



ISLAMIC FINANCIAL SERVICES BOARD

EXPOSURE DRAFT TN-4
TECHNICAL NOTE ON RECOVERY AND
RESOLUTION FOR INSTITUTIONS OFFERING
ISLAMIC FINANCIAL SERVICES

*Comments on this Exposure Draft should be sent to the
IFSB's Secretary-General no later than 29 December 2021 at
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15 November 2021

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The IFSB is an international standard-setting organisation which was officially inaugurated on 3 November 2002 and started operations on 10 March 2003. The organisation promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include the banking, capital markets and insurance sectors. The standards prepared by the IFSB follow a lengthy due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which includes issuing exposure drafts, holding workshops and, where necessary, organising public hearings. The IFSB also conducts research and coordinates initiatives on industry-related issues, and organises roundtables, seminars and conferences for regulators and industry stakeholders. Towards this end, the IFSB works closely with relevant international, regional and national organisations, research/educational institutions and market players.

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ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AT1	Additional Tier 1
CAR	Capital adequacy ratio
CET1	Common Equity Tier 1
CMG	Crisis management group
DI's	Deposit insurer's
D-SIB	Domestic systemically important bank
FDIC	Federal Deposit Insurance Corporation
FSB	Financial Stability Board
GFC	Global Financial Crisis
G-SIB	Global systemically important bank
G-SIFI	Global systemically important financial institution
IAH	Investment account holders
IFSB	Islamic Financial Services Board
IFSI	Islamic financial services industry
IIFS	Institutions offering Islamic financial services
IRR	Investment risk reserve
KA	Key Attributes
PER	Profit equalisation reserve
PONV	Point of non-viability
PSIA	Profit-sharing investment account
PSIFIs	Prudential and Structural Islamic Financial Indicators
RR	Recovery and resolution
RRP	Recovery and resolution planning
RSA	Regulatory and supervisory authority
RWAs	Risk-weighted assets
SIFIs	Systemically important financial institution
SNCR	Sharī'ah non-compliance risk
T2	Tier 2
TDI	<i>Takāful</i> deposit insurer
TDIF	Sharī'ah -compliant deposit insurance funds
TLAC	Total loss-absorbing capacity
TNRR	Technical note on recovery and resolution for institutions offering Islamic financial services
UPSIA	Unrestricted profit-sharing investment account

SECTION 1: INTRODUCTION

1.1 Background: The Need for a Technical Note on Recovery and Resolution (TNRR) for Institutions offering Islamic Financial Services (IIFS)

1. The global regulatory standard setters have developed the core principles for an effective framework for recovery and resolution (RR) of systemically important financial institutions (SIFIs) as part of their responses to the Global Financial Crisis (GFC). The main objective of the RR framework is to preclude use of public or taxpayer resources to revive failed SIFIs (both global and domestic), and thus avoid incidences of moral hazard. The subsequent global regulatory reform agenda developed by the G-20 and the Financial Stability Board (FSB) underscored the importance of developing appropriate frameworks for recovery and resolution of stressed financial institutions, particularly those that are of systemic importance.

2. The issue of RR has been at the forefront of the global regulatory agenda. International standards for recovery and resolution of financial institutions have evolved since the GFC, culminating in the FSB's "Key Attributes of Effective Resolution Regimes for Financial Institutions". The FSB's Key Attributes (KAs) were aimed, inter alia, at providing a framework for the recovery or resolution of stressed SIFIs (both domestic and global), in an orderly manner, without severe systemic disruption or taxpayer exposure to loss from solvency support while maintaining continuity of vital economic functions. National frameworks for RR of stressed financial institutions have been developed globally.

3. The FSB's Key Attributes have been employed by regulators across multiple jurisdictions as a useful benchmark for establishing regulatory requirements for RR. The prime objective of RR, as enshrined by the FSB, is to enable banks and other financial institutions to restore viability through their own actions, obviating the need for intervention by public authorities, often using taxpayer funds, to enforce specific recovery and/or resolvability powers. Recovery plans include liquidity enhancement, other reorganisation, and restructuring concepts to restore financial strength and viability when the firm comes under severe stress. The resolution aspect of the framework is for authorities to be able to plan how best to resolve financial institutions without severe systemic disruption and without exposing taxpayers to loss, while protecting vital economic functions through mechanisms that make it possible for shareholders and unsecured and uninsured creditors

to absorb losses in a manner that respects the hierarchy of claims in liquidation and allowing banks and other financial institutions to fail, given the risks of doing business.¹

4. The absence of a Sharī'ah-based framework of proactive measures for dealing with stressed IIFS is one of the significant gaps in the regulatory regime for the Islamic financial services industry (IFSI). Within the wider financial stability framework of countries with a material presence of Islamic banking, there is a critical need to deal with any stressed IIFS in a prudent manner without compromising taxpayers in the economy, with the aim of preserving both economic and financial stability. It is particularly relevant to note that IIFS in many countries are large enough to qualify as domestic systemically important banks (D-SIBs) in their respective countries.

5. Since the RR framework was conceived as a critical element of the post-GFC crisis regulatory reform agenda to deal with failing D-SIBs and global systemically important banks (G-SIBs), the emergence of Islamic D-SIBs necessitates the development of regulatory standards for RR. In addition, due to the growing size and complexities of IIFS, the development of the TNRR is critical to ensure the successful implementation of RR for any stressed IIFS, including (but not limited to) that of an insolvent IIFS, and specifically to address various challenges related to Sharī'ah-compliant RR tools or measures. For example, the continued enforceability and Sharī'ah compliance of various Islamic contracts while being subject to RR measures such as asset sales is critical for IIFS. In such situations, there is a need for harmonisation of the applicable legal framework (common and civil law) with the Sharī'ah governance framework.

1.2 Main Objectives of the TNRR

6. The primary objective of the TNRR is to facilitate the relevant regulatory and supervisory authorities (RSAs) and other related authorities to establish an effective RR framework, and appropriate tools for its effective implementation, for IIFS in a manner that is fully compliant with Sharī'ah principles. The foregoing primary objective of the TNRR subsumes the following constituent objectives:

- a. to set out the essential measures to carry out effective recovery and resolution planning (RRP) for all IIFS;
- b. to support and enable effective resolvability assessments critical for the IIFS;
and
- c. to ensure Sharī'ah governance in relation to the RR framework for IIFS.

¹ Refer to IFSB, WP-07: *Recovery, Resolution and Insolvency Issues for Institutions offering Islamic Financial Services*.

1.3 Scope of the TNRR

7. The TNRR is primarily intended to facilitate the establishment of effective RR frameworks for the IIFS sector as part of the firm-level regulation of full-fledged (i.e. separately incorporated) banks, including both D-SIBs and non-DSIBs. These IIFS include, but are not limited to, commercial banks, investment banks and other fund-mobilising institutions, as determined by the respective supervisory and related authorities, that offer services in accordance with Sharī'ah rules and principles.

8. The scope of the TNRR also includes Islamic banking “windows” (IBWs), which are part of a conventional financial institution (either a branch or a dedicated unit) while providing financial services in a fully Sharī'ah-compliant manner. They are not separate legal entities and do not have their own balance sheet or ability to own or owe their assets or liabilities. Their assets and liabilities are reported within the accounts of the conventional financial institution of which they form a part.² The coverage of IBWs in this document reflects the “proportionality” aspect, taking into account their nature, size, operations, legal form and complexity.

1.4 Approach of the TNRR

9. The TNRR adopts a supplementary approach by supplementing the FSB’s Key Attributes. This approach aims to provide complementary standards and information addressing the idiosyncrasies of Islamic finance and Sharī'ah compliance requirements applicable to each KA. The TNRR aims to address all types of IIFS as defined in section 1.3 on the scope of the TNRR.

10. In addition to providing supplementary information and complementary standards to the KAs, the TNRR intends to provide guidance and standards addressing the Sharī'ah specificities in relation to the high-level RR framework and the recovery planning process for the IIFS, which are not covered in the FSB’s KAs.

1.5 Pre-Conditions for Effective Recovery and Resolution of IIFS

11. In order to implement an effective RR framework in any jurisdiction, a set of pre-conditions needs to be established. These pre-conditions are outlined in the FSB’s methodology for assessment of the effectiveness of an RR framework in any jurisdiction.

² It is important that IBWs be completely separate from their conventional parents in terms of their capital requirements and accounting for profit and loss, by ensuring that their operations are not intertwined with those of the parent. However, profits generated by the Islamic window in its capacity as *muḍārib* or *wakīl* can be transferred to the conventional parent in its capacity as the owner of the Islamic window.

12. Some of these pre-conditions may be beyond the direct remit or capabilities of RSAs or resolution authorities in a particular jurisdiction. It is essential for the various authorities, including government agencies, to coordinate adequately to ensure that these pre-conditions are met in an effective manner to ensure the success of their RR framework. The absence of some of these pre-conditions, or inadequate implementation of the pre-conditions, can gravely weaken the quality and effectiveness of the RR framework. The presence of the pre-conditions will have a positive impact, and weaknesses in those areas may have a negative one, on the effectiveness of resolution regimes.

13. The pre-conditions that are set out in the FSB's KAs are applicable mainly to the regulation and supervision of RR frameworks for IIFS. Pre-conditions that are specific to IIFS are defined in the following paragraphs.

1.5.1 Effective Sharī'ah-compliant protection schemes for investors in IIFS and other protected clients, and clear rules on the treatment of assets

14. Jurisdictions should also maintain arrangements to promote a high level of coordination and cooperation between protection schemes and other agencies that constitute the "safety net" to ensure clear allocation of responsibilities and accountability and effective crisis management. Jurisdictions should have in place clear Sharī'ah-compliant rules on how losses of IIFS in resolution are shared among various categories of their investors in the event of shortfalls in their pool of assets.

15. A robust Sharī'ah framework in a jurisdiction will facilitate the effective implementation of Sharī'ah-compliant deposit (or investor protection) schemes and treatment of assets. The authorities' treatment of protected depositors or investment account holders (IAH), depending on the jurisdiction's policies and laws, should also ensure their consumer protection. Such deposit protection may include coverage of current accounts offered by IIFS, depending on the scope of deposit protection offered in a particular jurisdiction.

16. Among other things, the framework should provide mechanisms for how the differing Sharī'ah opinions within a jurisdiction can be resolved to promote greater acceptability of Islamic finance practices and to avoid confusion and misunderstandings during the implementation.

1.5.2 Well-developed legal framework and robust Sharī'ah governance

17. Robust legal and Sharī'ah governance are essential infrastructures for ensuring certainty, clarity and consistency for transparent and predictable RR outcomes. It is

essential that the legal framework includes elements that enable the resolution authority to cooperate with relevant foreign authorities and to enter into institution-specific cross-border cooperation agreements between the relevant home and host authorities. The legal framework should provide for all the appropriate Shari'ah-compliant RR tools and options for the relevant authorities to make informed decisions about a distressed IIFS.

18. In addressing the Shari'ah specificities for IIFS, robust Shari'ah governance is important to ensure the RR measures and tools chosen for use by the relevant authorities are compliant with Shari'ah. This provides clarity and uniformity of Shari'ah interpretations on any Shari'ah matters arising from RR tailored for IIFS. It is expected that the legal and Shari'ah governance will be in harmony through codified laws or regulations in addressing the Shari'ah issues of RR in their respective jurisdictions.

1.6 Scope of the RR Framework for IIFS

19. Any IIFS that could be deemed as systemically significant by the relevant RSA, or by other authorities such as a financial stability oversight body or the central bank, should be subject to an RR framework that meets the essential elements and features described in this TNRR. The RR framework established by the RSA should be clear and transparent as to the IIFS covered under its scope and should extend to:

- a. holding companies of those IIFS;
- b. non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate; and
- c. branches of foreign IIFS or conventional banks, apart from branches in jurisdictions subject to a binding obligation to implement the RRP mandated by the home jurisdiction.

20. The RR regime established by the RSA should require IIFS to prepare recovery plans, and to be subject to resolution plans that are prepared by the RSAs. The RR regime should consider the following:

- a. establishing an RRP, including a group RRP, where applicable;
- b. that RRP are the subject of specific cross-border cooperation agreements between home and host authorities; and
- c. including periodic review by the relevant authorities that have power over the RR of IIFS.

21. The high-level framework for developing and implementing the RR for IIFS is described in Figure 1.1. The development and implementation of the RR framework is comprised of two phases: (A) preliminary analysis of RR; and (B) RRP processes. The detailed operationalisation of the RR framework for IIFS is discussed in **Annex A**.

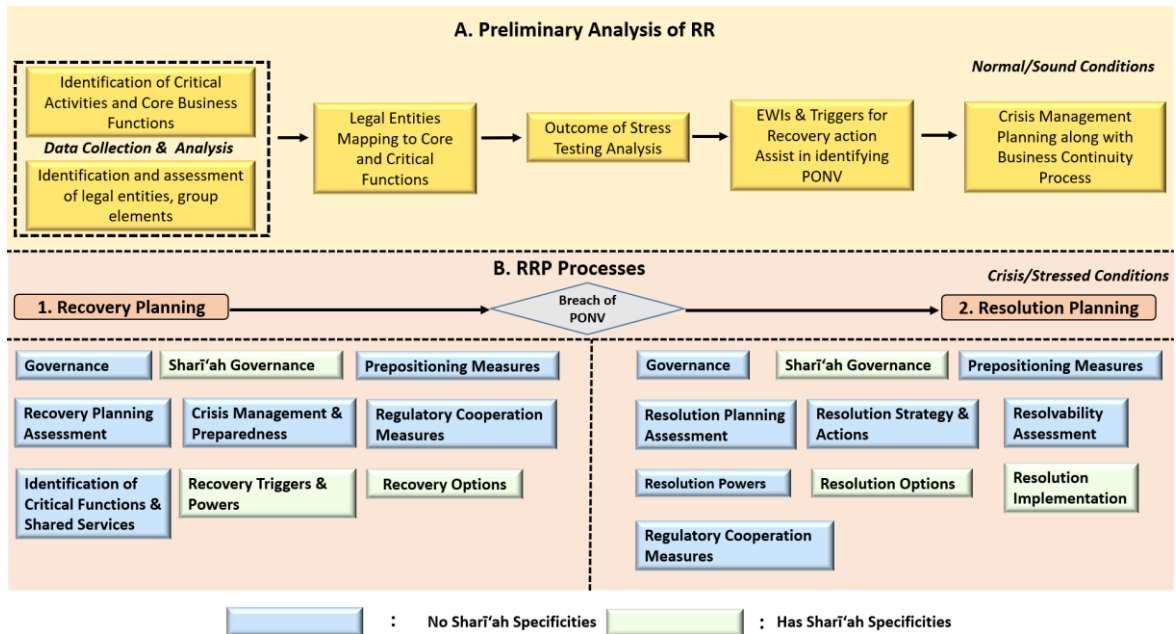


Figure 1.1: Diagram of Flow Framework of Recovery and Resolution Operationalisation Concepts for IIFS

SECTION 2: RECOVERY PLANNING FOR IIFS

2.1 Introduction

22. The core objective of recovery planning is to ensure that financial institutions are well prepared to respond promptly to, and to recover from, severe stress, by implementing pre-planned strategies that are in proportion to and suitable for the size, nature and structure of the stress.

23. Recovery planning should focus on the possible courses of action an IIFS may take in a range of stress situations in order to restore its financial strength and viability. Recovery plans detail the actions an IIFS needs to take to restore its capitalisation and liquidity to levels required for sound operations and to meet regulatory requirements. This would mean restoring its capital and liquidity positions to acceptable levels and staying well-funded in an adverse event or scenario.

24. Recovery planning for an IIFS should, at the minimum, contain information on its core business activities, critical functions, business group structures and interrelations with other group entities (including, but not limited to, financial institutions in the group), early warning indicators, and the recovery plan triggers. The IIFS should develop a variety of contingent funding and capital recovery actions to ensure that it can execute appropriate recovery actions while maintaining liquidity throughout the crisis horizon. The recovery options are comprised of, but not limited to, capital replenishment, liquidity enhancement and asset sales.

25. In proposing its recovery options, the IIFS should consider the risks involved in their execution. These include not only the risks to successful execution in adverse market conditions, but also the impact of each of the potential recovery tools (or options) on the business and risk profile of the IIFS, as well as on its ability to maintain its franchise viability and continue to implement its business strategy within its stated risk appetite. Detailed guidance on recovery planning for IIFS is provided in **Annex B**.

2.2 Sharī'ah Governance Framework

26. The RRP framework for the IIFS should ensure that its design, procedures, operations and ongoing monitoring mechanisms are all in continued compliance with Sharī'ah principles.

27. The Sharī'ah board within the IIFS should conduct its activities in an independent manner and facilitate the process of effective deliberations and Sharī'ah pronouncements in the preparation and activation of recovery planning. The Sharī'ah board should be

independent from the IIFS management so as to be able to resolve and decide any Sharī'ah issues and aspects arising from the recovery planning.

28. Senior management with responsibility for preparing, reviewing and updating the recovery plan should be informed and guided by the Sharī'ah board in order to ensure that the resulting recovery plan is in compliance with Sharī'ah principles. In addition, senior management and the Sharī'ah board should address the compatibility and compliance of all Sharī'ah contracts employed by the IIFS in relation to the recovery options identified as part of the recovery plan to deal with the stress scenarios. In order to ensure that the recovery plan fulfils Sharī'ah requirements, the Sharī'ah board must:

- a. advise on and guide the application of Sharī'ah requirements in the recovery options and other relevant components of the recovery plan;
- b. advise on and provide clarification of relevant Sharī'ah rulings, decisions or policy documents on Sharī'ah matters issued by the IIFS, and (if relevant) by any other authorities impacting, or which may impact, on the development and implementation of the recovery plan;
- c. identify the pre-positioning measures for various Islamic contracts that are required to implement a Sharī'ah-compliant recovery option; and
- d. give any Sharī'ah opinions and approvals, where necessary.

2.3 Idiosyncratic Issues or Challenges Faced by IIFS

29. The recovery planning process and the specific choices required to be made in formulating a recovery plan are riddled with unique issues and challenges, given their need to be fully compliant with Sharī'ah at all times. Such challenges include the following:

- a. Challenges in using the recovery options of asset sales in IIFS (*as discussed in sections 2.4.1 and 2.4.2 below*):
 - i. Sharī'ah compliance of sale/transfer of debt-based contracts such as *murābahah* at a discount (below par value), given the predominance of debt-based contracts in IIFS systems;
 - ii. plausibility of conventional financial institutions purchasing assets based on debt-based contracts, given the need to maintain the Shariah compliance of the assets; if not plausible, what kinds of conditions can be imposed on the buyer to facilitate continued Sharī'ah compliance;
 - iii. asset sales contracts should be Sharī'ah-compliant and have been tested under

a stressed scenario; and

- iv. asset sales and/or transfers to conventional entities are possible only under a guarantee of continued Sharī'ah compliance in respect of management of the assets sold/transferred.
 - b. Challenges in the ability of a non-Islamic buyer to continue to ensure Sharī'ah compliance and maintaining the Sharī'ah animation of IIFS contracts and assets (*as discussed in sections 2.4.1 and 2.4.2 below*).
 - c. Challenges in transferring profit-sharing investment account (PSIA) schemes to other IIFS as the new *muḍārib* (*as discussed in section 2.4.2*).
 - d. Determination of the extent of loss absorbency of IAHs in an unrestricted PSIA (UPSIA) scheme, considering the policy of the relevant government to provide financial safety net protection to investments in UPSIA. Availability of specific policy direction from the government on recovery support for investments in UPSIAs (*as discussed in section 2.4.2*).
 - e. In the case of an IIFS seeking group support as a recovery option or in a crisis from a conventional parent, permissible types of support structures and contracts (*as discussed in section 2.4.3*).
 - f. Challenges of financial incentives by using *qarḍ ḥasan* as a recovery tool in offering liquidity support to a subsidiary, as *qarḍ ḥasan* is not allowed to repay any compensation, which results in no return or compensation to the provider (*as discussed in sections 2.4.3 and 2.4.4*).
30. The presence of Sharī'ah non-compliance risk (SNCR) is identified on the basis of the underlying contracts applied, despite the fact that Sharī'ah non-compliance events may occur on various occasions and in various forms. A Sharī'ah-compliant contract is deemed valid and effective if all the essential elements and the requirements of the contract are fully satisfied. Generally, there are five essential elements in a Sharī'ah-compliant contract – namely, two contracting parties, subject matter (asset and price), and offer and acceptance. Each essential element requires several conditions to be met.³
31. SNCR can lead to non-recognition of an IIFS's income and resultant losses, resulting in an adverse impact on the profitability and capital position of the IIFS. More importantly, SNCR arising from failure to ensure compliance with Sharī'ah may result in impairment of the franchise value of the IIFS concerned and of the trust it enjoys with its customers, both

³ Refer to IFSB WP-5: *Shari'ah Non-Compliance Risk in the Banking Sector: Impact on Capital Adequacy Framework of Islamic Banks*.

of which are critical success factors for any IIFS. SNCR can take two broad forms in IIFS: (a) risks relating to potential non-compliance with Sharī'ah rules and principles in the IIFS's operations; and (b) the risk associated with the IIFS's fiduciary responsibilities as *mudārib*, *wakil* or *musharik* towards fund providers under the *muḍārabah*, *wakala* or *musharakah* forms of contracts, according to which, in the case of misconduct or negligence by the IIFS, the funds provided by the fund providers become a liability of the IIFS. *Sukūk* structures may also be exposed to SNCR, which may adversely affect their marketability and liquidity and, hence, their value.

32. The Prudential and Structural Indicators for Islamic Financial Institutions (PSIFIs) database could be useful in identifying quantitative indicators for triggers and to monitor the progress of the recovery.

33. Among many others, the quantitative indicators that can be useful at the recovery stage are:

- a. capital adequacy ratio (CAR) with the Islamic Financial Services Board's (IFSB) formula;⁴
- b. income distributed to IAHS out of total income from assets funded by PSIFIs;
- c. alpha, defined as the proportion of the IAHS's funds used to finance the asset side of the IIFS that is exposed to market and credit risks.⁵

34. Useful qualitative indicators are:

- a. accounting treatment that recognises the unique aspects of IIFS products and services;
- b. the type of asset claims and possession of the assets; and
- c. the contractual terms and covenants of unrestricted profit-sharing investment account holders (PSIFIs) and possible early redemptions.

2.4 Recovery Options

35. A recovery plan should be assessed against appropriate stress scenarios and according to its fulfilment of Sharī'ah principles within the Sharī'ah respective jurisdiction's

⁴ Although not all IFSB members have implemented the CAR ratio with the IFSB standard, there is an urgency surrounding implementation of the CAR calculation based on RCAS due to the alpha factor arising from the impact of the existence of a profit/risk-sharing contract.

⁵ See IFSB, GN-4: *The Determination of Alpha in the Capital Adequacy Ratio for Institutions (other than Insurance Institutions) offering only Islamic Financial Services*.

Sharī'ah framework. Such assessments should form a significant input to assessing the credibility of the IIFS's recovery plan.

2.4.1 Asset sales

36. Sales of assets help in the recovery of capital adequacy by reducing the risk-weighted assets (RWAs) of the IIFS, and also strengthen the liquidity position with cash flows realised from asset sales. Such distressed sales are done with the understanding and acceptance that haircuts will need to be taken against the market value of such assets. The recovery plans should attempt to assess and indicate the extent of an expected haircut on the value of assets identified for this option. Such assessments can be made through historical data analysis of the relevant marketable asset in terms of trading volumes and price trends.

37. Given that a vast majority of the assets of an IIFS are *murabahah* financing, asset sales are one of the easiest options for an IIFS in stress. Given the Sharī'ah restrictions that prohibit selling financing contracts at a discount or a premium and the sale of debt for cash, an IIFS trying to recover its capital position through distressed asset sales will not be able to sell its assets except through transfer (*hiwalah*) at full face value. In a scenario where the IIFS is implementing its recovery plan, it is not likely to find any interested buyers of those *murabahah* financing assets at full face value, making asset sales an infeasible option. Therefore, RSAs need to consider the implications of these Sharī'ah restrictions on the feasibility of using asset sales as a recovery tool.

38. Another contract is a *hasm sila'* (asset discount through a commodity-based contract) in which,⁶ under a stress scenario or *darurat* situation, a bank may exchange its financing for a commodity. If this transaction is not pre-planned, such a recovery option is more likely to be acceptable under Sharī'ah. The transaction has to be supported by the IIFS's estimated cash flow realisation as a result of selling the commodity received in exchange for its assets in the open market, which may also be subject to distressed haircut conditions.

39. An added complexity with this recovery option may relate to the identifiable purchasers (which might be a conventional institution) of an IIFS's assets/business units. According to the IFSB's PSIFIs data, IIFS assets across a range of jurisdictions are heavily concentrated in three economic sectors: real estate financing, vehicle financing activities, and other household financing. It is plausible, therefore, that a market-wide stress event may well impact all IIFS in a particular jurisdiction with the same degree of severity. If this is the case, all IIFS may be trying to sell their assets at the same time in order to recover

⁶ The contract is still debatable among the *madhāhib* and jurisdictions regarding its contract permissibility.

their capital positions. RSAs also have the role of considering such risk concentration issues when developing a recovery and resolution framework for the industry.

2.4.2 Pre-positioning measures for asset sales

40. In order for an asset sale to be considered as a feasible resolution tool, measures should be taken by the IIFS to identify those of its assets that can be sold to external counterparties in full compliance with the Sharī'ah principles as approved by the Sharī'ah board. In addition, the measures should ensure that the prospective acquirer is in a position to sustain the Sharī'ah compliance of the asset being sold, unless the original borrower of that asset has contractually agreed to give up on that requirement. The role of the RSA is to assess whether such pre-positioning measures are feasible and would stand the test of Sharī'ah compliance, apart from the issue of realising the value of the asset in a stressed market scenario.

41. It is essential that the relevant Sharī'ah boards, whether centralised or at the IIFS level, decide on the permissibility of the asset sales and under what terms and conditions. Such an a priori dispensation would enable the IIFS to consider such tools as part of their recovery plans. Successful completion of such a Sharī'ah opinion and consequential actions to pre-position all credit contracts for potential asset sale would make such an asset sale a feasible tool for the purpose of the recovery plans.

42. RSAs will need to consider whether an IIFS can sell or transfer its assets to a conventional buyer or counterparty in a stress event, particularly if no Sharī'ah-compliant buyers are available. This issue gains importance due to the fact that the acquirer of the financing, and consequently the relationship with the IIFS's client, must be capable of sustaining the full Sharī'ah compliance of that financing or transaction. Such transactions have to be referred to respective Sharī'ah boards to elicit their opinion on an a priori basis, so that the feasibility of such tools as part of an RRP can be clearly determined and assessed.

43. With respect to the PSIA treatment, there are challenges in transferring PSIA schemes to other IIFS as the new *muḍārib*, for the following reasons:

- i. the ability to bifurcate the commingled assets of an unrestricted PSIA scheme and to identify the portion belonging to the Islamic bank for pricing;
- ii. the need to obtain the consent of the IAH for the pricing and other terms of the transfer of the PSIA belonging to IAH to the new *muḍārib* to replace the first one;

- iii. provision for the IAH to perform their due diligence on the potential buyer as the new *muḍārib*, both from financial and conduct perspectives; if there is a large body of IAHs involved, approval may need to be determined by a general meeting of IAHs or by the Investment Advisory Committee for that PSIA; and
- iv. questions around coverage or eligibility of PSIA investments for any kind of support from the group or resolution.

44. The extent of loss absorbency of IAHs in an UPSIA scheme should be determined, considering the policy of the relevant government to provide financial safety net protection to investments in UPSIA. Specific policy direction from the government on recovery support for investments in UPSIAs should be formulated during the recovery phase.

2.4.3 Group capital support

45. In financial groups, a failure of, or a stress event in, one part of the group is likely to lead to contagion and contamination of the rest of the group. There are different models for how banking groups manage their liquidity and capital; this can be either centralised (i.e. in the parent) or decentralised (every subsidiary is responsible for its own capital and liquidity as per its local market). In a stressed situation, a subsidiary may look to its group/parent for support.

46. There are two Sharī'ah aspects that need to be considered by IIFS: (a) the nature and type of support structures and contracts that are permissible, and their effects; and (b) the complexities associated with having an Islamic subsidiary that is part of a conventional banking group.

47. In terms of structures and contracts that can support a group member or subsidiary, a variety of contracts can be structured by the IIFS, subject to Sharī'ah regulation at respective jurisdictions:

- a. ***Qarḍ ḥasan (benevolent loan)***: This facility downstreams liquidity to a subsidiary without any interest payment or compensation. In a stress event, *qarḍ ḥasan (qarḍ)* may also be used to provide liquidity support to a group member. For RSAs, there should be awareness of the risk being placed on the *qarḍ* provider and an assessment of any possible group contagion effects. Subject to supervisory and Sharī'ah judgments, subordination makes the recovery option more akin to capital investment, whereas normal *qarḍ* provisions, which establish the provider as a normal unsecured creditor, are seen more as a bridge funding tool, depending on maturity.

- b. ***Tawarruq (commodity-based murābahah)***: Depending on the respective Sharī'ah board's jurisdiction, this mechanism could be utilised as a liquidity support mechanism from the parent bank to their subsidiary bank through the tripartite sale arrangement with the commodity, such as palm oil or metal, that may be varied based on the jurisdiction's practices. This contract, if pre-agreed and with defined trigger points, can provide funding support to an entity in stress and help it to recover at least its liquidity position.
- c. ***Equity participation through a mushārah or muḍārah contract***: This mechanism is the most permanent and robust form of intragroup support through injection of capital from the parent bank to their subsidiary institutions with the defined investment purposes. For doing so, the parent bank has to define in the recovery plan a pre-arranged equity injection as a recovery option with clear terms and conditions.

2.4.4 Sharī'ah pre-positioning measures for group capital support

48. RSAs need to devote careful consideration, when constructing their recovery plan, to possible solutions provided by the respective Sharī'ah board if, in the end, the parent bank resorts to conventional financing methods specifically to help save an entity in a stressed situation using *ḍarūrah* principles. Where a conventional parent has an Islamic subsidiary, it needs to consider using Sharī'ah-compliant downstream support methods. Such structures will not be used in business-as-usual circumstances by any conventional entity; however, RSAs may wish to explore having them as a “back-up” recovery mechanism in the wider RRP framework.

49. For *qard ḥasan*, IIFS have to coordinate with their Sharī'ah board, on a proactive basis, to resolve the Sharī'ah issues of compatibility of the contract in relation to the subordination of the funds provided in loss absorbency if the IIFS were to eventually move into the resolution phase.

50. If the parent is in a different jurisdiction from the subsidiaries, then the home and host authorities, including the Sharī'ah board, should coordinate to have a binding agreement to resolve the operationalisation of group capital support that complies with the Sharī'ah requirement.

51. This pre-positioning measure is equally relevant to recovery tools proposed to employ *tawarruq* contracts, as they suffer from the same conflict between the intended objective of the contract and its expected outcome. In these cases, the contract documentation updated to incorporate the necessary pre-positioning measures (or clauses)

has to be approved by the Sharī'ah supervisory board on an a priori basis. On receiving Sharī'ah approval, the contract documentation should be used to update all credits of that IIFS based on *tawarruq*. If these pre-positioning measures are not completed, use of this recovery tool must not be considered as part of the approved recovery plan.

2.5 Regulatory Cooperation Measures

52. The entire content of FSB KA 12, setting out the detailed standards and guidance in respect of regulatory cooperation measures, can be applicable to the supervision and regulation of IIFS as well as to their RRP frameworks.

SECTION 3: RESOLUTION PLANNING AND IMPLEMENTATION

3.1 Introduction

53. The resolution planning process is intended to facilitate the development of effective and credible resolution plans that would clearly specify the use of chosen resolution tools and strategies by the relevant authorities, as and when needed. Resolution planning involves relevant RSAs and resolution authorities devising a high-level resolution strategy for an IIFS, which will subsequently be converted into an operational plan for resolution. This process requires IIFS-specific data from the relevant IIFS and the RSAs on its various idiosyncratic factors in order to provide the resolution authority with the necessary information for devising an appropriate and customised resolution strategy.

54. A resolution plan and its component tools can be executed only by the authorities that have power to do so and have the policy objectives of precluding use of taxpayers' money and preserving financial stability. A credible resolution plan should, at the least, contain detailed information on the chosen resolution strategy, a resolution trigger in the form of a point of non-viability (PONV), pre-positioning requirements, and the chosen resolution tools to execute a controlled winding-up process.

55. The resolution plan may also include information to be considered and the criteria to employ in deciding on the choice of specific resolution tools in the context of various Sharī'ah aspects of the specific IIFS. The relevant resolution authority should decide on the range of resolution tools for executing the resolution plan, depending on the various aspects of the IIFS in terms of its strategy, business functions and risk appetite. The decision on the resolution plan should be communicated clearly to the national Sharī'ah council or Sharī'ah board in the respective jurisdiction in order to ensure its compliance with Sharī'ah principles. Detailed guidance on resolution planning and implementation for IIFS is provided in **Annex C**.

3.2 Governance Framework

56. FSB KA Annex 4 sets out the detailed standards and guidance in respect of the governance framework for RSAs or resolution authorities, IIFS, and cross-border coordination that can be applicable to IIFS and their resolution planning framework.

3.3 Sharī'ah Governance Framework for Resolution Planning

57. The resolution planning framework should include requirements for the crisis management groups (CMGs) of an IIFS covered by it, to coordinate with the respective

national Shari'ah council in order to ensure that the resolution plan and its implementation are in full compliance with national and Shari'ah laws and are not characterised by conflicts. The CMG's decision-making process for implementing resolutions has to be clear and aligned with that of the respective national Shari'ah council in terms of incorporating Shari'ah views as part of the RRP process for any IIFS.

58. In the dual banking system context, the existing legal frameworks for conventional banking and financial services have to interweave with Shari'ah law to recognise Islamic financial transactions, due to their nature as trade and investment vehicles. Despite the many constraints that may be expected if a country's general laws are to be applied directly to Islamic financial transactions, resulting in potential conflicts and adverse legal effects, the authorities should endeavour to harmonise the requirements of Shari'ah law with the prevailing legal system through the adjustment and management of conflicts between the conventional and Islamic legal principles.

59. In the event that a conflict is not resolved among the authorities, there could be potential conflicts between the two distinct legal systems⁷ that could affect the enforcement of Shari'ah contracts in any jurisdiction. In particular, a paradox between Shari'ah law and secular law, covering common law and civil law, ceases to exist where the former is sacrificed to accommodate the latter. Therefore, enforceability of contracts under Shari'ah law is important for resolving an insolvent IIFS, particularly in the event of a legal dispute during the settlement of asset sales and/or liquidation of investment IAH in relation to shareholders' interests.

60. The prevailing governance should ensure that the resolution planning process is in full compliance with Shari'ah principles in regard to the following aspects:

- a. the use of resolution tools: bail-ins, asset transfers, bridge banks and other tools must be Shari'ah-compliant, with pre-positioning measures required to be completed to ensure their Shari'ah compliance when they are employed;
- b. the treatment of assets funded by PSiAs and the rights of IAHs;
- c. the treatment of profit equalisation reserve (PER) and investment risk reserve (IRR) funds;

⁷ English common law and civil law each present distinctive problem when they collide with Shari'ah. The problem in using Shari'ah finance in a common law jurisdiction is the conflict that emerges between Shari'ah law and common law; the national law/common law always prevails over Shari'ah law when there are disputes. As a consequence, the contract is interpreted solely based on what is written in the contract in respect to Shari'ah regulations. On the side of civil law, one sees a lack of predictability, transparency and consistency. Full codification of law, which is needed for predictability, is not implemented in the countries under civil law regimes. Therefore, RSAs need to consider the conflict between the secular law and Shari'ah by giving Shari'ah precedence over the secular law should a conflict arise.

- d. Sharī'ah review of Islamic contracts used by the IIFS as part of resolvability assessment and consequent pre-positioning measures to prepare them for Sharī'ah-compliant resolution; and
- e. legal governance and enforcing Sharī'ah contracts in the resolution regime.

3.4 Set-Off, Netting, Collateralisation and Segregation of Client Assets

61. The entire content of FSB KA 4, setting out the detailed standards and guidance in respect of netting, collateralisation and segregation of client assets, can be adopted by IIFS and their resolution planning framework. In addition, complementary guidance is provided in this section to address the issues arising from Sharī'ah aspects of netting, collateralisation and segregation of client assets in relation to their treatment in resolution.

62. Additional guidance is provided to recognise the IIFS specificities whereby IIFS may often be involved in financial services activities wherein they may be holding, controlling or managing assets or investments belonging to their clients. For example, the IIFS may be managing the assets belonging to a pool of restricted PSIAs as a *muḍārib*. In most such cases, the IIFS would also be holding the assets or investments involved in safe custody. The assets held in that fashion do not belong to the IIFS involved and belong instead to its clients. Therefore, the segregation of those client assets needs to be maintained through a resolution process, and such assets cannot be included as part of the resolution arrangements.

3.5 Safeguards

63. The entire content of FSB KA 5, setting out the detailed standards and guidance in respect of safeguards, can be applicable to IIFS and their resolution planning framework. The safeguards addressed in KA 5 include those in respect of the creditor hierarchy and the “no creditors worse off” (NCWO) principle, and legal remedies and judicial action aspects. With respect to calculating the NCWO principle for the IIFS, there is a creditor hierarchy⁸ mechanism for IIFS to fulfil the Sharī'ah principles, as discussed in section 3.11.2 on asset and liability transfers and bridge banks.

3.6 Funding of Firms in Resolution

64. The entire content of FSB KA 6, setting out the detailed standards and guidance in respect of funding of firms in resolution, can be applicable to IIFS and their funding in resolution. In addition, complementary guidance is provided in this section to address the

⁸ See paragraph 84.

issues arising from Sharī'ah compliance issues arising from funding IIFS in resolution.

65. In order to facilitate temporary funding of IIFS in resolution, resolution planning frameworks need to be complemented by Sharī'ah-compliant deposit/investor protection arrangements or safety nets that are funded by Sharī'ah-compliant resolution funds or a funding mechanism with ex-post recovery of the costs of providing temporary funding. The provision of such funding support by relevant authorities should be Sharī'ah-compliant and subject to strict conditions that minimise the risk of moral hazard. It should be subject to:

- a. an assessment that the provision of temporary funding is essential to preserve financial stability and allow effective implementation of the prepared resolution plan to achieve an orderly resolution, and that private sources of funding have been exhausted or cannot achieve these objectives; and
- b. all the losses (including the operational costs or resolution) shall be borne by equity holders

3.7 Sharī'ah and Operational Issues Related to Resolution Options

66. In the process of developing a credible and effective resolution plan for an IIFS, the idiosyncrasies of the business activities and processes followed by the IIFS, and the overarching requirement to comply with Sharī'ah in respect of all their activities, leads to a series of significant challenges related to Sharī'ah and operational issues. They include (among others):

- a. doubts about Sharī'ah compatibility of bail-in capital – the bail-in concept of a mandatory debt write-down by a resolution authority (or about the sale/conversion of debt at below par value) (*as discussed in section 3.11.1*);
- b. need to ensure that current accounts held by IIFS are not subject to bail-in (*as discussed in section 3.11.1*);
- c. ability to clearly identify and value the assets or the share of assets belonging to PSIA holders for appropriate treatment as part of the resolution (*as discussed in section 3.11.2*);
- d. ongoing Sharī'ah issues with regards to debt write-downs, asset transfers and bridge banks (*as discussed in section 3.11.2*);
- e. the need to harmonise creditor hierarchies specified by the resolution regime with Sharī'ah (*as discussed in section 3.11.2*);
- f. questions around coverage or eligibility of PSIA investments for any kind of support from the group or resolution authority or deposit insurer; depends on

- public policy in each jurisdiction (*as discussed in section 3.11.2 and Annex C (6)*);
- g. challenges faced by IIFS in meeting their fiduciary duties to IAH (both unrestricted and restricted) during and after the resolution (*as discussed in section 2.3*);
 - h. uncertainty over the treatment of PSIAs based on a *muḍārabah* or *wakālah* contract, owing to the conflict between their contractual terms and the real risk-return profile sought by the investors, as suggested by the practice of profit smoothing (*as discussed in section 3.13*); and
 - i. the need to exclude restricted PSIAs from the resolution package or as part of insolvency assets (*as discussed in section 3.4*).

3.8 Key Elements for Sharī'ah-Compliant RRP Framework

67. The following measures can be useful for addressing the challenges and issues highlighted earlier in relation to the development and implementation of a credible Sharī'ah-compliant RRP for an IIFS:

- a. RSAs or resolution authorities should work towards enacting dedicated legislation setting out their policy and expectations about the RRP regime, the RRP process and the resultant plans for IIFS, in order to address all the peculiarities of IIFS and their operations as well as to support compliance with Sharī'ah in all aspects.
- b. Sharī'ah boards (at the IIFS and RSA levels) should be engaged with at an early stage in order to gain clarity about and understanding of Sharī'ah issues with potential tools and pre-positioning measures.
- c. Ownership of the PER and IRR should be clearly identified during the resolution process, either through disclosure requirements, or by specific contractual terms of the investment account, to ensure that the resolution distributes PER and IRR to the legitimate owners, the IAH.
- d. Potential avenues for group support should be defined in a Sharī'ah-compliant manner through a commodity-vector *murābahah*. With pre-defined terms and trigger points, such contracts can enable funding support from group entities.

3.9 Pre-Positioning Requirements for Resolution Implementation

68. Pre-positioning arrangements for an IIFS also include the various preparatory measures and arrangements to be carried out, *ex ante*, in respect of various Islamic

contracts used by the IIFS so that the chosen recovery and/or resolution tools can be implemented when required. This is a critical issue for the implementation of RRP for IIFS.

69. One of the key pre-positioning measures for enabling effective resolution of an IIFS is to ensure continued access to liquidity and banking service in the event of its failure. This includes, but is not limited to, having the information technology (IT), payments, resources, and process functionality in place ahead of a crisis, such that should an IIFS enter into statutory management, access channels can be closed, limiting access to withdrawals by creditors, and reopened for business by 9 am the next business day, enabling customers to have access to the available or good portion of their funds.

70. An IIFS subject to RRP requirements should be required to establish pre-positioned operational and technical arrangements for its resolution. The IIFS must have in place a pre-positioned IT functionality that is adequate in its RSA's assessment or compliant with pre-defined policy.

71. Pre-positioning measures employed by the IIFS to deliver its products and services are important for the resolvability of the IIFS and to facilitate the smooth implementation of its resolution plan. The following are examples of potentially useful pre-positioning measures:

- a. pre-approval of RRP of IIFS by their Sharī'ah supervisory boards and by the national Sharī'ah boards, if any;
- b. the need to ensure a public declaration of insolvency by the RSA or the relevant resolution authority, to comply with Sharī'ah;
- c. the issuance of eligible capital (Additional Tier 1 [AT1] and Tier 2 [T2] capital) using *muḍārabah ṣukūk* [AT1] or ṣukūk that result in indebtedness for IIFS' [T2];
- d. disclosures on whether product-level requirements (either *Sharī'ah* or operational) of the IIFS would continue to be maintained by a potential conventional buyer;
- e. enabling of sales of assets in PSIA as a resolution option, specifically by implementing contract-specific pre-positioning measures;
- f. a requirement for IIFS to have properly audited records detailing the commingling of funds in an unrestricted PSIA, and the share of assets owned by IAH;
- g. contractual insertions into PSIA contracts that give IAH consent to novate or transfer to a suitable new *muḍārib* in the event of a pre-defined stress;
- h. policy guidance on the sale of restricted PSIA business to Sharī'ah-compliant

non-bank financial institutions;

- i. consent from the IAH regarding novation of PSIA muḍārabah contracts.
- j. discussion by members of the Sharī'ah board on the use of conventional financing methods specifically to help save an entity in stress (using the *ḍarūrah* principle). (Where a conventional parent has an Islamic subsidiary, it needs to consider using Sharī'ah-compliant downstream support methods);⁹ and
- k. using the concept of *hiwālah* as a potential way of dealing with the issue of debt transfer to an asset buyer or a bridge bank. *Hiwālah* allows a debtor to assign his, her or its obligation to another debtor, so long as that assignee party is solvent (without the creditor's consent). An Islamic bank can be pre-positioned to avail itself of this facility by inserting provisions into relevant contracts that allow a *hiwālah*-type transfer to take effect immediately upon the decision of the resolution authority to use that tool.
- l. prior assessment by IIFS may be required in jurisdictions to allow them to identify which types of contracts (including combination/hybrid structures) need prior consent for a sale, and whether this consent can be sought at contract inception.
- m. enhancement of Sharī'ah governance frameworks and new product approval processes employed by IIFS to ensure new products or new processes introduced are consistent with their RRP and do not endanger the plausibility of the stated resolution options.

3.10 Resolution Actions

72. In the case of resolution, secured creditors will be paid up to the amount of their security, followed by unsecured creditors, and creditors who have agreed to delay their right to receive the payment until other creditors are paid. Whenever there is a leftover funds from resolution, it is permissible to allocate the funds to the shareholders as residual claimants. Assets in the investment accounts based on *wakalah* and muḍārabah belong solely to IAH and not to IIFS. The complete resolution cycle from closure to resolution can be broken down into the following phases:

- a. The IIFS is placed under statutory management and is temporarily closed.
- b. Balances of customers' liability account are determined on the date of the freeze.
- c. A partial freeze is applied (i.e. the payment of a proportion of liabilities to customers, referred to as the "frozen funds", is suspended) based on estimated losses.

⁹ This practice can only be implemented under a *darūrah* situation.

- d. Sharī'ah-compliant resolution funding or government support is secured, via a guarantee for the unfrozen funds and other new liabilities entered into by the reopened IIFS.
- e. The IIFS reopens for core transaction business the next business day.
- f. A partial freeze is applied to all liabilities that have not been pre-positioned. (These liabilities remain fully frozen for a period until they can be dealt with by the statutory manager.)
- g. Additional frozen funds are released as and when directed by the statutory manager of the IIFS and/or the resolution authority.
- h. A decision is made on the future operations and potential restructuring of the failed IIFS.

73. Customers' ability to access their funds would be suspended, and cash withdrawals by creditors in the IIFS blocked, overnight, with the IIFS reopening on the next business day. Customers would then have access to their unfrozen funds. Additional funds can be made available at a later date, but this will be dependent on the determination of final losses and the position of the various liability holders in the creditor hierarchy of the IIFS. The practical aspects of resolution planning of IIFS can be drawn from the conventional counterparts by taking into account Sharī'ah considerations where necessary.

3.11 Resolution Options

3.11.1 Sharī'ah-compliant contractual bail-in

74. The resolution authority will need legal powers to enforce bail-ins, including but not limited to enforcing conversion of contingent capital instruments, the writing down of equity and the absorption of losses. From a regulatory capital perspective, some capital-qualifying instruments may already have bail-in features, such as AT1 *ṣukūk*.

75. According to the IFSB's revised capital adequacy standard, an IIFS may issue a Sharī'ah-compliant AT1 *ṣukūk* with going-concern loss absorption features including, but not limited to, contractual terms to enable its conversion into Common Equity Tier 1 (CET1) capital at a specified trigger point determined by the regulatory authorities so as to qualify for inclusion in AT1 capital. Additional Tier 1 capital must consist only of instruments that are capable of a high degree of loss absorbency. AT1 capital comprises the sum of the following elements:

- a. *ṣukūk* issued by IIFS that meet the eligibility criteria for inclusion in AT1 capital

b. *ṣukūk* issued by consolidated subsidiaries of the IIFS to third-party investors that meet the eligibility criteria for inclusion in AT1 capital and are not included in CET1 capital; and

c. regulatory adjustments applied in the calculation of AT1 capital.

76. From a resolution powers perspective, bailing-in with AT1 *ṣukūk* is valid as long as the resolution authority has the necessary legal powers to enforce its bail-in. The bail-in form of debt write-downs may be difficult in the Islamic context. Based on Sharī'ah principles, while debt forgiveness is regarded very positively under the Sharī'ah, voluntary debt forgiveness can only be effected with creditor consent. Debt cannot be extinguished except through voluntary write-down or repayment.

77. A clear definition of a PONV and its determination would help in dealing with getting consents from creditors or AT1 *ṣukūk* holders even at the time of issue of such liabilities. The definition of PONV in the event of the IIFS going beyond it can be incorporated into the issue documents or indenture documentation of the AT1 or T2 *ṣukūk* issued to meet total loss-absorbing capacity (TLAC) requirements, as required pre-positioning measures to facilitate resolution plans.

78. Consequently, Sharī'ah-compliant mechanisms for effective application of bail-in should be defined and clarified as part of the design of the resolution framework with robust legal and Sharī'ah governance with the following considerations:

a. incorporation of Sharī'ah-compliant bail-in powers into Islamic banking contracts that need to be structured and approved by their respective Sharī'ah board;

b. involvement of the Sharī'ah board in advising the resolution authority; and

c. the taking of pre-emptive measures and actions early in the relationship process in order for many of these issues to be addressed within the CMG and the Sharī'ah boards.

3.11.2 Asset and liability transfers and bridge banks

79. The Sharī'ah issues arising from this resolution option are similar to those arising from asset sales under the recovery options, being: debt haircuts; lack of IIFS as purchasers; conventional banks (or even non-banks) acting as the purchaser; and the complexities presented by a PSIA (commingled) business unit. In addition, any novation of PSIA *muḍārabah* contracts will also need consent from the IAH.

80. The ideal way of performing asset transfers and bridge banking is to transfer a debt to a new assignee (a solvent bank or a bridge bank), as found in the concept of *hiwālah*. This concept allows a debtor to assign his, her or its obligation to another debtor, without the creditor's consent, so long as that assignee party is solvent.¹⁰ This could work on both sides of the balance sheet: liabilities (where the failed IIFS is the debtor) and assets (where the clients are the debtors), including an insertion in the contract that allows for a *hiwālah*-type transfer to take effect to an appropriate assignee (third-party bank or bridge bank) as per the resolution authority's decision and best judgment.

81. That approach could be a useful pre-positioning measure in preparing the relevant contracts by having appropriate clauses to facilitate a *hiwālah*-type transfer, which would significantly enhance the feasibility of the asset transfer or bridge bank options as feasible resolution tools. Legal clarity and resolution are important with regards to the trigger points that allow such a clause to take effect.

82. The protection of party rights in accordance with Sharī'ah contracts is a key issue in any novation or transfer process. Prior assessment by IIFS may be required in jurisdictions to allow them to identify which types of contracts, including combination/hybrid structures, need prior consent for a sale, and whether this consent can be sought at contract inception.

83. The process of moving a business to a bridge institution would need to be carried out quickly in a resolution scenario, so seeking the consent of various stakeholders or counterparties at that stage is unfeasible. Hence, the pre-positioning measure of preparing the relevant contracts by inserting the necessary clauses at the point of contract inception to facilitate asset transfer as part of a resolution plan is needed. This requirement should be incorporated into the normal legal and Sharī'ah review that forms part of any new product or new process approval mechanism.

84. Legal clarity of creditors hierarchy at the time of entering into the relevant contracts and transactions within the resolution powers needs to be ensured. IAH should have total independence with the assets that are equivalent to their account balances, if these assets are not at a loss, along with the profits achieved. If there is a loss, the IAH are entitled to the residual of those assets. Under the asset sales implementation practicalities, the

¹⁰ This view is adopted more so by the Ḥanbalī school of jurisprudence.

creditor hierarchy should be observed in adherence with Sharī'ah principles,¹¹ with the ranking as follows:

1. account holders protected by a third party;
2. collateral-secured creditors, who should be given priority in paying their debts from the collateral up to the value of their collateral, and owners of assets that still exist in their original state will get the assets;
3. unsecured creditors, current account holders, and IAH that have incurred a loss due to negligence or misconduct, or who have otherwise breached contractual terms by the IIFS, up to the amount of the loss, who should receive an amount pro-rata to their proportion in the debt; and
4. creditors who have agreed to delay their right to receive the payment until other creditors are paid.

Whenever there is a leftover portion of funds from a post-sale transaction, it is permissible to allocate the funds to the shareholders as residual claimants.

85. The Sharī'ah issues in relation to the potential sale or transfer of certain Islamic contracts need to be identified as part of the resolvability assessment process, along with adequate measures for addressing those issues. The resolution planning process must focus on developing and implementing such pre-positioning measures for the relevant Islamic contracts. This needs to be effected to the extent that, should the resolution plan be triggered, it would be capable of being implemented immediately without any uncertainty or restrictions.

86. The Sharī'ah governance and new product approval processes should be updated in line with these pre-positioning measures to ensure that any new product is compliant with the RRP and Sharī'ah requirements.

87. In addition, the RSAs must assess the capacity of an acquiring entity to sustain the Sharī'ah compliance of the assets and activities being acquired. A primary requirement for this would be to ensure that the acquiring entity of the assets and liabilities of an IIFS is qualified and permitted to undertake Islamic operations.

3.11.3 Recapitalisation and mergers

88. With this recovery tool, the conventional bank resolution frameworks are applicable and typically empower the resolution authorities to take control of a troubled financial institution and merge it with another institution without the consent of the existing

¹¹ See the Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI's) Shari'ah Standard 43 for further details.

shareholders or other stakeholders. There are two Sharī'ah considerations when merging with the IIFS in the case of a distressed institution:

- a. The merging institutions have to be Sharī'ah-compliant, with a clear legal framework and proper licensing.
- b. Merger procedures may need to be established to address cases where the acquirer's Sharī'ah board is of the opinion that some of the operations undertaken by the acquired bank are not Sharī'ah-compliant and should be disposed of or liquidated. In some cases, disposing of such operations might cause the purchaser to incur losses; while in extreme cases it could lead to its failure, thereby threatening the stability of the financial system. In such a case, the resolution framework might provide for temporary financial assistance, such as a resolution fund based on *takāful*, under strict pre-set conditions for addressing any Sharī'ah non-compliance issue in a timely manner.

3.12 Regulatory Cooperation Measures

3.12.1 Domestic cooperation

89. The entire content of FSB KA 11, setting out the detailed standards and guidance in respect of regulatory cooperation measures with domestic regulatory authorities, is applicable to IIFS in relation to their resolution planning framework. In adhering to Sharī'ah principles, RSAs, together with the financial safety net authorities, have to coordinate with the national Sharī'ah council or Sharī'ah boards to obtain the necessary Sharī'ah fatwa or approvals before operationalising the resolution strategy and actions using appropriate resolution tools or measures.

3.12.2 Cross-border cooperation

90. The entire content of FSB KA 7, setting out the detailed standards and guidance in respect of cross-border regulatory cooperation measures, can be applicable to IIFS in relation to their resolution planning framework. In order to ensure the Sharī'ah harmonisation of cross-border cooperation, both home and host authorities have to provide information on fatwa or Sharī'ah guidance related to resolution planning and implementation matters. Based on the deliberation on fatwa interpretations, in advance before the resolution planning process, both home and host authorities must agree on the binding fatwa that will be imposed on the resolution implementation.

3.13 Sharī'ah Perspective on Insolvency

91. In Sharī'ah views, insolvency may be one or both of two things: (a) a debtor's inability to pay his or her creditors; or (b) an excess of liabilities over assets. Bankruptcy is a legal declaration of one's inability to pay off debts owed. The legal proceeding that follows may be intended either to reorganise/restructure the failed entity, or to liquidate the assets for the benefit of the creditors. Insolvency can be described as a state of being which may then result in the bankruptcy proceeding.

92. In the bankruptcy process, Sharī'ah principles with regards to asset sales, creditor hierarchies¹² and procedure need to be examined in the context of the contemporary use of Islamic finance structures and contracts.

93. Procedural requirements for dealing with insolvency are detailed from a Sharī'ah perspective:¹³

- a. The stages of insolvency specify that creditors should seek the assistance of a concerned authority when their demands for debt payment are not satisfied by the debtor through the filing of a claim.
- b. The debtor can make an application for an insolvency declaration to the relevant authority.
- c. The authority (likely a judge/court) will then assess the claim and make the declaration of insolvency.
- d. Regarding the asset sale mechanism, the sale and distribution of the debtor's assets should not be done with excessive haste (i.e., in a "fire sale"), which may hurt the debtor's position (and, indeed, that of the creditors).
- e. Developed recovery and resolution frameworks should also be cognisant of minimising price dislocation as a result of recovery or resolution. The authorities should acknowledge that the severity of the stress, or indeed the desperation of the sale, can further impact on this discount.

94. In adhering to Sharī'ah principles, two issues need to be considered in a resolution plan regarding insolvency for IIFS. They are as follows:

¹² Refer to paragraph 84 for the definition of creditor hierarchy.

¹³ See AAOIFI's Standard 43 on insolvency for further details.

a. Treatment of unrestricted PSIAH

PSIAs are often pooled investments, which can either be unrestricted (the investments are unspecified) or restricted (the investments are specified). The legal and regulatory treatment of the unrestricted IAH in the respective jurisdiction should be in compliance with Sharī'ah, so that the investment pool is treated as follows: if the IAH agrees that IIFS may commingle its own funds with their funds, giving that each portion is clearly identified, the loss or insolvency of IIFS means also a loss for the IAH as they share the return and bear the loss, as the case may be.

Apart from the hierarchy issue,¹⁴ another issue that arises from IAH is the proportion of the investment liquidation should there be a loss in the investment pool. IAH have invested in specific assets, which should be identifiable and sold at the best attainable price in a proportional manner in accordance with the ownership of the assets.

b. Treatment of PER and IRR

An IIFS may create a PER (which contains profits derived from investments that belong both to the bank and to the IAH) that is used largely to give an expected (or specific) rate of return on PSIAs, which is usually consistent with the prevailing market benchmark. The PER may retain profits from one period of outperformance for smoothing in a later period. Banks may also create IRR funds (which contain investment profits after the [*mudharibs*] banks' share has been taken and these funds are generally used to cushion the IAH from capital losses).

Based on the legal and regulatory treatment of the unrestricted IAH in the respective jurisdiction, the treatment of PER and IRR during the liquidation process follows the treatment of the investment pool, as mentioned above.

It is also critical that contractual ownership claims on each set of funds that belong to the bank and the IAH should be clear. The profit-sharing ratio can be used to work out how much of the PER fund belongs to the bank (if some of its profits have been allocated for the PER alongside other investors) and how much belongs to the IAH. The documentation and internal records should be clear in order to recognise the distinct types of ownership.

¹⁴ Refer to creditor hierarchy in paragraph 84.

Annex A: Operationalisation of the Recovery and Resolution Framework for IIFS

1. Data Collection and Analysis

This is the initial phase of RR framework development; wherein relevant data are collected as a basis for developing the RRP. One of the main purposes of RRP is to provide for the continuation of business functions that, if disrupted, could pose a risk to the financial system and the economy. Hence, the collection of information to determine which are core and critical functions is important, as discussed below.

- a. **Core businesses** are those that management considers essential to be preserved through a crisis. Identifying core businesses is critical to recovery planning, because the surviving entity in a recovery plan must be a stable and coherent financial institution with continuing operations.
- b. **Critical activities and functions (called “systemic activities” in some jurisdictions)** are those that, if discontinued, could pose a risk to financial stability or disrupt the financial system abruptly, as well as those functions that are considered necessary to support the firm’s important systemic activities. This is particularly addressed to domestic systemically important banks. Critical activities include, but are not limited to, interbank transactions, transaction platforms and dependencies that support systemically important activities. These include payments infrastructure, clearing systems, custody services to support other banks, financial technology (fintech), and operations across the institutions.

Banking supervisors need to approve the definition and identification of critical activities before the IIFS prepare the recovery plan in order to be aligned with prevailing rules and regulations in the respective jurisdictions. During the normal situation, IIFS should also map their business activities to specific legal entities, such as dealing with the hierarchy of priority claims for depositors and shareholders¹⁵ and contractual relationships across Islamic contracts which are critical in executing the RRP. In addition, as part of RRP development, D-SIBs are asked to provide information on mapping their legal entities to the business lines they support and to the economic functions those business lines provide.

Supervisors should collect relevant data from IIFS during normal/business-as-usual conditions, as this will be important for effective implementation of RRP and their deployment when required. Such data are critical for IIFS to assess the business processes in place for enabling crisis management among high-level regulators (macro level) and IIFS management (micro level) based on applicable well-functioning crisis management

¹⁵ Refer to creditor hierarchy in paragraph 84.

protocols in the respective jurisdictions. As for conducting the resolution in an orderly manner, the RSA should collect a set of core information from the bank and the agencies performing critical functions to assist resolution planning under four key components:

- a. critical functions analysis;
- b. identification of significant legal entities;
- c. business lines and operating models; and
- d. mapping of dependencies.

In order to implement the resolution strategy, an executable resolution plan has to be developed on the basis of the strategy. This will necessitate the collection of additional information and analytical inputs from banks to assist the resolution authority in converting the resolution strategy into a plan. In addition, periodic resolvability assessments should be conducted by authorities to evaluate the feasibility of the resolution plan. The aim of these assessments is to improve resolvability by identifying, and then addressing, obstacles to orderly resolution.

2. Identification of Critical Functions and Shared Services

a. Critical functions

As defined by the FSB, a critical economic function has the following two elements:

- a. it is provided by an IIFS to third parties not affiliated to the firm; and
- b. the sudden failure to provide that function would be likely to have a material impact on the third parties, give rise to contagion, or undermine the general confidence of the market participants due to the systemic relevance of:
 - i. the function for the third parties; and
 - ii. the IIFS in providing the function.

The absence of any one of these elements indicates that a function is not critical. The failure of some services provided by a financial firm will not have a substantial impact on customers, counterparties, markets or the economy. Services that do not have a significant impact on economic or financial stability, or that can be substituted with a minimum of time and cost, should not be considered critical. Similarly, the impact of withdrawal of certain activities might only be felt some time after the withdrawal has occurred. This is particularly true for those activities that are not transaction-intensive, such as long-term lending. The criticality of such functions depends greatly on the ability of the market to substitute the role of the failing banking group within a reasonable time frame.

Applying the definition given above, the criticality of a function can be assessed in a three-step process:¹⁶

- a. analysis of the impact of the sudden discontinuance of the function (“impact assessment”);
- b. evaluation of the market for that function (“supply side analysis”); and
- c. assessment of the impact of a failure of a specific IIFS that performs that function (“firm-specific test”).

Certain aspects of the assessment are highly market-specific and require in-depth knowledge of the specific circumstances in which a critical function is provided. In particular, the criticality of a function that a firm provides can vary across countries. Home supervisors should communicate with relevant host authorities so that the assessment considers all relevant jurisdictions and markets where an IIFS is active. The assessments should take into account those functions and services deemed to be critical in host jurisdictions.

Depending on the nature, complexity and risk profiles of the IIFS, the critical functions are not limited to:

- a. payment system, clearing and settlement;
- b. corporate financing;
- c. treasury and asset–liability management desk;
- d. retail operations and payment; and
- e. investment banking.

b. Critical shared services

As defined by the FSB, a critical shared service has the following elements:

- a. An activity, function or service is performed by either an internal unit, a separate legal entity within the group or an external provider.
- b. That activity, function or service is performed for one or more business units or legal entities of the group.
- c. The sudden and disorderly failure or malfunction would lead to the collapse of, or present a serious impediment to the performance of, critical functions.

If one of those elements is absent, this suggests that the shared service is not critical. For example, if an internal activity, function or service, such as facilities management, can easily be substituted from other, external, sources, then that shared service is not critical, even if it is necessary for maintaining the critical functions of the company. Similarly, the

¹⁶ See FSB, *Guidance on Critical Functions and Critical Shared Services* for more details.

fact that an activity, function or service is shared does not necessarily mean that it is a *critical* shared service, as it may support tasks not directly related to maintaining critical functions – for example, a centralised marketing department.

Critical shared services are related to the critical functions a firm performs: they provide the internal and essential infrastructure the firm needs to continue operating. Their designation should therefore follow from the identification of the critical functions. Given the variety of shared services and the limited time and resources in resolution, it might be helpful to rank the shared services in order of priority. While some shared services have to be continuously provided, there might be others that could be interrupted for a short period without leading to a collapse of the critical function. In prioritising shared services, the following questions are relevant:

- a. How severe are the consequences of the failure of a particular service on one or more critical functions?
- b. How quickly will the failure of a particular shared service lead to a collapse of one or more critical functions?

For the purposes of this analysis, there should be a clear understanding of the following aspects of the shared services at the legal entity level:

- a. the provider and the recipient of the services;
- b. the nature of the services being provided;
- c. the financial terms on which those services are offered;
- d. the existence of service-level agreements and the validity of such agreements in the event of failure;
- e. The impact of default on the ability of the firm to maintain these services; and
- f. the substitutability of the services being provided.

Critical shared services should be organised or procured in a way that ensures the continued availability of shared services to all relevant parts of the firm under the chosen resolution strategies. Examples of arrangements that can achieve that objective include, but are not limited to, performing shared services out of separate legal entities or preparing in advance to contain a crisis. If the service arrangement is with an external provider, arrangements should be in place in order to ensure continuation of the services.

Given that the vast majority of firms' business processes are likely to depend on IT systems, it is important that the complexities of dependencies arising from shared IT systems, which may differ from the structure of business processes, are understood.

Depending on the nature, complexity, and risk profiles of the IIFS, the critical shared services are not limited to:

- a. information technology;
- b. payment system, clearing and settlement;
- c. risk management; and
- d. outsourced operations.

3. Crisis Management and Preparedness

A robust operational framework is a prerequisite for effective resolution planning and preparedness for dealing with a crisis. All *takāful* deposit insurers should ensure that they have in place the necessary tools and procedures (operational capabilities) to perform their normal operations in accordance with the mandate as described in FSB KA 2.

RSAs should establish effective information-sharing arrangements with other authorities that have the power over the members of financial safety net (FSN) to prepare for handling extraordinary situations. The information-sharing and coordination arrangements between FSN participants, typically established in stable times, serve as a basis for enhanced sharing of information and coordination during crises. Ongoing information sharing and the coordination of actions should be explicit and formalised through legislation, regulations, memoranda of understanding or other legal provisions.

RSAs should develop resolution plans to prepare an appropriate and effective response to the extraordinary situation in the event that it occurs. The scope and areas covered by resolution plans are likely to vary depending on the mandate of the RSAs. The RSAs should identify options for dealing with unexpected situations, to maintain business continuity and continue to perform their role in areas such as pay-outs, funding, recovery and resolution, and communication.

In addition, RSAs together with the FSN have to coordinate with the national Sharī'ah council or Sharī'ah boards to obtain the necessary Sharī'ah approvals to operationalise any actions, measures or resolution plans in a Sharī'ah-compliant manner in order to deal with a failed IIFS under a recovery or resolution action.

RSAs and relevant authorities should document the resolution planning framework in easy-to-use "handbooks", "playbooks" or other such documents that provide guidance and other necessary information for the design and implementation of a resolution planning framework.

For a resolution plan to be implemented effectively, RSAs need to allocate adequate resources, such as staff (in-house or outsourced), technical expertise and funds. Resolution plans that include business continuity planning of the IIFS should be regularly tested by RSAs and IIFS should be informed, where applicable. Not all areas of the plan are required to be tested annually, but the RSAs should ensure that critical areas, as indicated in the critical functions and shared services, are tested regularly. The frequency of testing should be decided according to the nature and importance of each critical area. The RSAs should maintain a schedule of tests to be conducted over a chosen planning period.

The stress scenarios should be built around different assumptions regarding the severity of a crisis, ranging from idiosyncratic to system-wide shocks. The weaknesses observed during tests should be corrected and the lessons learnt from each exercise documented as part of the recovery plan. A communication strategy for resolution and crisis situations should be aimed at and involve all stakeholders, FSN participants, media, and so forth.

Resolution plans for cross-border information sharing and cooperation should be prepared and tested in jurisdictions where there is a material presence of cross-border firms. The plans must aim to ensure that cross-border information sharing and cooperation arrangements are adequate and effective.

IIFS should identify and compose early warning indicators (EWIs) and recovery triggers, mainly capital and liquidity indicators, as pre-emptive measures for the crisis situation. This identification should be well described in the recovery plan prepared by the IIFS and be submitted to the RSAs for the verification and approval.

4. Crisis Management Groups

In addition to FSB KA 8, guidance is provided for recognising the needs of IIFS. The CMGs should interact and coordinate with the national Sharī'ah council or Sharī'ah board in the respective jurisdiction to seek and obtain the Sharī'ah opinions or fatwas necessary to operationalise various actions of RRP. Similar Sharī'ah approvals and opinions are also essential to ensure that the RRP for failed IIFS can be executed with appropriate Sharī'ah principles and contracts. CMGs must periodically review the liquidity and capital management plans for stressed situations. It must also periodically review the appropriateness of the Sharī'ah-compliant deposit insurance, and the validity of Sharī'ah contracts to be executed as part of the resolution actions.

Institution-specific cross-border cooperation agreements

The entire content of FSB KA 9, setting out the detailed standards and guidance in respect of cross-border cooperation agreements, can be applicable to the supervision and regulation of IIFS as well as to their RRP frameworks. The home and host authorities should have a binding agreement on the Sharī'ah approvals or fatwa that will be imposed on the resolution implementation.

5. Periodic Evaluation: Stress Testing Analysis¹⁷

Stress testing analysis is important for gauging the level of capital and liquidity of the IIFS, and can aid the RSAs in:

- a. ***Identification of the key vulnerabilities and PONV:*** IIFS are expected to identify, describe and quantify key vulnerabilities whereby risks can result in financial stress, or cause difficulty in addressing financial stress should it arise. These vulnerabilities will be the starting point for generating scenarios for RRP. In addition, the RSAs should identify its PONV whereby its business becomes unviable and its business model can no longer attract funding or not be supported with sufficient regulatory capital.
- b. ***Scenario analysis and stress testing:*** IIFS should employ scenario analysis and stress testing effectively to identify their vulnerabilities and define their PONV. Stress tests conducted for this purpose should include at least one idiosyncratic scenario and at least one systemic stress scenario which can help in assessing the IIFS's viability under the stressed scenario in terms of both liquidity and capital aspects. Based on the identified vulnerabilities, the IIFS needs to employ stress testing to determine at the granular level the potential impact of distress on the IIFS as a whole and on its key business components, as well as the feasibility and impact of its recovery options.

6. Resolvability Assessments

The entire content of FSB KA 10 and Annex-3 of the FSB KAs document, setting out the detailed standards and guidance in respect of resolvability assessments, can be applicable to the RR frameworks of IIFS. In addition, complementary guidance is provided as part of this section to address the issues arising from Sharī'ah aspects of the structure and the operation of IIFS and their business activities in relation to resolvability assessments.

¹⁷ See IFSB 13: *Guiding Principles on Stress Testing for Institutions offering Islamic Financial Services* and Technical Note 2: *Technical Note on Stress Testing for Institutions offering Islamic Financial Services (IIFS)* for more details.

In addition to the aspects outlined in KA 10, resolvability assessments for IIFS must involve a high degree of focus on the sustainability of Sharī'ah-compliant contracts and processes, throughout the process of resolution, as well as their durability under the new structure or entity that results after resolution. Resolvability assessments in the IIFS are more complicated than for its conventional counterparts, as IIFS must also include a review of all the products, Islamic contracts, and Sharī'ah-compliant processes and procedures employed by an IIFS in respect of the feasibility of applying the potentially available resolution tools and strategies.

A detailed and critical resolvability assessment is essential for preparing feasible resolution plans and for evaluating the various resolution tools and strategies available. Such resolvability assessments are also crucial for identifying the various pre-positioning measures required, as elaborated elsewhere in this technical note. The identification of potential Sharī'ah compliance challenges and the necessary pre-positioning measures must be a regulatory requirement in relation to the resolvability assessments by IIFS.

Specifically, resolvability assessments for IIFS must address:

- a. the identification of various factors and conditions related to the operation of an IIFS, primarily the Sharī'ah compliance obligations, which could affect the effective implementation of a chosen resolution action or plan;
- b. the ability of various stakeholders involved in maintaining the critical economic functions of the IIFS to sustain Sharī'ah compliance in the post-resolution phase (especially crucial for IIFS that are part of financial groups with largely conventional financial institutions);
- c. the ability of other group entities to absorb or unwind the intragroup exposures of the IIFS under resolution, if group support is envisaged as part of resolution;
- d. the adequacy of the RRP prepared by an IIFS, with specific reference to the peculiarities of its operations and its ability to sustain Sharī'ah compliance; and
- e. identification of various pre-positioning measures or specific actions required to ensure Sharī'ah compliance of the entire resolution action and to sustain the Sharī'ah-compliant nature of the resulting post-resolution entity.

In the event of IIFS forming part of global systemically important financial institutions (G-SIFIs) (or cross-border financial groups), the group resolvability assessment must include a specific assessment of the resolvability of the IIFS and its implications for the resolvability of the group as a whole. If the IIFS is not regulated by the home supervisor of the G-SIFI

which has the mandate to conduct the group resolvability assessment according to FSB's KA 10, it is likely that the home supervisor is not equipped to carry out the resolvability assessment of an IIFS. In such cases, the resolvability assessment of the IIFS must be carried out by its own supervisor and coordinated within the IIFS' CMG. This will ensure that the knowledge and expertise required to execute the resolvability assessment of the IIFS are available with the assessor.

The resolution authority in a jurisdiction should have adequate powers to legally mandate the adoption of appropriate measures, including (but not limited to) changes to the IIFS' products, businesses, processes, procedures, structure and organisation essential for ensuring optimal resolution outcomes while maintaining Sharī'ah compliance.

The FSB's Key Attributes (KAs) document outlines a three-stage process for completing a resolvability assessment. The first stage of that process relates to the feasibility of resolution strategies, in the context of the IIFS' RRP, the resolution tools available, and the capabilities of the relevant RSA to implement the chosen resolution strategy. In this stage, assessment of an IIFS must, in addition to those strategies specified in the FSB's KAs, evaluate the Sharī'ah compliance of the resolution strategies involved.

For example, in the case of a top-down strategy that involves single-point entry at the ultimate parent of a group of which the IIFS is a member, the instruments used and transactions to be carried out to upstream losses for consolidation at the ultimate parent need to be Sharī'ah-compliant. The feasibility of the strategy and the manner of upstreaming losses as identified by the RRP of the group needs to be tested for Sharī'ah compliance when it is employed by the IIFS. Sharī'ah limitations on asset sales or transfers of specific categories of Islamic contracts may prevent the operation of some strategies for the IIFS, though they may be perfectly feasible for the rest of the conventional entities in the financial group. Stage 2 of the assessment process does not have specific implications for an IIFS, apart from those specified in the FSB's Key Attributes.

In relation to stage 3 of the resolvability assessment, which involves identification of the pre-positioning measures to be taken to improve resolvability and achieve optimal post-resolution outcomes, the assessment for an IIFS must focus on the need to sustain Sharī'ah compliance through the process and to ensure that the post-resolution arrangement continues to be Sharī'ah-compliant. An IIFS may require a range of pre-positioning measures to address the identified challenges in the RRP to ensure Sharī'ah compliance at all times. The various challenges that may arise in implementing the RRP framework and the RRP when triggered, as well as the pre-positioning measures to address those challenges, are described in detail elsewhere in this document.

Annex B: Guidance on the Recovery for IIFS

1. Governance Framework of Recovery Planning

The recovery plan is intended to serve as a guide and catalogue of solutions for the recovery of a distressed IIFS. An IIFS facing material levels of solvency and/or liquidity stress, beyond the levels manageable with business-as-usual risk management and capital replenishment measures, is deemed to have entered the recovery phase. Typically, IIFS in this stage would be facing sharp erosion of their capital base and the prospect of breaching their regulatory capital requirements. An IIFS would continue to be in the recovery phase, until it has been determined to have passed the PONV. If an IIFS is determined to have passed the PONV, it would be assessed as having met the conditions for resolution. To be eligible to continue in the recovery phase, there should be a reasonable prospect of recovery for the IIFS, if appropriate recovery measures are taken. The recovery plan should include measures to mitigate the stress being experienced by the IIFS, to minimise the incidence of further losses, and to reduce its risk profile and conserve its capital, using a combination of strategic as well as tactical options, such as the divestiture of business lines and restructuring of liabilities.

The responsibility for developing and maintaining and, where necessary, executing the recovery plan lies with the senior management of the IIFS. The recovery plan prepared by the IIFS should be submitted to the relevant RSA for review, and the RSA should review the recovery plan as part of the overall supervisory process, assessing its credibility and ability to be effectively implemented. The authorities should have the requisite powers to require the IIFS to make the necessary changes to achieve the required level of credibility for the recovery plan and to force the implementation of recovery measures if necessary.

IIFS should be required to update the recovery plan at regular intervals, and upon the occurrence of events that materially change the firm's structure or operations, its strategy or aggregated risk exposures. The risk profile contained in the recovery plan should recognise the specificities and the risk of the IIFS that is commensurate with the action plan executed by the senior management should the recovery phase materialise in compliance with Sharī'ah.

The RSAs should be required to regularly review the exogenous and firm-specific assumptions a recovery plan is based upon and to assess on an ongoing basis the relevance and applicability of the plans. If necessary, firms should adapt their recovery plan accordingly.

2. Key Elements of Recovery Planning

The entire content of FSB KA 11.5, setting out the detailed standards and guidance in respect of key elements of recovery planning, can be applicable to IIFS. In addition, complementary guidance is provided (in paragraphs 22–52) as part of this section to address issues arising from Shari'ah aspects of the recovery planning process as well as from the development and use of recovery plans.

Recovery planning involves supervisory and resolution authorities ensuring that the IIFS for which an RRP is required maintains a recovery plan that identifies options for restoring financial strength and viability when the IIFS comes under severe stress. The recovery plan may include measures to reduce the risk profile of a firm to replenish capital, as well as strategic options, such as the divestiture of business lines and the restructuring of liabilities.

Successful implementation of a recovery plan to replenish the capital and liquidity position of a stressed IIFS is critical in avoiding potential contagion to other banks or in preventing systemic instability in the financial system. The presence of feasible RRP for IIFS is likely to promote the stability and effective working of the banking system, of which they are a part. For this reason, the recovery planning should ideally address, but not be limited to, the following:

- a. forming an integral part of a bank's risk management framework;
- b. identifying and explaining how the bank will monitor the need to trigger recovery actions;
- c. setting out a full menu of recovery options;
- d. assessing the impact and probable success of the recovery options;
- e. identifying the key steps and milestones in implementing the recovery options and the key management personnel involved in activation and decision making; and
- f. mapping out a communication strategy to support the deployment of the recovery options.

Based on the prevailing regulations, the RSAs should attempt to provide useful guidelines on the minimum requirements to be incorporated in the recovery plan. Among many others, these requisites are:

- a. business conditions analysis that covers line of business, network of offices, and subsidiaries, along with identification of critical activities and core business functions;

- b. scenario design comprised of idiosyncratic and systemic shocks for stress testing;
- c. list of feasible recovery options;
- d. disclosure of recovery options;
- e. governance structure and clear decision-making process; and
- f. internal crisis management planning.

An IIFS should demonstrate that it is able to identify the point at which it needs to trigger the deployment of its recovery plan, and to implement at least one of the recovery options detailed in its recovery plan. Therefore, the bank should develop and maintain a trigger framework, which is fully embedded within its ERM framework, to activate recovery action in a timely manner. Recovery triggers should be well defined and customised to the full range of risks faced by an IIFS. The threshold level for triggers should be calibrated appropriately and be set out clearly in the IIFS's recovery plan.

Triggers should comprise a mix of qualitative and quantitative metrics that are most relevant to the bank concerned. The set of triggers may be based on internal EWIs used by banks in their existing enterprise risk management frameworks. In identifying suitable indicators for the purposes of developing recovery triggers and data sources for tracking events that may trigger its recovery plan, the bank should consider the intrinsic characteristics and qualities of the indicators that facilitate close monitoring of an evolving situation, such as their tractability, sensitivity and forward-looking capability.

Triggers should not lead to automatic deployment of recovery actions. A trigger event should always be brought to the attention of the bank's board. The board should also be informed of the corresponding course of action determined by senior management and/or the relevant board committee.

The quantitative and qualitative trigger indicators, among others, are as follows:

- a. rating downgrade or the expectation of a downgrade;
- b. fall in share price;
- c. substantial or sustained withdrawal of deposits (UPSIAs, in the case of IIFS);
- d. early redemption of liabilities by counterparties;
- e. difficulty in obtaining funding or raising capital; and
- f. fall in regulatory capital and liquidity ratios.

As IIFS have additional risks embedded in the Sharī'ah contract on top of the key mainstream risks under the conventional system, there is a need for additional triggers,

both qualitative and quantitative factors, which recognise the nature of IIFS and the peculiarities of their operations and risk profile. The risk management framework for IIFS could be a useful starting point for identification of triggers. In addition to the key inherent risks, IIFS' risk elements cover equity investment risk and rate of return risk. IIFS also have displaced commercial risk, withdrawal risk and Sharī'ah non-compliance risk (SNCR) emanating from the special characteristics of their business model, contracts and operations.¹⁸ SNCR is an important aspect within the Sharī'ah framework for IIFS to ensure that their operations comply with the Sharī'ah principles at all times.

Timeliness of execution is a key factor for the successful deployment – and, hence, credibility – of the recovery options. A bank should carefully estimate the time frame within which each recovery option can be implemented and assess whether its capital and liquidity could be effectively replenished to sound levels. A bank should invest sufficient effort in formulating and preparing for each of the options and undertake advance planning as necessary. This includes identifying any obstacles to, and risks of, executing each of the recovery options and taking actions to enhance the readiness of options accordingly.

¹⁸ See IFSB-1: *Guiding Principles of Risk Management for Institutions (other than Insurance Institutions) offering only Islamic Financial Services (IIFS)* for further details.

Annex C: Guidance on the Resolution for IIFS

1. Key Elements of Resolution Planning

The entire content of FSB KAs 11.6 to 11.12, setting out the detailed standards and guidance in respect of resolution planning and implementation of resolution plans, can be applicable to IIFS and their resolution planning frameworks. Complementary additional guidance is provided in this section to address the specific issues arising from Sharī'ah compliance in relation to resolution planning and the implementation of resolution plans.

The resolution authority should identify potential resolution strategies and assess the necessary pre-conditions and operational requirements for their implementation, including arrangements for cross-border coordination. In addition to the overall resolution strategy and the underlying strategic analysis, the resolution authority should identify the following:

- a. regulatory thresholds and legal conditions that provide grounds for the initiation of official actions, specifically the PONV (including thresholds for entry into resolution) and the scope for authorities' discretion (e.g. the extent to which authorities can refrain from taking actions or not avoid acting under certain conditions);
- b. any critical interdependencies and the impact of resolution actions on other business lines and legal entities (would other entities be able to continue to operate?); financial contracts (do authorities have powers to limit or suspend termination or to close out rights?); markets and other firms with similar business lines; and comparative estimates of losses to be borne by creditors and any premium associated with various resolution strategies;
- c. the range of sources available for resolution funding;
- d. the process for disbursements by depositor protection arrangements covering the IIFS concerned and other financial safety nets applicable;
- e. the processes for preserving uninterrupted access to payment, clearing and settlement facilities, exchanges and trading platforms;
- f. the internal processes and systems necessary to support the continued operation of the IIFS' critical functions;
- g. processes for their cross-border implementation;
- h. proper communication strategies and processes to coordinate communication with host resolution authorities; and

- i. applicable Shari'ah contracts that can be applied for the resolution actions forming part of duly approved resolution plans for the IIFS in its various markets.

The RSAs (or the resolution authority in a jurisdiction) must issue regulations and/or guidance setting out the expectations for the resolution planning process and the resultant resolution plans of IIFS. In particular, this should address the various pre-positioning measures consistent with the policy of the relevant authorities and internal Shari'ah governance in affected IIFS.

2. Resolution Strategy

It is critical to devise an appropriate strategy for the implementation of a resolution action. There are two main choices for a resolution strategy: namely, top-down and bottom-up strategies. As the name suggests, top-down strategy involves execution of the resolution at the top-most parent (ultimate parent) of the group, by up-streaming and consolidating all the losses to that ultimate parent. Resolution is then applied at that level, by a single resolution authority, which would be the home resolution authority for the ultimate parent.

Top-down strategy involves the "single point of entry" resolution approach, which involves the resolution at the ultimate parent wherein all the losses of the group have been consolidated. The approach involves a strategy in which the ultimate parent holds all the loss-absorbing capital and capacity for the group. The conversion of AT1 and T2 capital available with the ultimate parent would absorb all consolidated losses and allow sustenance of the IIFS.

Bottom-up strategy involves resolution and loss absorption by individual entities at multiple points across the group, wherever losses have occurred. The bottom-up approach involves a "multiple points of entry" approach, rather than just at the topmost parent. The strategy involves ensuring the availability of loss-absorbing capital at each of the subsidiaries or group entities. If the amount of loss-absorbing capital available with any of the entities in the group is inadequate to absorb its losses, capital is down-streamed from the parent entities above to the particular subsidiary that has inadequate loss-absorbing capital. In some cases, this might cause the parents to fail (depending on the amount of losses in relation to the capital base of the parents).

3. Resolution Authority

FSB KA 2 is setting out the detailed standards and guidance in respect of the resolution authority, and their constitution and operation can be applicable to IIFS and

their resolution planning framework. In adhering to a particular jurisdiction's Sharī'ah governance framework, the Sharī'ah board or the national Sharī'ah council is also part of the resolution authority before the resolution process begins. Sharī'ah board also has a role in validating an appropriate Sharī'ah-compliant contract for the resolution tools or actions.

4. Resolution Powers

The entire content of FSB KA 3, setting out the detailed standards and guidance in respect of resolution powers, including the aspects listed below, can be applicable to IIFS and their resolution planning framework:

- a. entry into resolution;
- b. general resolution powers;
- c. transfer of assets by sale and liabilities by *hiwala*;
- d. bridge institution;
- e. bail-in with resolution; and
- f. exercise of resolution powers.

The resolution powers should be exercised without the need to obtain the consent of existing shareholders or creditors, subject to appropriate safeguards such as the “no creditors worse off” principle. Above all, clarity in the legal framework is required to ensure that the resolution authority is able to exercise these powers promptly and with legal certainty.

Takāful deposit insurers capable of operating on a Sharī'ah-compliant basis must have adequate powers and tools to ensure that delivery of responsibilities, including the provision of financial support for the IIFS, the transfer of assets and liabilities, assets sale, the establishment of a temporary bridge bank and other resolution mechanisms, are fully compliant with Sharī'ah rules and principles. In cases that require the use of funds collected by way of contributions paid by member IIFS, usage of those funds for a deposit cover should be stated in the form of a *takāful* contract. Under such a *takāful* contract, IIFS would undertake to donate a certain amount in return for receiving Sharī'ah-compliant deposit protection through any Sharī'ah-compliant resolution mechanism in the event of failure and liquidation.

Given the importance of Sharī'ah-compliant deposit insurance funds (TDIF) for the resolution actions or measures specified by the resolution plan approved by the CMG and the Sharī'ah board, the Sharī'ah governance within the *takāful* deposit insurer (TDI) has to be effective to ensure that all its operations and activities as part of executing the resolution

plan for the IIFS are fully Sharī'ah-compliant. The crucial aspects of a deposit insurer's (DI's) operations that are required to be fully Shariah-compliant include the following:¹⁹

- a. Contributions received from all the IIFS covered by the TDI are correctly channelled and maintained by the TDI in the TDIF. Where contributions for the protection of investment accounts are maintained separately from those received for the protection of deposits, the TDI ensures such segregation of contributions.
- b. Only permissible expenditures are charged to the TDIF.
- c. The funds of the Sharī'ah-compliant deposit insurance fund TDIF are invested only in Sharī'ah-compliant assets, securities or instruments.
- d. Investment returns that are generated from non-Sharī'ah-compliant assets are treated appropriately based on the Sharī'ah board's rulings (e.g. distributions to charitable bodies).
- e. Payments to insured depositors and IAH are made from appropriate funds (i.e. the TDIF).
- f. Sources of external funds (if any) are Sharī'ah-compliant. For instance, if the TDI borrows from the government, the agreement between the DI and the government does not contain an interest (*riba*) element.
- g. Resolutions of failed IIFS take into account their unique characteristics and retain the Sharī'ah-compliant status of all aspects of their business.

5. Resolution Actions

IIFS resolution is an option that provides the ability to allocate losses to creditors of the failed IIFS without causing unnecessary disruption to the payments system and customers' access to liquidity. As a general principle, first losses are allocated to and borne by shareholders, followed by creditors who have agreed to delay their right to receive payment until other creditors are paid. Claims of creditors who have agreed to delay their right to receive payment until other creditors are paid, and other capital providers, will be fully frozen and will not be available for payment unless the senior creditors have been paid in full.

The complete resolution cycle from closure to resolution can be broken down into the following phases:

- a. placing the IIFS under statutory management and temporarily closing it;

¹⁹ See International Association of Deposit Insurers' discussion paper, "Sharī'ah Governance for Islamic Deposit Insurance Systems", for more detail.

- b. curbing customers' access to their accounts and freezing all liabilities of the IIFS temporarily, when the IIFS is under statutory management;
- c. determining customer liability account balances on the date of the freeze;
- d. applying the partial freeze (i.e. suspending the payment of a proportion of liabilities to customers [referred to as "frozen funds"] based on estimated losses);
- e. securing Sharī'ah-compliant resolution funding or government support, via a guarantee for the unfrozen funds and other new liabilities entered into by the reopened IIFS; and
- f. reopening the IIFS for core transaction business the next business day.

6. Sharī'ah-Compliant Deposit Insurance Funds

TDIF is an essential Sharī'ah-compliant resolution process implemented by authorities. The TDI collects contributions from banks on current accounts and protects the insured depositors of a failed bank. In the case of investment deposits (PSIAs), the contributions will be collected from depositors to provide protection in the case of loss that is not a result of mismanagement. It is worth noting that, from a Sharī'ah perspective, the permissible model for deposit insurance is *takāful*. Although Sharī'ah boards and standards do not permit the use of the Kafalah Bil Ajr model, the applicable Sharī'ah standards and regulations in certain jurisdictions permit its use, where funding is paid by each Islamic bank to obtain the deposit insurer's guarantee and the fund is owned by the deposit insurer.²⁰

Donation (*tabarru'*) is defined as the voluntary transfer of ownership of an asset or its usufruct from one party to another without stipulating any price or value in exchange for the transfer. Under a TDIF that operates based on the donation contract, an IIFS agrees to pay premiums in the form of donations or voluntary contributions to a fund (deposit insurance fund). The TDI, acting as manager of the fund, will use the fund to reimburse depositors of any IIFS that suffers a failure.

This form is suitable for a *takāful* deposit insurance system in which membership is not mandatory. Under such a form, all IIFS in the system agree to make voluntary contributions (in the form of premiums) to protect depositors of any IIFS that suffers a failure. Given that *tabarru'* and *ta'awuni* are the main features of *takāful*, the *takāful* deposit insurance system operating under such a contract may be referred to as "deposit *takāful*".

²⁰ See IADI-IFSB standard on Core Principles for Effective Islamic Deposit Insurance Systems.

From the Sharī'ah perspective, when the TDI has a mandate and additional responsibilities, including providing financial support, the transfer of assets and liabilities, the sale of assets, the establishment of a temporary bridge bank and other resolution mechanisms that are in line with Sharī'ah rules and principles, which require the use of its own funds that have been collected from the contributions paid by the member IIFS, such usage should be stated in the *takāful* contract. The policy should state that IIFS would undertake to donate a certain amount in return for receiving financial support through any Sharī'ah-compliant resolution mechanism in the event of severe financial distress, or depositor reimbursement in the event of failure and liquidation.

Whenever the TDIF has subrogation practices, it is permissible from a Sharī'ah perspective for the DI to substitute the protected investors and account holders in relation to their rights associated with a debt or a claim after reimbursing them to recover such debt or claim from the IIFS, provided that the TDI will not be given a higher claim in relation to the other liabilities of the IIFS; instead, all liabilities should rank *pari passu* followed by the shareholders of the IIFS. Furthermore, such a mechanism should be stipulated in the *takāful* contract signed between the TDI and the IIFS.

During the funds reimbursement process post-asset sales transactions, from a Sharī'ah perspective, IIFS liabilities should be paid according to the creditor hierarchy. However, when a TDI is responsible for the coverage of certain types of deposits, it would be permissible to grant these deposits a higher claim over other types of unprotected deposits by paying their holders the protected portion of their deposits from the TDI. As for the unprotected portion of these deposits, it will not be given a higher claim than other liabilities of the IIFS; rather, each creditor should receive an amount on a pro-rata basis relative to his or her proportion of the debt.

Given the wide range of potential treatments across different categories of investors in an IIFS, it is essential to determine the eligibility of the investors for financial safety net support such as TDI in the event of a resolution action. The results of that determination need to be clearly communicated to the relevant classes of investors as part of the product documentation, agreements, and any pre-sale marketing material. This is particularly relevant for IAHS and those in unrestricted PSIAs, as they may not be eligible for TDI protection while not being aware of the fact that they may not receive the same level of protection as other investors in the same IIFS. In such cases, clear disclosure of their eligibility under TDI or other financial safety net protection, and of how they would be treated under a resolution action, needs to be included in pre-sale marketing materials and in all relevant product documentation in order to preclude potential cognitive dissonance for the PSIA investors.

A TDI is expected to play a role in resolving any failed IIFS with the appropriate Sharī'ah modality. The TDI has to ensure that the contributions received are managed and utilised for permissible activities. In a dual deposit insurance system, where the DI operates a Sharī'ah-compliant deposit insurance scheme alongside a conventional deposit insurance scheme, contributions to the Sharī'ah TDIF should be segregated and maintained separately from a conventional deposit insurance fund, so that the Sharī'ah-compliant status of contributions for the TDIF can be maintained.

APPENDIX A: Definitions of Key Terms

Bankruptcy	A legal declaration of one's inability to pay debts owed.
Contractual Bail-in	An arrangement in which creditors of a failing financial institution are required to cancel some of its debts as part of a plan to save it from collapse. Under Basel III, regulators have the power to impose losses on bondholders/ <i>ṣukūk</i> holders while leaving untouched other creditors of similar stature.
G-SIFIs	A financial institution that, because of its size and/or interconnectedness, could pose a material risk to financial stability and the real economy on a global scale if it were to fail.
<i>Iflās</i>	An Arabic term for "bankruptcy". It refers to the scenario where a person's debt exceeds his or her assets, as well as to the inability to meet liabilities as they fall due.
<i>Ijārah</i>	An agreement made by an institution offering Islamic financial services to lease to a customer an asset specified by the customer for an agreed period against specified rental. An <i>ijārah</i> contract commences with a promise to lease and is immediately binding on the part of the potential lessee.
Insolvency	A debtor's inability to pay his or her creditors. The term also refers to an excess of liabilities over assets.
Investment Risk Reserve (IRR)	The amount appropriated by the institution offering Islamic financial services out of the income of investment account holders (IAH), after deducting the <i>muḍārib's</i> share, in order to cushion against future investment losses by the IAH. ²¹
Islamic Deposit Insurance Scheme (IDIS)	The scheme of a deposit insurer and its relationships with the financial safety-net participants that support Islamic deposit insurance functions and resolution processes.
<i>Maqāṣid al-Sharī'ah</i>	The fundamental objective of Sharī'ah, which is to promote and protect the interests of all human beings and to avert any harm that may affect their wellbeing.
<i>Muḍārabah</i>	A partnership contract between the capital provider (<i>rabb al-māl</i>) and an entrepreneur (<i>muḍārib</i>) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence or breach of contracted terms.
<i>Murābahah</i>	A sale contract whereby the institution offering Islamic financial services sells to a customer a specified kind of asset that is already in its possession, whereby the selling price is the sum of the original price, direct expenses and an agreed profit margin.

²¹ Refer to paragraph 94 (b).

<i>Mushārah</i>	A contract between the institution offering Islamic financial services and a customer whereby both would contribute capital to an enterprise, whether existing or new, or to ownership of real estate or a movable asset, on either a temporary or a permanent basis. Profits generated by that enterprise or real estate/asset are shared in accordance with the terms of the <i>mushārah</i> agreement, while losses are shared in proportion to each partner's share of capital.
Pre-positioning Requirements	The various preparatory measures and arrangements to be carried out, a priori, in respect of various Islamic contracts used by the IIFS so that the chosen recovery and/or resolution tools can be implemented when required.
Profit Equalisation Reserve (PER)	The amount appropriated by the institution offering Islamic financial services out of the <i>muḍārah</i> income, before deducting the <i>mudārib</i> 's share, in order to maintain a certain level of return on investment for investment account holders and to increase owners' equity.
<i>Qarḍ</i>	A loan intended to allow the borrower to use the funds for a period with the understanding that this would be repaid at the end of the period, where it is not permissible for any increase in cash or benefit.
Recovery Plan	A plan containing a series of clear and predefined options that will be executed by a financial institution in the face of financial stress. The plan should be integrated into the financial institution's existing governance framework and processes. It should include regular monitoring of early warning signs and predefined triggers to identify the necessary actions, and regular reviews and updates.
Sharī'ah-compliant Deposit Insurance Funds (TDIF)	The funds managed by a deposit insurer that fulfil Sharī'ah principles in supporting the financial safety net for the IIFS for the purpose of preserving stability of the financial system.
<i>Ṣukūk</i>	Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets that are <i>Sharī'ah</i> -compliant.
Systemically Important Financial Institutions (SIFIs)	A bank, insurance company or other financial institution whose failure might trigger a financial crisis. They are colloquially referred to as "too big to fail" as per the Financial Stability Board's definition.
<i>Takāful</i>	The term is derived from an Arabic word meaning "solidarity", whereby a group of participants agree among themselves to support one another jointly against a defined loss. In a <i>takāful</i> arrangement, the participants contribute a sum of money as wholly or partially <i>Tabarru'</i> (donation) into a common fund, which will be used for mutual assistance for the members against a defined loss or damage, according to the terms and conditions of the <i>takāful</i> .
<i>Tawarruq</i>	A sale contract that consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis.

<i>Wakālah</i>	An agency contract where the customer (principal) appoints the institution offering Islamic financial services as agent (<i>wakīl</i>) to carry out the business on their behalf and where a fee (or no fee) is charged to the principal based on the contract agreement.
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APPENDIX B: Gap Analysis of Recovery and Resolution (RR) for IIFS

TNRR	FSB Key Attributes (KA) Standard Benchmark	Regulatory Gap	Justification and Relevance for IIFS
A. Broad RR Framework			
Resolution Authority	FSB KA 2	Not Applicable	Not Applicable
Resolution Powers	FSB KA 3	Not Applicable	Not Applicable
B. Preliminary Analysis of RR			
Data Collection and Analysis	Value addition in TNRR to regulate in a more prudent manner for the IIFS		
Identification of Critical Functions and Shared Services	FSB Guidance on Identification of Critical Functions and Shared Services	Not Applicable	Not Applicable
Crisis Management and Preparedness	Value addition in TNRR to regulate in a more prudent manner for the IIFS		
Crisis Management Groups	FSB KA 8	Not Applicable	Not Applicable
Stress Testing	Value addition in TNRR to regulate in a more prudent manner for the IIFS by referring to the IFSB Standards on Stress Testing as a guidance		
Resolvability Assessments	FSB KA 10	An absence of the resolvability assessment for the Sharī'ah contracts	Incorporating the resolvability assessment for the Sharī'ah contracts in ensuring the soundness of IIFS during the stress modes
C. Recovery Process for IIFS			
Governance Framework	FSB KA 11	Not Applicable	Not Applicable
Sharī'ah Governance Framework	Value addition in TNRR to recognise the IIFS specificities		
Key Elements of Recovery Planning	FSB KA 11	An absence of Sharī'ah principles fulfillment for the credible recovery options	Credible recovery options need to fulfil the Sharī'ah principles with the applicable Sharī'ah contracts for each recovery option
Recovery Triggers and Powers	Value addition in TNRR based on IFSB, WP-07: <i>Recovery, Resolution and Insolvency Issues for Institutions offering Islamic Financial Services</i>		
Recovery Options	Value addition in TNRR based on IFSB, WP-07: <i>Recovery, Resolution and Insolvency Issues for Institutions offering Islamic Financial Services</i>		
Regulatory Cooperation Measures	FSB KA 12	Not Applicable	Not Applicable

D. Resolution Process for IIFS			
Governance Framework	FSB KA 11	Not Applicable	Not Applicable
Sharī'ah Governance Framework	Value addition in TNRR to recognise the IIFS specificities		
Key Elements of Resolution Planning	FSB KA 11	An absence of Sharī'ah contracts available during the resolution process for the failed IIFS	Addressing the importance of the Sharī'ah contracts for the resolution mechanism for IIFS
Pre-Positioning Requirements for Resolution Implementation	Value addition in TNRR to regulate in a more prudent manner for the IIFS		
Resolution Strategy and Actions	Value addition in TNRR to regulate in a more prudent manner for the IIFS		
Resolution Implementation	FSB KA 4-6	Applicable for KA 5 regarding Sharī'ah treatment for the creditor hierarchy during the liquidation that is still absent at the prevailing regulation	Creditor hierarchy treatment vis-à-vis depositors is addressed from the Sharī'ah perspective
Resolution Options	Value addition in TNRR based on IFSB, WP-07: <i>Recovery, Resolution and Insolvency Issues for Institutions offering Islamic Financial Services</i>		
Regulatory Cooperation Measures	FSB KA 7-9	An absence of the Sharī'ah regulation coordination between home and host	Home–host coordination regarding the Sharī'ah regulation is addressed
Sharī'ah Perspective on Insolvency	Value addition in TNRR based on IFSB, WP-07: <i>Recovery, Resolution and Insolvency Issues for Institutions offering Islamic Financial Services</i>		