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Malaysian's Government Linked Investment Companies: Is There a Need for Shariah Governance Framework?

Syarikat Pelaburan Berkaitan Kerajaan Malaysia: Adakah Perlu Rangka Kerja Tadbir Urus Syariah?

Wan Amir Shafiq bin Ab. Nasir^{*}, Rusni Hassan^{**}, and Ibraheem Musa Tijani^{***}

Abstract

This paper attempts to examine the absence of a Shariah Governance Framework (SGF) in Malaysian's Government Linked Investment Companies (GLICs). A GLIC is essential for the Malaysian economy, while SGF is practiced by the Islamic Financial Institutions (IFIs) in Malaysia to ensure end-to-end Shariah compliant process in the business operation of the banks and takaful operators. When the GLIC aims to provide Shariah compliant returns to their investors (public), the move should be supported by all stakeholders as majority of the investors of the GLICs are Muslims, and thus the demand for a Shariah compliant dividend is expected. As for the IFIs in Malaysia, the Central Bank of Malaysia requires all IFIs to establish an SGF to ensure their activities comply with Shariah principles. The question arises whether this requirement should be practiced by the GLICs too. This paper examines the importance of SGF to be established by the GLICs. Since this study is focusing on the importance of SGF in GLICs, interviews and document analysis methods are used for data collection.

Keywords: Government Linked Investment Companies, Shariah Governance Framework, Shariah Compliance, Islamic Finance.

Abstrak

Makalah ini cuba meneliti permasalahan mengenai ketiadaan Kerangka Tadbir Urus Syariah (Shariah Governance Framework atau SGF) di Syarikat Pelaburan Berkaitan Kerajaan (Government Link Investment Companies atau GLIC) di Malaysia.

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Syarikat Pelaburan Berkaitan Kerajaan adalah penting untuk ekonomi Malaysia, sementara Kerangka Tadbir Urus Syariah merupakan peraturan yang dipraktikkan oleh Institusi Kewangan Islam (IKI) di Malaysia untuk memastikan proses patuh Syariah dipatuhi secara keseluruhan dalam setiap aspek operasi bank Islam dan pengendali takaful. Apabila Syarikat Pelaburan Berkaitan Kerajaan menjalankan perniagaan bertujuan untuk memberikan pulangan patuh Syariah kepada pelabur mereka, langkah tersebut harus disokong oleh semua pihak yang berkepentingan kerana majoriti pelabur Syarikat Pelaburan Berkaitan Kerajaan adalah beragama Islam yang mengharapkan dividen yang patuh Syariah. Di Malaysia, Bank Negara Malaysia menghendaki semua IKI mengamalkan Tadbir Urus Syariah untuk memastikan aktiviti mereka mematuhi prinsip Syariah. Persoalan yang timbul adakah syarat ini juga harus dipraktikkan oleh Syarikat Pelaburan Berkaitan Kerajaan. Makalah ini mengkaji sama ada perlunya Kerangka Tadbir Urus Syariah ditubuhkan oleh Syarikat Pelaburan Berkaitan Kerajaan ini. Kajian ini akan memfokuskan pada keperluan Kerangka Tadbir Urus Syariah dalam Syarikat Pelaburan Berkaitan Kerajaan di mana kaedah temuduga dan analisis dokumen adalah kaedah yang digunakan untuk pengumpulan data.

Kata Kunci: Syarikat Pelaburan Berkaitan Kerajaan, Kerangka Tadbir Urus Syariah, pematuhan Syariah, kewangan Islam.

Introduction

Government Linked Companies (GLCs) and GLICs plays a major role in the Malaysian economy. It was quoted in the Government Linked Companies Transformation Programme (GLCTP) report by the Prime Minister of Malaysia (2015), who is also the Chairman of the Putrajaya Committee on Government Linked Companies High Performance, that “the Government Transformation Programme (GTP) and Economic Transformation Programme (ETP) has successfully propelled the country further in its economic and social development. Malaysia’s Gross National Income (GNI) per capita has grown 40.4% from USD 7,590 in 2009 to USD 10,660 in 2014 and is expected to achieve the target of USD 15,000 by 2020. Our economic growth has been recognised by international bodies such as Bloomberg, which has rated Malaysia as the world’s fifth most promising emerging market in 2015 and the only ASEAN country in its top ten. In July 2015, Malaysia was ranked as the eighth most efficient government globally by the World Economic Forum. Malaysia’s economic growth and development would not have been successful, had the Government Linked Companies Transformation Programme not been initiated to transform the GLCs” (pp.7). It was also supported by the Secretariat to the Putrajaya Committee on Government Linked Companies High Performance, Tan Sri Dato’ Azman Hj. Mokhtar and Mohd Izani Ashari that “the GLCs have made RM 153.9 billion

worth of domestic investments from FY 2004 to FY 2014 and employed 225,050 Malaysians in 2014 (28 July 2015) (Putrajaya Committee on GLC high performance 2015, pp.9)". This shows that the GLCs and GLICs strongly supports growth of the Malaysian economy especially in the financial system.

In Malaysia, there are a few GLICs that can be considered as 'giant asset management companies. These companies have an abundance of investments especially in companies listed in Bursa Malaysia. Examples of these GLICs are Lembaga Tabung Haji (LTH), Employees Provident Fund (EPF), Khazanah Nasional Berhad (Khazanah) and Permodalan Nasional Berhad (PNB).

Islamic finance is not new in Malaysia. Since the introduction of the first Islamic bank in Malaysia, i.e. Bank Islam Malaysia Berhad (BIMB) in 1983, its progressive development has been remarkable. Malaysia is now the leader in Islamic Finance globally having comprehensive and supportive infrastructure particularly in Shariah compliance and governance. All Islamic financial activities must comply with regulatory standards and its Shariah requirement set by the Central Bank and the Securities Commission of Malaysia (SC).

However, Islamic Finance is new to GLICs, but they can learn from the established Islamic finance industry such as Islamic banking and takaful. All Islamic banking business activities must comply with regulatory standards and its Shariah requirement set by the Bank Negara Malaysia (BNM) and SC. The rationale of it is that in Islamic institutions, the competition is not only among the Islamic Banking industry but includes conventional banks too as they have been in the industry far longer than the Islamic banks. Since Islamic banks have to adhere to the Shariah principles laid out in the Holy *Quran* and *Hadith*, it is a challenge for Islamic banks to adhere to the Shariah requirements regulation set by the regulators while providing attractive yields and service in order to compete with the conventional system. Poor Shariah governance of Islamic banks could cause reputational crises. Furthermore, the need of strong governance in Islamic finance is needed now more than ever. Shariah governance is the very essence of the Islamic financial system in building and maintaining the confidence of the shareholders as well as the other stakeholders that all transactions, practices and activities are in compliance with the Shariah principles (ISRA 2016, p.703).

This research focuses on the issue of the lack of existence a Shariah governance in GLICs that were not governed by the regulators

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such BNM and the SC. In Malaysia, these two institutions govern the financial industry heavily including the Islamic banks and takaful companies. Hence, they impose strict regulations on all aspects of Shariah-compliance through the introduction of SGF in 2010.

Taking Malaysia's experience into research, the government through these GLICs have been investing and managing companies before the introduction of Islamic finance. Hence, when the demand for Islamic finance increases year after year, the government has to follow suit especially if it is using the public's money in managing the companies.

Research Objective

This study aims to achieve the following objective:

- To scrutinise the Shariah governance practices in GLICs.

Research Question

- To what extent does the GLICs practices Shariah governance in their operations?

Problem Statement

There are no regulatory requirements for GLICs to comply with Shariah requirements in their operations and thus no specific framework to govern the Shariah activities. The SGF was introduced by BNM in 2010 and the IFIs related under this framework are the Islamic banks and takaful companies licensed under Islamic Financial Service Act 2013 and the development financial institution prescribed under the Development Financial Institutions Act 2002 that participates in the Islamic Banking Scheme (Central Bank Malaysia, 2002 & Amendment, 2015). However, the GLICs were excluded from the obligation to set up an SGF to ensure Shariah governance structures, processes and arrangements are in accordance with the Shariah. The Framework provides a comprehensive guidance to the board, Shariah Committee and management of the IFI in discharging its duties in matters relating to Shariah and outlines the functions relating to Shariah review, Shariah audit, Shariah risk management and Shariah research.

This research will be focusing on GLICs that are working in a similar manner with the IFIs whereby they are using the public's deposits or investment to invest according to their investment portfolio. GLICs are defined as Federal Government-Linked Investment Companies such as

Employees Provident Fund (EPF), Lembaga Tabung Angkatan Tentera (LTAT), Lembaga Tabung Haji (LTH) and Permodalan Nasional Berhad (PNB) (Putrajaya Committee on GLC high performance, 2015).

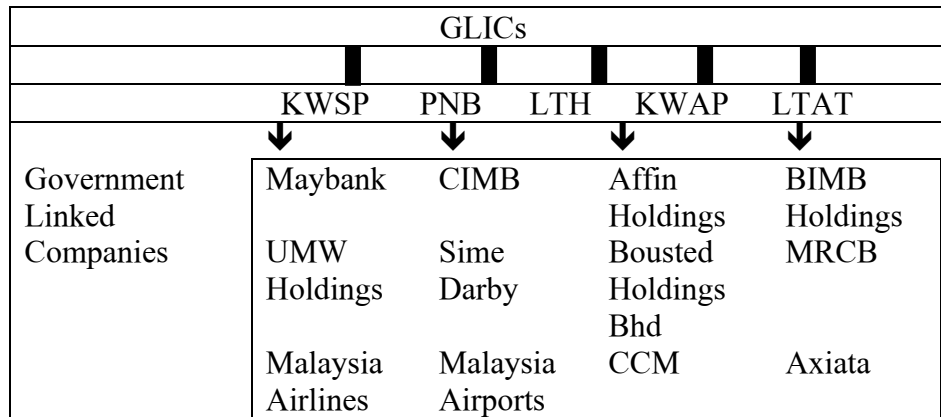
In 2013, the Government has introduced the Islamic Financial Services Act (2013) whereby it penalises the offenders who breach the Shariah principles with heavy punishment up to RM25 million or/and 8 years imprisonment. According to Miskam & Nasrul (2013), this Shariah governance provisions under the Shariah Advisory Council (SAC) is among the latest features made available which empowers the authorities of SAC itself as well as posing a more diverse practicality over the main aspects in IFI while maintaining the status as the highest supervision power for the IFIs in Malaysia. Based on the literature available, most of the GLICs are trying to introduce Shariah compliant investment to meet the expectations from the public.

The implication of non Shariah governance in an IFI is a disadvantage to the *ummah* (global Muslim community). It is about time that the governance of these institutions should be uphold in all aspects including Shariah compliant aspect and activities as *amanah* (trust) in Islam must be carried seriously.

GLICS and Shariah Governance Framework 2019

In Malaysia, there is a difference in the definition of GLCs and GLICs. The GLCs are controlled by the Malaysian government via the Federal GLICs, whereas the GLICs are defined as an investment arms of the government that allocate government funds to the GLICs (Lau & Tong, 2008). The GLICs such as EPF, Kumpulan Wang Persaraan (Diperbadankan) (KWAP), LTH, LTAT and PNB were not directly funded by the government. They receive funds from the public which they invest to generate returns for their investors. Meanwhile, the example of GLCs in Malaysia are Maybank, Sime Darby, CCM, Axiata, Tenaga Nasional Berhad, Malaysia Airlines and UMW (Putrajaya Committee on GLC high performance, 2015). Diagram 1.1 explains the relationship between the GLICs and GLCs.

Diagram 1.1: GLCs are owned by GLICs



Source: Authors' own

Each GLICs has an important social agenda, along with economic agenda of good investment returns (Gomez 2017). Different GLICs were created for different purposes and will carry different mandates set by the government. For example, LTH was mandated to manage the public's money in helping the Muslims in achieving the 5th pillar of Islam which is to perform Hajj (Tabung Haji, 2017), KWAP was mandated to assist the Federal Government in funding its pension liability (KWAP, 2017), the EPF was mandated to provide the best retirement savings for Malaysians (KWSP, 2017), while PNB was created as an instrument of the Government's New Economic Policy (NEP) (Jabatan Penerangan Malaysia, 2017) to promote shared ownership in the corporate sector among the Bumiputera (sons of the soil) (PNB, 2017b).

The funds for these GLICs come from the public. As the awareness of the public or investors on Shariah compliant return increases, these GLICs are keen to invest in accordance to Shariah. However, unlike the IFIs, they are not regulated under the regulators who impose Shariah governance. Therefore, there is a need for Shariah governance in GLICs to ensure the transaction was made in accordance with Shariah principles.

Government Linked Investment Companies

In this research, 'GLICs' refers to EPF, LTH, PNB, LTAT and KWAP. These GLICs act in the same manner whereby they manage

public's fund and provide dividends every year. These GLICs function in various ways. It may be a holding company, a pension fund, a special purpose fund, a sovereign wealth fund or a trust fund manager. While PNB was incorporated under the Companies Act, the other GLICs are statutory bodies. For example, EPF is a federal statutory body under the purview of the Ministry of Finance¹. LTAT is a government statutory body which was established by act of Parliament (Act 101 1973)², KWAP as a statutory body has adopted the Statutory Bodies (Discipline and Surcharge) Act 2000 as part of its Terms of Conditions of Employment to all employees³. Lastly, LTH is a statutory body setup by the Government of Malaysia in 1963. Some of these GLICs have a long history and were established after Malaysian Independence in 1957. For example, LTH was established in the 1960s, LTAT in 1970s while PNB was established in the 1980s while EPF in 1990s. PNB was established after the government decided to intervene in the corporate sector to rectify social injustices. PNB's function is to redistribute corporate wealth more equitably among all Malaysians. The GLICs function primarily as investment holding companies, a business operation method adopted by corporations classified as business groups (Gomez, 2017). Gomez (2017) further adds that "the Ministry of Finance has control of these GLICs, each functioning as huge business group, acting as a holding company with an equity stake in a large number of publicly listed firms which in turn own a huge volume of quoted and unquoted companies. The joint and cross-equity holdings within this pyramiding structure provides the shareholder at its apex, the Minister of Finance, enormous voting rights over quoted companies under the GLICs (pp.12)".

Significance of GLICs

According to Lau & Tong, (2008) "GLICs are investment arms of the government that allocate government funds to the GLCs. In addition to having ownership in GLCs, the Malaysian government also has an influence in the appointment of members of the board of directors and senior management positions (pp.1 & 2)."

¹ [https://en.wikipedia.org/wiki/Employees_Provident_Fund_\(Malaysia\)](https://en.wikipedia.org/wiki/Employees_Provident_Fund_(Malaysia))

² <http://www.ltat.org.my/en/>

³ <http://www.kwap.gov.my/EN/UsefulInformation/Publication/Annual%20Reports/KWAP%20Annual%20Report%202014.pdf>

⁴ <https://www.tabunghaji.gov.my/en/corporate-profile>

The role played by GLCs in Malaysia is widespread and pervasive. In terms of countries that have the highest GLCs presence among their largest firms, Malaysia ranks fifth highest in the world (Kowalski et al. 2013). With total assets amounting to 51% of GDP at end-2015, it shows how the GLCs in Malaysia dominate the economic landscape at home (Menon, 2017). As defined by the Government, GLCs are companies that have a primary commercial objective, with the Malaysian government has a controlling stake in major decisions, for example contract awards, strategy, restructuring and financing, acquisitions and divestments, appointment of management positions and so on.

GLICs are defined as Federal GLICs that allocate some or all of their funds to GLCs investments. Defined by the influence of the Federal Government in: appointing or approving Board members and senior management, and having these individuals report directly to the Government, as well as, in providing funds for operations and/or guaranteeing capital (and some income) placed by unit holders. Examples of the GLICs in Malaysia are EPF, LTAT, LTH, and PNB. The GLCs and GLICs employ roughly 5% of the national workforce (Khazanah, 2018).

In 2005, they account for approximately RM260 billion in market capitalisation or approximately 36% and 54% respectively of the market capitalisation of Bursa Malaysia and the benchmark KLCI (Putrajaya Committee on GLC high performance, 2005). Furthermore, it was also stated in the same report that “in the areas of building international economic linkages through investments in foreign ventures and investments in the new growth sectors, GLCs and GLICs are increasingly playing a more active and significant role in line with a gradual internationalisation of Malaysian economic interests in tune with increased global economic liberalization (pp.2)”.

Malaysian GLICs

Lembaga Tabung Haji (LTH)

LTH is the premiere Islamic financial institution in Malaysia, a statutory body setup by the Government of Malaysia in 1963. LTH's roots can be traced to two bodies responsible for the administration of pilgrimage matters, the Perbadanan Wang Simpanan Bakal-Bakal Haji (Prospective Pilgrims Fund Corporation) and the Pejabat Urusan Hal Ehwal Haji (Pilgrimage Affairs Management), later merged into

Lembaga Urusan dan Tabung Haji (Pilgrims Management and Fund Board) in 1969. The Perbadanan Wang Simpanan Bakal-Bakal Haji was formed in 1962, a result from working paper prepared entitled “Plan to Improve the Economy of Prospective Pilgrims” by professor of economics, Ungku Aziz, based at the University of Malaya in 1959 (Gomez, 2017). In the past, Muslims could not save sufficient funds for the pilgrimage. This resulted to selling their land to raise funds to perform the hajj.

Governed by Tabung Haji Act 1995 (Government of Malaysia, 1995), it is the pioneer in IFI to facilitate Muslim community’s savings for the Hajj and Pilgrimage. The government subsidized the costs incurred for pilgrimage for approximately RM 9,000 per person thus keeping the cost borne by each pilgrim for the hajj to approximately RM 10,000 and in 2016, LTH’s total asset was RM 63.5 billion (LTH, 2016).

Kumpulan Wang Persaraan Diperbadankan (KWAP)

In 1991, the Pensions Trust Fund Act was promulgated to create a reserve to financially assist the government in servicing its pension responsibilities (Government of Malaysia, 1991). The Pensions Trust Fund, established through the act, fell under the responsibility of the Accountant General’s office, situated in the Ministry of Finance. Thus, a Pensions Trust Fund council and an investment panel were created to administer the fund and their members were appointed by the Minister of Finance. Later, the Pensions Trust Fund was reconstituted as KWAP through the Retirement Fund Act 2007 (Government of Malaysia, 2007). All the powers, functions, activities, asset and liabilities of the Pensions Trust Fund were taken over by the KWAP. Under this scheme, the federal government contributed 5% of the total annual budgeted emolument. Meanwhile, statutory bodies, local authorities and other agencies contributed 17.5% of their employees’ salaries into KWAP (KWAP, 2013). The council that was set up earlier was replaced by a board of directors while the investment panel remained. The appointment of these members was by the Minister of Finance (Gomez, 2017). In 2016, KWAP had a total fund size of RM 125 billion (KWAP, 2016).

Lembaga Tabung Angkatan Tentera (LTAT)

LTAT is a retirement savings fund established in 1972 and financed through direct collections from its members. LTAT’s primary objective is to provide retirement benefits and other benefits to its members including officers. The second objective is to implement

transition training programmes for military personnel that will retire and has retired. Since its establishment, this scheme is compulsory only for the military personnel who are not eligible for pension after their service (Government of Malaysia, 2006). In 2015, there has been amendment made in the LTAT Act. Hence, it is compulsory for every staff of Angkatan Tentera Malaysia (ATM) to contribute in this scheme (LTAT 2015). This has made the savings fund bigger and as at December 2016, total asset of LTAT is amounting to RM 9.6 billion (LTAT 2016).

Employees Provident Fund (EPF)

The EPF was established in 1991 which provides retirement benefits for members in a reliable manner (EPF Act 1991, 2015). The scheme was intended to help employees from the private sector, as well as civil servants who preferred this scheme to save a fraction of their salary during their working period for the purpose of retirement or if in the case of the employee are no longer fit to work. Even though the scheme were aimed for retirement for its members, this scheme allowed members to withdraw up to one third of their savings at the age of 50 to purchase a house and medical (Gomez, 2017).

According to Doraisamy (2009), “the rate of contribution was originally set at 5% each for the employer and the employee and remained unchanged until 1975. From 1975 to 1980 the rate of contribution for the employee was 6% while 7% for the employer. It was 9% and 11% respectively during 1980-1992, 10% and 12% respectively during 1993-1994 period. Since 1995, the rate has been 11% and 12% respectively giving a total contribution rate of 23% of the employees’ base remuneration, excluding overtime payments and gratuities” (pp.21). EPF grew rapidly to become an extremely financially well-endowed savings institution. Within a year of its incorporation, EPF had half a million contributing members with funds totaling RM 516.6 million (Gomez, 2017). In 2017, the EPF has approximately 14 million members with 7 million active members who are contributing to the EPF. This has made the total investment assets rose up to RM791 billion, which is the biggest in Malaysia in terms of size (EPF, 2017). This money was invested in Malaysian Government Securities, Money Market Instruments, Loans and Bonds, Equity and Property.

Permodalan Nasional Berhad (PNB)

PNB was established to promote share ownership in the corporate sector among the Bumiputera (son of the soil). There were only 23 public enterprises in 1957 and by the late 1960s the Bumiputera community only owned 2% of the listed company in Malaysia. PNB is a unique case study as it was introduced to support the Government's New Economic Policy.

According to Lim Mah Hui (1981), "analysis of top 100 quoted firms during the 1970s revealed that the corporate sector had undergone little structural change. A substantial degree of interlocking stock ownership through business groups prevailed, indicating that wealth remained concentrated in the hands of large foreign corporations and a few Chinese family-owned firms (Gomez, 2017, pp.34). This led to the racial riot of 1969 which goes down as a bad history for Malaysians. Gomez, (2017) continued that when the riots of 1969 occurred, this conflagration was attributed to wealth and social inequities that had not been redressed since independence. Hence in 1971, the Government introduced the NEP which aims to promote share ownership in the corporate sector. The NEP was a 20-year programme so the Government created Yayasan Pelaburan Bumiputera (Bumiputera Investment Foundation) to support this new policy. The Yayasan Pelaburan Bumiputera was founded by then, Prime Minister of Malaysia Tun Hussein Onn. The Yayasan Pelaburan Bumiputera was led by a board of trustees headed by the Prime Minister of Malaysia.

In 17 March 1978, PNB was incorporated and followed by the establishment of its wholly owned subsidiary Amanah Saham Nasional Berhad (ASNB) in 1979, this was a start of an investment landscape in Malaysia. Meanwhile, ASNB's task was to manage the unit trust funds launched by PNB (ASNB, 2018). With only RM 3.5 billion asset under management in 1981, PNB's investment has grown up to RM 279.2 billion asset under management in 2017 (PNB, 2017a).

Shariah Governance Framework 2019

SGF is well known in the IFIs. Hence, in discussing GLICs investing in a Shariah compliant manner thus aims to be undertaking Shariah compliant activities, Shariah governance must be highlighted as it is a key function in an Islamic financial intermediary. Among the aims of this study is to examine the Shariah governance practices of GLICs. Corporate governance in Islam requires an additional layer of governance for the purpose of Shariah compliance. With this aspiration, corporate

governance in the IFIs needs a set of institutional arrangements to oversee the Shariah compliance aspect of their business and operations. Since there is lack of a specific model of corporate governance in Islamic literature, the Shariah governance system was introduced to complement the existing corporate governance framework in the IFIs (ISRA, 2016).

Since the Islamic financial industry has good Shariah governance practices, the study also examines IFI's Shariah governance with the purpose of identifying the Shariah governance features or aspects that can be adopted by the GLICs.

Shariah governance is essential in institutions that are providing Islamic financial services to customers. Currently, any IFIs under the purview of SC and BNM must have Shariah governance components in the company's structure.

From the perspective of Shariah, governance is important to ensure that human do not betray the trust given on them. Dealings must be transacted in a proper manner and the institutions need to fulfil the obligations upon them as the public's trust lies on them to ensure Shariah compliant income from their savings or investment.

Shariah governance here will be segregated into two which are the principles and pillars of Shariah governance and the structure of Shariah governance that were applied in the current IFIs.

The SGF is defined by the BNM as "a set of organisational arrangements through which IFIs ensure effective oversight, responsibility and accountability of the board of directors, management and Shariah Committee." (Central Bank Malaysia, 2009b, pp.99) Meanwhile, the Islamic Financial Services Board (IFSB, 2009), an international standard setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry defines the Shariah Governance System as "the set of institutional and organisational arrangements through which an IIFS⁵ ensures that there is effective independent oversight of Shariah compliance over each of the following structures and processes:

- a) Issuance of relevant Shariah pronouncement resolutions,
- b) Dissemination of information on such Shariah pronouncements/resolutions to the operative personnel of the IIFS who monitor the day-to-day compliance with the

⁵ Institutions offering Islamic financial services (include windows operation, Islamic insurance/Takaful institutions and Islamic mutual funds, as well as fund management companies)-IFSB

- Shariah pronouncements/resolutions vis-à-vis every level of operations and each transaction,
- c) An internal Shariah compliance review/audit for verifying that Shariah compliance has been satisfied, during which any incident of non-compliance has been satisfied, during which any incident of non-compliance will be recorded and reported, and as far as possible, addressed and rectified, and
 - d) An annual Shariah compliance review/audit for verifying that the internal Shariah compliance review/audit has been appropriately carried out and its findings have been duly noted by the Shariah board (pp.2 & 3).”

This shows that the Shariah governance does not only rests on the shoulder of the business units, but also extends to every aspect of an organization, including the Board of Directors, Shariah Committee and Senior Management and the Chief Executive Officer of the IFIs.

The discussions above were detailed from one angle whereby structured and rigorous Shariah governance is needed to ensure the day to day business operation of IFIs are in line with the Shariah principles, not only from the resolution by the Shariah committee, but also including every single process of the IFIs.

The other scope of discussion on Shariah governance is the type of Shariah governance structure that is applied in the IFIs. In Islamic finance practice, the Shariah supervisory or Shariah governance differs from each region. In some countries, the Shariah Advisory Board of the IFIs put high standards in each transaction to ensure every transaction is Shariah compliant. The Shariah Advisory Board of an institution will determine the final ruling on Shariah compliance matters. For other countries like Malaysia, the IFIs are regulated by the regulators and matters related to Shariah are guided by the SAC of the regulators. In the case of Malaysia, it is the SAC of BNM and SC. The example of both types of Shariah governance structure are elaborated below.

There are two types of Shariah governance structures. The first model is the centralized Shariah governance structure with a central Shariah Committee (Shariah Advisory Council for Malaysia) at the national level (Hassan et al. 2013). This is to ensure consistency on Shariah rulings practiced in the country. The second model leaves the Shariah governance up to the Shariah Advisory Board of the institutions and this is the practice in the GCC countries. According to (Rahman, 2016), the Shariah governance are different in Malaysia compared to the GCC countries. In Malaysia, they applied the centralized Shariah

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governance model whereby the BNM and SC will provide advice on matters pertaining to Shariah. This model was also used in some other OIC countries such as Bahrein, Qatar, UAE, Kuwait, Indonesia and Brunei whereas in Syria, Oman, Yemen, Libya and Iraq, the Shariah supervisory regulatory framework is only at the institutional level (Grassa, 2015).

In Malaysia, the country practice the structured Shariah supervisory in which it is centralized and the Highest authority are the regulators such as the SAC of BNM and SC (Central Bank Malaysia, 2009a). It is stated in the Shariah Governance Framework 2010 under Principle 6: Professional ethics, judgement and consistency shall be maintained in ensuring Shariah compliance, that “in the event where the decision given by the IFI’s Shariah Committee is different from the ruling given by the SAC of BNM and SC, the rulings of the SAC shall prevail. However, the Shariah Committee is allowed to adopt a more stringent Shariah decision (pp.21)” (Central Bank Malaysia, 2010). This is to ensure consistency in determining Shariah compliance transaction in a country but there is also some freedom for the Shariah Committee of an IFI to enhance the ruling and adopt more strict view in terms of Shariah compliance. Later in the Policy Document on Shariah Governance that was issued in September 2019, it was stated in the standard 10.7: “In the event where the Shariah committee decides or advises to place additional restrictions on the operations, business, affairs and activities of the IFI in applying the SAC rulings, the IFI must:

- a) document the deliberations and justifications of the Shariah committee decision or advice;
- b) ascertain the board’s views on the decision or advice made by the Shariah committee with regards to the SAC ruling; and
- c) ensure immediate notification to the Bank of such decision or advice (pp.7) (Central Bank Malaysia, 2019).”

Some countries found that there are certain regulatory issues in adopting SGF. For example, in some countries, there are issues on the legal status of the Shariah pronouncement, conflict of laws, court’s jurisdiction, addressing issues on differences of Shariah rulings and many more (Hasan, 2010). In Malaysia, this issue has been resolved when it is stipulated in the Central Bank of Malaysia Act 2009 whereby it clearly states that Shariah rulings are binding to both court and arbitration (Central Bank Malaysia, 2009a). In another word, any issues that were brought up to the Court pertaining to Islamic finance must adhere to the

resolution made by the SAC of BNM and SC. In some country, this was not the case as the status of Shariah rulings are still unclear. “While legal framework of Malaysia and the UAE has provided clear position of rulings made by the Shariah board, the situation is different in other jurisdictions as in the UK, Saudi Arabia, Kuwait, Qatar and Bahrain as the status of Shariah pronouncements is still ambiguous” (Hasan, 2010, pp.106). There are some issues if the Shariah governance were not centralized as practiced in Malaysia. The Shariah Board (or Shariah Supervisory Board for some countries) are required to submit an unbiased opinion in all matters pertaining to their assignment (Grais & Pellegrini, 2006). However, their employment contract with the IFI could give negative impact to the independence of the Shariah Board members. Often, some Shariah Board members sit on more than one IFIs. This could give the Shariah Board members access to other IFIs which mostly are competitors to one another. Thus, the conflict of interest may arise here. Malaysia has dealt with this concern by limiting the Shariah Board members to sit to only one particular sector. For example, a person who sits on the SAC of BNM are not allowed to sit on the Shariah Committee of an Islamic Bank or Takaful institution (Central Bank Malaysia, 2005). A scholar may sit on only one Shariah Committee of a Bank and this applies to the Takaful industry as well. While other countries rely heavily on their Shariah Board on the issue of Shariah governance, SGF that was introduced by BNM in 2010 put that responsibility on every level that carries the function of the financial institutions including the Board of Directors and related top management (Central Bank Malaysia, 2010). With a strong structure protecting the Shariah matters in an Islamic finance transaction, GLICs should cherish and be part of this eco-system in ensuring that the transactions are according to the Shariah principles, especially if the institutions announced to public that their investment is Shariah compliant such as KWSP-i and PNB who strongly hold on the Fatwa that states the investment PNB under the management of ASNB falls under *hukm Harus* (Prof Emeritus Tan Sri Dato’ Dr. Abd. Shukor, 2014). Unfortunately, GLICs are still isolated from these strong Shariah governance.

The SGF that was introduced by BNM and applied in Malaysia starting year 2010 will ensure that all operations and business activities carried by the IFIs will be in accordance to Shariah. In the Islamic finance industry, Malaysia’s structure can be considered as among the most structured Islamic finance available in the world. However, the structure of IFIs in Malaysia has yet to impact the GLICs from the

perspective of Shariah governance. Hence, it is a topic that has yet to be brought up extensively so it may be a new knowledge or research to be explored. According to Kasim, Nuhtay, & Salman (2013), there is a serious need to have a SGF for Islamic Capital Market (ICM). Islam promotes justice and transparency and these concepts will not only encourage the Islamic banking sector, it will also improve the ICM players to take care of rights of stakeholders, investors and also may able to observe the independence and responsibilities of the Shariah Advisory Board and the member of Board of Directors of an institution.

As portrayed, it is important for the GLICs to adopt if not all, some of the important characteristics of these important pillars of Shariah governance.

Discussion and Findings

Why Shariah Governance is Important to GLICs

Shariah governance is important to ensure the operation of an institution is within the principles of Shariah. There are 3 important aspects of Shariah governance that needs to be highlighted:

- a) Structure. The structure on Shariah governance is important because its role is to set out expectations of an Islamic institution's Shariah governance structures. This is to ensure all operations, process and business activities are in accordance with Shariah. For example, the Standard Operating Procedure in handling Shariah compliance investment must always be adhered to.
- b) People. The people in an IFI need to carry their task in duties relating to Shariah. This includes the board of directors, Shariah committee and the management team.
- c) Process. The process to undertake Shariah compliant investment is important. Hence, there is the need for Shariah review, Shariah audit, Shariah risk management and Shariah research.

Since there are no specific SGF available for GLICs, it is important to examine the respective institutions as regard to their practices relating to Shariah governance.

1. The table below provides an insight of the traces of Shariah governance practices in the GLICs in Malaysia⁶.

	EPF	LTH	KWAP	LTAT	PNB
Shariah Advisory Committee	✓	✓	-	-	✓
Shariah Department / Secretariat	✓	✓	-	-	✓
Shariah Risk	✓	✓	-	-	-
Shariah Review	✓	✓	-	-	-
Shariah Audit	✓	-	-	-	-

2. The Need of Shariah Governance Framework for Government Linked Investment Companies

Corporate governance is essential in an institution. Malekian & Daryaei (2010) defines corporate governance as “the way in which the boards oversee the running of a company by its managers, and how board members are, in turn, accountable to shareholders, stakeholders and the company (pp.2)”. Muneeza & Hassan (2014) considers this as a good definition of conventional corporate governance, as it does not cover the accountability of the Board of Directors to God and the society which are crucial factors in Shariah corporate governance. Some defined Shariah corporate governance (Shariah governance) as the Islamic version of corporate governance. Muneeza & Hassan (2014) argues that this is the simplest way to explain what Shariah corporate governance is. It can be observed here that Islamic principles does not stop only at the stakeholders, but it takes governance to another level which is accountability of the Board of Directors to God. In Islamic finance, there are certain prohibited activities as outlined by the regulators of each countries. Shariah governance is a step to ensure that the institutions act within the allowed parameters in the Islamic finance industry and the Board of Directors are responsible to conduct these activities within the Shariah principles.

⁶ Interview with Shariah Officer Lembaga Tabung Haji on 21st May 2018; Interview with En. Rais from Kumpulan Wang Persaraan (Diperbadankan) 22nd May 2018; Interview with En. Kamarul from Lembaga Tabung Angkatan Tentera on 22nd May 2018

Sabirzyanov & Hasan (2015) states that the difference between conventional financial institution and IFI is that the IFI has the responsibility to ensure the compliance with the Shariah principles in its products, instruments, operations, practices and management. Hence, Shariah governance is another component peculiar exclusively to the IFIs. A sound Shariah governance involves instituting structures, controls, and processes to ensure that Shariah principles and requirements are fulfilled in all contractual, procedural, and operational aspects of an IFI from the perspectives of different stakeholders (CIBAFI & The World Bank, 2017). Principle 3.1 of the Islamic Financial Services Board (IFSB) Guiding Principles on Corporate Governance for Institutions Offering only Islamic Financial Services states that “Institutions offering Islamic financial services⁷ shall have in place an appropriate mechanism for obtaining rulings from Shariah scholars, applying fatwa and monitoring Shariah compliance in all aspects of their products, operations and activities (pp.11)” (IFSB, 2006). The IFSB Guiding Principles on Risk Management for Institutions Offering Only Islamic Financial Services similarly states that “Institutions offering Islamic financial services shall have in place adequate systems and controls, including Shariah Board/Advisor, to ensure compliance with Shariah rules and principles (pp.26)” (IFSB, 2005). This shows that the issue of ensuring Shariah compliance activities in a financial institution must be taken seriously. Hence, the need of Shariah governance is emphasized by many contemporary scholars.

With the growth and progress of the Islamic finance industry, many believe that Islamic finance should not only stopped at the financial institution level but should also be extended to the GLICs, especially as they are working in a similar environment with the other financial institutions. What was meant similar is that the GLICs also takes deposit from the public, invest according to their strategic planning and lastly giving return to the stakeholders, in which the return is also called dividend. The public who represent the Muslim majority in Malaysia expects to receive clean dividend (halal), the same as they treat the other financial portfolio. This means that Shariah needs to be taken as one of the top priorities in financial activities handled by the GLICs.

⁷ Institutions offering Islamic financial services (include windows operation, Islamic insurance/takaful institutions and Islamic mutual funds, as well as fund management companies)-IFSB

Taking Malaysia as a case study, the government through these GLICs has been investing and managing companies even before the introduction of Islamic finance. Therefore, when the demand of Islamic finance increases over time, the GLICs has to follow suit especially if it is using public's money in its investment. However, this progress is yet to happen in the GLICs.

These GLICs have their own task in fulfilling the mandate set by the government. Different GLICs were created for different purposes and will carry different mandates set by the government. For example, LTH was mandated to manage the public's money in helping the Muslims in achieving the 5th pillar of Islam which is to perform Hajj (Tabung Haji, 2017), KWAP was mandated to assist the Federal Government in funding its pension liability (KWAP, 2017), EPF was mandated to provide the best retirement savings for Malaysians (KWSP, 2017) while PNB was created as an instrument of the Government's New Economic Policy (NEP) (Jabatan Penerangan Malaysia, 2017) to promote share ownership in the corporate sector among the Bumiputera (sons of the soil) (PNB, 2017b). Although there was no direct mandate from the government to increase its Shariah compliant investment, it can be assumed that the initiative came from the institutions themselves.

Conclusion

In summary, the GLICs in Malaysia have made their own initiative to invest in the Shariah compliant instruments as the demand from investors are well known. However, unlike the IFIs, there are no standard guideline of SGF for these GLICs. Some of these GLICs has their own Shariah governance standards and some are yet to implement Shariah governance to oversee the investment activities of these GLICs. With the money held by the GLICs is huge compared to the normal financial institutions, the GLICs must somehow be governed with a proper Shariah governance to ensure every transaction is Shariah compliant. Most of the GLICs in Malaysia are applying the Shariah supervisory regulatory framework only at the institutional level. The role of supervising the Shariah governance in an institution is only at the Shariah Board level. Since it is not under the purview of the regulators and the Shariah governance in GLICs are done in-house, the need of strong Shariah governance in an organisation as big as GLICs is essential especially in the modern world.

With the transparency that the public demand of the investment in this new era, Shariah governance might help public confidence since

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Shariah governance helps ensure that all transactions are done in a Shariah compliant manner. Clearly, the IFIs needs to uphold the importance of Shariah as Shariah is not a matter that could be taken lightly. If a transaction is being done not in compliance to the Shariah principles, the institutions cannot take the income and have to donate this portion to charitable bodies (Gamaleldin, 2015). GLC's investment is scrutinized now more than ever as the industry is moving towards Shariah compliant investment rapidly. It is clear that the GLICs are not operating in the same arena with other IFIs. On one hand, Malaysia operates with a Shariah supervisory regulatory framework for both national and institutional level by having BNM and SC as the central body for Shariah Supervisory (Grassa, 2015). With this, all IFIs under BNM and SC has to adhere when the regulators introduced SGF in 2010. On the other hand, the GLICs are not governed especially in terms of SGF by the regulators. Hence, the GLICs only apply Shariah supervisory regulatory framework only at the institutional level (if any). Consistency is important to enhance the confidence of the public that GLICs will handle transactions in a serious Shariah compliant manner. With rising cases that makes the public more curious about the governance of the institutions that are not regulated under the regulators, it is time for the GLICs to enhance their governance including Shariah governance.

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