

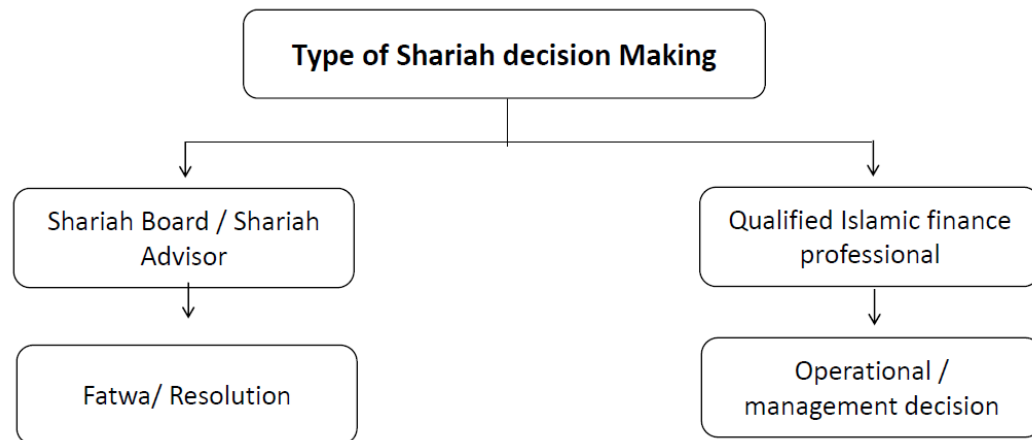
Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

**14th AAOIFI – World Bank Annual Conference on Islamic Banking and Finance:
“The Revolution in the Global Islamic Finance Ecosystem: The Need for Governance, Standardization and Regulatory Support”, Kingdom of Bahrain. 3-4 November 2019, Kingdom of Bahrain**

***SHARI’AH* DECISION MAKING PROCESS**

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Dimensions of *Shari'ah* decision making in Islamic finance




- *Shari'ah* decision making is a process/ an exercise undertaken by the Qualified Islamic finance scholars or professionals in order to provide a *Shari'ah* position that could be in a form of *Shari'ah* Ruling on operations matter or management decision to resolve a *Shari'ah* compliant matter and to provide a solution for existing or future issues faced by the IFI within the *Shari'ah* rules, values and principles.

The *Shari'ah* decision making of *Shari'ah* board and senior management in the IFI

The difference between *Shari'ah* decision making of *Shari'ah* board and senior management in the IFI;

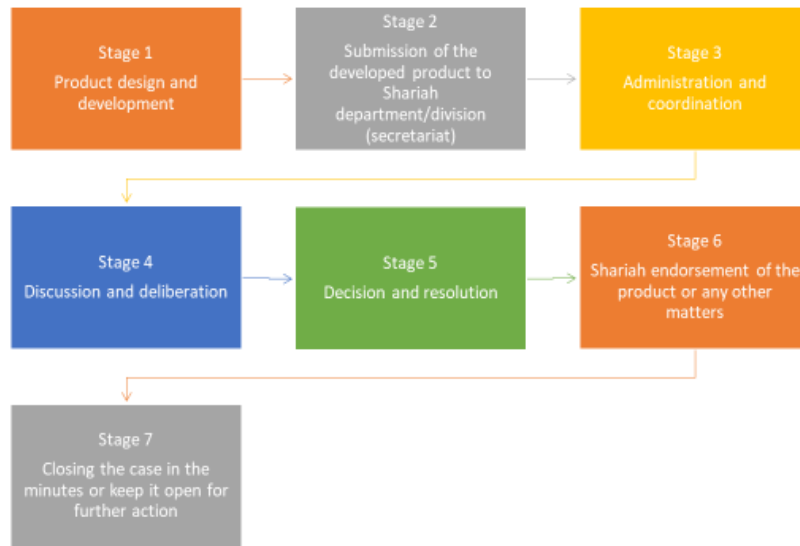
- The *Shari'ah* board will form a fatwa or *Shari'ah* ruling related to *Shari'ah* matters,
- The decision of the senior management would be in a form of resolution of decision that is operational and management in nature but has *Shari'ah* implications.
- Both decision have *Shari'ah* implications by end result
- *Shari'ah* board decision covers on *Shari'ah* matter
- Decision of senior management encompasses the operations and management matters.

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- The key point here is that the management and board should not discount the importance of *Shari'ah* in their resolution, it should be integrated in their thinking and decision-making process.

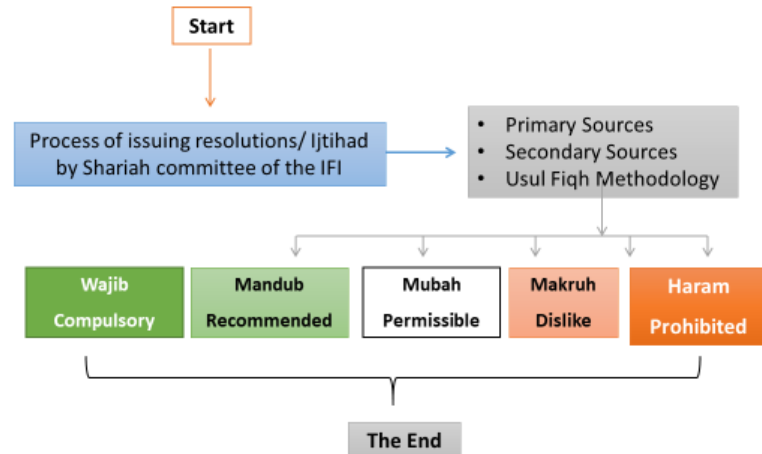
The structured methodology & process of obtaining *Shari'ah* ruling/ resolutions in Islamic finance matters

- The *Shari'ah* board of the Islamic Financial Institutions in issuing resolutions or *Shari'ah* rules related to Islamic finance matters follow a sound structured and process to ensure consistency and robustness of the decision making; the methodology employed is briefly described as follows:

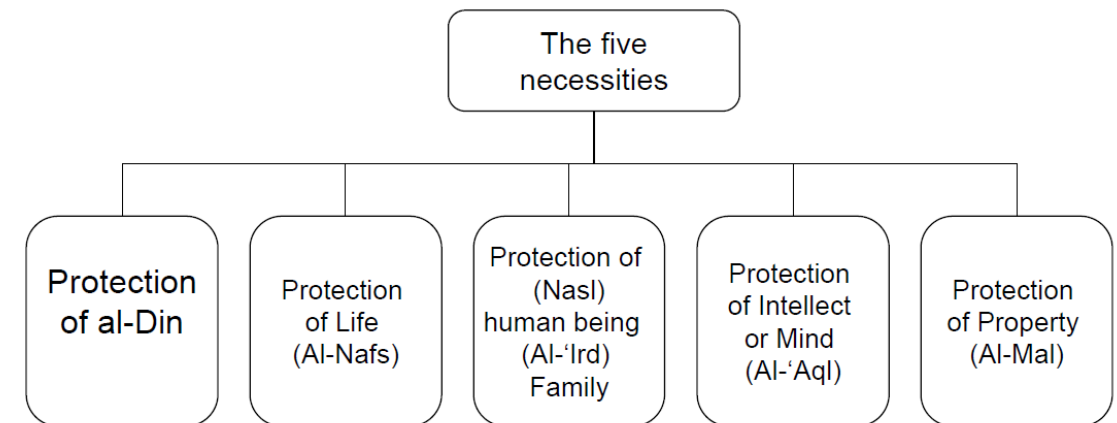
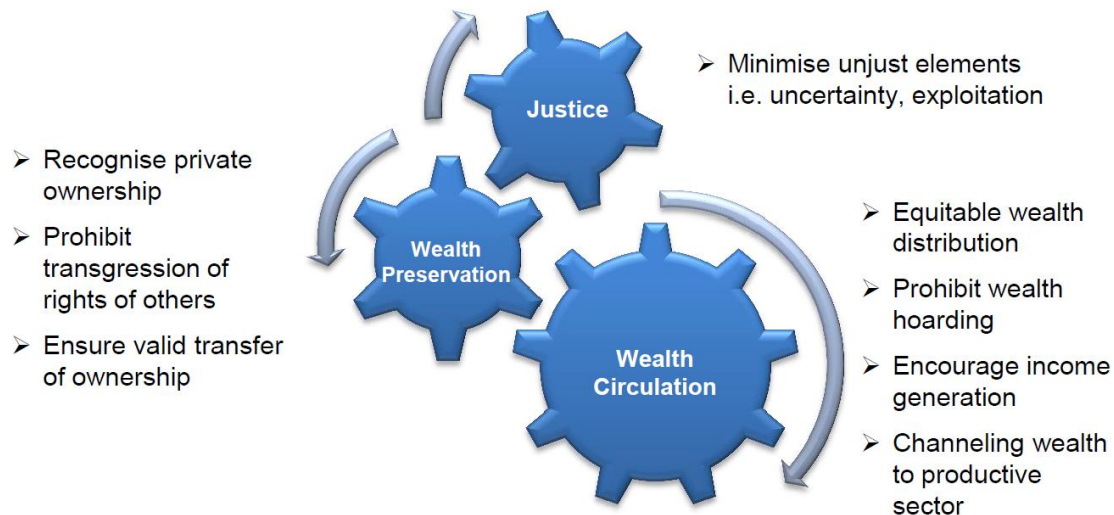
GUIDELINE FOR DECISION-MAKING PROCESS FOR SHARIAH COMMITTEE



The process of issuing resolutions



Shari'ah decision making and Consideration for Maqasid al Shari'ah in economics and finance



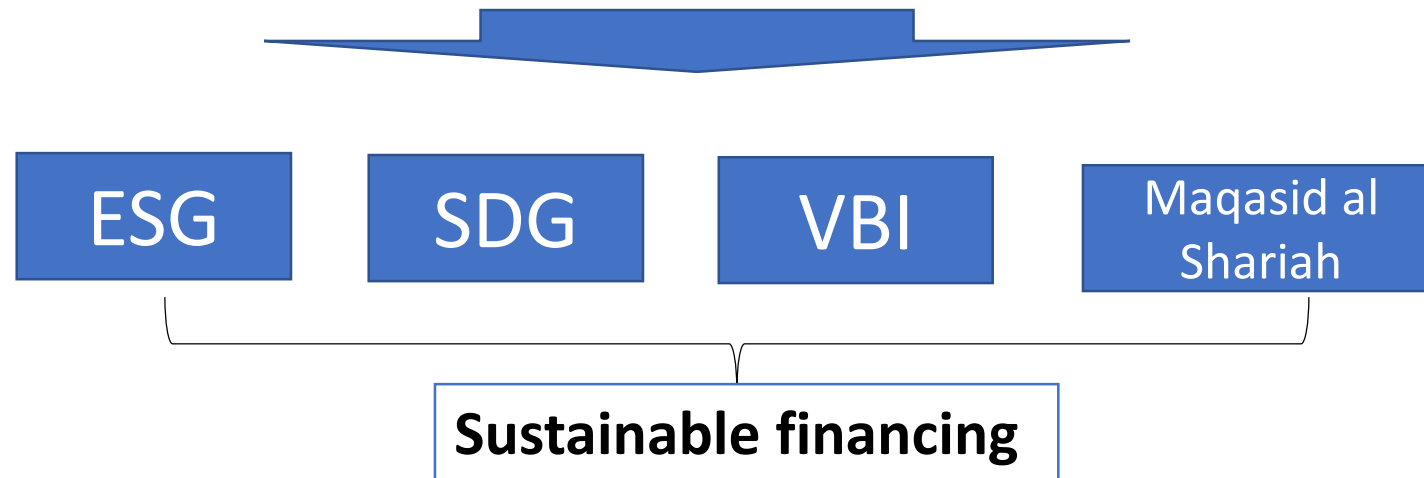
The *Shari'ah* decision making should reflect Maqasid al *Shari'ah*, where the outcome of the decision must be in accordance with the objective of *Shari'ah*.

***Shari'ah* decision making and Consideration for Sustainability**

Sustainability is one of the most significant trends in the current financial markets:

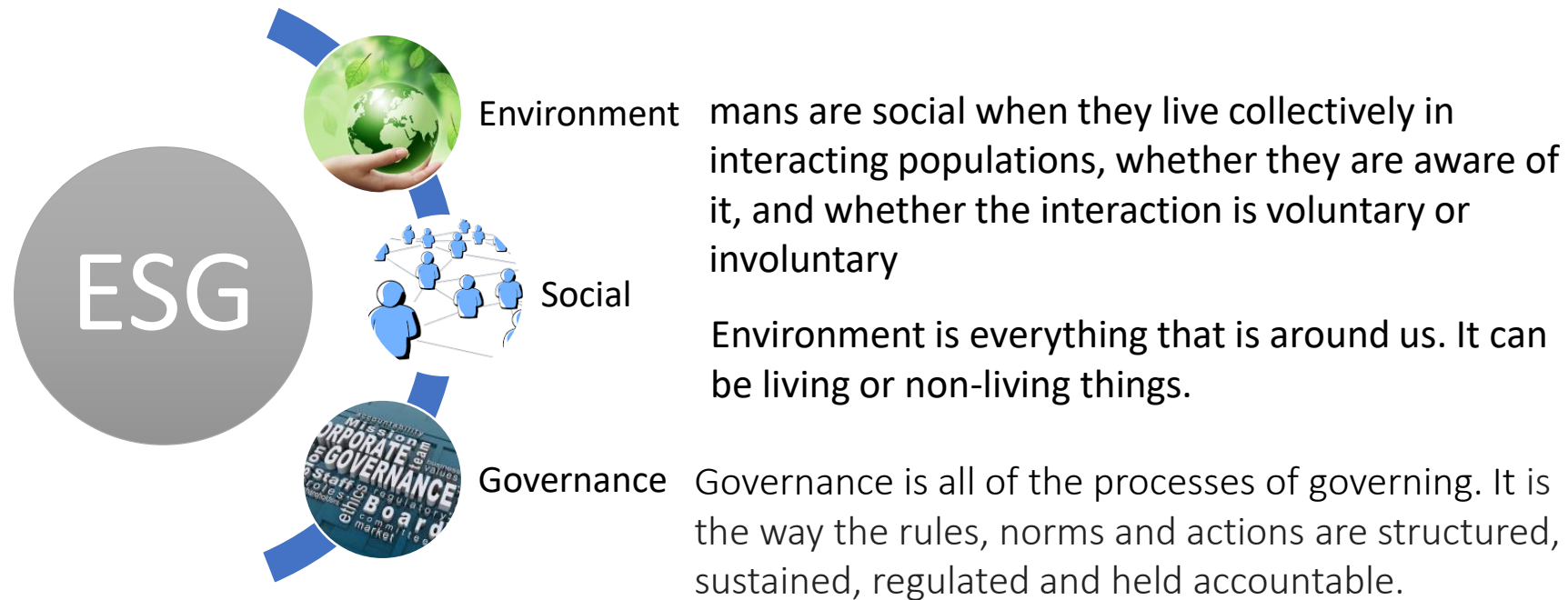
1. Whether in the form of investors' desire for sustainable responsible investing (SRI),
2. or corporate management's focus on corporate social responsibility (CSR),

The content, focusing on sustainability and ESG (environmental, social and governance) issues, is the same.



Sustainable finance

Sustainable finance refers to any form of financial service integrating environmental, social and governance (ESG) criteria into the business or investment decisions for the lasting benefit of both clients and society at large.



E**S****G****ENVIRONMENTAL ("E")****SOCIAL ("S")****GOVERNANCE ("G")**

Biodiversity/land use

Community relations

Accountability

Carbon emissions

Controversial business

Anti-takeover measures

Climate change risks

Customer relations/product

Board structure/size

Energy usage

Diversity issues

Bribery and corruption

Raw material sourcing

Employee relations

CEO duality

Regulatory/legal risks

Health and safety

Executive compensation schemes

Supply chain management

Human capital management

Ownership structure

Waste and recycling

Human rights

Shareholder rights

Water management

Responsible marketing and R&D

Transparency

Weather events

Union relationships

Voting procedures



S D G

SUSTAINABLE DEVELOPMENT GOALS

1 NO POVERTY 	2 ZERO HUNGER 	3 GOOD HEALTH AND WELL-BEING 	4 QUALITY EDUCATION 	5 GENDER EQUALITY 	6 CLEAN WATER AND SANITATION 
7 AFFORDABLE AND CLEAN ENERGY 	8 DECENT WORK AND ECONOMIC GROWTH 	9 INDUSTRY, INNOVATION AND INFRASTRUCTURE 	10 REDUCED INEQUALITIES 	11 SUSTAINABLE CITIES AND COMMUNITIES 	12 RESPONSIBLE CONSUMPTION AND PRODUCTION 
13 CLIMATE ACTION 	14 LIFE BELOW WATER 	15 LIFE ON LAND 	16 PEACE, JUSTICE AND STRONG INSTITUTIONS 	17 PARTNERSHIPS FOR THE GOALS 	



Consideration of the criteria of green technology and sustainable development in offering products and services

Value Based Intermediation

An intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct and offerings that generate positive and sustainable impact to the economy, community and environment, without compromising the financial returns to shareholders

The benefit



Financial Industry

*Greater innovation,
enhanced efficiency
and effective
ecosystem*



Customer/Community

*Improved standard of
living, fair and
transparent treatment*



Government

*Realignment of
business focus with
national agenda*



Regulator

*Strengthened
financial stability*

Criteria of sustainability for financing decision making

1	2	3	4	5	6	7
CSR Policies, Procedures, Departments	Financial Inclusion, Micro and SME Finance	Non Profit Financing	Philanthropic and Social Programmes	Impact of the Environmental and Social Activities	Assessing, Screening of Environmental and Social Risks	Staff Competency and Customer Relations
✓	✓	✓	✓	✓	✓	✓

The above process is after

- Compliance with *Shari'ah* requirements
- Compliance with Legal requirement
- Compliance with other requirements where applicable (depending on each country)

Criteria of sustainability in investment decision making

Suggesting Green category for Shariah compliance investment

SC Methodology for Shariah compliance stock screening

Green Shariah compliance category stock

ESG

SDG

VBI

Maqasid al Shariah

Examples

1	2	3	4	5	6	7
CSR Policies, Procedures, Departments	Financial Inclusion, Micro and SME Finance	Non Profit Financing	Philanthropic and Social Programmes	Impact of the Environmental and Social Activities	Assessing, Screening of Environmental and Social Risks	Other Elements of ESG, SDG & VBI
✓	✓	✓	✓	✓	✓	✓

Sustainable financing

Independence and conflict of interest issue

Conflict of interest could represent an issue if it is not well addressed in the context of *Shari'ah* decision making process, among the vital aspects that should be considered in the conflict of interest is as follows:

- Disclosure requirement of potential conflict of interest such as having relationship or interest in the subject matter of the decision.
- It could be the person who is making decision is a *Shari'ah* advisor of that particular company, he or she could be one of the shareholders of the company, he or she could have relatives working in the subject company.

Risks Mitigation in *Shari'ah* decision making

- *Shari'ah* non-compliance risk or otherwise, is part of the possible risks that could be associated with the *Shari'ah* decision making.
- *Shari'ah* non-compliance risk may have a significant impact and implication on the profitability of the IFI and its branding, image as well as reputation.
- Hence, *Shari'ah* non-compliance risk must be mitigated in *Shari'ah* decision making.

The role of good governance practices in avoiding hidden traps

- Governance aspect is a very important in *Shari'ah* decision making, it determine the appropriate process that should be followed, to determine the accountability, responsibility and scope of agreed upon duties to discharge the obligations.
- It should be clearly incorporated in the SOP and corporate governance framework of IFI.
- Proper illustration on the line of reporting
- Proper illustration on the delegation of power

The importance of critical *Shari'ah* analysis

- *Shari'ah* analysis is part and parcel of *Shari'ah* decision making
- An appropriate *Shari'ah* analysis must take place to ensure very effective and efficient decision and resolutions.
- Brief descriptions of the different dimensions of the *Shari'ah* analysis are as follows:

Cont.

A. Fundamental Aspects of *Shari'ah* analysis in *Shari'ah* decision making

- Understanding the composition of Islamic finance industry
- *Understanding Shari'ah* principles and values in Islamic economics and finance
- Connecting the dots between the *Shari'ah* contracts and the enhanced *Shari'ah* contracts
- Appreciate the enhanced of *Shari'ah* concepts and terms in Islamic finance

B. Framework of *Shari'ah* analysis in *Shari'ah* decision making

- Product descriptions and features
- Legal and Regulatory requirements
- *Shari'ah* compatibility

D. Parties involved in *Shari'ah* decision making at approval stage

- Owner of the product
- *Shari'ah* department
- Legal department
- Risk management
- *Shari'ah* board
- Risk management

C. Practical and technical knowledge in *Shari'ah* analysis in *Shari'ah* decision making. Understand:

- The nature of Islamic finance business model
- Islamic finance versus conventional finance
- Prohibited elements and activities in Islamic financial system
- Business ethics, values, principles and norms of Islamic Finance
- The different Islamic finance portfolios
- Understanding the scope of the proposed product and its niche market
- Selection and mapping of the *Shari'ah* contracts
- Differentiate exchange contracts and voluntary contracts
- Ensure the compliance of the *Shari'ah* contracts
- Careful design of the combination of contracts
- Observation of the sequence of the execution of contracts

THANK YOU

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