



Shari'ah Governance of Islamic Non-Banking Financial Institutions in Malaysia: A Conceptual Review

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Received: 3rd February 2021

Accepted: 12th March 2021

Published: 18th March 2021

Abstract

It is widely recognized that Malaysia is among the leading countries in the Islamic banking industry. This is due to its comprehensive regulatory framework from the *Shari'ah* aspects, particularly *Shari'ah* governance. Bank Negara Malaysia (BNM), as the regulator, is closely monitoring all players in this industry so that they can follow all its policies and regulations closely. Nevertheless, the Islamic Non-Banking Institutions (NBFIs), seem to be contrary in this aspect. In fact, it is not compulsory for the NBFIs to adhere to the BNM's policies, particularly regarding the *Shari'ah* governance framework. Therefore, this study aims to explore *Shari'ah* governance practices among selected Islamic NBFIs in Malaysia. Since this study is a conceptual review, it adopts library research to achieve its objective. The finding reveals that there are different practices of *Shari'ah* governance among the Islamic NBFIs due to different sizes of their institutions and the complexity of their products. While the flexibility may bring benefits for the NBFIs, their respective regulators should enhance the *Shari'ah* governance aspects by providing a comprehensive policy as well as improving its enforcement particularly from the check and balance perspective. Also, the study suggests that the Islamic NBFIs should establish an association among its members to promote coordination, strengthen the governance, and exchange views, particularly on *Shari'ah* aspects.

Keywords: *Shari'ah* Governance Framework, Islamic Finance, and Islamic Non-Banking Institution

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INTRODUCTION

In general, financial institutions can be categorized into banking and Non-Banking Financial Institution (NBFI) (Fadzlan Sufian, 2008). As for the former, banking institutions typically comprise of commercial banks, financial companies, and merchant banks, while the latter is considered a sub-sector for banking institutions that is usually not accepting deposits. NBFIs encompass the insurance or takaful sector, cooperatives, micro-financing, fund management, and pawnbroking. Without any doubt, non-banking institutions are also vital components of the financial system's development as they play significant roles in the society as well as contribute to the country's economy (Aminul & Jamil, 2004).

Similar to banking institutions, non-banking institutions also provide *Shari'ah* compliant services to the society, especially for Muslims who direly need these services because of their religious obligation. Such services include the Islamic unit trust, *Ar-Rahnu*, Islamic mortgage, and Employee Provident Fund (EPF). In fact, history shows that the first Islamic financial institution in Malaysia was not pioneered by the Islamic banking institutions, instead, it has come from a non-

banking institution namely the Lembaga Tabung Haji (TH), which was established in 1963 (Baig, 2016) TH has been functioning as the only institution that serves for pilgrimage management as well as provides a savings and investment service for Muslims in this country (Ishak, 2011). Like their Islamic banking counterparts, the Islamic NBFIs should have similar governance infrastructure to ensure their activities are *Shari'ah* compliant all the time.

After the first Malaysian Islamic bank was established in 1983, known as the Bank Islam Malaysia Berhad (BIMB), this country has experienced a remarkable progressive growth in Islamic finance. It is currently leading the world in terms of the comprehensiveness of its *Shari'ah* governance framework and government supported infrastructure towards the Islamic finance industry (Khiyar, 2012). In general, all Islamic banking activities must comply with the requirements set out by the Bank Negara Malaysia (BNM). Nevertheless, it is not required for the Islamic NBFIs to comply with the *Shari'ah* governance policies issued by BNM. Generally, the NBFI has its own act. For instance, Islamic cooperative institutions must adhere with the guidelines issued by the *Suruhanjaya Koperasi Malaysia*

(SKM), while the EPF must comply with the EPF Act 1991 (Wan Amir & Rusni Hassan, 2020). Also, TH must comply with the Tabung Haji Act 1995 (Nurhasanah, 2015).

Despite the Islamic NBFIs playing a significant role in the economic growth as claimed by Puad et al., (2017), studies regarding *Shari'ah* governance of the Islamic NBFIs in Malaysia are still limited. Given the fact that the *Shari'ah* governance framework is an important limb in the Islamic financial institution's structure, the international setting body such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), have issued the *Shari'ah* governance standards and policies as guideline principles for the Islamic banking institutions. In Malaysia, the *Shari'ah* governance framework has been issued by the BNM for Islamic Banks and Takaful companies (Hassan & Salman, 2017). Although the Islamic non-banking institutions have begun their operations in Malaysia for more than 50 years, there is no comprehensive standard framework of *Shari'ah* governance issued for the Islamic NBFIs. Also, a comparative study is applied to compare between the Islamic NBFIs standards with the *Shari'ah* governance framework issued by the BNM. It is noted that Takaful companies and Development Financial Institutions are required to comply with the regulations issued by the BNM, hence, the research focuses on the issue of the inadequacy of a *Shari'ah* governance practice for the Islamic NBFIs that are not governed by the BNM. As the Islamic NBF industry in Malaysia is too broad, the study is limited to the selected Islamic NBFIs which are among the largest Islamic NBFIs in Malaysia. As case studies, the research has selected among the most famous Islamic NBFIs, which consisted of market-marker or fund manager companies, Islamic cooperatives, and government link investment companies, which provide *Shari'ah* compliant services.

Despite this study utilizing secondary data, it significantly contributes to the existing literatures in the area of *Shari'ah* governance, particularly for the Islamic NBFIs, which is still few.

OVERVIEW OF NON-BANKING INSTITUTION IN MALAYSIA

The Concept of Non-Banking Institution

In view of the complexity of the banking system and the geo-economic differences in each jurisdiction, consequently there is no standard definition for the NBF. This terminology has been referred differently based on the legal framework of every country. Some countries refer to the NBF as 'shadow banking.' Also, this terminology could be used interchangeably and carry the same meaning. During the global financial crisis in 2008, the term 'shadow banking' became popular. Nevertheless, the Financial Stability Board (FSB) has decided to change the term 'shadow-banking' into "non-bank financial intermediation" in its report (FSB Report, 2020).

As among the earliest used terminology, 'shadow banking' is defined as a "levered-up financial intermediary whose liabilities are broadly perceived to be similar in money-goodness and liquidity as conventional bank deposits" (Gabrieli et al., 2017). Nevertheless, Amar & Farid, (2010), argued that connotation does not carry a real meaning of a NBF, rather it reflects a 'shadow economy'. In addition, 'shadow banking' is defined as "non-depository (non-bank

credit providers to small-and mid-sized businesses without access to bank credit' (Zabala & Josse, 2018). On top of that, Onger (2014), defines a NBF as "a financial institution that does not have a full banking license and cannot accept deposits from the public". This definition implies the main characteristics of a NBF, which is, it does not accept deposits from the public. In spite of that, the definition may not be applied in Malaysia, as Tabung Haji, one of the Islamic NBFs, has been accepting deposits from the public for a long time (Khaliq Ahmad, et al., 2012). Hence, it can be concluded that 'shadow banking' or Non-Banking Institution's definition varies from one country to another.

The most practical definition may be set by the Financial Stability Board (FSB), which refers to "credit intermediation involving entities and activities outside the regular banking system" (FSB Report, 2020). The definition was then supported by Muhamad Amar (2013), when he refers to a NBF in Malaysia as "a credit intermediation system that involves entities and activities outside BNM's regulatory perimeter" (Muhamad Amar, 2013). Therefore, it can be concluded that, in the Malaysian financial system, the NBF is an entity which is not a licensed bank by BNM but is actively involved in offering financial products and services. In fact, a NBF in Malaysia seems to have similar characteristics to other banking systems as it provides similar financial services, except that BNM does not regulate it.

In terms of regulatory requirements, the NBFs have important inter-linkages with the financial system. However, a NBF is usually less regulated and not being directly supervised by the BNM. Apparently, under the Central Bank of Malaysia Act 2009, the provision in this act has given the power to BNM to collect data and information on NBFs, to conduct ongoing surveillance and oversight of the NBFs, and take necessary risk mitigation measures in ensuring financial stability (BNM, 2011). Hence, the role of BNM is only to monitor from time to time or as necessary, and to provide advice as a pre-emptive measure of which to avoid any harm to the overall financial system (BNM, 2016). For instance, in year 2016, BNM has issued a warning letter to TH in order to strengthen its risk management practices further because its liabilities was growing more than its assets which ultimately might jeopardize TH's position in the future (The Edge, 2016).

In terms of its roles, similar to the conventional banking system, an Islamic NBF is one of the vital components in the financial system development, plays significant roles in the society, and contributes to economic development (Aminul & Jamil, 2004). One of the main purposes of the establishment of a NBF is to facilitate the financial services to a specific segment of society (BNM, 2011). In other words, a NBF is established to serve specific social objectives, which the banks are unable to do so. For example, commercial banks are generally profit-oriented, risk-averse, and extremely strict regarding credit approval. Consequently, the bank will only provide loans or financing to the 'bankable' customers based on their creditworthiness.

Apart from that, among the roles of a NBF is playing a complementary role to the banking institutions, making financial system to be more inclusive and accessible, particularly for special needs such as providing financial services to the rural area, assisting small scale businesses, granting capital to start-up companies, and so forth (Onger,

2014). Moreover, it is identified that a NBFI plays a vital role in the developing economy, acting as a back-up facility if the primary banks failed (Ongeri, 2014). In more detail, NBFIs can protect the economy from economic recession and enable speedy recovery for economic growth after the crisis. It is also suggested that the capital market plays a vital role in providing an avenue to the investors for alternative savings in the bank (Nawal, et al, 2013).

SHARI'AH GOVERNANCE FRAMEWORK PRACTICE IN ISLAMIC NBFI

As the study attempts to explore the *Shari'ah* governance practices among the Islamic NBFIs, it is imperative to understand the classification of NBFIs in Malaysia. According to the Malaysia Financial Stability and Payment System Report 2011 issued by the BNM, the NBFIs may be categorized into three main categories, as illustrated by the Financial Stability Report, (2011), as follows:

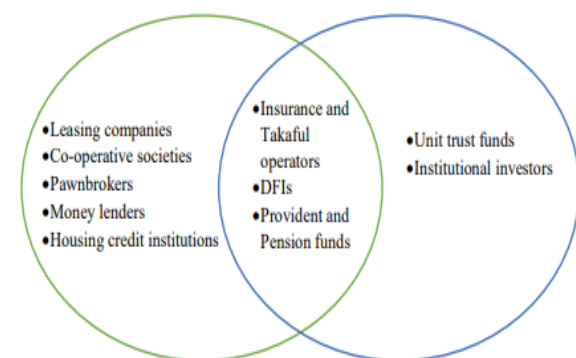


Figure 1: Non-Banking Institutions in Malaysia

It is noted that not all NBFIs in Malaysia provide Islamic financial services and products. Hence, this study is only limited to the 'Islamic NBFIs'. Besides, despite takaful companies and development financial institutions being positioned in the NBFI sector, in this study, both institutions are excluded because they are regulated and directly supervised by the BNM. Notably, both institutions are required to comply with the *Shari'ah* governance frameworks of BNM.

Shari'ah Governance Practices for Islamic Banking and Takaful in Malaysia

The *Shari'ah* governance framework is an additional layer to the existing corporate governance where it reflects a few important elements such as integrity, transparency, accountability and responsibility (ISRA, 2011). The main function of *Shari'ah* governance is to ensure that the institution adhere to the *Shari'ah* law and regulations (Iqmal & Kamaruddin, 2020). Malaysia is among the countries which prefers a pro-active model, where in this model there is a strong intervention by the central bank (Z. Hasan, 2010). In this regard, the BNM has taken efforts to develop a sound and robust *Shari'ah* governance framework for the Islamic banking and Takaful industries (Laldin & Furqani, 2018). The commitment of BNM is evidenced by continuously developing and issuing *Shari'ah* governance since 2005, with the issuance of the Guidelines on the Governance of *Shari'ah* Committee for the Islamic financial institutions. Briefly, this guideline emphasized more on the *Shari'ah* committee, such as procedures of the appointment of a *Shari'ah* committee, its roles and responsibilities, and its relationship with the respective *Shari'ah* committee at the institutional level with the *Shari'ah* Advisory Council of BNM.

As the Islamic financial institution industry began to mature and gain experience, BNM had issued a more comprehensive *Shari'ah* governance framework, which came into effect in 2011. As compared to the previous one, this updated framework introduced four dedicated *Shari'ah* control functions: namely the *Shari'ah* Review, *Shari'ah* Audit, *Shari'ah* Risk, and *Shari'ah* Research as illustrated below: -

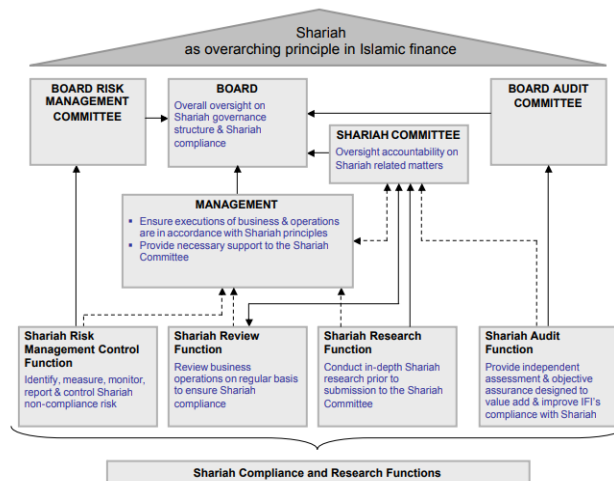


Figure 2: *Shari'ah* Governance Framework BNM 2010

Pursuant to the rapid development and complexity of the Islamic finance industry in Malaysia, the efforts to further enhance the *Shari'ah* governance framework remain as the first concern by BNM. In this regard, in September 2019, BNM has issued a revised *Shari'ah* governance framework known as the *Shari'ah* Governance Policy Document (SGPD 2019). Among the key highlights in this SGPD (2019) is to strengthen the oversight accountabilities of the BOD, and to promote a sound *Shari'ah* compliance culture to be implemented within the IFIs. The *Shari'ah* committee is expected to establish a comprehensive methodology in the decision-making process during the meeting. In addition to that, the management is expected to ensure the effective implementation of the *Shari'ah* governance policies, procedures and practices. Finally, BNM has also strengthened the overall *Shari'ah* non-compliance risk management in the IFIs through the *Shari'ah* control functions. Interestingly enough, the *Shari'ah* research role has been taken out of the SGPD 2019, and that function has been taken over by the *Shari'ah* Secretariat.

It is noted that Malaysia has also adopted a two-tier model of *Shari'ah* governance. The highest authority, namely the *Shari'ah* Advisory Council, sits at the national level, whereby the *Shari'ah* committee works at the institutional level (as depicted below). The *Shari'ah* Advisory Council's ultimate objective is to reduce opinion differences, ensure harmonization of *Shari'ah* ruling, and promote good governance within the IFIs (Grassa, 2015).

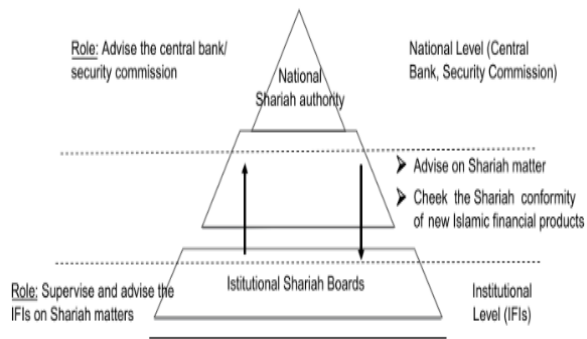


Figure 3: Two-Tier *Shari'ah* Governance Model

***Shari'ah* Governance in Islamic Fund Management**

Even though Malaysia has led every Muslim country in terms of the Islamic capital market infrastructure, nevertheless, it is argued that there is still a scarcity of a comprehensive framework for *Shari'ah* governance in the Islamic capital market sector (Hassan & Salman, 2017). Further, Nawal et al., (2013), argue that there is a lack of study discussing *Shari'ah* governance in the Islamic capital market.

In Malaysia, the Islamic capital market is currently being regulated by the Security Commission. Therefore, the *Shari'ah* Advisory Council of Security Commission (SAC of SC) is responsible for advising on *Shari'ah* issues concerning the Islamic capital markets. In parallel with the *Shari'ah* governance structure of Islamic banking and takaful, Malaysia's Security Commission has also adopted a two-tier model of governance. SAC of SC was established in 1996 and positioned at the national level to provide guidance and advice to the investors, the government, and the industry. While at the institutional level, it is required for the respective Islamic capital market products and services to appoint a *Shari'ah* advisor so as to ensure *Shari'ah* compliance (Hassan & Hussain, 2013). Nevertheless, Razinah et al. (2017), further commented that the role of the Security Commission Malaysia, as the primary regulator of the ICM, is essentially needed to strengthen that a robust *Shari'ah* governance is being adequately implemented.

Generally, the primary purpose of establishing the Guidelines on Islamic Fund Management issued by the Security Commission Malaysia under CMSA 2007 is to guide the Islamic fund management company's operation and activities. In this guideline, it is required for the fund management company to appoint a *Shari'ah* advisor, either in individual capacity or corporation, regardless of being a Malaysian or foreign company or person (SC, 2009).

R. Hassan & Hussain (2013), argued that there is inconsistency in terms of the minimum experience of a *Shari'ah* advisor in the guidelines issued by the SC. Surprisingly, there is no minimum number of compositions for a *Shari'ah* advisor to be appointed as required by the SC and no specific requirements on the *Shari'ah* control function. Hence, the function will be undertaken by a 'compliance officer' who is principally responsible for reporting any *Shari'ah* non-compliance event to the *Shari'ah* advisor and board (SC, 2007). Nevertheless, (A. N. Hasan, Abdul-Rahman & Yazid, 2020), opined that the current guidelines by the SC is adequate to ensure the Islamic fund management industry is *Shari'ah* compliance.

***Shari'ah* Governance in Islamic Cooperatives**

With the emergence of Islamic cooperatives in Malaysia, it is imperative to establish a comprehensive *Shari'ah* governance framework in the Islamic cooperative sector. Unlike the Islamic banking sector of which the BNM are supervising their activities, the jurisdiction of cooperatives in Malaysia will be under the supervision of the Malaysia Cooperative Societies Commission or *Suruhanjaya Koperasi Malaysia* (SKM) (Harith Hamidi, 2017).

In parallel with the development of the IFIs in Malaysia, SKM as a primary regulator for this sector has successfully issued its own *Shari'ah* Governance Framework for the Islamic cooperatives in 2015. This guideline is issued under section 86B of the Cooperative Societies Act 1993, to regulate cooperatives in operating its business or activities based on the *Shari'ah* principles (SKM, 2015). Nevertheless, it is argued that the *Shari'ah* Governance Framework issued by SKM is merely mirroring the *Shari'ah* Governance Framework of BNM 2010, except for a few requirements which slightly differ with BNM (Issyam, et al, 2016).

Notably, the Islamic cooperative has adopted a single-tier model whereby the *Shari'ah* committee is only established at the institutional level (Harith Hamidi, 2017). Issyam et al. (2016), further pointed out that the absence of a centralized *Shari'ah* Advisory body at the national level might attract reputational risk issues, particularly regarding court's legal cases. Unlike Islamic banking and takaful industry, the *Shari'ah* Advisory Council of the BNM's ruling shall be binding upon the court and arbitration (Z. Hasan, 2010). Thus, the study suggested that SKM should establish a central *Shari'ah* Advisory body at a national level, similar to the Islamic bank.

Without any doubt, the main pillar of *Shari'ah* governance is the establishment of a *Shari'ah* committee to monitor the activity of the institution in accordance with the *Shari'ah* principles. For the Islamic cooperative sector, the *Shari'ah* committee may be established into three segments as follows (Harith Hamidi, 2017):-

- I. An internal *Shari'ah* committee
- II. An external *Shari'ah* committee
- III. A *Shari'ah* Committee for the whole group of cooperatives

The minimum composition of a *Shari'ah* committee shall consist of three members (SKM, 2015). Due to its complexity and size, it is reasonable and adequate for the Islamic cooperative sector. As for qualification, it is required that the majority of the members in the *Shari'ah* Committee shall at least hold a bachelor's degree in *Shari'ah*, which includes a study in Usul Fiqh (the origin of Islamic law) or Fiqh Muamalat (Islamic transactions/commercial law).

Further scrutiny to the *Shari'ah* Governance Framework issued by *Suruhanjaya Koperasi Malaysia* (SKM, 2015), observed that there is no specific mention of a *Shari'ah* control function such as *Shari'ah* Review, *Shari'ah* Audit, *Shari'ah* Risk, and other support functions except that it is required for the institution to appoint at least one officer who is responsible for *Shari'ah* Secretariat matters. Apart from that, an internal audit is responsible for ensuring effective control mechanisms and the *Shari'ah* compliance aspects of the Islamic cooperative are in place.

Shari'ah Governance Ar-Rahnu (Pawn Broking)

One of the non-banking institutions that provide the customers with financial services is the *Ar-Rahnu* institutions (pawn broking). In general, an *Ar-Rahnu* provider can be categorized into three primary types of institution (Shah & Sharif, 2017):

- i. *Ar-Rahnu* under Islamic banking institutions
- ii. *Ar-Rahnu* under Islamic co-operative
- iii. *Ar-Rahnu* under corporation

Generally, the *Ar-Rahnu* providers under type (i) and (ii) are under the purview of BNM, which is not the subject in this discussion. Hence, the study attempts to review only existing literature for type (iii), where the regulator is under the Ministry of Housing and Local Government.

Regarding the *Shari'ah* governance in this sector, the National Fatwa Committee of Malaysia has suggested that an *Ar-Rahnu* provider should appoint an internal *Shari'ah* Advisor to monitor its business and operations according to the *Shari'ah* principles (JAKIM, 2015). Nevertheless, it is argued that there is no proper guidelines on *Shari'ah* governance issued for *Ar-Rahnu* providers (Shah & Sharif, 2017). The study posited that there is inconsistency in the implementation of the *Shari'ah* Governance Framework guidelines issued by the regulatory body level to the *Ar-Rahnu* institutions (Shah & Sharif, 2017). This is because some of the service providers are established under different regulators, as mentioned earlier. Therefore, it is suggested that in order to standardize the implementation of a *Shari'ah* Governance Framework among the *Ar-Rahnu* providers in Malaysia, it is primarily related to the appointment of an internal *Shari'ah* committee for the *Ar-Rahnu* institutions. This research concluded that if an *Ar-Rahnu* service provider is not under the supervision of BNM, the implementation of the *Shari'ah* Governance Framework may be questionable and lack enforcement, and also ineffective (Shah & Sharif, 2017).

Unlike conventional pawn-broking institution, *Ar-rahnu* has charged the fees based on Islamic contract which are free from the element of *riba*, *gharar* (uncertainty) and *maysir* (gambling). Previously, the practice was based on a combination of several contracts, including *Qardhul hassan*, *Wadhiah Yad Dhamanah*, and *Ujrah* as a single product (Hadiyan et al., 2020). However, this product has been criticized by the Shariah scholars due to issue of *hiyal* (legal trick) in permitting the prohibition of *riba* (Ahmad Faizal et al., 2017).

As a respond to this issue, the SAC of BNM in its meeting on 25 June 2019 and 31 July 2019 viewed that the current practice of *Ar-rahnu* product which based on the above combination is prohibited from *Shar'iah* point of view (BNM, 2019). Nevertheless, the new regulation issued by SAC of BNM is only applicable to the Islamic banking, Islamic Development Financial Institutions and Takaful, not for the Islamic NBF. This is could trigger *Shari'ah* issues on the status of al-Rahnu among the Islamic NBF. Consequently, to what extend that the Islamic NBF has taken initiative to comply with this ruling? Moreover, despite *Ar-Rahnu* has been existed in Malaysia for than 20 years but there is no specific guideline or act that govern the overall Islamic pawn-broking. Hence, the research is viewed that *Ar-rahnu* institutions particularly Islamic NBF should review and restructure their product in line with the updated version SAC of BNM's ruling.

Shari'ah Governance in Government-Linked Investment Companies (GLICs)

In Malaysia, GLICs are the government's investment arms in allocating some or all of their funds to publicly listed companies on Bursa Malaysia, which are known as Government-Linked Companies. In general, there are seven prominent GLICs: these are the *Employee Provident Fund* (EPF), *Khazanah Nasional Berhad*, *Kumpulan Wang Amanah Pencen*, *Lembaga Tabung Angkatan Tentera*, *Lembaga Tabung Haji* (TH), *Menteri Kewangan Diperbadankan*, and *Permodalan Nasional Berhad* (PNB) (R. A. Rahman, et al, 2019). It is identified that among the GLICs involved with Islamic finance practices are the PNB, EPF, and TH. The research begins with *Shari'ah* governance of PNB, EPF, and lastly a discussion on TH.

In the recent PNB Annual Report (2019), there is slight information on the *Shari'ah* governance implemented in PNB, where the *Shari'ah* Department is reporting directly to the President & the Group Chief Executive. Nevertheless, there is no further specific illustrations on the *Shari'ah* control function. Apart from that, there are seven members of the *Shari'ah* Committee appointed by PNB. The PNB's SAC also has declared that the products being managed by the institution comply with the *Maqasid Shari'ah* and *Siyasah Shar'iyyah* principles. The study conducted by Wan Amir & Rusni Hassan (2020), revealed that there is no *Shari'ah* control functions such as the *Shari'ah* Review, *Shari'ah* Audit, and *Shari'ah* Risk, except for *Shari'ah* research in PNB.

Nurshuhaida et al. (2013), have conducted a study on *Shari'ah* compliant investments in EPF and pointed out that there is an urgency to establish a proper *Shari'ah* governance framework in EPF. This is due to the fact that the EPF investment is mixed, comprising both non-*Shari'ah* and *Shari'ah* compliant investment instrument. The study suggested that EPF needs to create a dual investment portfolio, whereby the funds collected by the EPF is to be separated into two different pools of fund, namely a conventional fund and an Islamic fund (Nurshuhaida et al., 2013). Hence, EPF should incorporate a proper *Shari'ah* governance process to monitor the *Shari'ah* compliance status of the Islamic fund portfolio.

Since the previous study was conducted in 2013, a *Simpanan Berasaskan Syariah* (savings based on *Shari'ah* principles) has been introduced in August 2016, with an initial RM100 billion funds allocated to the Islamic portfolio. Accordingly, in 2017, EPF has established a sound and robust *Shari'ah* governance structure as per diagram below (EPF, 2017).

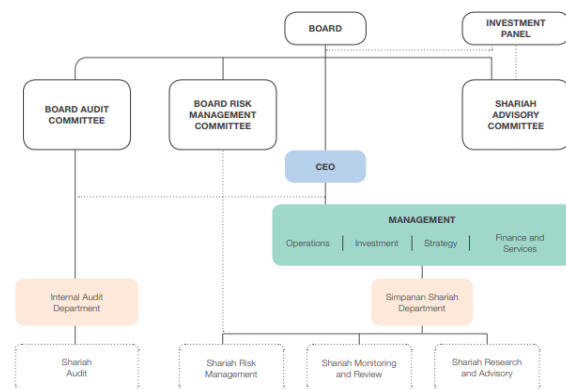


Figure 3: *Shari'ah* Governance Structure of EPF

It is noted that the *Shari'ah* Committee of EPF consists of five qualified *Shari'ah* members (EPF, 2017). The *Shari'ah* committee is the authority for the ascertainment of *Shari'ah* matters and to advise the Board and the Investment Panel in ensuring that the management of *Simpanan Shari'ah* complies with *Shari'ah* principles. The *Shari'ah* committee's ruling shall be binding under section 23D(2) of the EPF Act 1991 (EPF, 2018).

TH is one of the pioneering Islamic financial institutions in the world, and the first IFI established in Malaysia. TH's main services are to provide savings and investment services that comply with *Shari'ah* principles (Suhaini Abdul Majid et al., 2016). Any activities that violate the *Shari'ah* principles may deviate from its objectives to provide *Shari'ah* compliant financial services for Muslims in Malaysia.

The development of the *Shari'ah* governance aspect in TH involved several phases. In the early phase, TH sought advice from the National *Fatwa* Committee of Malaysia or forwarded *Shari'ah* issues to the *Shari'ah* committee of Bank Islam (subsidiary of TH). The study also emphasized that to safeguard TH as an Islamic financial institution, the investments in TH are not involved with the banking industry (except for Bank Islam) and insurance company (except for Takaful Malaysia Berhad) (Joni Tamkin & Zarrina, 2005). For the second phase, according to Usman (2016), TH has established the Investment Advisory Committee (subset board committee) to ensure the success of its investment activities. Interestingly enough, the initiative was taken by TH as a control mechanism in ensuring *Shari'ah* compliance. The appointed investment panel members must have a *Shari'ah* background and professional expertise in finance and economy in Malaysia. In the recent phase, TH finally successfully established its own *Shari'ah* Committee in 2010, starting with three members (Annual Report TH, 2010). Further to that, the research by Suhaini Abdul Majid et al. (2016), revealed that TH had established a *Shari'ah* division in 2014, which is accountable for ensuring all policies, procedures, and necessary processes comply with *Shari'ah* principles.

RESULT AND DISCUSSION

Any organization that claims to uphold the principles of *Shari'ah* in their business and operation activities must establish a sound and robust *Shari'ah* governance framework, regardless of whether it is a banking institution or non-banking financial institution (Azmir & Shahrul, 2020). This is due to the fact that Islamic NBFIs are also exposed to the additional type of risk which is known as the *Shari'ah* non-compliance risk. Hence, it is crucial to implement good *Shari'ah* governance practices in ensuring end to end *Shari'ah* compliance.

Since Islamic NBFIs are not subjected to compliance with the SGF of BNM, and there is no standard that has been issued to this sector, it is vital to examine the current practices of *Shari'ah* governance in the Islamic NBFIs. The matrix table below indicated the *Shari'ah* governance implementation in the respective Islamic NBF institutions: -

Table 1: *Shari'ah* Governance Framework Islamic NBF1

	FM	Cooperative	Ar-Rahnu	PNB	EPF	TH
<i>Shari'ah</i> Committee	√	√	X	√	√	√

<i>Shari'ah</i> Research	X	√	X	√	√	√
<i>Shari'ah</i> Review	X	X	X	X	√	√
<i>Shari'ah</i> Audit	X	X	X	X	√	X
<i>Shari'ah</i> Risk Management	X	X	X	X	√	X

Source: Researcher's compilation

Based on the above matrix table, almost all the Islamic NBFIs have their own *Shari'ah* committee except for the *Ar-Rahnu* provider. Nevertheless, there are differences in terms of *Shari'ah* committee's composition numbers. While for the *Shari'ah* control functions, only PNB has all the *Shari'ah* control functions, and other institutions have no clear requirements for the internal arrangements. Thus, the finding of this study presented that there is inconsistency in terms of the *Shari'ah* governance process of Islamic NBFIs.

Understandably, the primary reason is due to differences in regulators, guidelines and Acts that govern each Islamic NBF1. For the Islamic fund management, the regulator is the Security Commission, while Islamic Cooperative is governed by the *Suruhanjaya Koperasi Malaysia*. It is noted also that except for the *Ar-Rahnu* service that is operated by the Islamic cooperative and subsidiary of the Islamic bank, there is no specific *Shari'ah* governance except for rulings by the National *Fatwa* Committee. GLICs have been created by the government to serve specific mandate and purpose. In general, they must comply with the respective act, hence the *Shari'ah* governance is done in-house, and at the best effort basis. To ease understanding, the table below summarizes the requirement of each institutions:-

Table 2: Legislation and Guideline

No	Institution	Regulator	Act and Guideline
1	Islamic Fund Management	Security Commission	<ul style="list-style-type: none"> Capital Market Service Act (CMSA) 2007 <i>Shari'ah</i> Advisor Guideline Islamic Fund Management Guideline
2	Islamic Cooperative	<ul style="list-style-type: none"> <i>Suruhanjaya Koperasi Malaysia</i> 	<ul style="list-style-type: none"> Cooperative Societies Act 1993 <i>Shari'ah</i> governance framework (SKM)
3	<i>Ar-Rahnu</i> (corporation)	<ul style="list-style-type: none"> No Regulator 	<ul style="list-style-type: none"> No specific guideline issue except National <i>Fatwa</i> Committee
4	PNB	<ul style="list-style-type: none"> Minister of Finance 	<ul style="list-style-type: none"> <i>Minister of Finance (Incorporation) Act 1957</i>
5	EPF	<ul style="list-style-type: none"> Minister of Finance 	<ul style="list-style-type: none"> EPF Act 1991
6	Tabung Haji	<ul style="list-style-type: none"> Prime Minister's Department (religious affairs) 	<ul style="list-style-type: none"> TH Act 1995

Source: Researcher's compilation

CONCLUSION

In summary, the Islamic NBF1 is different from the Islamic banking institution in terms of its business objectives and the Islamic NBF1 also plays an important role to complement the gap left by the Islamic banking sector. Nevertheless, both institutions are part of the Islamic Financial Services, where it is expected that all of them must ensure that the business activities and operations are following the *Shari'ah* principles. Hence, *Shari'ah* governance is a vital organ in the Islamic NBFIs, that promotes transparency, fairness, and justice to all

the contracted parties, which would ultimately enhance the confidence of the public, investors, and all the stakeholders.

Despite the fact that it is not compulsory for most of the Islamic NBFIs to follow the SGF of BNM, the current implementation of *Shari'ah* governance is adequate because most of them have their own *Shari'ah* committee, and at least there is an effort by the Islamic NBFIs to appoint an internal *Shari'ah* compliance officer to assist the *Shari'ah* committee in managing *Shari'ah* compliance issues. The composition of *Shari'ah* committee members in an Islamic NBFIs depends on the size and complexity of the product. For example, the Islamic fund products are straightforward issues because the status of *Shari'ah* compliance stocks relies on the *Shari'ah* Advisory Council of the Security Commission. Apart from that, the product and services offered by the Islamic cooperatives are also not involved with complex products such as derivatives, structured products, and trade finance products, as normally, the Islamic cooperatives are only offering personal financing. As such, generally, Islamic NBFIs do not require a large composition of *Shari'ah* committee as compared to the Islamic bank. Moreover, without highly being regulated by the BNM, it gives an advantage to the Islamic NBFIs by having more flexibility on how to establish a comprehensive governance depending on their needs, size and complexity of products and services.

On the other hand, even though the current implementation of the SGF among the Islamic NBFIs appear to be well-adequate, the respective regulators such as the SKM and the MOF should shift their attention to the *Shari'ah* governance aspects by issuing comprehensive *Shari'ah* governance guidelines, policy and more enforcement on the *Shari'ah* governance implementation. Such *Shari'ah* governance should be more consistent with the latest practices of the Islamic banking industry. Pursuant to the rapid development of the Islamic banking industry, consistency is important. Otherwise, the Islamic NBFIs would be left behind where *Shari'ah* governance is concerned.

Earlier finding highlighted that the establishment of the *Shari'ah* control function is still in the infancy stage. Nevertheless, check and balance for the institution is essential to ensure the *Shari'ah* resolution issued by the respective *Shari'ah* committee is being adopted by the senior management. Hence, it is suggested that all Islamic NBFIs should make it compulsory to have the *Shari'ah* Audit function as a third line of defense. Apart from that, to ensure consistency among the Islamic NBFIs, the study also suggested that the Islamic NBFIs should establish an association among its members to promote coordination, strengthen the governance, exchange views from the *Shari'ah* committee and so forth. Using this platform, from the Human Capital perspective, in order to produce a pool of *Shari'ah* officer talents, more collaborations could be initiated between the industry and universities.

While this study is limited due to the lack of empirical analysis, it could be considered among the preliminary studies on the *Shari'ah* governance framework for Islamic NBFIs. Hence, for further studies, it is recommended to carry out empirical studies regarding the gap analysis between the *Shari'ah* Governance Framework of BNM and the respective Islamic NBFIs.

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