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## The Implementation of *Shariah* Governance Framework of 2010: Advantages and Constraints

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### ABSTRACT

The Central Bank of Malaysia (hereinafter referred to BNM) has introduced the guideline on *Shariah* Governance Framework for Islamic Financial Institutions (IFIs) (hereinafter referred to as SGF 2010) in October 2010 to have proper *Shariah* governance. All Islamic Financial Institutions in Malaysia are required to adopt SGF 2010 effectively on 1<sup>st</sup> January 2011, giving the IFIs six months to comply with. Within such period, the IFIs need to confirm that they have met all the requirements and are operating in accordance with it. After one year of the implementation there is a need to study the effects of SGF 2010 on IFIs. Thus, this article investigates the advantages and constraints resulting from the implementation of SGF 2010. The findings and analysis show that the SGF was well received by IFIs. However there are few constraints and challenges need to be rectified. This survey was conducted through the collection of data and information by distributing the questionnaire to the respondents who are involved in IFIs' industries such as the management of the IFIs, be it Islamic banks and Takaful institutions, *Shariah* Committee and *Shariah* Officers. Most of the data in this study were collected and analyzed using the Statistical Package for Social Sciences (SPSS) software version 16.0 and Microsoft Excel. Additional the descriptive analysis is used to determine the number of frequencies and percentages.

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## INTRODUCTION

Malaysia can safely be dubbed as the cranium of Islamic banking and finance. The systemic approach used in Malaysia to introduce and develop Islamic banking and finance is remarkable. Not only that, the legal structure of Islamic banking in Malaysia is far ahead of the rest of the world. The Malaysian legal framework for Islamic finance is undoubtedly the most developed and holistic in its approach (Parker 2011). Starting from the establishment of the first Islamic bank in Malaysia which is Bank Islam Malaysia Berhad in 1983, there have been radical changes in the *Shariah* governance structures followed by the Islamic Financial Institutions. Bank Negara Malaysia (the BNM) has continuously enhanced the regulations on *Shariah* governance of Islamic Bank and Financial Institutions by amending the relevant regulatory framework. Several legislations, guidelines, and circulars related to *Shariah* governance have been introduced to enhance, solve and curb the *Shariah* governance conflict facing Islamic Financial Institutions in Malaysia (Report 2013). In 2010 BNM, introduced a new set of rules and procedures for *Shariah* governance structure known as *Shariah* Governance framework of 2010 (SGF 2010). After one year of the implementation of SGF a survey was conducted to look into the effectiveness of this new governance. The survey involved many aspects, however this article will only focus on advantages and constraints faced by the Islamic financial institutions.

### Research Methodology:

#### Questionnaires:

A questionnaire is a research instrument consisting of series of questions and other prompts for the purpose of gathering information from respondents. It is series on questions asked to individual to obtain statistically

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useful information about a given topic. For the purpose of this study, questionnaires have been distributed to the relevant respondents consisting of 25 Islamic Banks and 12 Takaful Institutions in Malaysia. The purpose of the questionnaire is to analyse the Islamic Financial Institution's adoption of SGF 2010 and to identify the problems and constraints in their implementation.

This study has been carried out through the collection of data to obtain the percentage from a sample. The data were obtained through a set of questionnaire sent to the respective respondents in the Islamic Financial Institutions. They are the *Shariah* Committee, Management and *Shariah* Officer from Islamic Banks and Takaful Institutions.

Likert scale is used to measure the level of approval for the resources effectiveness, manpower efficiency, advantages and constraints on the implementation of SGF 2010. These factors are assessed according to the Likert scale scores 1 (strongly disagree) to 5 (strongly agree). Most of the data in this study were collected and analysed using the Statistical Package for Social Sciences (SPSS) software version 16.0 and Microsoft Excel. Descriptive analysis is used to determine the number of frequencies and percentages. In addition, researchers also use multiple response analysis for the related questions. A total of 88 respondents have contributed to the research. This is to obtain a percentage from the sample.

A total of 88 respondents which are divided into three groups, namely *Shariah* Committee (34.5%), Management (35.6%) and *Shariah* Officer (29.9%) were approached to answer the questionnaires. 79.5% of them are from Islamic Banks while the rest (20.5%) are from Takaful. The respondents consist of *Shariah* Committee (35.2%), *Shariah* Officer (28.4%), Head of *Shariah* Department (15.9%), Chief Executive Officer (2.0%) and other positions (18.2%). (Report, 2013)

The questions/ statements distributed to the respondent are shown in the table below:

**Table 1:** Questions/ statements to be decided by the respondents. There are 14 statements consisting of advantages and constrains normally faced by the Islamic financial institutions. The outcomes of the questionnaire are shown in table 2 below.

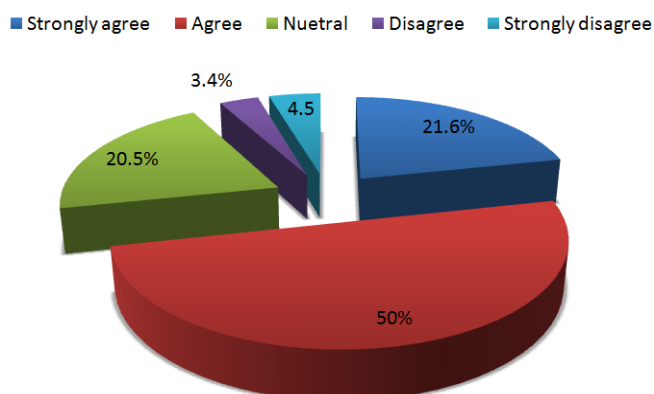
No	Statement
1	SGF 2010 has enhanced the institution's product development.
2	SGF 2010 has increased the institution's turnover.
3	SGF 2010 has enhanced the efficiency of the institution
4	SGF 2010 has increased the institution's cost.
5	SGF 2010 has increased the efficiency of product development
6	SGF 2010 has smoothened the communication between all stakeholders of the institution.
7	SGF 2010 has improved the professional Monitoring of the Islamic financial products
8	The <i>Shariah</i> Committee's resolution has caused the difficulties to the Board of Directors in making business decisions.
9	The institution finds it difficult to get qualified <i>Shariah</i> officer.
10	Easier to obtaining Bank Negara Malaysia's approval
11	Delay in the approval of the products
12	Longer time to obtain <i>Shariah</i> Committee's approval
13	Reduction of <i>Shariah</i> non-compliance issue.
14	SGF 2010 can increase the number of customers.

**Table 2:** Respondents' distribution on advantages and constraints of SGF 2010.

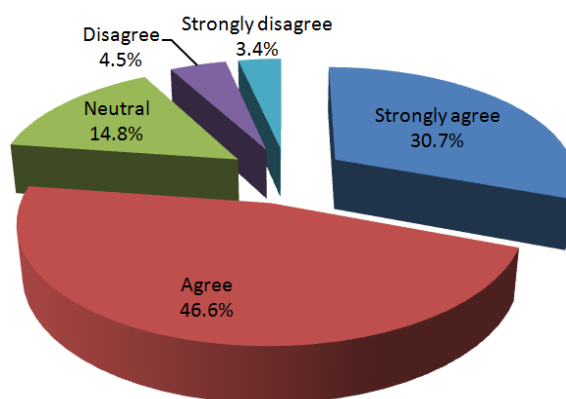
Statement no	Strongly Disagree		Disagree		Neutral		Agree		Strongly Agree	
	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage
1	4	4.5%	3	3.4%	18	20.5%	44	50.0%	19	21.6%
2	2	2.3%	6	6.8%	47	53.4%	31	35.2%	2	2.3%
3	3	3.4%	5	5.7%	19	21.6%	41	46.6%	20	22.7%
4	3	3.4%	15	17.0%	28	31.8%	33	37.5%	9	10.2%
5	3	3.4%	5	5.7%	22	25.0%	40	45.5%	18	20.5%
6	3	3.4%	2	2.3%	25	28.4%	44	50.0%	14	15.9%
7	3	3.4%	4	4.5%	13	14.8%	41	46.6%	27	30.7%
8	21	23.9%	40	45.5%	21	23.9%	6	6.8%	0	0.0%
9	5	5.7%	10	11.4%	26	29.5%	37	42.0%	10	11.4%
10	2	2.3%	7	8.0%	54	61.4%	21	23.9%	4	4.5%
11	15	17.0%	28	31.8%	33	37.5%	11	12.5%	1	1.1%
12	12	13.6%	34	38.6%	29	33.0%	11	12.5%	2	2.3%
13	4	4.5%	8	9.1%	29	33.0%	30	34.1%	17	19.3%
14	4	4.5%	9	10.2%	63	71.6%	8	9.1%	4	4.5%

The following charts show the advantages of having SGF 2010 according to the survey

Chart 1 shows that out of 88 respondents, 71.6% of them agree (strongly agree and agree) that SGF 2010 has enhanced the institution's product development. This is perhaps due a number of features embedded in the SGF such the introduction of *Shariah* audit and review function.

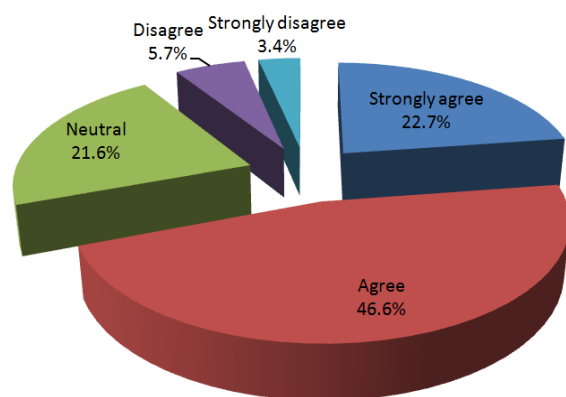


**Chart 1:** Enhancement of product development.



**Chart 2:** Improvement of professional monitoring of Islamic financial products.

Chart 2 shows that 77.3% of the respondents are of the opinion (agree and strongly agree) that SGF 2010 has improved the professional monitoring of Islamic financial products. This is because under SGF any product has to undergo several steps before it was finally approved.

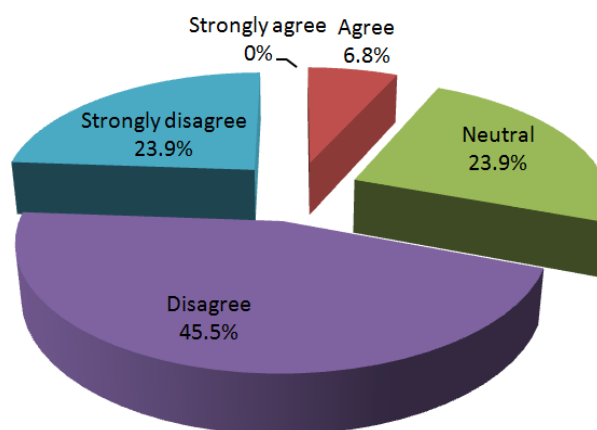


**Chart 3:** Enhancing the efficiency of the institution.

Chart 3 shows that 69.3% of the respondents agree that SGF has enhanced the efficiency of the institution

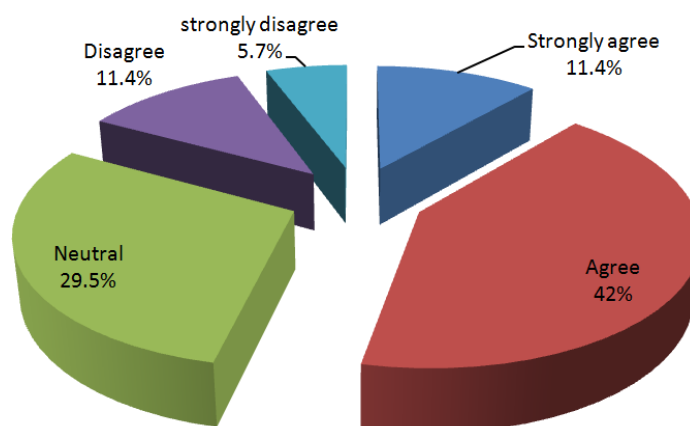
From table 2, the outcomes of the survey also show that only 37.5% of them agree that SGF 2010 has increased the institution's turnover. 66% respondents agree that SGF 2010 has increased the efficiency of product development while 65.9% of them think that SGF 2010 has facilitated the communication between all stakeholders of the institution. With the additional numbers of *Shariah* Committee members from 3 to 5 members, the respondents' perception is as follows: Only 28.4% of them said that it is easy to obtain the approval from Bank Negara Malaysia even though the number of *Shariah* Committee has increased. 53.4% of them think that with this addition, there has been reduction of *Shariah* non-compliance issue

The following charts show constraints faced by the Islamic financial institutions with the implementation of SGF 2010



**Chart 4:** Causing difficulties to Board of Directors in making business decisions

Chart 4 shows that the perception that the BODs are not comfortable with resolutions of *Shariah* committee is not true when 79.4% of the respondent disagree (strongly disagree and disagree) that the *Shariah* Committee's resolution has caused difficulties to the Board of Directors in making business decisions



**Chart 5:** Difficulty in getting qualified *Shariah* officer.

Chart 5 shows that 53.4% of the respondents agree that the institution finds it difficult to get qualified *Shariah* officer. This is perhaps due to the fact that it is hard to find a person who is well versed both in *Shariah* and modern transaction. As for other statements table 2 shows that 48.8% of the respondent strongly disagree and disagree that they face delays in getting the approval of the products and 52.2% (of them do not think (strongly disagree and disagree) that there is longer time to obtain *Shariah* Committee's approval. However, most of the respondents (71.6%) did not say agree or disagree (neutral) that the SGF 2010 can increase the number of customers.

#### **Conclusion:**

The survey finds that most of the respondents agree that with the introduction of SGF 2010 the institutions become more efficient in their operation and they are better equipped with rules and guidelines in running their business. This is evident from the fact that through the questionnaires more advantages are found compared to constraints. In other words the introduction of SGF 2010 brings more benefits to Islamic financial Institutions in Malaysia.

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