



# The Impact of Shariah Board on the Performance of Islamic Banks and the Relevance of Shariah Committee (BNM) New Ruling on the Restructuring of Islamic Financing Facility during the Pandemic Crisis

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**Abstract:** This study examines the impact of Shariah Board (SB) characteristics on the financial and social performance of Islamic banks (IBs) from the perspectives of Agency Theory (AT), Stewardship Theory (ST) and the Resource Dependence Theory (RDT). To meet its objective, GMM is employed on a panel data of 15 IBs in Malaysia from 2010 to 2018 covering the pre and post implementation of IFSA 2013 with three performance measurements; ROA and ROE (financial performance) and Zakat over Equity (social performance). SB education, SB reputation, and SB expertise are positively related to IBs performance; while SB remuneration and SB cross membership are negatively related to performance. SB size is found to be insignificant. The study therefore concludes SB is relevant to the performance of IBs. The study also discusses the response of SB at the central bank (SAC-BNM) via its new ruling on financing restructuring in alleviating the hardship of IBs' customers during the pandemic crisis.

**Keywords:** Shariah Governance, Islamic Banks, Shariah Board, Pandemic, Performance

**JEL Classification:** G2, G3



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## Introduction

The global financial crisis (GFC) of 2007/2008 reveals a pattern of inadequate capital and liquidity buffers and excessive risk taking in the banking sector (Nomran & Haron, 2021). Although many conventional banks experienced financial difficulties because of the GFC, only a small fraction of Islamic banks (IBs) were affected by the same crisis (Sellam & Tahari, 2017). The limited effect of financial crisis on IBs has attracted the attention of policymakers and researchers in the past few years (Grassa & Matoussi, 2014; Hakimi et al., 2018; Alsartawi, 2019). In this regard, Abd Razak (2018) suggested that the resilience of IBs has been attributed to the strong principle of Islamic banking that prohibits interest-bearing financial instruments as well as the uniqueness of Islamic corporate governance (CG) system.

IBs operate in adherence to the Shariah principles which is mainly to avoid *riba* (interest), *gharar* (uncertainty), *maysir* (gambling), and other activities which are prohibited in the Quran and Sunnah (al-Baqarah: 278-279; al-Ma'idah: 90 – 91) and to avoid Shariah non-compliance (SNC) risk. Despite this, IBs nevertheless are not immune to risk such as market risk, credit risk, operational risk, manipulation and fraud (Nomran & Haron, 2021). Due to the risk exposure, IBs therefore must be regulated by the same governance of conventional banks (CBs) with additional layer of Shariah governance (SG) (Miskam & Mat Hassan, 2017). Following this, the existence of Shariah board (SB) distinguishes IBs from their conventional counterpart (Lassoued, 2018; Nomran & Haron, 2020) and acts as a unique CG mechanism in IBs (Mim & Mbarki, 2020). SB functions to ensure IBs operate based on Shariah as SNC events can cause reputational risk and may trigger financial turmoil on Islamic banking (Nomran & Haron, 2020). Undoubtedly, the essence of Islamic banking must appeal to primarily Muslim customers who subscribed to IB's products and services to fulfill their religious obligations (Haron et al., 2020).

The SB of IBs in Malaysia consists of Shariah advisors who need to fulfill certain requirements as determined by the Bank Negara Malaysia (central bank) Shariah Advisory Council (BNM, 2019). As the financial system becomes more complex and competitive, especially in a dual banking system like Malaysia, there are number of challenges for effective SG, and the main issue is the attributes of Shariah scholars (Grassa, 2015; Abd Razak, 2018). As stated in the SG framework of BNM, Shariah scholars are not only required to have knowledge in *fiqh muamalat* (Islamic transaction), but also finance and accounting knowledge, for them to really understand the banking operations of IBs (BNM, 2019). This is important as they are responsible to make important decisions to introduce new financial instruments based on Shariah requirement and have the power to disapprove transactions which contradict

with Shariah rulings (Alsartawi, 2019) or to introduce any new rulings at the BNM level to response to pandemic crisis with the objective to alleviate the hardship of IBs' customers during the pandemic crisis (BNM, 2020). Therefore, the characteristics of SB need to be observed carefully to ensure effective SG, crucial for the expansion of the industry and trust of customers on IBs and future performance.

Previous studies have recorded that there is a significant influence between SB characteristics and performance of IBs (Nomran et al., 2017; Hakimi et al., 2018; Rahman & Haron, 2019; Nomran & Haron, 2019). Board of directors (BOD), in this case the SB plays an important role in mitigating and preventing agency problem since they are responsible in ensuring the firm operates and performs in the best interest of all stakeholders (Mori and Towo, 2017; Aslam & Haron, 2020). Among the characteristics commonly discussed in the past literature are the SB size, SB cross membership, SB educational qualification, SB reputation and SB expertise. Board structure, as represented by BOD of the bank, correspondingly plays an important CG role in IBs (Rahman & Haron, 2019). The board is responsible to approve all policies relating to Shariah matters upon consultation with the SB and to ensure the policies are implemented effectively (BNM, 2019). Therefore, the structure of the board cannot be neglected in a study of SG. The board size and board independence are the most studied board structure attributes in relation to the performance of IBs (Mollah & Zaman, 2015; Mori & Towo, 2017; Hakimi et al., 2018; Nomran & Haron, 2019; Rahman & Haron, 2019).

This study focuses on Malaysia as the country with Islamic financial institutions (IFIs) at the international forefront in Islamic banking and finance (IBF), having dual banking system with a well-defined SG framework (PwC, 2008). The role of SB is crucial for the Islamic banking industry because banking in general plays important role in the national economic development (Nomran & Haron, 2021) along with its functions as the financial intermediaries between surplus and deficit units (Andrieş et al., 2018) and the Islamic banking industry is no exception. As one of the Islamic finance global leaders, Islamic banking assets in Malaysia accounted for 10.8% of the global Islamic banking assets in 2018, behind Iran (32.1%) and Saudi Arabia (20.2%) (IFSB, 2019). The key factor to the success of the Islamic banking in Malaysia is due to the strong legal framework of IBF. This includes the comprehensive legislations that harmonized the secular law and the strong leadership initiatives under taken by the central bank (Laldin & Furqani, 2018). With regard to the legislations, there are three revised SG guidelines that have been issued by BNM to improve the governance structure of IFIs. These involved the guidelines on the Governance of Shariah Committee for the IFIs (BNM/GPS 1), Shariah Governance Framework 2010 (SGF 2010) and Shariah Governance Policy 2019 (SGP 2019).

In 2013, IFSA (2013) was introduced to replace and repeal the Islamic Banking Act (IBA) 1983 and Takaful Act 1984. Following this, two years grace period were given to IBs to comply with the Act (Lee & Oseni, 2015). The IFSA (2013) is a more comprehensive legal framework than the IBA 1983. In IFSA (2013), there are provisions on SG aspects which have brought positive changes to the ecosystem of IBF in Malaysia (Muneeza, 2014). Further, the IFSA (2013) aims to facilitate a comprehensive legal framework in compliance with Shariah in all aspects of supervision and regulation (Budiman et al., 2019). Specifically in Part IV (Division 2) of IFSA (2013) instates the SG for IFIs, which include the establishment, appointment, duties, cessation, and notice of cessation of SB. The SGF (2010) and IFSA (2013) offer many provisions on SB to enhance their roles and strengthen their positions which is not included in the previous act – IBA (1983) (Itam@Ismail & Hassan, 2016). Any weaknesses in banking governance will affect the banking sector and may cause systemic risk to the economy of a country. In this regard, managerial misconduct, fraud and negligence are proven to be the outcomes of a weak governance causing losses of shareholders' wealth and bankruptcies (Baker & Powell, 2009). Therefore, having implemented the IFSA (2013), it was expected that the performance of IBs in Malaysia will improve further in line with the strengthening of SG brought by the Act.

Having explained the above scenario, this study therefore aims to examine the impact of SB characteristics on the performance of IBs in Malaysia covering the period of pre and post IFSA 2013, pre (2010-2013) and post (2014-2018), to ascertain whether SB is relevance to the performance of IBs. This study differs to other past studies on SB and performance of IBs. First, the comprehensive SB characteristics that being incorporated into the discussion compared to past studies. Second is the role of IFSA in determining the performance of IBs which are not being examined in the past empirical studies of IBs in Malaysia. Third is the discussion on the role played by the SB at the central bank (SAC-BNM) on the new ruling on financing restructuring in alleviating the hardship of IBs' customers during the pandemic crisis.

This study therefore is expected to contribute in enriching the literature of SG of IBs. This study is organized into four sections. Section 1 is the introduction. Section 2 deals with the related literature and the hypotheses development. Section 3 presents the data and methodology, while Section 4 discusses the empirical result. Section 5 discusses the role played by SAC in the new ruling in response to the pandemic crisis. The last section concludes the whole study.

## Literature Review and Hypotheses Development

AAOIFI defines SB as an independent body that specialized in *fiqh muamalat*. They are entrusted with the duty of reviewing, supervising, and directing the activities of IBs (AAOIFI, 2017, pp. 28). The responsibilities of SB of IBs include providing advice and decision to the IBs on the application of rulings provided by the SAC-BNM or standards on Shariah matters that are applicable to all activities of IBs. These include providing advice and decision on matters that require reference to the SAC, providing advice and decision on the activities of IBs that may trigger SNC events, deliberating and affirming SAC findings, and endorsing a rectification measure regarded to SNC events (BNM, 2019).

Due to the importance of SB on SG and Islamic banking and the uniqueness of SB itself, researchers have studied SB characteristics and its influence on the performance of IBs (Nomran et al., 201; Almutairi et al., 2017; Nomran et al., 2018; Rahman & Haron, 2019; Alsartawi, 2019). Despite this, research on SG is still very limited, especially in investigating the impact of SG on the performance of IBs (Mollah & Zaman, 2015; Nomran et al., 2018; Nomran & Haron, 2021). Further, the findings nevertheless were mixed. Therefore this study aims to reexamine the nature of the relationship using quite a recent data of IBs (2010-2018).

Researchers argued that factors that may affect the BoD will affect the SB as the roles of the BoD, audit committee and SB are similar (Bukair & Rahman, 2015). The SG structure and the conventional board structure seem to be the same as well (Bhatti and Bhatti, 2010; Nomran et al., 2018). Then, the CG theories such as the Agency Theory (AT), Stewardship Theory (ST) and the Resource Dependence Theory (RDT) can be extended to explain the expected impact of the SB characteristics on the IBs performance. The studies such as Farook et al. (2011) and Nomran et al. (2018) have employed these theories as a theoretical base in explaining the role and effectiveness of SB in IBs. In the following section, this study reviews the characteristics of SB commonly discussed in past literature (SB Size, SB Educational Qualification, SB Reputation, SB Expertise, SB Remuneration, SB Cross-membership).

### SB Size

Large SB Size may improve the monitoring quality of the SB, thus avoiding the SNC events that may occur. Safiullah and Shamsuddin (2018) find that insolvency risk of IBs decreased as the SB Size increased. Nomran et al. (2018) find a positive relationship between SB Size and the performance of IBs, which is consistent with the ST and RDT. Based on RDT, large board size improves external relations, advi-

sory capacity, and deliberation (Pfeffer, 1972). A few other studies have found the same result (Almutairi & Quttainah, 2017; Nomran et al., 2017; Farag et al., 2018; Nomran & Haron, 2019). These studies suggest that large SB improves advisory and monitoring functions, the behavior of management, and organizational performance (Almutairi & Quttainah, 2017). However, there are also previous studies that found negative relationship between SB Size and IBs performance (Nomran et al., 2017; Rahman & Haron, 2019). Further, a recent study by Nomran and Haron (2020) found the importance of small SB size on the performance of IBs as compared to large SB size with optimal size of five. The negative result between SB Size and performance supports the AT that assumes small corporate board is more effective than large corporate board as large boards are associated with free rider issues and high coordination costs (Jensen, 1993). Looking at the ambiguity in the past literature, this study hypothesizes *H1*: SB Size is significantly related to the performance of IBs.

## SB Educational Qualification

Education level indicates a person's knowledge, values and skills, and therefore, a good proxy for firm profitability in line with RDT (Hambrick & Mason, 1984). As for SB in Malaysia, the BNM requires SB members must at least hold a bachelor's degree from a recognized university in Shariah, including *fiqh muamalat*, and be able to demonstrate an adequate understanding of finance in general and Islamic finance in particular (BNM, 2019). In fact, it is a basic requirement for a Shariah scholar to possess sufficient Shariah knowledge and the educational qualification is the easiest way to determine the competency of an individual to be a Shariah scholar (Nomran & Haron, 2021). The study of Nomran and Haron (2019) on dual board governance structure and multi-bank performance that focuses on GCC countries finds that SB educational qualification is positively and significantly related to the performance of IBs. Almutairi and Quttainah (2017) investigate the impact of SB educational qualification on IBs performance of 15 countries and found that SB education is positively related to bank performance. They cited that members who hold postgraduate degree have great analytical skills and have excellent ideas. However, there are several studies that documented the opposite result. Rahman and Haron (2019) recorded negative impact of SB educational qualification on the bank performance because most of the SB members with PhD specialized in Shariah field but they lack knowledge and skills in business, accounting, and finance. Nomran et al. (2017) study the impact of SB members with doctorate degree on the performance of IBs in Indonesia and Malaysia, where only 50.2% of the SB mem-



bers possess accounting or finance knowledge and found the negative relationship. A negative relationship is also found between SB members with doctorate degree and the performance of IBs for the study period from 2008 to 2015 (Nomran et al., 2018). The study shows that only 58.6% of the SB members of the IBs in Malaysia have knowledge and skills in accounting and finance. Since both positive and negative impacts of SB educational qualification on banks' performance have been reported in the past literature, this study hypothesizes *H2*: SB educational qualification is significantly related to performance of IBs.

### SB Reputation (SB members sitting on other IFI's SB)

RDT states that one of the strategies to provide vital resources to the organization is to bring representatives from external organizations into a particular organization (Biermann & Harsch, 2016). In the SB context, the demand to hire Shariah scholars that sit on AAOIFI board is high due to their reputation (Rahman & Haron, 2019). Nomran and Haron (2020) argued that those Shariah scholars with AAOIFI affiliation can deliver their task more effectively as they represent the global industry knowledge. The endorsement made by the SB of AAOIFI is considered as the best rated *fatwa* (Shariah ruling) as the SB of AAOIFI is the highest SB in the industry and it is comprised of highly reputable Shariah scholars (Nomran & Haron, 2021). On this regard, Nomran et al. (2018) find that SB reputation has positive impact on the performance of IBs in Malaysia. The result confirms the RDT argument that corporate board provides vital resources for organization, including the members' reputation. However, there are also studies that found negative impact of SB reputation on financial performance (Nomran et al., 2017; Rahman & Haron, 2019; Nomran & Haron, 2019). Nomran et al. (2017) suggested the negative impact is due to high cross membership among the reputable scholars. Further, Rahman and Haron (2019) explain that SG in Indonesia allows SB members on National Supervisory Board of Indonesia (*Majelis Ulama Indonesia*) to sit on IBs' SB led to the conflict of interest. Since most of the studies recorded positive impact of SB reputation on IBs' performance and following the RDT, this study hypothesizes *H3*: SB reputation is positively related to the performance of IBs.

### SB Expertise

Alnasser and Muhammed (2012) stated that competency issue is related to the area of expertise that the SB members possess. Noordin and Kassim (2019) find that the participation of Shariah scholars in the Malaysian IBs with professional backgrounds, such as law and accounting have increased from 44% in 2009 to

75% in 2013. Previous studies have reported positive impact of SB expertise on the performance of IBs (Nomran et al., 2017; Hakimi et al., 2018; Nomran & Haron, 2018). Nomran and Haron (2019) stated that, in logical sense, having more SB members with accounting or finance expertise will increase the profitability of the IBs, hence for the bank to pay higher zakat. Nomran et al. (2017) find positive relationship between SB expertise and IBs performance using ROA. This is because SB members can assist board to increase IBs' performance by having a solid understanding on banking operations (Hakimi et al., 2018), in line with ST and RDT. Thus, the hypothesis statement is *H4*: SB expertise is positively and significantly related to the performance of IBs.

### SB Remuneration

Remuneration is an effective catalyst for a better performance of a firm as proposed by the AT, and appropriate remuneration is regarded as a good governance practice (Haron, 2018). Fama and Jensen (1983) and Murphy (1985) have recorded a linkage between remuneration and corporate performance. Fama and Jensen (1983) and Razali et al. (2018) highlighted that remuneration is an attractive incentive that can mitigate agency problem, thus improve firm performance. This is because high remuneration motivates directors to perform their duty at the best interest of shareholders. Nur-Al-Ahad et al. (2018) also find a significant and positive relationship between directors' remuneration and the performance of Malaysian government-linked companies' (GLCs). Remuneration has been a source of motivation for board to come out with great planning and strategies. In the context of banking sector, Lee and Isa (2015) find that directors' remuneration is positively related to bank performance. The finding indicates that remuneration can motivate directors to effectively monitor the management. In relation to SB members, they are also being paid by IBs for their services, like the BOD. Nomran and Haron (2021) highlight that the services rendered by SB are regarded as professional services and not only as religious duties and as such, their services need to be compensated. Hence, *H5*: SB remuneration is positively and significantly related to IBs' performance in Malaysia.

### SB Cross Membership

Cross-membership is associated with greater monitoring as SB members will be exposed to more discussion about the industry and application of Shariah in banking (Farook et al., 2011). Najwa et al. (2019) find that higher number of SB members with Shariah supervisory experience moderates the relationship between



board size and insolvency risk. Larger board size is likely to reduce insolvency risk when SB has higher percentage of members with Shariah supervisory experience. Cross-membership may reflect the experience of SB members in Shariah supervisory experience, though SB with multiple board representations may cause concentration risk, lack of diversity and independence making them incapable to undertake expected tasks (Nomran & Haron, 2021). Besides, inadequate number of qualified scholars in Islamic finance is the main reason for scholars to sit on multiple boards. Nomran et al. (2018) find that SB cross membership has a positive relationship with the performance of IBs in Malaysia. This result is aligned with RDT in which SB cross-memberships expose SB scholars to more debates relating to Islamic banking industry. There are other studies with similar results (Almutairi & Quttainah, 2017; Nomran et al., 2017; Nomran & Haron, 2019). Almutairi and Quttainah (2017) examine the impact of SB on the performance of IBs in 15 countries and concluded that cross-membership will enable SB members to communicate with other boards and create greater resource allocations, leading to better performance. However, Nomran et al. (2017) find negative relationship between SB cross-membership and performance of large IBs. Their finding supports the argument of AT that SB cross-membership is associated with conflict of interest which may occur as SB members have access to proprietary information (Garas, 2012). Hence, based on ST and RDT, the hypothesis is *H6*: SB Cross-Membership has a significant positive impact on IB performance in Malaysia.

## Data and Methodology

### Sample

This study employs a panel data approach covering all IBs (full-fledged) in Malaysia from 2010 to 2018 (nine years), covering pre (2010-2013) and post (2014-2018) IFSA (2013) implementation. Based on the BNM latest list, there are currently 16 IBs operating in Malaysia. Of those 16, 15 Islamic banks are included in the sample with the exception of Malaysia Building Society Berhad (MBSB). The bank only operates as Islamic bank beginning of April 2018 following the acquisition on Asian Finance Bank.

### Measures of variables

This study employs two measures of financial performance (ROA, ROE) and social performance (Zakat ratio). ROA is the net income divided by total assets and ROE is the net income divided by total shareholder's equity. These two accounting measures are consistent with previous studies in the field of CG (Bukair & Rah-

man, 2015; Nomran et al., 2018; Hakimi et al., 2018). Next is ZOE (zakat paid over total equity). According to Rosman et al. (2019) and Haron et al. (2021), zakat is an income distribution post performance to meet the social responsibility of IBs, and is an efficient measurement tool to implement CSR program as it improves performance while considering the society. Further, ZOE reflects the zakat impact on investment portfolio of IBs (Nomran & Haron, 2019).

The explanatory variables used in this study are the SB size, SB education-  
al qualification, SB reputation, SB expertise, SB Remuneration, SB cross-member-  
ship. These CG variables are accessible in the statement of CG of Islamic banks' annual report and profile of SB.

SB size refers to total number of SB members of the bank. SB of IBs in Malaysia must at least comprise of five SB members and minimum three SB members for Islamic window or foreign branch in Malaysia (BNM, 2019). SB educational qualification refers to the percentage of scholars who have PhD degree, while SB expertise refers to percentage of SB members with accounting or finance knowledge. SB reputation refers to the percentage of scholars who sit on the board of AAOIFI and at least one other SB membership in other IBs. Scholars affiliate to AAOIFI is assumed to be scholars with high reputation as SB of AAOIFI is the highest SB in the world (Nomran et al., 2018). SB cross-membership is the percentage of scholars who sit on another SBs of IBs (local and abroad) (Rahman & Haron, 2019). In Malaysia, BNM restricts that a SB member can only serve in one licensed IB, one takaful operator, and one prescribed institution (BNM, 2019). SB remuneration is the log of the amount of total compensation paid to SB member/directors of bank including cash and non-cash compensation.

This study incorporates two types of control variable, first is board governance and second, bank specific variable. Board governance comprises of Board size, Board independence and Board remuneration. Board size refers to the total number of board members while board independence is the proportion of independent (non-executive members) on the board. According to BNM's guideline on CG, the board must be of a size that can promote effective deliberation and have majority as independent directors (BNM, 2016). Board remuneration is the log of the total compensation paid to directors of the bank (cash and non-cash compensation). Bank specific variable includes bank size (BSize), bank age (BAge), capital adequacy ratio (CAR), and financing to total assets (FINTA). These bank characteristics may affect the performance of IBs. BSize is measured by natural log of total assets at the year-end, BAge is the number of years since the bank is established, CAR is total equity to total assets and FINTA is financing (loan) to total asset.

## Regression Model

This study employs a dynamic panel data model of the Generalize Method of Moments (GMM), to determine the relationship between SB characteristics and performance of IBs in Malaysia. One of the advantages for employing GMM is to solve the problem of reverse causality, meaning that there is a possibility of two-way causal relationship between the explanatory and dependent variable (Hakimi et al., 2018). GMM is also able to control the endogeneity, which is referring to the issue of explanatory variable being correlated with the error term and which may lead to incorrect interpretations. Besides, firm performance is not strictly exogenous, and that the current CG structure may be determined by the past performance of the banks. The following regression model is employed to test the relevant hypotheses.

$$\text{PERFORM}_{it} = \beta_{0it} + \beta_1 \text{PERFORM}_{it(-1)} + \beta_2 \text{SB-SIZE}_{it} + \beta_3 \text{SB-EQ}_{it} + \beta_4 \text{SB-REP}_{it} + \beta_5 \text{SB-EXPER}_{it} + \beta_6 \text{SB-REM}_{it} + \beta_7 \text{SB-CRM}_{it} + \text{Control} (\beta_8 \text{BOARD-SIZE}_{it} + \beta_9 \text{BOARD-IND}_{it} + \beta_{10} \text{BOARD-REM}_{it}) + \text{Control} (\beta_{11} \text{BSIZE}_{it} + \beta_{12} \text{BAGE}_{it} + \beta_{13} \text{CAR}_{it} + \beta_{14} \text{FINTA}_{it}) + \text{Control} (\beta_{15} \text{DUMIFSA}_t) + \epsilon_{it} \quad (1)$$

where 'i' indicates the Islamic banks ( $i = 1, \dots, 15$ ) while 't' indicates year ( $t = 2010, \dots, 2018$ ). PERFORM = Performance of IBs, PERFORM(-1) = Lagged performance of IBs, SB-SIZE = SB Size, SB-EQ = SB Educational Qualification, SB-REP = SB Reputation, SB-EXPER = SB Expertise, SB-REM = SB Remuneration, SB-CRM = SB Cross Membership, Control variables: Board Governance (Board Size, Board Independence, Board Remuneration), Bank specific (Bank Size, Bank Age, CAR, FINTA) and IFSA (Dummy 0 = 2010-2013), (Dummy 1 = 2014-2018).

## Analysis and Findings

### Descriptive Analysis

Table 1 reports the average scores for the dependent variables (ZOE, ROA, ROE) are 0.001, 0.0064 and 0.0933, respectively. The average scores for ROA and ROE in this study are slightly higher than those reported (0.006 and 0.0909) on the Malaysian IBs from 2008 to 2015 in Nomran et al. (2018). This indicates that the overall performance of IBs in Malaysia from 2010 to 2018 has increased slightly compared to a period from 2008 to 2015. The proxy for zakat (ZOE) is quite low as not all IBs are paying zakat, especially foreign IBs. Four out of 15 banks are not paying zakat under the period of study; these IBs are KFH (Malaysia), SCS, HSBC Amanah, and Al-Rajhi. KFH paid zakat once in 2010 but discontinued from paying zakat since 2011 because the shareholder of KFH (Malaysia) Berhad, Kuwait Finance House (KFH), paid zakat on behalf of its subsidiary.

The mean of board size is 6.9478 with minimum three members and maximum 10 members. The minimum number of board members in IBs is consistent with the study conducted by Nomran and Haron (2019) on Southeast Asia that shows minimum and maximum board size to be three (3) and 12 members, respectively. The mean of SB size is five (5) with minimum three (3) members and maximum of nine (9) members. The mean score of board remuneration is higher than SB remuneration with 6.3437 and 5.4901, respectively. For other SB characteristics variables, the mean for the SB cross-membership is 0.2598, the SB education is 0.8112, the SB reputation is 0.0122, and SB expertise is 0.8819.

**Table 1**

*Descriptive Statistics*

Variable	Observation	Mean	Min	Max
<i>Performance variables</i>				
Zakat (ZOE)	131	0.0011	0.0000	0.0122
ROA	131	0.0064	-0.0447	0.0155
ROE	131	0.0941	-0.3146	0.2250
<i>Corporate governance variables</i>				
SB Remuneration	133	5.4901	4.6990	6.1086
SB Size	131	5.1985	3.0000	9.0000
SB Cross-membership	127	0.2598	0.0000	1.0000
SB Education	127	0.8112	0.4000	1.0000
SB Reputation	127	0.0122	0.0000	0.2000
SB Expertise	127	0.8819	0.0000	1.0000
<i>Control variables</i>				
Board Size	134	6.9478	3.0000	10.0000
Board Independence	133	0.6018	0.2500	1.0000
Board Remuneration	131	6.3437	4.7782	7.0397
Bank Size	131	10.3161	9.6098	11.3526
Bank Age	133	0.9129	0.3010	1.5441
CAR	131	0.0798	0.0371	0.1857
FINTA	131	0.6503	0.3901	0.8325
IFSA 2013	135	0.5556	0.0000	1.0000

## Correlation

Table 2 presents the correlation coefficients between the explanatory variables employed in this study. The correlation between Board Remuneration and Bank Age is the highest ( $r=0.6629$ ), while the lowest correlation is between Board Size and SB Education ( $r=-0.001$ ). The collinearity problem is absent if the correlation coefficient is less than 0.95. Hence, all proposed variables are included in this study.

**Table 2**

*Pearson Correlation*

Independent Variables	Board Size	Board Independence	Board Remuneration	SB Remuneration	SB Size	SB Cross membership
Board Size	1	-0.3223	0.076	-0.1905	0.0801	-0.0821
Board Independence		1	0.0366	0.3053	0.2006	0.0437
Board Remuneration			1	0.2478	0.3111	0.2974
SB Remuneration				1	0.3533	-0.0641
SB Size					1	0.3509
SB Cross membership						1
SB Education						
SB Reputation						
SB Expertise						
Bank Size						
Bank Age						
CAR						
Asset Portfolio						
IFSA 2013						

IFSA (2013)	FINTA	CAR	Bank Age	Bank Size	SB Expertise	SB Reputation	SB Education
-0.2767	-0.3741	-0.0246	0.0061	-0.053	0.2833	-0.0523	-0.001
0.2538	0.3379	-0.1034	0.037	0.3347	-0.0325	0.2448	0.0479
0.2138	0.0707	-0.0894	0.6629	0.4619	0.1615	0.098	0.0323
0.3585	0.3273	0.3162	0.3274	0.2568	-0.123	0.2226	-0.1136
0.2651	0.1697	-0.2456	0.3469	0.4801	0.3859	0.3774	-0.0468
-0.0118	0.0946	-0.3546	0.2301	0.4854	0.1991	0.4818	0.3561
-0.0405	0.0893	-0.126	-0.0351	0.1542	0.2181	0.0614	1
-0.0218	0.2396	-0.3064	0.0102	0.442	0.0959	1	
0.1126	-0.0365	-0.1691	0.2368	0.2337	1		
0.2531	0.4297	-0.4726	0.3765	1			
0.4741	0.0471	0.0635	1				
0.0195	-0.1377	1					
0.5737	1						
1							

## Hypotheses test

This study employs system-GMM to investigate the impact of SB characteristics on performance of IBs in Malaysia. Lag of dependent variable is treated as endogenous variable following the study of Nomran and Haron (2019). This study performs two diagnostic tests, which are [AR(1) and AR(2)] to confirm the absence of autocorrelation and Sargan test to ensure the validity of instrumental variables used in the regression model.

Table 3 presents the regression results (ROA, ROE and ZOE). SB education is positively significant to bank performance (ROE), in support of RDT. It indicates that IBs with SB members having PhD degree contributes to the performance of the banks, in line with Almutairi and Quttainah (2017) and Nomran and Haron (2019) that focuses on the Southeast Asia. Hambrick and Mason (1984) emphasize

that education level indicates a person's knowledge and skills and as such, it is a good proxy for firm profitability. *H2* is thus supported.

SB reputation is positively related to bank performance (ROE), in support of RDT. It indicates that IBs with SB members who sit on the board of AAOIFI and at least another SB membership in other IBs contribute to better performance. SB members affiliated with AAOIFI are believed to have knowledge and expertise that can complement other abilities of SB and they are regarded as highly reputable Shariah scholars (Almutairi & Quttainah, 2017; Nomran & Haron, 2021). *H3* is thus supported.

A significant positive relationship is found between SB expertise and performance (ROA), in support of previous studies (Nomran et al., 2017; Hakimi et al., 2018; Nomran & Haron, 2019). SB members with knowledge in the field of accounting, or economic, or finance can assist the board effectively as they have a good understanding on banking operation (Hakimi et al., 2018). *H4* is thus supported, in line with ST and RDT. SB remuneration has a significant negative impact on IBs performance (ROA). It infers that remuneration is not a source of motivation for SB members to improve IBs performance, in contrast to AT. In fact, remuneration could be a social duty for SB to improve IBs performance for the benefit of the Islamic banking industry. Haron (2018) in his study argued that the ethical values and social duty attached to Muslim directors motivate them to disregard attractive remuneration as a catalyst to give their best. *H5* is thus not supported.

A significant negative relationship is found between SB cross-membership and bank performance (ROA), in support of AT in which conflict of interest may occur as cross-membership is associated with access to proprietary information (Garas, 2012; Nomran et al., 2017). *H6* and ST/RDT are thus not supported. The finding is however inconsistent with the previous studies of Almutairi and Quttainah (2017) and Nomran and Haron (2019). As stated by Nomran and Haron (2021) the multiple SB representation may cause concentration risk, making them incapable to undertake expected tasks. The SB members of IBs in this study are not sitting on two or more IBs in Malaysia because of the restriction imposed by the central bank but on the SB of IBs in other countries. The study however did not find significant evidence on the relationship between SB Size and performance of IBs. *H1* is thus not supported.

This study records the influence of control variables on the performance of IBs (Board size, Board Independence, CAR and IFSA-2013). Based on the empirical evidence, SB therefore is relevant to the performance of IBs. Next, we discuss the recent new ruling by the SB at the central bank (SAC-BNM) on the restructuring of Islamic financing facility during the pandemic crisis.



**Table 3**

*Two-step system GMM*

	(1) ZOE		(2) ROA		(3) ROE	
Independent Variable	Coefficient	p-value [Z-Statistic]	Coefficient	p-value [Z-Statistic]	Coefficient	p-value [Z-statistic]
ZOE (-1)	3.8494	[0.4830]				
ROA (-1)			0.2647	[0.3460]		
ROE (-1)				0.8532	[0.1810]	
<i>CG Variable</i>						
SB Size	-0.0037	[0.5140]	0.0018	[0.3300]	-0.0099	[0.7530]
SB Education	0.0316	[0.6360]	0.0634	[0.2140]	2.2158	[0.0580*]
SB Reputation	0.0092	[0.9430]	0.1672	[0.6090]	5.6977	[0.0950*]
SB Expertise	0.0448	[0.4020]	0.0209	[0.0400**]	-1.0799	[0.2100]
SB Remuneration	0.0113	[0.4950]	-0.0886	[0.0080***]	0.7519	[0.1300]
SB Membership	-0.0083	[0.7110]	-0.0145	[0.0100***]	0.1438	[0.2240]
<i>Control Variable</i>						
Board Size	-0.0005	[0.7600]	0.0059	[0.4380]	0.1026	[0.0870*]
Board Independence	-0.0053	[0.0510*]	-0.0058	[0.7470]	-0.6710	[0.0650*]
Board Remuneration	-0.0134	[0.3990]	-0.0088	[0.8230]	-0.5091	[0.1180]
IFSA 2013	-0.0143	[0.4680]	-0.0055	[0.1640]	-0.0711	[0.0630*]
Bank Size	-0.0001	[0.9830]	0.0305	[0.1630]	-0.2309	[0.2910]
Bank Age	-0.0401	[0.5580]	0.0383	[0.3010]	0.9749	[0.0850]
CAR	-1.2343	[0.5120]	0.4941	[0.0690*]	-3.6016	[0.3200]
FINTA	0.1938	[0.5160]	0.0712	[0.1850]	-0.4391	[0.2110]
AR(1) (p-value)	-0.0500	0.9620	-0.3600	0.7180	0.0000	0.9980
AR(2) (p-value)	0.4700	0.6360	0.1300	0.9000	-0.5200	0.6000
Sargan statistic	25.5400	0.3230	12.0000	0.9870	15.8700	0.8610

## **Sac New Ruling On Restructuring of Islamic Financing Facility During Pandemic Crisis**

The COVID-19 pandemic and Movement Control Order (MCO) aimed at curbing the spread of the pandemic have had a devastating effect on the Malaysian economy. The spread of COVID-19 has also affected global supply and demand, which exacerbated the effects of the health crisis on the country's economy. As a result, majority of the business sector is affected especially in terms of finance and cash flow, to the extent that businesses cannot be sustained and are forced to take measures to reduce costs. These include, among others, by reducing the size of the workforce, shortening working hours and even closing down the operations. As a result, many employees have lost their jobs or faced declining monthly incomes. To ease the financial burden of individuals and small and medium enterprises (SME), various forms of assistance have been granted by the government including providing a temporary deferment on the monthly payment of financing (moratorium).

This unprecedented issue needs to be addressed immediately to avoid a sudden and significant increase in impairment that can lead to bankruptcy and insolvency with longer term adverse implications on the people and economy. This can also have adverse effects on the strength of banking institutions. In such environment, rescheduling and restructuring of original financing allow businesses and individuals to better manage their financial obligations to suit their prevailing financial situation. Therefore, the process involved in rescheduling and restructuring any facility has to be efficient, seamless and flexible in such environment to enable those adversely affected to be able to accord attention towards finding new employment or additional income, or revive their businesses.

In this regard, SAC-BNM has made a new ruling on practices of restructuring on Islamic financing facilities during the Covid-19 crisis on 30<sup>th</sup> Special Meeting, effective 10 August 2020 (BNM SAC Statement - 2020). The SAC rulings aim to ensure an efficient, unified and flexible restructuring process to cater for the different needs and circumstances of vulnerable groups such as lower-income individuals and small businesses in the pandemic situation.

The ruling discusses three important aspects. First, the restructuring of an Islamic financing facility based on original Shariah contracts, second, restructuring the facility into a conventional loan, and third, compounding profit on restructuring.

The Islamic financing facility may be restructured based on original Shariah contracts using a supplementary agreement that is cross-referred to the terms and conditions of the original agreement. This means no new agreement is re-

quired, intended to reduce the cost and challenges to IBs' customers, and operational burden on IFIs, particularly during the hard time caused by the pandemic. Variation to the terms and conditions of the original agreement via a supplementary agreement is allowed provided it has been agreed and clearly communicated to the contracting parties. SAC quoted Al-Zuhayli (2006) on the following *fiqh* maxim, "*The original ruling for a contract is the consent of the contracting parties and its effect is based on what has become the rights and duties as agreed in the contract.*" Cross-referencing of the modified terms and conditions in a supplementary agreement to the original agreement is allowed according to SAC based on *maslahah* to ensure an efficient and cost effective restructuring process is in place especially in the current challenging circumstances caused by COVID-19. SAC quoted Al-Suyuti (1403) on the following *fiqh* maxim, "*Hardship begets facility.*" SAC further quoted that Shariah has no objection for the restructuring of a financing using a Shariah contract that is different from the original contract, and consolidation of financing based on various Shariah contract into a single Shariah contract, in line with the hadith in *Sunan Abi Daud* (Abu Daud, 1999): "*(Dealing of) Muslims is based on conditions (as agreed) amongst them, except conditions that permit a forbidden matter or forbid a permissible matter.*"

A new agreement however is required if the restructuring involves the application of a different Shariah contract, for example, a house financing that is originally based on *musharakah mutanaqisah* (diminishing partnership) is being restructured using *ijarah*; or a combination of multiple financing based on various Shariah contracts into a new single Shariah contract as part of a debt rationalization exercise.

SAC had ruled that while IFIs may restructure a conventional loan into an Islamic one, they are not allowed to do the opposite. In this situation, the customer's choice is beyond the responsibility and control of the IFI. According to SAC, Shariah allows the restructuring of a conventional loan facility into an Islamic financing facility on the basis of helping the community/customer to get out of matters that are forbidden by Shariah, in line with the concept of *ta'awun* (mutual assistance) for goodness. SAC quoted *al-Ma'idah* (2): "*...help one another in furthering virtue and God consciousness, and not in what is wicked and sinful...*"

As for compounding profit on restructuring, IFIs were not allowed to include and account for any accrued profit on an original financing as the new principal amount for the restructured facility. Such practice aims to avoid multiplying of profits charges on debts (compounded profits). Therefore, in implementing a restructuring, the new principal amount for the restructured facility is equivalent to the outstanding principal amount of the original facility, provided there is no additional

financing. IFIs are allowed to charge a new profit rate on the new principal amount. SAC ruled that the amount of accrued profit and late payment charges (where applicable) on the existing financing can be carried forward and added to the total financing obligation, but the amount cannot be capitalized in the calculation of new profit. The ruling regarding compounding of profit is not applied retrospectively considering that previous restructuring practices may have imputed such application of compounding profit. This is based on the consideration of *maslahah* and worsening of difficulties (*raf' al-haraj*), particularly in the current outbreak of COVID-19 and the impact of Movement Control Order (MCO) to the economy.

## Conclusion and recommendations

This study examines the impact of SB characteristics and provides empirical evidence on the relevance of SB (Reputation, Education, Expertise, Remuneration, Cross membership) on the performance of IBs. The study also discusses the recent ruling by SAC (BNM) on financing restructuring of IFIs in alleviating the hardship of IFIs' customers during the pandemic crisis. In conclusion, this study contributes to the literature of SG in Malaysia in term of SB attributes and the financial and social performance of IBs and the new Shariah rulings by SAC during pandemic. Future studies may incorporate Shariah governance index to further understand the impact of SB on the performance and betterment of IBs.

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