Principles of Governance in Islamic Banks (Case Study of Al Baraka Bank Algeria - Mostaganem Agency)

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Abstract:

This study aims to identify the principles of banking governance and the principles of Sharia governance and how to apply them in Islamic banks, where the study was conducted on Al Baraka Islamic Bank by following the interview methodology and after analysing all the answers, we reached several results Which represent in,

Al-Baraka bank applies most of the standards of governance, banking and Sharia governance, but all decisions are related to the parent unit of the bank, which causes slow decision-making, especially financing, in addition to the absence of a risk management unit in all agencies, and this leads to a lack of quality of financial services.

Keywords: banking governance**;** Sharia governance; Islamic bank.

Jel Classification Codes: G34,G21

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1. INTRODUCTION

The concept of corporate governance covers a set of rules, procedures and operational structures that guides the short term and long-term actions of companies, banks etc.…. Corporate Governance is needed to create a corporate culture of consciousness, transparency and openness. It refers to a combination of law, rules, regulations, procedures and voluntary practices to enable companies to maximize shareholder's long-term value. The Basel Committee on Banking Supervision has been working in this field for many years, (E.K1, S, & Sivaram, 2022)

The Islamic banking sector has imposed itself on the global financial sector, and the spread of Islamic banks has become clearly visible, and the Islamic financial sector continues to expand methodology. It is estimated that the number of Islamic banks is 265 banks operating in 45 countries, including most countries of the Islamic world, Europe, North America and some other regions, while 300 conventional banks offer Islamic banking products. After the stifling financial crisis experienced by the United States of America about two years ago, and the similar crisis in Europe, officials have paid attention. European financiers pointed to the importance of attracting Islamic banking and that Islamic banking institutions were not affected by the global financial crises and remained to maintain their financial capabilities and capabilities with a surplus in profit. (2022)

From the above, we decided that the subject of our study is about Islamic banks and how they apply governance standards because they are subject to dual governance, banking and legitimacy, and the case of the study was Al Baraka Islamic Bank of Algeria (Mostaganem- Agency)

Accordingly, the following problem arises:

What are the governance standards applied by Al Baraka Bank?

In order to answer the problem, we chose the interview method in order to obtain as much information as possible.

2. Literature Review

2.1 definition of corporate governance

The linguistic origin of governance goes back to a Greek word that means the ability of the ship's captain to control it according to his skills and good management amid storms and waves and what he must have of morals, values and honourable behaviour’s in preserving passengers and their property (heriz, 2020)

Corporate governance has been looked at and defined variedly by different scholars and practitioners. However, they all have pointed to the same end, hence giving more of a consensus in the definition. For example, Hasan,(2009)

Generally, the definition of corporate governance can be divided into two senses. Firstly, in narrower sense corporate governance can be defined as a formal system of accountability of senior management to the shareholders. Secondly, in expansive term, corporate governance includes the entire network of formal and informal relations involving the corporate sector and their consequences for society in general , (Brahim & Nourredine, 2017) defined as a good a good management of internal company and careful decision of resource allocation can reinforce company performance, and The mechanisms which intend to determine the authorities and have an impact on the directors decisions, in other word govern their leadership toward the corporate and set the scope of their authorities, According to Benelhadj Djelloul Rachida (2022) , corporate governance is concerned with ways of bringing the interests of (investors and managers) into line and ensuring that firms are run for the benefit of investors. Corporate governance is concerned with the relationship between the internal governance mechanisms of corporations and society’s conception of the scope of corporate accountability, Boufatah Belkacem, (2018) defined it s as a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby, mitigating agency risks which may stem from the misdeeds of corporate officers .

2.2 Governance banking system

The application of governance in banks is more important than other institutions, because the collapse of banks may lead to the collapse of the entire financial system and this leads to a financial crisis, which may turn into an economic crisis, this negatively affects the macroeconomic situation. The Bank of International Settlements (BIS) defines governance in the banking system as the methods by which banks are managed through the Board of Directors and senior management, through which the manner of setting objectives and protecting the interests of shareholders and stakeholders. In the light of the prevailing law and regulations, and to ensure the protection of the interests of depositors. (Chahra Adissa, 2019) .

Also ,it s defined by Beladjeraf Samia,(2020) as A group of regular and financial mechanisms through it they create and organize the proper practices in order to preserve the shareholders „ rights.And the others from the stakeholders and to ensure that the company stays in business environment and competition

The Basel Committee on Banking Supervision (1999) states that from a banking industry perspective, corporate governance involves the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management, affecting how banks:

- set corporate objectives (including generating economic returns to owners);
- run the day-to-day operations of the business;
- consider the interest of recognized stakeholders;
- align corporate activities and behaviours with the expectation that banks will operate in safe and sound manner, and in compliance with applicable laws and regulations; and protect the interests of depositors. (Nigeria, 2012)

2 3. Principles of Banking Governance:

The Basel Committee on Banking Supervision is one of the most important bodies that have made great efforts to achieve the good governance of banks and financial institutions, the Committee issued in 1999 the document "Strengthening Corporate Governance in Banking Institutions", which stated seven basic principles to ensure the balanced performance of banks derived from the principles published by the

Economic Cooperation Organization to be developed in 2006, then in 2010 and then in 2015 and can be reviewed in its final version in the following (Chayb, 2018):

– The company values, honour characters of proper behaviours and other standards of good behaviours and the systems through its use the application of these standards will be achieved;

– A well-prepared strategy for the company under which its total success can be measured and the individuals „ contribution in this;

– The proper distribution of responsibilities and decision –making centres including functional hierarchy of required approvals from the individuals to the council;

– - Establishment the mechanism for the effective cooperation among the board of directors, finance audit, and the higher management;

– Availability of strong and internal tuning system including internal and external audit tasks and independent risk management about business lines taking into consideration the authorities that fit with responsibilities (checks and balances);

– A special observation of risks centres in the locations that conflicts of interest's mount including work s relationship with borrowers who are linked to the bank, the major shareholders and the high administration, or the major decisions makers in the institution;

– the financial and administrative incentives of the high administration which achieve the work in a proper way, also concerning the directors or employees whether in the form of compensation, upgrades or other elements;

– The information flows in a convenient form internally or abroad (Beladjeraf Samia, 2020);

– Compliance: The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance function;

– Internal audit: The internal audit function provides independent assurance to the board and supports board and senior management in promoting an effective governance process and the long-term soundness of the bank. The internal audit function should have a clear mandate, be accountable to the board, be independent of the audited activities and have sufficient standing, skills, resources and authority within the bank;

– Compensation: The bank's compensation structure should be effectively aligned with sound risk management and should promote long term health of the organisation and appropriate risk-taking behaviour;

– Disclosure and transparency: The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants;

– The role of supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors (Chahra Adissa, 2019) .

2 .4 Corporate Governance in Islamic Finance

According to Sarwar Uddin Ahmed,(2016) the concept of corporate governance is not new in Islam however, Islamic perspective of corporate governance, to some extent, has differences in comparison to conventional concept of corporate governance. A person's daily activities and transaction should be based on the values of truthfulness, firmness, fairness, and respect for the law, kindness, forbearance, tolerance and uprightness, instead of deceit, haughtiness, class consciousness, ostentation, insubordination, envy, jealousy, backbiting and self-aggrandizement. Firstly, in Islam it can be observed that, since initiation of Muslim civilization, both broad guiding principles and structured Islamic jurisprudence (Shari'ah based Islamic laws) persisted to ensure ethical standard in the society. In one hand Muslims always have an "implicit agreement" with God (Allah SWT) for their worldly deeds; on the other hand, while involving with contractual obligations to human, Muslims form "explicit agreements" that reflects Islamic fundamental principles or implicit agreements. As Islamic banks follow PLS (profit and loss sharing) model, depositors also bear risk of the ventures used by those funds by the bank and this is guided by specific modaraba and musharaka rules/acts. Thus, implicit agreement to Allah SWT (God) plays crucial role in corporate governance in Islam and this aspect of having implicit contract with God does not exist in the conventional concept of corporate governance.

Islamic banking refers to a system of banking or banking activity that is consistent with Islamic law principles and guided by Islamic economics

In addition, Islamic law prohibits investing in businesses that are considered unlawful or haram (such as businesses that sell alcohol or pork, or businesses that produce media which are contrary to Islamic values). (De Faten Ben Bouheni, 2016)

The Islamic Bank, it may use the same mechanisms as a conventional bank, in addition to the Shariah boards, the Shariah review unit, the IFSB and the IIRA as main mechanisms of monitoring the Islamic Banking system. Unlike the conventional system, the Islamic financial system is based on the active participation of public policy institutions, regulatory and supervisory authorities, and Shariah authorities. These institutions collectively monitor the performance of the firm and its faithfulness and commitment to explicit and implicit contracts (Ammi, 2015)

Table 1. Shariah Governance Disclosure Index

	Required by law (mandatory) of GP8-i, IFSA and SGF
Shariah Committee (SC) (8 items)	- Members of the SC are individuals with relevant experience and qualification in Shariah. - No fewer than five qualified individuals are to be appointed as SC - Majority of the SC must be qualified and possess in-depth knowledge in Shariah - At least one (1) member of the SC is appointed as a member of the board - Disclose adequate information on the IFI's state of compliance in its annual report Duties of SC - Meetings are scheduled to be held at least six (6) times annually - At least 75% minimum attendance requirement of the meetings"
2. Shariah	- Planning and implementing the Shariah review programme,

Review (4 items)	which encompasses its objectives, scope, reporting, rectification and follow-up actions - Documenting all processes carried out during the Shariah review - Reporting the Shariah Reporting the Shariah review outcome and highlighting any non-compliances to the Shariah Committee and the management review outcome and highlighting any non-compliances to the Shariah Committee and the management - Rectifying any instances of non-compliance to prevent their recurrence
3. Shariah Audit (4 items)	- Performing Shariah audit on financial statement items - Performing Shariah audit by internal auditors that have adequate knowledge and training in Shariah - Performing compliance audit on organisational structure, people, process and information technology application systems - Reviewing of adequacy of the Shariah governance process.
4. Shariah Risk Management (4 items	- Carrying out by risk officers with relevant qualifications and/or experience - Facilitating the process of identifying, measuring, controlling and monitoring Shariah non-compliance risks inherent in the IFI's operations and activities - Formulating and recommending appropriate Shariah non-compliance risk management policies and guidelines - Developing and implementing processes for Shariah non-compliance risk awareness in the IFI
5. Transparency & Disclosure items)	- Disclose the audited financial statement - Disclose the audit report - Involvement in non-permissible activities and less the percentage of profit, reason for involvement in non-permissible activities and handling of non-permissible activities. - Basis of Shariah concept in approving new product. - Amount paid for zakat - Uses/beneficiaries of zakat - Attestation that zakat has been computed according to Shariah - Sources of charity (Sadaqat) and its uses

Source: Rosnia Masruki et al ,(2020)

3. Methods

In our research, we resorted to using the interview tool to collect information, which has the advantage of embodying the reality of the case under study, we left the researcher the opportunity to present all areas related to the study through semi-directed questions, regarding the theoretical aspect of the study; The descriptive approach was adopted, which allows to describe theoretically the studied phenomenon,

3.1 Spatial and temporal boundaries of the interview:

An interview was conducted with the Deputy Director of Al Baraka Bank Algeria Agency for of Mostaganem, on Monday, December 26, 2022

3. 2 About the Al Baraka Banking Group

Al Baraka Banking Group (BBG) is licensed as an Islamic wholesale bank by the Central Bank of Bahrain and is listed on Bahrain Bourse and Nasdaq Dubai. It is an international Islamic banking group providing its services in countries with a population totalling around one billion. The Group has a wide geographical presence in the form of subsidiary banking units and representative offices in 17 countries, which in turn provide their services through over 695 branches. BBG Units offer its services for corporate, treasury and investment banking, strictly in accordance with the principles of the Islamic Shariah. The authorized capital of BBG is US$ 2.5 billion and total assets amounted to US$25.5 billion (Besseba Abdelkadir1, 2019)

3.3 Interview content:

A semi-guided interview was conducted by asking a set of codified and uncodified questions, the researcher answered all the questions and restricted them in writing, the opportunity to express an opinion freely with some guidance from the researcher was given in order to shed lighter on the points that serve the subject of our research. The questions generally revolved around the extent to which the governance standards of the Basel Committee and the standards of Sharia governance were applied, as each criterion was addressed separately.

4. Results and Discussion:

The interview was divided into two axes, the first axis was related to the principles of banking governance of the Basel Committee, and the second axis was related to the Sharia governance standards of the Accounting and Auditing Organization for Islamic Financial Institutions.

The first axis

The summary of the answers was that all the standards of banking governance, which were addressed in the theoretical aspect, are applied in the banking agency. of Al Baraka Bank the Deputy Director also added that the nature of the decisions is centralized, which means that they are subject to the senior management to collect their aspects, and the agencies only have to implement the decisions addressed to them

As for risk management, it does not exist at the agency level, but it is located in the main unit, and before making any decision, the risk department is informed, which undertakes the study and making the appropriate decision **.**

The second axis

As for the Standards of Sharia Governance that have been addressed, most of them are applied in the Agency, except for the Sharia Committee in terms of: the appointment of a member of this committee in the Board of Directors and the number of meetings that must be less than 6 times a year, as the Deputy Director was unable to answer these questions.

As for the standards of Sharia auditing and risk management, they are all applied, and as for the terms of transparency and disclosure, the Deputy Director added regarding Zakat that it should be only in savings accounts.

As for the sources of charity and its use, the Deputy Director stated that in the event that an error is discovered in the financial transaction by the Sharia Audit Committee, the employee is subject to reprimand and the profit achieved from this forbidden operation goes to a special account called charity, which is spent in helping the charitable associations **,** Or it can be provided to the Ministry of Religious Affairs and it can also be provided in the form of assistance to workers in cases of surgery

The Deputy Director also added that the Sharia Committee conducts inspection visits three times a year to evaluate transactions, identify errors and make recommendations to contact the Sharia Audit Committee.

5. CONCLUSION:

We conclude from this study that Al-Baraka Agency of Mostaganem applies most of the standards of banking and Sharia governance, but all decisions are related to the parent unit of the bank, which causes slow decision-making, especially financing, in addition to the absence of a risk management unit in all agencies, and this leads to a lack of quality of financial services.

Also, the lack of inspection visits to the Sharia Committee may lead to a backlog in the operations to be audited and lead to a high rate of error in financial transactions.

Therefore, the bank should try to establish a Sharia audit committee that conducts daily audits to avoid errors, as well as establishing risk management units in all agencies to raise the quality of financial services.

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7. Appendices:

Overall questions posed to the Deputy Director:

In the beginning, the field was left open and we talked about governance in general. During the dialogue, a number of questions were asked:

- **The first section was on the governance principles established by the Basel Committee**.
  - What are the qualifications of the Board of Directors?
  - What are the general responsibilities of the Board of Directors?
  - What is the structure of the Board of Directors and what are its responsibilities?
  - Does the bank have a separate risk management function?
  - Does the bank have an internal audit committee?
  - How compensation and remuneration are structured
  - Is all the information available to stakeholders and depositors?
  - What is the role of regulatory authorities?
- **The second part of the questions was about Shariah standards for governance.**

First, they talked about Sharia governance, Islamic financing formulas, and developments in the field of Islamic banks, and during that, a set of questions were asked:

- What is the number of members of the Sharia Committee and what are their qualifications?
- How many meetings does the Shariah Committee hold per year?
- How to apply the process of Sharia review?
- What are the stages followed by the Islamic Bank to issue a new service?
- How is the amount of Zakat calculated and from which account is it deducted?
- What are the sources of charity and where is it spent?