic bank needs also to participate actively in the process of the socio-economic development of Islamic systems (countries). According to Dusuki and Abdullah, (2006); Bello Dogarawa (2011c), Islamic banking system has the following distinctive salient features:

i. Justice, fairness and balanced society are what the Islamic banking system are striving for,

ii. The principle of brotherhood and cooperation are what the Islamic banking system is constructed upon,

iii. Ethical and moral framework of the Islamic law of Shariah is what Islamic banking system grounded upon.

Therefore “do good to others (benevolence) and equal rights for all person (egalitarianism) for the betterment of the Ummah” Rifaat Ahmed Abdel Karim (n.d., p.1) appears as the central philosophy of Islamic financial institutions (Islamic bank inclusive). Thus, Islamic finance presents significant appeal to the growing Socially
Responsible Investment (SRI), sustainable investments and ethical finance. In fact, it linked to the economy and has greater and improved levels of transparency, fairness, ethics and social responsible in modern finance (Zeti Aziz, 2012). Islamic banking is a subset of the Islamic economic system that strives for a just, fair and balanced society as envisioned and deeply inscribe in the objectives of Shariah. Recently, the beauty of Islamic banking is started realized by the people through its value-proposition and the way in which Islamic finance is done. Islamic finance lay emphasis on importance of basic banking and the need to have a clear separation from higher risk-taking activities, such as complex derivatives and structured credit instruments. It also emphasizes a close link between financial transactions and real economic activity. Therefore, it serves the real economy.

The ongoing economic challenges in the major advanced economies have resulted in the re-emphasizing on the importance of growth that is sustainable and responsible like that of Islamic finance. Islamic finance presents significant appeal to the growing Socially Responsible Investment (SRI), sustainable investments and ethical finance. In fact, it linked to the economy and has greater and improved levels of transparency, fairness, ethics and social responsible in modern finance (Zeti Aziz, 2012). On the other hand, it has been said by an Islamic banking expert that Islamic finance had given universal recognition. While the International Monetary Fund (IMF) had observed that in times of recessions an Islamic economic system seemed to have greater capacity to absorb than its western counterpart. For instance, according to Dato’ Mohamed Shamusudin who is an Executive Director of the Association of Islamic Banking Institutions (AIBIM) in Malaysia “Islamic financial institutions have fared better than conventional banks during the financial crisis because Islamic finance principles are more conservative”, (The Malaysian Insider, Monday, April 20, 2009, p3). Fatai (2011, p.8) also has the same view “The recent global financial crises have made several countries in the world to reconsider the practice of Islamic banking alongside the conventional banks”.

The main reason for the wonderful performance of Islamic financial can only be found in the words of Almighty Allah, i.e. Muslims/Islamic Holy books (The holy Qur’an):
“O mankind a direction has come to you from God; is a healing for the ailments in your hearts and it is guidance and mercy (Rahmah) for the believers” (Al-Qur’an. Yunus 10:7). “God never intends to impose hardship on you” (Al-Qur’an. Al-Mai’dah 5: 6). Then it is declared in an affirmation sense that “God intends to make things easy for you” (Al-Qur’an. Al-Nisa 4:28).

For instance, the prohibition of Ribā in the Qur’an is not to make things difficult for us but instead is just to make life easy for everybody.

“Verily, there has come unto you a Messenger (Muhammad, SAW), from amongst yourselves (whom you know very well). It grieves him that you should receive any injury or difficult. He is anxious over you, for the believers Allah is full of, kind and merciful (Rahmah)” (Al-Qur’an. Al-Tawba 9:128).

Therefore, if people can obey Allah (SWT) by following the rules and principles of Shariah as laid down in the Qur’an, in all our economic transactions no doubt the life will be easy for everybody (rich or poor) to live. Given the enormous benefits of Islamic banking system highlighted above, whatever and in any amount of resources channeled to this noble course to address the identified challenges can never be in vain, thus, the purpose of this study.

On the other hand the most features that distinguish Islamic banking system from conventional system are the regulations that govern them and the adopted governance mechanisms. Although Islamic banking system is expected to conform to the same existing man-made laws and regulations as their conventional counterparts, but most important is that they must also adhere to the divine rules and principles known as the Shariah. In order to reduce bank failure to minimum bearable level regulatory authorities in conventional systems ought to approach Islamic banking with an open mind realizing the potential gains that this already sizable and growing market could bring to the global economy in general and to selected counterparties in particular Luca Errico and Mitra Farahbaksh (1998). Under Islamic finance system, the regulatory authority such as Central Bank of Nigeria (CBN) is expected to play a dual role. First, is to provide prudential supervision especially in the areas of moral hazard considerations, safeguarding the interests of demand

---

depositors and systematic considerations. The second role is to ensure that banks offering Islamic financial products are strictly complying with Shariah in their operations and reporting procedure.

In the global Islamic banking industry, new participants must incorporate Shariah as an underlying principle. Also as a key differentiating factor to all aspects of its operations from organization and governance, to efforts to innovate and brand. In order to achieve this effectively and efficiently, a new participant needs to learn and partner with banks that have already successfully implemented Shariah-compliant banking activities, thus the argument for the current study. Whilst the Islamic bank is a business and must be profit oriented, it must aim at promoting Shariah, Islamic values as well as protecting the needs of Islamic society as a whole, called balanced objective. Therefore, there is a need to learn from the experienced operator that has recorded significant success in the industry for more than three (3) decades such as Malaysia. This study is timely in view of the current government and individual initiatives to establish more Islamic bank and financial institutions in Nigeria. The study tries to provide detailed insights into implementation of Islamic banking system in terms of shariah governance system.

Based on the available literature to current researcher, this study will be one of its kinds in the area of investigating Islamic banking system of the country in terms of its regulatory and supervisory practices regarding shariah governance system. Thus, the study tries to provide detailed insights into establishment and smooth running of Islamic banking system in terms of shariah governance system of the two countries. Therefore, the study will have policy implication to the CBN and other stakeholders in the area of Islamic banking system. Findings of this study will be a source of reference for Nigeria and other countries in formulating the similar concept of Islamic banking system. The study will also add to the pool of available literature available on the subject matter. This paper is structured as follows: it consists of five sections, in section is the introduction and rationale for the study. Section two discusses research methodology applied by the study. Findings of the study are presented in section three. In section four is conclusion while section five consists of suggested recommendations.
RESEARCH METHODOLOGY

The study employed qualitative research method which consists of personal/face-to-face in-depth-interview with regulatory officers, practitioners, academicians who are directly involved in the operations of Islamic banking system in two countries Malaysia and Nigeria using a written semi-structured interview questions and the study also employs library work inform of documentary review. Electronic recording devices audio and video camera are used and the voices from the recording devices are transcribed. A total number of twenty-two (22) respondents (from Malaysia and Nigeria) are voluntarily participated in the study. The information generated from the face to face in-depth semi-structure interview conducted with the aim of obtaining primary data for the study was transcribed and analyzed. The implications drawn are presented below.

FINDINGS OF THE STUDY

The section below deals with the discussion on general picture of shariah governance system provided by the central bank of Nigeria regarding Islamic banking system making use of Malaysian experience as the base.

Shariah Governance

1. Scope of shariah governance

A book written and published by ISRA in 2012, defines scope of shariah governance as follow:


The entire respondents for the study, that are shariah scholars from both countries (except respondent R4 from Nigeria with no opinion) are agreed with defined scope of shariah governance by ISRA above. While respondent R5 was able to add internal shariah audit to the list of the scope. In addition respondent R13 was of pinion that this list can change from time to time based on need and situation.

2. Shariah risks

Iqbal and in Mirakoh in 2007, classified shariah risk into two; they said you have one risk, which is due to the non-standard practice of
Islamic financial product and the second one to be non-compliance to the shariah

All the shariah scholar respondents from both countries (except respondent R4 from Nigeria with no opinion) were not agreed with non-standard practice of Islamic financial product as a class of shariah risk but they all agreed with the non-compliance to shariah. Respondent R5 was of the opinion that we should not call this as shariah risk because if we say shariah risk, a lay man might take it as if shariah is imposing a risk on the system. Whereas this is the risk that the institution which based its operations on shariah principles can face, if it tried not to abide by these shariah principles in its operations.

Shariah board
3. Roles of shariah board
From the responses of respondents R5, R11, R12, R13 and R16, it was cleared that all of them are aware and awaken to the roles and responsibility as shariah scholars. They were able to define and explain roles of shariah board as was stated in the Shariah Governance System (SGS) of Malaysia and in the guidelines of shariah Governance of Nigeria.

4. Shariah board at macro (national/ regulator) and micro (bank/ operator) levels
All the shariah repondents for the study were in support of the opinion that to have shariah board at both the regulator’s and operator’s levels is the best and both countries Malaysia and Nigeria are practicing of having shariah borad at the regulator’s and operator’s levels. But respondent R16 was of different opinion, he was in support of shariah at the operator’s level only and he based his argument on his current experience in practice. For detailed on this please refer to verbatim responses of respondent R16 under this significant theme above. The attention of the regulator is hereby called for on this.

5. International standard setting agencies AAOIFI, IFSB
All the shariah scholar respondents are of the same opinion that there is no any conflict in standards issued by the two agencies AAOIFI and IFSB. Their standards are complementary to each other, that of IFSB address issues relating to regulations and is for regulators. While that of AAOIFI is addressing issues that are relating to operations in the industry and therefore it is for operators. All these
respondents encourage all countries with Islamic banking system to make use of both standards. According to respondent R4 he heard about AAOIFI but he has never read anything about AAOIFI. This is a surprise for a shariah scholar to be totally ignorant of a popular body in the field of shariah and others standards on Islamic banks and financial institutions. Therefore, the attention of the regulators is being call for by the study. There is a need to make sure that their shariah scholars and other staff are more exposed in order to meet up with the standard.

**Shariah Governance Process**

6. Appointment of shariah board
From the responses obtained by the study Nigeria is following the method of appointing shariah board members by Malaysia especially at the operator’s level.

7. Composition of Sharia board
Composition number of shariah board at operators’ level with minimum of three (3) and maximum number is up to the operator for both countries Malaysia before and Nigeria is the same. But with the new Islamic Financial Service Act 2013 the minimum number is five.

8. Ideal composition number for shariah board (between three 3 and six 6)
All the respondents are agreed with the ideal number of minimum of three (3). But for the maximum ideal number of six they were not in support of this. Majority of them preferred the odd number for ideal composition number.

9. Shariah board term
For Malaysia at the operator’s the term is two years and it is renewable while that of Nigeria is four years and subject to a maximum of three terms.

10. Secretariat for the shariah board
The shariah boards of all the shariah scholars interviewed are having secretariat at both levels national and operator.

11. Shariah officer/secretary
All the shariah scholars interviewed confirmed that their shariah boards have a secretary or shariah officer.
12. Qualification for the shariah board
Required qualifications of a shariah scholar at the beginning of the industry in Malaysia are the same with the current practice in Nigeria.

13. Shariah board to comprise experts from the various fields (like Fiqh Muammalat chartered accountant, lawyer, conventional lawyers, judges, central bankers, or finance expert).
The respondents are of the two opinions regarding this issue, respondents R2, R5, R11 are not in support of having those experts as member of shariah board but these experts can be invited as consultant to advice the board they cannot take part in giving shariah ruling. On the other hand respondents R12, R13, R4, and R16 are in support of having those experts as member of shariah board. This is what is currently in practice in Malaysia, but respondent R13 revealed that this choice depends on the maturity of the market for example Malaysian market is already matured. In addition according to respondent R12 the majority members of the board should be shariah scholars and the chairman of the board should be shariah scholar.

14. Qualification, experience, and reputation of the shariah board members
All the shariah scholars interviewed were agreed that we should not compromise qualification and reputation (good character) in selecting shariah board members. But in terms of experience we should give chance for the new shariah scholars to gain experience by including them in the board members but they should not be the majority in number for any shariah board.

15. Shariah Compliance Process
Standard guideline for the shariah board in terms of management, product approval, auditing
Malaysian shariah governance system has provided guidelines on this but Nigeria needs to get ready to develop its own.

16. Meeting schedule
The schedule of meeting for both national and operator in Malaysia is monthly plus emergency meeting if needed. While in Nigeria is quarterly plus emergency meeting.
17. **Before the meeting when to receive the necessary documents?**
From the responses of all the shariah scholars interviewed, it was revealed that there was no specific time frame before the meeting that the board members should receive the necessary documents in preparation for the meeting.

18. **Shariah issues that have discussed in shariah board meeting**
Majority of the issue normally discussed are centered on product and some others relating sharing rulings.

19. **Development of Islamic financial products by the National Shariah board**
At the national level in Malaysia shariah board normally developed Islamic financial products especially for Islamic money market, Islamic liquidity instruments, sukuk, and Islamic financial market according to respondent R12. But this situation is yet to be experienced in Nigeria.

20. **Shariah compliance review**
In Malaysia, the national shariah board does not involve in shariah compliance review. This is done by shariah board at the operator’s level. The same situation is applicable in Nigeria.

21. **Internal review and external review**
The choices of internal or and external review exercise depends on the individual operators.

22. **Shariah report: time internal, format and contents**
In Nigeria the detailed shariah governance system is yet to be developed. And the guidelines on shariah governance that are available do not provide details on this. In Malaysia the detailed is provided inside the shariah governance system.

23. **Remuneration for the shariah board members**
All the shariah scholars interviewed are satisfied with the current practice regarding remuneration being paid to them except respondent R16. He complaint bitterly that, that of the shariah scholars is expensive especially the foreign shariah scholar. However,
he suggested some ways out and the attention of the relevant regulators is hereby called for on this by the study. Detailed on this will be provided in chapter seven of the study.

**Four Issues and Challenges for Shariah Governance**

24. Independent of shariah board members

i. Competency and Conflict of interest of shariah board members

Disclosure, transparency and consistency

Both the guidelines and shariah governance present at the both countries have tried to address these issues. But more detailed on this is still required in Nigeria. Moreover these issues are global issues and all the necessary parties are being tried on continuous basis to address them.

ii. Legal status of any shariah pronouncement

In Malaysia as well as in Nigeria, the shariah pronouncement by the national shariah board is bound on all the operators in the industry. But in terms of legal backing in the country, Malaysia has already secured legal backing on this. On the other hand legal backing on this is yet to be secured in Nigeria. In addition respondent R12 suggested compliance encouragement through incentive and good culture.

iii. Maximum utilization of shariah principle in developing Islamic financial products

Respondent R12 was of opinion that the approach of muamalat is to facilitate because muamalat is something dynamic. We should look at thing properly unless we see that it will bring more harm than good so generally thing is halal unless proven otherwise. Respondent R16 looked at this from different angle, he cited Mudarabah and musharakah case at Jaiz bank, in which the bank was able to utilize these two products successfully, actually in practice most of Islamic banks all over the world are running away from these two products.

iv. Harmonization of shariah interpretation across the jurisdictions

According to respondents R2, R13 more discussion is needed among the scholars to bring closer understanding, the frequency of the international forum of scholars will bring convergence but complete harmonization of interpretation is not possible.

v. High quality and standard of shariah services (suggestions for professional body, code of conduct)
From the responses of respondents R11, R12, R13 in Malaysia the association of shariah scholars has been formed this is to guarantee quality and professional education program for the shariah advisers in any shapes. This association is called Association of Shariah Scholars and Advisory Scholars (ASSAS). However, respondents R16, R2, R5 R4 are in support of forming such association in Nigeria.

.25. Lessons from Malaysia experience
All the shariah scholars interviewed by the study are of the same opinion that Nigeria has a lot to learn from Malaysian model of Islamic banking system.

CONCLUSION
The broad objective of conducting in-depth interview by the study is to explore the situations in both countries Nigeria and Malaysia in order to draw conclusion on what Nigeria can learn from Malaysian experience in terms of Islamic banking system. From the findings of this study, in terms of basic minimum things, most, but not all of the situations regarding shariah governance, in Nigeria are in line with footsteps of Malaysia. Thus, lots need to be done. The regulators should bear it in mind that in terms of shariah governance framework what they are have done are just the basic minimum required for the start, they should be prepared and ready for the comprehensive effective and efficient frameworks for the industry.

SUGGESTED RECOMMENDATIONS
This section presents recommendations of the study and these recommendations were majorly based on the suggestions made by the respondents of the study and others from the literature reviewed by the study.

1. The findings of the study revealed that not all the members of shariah board for CBN are well equipped. Therefore, this study recommends appropriate and effective courses, programs and training for all the shariah scholars (both the current ones and the potential) in the country. And these courses or training should not be two weeks nature but should be like postgraduate diploma three to six months. Both the shariah fiqh muamalat; and convention
economics, banking and finance aspects should in emphasized in these courses and trainings.

2. In order to facilitate progress in the industry the regulators, operators and shariah scholars should be well aware that we have to handle issue of muamalat with open mind, we should not be restrictive.

3. Shariah Advisory council at the central bank should made it mandatory for the operators to include at least one foreign shariah scholar among their shariah boards’ members for at least the first four years of operation this will allow transfer of knowledge, experience and skill from this foreign member to the local shariah scholars. Currently in Nigeria will may have shariah scholars in the area of fiqh muamalat in general but knowledge, skill and experience in the area of banking and finance, business are not there.

4. The regulators should bear it in mind that in terms of regulations and supervisions and shariah governance framework what they have done are just the basic minimum required for the start, they should be prepared and ready for the comprehensive effective and efficient frameworks for the industry.

5. On the issue of remuneration for the shariah board members at the operator level, respondents R16 and R19 lamented that the cost is too expensive. This study recommends that the suggestions of respondent R16 should be followed. And in addition, the operator should sit down these shariah scholars and table their problems before them and the operator should ask for these shariah scholars’ help for the way out. Researcher hopes that these shariah scholars will reason with the operator and find ways to reduce their allowance as a way of sacrifice for the development of the industry.

6. Ethics, morals and values in Islamic should be made mandatory as a course to be attempt by all the regulators’ officers (that will be involved in the operation of the industry), shariah scholars and all the employees of the operators (from the top management officers to the lowest level).

7. As lamented by all the operators’ respondents the issue of providing Islamic liquidity instruments by the regulators especially central bank of Nigeria, DMO, Ministry of finance, for the effective and efficient operation of the industry should be handled as a matter of urgency. This has been the major cause of loss recorded by Jaiz bank in its financial report of 2012. From Malaysian experience central bank of Malaysia and ministry of
finance had provided Islamic liquidity instruments for the operation of Islamic banks through the provision of Investment Act 1983. According to the one the Malaysian respondents for the study Ismail Mahayudin (which is respondent R6), for the first three months of the operation of the pioneer bank in Malaysia (Bank Islam) the bank transacts with the central bank of Malaysia (BNM) only.

8. It was revealed from the findings of the study that there is no Islamic or shariah compliance instruments for deposit insurance in the country. This issue should be handled together with that of issue of Islamic liquidity instruments. The concerned regulators should use Malaysian experience on this as a guide.

9. According to respondent R12 of the study, if a person or nation failed to plan that person or nation has already planned to fail, therefore, issue of specific master-plan for the development of industry should be handled by both the regulators and operators as one of the major important requirements for the effective and efficient operation of the system.

10. From the findings of the study revealed that in general there is no provision for comprehensive documentary exercise like that of Malaysia, this is not peculiar to Islamic banking system but to conventional banking also. Thus, this study hereby recommends that both the regulators and operators should establish a unit in their organization to handle the issue of comprehensive documentary like that of Malaysia. The researcher hopes that this study will serve as basis for the comprehensive documentary for the industry in Nigeria.

11. The regulators especially CBN should form a body which will include all the operators in the industry and the regulators plus Shariah board members at CBN. This body will be like a consultative forum in which all the operators will be able to share their experiences, to table all their challenges, problems, obstacles and discuss with the regulators in order for find the way out. This forum also will give the regulators the chance to rub mind with the operators on the new update in the industry.

12. The findings of the study revealed that the level of research and development in the industry and generally at the regulator’s and operator’s levels is very low. And a nation will not be able to develop if the issue of research and development is not handled as a matter of priority. Thus, this study recommends that a department which will be called research and development should be established in each of all arms of government that has one thing
or the other to do with Islamic and conventional banking and financial systems and the activities of this department should be funded adequately. And as part of requirements all banks and other financial institutions should be mandated to establish a unit called research and development in their respective organizations. The activities of this department should be designed to follow footsteps of Malaysia and other developed countries like USA, UK, and Japan among others.

13. The regulators and operators should partner with the research institute and individual researchers in the area of products development, services quality, customers services and any other issues that having something to do with growth and development of the industry.

14. The educational institutions that are interested in running courses or programs in the area of Islamic banking and finance should bear it in minds these four demands by the industry in draw up their curriculum: 1. Knowledge of banking, finance, economics, accounting, business and shariah; 2. Skills; 3. Attitude; and 4. Religiosity. In additional a lot of seminars and workshops should be included in the programs. In taking care of practical aspect of the programs, experienced industry experts should employed on part-time basis to lecture the students and students should be mandated to go for practical training. Furthermore, involvement of industry in draw up curriculum for the programs is very important. The two major languages English and Arabic should be emphasized.

References


