



## SHARIAH GOVERNANCE FRAMEWORK OF ISLAMIC BANKS IN BANGLADESH: PRACTICES, PROBLEMS AND RECOMMENDATIONS



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### ABSTRACT

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Shariah Governance Framework (SGF) is a structural process by which Islamic banks monitor, control and conduct their activities. This study describes the overall scenery of SGF of Islamic banks in Bangladesh. The paper also reviews the current practices, problems, legal and regulatory issues by using a deductive procedure and provides some propositions for the enhancement of SGF. The main objective of this paper is to understand the SGF, its current practices, problems and challenges which will be helpful to develop a SGF for Islamic banks in future. The study reveals that the Shariah governance system in Bangladesh is mainly voluntary rather than regulatory and there is an absence of full-fledged SGF. It seems that the Board of Directors (BOD) uses the Shariah Supervisory Board (SSB) in accomplishing their objectives and responsible for overall Shariah activities rather than the SSB. In order to improve the SGF, Bangladesh government should enact a law for the operations of Islamic banks. Besides, Bangladesh Bank (BB) should come out with a comprehensive Centralized SGF by outlining the roles, powers, and functions of all stakeholders to ensure the accountability of their works and improve the quality of the Shariah compliance. Moreover, the central bank can set up a Central Shariah Supervisory Board (CSSB) in its head office or can recognize existing Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) along with power so that they can supervise and monitor overall activities of Islamic banks and solve the disputes among the stakeholders regarding the Shariah issues of Islamic banks.

**Contribution/ Originality:** This study is unique regarding the Shariah governance of Islamic banks in Bangladesh. The study contributes in the existing literature by illustrating the whole picture of the Shariah governance so that the academicians, and regulators can get the overall picture as well as the regulatory authorities can take initiatives to mitigate the problems and development of Shariah governance.

## 1. INTRODUCTION

Shariah governance system is an important issue for Islamic Financial Institutions (IFIs). This includes the Shariah corporate control process, efficient and useful governance (Sori *et al.*, 2015). The idea and structure of corporate governance are practiced in corporations such as conventional banking do not fully purpose the principles governed in Islamic financial institutions (IFIs) (Abu-Tapanjeh, 2009; Perry, 2011; Sulaiman *et al.*, 2015). As the enhancement and development of a nation is largely depend on the roles of financial arenas (Ahmad and Malik, 2009; Hosen *et al.*, 2018) whereas the Shariah<sup>1</sup> enhances Islamic banks to support social justice and Islamic values in carrying out their business (Dusuki, 2008; Abu-Tapanjeh, 2009; Saif and Muhammed, 2012). Therefore, a measure of a firm's ability that is not only traceable to the efficiency of the entity itself, but also related to its performance (Samuel *et al.*, 2019). In addition, any performance measure must accomplish numerous surroundings such as separate and measureable; communicable through the corporation and departments; central to achieving objects; and relevant to tactical business components (Jackson, 2017). The good and robust Shariah governance system practiced by IFIs that comport with Shariah guidelines helps to sustain Islamic financial institutions (Sori *et al.*, 2015). Poor Shariah governance systems as well as weak Shariah and Islamic financial law lead the IFIs in market failure and decline the full financial systems (Sori *et al.*, 2015; Hassan *et al.*, 2017).

The Shariah governance guidelines are the tools used to meet the unique needs of the Islamic banking sector. As a component of Shariah Governance Framework (SGF), in Bangladesh, the members of SSB are appointed and remunerated by the Islamic Bank, play only the role of advisory bodies. They do not have the necessary authority to accomplish the task and implement decisions and this can be explained by their dependence on the management. Also, it should be noted that the diversity of backgrounds and the different schools of jurisprudence of SSB members as well as the regional context creates inconsistency in the interpretation of Shariah and may thus prevent the harmonization of product and financial operations. In fact, the independence of the SSB in their mission of supervision and the consistency of Shariah ruling can contribute to an efficient Shariah governance structure. The regulation of Shariah governance in Islamic banks aims to preserve the credibility of the industry.

The objective of this paper is to summarize the current practice, and problems of SGF of the Islamic banks in Bangladesh which will be supportive to develop a SGF for the Islamic banking industry in Bangladesh. This paper highlights the Shariah governance history along with its uniqueness, current legal and regulatory bodies of Shariah governance, and provides some recommendations for the development of SGF of Islamic banks in the Bangladesh. Absence of proper SGF and weak monitoring system allow the Islamic banks to develop their own strategy and governance framework. Therefore, it is very general to have diversity in the SGF and the distinct position of SSB. As a result, this diversity creates several questions i.e. How does the SSB work with Shariah department, management and other respected parties of the organization to implement the Shariah rules and regulations in organizational management systems and banking activities within a proper guideline and a sound governance framework?. How does SSB monitor their activities and solve the Shariah disputes among the various parties? Why there is no position of SSB in the organizational framework of the Islamic banks?; about the current practices SGF. So, it's important to develop a comprehensive CSGF to apply the Shariah rules, monitor the banking activities, solve the Shariah issues, increase the Shariah compliance quality, public confidence, develop new Shariah-based products, minimize the Shariah compliance risk and to provide a better customer services regarding the Shariah issues on banking business activities.

The rest of the paper has described as follows. Section 2 illustrates the SGF and its mechanism; section 3 explains the background of Shariah governance system of Bangladesh along with its uniqueness. Section 4 outlines the monitoring bodies of Shariah governance while the section 5 narrates the current practices of Shariah

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<sup>1</sup>The term "Shariah" used in Islamic banking to refer the banking activities that are conducting in compliance with the principles of Islamic Shariah.

governance and section 6 describes the problems of Shariah governance practices. Section 7 provides some recommendations and final section concludes the paper.

## 2. SHARIAH GOVERNANCE

Shariah governance is a unique system of governance, which concerned that the activities of Islamic banks are conducting by the principles of Shariah. IFSB standard 3 (2006) defines corporate governance of IFIs as "...a set relationship between a company's management, its BOD, its shareholders and other stakeholders which provides the structure through which the objectives of the company are set; and the means of attaining those objectives and monitoring performance are determined." [Ginena and Hamid \(2015\)](#) defined Shariah governance as a complete system that conducts how the operations and transactions of IFIs are following the guidelines of Shariah. Due to the absence of the particular Shariah governance system, Shariah governance structure has introduced by containing the elements of conventional corporate governance with the mixture of Shariah principles. SGF of Islamic financial institutions is peculiarly exclusive, unique and opposite of conventional corporate governance system ([Dusuki, 2011](#)). The main purpose of Shariah governance is to enhance the implementation of Shariah principles by all Islamic banks. The execution of sound Shariah guidelines assures that all transactions and business activities comply with Shariah principles and protect the interest of all internal and external parties, customers, depositors and all other parties related with banks. Consequently, it is vital to have a Shariah guideline in a standard and sound form, where all banks can follow and implement that guideline and supervised by the SSB, BOD and regulatory body. The SSB should appoint by respected banks and their roles and responsibilities are supervising and monitoring the business activities in ex-ante and post ante basis. These should be done by the Shariah scholars who have adequate knowledge, practical experience including *usul al-fiqh* and *fiqh al-muamalat* ([Abdullah and Rahman, 2017](#)).

In the absence of a comprehensive SGF, Shariah violation may be instituted that may drive to economical and non-economical danger. Implementation of Islamic principles in Islamic banks creates a great importance on robust corporate governance structure and values, transparency, disclosure and solid implementation of Shariah principles. The SGF use as a guideline towards various stakeholders on implementing the Shariah compliance in all over the activities of IFIs. The principles aim of the SGF is to improve the Shariah compliance quality, Shariah governance process, accountability and independency of stakeholders, and decision-making ([Bank Negara Malaysia, 2010](#)). It hopes that the application SGF will play an important role in developing a more sound and robust SGF to promote the quality of Shariah compliance within the activities of Islamic banks. A proper SGF model will add extra value such as accountability, transparency, disclosure and independency to Shariah implementations. A sound SGF model will increase the quality of Shariah implementation by making a proper linkage and combination with management, BOD, SSB, Shariah department, and other wings related with organization. The level of Shariah compliance will improve by creating the transparency and accountability within the organization.

It is required for Islamic banks to have a strong Shariah governance to the development of Islamic banking industry and subsequently the government execute legal settings for the formation of SSB ([Hasan, 2008](#)). In the Islamic financial management system, Shariah governance is especially individual and unique<sup>2</sup> ([Hasan, 2014](#)). Another basic difference of IFIs is the compliance of Shariah principles in all over the banking activities. In every aspect of activities, IFIs have to follow the Shariah rules and regulations.

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<sup>2</sup> In Islam, interest, garar, gambling, and uncertainty are strictly prohibited where in the conventional system it is established and well known. Implementations of Shariah principles in IFIs make it different from conventional financial institutions ([Chowdhury, N. and F. Shaker, 2015. Shariah governance framework of the islamic banks in Malaysia. International Journal of Management Sciences and Business Research, 4\(10\): 115-124.](#)

### 2.1. Internal Shariah Governance Mechanisms

Shariah governance is the composition of numerous internal parties namely BOD, SSB, management, internal Shariah department's officers of Islamic banks. Moreover, the Islamic banks need to set up an additional set of organizational arrangements in the organizations such as a SSB, an internal or external Shariah review and an internal Shariah compliance unit to meet the religious obligation of Shariah compliance in all aspects of their business transactions and operations. The institutional arrangement of SSB in the Shariah governance mechanism differentiate the Shariah governance from the conventional corporate governance. It is the responsibility of the numerous parties of Islamic banks to ensure the Shariah compliance within the organization. For example, BOD is liable to implement the recommendations of SSB and take care of the management to assure the business activities of the organizations according to Shariah principles and fulfil the demand of all stakeholders (Islamic Financial Services Board, 2006; AAOIFI, 2010; BNM, 2010;2013). Moreover, management should provide the Shariah compliance report of all activities of Islamic banks to BOD (IFSB, 2006; BNM, 2010;2013).

SSB is one of the most important body for Islamic banks. The BOD appoints the SSB and monitored by the rules and regulations. SSB is responsible for Shariah related issues within the organizations, gives their opinion regarding Shariah issues, and provides a compliance report on the overall activities (Zaidi, 2008). The effective management system of the organizations would improve the confidence and trustworthiness level of various stakeholders related to the Islamic banking industry (Chapra and Ahmed, 2002; Greuning and Iqbal, 2008). Shariah officers and their roles are very important in Islamic Shariah governance systems. They assist the SSB in performing their duties. SSB gives their opinion on the ex-post Shariah compliance activities based on the Shariah officer's report (Islamic Financial Services Board, 2009; BNM, 2010). The Shariah officers being the same requirements like as SSB in that they should have a qualification of Shariah background (IFSB, 2009; BNM, 2010). In this regard, Hossain (2012) suggested that SSB should emphasize on Shariah advisory role whereas the obligation is Shariah compliance review and to provide a Shariah compliance report towards the external Shariah auditor in order to improve the quality of Shariah compliance assurance. After the Shariah audit, results should submit to the SSB at least once in a year. Several studies have argued that an efficient Shariah audit framework in Islamic financial institutions will promote the coordination of Shariah practice and minimize the Shariah non-compliance risk (Rahman, 2008; Shahwan *et al.*, 2010; Uddin *et al.*, 2013).

Shariah governance is the heart of Islamic finance as it provides complete guidelines to assure the Shariah principles in undertaking the business. Ignoring the Shariah governance one cannot guarantee that a true and successful Islamic financial system and markets are in place. A comprehensive Shariah governance system is based on four pillars such as management and supervision, Shariah advisory board, Shariah compliance and review, and finally transparency and disclosure (Minhas, 2012). The general approach to Shariah governance system mentions that both ex-ante and ex-post processes are essential parts of good governance practices. The relevant ex-ante processes include issuance of Shariah resolutions and compliance checks before the product offered to the customers (Nuhtay and Salman, 2013).

An internal audit unit assists SSB to review the Shariah compliance aspects in Islamic banks. The Shariah review addresses the Shariah compliance matters of products offered and this process needs a sound Shariah internal control system. The Shariah review process requires an internal auditor to review every stage of the Shariah governance process and this includes the conception of a product, product design, product documentation, product testing, product implementation and product review. In the event of disputes or conflict of opinion between management and Shariah auditors, the individual SSBs can solve the matters. Similar to the normal review process, the Shariah review report should be presented to the SSB, the audit committee, the BOD and the shareholders of the IFIs (Hasan, 2011).

### 3. HISTORICAL DEVELOPMENT OF SHARIAH GOVERNANCE IN BANGLADESH

Bangladesh is one of the Muslim majority countries in the world. The majority (above 80%) of the people of this country are mostly dedicated to the Islamic way of life as directed in the Qur'an and Hadith. Therefore, naturally, a deep spirit remains in the heart of these people to lead their lives in the fashion suggested by Islam (Abdullah, 2008). Muslim majority and belief of people towards to Islam motivated to the growth of Islamic financial sector in Bangladesh. Bangladesh is the first country in Southeast Asia where Islamic banking has been introduced with the establishment of Islami Bank Bangladesh Limited on March 30, 1983 (Hassan *et al.*, 2017; Noman *et al.*, 2017). Currently, Bangladesh has eight private Islamic banks with 998 branches out of total 9453 branches of the banking industry. In addition, 21 Islamic banking branches of 9 conventional commercial banks including 3 international banks and 25 Islamic banking windows of 7 conventional commercial banks, 2 Islamic non-bank financial institutions and 8 Islamic insurance companies with around 39 conventional banks (BB, 2016). Along with the global rapid growth<sup>3</sup>, as per BB, report, total investments in Islamic banking sector stood at Tk. 158849.69 crores at the end of July-September 2016 quarter, which went up by Tk. 2225.75 crores or by 1.42% and by Tk. 23788.06 crores or by 17.61% compared to previous quarter and same quarter of the preceding year respectively.

Bangladesh does not have separate acts and laws and regulatory bodies for controlling, guiding and supervising Islamic banks. That is why respective Islamic bank has developed their own Shariah governance from its beginning and run by separate bodies. In banking Company Act, 1991 Bangladesh government has made some amendments for Islamic banks and the central bank did not set up any separate department for controlling, guiding and supervising the Islamic banks. In 2009, Bangladesh bank, country's central bank introduced a Shariah governance guideline for Islamic banks including the establishment criteria of Islamic banks, converting conditions of changing to the Islamic banks from conventional, products, deposit and Islamic investment approaches, roles and responsibilities of SSB, Shariah compliance responsibility and quality and appointment criteria of *Muraqib*s. On the other hand, the BOD of Islamic banks and subsidiaries, conventional commercial banks having Islamic branches or windows should form with directors having required knowledge and expertise with Shariah jurisprudence. In the guidelines, a major issue is that the optimization of SSB for an Islamic bank that opposes the global practice Islamic finance (BMB Islamic, 2011). In its guidelines, central bank stated that it would be the accountability of the BOD of that particular bank to ascertain the overall activities comply with Shariah. The board may constitute an independent SSB with experienced and knowledgeable persons in Islamic Jurisprudence and board shall be accountable for any lapses or irregularities on the part of the Shariah Supervisory Committee (Bangladesh Bank, 2009). Due to the lack of the CSSB at the central bank, Islamic banks have formed their own SSB and discuss with themselves or Shariah advisers to approve new products. Different thought of schools sometimes makes confusion amongst the SSB and occasionally, one SSB accepts the identical financial products or instruments and another board rejects that products.

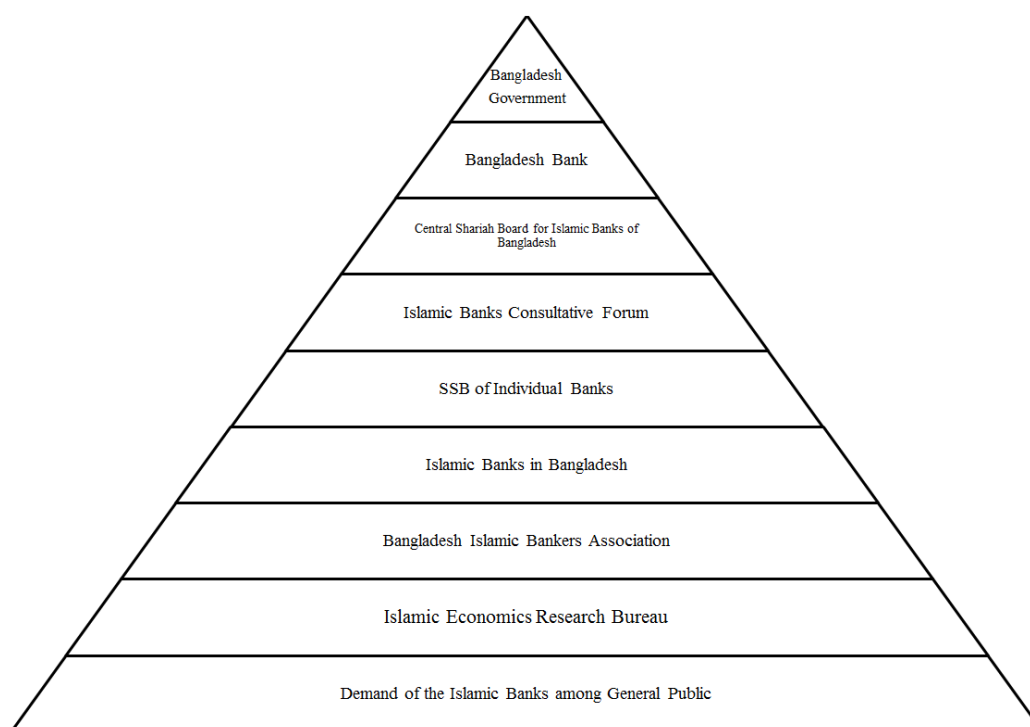
#### 3.1. Uniqueness of Shariah Governance of Islamic banks in Bangladesh

SGF of each country is unique due to the cultural, social and political situation as well as from the legal and regulatory perspective. Comparing with the other countries like Malaysia, Pakistan, Sudan, Bahrain, Indonesia and Saudi Arabia, SGF of Bangladesh looks to be unique structure. In most of the countries, Islamic financial industry and the Shariah governance structures have developed and executed by the respective government. But in Bangladesh, Islamic banks and financial industry, its Shariah governance mechanisms are developed and improved by general people's initiatives (Hassan *et al.*, 2017).

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<sup>3</sup> By the end of 2015, the total asset of the Islamic financial industry expected to reach \$2 trillion. Based on the statistics of GIFR 2018, in 2017, the estimated amount of the world Islamic finance sector was \$2.431 trillion with a rapid growth of 6.02 % which indicates that, it is one of the fastest rising industries.

However, the SSB monitors the banking activities and Shariah related issues of the Islamic banks and financial institutions but in respect to the BB guideline, they are not responsible for the Shariah compliance and Shariah related issues. BB in its guideline has provided the power and accountability towards the BOD to assure the Shariah compliance of the Islamic banks operational activities. To standardize the Shariah issues and to assist themselves the BOD and Chief Executive Officers molded Islamic Banks Consultative Forum (IBCF), Bangladesh Islamic Bankers Association (BIBA) and Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) in privately. At present, the CSBIB provides an advisory service and monitors the activities of SSB as a private organization. Shariah rules and guidelines provided by CSBIB are not obligatory for Islamic banks but they did not violet the resolutions of CSBIB because of their reputational risk (Uddin, 2014). As an authority, BB justifies the SSB reports yearly.



**Figure-1.** Unique Shariah governance mechanism of Bangladesh

Source: Hassan *et al.* (2017) modified.

Central bank as a regulatory authority should provide the Shariah governance from itself to follow the Shariah guidelines. Along with the guidelines of BB, it suggests the Islamic banks to follow the AAOIFI standards but they are not bound to obey the rules of AAOIFI or IFSB in maintaining the Shariah governance. Hence, the self-developed Shariah governance mechanisms of Islamic banks appear much flexible in its practice (Hassan *et al.*, 2017). Yet, Islamic banks presumed to desire to transfer the responsibility of themselves to the BOD and take the advantage of Islamic banking guidelines of the central bank (Hassan *et al.*, 2017). Besides this, they observed that in performing the business and to attain the ultimate level of the targeted profit in the image of Islamic banking, the BOD appears to use the SSB as a showcase.

#### 4. MONITORING BODIES OF SHARIAH GOVERNANCE FOR ISLAMIC BANKS

Political support is a key driving tool for the development of Islamic finance in any country. For the enhancement of Islamic finance, a supportive and well regulatory and supervisory framework is an imperative part. Islamic banks have to follow the country's banking legal and regulatory Acts besides the Shariah rules and regulations. In Bangladesh, Islamic banks follow more laws and regulations than the commercial banks because; they are following traditional rules and regulations of banks, Shariah principles, and international Islamic standards

like AAOIFI and IFSB (Hossain, 2012); (Ullah, 2013). Banking companies in Bangladesh also comply with other acts like the Banking Companies Acts (1991) later amended in 2003, 2013 and 2018, the Companies Act (1994), and International Financial Reporting Standard (IFRS).

**Table-1. Current Shariah governance monitoring bodies in Bangladesh**

Monitoring bodies of Shariah governance for banking companies
<ul style="list-style-type: none"> <li>▪ Ministry of Finance and Bangladesh Bank</li> <li>▪ Islamic Banks Consultative Forum</li> <li>▪ Central Shariah Board for Islamic Banks of Bangladesh</li> <li>▪ Shariah Supervisory Board of the Individual Bank</li> </ul>

Source: Hassan *et al.* (2017).

#### 4.1. Ministry of Finance and Bangladesh Bank

The ministry of finance governs BB and the finance and capital market of Bangladesh. As a guardian and regulator of the banking industry, BB roles and responsibilities are very low in implementing the Shariah rules and regulations as it only justifies the SSB reports of Islamic banks (Habib *et al.*, 2013; Alangir, 2016). The BOD will be responsible for any noncompliance activities of Shariah principles in the banking activities. However, to monitor and control the Islamic banks, the central bank does not have a separate department that is why it reviews the Islamic banks with the inspection of traditional banks guidelines (Hassan *et al.* (2017). To monitor the supervisory activities of SSB of Islamic banks, BB has formed a competency group to develop the checklist of Shariah compliance.

#### 4.2. Islamic Banks Consultative Forum

Islamic Banks Consultative Forum (IBCF) established on 11th October 1995 by Islamic banks and banking branch of conventional banks to provide services towards the development of Islamic banking industry. Its organizational structure consists with Chairman, CEO or Managing Directors of Islamic banking service providers and one member from the central bank. The IBCF can be considered to be effective in following the general goals of Islamic bankers, developing the policies in attaining the goals, handling the problems and issues for the development of the industry. IBCF already accomplished most of the goals and that is why the member, member banks and whole banking industry has been attaining the results from this forum. CSBIB, Bangladesh Government Islamic Investment Bond, Islamic Insurance Companies, modernizing new Islamic financial products and group investment are the successful achievements of the IBCF. IBCF has launched 'IBCF Research Training Academy' in 2016 for the development of talent management process, human capital and leaders.

#### 4.3. Central Shariah Board for Islamic Banks of Bangladesh

Central Shariah Board for Islamic Banks of Bangladesh established in 2002 for developing and assuring the uniform Shariah ruling for Islamic banking sector of Bangladesh. The aim of the CSBIB is to supervise and assist Islamic banks and banking branches or windows to implement the Shariah rules and regulations in all over the Islamic banking business activities. Beside these, CSBIB provides and supports the government, BB, others regulatory body and all members bank in obeying the Shariah objectives in Islamic banking activities. For the development of the quality of *Fiqh* Members and *Muraqibs* of the member banks, CSBIB arranges training programs and general view exchange to focus on the significance of Islamic banking and finance.

#### 4.4. Shariah Supervisory Board of the Individual Bank

In accordance with BB guidelines, Islamic banks have their own SSB for supporting the BOD in performing their jobs to assure the Shariah compliance of Islamic banks. BOD is responsible to appoint the qualified SSB members based on BB requirements. Due to the scarcity of Shariah scholars, few of them are dominating most of

the Islamic banks and insurance companies' SSB chairperson and membership though, some of them do not have recognized educational background in Islamic Shariah (Malik *et al.*, 2011). Moreover, few SSB members selected from the BOD or management.

## 5. CURRENT PRACTICES OF SHARIAH GOVERNANCE

Islamic banks are more self-regulative rather than the central bank guideline. As a result, it is the responsibilities of the banks, BOD, and SSB to ensure the proper implementation of Shariah principles within the organizations. In the subject of Shariah supervising, controlling, guiding and monitoring, the roles of the central bank is very weak and it only justifies the Shariah report of respective institutions provided by SSB (Habib *et al.*, 2013). In spite of these limitations, the self-regulated practices of Shariah principles make Islamic banks more successful in their business activities. In contrast, the absence of a comprehensive SGF and guideline creates some problems in the current practices of Islamic banks. these are undeveloped accounting principles and procedures, lack of harmonization of Islamic financial practices, corrupted mode of financing (Sarker, 2012; Ahmad *et al.*, 2014) inappropriate organization of the Shariah councils, weak follow-up of the Shariah implementation status of the Islamic banks (Ahmad *et al.*, 2014; Perves, 2015) and inappropriate presentations of SSB report which generates confusion among the stakeholders regarding the information (Ahmed and Khatun, 2013). The absence of such a supportive framework obstructs Islamic banking in its effective and smooth functioning in line with the principles of Shariah (Ahmad *et al.*, 2014). Together with BB guideline, Islamic Banks follow the AAOIFI guidelines in monitoring their banking activities. In Bangladesh, every Islamic banks have a separate SSB in their apex line, which consists of Shariah scholars. Some institutions called it SSB; some others called it Shariah Supervisory Committee, Shariah Committee, and Shariah Board. Within eight full-fledged Islamic banks, four Islamic banks have the position of SSB in their organizational structure. Like Islamic banks, Islamic banking branches and windows of conventional banks have also the SSB with prominent scholars. The SSB has formed with a chairperson, vice-chairman member secretary, and few ordinary members. If any Islamic bank wants to develop a new product, first they brings it to the SSB meeting for the opinion of themselves where it is Shariah-compliant or not.

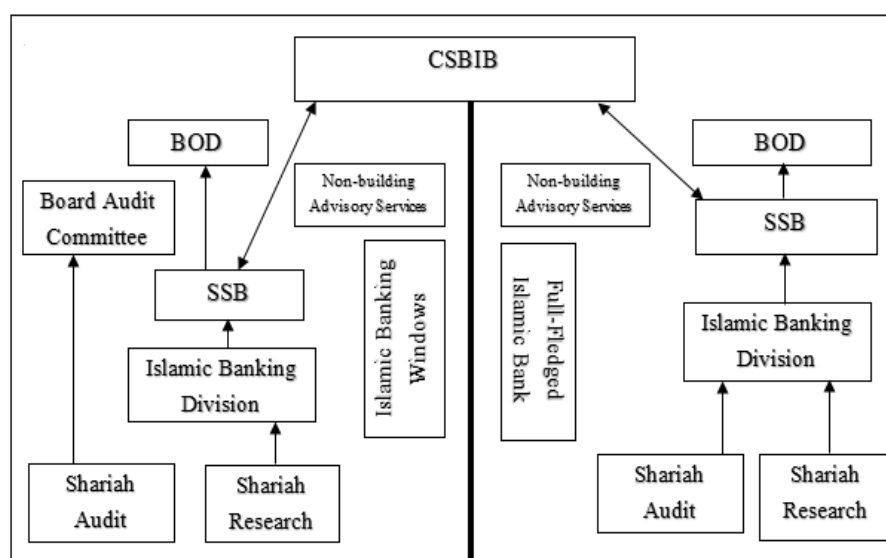


Figure-2. Shariah governance Structure of Islamic Banks in Bangladesh

Source: Abdullah and Rahman (2017). Modified

According to BB guideline, the conventional banks, which have Islamic banking branches or windows, must have Islamic banking division in their respective head offices and in case of foreign bank it should be in the Country office (in Bangladesh). These Islamic banking divisions are required to coordinate their Islamic banking activities



with the central bank to ensure proper compliance with various rules and regulations. All of the institutions having Islamic banking branch or windows have the separate SSB in monitoring the Shariah standards. For supporting the SSB, every Islamic bank have a separate Shariah department or Shariah secretariat who helps them in preparing, preserving and presenting the documents. However, some Islamic banks name it a Shariah Inspection and Compliance Division. Within this, four banks (those have the SSB position in the organizational framework) only one bank have a direct connection with the Shariah department or Shariah secretariat. As a result, the current practices are unable to ensure accountability, independency and supervise the Shariah functions properly.

The SSB monitors the banking activities related with Shariah, Shariah audit review and Shariah compliance review and gives their opinions on the banking activities which is published in their annual report and submit to the BB (Abdullah and Rahman, 2017). The individual SSB of the Islamic banks also evaluates the performance of the officials in terms of their Shariah compliance and conducts Shariah inspection to ensure that the Shariah principles are being implemented (Alamgir, 2016). Generally, SSB performs the audit of the banking activities in once or twice in a year. However, along with the full-fledged Islamic banks, Islamic banking branches and windows of commercial banks also have separate Shariah audit unit with few officers. The officers of this section known as muraqib and most of the cases, they conduct the Shariah audit. The Shariah auditors of full-fledged Islamic banks are responsible report to the SSB by Shariah secretariat or Shariah compliance unit (Abdullah and Rahman, 2017). In the case of Islamic banking windows, Shariah auditors are required to report to SSB and the Board Audit Committee. They also disclose the Shariah audit report in their annual report separately with the conventional report. To assure the Shariah compliance, Islamic banks conduct internal Shariah review on during and post-operation activities which are mainly related to the SSB supervision, monitoring and controlling (Rahman, 2014). The Audit committee of Islamic banks also liable for Shariah compliance matters besides the rules and regulations of the central bank (Alamgir, 2016). Additionally, some Shariah officers' communicate with the SSB for their guidelines and opinions. There are a few Islamic banks where Shariah research is conducted by some of the Shariah department officers (Abdullah and Rahman, 2017).

## 6. PROBLEMS OF SHARIAH GOVERNANCE IN BANGLADESH

In conducting Islamic banking business there is an absence of corporate governance system and full-fledged legal framework in Bangladesh which obstructs the development of Islamic banking industry (Mamun, 2011; Ahmad *et al.*, 2014; Perves, 2015). For governing, monitoring, regulating and guiding the Islamic banking activities there is an absence of a well-defined full-fledged regulatory and supervisory specific and structured governance framework (Mamun, 2011; Perves, 2015). The supervision, regulation, and promotion of Islamic banks in accordance with the guidelines, rules, and regulations of the central bank look inadequate because of the conventional practices. These conventional regulatory and supervisory systems definitely able to control and monitor the Islamic banking operational activities with a view to minimize the possibility of their failure, enhance the people's confidence in the banking structure and make certain its stability. In contrast, the regulators and supervisors have to ensure the Shariah principles in the activities of Islamic banks. The absence of Shariah implementation and supervision may lead the Islamic banks into the systematic Shariah distress such as; lose the customer and government confidence, negative impact on the institutional image and financial Shariah non-compliance losses. Moreover, the absence of a comprehensive set of regulatory framework on Shariah governance constructs regulatory gaps and confusions to the conventional bankers (Sarker, 1999) the Muslim businessmen and industrialists (Ahmad *et al.*, 2014) governments (Abdullah and Rahman, 2017) with regard to the legal and Shariah compliance of Islamic banks. To enhance the quality of the Shariah compliance and develop the confidence of general people towards the Islamic banks, there is an importance of a sound and comprehensive SGF.

### 6.1. Regulatory Problems

Islamic banks are facing numerous problems in their operational activities as well as Shariah governance practices from various stakeholders. New banking regulations and lack of Shariah-compatible regulatory and supervisory standards are one of the hindrances of the development of Islamic banking. Earlier studies revealed that there is a lack of corporate governance and an absence of full-fledged legal framework in the Islamic banks (Ahmad *et al.*, 2014; Perves, 2015). Moreover, due to low efficiency, small bank size and lack of specific regulatory framework in Bangladesh Islamic banks are not capable of using their high capitalization for increasing profitability (Noman *et al.*, 2017).

Ahmad and Hassan (2007) based on empirical evidence outlined that, there is a lack of a well-defined regulatory and supervisory framework for Islamic banks for their effective functioning in line with the tenets of Shariah. They also suggested that Islamic banks in Bangladesh should have an independent banking act to control, guide, and supervise their functions and provide legal support to the parties concerned. It is evident that the main challenge for Shariah governance in Bangladesh is that there are no mandatory guidelines from BB requiring compliance with the resolutions of SSB whereas it is considered the most important part of Shariah governance system (Hasan, 2014). Moreover, there is no formal recognition of the CSBIB by BB. Therefore, Islamic banks are not formally obliged to follow resolutions issued by CSBIB. Furthermore, it is quite difficult to find qualified Shariah scholars to serve as members of SSB in accordance to the guideline of BB. Rahman (2014) outlined that Shariah scholars in Bangladesh have limited knowledge of Islamic finance and banking. The people those who know Arabic and English well enough, they are unable to conduct research in Islamic banking and finance. In contrast, those who have knowledge in Shariah, they have little knowledge in the area of Islamic banking and finance, or the practice of Islamic banking.

However, the government support is insufficient for the development of a strong Shariah governance system in parallel to conventional corporate governance system. Moreover, government rules and regulations are flexible for conventional banking but quite strict for Islamic banking. For example, in 1997, Prime Bank Limited secured a license to open five Islamic banking branches but until now, it has not received a license to open any more such branches; at the same time, it has received permission to open more than 100 conventional banking branches. Since 2005, the Arab Bangladesh Bank Limited has not received any license to open an Islamic banking branch. Similarly, more than 23 conventional banks did not get permission to open further Islamic banking branches after they started with a few. At present, six conventional banks are waiting for licenses from BB to convert into an Islamic bank. We can conclude that the regulator intends to confine Islamic banking.

### 6.2. Practical Problems

It is evident from the Annual Reports of the SSB of the Islamic banks that, in many cases, they were dissatisfied at the further delay in Shariah execution in the banking activities and both the owners and the management reluctance to obey the Shariah principles (Sarker, 2005; Ahmad *et al.*, 2014). Due to the competition in banking sector Islamic banks partially follow the Shariah rules which obstruct the system from having desired impact (Mamun, 2011). Besides, the nature of management's in obeying Shariah guidelines are not proactive and they have the intensities to follow partially (Ahmad *et al.*, 2014). Moreover, Perves (2015) highlighted that the SSB positioned is not well organized and low monitoring quality of Shariah assurance in Islamic banks. The Shariah ruling procedures are not unified in different cases and operational procedures are different in Islamic banking practices. In financial reporting, practices of accounting principles and procedures are not well-developed and there is a lack of harmonization within the Islamic banks.

### 6.3. Shariah Compliance

Another most important challenges faced by Islamic banks is full compliance with Shariah rules, regulations and principles in all their activities to make it more transparent and disciplined. Regarding impediments to Islamic

Shariah compliance, [Ahmad and Hassan \(2007\)](#) opined that the most important issue is the lack of a well-defined regulatory and supervisory framework for Islamic banks for their effective functioning in line with the tenets of Shariah, that is why its follow the same policy guidelines for Islamic and conventional banking by the BB. The failure of establishing Shariah compliance prompts to the reputational risk as well as instability of Islamic banks. Moreover, Islamic banks need to ensure their customers that all of their operational activities are performing by following the Shariah rules.

However, the SSB has some limitations in performing their activities. Besides, some banks have formed their SSB consisting both outsiders Shariah scholars and insiders management employee, but the employment of insiders is a complete deviation of the AAOIFI standards. Reports of the SSB have not presented in a uniform way, which makes misperception among the stakeholders concerning information. Therefore, the disclosure of the doubtful income shows the effectiveness of the Islamic banks, few reports of the SSB did not remark the income of doubtful amount at all. It has assumed that if the quality of Shariah compliance is higher the growth of Islamic banking will be better than the current growth. Moreover, the standardization and transparency should ensure by the SSB in the Shariah reports ([Ahmed and Khatun, 2013](#)). In addition, the low quality of the Shariah compliance and Shariah governance would demoralize the trustworthiness of Islamic banking activities and services ([Ahmed and Khatun, 2013](#)). [Sarker \(2005\)](#) highlighted that if the quality of Shariah compliance is more, there will be a greater possibility of Islamic banking growth.

#### 6.4. Shariah Audit

Shariah audit is one significant element of Islamic banks and differentiates from the conventional banks. None of the Islamic banks in Bangladesh are fully compliant with the AAOIFI Shariah governance system because no one of them has audit and governance committee at the board level. The average quality of Shariah compliance of full-fledged Islamic banks is medium and lower but it is higher than the Islamic banking branches and windows of conventional banks. The Shariah audit functions are conducted and inspected by the individual SSB of the particular bank. Moreover, there is a lack of sincerity among these banks to comply with Shariah and conduct proper Shariah audits ([Ullah, 2014](#)). It observed earlier that there are no separate sections for Shariah review and risk management in Islamic banks. However, the Shariah auditors or muraqibs partially perform both of these tasks but in practice, there is an absence of full-fledged Shariah Audit.

## 7. RECOMMENDATIONS

Considering the issues and challenges mentioned above, it recommends that the government of Bangladesh enact separate and comprehensive legislation for the operation and improvement of Islamic banking. This would strengthen the Shariah governance system among Islamic banks in Bangladesh and minimize the fraudulent behavior relating to their application of Shariah principles. Moreover, the central bank should also provide more specific guidelines on the Shariah governance system. There should be a separate section in BB to regulate, monitor and supervise the operations of Islamic banks. Furthermore, there is a need for a CSSB with the authority to monitor and oversee the SSB of all Islamic banks as well as their overall application of Shariah principles. The CSSB should promulgate resolutions regarding Shariah matters, which would be binding on all Islamic banks. On the other hand, BB can also recognize the CSBIB by giving them the authority or can set up a new CSSB to monitor and supervise all Islamic banks in Bangladesh. BB should make the resolutions issued by CSBIB mandatory for all Islamic banks.

To minimize the disputes in the current practices, BB can develop a CSGF so that, all the Islamic banks can follow the homogeneous rules and guidelines. Moreover, the centralized practices will reduce the Shariah conflicts, increase the public confidence as well as institutional acceptance and image. By applying the CSGF, the central bank can easily monitor the Islamic banks, protect the independency of the SSB, ensure the accountability of all parties

and maintain transparency in the overall business activities. To enhance the current practices of SGF, the BOD, SSB, management, and Islamic banks should more proactive in implementing the Shariah rules and regulations. A proper monitoring and supervising system may improve the quality of Shariah compliance. In this case, the independency of SSB is more important. The accountability of the various parties may increase the excellence of SGF. Moreover, the CSGF will improve the Shariah audit, Shariah risk management system, Shariah review system, and ensure the disclosure of all relevant information with the Shariah non-compliance unit. The SSB and Islamic banks should disclose the Shariah non-compliance amount in their annual report. The central bank can apply an external Shariah audit and review system to enrich the confidence of customers, depositors, bankers, and general people and safeguard the high accuracy of the SG system by giving the authority to the CSSB or a private authorized body in time to time.

Besides, all Islamic banks should establish their own Shariah research and development division, which would assist SSB to identify issues with Islamic banking products. Moreover, it might help the development of innovative Shariah-compliant financial products. To reach desired levels of efficiency, Islamic banks should find more standardized financial instruments and innovations in accordance with the Shariah principles, which will enable them to deal with other interest-based conventional banks. Islamic banks should allocate sufficient funds to these divisions to conduct rigorous research. BB can play a strong role by issuing an order towards the Islamic banks to set up a research and development division within the organization. Islamic banks advise to invest more in nursing qualified Shariah scholars. Talent development programs might develop to this end. Under such programs, banks may employ some Shariah graduates for a certain period, within which banks would rotate participants through different departments of the bank to familiarize them with the different operations and functions of an Islamic bank. A generation of qualified Shariah scholars may create through such programs. Furthermore, all Islamic banks, as well as BB, should organize seminars and workshops to improve the banking knowledge of Shariah scholars and employees. Islamic banking institutions could offer short-term certificate courses for Shariah advisors. They should pay more attention in Research and development to formulate the proper guidelines and policies to encourage investments under *Mudaraba* and *Musharakah* modes. Furthermore, to strength the employees level of knowledge, Islamic banks can also introduce cutting-edge leadership training programs combining with Shariah, finance, and economics as well as on emerging country economic and financial issues in their training institutes. They may also consider the current cross-border experiences of Islamic banking to enrich their knowledge and experiences.

In monitoring the Islamic banking activities researchers emphasized on the development of a proper and sound Shariah governance systems for IFIs (Sarker, 1998; Ahmed and Khatun, 2013; Perves, 2015). This is because of the absence of Shariah compliance products. Further, Noman *et al.* (2017) suggest that the central bank needs to come out with specific regulatory policy framework in order to improve investment opportunity and managerial capability and high capitalization for different maturity periods. As, the fundamental principle of Islamic banks is to ensure equity and distributive justice in the economic life of the mass people, they should achieve balanced growth and equitable development through diversified investment operations. However, the government does not support Islamic banks as like Malaysia, where the government directly patronizes Islamic banking. In Bangladesh, Islamic banking is moving forward due to public support, despite the government's lack of responsiveness. Moreover, the government should patronize the development of Islamic banking operations. The government should provide equal guidelines for the Islamic banks as like the conventional banks, so that, the Islamic banks can smoothly perform its activities. Besides this, the Islamic banks requisite to prove that they are sincere in complying the Shariah rules and regulations in their activities in order to attain the public and government trust.

## 8. CONCLUSION

Shariah governance is the prerequisite for implementing Shariah principles in Islamic banking and finance. For effective Shariah governance, well-developed governance mechanisms including specific rules, regulations, laws,

acts, regulatory bodies and overall control of a central body are obvious. Bangladesh does not have any recognized Shariah governance mechanisms. It seems that the central bank is tolerating Islamic banks rather than promoting though it had a tremendous role in opening the door for Islamic banking. However, the Islamic banks can enlarge their Shariah secretariat department by establishing additional sections such as Shariah review, Shariah risk management, and Shariah research and development to enhance banking activities. For effective implementation of Shariah principles, institutional SSB should play an active role. Moreover, BB should provide uniform instructions for the structure, tenure, size, powers, responsibilities, accountabilities and ensure the independence of the SSB. The Central bank also needs to provide a structure of SSB report that may include activities they performed, number of meetings held, number of branches inspected, areas of Shariah violations, actions taken to ensure Shariah compliance in those areas, sources of prohibited incomes, use of these incomes, and payment of zakat. Muslim-majority Bangladesh is a very fertile land for nourishing Islam, Islamic values, Shariah compliance, and Shariah governance. If sufficient measurements will take in time to time, Bangladesh can be a role model for the Shariah governance practices in the world.

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