

FAQs on IFSB-22:

Revised Standard on Disclosures to Promote Transparency and Market Discipline for Institutions Offering Islamic Financial Services

[Banking Segment]

Q1. What is the recommended period for the implementation of the provisions of this standard? Are all the requirements have the same implementation date?

Answer: Regulatory and supervisory authority (RSAs) are expected to commence implementation of this standard in their jurisdictions from end-2020, except for the disclosure requirements as contained in the table under Paragraph 16 of the standard.

Please note that when an IIFS is under a transitional arrangement permitted by IFSB standards and does not already comply with the fully loaded requirements, the transitional data should be reported. IIFS should clearly state whether reported figures are computed on a transitional or fully loaded basis.

Q2. Does the standard gives options for IIFS to report their disclosure requirements in a format or documents different from the regulatory stand-alone disclosure document required by the standard?

Answer: Yes, the standard has given IIFS the option to report using a stand-alone disclosure documents. However, IIFS must ensure that the information disclosed must comply with the requirements of Paragraphs 22 to 24 of the standard.

Q3. What does the standard mean by “comply or explain” basis? In addition, could you provide some instance where it could be applied?

Answer: “Comply or explain” is a regulatory and supervisory approach that requires entities to comply with an extant regulation or explain the reason for the inability of the entity to comply with the requirement. The comply or explain approach is applicable to a situation where the observance of any of the component of the disclosure requirements is not feasible due to either is not applicable to the concerned IIFS or because the necessary data are not available. In situation like this, the concerned shall be required to clearly and adequately explained

Q4. The standards seems to consider the funds provided by the Investment Account Holders (IAH) as part of an IIFS equity capital as presented in Paragraph 45. Could there be any rationale to doing that?

Answer: The IFSB in a number of its standards and other publications, has unequivocally, stated that the fund provided by the IAH is not to be considered as part of the equity capital of

the IIFS, and this standard is not an exception. The reference to the word “equity” of the IAH does not imply that such amounts are part of the bank’s own (shareholders’) capital. By virtue of the Muḍārabah contract, IAH share profits earned on assets financed by their funds with the bank as Muḍārib, and are exposed as Rabb al-māl to losses on assets financed by their funds. Thus, they are in principle a type of equity investor, rather than a creditor. By virtue of the general principles that the fund of IAH is loss bearing, there is the need to clearly provide disclosure on the funds invested by the IAH and the related prudential reserves (if any). In the event of impairment of the assets that results to losses, it will be transparent as to what amount of loss is attributed and borne by the IAH.

(Paragraph 45, Footnote 12 and Template 1)

Q5. Row 1 of template 2 require the disclosure of credit risk under the standardised approach that included credit risk exposure to restricted and unrestricted profit sharing investment account (PSIA). In the same template, row 15 requires for the disclosure of credit and market risk exposure for restricted and unrestricted PSIA. This seems like a repetition of disclosure and will like to understand the rationale if any?

Answer: Row 1 and 11 of the template require the disclosure of total credit and market risks exposure, respectively, of IIFS and the PSIA. The rationale is, among others, to give a comprehensive view of the credit and market risks exposures in the books of the IIFS. This will give information on the total assets manage by the IIFS that are exposed to credit and market risk. Having a holistic view of the total assets will assist the users of the information to appreciate the exposures and also understand the basis upon which the IIFS makes provisions and other mitigating controls for the risks. On the other hand, row 15 provide information on PSIAs exposure to credit and market risk, which in principle, it should be borne by the IAH.

Q6. The disclosure requirement in row 1 and row 2 of template 6 are confusing as they tend to require IIFS to disclose the same information, what precisely is the different information they require?

Answer: Template 6 is about disclosing information on capital distribution constraints. This information is to notify the market participant for a possible restriction on capital distribution imposed on an IIFS for the failure to meet regulatory capital ratios. The template discloses IIFS CET 1 capital ratios that would trigger capital distribution restrictions, when the actual capital ratios falls below the required minimum. On one hand, the template requires the disclosure of **minimum CET 1 capital ratio** and on the other **minimum regulatory capital ratio**.

Row 1 considers only CET1 capital used to maintain minimum CET1 capital ratio, applicable risk-based buffer requirements (i.e. CCB, CCyB and additional capital requirements for D-SIBs) and any CET1 capital required by the applicable supervisory review process (SRP)

standards. While row 2 discloses information on CET1 capital used to meet regulatory minimum capital ratios (e.g. CET1 capital used to meet minimum tier 1 and/or total capital requirements) in addition to risk-based buffer requirements and any CET1 capital required by the applicable SRP standards. National supervisor may wish to add more rows to accommodate other national requirement that would trigger capital distribution constraints.

Paragraph 68 provides a numerical illustration on how IIFS would disclose their CET1 capital ratios based on the requirement of Template 6. This illustration reproduced here and it assumes that, an IIFS that has a CET1 capital ratio of 12%, currently meets the IFSB-15 minimum CET1 ratio requirements of 4.5%, has a CCB of 2.5% CET1, a CCyB of 2% and uses CET1 capital of 1% of its RWA to meet its minimum of 6% tier 1 capital ratio. The IIFS, in this scenario, will disclose a capital distribution trigger of 9% (being 4.5% + 2.5% + 2%) in row 1, which does not consider CET1 that the IIFS has used to meet other regulatory minimum capital requirement (tier 1). The capital distribution trigger disclosed in row 2 will be 10% (4.5% + 2.5% + 2% + 1%), reflecting the true trigger by incorporating CET1 capital that the IIFS has used to meet its minimum tier 1 capital requirement.

If the ratio disclosed in column (b) is higher than the minimum requirements in column (a), users of data disclosed in this template will know that capital distribution constraints are not triggered for this IIFS. And if the reverse is the case, the users of the data will be able to appreciate the justification for the restriction on capital distribution.

(Paragraphs 64-68 and Footnote 23)

Q7. For the disclosure requirement relating Templates 8 and 9, what will be the treatment in the event that an IIFS restates its prior accounting balance sheet, does the IIFS needs to restate the prior year reconciliation templates?

Answer: The requirement to keep an archive of a minimum period also applies to the reconciliation template. As such, any prospective/retrospective restatement of the balance sheet would require similar amendments to be reflected in the reconciliation templates within the archive with a clear indication that such a revision has been made. In a situation where this is not feasible, the IIFS shall be required to disclose the challenge and provide satisfactory explanation to the users of the information.

Q8: What will be the treatment when an item attracts capital charges according to more than one regulatory risk category, and how possible is it to ensure that the reconciliation of some of the relevant columns?

Answer: Where a single item attracts capital charges according to more than one regulatory risk category, Paragraph 73 provides that the item should be reported in all regulatory risk

categories for which the item is subject to capital charges. Accordingly, the horizontal sum of amounts in columns (c)–(g) may not equal amounts in column (b).

Q9. Does the disclosure in row 3 (total net amount under regulatory scope of consolidation) relate to accounting equity?

Answer: No it does not. The netting between assets and liabilities in Template 9 does not lead to accounting equity under a regulatory scope of consolidation being disclosed in row 3, as this does not capture the entire assets of the IIFS. Assets and liabilities included in rows 1 and 2 are limited to those assets and liabilities that are taken into consideration in the regulatory framework. Other assets and liabilities not considered in the regulatory framework are to be disclosed in column (g) in Template 8 and are consequently excluded from rows 1 and 2 of Template 9.

Q10. In the event of smoothing practice by an IIFS and the accumulation of Profit Equalisation Reserve (PER) and Investment Risk Reserve (IRR), what is the treatment for the disclosure requirement for these reserves.

Answer: The standard provides that IIFS should disclose the policies and rules governing the transfer of funds to or from PER and IRR. This includes disclosure of the treatment of PER and IRR funds when IAH terminate their contractual relationship with the IIFS. Furthermore, where PER and IRR are kept separately for unrestricted and restricted PSIA, then movements in each of these reserves must be disclosed separately in Table 8 and Table 9, respectively. If, however, PER and IRR are kept for both unrestricted and restricted investment accounts without segregation, then transfers to and from these reserves must be made by account category.

(Paragraph 81, Rows 5, 12, 13, 15 and 16 of Table 8; Rows 6, 10, 11, 12, 14, and 15 of Table 9; and footnote 30)

Q11. In view of the unsophisticated nature of retail investors, who mostly lack investment knowledge and the skills to comprehend some of the information in the disclosure documents, what are the provision of this standard to address this important issue?

Answer: The standard has recognized this challenge that some retail investors lack the required skills to comprehensively understand the information disclosed by the IIFS and in view of which the standard requires IIFS to provide simplified disclosures in plain language in the account opening forms, or in product disclosure sheets, product highlight sheets or key investors information documents, and in stakeholder reports so that investors are provided with comprehensible and balanced information on which to base their investment decisions. Such retail investor-oriented disclosures shall be designed to be readily accessible and

reasonably easy to understand by investors who are not financial professionals. This will enable them to monitor the IIFS's performance as well as that of the fund managers, thereby contributing to market discipline. See the reference below for more details.

(Paragraphs 87-89)