

FAQ on IFSB-24:

Guiding Principles for Investor Protection in Islamic Capital Markets

Q1: IFSB-21 (Core Principles for Islamic Finance Regulation - Islamic Capital Market Segment) discusses investor protection in many of its principles. How does this standard (IFSB-24) differ from IFSB-21?

Answer: The Islamic Financial Services Board's IFSB-21 builds on a conventional standard that addresses, the safeguards that need to be in place to ensure investor protection, while considering the specificities for Islamic finance at a similarly high level found in the conventional standard. On the other hand, this standard (IFSB-24) deals with investor protection in more depth (yet in line with the IFSB-21) by addressing those areas where guidance is needed on Islamic finance specificities. It draws on and, where relevant, complements more detailed guidance contained in other IOSCO documents on specific areas relevant to investor protection. It also draws on international good practices as expressed in particular regulatory regimes, notably (but by no means exclusively) in the European Union under the Markets in Financial Instruments Directive (MiFID). Best practices in this standard are therefore largely intended to focus on areas where guidance is needed on Islamic finance-specific issues, while also includes some generally applicable provisions that need to be mentioned in order for the standard to provide a reasonably coherent investor protection framework.

Q2: What is the "misselling risk"?

Answer: Misselling risk occurs when financial instruments are sold to irrelevant client category or target market. Therefore, where firms offer Shariah-compliant financial instruments to clients, and in particularly complex products, regulators should require firms to ensure that: 1) products are designed to meet the needs of an identified target market within the relevant categories of clients, 2) that they undergo appropriate Shariah and product approval processes, and 3) that reasonable steps are taken to ensure that the financial instrument is distributed to the identified target market.

Q3: What does "product intervention" mean? And in which cases does it happen?

Answer: Product intervention can be used as a tool by regulators, together with product governance obligations, to prevent any risks to investor protection, including significant Shariah

compliance issues, if they have been identified by the regulator. Regulators may undertake temporary product intervention measures where a product claimed as Shariah-compliant creates a significant investor protection concern.

Q4: “Suitability Assessment” and “Appropriateness Assessment” sound quite similar. What are the main differences between them?

Answer: To undertake **suitability assessments**, a firm offering investment advice or portfolio management services in Shariah-compliant instruments should be expected to obtain the necessary information in relation to:

- a. The client or potential client’s knowledge and experience in the ICM and Shariah-compliant instruments and services;
- b. The financial situation of the client, including the ability to bear losses; and
- c. The client’s investment objectives, including risk tolerance and preference for Shariah-compliant investments.

Where the **appropriateness assessment** applies, a firm may be required to seek information from a client on his/her ability to understand the risks of a specific type of Shariah-compliant investment product or service (i.e. the knowledge and experience of the client about this particular product or service). This is to enable the firm to determine whether that investment product or service is appropriate for the client or not. Moreover, unlike the requirements for suitability, there are no specific requirements to assess the client’s financial situation or investment objectives.

Q5: Are professional/sophisticated/institutional investors supposed to go through any suitability/appropriateness assessment?

Answer: There should normally be an assessment of the suitability or appropriateness of an investment for a particular retail client by the firm, whereas professional/sophisticated or institutional clients are assumed to have the necessary experience and knowledge to understand the risks involved in relation to particular Shariah-compliant investments or transactions. This does not, however, preclude the application of suitability or appropriateness assessments for these category of investors (usually more limited assessments than those for retail investors).

Q6: Is investment education necessary for non-retail investors who are usually experienced and have more financial knowledge?

Answer: Investor education efforts should generally target existing and potential investors who lack experience or financial sophistication, as well as those investors who have limited knowledge of Islamic finance and the ICM. The focus of investor education and financial literacy programmes might be on improving retail investor knowledge of basic core competencies for investing in the ICM, and on raising awareness and promoting understanding of the types of Shariah-compliant investment products and services that are available.

Q7: How do investor education and financial literacy programs differ from promotional materials provided by ICM entities, since both of them aim at raising the financial knowledge of the investor?

Answer: Unlike promotional materials, investor education and financial literacy programmes should be developed to meet the needs of specific audiences. Such programmes are usually most effective when based on particular retail investor segments – for example, age, life event, risk or behavioural profile, or level of financial knowledge. The focus of investor education and financial literacy programmes may be on improving retail investor knowledge of basic core competencies for investing in the ICM, and on raising awareness and promoting understanding of the types of Shariah-compliant investment products and services that are available.

Q8: What appropriate systems and mechanisms for monitoring ex-ante and ex-post Shariah compliance ensure?

Answer: Such systems and mechanisms can help ensuring the following:

- a. Consistent compliance with Shariah rules and principles in the daily operations of the firm;
- b. Any products offered to clients have gone through appropriate Shariah approval and/or screening processes;
- c. Periodic reviews of Shariah compliance status; and
- d. Purification of any tainted income.

Q9: What a designated Shariah compliance function or officer is responsible for monitoring?

Answer:

- a. Day-to-day compliance with Shariah principles of all products and services offered by the firm that are marketed as Shariah-compliant;
- b. Day-to-day compliance with Shariah principles of all the firm's relevant internal operations related to the provision of financial services, where the firm presents itself to be Shariah-compliant; and
- c. Where relevant, the implementation of any specific fatwa (resolutions) issued by the Shariah board/adviser.

Q10: How can a firm ensure Shariah-compliance of a product?

Products offered by a firm should undergo approval by a competent Shariah board/adviser and/or a Shariah screening process (for relevant products), which should be in conformance with the concerned jurisdiction's centralised Shariah guidelines (if applicable and available). The Shariah screening methodology and criteria and the relevant fatwa (resolution) issued by the Shariah board/adviser should be transparent and made available to investors in an easily understandable format.