



CRITERIA OF POTENTIAL SHARIAH NON-COMPLIANCE EVENT: ANALYSIS IN A FULL-FLEDGED ISLAMIC BANK IN MALAYSIA

Aizul Aiman Musa

Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia,
Bandar Baru Nilai 71800, Nilai, Negeri Sembilan, Malaysia

aizulaiman@gmail.com

Supiah Salleh

Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia,
Bandar Baru Nilai 71800, Nilai, Negeri Sembilan, Malaysia

chuyah@usim.edu.my

Zurina Shafii

Faculty of Economics and Muamalat Universiti Sains Islam Malaysia,
Bandar Baru Nilai 71800, Nilai, Negeri Sembilan, Malaysia

zurina.shafii@usim.edu.my

ABSTRACT

Referring to the latest ORR policy document issued in 2023, Bank Negara Malaysia (BNM) has removed the requirement for a Potential Shariah Non-Compliance (SNC) to be confirmed by a “qualified Shariah officer” and replaced with the “officer within Shariah control function” which could include officers with and without the Shariah study background. This amendment raised questions on how the officer without the Shariah study background assessed and confirmed an event as a Potential SNC before escalating it to the Shariah Committee for confirmation. In general, Islamic banking is distinguished from conventional banking by its adherence to the principles of Shariah. As compared to its counterpart, Islamic banking is exposed to an additional risk peculiar to its operation: the SNC risk. Thus, proper management of SNC risk is vital for Islamic banking since the impact of the risk could not only possibly affect the financial but also the image it carries. One of the governance aspects in managing SNC risk is the capability of its officer to identify, assess, and report SNC incidents. In this regard, BNM through its Operational Risk Reporting (ORR) policy document, requires Potential SNC events and Actual SNC events to be reported to the BNM. This paper discusses the criteria for Potential SNC events as a guide to be used by officers within the Shariah control function. This research adopted a qualitative approach using interviews and comparative content analysis of the financial statements of one of the full-fledged Islamic banks in Malaysia as the methodology for data analysis.

Keywords: Potential Shariah Non-Compliance Event, Shariah Control Function, Shariah Non-Compliance Reporting

Submitted: 03/03/2025

Accepted: 16/06/2025

Published: 28/07/2025





INTRODUCTION

Shariah compliance is a vital aspect that all Islamic financial institutions (IFIs) observe. The term Shariah compliant refers to adherence by IFIs to the religious laws of Islam, also known as Shariah. The Shariah is a religious code that governs the lives of Muslims in all aspects, including financial ones. Shariah compliance is a vital aspect that all IFIs should observe to provide their customers with Islamic financial services in accordance with Islamic requirements. The observance of Shariah compliance by IFIs is vital for the Islamic economy, since it ensures the upholding of religious values and principles and also helps to increase the credibility of Islamic financial products in the eyes of consumers.

In this instance, IFIs shall have an organizational structure and process in handling and managing Shariah non-compliance risk. Normally, IFIs implement three (3) lines of defense: the risk-taking unit is the first line, the risk control unit is the second line, and the independent assurance unit is the third line (Hakim, 2017). Overall, when we discuss the management of Shariah non-compliance risk, it shall involve the analysis of the bank's risk exposure to such risk, putting sufficient control in place to proactively mitigate the risk and also to have the reporting system should the risk materialize.

The discussion in this paper surrounds one aspect of such risk management: the Shariah non-compliance event reporting mechanism of IFIs in Malaysia. As a background, the Government of Malaysia introduced the Islamic Financial Services Act (IFSA) in 2013, which has outlined the importance of each IFIs to ensure that their aims, operations, and business activities are all in compliance with the Shariah and has also provided the requirement for notification to Bank Negara Malaysia (BNM) and the IFIs' internal Shariah Committee (SC) for non-compliance with Shariah (Malaysia, 2013). In relation to the reporting framework, BNM first issued the Shariah non-compliance reporting guideline in 2013, which has since superseded several policy documents, and the latest was the BNM Operational Risk Reporting (ORR) policy document issued in 2023. In general, the policy document prescribed the process flow pertaining to Shariah non-compliance (SNC) events and classified SNC events into Potential SNC events and Actual SNC events.

LITERATURE REVIEW

SNC from Shariah Perspective

Shariah's literal meaning is a path to a source of water. By definition, shariah can be defined as a divine revelation from Allah through its messenger to guide his creation on the path to live in this world. This would include all aspects of human life, such as belief, ethics, worship, the way humans interact with humans, and with nature or even animals (Islam, 2022). Above all, Shariah also comes with set of dos and don'ts which accompanied by the concept of reward and punishment by Allah. Anything that goes against the command of Allah or the rule set out by Shariah is considered a Shariah noncompliance event and is closely related to the concept of sin in Islam. Prophet Muhammad ﷺ explained the concept of good deed and sin in his hadith:

*“Righteousness is in good character, and wrongdoing is that which wavers
in your soul, and which you dislike people finding out about”*
Hadith. Muslim. Kitab Al-bir wa al-Silah wa al-Adab. No. 2553





The hadith explained the nature of good deed when we have a good morale and attitude, while the nature of sin is when we did something that could disconcert our mind, which we would like to conceal from everyone knowing it. In general, we can understand that the concept of SNC or sin in Islam involves all its branches or principals: *Fiqh Aqidah* (act of believe), *Fiqh Ibadah* (act of worship), *Fiqh Muamalat* (law of transaction), and *Fiqh Akhlak* (morale), since all of these branches are established based on the command of Allah and His prophet.

In Islamic law of transaction, the general maxim outlined by Islamic scholars to be the foundation of ruling is “*the primary ruling for contracts and conditions in financial dealings is permissibility (unless proven otherwise)*”. This maxim indicates that the general concept of a contract between human beings is acceptable. With this, the *Fiqh Muamalat* discipline is made more dynamic, adaptive, accommodating, and flexible in nature, allowing people and institutions to play a greater role in their respective fields of expertise (Jalil et al., 2014). Although the general concept in contract and conditions is permissible, it is still bounded by certain Shariah requirements where failure to adhere could render the contract and conditions SNC or have the potential to SNC.

The SNC in the context of Islamic Banking can be seen from the validity of the executed Shariah contract. According to Islamic scholars, the effects of a contract in terms of its validity can be categorized into two (2); *sahih* (valid) and *ghayr sahih* (invalid). *Sahih* contract refers to a contract that fulfills all its essential pillar (*Rukn*) and its related attributes (*Wasf*), which is also considered valid when the objective is met (Al-Razi, 1997; Al-Zarkashi, 1985). For instance, the sale contract is considered *Sahih* when its essential pillar such as offer and acceptance is clearly executed, the legal capacity of both contracting parties is sufficient, the subject matter is Shariah compliant, and the objective of sale is met, which is the transfer of assets and ownership from buyer to seller, and vice versa.

An invalid contract is the opposite of a valid contract when its requirement is not met by the essential pillar or its related attributes. Although the majority of scholars do not differentiate the invalid contract, only *batil* – Hanafi school of taught has further classified the invalid contract into two: *batil* and *fasid* (Al-Razi, 1997; al-Zuhaily, 2009). Al-Zuhaily (2009) explained that the *batil* contract from the Hanafi School of Teaching refers to defects in the essential pillar – offer and acceptance – or in the subject matter or lack of legal capacity, while *fasid* contract refers to a defect in its external conditions. Both would carry different consequences, in which the former would render the ownership void, and as for the latter, the ownership will only be valid after the defect is removed and consent is obtained from the owner.

After all, in the context of Islamic law of transaction, non-fulfillment of the essential requirements of contract would render it non-compliant to Shariah, which requires rectification such as removal of the defect matter, purification of income, and unwinding of the contract (Lahsasna, 2014; Mohd Noor et al., 2018; Omar & Hassan, 2019). Dusuki et al. (2012) suggested that the Hanafi view is more practical in the current context, as it provides more flexibility to the industry to apply Islamic law, as opposed to the view of the majority of classical scholars.

Additionally, Islamic scholars classify the invalidity of a contract from its context as two: (1) invalid due to defects in its essence (*Haram li Dhatih*) and, (2) invalid due to external reasons (*Haram li Ghayrih*). The former refers to prohibition of itself, such as prohibition of *Riba* and prohibition of gambling where the original ruling is already prohibited. As for the latter, referring to the ruling that was permissible in its original form but became prohibited due to external factors such as sale during *Juma'h* prayer, in which the sale in itself is permissible, but since it was done during *Juma'h* prayer, it is prohibited or eating someone belonging unjustly, which the act of eating in itself is permissible, but since the way it derives





is prohibited, eating is prohibited (Al-Salmi, 2005; Al-Taftazani, n.d.; Ibn 'Abidin, 1966). Al-Nawawi (n.d.), in his book *al-Majmu'*, gave another example of *Haram li Ghayrih* where he stated that a sale with undisclosed defect ('*Aib*) to the buyer while the seller knew about the defect is prohibited and he further explained:

"The prohibition (of sale & hiding the truth of the defect) is different. The falsehood is prohibited due to its essence and the sale is not prohibited by its essence but due to its attribute which is the act of undisclosed defect by the seller"

Apart from the above, there are circumstances in Shariah where the ruling is not clear, which Islamic scholars have classified as *Shubhah*. The concept of *Shubhah* was recorded in the hadith narrated by al-Nu'man bin Bashir:

"The lawful is clear and the unlawful is clear, and between the two of them are doubtful matters about which many people do not know. Thus, he who avoids these doubtful matters certainly clears himself in regard to his religion and his honor. He who falls into the doubtful matters falls into that which is unlawful like the shepherd who pastures around a sanctuary, all but grazing therein."
Hadith Muslim. Kitab al-Musaqah. No. 1599

Al-Nawawi (1972) in his *al-Minhaj*, a commentary book on Sahih Muslims stated that the above hadith is one of the pivotal hadiths that became the basis of most rulings in Shariah. Some Islamic scholars have clustered this hadith as one of three hadiths that became the root of the ruling in Shariah. This hadith shows that there are also some circumstances in Shariah, although with the clear ruling of *Halal* and *Haram*, humans can also be in the state of *Shubhah* (doubtful). Referring to classical Islamic jurisprudence, *Shubhah* is something that is uncertain about its permissibility or, in the context of *Jinayat* (Islamic Law of Punishment), it refers to a situation of ignorance or lack of evidence where doubt still exists (Al-Jarjani, 1983; Al-Suyuti, 1983; Ibn Nujaim, 1999). Two other terminologies are often used to discuss this concept:

1. *Al-Syak*:

This refers to something that is uncertain between two things; it could be doubtful matters that stand on the same level of doubt, or either one prevails. It also refers to a situation where preference was not made; thus, the matter was left undecided (Al-Jarjani, 1983).

2. *Al-Dhzon*:

This refers to something that is close to certain, but could still have some room for doubt. Al-Jassas (1994), in his book *al-Fusul fi al-Usul* explained that one of the types of *Ijtihad* would include a situation where reasonable doubt is used in analogical reasoning (*Qiyas*) when the operative causes (*Illah*) are uncertain. Hence, *al-dhzon* has the highest level of probability, or some would say a belief with reasonable doubt.

In Islamic law of transaction, *Shubhah* could be in a situation where the contract resembles a prohibition, such as *Bai' al-Muhaqalah*. This type of sale refers to the sale of unharvested grains with processed grains. This type of sale is prohibited due to the uncertain amount of subject matter and also resembles *Riba* (*Shubhah Riba*), which is invalid (*Batil*) from the majority's view and voidable (*Fasid*) from Hanafis (*Al-Mausu'ah al-Fiqhiyyah*, 1984).





In summary, potential SNC event in Islamic Banking resembles the concept of *Shubhah* matters where the outcome could be two-sided; either it potentially turns into lawful activity which is non-SNC or unlawful which is SNC, and in the context of transaction, the outcome could be valid or invalid. The same hadith suggests the concept of a potential SNC event, where the *Shubhah* matter has more potential for Shariah non-compliance events rather than Shariah compliance outcomes. Hence, Shariah urges to avoid *Shubhah* matters as a precautionary measure. There is one Islamic legal maxim which states: “*Shubhah* does the work of the truth (in affirming the unlawful)” (Al-Sarkhasi, 1993). This maxim suggests that *Shubhah* carries more burden towards the unlawful from a risk perspective; hence, it should be avoided or removed as to be innocuous.

SNC from Regulatory Perspective

The Islamic Financial Services Act 2014 (IFSA) has outlined the importance of each Islamic financial institution to ensure that their aims, operations, and business activities are all in compliance with Shariah (Malaysia, 2013). This is further supported by the BNM Shariah Governance Framework for Islamic Financial Institutions, which was revised in 2019 and called the Shariah Governance Policy Document. It has stressed the board’s expectations, the Shariah committee, and senior management in promoting a strong Shariah compliance risk culture within Islamic financial institutions (BNM, 2019).

The Shariah compliance culture in Islamic banking institutions shall not only be seen in the application of Shariah contracts used in the products offered, but Shariah compliance culture must also be in the aims, operations, business, affairs, and activities of an Islamic banking institution. Failure to cultivate the Shariah compliance culture in all aspects outlined exposes institutions to SNC risk (Hakim, 2017; Hasan, 2010; Kusumaningtias, 2024). In this instance, Islamic Financial Service Board (IFSB), (2005) in its guiding principles of risk management has outlined six (6) area of risk in Islamic financial institution which include SNC risk as part of the operational risk. Whilst, in the context of Malaysia, Section 28 (3), the IFSA provides:

“Where an institution becomes aware that it is carrying on any of its business, affair or activity in a manner which is not in compliance with Shariah or the advice of its Shariah committee or the advice or ruling of the Shariah Advisory Council, the institution shall—

- (a) immediately notify the Bank and its Shariah committee of the fact;*
- (b) immediately cease from carrying on such business, affair or activity and from taking on any other similar business, affair or activity; and*
- (c) within thirty days of becoming aware of such non-compliance or such further period as may be specified by the Bank, submit to the Bank a plan on the rectification of the non-compliance.”*

Based on this provision, it can be inferred that from a regulatory perspective, the SNC is when the business, affairs, or activity of IFIs is carried out in a manner similar to the general Shariah requirement, resolution of its internal Shariah committee, and ruling by the Shariah Advisory Council of BNM (SAC BNM).

In addition, BNM introduced the Operational Risk Reporting (ORR) policy document, which requires financial institutions to report the exposure of operational risk to BNM, including Loss Event Data, Key Risk Indicators and Scenario Analysis (BNM, 2023). One of the reportable operational risk events that require reporting into ORR is an SNC event, which





shows that BNM as the regulator is of great concern for the Shariah risk exposure to IFI (Omar & Hassan, 2019). In this regard, BNM has consistently, albeit with multiple revisions of the policy document, classified SNC events into two (2) classifications; Potential SNC and Actual SNC. Potential SNC are defined as any Shariah-related event detected and confirmed by an officer within the control function where the SC's decision is pending. An Actual SNC is defined as any SNC event that has been confirmed by the Reporting Entity's SC (BNM, 2023).

In comparison to the previous BNM Operational Risk Reporting Requirement - Operational Risk Integrated Online Network (ORION) policy document versions 2014, 2017, 2018, and 2021, BNM has removed the requirement for a Potential SNC to be confirmed by a qualified Shariah officer (QSO). BNM (2018) has defined qualified Shariah officers as officers who hold at least a bachelor's Degree in Shariah, which includes a study in *Usul Fiqh* (the origin of Islamic law) and *Fiqh Muamalat* (Islamic transaction/commercial). The latest ORR has broadened the requirement for the officer within the control function, which is defined as an officer who meets the following criteria (BNM, 2023):

1. is independent of business lines and is not involved in revenue generation.
2. possesses sound understanding of relevant Shariah requirements applicable to Islamic financial business.

The new BNM ORR requirement for the confirmation of potential SNC, as we can see, is extended to those who may not possess a bachelor's degree in Shariah but rather sufficient to have a sound understanding of Shariah requirements. Some may argue about the capability of the officer without a Shariah background to grasp the Shariah issue, which may create difficulty for the officers to confirm whether an issue is tantamount to Potential SNC events. This statement is supported by research Omar & Hassan (2020) that highlighted one of the challenges faced by IFI in managing SNC events is the lack of knowledge of the working level in detecting and analyzing the Shariah issues. One of the highlighted recommendations is for BNM to meet the criteria of SNC for the guidance of SC and QSO. Needless to say, if the suggestion to establish SNC criteria is for the guidance of SC and QSO – who possessed a Shariah degree – what more for those who do not have a Shariah background. Here, the researcher agrees with the notion of having the parameter, but the focus should be on guiding the officer in the Shariah control function – especially for non-Shariah study background – in detecting and analyzing the Shariah issues, since their part in detecting Shariah issues is crucial for the event to be reported and further deliberated by SC.

METHODOLOGY

This study employed a qualitative approach using interviews and a comparative content analysis methodology to analyse the data. This approach is more suitable to be used in order to achieve the objective and the information gathered is subjective in nature and the outcome could not be quantified in numerical form. Table 1 provides a brief background of the respondents.

Table 1: Background of the respondents

No.	Respondent	Background of the Respondent
1	R1	Shariah Committee of the Bank
2	R2	Shariah Committee of the Bank
3	R3	Officer in Shariah Review Function of the Bank
4	R4	Officer in Shariah Audit of the Bank





5	R5	Officer in Shariah Risk of the Bank
6	R6	Officer in Shariah Department of the Bank

In addition, this study considered the disclosure of SNC events as stated in the Shariah Committee Report and Basel II Pillar 3 Disclosure in the financial report of the Bank as the content for the case study analysis to support the findings from the interview. Table 2 summarizes the SNC event reported in the bank's financial statement for the year 2019-2023.

Table 2. Summary of SNC event disclosed in the Bank Audited Financial Statement 2019-2022

Year of Annual Report/Financial Statement	SNC Event Disclosed
31 March 2019	SNC income from nostro account
31 December 2019	<ol style="list-style-type: none"> 1. SNC income from five (5) number of events (The event was not disclosed in the report) 2. SNC income from nostro account
31 December 2020	<ol style="list-style-type: none"> 1. One incident of zakat payment made to a different state zakat authority which was not as per the instruction on the Service Request Form (SRF) 2. Sponsorship granted to Shariah non-compliance event not as per the guideline approved by Shariah Committee
31 December 2021	<ol style="list-style-type: none"> 1. Delay in allocating the gold in gold's account due to system error 2. Indication of repurchase term in the first aqad of Bai' 'inah 3. Two (2) events related to late payment charges due to system error 4. Two (2) events related to savings account used by customers for Shariah non-compliance purposes.
31 December 2022	Delay in allocating the gold in gold's account due to system error
31 December 2023	<ol style="list-style-type: none"> 1. Element of profit compounding in restructured account 2. Absence of Shariah screening process for i-PUSH Scheme application, which has led the Bank to be involved in facilitating financing to Shariah non-compliance business

In this study, the researcher employs a comparative case study content analysis methodology, which entails the identification of patterns, themes, and relationships of the past SNC cases disclosed in the financial report coupled with interview data collection techniques. The data sourced from the disclosure of SNC event alone may not be sufficient to imply the criteria of potential SNC event. This is because there are probabilities that other events are being classified as potential SNC event, however it has not been decided as actual SNC event by the SC. Hence, through interview session, the researcher figured-out other occurrence which could contribute to potential SNC event from practical aspect.

Analysis began concurrently with data collection, allowing for iterative refinement of the process. Interviews were transcribed, and reflexive notes were taken immediately after each session to deepen understanding and guide subsequent data collection. An open coding





approach was applied, where transcripts were examined for significant segments annotated with keywords or participant-derived phrases. Emergent codes were grouped into categories, from which overarching themes and sub-themes were derived. These themes were aligned with the research questions to ensure analytical coherence and supported by participant quotations to maintain authenticity.

FINDINGS AND DISCUSSION

The findings of this study are based on the responses of the respondents, as stated above. Respondents were queried about the scope of the SNC event in the bank. To determine the criteria, the question is intended to identify whether the SNC could only occur in contractual events or whether it could also occur in non-contractual situations. In general, the scope of SNC in this bank is guided by the overarching principles outlined in IFSA, where it requires that IFIs' aims and operations, business, affairs, and activities are all in compliance with the Shariah. In this note, Respondent R1 stated that:

“Shariah compliance is not limited to contracts. We are also guided by the provision in IFSA 2013 where it stated the Shariah compliance in the Bank shall be in its businesses, operations, affairs and activities.”

Specifically, a main finding from the interview is that the majority of the respondents stated that the SNC in the Bank could happen in Shariah contracts and non-contracts. For instance, Respondent R3 states that:

“The scope of SNC is broad. While it heavily emphasizes compliance with Shariah contracts, it also covers non-contractual elements”

Although majority of the respondents agree that SNC could occur in contract and non-contract situation, Respondent R2 shares his different opinion where he views that SNC could only occur when there was breach of Shariah requirement in a contract whilst for non-contract incident, though there was an operational lapse and could affect the Bank's reputation but it may not qualify to be categorized as SNC. This is based on Respondent R2 opinion as below:

“However, in my opinion, SNC applies to contract-based incidents only, while non-contractual matters like marketing lapses or staff conduct may not qualify as SNC but can affect the bank's reputation.”

A contract-related SNC event primarily focuses on the validity and compliance of contracts under Shariah principles. These include agreements that may be deemed void (*batil*) or voidable (*fasid*) owing to the presence of *Riba* (interest), *Gharar* (uncertainty), or other impermissible elements that relate to the tenets of the Shariah contract. Respondent 3 highlighted:

“For contract-related issues, the consideration is mainly given to assess on which part of Shariah requirement has been breached. The validity of the contract either fasid or batil is the effect of non-compliance to the Shariah requirement meaning either or, the violation of Shariah requirement has occurred.”





In addition, contract-related SNC events could also occur due to external factors, such as the purpose of financing. The purpose of financing is not a pillar (*Rukn*) of the contract and is considered an external factor (*Haram li Ghayrih*). In this note, Respondent R6 shared the following:

“Yes, external factor or condition to the contract is also considered in confirmation of SNC event. For example, while a Tawarruq contract may be valid, its purpose might involve prohibited activities, which affected the validity of the contract.”

As for non-contractual SNC, Section 28 (1) of IFSA 2013 provides:

“An institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with Shariah”.

Referring to this provision, the occurrence of non-contractual SNC incidents is more likely related to the affairs and activities of the bank, which include its staff conduct, marketing, campaigns, sponsorship, and events.

The terms “affairs and activities” is a wide term where the scope could be interpreted as IFIs’ internal affairs and activities to its staff and also to its customer. Thus, Respondent R2 provides his differential opinion where he opines SNC could only emerge if Shariah condition in a contract was violated and in the event of a non-contractual event, it may not fit to be categorized under SNC. Respondent R2 stated:

“In my opinion, SNC applies to contract-based incidents only, while non-contractual matters like marketing lapses or internal event or staff conduct may not qualify as SNC but can affect the bank’s reputation.”

Nonetheless, except for respondent R2, all respondents agreed that non-contractual events could still be categorized as SNC events based on the overarching principles provided in IFSA 2013. To support the findings, the researcher refers to the disclosure of SNC in the financial statement to determine the scope of SNC. Table 3 below shows the findings:

Table 3: Findings on the scope of SNC event from contract and non-contract perspective

Year of Annual Report/Financial Statement	SNC Event Disclosed	Content Findings	Analysis	Category of SNC
31 March 2019	SNC income from nostro account	The return received from the placement of money in the conventional nostro account is considered as <i>Riba</i> (Interest from the loan given to the conventional bank)		Contract Related
31 December 2019	1. SNC income from five (5) number of events (The event	1. Could not be determine since the description of SNC		1. Undetermined





	<p>was not disclosed in the report)</p> <p>2. SNC income from nostro account</p>	<p>event was not disclose</p> <p>2. The return received from the placement of money in the conventional nostro account is considered as <i>Riba</i> (Interest from the loan given to the conventional bank)</p>	<p>2. Contract Related</p>
31 December 2020	<p>1. One incident of zakat payment made to a different state zakat authority which was not as per the instruction on the Service Request Form (SRF)</p> <p>2. Sponsorship granted to Shariah non-compliance event not as per the guideline approved by Shariah Committee</p>	<p>1. The Bank offers Zakat payment services which allow the customer to choose “<i>Pusat Pungutan Zakat</i>” of preferred state and pay through the Bank. The Bank acted beyond the authorization which is contrary with the subject matter of <i>Wakalah</i> contract i.e. not following the specific authorization by principal to pay to a specific Zakat state authority.</p> <p>2. Seem to be associating with SNC activity</p>	<p>1. Contract Related</p> <p>2. Non-contract related</p>
31 December 2021	<p>1. Delay in allocating the gold to a gold's account due to system error</p> <p>2. Indication of repurchase term in the first aqad of Bai' 'inah</p> <p>3. Two (2) events related to late payment charges</p>	<p>1. <i>Riba Nasiah</i> (Delay in exchanging <i>ribawi</i> item)</p> <p>2. Invalid <i>bai' inah</i> contract due to inter-conditionality</p> <p>3. This is not related to the Shariah contract per se but on the</p>	<p>1. Contract Related</p> <p>2. Contract Related</p> <p>3. Non-contract related</p>





	(LPC) due to system error	LPC charges imposed to customer which render adverse impact to customer.	
	4. Two (2) events related to savings account used by customers for Shariah non-compliance purposes.	4. Seem to be facilitating the SNC activity	4. Non-contract related
31 December 2022	Delay in allocating the gold to a gold's account due to system error	<i>Riba Nasiah</i> (Delay in exchanging <i>ribawi</i> item)	Contract Related
31 December 2023	<p>1. Element of profit compounding in restructured account</p> <p>2. Absence of Shariah screening process for i-PUSH Scheme application, which has led the Bank to be involved in facilitating financing to Shariah non-compliance business</p>	<p>1. This SNC event does not relate to a breach of Shariah contract requirement per se. However, the event was not conformed to SAC BNM ruling which prohibit the compounding of profit for restructuring cases on the basis of <i>Ehsan</i>.</p> <p>2. Seem to be facilitating the SNC activity</p>	<p>1. Non-contract related</p> <p>2. Contract related</p>

From the disclosure, the SNC event that occurred at the bank was not only related to the Shariah contract but also to non-contracts, such as involvement with SNC entertainment, excessive charges, and involvement of the Bank with SNC activities. Hence, the discussion here is beyond the validity of Shariah contracts, such as valid or invalid contracts, but shall include *Haram*, *Halal* or *Shubhah* contracts in the context of general Islamic transactions.





Based on the findings from the interview and the content analysis, the criteria for SNC events in the bank are quite a few, and some of them are different in nature. Figure 1 depicts the criteria for SNC events based on these findings. Officers in the Shariah control function could use the following criteria as a guide to determine the potential SNC event for the Shariah incident detected.

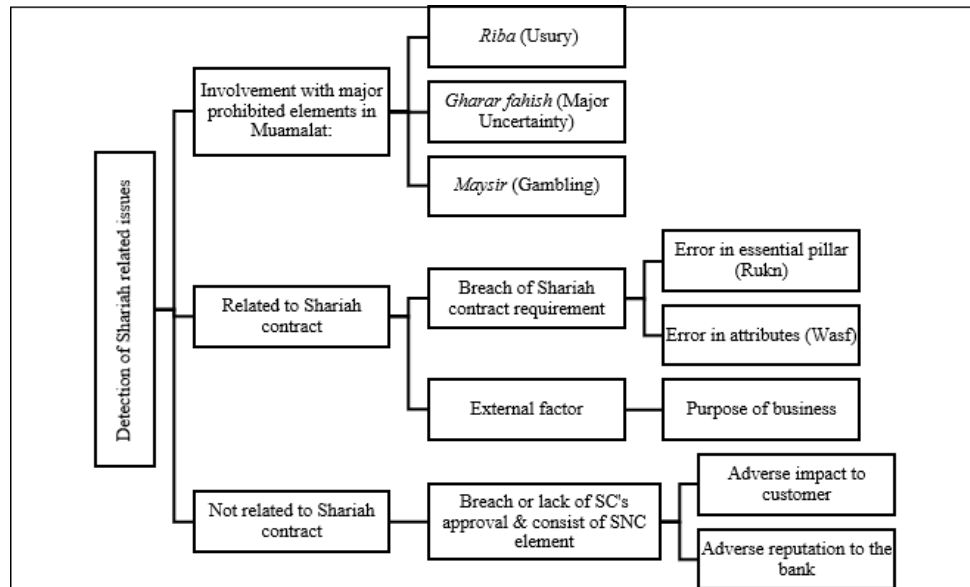


Figure 1: Criteria of Potential SNC events

Figure 1 above suggests that any Shariah-related issues detected by the officer within the Shariah control function shall be filtered by its scope of non-compliance, whether the issues relate to the major prohibition elements in *Muamalat* such as *Riba*, *Gharar Fahish* and *Maysir*, or related to the Shariah contract where certain requirements of the contract were lacking either in its pillar or in its attributes. As for non-contract incidents, the assessment shall be done to ascertain whether there was a breach to the specific resolution and guidelines approved by the SC pertaining to the event, and whether or not the non-contract incident consists of SNC elements. If the incident hit one of the criteria, it could be considered as a potential SNC event. These are the main criteria for the officer to observe before confirming a potential SNC. As such, the Shariah officer must have sufficient knowledge of the characteristics of the prohibited element.

CONCLUSION AND RECOMMENDATIONS

The scope of Shariah in Islamic banking operations not only surrounds the discussion on the Shariah contract, but also includes the value or morale on the name it carries. This study identified the general criteria of potential SNC events, and the officer in the Shariah control function of the bank must be able to articulate and relate the banking operation with the Shariah requirement. The confirmation of a potential SNC event at the moment still requires human interpretation and judgement because the nature of the Shariah-related incident could vary from one to another, which could be a straightforward breach of the Shariah requirement and sometimes it could be a complex case where it involves multiple layers of Shariah contract and consideration. Thus, it is important for the officer to have at least the basic knowledge in *Fiqh Muamalat* and *Usul Fiqh* – although it is no longer a requirement–in order to assess the





operational issues detected from the Shariah perspective effectively and continue to enhance their knowledge of Islamic banking and finance, such as governance, compliance, accounting, auditing, risk management, credit, and other segments in this industry. Of course, the final decision of whether the Shariah issue is tantamount to actual SNC events relies on the decision of the SC, but it started with the filtering process by the officer. This study is limited to only one Islamic bank in Malaysia, with a limited sample size but it is hoped that it could provide guidance for the industry and add value to industry players. Future research is expected to expand the criteria with more involvement of IFIs and the respondent. There could be other criteria which other Banks are looking at, considering the absence of standardize criteria of potential SNC at industry level.

REFERENCES

- Al-Jarjani. (1983). *Kitab Al-Ta'rifat* (First). Dar Kutub Ilmiah.
- Al-Jassas, A. ibn A. A. B. (1994). *al-Fusul fi al-Usul* (Second). Wizarat Al-Awqaf.
- Al-Mausu'ah al-Fiqhiyyah*. (1984). Wizarat al-Awqaf wa al-Shu'un al-Islamiyyah.
- Al-Nawawi. (n.d.). *Al-Majmu' Syarh Al-Muhazzab* (Vol. 12). Dar al-Fikr.
- Al-Nawawi. (1972). *Al-Minhaj bi Sharh Sahih Muslim* (Second, Vol. 11). Dar Ihya' al-Turath al-Arabi.
- Al-Razi. (1997). *al-Mahsool* (Third, Vol. 1). Muassasah al-Risalah.
- Al-Salmi, I. N. (2005). *Usul Fiqh - La Yasa'u al-Faqih Jahluhu* (First). Dar al-Tadmiriah.
- Al-Sarkhasi, M. A. (1993). *Al-Mabsut* (Not stated). Dar al-Makrifah.
- Al-Suyuti. (1983). *Al-Ashbah wa Al-Nadhzoir* (First). Dar Kutub Ilmiah.
- Al-Taftazani, S. A. M. (n.d.). *Syarah Talwih 'ala Tawdhiih* (Vol. 2). Maktabah Sobih.
- Al-Zarkashi, B. A. M. ibn A. (1985). *Al-Manthur fi al-Qawaid al Fiqhiah* (Second, Vol. 2). al-Wizarah al-Awqaf.
- Al-Zuhayli, W. (2009). *Al-Muamalat al-Maliah al-Mu'asarah* (Seventh). Dar al-Fikr.
- BNM. (2018). *Operational Risk Reporting Requirement - Operational Risk Integrated Online Network (ORION)*. Bank Negara Malaysia.
- BNM. (2019). *Shariah Governance Policy Document 2019*. Bank Negara Malaysia.
- BNM. (2023). *Operational Risk Reporting (ORR)*. Bank Negara Malaysia.
- Dusuki, A. W., Ali, M. M., & Hussain, L. (2012). A Framework for Islamic Financial Institutions to Deal with Shari'ah Non-compliant Transactions. *ISRA Research Paper* (NO. 42/2012).
- Hakim, A. L. (2017). Application of Three Lines of defense in Islamic Financial Institution. *International Journal Of Management and Applied Research*, 4(1), 44–57. <https://doi.org/10.18646/2056.41.17-005>
- Hasan, Z. (2010). Regulatory Framework of Shari'Ah Governance System in Malaysia, GCC Countries and the UK. *Kyoto Bulletin of Islamic Area Studies*, 3(2), 82–115. <https://www.researchgate.net/publication/256043882>
- Ibn 'Abidin. (1966). *Rad Al-Muhtar 'ala al-Dur Al-Mukhtar* (Second, Vol. 2). Syirkah Maktabah wa Matba'ah Mustafa al-Babi al-Halbi.
- Ibn Nujaim. (1999). *Al-Ashbah wa Al-Nadhzoir* (First). Dar Kutub Ilmiah.
- Islam, M. R. (2022). Origin and Theoretical Development of Islamic Shari'ah: An Overview. *Rajshahi University Journal of Arts & Law*, 50, 44–63.
- Islamic Financial Service Board (IFSB). (2005). *Guiding Principles of Risk Management for Institutions (Other Than Insurance Institutions) Offering Only Islamic Financial*





- Services.Www.Ifsb.Org.
<https://www.ifsb.org/download.php?id=4357&lang=English&pg=/published.php>
- Jalil, A., Ramli, A. M., & Shahwan, S. (2014). *The Four Introductory Theories of Fiqh Muamalat* (First). Wisdom Publication.
- Kusumaningtias, R. (2024). *Impact and risk management of sharia non-compliance in Islamic banking* (Vol. 2).
- Laahasna, A. (2014). *Shariah Non-Compliance Risk Management and Legal Documentation in Islamic Finance*. John Wiley & Sons Singapore Pte. Ltd.
- Malaysia. (2013). *Islamic Financial Services Act 2013*.
- Mohd Noor, N. S., Ismail, A. G., & Muhammad, M. H. (2018). Shariah Risk: Its Origin, Definition, and Application in Islamic Finance. *SAGE Open*, 8(2).
<https://doi.org/10.1177/2158244018770237>
- Omar, H. N., & Hassan, R. (2019). Shariah Non-Compliance Treatment in Malaysian Islamic Banks. *International Journal of Management and Applied Research*, 6(4), 220–233.
<https://doi.org/10.18646/2056.64.19-016>
- Omar, H. N., & Hassan, R. (2020). Challenges Faced by Malaysian Islamic Banks in Treating Shariah Non-compliance Events. *7th ASEAN Universities International Conference on Islamic Finance (7th AICIF2019) - Revival of Islamic Social Finance to Strengthen Economic Development Towards a Global Industrial Revolution*, 256–264.
<https://doi.org/10.5220/0010145102560264>

