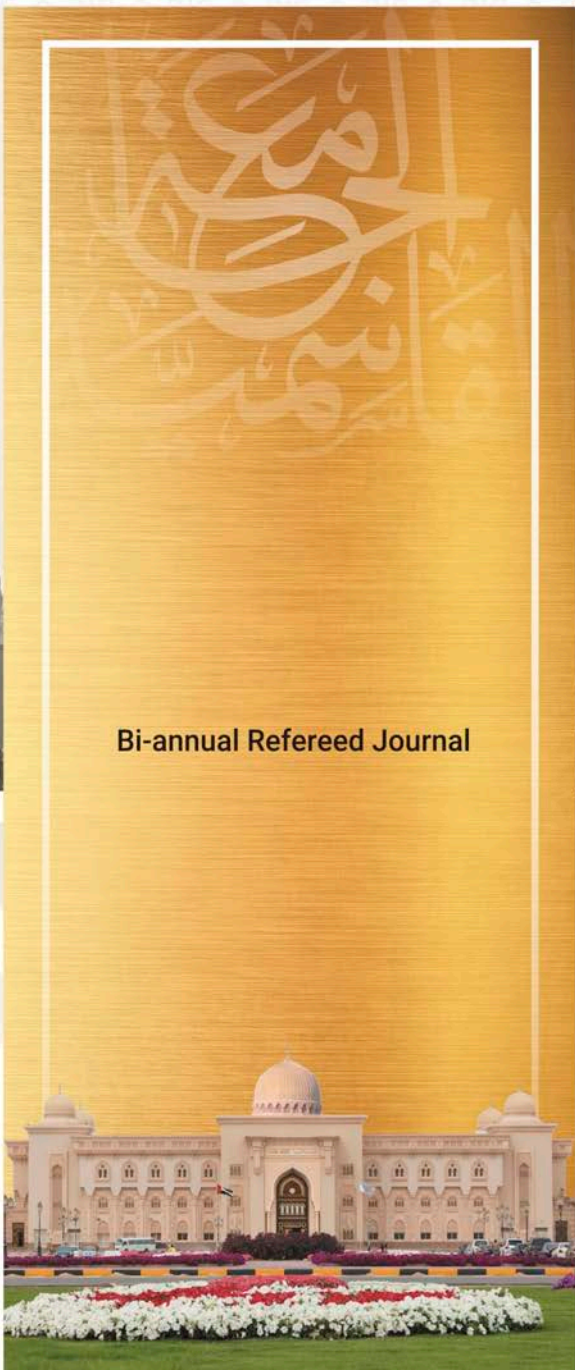
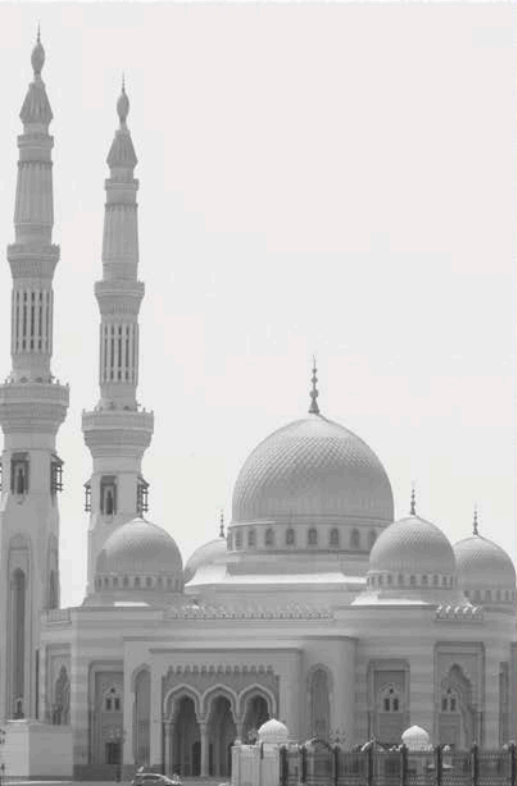


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حوكمة الشريعة الإسلامية في تركيا: التطور والتحديات والإطار المفاهيمي

## *SHARI'AH GOVERNANCE IN TÜRKİYE: EVOLUTION, CHALLENGES, AND CONCEPTUAL FRAMEWORK*<sup>1</sup>

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### الملخص

في أعقاب الاستقلال، شرعت الدول الإسلامية في استكشاف النماذج الاقتصادية، مما أدى إلى صياغة الاقتصاد الإسلامي الجديد بحلول أواخر الستينيات. وحفزت أزمة النفط عام 1973 ظهور الدول العربية الغنية، مما مهد الطريق لإنشاء التمويل الإسلامي من عام 1974 فصاعدًا. وبحلول التسعينيات، تطلب التوسع السريع لصناعة التمويل الإسلامي جهود توحيد المعايير، مما أدى إلى إنشاء هيئات مثل هيئة المحاسبة والمراجعة للمؤسسات المالية الإسلامية (AAOIFI) ومجلس الخدمات المالية الإسلامية (IFSB). من السمات المميزة للمؤسسات المالية الإسلامية التزامها بحوكمة الشريعة، وضمن الامتثال للمبادئ الإسلامية جنبًا إلى جنب مع ممارسات حوكمة الشركات

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التقليدية. تدرس هذه الدراسة التطور التاريخي والإطار الحالي لحوكمة الشريعة في تركيا مع معالجة التحديات والصعوبات التي واجهتها في تنفيذها. وتسلط النتائج الضوء على الحاجة إلى مزيد من التحسين في ممارسات الحوكمة لتتماشى مع مبادئ الشريعة والمشهد المالي العالمي المتطور.

## Abstract

In the aftermath of independence, Islamic nations embarked on an exploration of economic models, leading to the formulation of the New Islamic Economics by the late 1960s. The 1973 oil crisis catalyzed the emergence of affluent Arab nations, paving the way for the establishment of Islamic finance from 1974 onwards. By the 1990s, the rapid expansion of the Islamic finance industry demanded standardization efforts, resulting in the creation of bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). A defining feature of Islamic Financial Institutions (IFIs) is their adherence to *Shari'ah* governance, ensuring compliance with Islamic principles in conjunction with conventional corporate governance practices. This study examines the historical development and current framework of *Shari'ah* governance in Türkiye while addressing the challenges and difficulties encountered in its implementation. The findings highlight the need for further refinement in governance practices to align with both *Shari'ah* principles and the evolving global financial landscape.

**الكلمات الدالة:** إطار حوكمة الشريعة الإسلامية، التمويل الإسلامي، تركيا، اللجنة الشرعية.

**Keywords:** *Shari'ah* Governance Framework, Islamic Finance, Türkiye, *Shari'ah* Committee.

## 1.0 Introduction

Corporate governance, defined as the "governance of top management" of a company, institution, or organization, entails the management activities performed by a team (Monks & Minow, 2011). Corporate governance involves all types of oversight and regulation within an organization, but it does not inherently cover compliance with *Shari'ah* principles. For Islamic Financial Institutions (IFIs), *Shari'ah* governance is an equally critical component, ensuring adherence to *Shari'ah* laws. To build and sustain the trust of shareholders and other stakeholders, it is essential to maintain robust corporate and *Shari'ah* governance within IFIs (ISRA, 2023).

Two major standard setters in Islamic finance define *Shari'ah* Governance System as follows. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines Governance System as an independent body tasked with overseeing, supervising, and providing *fatwas* on Islamic banking and finance to ensure compliance with Islamic law (AAOIFI, 2005). The *Shari'ah* Governance System, as defined by the Islamic Financial Services Board (IFSB), involves institutional and organizational arrangements aimed at ensuring effective oversight of *Shari'ah* compliance within Islamic financial institutions, encompassing the issuance of relevant *Shari'ah* pronouncements, information dissemination, and internal *Shari'ah* compliance reviews (IFSB, 2009).

In practice, Regulatory and Supervisory Authorities are crucial to corporate governance as they establish the legal and regulatory framework necessary for a robust governance system. Regulatory authorities are tasked with issuing guidelines to ensure financial system stability, developing internal controls, risk management protocols, transparency standards, and overseeing the overall operations of IFIs. Complementing this role, supervisory authorities are responsible for monitoring the effectiveness of the governance system and ensuring compliance with regulations.

In Türkiye, after obtaining Participation Banking status in 2005, participation (Islamic) banks established *Shari'ah* Committees within their structures. Regulatory communiqués on *Shari'ah* Governance were issued through various institutions such as the Prime Ministry, the Participation Banks Association of Türkiye (TKBB), and the

Banking Regulation and Supervision Agency (BDDK) from 2006 to 2018. In 2018, the Central *Shari'ah* Advisory Board (*Shari'ah* Supervisory Board) was established under the umbrella of TKBB. The most recent development occurred in 2019 with the issuance of the "Communiqué on Compliance with Principles and Standards of Interest-Free Banking," which brought written regulations on *Shari'ah* Governance System within banks into effect (Republic of Türkiye, 2019).

This study seeks to offer a comprehensive analysis of the prevailing *Shari'ah* Governance framework in Türkiye, with a focus on comparing it with the established standards and guidelines of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB). The objective is to critically evaluate the existing system, identify areas of divergence or challenges vis-à-vis international benchmarks, and propose recommendations for enhancing current practices. By delving into these aspects, the research aims to contribute valuable insights to the ongoing discourse on *Shari'ah* Governance in the context of Islamic finance in Türkiye.

## 2.0 Literature Review

There are numerous studies regarding *Shari'ah* Governance System, examining their role, challenges, and significance within the context of Islamic finance governance. Farook and Farooq (2013) shed light on the scarcity of Islamic jurists in Malaysia and its repercussions on *Shari'ah* compliance. They highlight how the shortage of Islamic jurists leads to decision-making monopolized by the minority, affecting the sustainability of the Islamic finance industry. Moreover, inadequacies in training, particularly in Islamic commercial law (*fiqh al-mu'amalat*), exacerbate challenges faced by the industry. To address these issues, the authors advocate for the establishment of an advanced higher education system and propose the implementation of certification programs such as the Certified *Shari'ah* Adviser and Auditor (CSAA) to enhance expertise in *Shari'ah* compliance.

Bektaş and Yenice (2022) explore the role and evolution of *Shari'ah* Advisory Committees in Türkiye's *Shari'ah* governance framework. Through qualitative research methods, they delineate three

historical stages in Türkiye's *Shari'ah* governance evolution: the Individual Initiative Period, Institutionalization Period, and Full Institutional Period. *Shari'ah* Advisory Committees have played a pivotal role in each stage, prompting the authors to suggest five recommendations for enhancing their effectiveness and improving the *Shari'ah* governance system in Türkiye. These include fostering collaboration between universities and banks, devising a systematic action plan for *Shari'ah* policy-making, and archiving *Shari'ah* Advisory Committees decisions systematically.

Bahari and Baharuddin (2016) investigate the roles of *Shari'ah* review and *Shari'ah* audit in Malaysia, aiming to address issues within the Islamic Financial Institutions (IFIs) and analyse the historical development of *Shari'ah* governance in Malaysia. They argue that ineffective governance contributes to financial market failures and pinpoint several challenges within *Shari'ah* governance, such as the lack of comprehensive *Shari'ah* compliance assessments and the reliance on opinions rather than mandatory *Shari'ah* reports. To mitigate these challenges, they propose comprehensive annual audits by *Shari'ah* Committees to ensure compliance with Islamic law, drawing on Hameed's (2009) critique of *Shari'ah* governance and the inability of *Shari'ah* Committee members to align banking products with *Shari'ah* principles, particularly when relying solely on the decisions of scholars from the Shafi'i school of thought.

Collectively, these studies underscore the critical role of *Shari'ah* Advisory Boards in ensuring *Shari'ah* compliance and governance within Islamic financial institutions, while also highlighting the challenges and proposing solutions to enhance their effectiveness and sustainability.

Alam et al. (2019) scrutinized the absence of a comprehensive *Shari'ah* Governance Framework (SGF) in Bangladesh and addressed the practical challenges within the system. Employing a deductive approach, they identified these challenges and proposed solutions, suggesting the enactment of legislation in Bangladesh to enhance the SGF. They also recommended the establishment of a Centralized *Shari'ah* Supervisory Board under the auspices of the Central Bank or granting authority to the Central *Shari'ah* Board for Islamic Banks of Bangladesh. Among their suggestions is the publication of a *Shari'ah*

report by the Central Bank detailing its activities, meeting frequencies, efforts to ensure *Shari'ah* compliance, prohibited sources of income, and their utilization areas. Notably, Bangladesh lacks any functioning *Shari'ah* Governance mechanism, and these proposals contribute to the establishment of a regulatory and supervisory *Shari'ah* Governance Framework. The authors posit that if implemented, such initiatives could position Bangladesh as a role model among *Shari'ah* Governance mechanisms worldwide. Additionally, they highlight the implementation of *Shari'ah* Governance mechanisms in Bangladesh, such as Central *Shari'ah* Board for Islamic Banks of Bangladesh, *Shari'ah* Audit Committee, Internal *Shari'ah* Governance, and External *Shari'ah* Governance, to enhance the quality of *Shari'ah* compliance.

Examining the Ottoman-era *Shari'ah* Governance System, Demirkaya (1998) notes the historical evolution of administrative functions, particularly in the realm of municipal duties. While many governments worldwide either undertook these duties themselves or delegated them to municipal organizations, the Ottoman Empire adopted the Islamic institution of Hisbah. Hisbah, prevalent in nearly all Islamic states from the inception of Islam until the early 21st century, underwent changes and developments over time. Demirkaya highlights significant transformations, such as the conversion of the office of Hisbah inspector into the ministry of Hisbah in 1826, attributing the restructuring to the identity quest and trust issues among the statesmen of that era. These historical events and developments underscore the intricate nature of the Ottoman-era *Shari'ah* Governance System.

Obid and Naysary (2019) presents an integrated theory based on key roles using the agency theory, stewardship theory, and stakeholder theory, derived from Corporate Governance and *Shari'ah* Governance. The authors, among the pioneering attempts in *Shari'ah* Governance, utilized the Qualitative Content Analysis (QCA) method to analyze the stakeholder and agency theories, highlighting the problem of information asymmetry. The integrated theory suggests that in a social system, the function of maximizing profits, coupled with psychology and welfare responsibilities, is facilitated. It proposes the prevention of information asymmetry and advocates for a *Shari'ah* Governance

Framework and conceptual framework in alignment with principles of competency, accountability, transparency, and integrity.

Hasan (2010) conducted a comparative analysis between the regulatory frameworks of *Shari'ah* Governance Systems in the Gulf Cooperation Council (GCC) countries, including Saudi Arabia, the United Arab Emirates, Qatar, Oman, Bahrain, Kuwait, Malaysia, and the United Kingdom. The study identifies five *Shari'ah* Governance models: *Reactive*, *Passive*, *Minimalist*, *Proactive*, and *Interventionist*, outlining their characteristics and specific applications. Hasan emphasizes the need for a *unified legal framework* to encompass all these models, suggesting that at least one of the models should adhere to an appropriate legal framework to further enhance the *Shari'ah* Governance System's development.

Aziz et al. (2019) compared the Guidelines on the Governance of *Shari'ah* Committee (GGSC) published in Malaysia in 2005 and the *Shari'ah* Governance Framework Bank Negara Malaysia (SGF-BNM) issued by the Central Bank in 2010. Their analysis evaluated the enhancements in *Shari'ah* compliance and governance principles between the two frameworks. While GGSC 2005 contained principles for *Shari'ah* compliance and audit, SGF 2010 was deemed more effective in supporting Islamic banking practices with *Shari'ah* principles. The authors highlight the efforts to bridge the gap between Corporate Governance and *Shari'ah* Governance, expanding the scope of *Shari'ah* compliance and audit units and ensuring confidentiality and integrity in audits. Concrete recommendations include expanding the scope of *Shari'ah* units, implementing separate governance policies for each *Shari'ah* organ, publishing joint *Shari'ah* audit bodies and standards, enhancing *Shari'ah* knowledge and operational expertise, and establishing universal *Shari'ah* Governance standards.

Kasim et al. (2013) addressed the problem of the *Shari'ah* Governance Framework of the Central Bank of Malaysia not encompassing the Islamic Capital Market (ICM). They emphasized the critical role of the ICM in ensuring *Shari'ah* compliance, independence, conflict of interest, and competence, advocating for a robust *Shari'ah* Governance Framework to promote economic development.



Contrary to Kasim et al. (2013), Hasan et al. (2020) examined the *Shari'ah* Governance practices of Islamic Fund Management Companies (IFMCs) in Malaysia, suggesting that the current *Shari'ah* Governance standards are sufficient for *Shari'ah* compliance in IFMCs. They argue against the necessity of a *Shari'ah* Governance Framework, stating that the existing guidelines adequately ensure *Shari'ah* compliance in fund management.

The literature on *Shari'ah* Governance delves into various aspects concerning its implementation and effectiveness across different contexts. Studies examine the shortage of Islamic jurists in Malaysia, highlighting decision-making challenges. Comparisons across countries reveal diverse *Shari'ah* Governance models, indicating the necessity of a unified legal framework. Evaluations of *Shari'ah* Governance guidelines in Malaysia emphasize improvements supporting Islamic banking practices. Challenges such as information asymmetry and regulatory deficiencies are identified, urging for enhanced oversight and transparency. While some argue for a separate *Shari'ah* Governance Framework, others propose an integrated theoretical framework based on agency and stakeholder theories. Overall, these studies contribute to understanding and improving *Shari'ah* Governance practices worldwide.

### **3.0 Methodology**

This study employs a comprehensive approach to examine the evolution and effectiveness of *Shari'ah* governance in Türkiye, integrating qualitative content analysis (QCA), historical analysis, and comparative analysis. Qualitative content analysis is utilized to explore governance theories - agency, stewardship, and stakeholder - and their alignment with *Shari'ah* frameworks. This method provides a detailed examination of governance structures and highlights areas for improvement. A historical analysis traces the development of *Shari'ah* governance across three distinct periods: the Individual Initiative Period, the Institutionalization Period, and the Full Institutional Period. This chronological approach contextualizes the evolution of governance practices and their impact on *Shari'ah* compliance. The study also conducts a comparative analysis of governance frameworks in different countries, particularly focusing on

Gulf Cooperation Council (GCC) nations. This comparison reveals both the diversity and commonalities among global *Shari'ah* governance systems, offering insights into best practices and challenges.

Building on these analyses, the study offers recommendations to enhance Türkiye's *Shari'ah* governance framework, including the development of educational programs and certification initiatives to improve expertise in *Shari'ah* compliance. This integrated methodology offers valuable insights for policymakers, scholars, and practitioners, contributing to the advancement of *Shari'ah* governance in Türkiye.

#### **4.0 Global Development of *Shari'ah* Governance**

The Islamic Development Bank (IDB), established in 1973 to support the economic development of member countries of the Organization of Islamic Cooperation (OIC) and Muslim minorities in other countries, commenced operations in 1975 without a formal *Shari'ah* board. However, consultations with numerous Islamic jurists were conducted to ensure that the bank's activities were religiously permissible. Until the establishment of an official *Shari'ah* board in 2003, certain matters related to the bank's operations were deliberated and resolved at the Islamic *Fiqh* Academy (Kahf, 2004).

The first Islamic bank to have an official *Shari'ah* board was the Faisal Islamic Bank of Egypt, established in 1976. This practice was subsequently adopted by the Islamic banks of Jordan and Sudan in 1978, Kuwait Finance House in 1979, and Bank Islam Malaysia Berhad in 1983. In subsequent years, the implementation of *Shari'ah* boards became widespread among Islamic banks (Kahf, 2004).

Over the past years, various types of *Shari'ah* advisory structures and practices have emerged in Muslim majority nations as a result of developments in the field. This section will focus on different types of *Shari'ah* advisory boards, and the models applied by various countries in terms of whether these boards are subject to higher oversight.

##### *4.1 Types of *Shari'ah* Boards*

*Shari'ah* boards can be categorized into three levels of effectiveness:

(i) *International Level *Shari'ah* Boards:*

International *Shari'ah* boards generally refer to independent *Shari'ah* committees formed through the collaboration of multiple Muslim-majority countries. Examples include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Development Bank (IsDB).

(ii) *Central Shari'ah Committee:*

A central *Shari'ah* committee can be established either at the regulatory level, such as within a central bank or securities commission, or at the national level, such as a national fatwa/religious council or a specialized committee for the Islamic finance industry. Regardless of their specific formation, central *Shari'ah* committees serve as the highest *Shari'ah* authority for Islamic financial institutions (IFIs) and play crucial roles in harmonizing and standardizing fatwas. Table 1 lists some of these central *Shari'ah* committees worldwide. It is important to note that the scope of work and the enforceability of these authorities' opinions can vary between countries.

Table 1: Countries with a Central *Shari'ah* Committee for Islamic Finance

Country	Year of Establishment	<i>Shari'ah</i> Committee
Sudan	1992	Central Bank of Sudan established Supreme <i>Shari'ah</i> Board
Malaysia	1996	Securities Commission Malaysia established <i>Shari'ah</i> Advisory Council (SAC-SC)
Malaysia	1997	BNM established <i>Shari'ah</i> Advisory Council (SAC-BNM)
Indonesia	1999	Indonesian Ulema Council established Dewan Syariah Nasional <i>Shari'ah</i> Council (DSN-MUT)
Bangladesh	2001	Central <i>Shari'ah</i> Board for Islamic Banks of Bangladesh was established by several Islamic Banks as a national non-profit corporate body

Pakistan	2004	SBP <i>Shari'ah</i> Advisory Committee
Brunei Darussalam	2006	Establishment of <i>Syariah</i> Financial Supervisory Board, for which Brunei Darussalam Central Bank is the secretariat
Maldives	2010	Maldives Monetary Authority <i>Shari'ah</i> Council
Nigeria	2013	Central Bank of Nigeria Financial Regulation Advisory Council of Experts (FRACE)
Libya	2013	Central Bank of Libya Central <i>Shari'ah</i> Supervisory Board
Pakistan	2014	Securities and Exchange Commission of Pakistan <i>Shari'ah</i> Advisory Committee
Oman	2014	Central Bank of Oman Higher <i>Shari'ah</i> Supervisory Authority
Afghanistan	2014	Da Afghanistan Bank <i>Shari'ah</i> Supervisory Board
Morocco	2015	<i>Shari'ah</i> Committee for Participatory Finance established under the Higher Council of Ulema of Morocco
Djibouti	2015	Central Bank of Djibouti National <i>Shari'ah</i> Committee established by presidential decree
Bahrain	2015	Central Bank of Bahrain Central <i>Shari'ah</i> Supervisory Board
United Arab Emirates	2017	Central Bank of the United Arab Emirates established Higher <i>Sharia</i> Authority
Türkiye	2018	Central Advisory Board formed under the Participation Banks Association of Türkiye (TKBB)
Palestine	2019	Higher <i>Sharia</i> Supervisory Board established by Palestine Monetary Authority and Palestine Capital Market Authority

Algeria	2020	National Fatwa Authority for the Islamic Finance Industry established under High Islamic Council of Algeria
Kuwait	2020	Central Bank of Kuwait established Higher Committee of <i>Shari'ah</i> Supervision
Philippines	2022	<i>Sharia</i> Supervisory Board in the Bangsamoro Autonomous Region in Muslim Mindanao established by <i>Bangko Sentral ng Pilipinas</i>
Bangladesh	2023	Bangladesh Securities and Exchange Commission established <i>Sharia</i> Advisory Council

Source: Adapted from ISRA 2023

IFSB-AAOIFI (2022) summarizes the functions of the central *Shari'ah* committees as follows: (i) advisory functions; (ii) fatwa functions; (iii) regulation-related functions and (iv) oversight and supervision related functions.

*(iii) Shari'ah Committee:*

The *Shari'ah* committee is pivotal in ensuring *Shari'ah* compliance, which in turn affects the credibility of Islamic financial institutions (IFIs). According to AAOIFI GS. No.1, a *Shari'ah* committee is an independent entity responsible for directing, reviewing, and supervising the activities of IFIs to ensure *Shari'ah* compliance and for issuing fatwas (Islamic legal rulings) related to Islamic banking and finance. Similarly, IFSB-10 describes a *Shari'ah* committee as a body composed of *Shari'ah* scholars who provide *Shari'ah* expertise and serve as special advisors to IFIs.

*Shari'ah* committees at the individual IFI level handle micro-level responsibilities, whereas those at the standard-setter or regulator level manage macro-level tasks such as developing standards and promoting uniform *Shari'ah* governance practices. It is now standard practice for IFIs worldwide to establish their own *Shari'ah* committees, regardless of the existence of a central *Shari'ah* committee. According to IFSB – AAOIFI (2022), all IFIs are required

to have an independent, competent, empowered, and adequately resourced *Shari'ah* committee.

The roles and responsibilities of a *Shari'ah* committee include: (i) approving all relevant documentation for products and services, (ii) reviewing and approving all policies and procedures, (iii) overseeing and approving the profit/loss calculation and distribution, (iv) reviewing and approving the accounting treatment of products and services, (v) reviewing and approving the IFI's annual zakat calculations, (vi) reviewing the reports and observations of the *Shari'ah* compliance function, internal *Shari'ah* audit function, and external *Shari'ah* audit, (vii) providing input to the annual plans of the internal *Shari'ah* audit, and (viii) specifying the means of disposal of earnings.

## **5.0 Historical Developed of *Shari'ah* Governance in Türkiye**

The historical development of *Shari'ah* governance in Türkiye is characterized by several key milestones that have shaped the framework for Islamic finance in the country. One of the earliest significant developments occurred in the 1980s with the establishment of Special Finance Institutions (SFIs), including Faisal Finance Institution and Albaraka Turk, following the issuance of the Council of Ministers Decree No. 83/506 in 1983, which permitted the SFIs based on Islamic principles.

Subsequent regulatory changes played a pivotal role in advancing *Shari'ah* governance within Türkiye's Islamic finance sector. Notably, the Banking Law No. 5411 of October 19, 2005, officially recognized participation banking operating in accordance with Islamic principles, marking a shift towards greater regulatory clarity and oversight. This legal framework facilitated the rapid growth of participation banking in Türkiye, leading to the emergence of several key institutions such as Kuveyt Turk Participation Bank, Türkiye Finans Participation Bank, and Albaraka Turk Participation Bank.

In recent years, Turkey has further strengthened its *Shari'ah* governance framework through initiatives such as the establishment of the TKBB Advisory Board in 2018. and the issuance of the "Communiqué on Compliance with Principles and Standards of

Interest-Free Banking" in 2019. These developments have introduced standardized practices and enhanced oversight mechanisms, contributing to the maturation of Islamic finance in Türkiye.

Following this legal reform, the participation banking sector in Türkiye experienced rapid growth. As of 2023, Türkiye is home to six participation banks: Kuveyt Turk Participation Bank, Türkiye Finans Participation Bank, Albaraka Turk Participation Bank, Ziraat Participation Bank, Vakıf Participation Bank, and Emlak Participation Bank. Additionally, there are three digital participation banks: Hayat Participation Bank, TOM Participation Bank, and Kasa Participation Bank. The participation banking sector boasts a network of 1401 branches, reflecting a 12.2% increase with a change of 3.4%. Employment within the sector has also grown, with 17,420 employees representing an 8.5% increase with a change of 1.6%. The participation banking industry continues to experience innovative and sustainable development, guided by its acquired vision and mission. The sector's share within the financial landscape rose to 8.3% between December 2021 and July 2022, marking a notable 41.7% change. Table 2 illustrates the key developments within the Turkish Islamic banking sector.

Table 2: Key Developments in the Turkish Islamic Banking Sector

Year	Event/Development
1975	Türkiye became a founding shareholder of the Islamic Development Bank with an 8.5% capital share.
1983	Council of Ministers Decree No. 83/506 granted legal activity permit to Special Finance Institutions (SFI).
1984	Albaraka Turk Special Finance Institution
1985	Faisal Finance Institution
1989	Kuwait Turk Special Finance Institution
1991	Anadolu Special Finance Institution
1996	Asia Special Finance Institution
1999	Special Finance Institutions were included in the scope of Banking Law No. 4389.
2000	Banking Regulation and Supervision Agency (BDDK)
2001	Turkish Participation Banks Association came into effect with the Banking Law No. 4389 and the Statute No. 2001/3138.

2005	With the Banking Law No. 5411, the title of the institutions in the sector was changed from "Special Finance Institution" to "Participation Bank".
2009	Neova - The first Takaful company
2013	Participation Pension Fund - The first interest-free pension fund
2016	Vakif Participation Bank (State Owned Islamic Bank)
2018	"Central Advisory Board" under the umbrella of the Turkish Participation Banks Association (TKBB).
2018	Presidency Financial Office came into effect in the Official Gazette after the transition to the Presidential Government System on June 24, 2018.
2019	Emlak Participation Bank (State Owned Islamic Bank)
2019	The Insurance General Directorate and the Insurance Supervisory Board were merged to establish the Insurance and Private Pension Regulation and Supervision Institution.
2022	The Presidency Financial Office published the Presidential Decree No. 2022/16 regarding the "Participation Finance Strategy Document (2022-2025)" in the Official Gazette dated October 5, 2022, and numbered 31974.
2022	Hayat Participation Bank -The first Digital Participation Bank,
2022	The Digital, Kasa Participation Bank A.Ş.
2022	The Digital, TOM Participation Bank A.Ş.

Source: Compiled by the authors by examining the websites of the institutions.

The functions of the central *Shari'ah* committees can be summarized as follows: (i) advisory functions; (ii) fatwa functions; (iii) regulation-related functions and (iv) oversight and supervision related functions (ISRA, 2023).

## 6.0 Components of *Shari'ah* Governance in Türkiye

In Türkiye's *Shari'ah* governance structure, three key entities play pivotal roles at the fatwa level. The first is the Advisory Board within the Participation Banks Association of Türkiye (TKBB). The TKBB Advisory Council is a National (Central) *Shari'ah* Board which plays a critical role in the *Shari'ah* governance framework of Islamic finance in Türkiye. In accordance with the decision dated 22.02.2018 by the Banking Regulation and Supervision Agency (BDDK), "It has been decided to form a committee by the Association of Participation Banks



of Türkiye to determine the professional principles and standards related to participation banking”, the Participation Banks Association of Türkiye (TKBB) decided to establish a committee to determine principles and standards related to participation banking and ensure compliance of participation banks with the decisions of this committee (TKKB, 2024).

This committee within TKBB, comprised of seven (7) members appointed by the Board of Directors, has specific qualifications for its members. Four members hold doctoral degrees in Islamic Sciences, one member is recommended by the Directorate of Religious Affairs (Diyanet İşleri Başkanlığı) from among members of the Religious Affairs High Council (Din İşleri Yüksek Kurulu), one member holds a postgraduate diploma in business, economics, finance, banking, law, or related fields with at least seven years of managerial experience in participation banking, and another member holds a law degree. Some of the tasks of this Advisory Board are as follows:

- (i) Determine professional principles and standards that participation banks must adhere to, following standards published by international organizations in the field of participation banking.
- (ii) Make general decisions as needed to eliminate differences in practices among participation banks.
- (iii) Evaluate the compliance of participation banks' operations with the established professional principles, standards, and general decisions.
- (iv) Provide opinions to public institutions, professional organizations with public entity status, and other entities on matters related to interest-free financial activities upon request.
- (v) Ensure that disputes between participation banks and their customers within the scope of professional principles and standards are resolved by the relevant participation bank.

Table 3 summarizes the standards issued by TKBB Advisory Board as July 2024.

Table 3: Standards Issued by the TKBB Advisory Council

TKBB Participation Finance Standards No:1	Share Certificate Issuance and Trade	Release Date: 26.08.2020
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TKBB Participation Finance Standards Standards No: 2	<i>Tawarruq</i>	Release Date: 02.03.2021
TKBB Participation Finance Standards Standard No: 3	<i>Murabahah</i> Standard	Publication Date: 06.05.2021
TKBB Participation Finance Standards Standard No: 4	Suretyship Standard	Publication Date: 17.12.2021
TKBB Participation Finance Standards Standard No: 5	<i>Mudarabah</i> Standard	NA

Source: Compiled by the authors by examining the websites of TKBB.

The second is the Religious Affairs High Council (Din İşleri Yüksek Kurulu - DİYK) under the Presidency of Religious Affairs (Diyanet İşleri Başkanlığı - DİB). Established as a central authority overseeing religious affairs in the country, the DİYK plays a significant role in matters related to Islamic jurisprudence and religious guidance.

The DİYK comprises scholars and experts in Islamic law and theology who are tasked with issuing fatwas on various religious and societal issues. While its primary focus is on matters of faith and religious practice, the DİYK also extends its purview to issues concerning Islamic finance and banking.

Within the context of *Shari'ah* governance in Türkiye, the DİYK's role involves providing guidance and interpretations of Islamic law as they relate to financial transactions and banking operations. While its opinions are not legally binding on Islamic financial institutions (IFIs), they carry considerable weight and influence among the public and can indirectly shape the practices of IFIs in alignment with Islamic principles.

The presence of a DİYK representative among the seven members of the TKBB Advisory Council highlights the integration of religious expertise into the governance structure of Islamic finance in Türkiye. The DİYK representative on the TKBB Advisory Council contributes religious and scholarly insights to discussions and decisions related to *Shari'ah* compliance and governance within the participation banking sector. This collaboration underscores the

concerted effort to ensure adherence to Islamic principles and ethical standards in financial practices, reflecting the cooperative engagement between religious authorities and banking professionals in shaping the landscape of Islamic finance in Türkiye.

The third group within Türkiye 's *Shari'ah* governance framework comprises private *Shari'ah* committees, which play a crucial role in overseeing *Shari'ah* compliance within the country's Islamic finance sector. These private *Shari'ah* committees can be further categorized into in-bank *Shari'ah* committees and independent committees.

- a) *In-Bank Shari'ah Committees:* In-bank *Shari'ah* committees operate within individual financial institutions, particularly participation banks, to ensure that all financial products and services comply with *Shari'ah* principles. These committees typically consist of *Shari'ah* scholars, legal experts, and industry professionals who collaborate to review and approve financial offerings, transactions, and operational practices. The primary responsibility of In-Bank Advisory Committees is to provide guidance and issue fatwas on matters related to *Shari'ah* compliance within the institution.
- b) *Independent Committees:* Independent committees are external bodies established to provide impartial oversight and review of *Shari'ah* compliance within Islamic financial institutions. These committees are not affiliated with any specific bank and are composed of experienced *Shari'ah* scholars and experts in Islamic finance. Their primary role is to conduct audits, assess compliance, and provide objective feedback on the implementation of *Shari'ah* principles in financial activities.

In Türkiye, the development of *Shari'ah* Committees has evolved alongside the development of participation finance, often driven by individual initiatives. As was mentioned earlier, Special Finance Institutions (SFIs) were granted the title of Participation Banks with the Banking Law No. 5411 in 2005. The period between 1983 - 2005 is known as the era of individual initiative. From 2005 onwards, *Shari'ah* Committees began to institutionalize. Especially with the establishment of the TKBB *Shari'ah* Advisory Board in 2018

and the publication of the "Regulation on Compliance with Islamic Banking Principles and Standards" in 2019, they formalized into a fully institutionalized phase. This regulation underwent updates on November 30, 2021, and August 13, 2022. Additionally, various regulations have been introduced by authorized institutions to foster the development of Advisory Committees. In 2020, the Insurance and Private Pension Regulation and Supervision Institution (SEDDK) published the "Regulation on Insurance and Individual Pension Activities within the Framework of Participation Principles." Lastly, in 2021, the "Regulation Amending the Regulation on Compliance with Islamic Banking Principles and Standards" was issued, introducing current amendments. Table 3 illustrates the three fundamental periods in the development of Advisory Committees in Türkiye.

Table 4: Development of *Shari'ah* Governance in Türkiye

	1983 -2004	2005 -2018	2018 – Present	
	Individual Initiative Period	Institutionalization Period	Full Corporate Period	
			2018	2019
SC*	✘	✓	✓	✓
SAC**	✘	✘	✓	✓
ISCU***	✘	✘	✘	✓

\**Shari'ah* Committee \*\**Shari'ah* Advisory Council \*\*\*Internal *Shari'ah* Compliance Unit

Source: Adapted from Bektaş and Yenice (2022)

During the period from 1983 to 2004, it is observed that there were no advisory committees within the SFIs, and decisions were made based on individual judgments by Islamic scholars. In 2005 SFIs were elevated to the status of participation banks, and an Advisory Committee was established within each participation bank. As of 2018, with the establishment of the TKBB Advisory Board, encompassing all participation banks, Türkiye transitioned into a fully institutional era. As of 2022, there is no information available on the

websites of Hayat Participation Bank Inc., Kasa Participation Bank Inc., and T.O.M. Participation Bank Inc., which were established as Digital Participation Banks, regarding the members of their Advisory Committees.

## **7.0 Challenges and Difficulties**

### *7.1 Trust in Internal Audit of IFIs*

In addition to its role in *Shari'ah* compliance review, the *Shari'ah* Board also has the responsibility of auditing *Shari'ah* Governance processes. It is observed that Islamic jurists predominantly rely on the internal audit departments of Islamic financial institutions (IFIs). This practice indicates that post facto processes related to *Shari'ah* compliance are largely determined by the internal audit function of IFIs rather than by the *Shari'ah* Board itself. Consequently, gaps and deficiencies are revealed in the existing *Shari'ah* Governance practices, which encompass internal *Shari'ah* Governance Framework, qualification mechanisms of the *Shari'ah* Board, independence, transparency, confidentiality, operational procedures, and the evaluation by the *Shari'ah* Board. Regulatory frameworks influence the degree of disclosure and transparency in *Shari'ah* Governance practices in IFIs. Although a framework based on the resolution published by the *Shari'ah* Advisory Council has been established, *Shari'ah* Committees of Participation Banks make decisions according to their own jurisdiction. This indicates deficiencies in the internal audit process of IFIs.

### *7.2 Independence of the Shari'ah Committee*

The most critical issue in *Shari'ah* compliance is the independence of the *Shari'ah* Committee. Rammal (2006) argued that one reason for this issue is that members of the *Shari'ah* committee receive remuneration from the Islamic Financial Institutions (IFIs), creating a potential conflict of interest. This financial incentive might pressure committee members to legitimize unlawful or questionable operations to maintain their positions on the *Shari'ah* committee. One of the measures that could be proposed in this regard is the examination the appointment method of *Shari'ah* committee members.

For instance, having a member of an IFI's *Shari'ah* Committee also serve on the *Shari'ah* Committee of another IFI within the same sector undermines the principles of confidentiality and independence. In some jurisdictions, including Saudi Arabia, Kuwait, Bahrain, the UAE, and Qatar, many *Shari'ah* scholars have, for years, been permitted to sit on multiple *Shari'ah* committees without any restrictions. In Türkiye, on the other hand, an individual is permitted to sit on the board of two Islamic banks. This circumstance fosters a negative perception of the *Shari'ah* committee by highlighting concerns regarding conflicts of interest, confidentiality, and overall effectiveness. To address this issue, some regulators have deemed it necessary to establish regulatory provisions that clearly limit the *Shari'ah* committee membership of a single individual. In Malaysia and Oman, an individual is restricted to serving on the *Shari'ah* committee of only one IFI per sector. For instance, a person can be a *Shari'ah* committee member of only one Islamic bank, one *takaful* operator, and one Islamic non-banking institution.

Additionally, the compliance unit and other auditing units must make independent decisions. Moreover, despite the expectation for the *Shari'ah* committee to audit governance processes, it is observed that *Shari'ah* scholars predominantly seek support from the internal audit department of IFIs. This practice indicates that post facto processes are largely determined by the internal audit function of IFIs rather than by the *Shari'ah* committee itself. *Shari'ah* committee members can only express opinions or provide expert witness testimony. However, the management cannot enforce the decisions made.

### 7.3 Shortage of *Shari'ah* Experts

The shortage of *Shari'ah* experts pertains to the adequacy of its members. Ideally, *Shari'ah* scholars should be knowledgeable in both Islamic law and banking and accounting. As stated in the SGF-BNM 2010, all IFIs must have an *Shari'ah* scholar on their staff (BNM, 2010). The lack of sufficient knowledge in the field of Islamic jurisprudence among professionals within IFIs is the primary reason for the shortage of *Shari'ah* experts. Decisions made by experts who do not have the necessary qualifications and training to determine whether a financial product is permissible or not will lead to problems

in both the *Shari'ah* Governance System and the Corporate Governance System.

#### 7.4 *Shari'ah* Committee Report

The annual report published by IFIs contains *Shari'ah* decisions. However, these decisions need to be addressed in a separate report. Details such as the authorization of financial activities, *fatwas* issued on products, committee meetings, the usage areas of non-permissible income, calculations made, and the purification system of the financial pool, among others, should all be published. All details related to *Shari'ah* Governance should be included in the annual activity report.

### 8.0 Recommendations

First, in the recruitment process of particularly *Shari'ah* Governance units in Islamic (participation) banks in Türkiye undergraduate and graduate students from the Department of Islamic Economics and Finance (IEF) such as graduates of Economic and Administrative Sciences Faculties should be evaluated to promote awareness and recognition of the department. This is because the qualifications sought in the recruitment of Participation Banks do not typically include the IEF department. In Türkiye's participation banks, only one bank includes the phrase "IEF graduate" among the qualifications sought in recruitment. This sensitivity should be applied in the recruitment process of all participation banks. This will enable up-and-coming *Shari'ah* scholars equipped with knowledge in Islamic Economics and Finance through departmental courses to contribute to both the industry and academia. Thus, it will prevent difficulties in the sector and pave the way for new developments and initiatives.

Second, women committee members with expertise in Islamic Commercial Law should be appointed to serve as *Shari'ah* committee members. There are no women committee members in Participation Banks in Türkiye. In fact, there are no female members on the TKBB Advisory Board either. Consequently, the presence of female academics specializing in Islamic Economics and Finance will contribute to the sector. This will accelerate sectoral growth, enabling faster adaptation to new developments. Additionally, the employment

of expert female personnel/academics in the sector will increase the rate of female employment.

Third, the elective courses offered in the Department of Islamic Economics and Finance should be provided in the Faculties of Economic and Administrative Sciences, Engineering, and Law, according to the regulations, the graduates from these department can be employed as *Shari'ah* committee members and Internal *Shari'ah* compliance officers. This will ensure that students with potential for employment in IFIs have sufficient knowledge at the undergraduate level. Moreover, through the education received, there will be an increase in Islamic financial literacy.

Forth, when examining the educational backgrounds of TKBB Advisory Board and *Shari'ah* committee members in Türkiye and comparing them with AAOIFI and IFSB appointment standards, it is generally observed that members in Türkiye have received education in Islamic sciences and theology without the clear reference to Fiqh al Muamalat. However, it has been observed that institutions do not provide supportive education beyond the individual education of the members.

Fifth, the number of supportive education programs to increase the educational level of personnel and members of *Shari'ah* committees in IFIs in Türkiye is insufficient. Insufficient compulsory training, seminars, and mandatory training make compliance with regulations difficult and hinder the monitoring of sectoral developments. Training institutions should be established in Participation Banks under the leadership of the Banking Regulation and Supervision Agency (BDDK) and the Participation Banks Association of Türkiye (TKBB) to increase the knowledge level of all personnel. Compulsory training sessions and seminars should be regularly organized for units with fatwa authority, conferences should be held for managers to inform them about sectoral and non-sectoral developments, and programs should be established to monitor developments for sustainability. Moreover, all these training programs should be made compatible with technology and made available to users. Necessary monitoring and supervision should also be provided regarding participation and compliance with the programs. Through these initiatives, the quality of work and productivity will increase



with qualified employees in the sector. This will also lead to an increase in Islamic financial literacy levels.

Sixth, a regulation should be issued in Türkiye within the framework of participation principles, preventing *Shari'ah* committee members from sitting on more than one *Shari'ah* committee of IFIs at the same sector. This is because precautions should be taken for any activity that may jeopardize the principles of *confidentiality* and *independence*, which may IFIs and compromise the principle of confidentiality, providing competitors with a competitive advantage. Therefore, no regulations or standards contrary to the principles of confidentiality and independence should be present.

## 9.0 Conclusion

The development of Islamic Finance has been achieved through complementary financial services, banking practices, and financial products. This development has also paved the way for the emergence of related new sectors. One of the significant developments in the field of Islamic Finance is the establishment of the *Shari'ah* Governance Framework. The formation of international standard-setting bodies such as AAOIFI and IFSB, which standardize financial transactions and instruments, the establishment of the Central Advisory Board, and the development of the *Shari'ah* Governance Framework are of immense importance. In this article, the guiding principles of AAOIFI and IFSB, which play a crucial role in ensuring *Shari'ah* compliance, have been examined, and the authors shed light to the development of the *Shari'ah* governance in Türkiye by highlighting some of the limitations to achieve a world-standard *Shari'ah* governance framework.

As a result of these analyses, challenges that are important for IFIs have been observed. In this regard, the publication of a comprehensive guide on the *Shari'ah* Governance Framework for IFIs is an important necessity. Furthermore, efforts should be made to identify existing problems. The paper proposes solutions to the identified problems. Implementing these recommendations will contribute to the development of IFIs and the *Shari'ah* Governance System, while playing a key role in economic and social growth. At this point, the article aims to bridge the academic and sectoral gap by

identifying problems with the *Shari'ah* Governance System in Türkiye and conducting an examination of *Shari'ah* Governance in IFIs. Additionally, there is a research gap regarding studies on how to strengthen *Shari'ah* Governance in IFIs and the societal need for and impacts of this development.

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