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# Shariah Non-Compliance Treatment in Malaysian Islamic Banks

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**Abstract**
Islamic finance in Malaysia has been growing rapidly in the past 30 years. In 2019, there is a total of 16 Islamic banks listed and supervised by Bank Negara Malaysia (BNM), with 5 out 16 banks are foreign entities. In view of the rivalry with the conventional banking sector, Islamic banks offer new innovative Islamic products and financial projects which may lead to greater risk of Shariah Non-compliance (SNC) exposure to the Islamic Financial Institutions (IFIs) in its effort to stay competitive. This paper attempts to explore the current practices of Islamic banks in treating (SNC) and the extent of compliance with BNM rules and guidelines, particularly BNM Operational Risk Integrated Online Network (ORION) requirement on SNC reporting event. This paper adopts a qualitative research method by conducting semi-structured in-depth interview with the Islamic banking professionals targeting five Islamic banks. Both primary and secondary sources are used for data collection. The finding shows that these Islamic Banks adhere to the BNM rules and requirements, with some minor differences in the implementation process. The findings would contribute positively in terms of enriching and contributing to the existing literature on the SNC practices by Islamic Banks whilst at the same time establishing the levels of compliance of the banks under investigation.

**Keyword:** Shariah Non-Compliance Risk; Shariah Non-Compliance Event; Shariah Non-Compliance Reporting; Islamic Banks; BNM guidelines; Bank Negara Malaysia

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# 1. Introduction

The push for innovation to fulfil commercial purposes has led many Islamic financial institutions (IFIs) to adopt conventional principles and instruments. However, this may expose the IFIs towards the risk of Shariah Non-compliance (SNC), as all financial transaction, projects and activities must comply with the law of Shariah. BNM has issued a Shariah Governance Framework in 2010 to be complied by all IFIs that include established core functions that would guide the Islamic Banks in achieving effective operational excellence and concurrently adhering to the Shariah principles.

Nonetheless, despite the BNM framework and guidelines, SNC risks can potentially arise when there is a mistake made in the documentation process in dealing with a certain contract. Apart from that, conflicts appear when the Islamic products are improperly managed although the terms and conditions in place have already been stipulated to be in line with Shariah. According to Islamic Financial Services Board (IFSB), SNC risk is defined as "The risk that arises from the bank's failure to comply with rules and principles determines by the relevant Shariah regulatory councils" (IFSB, 2016, p. 16). Shariah compliance is the core element and the most predominant factor in operations of the Islamic banking and finance business. Failure to adhere to Shariah principles and values in carrying out the financial activities, business and operations may lead the Islamic bank to be exposed to the risk of non-compliance. SNC risk is considered as the unique risk of Islamic banks and IFIs compared to the conventional counterparts.

Therefore, this paper seeks to explore the processes taken by Islamic banks in Malaysia in the case of SNC events. Management of non-compliance issue is crucial in ensuring customers' faith and confidence in the Islamic banking and finance. Hence, monitoring of SNC events has to be on continuous basis and transparent in establishing credibility of the banks in their transactions. The significances of this paper include enriching the existing literature on this topic and increasing the awareness among the beneficiaries and the regulators to better improve the policy and guidelines on SNC event in Malaysia.

The scope of this paper is limited to Malaysian Islamic banks practices on SNC treatment which is regulated by Bank Negara Malaysia (BNM). This paper focuses on the steps taken from the identifying process, the investigation and reporting process and rectification plan. In addition, this paper intends to examine the rules and guidelines by BNM and IFSA on SNC events and the actual practices of Islamic Banks to ascertain the level of conformity with the regulations.

This paper is structured as follows: Section two discusses the overview of Islamic banking industry in Malaysia, elements of Shariah Non-compliance (SNC) risk, and statutory requirement on Shariah Non-compliance (SNC) event; Section three describes briefly about the methodology used; Section four presents the analysis and findings; Section five provides conclusions.

## 2. Islamic banking industry in Malaysia

Islamic finance and banking industry in Malaysia has been rapidly growing and increasing remarkably since more than 30 years ago. Malaysian model of Islamic banking today is one of the most advanced Islamic banking systems in the world.

In order to differentiate Islamic from conventional banking, we should begin by looking at the differences between conventional and Islamic banking. Conventional banks offer facilities based on loan arrangement and interest with the contractual term used between the bank and the customers are as borrower and lender. The underlying principles that govern Islamic banking are mutual risk and profit sharing between parties involved, the assurance of fairness for all and the transactions involve an asset and ownership or an underlying business activity that does not contradict with Shariah. Islamic banks offer facilities with a various financing arrangement with the contractual terms used between the bank and the customers as partners, buyer and seller, *wakil* (agent), fund provider and entrepreneur.

The first Islamic commercial bank in Malaysia, Bank Islam Malaysia Berhad (BIMB) was established and started its operations in July 1st 1983. BIMB operated as the only Islamic bank in Malaysia for 10 years before the government allowed Islamic Windows Operation, also known as 'Window' to be offered by other conventional banks. Islamic Financial Board Services (IFSB) defined Islamic Window Operation as "A part of a conventional financial institution (which may be a branch or dedicated unit of that institution) that provides both fund management (investment accounts) financing, and investment that are Shariah compliance, with a separate fund" (IFSB, 2017, p. 61). Window operation has contributed to the growth of Islamic banking and finance in Malaysia as the conventional banks started offering Islamic financing product to the customers. The number of Islamic banks in Malaysia continues to grow and currently there are 16 Islamic banks that are supervised by Bank Negara Malaysia including several foreign owned entities.

The Malaysian regulatory authority adopts a proactive approach in strengthening Shariah governance framework (Hassan 2010). In 2010, Shariah Governance Framework (SGF) was introduced by Bank Negara Malaysia and being implemented starting 1st January 2011 by Islamic Financial Institutions. The Shariah Governance Framework played an important role in supporting the robust development of the Islamic finance industry and promoting end-to-end Shariah compliance in Malaysia (BNM, 2010).

The objectives of Shariah Governance Framework are: (i) to provide the guidelines of Shariah governance structures, processes and arrangements for all Islamic banks and IFIs to ensure the compliance with Shariah rules in the entire business operations and activities, (ii) to provide comprehensive guidance for Shariah Committee (SC) and the management of IFIs in their business conduct or any matters relates to Islamic financial, (iii) Lastly, to highlight the SGF key functions such as Shariah risk management, Shariah review, Shariah research and Shariah audit (BNM, 2010).

The Islamic Financial Institutions shall ensure that the reporting on Shariah matters is carried out effectively in an orderly manner on regular basis. The Shariah Committee (SC) of IFIs shall report to the board of directors on Shariah related matters. The Shariah review function shall simultaneously report to the SC and the management. Next, the Shariah audit function shall report to the SC and Board Audit Committee on Shariah matters. All SNC events that have been identified by any means of channels or sources shall be reported to the Board of Directors and the central bank of Malaysia (BNM, 2015).

In Malaysia, there are a comprehensive regulations made to ensure IFIs did not contradict with Shariah principles in the overall business activities. The regulation is Islamic Financial Services Act (IFSA) that came into force in 2013 as an omnibus act, consolidating the Islamic Banking Act 1983 & Takaful Act 1984 and repealing both. IFSA 2013 introduces end-to-end Shariah compliance regulatory framework for IFIs. The act was enacted to provide:

(i) The comprehensive regulation and supervision of Islamic financial institutions, payment systems and other relevant entities in Malaysia to ensure all the activities, product and services offered complies with Shariah

(ii) The oversight of the Islamic money market and Islamic foreign exchange market

(iii) To promote financial stability and IFIs compliance with Shariah laws and principles

Section 28(1) IFSA 2013 states that all operations, businesses, affairs and activities of the Islamic Banks and Institutions must comply with Shariah at all times (Kunhibava, 2015). It shows that starting the requirements of Shariah must be fulfilled from the beginning until the end of the agreement.

### *2.1. Elements of Shariah Non-compliance Risks*

A Shariah compliant financial product should be free from prohibitive elements, namely riba (interest), gharar (uncertainty), ghubn (inequality), ikra (duress), ghalaṭ (mistake), taghrir (deception), jahalah (ambiguousness). These elements need to be fully apprehended by Islamic banks in order to carry out an effective Shariah risk management (Hassan, 2016). The following list summarises the elements that can bring possibility of SNC event:

1. *Riba* relates to the loan contract that the conventional banking adopted nowadays. They charge interest with specific increase on the amount of money that the customer borrowed in a given time period. It is also forbidden to obtain unfair gain in the exchange between commodities on the spot. The exchange of currencies and commodities, included in the six *ribawi* items (gold, silver, barley, wheat, dates and salt) stated in the hadith are considered as *riba*. If the Islamic bank fails to eliminate the element of interest and unfair gain by either party in its products and services, they will be exposed to SNC risk.

2. The transactions that involve minor *gharar* in the contract and execution will not render the contract null and void. Furthermore, the transactions that involve excessive amount of *gharar* may deem the contract to become null and void as it may lead to the occurrence of potential SNC (Shafii et a., 2010).

3. *Taghrir* is fraud or cheating. For instance, a seller intentionally presents a misleading fact about the product to deceive the buyer to enter the contract. This can lead to SNC as it breaches the fundamentals of Shariah principles that require any transaction to be based on mutual consent of both parties (Lahsasna, 2014).

4. *Ghubn* in Islamic financial transaction means an inequality of the product value in a cumulative contract due the ignorance by both contracting parties (Lahsasna, 2014). In the event when excessive *ghubn* exists in the contract, it may invalidate the contract as it is considered as a deception by one party to induce the other party to enter the contract.

5. *Ikrah* refers to a threat done by one party to force another party to enter the contract. The *ikrah* or duress may cause the contract to become invalid and lead to SNC (IFSB, 2016).

6. *Ghalat* is a mistake that takes place in a transaction contracts due to false prediction and assumption about the product or subject matter (Lahsasna, 2014).

7. *Jahalah* or ambiguousness on the subject matter may lead to dispute between the parties. Therefore, Islam required the seller to provide appropriate information and sufficient details regarding the subject matter to the buyer. Excessive ignorance in any transaction executed refutes mutual consent of the contracting parties, and it will render the contract as null and void (Hassan, 2016).

8. *Ahliyyah* refers to the legal capacity of a person to enter a valid contract. The person should be able to be held accountable and reaches age of criminal responsibility; otherwise the contract is deemed as void (IFSB, 2016).

### *2.2. Statutory Requirement on Shariah Non-compliance Event*

Shariah Governance Framework's core functions such as Shariah risk management, Shariah review and Shariah audit are required to be performed on continuous basis to ensure an effective management within the bank. Some important provisions of IFSA on Shariah Requirement for Islamic Banks and IFIs are Section 28 (1) & (2) of IFSA 2013. It states that IFIs shall ensure that its aims and the entire operations, business, and activities are in accordance with Shariah rules at all times. Compliance with any ruling and decision made by the Shariah Advisory Council (SAC) in respect of any particular aim and operation, business, affair or activity by shall be deemed to be Shariah compliance.

Should there be any disregard on Shariah principles or any breach of contract with regards to the Shariah compliant requirement or it contains any standards against BNM guidelines, the Islamic banks and IFIs will be exposed to the risk of SNC. BNM also provides guidelines on the reporting process of SNC event in Operational Risk

Integrated Online Network (ORION) policy document published by BNM in 2018. The guidelines include the reporting types and timeline on SNC event. The financial institutions or Islamic Banks that are exposed to SNC will be required to undergo the rectification process in accordance with Section 28(3) of IFSA 2013.

Section 28 (3) IFSA 2013 stipulates that, when IFIs becomes aware of the SNC event in any of its business or activity or any disregard towards the advice and ruling of Shariah committee or Shariah Advisory Council, they shall:-

1. Immediately notify its Shariah committee about the event
2. Immediately notify Bank Negara Malaysia of the event
3. Immediately stop the non-compliant act and cease from carrying on or taking on any other similar business, affair or activity
4. Immediately come up with a rectification plan within 30 days after becoming aware of such non-compliance, and submit the plan to the Bank Negara Malaysia for the rectification process

Section 28 (4) IFSA 2013 states that the bank may be put through an assessment as it thinks necessary to determine whether the institution has rectified the non-compliance events or not, referred to the subsection (3).

Failure to resolve and rectify the non-compliance issue will result them subject to punishment either under Section 59 (3) of Central Bank Malaysia Act 2009 or Section 28(5) or 29(6) of IFSA 2013. Any person who contravenes or disregards the subsection (1) or subsection (3) of Section 28 of IFSA 2013, commits an offence and shall, on conviction, be liable to imprisonment for a term not more than eight years or a fine not more than twenty-five million ringgit or be subject to both penalties. But this does not render the transaction becomes void under Malaysian Law and in fact it is still enforceable (Lee, 2017).

## 3. Methodology

A qualitative method is more suitable and appropriate for a research that explores the variation and diversity in any aspect of social life (Kumar, 2014). Qualitative method is concerned with subjective assessment of opinions, attitudes and focuses more on naturalistic setting. As for this paper, a qualitative method is deemed to be more suitable compared to quantitative method due to the exploratory nature of this research. This research uses interview and document analysis in accomplishing research objectives. Semi-structured interviews conducted with the respondents aim to explore the management and treatment of Islamic Banks towards SNC. Secondary data collected through sources such as journal articles and official websites of authoritative bodies, complement the findings from the interviews.

Adopting a convenience sampling method, five Islamic banks were selected (31.25% of total Islamic banks in Malaysia). There are twelve respondents that contributed to the findings of this study, all of them are Malaysians. The following table lists out the related information about the respondents for semi structured interviews.

**Table 1: List of Respondents for Semi Structured Interviews**

| No | Bank | Positions |
|---|---|---|
| 1 | Bank A | Head of Shariah Review and Assurance, Group Shariah Business Compliance |
| 2 | Bank A | Section head, Shariah Review and Assurance, Group Shariah Business Compliance |
| 3 | Bank B | Manager, Shariah Supervisory |
| 4 | Bank B | Assistant Manager, Shariah Supervisory |
| 5 | Bank C | Shariah Risk Management |
| 6 | Bank D | Director, Islamic Banking Compliance, Group Compliance |
| 7 | Bank D | Assistant Manager, Group Compliance |
| 8 | Bank E | Head of Shariah Compliance Review |
| 9 | Bank E | Shariah Advisory |
| 10 | Bank E | Shariah Advisory |
| 11 | Bank E | Shariah Review |
| 12 | Bank E | Shariah Risk Management |

All the respondents have the experience of working in the Islamic banking industry ranging from 2 years to 10+ years. The respondents are willing to participate in the interview and give an accurate and relevant data to contribute to the topic of this study via their hands-on knowledge and vast experience in the industry to support the findings.

## 4. Analysis and findings

### *4.1. Shariah Governance and Key functions*

BNM has published a general requirement of Shariah Governance Framework in 2010 and described the essential functions or key organs of the framework. IFIs have to implement the standard set up by BNM and establish their own internal Shariah governance framework with the four key functions to ensure an effective financial operation. IFIs must understand Shariah governance and how it affects Shariah compliance (Haqqi, 2014).

The Shariah Compliance function of Islamic Bank shall comprise Shariah review, Shariah audit, Shariah risk management and Shariah research. These functions shall be carried out through Shariah audit and Shariah review, and will be supported by Shariah risk management control and internal research. The Islamic banks must ensure that the competency, reporting structure, management and independency of these key functions meet the requirements set by BNM (2010).

Shariah review function refers to a regular assessment and evaluation on Shariah compliance in the overall operations of IFIs, including product development process and rectification plan as a control mechanism to prevent occurrence of SNC event (BNM, 2010). Next, Shariah audit function is a periodical and independent assessment to improve Shariah compliance of IFIs in overall business operations (BNM, 2010). Shariah audit acts as last line of defence against risk of non-compliance (Hakim, 2017). Shariah risk management function refers to a function that identify, measure, monitor and controlling the risk of SNC to enable the IFIs to operate their business activities effectively (Lahsasna, 2014). Lastly, Shariah research function is an internal unit that conduct the approval process, performing in-depth research on Shariah matters, assisting and providing advice to the relevant parties based on Shariah Committee decision (BNM, 2010).

All five Islamic banks implement the BNM guidelines and have established internal Shariah governance framework consisting of these four key functions but with slightly different names for each function. The Shariah functions work together to ensure an effective process in monitoring SNC risk. From the researcher point of view, Shariah research and secretariat function play a big role on this aspect as they are responsible to undertake administrative duties relating to the Shariah Committee. They have to coordinate SC meeting, compile proposal paper and disseminate SC decision. They are also required to perform further research on SNC event and form part of the presentation to SC, including any new products that need to be reviewed (BNM, 2010).

### *4.2. Process Involved in Shariah Non-compliance Treatment*

The researcher concluded that there are four major processes taken by Islamic Banks in treating SNC event. The first process is identifying the SNC event, followed by the second process which is to get the confirmation from Qualified Shariah Officer (QSO) on the potential issue. The third process is to get the decision by Shariah Committee (SC) and last process is to propose a rectification plan. In ORION policy document, the requirement on SNC reporting has been provided for the second, third and fourth process. The researcher divides each of the processes in the following parts to explain in more detail on the sequence of the SNC treatment by Islamic banks.

#### 4.2.1. Identification of Shariah non-compliance Event

SNC risk may arise from various areas, such as the structure of the product. These must be given attention accordingly as any violation of Shariah rules for the features of the contract may lead to SNC. The documentation must not contradict with Shariah principles, as the nature of Islamic finance are different compared to conventional counterparts, with additional requirements in the terms and conditions of the product and services. SNC can also arise from improper execution of the product even its underlying contract is in accordance with Shariah rules and principles. A weak system technology will worsen the effectiveness of managing SNC risk, meanwhile the inappropriate advertisement or questionable and improper marketing may deliver false image representation of the Islamic bank and the product offered and it may tarnish the reputation of IFIs in the eyes of the public.

The respondents highlighted that the possible SNC incident may be detected via several channels such as:

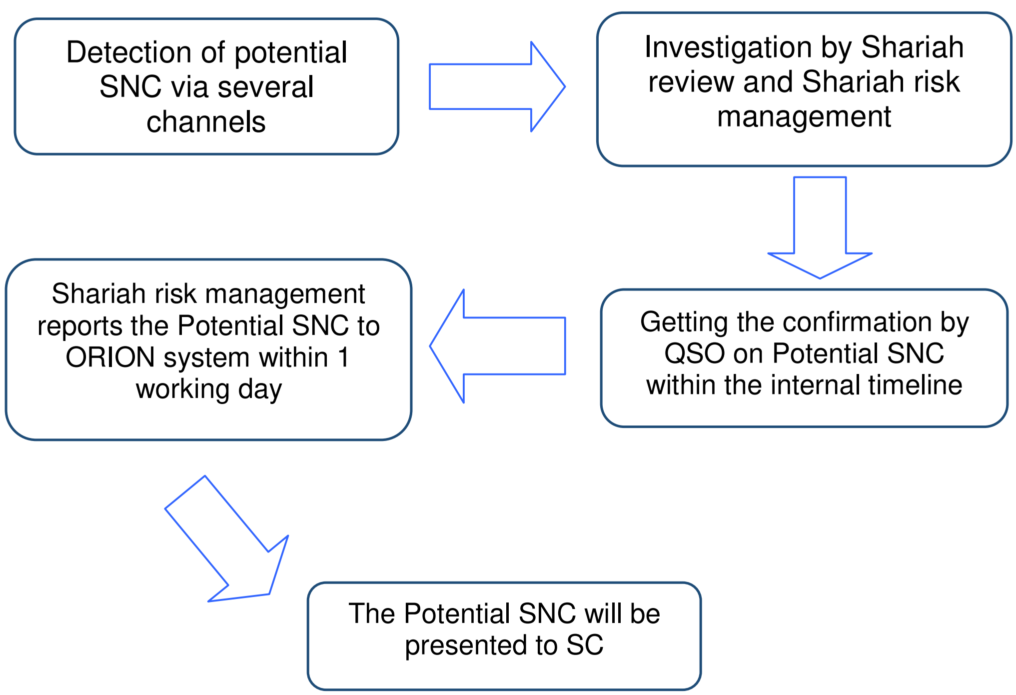
1. Detection by Shariah review team by reviewing the business operations
2. Audit team detected the issue through internal audit or assessment
3. Detection by Operational Risk Management team on possible SNC risk

4. Self-assessment by the business unit in conducting daily operations (Hakim, 2017)
5. The internal reporting on Shariah issues
6. The public (Lahsasna, 2014)
7. Report made by whistle-blower
8. Customer complaints
9. Shariah Advisory Council (Lahsasna, 2014)
10. Third party such as consultants or BNM Audit team

### 4.2.2. The Role of Qualified Shariah Officer

The detection will be investigated by Shariah review and risk management, and will be confirmed by Qualified Shariah Officer (QSO) as Potential SNC before the issue being presented to Shariah Committee for decision. BNM defines Potential SNC as "any SNC event detected and confirmed by a QSO but pending decision by the Shariah Committee". Figure 1 outlines the summary of QSO Confirmation process:

**Figure 1: The Process of QSO Confirmation**

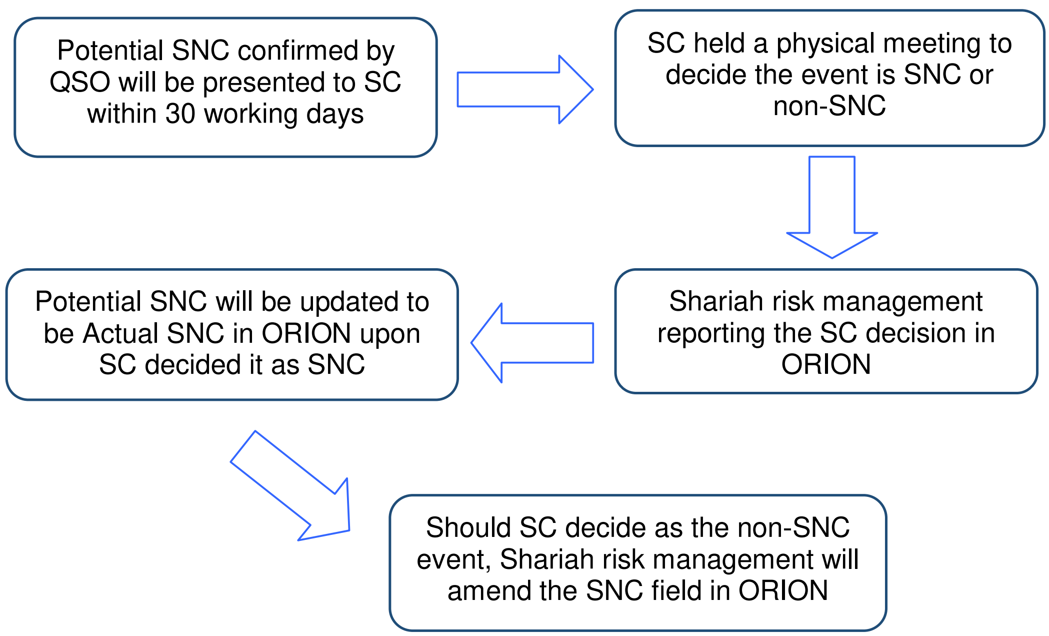



Each bank appoints different Qualified Shariah Officer (QSO) that holds the responsibility to confirm any Shariah issue detected. QSO appointed by Bank A is the Head of Group Shariah Business Company. For Bank B, the QSO is the Head of Shariah and Shariah Review function. The QSO of Bank C is the Chief Shariah Officer. Meanwhile, Bank D and Bank E both have Shariah review function as their QSO. The banks have internal timeline from the detection and the investigation process of SNC to get the QSO confirmations. BNM only provides the reporting timeline after the QSO confirmation until the rectification plan. It has been revealed by the respondents that the internal timeline for Bank A is 10 working days. While Bank B and E are 14 working days, Bank C is 2 working days and Bank D is 7 working days (minimum internal timeline). Each of the bank's Shariah Risk Management must report the Potential SNC that is confirmed by the QSO within the internal timeline according to their respective bank in the ORION system within 1 working day.

### 4.2.3. Decision of Shariah Committee on Shariah non-compliance Event

The Potential SNC event that has been confirmed by QSO of the respective bank will be presented to Shariah Committee within 30 working days after becoming aware of Shariah non-compliance (BNM, 2010). Shariah Committee will then decide if the event is SNC or non-SNC. Figure 2 below summarizes the process of Shariah Committee decision on SNC:

**Figure 2: The Process of Shariah Committee Decision**



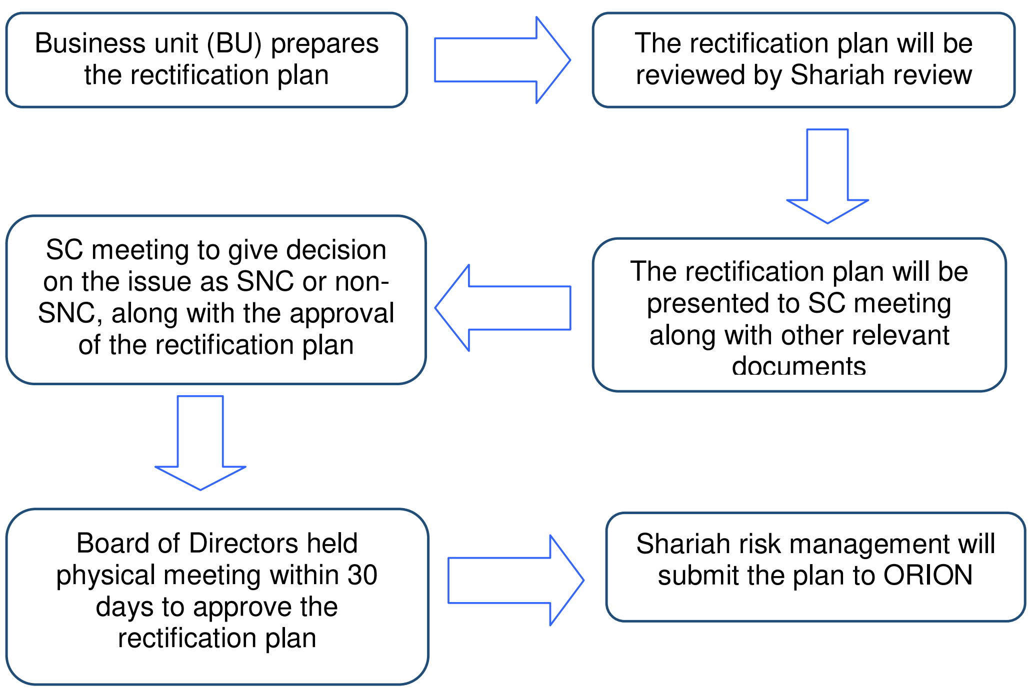

The event that has been decided by Shariah Committee as SNC will be reported by Shariah risk management in ORION and becomes an Actual SNC event. Islamic banks are required to conduct an ad-hoc meeting to discuss specifically on the Potential SNC matter. The ad-hoc meeting may consist of a minimum required quorum.

During the reporting SNC in the ORION, Shariah risk management must select one Shariah contract as the primary contract of the product and provide the Secondary Shariah contract. If there are several products involved in an SNC event, several Shariah contracts can be selected based on the number of products involved. If the SNC event involves an advertisement or any questionable sponsorship that does not follow the Shariah rules, they may select "Others (please specify)" option that is provided. Furthermore, the specific contract used must be specified in the 'Shariah Supporting Contract Comments' field. The source of detection of the potential SNC and actual SNC should be reported too, for example, the whistle-blower, the business unit and Shariah functions unit. In the event if Shariah Committee decides that the Potential SNC is non-SNC, then the Shariah Risk Management will have to update and amend SNC field in ORION, from the option "Yes" to "No". The event needs to be reassessed due to the change of status and it may be considered as an operational lapse under the operational risk event.

### 4.2.4. Rectification Plan

The rectification plan is compulsory as a correction to resolve the SNC event and for the purpose of mitigating any recurrent event. The plan must be approved by Shariah Committee and Board of Directors before being submitted in ORION system. In the revised ORION policy document, the circular resolution is no longer allowed. All the Shariah Committee meeting and board meeting must be a physical meeting. Hence, some respondents said they will try to ask for QSO confirmation for the SNC event before being tabled to Shariah Committee and get the approval for the rectification plan from Board of Directors, as close as possible to the pre scheduled meetings. This is one of the strategies to avoid calling the Shariah Committee and Board of Directors for an inevitable ad-hoc meeting to get their approval for the rectification plan. This way, they may reduce the time gap and immediately do the rectification processes instead of stopping the whole activity after the declaration of Actual SNC. Figure 3 shows the process of the rectification plan.

**Figure 3: The Process of Rectification Plan**



All the respondents said the business unit or, the respective process owner will be responsible to prepare the rectification plan. It will be presented along with the evidence and documents related to justify the event in the SC meeting. However, the plan will be reviewed by Shariah Review before being tabled in the meeting. The SC and Board of Directors have to approve the rectification plan before being submitted to ORION within 30 calendar days after the reporting date of Actual SNC. If, there is no pre scheduled board meeting held within the 30 days period, Islamic banks are required to conduct an ad-hoc meeting to get the approval on the rectification plan. The ad-hoc meeting may also consist of the minimum required quorum.

### *4.3. Summary of the SNC Treatment*

In the event the bank becomes aware of Potential SNC that confirmed by QSO, the issue will be tabled at the Shariah Committee meeting. Should Shariah Committee decide it is Actual SNC, actions must be stopped immediately and ceased from carrying on or taking on any other similar business, affair or activity (BNM, 2017). The respective business unit or the business owner shall immediately come up with the rectification plan within 30 days. The plan should be endorsed by Shariah Committee and approved by Board of Directors before submitting to ORION. The action is taken to resolve the SNC event and mitigate recurrence in the future.

Any income derived from the activity that is declared as Actual SNC will be channelled to charity or any other means as prescribed by Shariah Committee for purification purposes. The respective Business Owner with advice from finance division is responsible to calculate the SNC amount and transfer to Charity General Ledger: for example, late payments charges (Lahsasna, 2014).

SNC event may also cause the Islamic bank to face legal actions. They can also be penalized or liable for direct cost of regulatory penalties, such as Section 28(5) of IFSA 2013.

Risk management team must perform a monthly follow-up and provide the monthly update to Shariah division and the update on the rectification plan status will be presented to Shariah Committee of the respective bank. Latest actions taken by the Islamic banks as a control measures to rectify the Actual SNC must be updated in ORION system.

## 5. Conclusion

As Malaysia adopts a dual banking system, Islamic banking industry continuously grows and pushes for new innovation for commercial satisfaction to attract interest of Muslim customers. This may lead many IFIs to develop the products and services adopted from conventional counterparts that can result in a greater exposure towards SNC risk, as the products, financial transaction, and overall activities of IFIs must comply with Shariah principles.

Conclusion that can be drawn from the five Islamic banks interviewed is that they adhered to the BNM guidelines and standards that are imposed to all IFIs. This includes the ORION reporting requirement on SNC event (BNM, 2018), but with some minor differences in the internal governance framework and the implementation process. Failure to comply with the guidelines as included in ORION reporting requirement may cause the IFIs to face judgements and pay fine for legal liability and other relevant legal actions and punishment.

SNC event is usually a case-to-case basis and it does not solely focused on the financial transaction only, it goes beyond documentation, terminology and transaction. It may also arise because of audit dysfunctional behaviour (Paino et al., 2010) and inefficient governance system (Alam, 2013). For instance, failure to uphold Shariah governance and fail to get the agreement of Shariah Committee on a certain deal may also lead to SNC.

The Islamic banks must manage SNC risk as a pre-event control measure. They must ensure all the arrangement, terms and condition do not contradict with Shariah before the execution with continuous review done for measuring purpose. As an example, Bank D has a corporate finance deal that has the possibility of SNC; the bank will take an internal control to ensure that the deal will stay in line with Shariah. They must do a risk assessment to all products of the business corporate banking deal, and assign a risk rating based on the complexity of the deal. The banks will compare the BNM new guidelines in detail for the purpose of identifying the gap and avoiding from breaching it. This method of identifying the gap to manage the risk may also be applied beyond the banking platform.

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