

The Composition of Shariah Committee Members of Islamic Banking Institutions in Malaysia: Legal Requirements and Practices

Mohammad Azam Hussain

School of Law, Universiti Utara Malaysia, Sintok, Kedah, Malaysia
hmazam@uum.edu.my

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Abstract

The Shariah Committee plays an essential part in ensuring that Islamic banking institutions comply with Shariah. Establishing a Shariah Committee is a legal requirement as stipulated in the Islamic Financial Services Act 2013. The composition of the Shariah Committee is very important to ensure the effectiveness of the committee in carrying out its duties and responsibilities. To what extent the requirement of the law pertaining to the composition of Shariah Committee? Whether the Islamic banking institutions comply with the legal requirement pertaining to the composition of Shariah Committee? This article seek to analyse the existing legislation pertaining to the composition of Shariah Committee. Secondly, this study will analyse the composition of Shariah Committee of Islamic banking institutions in Malaysia. By employing legal research methodology and content analysis method, the study found that the existing law requires the institutions to appoint at least five members to sit as Shariah Committee. At the same time, the composition of Shariah Committee according to education background is also significant where majority of members should possess Shariah background. This study found that, majority of the institution comply with the requirement of the law to have at least five members. However, it is found that several Islamic banking institutions fail to comply with the requirement to appoint at least five members.

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1. Introduction

Shariah supervision is a key element for Islamic banking institutions to assure that Shariah principles are always complied with in their operations and Islamic banking activities. Shariah supervision can be referred to as a set of rules or controls which were constructed based on the principles of Shariah. Its implementation is monitored in order to ensure that the activities are not invalidated by contravening the Shariah principles.

In the implementation of Islamic banking business by Islamic banking institutions, the Shariah supervision is a method of *hisbah* in Islamic law in ensuring that the Islamic banking institutions comply with Shariah principles. The word *hisbah* can be defined as enjoining

what is right (*al-ma'ruf*) when it is left and forbidding what is wrong (*al-munkar*) when it is done and reform among people (al-Kafrawy, 2006). Accordingly, the mandate to conduct the *hisbah* which is known as *wilayah al-hisbah* relies on the Shariah Committee as a body which is designated and responsible to ensure the Shariah compliance in the whole operation of Islamic banking institutions. Indirectly, it will lead to better governance of the institutions.

Failure to comply with Shariah principles may lead the Islamic banking institutions in its operation and business activities to contravene the Islamic tenets. In order to comply with Shariah principles, a robust Shariah advisory framework should be given appropriate attention

and its importance should not be underestimated. The Shariah Committee is the key body that plays an important role in the Islamic banking institutions' Shariah advisory framework (Bakar, 2002).

The Shariah Committee has a significant role in ensuring that the products and facilities given by the Islamic banking institutions comply with the Shariah principles (Alam, et. al., 2020). The Shariah Committee is referred to people entrusted with assuring compliance aspects of specific products and tools used in the Islamic finance industry, which widely includes banking, capital markets and takaful (Laldin, 2008). This Committee may also be described as an independent body of specialist jurists in *Fiqh al-Muamalat* (Islamic transaction/commercial law) entrusted with the duty of directing, reviewing, supervising and/or approving the activities of Islamic financial institutions in order to assure compliance with Shariah rules and principles (Hassan, Triyanta & Yusoff, 2011).

Historically, since 1983, every Islamic banking institutions including participating banking and financial institution in the Islamic Banking Scheme is required to establish its own Shariah Committee pursuant to the need of the legislations governing Islamic banking business in Malaysia. In relation to such legal requirement, the appointment, qualification and number of members of the Shariah Committee of Islamic banking institutions are among the important points that should be addressed by the Islamic banking authority, in particular Central Bank of Malaysia. The composition of the Shariah Committee reflects the Shariah Committee's efficiency, objectivity and independence in discharging its duties (Laldin, 2009). This article seeks to analyse the composition of Shariah Committee of Islamic banking institutions in Malaysia from the legal perspective and the practice of Islamic banking institutions in order to comply with the legal requirement.

As the crucial roles of Shariah Committee in ensuring Shariah compliance of Islamic banking business activities, composition of this committee is noteworthy to be addressed. What is the appropriate number of members should consist in the Shariah Committee? What is the qualification should they possess to guarantee them carrying out their duties and responsibilities effectively? Referring to international standard namely, Governance Standard for Islamic Financial Institutions No. 1 on the Sharia Supervisory Board: Appointment, Composition and Report, Article 2, issued by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), defines Shariah Committee as:

A Shari'a supervisory board is an independent body of specialized jurists in *fiqh al-muamalat* (Islamic commercial jurisprudence). However, the Shari'a supervisory board may include a member other than those specialized in *fiqh al-muamalat*, but who should be an expert in the field of Islamic financial institutions and with knowledge of *fiqh al-muamalat*. The Shari'a

supervisory board is entrusted with the duty of directing, reviewing and supervising the activities of the

Islamic financial institution in order to ensure that they are in compliance with Islamic Shari'a rules and principles. The *fatwas*, and rulings of the Shari'a supervisory board shall be binding on the Islamic financial institutions.

Based on the above AAOIFI's standard, it reflects the composition of Shariah Committee in relation to the qualification of the members, i.e. they should be specialized jurists in *Fiqh al-Muamalat* (Islamic transaction/commercial law). Moreover, the committee can include members with the expertise in Islamic financial institutions and with knowledge of *Fiqh al-Muamalat* (Islamic transaction/commercial law).

According to al-Qattan (2008), the members of the Shariah Committee should have the characteristics of *mufti* (expounder of Islamic law) such as being Muslim, just, sane, adult, being a jurist capable to perform *ijtihad* (juristic inference), mentally acute and having a proper mind, thought and disposition in the field of *fiqh* (Islamic jurisprudence) as well as other characteristics related to it. Apart from that, the person must be someone with a Shariah background, have good knowledge in principles of *fiqh* (Islamic jurisprudence) especially in the field of *Fiqh Muamalat* (Islamic commercial/transaction law) (Laldin, 2009).

Meanwhile, according to Yakuby (2005), besides the ability to issue *fatawa* (Islamic legal opinions) which is mainly concerned with financial transactions, it is necessary to have considerable knowledge and experience of modern transactions. This also shared by Abd. Rahman (2010) opines that the ability to communicate in English is also indispensable in examining legal documents that are usually written in English. Failure to improve, on their part, will weaken and delay the *fatawa* (Islamic legal opinions) process. He also emphasizes that the in-house Shariah Committee must have formal Shariah education.

Regarding the number of members, the standard of AAOIFI stipulates that Shariah Committee shall be made up of at least three members. However, there is no maximum number of members to be appointed as Shariah Committee specified by AAOIFI's standard (AAOIFI, Governance Standards for Islamic Financial Institutions No. 1, Shari'a Supervisory Board: Appointment, Composition and Report, Article 7). It depends on the necessity and on the scope of the services required by the Islamic banks. Hence the common number of Shariah Committee members of Islamic banking institutions is three parallel with the AAOIFI's standard (Alman, 2012; Rahman & Bukair, 2013).

According to Laldin (2009), a large number of members in the Shariah Committee will lead to the integration of knowledge among the members and the majority opinion will carry weight. The decision will be made through the discussion among them. Shariah Committee will work diligently and focus on the issues. At the same time, it will increase the confidence of

customers and will enrich the works in Islamic jurisprudence. The members are complementary to each other in terms of experience, knowledge and qualifications to assure the capability of the financial institutions in carrying out Islamic financial business as well as to maintain their integrity. Meanwhile, Dahlifah and Sunarsi (2019) opine that, an increase in the number of members of the Shariah Committee leads to a higher level of disclosure of Shariah compliance in monitoring.

al-Jarhi (2001) believes that the task of issuing a *fatwa* (Islamic legal opinion) is usually preferable to assign this task to the *Ulama* (Islamic scholars) council at national level. However, if the banks can choose their own Shariah Control Board, the selection method opens the door to variations in Islamic banks' banking practices, including those that operate in the same country. The central bank should establish a department for Shariah-based control and audit within its organizational framework, consisting of a number of *Ulama* (Islamic scholars) in Islamic jurisprudence, that are very well versed in financial, legal and accounting issues.

In the opinion of Muhammad Yunus (Laldin, 2009), single member of Shariah advisory panel will affect the independence of such Shariah advisor in carrying out his duties and responsibilities. In making decisions, the respective Shariah advisor will face the pressure from the management of the Islamic bank. Another reason is pertaining to the job perspective. It is impossible for a single Shariah advisor to absorb the entire operation and activities of the Islamic bank, the complexity of modern transactions as well as the current legal issues.

According to al-Ba'li, the Sharia Committee is consisting of no less than three members. One of them should be appointed as a chairman (Hassan et al, 2010). The number of members should be at least three based on the following reasons: (a) enable the members to help each other in discharging their duties and responsibilities; (b) they will have an opportunity to discuss among them on the matters brought before them; and (c) to guarantee that there is no deviation from the boundary set by Allah. According to Hamza (2016), with the small number of Shariah Committee, it can be easily controlled by the management and the Board of Directors. Meanwhile, with large size of Shariah Committee, it is better as it enables the institutions to have more scholars with various experience, expertise and skills.

In a nutshell, it can be concluded that, the main qualification of the member of Shariah Committee is the capability to perform *ijtihad* (juristic inference). Indirectly it requires such members to equip themselves with the criteria as a *mufti* (expounder of Islamic law). This is important to enable such members to solve any issues or problems arising with respect to the implementation of Islamic financial business. Knowledge in *Fiqh al-Muamalat* (Islamic commercial/transaction law) is a must. Reasonable knowledge related to modern financial and banking is also required. Mean

while other criteria such as English language proficiency are seen as an added value to the Shariah Committee.

Regarding the number of the Shariah Committee, it seems that majority of scholars opine that, the number of members should not be less than three. There is no maximum number of members and depends on the necessity and on the scope of the services required by the Islamic banks.

2. Methodology

This study adopted a legal research approach. Legal analysis is a systematic way to study, examine, evaluate and conceptualize legal problems related to enforcement systems and the implications of legal rules and principles (Zahraa, 1998). For the purpose of this paper, legal research was used to study the existing legislations regulating the composition of Shariah Committee of Islamic banking institutions in Malaysia. The data used were largely library based consisting of primary and secondary data. The primary data was collected from statutes passed by the Parliament of Malaysia as well as the Guidelines issued by Central Bank of Malaysia. Meanwhile the secondary data was based on published materials comprising of books, relevant articles from journals, on-line databases and the Internet. According to Yaqin (2004), legal research usually involves four methods, namely analytical, philosophical, historical and comparative. In this study, the analytical method was used by scrutinizing the related provisions of law pertaining to the composition of Shariah Committee members of Islamic banking institutions in Malaysia.

3. Results and Discussion

In this part, for easier understanding, the discussion is divided into two parts as follows:

Legislation Governing the Composition of Shariah Committee in Malaysia

The establishment of the Shariah Committee of Islamic banks in Malaysia is governed by the 2013 Islamic Financial Services Act (Act 759) (hereinafter referred to as "IFSA") and several guidelines provided by the Central Bank of Malaysia in compliance with the powers conferred by IFSA. The requirement to the establishment of the Shariah Committee by Islamic banks is derived from section 30 of IFSA which states:

30. (1) A licensed person shall establish a Shariah committee to advise the licensed person to ensure compliance with Shariah in their business, affairs and activities.

(2) For the objectives of subsection (1), if there is more than one person licensed within a financial group, one of the persons licensed can apply to the Bank to form a single Shariah committee in the financial group and the Bank can authorize the application in writing if the Bank is satisfied that the Shariah committee so established is

capable of assuring compliance with Shariah by all licensed persons within the financial group.

(3) The Bank may allow an authorized person or operator of a designated payment system to set up a Shariah committee to advise the authorized person or operator of a designated payment system to ensure Shariah complies with their business, affairs and activities.

The above provision does not stipulate the matters pertaining to the composition of Shariah Committee established by the Islamic banking institutions. In this regard, the Islamic banking institutions have to follow the Guidelines issued by Central Bank of Malaysia namely, Shariah Governance Framework for Islamic Financial Institutions (hereinafter referred to as “SGF”). Principle 2.3 of SGF states that:

2.2 The Shariah Committee members shall be appointed by the board upon the recommendation of its Nomination Committee. The number of Shariah Committee members to be appointed must not be less than five (5), the majority of whom must possess strong knowledge in Shariah and backed by the appropriate qualifications in that area. The board must ensure that the Shariah Committee members are aware of their fiduciary responsibilities in discharging their duties.

Based on the SGF, the Islamic banking institutions are required to appoint a minimum of five members to sit in its Shariah Committee. Such number of members is seemed adequate to perform the duties and responsibilities assigned to them. The Islamic banks are permitted to appoint more than five persons since the SGF does not specify the maximum number of member to be appointed. It depends on the discretion of the institutions in ensuring the effectiveness of Shariah supervision carrying out by their Shariah Committee. For instance, the Islamic bank expands its Islamic banking business by offering new Islamic financing facilities/products or upon opening new branches locally or abroad. What is more important is the output and the effectiveness of the work done by five members compared with the work done by more than five members but failed to perform the duties and responsibilities effectively.

Apart from that, SGF requires that majority of the members to possess strong knowledge of Shariah backed by the appropriate qualification in that area (SGF, Principle 2.3 of Part 2). Accordingly, they must have academic qualification at least bachelor’s degree in Shariah, which includes study in *UsulFiqh*(Islamic Jurisprudence) or *FiqhMuamalat*(Islamic transaction/commercial law) from a recognised university (SGF, Appendix 2 – Qualification).

SGF allows the Islamic banking institutions to appoint experts from relevant backgrounds such as finance and law as a member of the Shariah Committee provided that such members must not form the majority of the members. Those experts could provide input on related areas and support the depth and breadth of the Shariah deliberations (SGF, Appendix 2 – Qualification). It

would be an advantage if all members of the Shariah Committee besides being experts in the field of Shariah, they are also experts in the fields related to finance, economics and law (Kamaruddin, 2020). For example, an Islamic bank may appoint person who holds a bachelor’s degree with the combination of study in the field of Shariah and Law, Shariah and Economic or Shariah and Finance from recognized universities.

In addition, the Islamic banking institutions should also consider the level of knowledge and language proficiency of a member in forming the composition of the Shariah Committee. In line with the duties of the Shariah Committee to deliberate the Shariah issues based on references which are mostly in Arabic Language, majority of members should be able to demonstrate strong proficiency and knowledge in Arabic both written and verbal. At the same time, they must also have good understanding of Malay Language and English (SGF, Appendix 2 – Qualification). Finally, the institutions must also take into consideration the diversity of backgrounds of the members of Shariah Committee including their qualification, experience and knowledge (SGF, Appendix 2 – Qualification).

With the latest development to strengthen the Shariah governance of Islamic banking institutions, Central Bank of Malaysia has issued the new policy of Shariah Governance on 20 September 2019 (Kamaruddin, et. al., 2020). This new policy is applicable to the following institutions; (i) Licensed Islamic banks;(ii) Licensed takaful operators including professional retakaful operators;(iii) Licensed banks and licensed investment banks approved to carry on Islamic banking business; (iv) Prescribed development financial institutions approved to carry on Islamic financial business; and (v) Shariah committee members. This policy document comes into effect on 1 April 2020, with the exception of paragraph 12.5 which comes into effect on 1 April 2023 (Shariah Governance, 2019).

Regarding the composition of the Shariah Committee members of Islamic banking institutions in Malaysia, the new policy as follows:

13.1 An IFI shall ensure that Shariah committee must be of a sufficient size that–

(a) reflects the business needs of the IFI or the financial group; and

(b) enables a conducive environment for sound deliberation of Shariah matters.

13.2 An IFI must ensure that its Shariah committee, at minimum, comprise of at least five (5) Shariah committee members.

13.3 An IFI must ensure that–

(a) majority of its Shariah committee members are Shariah qualified persons; and

(b) the chairman of the Shariah committee must be a Shariah qualified person.

13.4 Notwithstanding paragraph 13.2, an IFI operating as an Islamic window or a foreign branch in Malaysia must

ensure that its Shariah committee, at minimum, comprise at least three (3) Shariah committee members.

13.5 Where there is more than one IFI within a financial group, section 30(2) of the IFSA states that one of the IFIs may submit application to the Bank for its approval to establish a single Shariah committee to serve the entire financial group.

With the latest improvement regarding the composition of Shariah Committee member, it can be seen that, the all Islamic Financial Institutions (IFI) in general and Islamic banking institutions particularly to give attention to the sufficient size of Shariah Committee to serve the institution. The institution also shall ensure the conducive environment for sound deliberation of Shariah matters. Meanwhile the number of Shariah Committee members is still the same as before i.e. shall comprise at minimum, five (5) Shariah committee members. However for institutions with an Islamic window or a foreign branch in Malaysia, they must ensure that its Shariah committee, at minimum, comprise at least three (3) Shariah committee members. Regarding the qualification of the members, the new policy still require the same and emphasizing that majority of the members shall be Shariah qualified persons. Also, the chairman of the Committee must be a Shariah qualified person.

Based on the above discussion, it can be summarized that the Islamic banks merely should not appoint at least five members in forming Shariah Committee, but should also take into consideration the composition of such committee as laid down by the new policy of Shariah Governance including Shariah qualification of the members.

The Composition of Shariah Committee Members of the Islamic Banking Institutions in Malaysia

In general, there are four (4) types of banking institutions in Malaysia offering Islamic banking facilities, namely; (i) Islamic banks; (ii) Commercial banks with Islamic window; (iii) Development Financial Institutions with Islamic window; and (iv) Investment banks with Islamic window. Islamic banks are licensed under IFSA. Meanwhile, the rest on banking institutions are licensed by different statutes, namely Financial Services Act 2013 and Development Financial Institutions Act 2002. Notably, even though those banking institutions are not licensed under IFSA, the respective institutions are required by the law to comply with IFSA in the matters of Shariah compliance (IFSA, section 14).

The following Table 1 reflects the composition of Shariah Committee Members of the Islamic banks and banking institutions with Islamic window.

Table 1: The Composition of Shariah Committee of Islamic Banking Institutions in Malaysia

Categories	Institutions	Number of Members	Shariah Background	Non-Shariah Background
Islamic banks	Affin Islamic Bank Berhad	6	5	1 (Legal)
	Al Rajhi Banking and Investment Corporation (Malaysia) Berhad	5	5	-
	Alliance Islamic Bank Berhad	6	5	1 (Finance)
	AmIslamic Bank Berhad	5	5	-
	Bank Islam Malaysia Berhad	6	6	-
	Bank Muamalat Malaysia Berhad	5	5	-
	CIMB Islamic Bank Berhad	6	5	1 (Law)
	Hong Leong Islamic Bank Berhad	5	4	1 (Law)
	HSBC Amanah Malaysia Berhad	6	4	2 (Legal & Management)
	Kuwait Finance House (Malaysia) Berhad	5	5	-
	Maybank Islamic Berhad	7	5	2 (Legal & Islamic Studies)
	OCBC Al-Amin Bank Berhad	5	4	1 (Islamic Studies)
	Public Islamic Bank Berhad	5	4	1 (Accounting)
	RHB Islamic Bank Berhad	6	4	2 (Accounting & Islamic Finance)
	Standard Chartered SaadiqBerhad	6	5	1 (Accounting)
	MBSB Bank Berhad	4	2	2 (Islamic Finance & Finance)
Commercial Banks (Islamic Windows)	BNP Paribas Malaysia Berhad	5	2	3 (Law, Islamic Finance & Finance)
	Citibank Berhad	5	4	1 (Finance)
	Deutsche Bank (Malaysia) Berhad	3	3	-

	Sumitomo Mitsui Banking Corporation Malaysia Berhad	3	2	1 (Islamic Banking)
	Mizuho Bank (Malaysia) Berhad	3	3	-
Development Financial Institutions (Islamic Window)	Bank Kerjasama Rakyat Malaysia Berhad	7	6	1 (Finance)
	Bank Pembangunan Malaysia Berhad	6	4	2 (Accounting & Management)
	Bank Pertanian Malaysia (Agrobank)	6	5	1 (Economy)
	(Small Medium Enterprise Development Bank Malaysia Berhad (SME Bank)	5	3	2 (Legal & Banking)
	Bank Simpanan Nasional	5	4	1 (Legal)
	Export-Import Bank of Malaysia Berhad (EXIM Bank)	6	4	2 (Legal & Islamic Finance)
Investment Banks (Islamic Window)	Kenanga Investment Bank Berhad	3	2	1 (Accounting)
	Malaysian Industrial Development Finance Berhad	5	4	1 (Legal)
	KAF Investment Bank Berhad	3	3	-

Source: Centre for Shariah Reference in Islamic Finance, Central Bank of Malaysia

Based on the above Table 1, all Islamic banks and Islamic window banking institutions comply with the requirement of IFSA to establish Shariah Committee to ensure Shariah compliance in their Islamic banking business activities.

Regarding the number of Shariah Committee member, it can be seen that majority of institutions comply with the requirement of SGF to appoint at least 5 members. The biggest number is 7 members and the lowest is 3 members. 6 institutions fail to comply with the requirement of SGF and have less than 5 members in its Shariah Committee.

In relation to academic qualification which emphasizes on the Shariah background, it can be seen that, all institutions appoint Shariah Committee member with Shariah background. 8 institutions appoint only members with Shariah background. Meanwhile, majority of institutions appoint a combination members with the qualification of Shariah and other relevant background such as Legal, Finance, Management, Accounting, Islamic Studies and Islamic Finance.

As required by SGF that, the majority of members of Shariah Committee should possess Shariah qualification, it can be seen that, majority of Institutions comply with such requirement. However 1 institution does not comply with such requirement. It should be 3 members with Shariah background and 1 with other qualification.

4. Conclusion

Based on the above discussion, it can be concluded that, the Islamic banking institutions should take into consideration pertaining to the composition of Shariah Committee establish by them. Not only to fulfill the requirement of the law. The regulators should always monitor the practice of Islamic banking institution in the appointment of Shariah Committee members to make sure that the institution always comply with the

requirement of the law. Meanwhile for the institutions, the management should always observe the requirement of the law. Failure to comply might expose them to the legal action taken by the authority as prescribed by IFSA.

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