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البنك المركزي الصومالي

CENTRAL BANK OF SOMALIA

Licensing and Supervision Department

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Guidelines on Shari'ah Governance Framework for Islamic (ICBs) in Somalia

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PART I - INTRODUCTION

1. Introduction

- (1) These Guidelines, the Shariah Governance Framework (the "SGF"), set out the Central Bank of Somalia's (CBS) expectations in relation to the minimum standards for Shariah Governance framework by all Islamic Commercial Banks (hereinafter referred to as "ICBs"), and therefore will form part of the framework used to assess the effective of Shari'ah Governance and to ensure that its Islamic operations and business activities are in accordance with the principles of Shariah.
- (2) CBS places great importance in ensuring that the ICBs operates in accordance with Shariah principles. This is to be achieved through the one-tier Shariah governance infrastructure (Decentralized Model) which is internal Shariah Committee formed in each respective ICB.
- (3) The Islamic Financial Service Board (IFSB)¹ has issued a standard on Shariah Governance Framework (IFSB-IO). The full document can be downloaded at: <https://www.ifsb.org/published.php>

2. Authority

- (1) This guideline is made by the Central Bank of Somalia (CBS) pursuant to its authority set forth in Sections 34 and 108 of the Financial Institutions Law, 2012 ("FL").

3. Applicability

- (2) This Shariah Governance Framework (SGF) guideline document is applicable to Islamic Commercial Banks (ICB) which includes full-fledged Islamic banks, branches or subsidiaries of international banks offering Islamic banking services and Islamic banking windows offered by conventional banks.

4. Objectives

The Shari'ah Governance Framework (SGF) is issued for the following objectives:

- (1) Providing guidance to Islamic Commercial Banks (ICB) to implement Shari'ah governance structures, processes, and arrangements to ensure that all their operations and business activities are in accordance with Shari'ah.
- (2) Providing guidance to the board, Shari'ah Committee, and management of the ICB in discharging its duties in matters relating to Shari'ah; and
- (3) Outlining the functions relating to Shari'ah audit/ review and Shari'ah research.

¹ The Islamic Financial Services Board (IFSB) is an international standard-setting organization that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors.

PART II: DEVELOPMENT OF SHARI'AH GOVERNANCE FRAMEWORK**5. Shari'ah Governance Framework (SGF)**

- (1) An ICB is required to develop an internal Shari'ah governance framework to ensure an end-to-end Shari'ah compliant control mechanism for its business operations.
- (2) For an ICB that in its Article of Incorporation indicates that the ultimate responsibility for Shari'ah matters is with the shareholders, the shareholders shall approve the SGF. Nonetheless, the shareholders may delegate the responsibility on Shari'ah matters to the Shari'ah Committee, which will be the ultimate organ within an ICB and shall report to the shareholders via the general assembly on annual basis.
- (3) An ICB needs to reassess the practicality of implementing the SGF according to the nature of business, complexity of the operation, size, and immediate future strategic business expansion plan of an ICB. Nonetheless, an ICB shall seek prior approval of the CBS to implement the minimum requirements as specified in the SGF.
- (4) The SGF of an ICB shall, at the minimum, comprise the following:
 - A board of directors (BOD) that plays adequate oversight roles on Shari'ah compliance aspects of the ICB's overall operations.
 - The requirement for an ICB to establish a Shari'ah Committee of which the majority shall comprise persons with appropriate qualifications and experience in Shari'ah;
 - The responsibility for the management of the bank to provide adequate resources and capable manpower support to every function involved in the implementation of Shari'ah governance,
 - An internal Shari'ah review/audit that is conducted on a continuous basis covering end-to-end process of product and services and other activities of an ICB.
 - An internal Shari'ah secretariat to perform secretariat function and Shari'ah research.
- (5) The SGF shall be translated through a set of policies and procedures that further explains the structure, roles, responsibilities, accountabilities, and the scope of duties of the various functions within an ICB.
- (6) The ICB shall establish formal reporting channel(s) among the key functions to ensure that the reporting on Shari'ah matters is carried out effectively and on timely manner.
- (7) The size of an internal Shari'ah research, review/audit functions within an ICB will depend on the size and nature of the business operations of the institution.
- (8) An ICB that need to resort to other alternatives or means, e.g. outsourcing is allowable subject to the approval of the Central Bank of Somalia (CBS).
- (9) A branch or a subsidiary for an international Islamic bank, may leverage on its head office's Shari'ah committee subject to the approval of the CBS. Nonetheless, the branch of an international Islamic bank is still required to comply with other requirement of establishing an internal Shari'ah review/audit function.

Part III: Accountability and Responsibility of Key Functions**6. Accountability and responsibility of the General Assembly and Board of Directors**

- (1) For an ICB that its Article of Incorporation indicates that the shareholders in the general assembly (GA) are the ultimate body within an ICB in ensuring overall SharT'ah compliant, the GA shall approve the SGF. The GA may delegate certain roles and responsibilities to be executed by the BOD and the management in implementing and operationalizing the SGF.
- (2) For an ICB that its Article of Incorporation indicates that the BOD is ultimately accountable and responsible on the overall Shari'ah matters, the BOD is to approve the SGF and to ensure its implementation by the management.
- (3) The BOD is also expected to perform diligent oversight over the effective functioning of the IIBS's Shari'ah governance framework and ensure that the framework commensurate with the size, complexity, and nature of its business.
- (4) The Shari'ah Committee members shall be appointed by the GA or by the BOD depending on the individual IIBS's governance structure in the Articles of Incorporation.
- (5) The number of Shari'ah Committee members to be appointed must not be less than three (3), with the majority must possess strong knowledge in Shari'ah.
- (6) At least one of the Shari'ah Committee members must be a Somalian residing in the country.
- (7) The BOD must ensure that an effective communication policy among the key functions of the IIBS and with staff is in place to facilitate smooth escalation of material matters relating to Sharrah.
- (8) The general assembly or the BOD shall remunerate the Shari'ah Committee members appropriately.

7. Accountability and responsibility of the Shariah Committee

1. The Shari'ah Committee shall be responsible and accountable for all its decisions, views, rulings, and opinions related to Shari'ah matters.
2. The Shari'ah Committee is expected to rigorously deliberate the issues before making any decisions. The Sharrah decisions, views and opinions shall bind the operations of the ICB.
3. The Shari'ah Committee is expected to perform an oversight role on Shari'ah matters related to the ICB's business operations and activities through Shari'ah review/audit and Shari'ah Secretariat/Research functions.
4. Further requirements on the duties and responsibilities of the SharT'ah Committee and the operation procedures for the Shari'ah Committee are detailed out in Appendix 1 and Appendix 2 respectively.
5. In discharging its duties, the Shari'ah Committee is expected to disclose sufficient information in the ICB's annual report on the state of Shari'ah compliance of the ICB. The disclosure, at minimum, should include:
 - a) the purpose of the Shari'ah Committee's engagement.
 - b) a clear statement of management's responsibility in ensuring compliance with Shari'ah principles.

- c) a statement describing the nature of the work performed.
- d) confirmation that the Shari'ah Committee has performed appropriate tests, procedures, and review work as appropriate.
- e) Shari'ah Committee's opinion on the ICB's compliance with Shari'ah in respect of contracts and related documentation used.
- f) appropriateness of Shari'ah basis for the allocation of profit between shareholders and investment account holders.
- g) if any, disposal of any earnings from prohibited sources/means to charitable causes.
- h) zakat computation; and
- i) any known non-compliance with Shari'ah and action taken to remedy such noncompliance.

8. Accountability and responsibility of the Management

- (1) Management shall be responsible for implementing Shari'ah rulings and decisions made by the Shari'ah Committee of the ICB respectively.
- (2) Management is expected to provide complete and accurate information and disclosure to the Shari'ah Committee in a timely manner for the Shari'ah Committee to discharge its duties effectively.
- (3) It is the responsibility of management to allocate adequate resources and manpower to support the Shari'ah governance framework such budget allocation, reference and research materials, trainings, and development, etc.
- (4) It is the responsibility of management to promote the awareness of Shari'ah compliance culture within the organization. A holistic culture of Shari'ah compliance refers to the way in which the ICB complies with Shari'ah principles in its overall operations.
- (5) In the situation where management discovers certain operations are carrying out business(es) which is(are) not in compliance with Shari'ah, or against the advice of its Shari'ah Committee, management shall on timely manner notify the BOD, Shari'ah Committee, and the CBS. ICB's annual report.

Part IV: Independency

9. Shariah Committee Independency

- (1) The BOD and management shall recognize the independence of the Shari'ah Committee in exercising objective judgment in deliberating issues brought before them.
- (2) The BOD and management shall ensure that decisions made by the Shari'ah Committee are duly observed and implemented by the ICB.
- (3) The Shari'ah Committee shall have access to accurate, timely and complete information from management.
- (4) In the situation where the Shari'ah Committee discovers certain operations and activities of the ICB are not Shari'ah compliant, the Shari'ah Committee shall inform the BOD and/or the general assembly (depending on ICB's governance structure) on the Shari'ah non-compliant issue and shall recommend suitable measures to rectify the situation.
- (5) In cases where Shari'ah non-compliant activities are not adequately addressed or no rectification measures are made by the ICB's management, the Shari'ah Committee shall inform the Central Bank of Somalia. All appointment including reappointment, resignation and removal of the Shari'ah Committee members shall be made through the BOD and the name of the Shari'ah Committee members shall be submitted to the Central Bank of Somalia for information.

Part V: Competency**1. Competency and capability**

- (1) The BOD and management are expected to have reasonable understanding on the principles of the Shari'ah and its broad application in Islamic finance.
- (2) The Shari'ah Committee is expected to have a strong understanding of Shari'ah and have sufficient knowledge on Islamic finance.
- (3) The Shari'ah Committee members are expected to keep abreast of the latest development of Islamic finance and relevant knowledge on Shari'ah.
- (4) The ICB shall develop a set of fit and proper criteria for the appointment of any Shari'ah Committee member, using the minimum criteria set in this guideline (Appendix 3).
- (5) The ICB shall provide necessary support to have access to other professionals such as lawyers, accountants, and economists in getting their appropriate assistance and advice.
- (6) The ICB is required to formulate a performance appraisal methodology of the Shari'ah Committee members which should include the element of competence, knowledge, contribution, and overall effectiveness of the Shari'ah Committee members on Shari'ah deliberations.
- (7) The ICB should develop a succession-planning program for the Shari'ah Committee members to ensure continuity of the Shari'ah compliance governance and processes.

Part VI: Confidentiality**2. Confidentiality**

- (8) The Shari'ah Committee shall be given the necessary access to files, records, draft materials, and conversations, including those categorized as confidential, as long as the information is related to the work undertaken by the committee.
- (9) It is always the responsibility of the individual Shari'ah Committee to observe the principle of confidentiality.
- (10) Confidential information is defined as information received by members of the Shari'ah Committee that is not public in nature and has not been authorized to be made public.
- (11) An ICB shall not appoint any member of its Shari'ah Committee from a Shari'ah Committee of another ICB. This is to ensure that the committee member would be more focused and independent to avoid conflict of interest and to maintain the confidentiality of information.
- (12) The members of the committee shall be expected to sign a non-disclosure agreement after their appointment.

Part VII: Consistency**3. Professional ethics, judgment, and consistency**

1. An ICB is encouraged to adopt the "Basic Professional Ethics and Conduct for Members of the Shari'ah Board" as per the IFSB 10.
2. The Shari'ah Committee is expected to develop a structured process in arriving at Shari'ah decisions which must be documented, adopted, and maintained at all times to ensure the credibility of the process.
3. Members of the Shari'ah Committee must exercise appropriate judgment by keeping in mind both the technical aspects of Shari'ah and the objective of Shari'ah. They should be cognizant to legal, regulatory environment and ethical dimension in their judgment.
4. Members of should appreciate the diversity of opinions among various mainstream school of thoughts and differences in expertise among the fellow members of the Shari'ah Committee. No one member should dominate the Shari'ah Committee's judgement.

Part VIII: Shari'ah Compliance Function**4. Comprehensive Shari'ah compliance function**

- (1) The ICB must also ensure that the independence, competency, control, management reporting structures and activities of these functions meet the requirements of the SGF.

5. Shari'ah Review/Audit Function

- (1) The ICB shall establish Shari'ah compliance functions to be carried out through the review/ audit function.
- (2) The Shari'ah review/audit function refers to regular assessment on Shari'ah compliance in the activities and operations of the ICB.
- (3) The review/audit function shall be performed by qualified personal with adequate knowledge on Shari'ah, particularly in Fiqh Al-Muamalat, with the objective of ensuring that the activities and operations carried out by the ICB are Shari'ah compliant at all times specially in the product development process operation procedures for the Shari'ah Committee are detailed out in Appendix 4.
- (4) The review/audit function may be outsourced to external Shari'ah compliant service provider provided that the oversight, accountability, and responsibility over these functions must remain with the ICB.
- (5) Any incident of non-compliance shall be recorded and reported to the Shari'ah Committee to be deliberated, addressed, and rectified by the ICB accordingly.
- (6) The SharT'ah review/audit unit shall ensure to maintain all records of its assessment for analysis purposes

6. Shari'ah Secretariat/ Research Function

- (1) An ICB shall establish an internal unit comprising qualified Shari'ah officers to conduct the secretarial role and research function.
- (2) The role of the secretariat shall include coordinating meetings, compiling proposal papers, disseminating Shari'ah decisions to relevant stakeholders and engaging with relevant parties who wish to seek further deliberations of issues by the SharTah Committee.
- (3) The Secretariat role also is expected to ensure proper deliberation process and dissemination of SharT'ah related matters to the Shari'ah Committee on timely manner.
- (4) Meanwhile, the Shari'ah research function is expected to conduct pre-product approval process, research, vetting of issues for submission to support Shari'ah Committee in deliberation and making sound decision.
- (5) This function is also expected to provide day-to-day internal Shari'ah advice and consultancy to relevant parties, including those involved in the product development process for matters that have been approved by the Shari'ah Committee.
- (6) The function shall be performed by qualified Shari'ah officers, and the scope of work shall predominantly cover aspects of the SharT'ah matters.
- (7) In undertaking such research, advice and input on technical matters may be sought from the experts, e.g. accountants, actuaries, to ensure comprehensiveness and completeness of the information and analysis in assisting the Shari'ah Committee in understanding of the relevant concepts and approaches for sound decision-making purposes.

Appendix 1: Duties, Responsibilities & Accountability of the Shari'ah Committee

The main duties and responsibilities of the Shari'ah Committee are:

1. Responsibility and accountability

The Shari'ah Committee is expected to understand that, in the course of discharging the duties and responsibilities, it is accountable for all its SharT'ah decisions, opinions and views.

2. Advise the board and ICB.

The Shari'ah Committee is expected to advise the BOD and provide input to the ICB on Shari'ah matters in order for the ICB to comply with SharT'ah principles at all times.

3. Endorse Sharrah policies and procedures.

The Shari'ah Committee is expected to endorse Shari'ah policies and procedures prepared by the ICB and to ensure that the contents do not contain any elements which are not in line with Shari'ah.

4. Endorse and validate relevant documentations.

To ensure that the products of the ICB comply with SharT'ah principles, the Shari'ah Committee must approve:

- (i) the terms and conditions contained in the forms, contracts, agreements, or other legal documentations used in executing the transactions; and
- (ii) ii) the product manual, marketing advertisements, sales illustrations and brochures used to describe the products.

5. Assess work carried out by Shari'ah review/ audit.

To assess the work carried out by SharT'ah review/audit to ensure compliance with Shari'ah principles which forms part of their duties through providing their assessment of Shari'ah compliance and information in the annual report.

6. Assist related parties on Shari'ah matters.

The related parties of the ICB such as its legal counsel, auditor or consultant may seek advice on Shari'ah matters and the Shari'ah Committee is expected to provide the necessary assistance to the requesting party.

7. Advise on matters to be referred to the General Assembly or the BOD

The Shari'ah Committee may advise the ICB management, after taking all necessary steps, to consult the General Assembly or the BOD (depending on the ICB's governance structure) on Shari'ah matters that could not be resolved and copy the Central Bank of Somalia for information.

8. Provide written Shari'ah opinions.

The SharT'ah Committee is required to provide written Shari'ah opinions in circumstances where the ICB submits applications to the Central Bank of Somalia for new product approval.

Appendix 2: Operation Procedures for the Shari'ah Committee**a) Frequency of Meetings and Attendance**

- It is advised that meetings are held regularly to ensure that the Shari'ah Committee is kept sufficiently in touch with the business of the ICB.
- In this regard, Shari'ah Committee meetings shall be held at least once every quarter.
- The Shari'ah Committee member is expected to contribute and allocate adequate time and efforts to discharge his or her duties effectively. The Shari'ah Committee member must attend at least 75 percent of the Shari'ah Committee meetings held each financial year. Where necessary, the participation of the Shari'ah Committee can be facilitated by means of video or telephone conferencing.
- The number of Shari'ah Committee meetings held in the year, as well as the attendance of every Shari'ah Committee member shall be disclosed in the ICB's annual report.

b) Minimum Quorum

- The minimum quorum of a Shari'ah Committee meeting shall be two-third majority of attending members must be members with Shari'ah background.

c) Decision-making

- Decisions shall be made based on the majority of members with Shari'ah background in the situation that all three members attending the meeting. In a situation where only two out of three Shari'ah Committee members attending the meeting, the decision shall be made on consensus basis and both members shall be from Shari'ah background.

d) Chairman

- The Chairman of the Shari'ah Committee shall be a member with qualified Shari'ah background.

e) Reporting

- The Shari'ah Committee shall put on record in its report or statements addressed to the BOD, its concerns over any Shari'ah non-compliance issues.

Appendix 3: 'Fit-and-Proper' Criteria (person) of the Shari'ah Committee**a) Appointment of the Shari'ah Committee Member**

- The general assembly or BOD (depending on the ICB's governance structure) shall appoint the member of the Shari'ah Committee.
- The ICB shall inform the CBS about the appointment and reappointment of a Shari'ah Committee member.

b) Application Procedures of the Shari'ah Committee Member

- In processing the application of a Shari'ah Committee member, vetting shall be conducted to ensure that the proposed Shari'ah Committee member is a 'fit and proper' person. Similar vetting process shall also be conducted for his or her reappointment.

c) Resignation and Dismissal of the Shari'ah Committee Member

- An ICB shall notify the Central Bank of Somalia of any resignation or dismissal of a member of the Shari'ah Committee within fourteen (14) days of the date of resignation or dismissal, stating the of such resignation or dismissal.

d) Qualification

- A member of a Shari'ah Committee shall be a Muslim individual.
- The majority of the members in the Shari'ah Committee shall at least hold bachelor's degree in Shari'ah, recognized by the concerned authority in Somalia.
- It is reasonable to expect that the majority members of the Shari'ah Committee should be able to demonstrate strong proficiency and knowledge in written and verbal Arabic, Somali and English. The requirement of having strong proficiency in the languages is to ensure that the Shari'ah Committee can provide value added opinion on all documents spell out in the languages.
- The Shari'ah Committee may comprise experts from relevant backgrounds such as banking, finance, and law, which could support the depth and breadth of the Shari'ah deliberations. However, these members must not form the majority of the Shari'ah Committee.
- The Shari'ah Committee preferably shall comprise members of diverse backgrounds in terms of qualification, experience, and knowledge.

e) Disqualification

- The members of the Shari'ah Committee shall be persons of acceptable reputation, character, and integrity. In particular, any member should be disqualified due to any of the following breaches:
 - i. acted in a manner which may cast doubt on his fitness to hold the position as a Shari'ah Committee member.
 - ii. failed to attend 75 percent of the Shari'ah Committee meetings in a year without reasonable excuse; iii. declared a bankrupt or a petition under bankruptcy laws is filed against him.
 - iii. found guilty of any serious criminal offence or any other offence punishable with imprisonment or
 - iv. subject to any order of detention, supervision, restricted residence, or banishment.
- If a Shari'ah Committee member becomes subject to any ground of disqualification stated above, the ICB shall terminate the appointment of the Shari'ah Committee member.
- The Shanah Committee member shall not be:
 - i. an employee of the ICB or any of its related companies for the current financial year; and
 - ii. a Shari'ah Committee member of another ICB within the same industry.

Appendix 4: Product Development Process

- One of the major deliverables of every ICB is the offering of Shariah compliant financial products to the market to meet the demand of the customers. In this regard, the ICB must ensure that the product development process is comprehensive and robust to minimize possibilities of the product to be nullified on Shariah grounds.
- Generally, Shariah non-compliance may occur during the product development process that could originate from improper structuring of products, lack of internal research in understanding the appropriate Shariah concepts, and misrepresentation of the product at issuance or marketing stage of the product.
- The ICB must acknowledge that managing a Shariah-based institution has to be a continuous process, and it requires the ICB to have in place adequate and appropriate measures and controls, including risk-mitigating instruments that could address or mitigate Shariah non-compliance instances.
- Therefore, the ICB is expected to refer all Shariah issues related to its end-to-end product development design and process to the Shariah Committee. The requirement for an advice or a decision must be made in a comprehensive manner for effective deliberation by the Shariah Committee. This will include explaining the process involved, documents used and other necessary information.
- All new products shall be certified by the Shariah Committee and must be backed by the relevant fiqh literature, evidence, and reasoning. There shall be rigorous deliberation process among the Shariah Committee as well as detailed scrutiny of the legal contracts and other documents relevant to the products or transactions.
- Product development covers both pre-product approval (i.e. process of product structuring and developing prior to introduction to the market) and post-product approval process (i.e. process after the product has been offered to the customers and transactions have been carried out).
- **Pre-product Approval:** Pre-product approval process involves namely the issuance of Shariah decisions, product structuring or design processes backed by comprehensive Shariah research, vetting of contracts and agreements as well as compliance checks before the product is offered to the customers.
 - There shall be a formal and transparent procedure for issuance of Shariah decisions which are well documented and approved by the board and Shariah Committee.
 - An ICB shall ensure that the pre-product approval process includes, among others, a review of the concept, structure, term sheet, documentations, policies and procedures, pamphlets, brochures, and advertising materials. The documents shall be approved by the Shariah Committee of the ICB.
- **Post-product Approval:** Post-product approval process involves monitoring product implementation to ensure compliance with Shariah principles, identifying the area of potential Shariah non-compliance risks and proposing the relevant actions to the management. An ICB must ensure that post-product approval in its Shariah governance framework also includes internal Shariah review and Shariah governance reporting. Without such follow-up, the ICB would not be able to monitor the consistency of its Shariah compliance and effectively manage any Shariah non-compliance risks that may arise over time.



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