

An Overview of Corporate Governance Practices of Selected Islamic Banks

Zainab Belal*

IIUM Institute of Islamic Banking and Finance (IiBF) Kuala Lumpur, Malaysia
Email: zainabelal24@gmail.com

Mustapha Hamat*

IIUM Institute of Islamic Banking and Finance (IiBF) Kuala Lumpur, Malaysia
Email: mustapha.hamat@gmail.com

Abstract

Complying with Corporate Governance (CG) standards is not mandatory but with collapse of many financial institutions, compliance with high standards of CG in banking operation has become a necessity. This is due to the fact that many banks and companies worldwide collapsed as a result of poor corporate governance practices such as Bank of Credit and Commerce International (BCCI) 1991, Barings Bank 1995, Lehman Brothers 2008, Enron 2001, WorldCom 2001, etc. Therefore, the objective of this paper is to examine and ascertain whether present level of CG standards practiced by Islamic banks is adequate to prevent or safeguard the banks from collapsing. The approach of the study is to evaluate the effectiveness of board and the various board committees utilizing data published in financial statement of the selected banks. The methodology used in this paper is analytical descriptive to reach accurate results and as more appropriate approach with this research. The study finds out that the selected banks comply with CG standards adopted; however such compliance does not mean that the board, the board committees will be constantly reliable. Therefore, instilling the Islamic values such as the concepts of *ihsân*, honesty, and accountability is paramount to prevent CG failures and protect/safeguard the banks from collapsing.

Keywords: Corporate Governance, Islamic Banks, Board, Committees, *Ihsân*

* International Islamic University Malaysia, P.O. Box 10, 50728 Kuala Lumpur, Phone: (+603) 6196 4000, Fax: (+603) 6196 4053, Email: webmaster@iium.edu.my

Abstrak

Sistem Tata Kelola Perusahaan (Corporate Governance) sebenarnya tidak wajib diterapkan, akan tetapi seiring dengan runtuhnya perusahaan-perusahaan besar sebagai lembaga keuangan menjadikan Corporate Governance dengan standar yang tinggi sebagai suatu kebetuhan yang patut dipenuhi. Hal ini berdasarkan fakta bahwa banyaknya bank dan perusahaan yang runtuh di seluruh dunia sebagai akibat dari praktik tata kelola perusahaan yang buruk, seperti Bank Kredit dan Perdagangan Internasional (BCCI) 1991, Barings Bank 1995, Lehman Brothers 2008, Enron 2001, WorldCom 2001, dan lain-lain. Oleh karena itu, tujuan dari makalah ini adalah untuk menguji dan memastikan apakah standar Corporate Governance yang dipraktikkan oleh bank syariah cukup untuk mencegah atau melindungi bank dari keruntuhan. Pendekatan penelitian ini adalah untuk mengevaluasi efektivitas dewan dan berbagai komite dewan dengan memanfaatkan data yang dipublikasikan dalam laporan keuangan bank yang dipilih. Metodologi yang digunakan dalam penulisan ini adalah deskriptif analitis untuk mencapai hasil yang akurat dan pendekatan yang lebih tepat. Studi ini menemukan bahwa bank-bank yang dipilih sesuai dengan standar CG telah diadopsi. Namun kepatuhan tersebut tidak berarti bahwa dewan atau komite dewan akan terus menerus dapat diandalkan. Oleh karena itu, menanamkan nilai-nilai Islam seperti konsep *ihsân*, kejujuran, dan akuntabilitas sangat penting untuk mencegah kegagalan Corporate Governance dan melindungi dan menjaga bank dari kebangkrutan.

Kata Kunci: Corporate Governance, Bank Islam, Dewan, Komite, Ihsân

Introduction

During the last few decades, the Corporate Governance (CG) has gained a vast interest by the public especially after the subprime crisis and the collapse of many popular companies and banks worldwide, more specifically, when the cause of these scandals and financial crisis were attributed to poor corporate governance practices. To prove this; CG has gained a huge importance in USA due to the occurrence of Allied Crude Vegetable Oil Refining Corp 1963 and Watergate 1970s. The US regulatory and legal bodies were able to specify the control failures that led number of corporations to make illegal contributions and thus bribe the government officials. As a result, US came up with new acts such as

Foreign and Corrupt Practices Act of 1977, followed by Securities and Exchange Commission's proposals for mandatory reporting on internal financial controls 1979. Nevertheless, in 1985 US could not prevent high profile businesses from failure. In the same period US confronted the collapse of many institutions such as WorldCom 2001, Enron 2001, Adelphia Communications 2002, Arthur Andersen 2002, and the collapse of Savings and Loan.¹

In UK, the situation might be a slightly better than US. The attention to CG practices was driven by the collapse of Bank of Credit and Commerce International (BCCI) 1991 and Barings 1995. The former bank was engaged in various fraudulent, unethical, and illegal activities such as money laundering and other financial crimes. Likewise, the later also was collapse due to poor speculative investments undertaken by its employee. Overall, the mentioned examples of business failures are all attributed to the improper structure and objectives of the top management. Accordingly, such failures affected the interests of all share/stakeholders and the entire economic growth.

The term corporate governance has been existed since 1970s in United States. However the major attention to the term "Corporate Governance" was brought in 1997 after the Asian financial crisis and collapse of some listed corporations due to fraud and corruptions. Then, the term CG caught the attention of the world during the global financial crisis 2008. Fraudlement, tax evasion, lack of transparency, and disclosure led to the increasing importance to talk about CG in companies and financial institutions. Therefore, CG deems to be very significant supervisory tool that can be used not only to detect these manipulations but also to avoid them and protect the rights of all share/stakeholders.

Furthermore, CG is an important tool to ensure stability of the corporations, in this paper the author takes banking sector as area of study. In banking industry, banks must have corporate governance since banks play a crucial role in the development of the economy as whole. Since banks take deposit from the depositors, savers, households, government, etc, it is very paramount for these banks to be well governed to assure the financial stability and the overall development of the economy.

¹ "List of Corporate Collapses and Scandas", https://en.wikipedia.org/wiki/List_of_corporate_collapses_and_scandals, Retrieved October 03, 2015.

Literature Review

There are some literatures which discussed the rational of CG from divine perspective. For instance, the study of Ali, 1977 provides that, human being, beside flesh and bones, is created with other forces: forces of intellect, force of instincts, forces of sentiment/desire and the forces of emotions. Only the force of *al-'aql* is consistency leads human being to the good behaviour. Whereas the other four forces are consistently lead humankind to commit undesirable behaviours such as, aggressiveness, envies, greed, etc.² From the looks of these forces it is extremely challenging for human beings to observe and follow what have been directed by the forces of *al-'aql*. Allah SWT created mankind with this basic characteristic as a part of mankind's life in this materialistic world, and to ensure that mankind will not go astray (violate the divine principles) He sends down the prophets and messenger which always come together with revelation of books such as al-Enjeel (Gospel), al-Zaboor (Psalms), al-Torat (Jewish), and al-Qur'an, where these divine books are actually general governance standards to guide the mankind how to behave and the prophets and messenger are the mankind that guide us to follow those standards.

When human being have assumed some responsibilities as *khalifah* in certain organizations a specific governance standards are needed to manage such organization (QS. al- Qasas [28]: 77). The verse clarifies that one shall seek the lawful means and it is prohibited to seek corruption as Allah does not like the spreaders of corruption. For example, a person holds managing director position of the bank he is responsible, based on guidelines, principles, and standards revealed in the mentioned divine books, he has to develop a specific governance standards for the purpose of managing the bank. These principles applied to all mankind in all situations. The existing of the any form of governance standards be *syariah* governance, family governance, or organization governance, is basically a creation of conducive environment for the management of the institution.

Nevertheless, rationale of CG from secular perspective differs from the divine perspective in some aspects and agrees on some others. From secular perspective governance is founded on "trust"

² Hassan Ali, *Târîkh al-Tasyrî' al-Islâmiy: al-Madkhal li al-Fiqh al-Islâmî*, (Kuwait Kuwait University, 1977), 2.

we generally talk about the relationship between trust and governance. However, from divine/Islamic perspective it is founded on the basis of “vice-gerency and ability of mankind to make choice in this world” or “*istikhlâfiyah*”.³ Meanwhile, it concurs with secular in the importance of trust (QS. al-Ahzab [33]: 72). The mentioned verse indicates that Allah gave trust (freedom of making choices according to Allah’s will) to heaven, earth, and mountains however they refused bearing it, but man undertook it. He was indeed unjust and foolish.

The rational of having a good CG practices is to ensure that the business environment, in which companies/banks operate, are fair and just with sufficient levels of transparency in order to held such business entities accountable for their actions.⁴ One can clearly notice that in capitalist perspective, people do not take into account the duties of the creations to the Creator (Allah SWT). Therefore, behaving in a legal way does not always mean behaving in ethical way.

The term Corporate Governance was initially introduced by Adam Smith in 1776 in his book named *The Wealth of Nations*. This book was published 68 years prior to the modern incorporation system which was developed by Joint Stock Companies Act 1844. On corporate structure and management, Adam Smith said: “The trade of joint stock company is always managed by a court of directors (which is called now the Board of Directors) .The court, indeed, is frequently, subject, in many aspects, to the control of a general court of proprietors (which now is called shareholders in general meetings)”.⁵

On shareholder Adam Smith said: “....the greater part of those proprietors (meaning shareholders) seldom pretend to understand anything of the business of the company, but receive contentedly such half yearly or yearly dividend, as the directors think proper to make to them...” On directors responsibility and the corporate governance issues there is a relationship with what Adam Smith

³ Valerie Braithwaite and Margaret Levi, *Governance and Trust*, (New York: Russell Sage Foundation, 2003), 9.

⁴ M. Tarek Youssef, “Corporate Governance An Overview – Around the Globe”, <http://www.eiod.org/uploads/Publications/Pdf/Corp.%20Governance-1.pdf>

⁵ Vincent P.C. Kwan, “Proposed Changes to the Listing Rules”, *The Chamber of Hong Kong Listed Companies Magazine*, (Hong Kong: The Chamber of Hong Kong Listed Companies, 2008), 16-17.

stated the following comment: “the directors of such companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private co-partner frequently watch over their own. Negligence and profusion, therefore, must always prevail, more or less, in the management of affairs of such a company”.⁶

There are numerous studies conducted on the topic highlighting various aspects of corporate governance and its importance. Some of them, the study entitled; “*Corporate Governance an Overview-Around the Globe*”, the study provides the definitions of CG provided by number of authors around the world. For instance, UK - Cadbury Report, 1992 defines CG as “The system by which companies are directed and controlled”. Meanwhile, the Organization for Economics and Co-operation and Development (OECD), 2004 defines CG as “Corporate Governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate Governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”.⁷ The study also illustrates the importance, benefits, and various CG Models being used around the globe.

A study conducted by Khan, examines the various literatures written on the topic in order to come out with conclusion on the effectiveness of corporate governance to various companies and institutions. In addition, the study also suggests some effective CG mechanisms will reduce the principal-agent conflicts in the organization.⁸

One of the recent studies which analyze the roles of CG in banks default during the recent global financial crisis, the study investigates the effect of banks’ ownership and structures of the management on the likelihood of default. The study finds out that the defaults are significantly influenced by the banks’ ownership structures. For instance, the shareholding of outside directors and

⁶ *Ibid.*, 16-17.

⁷ M. Tarek Youssef, “Corporate Governance...”.

⁸ Humera Khan, “A Literature Review of Corporate Governance”, *International Conference on E-business, Management, and Economics*, IPEDR Vol. 25, (Singapore: IACSIT Press, 2011),1.

chief officers indicate lower possibility of default. On the contrary, shareholdings by the lower-level managers such as vice presidents raise default risk substantially.⁹

The Organization for Economics and Co-operation and Development (OECD) also examines the relation between recent financial crisis and CG practices in its report 2009, taking into consideration risk management systems and executives' salaries. The report concludes that financial crisis can be, to some extent, ascribed to the failures and weaknesses in the CG which could not manage the risks effectively.¹⁰

Another study compares between CG from Western and Islamic perspectives. The author intended to compare between the concepts, principles and models of CG from both Western and Islamic perspective but with more concentration on the Islamic governance framework of Islamic financial institutions. The study concludes that CG model from *syariah* perspective considers Islam as the superior stakeholder beside the other stakeholders. The nomination of Islam as the supreme stakeholder impacts the entire structures of CG system which assigns *syariah* as the governing law of all affairs of the corporation. As a result, it leads to the setting up of the *syariah* boards to ensure compliance as a part of CG practices.¹¹

Methodology and Data

The type of data collection is secondary data sources which obtained from previous literatures on the topic of study from articles journals, financial reports, web pages/sites, published researches, books, etc. This paper uses descriptive analytical approach which is more appropriate approach with the nature of this study. The study attempts to highlight corporate governance standards and evaluate the CG practiced by the selected banks. To achieve this objective, the study focuses mainly on the board and board committees.

⁹ Allen N. Berger, Björn Imbierowicz, Christian Rauch, "The Roles of Corporate Governance in Bank Failures during the Recent Financial Crisis", *European Banking Center Discussion Paper No. 2012-023*, (Netherlands: Tilburg University, 2012), 26.

¹⁰ Grant Kirkpatrick, "The Corporate Governance Lessons from the Financial Crisis", *OECD Journal: Financial Market Trends*, Vol. 2009, Issue 1, 2.

¹¹ Zulkifli Hasan, "Corporate Governance From Western And Islamic Perspectives", *Annual London Conference on Money, Economy, and Management*, (Durham: School of Government and International Affairs, University of Durham, 2008), 8.

Research Problem

Despite the fact that CG is not a mandatory requirement for banks and companies, however, its benefits make it necessity and no longer as an option. Particularly in the light of global financial and economic crisis which became an attribute of the capitalist economy system's attributes. Thus, adopting good CG principles and practices enhance the levels of transparency and creditability of banks and listed companies in the markets and subsequently will improve the level of confidence, trust by the stakeholders.

Therefore, due to the importance of CG to the listed companies in general and banks in particular, we will, through this research , try to find out whether present level of CG standards practice by banks (Islamic/conventional) is adequate to prevent the banks from collapsing. The approach of this research is to evaluate the effectiveness of board and the various board committees utilizing secondary data related to this research.

Discussions and Findings

In this section, the writer is evaluating the Annual Reports of three selected Islamic banks namely; RHB Islamic Bank 2012 (Malaysia), Masraf al-Rayan 2014 (Qatar), and European Islamic Investment Bank 2014 (UK), in order to come out with the conclusion on whether the corporate governance practices of the chosen banks are adequate.

RHB Board of Directors

RHB Islamic Bank's Board is obliged to ensure high level of governance in order to protect and preserve the shareholder and other stakeholders' interests simultaneously promoting the highest standards of fairness, transparency, and accountability, in order to ensure higher level of integrity, business ethics and professionalism. RHB Group adapted market best practices in order to implement transparency and accountability with Islamic bank. Moreover, RHB banking group's corporate governance is based on the following standards:

1. Malaysian Code on Corporate Governance 2012 (the Code)
2. Bank Negara Malaysia's (BNM) Guidelines on Corporate Governance for Licensed Institutions (BNM's CG Guidelines)
3. Bursa Malaysia Securities Berhad's (Bursa Securities) Main Market Listing Requirements (MMLR) and Corporate

- Governance Guide (CG Code).
4. Minority Shareholders Watchdog Group (MSWG) Corporate Governance Best Practices.

The board complies with principles presented in BNM's Guidelines on CG in which the former adapts six basic principles for good governance which are; leadership and stewardship, empowerment and accountability, communication and transparency, service and fairness, accomplishment and measurement, continuous learning and growth. The members board are also expected to perform their duties with highest level of honesty, integrity, and professionalism in order to best serve the interests of the RHB Islamic Bank' shareholders and stakeholders altogether ensuring the highest corporate governance standards. These traits of the board members are affirmed in Quran (QS. al-A'raf [7]: 181), Allah has created a nation which guide with truth and establish justice therewith.

All members of the board should posse the required skills, knowledge, experience, and an adequate commitment in order to contribute to the overall development and growth of the group as whole. These traits are mentioned in the Quran (QS. al-Baqarah [2]: 247), the verse illustrates that Allah chose Talut as the king because Allah has blessed him with knowledge and stature even though he is not rich.

Table 1: Board of Directors and Committees of RHB Islamic Bank¹²

BOD/COMMITTEES	DESCRIPTION OF RESPONSIBILITIES
Chairman (Tuan Haji Khairuddin Ahmad)	<ul style="list-style-type: none">▪ He is also INED (Independent Executive Director▪ ensures that his roles are delimited from the Managing Director▪ smoothes the functioning of the Board without engaging with the management▪ sustains and promote a great quality of corporate governance▪ ensures that the board is operating in an effective manner▪ characteristics of Chairman comply with the clauses of 2.38 and 2.39 of BNM's guidelines on CG.

¹² Annual Report of RHB Islamic Bank, 2012, <http://www.rhbgroup.com/uploads/files/investor-relations/annual-reports/rhb-islamic-bank-2012.pdf>, Retrieved April 15, 2015.

BOD/COMMITTEES	DESCRIPTION OF RESPONSIBILITIES
Managing Director	<ul style="list-style-type: none"> manages the day to day activities and operations ensures all policies and directions are implemented accordingly.
Non-Executive Director (NEDs)	<ul style="list-style-type: none"> independent directors in terms of regulatory provisions provides proper judgements, contributions and consultations to the board possess good character, integrity and focused goals.
Group Risk Management Committee	<ul style="list-style-type: none"> all members are INEDs provides good oversight and governance over the risks at the group deals with risks that are specifically inherent in Islamic finance in accordance to BNM's requirement.
Group Audit Committee	<ul style="list-style-type: none"> all members are independent provides independent oversight over financial reports, internal control system and check and balance strategies.
Group IT and transformation strategy	<ul style="list-style-type: none"> consists of three INEDs (Chairman , the Group Managing Director and the Managing Director).
Group <i>Syariah</i> Committee	<ul style="list-style-type: none"> Comprises of qualified and knowledgeable <i>syariah</i> scholars ensures all the activities, businesses and operation of the bank are <i>syariah</i> compliance.
Directors Remuneration	<ul style="list-style-type: none"> provides remuneration to NEDs in three forms: annual fees, allowances, and benefits in kind.
Communication with shareholders and investors	<ul style="list-style-type: none"> keep all share/stakeholder informed about all the materials business matters concerning the group ensure compliance to corporate governance keep good investors relations and ensures continuous communication with shareholders.

Masraf al-Rayan and European Islamic Investment Bank

This section illustrates CG practices of two banks namely; Masraf al-Rayan and European Islamic Investment Bank. From examining the financial report 2014 of the former bank, the author finds out that it complies with Qatar Central Bank Corporate Governance Guidelines for Banks and Financial Institutions, 2nd, 3rd articles of CG Guidelines for list companies regulated by “Qatar Financial Markets Authority”¹³ such compliance is meant to achieve highest levels of transparency and hence increase clients and shareholders’ trust and confident.

Board of Directors at Masraf al-Rayan consist of chairman (managing director also), vice chairman, and seven board members. Meanwhile, the senior management comprises of total 15 members, including the Group CEO, chief operating officer, CEO al-Rayan Ventures, financial controls, chief risk officer, executive manager (*syariah* audit), etc.

Masraf al-Rayan Board Committees

Table 2: Board Committees of Masraf al-Rayan¹⁴

BOARD COMMITTEES	DESCRIPTION OF RESPONSIBILITIES
Executive Committee	<ul style="list-style-type: none">▪ comprises of chairman and three other members.▪ assists the board in reviewing the banks’ activities and conducts studies on specific matters.▪ provides recommendations to the board regarding risk policies.▪ Committee had five meetings during 2014.
Internal Audit Committee	<ul style="list-style-type: none">▪ committees comprises of chairman and three other members (Majority are independent).▪ appoints its staff members, adopts policy for contracting the external auditors, monitoring, and supervising the independence of the external auditors.▪ discusses with the external auditors about nature and scope of audit effectiveness according to international audit standards.

¹³ “Annual Report of Masraf al-Rayan”, <http://www.alrayan.com/en/Annual-Reports>, Retrieved September 15, 2015.

¹⁴ *Ibid.*

BOARD COMMITTEES	DESCRIPTION OF RESPONSIBILITIES
Remuneration and Governance Committee	<ul style="list-style-type: none"> determines the remuneration policy including the allowances for the Chairman, all members of the board and senior executive management. updates the regulation rewards and compensations when needed.
Nomination and Governance Committee	<ul style="list-style-type: none"> appoints and re-appoints board members. determines the required qualifications for potential board members. ensures that all board members are committed and possess all skills, experiences and expertise.
Group Investment Committee	<ul style="list-style-type: none"> led by Chairman and four other qualified members. responsible for preparing, developing investment policies for the group. reviews and approves investment activities of the group, ensure the compliance of Group's investment portfolio with the investment policy, etc.
Syariah Supervisory Board (SSB)	<ul style="list-style-type: none"> Members are elected by General Assembly of the bank for three years 2014-2016. reviews the proposed contracts, provides answers on any matter related to <i>syariah</i>. problem solving of any issue might arise during implementation stage.

European Islamic Investment Bank

European Islamic Investment Bank (EIIB) is Islamic bank was founded in England and Wales on January 2005 and was given the authorization by UK's Financial Services Authority on March 2006. It was the first independent Islamic Investment bank that to be regulated and authorised by UK's Financial Services Authority (FSA). Concurrently, it is regulated and authorized by Financial Conduct Authority. EIIB believes that good CG practices is essential for achieving the group's objectives and has took those principles into consideration in formulating Group's risk management framework together with UK Corporate Governance Code 2012.

European Islamic Investment Bank Board

The European Islamic Investment Bank (EIIB) is headed by number of executive and non-executive directors with the required experience and expertise in the financial services and deep relationships particularly in Middle East and North Africa (MENA) region. It is evident that EIIB' board is fulfilling the requirements stated in UK CG Code 2012. The Board of Directors at EIIB comprises of five non-executive directors and one executive director, their names, specialization, and number of meetings attended by each director and whether they hold other positions are clearly stated. EIIB' board meetings in 2014 exceeded the minimum requirements with total six meetings. In addition, EIIB's board makes decisions with regard to various matters such as; approval of annual reports and financial statements; disbursement of the dividends, objectives of the group in the long run, strategies to accomplish those objectives, budgets and plans, credit exposures, capital expenditure, etc.¹⁵ All those duties of EIIB's board are in the line with requirements specified by UK Corporate Governance Code 2012.

EIIB Committees

The European Islamic Investment Bank (EIIB)'s board consists of number of sub-committees that are required to fulfil their duties as required by the board and UK CG Code 2012.

Table 3: EIIB Board Committees¹⁶

Board Committees	Description of Responsibilities
Audit Committee Wright (Chairman) and Mohammed al-Sarha	<ul style="list-style-type: none">▪ reviews the external auditors' remuneration, evaluates their level of independency and may recommend them for re-appointment in AGM.▪ reviews financial statements.▪ assesses the quality and acceptability of accounting policies adopted, disclosure requirements, the scope of work of the internal auditors, etc.▪ Nevertheless, the annual report 2014 of EIIB does not include the detailed responsibilities of Audit Committee as required by UK CGC 2012.

¹⁵ "Company Info: About Us: European Islamic Investment Bank PLC,2015". <http://www.eiib.co.uk/html/aboutus.asp>, Retrieved September 02, 2015.

¹⁶ "Annual Report of European Islamic Investment Bank PLC, 2014". <http://www.eiib.co.uk/documents/eiibannualreport2014.pdf>, Retrieved September 02, 2015.

Board Committees	Description of Responsibilities
Nomination and Remuneration Committee	<ul style="list-style-type: none"> ▪ reviews the composition of the board in terms of the required skills, experiences and qualification of the directors. ▪ makes recommendations to the board with regard the potential candidates. ▪ it also makes recommendation to the board for re-appointment of non-executive directors. ▪ reviews remuneration policy of the senior management and incentives given to directors. ▪ excessive payment of the executive's remunerations is not encouraged by UK CGC2012 but attractive to retain and attract directors.
Board Risk Committee	<ul style="list-style-type: none"> ▪ assists the board in managing investment risks that might emerge during its investment activities. ▪ the CEO, head of risk management and financial director shall meet at least three times a year.
Executive Management Committee	<ul style="list-style-type: none"> ▪ assists CEO in fulfilling his/her duties. ▪ the committees meets up at least once a month. ▪ the meeting is attended by CEO, Senior management from risk, finance, treasury, principal and banking investment, assets management, legal/compliance and HR.
Syariah Supervisory Board Members	<ul style="list-style-type: none"> ▪ ensures the compliance of the banking operations, activities. ▪ and products to <i>syariah</i> principles. ▪ consists of four members' two chairmen and other two members to advice on <i>syariah</i> related matters.

Characteristics of Effective Board and Board Committees from Islamic Perspective

Islamic banks differ from their counter parties due to the fact Islamic banks have dual governance system which are; the board of directors (to supervise and monitor the management aspects of the bank) and the *Syariah* Supervisory Board (to ensure the compliance of the banking operations with *syariah* principles). The existence of

two different objectives in the same bank might lead to increase the intensity of conflicts of interests. The efficiency of the bank depends on the relationship between the used means of production and the outcomes; we can say the bank is efficient if it could achieve the attended outcomes with rational use of the available means.¹⁷

With reference to section (4), the study finds out that all selected banks were complying with CG standards they adopted. However, such compliance does not guarantee that those Boards and committees are consistently reliable and the bank will not collapse in the long run. Therefore, we need to refer to the biography of Prophet Muhammad SAW and the caliphs how they succeeded in governing the Islamic State. For instance, the prophet appointed some teachers to teach Quran and *al-fiqh* to Muslims and provides and the first salaries were paid to those teachers. Furthermore, prophet emphasized that if someone was assigned to do a task, must perform it in the best way.

Moreover, the Prophet SAW said that "The signs of a hypocrite are three: when he speaks he lies, when he promises he breaks his promise, and when he is trusted he betrays his trust." (Sahih Bukhari 33, Sahih Muslim 59). Therefore, in the process of appointment of board directors, senior managers and committees, the concerned parties must ensure that the candidates are free from those horrible characteristics.

In order for CG standards and guidelines to work out, the mankind must fear and hold accountable for their mistakes. When Allah SWT sends al-Qur'an as governance standards, He clearly indicates the rewards of we obey (heaven) and punishments if we do not (hell fire). Therefore, board and committees must fear not only regulatory bodies but also (and most importantly) Allah SWT and applying the concept of *ihsân* in the bank in order for board, committees, etc, work effectively. When the Prophet SAW was asked; what is *ihsân*? he replied: "worshiping Allah as you see Him, if you do not see Him, He sees you".

As the prophet Muhammad SAW is the role model for all Muslims and even non-Muslims in terms of good character, honesty, integrity, etc as Allah SWT says, "*You are of the highest noble character*" (QS. al-Qalam [68]: 4). All the internal stakeholders such as board of director, board committees, senior management, employees, should refer to biography of prophet and how he could handle things effectively. *Syariah* Supervisory Board also is the role model for the

¹⁷ Shawqi Buraqaba, *Corporate Governance in Islamic Banks*, (Algeria: University of Scieinse in Economics, 2009), 17.

internal and external stakeholders, therefore, the *syariah* scholars must be qualified and have they required experience and expertise as the inefficient *Syariah* Supervisor Board (SSB) might cause the bank to incur additional and necessary costs due to weak fatwas issued. Thus, lack of confidence of the public in the bank and they might withdraw their deposits from it.

Summary of Various Corporate Governance Principles and Codes

One cannot deny that there is unanimous convention that good CG practices are necessary for protection and sustainability of banks and safeguards them against crisis. Therefore, some international organizations such as OECD 1999 made a significant contribution by providing a sound CG principles that are adopted by 30 member countries and become as a benchmark for policy makers, corporations, regulatory framework, etc. The gist of OECD principles can be summarized in four principles. The mechanism of business ethics, decision making, transparency and sufficient disclosure, and book keeping, OECD principles are considered as one of the soundest principles and are adopted even by non-member countries.¹⁸

With regards UK CGC 2012, it provides detailed principles to ensure good CG practices. The code emphasizes that bank must be led by effective board, the appointment of it and its committees must be rigorous and transparent and members must balance skills, experience and expertise. In addition, all board members must be committed to perform their duties within the required time frame and developing and updating directors' skills are highly encouraged. The board also should evaluate their performance on annual basis of its directors and committees. Moreover, the board should present a true evaluation of the company current position in its financial and business reports, to determine the risk that are willing to undertake to accomplish its objectives, remuneration should be attractive but not excessive and the board are advised to utilize the AGM to hear from investors and an effective communication is encouraged.

It is very pertinent to discuss Islamic CG principles as previously the author discussed the conventional principles. Islamic banks must only conduct ethical businesses as Muslims are vice-regent of Allah

¹⁸ Abdussalam Mahmoud Abu-Tapanjeh, "Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles", *Critical Perspectives on Accounting*, Volume 20, Issue 5, July 2009, Page 559. doi:10.1016/j.cpa.2007.12.004.

SWT in earth and be conscious that even if we were successful of concealing something from legal authorities we cannot conceal it from Allah. In addition, all business transaction must be fair, just, and transparent, and comply with the *syariah* principles. In terms of decision making Islam encourages consultation of all parties regardless of their designations (QS. Alu Imran [3]: 159), emphasizes on the importance of consultation in all matters. The board and senior management are encouraged to consult stakeholder such as, employees, investors, clients, etc, before making the final decisions.

Concerning transparency and disclosure, hum being are accountable to Allah (S.W) and must be honest, fair and transparent in disclosing all information related to the transaction and make things clear to the other party. Therefore, the board must ensure that all the information revealed is true, adequate and accessible to the investors. Last but not least, with regard book keeping Islam encourages mankind to write down all transactions and have witnesses in order to ensure fairness and justice to all parties involved. This has been supported by many verses in al-Qur'an such as, QS. al-Baqarah [2]: 282 and QS. al-Anfal [8]: 27. The former verse alludes that when you contract (in debt obligation) with each other write it down to ensure justice for all parties involved and the former verse clearly prohibits betraying of trust.

Conclusion

The study finds that RHB Islamic Bank complies with BNM's Guidelines on CG, Bursa Malaysia Securities Berhad's (Bursa Securities) and Minority Shareholders Watchdog Group. Nevertheless, other Islamic banks in Malaysia such as adopts only two guidelines namely; BNM' Guidelines and MCCG 2012 practices. RHB Islamic Bank provides very detailed information in its annual report compared to its counter parties. With regard to Masraf al-Rayan, it complies with Qatar Central Bank Corporate Governance Guidelines for Banks and Financial Institutions, (2nd, 3rd) articles of CG Guidelines for List Companies regulated by Qatar Financial Markets Authority.

The study also reveals that all banks examined did not disclose the duration of annual meetings and the percentages of dividend distributed among the shareholders except in the case of EIIB. However, EIIB should consider increase in the audit committee members to enhance the efficiency of the bank.

At the end, it should be taken into consideration that merely complying with the CG standards and guidelines neither guarantee that

the board and committees will consistently be reliable nor will prevent the banks from collapsing. Most importantly, applying the concept of *ihsân* and reward/punishment in order for CG is to work effectively.[]

Bibliography

- Abu-Tapanjeh, Abdussalam Mahmoud. "Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles", *Critical Perspectives on Accounting*, Volume 20, Issue 5, July 2009, Page 559. doi:10.1016/j.cpa.2007.12.004.
- Ali, Hassan. 1977. *Târîkh al-Tasyrî' al-Islâmiy: al-Madkhal li al-Fiqh al-Islâmî*. Kuwait Kuwait University.
- Annual Report of European Islamic Investment Bank PLC, 2014. <http://www.eiib.co.uk/documents/eiibannualreport2014.pdf>, Retrieved September 02, 2015.
- Annual Report of Masraf al-Rayan, <http://www.alrayan.com/en/Annual-Reports>, Retrieved September 15, 2015.
- Berger, Allen N., et. al. 2012 "The Roles of Corporate Governance in Bank Failures during the Recent Financial Crisis", *European Banking Center Discussion Paper No. 2012-023*. Netherlands: Tilburg University.
- Braithwaite, Valerie., and Levi, Margaret. 2003. *Governance and Trust*. New York: Russell Sage Foundation.
- Buraqaba, Shawqi. 2009. *Corporate Governance in Islamic Banks*. Algeria: University of Sceinse in Economics.
- Company Info: About Us: European Islamic Investment Bank PLC, 2015. <http://www.eiib.co.uk/html/aboutus.asp>, Retrieved September 02, 2015.
- Hasan, Zulkifli. 2008. "Corporate Governance From Western And Islamic Perspectives", *Annual London Conference on Money, Economy, and Management*. Durham: School of Government and International Affairs, University of Durham.
- Khan, Humera. 2011. "A Literature Review of Corporate Governance", *International Conference on E-business, Management, and Economics*, IPEDR Vol. 25. Singapore: IACSIT Press.
- Kirkpatrick, Grant. "The Corporate Governance Lessons from the Financial Crisis", *OECD Journal: Financial Market Trends*, Vol. 2009, Issue 1.
- Kwan, Vincent P.C. 2008. "Proposed Changes to the Listing Rules", *The Chamber of Hong Kong Listed Companies Magazine*. Hong Kong: The Chamber of Hong Kong Listed Companies.
- List of Corporate Collapses and Scandas, https://en.wikipedia.org/wiki/List_of_corporate_collapses_and_scandals, Retrieved October 03, 2015.
- RHB Islamic Bank, "Annual Report, RHB Islamic Bank, 2012", <http://www.rhbgroup.com/uploads/files/investor-relations/annual-reports/rhb-islamic-bank-2012.pdf>, Retrieved April 15, 2015
- Youssef, M. Tarek. "Corporate Governance An Overview – Around the Globe", <http://www.eiod.org/uploads/Publications/Pdf/Corp.%20Governance-1.pdf>