

## Governance of Islamic Banks in Palestine

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### Abstract

The purpose of this study is to clarify the meaning of the governance of Islamic banks in Palestine, and the extent of their effectiveness in achieving transparency and stability of economy. It consists of two parts: the first one explains the meaning of governance in general, the circumstances of its inception, its purposes, and elements. The second one focuses on governance in Islamic banks as an organizational management work aimed at raising the level of performance of Islamic banks and thus increasing confidence by investors, shareholders and the general public. The study concluded that the system of governance that has been created as a result of certain economic conditions in the world fits in accordance with the Islamic Shari'a and is considered within the framework of the interests which are reasonable, and its benefit is clear. Moreover, the Shari'a is concerned with the interests of the people.

**Keywords:** Islamic Jurisprudence, Islamic Banks, Economics, Palestine.

## حوكمة المصارف الإسلامية في فلسطين

### ملخص

تهدف هذه الدراسة إلى بيان مفهوم الحوكمة في المصارف الإسلامية في فلسطين، ومدى فاعليتها في تحقيق الشفافية، والاستقرار في الاقتصاد بشكل عام، وكذلك دورها في تعزيز الثقة بالأداء المصرفي عموماً، والمصرف الإسلامي خصوصاً، وقد جاءت في مباحث عدة: بينت أولاً معنى الحوكمة، وظروف نشأتها، والغاية منها، وعناصرها، ثم بينت ثانياً الحوكمة في المصارف الإسلامية، وأنها عمل إداري تنظيمي بامتياز، يهدف إلى رفع المستوى الأدائي للمصارف الإسلامية، ومن ثم زيادة الثقة من قبل المستثمرين والمساهمين والجمهور بشكل عام.

وقد خلصت الدراسة إلى أن نظام الحوكمة الذي تم استحداثه نتيجة ظروف اقتصادية معينة في العالم مرعي في الشريعة الإسلامية ومعتبر، ضمن إطار المصالح المرسلّة، فمصلحته راجحة، ونفعه واضح، والشريعة إنما جاءت ترعى مصالح العباد، فهي خير كلها، ونفع كلها...  
الكلمات الدالة: حوكمة، مصارف إسلامية.

## Introduction.

Islamic banking has become a reality in Muslim societies, and it is an integral part of the economic bodies in general. This category of banking sector like others need to be controlled, guided, observed and developed, otherwise it will retreat. Having said that or based on that, governance is a secure guarantee of the quality, continuity, increase and effectiveness of work and its outcome. This research examines the governance of Islamic banks in Palestine. It sheds light on the importance of this sector as it affects the current economic and business environment of people's

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lives directly, as banks in general represent the essence of economic work in societies today. The study consists of three parts.

**The First Part - Governance: concept, origin, goals** and characteristics of Islamic banking.

Section one: concept of governance, its emergence, goals, importance and components.

Section Two: characteristics of Islamic banking.

**The Second Part - Governance of Islamic Banks.**

Section One: Governance of Islamic Banks.

Section Two: Need of Islamic Banks to Governance.

Section Three: Legalization of governance.

**The Third Part**

Scope of Implementation of Principles of Governance in Islamic Banks in Palestine.

## **Part One: Governance: concept, origin, goals and characteristics of Islamic banking.**

### **Section One: Concept of Governance: language, and terminology:**

Linguistically speaking, the word "Governance" has no history of use in dictionaries to explain the meaning of the term as it is used in modern economy. Researchers used to introduce certain explanations for terms they used in their work giving justifications for the use of terms and the scope of semantic implications intended by them to serve specific communicative message.

The term, governance, is a non-standard derivation because it does not follow the rules of language in the extraction of sources. It matches the verb "fa'oula", and it is not a source of derivatives. It is an extraneous term on the language. The Arab language league approved in 2002 the translation of the word "governance" and stated that one of its meanings is (ruling).

Governance is known as one of the terms used in the economic field today. Thus, it is necessary to clarify the meaning of governance among economists. Several definitions are presented for this term. One of these is the International Finance Corporation (IFC) definition. It stated that governance is "the system by which companies are managed and controlled."

The Organization for Economic Co-operation and Development (OECD) defined it as: "a set of relationships between the directors of the company, the board of directors, shareholders and other stakeholders". Another definition specifies that "Governance" is a set of laws, regulations and decisions that aim at achieving quality and excellence in performance by selecting appropriate and effective methods to achieve the company's plans and objectives.

Based on the above mentioned definitions, we conclude that the term "governance" refers to the good management of commercial institutions and companies that generate profits in order to prevent them from manipulating consumers, and to preserve businesses from being collapsed.

This system seeks to create a state of balance and stability in financial institutions in general. Thus, the term "governance" is used in modern economics for the purpose of good management of financial institutions with a view to monitor and observe these institutions. This understanding stands for the meaning of governance.

I think that the expression of what they meant by the term of governance was not accurate, and I suggest replacing it with other terms. For example: the banking system, institutional, banking or institutional accounting, the control system, the quality of banks or institutions and so on.

### **Second Section: Emergence of Governance.**

The term "governance" as text and content is a new term. Several studies have confirmed that the first use of the term was after the financial and economic crisis that emerged in the nineties of the last century in several countries in the world, such as America and East Asia and Russia. The economy of these countries and other ones suffered from major economic declines and led to the bankruptcy of many companies and banks and the like, which undermine confidence in these companies by shareholders and investors. Studies confirm that the administrative and legal abuses to obtain money - whether in person or for the benefit of the institution form the main reason for the existence of such financial crises. This situation creates a bad need for establishing an administrative system to control companies and financial institutions in general within the States. The system aims to strengthen the economy and prosperity by monitoring individuals and companies as well as governments in the economic field. This in turn creates confidence by investors in such financial institutions, and drives towards investment.

### **Third section: Objective of Governance, justification for its existence, and the main parties therein.**

Governance aims to enhance trust in the company by shareholders, including: good management, transparency, accountability, etc., which in turn fulfills the highest interest for which the company originated. It also gives the investor an incentive to invest, and encourages others to do so.

- (Board of Directors)•
- (Managers) •
- (Shareholders).

### **Second Section: The characteristics of Islamic Banking.**

Islamic banking is based on clear rules which derived from Islamic law, that cannot be bypassed or tolerated. It represents the main chapter in the distinction between Islamic and non-Islamic banking.

- 1- Reba, interest, is strictly prohibited in Islam. The Islamic bank is based on rejecting the principle of usury in response to the command of God that says: "Those who eat riba do not rise except as the one who is doing ... O ye who believe! Fear Allah and remove what remains of riba ..." (Peace and blessings of God be upon him) who said: "A dirham of riba that a man eats is worse than committing more than thirty-six prostitutes." The sins of riba are not hidden, and its misdeeds are innumerable, so the Islamic Bank rejected the idea of Reba.
- 2- Investment of money by legitimate means, which contributes to the economic development of society in general. The Islamic Bank invests money by operating it in legitimate ways, such as selling Murabaha for the purchase order, operational leasing, partnership of contracts, and so on.

- In legitimate ways, the bank plays a positive role in society, thereby supporting economic development, which is an integral part of the architecture of the land.
- 3- Ethics of the Islamic religion in banking, honesty, honesty, sincerity, clarity, non-fraud and so on, which is an integral part of the eternal message of Islam and then the banking business based on the Islamic religion.
  - 4- The performance of what God imposed in this money from "Zakat", Islamic bank is doing a business, the imposition of God in which Zakat extracted from it and distributed to the beneficiaries, mentioned God Almighty in his book.

## **Part Two: Three Sections.**

### **The first section: Islamic bank governance: concept, objectives, determinants, and elements.**

Now, after defining the term "governance" - in general - language and terminology, I show what it means for Islamic banks.

We have already stated that the purpose of governance - in general - is the regularity of financial institutions within the framework of regulated control, which is expressed as: good management or wise management.

This concept extends to Islamic banks which badly need such system. This is obvious from the definitions in this regard, which include:

- (sound regulations, applications and practices applied by Islamic banks to achieve fair treatment of shareholders and employees of Islamic banks ...) this is a comprehensive definition of mentioned by some.
- It is defined as "a set of laws and regulations that provide sound information to the board of directors of Islamic banks; to achieve the objectives that are in the interest of the Bank's customers and shareholders ...".

It is clear through these definitions that it is intended to achieve the benefit of customers and shareholders through good governance, which in turn achieve: integrity, transparency and justice.

### **Objectives of Islamic Banking Governance**

The aim of governance is to achieve a set of objectives that will raise the level of banks in general, and Islamic ones in particular, by raising the level of performance and services and enhancing confidence in the banking institution in general. Hence, the objectives achieved by governance can be summarized in the following:

- 1- Transparency is an important and necessary element of clarity and uncertainty, which creates confidence in the bank, and succeeds, in the best form.
- 2- Responsibility, which means the conduct of the executive management of the bank, as well as the board of directors in a professional spirit, and the correct and successful work ethic, which in turn increases production, and enhances public confidence in the institution.
- 3- Equality, which means not to withhold small investors in the institution from the exercise of the rights guaranteed by the law of this institution, from: accounting, voting, constructive criticism

and participation in the General Assembly... The shareholder of one share, has the full rights of the owner of millions Stocks of all that stated.

- 4- Accountability means management is responsible for the work and be questioned for it. This responsibility or accountability in turn creates a state of harmony between the interests of management, and the interests of shareholders.

These four items summarize the objectives that likely to be met through governance of Islamic banks in particular, which in turn, lead to other issues as:

1. Citizen's confidence in effective banking institutions - especially Islamic ones - and then the national economy in general, by reducing financial risks.
2. Improving the financial performance of the institution and other institutions of the country.
3. Marketing the banking institution by demonstrating the ethics of hard and professional work.
4. Increasing confidence by the active institutions in the society and the financial markets, which in turn enhances the means of cooperation and opens the horizons for serious and open banking work, which keeps it away from rigidity and selfishness?

#### **Elements of Governance in Islamic Banks:**

We know that governance is a regulatory system consisting of a set of laws, regulations and procedures aimed at safeguarding the rights of shareholders and investors in general and increasing profit. In this case, it relates to the administration of work. If the work is limited to a single person or a limited number, the situation is easy. Therefore, it is required if various parties within the institution are responsible in order to prevent conflicting orders, and overlap of powers among them.

It is well known that banks in general are managed from more than one body, either directly or indirectly, as well as beneficiaries from different bodies. Therefore, we find those who spoke about the governance elements (parties) who made them three parties, as follows:

- Shareholders, owners of capital in the bank, who are entitled to elect the Board of Directors.
- The Board of Directors: These are directing, monitoring and evaluating the performance of the executive management, and presenting the reports to the owners of capital (shareholders).
- Executive Management: Its mission is to manage the bank directly, to submit periodic reports on the progress of the work to the Board of Directors, and to present the reports transparently to the shareholders.

The above elements represent the parties to governance in all institutions, including the Islamic Bank, and as the researcher presented, the Islamic Bank is in need of governance, increased transparency, quality of work and good results.

But the Islamic Bank differs from other banks which take interest" Reba". It requires a system of legitimate control of the bank's transactions: auditing and controlling them according to the provisions of the Islamic Sharia, and accept what was in accordance with the provisions of Sharia, and reject what was contrary to them, and correct what was in need of correction.

The Shari'a Supervisory Board of Islamic Banks is the Sharia Supervisory Board, a group of Islamic jurists specializing in financial transactions. Their mission is to audit and investigate the transactions conducted by the Islamic Bank in order to achieve consistency with the provisions of Islamic Sharia. This body is a key element in governance, in addition to its original elements. It is an

important aspect which cannot be overlooked, neutralized, or weakened. It must be strengthened because it is important in the integrity of people's transactions and thus their economic life in general according to the rules of Sharia,

### - **Effective Governance Standards in Islamic Banks.**

The application of effective governance in Islamic banks depends on two things:

The first is internal, which is based on controlling the relationship and allocating powers among the main constituent elements of governance: from an administrative, executive, and a general assembly to distribute powers and to reduce, if not terminate, the conflicts between the tasks of each party.

The other thing - external - and aims at achieving economic stability that encourages investment, and reassure and satisfy both an investor, and the bank, through the effective control and organization of banking transactions, which in turn achieve regulatory regulation of markets, and provide the necessary funding for projects of various types by the bank, which create psychological satisfaction with both the bank and the investor.

### **The Second Section: The Need for Islamic Banks to Governance.**

In this time, banks are the mainstay of the economy, its backbone, and the need for it to grow to regulate people's transactions and to facilitate their financial affairs. Therefore, the organization of these banks has been an urgent necessity because of their effectiveness and services in society as a whole, and as the governance means the development of the system of control and transparency within the bank, which in turn enhances the desire to deal with the public with banks as a result of increasing confidence in it, in addition to the promotion of production and work, the need is urgent. Banking in a productive and effective way will only be through the proper application of corporate governance in the banking business.

Especially if we know that Islamic banks aim to operate money, and enter directly into the labor market, they seek real partnership with their clients, and support all projects: small, or large, and committed in all, but all dealings with the law of Sharia, based on Profit and loss. They win if the profit is achieved, and loose if there is no profit, on the basis that both situations are possible.

As Islamic banks, as I mentioned earlier, differ from Reba-based banks in being more in contact with the reality of economic activity and more directly to the market in general, they are directly related to it. This takes more than one form: selling "Murabaha" to the buyer, partnerships that end by owning the goods or products, rent that leads to ownership, documentary credits, letters of guarantee... and so on, some of these services as documentary credit and letter of guarantee are common with other commercial banks. However, the work of Murabaha is limited to the Islamic banks. Thus, the need for an effective regulatory system - expressed in governance - is an urgent necessity as it is progressing; to enhance public confidence, safeguard rights, and to ensure the success and continuity of work: shareholders, administrators, and the public - in general - which is the real and actual flow of these banks deal, and then profit. This finding was confirmed by a number of researchers who work in this field.

### **The Third section: Islamic legalization of Governance:**

Governance as approved by the economic development organizations aims to achieve a rational financial policy, which follows effective management of money, in the administrative work as a whole, and justice in all matters: the distribution of powers to ensure the promotion of accounting and transparency, and it achieves the principle of consultation between all parties, Abolition of tyranny, and exclusivity of decision.

If we look at all these elements, we find that they are authentic principles in the Islamic jurisprudence, but the whole Sharia, as stated below:

- Good governance, governance has already meant good governance in general, and money in particular, and in view of the sources of Sharia, we find that the money conservation, development and exploitation of one of the purposes of Sharia law, has recommended the conservation of money, and called for the development of legitimate methods, and operation in what is beneficial And useful, and forbids unwise spending of money, and extravagance in it, as well as the payment to those who cannot use properly, The Almighty says: "Do not give the foolish people your money, which God has made you standing ..." and ordered that we do not pay orphan money to him until we determine his ability to manage this money rationally.

The principle of justice, any work done with the participation of others, needs to apply justice among its members, otherwise it will not succeed, and failure will be his fate, and banking in general need to achieve this principle, to manage the powers between the parties, and the distribution of rights. There is no doubt that justice is an inherent principle in the religion of Allah. The Almighty says: "Allah commands justice, charity, and obedience ..." "Allah enjoins you to perform the ..." and forbade the Almighty to ignore justice even with enemies. (Peace and blessings of Allah be upon him) said: "Be right among your children ...".

### **The principle of Shura:**

Shura is a great principle in Islam which is complementary to justice, so justice cannot be achieved without Shura. No matter how human knowledge, experience and knowledge of life matters, he might miss many things. To overcome such issue one has to rely on "Shura" as the path of justice, That the justice in its finest form, it must be from the consultation, and God Almighty ordered us, the Almighty said: "and consulted them in the matter," and said: "and ordered to consult them," The Prophet peace be upon him consulted with his companions, it was reported that no one exceeds the prophet in his consultation with the companions peace be upon him.

Consultation is an inherent characteristic of governance. It adopts it, and makes it an integral part.

The accounting of the Prophet (peace and blessings of Allah be upon him) is not hidden for the messengers who sent them to collect the Zakat and the money owed by the Muslims, as well as the accountability of Omar, may Allah be pleased with him, and the leaders of the soldiers in matters of money, and others, as well as transparency and clarity was This is clearly evident in his biography of the Prophet (peace and blessings of Allah be upon him) and the biography of his companions. Since governance in its contemporary sense includes all the preceding elements, it is accepted in religion, and even encouraged.

### **The Third Part: Implementation of the Principles of Governance in Islamic Banks in Palestine:**

The Islamic banks in Palestine and abroad have always been in a process of development. They did not ignore the rules of corporate governance approved by the competent authorities. In Palestine, Islamic banks have adhered to the principles of corporate governance stipulated in the Code of Corporate Governance. Which is one of the Islamic banks in Palestine - represented by its Board of Directors in its meeting held on 12/5/2011 decided to abide by these principles and the need to circulate them to the relevant parties so that they can be activated and work by, "The Palestinian Islamic Bank is committed to implementing corporate governance principles as stipulated by all Palestinian regulatory authorities. According to the Corporate Governance Declaration issued by the Palestinian Monetary Authority and the Palestinian Capital Market Authority, the Bank's governance has been strengthened through the development of the Code of Conduct for the Board of Directors, to modify the structure of the bank to fit with the achievement of its objectives as well as to modify and modernize the system of incentives and rewards.

The Arab Islamic Bank has also committed to adhere to the principles and rules of corporate governance contained in the Code of Corporate Governance in Palestine. The Bank's annual report for 2012 stated that the Bank is committed to applying the latest banking standards in the management of financing risks to achieve transparency and compliance with regulatory decisions and Palestinian monetary fund regulations. Governance, including organizational, administrative and developmental means and methods, is part of the components of Islamic banks operating in Palestine.

### **Conclusion:**

The study included the following results:

- Governance is an innovative and new system, in which the reader stands through this research that this system is existing and promising. The rule of jurisprudence and the principles of legislation are not restricted to it, but rather support it and adopt it, especially as it cares for the interests of the people and preserves their rights.
- Governance in Islamic banks is a necessity of legitimacy, in its structure, taking into account interests, achieving financial security, and economic stability within society.

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