



ISLAMIC FINANCIAL SERVICES BOARD

IMPLEMENTATION GUIDELINES 2020 REPORT

ISLAMIC FINANCIAL SERVICES BOARD

STANDARD IMPLEMENTATION
SUPPORT DOCUMENT



ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

The IFSB is an international standard-setting organisation which was established 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 comprehensive due process as outlined in its Guidelines and Procedures for the Preparation of Standards/Guidelines, which involves, but is not limited to, the issuance of exposure drafts, the holding of workshops and, where necessary, 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.

For more information about the IFSB, please visit www.ifsb.org.

CONTENTS

FOREWORD	4-5
EXECUTIVE SUMMARY	6-8
SECTION I Background	9-20
SECTION II Introduction	21-23
SECTION III Implementation Challenges	24-29
SECTION IV Implementation Guidelines	30-34
SECTION V BAHRAIN (Central Bank of Bahrain)	35-43
SECTION VI JORDAN (Central Bank of Jordan)	44-50
SECTION VII REPUBLIC OF KAZAKHSTAN (Agency of the Republic of Kazakhstan for regulation and development of financial market)	51-56
SECTION VIII OMAN (Central Bank of Oman)	57-64

FOREWORD

The first edition of the IFSB's Implementation Guidelines Report is another initiative that falls within its mandate. The report reflects the development of the Islamic finance industry and implementation of key prudential requirements based on IFSB standards within four jurisdictions – Bahrain, Jordan, Oman and Kazakhstan.

As I write this, the COVID-19 pandemic continues to challenge our societies and economies, presenting a great test to the stability and resilience of the global financial system. During this challenging time, the IFSB continued to provide support to all its members particularly Regulatory and Supervisory Authorities (RSAs) to facilitate the implementation of its standards in member jurisdictions. Throughout 2020, we have shifted all of our physical "Facilitating the Implementation of IFSB Standards" (FIS) workshops to online platform as virtual platforms which were made available to all IFSB members. We also continue to extend Technical Assistance and Policy Advice to our members through online means in order to support their initiatives in building more sound and effective Islamic finance regulatory framework. The IFSB Secretariat has also kept monitoring the developments in the financial system of our member jurisdictions through surveys, webinars and has published a compendium of policy responses and a working paper on assessing the stability of the Islamic banking industry amidst the COVID-19 pandemic.

Meanwhile, this report is another result of our close cooperation with our RSA members, which has focuses on the status of Islamic finance in these jurisdictions and their experience in implementing IFSB standards. The Implementation Guidelines Report is part of IFSB's efforts to promote and establish sound regulatory and supervisory systems for maintaining a fair, safe and stable Islamic financial services industry (IFSI). This publication is a timely analysis of jurisdictions experience in developing Islamic finance infrastructure, which illustrates the current stage of IFSI in each country, the level of compliance with key regulatory requirements based on IFSB prudential standards, challenges faced by RSAs in implementing IFSB standards and future expectations related to the prudential regulations.

We believed that, the Implementation Guidelines Report will benefit all our members that like to enhance the Islamic finance sector in their respective jurisdictions and ensure effective implementation of IFSB standards. Moreover, we want IFSB members – those participating in Implementation Guidelines and those reading it – to treat this report as a reference toolkit for other implementation tools provided by the IFSB. For example, the Impact and Consistency Assessment Programme (ICAP) might benefit jurisdictions with high IFSB standards implementation rate to get a validated representation of their implementation status and identify any regulatory gaps that might have a serious impact on their financial sector. While Policy Advice and Technical Assistance will be helpful for IFSB members with an objective to develop the local Islamic finance market and implementing IFSB standards.

The Implementation Guidelines Report is firstly based on data collected by a recent survey of participating jurisdictions and secondly on internal research conducted by the IFSB Secretariat. You will find key sections related to Islamic finance regulatory framework, Shari'ah governance, Liquidity management, as well as challenges in adopting IFSB standards.

This report wouldn't be possible without efforts and support from our members: the Central Bank of Bahrain, the Central Bank of Jordan, Agency of the Republic of Kazakhstan for Regulation and

Development of Financial Market, and the Central Bank of Oman. We would like to extend our sincere appreciation and gratitude to representatives from these institutions who contributed to the Implementation Guidelines Project including: Mrs Shireen Al Sayed, Head of Regulatory Policy Unit at the Central Bank of Bahrain; Mr Hussam T. Alowaisy, Senior Examiner at the Central Bank of Jordan; Ms Aziza Gabitkyzy, Leading Specialist of International Relations and External Communications Division at the Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market; and Mrs Raja Salim Al Hadhrami, Senior Islamic Banking Analyst at the Central Bank of Oman. The report was produced by a core team from the IFSB Secretariat led by Mr Walid Al Zahrani, Assistant Secretary-General Implementation and Resources, with his team members Mr Esam Osamah Al-Aghbari, Mrs Ainaz Faizrakhman and Dr Hechem Ajmi.

The IFSB takes this opportunity to also acknowledge the immense contribution and the unwavering support by all its members towards its implementation support initiatives and technical work streams. We wouldn't have achieved these great milestones without the commitment of its members and its dedicated staff.

I hope this first edition of Implementation Guidelines will add an inclusive value to all our members and it will enhance the international cooperation between all countries developing Islamic financial market.

I am also taking this opportunity to invite other IFSB RSA members to participate in our future editions of the Implementation Guidelines Report.

On behalf of the IFSB Secretariat, I wish all IFSB members, readers and their families a good health and prosperity, particularly at this challenging times.

Dr Bello Lawal Danbatta
Secretary-General
Islamic Financial Services Board

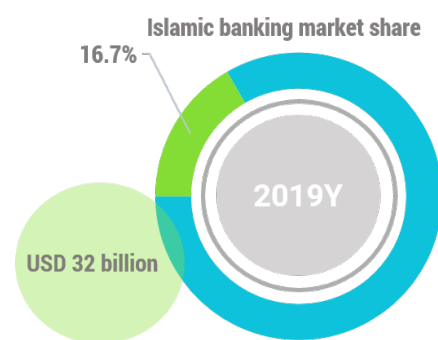
EXECUTIVE SUMMARY

Since its establishment, the IFSB has conducted several types of activity that support the implementation of standards in member countries. These activities include: FIS and Capacity building workshops, Technical Assistance, Policy Advice, the translation of IFSB standards into additional languages and developing FAQs section on the website. Another activity that is meant to raise awareness on IFSB standards among the members is Implementation Guidelines Project that kick started in 2020 and engaged four member RSAs from different jurisdictions that have the highest implementation rate of IFSB Islamic banking standards. The first Implementation Guidelines Report of 2020 is dedicated to report the experience of these four jurisdictions, including Bahrain, Jordan, Kazakhstan and Oman.

To document these RSAs experience, IFSB developed a questionnaire that became an initial outline for Implementation Guidelines research. The next step for the Secretariat was to use Implementation Survey's data of 2020 and do their own research on jurisdictions' market conditions, legal framework and Islamic finance milestones.

After all data was collected, individual country reports were drafted. This followed by a joined webinar with all four RSAs as sharing of experience session. Additional information was collected during the session and put into the second draft of the individual country reports. The second draft of the individual country reports was sent to respective RSAs (the Central Bank of Bahrain, the Central Bank of Jordan, Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market, and the Central Bank of Oman) to get verification on individual reports related to their jurisdiction. The Secretariat received each RSAs confirmation of their individual country reports with some updated information, which gave IFSB a green light to proceed with a final report.

BAHRAIN



1979

THE FIRST ISLAMIC BANK
ESTABLISHED



SHARI'AH GOVERNANCE

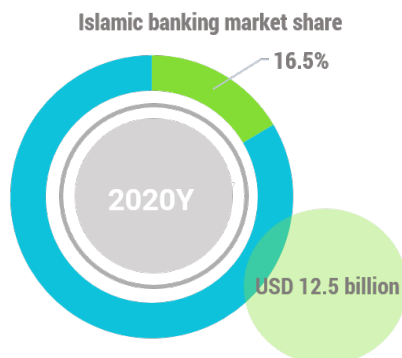
- 2015 The CBB issued a resolution in respect of the establishment of a Central Shari'ah Supervisory Board (CSSB).
- 2018 The Shari'ah governance framework became effective.
- 2020 The CBB established a new rule that the Internal Shari'ah audit function of Islamic banks must be governed by a policy and procedures manual prepared by the management of the licensee in consultation with the CSSB.

The CBB faces no significant challenges in implementing IFSB standards



highest IFSB standards implementation rate

JORDAN



total assets of the Islamic banking sector

The CBJ faces no significant challenges in implementing IFSB standards



1978

THE FIRST ISLAMIC BANK ESTABLISHED

2000

The Banking Law of 2000 introduced, outlining regulations and provisions applicable to all institutions engaging in banking activities including Islamic banks.

SHARI'AH GOVERNANCE

2000

Shari'ah Governance System is part of the requirement under the Banking Law of 2000

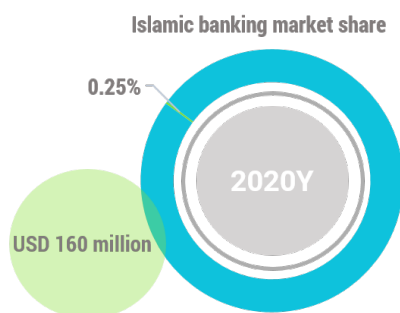
2016

Instructions of Corporate Governance are included into the CBJ guidelines to ensure the competency and independence of the Shari'ah Board members



highest IFSB standards implementation rate

KAZAKHSTAN



total assets of the Islamic banking sector

CHALLENGES

lacking of local Shari'ah scholars
relatively small size of the Islamic finance industry

2

full-fledged Islamic banks

2009

THE FIRST ISLAMIC BANK ESTABLISHED

2009

The Law of Kazakhstan was introduced to cater Islamic finance and Islamic banks

SHARI'AH GOVERNANCE

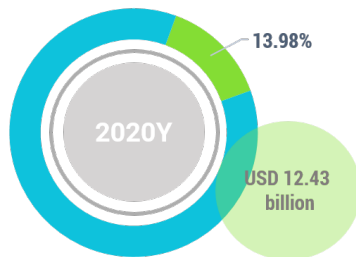
Council on the principles of Islamic finance should be established within each operating Islamic bank within the jurisdiction to monitor the Shari'ah compliance



medium IFSB standards implementation rate

OMAN

Islamic banking market share



total assets of the Islamic banking sector

2013

THE FIRST ISLAMIC BANK
ESTABLISHED



highest IFSB standards implementation rate

2

full-fledged
Islamic banks

5

Islamic windows

86

Islamic banking branches of
commercial banks

2012

Islamic banking law royal decree introduced

SHARI'AH GOVERNANCE

2013

The CBO established a High Shari'ah Supervisory Authority

CHALLENGES

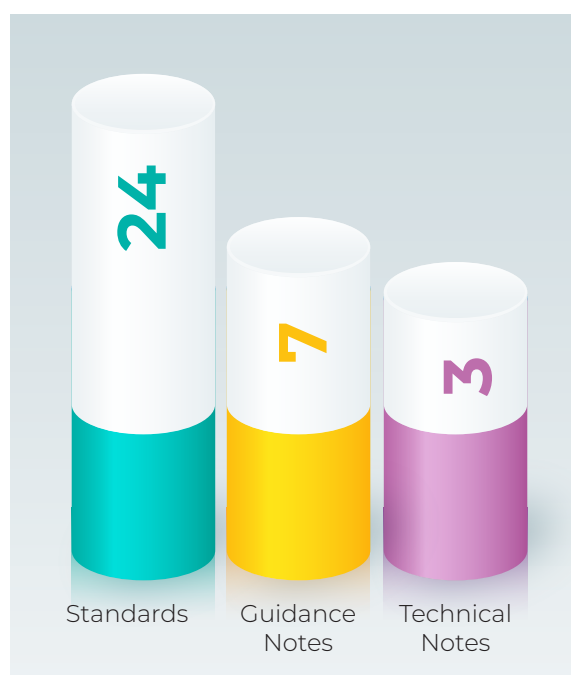
The main challenges for the CBO in the early phase was the availability of qualified staff

Section I: Background

The Islamic Financial Services Industry (IFSI) has seen significant growth and is now estimated to worth USD 2.44 trillion based on the 2020 IFSB IFIS Stability Report. The Islamic finance ecosystem has developed exponentially with the emergence of a full suite of Shari'ah-compliant offerings such as Takaful, Islamic funds, Shari'ah advisory firms, *Sukuk* and more. Islamic Banking is the largest sector in IFSI, contributing 72.4% or 1.76 trillion of the industry's assets (*IFSB IFIS Stability Report 2020*). There are many elements which have contributed to the growth of Islamic finance globally. However, one of the most notable reasons that facilitated such growth was the introduction of sophisticated regulatory regimes in different jurisdictions, that have slowly built the confidence of customers, leading to more demand for Shari'ah-compliant products and services.

In 2002, the IFSB was founded to serve as an international standard-setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry. The IFSB has a mandate to promote the development of a prudent and transparent Islamic financial services industry by introducing new, or adapting existing international standards consistent with Shari'ah principles, and recommend them for adoption. Since its inception, the IFSB has issued thirty-four Standards, Guiding Principles and Technical Notes for the Islamic financial services industry.

Figure 1: IFSB published standards



The published documents addressing three Islamic finance sectors, including Islamic Banking, Takaful and Islamic Capital Markets. Table 1 highlights details on related sectors and objectives of issued standards.

The IFSB works closely with its members in the process of developing global prudential standards and guiding principles for the IFSI. As of March 2021, the IFSB, comprising 188 members from 57 jurisdictions, consisting of regulatory and supervisory authorities, international inter-governmental organisations and market players (financial institutions, professional firms, industry associations and stock exchanges) – those international, regional and national organisations and market players that share IFSB's objectives.

Figure 2: IFSB Members



No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
1	Risk Management (IFSB-1)				This standard was issued in 2005 and designed to provide a set of principles and guidelines of best practice for establishing and implementing effective risk management in IIFS, which complements the current risk management principles issued by the BCBS and other international standard-setting bodies in order to cater for the specificities of IIFS.
2	Capital Adequacy (IFSB-2)				<p>IFSB-2 was issued in 2005 and aimed to address the specific structure and contents of the Shari'ah-compliant products and services offered by the IIFS that are not specifically addressed by international capital adequacy standards, and Shari'ah-compliant mitigation.</p> <p>Another objective of this standards was to standardise the approach in identifying and measuring risks in Shari'ah-compliant products and services and in assigning risk weights to meet internationally acceptable prudential standards.</p> <p>The IFSB-2 is superseded by IFSB-15.</p>
3	Corporate Governance (IFSB-3)				Issued in 2006, this document's objective is to facilitate IIFS in identifying areas where appropriate governance structures and processes are required, and to recommend best practices in addressing these issues. For this it sets out seven guiding principles of prudential requirements in the area of corporate governance for IIFS.
4	Transparency and Market Discipline (IFSB-4)				Issued in 2007, the purpose of this standard is to specify a set of key principles and practices to be followed by IIFS in making disclosures, with a view to achieving transparency and promoting market discipline in regard to these institutions. For this purpose, recommendations have been developed for a set of disclosures that are differentiated by the type of stakeholders and that focus on the risk profile and financial soundness of the IIFS.
5	Supervisory Review Process (IFSB-5)				<p>Issued in 2007, the overall aim of this document is to set forth guidance on key elements in the supervisory review process for authorities supervising IIFS using a risk-based approach and best practice.</p> <p>The IFSB-5 is superseded by IFSB-16.</p>

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
6	Governance for Collective Investment Schemes (IFSB-6)				IFSB-6 was issued in 2009 with the purpose of further strengthening the governance in the IFSI and promoting soundness and stability in the Islamic financial system. This document is a second tier of IFSB's governance standards by focusing on collective investment schemes (CIS) that are claimed to be Shari'ah-compliant.
7	Special Issues in Capital Adequacy (IFSB-7)				<p>Issued in 2009, this document covers matters that were not covered in IFSB-2 and specifically those related to types of <i>Sukuk</i>, to <i>Sukuk</i> origination and issuance, and to investment in real estate.</p> <p>This Standard applies to both originating and issuing IIFS, as well as to <i>Sukuk</i> that are traded in the secondary market, the market risk capital requirement, and to real estate investment.</p>
8	Governance for Islamic Insurance (Takaful) Operations (IFSB-8)				<p>This document was issued in 2009 with the aim to adapt and reinforce the existing internationally recognised frameworks or standards for Takaful undertakings so that they stand on a level playing field with their conventional counterparts. In this respect, this document is built around the following premises and objectives:</p> <ul style="list-style-type: none"> (i) reinforcement of relevant good governance practices as prescribed in other internationally recognised governance standards for insurance companies, while addressing the specificities of Takaful undertakings; (ii) a balanced approach that considers the interests of all stakeholders and calls for their fair treatment; and (iii) an impetus for the development of a more comprehensive prudential framework for Takaful undertakings.

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
9	Conduct of Business for Institutions offering Islamic Financial Services (IIFS) (IFSB-9)				<p>The seven Guiding Principles highlighted in the IFSB-9 set out a framework intended to complement and “add value” to other IFSB standards and existing internationally recognised frameworks that set out sound principles and best practices pertaining to the conduct of business by participants and institutions in the conventional banking, insurance and capital market industry segments, by addressing the specificities of the IFSI.</p> <p>This cross-sector standards was issued in 2009 to cover all three sectors: Islamic banking, Islamic insurance and Islamic Capital Markets, including “windows” of conventional firms to ensure an adequate systems of control over the conduct of business.</p>
10	Shari’ah Governance System (IFSB-10)				<p>Issued in 2009, this document contains nine guiding principles and recommended practices that were designed to complement other prudential standards issued by the IFSB by highlighting more detailed components of a sound Shari’ah Governance System, especially concerning the competence, independence, confidentiality and consistency of Shari’ah boards, and transparency of the audit and review process for compliance with Shari’ah rulings.</p> <p>IFSB is currently working on issuing a more comprehensive Shari’ah governance standard.</p>
11	Solvency Requirements for Takaful (Islamic Insurance) Undertakings (IFSB-11)				<p>Issued in 2010, the overall objective of this document issued is to set forth key principles on the solvency requirements for Takaful undertakings.</p> <p>This Standard is applicable to all Takaful and Retakaful undertakings and recommended to be read together with the Guiding Principles on Governance for Takaful (Islamic Insurance) Undertakings IFSB-8.</p>

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
12	Liquidity Risk Management (IFSB-12)				<p>This set of 23 guiding principles within the IFSB-12 is intended to provide guidance to IIFS in a number of key areas in their management of liquidity risk, and to facilitate the supervisory authorities' assessment of the adequacy of IIFS' liquidity risk management framework and levels of liquidity within their constituency.</p> <p>IFSB-12 was issued in 2012 and takes into consideration the specificities of the IIFS and complements relevant existing and emerging international best practices.</p>
13	Stress Testing (IFSB-13)				<p>These Guiding Principles address the specificities of institutions offering IIFS in the banking segment with respect to stress testing, and complement other existing internationally recognised frameworks that set out sound principles and best practices pertaining to stress testing for conventional counterparts so that IIFS stands on a "level playing field" with their conventional institutions.</p> <p>IFSB-13 was issued in 2012 and supplements both IFSB-1 and IFSB-5.</p>
14	Risk Management for Takaful (Islamic Insurance) Undertakings (IFSB-14)				<p>This document establishes minimum standards in the area of risk management, for the direction and guidance of Takaful Operators and insurance/Takaful supervisors.</p> <p>The principles and recommendations set forth in this document that was issued in 2013 are intended to achieve the following main objectives:</p> <ul style="list-style-type: none"> (i) to help understand the risks to which a Takaful undertaking (TU) is exposed; (ii) to provide minimum standards for the development of a risk management framework for ease of management of the TU and supervision by its governing bodies and supervisory authorities; and (iii) to help create a safe and prudent environment for the growth, sustainability and development of the Takaful industry.

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
15	Revised Capital Adequacy (IFSB-15)				Issued in 2013, this Standard covers some additional areas not previously included in IFSB standards and guidelines related to capital adequacy. It also aims to provide a more comprehensive guidance to supervisory authorities on the application of capital adequacy regulations for IIFS by combining and enhancing the contents of IFSB-2 and IFSB-7, thus providing a level playing field to IIFS vis-à-vis market players.
16	Revised Supervisory Review Process (IFSB-16)				Issued in 2014, the overall aim of this document is to revise and replace IFSB-5 in setting forth guidance on key elements in the supervisory review process for authorities supervising IIFS (excluding Islamic insurance (Takaful) institutions and Islamic collective investment schemes). It takes into consideration the specificities of the IIFS, the lessons learned from the crisis, while complementing the existing international standards on the supervisory review process, in particular those of the BCBS.
17	Core Principles for Islamic Finance Regulations (IFSB-17)				<p>Issued in 2015, the main objective of the IFSB-17 is to provide a set of core principles for the regulation and supervision of the IFSI (CPIFR), taking into consideration the specificities of the IIFS in the banking segment and the lessons learned from the financial crisis, and complementing the existing international standards, principally the BCBS's Core Principles for Effective Banking Supervision. The objectives of the CPIFR include:</p> <ul style="list-style-type: none"> (i) providing a minimum international standard for sound regulatory and supervisory practices for the effective supervision of the IIFS; (ii) protecting consumers and other stakeholders by ensuring that the claim to Shari'ah compliance made explicitly or implicitly by any IIFS is soundly based; (iii) safeguarding systemic stability by preserving the linkages between the financial sector and the real economic sector that underlie Islamic finance; (iv) ensuring IIFS acts in accordance with their fiduciary responsibilities in all operations, especially concerning investment account holders.

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
18	Retakaful (Islamic Reinsurance) (IFSB-18)				Issued in 2016, this standard aims to provide RSAs of the Takaful and Retakaful industry. It sets out basic principles and best practices pertaining to Retakaful activities of both Takaful and Retakaful Operators (TOs and RTOs). It is intended to be applied by RSAs to TOs and RTOs in their jurisdiction with reference to both inward and outward Retakaful activities.
19	Disclosure Requirements for Islamic Capital Market Products (IFSB-19)				<p>Issued in 2017, this standard is applicable only to <i>Sukuk</i> and Islamic collective investment schemes (ICIS).</p> <p>The IFSB-19 intends:</p> <ul style="list-style-type: none"> (i) to provide a basis for RSAs to set rules and guidelines on disclosure requirements for ICM products, specifically for <i>Sukuk</i> and ICIS; (ii) to outline a basis for RSAs to assess the adequacy of the disclosure frameworks specified by others; (iii) to provide a comprehensive disclosure framework for participants in the ICM; (iv) to create greater harmonisation of regulation and practice in the ICM, and thus facilitating cross-border offerings.
20	Supervisory Review Process of Takaful/ Retakaful Undertakings (IFSB-20)				Issued in 2018, this standard describes and consolidates key elements of the supervisory review process. The goal of the standard is to assist RSAs to develop an integrated system for assessing the governance framework, capital adequacy, risk management framework and Retakaful programmes of Takaful and Retakaful undertakings, as highlighted and recommended in IFSB-8, IFSB-11, IFSB-14 and IFSB-18, as well as other matters relevant to all areas of supervision, with a particular focus on those areas specific to Islamic finance.

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
21	Core Principles for Islamic Finance Regulation [Islamic Capital Market Segment] (IFSB-21)				<p>Issued in 2018, the main objective of this document is to provide a set of core principles for the regulation and supervision of the ICM, taking into consideration the specificities of Islamic finance, while complementing the existing international standards, principally IOSCO's "Objectives and Principles of Securities Regulation and its Methodology" (May 2017). In particular, the objectives of the core principles:</p> <ul style="list-style-type: none"> (i) to provide a minimum international standard for sound supervisory practices for the regulation and assessment of the ICM; (ii) to protect consumers and other stakeholders by ensuring the claim to Shari'ah compliance made explicitly or implicitly by any ICM product or service is sound and supported by appropriate disclosures; and (iii) to enhance the soundness and stability of the ICM – as an integral part of the IFSI and the global financial system – by helping RSAs to assess the quality of their relevant supervisory systems and identify areas for improvement as an input to their reform agenda.
22	Revised Transparency and Market Discipline (IFSB-22)				<p>Issued in 2018, the IFSB-22 aims to specify a set of key principles and practices to be followed by IIFS in the banking sector in making disclosures, with a view to achieving transparency and promoting market discipline concerning these institutions. It further addresses some additional areas not previously covered by IFSB standards and guidelines related to disclosure, and aims to promote consistency and comparability of disclosures among IIFS by introducing harmonised templates for the disclosure of quantitative information of key risks relevant to IIFS.</p>

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
23	Investor Protection in Islamic Capital Markets (IFSB-24)				<p>Issued in 2020, this standard is intended to set out minimum requirements to be applied in the ICM for the protection of investors and the promotion of financial stability.</p> <p>The principles set forth in this standard aim to achieve the following objectives:</p> <ul style="list-style-type: none"> (i) to address the Islamic finance-specific issues that need to be considered within regulatory frameworks for investor protection; (ii) to define best practices for investor protection in relation to the ICM; (iii) to support the development of robust investor protection frameworks for the ICM; (iv) to increase harmonisation of regulatory practice, to support the development of the international ICM.
24	Disclosures to Promote Transparency and Market Discipline for Takaful/ Retakaful Undertakings (IFSB-25)				<p>Issued in 2020, the IFSB-25 is intended to set out requirements to be applied by RSAs to Takaful and Retakaful undertakings to promote transparency and market discipline by providing sufficient disclosures to the market and to actual or potential participants. The ultimate goal is to protect the interests of participants, shareholders, investors and other stakeholders, along with maintaining the stability of the Takaful industry.</p>
25	Recognition of Ratings on Shari'ah-Compliant Financial Instruments (GN-1)				<p>Issued in 2008, the objective of this Guidance Note (GN) is to outline criteria which the IFSB recommends national supervisors to take into account when determining which external credit assessment institutions may have their ratings used to calculate capital adequacy ratios under the IFSB's December 2005 Capital Adequacy Standard.</p>

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
26	Risk Management and Capital Adequacy Standards: Commodity <i>Murabahah</i> Transactions (GN-2)				Issued in 2010, GN-2 highlights risks associated with Commodity <i>Murabahah</i> Transactions and products of similar design and structure, and to assess their implications in relation to the regulatory capital requirements in IIFS.
27	Practice of Smoothing the Profits Payout to Investment Account Holders (GN-3)				Issued in 2010, GN-3 aims to: <ul style="list-style-type: none"> (i) complement other prudential standards issued by the IFSB by highlighting in detail, to the supervisory authorities in particular and the industry's other stakeholders in general, various issues related to Smoothing triggered by various methods, including forfeiting of the <i>Mudarib</i> share of profits, transfer of profits from shareholders to Investment Account Holders (IAH), maintenance of a profit equalisation reserve by the IIFS, etc. These issues, inter alia, accentuate various transparency, corporate governance and harmonisation concerns; (ii) recommend to national supervisory authorities a number of "best practices" for the regulation and standardisation of techniques for Smoothing by IIFS in their jurisdiction; (ii) promote a wider debate on key points with regard to Smoothing practices adopted by IIFS.
28	Capital Adequacy Standard: The Determination of Alpha in the Capital Adequacy Ratio (GN-4)				Issued in 2011, this document aims to: <ul style="list-style-type: none"> (i) provide a methodology to estimate the value of alpha to be used in the supervisory discretion formula in calculating the CAR of IIFS; (ii) demonstrate how to measure the Displaced Commercial Risk – that is, the additional risk that IIFS shareholders may assume in order to cushion the returns payable to IAH against variations in asset returns.
29	Recognition of Ratings by External Credit Assessment Institutions (ECAIs) on Takaful and Retakaful Undertakings (GN-5)				Issued in 2011, the objective of this Guidance Note is to facilitate the emergence of generally accepted criteria for the recognition by national supervisory authorities and the wider financial community of credit ratings on Takaful and Retakaful undertakings.

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
30	Quantitative Measures for Liquidity Risk Management (GN-6)				<p>Issued in 2015, the GN aims to:</p> <ul style="list-style-type: none"> (i) complement other prudential standards issued by the IFSB, as well as to support the harmonised application of the international regulatory regime in the area of liquidity risk management, by providing guidance on the application of global liquidity standards for the IIFS, especially the LCR and NSFR at the current stage, with suitable adjustments based on the specific operational characteristics; (ii) provide guidance to supervisory authorities on the application of the LCR and NSFR in their jurisdictions and on their role in assessing the discretionary items specified in this GN, including application of the alternative liquidity approaches; (iii) delineate the disclosure requirements required alongside the application of liquidity standards; (iv) present the templates of the LCR and NSFR, which need to be considered in the planning and monitoring of liquidity risk.
31	Shari'ah-compliant Lender-Of-Last-Resort Facilities (GN-7)				<p>Issued in 2019, the GN covers:</p> <ul style="list-style-type: none"> (i) preconditions for developing and implementing the Shari'ah-compliant Lender-Of- Last-Resort (SLOLR) mechanism, including considerations of moral hazard and achieving a level playing field between the conventional and Islamic systems; (ii) Shari'ah perspectives on instruments, and operating modalities, for developing SLOLR facilities for IIFS; (iii) supervisory and operational considerations for SLOLR; (iv) the broader integration of SLOLR within the macro prudential framework and its implications from a monetary policy perspective (if any).
32	Development of Islamic Money Markets (TN-1)				<p>Issued in 2008, this documents intends to provide the existing practices and infrastructures of Islamic money markets across countries and give recommendations to address impediments to the development of efficient Islamic money markets.</p>

No.	Standards	Islamic banking	Islamic Capital Markets	Islamic	Objectives
33	Stress Testing (TN-2)				<p>Issued in 2016, TN-2 aims to:</p> <ul style="list-style-type: none"> (i) facilitate the design and simulation of solvency and liquidity stress tests for IIFS, including providing guidance on establishing macro financial links, running scenarios of various assumptions and stress parameters; (ii) highlight the specificities of risk exposures in IIFS and how they need to be captured in stress-testing exercises; (iii) provide stylised numerical examples of IIFS stress tests under different shock scenarios.
34	Financial Inclusion and Islamic Finance (TN-3)				<p>Issued in 2019, TN-3 aims to provide guidance on good practices in regulating the financial sector to enhance financial inclusion through Islamic finance, while also considering the proportionality in balancing the benefits of regulation and supervision against the risks and costs.</p>

Section II: Introduction

1 Overview on the implementation of IFSB standards

As indicated above, the implementation of IFSB standards is part of the core mandate of the organisation. Full, timely and consistent adoption and implementation of standards are essential in achieving stability and resilience of the industry. As a result, Strategic Key Result Area 2 (SKRA2) under the IFSB Strategic Performance Plan (SPP) 2019-2021, aims at increasing the level of implementation of IFSB standards by increasing capacity building initiatives, enhancing technical support to member jurisdictions and enhancing monitoring and assessment of the adoption of IFSB standards, was produced. To achieve these outcomes, a number of activities are planned to be conducted each year that will have direct and indirect impact on the implementation of IFSB standards. Figure 3 below shows SKRA 2 planned activities for 2019-2021.

Figure 3: SKRA 2 Outcomes and KPIs

SKRA 2 Facilitating the Implementation of Prudential Standards and Capacity Development			
OUTCOMES	OUTPUTS	KPI	CONTRIBUTION TO SKRA
OUTCOME 4: Increased Capacity Building Initiatives on the IFSB Standards and Guidelines in member Jurisdictions	1. FIS & RSA Workshops 2. Capacity Building for Market Players 3. E-Learning 4. Outreach Programmes	Standards Implementation rate among Member jurisdiction (%)	100%
OUTCOME 5: Enhanced Technical Support to member Jurisdictions for Effective Implementation of the IFSB Standards and Guidelines	1. Technical Assistance 2. Policy Advice 3. FAQs 4. Framework and Guidance		
OUTCOME 6: Enhanced Monitoring and Assessment of the Adoption of the IFSB Standards in Member Jurisdictions Effective Implementation of the IFSB Standards and Guidelines	1. Implementation Survey and Report 2. Country/Self-Assessment 3. Impact and Consistency Assessment Programme (ICAP)		

IFSB developed a wide range of tools to enhance the implementation of IFSB standards by RSAs. One of the core activities conducted yearly on a continual basis is “Facilitating the Implementation of IFSB Standards Workshop” (FIS Workshop) that was introduced in 2007 and structured with the aim to bring deep understanding of IFSB standards and practical case studies. RSA workshops and

Capacity Building workshops are another initiatives that are held annually to address regulators and market players' needs.

Other important implementation tools available for all IFSB members are Technical Assistance and Policy Advice. Both of these technical support initiatives are recognised among the most significant implementation tools demanded by IFSB members (according to the 2020 Implementation Survey). IFSB has developed a structured approach when it comes to discussing technical issues of the IFSB standards implementation process that RSAs are facing, which followed by detailed report and recommendations, as well as conducting a gap analysis to ensure consistency of jurisdiction's legislation with IFSB standards. IFSB has provided numerous remote and on-ground technical support to IFSB Members. A special FAQ section is also available on IFSB's website as a quick reference to IFSB standards, guidance notes and technical notes, aimed to reduce the knowledge gaps and clarify certain aspects in IFSB standards.

As mentioned above, the implementation and applicability status of the IFSB standards are being monitored through the Implementation Survey. Implementation Survey tracks the adoption of the IFSB standards through a questionnaire, which covers the progress made in implementing published standards by member RSAs, as well as the major challenges and constraints that RSAs are facing in the process. The Implementation Survey is thus an important component of the IFSB's efforts towards enhancing the implementation of IFSB standards by identifying the right strategies that can assist in accelerating and strengthening the process of implementing IFSB Standards. Implementation Survey is being conducted twice a year: the first Implementation Survey is a "Master Non-technical Survey" covering all IFSB RSA Members, while the second Implementation Survey is designed specifically for IFSB's Council members. Since 2012, the IFSB has conducted ten surveys on standards implementation among its member supervisors.

In 2020 IFSB introduced a new programme designed to assess the consistency and impact of IFSB standards in member countries – the Impact and Consistency Assessment Program (ICAP). Approval of the ICAP concept was the next logical step for the IFSB Council, which over the years has demonstrated its commitment towards increasing the implementation rate of IFSB standards among IFSB members and in ensuring that the IFSB standards delivered the desired impact for the overall benefit of the global Islamic Financial Services industry following its mandate. The ICAP is meant to provide a validated representation of the implementation status by member RSAs and allow the identification of any regulatory gaps that might have a serious impact on the financial sector in member jurisdictions. It will also allow the IFSB to extend any support required to redeem gaps and to ensure effective implementation of standards by member jurisdictions.

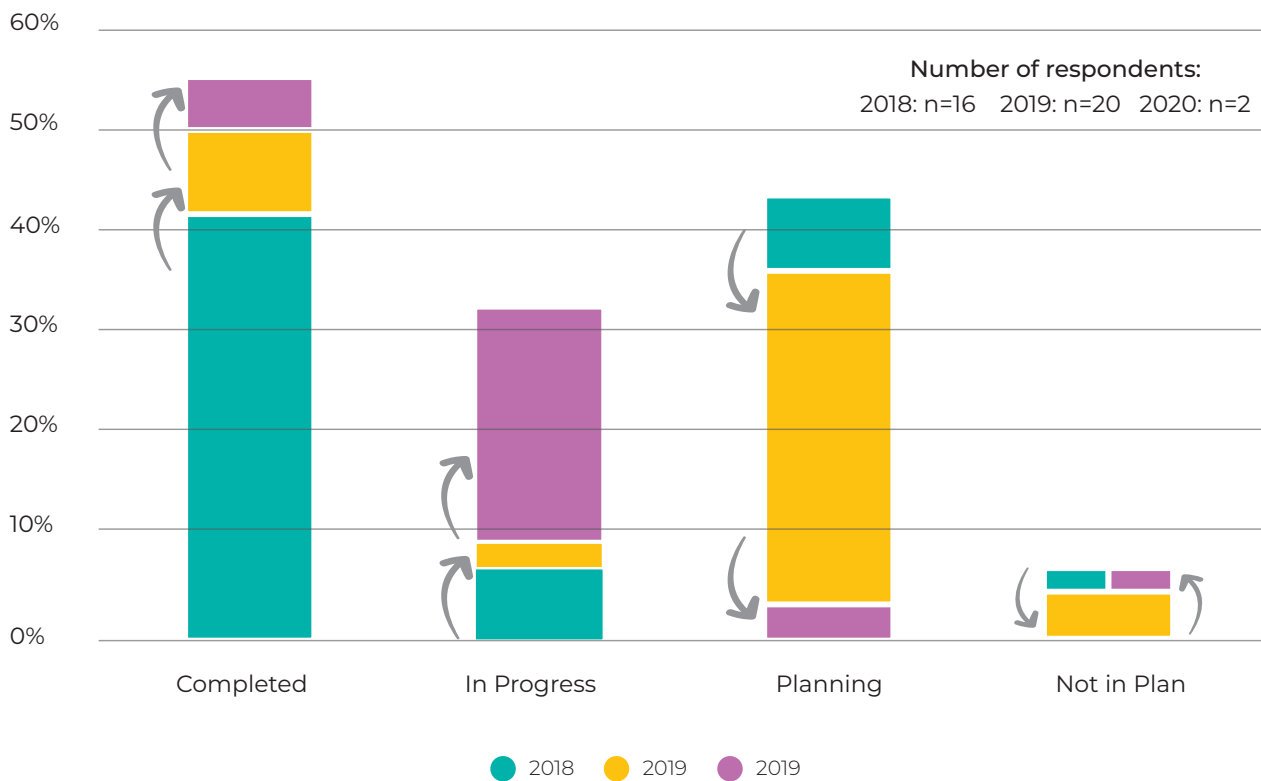
2 Snapshot on current state of implementation

The Implementation Survey (Master Non-technical Survey) covers 21 IFSB Standards across the three core segments of the IFSI. Specifically, 12 standards for Islamic banking, 5 standards for Takaful, 2 standards for ICM and 2 cross-sectoral standards.

Based on the 2020 Implementation Survey, the implementation of IFSB standards is in progress in many countries. Some jurisdictions are more advanced, having completed implementation of many of the IFSB standards, while others are still in the early planning stages. For the banking sector, based on the Implementation Report, 56% of the standards were implemented by respondents. In the Takaful sector, 55% of the Takaful standards have been implemented by member RSAs. In

addition to that, 59% of the standards were implemented by respondents regulating the Islamic Capital Markets sector. Figure 4 below provides the implementation status developments for the past three years from 2018 till 2020 considering all three sectors: Islamic banking, Islamic Capital Markets and Islamic insurance.

Figure 4: Implementation Status 2018-2020. Overall Comparison



Based on the 2020 Implementation Survey results, the most implemented Islamic banking standard with a 100% implementation rate among all respondents is IFSB-10 on Shari'ah Governance, followed by the Corporate Governance standard (IFSB-3) with 67% Implementation rate, and the Capital Adequacy standard (IFSB-15) with 64%. In the Islamic Capital Markets section, IFSB-6 on Governance for Islamic Collective Investment Schemes has a higher implementation rate with 57% completion rate compared to IFSB-19 on Disclosure Requirements for Islamic Capital Market Products with 43% of a completion rate, considering that IFSB-19 is a "young" standards released in 2017. For the Takaful standards, both IFSB-8 on Governance for Takaful Undertakings and IFSB-14 on Risk Management for Takaful Undertakings have an implementation rate of 67% and considered to record the highest completion rate among all other Takaful standards.

Section III: Implementation Challenges

There are certain challenges involved in developing an Islamic banking infrastructure and other sectors as Islamic Capital Markets and Islamic insurance that deliver compliance with IFSB standards. The IFSB, in line with its mandate, works to complement the prudential and supervisory standards issued by the International standard-setting bodies by addressing the specificities of Islamic finance. Therefore, IFSB standards and guidelines are an opportunity to drive greater operational efficiency of IIFS. The IFSB aims to contribute to the soundness and stability of the Islamic financial system, promote implementation and adoption of the requirements set within the standards, and deliver compliance by ensuring that IFSB members aware of the challenges involved and provided with all necessary implementation tools to support the issue solving. Some of the challenges involved in implementing IFSB standards and guidelines include:

1

Lack of knowledge in Islamic finance by RSA staff

Annual Implementation Survey findings indicated that lack of expertise in Islamic finance by member RSAs staff makes it challenging for jurisdiction to fully implement relevant IFSB standards. Even if the regulator supports the development of the Islamic finance sector, the lack of sufficient skills and expertise will hamper the implementation of effective practices and principles regulating the IIFS. The question remains of how RSAs can resolve this particular issue.

2

Supervisory staff lack capacity to supervise and assess compliance with Islamic finance related regulations and guidelines

This is another obstacle that jurisdictions face in the IFSB standards implementation process related to human resources and capacity building.

An effective system of supervision requires the supervisor to develop and maintain a proper assessment approach. However, when it comes to the supervision of Islamic finance related requirements some RSAs might not be able to establish a dedicated Islamic finance supervisory department or unit, which leaves staff carrying a general supervision process of a conventional bank to also assess the compliance of IIFS without having a proper understating in regulatory differences.

3

Lack of Shari'ah scholars to advise RSA on regulations related to Islamic Finance

Shari'ah scholars as experts in the field of Islamic commercial jurisprudence play an important role in ensuring that IIFS are complying with Shari'ah law. Some jurisdictions might face a shortage of Shari'ah scholars who understand and who can uphold the main pillars of Shari'ah principles in advising RSAs on Islamic finance regulation and related matters. The lack of local professional who meets the selection criteria for Shari'ah scholars may affect Islamic finance growth due to the limited capacity.

4

Lack of or poor quality of available industry data to support implementation of the standards

To deliver compliance against IFSB standards, IIFS should have quick and easy access to centralized and accurate data. Data management is significant for any prudential requirements. To get an accurate picture of the IIFS positions the regulator, the institutions and the market should have access to accurate data, which is up to date and consistent. The existence of regulatory timely data of high quality will ensure the practicality of implemented IFSB standards.

5

Process of standards implementation is too time intensive

Different jurisdictions face different challenges in applying IFSB standards. One of the challenges is that the IFSB standards implementation process takes a long time, requiring coordination among different departments of governing organisation and cooperation with external parties such as Shari'ah scholars, consultants, market players and so on.

6

Lack of financial resources to implement standards

For every jurisdiction, working out the most cost-effective approach for implementing the IFSB standards is a crucial issue. However, the implementation costs may substantially differ from one country to another and become a real impediment to the effective IFSB standards implementation process.

7

Size of the industry is too small to make implementation viable

Jurisdictions that have a relatively small share of the Islamic finance market might be far from being motivated to launch inclusive IFSB standards implementation process. Therefore one of the recommendations of IFSB is that applicability of the standards' requirements should commensurate with the size, nature and complexity of IIFS in the jurisdiction.

8

Existing statutory/legal framework does not support the implementation of standards

Some jurisdictions have regulatory legacies that don't segregate the regulation of Islamic financial institutions and their conventional counterparts. It means that some national regulations have to be amended to have parallel requirements. RSAs also might refuse to adopt the IFSB standards if other challenges complicate the implementation process and make it hard to undertake. Either way, RSA will need to address this matter if chooses to implement the IFSB standards.

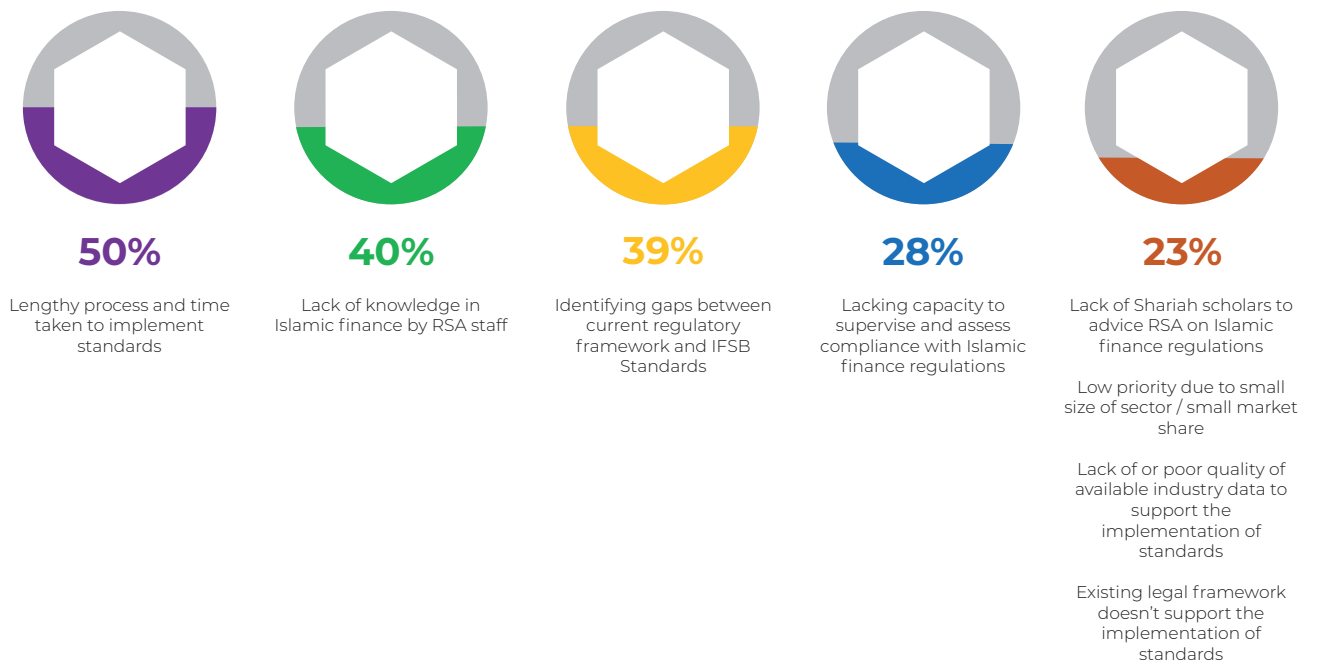
9

Identifying gaps between the existing regulatory framework and IFSB standards

Internal identification of gaps between the existing regulatory framework of the jurisdiction and IFSB standards ensures smoother implementation and compliance processes. A gap analysis and remediation process implies the necessary change initiatives and report on the overall readiness status of RSA to introduce proposed changes. RSAs might have difficulties in carrying such gap analysis proceedings internally due to the lack of staff competent both in local regulation and relevant IFSB standards, which will result in a low implementation rate.

Based on the 2020 Implementation Survey results, the top challenges identified by members of RSAs varies from the lengthy process to implement standards, lack of knowledge in Islamic finance and identifying gaps between the current regulatory framework and IFSB standards. Figure 5 below shows the challenges indicated by RSAs that participated in the 2020 Implementation Survey.

Figure 5: Implementation challenges based on the Implementation Survey 2020 findings



Implementing IFSB standards is a time-consuming process with barriers on RSAs way. It can be challenging for any jurisdiction. However, taking an integrated approach to implementing the requirements though relying on IFSB's support and requesting assistance is one of the solutions that can help regulators take IFSB standards in their stride.

The IFSB aware of the challenges involved and therefore developed a range of implementation tools to assist IFSB Members. Table 3 provides IFSB recommendations for each of the abovementioned challenges.

Table 3: IFSB recommendations for implementation challenges

No.	Challenges	IFSB initiatives	Recommendations to RSA
1.	Lack of knowledge in Islamic finance by RSA staff	<ul style="list-style-type: none"> • IFSB is able to assist jurisdiction by providing workshops specially designed for the needs of RSAs. Facilitating the Implementation of IFSB Standards (FIS) workshops and capacity building workshops can be conducted online and offline. • E-learning platform is also at convenience of IFSB members to get online-based knowledge on Islamic finance and IFSB standards. 	<ul style="list-style-type: none"> • Establish a dedicated team which will be carrying out Islamic finance regulation and supervision functions. • Providing staff with additional Islamic finance and IFSB standards related courses.
2.	Supervisory staff lack capacity to supervise and assess compliance with Islamic finance related regulations and guidelines	<ul style="list-style-type: none"> • In addition to the capacity building workshops, IFSB offers the Train of Trainers (TOT) programme which engages experts who are highly skilled and have a thorough understanding in IFSB standard to provide training for RSAs staff related to the compliance and regulation. • Another implementation initiative for RSA is to have a Resident Implementation consultant in particular jurisdiction to provide guidance in regards to the IFSB standards. • IFSB is developing and providing members of RSAs with supervisory reporting templates such ICAAP and Capital Adequacy templates. 	
3.	Lack of Shari'ah scholars to advise RSA on regulations related to Islamic Finance	<ul style="list-style-type: none"> • IFSB can facilitate jurisdictions in finding external Shari'ah experts that can advise RSA on Shari'ah related matters. 	<ul style="list-style-type: none"> • Rely on external Shari'ah advisors, foreign Shari'ah advisory firms, and at the same time bringing up local Shari'ah scholars with fit and proper criteria.

No.	Challenges	IFSB initiatives	Recommendations to RSA
4.	Lack of or poor quality of available industry data to support implementation of the standards	<ul style="list-style-type: none"> A credible, consistent and accurate database for Islamic finance is important for micro and macro-prudential oversight of the Islamic financial services industry (IFSI). The Prudential and Structural Islamic Financial Indicators (PSIFIs) project available with IFSB is addressing this particular challenge. Implementation Guidelines Report is another source of information that provide members of RSAs with basic data and prerequisites for effective standards implementation. 	<ul style="list-style-type: none"> Participate in IFSB's surveys, contribute to the PSIFIs data project.
5.	Process of standards implementation is too time intensive	<ul style="list-style-type: none"> IFSB's Implementation Guidelines will give a good start for the jurisdiction to get an understanding on where to start the process of implementation and save some time for the RSAs. Frequently Asked Questions (FAQs) along with technical notes provide basic support for the process of IFSB standards implementation to address the lack of understanding and lack of time that jurisdictions might have. For jurisdictions with non-English language regulations, IFSB has provided translation of standards into 3 other languages: Arabic, French and Russian. 	<ul style="list-style-type: none"> Develop a strategic plan for RSA on implementation of the IFSB standards.
6.	Lack of financial resources to implement standards	<ul style="list-style-type: none"> Though implementation tools as Technical Assistance and Policy Advice IFSB are able to identify the priority areas for the RSA to initiate the process of standards implementation. 	<ul style="list-style-type: none"> It is important to conduct a thorough forecast of the costs and benefits, focusing on the specific areas for each jurisdiction based on the proposal from internal experts and IFSB Secretariat.
7.	Size of the industry is too small to make implementation viable	<ul style="list-style-type: none"> For this, IFSB through Policy Advice tools is able to advise jurisdiction on developing a proper roadmap to introduce Islamic finance and strengthen the industry in the country. 	<ul style="list-style-type: none"> Increase public awareness and reinforce financial education in the area of Islamic finance. Provide a legal and regulatory framework to boost the growth of Islamic finance.

No.	Challenges	IFSB initiatives	Recommendations to RSA
8.	Existing statutory/legal framework does not support the implementation of standards	<ul style="list-style-type: none"> • To overcome the challenges within the existing legal framework, IFSB has a background of conducting the sharing of experience between members of RSAs concerning the implementation of standards. • The TOT Programme on its turn is providing customised consultations and solutions to IFSB members of RSAs. 	<ul style="list-style-type: none"> • Improving and adapting the legal and regulatory framework to the context of Islamic law and regulatory environment of the jurisdictions.
9.	Identifying gaps between the existing regulatory framework and IFSB standards	<ul style="list-style-type: none"> • IFSB is ready to assist members of RSAs in identifying regulatory gaps in their existing framework concerning the IFSB standards through Technical Assistance or Policy Advice initiatives. • The newly introduced Impact and Consistency Assessment Programme (ICAP) and Country/ Self-Review Assessment are designed to facilitate RSAs in identifying regulatory gaps. 	<ul style="list-style-type: none"> • Use IFSB templates to identify the gaps. • Participate in IFSB's Implementation Surveys and Implementation Guidelines Project.

Section IV: Implementation Guidelines

The implementation of IFSB standards could be a challenge in some jurisdictions due to the absence of detailed implementation guidelines. IFSB standards discuss and provide broad technical principles on different regulatory and supervisory areas, which can only be implemented if the jurisdiction has the right infrastructure and RSA has taken the right steps to ensure effective implementation. To assist member RSAs to overcome this challenge, the IFSB intends to publish a series of Implementation Guidelines publications to guide member RSAs on how to develop regulations and guidelines based on IFSB standards, drawing on the experience of those member countries that have successfully implemented the majority of IFSB standards.

1

In general, the Implementation Guidelines publications aim at:

- Creating an easy pass for member jurisdictions which want to improve their implementation rates by leveraging on the experience of other jurisdictions member.
- Documenting and reporting the development of the Islamic banking sector in jurisdictions where RSAs have successfully implemented IFSB standards.
- Highlighting the main challenges faced by members RSAs in implementing IFSB standards (when applicable) and how they were overcome.

2

The first series of the Implementation Guidelines publication is dedicated to reporting the experience of four jurisdictions including Bahrain, Jordan, Kazakhstan and Oman. This Implementation Guidelines report will focus on key areas that led to the development of Islamic banking in these jurisdictions and the necessary steps taken by RSAs to achieve a high implementation rate. The key areas addressed in the Implementation Guidelines are set out in Table 2 below.

Table 2: Key areas covered in Implementation Guidelines

No.	Key areas	Remarks
1.	Legislation and Laws	<p>One of the most essential conditions in developing the Islamic financial services industry within a country is to have a legal framework that is “friendly” to Islamic finance and could support and facilitate the growth of institutions providing Shari’ah-compliant services. In many cases, jurisdictions will introduce new laws or make changes to existing laws to accommodate Islamic finance specificities.</p> <p>Changes to the legislation system might be done gradually taking into consideration the high-priority goals of the country. While some jurisdictions amend their legislation to lay the foundation for inaugural <i>Sukuk</i> in the country, others – introduce changes to ensure a level playing field for both Islamic and conventional banks. This Implementation Guidelines report shows how the participated jurisdictions introduced new laws or made amendments to their existing legislation to facilitate the development of the Islamic banking sector.</p>

No.	Key areas	Remarks
2.	Shari'ah Governance	<p>An effective system of rules, practices and processes by which Islamic Financial Institutions (IFIs) are directed and controlled is important to ensure their business operations comply with Shari'ah rules and principles. It is perfectly understandable that RSAs may tailor the Shari'ah Governance System adopted by Islamic banks in their respective jurisdictions to suit market realities and the stage of development of their Islamic finance sector.</p> <p>Countries with a long and successful history of Islamic finance presence are systematically strengthening their Shari'ah Governance Framework.</p> <p>This Implementation Guidelines report will provide a summary of different practices in enforcing Shari'ah Governance requirements on Islamic banks in a different jurisdiction.</p> <p>Clarifying on a Shari'ah Governance System that is being imposed within jurisdictions helps to determine Shari'ah compliance guidance for structures and processes that should be followed by Islamic financial institution. Existing requirement on Shari'ah Board, issuance of Shari'ah standards, Shari'ah pronouncements/resolutions or lack thereof can be a further discussion between jurisdictions and IFSB and a subject for Technical Assistance or Policy Advice.</p>
3.	Development of Liquidity Management Infrastructure	<p>The development of a robust national liquidity infrastructure is important not only to reduce the cost of intermediation but also to influence the level of liquidity in the financial system. The ability of Islamic banks to weather a liquidity crunch is contingent upon access to a robust liquidity management infrastructure, which is still underdeveloped in some jurisdictions where Islamic banking products and services are offered. Lack of access to Shari'ah-compliant liquidity instruments can lead to inefficiencies in normal times (due to low returns on liquid assets) as well as the potential for systemic risks in times of crisis owing to the relatively limited liquidity of the instruments involved.</p> <p>This Implementation Guidelines report showcases the experience of building a Shari'ah-compliant liquidity infrastructure in jurisdictions with a mature Islamic sector. Not all jurisdictions have Shari'ah-compliant means to manage liquidity, therefore this area becomes significant for a review within the Implementation Guidelines to identify challenges and initiatives to solve those obstacles, as well as showcase a positive experience of building a Shari'ah-compliant liquidity management infrastructure.</p>

No.	Key areas	Remarks
4.	Financial Safety Nets	<p>Financial safety nets are very significant to RSAs in ensuring the soundness and stability of the financial system as the main crisis prevention strategies. Designing such a crisis management framework for the Islamic banking industry requires a robust structure for banking supervision, including a liquidity regime, capital adequacy, stress testing, and effective recovery and resolution regime.</p> <p>The implementation of well-designed mechanisms of the financial safety net is particularly challenging for the Islamic banking system, given the specificities of the Shari’ah contracts and funding structures of financial institution. Provisions of financial safety nets for Islamic banks must be Shari’ah-compliant, such as Shari’ah-compliant Lender of Last Resort (SLOLR) and Shari’ah-compliant Deposit Insurance (SCDIS). However, SLOLR and SCDIS introduction experience remains sparse among the RSAs regulating the Islamic banking sector due to the certain conditions necessary for mechanisms to be effective. The existence or otherwise of SLOLR and SCDIS can have an impact on the Islamic banking sector in jurisdictions, which can be determined in the Implementation Guidelines.</p>
5.	Effective Crisis Management and Resolution Framework	<p>The crisis and management resolution framework should define the powers and appropriate tools for relevant authorities (such as banking supervisors, national resolution authorities, finance ministries and central banks) to resolve a financial institution that is no longer viable and where there is no reasonable prospect of it becoming viable.</p> <p>Jurisdictions that offer Islamic financial services are confronted with the challenge of adapting the framework of crisis management and resolution to the specific circumstances of the Islamic Financial Services Industry (IFSI), and which has compatibility with Shari’ah principles. It is therefore important to develop a Shari’ah-compliant framework for crisis management and resolution to be able to restore stability and confidence in the IFSI, should the need arise.</p>

No.	Key areas	Remarks
6.	Disclosure Requirements	<p>Market discipline has long been recognised as a the key objective of financial sector regulation by the international standard-setting bodies and RSAs. The provision of meaningful information about key risk metrics to market participants is a fundamental tenet of a sound banking system. It reduces information asymmetry and helps promote comparability of banks' risk profiles and product offerings within and across jurisdictions.</p> <p>The IFSB has issued standards on Disclosures to Promote Transparency and Market Discipline which aim to specify a set of key principles and practices to be followed by Islamic financial institutions in the banking sector.</p> <p>Islamic banks and Islamic windows, due to the nature of their business, are required to provide a different set of disclosures, in comparison to conventional banks. This includes disclosures related to Investment Account Holders (IAHs), Shari'ah governance, risk management and exposures, among other things.</p> <p>This Implementation Guidelines Report provides a summary on disclosures required from Islamic banks in the four participating jurisdictions.</p> <p>The requirement are extended to Shari'ah Governance, Islamic windows, Investment Account Holder related disclosures and Implementation Guidelines might help to identify certain gaps in requirements of participated jurisdictions, as well as providing benchmark for other IFSB members.</p>
7.	Governance, Accounting & Auditing	<p>Islamic financial institutions must follow internationally accepted governance, accounting and auditing standards, to ensure a level playing field with conventional institutions.</p> <p>In 2006, the IFSB issued a standard on Guiding Principles on Corporate Governance. The principles are designed to facilitate IIFS in identifying areas where appropriate governance structures and processes are required and to recommend best practices in addressing these issues.</p> <p>In this Implementation Guidelines report, you will be able to see how the four participated jurisdictions have dealt with governance, accounting and auditing in institutions offering Islamic banking products and services.</p>

No.	Key areas	Remarks
8.	Rating of Islamic Financial Institutions and Shari'ah-compliant Instruments	IFSB Capital Adequacy Standards require Regulatory and Supervisory Authorities to identify eligible External Credit Assessment Institutions (ECAIs) which ratings may be used by IIFS to determine the risk weightings of Shari'ah-compliant assets. IIFS may use credit ratings issued by ECAIs when assigning risk weights and calculating their capital ratios. This implies that national supervisory authorities will delegate to ECAIs an important role in the calculation of IIFS' capital ratios. Therefore, having ECAIs to provide ratings on companies and Shari'ah-compliant instruments is quite important to facilitate the capital and risk calculations by the banks.
9.	Capacity Building and Talent Development	<p>Competent, independent and experienced professionals are the backbones of the Islamic finance sector. One of the main challenges in developing an Islamic finance industry in general, and implementing IFSB standards in particular, is having sufficient human resources with the required knowledge and skills to support the industry.</p> <p>Proper factors as having universities offering Islamic finance courses or programs, establishing cooperation between market players, regulators and Islamic finance experts, promoting capacity building and talent development are creating a condition for a more comprehensive Islamic finance industry.</p> <p>This Implementation Guidelines report will showcase how participated RSAs managed to build capacity and develop talents to meet the needs of the Islamic banking sector in their respective jurisdictions.</p>
10.	Challenges in Implementing IFSB Standards	This particular key area is a substantial input in the Implementation Guidelines report as it will allow us to understand jurisdictions' issues and concerns with the IFSB standards implementation process. Jurisdictions that haven't specified any significant challenges usually have a mature Islamic financial system and consistent in following the strategy of implementing IFSB standards. As part of its mandate, the IFSB will continue to provide the necessary support to member jurisdictions in implementing IFSB standards and assist them in overcoming any implementation challenges.



Section V: BAHRAIN (Central Bank of Bahrain)

1

Background

- 1.1 The Kingdom of Bahrain is considered a vital Islamic finance hub in the Middle East region. The first Islamic bank was established back in 1979 and the sector has grown rapidly since then. Currently, there are 6 fully fledged Islamic commercial banks, 5 Islamic windows and 10 Islamic investment banks operating in the country.
- 1.2 The total assets of the Islamic banking sector, as of December 2019, stand at USD 32 billion, representing 16.7% market share of the total banking sector in Bahrain. The average growth of the sector for the last five years (2015-2019) is 5.3%.
- 1.3 Central Bank of Bahrain (CBB) has established a comprehensive prudential regulations and reporting framework, tailor-made for the specific concepts and needs of Islamic banking. In addition, it has comprehensive governance, business conduct, enforcement and other standards to ensure soundness and safety of the Islamic banks.
- 1.4 In addition to the numerous Islamic financial institutions active in its financial sector, Bahrain also plays host to a number of organizations central to the development and growth of Islamic finance, including: i) the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI); ii) the International Islamic Financial Market (IIFM); iii) the Islamic International Rating Agency (IIRA); iv) the Shariya Review Bureau and the General Council for Islamic Banks and Financial Institutions (CIBAFI).

2

Legislations and Laws

- 2.1 The first Islamic bank in Bahrain began operating in 1979 which at that time was subject to the Bahrain Monetary Agency Law of 1973. In 2006, this law was superseded by Central Bank of Bahrain and Financial Institutions Law 2006 (CBB Law). The CBB Law provides enhanced enforcement powers to CBB as well as reinforces its operational independence. This law represented a significant modernization and simplification of Bahrain's financial services legislation, as well as marked the creation of a "single regulator" for Bahrain's financial services industry.
- 2.2 In July 2020, resolution No.18 of 2020 was issued with regards to standards governing transactions subject to the provisions of Shari'ah. The new resolution empowers CBB to specify the Shari'ah standards for Islamic transactions and contracts, thereby giving Islamic finance in general, and these standards in specific, a strong legal basis. The new provision serves to overcome any possible issues arising out of the implementation of general civil law provisions which may not fully cater to the nature and specificities of Islamic finance transactions and contracts.
- 2.3 The first article of the resolution states that all transactions and contracts used by Islamic financial institutions (including Islamic banks) should be in compliance with standards issued by AAOIFI that is published in the CBB's website. The resolution also stated that the validity of

the contract or the transaction would not be affected by any changes in the standards, given that these transactions were entered into based on the applicable standards at the time of execution.

- 2.4 In regard to the judicial system, Bahrain has an independent system that clearly recognises the differences between Islamic finance and conventional finance. However, there is no separate judiciary system that serves financial services solely. Disputes between Islamic banks and consumers are resolved through the civil courts. The resolution No.18 of 2020 ensures the application of Shari'ah standards by the courts when issuing their rulings in cases involving Islamic finance transactions and contracts.
- 2.5 In the absence of income tax, Islamic banks are able to compete with conventional banks on a level playing field. The only tax applicable to the banking sector is the Value Added Tax (VAT). The VAT Law No.48 of 2018 does not make a distinction between the treatment of Islamic and conventional banking products and services. The VAT regulation No. 12 of 2018 issued pursuant to the VAT Law deals with financial services and products in Article 81 and addresses the treatment of Islamic products in Article 81(e).
- 2.6 For the purpose of applying the VAT, Islamic finance products provided under a written contract in accordance with the principles of Shari'ah which simulate the intention and achieve effectively the same result as a non-Shari'ah-compliant financial product are treated in a similar manner as the equivalent non-Shari'ah financial products.

3

Shari'ah Governance

- 3.1 In 2015, CBB issued a resolution in respect of the establishment of a Central Shari'ah Supervisory Board (CSSB). The aim of establishing the CSSB was to develop the Islamic financial services sector and implement unified Islamic Shari'ah standards and practices across the sector. Based on their duties and functions, the Board shall study and provide Shari'ah pronouncement or Shari'ah opinion, as appropriate, regarding the following issues:
- New products proposed by Islamic financial institutions and Islamic windows of conventional financial institutions in the Kingdom of Bahrain.
 - *Sukuk* and other financial instruments issued by the Central Bank of Bahrain which comply with Islamic Shari'ah.
 - Initiatives to develop the Islamic financial services sector and other initiatives aimed at strengthening compliance with Islamic Shari'a Principles in the Islamic financial services sector in the Kingdom of Bahrain.
 - Rules and regulations proposed by the CBB for the Islamic financial services sector.
 - Issues referred to the Board by the Bahraini courts and other governmental bodies in respect of legal cases related to Islamic financial services sector.
 - Issues assigned to the Board by the CBB on internal and external Shari'a audit and Shari'a review of Islamic financial institutions and Islamic windows of conventional financial institutions in the Kingdom of Bahrain.
- 3.2 Central Bank of Bahrain has also issued a Shari'ah Governance Module to establish best practice Shari'ah governance principles in Bahrain, and to provide protection for investors and other Islamic bank's stakeholders through compliance with these principles. The Module provides detailed rules regarding the Shari'ah governance structure, the roles

and responsibilities of the Shari'ah Supervisory Board at the Islamic banks' level, Shari'ah coordination and implementation and roles of Shari'ah officers, roles and responsibilities of the internal and external Shari'ah auditors and the disclosure requirements to be made by Islamic banks regarding Shari'ah matters.

- 3.3 As per the rules and regulations of CBB, the Shari'ah governance structure adopted by Islamic banks must consist, at a minimum, of the following:
 - a. Shari'ah Supervisory Board (SSB);
 - b. Shari'ah Coordination and Implementation Function;
 - c. Internal Shari'ah Audit Function; and
 - d. Independent External Shari'ah Compliance Audit (IESCA).
- 3.4 According to CBB's regulations, Islamic banks must have a Shari'ah Supervisory Board, which must consist of at least three scholars specialized in *Fiqh al Muamalat*, and whose members must be approved by the shareholders in their annual general meeting upon the recommendation of the Board of Directors taking into consideration the CBB regulations, resolutions and directives.
- 3.5 Central Bank of Bahrain also makes it a requirement that Islamic banks must comply with the Shari'ah rules and principles as expressed in AAOIFI Shari'ah and accordingly standards and in the rulings of the Centralized Shari'ah Supervisory Board and their respective SSB.
- 3.6 Central Bank of Bahrain regulations also specify the competencies required in Shari'ah Board members and Shari'ah Secretariat members. The regulations stipulate that Board of directors of the Bahraini Islamic bank must carry out a background check and consider the following criteria when assessing the fitness and propriety of individuals to serve on the SSB:
 - a. Have a clean background, a good character and conduct by being recognised for honesty, integrity and good reputation in their professional business and/or financial dealings, and not previously been convicted of any moral turpitude, felony or criminal offence;
 - b. Have competence, diligence, capability and soundness of judgement;
 - c. Have strong proficiency in Arabic, as they need to be very conversant with the primary sources of the Shari'ah;
 - d. Have at least a Bachelor's degree (or its equivalent) in Islamic Shari'ah;
 - e. Have a certified degree in *Fiqh al Muamalat* (Islamic commercial jurisprudence) with strong understanding of *Usul al Fiqh* (rules of Islamic jurisprudence);
 - f. Have adequate understanding of banking, Islamic finance and accounting;
 - g. Have accumulated overall experience of at least seven years in Shari'ah related scholarly pursuits (e.g. teaching, research, *fatawa* issuance, etc);
 - h. At least one SSB member should have a fair understanding of the legal and regulatory framework applicable to the functions of the Bahraini Islamic bank licensee.
- 3.7 Central Bank of Bahrain has also specific regulations to ensuring the independence of the Shari'ah Board and how conflicts of interest could be managed. Based on CBB's rulebook, in case of a conflict of interest, the member of the SSB must declare it in writing to the SSB of the Bahraini Islamic bank licensee. He must similarly report any such conflict in regard to members of his family, business associates or companies in which he has an interest. Where there is such a conflict of interest, or a duty to another party, then he must abstain from participating in the relevant discussion, decision or action. Where a notification is made of a conflict, it must be recorded and retained by a designated officer.

- 3.8 Central Bank of Bahrain Rulebook has also stated specific regulations related to the principle of confidentiality. Accordingly, the rules require SSB members to ensure that information obtained in the course of their duties is kept confidential. The duty to observe confidentiality applies to all information with which members of the SSB are entrusted by the Islamic bank, or which is brought to their attention during or at any time after the carrying out of their assignment.

4

Development of Liquidity Management Infrastructure

- 4.1 Central Bank of Bahrain has in place a liquidity framework to facilitate and offer liquidity solutions to market players in order to promote better liquidity management by the Islamic financial institutions. CBB offers several liquidity tools for Islamic retail banks including the Islamic *Sukuk* Liquidity Instrument (ISLI), CBB *Wakalah* Facility and Shari'ah-compliant *Waad* Foreign Exchange Forward Facility.
- 4.2 The mechanism of the Islamic *Sukuk* Liquidity Instrument (ISLI) is based on Sale and Purchase transactions meant to help Islamic banks in managing their liquidity. It is a short-term liquidity facility (one week) which enables Islamic banks to have access liquidity. It involves three separate *Sukuk* sale and purchase transactions requiring the existence of three parties, namely the *Sukuk* owner (the bank in need of liquidity), the intermediary bank (the market maker) and the CBB which offers the liquidity.
- 4.3 CBB *Wakalah* Facility allows Islamic retail banks to place their excess liquidity with the CBB for overnight to one week. Islamic retail banks need to sign a *Wakalah* agreement which appoints the CBB as an agent (*Wakil*) to invest cash on behalf of the bank (*Muwakkil*). Accordingly, the *Wakil* will invest these funds in the investment portfolio allocated in advance, which consists of international Islamic *Sukuk* in US dollars and cash in Bahraini dinars.
- 4.4 Shari'ah-compliant Foreign Exchange Forward Facility is based on single binding *Wa'ad* structure. This tool is a Shari'ah-compliant alternative to the Foreign Exchange Forward that has been developed by the International Islamic Financial Market (IIFM) and International Swaps and Derivatives Association (ISDA).
- 4.5 There are also other instruments used in managing liquidity in Bahrain. These include *Sukuk Al Salam* as well as short and long term *Ijara Sukuk*.
- 4.6 *Sukuk Al Salam* was first issued in 2001. It is a Bahraini dinar (BHD) denominated debt instrument issued in accordance with Shari'ah rules and principles. These *Sukuk* are issued on a monthly basis and have a three-month (91 days) maturity. The *Sukuk* represent real commodities (Residual Gas), which is considered as a liability sold against deferred delivery. The following explain the main features of the *Sukuk*:
- The Government of Bahrain undertakes to sell commodities to be delivered in the future to the investors for advance payment in the value of securities issued.
 - The investor will receive the proceeds arising from the sale of commodities to an independent party (third party) who is completely and partially different from the seller, at a price exceeding the forward buying price.
 - *Al Salam Sukuk* are issued through a fixed-rate tender procedure. The rate of return is pre-set by the Monetary Policy Committee.
 - All domestic retail banks, the Social Insurance Organisation, selected wholesale banks and other central banks are invited to participate. Individuals and investment institutions & companies can participate through their retail banks or Bahrain Bourse.

- 4.7 The short term *Ijara Sukuk* was first issued in August 2005. It is a BHD- denominated leasing instrument issued in accordance with Shari'ah rules and principles. *The Ijara Sukuk* are issued on a monthly basis and have a six-month (182 days) maturity. It is structured based on leasing contracts for an asset owned by the Government of Bahrain. The Ministry of Finance and National Economy (MOFNE) selects the asset which is to be used for the issue. The following explain the main features of the *Sukuk*:
- Government of Bahrain sells an asset to the investors, who will buy and own it before renting back to the Government at a predetermined rental rate, via a rental contract.
 - The Government will also issue a binding promise to buy back the asset at its par value at the end of the rental period.
 - Short Term *Ijara Sukuk* are issued through a fixed-rate tender procedure. The rate of return is pre-set by the Monetary Policy Committee.
 - All domestic retail banks, the Social Insurance Organisation, selected wholesale banks and other central banks are invited to participate. Individuals and investment institutions & companies can participate through their retail banks or Bahrain Bourse.

5

Financial Safety Nets

- 5.1 CBB offers Shari'ah-compliant Lender of Last Resort (SLOLR) facility to Islamic banks that need access to liquidity. CBB uses Islamic *Sukuk* Liquidity Instrument (ISLI), explained above, to provide liquidity support.
- 5.2 CBB is also the administrator of the deposit protection scheme in Bahrain which provides deposit protection to both Islamic and conventional banks. The deposit protection scheme was founded in 1993 and was mainly providing protection to conventional deposits. However, in 2010, CBB issued a resolution with respect to promulgating a Regulation "Protecting Deposits and Unrestricted Investment Accounts". CBB has taken this initiative considering the need to develop the previous post-funded scheme and replace it with a new prefunded scheme to bring deposit protection more closely in line with international best practices, as most of those schemes in developed countries have turned to a prefunded scheme where funds are being collected and paid in advance to compensate depositors.
- 5.3 The new scheme requires the establishment of two separate funds (Conventional fund and Islamic fund) which shall be maintained and administered by one board in which the funds are accumulated separately in advance based on regular contributions by the member banks. The two funds cover eligible accounts which include all types of deposits in conventional and Islamic banks in addition to the unrestricted investment accounts in Islamic banks.
- 5.4 The contribution of each member conventional bank or Islamic bank in the total amount of the respective funds shall be determined on an annual pro-rata basis of the total eligible accounts. CBB shall provide the Board with the necessary data to allow it to determine the amounts of contributions each conventional bank or Islamic bank shall make. The Board is required to periodically assess the size of the conventional fund and Islamic fund in relation to liabilities to be covered and, where appropriate, make recommendations to the CBB for increasing or decreasing the amounts of the conventional fund and Islamic fund.
- 5.5 The Board may allow member banks to make their contribution in the form of monthly instalments, which shall be charged against the profit and loss account of these member banks. Furthermore, and as per Article (15) of the regulation, monies once contributed shall legally belong to the fund and are non-refundable in any circumstance to the contributing members.

- 5.6 Under the new regulation, the Shari'ah-compliant Deposit Insurance Scheme (SCDIS) in Bahrain extends coverage also to Unrestricted Investment Accounts (UIAs) in Islamic banks. Under the old scheme, only Islamic deposits, and therefore only current accounts in Islamic banks (being the only type of deposit accounts offered by Islamic banks), were covered. This amendment was introduced to maintain a level playing field and to encourage a healthy competitive environment between conventional and Islamic banks in Bahrain.
- 5.7 The proposed new regulation for the protection of deposits and UIAs was approved by the Central Shari'ah Supervisory Board (CSSB) of CBB, based on the following: "After hearing an explanation about the general framework of the regulation proposed by CBB for the protection of deposits and unrestricted investment accounts that aims to protect small depositors and investors in these accounts; and after hearing the clarifications provided by CBB, and based on incorporating the proposed amendments by the CSSB into the text of the proposed regulation; [the CSSB of CBB] is of the opinion that the essence of the issue and the parameters included within the scheme to ensure its independence is in compliance with Shari'ah rules and principles. The basis of approval stems from considering the scheme a form of Takaful built on providing donated contributions that are allocated for the coverage of risks, which the holders of unrestricted investment accounts and current accounts in retail Islamic banks may be exposed to."
- 5.8 The compensation to each eligible depositor and/or investor is up to a maximum coverage of BD20,000 (twenty thousand Bahraini dinars) from the total amount of his/her eligible accounts held with the defaulting bank regardless of the number of accounts and their currency. Other currencies shall be converted into Bahraini dinars at the exchange rate on the date on which the CBB determines a bank is a defaulting bank.
- 5.9 In the event of the amounts of the Islamic fund being insufficient to cover the total compensation payable, the SCDIS may cover the shortfall by arranging Shari'ah-compliant financing, and such financing facilities shall be reimbursed by future contributions from the Islamic banks. Investments made from the Islamic fund must comply with Shari'ah principles and be under the supervision of the CBB's Central Shari'ah Supervisory Board.
- 5.10 The ownership of the Islamic fund is given to the SCDIS, which itself is a separate legal entity. On the other hand, the Bahraini SCDIS does not accord protection to Restricted Investment Account Holders (RPSIAs).

6

Effective Crisis Management and Resolution Framework

- 6.1 In the Central Bank of Bahrain and Financial Institution Law includes various Articles of the law, which deal with solvency of banks, providing details on how banks will be placed under administration and compulsory liquidation. They, however, do not make a distinction between Islamic and Conventional Banks in this regard.
- 6.2 The Articles which deal with placement of licensee under administration specify the reason for putting a bank under administration, the appointment of external administrator, powers and duties of the administrator, suspension and termination of the administrator, amongst other things. The Articles also state the treatment of banks under compulsory liquidation.

- 6.3 In regard to recovery plans, all Islamic banks in Bahrain are required to prepare recovery plans, commensurate with the nature, size, complexity and scale of the bank's activities, in accordance with the CBB Rulebook, which includes a variety of feasible recovery options that could play a critical role towards improving resilience and viability ultimately. This includes:
- a. Issuance of capital instruments at short notice;
 - b. Seeking additional liquidity from existing or new sources; (c) Sale or disposal of a part of the business and assets;
 - d. Restricting new business activities;
 - e. Lowering dividend pay outs; and
 - f. Restructuring.
- 6.4 Recovery plans must be approved by the Board and must be reviewed regularly. The recovery plan must include information and analysis to reflect the appropriate coverage and granularity of the recovery plan, as well as key elements including:
- a. Governance arrangements and escalation process following a triggering event;
 - b. Quantitative and qualitative triggers and early warning indicators; and
 - c. Recovery options based on the appropriate number of market wide (systemic) stress scenarios and bank-specific (idiosyncratic) stress scenarios to assess which recovery options would be effective in a range of stress situations.
- 6.5 Recovery triggers must be well defined and tailored to the full range of risks faced by banks. Notwithstanding other triggers that might be considered, the capital ratio trigger must not be less than 13%. The threshold level for triggers must be calibrated with impact on the bank's capital and set out clearly in the bank's recovery plan. All Islamic banks must establish an adequate monitoring process to support the operation of the trigger framework in their recovery plan.

7

Governance, Accounting and Auditing

- 7.1 Central Bank of Bahrain has issued detailed regulations requiring Islamic banks operating in the country to adopt a Corporate Governance Framework. The regulations require Islamic banks to comply with corporate governance principles issued by the Ministry of Industry and Commerce and with International best practice corporate governance standards set by international organizations.
- 7.2 The CBB High Level Controls Module has provided detailed regulation in regards to the role and responsibilities of the Board of Directors (BOD), Independent Directors, Corporate Ethics, Conflicts of Interest and Code of Conduct, the role and responsibilities of different BOD committees including the Audit Committee, Risk Management Committee and the Remuneration Committee, Internal Audit, Compliance, the establishment of management structure and appointment of senior management, the communication between BOD and Shareholders, corporate governance disclosures and the principles of Shari'ah.
- 7.3 The CBB requires Boards to have sufficient independent board members including the requirement that certain Board Committees like the Audit Committee and Remuneration Committee be composed entirely independent or non-executive directors. The CBB also requires standard of remuneration for senior management and material risk takers including requirements for variable remuneration and alignment with risk outcomes.

- 7.4 In Bahrain, Islamic banks follow different accounting standards/ reporting methods compared to their conventional counterparts. While conventional banks operating in Bahrain must prepare their financial statements according to the international accounting standards (IFRS), Islamic banks should follow the accounting and auditing standards issued by AAOIFI. This is to ensure that the accounting and auditing for Islamic banks takes into account the specificities of operations and contracts used in Islamic banking.

8

Disclosures Requirements

- 8.1 Islamic banks operating in Bahrain are required to make certain disclosures which could be a little different than those made by their conventional counterparts. Amongst the disclosures required are general governance, Shari'ah governance, Investment Account Holders and Islamic windows related disclosures. Islamic banks are required to disclose departure from corporate governance guidance of the CBB with appropriate reasons.
- 8.2 For general governance disclosures, Islamic banks are supposed to provide explanation of any departure from complying with the applicable financial reporting standards. They are required to disclose their corporate governance arrangements and all related party transactions and treatment of material events.
- 8.3 Disclosures regarding Shari'ah governance include: disclosing their Shari'ah governance arrangements and processes; qualifications and areas of expertise of each Shari'ah Board member.
- 8.4 For Investment Account Holders, several disclosures are required in accordance with AAOIFI standards such as basis and method of allocation of assets, expenses and profit in relation to IAH funds, policies governing the management of IAH funds which covers the approaches to the management of investment portfolio, complaints procedures available to dissatisfied IAH etc.

9

Capacity Building and Talent Development

- 9.1 As a hub for Islamic finance, Bahrain has sufficient human resources with the required knowledge and skills to support the Islamic finance sector. As the sector grew and market expanded, Islamic finance became an attractive profession and the expert pool increased accordingly.
- 9.2 Central Bank of Bahrain has proactively been contributing and promoting capacity building and talent development for Islamic finance industry through hosting and supporting global organizations such as Bahrain Institute of Banking and Finance (BIBF) and General Council for Islamic Banks and Financial Institutions (CIBAFI).
- 9.3 The BIBF Centre for Islamic Finance focuses on operations, products, services and professional qualifications. The Centre offers the oldest Islamic finance professional qualification in the world – the Advanced Diploma in Islamic Finance (ADIF), which also is the only such Islamic finance qualification with a progression route into a UK MBA. It also provides the Advanced Diploma in Islamic Jurisprudence (ADIJ). The Centre also provides advisory and technical services to clients wishing to structure Islamic products or gain access to the Middle East capital markets or who need governance and regulatory framework development assistance.

- 9.4 CIBAFI as an international organization has a mission to support the Islamic finance industry by providing specific activities and initiatives, aiming to strengthen the growth of the industry, deepening Shari'ah objectives in financial dealings and transactions, and facilitate cooperation between members and institutions of common interest.
- 9.5 AAOIFI also provides internationally recognised qualification namely the Certified Islamic Professional Accountant (CIPA) and Certified Shari'ah Advisor and Auditor (CSAA). In addition, Bahrain's state university, the University of Bahrain, also provides academic qualification namely, B.Sc. in Islamic Banking & Finance and MSc in Islamic Banking and Finance.
- 9.6 Central Bank of Bahrain in partnership with Islamic Financial Institutions (IFIs) in Bahrain established the *Waqf* Fund in 2006. The member institutions made contributions to the *Waqf* Fund's corpus which is invested in Islamic money market instruments and the return is used to finance the Fund's initiatives. These initiatives are executed through partner organizations such as BIBF. The *Waqf* Fund's mandate is to serve its 22 member institutions through development initiatives and activities in Islamic finance training, education and research.

10 Challenges in Implementing IFSB Standards

Central Bank of Bahrain indicated that challenges impending the implementation of IFSB standards are very insignificant.



Section VI: JORDAN (Central Bank of Jordan)

1

Background

- 1.1 The Hashemite Kingdom of Jordan is one of the pioneers in the Islamic finance industry in the Middle East region. The first Islamic bank was established back in 1978 and the sector has expanded and grown rapidly since then. Currently, there are 4 fully fledged Islamic commercial banks operating in the country.
- 1.2 The total assets of the Islamic banking sector stand at USD 12.5 billion, representing 16.5% market share of the total banking sector in Jordan. The average growth of the sector for the last five years (2015-2019) is 10%.
- 1.3 Central Bank of Jordan (CBJ), the regulatory and supervisory of the banking industry, has introduced a series of instructions, regulations, and circulations focusing only on Islamic banks, taking into account the different nature of business Islamic banks involved in.

2

Legislations and Laws

- 2.1 In 2000, Jordan introduced its Law No. (28), also known as Banking Law of 2000, outlining regulations and provisions applicable to all institutions engaging in banking activities including Islamic banks. The law has introduced a number of provisions applicable only to Islamic banks, taking into consideration the specificities of Islamic banking business and operations.
- 2.2 The Banking Law has defined the objectives of an Islamic bank as well as the permissible and impermissible activities that an Islamic bank can engage in. Among the objectives mentioned in the law is the provision of banking services and practicing financing and investment on a basis excluding interest taking and/or giving in all forms and situations. Additionally, Islamic banks should provide services aiming at reviving social solidarity organized on the basis of mutual benefit.
- 2.3 The regulations also required Islamic banks to establish a Shari'ah Governance System to ensure that all products, services and activities are Shari'ah-compliant. The appointment, duties and other operating procedures concerning the Shari'ah Supervision Board will be elaborated upon in the Shari'ah Governance section of this report.
- 2.4 The Islamic bank may pursuant to orders issued by the Central Bank form a profit equalization reserve.
- 2.5 The law has also outlined some provisions related to the liquidation of an Islamic bank, providing guidance on how Deposit Insurance Corporation shall assume the liquidation of an Islamic bank taking into considerations the specificities of Islamic banking. The law specified how obligations and debts due from an Islamic bank under liquidation shall be settled including: the entitlements of depositors in the mutual fund accounts, entitlements of owners of *Muqharadha* bonds, investment portfolios, or investment funds and entitlements of depositors in specified investment accounts.

3

Shari'ah Governance

- 3.1 The Banking Law of 2000 requires Islamic banks operating in the Kingdom to establish a Shari'ah Governance System and to appoint a board to be designated as the Islamic Jurisprudence Supervision Board.
- 3.2 According to the law, the Islamic Jurisprudence Supervision Board shall comprise not less than three members and its opinion shall be binding on the Islamic bank. It has the following responsibilities:
 - Monitoring the compliance of the operations and activities of the Islamic bank with Islamic jurisprudence rules.
 - Giving opinion on the text of contracts required for the operations and activities of the bank.
 - Considering any matters referred thereto pursuant to specific orders of the Central Bank.
- 3.3 The law also specified the operational procedures in regard to the appointment of Chairman of the Islamic Shari'ah Supervision Board, the quorum of the Board meetings, the decision making (by consensus or majority voting), and the processes for discharging any member of the Board.
- 3.4 The Shari'ah Governance System enforced by CBJ requires Islamic banks to have structures and processes in place for:
 - Issuance of relevant Shari'ah pronouncements/resolutions.
 - Dissemination of information on such Shari'ah pronouncements/resolutions to the operative personnel of the Islamic bank.
 - Verifying that Shari'ah compliance has been satisfied and recording and reporting any incident of non-compliance to be addressed and rectified.
 - Conducting Shari'ah review/audit and ensuring that its findings have been duly noted by the Shari'ah Board.
- 3.5 In addition to that, CBJ requires the management of the Islamic Bank to facilitate the communication between all departments of the bank and Shari'ah Board and to facilitate the work of Internal Shari'ah Auditor.
- 3.6 To ensure competency of Shari'ah Board members, CBJ has issued Instructions of Corporate Governance for Islamic banks in 2016, and has outlined the following fit and proper criteria for Shari'ah Board members:
 - To hold a Bachelor degree, as a minimum, in Shari'ah science in the fields of Islamic *Fiqh* and principles, Islamic economy, or Islamic finance.
 - To have at least a five- year experience in issuing Fatwa and Shari'ah provisions and/ or experience in teaching or research of no less than four years after graduation.
- 3.7 In addition to that, based on CBJ's guidelines, the Central Bank can object to the nomination of any person to the Shari'ah Board if it finds out that such candidate does not fulfil any of the conditions mentioned above. The Chairman of the Board shall make sure that the Central Bank is notified of any material information that may impact negatively the fitness and properness of any member of the Board. In case there is a need to appoint members of Shari'ah Board who reside outside the Kingdom, the number of such members shall not exceed half of the Shari'ah Board.

- 3.8 To ensure the independence of the Shari'ah Board, CBJ has also included guidelines in its 2016 Instructions of Corporate Governance, in which Shari'ah Board members have to meet the following requirements:
- He/she shall not get any funding for himself/herself or for any of his/her second-degree relatives from the bank or from any of the subsidiary companies of the bank.
 - He/she shall not have worked as an employee of the bank or of any of the subsidiary companies of the bank during the two years prior to the date of appointment.
 - He/she shall not be a member of Shari'ah Board at any other licensed Islamic bank in the Kingdom. He/she shall not be also a member of a Shari'ah Board of more than four financial institutions that do not accept deposits and operating in the Kingdom. The absence of conflict of interests shall be ensured.
 - He/she shall not be a member of the bank's Board of Directors or owning a company which the bank deals with, except for transactions arising because of services and/ or ordinary works which the bank delivers to his clients provided that the same terms, of similar transactions with any other party, rule without any preferential terms.
 - He/she shall not be a second degree relative to any of the Board of Directors' members or any other person from the senior executive management at the bank. He/she shall not get from the bank any salary, cash amounts, rewards, privileges, or gifts except of what he/she receives in return of his/her membership of the Shari'ah Board or in return of any additional tasks he/ she is assigned without affecting his independency.
 - He/she shall not be a shareholder of the bank, a representative of a major shareholder of the bank, a shareholder of any of the subsidiary companies of the bank, or a shareholder of the group owning the bank.
- 3.9 Central Bank of Jordan has also issued guidelines to enhance the integrity, professionalism and credibility of the members of the Shari'ah Board. The Instructions of Corporate Governance for Islamic banks required a Shari'ah Board member to:
- Maintain equality and justice among the related parties (stakeholders).
 - Act in a way that allows him/ her to preserve his/ her honesty and integrity.
 - Take into consideration, when making a decision, the legislative and legal points in addition to the technical points of Shari'ah commitment.
 - Recognize difference of opinions among the jurisprudential schools and the variances of experience among his/ her colleagues at the Shari'ah Board.

4

Development of Liquidity Management Infrastructure

- 4.1 While there is a liquidity framework to facilitate and offer liquidity solutions to conventional banks, there is no framework that was set up for Islamic banks. However, Central Bank of Jordan extends *Qard Hassan* (benevolent loan) to Islamic banks when they are in need for liquidity (as Lender of Last Resort).
- 4.2 That being said, it should be noted that Islamic banks operating in Jordan enjoy high-level of liquidity. This pose a challenge as Islamic banks do not have much opportunities to place their excess funds in short term Shari'ah-compliant investments.
- 4.3 Central Bank of Jordan work with other sovereign entities such as the Ministry of Finance, to issue *Sukuk* and other Shari'ah-compliant instruments, where CBJ plays the role of director of issuances. In 2016, CBJ issued two rounds of Shari'ah-compliant sovereign *Sukuk* for the first time in the country's history. The first offering used a *Murabaha* (cost-plus financing) structure and was valued at JD75m (Jordanian dinars) (USD105.5m). The second *Sukuk*

used an *Ijara* (leasing) structure and was valued at JD34m (USD47.8m). This has given the opportunity to Islamic banks operating in Jordan to place their excess funds in Shari'ah-compliant instruments.

5

Financial Safety Nets

- 5.1 Jordan Deposit Insurance Corporation (JODIC) was established on September 2000 and acts as the operator and administrator of the deposit insurance scheme in the Kingdom. JODIC has two schemes that cover both conventional and Islamic banks.
- 5.2 The Shari'ah-compliant Deposit Insurance Scheme's (SCDIC) fund segregated and administered separately and independently from the Conventional Deposit Insurance Scheme (CDIS). The fund is managed by JODIC under the *Wakālah bi al-ajr* (agency with fee) arrangement. The fund will receive contributions as a donation (*Tabarru'*) from Islamic banks and Investment Account Holders IAHs, whereas the Ministry of Finance contributes to the capital on a pro rata basis, by analogy with the conventional system.
- 5.3 The SCDIS insures Islamic deposits and Unrestricted Profit Sharing Investment Accounts (UPSIA). Restricted Profit Sharing Investment Accounts (RPSIAs) for which an Islamic bank acts as agent are not insured, as the investors are more sophisticated and are assumed to evaluate the risks of the projects in which they choose to invest. The UPSIA is split into two portions: an invested portion and an uninvested portion; the percentage of each portion is designated in a separate contract with the capital provider.
- 5.4 Based on the above protection coverage, the fund has been divided into two separate portfolios: (a) a Takaful portfolio for credit accounts (including deposits and the uninvested portion of investment accounts), and (b) a Takaful portfolio for the invested portion of UPSIA. The contributions paid to the SCDIS against insuring credit accounts are to be borne by the IIFS, whereas the annual contributions for the invested portion of investment accounts are to be borne by the investors themselves and paid by the IIFS on their behalf.
- 5.5 In the event of an IIFS failure the insured credit accounts and invested portion of the Unrestricted Investment Account (UIA) will be covered to the maximum coverage limit of 50,000 Jordanian dinars for each depositor at each Islamic bank. All Islamic deposits and investment accounts are ranked *pari passu* with regards to priority of payments. Relevant Takaful portfolios are to be drawn upon when reimbursing credit accounts and UPSIAs. In the case of a shortfall in any portfolio, the fund may borrow in the form of a benevolent loan (*Qarḍ ḥasan*) from the conventional fund or from any third party in case of the fund's deficiency. The surplus of funds must be invested in Shari'ah-compliant and risk-free instruments, such as *Sukuk* issued by the government. In the event of the fund's liquidation, the remaining balance will be transferred to the Zakat fund, after covering all losses and expenses incurred by the Islamic fund.

6

Effective Crisis Management and Resolution Framework

- 6.1 As indicated above, the Banking Law of 2000 outlined provisions on the liquidation of an Islamic bank. According to the law "where the Central Bank has decided to liquidate an Islamic bank pursuant to the provisions of this law, the Deposit Insurance Corporation shall

assume the liquidation according to the liquidation provisions provided for in the law of the said corporation to the extent that these provisions are not in conflict with the provisions contained in this law particularly applicable to Islamic banks". This has ensured that the specificities and nature of Islamic banking will be taking into consideration during the liquidation process.

- 6.2 Under provisions of this law, the entitlements of depositors in the mutual fund accounts shall be settled in accordance with their respective terms. The entitlements of owners of *Muqharadha* bonds, investment portfolios, or investment funds, shall be settled in accordance with the terms pertaining respectively to each issue thereof. It is provided however that, beforehand, such entitlements shall be charged with their respective shares of the expenses and disbursements of the liquidator, and subsequently charged with their respective liabilities.
- 6.3 In regards to IAHs, the law addressed how the entitlements of investment accounts and holders of specified *Muqharadha* bonds shall each be attached to its respective specific project during the liquidation process. Such entitlements shall be subject to the outcome of their respective projects on the basis of "gains against losses," provided that, beforehand, the related expenses and liquidator's costs shall be deducted therefrom.
- 6.4 The law also specified how the liabilities and debts due from an Islamic bank under liquidation should be dealt with and that it should be paid in the following order:
 - The balance of expenses and disbursements incurred by the liquidator in the liquidation process.
 - The entitlements of the officers and employees of the Islamic bank in terms of salaries, remunerations, and any other labor compensation provided for in the Labor Law.
 - Any taxes and duties payable to the Government.
 - The entitlements of the depositors in the credit accounts.
 - The entitlements of the creditors and any other funds deposited with the bank for purposes other than investment and sharing in the profits accruing therefrom.
 - The entitlements of the investors in mutual fund accounts.
- 6.5 After paying depositors in the mutual fund accounts, IAHs based on the gain and loss on their specific projects and settling all liabilities and debts due from the bank, the remaining funds shall be distributed among the shareholders proportionately with the shares owned by each.

7

Governance, Accounting and Auditing

- 7.1 In 2004, Central Bank of Jordan issued Handbook of Corporate Governance followed by Corporate Governance Code (CGC) for banks in 2007 followed by Corporate Governance Instructions in 2014 (separate instructions for Islamic banks and separate instructions for conventional banks), followed by Amended Instructions of Corporate Governance for Islamic Banks No. (64/2016). The code (instructions) is intended to promote international best practice in the corporate governance of Jordanian banks. Based on this code, banks operating in Jordan are expected to produce their own codes according to its particular needs and principles and incorporating the minimum standards of the Central Bank of Jordan. Jordanian banks are also required to publish their own codes in the annual report and their websites, demonstrating their level of compliance and explaining if any provisions have been complied with in any particular year.
- 7.2 Islamic banks in Jordan comply with CGC by Central Bank of Jordan and observe guidelines and standards issued by international institutions including the Islamic Financial Services Board (IFSB). Accordingly, Jordanian Islamic banks' Corporate Governance Framework include

the following topics:

- Bank's Corporate Governance Code and the Publishing of the Code.
- Board of Directors (BOD) Composition.
- BOD Meetings.
- BOD Overall Responsibilities.
- Accountability and Responsibility of the BOD.
- BOD Committees.
- Shari'ah Supervisory Board.
- Fit and Proper Criteria for BOD Members, Shari'ah Supervisory Board Members, Senior Executive Management Members.
- Assessment of Management and Shari'ah Supervisory Board Members Performance.
- Compensation and Fees of Shari'ah Supervisory Board Members.
- Conflicts of Interest.
- Internal Audit.
- Internal Shari'ah Audit.
- External Audit.
- Risks Management.
- Compliance.
- Stakeholders Interests.
- Disclosure and Transparency.

7.3 In regards to accounting standards and reporting methods, Islamic banks in Jordan are required to prepare their financial statements in accordance with the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and in conformity with applicable laws and regulations of the Central Bank of Jordan.

7.4 In the absence of Financial Accounting Standards issued by AAOIFI relating to financial statements items, the International Financial Reporting Standards and related interpretations are applied in conformity with the Shari'a standards, pending the promulgation of Islamic Standards therefor.

8

Disclosures Requirements

8.1 Central Bank of Jordan has a separate disclosure framework for Islamic banks. The framework outlines disclosure requirements for general governance, Shari'ah governance and Investment Account Holders (IAHs).

8.2 For general governance disclosures, Islamic banks are required to disclose their corporate governance arrangements and practices, any related party transactions and treatment of material events by the Islamic bank, and any deviance from complying with financial reporting standards.

8.3 As for Shari'ah Governance disclosure requirements, Islamic banks are required to issue statements on the governance arrangements, systems and controls employed by the bank to ensure Shari'ah compliance; the independence of members of the Shari'ah Board or an advisory firm; and a declaration articulating the BOD's responsibility and accountability over the adopted Shari'ah Governance System. Islamic banks should also disclose qualifications and areas of expertise of each Shari'ah Board member, the appointment and change of members of the Shari'ah Board, and the board's opinion on the bank's state of compliance with Shari'ah rules and principles.

- 8.4 In addition to the above, Islamic banks should also disclose Shari’ah non-compliance events, Shari’ah pronouncements/resolutions and total number of violations that were the result of failing to apply Shari’ah rules and principles during the year.
- 8.5 Due to risk sharing feature in Investment accounts, Islamic banks mobilizing funds through *Mudharabah* are required to make certain disclosures to IAHs. The disclosures include the following:
- Written policies and including range of investment accounts, characteristics of investors, purchase, redemption and distribution procedures, professional resume portfolio managers, investment advisers and trustees, governance arrangements for the IAH funds procedures for trading and origination of assets and policies and procedures for valuation of PSIA assets.
 - A statement asserting that IAH funds are invested and managed in accordance with Shari’ah requirements.
 - Information on investment account products, such as fund/portfolio/product name, underlying contracts used and the manner in which the products are made available to investors.
 - A statement on the bank’s responsibility to furnish accurate and consistent information covering fluctuations of returns and risks taken by IAH.
 - Bases of allocation of assets, expenses and profit in relation to IAH funds.
 - Policies governing the management of both unrestricted and restricted IAH funds.
 - Particulars of the management of any third party to whom the bank has outsourced, or will outsource, the management of the PSIA.
 - Any changes to investment strategies by the bank or investment manager that could affect the IAH’s investment.
 - Quantitative disclosures such as total amount of IAH funds, PER-to-PSIA ratio, IRR-to-PSIA ratio, ROA, ROE, assets and financings funded by URPIAH and profit distribution.

9 Capacity Building and Talent Development

- 9.1 Jordan’s journey in Islamic banking started in late 1970s and experienced growth with new players entering the market in the 1990s and 2000s. As one of the jurisdictions with long history in Islamic banking, Jordan today has sufficient human resources with the required knowledge and skills to support the Islamic finance sector in the country.
- 9.2 Islamic banks operating in Jordan are responsible for formulating a strategy to enhance capacity building and ensure sufficient resources are in place. There are several universities in Jordan which offer program/courses in Islamic finance to support the Islamic finance sector and enlarge the talent pool.

10 Challenges in Implementing IFSB Standards

Central Bank of Jordan indicated that challenges impending the implementation of IFSB standards are very insignificant.



Section VII: REPUBLIC OF KAZAKHSTAN (Agency of the Republic of Kazakhstan for regulation and development of financial market)

1

Background

- 1.1 The Republic of Kazakhstan is rightfully considered to be an Islamic finance hub for Central Asia as a pioneer in Islamic finance industry among all the post-Soviet countries.
- 1.2 In Kazakhstan, Islamic finance was formally introduced in 2009 through adopting first set of legislative amendments in banking law and establishing first Islamic bank in the Republic – Al Hilal Bank, which is a 100% subsidiary of Al Hilal (UAE). As part of its business policy, Al Hilal Bank positioning itself as an Islamic Bank for corporate clients (legal entities).
- 1.3 There are two fully operating Islamic banks in Kazakhstan as of September 2020 – Al Hilal Islamic Bank JSC and Zaman-Bank Islamic Bank JSC (previously a conventional commercial bank that converted into the Islamic bank in 2017). These banks' combined assets represent 0.25% (69.1 billion Kazakhstan tenge) of total banking assets of the Republic of Kazakhstan as of 2020.
- 1.4 There is no unified Islamic finance law in Kazakhstan. Instead, domestic Islamic finance transactions are regulated by Kazakhstan's general banking, securities, insurance and other relevant legislations.
- 1.5 Kazakhstan, with a 70% Muslim population, has attracted an increasing amount of Islamic finance activity. In May 2015 by the Decree No. 393 of the President of Kazakhstan, Astana International Financial Centre (AIFC) was established, which legal framework is complementing existing regulations of the Dubai International Financial Centre (based on Common law of England and Wales). To promote the AIFC as a regional hub of Islamic finance, the Advisory Council on Islamic Finance (ACIF) and the Central Shari'ah Advisory Board under the AIFC have been established.
- 1.6 In March 2012 the Decree No. 37 of the Government of the Republic of Kazakhstan approved the Roadmap for the development of Islamic finance until 2020.
- 1.7 According to the Decree of the President of Kazakhstan from January 1, 2020 the new state body – the Agency of the Republic of Kazakhstan for Regulation and Development of Financial Market was established. Functions of state regulation and development of financial market and financial organizations, as well as protection of the rights and legitimate interests of consumers of financial services were transferred from the National Bank of Kazakhstan to the Agency. The Agency is the main supervisory authority on financial market of Kazakhstan.

2

Legislations and Laws

- 2.1 Since 2009, the National Bank of Kazakhstan has been developing the legal framework for Islamic banks in the country. A set of amendments to the Civil Code, Banking Law, Tax Law and other laws and regulations were introduced to level the playing field both for Islamic and conventional banks.

- 2.2 In 2009 the Law of Kazakhstan “On amendments and additions to some legislative acts of the Republic of Kazakhstan on the organization and activities of Islamic banks and Islamic finance” has been adopted.
- 2.3 The main block of changes concerning the introduction of Islamic finance instruments is related to the Law of the Republic of Kazakhstan “On Banks and Banking Activities in the Republic of Kazakhstan” and aimed at creation of a legal framework for the functioning of Islamic banks, the removal of restrictions preventing the introduction of Islamic banks, determination of the forms and methods of state regulation and supervision of Islamic banks, list and order of the Islamic banking operations.
- 2.4 Changes to the Law of the Republic of Kazakhstan “On securities market” allow the issuance and circulation of Islamic securities (*Sukuk*).
- 2.5 Changes to the Law of the Republic of Kazakhstan “On investment funds” include the possibility of creating Islamic investment funds. At the same time the shares and units of Islamic investment funds are also considered by the Law on Securities Market as Islamic securities.
- 2.6 In 2011, the Law of the Republic of Kazakhstan “On amendments and additions to some legislative acts of the Republic of Kazakhstan on the issues of Islamic finance” was adopted. According to the law the state was allowed to issue sovereign Islamic securities, as well as the list of corporate issuers of Islamic securities was expanded.
- 2.7 With regard to Islamic banking products there is a separate tax regime providing for tax incentives equivalent to traditional financial transactions (financial transactions are exempt from value added tax).
- 2.8 The Law “On amendments and additions to some legislative acts of Kazakhstan on insurance and Islamic finance” has been adopted in 2015. The Law includes issues of Islamic insurance, amendments providing for recognition of commodity *Murabaha* as Islamic banking operation, mechanisms and methodologies for tax administration of this operation, as well as acceptance of deposits by Islamic banks on the principles of agency activities (*Wakala*) and Islamic leasing.
- 2.9 On November 2015, the Law providing structure of government Islamic securities issuance and conversion conventional bank into Islamic has been adopted. The purpose of the adoption of the Law is to ensure the further development of Islamic finance in Kazakhstan by improving the existing structure of issuance of state *Sukuk* and the creation of conditions for the conversion of conventional banks into Islamic banks.
- 2.10 At the time, Kazakhstan does not have an independent judiciary that would recognize the Islamic finance rules and principles. All disputes between Islamic banks and consumers of financial services of Islamic banks in the Republic of Kazakhstan should be resolved within the Civil Law framework. It should be noted that Kazakhstan is a secular state, and there are no Shari'ah courts presented within the jurisdiction.

3

Shari'ah Governance

- 3.1 The banking regulator in Kazakhstan does not impose Shari'ah Governance System in the jurisdiction, nor does it have any specific regulations in the area of competence of Shari'ah Board members and Shari'ah Secretariat members in their traditional understanding.
- 3.2 According to the Kazakhstan Law on Banks and Banking, the Shari'ah Boards are termed as Council on the principles of Islamic finance. Each operating Islamic bank within the jurisdiction must appoint a Council on the principles of Islamic finance. This Council will have the final word on compliance issues.
- 3.3 The Council is an independent body appointed by the General meeting of shareholders of the Islamic bank on the recommendation of the Board of Directors. The Council on the principles of Islamic finance has the right to check at its discretion any transaction for compliance with the requirements of the banking legislation of the Republic of Kazakhstan. Law on Banks and Banking describes the role of the Council.

4

Development of Liquidity Management Infrastructure

- 4.1 Liquidity framework adopted by the National Bank of Kazakhstan does not segregate the solutions for Islamic and conventional financial institutions.
- 4.2 National Bank of Kazakhstan envisions to introduce a range of Shari'ah-compliant liquidity management solutions.
- 4.3 Under Basel III regime, Liquidity Coverage Ratio (LCR) requirement has been progressively implemented in Kazakhstan since 2017 and will reach 100% by 2022 and standard for Net Stable Funding Ratio (NSFR) is effective from 1 January 2019.
- 4.4 Jurisdiction has not issued any sovereign Shari'ah-compliant securities (*Sukuk*) yet, however legislation is creating conditions for issuing sovereign Islamic securities.
- 4.5 Astana International Exchange (AIX) on March 2020 announced the first cross listing at AIX of *Sukuk* issued by Qatar International Islamic Bank with primary listing on the London Stock Exchange (LSE). It is a Shari'ah-compliant fixed-income capital markets instrument with initial offer in the amount of USD500 million with a spread of 175 basis points over the 5-year mid swaps carrying a fixed coupon of 4.264% per annum.

5

Financial Safety Nets

- 5.1 National Bank of Kazakhstan is not offering a Shari'ah-compliant Lender of Last Resort (SLOLR) facility to Islamic banks that need access to liquidity. However, there is an alternative for Islamic banks to receive emergency funding. As with all other financial institutions of the Republic of Kazakhstan, Islamic banks have the right to rely on Loans of Last Resort in accordance with the Law of the Republic of Kazakhstan "On the National Bank of the Republic of Kazakhstan".

- 5.2 Interestingly, Islamic banks in Kazakhstan are not members of the mandatory deposit guarantee system, therefore Islamic banks' deposits are not guaranteed by the mandatory deposit guarantee system. In Kazakhstan, Islamic banks can be established as a non-profit organization (following organizational and legal form of a joint-stock company) that guarantees the return of deposits mobilized by Islamic banks.
- 5.3 It can be concluded that the Islamic banking sector is not affected by the absence of Shari'ah-compliant deposit insurance scheme.

6 Effective Crisis Management and Resolution Framework

- 6.1 In Kazakhstan a crisis management and resolution framework for Islamic banks are regulated by the Law of the Republic of Kazakhstan "On banks and banking activities in the Republic of Kazakhstan".
- 6.2 The issues of bank insolvency, restructuring and recapitalization operating within the jurisdiction are regulated by the Law "On banks and banking activities in the Republic of Kazakhstan" and the Law "On rehabilitation and bankruptcy".

7 Governance, Accounting and Auditing

- 7.1 National Bank of Kazakhstan sets the requirements for Islamic banks to adopt a Corporate Governance Framework. Since in Kazakhstan second-tier banks, including Islamic banks, are created in the form of joint-stock companies, the approval of the Corporate Governance Code of the company stated within the Law of the Republic of Kazakhstan "On joint-stock companies".
- 7.2 Kazakhstan has developed a separate accounting standards and reporting methods (including additions to the plans of accounts, special balance sheet accounts for accounting of Islamic Finance operations, and instructions on accounting and preparation of financial statements) that Islamic banks and Islamic special financial companies that Islamic banks need to follow. The current regulatory framework based on the standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and adopted within the framework of the General principles and bases of IFRS.

8 Disclosures Requirements

- 8.1 Islamic banks operating in Kazakhstan as joint-stock companies are following the general disclosure requirements considered by the Law of the Republic of Kazakhstan "On joint-stock companies", including disclosures of any departure from complying with the applicable financial reporting standards, disclosures related to the Islamic bank's Corporate Governance arrangements and practices and all related party transactions and treatment of material events by the Islamic banks.
- 8.2 The disclosures related to the Shari'ah governance that include governance arrangements, systems and controls employed by the Islamic banks to ensure Shari'ah compliance; BOD's responsibility and accountability over the Shari'ah governance of the Islamic bank and others

are regulated by the by the Law “On banks and banking activities in Republic of Kazakhstan” in part related to the **Council on the principles of Islamic finance**.

- 8.3 National bank of Kazakhstan does not regulate Islamic windows within its jurisdiction, hence no disclosure requirements are needed.
- 8.4 Amongst another disclosures that required is Investment Account Holders (IAHs) related disclosures, which regulated by the Law of the Republic of Kazakhstan “On securities markets”.

9

Rating of Islamic Financial Institutions and Shari’ah-compliant Instruments

- 9.1 There is no Local External Credit Assessment Institution (ECAIs) in Kazakhstan.
- 9.2 ECAIs that provide ratings to Islamic banks and Shari’ah-compliant instruments are regulated by the Resolution of the Board of the National Bank of the Republic of Kazakhstan “On establishing a minimum rating for legal entities, the need for which is required in accordance with the legislation of the Republic of Kazakhstan regulating the activities of financial organizations, the list of rating agencies that assign this rating” dated 24.12.2012 No. 385. Paragraph 3 of the above resolution establishes the following list of rating agencies: Standard & Poors; Moody’s Investors Service; Fitch.

10

Capacity Building and Talent Development

- 10.1 In Kazakhstan there is a sufficient human resources supporting local Islamic finance sector with their relevant knowledge and skills, among them are economists, accountants, auditors, and lawyers.
- 10.2 AIFC as a joint effort of the Kazakhstan Government and the National Bank is also contributing in strengthening and expanding Islamic finance experts’ pool within its capacity-building strategy aimed to keep up with the growth and demand of Islamic finance industry within jurisdiction.
- 10.3 National bank of Kazakhstan offers programs and courses on Islamic finance within its Training centre.

11

Challenges in Implementing IFSB Standards

- 11.1 According to the Implementation Survey 2019 responses, there are a few main factors that makes the adoption of the IFSB standards challenging for the Kazakhstan.
- 11.2 Even though regulatory authority and supervisory agencies of the Republic of Kazakhstan have sufficient number of Islamic finance staff (economists, accountants etc), however the jurisdiction is **lacking of local Shari’ah scholars** who can advise RSAs on regulations related to the Islamic finance sector. This also makes the identification of gaps between existing regulatory framework and IFSB standards challenging.

- 11.3 Another factor that constrains the implementation of IFSB standards within jurisdiction – is a relatively **small size of the Islamic finance industry**, while the process of IFSB standards implementation is considered to be too **time intensive**.
- 11.4 Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market periodically conducts a self-assessment to identify the maturity of the market prior to implementing international standards including IFSB standards, as further implementation of the standards is subject to the capacity of Islamic finance market in the country.



Section VIII: OMAN (Central Bank of Oman)

1 Background

- 1.1 The Sultanate of Oman represents a success story on the rapid growth of Islamic finance in a relatively short period of time and becoming systemically significant Islamic banking market. This milestone was achieved through well-thought-out legal and regulatory reforms to provide a sound basis for the establishment and growth of Islamic banking sector in the country.
- 1.2 Central Bank of Oman (CBO), in 2011, announced consideration of the initiative to allow Shari'ah-compliant banking as a parallel approach (dual banking system). Islamic Banking was formally facilitated in Oman with the issuance of Royal Decree in December 2012, effecting required amendments to Banking Law. The amendments to the Law were followed up by the issue of a comprehensive Islamic Banking Regulatory Framework (IBRF) and a detailed Regulation on establishing High Shari'a Supervisory Authority (HSSA).
- 1.3 Currently there are two full-fledged/local Islamic banks and 5 Islamic banking windows of 5 local commercial banks – with 86 dedicated Islamic banking branches. The growth in Islamic banking industry in the Sultanate of Oman continues to outpace the growth in conventional banking sector.
- 1.4 The total assets of the Islamic banking sector represents 13.98% of the total banking sector in Oman (USD 12.43 billion) as June 30th 2020. The combined average growth rate during last 5 years was quite high at 30.1% (from December 2015 till December 2019). During next 5 years, the annual growth rate in assets of Islamic Banking is expected to be modest around 10%, but still it may be considerably higher than growth in the assets of conventional banks.
- 1.5 Islamic banking falls under the purview of the Central Bank of Oman (CBO), which was established in the beginning of 1974 to regulate and supervise the activities of banking system. Since authorization of Islamic banking in 2012, CBO started licensing full-fledged Islamic banks and conventional banks for Islamic windows (collectively termed as "Islamic Banking Entities or IBEs" to offer Islamic banking services in the Sultanate.
- 1.6 In 2013 CBO established a High Shari'ah Supervisory Authority to advise on Shari'ah-compliant related transactions and settle Shari'ah-related disputes that may arise among the Shari'ah Supervisory Boards (SSBs) of IBEs in Oman.
- 1.7 In 2015 CBO established a dedicated Islamic Banking Department.
- 1.8 Sultanate of Oman is among the top-five jurisdictions in terms of the implementation of IFSB's key banking standards¹.

¹ According to the IFSB's Implementation Survey of 2020Y

2 Legislations and Laws

- 2.1 Islamic banking was formally introduced in Oman by Royal Decree (RD) No. 69/2012, which amended RD No. 114/2000 (the Banking Law) by adding a new chapter dedicated to Islamic banking. The main purpose of the Royal Decree was to add six additional articles, 121 to 126, to the Banking law of Oman to provide legal basis to the introduction of Islamic banking in the Sultanate. This chapter included provisions to grant CBO the authority to license and regulate, supervise Islamic banking activities in Oman conducted by IBEs.
- 2.2 Subsequently, the Central Bank of Oman issued circular IB 1/2012, promulgating the **Islamic Banking Regulatory Framework** (IBRF) on 18th December in 2012. The IBRF provides requirements and guidelines specific to Islamic banking as well as generally applicable banking rules and norms (to the extent they are not in conflict with norms applicable to Islamic banking), as set by CBO in accordance with the standards issued by international standard setting bodies such as BCBS, IFSB, AAOIFI, FATF et etc.
- 2.3 Sultanate of Oman has introduce taxation neutrality laws to ensure a level playing field for both Islamic and conventional financial institutions. The main legislation relating to taxation in Oman is RD No. 28/2009 (the Income Tax Law), which governs both Islamic and conventional businesses. Though there is no special or separate law governing the taxation of Islamic financial institutions, but the Income Tax Law contains a chapter specific to the income generated from Islamic financial transactions. This chapter was introduced by RD No. 9/2017, which amended the Income Tax Law for the purpose of, *inter alia*, clarifying the tax position of Islamic banks as part of an overall tax reform. In this regard, the Income Tax Law currently provides for the taxability of any amounts generated from an Islamic finance transaction obtained by a taxpayer in lieu of interest, which effectively makes virtually all Islamic financial transactions profits' taxable on a par with their conventional counterparts.
- 2.4 The Income Tax Law further provides that if the purpose of the transaction is to purely achieve a Shari'ah-compliant objective without the transaction including any financial aspect, such as the leasing of real estate or a movable asset, or establishing usufruct thereon, the transaction will not be taxable. Hence, income generated from such a transaction (excluding any interest-like payments) will not be deemed taxable in accordance with Article 76 bis (3) of the Income Tax Law.
- 2.5 The chapter relating to taxation of income generated from Islamic finance transactions also provides special rules concerning deduction of donation amounts paid by the borrower, the impact of credit losses on the calculation of the taxable income, and the submission by the taxpayer of evidence regarding specific matters when submitting its fiscal declaration or during the course of SGT decision-making regarding any petition filed by the taxpayer.
- 2.6 The Capital Market Law grants special purpose vehicles (SPVs) formed by originators for the purpose of issuing *Sukuk* exemption from payment of taxes and fees imposed by all Oman government bodies; hence, they are exempt from payment of, *inter alia*, income and withholding taxes.
- 2.7 Oman has efficient and independent judiciary. Under the court system in Oman, as provided for by RD No. 90/1999, the Primary Court (Commercial Circuit) (the Primary Commercial Court) is the only body in Oman with primary jurisdiction in relation to commercial disputes

(whether or not they relate to Islamic finance issues of a commercial nature); these are subject to appeals before the Appellate Court (Commercial Circuit) and the Supreme Court of Oman. Any matters arising between Islamic banks/Islamic windows (IBEs) and their consumers will be adjudicated through civil courts.

- 2.8 Similarly, parties to Islamic finance-related agreements are free to agree to refer disputes to an arbitral tribunal and to specify the law governing their transaction and the arbitration rules governing arbitral proceedings.
- 2.9 However, before any case is brought before the courts, Islamic Banks have a mechanism to resolve the disputes through their Customer Complaint System. Each Islamic Banking Entity is also having its own Shari'ah Supervisory Board, which are responsible to solve Shari'ah issues. Customers also have a right to complain directly to the Central Bank. In that case, CBO will follow up with respective Islamic Banking Entity for the amicable resolution of the issue. CBO also may refer any *Fiqh* related issues to its High Shari'ah Supervisory Authority (HSSA) for giving opinion.

3

Shari'ah Governance

- 3.1 IBEs shall be guided and supervised by their respective Shari'a Supervisory Boards (SSBs) on Shari'ah compliance, and by the HSSA. In order to govern the business activities of Islamic Banking Entities, CBO has defined a comprehensive "Shari'ah Governance Framework" mandated in the IBRF.
- 3.2 It is worth mentioning that Oman did not envision CBO to be a Shari'a regulator, as followed by most other banking regulators around the world. In order to govern the business activities of the IBEs, CBO has defined a comprehensive Shari'a Governance Framework mandated in the IBRF. "Providing a structure and system to govern all the business activities of the IBEs in order to ensure Shari'a compliance at all times and at all levels and to enable them to be perceived as Shari'a compliant by the stakeholders, including the general public" is the hallmark of Shari'a Governance Framework mandated.
- 3.3 The Board of the IBEs has the ultimate responsibility to create and maintain a robust Shari'a Governance Framework to ensure Shari'a compliance of the operations of the Licensee. The Board shall approve all the policies and procedures for the Licensee related to Shari'a matters in consultation with the Shari'a Supervisory Board and shall put in place a mechanism to ensure that such policies and procedures are effectively implemented.
- 3.4 IBRF outlines Roles and Responsibilities of the Shari'a Supervisory Board, which includes detailed guidance on upholding highest level of professionalism, consistency in issuing pronouncement and maintaining transparency in this process.
- 3.5 Shari'ah Governance System provide guidance, among others, on the following structures and processes:
 - HSSA at the Central Bank level;
 - Role of Board of Directors to ensure Shari'a Compliance;
 - Establishment of SSB in each IBE as per the specified Fit & Proper Criteria;
 - Appointment of Internal Shari'a Reviewer;
 - Issuance process of relevant Shari'ah pronouncements/resolutions;

- Dissemination of information on such Shari'ah pronouncements/resolutions to the operative personnel of the IBE who monitor the day-to-day compliance with the Shari'ah pronouncements/resolutions vis-à-vis every level of operations and each transaction;
- Establishment of an internal Shari'ah compliance review/audit for verifying that Shari'ah compliance has been satisfied, during which any incident of non-compliance will be recorded and reported, and as far as possible, addressed and rectified;
- Assurance that an internal Shari'ah compliance review/audit has been appropriately carried out and its findings have been duly noted by the Shari'ah Board;
- Sharia Examination by External Auditors;
- Shari'a Risk Control under Risk Management Division and dotted line reporting to the ISR.

4

Development of Liquidity Management Infrastructure

- 4.1 Liquidity framework adopted by the CBO does not segregate the solutions for Islamic and conventional financial institutions.
- 4.2 Central Bank of Oman envisions to introduce a range of Shari'ah-compliant liquidity management solutions to support its monetary objectives and resolve liquidity management issues being faced by Islamic Banking Entities. These solutions offer tools for injecting and mopping up liquidity on Shari'ah-compliant basis, which already have been reviewed by the HSSA, with addressing the contractual and operational aspects.
- 4.3 Under Basel III regime, Liquidity Coverage Ratio (LCR) requirement has been progressively implemented in Oman with effect from January 1, 2015 and standard for Net Stable Funding Ratio (NSFR) is effective from January 1, 2018. All IBEs are maintaining the LCR well above the minimum prescribed ratio.
- 4.4 Short-term liquidity management, as of now, is being done through inter-bank transactions, on mostly *Wakala* based. IBEs may make use of secondary market in *Sukuk* to address short-term liquidity management needs.
- 4.5 The CBO is currently in the process of launching short to medium-term liquidity management tools for Islamic Banking Entities.
- 4.6 The CBO has not issued any Shari'ah-compliant securities yet. However, Islamic Banking Entities can invest in sovereign *Sukuk* issued by the Government of the Sultanate of Oman in local and foreign currency.
- 4.7 The Government of Oman's first Shari'ah-compliant Sovereign *Sukuk* was sold in 2015, at OMR 250 million (Omani rial) (USD647.22 million), followed by a USD500 million six-year dollar private *Sukuk* issuance in July 2016. Further, in 2017 and 2018 International Sovereign *Sukuk* dominated in USD were issued amounting 2 billion and 1.5 billion, respectively, maturing in 7 years. In 2019 local Sovereign *Sukuk* was sold at OMR 300 million in two tranches (OMR 100 million for 5 years, and OMR 200 million for 7 years). The most recent local sovereign issuance was in May 2020 amounting at OMR 200 million for 6 years. More bond and *Sukuk* issues are being planned by the government.

- 4.8 Oman's Muscat Securities Market has launched a Shari'ah-compliant index – Muscat Securities Market Shari'ah Index – in 2013. Since then Muscat Securities Market independently conducts an annual review of the Shari'ah index sample based on its screening criteria. The Shari'ah Index sample for 2020 includes 15 companies.

5

Financial Safety Nets

- 5.1 The CBO is not yet offering a Shari'ah-compliant Lender of Last Resort (SLOLR) facility to IBEs that need access to liquidity. However, the HSSA has already approved the structure of a SLOLR product, based on *Mudaraba* principle.
- 5.2 Currently Islamic banks can get access to Shari'ah-compliant emergency funding through engaging with local interbank market and approaching other regional and international Islamic banks to obtain liquidity in Shari'ah-compliant manner.
- 5.3 At the moment, Shari'ah-compliant Deposit Protection Scheme is not introduced in Oman. The CBO is in undergoing discussions with Ministry of Legal affairs on finalizing the law related to Islamic Deposit Insurance Scheme for IBEs. Shari'ah-compliant Deposit Protection Scheme is structured to provide Takaful protection to the eligible deposit accounts held with member Islamic institutions. Each member institution shall pay an annual contribution calculated as a percentage of the average of month end balances of eligible deposit accounts held during a year by the member institution in accordance with the relevant Regulations or decisions issued by the Board of Governors. According to CBO, the introduction of such scheme will surely strengthen the safety net available to fund providers of IBEs in Oman and improve the confidence of customers on Islamic banking sector.
- 5.4 Shari'ah-compliant Deposit Protection Scheme aims at providing a comprehensive protection cover on deposits deposited with members to encourage savings, increasing and strengthening public confidence in the soundness of the financial conditions of the banking, sector in the Sultanate, and reducing the effects of systemic risks in the banking sector to enhance financial stability. This Deposit Protection Scheme will be subject to administrative and financial supervision of the Central Bank. A draft law has been prepared and undergoing revisions are taken place with Ministry of Legal Affairs then a Royal Decree will be issued in due course.

6

Effective Crisis Management and Resolution Framework

- 6.1 In Oman and the bank resolution framework is primarily applicable to Domestic Systemically Important Banks (D-SIBs), but at the discretion of CBO it may be extended to any entity licensed by CBO. At present, one bank (along with its Islamic window) in Oman is considered as a D-SIB.
- 6.2 The framework identifies a non-exhaustive set of tools that may be employed for resolving a bank. The tools cover:
- Bank insolvency laws.
 - Arrangements for dealing with non-performing assets.
 - Bank restructuring.
 - Bank recapitalisation.

- 6.3. The Bank resolution Framework is a part of the overall regulatory and supervisory architecture of CBO with an aim to prevent a bank/ financial institution to reach the failure or resolution phase in the first place. It triggers prompt corrective actions if the capital conservation buffers are drawn down, or weaknesses in the liquidity, asset quality or other areas of an institutions are noticed; set off institution-initiated recovery if the institution hits certain thresholds; and eventually if the recovery fails use the resolution toolkit for an orderly exit, without excessive market disruption.
- 6.4. The existing recovery and resolutions framework of CBO does not recognize the specificities of Islamic finance, because the Banking Law defines the *Hierarchy of Claims*. In the event of a resolution, the *Hierarchy of Claims* shall be determined according to the relevant clauses of the Banking Law.

7 Governance, Accounting and Auditing

- 7.1 The CBO sets the requirements for Islamic banks to adopt a Corporate Governance Framework. In Oman Islamic Banks and Islamic windows must follow the Corporate Governance rules given in IBRF.²
- 7.2 Sound corporate governance principles include establishment of corporate governance policy framework setting out rules and functions for each organ, balancing accountability for various stakeholders including Investment Account Holders, due diligence in the management of investment accounts and appropriate disclosures covering both financial and non-financial information and compliance with Shari'a principles in letter and spirit.
- 7.3 Corporate governance rules are meant to lay down the principles of demarcation between the role, responsibility and accountability of the Board of Directors and that of the management in the Licensees incorporated within the Sultanate of Oman.
- 7.4 Major Corporate Governance principles include:
 - Role and Responsibility of the Board of Directors.
 - Role and Responsibility of the Management.
 - Committees of the Board – Delegation of Powers.
 - Chief Executive Officer / General Manager.
 - Committees of Management – Delegation of Powers.
 - Deviations from the Stipulated Demarcation Procedures.
 - Prohibition on Holding of Multiple Directorships.
- 7.5 Islamic banks in Oman have different accounting standards/reporting methods compared to conventional banks. Islamic Banks must maintain comprehensive books of accounts and other records. Separate books of accounts shall be maintained for an Islamic window.
- 7.6 Books of accounts must comply with the Financial Accounting Standards issued by the Accounting & Auditing Organisation for Islamic Financial Institutions (AAOIFI), and where no relevant AAOIFI standards exist, with International Financial Reporting Standards (IFRS)/ International Accounting Standards (IAS).

²They should also follow the Code of Corporate Governance by the Capital Market Authority (CMA).

8

Disclosures Requirements

- 8.1 Islamic banks operating in Oman are practicing a separate disclosure requirements compared to their conventional counterparts. Amongst the disclosures required are: General governance, Shari'ah governance, Islamic windows and Investment Account Holders (IAHs) and related disclosures.
- 8.2 For General governance disclosures, Islamic banks are supposed to provide explanation of any departure from complying with the applicable financial reporting standards. They are required to disclose their corporate governance arrangements and all related party transactions and treatment of material events.
- 8.3 Disclosures on Shari'ah governance include: statement on the governance arrangements, systems and controls employed by the IIFS to ensure Shari'ah compliance; statement clearly articulating the BOD's responsibility and accountability over the Shari'ah governance of the Islamic bank; statement on the independence of members of the SSB or an advisory firm appointed by the Islamic bank to act as a SSB; qualifications and areas of expertise of each Shari'ah Board member. Appointment and change of members of the SSB during the financial year; SSB's opinion on the IIFS's state of compliance with Shari'ah rules and principles; disclosures of Shari'ah pronouncements/resolutions issued by the Islamic bank's Shari'ah Board.
- 8.4 For Islamic windows disclosures, financial statements of conventional banks are required to contain notes on Islamic window's financial statement; mechanism established to provide Shari'ah oversight of the activities of the Islamic window; disclosures related to Profit Sharing Investment Accounts (PSIA) and profit smoothing liquidity disclosures.
- 8.5 Disclosures on PSIA include:
 - Written policies and procedures applicable to the investment accounts including range of investment accounts, characteristics of investors, purchase, redemption and distribution procedures, professional resume portfolio managers, investment advisers and trustees, governance arrangements for the IAH funds procedures for trading and origination of assets and policies and procedures for valuation of PSIA assets.
 - Information on investment account products, such as fund/portfolio/product name, underlying contracts used and the manner in which the products are made available to investors.
 - Bases of allocation of assets, expenses and profit in relation to IAH funds.
 - Policies governing the management of both unrestricted and restricted IAH funds.
 - Any changes to investment strategies by the IIFS or investment manager that could affect the IAH's investment.
 - Quantitative disclosures such as total amount of IAH funds, PER-to-PSIA ratio, IRR-to-PSIA ratio, ROA, ROE, assets and financings funded by URPIAH and profit distribution.

9

Rating of Islamic Financial Institutions and Shari'ah-compliant Instruments

- 9.1 There is no Local External Credit Assessment Institution (ECAIs) in Oman. International ECAIs are rating local Islamic banking, *Sukuk* and other Shari'ah-compliant instruments issued under the jurisdiction of Sultanate of Oman.

10 Capacity Building and Talent Development

- 10.1 Oman has a reasonable supply of professionals such as accountants, auditors, lawyers and Shari'ah scholars etc. from local and international market though it is somewhat constrained due to relatively early phase of the introduction of Islamic finance in the country.
- 10.2 The Central Bank is contributing and promote capacity building and talent development for the Islamic finance industry within jurisdiction. CBO works closely with international partners as well as local educational institutions and training providers to arrange capacity building programmes. For this purpose, staff of the Central Bank, other regulators and Islamic financial institutions are nominated to attend these talent development initiatives.
- 10.3 CBO's staff and that of IBEs participate in international events, conferences and training programmes on a regular basis.
- 10.4 There are several colleges and universities and training providers, including College of Banking and Financial Studies, which offer undergraduate level degree in Islamic banking and finance in Oman. Several other universities offer Islamic finance courses in Shari'ah, economics, finance and management sciences.
- 10.5 CBO is pursuing cooperation with these institutions to get their feedback and views to be incorporated in the Central bank of Oman Strategy for Islamic Banking Development in Oman that is being prepared these days.

11 Challenges in Implementing IFSB Standards

- 11.1 The main challenges for Central Bank of Oman in the early phase was the availability of qualified staff. Supervisory staff had lack of capacity to supervise and assess compliance with Islamic finance related regulations and guidelines, as well as lack of knowledge in Islamic finance.
- 11.2 CBO addressed mentioned challenges with a mutli-pronged strategy:
 - Worked with a renowned consultancy firm to produce Oman's own primary regulatory framework, while learning the experience of other leading jurisdictions in Islamic finance.
 - Built internal resources by hiring qualified central bank staff and recruiting new external experts.
 - Exposed staff to several local and international trainings, seminars and regular degree programme on Islamic banking and finance.
- 11.3 The CBO is gradually implementing most relevant international Islamic finance standards by adopting them to the needs of local Islamic banking sector.
- 11.4 CBO is currently developing a strategy for the development of Islamic banking industry which will include a formal assessment on the future needs for Islamic banking industry in the Sultanate, while identifying an action plan to support the sustained growth of IBEs.

ISLAMIC FINANCIAL SERVICES BOARD

Level 5, Sasana Kijang, Bank Negara Malaysia 2, Jalan Dato' Onn, 50450 Kuala Lumpur, Malaysia
T: +6 03 9195 1400 | F: +6 03 9195 1405 | E: ifsb_sec@ifsb.org | W: www.ifsb.org