Corporate Governance Framework

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What is Corporate Governance?

- 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.

Source: G20/OECD Principles of Corporate Governance 2015
Why is Corporate Governance Important?

- Resolve conflicts of interest among the management, board, shareholders and other stakeholders, as well as protecting all stakeholders’ interests.
- Set vision and mission statements and strategic targets for the company.
- Achieve the strategic targets set by ensuring application of best practices in:
  - Internal control systems
  - Regulatory compliance
  - Accounting and Auditing
  - Risk Management
  - Information disclosures
  - Socially Responsible Business
  - Shariah compliance

Source: Tariqullah Khan, Corporate Governance in Islamic Banks, 2008
Building Blocks and Fundamental Elements of Effective Corporate Governance

Building Blocks of Corporate Governance

- Fairness
- Transparency
- Corporate Governance
- Accountability
- Independence

Elements of Corporate Governance

- Effective Governance Framework
- Rights and Equitable Treatment of Shareholders
- Stakeholders’s Rights
- Disclosure and Transparency
- Responsibilities of the Board

Source: OECD
Stakeholders in Corporate Governance Framework for Sukuk

Corporate Governance Framework

Management, Board, Shareholders, Employees

Communities

Users of Services

Policy makers, regulators, and government agencies

Suppliers of Funds
## Key Players in Corporate Governance of Islamic Financial Institutions - Environment

<table>
<thead>
<tr>
<th>Institutions / Players</th>
<th>Important Issues</th>
<th>Objectives / Responsibilities</th>
</tr>
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</table>
| **Overall Economic, Financial, and Legal System** | Efficiency of the Legal System  
Enforceability of Contracts  
Rule of Law | Promote strong business and legal environment that support CG |
| **Government and Laws**                          | Corporate law  
Disclosure/transparency Laws  
Laws facilitating operations of Islamic financial institutions (IFIs) | Provide governance structures  
Laws catering to the needs of IFIs |
| **Accounting Systems**                           | Accounting and audit standards for clear and transparent communication of information | Provide uniform, clear and transparent accounting standards |

Source: Chapra & Ahmed, Corporate Governance in Islamic Financial, IDB, 2002
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<th>Institutions / Players</th>
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<td>Supervisors / Regulators</td>
<td>Stability and soundness of the financial system (eliminate systemic risk)</td>
<td>Provide Guidelines for FIs Monitor overall operations in general and risky behavior in particular</td>
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<td>Develop internal controls, risk management procedures, and standards of transparency</td>
<td></td>
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<tr>
<td>Banking Associations</td>
<td>Minimum standards of CG</td>
<td>Set Principles and Sound practices</td>
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Source: Chapra & Ahmed, Corporate Governance in Islamic Financial, IDB, 2002
### Key Players in Corporate Governance of Islamic Financial Institutions – Public Institutions

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Source: Chapra & Ahmed, Corporate Governance in Islamic Financial, IDB, 2002
## Key Players in Corporate Governance of Islamic Financial Institutions – Institutional

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<tbody>
<tr>
<td>Shareholders</td>
<td>Shareholder Rights</td>
<td>Elect board members</td>
</tr>
<tr>
<td></td>
<td>Share in profit</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board of Directors</td>
<td>Ensure good management team</td>
<td>Set overall policy and strategy</td>
</tr>
<tr>
<td></td>
<td>Oversight of management</td>
<td>Accountability of the management</td>
</tr>
<tr>
<td></td>
<td>Protect shareholders and investment depositors rights</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Senior Management</td>
<td>Operate the institution efficiently.</td>
<td>Implement the policies set by the board in a sound and responsible manner</td>
</tr>
<tr>
<td></td>
<td>Right balance between risk and return</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Efficient incentive-structure</td>
<td></td>
</tr>
<tr>
<td>Internal Audit</td>
<td>Quality and quantity of information</td>
<td>Ensure that the policies set by Board are followed by the management (Compliance)</td>
</tr>
<tr>
<td></td>
<td>Transparency of information</td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>Skills and work ethics</td>
<td>Meet the goals set by the management</td>
</tr>
<tr>
<td></td>
<td>Right incentive-structure</td>
<td>Minimize operational risks</td>
</tr>
<tr>
<td>Sharī‘ah Boards</td>
<td>Set Sharī‘ah related rules and principles</td>
<td>Oversee compliance with its verdict</td>
</tr>
</tbody>
</table>

Source: Chapra & Ahmed, Corporate Governance in Islamic Financial, IDB, 2002
## Key Players in Corporate Governance of Islamic Financial Institutions – Other Stakeholder

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</table>
| Depositors             | Good service  
Comparative returns                                  | Act responsibly  
Monitor the performance                                                 |
| External Auditors      | Quality and quantity of information  
Transparency of information                                  | Evaluate the accuracy of the quality and quantity of information        |
| *Sharī‘ah Audit*       | Adherence to the *Sharī‘ah*                             | Ensure compliance with the *Sharī‘ah* Board verdicts.                   |

Source: Chapra & Ahmed, Corporate Governance in Islamic Financial, IDB, 2002
Protecting the Interests of Stakeholders

– Apply best practice standards and effective systems of accountability and incentives
– Unambiguous contracts and documented rights and responsibilities of parties
– Information disclosure and market discipline
– Institutional checks and balances
– Regulation and supervision
– Moral suasion
– Enabling environment

Source: Tariqullah Khan, Corporate Governance in Islamic Banks, 2008
Corporate Governance in Islamic Banks

- Shariah compliance
- Ethics & social responsibility
- Interests of Investment Account Holders (IAHs), especially the unrestricted deposits
- Potential conflicts of interest between shareholders and unrestricted IAHs especially where the funds are commingled
- Transparency in financial reporting, e.g. calculation of Muḍārib’s share (where funds are commingled) and profit distribution
- Muḍārib’s share in profits from assets financed by current accounts

Source: Tariqullah Khan, Corporate Governance in Islamic Banks, 2008
Shariah Governance Issues

- Key elements of a sound Shariah governance system (IFSB):
  - Competence (Scholars’ qualifications)
  - Independence (Independence from Board and Management)
  - Confidentiality (Conflicts given serving on multiple boards)
  - Consistency (of Fatwas, accountability)

- Complexity of Islamic financial products

- Shariah compliance
  - Pre-issuance compliance
  - Post-issuance compliance
  - Shariah audit

- New Malaysian Law
  - Shariah scholars could be subject to criminal prosecution and civil suites
Corporate Governance in Islamic Banks

Islamic Financial Services Board (IFSB), “Guiding Principles on Corporate Governance of Institutions Offering Islamic Financial Services (IIFS)”

- Scope and Related Issues
## Scope of IFSB Guidelines

<table>
<thead>
<tr>
<th>CG aspects already covered</th>
<th>OECD</th>
<th>BCBS</th>
<th>IOSCO</th>
<th>FRC/FSA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Directors/The Board</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Remuneration/Compensation</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Accountability and Audit</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Relations with Shareholders</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Shareholders</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Rights and Key functions</td>
<td>✓</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Equitable Treatment</td>
<td>✓</td>
<td></td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Other Stakeholders</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Employees/Manager</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulator/Supervisor</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>Disclosure and Transparency</td>
<td>✓</td>
<td></td>
<td>✓</td>
<td>✓</td>
</tr>
</tbody>
</table>

The issue of **IFS’ accountability and transparency to its customers, particularly IAH**, as well as **Shari‘ah compliance**, have not been covered or contemplated in any of the above documents.

Source: Hussain, Guiding Principles on Corporate Governance of Institutions Offering Islamic Financial Services ("IFS"): An Insight of the Exposure Draft, 2006
Scope of IFSB Guidelines

The IFSB Guidelines aims to cover these aspects:

- **Information environment and transparency:**
  - specifying and enforcing appropriate disclosure requirements
  - fostering auditors independence and enforce the relevant and applicable auditing standards
  - the focus is very specifically on protection of the IAH’s interests – not to overlap with general transparent reporting which would be covered by the Transparency and Market Discipline Standard

- **Organs of governance:**
  - safeguarding **interests of IAH**, especially the unrestricted
  - adequate monitoring of *Sharī`ah compliance*
Some Shared Institutions Needed for Effective Corporate Governance

- Credit-Rating Agencies, Chambers of Commerce, and Trade Associations
- Centralized Shariah Board
- Chartered Shariah Auditors
- Shariah Courts or Banking Tribunals
- Audit Organization
- Training in Islamic Banking
- Islamic Financial Market
- Lender of Last Resort
- Reform of the stock market

Source: Chapra & Ahmed, Corporate Governance in Islamic Financial, IDB, 2002
Thank You

For your further questions please contact:
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Disclaimers


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