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Measuring *Shari'ah* Governance Practices: The Development of *Shari'ah* Governance Practices Index (SGPi) for Islamic Financial Institutions in Malaysia

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ABSTRACT

This paper focuses on developing an index as a quantitative approach to assess *Shari'ah* governance in Islamic financial institutions (IFIs) in Malaysia. The objective is to construct and implement the *Shari'ah* Governance Practices Index (SGPi) to evaluate the extent of *Shari'ah* governance practices within the IFIs in Malaysia. The SGPi, formulated based on five principal dimensions – Board of Directors, *Shari'ah* Committee, Management, *Shari'ah* Compliant Functions, and Institution – is rooted in established standards pertinent to the period analysed. The methodological framework of the SGPi was employed on a dataset consisting of 31 Islamic financial institutions in Malaysia, encompassing Islamic banks, takaful operators, retakaful operators, and development financial institutions. This comprehensive approach facilitated a detailed evaluation of adherence to *Shari'ah* governance across various types of IFIs. The results indicate that, overall, Islamic financial institutions in Malaysia exhibit strong *Shari'ah* governance practices. However, a comparative analysis among different types of institutions revealed that Islamic banks tend to display slightly superior governance practices compared to takaful and retakaful operators, as well as development financial institutions. This study not only introduces a novel tool for measuring *Shari'ah* governance but also provides insights into the differing levels of compliance across various types of Malaysian IFIs, highlighting the significance of continuous improvement in governance practices to uphold the integrity and sustainability of the Islamic financial system.

1. Introduction

In the rapidly evolving field of Islamic finance, effective *Shari'ah* governance is not just a regulatory requirement but a cornerstone for the sustainability and integrity of Islamic financial institutions. Amidst a rapidly changing global scenario, characterised by complex financial

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structures and higher stakeholder expectations, these institutions face the complex challenge of adapting to these shifts while maintaining strict adherence to *Shari'ah* compliance. Consequently, the need for effective implementation of *Shari'ah* governance has become increasingly apparent. This governance, deeply rooted in the ethical precepts of Islamic teachings, provides a comprehensive framework comprising principles, processes, and oversight mechanisms, pivotal in guiding the financial practices of these institutions. By consistently adhering to *Shari'ah* principles, these governance structures not only ensure ethical conduct but also foster an environment of trust, transparency, and accountability among stakeholders.

Effective *Shari'ah* governance is critical for enhancing the credibility and stability of the Islamic financial system, while simultaneously ensuring the sustainability of Islamic financial institutions through adherence to *Shari'ah* compliance. Poor governance practices can expose these institutions to risks of *Shari'ah* non-compliance, which may undermine public confidence and jeopardize the financial stability and reputation of Islamic banking [1]. These risks highlight the importance of strictly following Shari'ah principles, not only to ensure the financial stability of these institutions but also to preserve stakeholder trust and gain wider public support. The establishment of a robust *Shari'ah* governance framework is therefore imperative, serving to mitigate potential compliance risks and catering to a wide range of stakeholders - including institutional investors, shareholders, and the Muslim community – who have vested interests in the ethical operation of these institutions.

Acknowledging the critical role of extensive *Shari'ah* governance practices in ensuring the sustainability and integrity of Islamic financial institutions, this paper seeks to evaluate the extent of *Shari'ah* governance practices within Malaysian Islamic financial institutions. The study also highlights the methodological framework on the construction of the *Shari'ah* Governance Practices Index (SGPi) that becomes the main tool to evaluate the *Shari'ah* governance practices. Section 2 begins with a review of existing literature on indices used to measure *Shari'ah* governance. Section 3 details the methodology employed in constructing the SGPi. The findings and a detailed discussion are presented in Section 4. Finally, the paper concludes in Section 5 with a summary of the study's key insights, its implications, and directions for future research.

2. Literature Review

The integration of *Shari'ah* governance into the Islamic financial system is a significant milestone in the evolution of corporate governance within Islamic financial institutions. *Shari'ah* governance, often utilised in academic research, describes the structure and processes that Islamic financial institutions employ to ensure compliance with *Shari'ah* principles [2]. With the rapid expansion of the industry and the need for sustainable growth, effective oversight of practices and adherence to *Shari'ah* rules and principles are essential. Despite the notable achievement of Islamic finance industry, there is a substantial gap in empirical research concerning the implementation of *Shari'ah* governance within Islamic Financial Institutions (IFIs). The use of indices is acknowledged as a crucial approach for assessing *Shari'ah* governance practices [3,4,5].

Amin *et al.,* [3] investigated *Shari'ah* compliance in the annual reports of Malaysian Islamic banks. They constructed a *Shari'ah* disclosure index using guidelines from Bank Negara Malaysia (BNM) and standards from the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI). The data were sourced from the 2016 annual reports of 16 Islamic banks in Malaysia. The study revealed that none of the banks fully met the mandatory disclosure requirements, although some provided voluntary disclosures. The focus was on selected items such as funding, deposits, investments, zakat and charity, *Shari'ah* non-compliance activities, *Shari'ah* committee, and Qard.

Masruki *et al.,* [4] aimed to explore the implementation of *Shari'ah* governance practices. They developed a disclosure index comprising five dimensions: *Shari'ah* committee, *Shari'ah* risk management, *Shari'ah* review, *Shari'ah* audit, and transparency and disclosure. The disclosure checklist was based on a review of prior studies and regulations, particularly the Financial Reporting Guidelines for Islamic Financial Institutions (GP8-i) 2005, the Islamic Financial Services Act (IFSA) 2013, the *Shari'ah* Governance Framework (SGF) 2010, and the SGF Exposure Draft 2017. The research spanned five years, from 2012 to 2016, and included a sample of sixteen Islamic banks in Malaysia. The findings suggest that Islamic banks are more inclined to disclose information about the *Shari'ah* committee than aspects related to *Shari'ah* control functions such as *Shari'ah* risk management, *Shari'ah* review, and *Shari'ah* audit, as well as transparency and disclosure. The results indicate that Islamic banks rely heavily on the expertise of their *Shari'ah* Committee for Shariah related matters and lack of disclosure regarding Shariah control functions.

An index focusing specifically on the *Shari'ah* Committee Report (SCR) was developed by Masruki *et al.,* [5]. They examined the extent of SCR disclosure by foreign-owned Islamic banks in Malaysia and Bahrain, using the annual reports of these banks from 2017. The findings reveal that foreign-owned international banks in Malaysia have a lower level of disclosure compared to Islamic banks in Bahrain. Moreover, the disclosure practices of most foreign-owned international banks in Malaysia tend to be overly simplified, lacking in comprehensive and precise information.

The disclosure index was also employed by Noordin and Kassim [6] to investigate the relationship between the composition of the *Shari'ah* Committee and the level of *Shari'ah* governance in Malaysian Islamic banks. They compared the level of *Shari'ah* governance disclosure before and after the implementation of the SGF 2010, using 16 Islamic banks. They found a significant relationship between the composition of the *Shari'ah* Committee and the level of *Shari'ah* governance disclosure before the SGF 2010. However, a weaker relationship was observed in 2013, as the differences in the composition of the *Shari'ah* Committee were smaller. The SGF 2010 specifies that the number of *Shari'ah* committees should not be less than five, which contributed to the weak relationship after the SGF's implementation and indicates that most Islamic banks comply with the principles.

Abdullah *et al.,* [7] focused on disclosure related to the *Shari'ah* supervisory board (SSB). They analysed the 2009 annual reports of 19 Malaysian and 6 Indonesian Islamic banks. An SSB index was developed by reviewing literature on SSB disclosure practices, AAOIFI governance standards, IFSB corporate governance guidelines, and local Malaysian and Indonesian policies and regulations. The index covered items such as the background of SSB members, the SSB's duties, responsibilities, and activities, the SSB report, and the SSB's remuneration. The results showed limited SSB disclosure among Malaysian and Indonesian Islamic banks, especially on sensitive items such as profit distribution and prohibition of earnings. The study also found that disclosure items were positively associated with cross-membership with other SSBs and a variety of expertise in SSBs, suggesting that higher levels of SSB disclosure are needed to demonstrate greater accountability

The assessment of *Shari'ah* governance practices was further explored by Shahar *et al.,* [8] through the analysis of disclosure elements in the annual reports of 16 IFIs. The study examines differences in disclosure practices based on the type, size, and holding company status of the IFIs. It reveals no significant differences in disclosure levels across various categories, but finds variances in certain specific dimensions, such as risk management. The research highlights the need for improvement in Shariah governance practices and transparency among IFIs.

3. Methodology

3.1 Construction of the Shari'ah Governance Practices Index (SGPi)

The development of the Shari'ah Governance Practices Index (SGPi) unfolds in a methodical two-stage process. The first stage lays the groundwork by establishing a weighted average for the SGPi, while the second stage is dedicated to the Index's construction, guided by a systematic approach to ensure robustness and accuracy.

3.1.1 Stage one: developing the weighted average

The initial phase in the development of the SGPi begins with an in-depth examination of the relevant standards pertinent to *Shari'ah* governance. Given that this study was conducted in 2017, the *Shari'ah* Governance Framework (SGF) of 2010 is identified as the primary source to determine the extent of *Shari'ah* governance practices in Malaysian Islamic financial institutions.

In the second step, the study focuses on identifying relevant sub-indices for the SGPi. Based on the SGF2010 guidelines, this process organises the index into five key dimensions, including 85 sub-items, all of which are detailed in Table 1.

Table 1
Themes of SGPi

Theme	Sub-theme	No. of items	Reference, SGF2010
Board of Director	Duties and responsibilities	11	Para 1.3, 2.1, 2.3, 2.4, 2.5, 2.7,3.3, 4.1
Sharīʿah Committee	Duties and responsiblities	5	Para 2.7,2.10 (appendix 4)
	Assessment and decision on *Shari'ah* matters	5	Para 3.3,4.4,4.5,6.1,6.2
	Competency	6	Para 4.1, appendix 2
	Appointment and composition	4	Para 2.3, 3.8, 4.2
	Information on *Shari'ah* matters and confidential information	7	Para 2.9, 3.4, 5.1, 5.2
Management	Duties and responsibilities	6	Para 1.3, 2.11, 2.14, 2.15, 4.1
	Information	3	Para 2.12
Sharīʿah Compliance Functions	*Shari'ah* Audit	6	Para 1.3, 7.8, 7.11, 7.12, 7.13,
	Shari'ah Review	7	Para 1.3, 7.1, 7.3, 7.5, 7.6, appendix 7
	Shari'ah Risk Management	5	Para 1.3, 7.1, 7.17, 7.18
	Shari'ah Research	4	Para 7.21, 7.22, 7.24
Institution	Reporting channel	7	Para 1.6, 3.2,
	Shari'ah secretariat	2	Para 7.25, 7.26
	Policies and procedures	7	Para 1.4, 1.5, 2.16, 2.2
Total items		85	

Next, step 3 involves developing a detailed questionnaire to assess *Shari'ah* governance practices in Malaysian Islamic Financial Institutions (IFIs). This process includes preparing two sets of questionnaires, where the first set is utilised for the weighted average calculation and the second for the construction of the SGPi.

3.1.2 Stage two: constructing the index

The fourth step entails the verification of face validity. The questionnaire is subjected to a comprehensive review by a panel comprising lecturers and postgraduate researchers, aiming to ascertain the validity and reliability of the research instruments.

After refining the questionnaire, it was disseminated for the purpose of data collection. The data collection was segmented into two phases: the first phase (Step 5) focused on the construction of the weighted average for the SGPi, and the second phase (Step 6) on the actual measurement of the SGPi. A detailed elaboration on this data collection methodology is presented in the subsequent sub-section.

Subsequently, the final phase of the methodology (Step 7) involves the computation of the Index. Scores are assigned based on the degree to which the responses reflect adherence to *Shari'ah* governance practices. Specifically, responses indicative of robust *Shari'ah* governance practices result in higher scores for the IFIs, while those suggesting less effective practices receive lower scores.

The figure 1 provided below illustrates the systematic process undertaken in the construction of the SGPi, from the initial study of relevant standards to the final calculation of the Index:

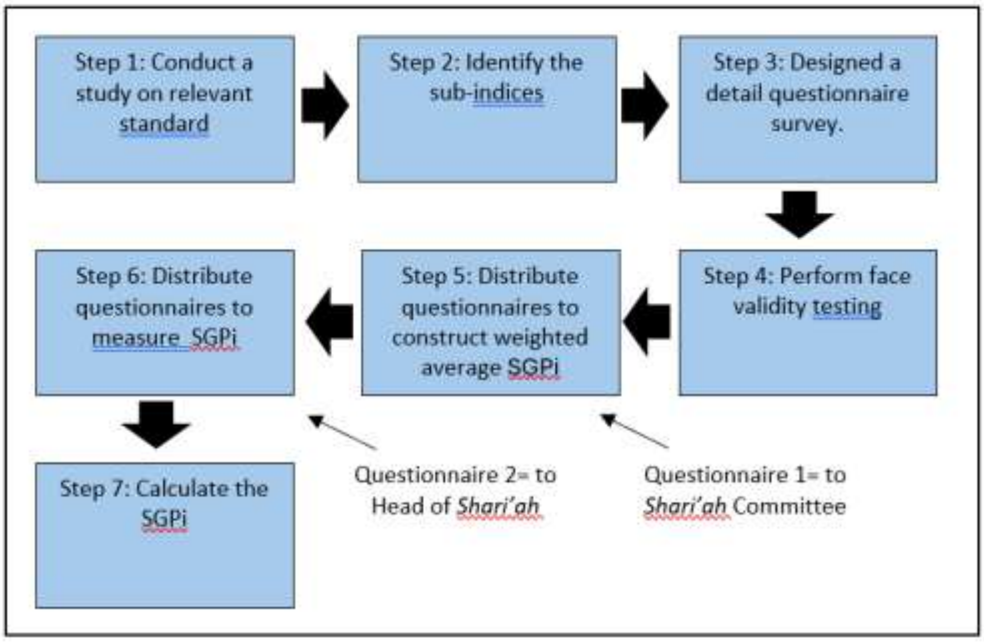


Fig. 1. Step by step in constructing the index

Shari'ah governance in Malaysia has been incorporated into the national legal framework, reflecting the country's adoption of an integrative approach to regulate its Islamic banking and finance system [9]. The effectiveness of the *Shari'ah* Governance Framework (SGF) is instrumental in enhancing stakeholder confidence and upholding integrity within the Islamic finance industry, thereby contributing to its financial stability [9]. In the 2010 *Shari'ah* Governance Framework (SGF), the scope of the *Shari'ah* committee's roles and functions was expanded beyond advisory capacities to encompass a higher level of accountability. This extension includes responsibility for overseeing the implementation of decisions and opinions within Islamic Financial Institutions (IFIs). Consequently, the *Shari'ah* committee is granted direct access to the Board of Directors (BOD), particularly for reporting issues related to *Shari'ah* non-compliance.

Furthermore, the 2010 *Shari'ah* Governance Framework (SGF) outlines the roles and responsibilities of management, emphasising their support for the *Shari'ah* committee. This includes providing essential information and ensuring the effective implementation of the decisions and opinions issued by the Shariah committee within Islamic Financial Institutions (IFIs).

The *Shari'ah* Governance Framework of 2010 (SGF 2010) underwent further enhancements, leading to the issuance of the *Shari'ah* Governance Policy Document (SGPD 2019) by Bank Negara

Malaysia (BNM) in September 2019. Table 2 below provides a comparative analysis between SGF 2010 and SGPD 2019:

Table 2
Comparisons between SGF 2010 and SGPD 2019 [10]

Discussion	SGF2010	SGPD 2019
Definition of *Shari'ah* governance	Not provided	Not provided
Objectives of *Shari'ah* governance	Discussed	Not provided
Structure of *Shari'ah* governance	Discussed	Discussed
Responsibility of the BOD for *Shari'ah* governance	Discussed	Discussed including on continuous development of the BOD on *Shari'ah* knowledge
Responsibility of SC	Discussed	Discussed
Responsibility of the management for *Shari'ah* governance	Discussed	Discussed including on continuous development of the management on *Shari'ah* knowledge
Control functions for *Shari'ah* governance	• *Shari'ah* review • *Shari'ah* audit • *Shari'ah* risk management • *Shari'ah* research	• *Shari'ah* review • *Shari'ah* audit • *Shari'ah* risk management • *Shari'ah* research function merged with the secretariat to the SC – not classified under control functions
Independence of SC	Discussed	Discussed
Competency of SC	Discussed	Discussed
Confidentiality of SC	Discussed	Discussed
Consistency of SC	Discussed	Discussed
Appointment, cessation disqualification of SC	Discussed in general	Discussed in detail-tenure not more than 9 years in the same IFI, not active in politics.
Composition of SC	Discussed in general	Discussed in details-at least 5 members
SC Meetings	Discussed in general	Discussed in details concern on non-physical meetings
Remuneration of SC	Discussed	Discussed
Shari'ah compliance culture	Discussed	Discussed
Transparency and disclosures	Provide example of minimum annual disclosure in appendix	Discussed report on *Shari'ah* governance practices in annual report

An analysis of the comparative table reveals that both the SGF 2010 and SGPD 2019 address similar elements, with the latter providing more extensive discussion on certain aspects. Notably, the SGPD 2019 emphasises the necessity for ongoing development in *Shari'ah* knowledge among the Board of Directors (BOD) and management. Additionally, it elaborates on the tenure of the *Shari'ah* committee, stipulating that members should not serve in the same Islamic Financial Institution (IFI) for more than nine years. The focus of *Shari'ah* governance extends beyond mere systemic and operational compliance; it also encompasses the integrity and reputation of IFIs, ultimately reflecting adherence to the commands of Allah (SWT). Hence, for IFIs, maintaining compliance with *Shari'ah* principles is of utmost significance.

3.2 Data Collection

In this study, a structured questionnaire survey was employed to gather data for developing the *Shari'ah* Governance Practices Index (SGPi), a tool designed to assess *Shari'ah* governance practices. The questionnaire comprises six distinct sections, encompassing General Information, Board of Directors Practices, Management Practices, *Shari'ah* Committee Practices, *Shari'ah*-Compliant Functions, and Reporting Channels. The components of the questionnaire were formulated based on the *Shari'ah* Governance Framework issued by Bank Negara Malaysia in 2010 (SGF 2010). This same questionnaire served the dual purpose of computing the weighted average and constructing the SGPi. The study employed a Likert scale to elicit responses for a series of statements, addressing both the calculation of the weighted average and the construction of the SGPi with a scale rating of 1 to 5 was used to obtain the response. The questions in this study were carefully designed to align with the established standards issued by Bank Negara Malaysia (BNM). This approach addressed key aspects of content validity, construct validity, criterion validity, and reliability. To ascertain face validity, the questionnaire was piloted with a group of five participants, including postgraduate students in PhD programs specialising in Islamic Banking and Finance and members of *Shari'ah* Committees. Face validity ensures that the questionnaire items are perceived as relevant, clear, unambiguous, and appropriate [11].

3.2.1 Data collection stage 1

The initial phase of data collection concentrated on establishing the weighted average for each item within the SGPi. The weighted average approach was adopted based on the notion that the index components have differing levels of importance, leading to a need for assigning more weight to certain sub-indices. Therefore, weighted average approaches are used to differentiate the level of importance between items in the SGPi, thus making the index more reliable and precise. The questionnaire survey was distributed to 100 members of *Shari'ah* Committees across various Islamic financial institutions in Malaysia, aimed at determining the weighted average for the SGPi. Out of the 100 surveys sent out, 31 responses were received from *Shari'ah* Committee members. These members were deemed suitable respondents for assessing the significance of each item in the SGPi, given their expertise in the field. Utilising a scale from 1 (not important) to 5 (very important), the respondents were requested to evaluate the importance of each item in the questionnaire. Figure 2 below provides a summary of the computation of the weightage for each item in the survey.

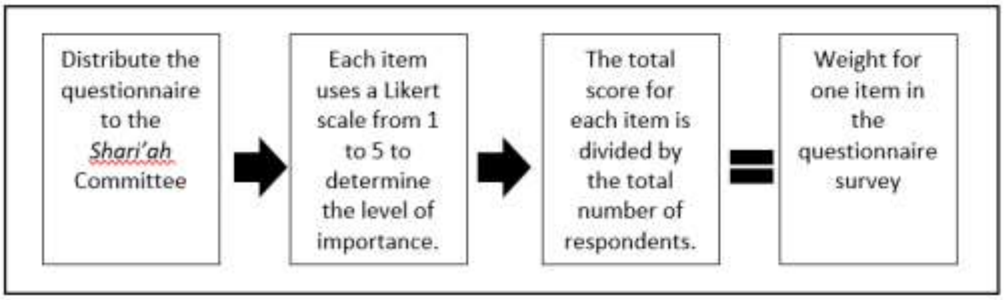


Fig. 2. Summary on the computation of weightage for each item

Table 3 presents an illustrative calculation of the weight assigned to each item in the questionnaire survey, aimed at ascertaining their level of importance. For instance, consider item 1, which accumulated a total score of 130 from 31 respondents. To determine the weight for item 1, this total score is divided by the number of respondents, in this case, 31, resulting in a weight of 4.19 for item 1. This methodology was consistently applied to all 85 items to establish the respective weights in the questionnaire survey. Subsequently, these weights were utilised in stage 2 to compute the overall index.

Table 3
Example of a computation on weight for each item

Item	SC1	SC2	SC3	→	SC31	Total score for each item (x)	Weight (x) / 31
Item 1	5	2	3		3	130	4.19
Item 2	3	3	4		4	140	4.52
Item 3	3	1	2		4	120	3.87
↓	↓	↓	↓		↓	↓	↓
Item 85	3	4	5		5	146	4.71

Note: SC means *Shari'ah* Committee

3.2.2 Data collection stage two

The second stage of the study involved the data collection process for the development of the *Shari'ah* Governance Practice Index (SGPi) for Islamic financial institutions in Malaysia. This subsequent survey was directed at a diverse group of 37 Islamic financial institutions, including Islamic banks, takaful operators, retakaful operators, and development financial institutions engaged in the Islamic banking system. From the total of 37 surveys distributed, 31 responses were received, resulting in an 83.78 percent response rate. The respondents included 13 Islamic banks (comprising 2 full-fledged Islamic banks and 11 subsidiary Islamic banks), 9 takaful operators, 3 retakaful operators, and 6 development financial institutions, representing a broad spectrum of the Islamic financial sector. The unit of analysis for this study comprises Islamic financial institutions; thus, the most appropriate respondent to act as proxies for these institutions are the head of the *Shari'ah* in each respective Islamic financial institution. These respondents were selected based on their specialised expertise and extensive experience in the relevant field of study. During this phase, the questionnaire survey from the initial stage was employed again, but with a variation in the wording style. Each respondent was required to assess the *Shari'ah* governance practices at their institution by using a score from 1 (very poor) to 5 (excellent) provided in the questionnaire survey.

The illustration provided in Table 4 demonstrates the process of calculating the SGPi for an Islamic Financial Institution (IFI), using Bank A as an example. In this phase, as in the previous one, each item in the survey is assigned a specific weight to indicate its importance relative to others. Hence, to compute the SGPi for Bank A, it is necessary to determine the weighted score associated with Bank A. Taking Bank A as an illustrative case, the analysis shows a weighted score of 12.57 (column c) and a total score of 20.95 (column d) for item 1. In contrast, item 2 records a weighted score of 18.08 (column c) and a total score of 22.60 (column d) , while item 3 has a weighted score of 11.61 (column c) with a total score of 19.35 (column d). This calculation process will be repeated for each item in the questionnaire up to the final item, which is item 85. Following this, the aggregate weighted scores for Bank A, encompassing items 1 to 85 as listed in column (c), will be totalled. Additionally, the overall scores for these items, as shown in column (d), will also be summed up.

Table 4
An example of calculation SGPi for each IFI

Item	(a) Score (1 to 5)	(b) Weight (from Table 2)	(c) Weighted (a) x (b)	(d) If fully complied = 5 x (b)
Item 1	3	4.19	3 x 4.19 = 12.57	5 x 4.19 = 20.95
Item 2	4	4.52	4 x 4.52 = 18.08	5 x 4.52 = 22.60
Item 3	3	3.87	3 x 3.87 =11.61	5 x 3.87 = 19.35
↓	↓	↓	↓	↓
Item 85	4	4.71	4 x 4.71 = 18.84	5 x 4.71 =23.55
Total			1636.58	1976.40
SGPi	Total weighted score / Total if fully complied c / d 1636.58 / 1976.40 0.8281			

The cumulative weighted score for the 85 items, when divided by the maximum possible score, results in a SGPi of 0.8281 for Bank A. This value signifies that Bank A has attained a compliance rate of 82.81% in relation to the standards set by the SGF 2010. This procedure will be similarly applied to other Islamic Financial Institutions (IFIs) within the specified study period. It should be noted that the computation illustration provided above is applicable to just one Islamic financial institution. Table 5 presents a comprehensive summary of the data collection process employed in the development of the SGPi.

Table 5
Summary on the data collection process in developing SGPi

	Stage 1	Stage 2
Purpose	To find the weighted average for SGPi	To develop the SGPi
Method	Distribute questionnaire 1 to the target respondents	Distribute questionnaire 2 to the target respondents
Scoring type	Likert- scale 1 to 5	Likert – scale 1 to 5
Value of scoring type	Of no importance to extremely important	Very poor to excellent
Targeted respondents	*Shari'ah* committee members from IFIs in Malaysia	Head of *Shari'ah* in each IFI in Malaysia

4. Result and Discussion

Table 6 below provides a ranking profile for individual Islamic financial institutions on the extent of their *Shari'ah* governance practices. The findings of the analysis indicate that *Shari'ah* governance practices are being effectively implemented across Malaysian Islamic financial institutions, as reflected by an industry average score of 0.8446. This figure implies that the institutions included in this study fulfil, on average, 84.46% of the *Shari'ah* governance guidelines set forth by Bank Negara Malaysia, reflecting sound adherence to these practices. Furthermore, the study revealed that full-fledged Islamic banks rank among the highest in terms of *Shari'ah* governance practices. This is illustrated by two such banks, identified as IB2 and IB3, which achieved scores of 0.9841 and 0.9563, respectively, indicating their robust adherence to *Shari'ah* governance. Both banks have achieved notable standing in the Islamic finance market, a factor that likely contributes to their enhanced adherence to sound *Shari'ah* governance practices, relative to other Islamic Financial Institutions (IFIs). The results also suggest that IB2 and IB3 have effectively utilised all available resources to ensure the implementation of robust *Shari'ah* governance practices within their institutions. As fully-fledged Islamic banks in Malaysia, they have been exclusively dedicated to Islamic financial activities since their establishment, channelling all efforts towards enhancing their *Shari'ah* governance practices. The institutions mentioned previously have been operational for a longer duration compared to other Islamic banks. This extended period of existence may have provided them with opportunities to accumulate knowledge through practical experience. Such experiential learning is likely to contribute to their favourable reputation, which in turn is associated with enhanced performance. Consequently, it was expected that these two banks would rank among the top three in their scores for *Shari'ah* governance practices.

Table 6
Ranking profile on the extent of *Shari'ah* governance practices based on SGPi

IFIs	Score based on SGPi	Ranking
IB1	0.9959	1
IB2	0.9841	2
IB3	0.9563	3
T1	0.9537	4
DF1	0.9481	5
IB4	0.9436	6
IB5	0.9365	7
IB6	0.9212	8
T2	0.9110	9
T3	0.8921	10
T4	0.8899	11
IB7	0.8872	12
DF2	0.8812	13
T5	0.8789	14
T6	0.8751	15
DF3	0.8723	16
DF4	0.8720	17
DF5	0.8511	18
IB8	0.8366	19
IB9	0.8289	20
IB10	0.8281	21
IB11	0.8095	22
T7	0.8050	23
IB12	0.8049	24
T8	0.7955	25
IB13	0.7659	26
RT1	0.7658	27
T9	0.7334	28
RT2	0.6666	29
DF6	0.5749	30
RT3	0.5185	31
Total score	26.1838	
Industry average (total score / 31)	0.8446	

Note: IB1 until IB13 refer to Islamic banks (including 2 full-fledged Islamic banks), T1 until T9 refer to takaful operators, RT1 until RT3 refer to retakaful operators, DF1 until DF6 refer to development financial institutions

Moreover, the data from the study suggests that IB1, a subsidiary Islamic bank, recorded the top score on the SGPi. It appears that IB1 has successfully implemented outstanding *Shari'ah* governance practices, evidenced by a 99.59 percent adherence rate to the SGF2010. The favourable outcome observed may be attributed to the sufficient staffing levels in the *Shari'ah* department and the high level of commitment from staff members, who possess substantial expertise in the field. This encompasses the contributions of the *Shari'ah* secretariat team at IB1. Sheikh Hassan [12] identified several key functions of the *Shari'ah* secretariat. These include, firstly, serving as an intermediary in communicating *Shari'ah* board decisions to relevant stakeholders; secondly, assisting the *Shari'ah* Committee through the preparation of essential documents required for undertaking supervisory functions and facilitating decision-making in product development, and thirdly supporting the *Shari'ah* Committee in ensuring that its decisions are effectively executed by the management. Furthermore, the individual holding the position of Head of *Shari'ah* at IB1 during the period under study possesses extensive expertise in the fields of *fiqh al-muamalat* (Islamic commercial law) and Islamic finance, with a professional background spanning over 25 years.

Additionally, the person leading the department also holds a professional certification as a Certified *Shari'ah* Advisor and Auditor (CSAA) granted by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) based in Bahrain. It is also important to mention that IB1 has a highly committed Chief Executive Officer (CEO) with over three decades of expertise in the financial sector, including a remarkable 19-year focus on Islamic financing. The presence of a capable leader and a CEO who demonstrates strong commitment to their roles may benefit IB1 by promoting robust *Shari'ah* governance practices.

The analysis also showed that retakaful operators, specifically RT1, RT2, and RT3, fall among the five lowest scorers in the SGPi assessment. Table 7 illustrates the SGPi rankings, organised into three distinct groups: Islamic banks, takaful and retakaful operators, and development financial institutions.

Table 7
Comparisons of SGPi based on types of institutions

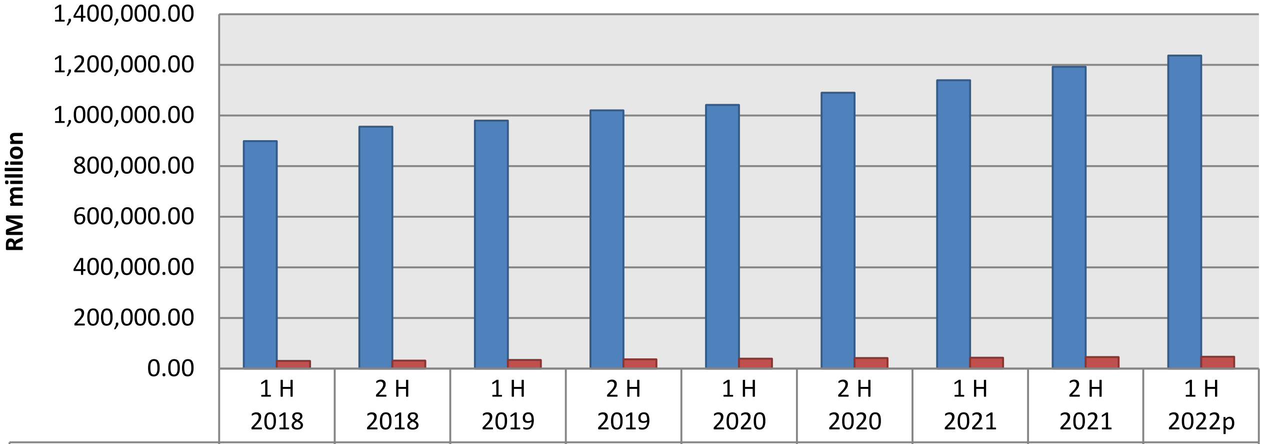
Institution	SGPi	Rank
Islamic banks	0.8892	1
Takaful and re*takaful*	0.8071	3
Development financial institutions	0.8326	2
Industry average	0.8446	

The findings indicate that Islamic banks exhibited slightly better performance in terms of SGPi when compared to development financial institutions (DFIs) and takaful and retakaful operators. The variation in Sharīʿah governance practices among Malaysian Islamic financial institutions may be attributed to several factors. First are the unique features of the industry within each category. The importance of banking is clear, as it plays a crucial role in the lives of individuals, making it an essential aspect that cannot be left behind. For example, governments employ banks as a means of overseeing and controlling the economic well-being of their respective nations. Similarly, businesses and individuals rely on banks for making investments, accumulating savings, and engaging in transactions related to the acquisition of goods and services. The dynamic nature of government regulations, technological advancements, and financial innovations has consequently led to an expansion in the range of banking services offered by these financial institutions. This expansion and the enhanced performance of Islamic banks in Malaysia can be partly attributed to the effective financial intermediation role they play in the economy, channelling funds to investment activities [13]. Moreover, the sustainability and growth of Islamic banking in Malaysia, as evidenced by its impact on major macroeconomic indicators, suggest a robust ecosystem supported by governmental ambition and increasing demand [14]. The growth of the takaful industry, while significant, may not directly compete with the banking sector but rather complements the overall Islamic financial system, contributing to economic development [15].

The increasing demand from Muslim customers for Islamic banking products and services has become a driving factor for commercial banks, investment banks, and finance companies to offer a diverse range of Islamic banking products and services, as well as to establish Islamic banks. Amin [16] found that religious beliefs were a more significant predictor of the intention to use Islamic credit cards. The study highlighted that adherence to Islamic values is one of the key determinants in the decision to subscribe to financial products. Additionally, Majid and Said Zulhanizar [17] identified that the primary factor influencing customers' choice of Islamic banks is their compliance with *Shari'ah* principles. While Islamic banks perform the same fundamental functions as conventional banks, they must ensure all transactions comply with Islamic rules and principles [18]. The Islamic Financial Services Act (IFSA) 2013 defines Islamic banking as "the business of accepting Islamic deposit, accepting money under investment account, provision of finance and other business relating to financial services". Currently, the perception of Islamic banking has evolved beyond merely serving the religious needs of the Muslim community. It is increasingly seen as a competitive business entity that must attract and retain customers, while simultaneously upholding its religious commitments. The dual objective of Islamic banks, seeking profit while fulfilling religious obligations, combined with the diverse needs of customers, necessitates a high level of *Shari'ah* compliance. This adherence is crucial for gaining public confidence in the services provided by these banks.

Regarding the takaful industry, its core principle can be characterised as a form of mutual assistance. Under this model, participants in takaful schemes collectively agree to contribute to a common fund, which in turn provides financial benefits to all members, as outlined in the Islamic Financial Services Act (IFSA) 2013. According to Aziah Abu Kasim [19], the takaful industry is characterised by principles such as cooperation, social guarantee, mutual protection, risk sharing, and solidarity. These virtues suggest that takaful institutions aim beyond mere profit generation or individual benefit in the event of predetermined occurrences. Both the takaful and retakaful industries face substantial risks, particularly when cash allocations are insufficient to cover claim obligations. The business model of these industries inherently involves high risk, especially under circumstances of inadequate funds for claim payments. Takaful operators are subject to various risks, including including credit risk related to qard-hasan facilities, operational risk, and Shariah risk [20,21,22]. Despite takaful being based on risk-sharing, the operational nature of takaful business necessitates risk management, as participants rely on takaful operators to mitigate future risks. Inadequate service provision can undermine public trust, leading to reduced market penetration in the takaful sector. Furthermore, the takaful product is tailored to specific segments, limiting its market reach. Consequently, due to the distinct nature of the business, target markets, and product offerings, it is expected that levels of *Shari'ah* governance practices will vary across institutions.

Second, the growth of different industries can potentially lead to variations in Sharīʿah governance practices. Figure 3 presents a visual representation of the growth of the Islamic banking business and the takaful industry, highlighting their comparative performance. The evidence indicates that although the takaful sector demonstrates annual growth, its rate of expansion has not paralleled that of the Islamic banking industry. The takaful sector demonstrates a more static growth rate compared to the dynamic expansion of the Islamic banking industry, resulting in a relative lag in performance. This observed occurrence can likely be attributed to various challenges including limited market penetration, a shortage of skilled professionals, insufficient technological skills, ineffective governance practices, and a lack of innovation in business models aimed at emerging market segments [24].



	1 H 2018	2 H 2018	1 H 2019	2 H 2019	1 H 2020	2 H 2020	1 H 2021	2 H 2021	1 H 2022p
Islamic banking	898,206.	955,598.	979,393.	1,019,33	1,041,62	1,089,54	1,139,09	1,191,62	1,236,23
Takaful	29,833.6	31,323.1	34,522.0	36,517.6	39,040.1	41,871.2	43,223.1	45,803.0	46,779.6

Fig. 3. Total Assets of Islamic banking system versus Takaful [23]

As identified by Ismail *et al.,* [25], the takaful industry faces a spectrum of challenges and issues. These include the requirement for a minimum paid-up capital of RM100 million to support the expansion of general takaful business, the need to separate composite entities by 2018, a lack of innovation and differentiation in product offerings compared to conventional insurance, significant capital requirements for takaful operators despite offering lower guarantees, which makes competition with established companies challenging due to a lack of economies of scale for many takaful operators, and a shortage of skilled professionals, further compounded by a trend of talent leaving the industry.

5. Conclusions, Implications and Future Research

The preservation of the long-term viability of Islamic Financial Institutions (IFIs) holds significant importance within the Islamic finance industry. To guarantee sustainability, the implementation of *Shari'ah* governance becomes crucial in ensuring that Islamic financial institutions adhere to the principles of Shariah. Therefore, this paper has assessed the extent of the *Shari'ah* governance practice in Islamic financial institutions in Malaysia. The study includes various types of Islamic financial institutions such as full-fledged Islamic banks, subsidiary Islamic banks, takaful operators, retakaful operators, and development financial institutions. The assessment is based on a few elements such as the Board of Directors, *Shari'ah* Committee, management, *Shari'ah* compliance functions, and the institutions themselves. This element is based on the available framework that has been used under the period of study, which is SGF2010. However, elements used in the present study based on SGF2010 [26] are the same as SGPD 2019 [27] since both have the same elements except only some improvements have been made in SGPD 2019. The study also provides a methodological framework that has been used to assess the *Shari'ah* governance practices by constructing the *Shari'ah* Governance Practices Index (SGPi).

The research concludes that overall, the Islamic financial institutions in Malaysia have shown good practices based on the industry average score. It is also reported that for individual performance in *Shari'ah* governance practices, the Islamic banks have scored in the top three ranks compared with other Islamic financial institutions. Among the top three ranks, two are from fully-fledged Islamic banks. Furthermore, in comparisons among the types of Islamic financial institutions, the Islamic banks show slightly better *Shari'ah* governance practices compared with other types such as development financial institutions, takaful, and retakaful operators. The study also revealed that sound governance practice may have an association with the growth of the industry and the nature of the industry itself. However, this may need further assessment which may contribute to the direction of future research.

Additionally, by having various IFIs in the present study, this may add to the new research findings on the existing literature. Further research could examine the extent of *Shari'ah* governance practices by adopting SGPD as a reference. Besides, the study also contributes to the use of SGPi as the main tool to measure the *Shari'ah* governance practices that may contribute to the existing literature for methodology aspects. As for future research, this method can be applied by having different established standards to assess the current practices during the period under study.

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