2016

Corporate Governance in Islamic Financial Institutions

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INTRODUCTION

Corporate governance has been at the forefront of discussions of the financial services industry for decades. Major failures in the business world, from Enron to Lehman Brothers, have been characterized as, among other things, failures of corporate governance. As a result, in order for a financial institution to compete on a global scale investors, regulators, and consumers must have faith that the solid corporate governance principles are embedded in the institutions core.

The Islamic finance industry, which "had worked effectively for centuries during the heyday of the Muslim civilization,"[1] has made resurgence on the global stage. As Islamic financial institutions (IFIs) expand and seek to compete with conventional finance beyond the Islamic world more attention is being given to the underlying structure of these institutions. Improving corporate governance in IFIs is an "indispensible" measure that must be taken for the industry to continue to grow and remain competitive.[2]

This paper summarizes some of the primary corporate governance concerns that are unique to IFIs and suggest additional steps that IFIs, regulators, and governments may wish to consider when developing robust corporate governance practices. Part I provides a background on corporate governance and an overview of IFIs. Part II then discusses the corporate governance challenges that are unique to IFIs. Part III summarizes the current efforts are being made by IFIs, regulators, policy makers, and independent organizations to address the challenges mentioned in Part II. And finally Part IV provides recommendations for additional steps organizations can take to strengthen the governance of IFIs.

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[1] M. Umer Chapra and Habib Ahmed, *Corporate Governance in Islamic Financial Institutions*, Islamic Development Bank, Occasional Paper 1423H, *g (2002).
[2] *Id.*

I. Background

A. Overview of Corporate Governance

At its core, corporate governance is a set of promises made by a corporation, and those that make the decisions for a corporation, to the corporation's stakeholders.[3] It can be viewed as a system of law, contracts, and social norms that govern the structure by which corporations make decisions.[4] Corporate governance is a defining feature in organizations where the decision makers, typically directors, are bifurcated from actual ownership of the corporation.[5]

This bifurcation of control and ownership raises potential problems on both the macro and the micro level. At the micro-level, firms must determine how to appropriately incentivize directors to make decisions for the benefit of the corporation and its owners, and also how to hold the directors accountable if, and when, their decisions harm the corporation. At the macro-level, governments benefit from well run corporations—both Enron and the 2008-2009 financial crises can be viewed as failures of corporate governance that have had rippling societal effects. Additionally, governments need well-run corporations to drive the economy. As a result, since the birth of the modern corporation in the twentieth century, corporate governance has been, and continues to be, an area of focus for both individual corporations and governmental entities.

For the individual institution, good corporate governance can make a world of difference. It facilitates access to external finance, especially when the corporate governance structure clarifies and

[3] *See* Jonathan R. Macey, *Corporate Governance: Promises Kept, Promises Broken*, Princeton University Press, 2 ("The purpose of corporate governance is to … motivate corporate mangers to keep the promises they make to investors.").
[4] *Id* at 9.
[5] Adolf A. Berle, Jr. and Gardiner C. Means, *The Modern Corporation and Private Property*, The MacMillan Company (1993), *Dispersion of Stock Ownership* (66–68).

creates enforceability of investor rights.[6] Additionally, strong corporate governance practices can lower the cost of capital for an organization by reducing the risk (perceived or actual) associated with lending to the corporation. The reduction of risk "translates into shareholders readiness to accept lower returns."[7] There is also evidence to suggest that strong governance translates to improved operational performance in an organization and increases the ability of an organization to withstand external shocks, including external financial distress.[8]

While there is no exact formula for the perfect corporate governance plan, there are basic principles that makeup what is accepted as good corporate governance. These include having clearly defined responsibilities and expectations for board members, disclosure and transparency requirements, well-defined shareholder rights, and mechanisms, both internal and external, to ensure compliance and hold board members accountable. As the list suggests, creating and sustaining good corporate governance requires participation from regulators, policy makers, courts and corporations. Clearly defined responsibilities for board members can come both from the company's charter[9] and from regulation, which may provide a floor for the expectations of company directors.[10] Disclosure and transparency requirements are often set by policy makers and enforced through regulatory action. Shareholder-rights often come from a combination of regulation, which again can serve to set the floor for such rights, and shareholder demands on corporations. As institutional investors have grown in size, they have been able to exert pressure on corporations to afford stronger shareholder protections.

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[6] Wafik Grais and Matteo Pellegrini, *Corporate Governance in Institutions Offering Islamic Financial Services: Issues and Options*, World Bank Policy Research Working Paper 4052, *5 (2006).
[7] *Id.*
[8] *Id. See also* Hawkamah *Policy Brief on Corporate Governance for Islamic Banks and Financial Institutions in the Middle East and North Africa Region*, *7 (2011) ("Good corporate governance is more than a noble idea. It encourages capital formation, lowers the cost of capital, improves the investment climate and helps establish strong markets.")
[9] *See, e.g.*, *General Electric Governance Principles*, *1 (General Electric 2014).
[10] *See, e.g.*, 8 Del. C. § 141 (2014).

Most importantly though, good corporate governance needs mechanisms in place to ensure compliance with the principles expressed through regulatory action and corporate charters. Companies strive to assure their shareholders that they intend to comply with their own standards by creating compliance boards and designating oversight responsibilities to specific directors. Regulators also get involved with ensuring companies are complying with the rules and regulations set by the policy makers. A robust legal system is also vital to ensuring compliance. Shareholder litigation in the United States has served a critical role in defining Corporate Governance standards for American corporations and in motivating directors to comply with minimum standards. Providing stakeholders a mechanism to air grievances against errant directors creates an environment where directors are more likely to comply with established standards of corporate governance.

B. Overview of Islamic Financial Institutions

Islamic finance[11] is the label used to describe the subset of financial services that complies with Islamic, or Sharia, law. "Islamic banking refers to a system of banking or banking activity which is consistent with Islamic law [Sharia] principles and guided by Islamic economics."[12] In the past century the global Islamic finance industry has grown significantly and now includes over $1 trillion in assets and more than 280 institutions operating in 38 countries.[13] While Islamic finance is not limited to only Islamic nations, it is primarily found in the Middle East, Southeast Asia, and the UK.

The main principles of Islamic finance include: (1) prohibition on *riba*, commonly referred to as interest, but which actually translates to "an unjustified increase"; (2) prohibition of *gharar*, or

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11 Like conventional finance, Islamic finance consists of a variety of financial services including traditional banking, investments, and *takaful* (insurance). This paper focuses primarily on banking and investment companies within the financial services industry.

12 Nasser Saidid, *Corporate Governance in Islamic Finance*, found in *Islamic Wealth*, Chapter 33, 435.

13 Wafik Grais and Matteo Pellegrini, *Corporate Governance in Institutions Offering Islamic Financial Services Issues and Options*, World Bank Policy Research Working Paper 4052, *3 (2006).

excessive uncertainty; (3) prohibition on financing *haram*, or prohibited, industries (for example sales of alcohol); and (4) quest for justice and an ethical society, which includes paying of *zakat*.[14] In order for investments to provide a return but not violate the prohibition on *riba*, Islamic investments are structured in a profit-sharing vehicle whereby the return to the investor is "linked to the profits of an enterprise and derived from the commercial risk assumed by that investor."[15] The most common Islamic investment is the *sukuk*, which in many ways is similar to a bond, and features the profit-sharing methodology. Other common Islamic finance instruments include *ijara*, which is similar to a lease style structure and is often used as an alternative to a traditional mortgage as a way to fund home-ownership, the *mudaraba*, which is a limited partnership style of investment where one partner is providing the investment.

While some common Islamic finance instruments have developed, for more complex financial transactions Islamic Financial Institutions (IFIs) seek to develop creative solutions that provide the financing the investors require and comply with the main Islamic principles. For the financial transaction to be deemed Sharia compliant, a Sharia scholar must issue a *fatwa*[16] asserting that the transaction is Sharia compliant. IFIs work with Sharia scholars to obtain *fatwas* for their financial transaction, paying the Sharia scholars for their service.

II. CORPORATE GOVERNANCE CHALLENGES SPECIFIC TO ISLAMIC FINANCIAL INSTITUTIONS

Having introduced basic principles of both corporate governance and Islamic finance, it is clear that IFIs are well suited to adopt and implement good corporate governance standards. The basic tenets of good corporate governance significantly overlap with principles that guide Islamic

[14] *Zakat* is a form of alms-giving that is required by the Quran as one of the Five Pillars of Islam. *Zakat*, Wikepedia (last visited Jan 29, 2016), available at https://en.wikipedia.org/wiki/Zakat.
[15] Latham Watkins, *The Sukuk Handbook: A Guide to Structuring Sukuk*, *1 (2015).
[16] A *fatwa* is essentially a legal opinion issued by a qualified scholar on a question of Islamic Law. *Fatwa*, Wikipedia (last visited Jan 29, 2016), available at https://en.wikipedia.org/wiki/Fatwa.

finance.[17] Despite the obvious synergies between corporate governance and Islamic principles, robust corporate governance practices have not gained a strong foothold in IFIs. The unique structure of Islamic finance and the desire to be competitive on an international scale while still preserving Sharia principles creates unique corporate governance challenges for IFIs that the industry is in the process of navigating. This section highlights the challenges that are unique to IFIs. The next section, Part IV, discusses what efforts are currently on-going to tackle these unique challenges, and then Part V provides some additional recommendations for the industry.

A. Sharia Supervisory Board

One of the defining features of Islamic Financial Institutions is the Sharia Supervisory Board (the "SSB"). The SSB is separate from the Board of Directors for the IFI, but works with the Board to ensure the IFI is complying with Islamic law. The SSB covers five main areas: "[1] ensuring compliance with overall Islamic banking fundamentals, [2] certifying permissible financial instruments through *fatwas*, [3] verifying that transactions comply with issued *fatwas*, calculating and paying *zakat*, [4] disposing of non-*Sharia* compliant earnings, and [5] advising on the distribution of income or expenses among shareholders and investment account holders."[18]

The SSB has substantial influence and control over IFIs and present unique challenges to IFIs. In order for members of the SSB to be effective they must be both Sharia scholars and financial experts. Unfortunately, this is not a common pairing of expertise. Sharia scholars with the requisite financial knowledge are in high demand and as a result many scholars sit on the boards of multiple institutions. This presents concerns about the independence and potential conflicts of SSB members, as they are able to obtain crucial proprietary financial information from multiple institutions.

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17 *See* Hawkamah, *Islamic Finance Policy Brief* at *9.
18 Saidid, *Corporate Governance in Islamic Finance*, at 441.

There is also concern that the scarcity of qualified individuals to serve on the SSBs makes it difficult for SSB members to meet all of their obligations for all of the boards on which they serve. This was a challenge in American organizations, that Board members for various companies were serving on too many boards and therefore were unable to meet all of the corollary fiduciary duties (duty of good faith, loyalty, candor, etc.). Many American companies now require that Board members not serve on more than three boards. If such a rule were to be applied to SSB members, there would not be enough qualified people to sit on all of the SSBs for the existing IFIs.

A further concern presented by the SSB is oversight. Countries vary regarding who and how Sharia boards are overseen. In many countries, and especially where Islamic finance is being used outside of an Islamic country, there is no formal oversight for the SSB. Therefore, there is no way to ensure that the *fatwas* issued by a given SSB are truly Sharia compliant. Since SSB members are often paid for issuing a *fatwa* by the IFI seeking to obtain the *fatwa*, there is a risk that an SSB may authorize a transaction as Sharia compliant when it is not. Such behavior could potentially erode investor confidence in the Islamic finance industry and render the distinctions between conventional finance and Islamic finance meaningless. Additionally, if there are disagreements between management, the Board and the SSB it is not clear how those disagreements should be resolved or who is overseeing whom for the sake of having the "final word." Need for independent oversight to avoid capture of the Sharia board by the institutions for whom they work (analogous to the rating agencies evaluating the credit-worthiness of financial instruments on behalf of the company selling the instruments)

B. Multiple Stakeholders

Under American law, the corporation is primarily viewed as the property of the shareholders, and therefore the driving force behind corporate governance is shareholder value maximization. The rest of the world tends to think of corporations more as social entities that have obligations beyond merely maximizing profits for the individual shareholders.[19] IFIs fall much more closely into the social entity view of a corporation than the American property view.

One of the challenges that comes with viewing the corporation as a social entity is lack of clarity on how directors should make decisions. When directors know that shareholders are their primary focus, it helps them prioritize competing interests that arise when making significant decisions for the organization. Conversely, for IFIs stakeholders include not just the shareholders, but customers that are involved in a profit-sharing mechanism, recipients of the IFIs *zakat*, members of the broader Islamic community, and the local communities where the IFI does business.[20] Scholars have noted that "[t]he most important stakeholder in the case of Islamic finance is Islam itself."[21]

One of the challenges for IFIs developing Corporate Governance is to provide guidance to the directors as to the key stakeholders for the corporation and how the directors should prioritize their interests when faced with difficult decisions. Not only is the priority of these varying interests unclear, it is also not clear what rights the stakeholder would have if they disagree with actions taken by the IFI. For example, if a customer no longer believed that his product was truly Shari'a compliant, would he have the right to challenge the Islamic nature of the investment? And to whom would he make such a challenge?

C. Conflicting Schools of Islamic Thought

Another challenge for IFIs is that Islam does not have one single set of legal principles. As a result, there are differing views as to what qualifies as Islamic finance. There are five major schools of Sunni Islam: hanafi, maliki, shafi'I, hanabali, and zhairi. While there is overlap among the varying

[19] William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 Card. L. Rev. 261, 271 (1992).
[20] Nasser Saidi, *Corporate Governance in Islamic Finance* at 439.
[21] M. Umer Chapra and Habib Ahmed, *Corporate Governance in Islamic Financial Institutions*, *13 (Islamic Development Bank 2002).

schools, there are substantial differences regarding the novel products being created in Islamic finance. Depending on which school a specific country follows may dictate what standards exist for IFIs. For companies seeking to operate in multiple countries throughout the Islamic world, this presents even more challenges. Unlike in America, where Delaware has become the standard-setting location for principles of corporate law, no single cohesive standard for corporate governance in IFIs has developed in the industry.

D. Accountability

An additional challenge of corporate governance for the IFIs is the lack of institutional structures available to ensure that board members are held accountable. This need for accountability applies both to members of the SSB and the general board of directors. Because of many of the challegnes discussed above, there are minimal controls available to ensure that a Bank that claims its products are Shari'a compliant are actually providing Shari'a compliant products. Additionally, the role of governments and central banks in developing and enforcing CG standards is not fully developed in the Islamic world.

III. Current Methods Companies and Countries Are Adopting to Resolve the Challenges

Policy makers, professionals, and academics are aware of the corporate governance challenges facing IFIs and are actively seeking solutions. A number of organizations are working to develop standards and provide best practices for IFIS. This section considers some of the ongoing efforts that companies and countries are adopting to try to mitigate and solve for the governance challenges discussed in the prior section.

A. Requirement of Sharia Compliance

Some countries are implementing external Sharia review boards as part of the Central Bank responsibilities. For these countries, the central bank can serve as an independent check on private

SSBs and uphold the Islamic standards of IFIs reducing the risk that IFI products merge too closely with conventional finance.

In some countries, regulators have already taken steps to preserve the Islamic distinction of IFIs by requiring that IFIs be completely separate from conventional banks, rather than allowing one bank to provide both IFIs and conventional financial products. Other countries remain willing to allow one entity to provide both types of financial services. For international IFIs the attempts by governments to clarify Sharia law runs the risk of increasing more governance complexity because now the entity must ensure it complies with the varying interpretations of Sharia compliance in all of the countries in which it practices.

Policy institutes and "think-tanks" have also sought to provide guidance on how individual institutions can better ensure they are incorporating Sharia compliance into their governance practices. For example, in 2009 the Islamic Finance Services Board (IFSB) created Guiding Principles on Sharia Governance systems for Institutions Offering Islamic Financial Services that advised "[e]ach [IFI] must ensure that the Sharia board has clear terms of reference regarding its mandate and responsibility; well-defined operating procedures and lines of reporting; and good understanding of, and familiarity with, profession ethics and conduct (to fulfill fiduciary duties of good faith, care, skill and diligence towards the shareholders)."[22]

B. Coalescing around specific Standards.

A number of organizations have provided benchmarks for corporate governance and have the potential for providing a unified thread in governance standards for IFIs. However, no single standard has emerged as the industry leader. Two leading standard setting organizations for IFIs are emerging from Southeast Asia: Islamic Financial Services Board (IFSB) and the Accounting and

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[22] Jahanara Sajjad Ahmad, *Corporate Governance in Islamic Banks*, Hawkamah, Principle 1.2 (2010).

Auditing Organization of Islamic Financial Institutions (AAOIFI).[23] The IFIs are also seeking to comply with international financial standards, including those set by Basel II and the Organization for the Economic Cooperation and Development (OECD). Different countries are tending to follow different standards. For example, the majority of IFIs in the UAE, where Dubai is located, only follow the international, non-Islamic, standards, but have not adopted IFSB or AAOIFI.[24] The majority of IFIs in Indonesia follow AAOIFI standards.[25] And IFIs in the Levant (Lebanon and Jordan) are following IFSB standards.[26]

Additionally, there is not yet one central location that is viewed as the hub for Islamic finance. Typically, once a market hub emerges, it is easier for standards to coalesce. For example, once Delaware emerged as the hub for incorporation, corporate governance standards for American businesses coalesced around Delaware law.[27] Currently Dubai, Indonesia and London are all in the running to become the market leader for Islamic finance. And, not surprisingly, each of these different regions has different standards for corporate governance. As the industry settles around a clear market leader location it may be easier for the industry to similarly settle around streamlined governance standards.

C. Attempting to Align International Standards with Islamic Principles

In addition to working to develop governance standards specific to IFIs, the IFIs and the regulatory and academic bodies are striving to ensure their governance principles comply with international standards for conventional banks. This includes adopting OECD and Basel III

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[23] Hawkamah, *Policy Brief on Corporate Governance for Islamic Banks and Financial Institutions in the Middle East and North Africa Region*, *17–18 (2011).
[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *See, e.g.,* Harvey Gelb, *Corporate Governance Guidelines—A Delaware Response*, 1 Wyo. L. Rev. 523, 529 (2001) ("Because many corporations with which investors are concerned are incorporated in Delaware, … Delaware law … of corporate governance … is important.")

standards. While countries and institutions have struggled to agree on the Islamic specific governance standards, all of the countries and institutions have largely adopted the principles laid out by the OECD and Basel III. This has provided some level of consistency among governance practices within the industry.

IV. Recommendations for Continued Strengthening of Corporate Governance

It is necessary to create stronger standards for corporate governance in IFIs in order to legitimize the Islamic finance industry and allow Islamic finance to continue to develop on a global scale. It is clear that policymakers, industry experts and academics are aware of the importance of corporate governance and are actively working to improve the governance of IFIs, but there is more that they can do. This final part lays out some suggestions for additional considerations that may be helpful in the quest to improve governance in IFIs.

The establishment of good corporate governance standards requires collaboration among the corporations themselves, regulators, policy makers, and the courts. Need to develop the Islamic Delaware equivalent – courts that are able to set legal standards. Although, civil law, so maybe less important? A country whose legislatures can set the standard for developing rules? Free-zones?

One of the most important steps that policy makers can take to improve governance in IFIS is to provide a means for adjudicating disputes over whether an Islamic Financial Institution is behaving in methods compliant with Shari'a principles. Currently robust mechanisms do not exist for experts to debate differing views on whether IFI products are Sharia compliant. Providing such a mechanism would lend substantial legitimacy to the Islamic finance industry and would also help create the transparency that is vital to good corporate governance. In order to create such a mechanism, policy makers must determine who would have to standing to raise concerns regarding the Sharia compliant status of IFI products. Additionally, they would need to provide a reputable place to adjudicate such concerns. Such a location could be developed within the Financial Centers, such as the Dubai Financial Center courts. Alternatively, the Sharia courts for individual countries could take on the role of addressing such disputes. Traditionally the Sharia courts have focused on Family Law matters, so it is likely new judges would need to be hired (or current Sharia Court judges would need substantial training) in order to have the institutional competency to handle such disputes.

Finally, the courts or policymakers would need to determine what the appropriate remedy should be in the event an IFI product is deemed non-Sharia compliant. Would the SSB members that issued the *fatwa* be held accountable in any way? Any potential liability that SSB board members might face should be carefully considered. If the liability faced by SSB board members is too high, it would only magnify the scarcity problem IFIs face in finding individuals to serve on the boards. However, some level of accountability is necessary to help legitimize the *fatwas* issued, especially in the eyes of the international community. Here, policy makers in these countries may be able to glean helpful lessons from the Delaware courts determination of liability for directors alleged to breach the fiduciary duty.

In the landmark Delaware case *Smith v. Van Gorkom*,[28] the Delaware Supreme Court ended an era of virtually no accountability for board members by finding the board of directors grossly negligent in the discharge of the duty of care during a merger transaction.[29] The initial response was fear that directors were now exposed to such high liability that no one would be willing to serve on the board of a Delaware corporation.[30] However, the courts quickly softened the standard of review to strike a balance between holding directors accountable, but not exposing them to undue risk for making difficult business decisions.

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[28] 488 A. 2d 858 (Del. 1985).
[29] *Id.* at 874.
[30] *See, e.g.*, Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom after Van Gorkom*, 41 Bus. Law. 1, 1 (1985) ("The Delaware Supreme Court in Van Gorkom exploded a bomb.")

Under Delaware law, directors that are alleged to have breached their fiduciary duty to a corporation are afforded protection under the business judgment rule, which is "that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[31]

This deferential standard of review afford substantial protection to allow directors to conduct the business of running a corporation without fear of liability for making a decision that, in hindsight, was not the best course of action, but ex ante was well reasoned. The business judgment standard of review, however, does not apply if the director acted in bad faith.[32]

A similar approach could be adopted for determining whether members serving on a SSB should be held accountable if it is later determined that an IFI product is not actually Sharia compliant. If the SSB members acted in good faith and faithfully applied *ijtihad*[33] when issuing the *fatwa* then they would not be liable for any later determination that the product was not in fact Sharia compliant. If, however, it was found that the SSB members did not fulfill their obligations to act in good faith when issuing the *fatwa*, but instead granted it with no consideration or purely for financial gain, there should be a mechanism by which the SSB members are held accountable. Finally, policy makers would need to provide regulation that clarified what liability for SSB members would look like in the event of liability. Since it would likely be difficult to quantify the financial harm to the IFI as a result of an inappropriately issued *fatwa* (although not impossible, if all such transactions were deemed void) regulators could create a statutory remedy or provide sanctions on SSB members (such as being prohibited from issuing *fatwas* for Islamic financial institutions in that country for a

31 *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243, 1246 (Del. 1999).
32 *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del 1993) ("To rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decisions, breached any one of the *triads* of their fiduciary duty—good faith, loyalty or due care.")
33 *Ijtihad* is an "Islamic legal term that means 'independent reasoning' or 'the utmost effort an individual can put forth in an activity.'" *Ijtihad*, Wikiepdia (last visited Jan 30, 2016) available at https://en.wikipedia.org/wiki/Ijtihad.

set period of time). Providing a mechanism to hold board members accountable for the determination that certain financial instruments or transactions are Sharia compliance will afford legitimacy to the Islamic finance industry and allow it to compete more rigorously in the international market.

When developing their governance standards, the Islamic finance industry should seek to learn lessons from corporate governance failures in other countries and industries. The evolution of governance standards is well documented and includes numerous trials and errors. Islamic finance regulators and institutions can take valuable lessons from this history and avoid making similar governance mistakes as the industry develops.

Perhaps one of the most important lessons is the importance of independent directors. Lack of independence was seen as a major causal factor in the Enron scandal, and the Sarbanes-Oxley legislation that followed set strict standards for requiring independence of board members. While independence is not a panacea solution for all potential corporate governance pitfalls, it having an independent board is a major element of strong corporate governance.

Currently less than 30% of directors are independent for the majority of IFI boards.[34] IFIs can incorporate further independence into their boards to strengthen their governance. Boards are able to find independent directors independent of government regulations, however, for independence to become a standard among IFIs either government regulators or investors in IFIs will need to mandate a minimum level of independence.[35]

Additionally, IFIs and the governance standard setting organizations should strive to clarify the purpose of the institutions. With the advent of the corporation in America, there was much

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[34] Hawkamah, *Policy Brief on Corporate Governance for Islamic Banks and Financial Institutions in the Middle East and North Africa Region*, *16 (2011).

[35] For example, independence of directors was largely the result of regulator action as part of the post-Enron activity. Conversely, the push for majority voting in corporations has largely come from shareholder pressure.

debate about the role of the corporation in society: was it a social entity or property of the company's owners? The debate has largely been settled in America that corporations are like property. In Europe, the debate was largely settled that corporations are social entities and serve more than just the pocketbooks of the owners. The Islamic principles underlying IFIs suggest that IFIs will want to structure their priorities more like European nations, viewing the institution as a social entity. Within this view, they should strive to clarify—through corporate charters and governance standards—the competing stakeholders and how the interests of those stakeholders will impact the decision-making of the board. Recognizing and enumerating these interests will allow the boards to confidently weigh the facts and implications of difficult decisions, and will also allow investors and regulators to hold directors accountable for the decisions that they make.

Finally, IFIs should consider where Islamic finance falls in the short-term versus long-term view of the corporation. There has been substantial literature written recently about the perils of short-termism, whether considering such perils a risk worth mitigating or an overblown fear by activist investors.[36] Since the Islamic finance industry is still relatively new, and the governance standards are still being developed, the IFIs have the opportunity to seriously consider the different sides of this debate and adopt standards that make the most sense for the industry. While it is likely that the IFIs will want to avoid an over emphasis on profit maximization, good governance of IFIs should lead to a profitable Islamic finance industry. The short-term versus long-term discussions can help the IFIs develop standards that respect the need for profit considerations and longer-term stability.

CONCLUSION

As Islamic finance continues to grow, the industry should strive to develop consistent and streamlined structures for establishing strong corporate governance practices. IFIs are uniquely

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[36] *See, e.g.*, The Economist, *The Creed of Speed: Is the Pace of Business Really Getting Quicker?* (Dec 5, 2015).

situated to emerge as leaders in financial corporate governance, both because of the underlying Islamic principles that drive IFIs and also because—as an industry relatively in its infancy—it can learn from the experiences of conventional finance across the globe and incorporate those lessons.