

# A REVIEW ON *SHARIA* REGULATORY FRAMEWORK (SRFW) OF ISLAMIC FINANCIAL INSTITUTIONS (IFIs) MALAYSIA BASED ON ISLAMIC SPIRITUAL QUALITIES

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**Abstract:** *This research was conducted to identify the Malaysian Sharia Governance Exposure draft act issued on 09 November 2017, consists of 34 pages by Central Bank of Malaysia (BNM). Hence the complete compliance of Malaysian Sharia Regulatory Framework SRFW remained the subject matter of the discussion of most of researchers which need more review on its documents research. This paper has two objectives. First, to identify Malaysian SRFW sections that are related to Sharia committees (SC). Second, to review Malaysian SRFW on recruitment criteria based on Islamic spiritual qualities. According to the previous studies a document research would be reviewed, analytical and descriptive approaches would also be adopted. Thus, there was a certainty between current laws of this regulatory draft and the current practices of Islamic banks in Malaysia, except otherwise as explained thoroughly. However, this study also proved and acknowledged Malaysian SRFW among the advanced and the most inclusive in today's world particularly with the adoption of Islamic spiritual qualities in its recruitment criteria. It comprises of Islamic Banking Act (IBA) 1983, Sharia Governance Framework (SGF) 2010, Islamic Financial Services Act (IFSA) 2013 and Sharia governance exposure draft (SGE) 2017. It can be easily concluded of positive use and adoption of the Malaysian SRFW by other Islamic countries for smooth take-up of Islamic Banking in their countries.*

**Keywords:** *Sharia Regulation, Sharia Committees, Islamic Banking in Malaysia. Spiritual.*

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## Introduction

*Sharia* Regulations of Islamic Financial Institutions in Malaysia was administered by Islamic Banking act IBA 1983, *Sharia* Governance Framework SGF 2010, Islamic Financial Services Act IFSA 2013 and the act of *Sharia* Governance Exposure draft SGE 2017 by Bank Negara Malaysia BNM. According to Islamic Financial Service Board IFSB 2009 the “*Sharia* Governance System refers to the set of institutional and organizational arrangements through which an IFIs ensures that there is effective independent oversight of *Sharia* compliance” (IFSB, 2009).

The main objectives of the *Sharia* Governance Framework of the Islamic Financial Institutions are designed to meet the following: “(i) sets out the expectations of the bank on an IFIs *Sharia* governance structures, processes and arrangements to ensure that all its operations and business activities are in accordance with *Sharia*. (ii) provides a comprehensive guidance to the board, *Sharia* committee and management of the IFI in discharging its duties in matters relating to *Sharia*; and (iii) outlines the functions relating to *Sharia* review, *Sharia* audit, *Sharia* risk management and *Sharia* research” (SGFW for IFIs, 2010). As a result, the *Sharia* governance which refers to the all component regarding active role of the *Sharia* board and compliance with *Sharia* is fundamental to Islamic Banks in particular and the implementation of *Sharia* governance which is encouraged by many *Sharia* bodies notably, Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), Islamic Financial Service Board IFSB 2009.

This study is aimed to achieve its main objective of identification of the sections in which the document discussed on matters related to *Sharia* committees of Islamic Banks as well as reviewing the text of the document on recruitment criteria base on Islamic spiritual qualities. However, in order to achieve the above-mentioned objectives, this study adopted the document research method as well as analytical and descriptive approaches, the document research consists of draft of SGE 2017 and supported by articles, classical and contemporary jurisprudence references as well as website information for the proper analysis.

### ***Sharia* Regulatory Framework of IFIs Malaysia**

The Act of *Sharia* Governance exposure draft SGE was issued on 09 November 2017 as one of the standards and guidelines of IFIs issued by the Bank Negara Malaysia BNM under the Banking and Islamic Banking in its website, the SGE draft sets out the Bank’s proposed regulatory requirements on *Sharia* governance for Islamic Financial Institutions. The draft which was issued on 09 November 2017, BNM/RH/ED 028-7 consists of 8 parts from A to H and divided into 23 sections include appendixes through 34 pages, it is also contains many parts and sections in relation to regulation of Islamic Banks and role of *Sharia* committees i.e. qualifications, conditions, attributes, manners of being *Sharia* supervisors and advisors and rules of supervisory and advisory mandates as well as knowledge of Islamic financial business (SGE draft, 2017). Notwithstanding, the banks executives, senior management and stakeholders were not left behind in the draft in mentioning their attributes, roles and rules toward successful *Sharia* compliance of Islamic Banks. Though, this study would focus mainly on *Sharia* committee members and the issues related to their recruitment criteria (SGE draft, 2017).

Moreover, the draft as a manifestation plan is strictly applicable to the following sectors as mentioned, such as Licensed Islamic Banks as well as *Sharia* committee members in which both are the subject matter of this study, Licensed takaful operators and professional re takaful operators, Licensed banks and Licensed investment banks approved to carry on Islamic Banking business, Prescribed institutions approved to carry on Islamic Banking business or Islamic financial business (SGE draft, 2017). Subsequently, *Sharia* committee or *Sharia* board under Islamic Bank stands as *Fatwa* committee as in the past, and in the present in some Islamic countries, and therefore, they oversee on anything related to transactional jurisprudence of Islamic financial business which is the main room of banking sector under *Sharia* compliance, again, they are to advise and supervise of all activities of Islamic Banks to ensure its fully compliance of *Sharia* Islamic law as an act of worshipping (*Ibada*) (Ullah, Harwood and Jamali, 2016).

However, the study of Yusoff and Sendaro (2017) acknowledged Malaysia's Regulatory Framework among the advanced and the most inclusive in today's world. Its framework comprises of Islamic Banking Act. 1983, Central Bank of Malaysia Act. 2009 and Islamic Financial Services Act. 2013 as well as SGE draft 2017. Siregar (2013) also classify Malaysia as the only country which has developed regulations in Islamic Finance advance. Hence, Islamic Banking industry is regulated under Bank Negara Malaysia.

Contrary to the above, Asni and Sulong (2018) analysed the Model of *Istinbat* by the *Shariah* Advisory Council of Central Bank of Malaysia and discovered that there were some products approved by the *Sharia* Advisory Council (SAC) which have been alleged as non-compliant to *Sharia*, and it leads to the challenge in *Sharia* courts. This happened because there is no strong legal framework outlined. Again, Al-Nawawy believes that in the field of Islamic Banking (Financial Transaction) unnecessary *Fatwas* are issued by some scholars who do not meet the requirements of doing so, in reference to the absence of Islamic spiritual qualities according to classical Islamic *Fatwa* framework (Lock, 2013).

#### ***Sharia* Governance of IFIs (SCs and the recruitment criteria)**

*Sharia* governance is a governance system that ensures all activities and business transactions by IFIs are free from non-allowable elements such as *Riba*, *Gharar*, *Maisir* and other similar attributes. The Islamic financial institutions are regulated in accordance with the *Sharia* principles, and the central bank in Malaysia has full authority to enact required laws and policy and to regulate the Islamic financial institutions. Hence, an effective legal framework can create a confidence on investors, and it reduces the abuses which affects the stability of financial relations. The regulatory laws of the Islamic finance need to be more advanced filling the gaps to ensure stability and proper development (Syarif, 2019).

However, most of the regulatory laws point out that conventional governance is different than *Sharia* governance and it is so, in the sense that the latter emphasize on fairness, integrity to all stakeholders through greater transparency and accountability that comply with *Sharia* principles and this is the fundamental differences between both systems. Moreover, the IFIs need to make sure on strong and well-functioning *Sharia* governance is in place to protect the interests of players and stakeholders of Islamic finance, since weak governance system would result in market failure and capital market dry up, and finally, the whole financial system will collapse (Sori & Eskandar 2017).

According to the study conducted by Sori and Eskandar (2017), the group of interviewees (including SCMs) pointed out that selection of right candidate for the *Sharia* committee is utmost significant since this will determine whether the committee is functioning towards objective set for them. A good mixture of relevant discipline should be observed carefully, where candidate with *fiqh*, *usul fiqh* and *muamalat* should be the majority members of the committee and candidate from other disciplines like legal, accounting, banking and business could be a helpful source of information for the *Sharia* people to understand the business and subsequently come out with resolutions and *Fatwas* in the context of the business and not only from theoretical perspectives.

Another line of thought, *Fatwas* are issued by *Sharia* scholars. As a result, AAOIFI consider the activities of *Sharia* advisors in IBs as *Fatwa* issuance, if it is so, and it is. Then the attitude and characteristic of *Sharia* advisors must be in line with Islamic *Mufti* in the form of recruitment criteria as outlined by many classical and contemporary Islamic jurisprudence books and articles (Lock, 2013). Nevertheless, it was found that the *Sharia* governance framework is an important mechanism to ensure that IFIs are carrying out their roles in accordance to *Sharia* principles in the interest of depositors, investment account holders, shareholders and stakeholders as well (Sori & Eskandar, 2017).

Morrison (2014) considered the necessity of reaching a uniform and consistent reading of *Sharia* board scholars. In so doing, it had regard for the institutional and regulatory underpinnings that might make such harmonisation possible by means of processes of centralised reference, review and enforcement process in respect of *Sharia* board members. In the same vein, Kamaruddin et al., (2020) concluded that the SCs must be observed on their independence toward their respected mandate to ensure that they can exercise their duties with objective and informed judgment. In this case, the BOD is required to ensure the independence of the SC to ensure the sound *Sharia* decision-making.

### Islamic Spiritual Qualities

The Islamic spiritual qualities are moral and spiritual qualities that have been recognized upon every Muslim individual toward the commencement of any act as an act of *Ibadat*, the mother and head of all the Islamic qualities before the commencement of any act is Integrity and Good intention (*Anniya Assaliha /Ikhlās*), it was reported on the authority of Umar Bin Kaddab in Prophetic Hadith that “Actions are judge according to intentions) as outlined by Imam Al Nawawy a prominent *Shafi* scholar Lock (2013). Furthermore, the Islamic moral values as distinctive framework for moral education, was studied by Halstead, J. M. (2007) in United Kingdom, the author examines the implications of the close link between morality and religion in Islamic thinking throughout his article. He examines- in the first half of the research - the implications of the close link between morality and religion in Islamic thinking as way out of the absent of discipline of ethics in Islam. Though, the authors attempt was educational research background, but it is still valid on the Muslims believers at various institutions, more especially *Sharia* advisors and supervisors of IBs with the critical challenging upon their task (Ulla et al., 2016). The author fundamentally asserts that moral education is about inner change, which is a spiritual matter that comes through the internalization of universal Islamic values. He also referred throughout his study the existence of morality in Islam in the many verses of the Qur’an that refer in the same breath to ‘those who believe’ and ‘those who do good deeds’ (Ibn Kathīr, 2000). As has been shown, religious and moral values in Islam are granted upon every

Muslims, most importantly Islamic scholars or *Muftis* who are the role model of the entire *Ummah*. So, *Sharia* advisors and supervisors of IBs are in high position to acquire Islamic spiritual qualities in order to possess deepest *Sharia* compliance as well as observing *Sharia* objectives which would be established thoroughly, this will come as result of their observation upon the awareness of Allah in all the task upon them, since actions are judge according to intentions (Halstead, J. M. 2007).

Wardhany and Arshad (2012) have studied and reviewed the role of *Sharia* board in Islamic banks as a case study of Malaysia, Indonesia and Brunei in order to emphasize on establishment of *Fatwas* within the Islamic bank (related the Islamic qualities upon *Sharia* advisors). The study was qualitative research and theoretically based on *Sharia* board and *Sharia* governance framework from AAOIFI and IFSB benchmark on Indonesia, Malaysia and Brunei Darussalam, the three countries are from the south east Asian region that adopts centralized models of *Sharia* governance. Moreover, the comparison was based on the listed criteria through the study, i.e. appointment, qualification, process flow, review and audit, governance, legislation, and remuneration. Furthermore, evidence from the analysis by the study suggests that both Indonesia and Malaysia are equally balanced. Thus, the equality between the responsibility and the authority is quite vital on supporting *Sharia* board in supervision IBs. The study again, suggests that the central bank of Indonesia needs to support the *Sharia* board so that the establishment of *Fatwas* would be attainable in Islamic banks.

In other hand, apart from the above listed criteria regarding *Sharia* board members advisors and supervisors of the selected countries of study, in order to acquire more trust of Islamic *Ummah* toward Islamic financial institutions IFIs on having deepest *Sharia* compliance and integrity of the industry, the Islamic moral and spiritual qualities need to be adopted through the current regulations of the selected countries, since none of the regulatory laws have included them as criteria according to study (Wardhany & Arshad, 2012). The strength of such an approach is that, if the uniqueness of the spiritual values based on the Quran and Hadith are the basis of Islamic finance according to Wardhany and Arshad, (2012) then, the Islamic moral and spiritual qualities based on classical Islamic *Fatwa* framework IFF should be at the standpoint of the regulations of Islamic banks as a recruitment criteria.

As discussed earlier, the relationship between *Sharia* board and Islamic financial institutions IFIs is quite unique. Evidently, they are responsible for advising, supervising and monitoring the compliance of *Sharia* rules of all the transactions and issuance of *Sharia* products. Furthermore, as a representative of the various Islamic scholars and *Muftis*, the *Sharia* board has the authority to issue *Fatwas* regarding the products and practices employed by Islamic banks. This great and very important task must be supported by remembering the advisors and supervisors with fairness of Almighty Allah and eternal reward as well as eternal punishment according to their different intentions and practices which are the matters of Islamic moral and spiritual qualities.

### **Review Part of the SGE Draft 2017**

The issue of complete *Sharia* compliance remained the subject matter of the discussion of most of researchers nowadays which need more review on the documents research of criteria recruitment through regulator laws of IFIs. Hence, part B and C of SGE Draft 2017 explains and discusses more on *Sharia* committee members, it uses the term *Sharia* committee SC as

mentioned in the draft. Thus, only key responsibilities and interaction with *Sharia* committee by the board (management of the Bank) are stated in part B of the draft. While, Part c discusses on *Sharia* committee, it consists of key responsibilities, *Sharia* committee meetings, appointments and removal, composition and secretariat to the *Sharia* committee. This study would emphasize only on *Sharia* committee, meetings and appointments and removal.

**Table 1. The summary text of working document of SGE 2017 according to part B and C only are as follows:**

**PART B**

Topic of the section	Available Sections	Total of the available sections	Main content of the sections	Researchers comments
9. Interaction with <i>Sharia</i> committee	S9.1 – S9.9	9 sections	Competency, knowledge and contributions of <i>Sharia</i> committee member	No Islamic Spiritual qualities were mentioned

**PART C**

Topic of the sections	Available Sections	Total of the available sections	Main content of the sections	Researchers comments
10. Key responsibilities	S10.1 – S10.12	Total of 12 sections	Ensure full <i>Sharia</i> compliance of IFIs	No Islamic spiritual qualities were mentioned
11. <i>Sharia</i> committee meeting	S11.1 – S11.15	Total of 15 sections	Physical presence of <i>Sharia</i> committee meetings	No Islamic spiritual qualities were mentioned
12. Appointment and approval	S12.1 – S12. 15	Total of 15 sections	Proper criteria and educational qualification of <i>Sharia</i> committee member	Being a Muslim individual as a <i>Sharia</i> committee member was mentioned
13. Composition	S13. 1 – S13. 6	Total of 6 sections	Conducive environment for sound deliberation and other industrial qualification	No Islamic spiritual qualities were mentioned
14. Secretariat to <i>Sharia</i> committee	S14.1 – S14. 3	Total of 3 sections	Communications and disseminating information	No Islamic spiritual qualities were mentioned

Table 1. (B and C) contained the summary text of working document of SGE 2017 as shown above, and it only mentioned being a Muslim individual as a *Sharia* committee member which might not necessarily content Islamic spiritual qualities as outlined under classical Islamic *Fatwa* framework as recruitment criteria upon every Islamic *Mufti* according to institutionalized or un institutionalized Islamic *Fatwa* institution.

**Results and Discussions**

The above-designed table is summarized text of the draft of SGE 2017 which is related to *Sharia* committee members appointment and removal in Islamic banks of Malaysia and its

shows comprehensive nature in accordance with general banking rules and compliance with *Sharia* Islamic law (Siregar 2013).

Though, the lack of Islamic spiritual qualities according to stated and reviewed text remained the absent and needed part of this draft, and in order to make the framework stronger, and avoid any challenges by *Sharia* courts of its approved products as non-compliant to *Sharia* as outlined by Asni and Sulong (2018) The basis of Islamic spiritual qualities should be part of criteria requirement in appointment exercises. Thus, the *Sharia* committee members are scholars of Islamic law and *Muftis*, but they still need to be remembered with the several Islamic spiritual qualities through the regulatory laws which would improve the mandate of supervisory and advisory (Halstead, J. M. 2007). Allah tasks believers with the act of remembrance to each other (*Tazkirah*) Suratul Adh-Dhariyat, 51: 55. The following Islamic spiritual qualities should be included in the draft to upgrade the mandate of advisory and supervisory of Islamic Banks as a recruitment criteria since it is the same attitude and characteristic of Islamic *Muftis* according to classical Islamic *Fatwa* and the institution remain Islamic (Lock, 2013; Amanullah, 2015).

Firstly: Integrity and Good intention (*Anniya Assaliha /Ikhlās*), as *Sharia* committee member one need to clean his intention for the mandate to be perfumed in the sake of Allah as declared by Surat Albayyinah Q 98: 5. Again, Umar Bin Khattab was reported to have said, "I heard Allah's Apostle saying, "The reward of deeds depends upon the intentions and every person will get the reward according to what he has intended. So, whoever emigrated for worldly benefits or for a woman to marry, his emigration was for what he emigrated for" (Bukhari, 2009; Lock, 2013).

Secondly: Observance of the Almighty Allah in secret as well as in the public (*Muraqaba*) and eternal accountability and supervision (The Supreme *Muraqaba*)

These qualities are upon everyone as confirmed by the statement of the Holy Quran; Al-Isra:17: 36; Qaff 50: 18 and Al-Infitar 82: 10. (Ibn Kathīr, 2000).

Thirdly: Sincerity and truthfulness i.e. Fearing Almighty Allah in all the activities of supervisory and advisory mandate (*Attaqwa*), as mentioned in Suratul Dalaq, Quran 65: 1- 4. This would absolutely link to the successful supervision of Islamic bank as promised by Almighty Allah.

Lastly, but certainly not the least: They (SCs) should always remember that they are the backbone of the IBs, if they succeed in the act of advisory and supervisory then the whole financial interaction will do the same and vis a vis. with this, they correspondence with Surat Al-hujra at; Quran 49: 10 and Surat Alma 'Ida; 5: 2 as they bring Muslims nearer to Almighty Allah with the *Fatwa* issuance of successful business transaction and interaction accordingly (Ibn Kathīr, 2000; Lock, 2013). Undeniably, an effective regulatory law can create a confidence on investors and reduces the abuses which affects the stability of financial relations then the basis of Islamic spiritual qualities can be the best solution as far as the institution is Islamic as concern. (Amanullah, 2015).

As such, this research is contributing a very important mechanism toward uplifting complete *Sharia* compliance through advisory and supervisory mandate of IBs in Malaysia through the

recruitment criteria. Since the classical Islamic *Fatwa* framework under Islamic jurisprudence adopted it and succeeded toward recruitment exercises upon every Islamic *Mufti* at various Islamic *Fatwa* Institutions (Lock, 2013; Halstead, 2007).

### Conclusion

To this end, absent of Islamic spiritual qualities which is the main qualities and characteristics between Islamic Banks and conventional, it includes the adoption of above-mentioned but not limited to, in to current RFW of Malaysia as recruitment criteria. It should also be included as a reminder to the entire board and management of the Islamic Banks more especially to *Sharia* committee members because of their mutual commitment with the activities of Islamic Banks in assuring complete *Sharia* compliance mechanism.

Finally, the paper seeks to improve the role of the *Sharia* committee members of Islamic Banks, its attached spiritual benefit apart from worldly benefit thoroughly, so that the SCs would acquire benefits of their job not only in this life, but also in the hereafter. With the new additional criteria in regulatory laws for recruitment exercises, it can be easily concluded of positive use and adoption of the Malaysian SRFW by other countries for smooth take-up of Islamic Banking in their various countries.

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