

FAQs on IFSB-9:

Guiding Principles on Conduct of Business for Institutions Offering Islamic Financial Services

1. What are the rationales for adopting the Conduct of Business for Institutions offering Islamic Financial Services (IIFS)?

Answer: The standard is developed to promote confidence, transparency, and fair dealing in the Islamic financial services industry (IFSI). These principles are based on the Sharī'ah principles and are intended to protect the interests of customers and maintain the integrity of the market. The principles also guide supervisory authorities in their supervision of the business conduct of IIFS and allow for flexibility in tailoring rules to fit the specific needs of different jurisdictions. The adoption of these principles aims to support the growth of the IFSI, strengthen its moral, social, and religious dimensions, and ensure that IIFS operates in a manner consistent with Sharī'ah principles.

2. What are the competitive advantages/added values of applying the framework recommended in IFSB-9 to IIFS' business operations?

Answer: The competitive advantages/added values of applying the framework outlined in IFSB-9 to IIFS' business operations are as follows:

- **Enhanced customer trust and confidence:** By adhering to the principles outlined in IFSB-9, IIFS can establish a climate of trust and confidence among their customers. This can lead to increased customer loyalty and satisfaction, ultimately contributing to the growth and success of the institution as well as the industry.
- **Sharī'ah compliance:** The framework emphasises the importance of Sharī'ah compliance in conducting business. By following these principles, IIFS can ensure that their operations are in line with the ethical and religious requirements of Islamic finance, as expected by their customers and other stakeholders.
- **Differentiation in the market:** Implementation of the framework sets IIFS apart from conventional financial institutions, offering a unique value proposition. This differentiation can be a competitive advantage, as it appeals to customers who prefer Islamic financial services and are seeking alternatives to conventional banking.

- **Strengthened ethical business conduct:** The principles in IFSB-9 promote ethical business conduct, upholding values such as truthfulness, honesty, fairness, and due care. By adhering to these principles, IIFS can build a reputation for integrity and responsible business practices, which can attract customers both Muslims and non-Muslims who value ethical considerations in their financial decisions.
- **Tailoring to local circumstances:** The framework allows for flexibility in implementation, enabling IIFS to adapt the principles to local regulatory requirements and market conditions. This flexibility ensures that IIFS can comply with the framework while considering the specific needs and circumstances of their operating jurisdictions.
- **Guidance for supervisory authorities:** IFSB-9 guides supervisory authorities in their supervision of IIFS. This can lead to more effective oversight and regulation, ensuring the stability and soundness of the IFSI.
- **Level playing field with conventional counterparts:** The standard complements the existing internationally recognised frameworks and strengthens sound principles and best practices pertaining to the conduct of business, by addressing issues specific to Islamic finance. This will allow IIFS to not only operate on an equitable level playing field with conventional counterparts but also in a manner that is consistent with business ethics reflecting Sharī'ah principles.

These competitive advantages/added values contribute to the overall success and sustainability of IIFS' business operations.

3. **How is the operating mechanism which IFSB-9 recommends will help to achieve its two main objectives regarding (a) the protection of the interests of its customers and (b) the integrity of the market?**

Answer: The operating mechanism prescribed by IFSB-9 is intended to help IIFS achieve two main objectives: protecting the interests of their customers and maintaining the integrity of the market.

The standard highlights that the codes of ethical business conduct, derived from Sharī'ah principles, should establish the expected standards of conduct behavior for all employees. These codes are to be disseminated through comprehensive training and awareness programs. Continuous evaluation and improvement are integral to ensuring that the code remains relevant and effective. Additionally, by disclosing the recommended information, IIFS can enhance market discipline and promote transparency, which can help protect the interests of their customers and maintain the integrity of the market.

4. Is there any differentiation regarding the applicability of the standard across Islamic finance sectors i.e., Islamic banking, Islamic capital market, and takaful?

Answer: The applicability of IFSB-9 remains consistent across Islamic finance sectors such as Islamic banking, Islamic capital market, and takaful. It can also be applied to all institutions offering Islamic financial services, including the “windows” of conventional firms.

It's worth noting that while IFSB-9 applies uniformly, the standard acknowledges the importance of proportionality, allowing for flexibility in tailoring rules to fit the specific needs of the supervisors.

5. Should the Board of Directors, Senior Management, and Sharī'ah Supervisory Board follow the same conduct of business?

Answer: Yes, the Board of Directors, Senior Management, and Sharī'ah Supervisory Board should follow the same conduct of business as expected of all employees. The code of ethics should state that the standard of conduct applies to every level of the organisation, including the highest echelons of leadership. This ensures a consistent and unwavering commitment to ethical practices throughout the institution, aligning with the principles outlined in IFSB-9.

6. To what extent do the principles apply to all IIFS employees, particularly for non-Muslim employees or third-party employees i.e., outsourced for specific services?

Answer: The principles of good business conduct are inclusive and applicable to all management and staff of IIFS, regardless of their religious beliefs. This includes non-Muslim employees and third-party employees who are outsourced for specific services. IIFS should ensure that all relevant employees are trained in the understanding of Sharī'ah principles, both generally and as they apply to the IIFS's business specifically. Therefore, all employees of IIFS, including non-Muslim and third-party employees, are expected to follow and demonstrate the same conduct of business principles to ensure ethical business conduct, protect the interests of customers, and maintain the integrity of the market.

7. We understand that an Islamic window is part of the conventional entity, and therefore, it will be required to comply with the overall corporate culture and code of conduct. Hence, how to apply principles in this standard to an Islamic window?

Answer: To effectively apply the principles to an Islamic window, the following steps can be taken:

- **Compliance with the overall corporate culture and code of conduct:** As an integral part of a conventional entity, Islamic Window will be required to align and comply with the overall corporate culture and code of conduct of the entity. This ensures that the conduct of business within the Islamic window remains consistent with the overall corporate culture and code of conduct of the entity.
- **Adoption of the Guiding Principles:** The Islamic window should proactively adopt the Guiding Principles outlined in IFSB-9 to govern its activities by the Sharī'ah principles. The flexibility provided by the standard in implementation allows the window to tailor its approach, considering the specific needs and circumstances of their operating environment. This adaptability ensures compliance with the framework without placing the Islamic window at any competitive disadvantage.

8. Since the principles and rules stated in the IFSB-9 are at a high level, how should the Regulatory and Supervisory Authorities (RSAs) translate these into practicable guidance? Can you please guide the implementation?

Answer: The IFSB-9 provides overarching guidance for the RSAs and IIFS. While the principles are high-level, they empower IIFS to develop structures for compliance and adapt them to local circumstances. The standard also guides the RSAs, since RSAs may have varying degrees of responsibility for regulating the conduct of business in their respective countries, allowing them to tailor the principles in a variety of ways, such as by-laws, regulations, internal rules within a company or institution, and unwritten principles and customs. Additionally, the standard provides illustrations to which each principle can be applied in practical realms.

Through these, both RSAs can translate the high-level principles into practicable guidance, ensuring that it is consistent with Sharī'ah principles.

9. Considering the proportionality principle in adopting IFSB standards that need to be commensurate with the size, characteristics, and level of development of the IFSI in a given jurisdiction, an RSA may decide to not adopt it fully. In that case, what are the minimum principles recommended to be included?

Answer: The IFSB-9 principles are intended to provide high-level guidance to RSAs and IIFS. The principles are designed to be flexible and proportionate to the size, characteristics, and level of development of the IFSI in each jurisdiction. Therefore, the standard does not prescribe a minimum set of principles that must be adopted by all

RSAs. Instead, the IFSB encourages RSAs to adopt the standard in a manner that is appropriate to their local circumstances. While recognising flexibility, the IFSB recommends that RSAs should adopt the standard in its entirety, as they are designed to be a comprehensive framework for the conduct of business in the IFSI.

10. What are critical areas in IIFS, given its business nature, that need to receive more attention?

Answer: Considering the unique nature of IIFS, two key areas demand heightened attention:

- IIFS must ensure that the persons entrusted to deal on behalf of the IIFS are equipped with an appropriate level of knowledge of the Sharī'ah-compliant characteristics of the financial products and services offered by the institution. Having staff with the necessary capabilities is instrumental to avoiding excessive levels of operational risk, and as such is a matter that falls under the supervisory review process.
- IIFS needs to have a system in place to identify and manage conflicts of interest. This is particularly important given the complex nature of some Islamic financial products and services, which requires strong governance especially when the IIFS management fulfills fiduciary duties to both shareholders and clients (e.g. investment account holder or takaful participant). For more detailed information on how conflict of interest should be managed refer to Question 18.

11. How to assess IIFS compliance towards the IFSB-9?

Answer: Appendix 2 suggests a "Model Self-Assessment Questionnaire" that can be used either by an IIFS that has adopted a voluntary approach to compliance with the IFSB-9 or by a regulator that decides to make compliance mandatory. The questionnaire is designed to help IIFS assess their level of compliance with the IFSB-9.

12. In ensuring an effective framework, does the standard provide supervisory tools to detect any risk arising from violations of business conduct as recommended in the standard?

Answer: IFSB-9 does not provide specific supervisory tools to detect any risk arising from violations of business conduct. The standard recognizes that supervisory authorities desiring to monitor compliance may do so based on their business model or the nature of the activity undertaken by IIFS. A combination of both approaches is considered desirable. In certain countries, breaches of rules of business conduct may not result in sanctions in the strict sense.

For a comprehensive supervisory review process and tools, the RSAs may refer to IFSB-14 and IFSB-20. These additional guidelines provide further insights into supervisory mechanisms to ensure effective oversight and risk detection within the Islamic financial services industry.

13. What are the pros and cons that an RSA should consider before deciding whether it is mandatory or voluntary for IIFS to adopt the conduct of business issued by RSA?

Answer: RSAs may choose to make compliance with a code of conduct by IIFS, mandatory or voluntary for several reasons.

A mandatory adoption can help to ensure that all IIFS operating within the jurisdiction comply with the necessary standards, which can help to promote a level playing field and ensure that customers are protected. It can be important where the consumer's financial literacy is very low and their capacity to make informed decisions.

However, a mandatory approach can create higher costs of compliance for IIFS. In this regard, voluntary adoption may be more appropriate for smaller IIFS or those operating in less developed markets, as they may not have the necessary resources to comply with the necessary standards. Thus, a self-regulation/voluntary approach may offer more effective incentives to comply than the use of sanctions in a mandatory approach.

In deciding whether it is compulsory or voluntary for IIFS to adopt the conduct of business issued by RSA, the RSA should carefully consider the specific needs and circumstances of their operating jurisdictions. Protecting the interests of the consumers and upholding the Sharī'ah principles should be the main objectives of choosing either approach.

14. What is the minimum product information to be disclosed to IIFS customers?

Answer: IFSB-9 does not prescribe any minimum product disclosure requirements. However, the standard emphasises that an IIFS shall provide clear and truthful information both in any public document issued and to its actual and prospective clients, both during the sales process and in subsequent communications and reports.

For comprehensive guidelines on product disclosures, RSAs are advised to refer to IFSB-19 for the Islamic Capital Market, IFSB-22 for Islamic Banking, and IFSB-25 for Takaful/Retakaful.

15. How RSA can ensure that no discriminatory treatment (e.g., in pricing) is present towards customers?

Answer: To ensure the absence of discriminatory treatment (e.g., in pricing), RSAs can implement the following best practices recommended in IFSB-9:

- **Transparent disclosure of costs and profit:** For example, for a Murābahah contract to be valid, the seller must disclose the original cost (including any discounts received) and the profit margin/markup. Similar transparency should also apply to commissions and agency fees for financing Takāful products.
- **Avoidance of “small print” and hidden cost:** The use of “small print” to make potentially important information less visible is not compatible with good business conduct and must be avoided. Likewise, there should be no “hidden costs” in financing Takāful products, such as commissions or agency fees that are not disclosed to the client.
- **Ethical sales practices:** Avoid the use of “hard selling” techniques intended to push a client into an agreement without having properly evaluated the benefits and costs that are not consistent with good business conduct. Additionally, in appropriate cases, it is required that clients be given a “cooling off period” to have ample time to evaluate the benefits and costs of a product before finally committing themselves.
- **Avoidance of misleading information:** An IIFS should not, either deliberately or through negligence, issue information that is potentially misleading to stakeholders or the market, nor should it manipulate prices by using any means such as making a false market, issuing misleading price-sensitive information and price-fixing in conjunction with other market players. In addition, an IIFS should not, either deliberately or through negligence, issue information that is misleading to stakeholders or the market regarding the Sharī‘ah compliance of its products or services, or of Sukūk issuances with which it is involved. Nor should an IIFS mislead clients or the market through the withholding of material information.
- **Prevention of market manipulation:** In general, “market manipulation” is defined as any practice that distorts prices or trading volume in the market with the intent to deceive people or entities that rely on publicly available information, to make profits by selling at inflated prices or buying at artificially depressed prices.

16. Due to a lack of qualified human resources, should RSA allow dual hatting in IIFS?

Answer: IFSB-9 underscores the importance of IIFS having the necessary capabilities to effectively carry out their business activities, which includes having qualified human resources with the appropriate skills and expertise. However, the standard does not explicitly address the issue of dual-hatting or the situation of a lack of qualified human resources.

Such challenges may be more prevalent in the context of Islamic windows. As discussed in Question 7, the standard allows for flexibility in implementation, enabling the window to comply with the framework while considering the specific needs and circumstances of their operating environment to avoid putting them at any competitive disadvantage.

Furthermore, IFSB-10 related to the Sharī'ah governance framework recommends that IIFS develop an in-house capability with appropriate qualifications and experience.

17. One way of protecting customers is by introducing customers' right to recourse. What are the key considerations (pros and cons) for RSA to introduce such customers right?

Answer: Introducing customers' right to recourse entails both benefits and drawbacks to be considered carefully by RSAs. On the one hand, it can increase customer confidence in the IFSI, improve dispute resolution, and enhance market integrity. On the other hand, it can increase costs for IIFS, create the potential for abuse, and introduce legal complexity. Ultimately, the decision to introduce customers' right to recourse should be based on a careful consideration of the potential benefits and drawbacks, as well as the specific needs and circumstances of the RSA and its financial system. It is worth noting that customers' right to recourse against sellers is more common in developed markets.

18. How conflict of interests shall be treated by IIFS?

Answer: IIFS must recognize, avoid, disclose, and manage conflicts of interest between themselves and their clients, bearing in mind their fiduciary duties (e.g., investment account holders as well as shareholders). IIFS should be transparent about conflicts of interest and ensure that their systems of remuneration and compensation do not provide perverse incentives to their management, staff, agents, brokers, or other representatives that could lead to conflicts of interest. Conflicts of interest may be managed through disclosure, internal rules of confidentiality, or other appropriate methods or combinations of methods.