

# THE HEARTBEAT OF ISLAMIC BANKS

**About The Author**

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MUATH MUBARAK highlights why Shariah is the heartbeat of an Islamic financial institution and Shariah supervision should not be taken lightly.

Shariah has been translated as 'Islamic law' but in fact Shariah comprises not only Islamic law, it also includes the moralities, ethics and guidelines for a complete way of human life. In the field of Islamic banking and finance, Shariah plays a vital role.

Enhancing stakeholder value is the ultimate purpose for any business including Islamic financial institutions (IFIs). Their financial stability and growth are two strategic factors considered by their shareholders and their confidence level is dependent on these main components.

Likewise for an IFI, Shariah compliance is the key and stakeholders are very vigilant about this. IFIs offer Islamic finance services which are expected to be offered within the purview of Shariah irrespective of the region and size of the organization.

Shariah plays a vital role in this young and niche market to be the best alternative financial sector with interest-free economic policies for the nation's development.

In order to ensure the Shariah compliance of the institutions, a Shariah supervisory board (SSB) comprises Shariah scholars who are experts in advising the management and stakeholders.

The SSB's main function is to ensure the Shariah compliance of the bank including the products and day-to-day operations. Internationally, the AAOIFI and the Islamic Financial Services Board (IFSB) have issued a number of guidelines and standards.

The requirements for all Islamic banks and financial institutions to carry out business in line with the Shariah rules and guidelines are clearly stated by these regulatory standard setting bodies, which have gained global acceptance by different nations.

On a periodic basis, the SSB examines the overall operations and activities of IFIs which will result in the publication of an independent opinion regarding the Shariah compliance of its activities. This exercise is called the Shariah Compliance Audit (SCA). The main objective of the SCA is to ensure that the activities of IFIs do not contravene Shariah principles. In short, it is a set of activities which are carried out to evaluate the organization's system, processes, projects, transactions and other procedures, and ensure they adhere to Islamic laws and regulatory requirements of the respective jurisdiction's law.

This audit can even be carried out based on client requirements for administration, management and client base. The SCA is drawn up according to the financial reporting disclosure standard requirements. Further, it states whether the IFI's financial statements and other related reports are revealing accurate information for the interested parties and stakeholders.

The above diagram shows the role of the SSB towards the IFIs. The SSB can be a centralized as one for the whole nation or else can be individually formed by different Islamic banks. As per the advice of global standard setting bodies, there should be a minimum of three to five Shariah scholars in a SSB.

The modern world's more complex transactions and modern financial products must undergo a Shariah screening system or rather a purifying system before the SSB can endorse any relevant product.

Shariah supervision may be thought of as the single most important distinction between a conventional and a truly Islamic financial venture. The Shariah compliance framework may include the following important tasks:

- Ensure the business transactions are fully Shariah compliant.
- Maintain a system of compliance having special emphasis on Shariah in the light of existing jurisdictional laws, rules, regulations, policies and procedures related to Islamic banks.
- Uphold the highest transparency and maintain justice.
- Provide all necessary documents to Shariah compliance officials in performance of their functions to ensure Shariah compliance.
- Hold Shariah audits periodically and ensure all the products and services are adhering to Islamic laws.
- Provide adequate advice in corporate governance and decision making.
- The SSB is responsible for educating the interested parties about the Islamic rules and regulation in all activities.

As Shariah supervision is an integral part of the industry, it requires the rating of each entity in order to identify the Shariah compliance rating for them which will attract investors and increase general public confidence. In order to meet the requirements of Shariah rating, the International Islamic

Ratings Agency (IIRA) was established in July 2005 in Bahrain.

The main objective of the IIRA is to facilitate the development of regional and national financial markets and to improve their functioning as well as improve the quality of rating agencies.

The IIRA is like other credit rating agencies but only the difference is it looks at the Shariah.

The IIRA offers Shariah quality ratings for the assessment of the level of compliance with principles of Shariah and provides rating for all types of issuers and issues.

Shariah is the heartbeat for an IFI and therefore Shariah supervision is not a matter to be taken lightly. The investors and general public confidence, in any sector, are always important considerations. So every organization must make sure that their institution's heartbeat is functioning properly to stay alive in the spirit of Shariah, which is the core goal for any IFI.

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#### THE ROLE AND RESPONSIBILITIES OF THE SSB

