ISLAMIC FINANCIAL SERVICES BOARD

IMPLEMENTATION GUIDELINES REPORT

2023

www.ifsb.org

ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)

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

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Foreword

I am honoured to present the second edition of the "Implementation Guidelines Report," a significant advancement in our quest to strengthen the Islamic Financial Services Industry (IFSI). This edition not only reflects on the dynamic progression of the IFSI but also embodies our unwavering dedication to promoting a resilient and robust sector. It emphasises the crucial need for effective implementation of IFSB standards across diverse jurisdictions, highlighting the essential role of collaborative efforts in this endeavour, especially amid dynamic global financial challenges where the implementation of IFSB standards is not just important but a necessity to overcome such challenges.

The report thoroughly explores both the challenges and triumphs encountered in the implementation of our standards. It underscores the importance of knowledge-sharing and our commitment to adapting to the unique needs of our member countries. By including comprehensive guidelines and extending case studies, the report demonstrates our focus on practical, actionable solutions, ensuring that the aspirational goals of the IFSB are realistically achievable.

This report is not merely a reflection of our past achievements but also serves as a guide and inspiration for our future endeavors. It is through our collective wisdom, shared experiences, and steadfast commitment that we continue to forge a path toward a stable, sound, and prosperous financial future. The "Implementation Guidelines Report" stands as a testament to our ongoing mission to contribute to the sustainable development of the global Islamic financial services industry.

In the making of this report, we are highly indebted to the Indonesia Financial Services Authority, the Central Bank of Nigeria, the State Bank of Pakistan, and the Central Bank of Sudan, and for their immense support.

Their involvement has been pivotal to the Implementation Guidelines project. I also extend my gratitude to the core team from the IFSB Secretariat, led by Dr. Abideen Adeyemi Adewale, Acting Assistant Secretary-General, along with the Secretariat members including: Mrs. Ainaz Faizrakhman, Dr. Osama Alchaar, and Mr. Muhammad Arif, for their dedicated efforts in bringing this report to fruition.

I hope that these Implementation Guidelines will bring extensive value to all our members, enhancing invaluable references in the development of the IFSI and implementing IFSB standards. Finally, this report serves as an open invitation to other IFSB RSA members to participate in future editions, furthering our collaborative efforts and shared success.

Dr Bello Lawal Danbatta
Secretary-General
Islamic Financial Services Board
December 2023

Executive Summary

This "Implementation Guidelines Report" offers a view of the Islamic Financial Services Industry (IFSI), focusing on the significant efforts in establishing and implementing IFSB standards, particularly for the Islamic banking sector. The IFSB, in collaboration with its members, demonstrates a strong commitment to enhancing the application of these standards across various global jurisdictions. This commitment is underscored by an emphasis on the necessity of capacity building, technical support, and rigorous monitoring processes to ensure the successful adaptation and adherence to these standards on a worldwide scale.

Addressing the challenges in the implementation of these standards forms a significant portion of the present report. It identifies critical areas such as existing knowledge gaps in Islamic finance, the limitations within the current legal frameworks, and constraints due to limited resources. In response, the report suggests a range of strategies aimed at overcoming these obstacles. These strategies emphasise the importance of developing customised solutions that are tailored to the specific needs and contexts of different jurisdictions.

Furthermore, the report explores a set of detailed guidelines designed to facilitate the adoption of the IFSB standards. These guidelines have been formulated based on the collective experiences and practices observed in various regions. They cover essential areas such as legislative changes, Shari'ah governance, liquidity management, and crisis management frameworks. These guidelines are intended to serve as a comprehensive blueprint for jurisdictions that are striving to implement these standards effectively and efficiently.

A significant addition to this second issuance of the Implementation Guidelines Report is the expansion of case studies in Islamic banking in four additional jurisdictions: Indonesia, Nigeria, Pakistan, and Sudan. These case studies have been compiled with the assistance and verification of the respective jurisdiction's Regulatory and Supervisory Authorities (RSAs). It provides practical examples that showcase how different regions have successfully implemented the IFSB standards. These examples offer valuable insights into the practical aspects of the adoption and adaptation processes in diverse regulatory and economic environments.

In conclusion, the "Implementation Guidelines Report" stands as a comprehensive resource and effective guide for the implementation of IFSB standards, with the hope of contributing to the continued development and stability of IFSI globally.

Section 1: Background

Amid a period of challenging global financial conditions, the IFSI demonstrated a considerable expansion, reaching an estimated value of USD 3.25 trillion, as reported in the IFSB IFSI Stability Report 2023. Islamic banking maintained its dominance within the IFSI, with an asset size of USD 2.25 trillion (69.3%), followed by the Islamic capital market with an asset size of USD 966.3 billion (29.8%) and *Takaful* with contributions of USD 30 billion (0.9%).

The remarkable global development of the IFSI can be attributed to various factors, but notably, the introduction of sophisticated regulatory frameworks across various jurisdictions has played a pivotal role. These regulatory measures, implemented across many jurisdictions, have gradually fostered customer confidence, consequently fueling a heightened demand for Shari'ah-compliant products and services. This trend underscores the critical interplay between regulatory environments and the sustained growth of the Islamic financial services sector on a global scale.

Established in 2002, the IFSB was founded to function as an international standard-setting entity for RSAs with a shared commitment to promoting the stability and soundness of the IFSI. Tasked with the responsibility to foster the growth of a judicious and transparent Islamic financial services sector, the IFSB is mandated to introduce new standards or adapt existing international ones in harmony with Shari'ah principles and recommend them for adoption.

Since its inception, the IFSB has played a pivotal role, issuing a total of 42 Standards, Guidance Notes, and Technical Notes designed to regulate and guide various aspects of the IFSI. This commitment underscores the organization's dedication to maintaining high standards and promoting adherence to Sharīʿah principles within the global Islamic financial landscape.

The documents published by the IFSB address three key sectors within Islamic finance: Islamic Banking, Islamic Capital Markets, and *Takaful*.

The IFSB actively collaborates with its members in the development of global prudential standards and guiding principles for the IFSI. As of August 2023, the IFSB comprises 188 members from 58 jurisdictions, consisting of 81 RSAs, 10 international organisations, and 97 market players, including financial institutions, professional firms, industry associations, and stock exchanges. These members collectively represent international, regional, and national organisations, as well as market players who share common objectives with the IFSB in promoting and upholding the principles of Islamic finance.

Section 2: Introduction

Overview of the Implementation of IFSB Standards

The implementation of IFSB standards constitutes an indispensable aspect of the organisation's core mission. The complete, timely, and consistent adoption and application of these standards are necessary for attaining the stability and resilience of the IFSI. Consequently, Strategic Key Result Area 2 (SKRA2), delineated in the IFSB Strategic Performance Plan (SPP) for 2022-2024, is designed to elevate the level of IFSB standards implementation. This elevation is to be achieved through the augmentation of capacity-building initiatives, the reinforcement of technical support provided to member jurisdictions, and the enhancement of monitoring and assessment mechanisms for the adoption of IFSB standards. Under the IFSB SPP 2022-2024, a comprehensive set of activities is outlined for each year, strategically planned to exert both direct and indirect influence on the implementation of IFSB standards.

The IFSB has developed a comprehensive set of tools aimed at increasing the implementation of its standards, as seen in Table 1. A fundamental aspect of this effort involves strengthening capacity-building efforts for IFSB standards within member jurisdictions through various activities. These include recurrent yet adaptive workshops involving regulators and market players, an online e-learning portal for independent learning, and an active outreaching participation in non-IFSB events. Other activities include sharing of member jurisdiction experiences, and the new “training of the trainer”s programme enabling diverse qualified trainers within members jurisdiction to collaborate in spreading IFSB standards globally.

Table 1: SKRA2 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. Workshops 2. E-Learning 3. Outreach programmes 4. Training of the trainer program	**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	1. Implementation Survey and Report 2. Impact and Consistency Assessment Programme (ICAP)		

Another central initiative in accelerating the implementation of IFSB standards is the invaluable technical support for member jurisdictions. This support includes Technical Assistance (TA) and Policy Advice (PA) to address technical challenges, conduct gap analyses, and provide recommendations. To bridge knowledge gaps and provide quick references, a dedicated FAQ section on the IFSB website aids the frequent discussion related to IFSB standards, while the framework and guidelines offer insights from the successful implementation of the IFSB standards in other member jurisdictions.

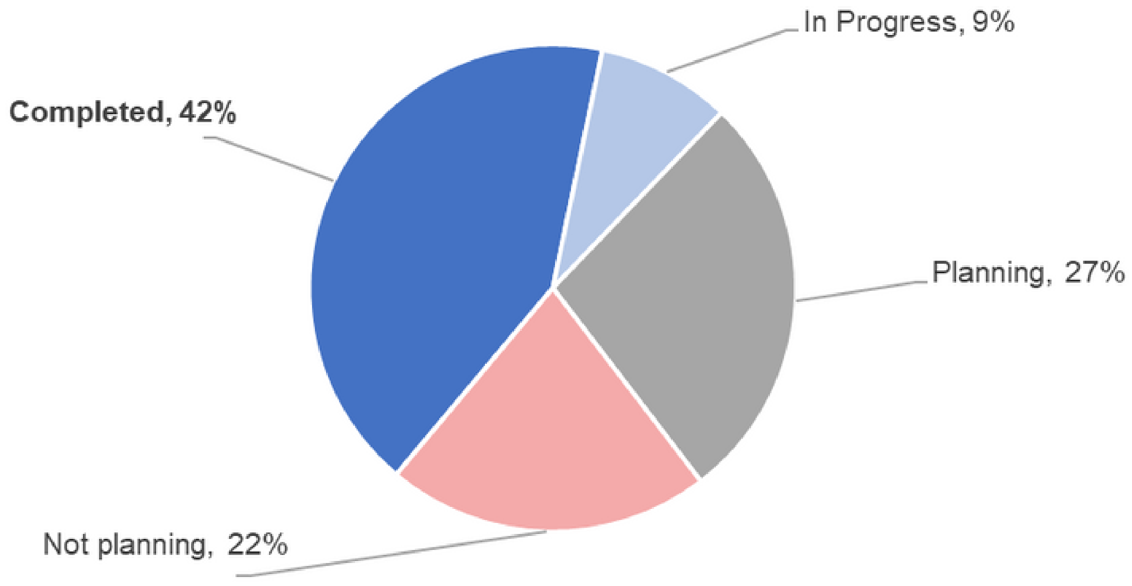
To further expedite the implementation of IFSB standards, an essential focus is on enhancing the monitoring and assessment of their adoption within member jurisdictions. This objective is achieved through a range of activities. Notably, the Implementation Survey and Report serve as crucial tools for tracking adoption progress and identifying challenges faced by RSAs. Member jurisdictions also have the option to request and conduct country/self-assessments, bolstered by self-assessment templates thoughtfully provided by the IFSB for key standards. Additionally, the Impact and Consistency Assessment Programme plays an integral role in ensuring that IFSB standards deliver the intended benefits to the global IFSI.

Snapshot on the current state of implementation

The Secretariat annually conducts an Implementation Survey to assess the progress made by members of RSAs in implementing the published standards of the IFSB. The Survey also seeks to understand the significant challenges and constraints faced by these member RSAs during the implementation process. The valuable feedback received from member RSAs plays a crucial role in identifying strategies to expedite to strengthen the adoption of IFSB standards.

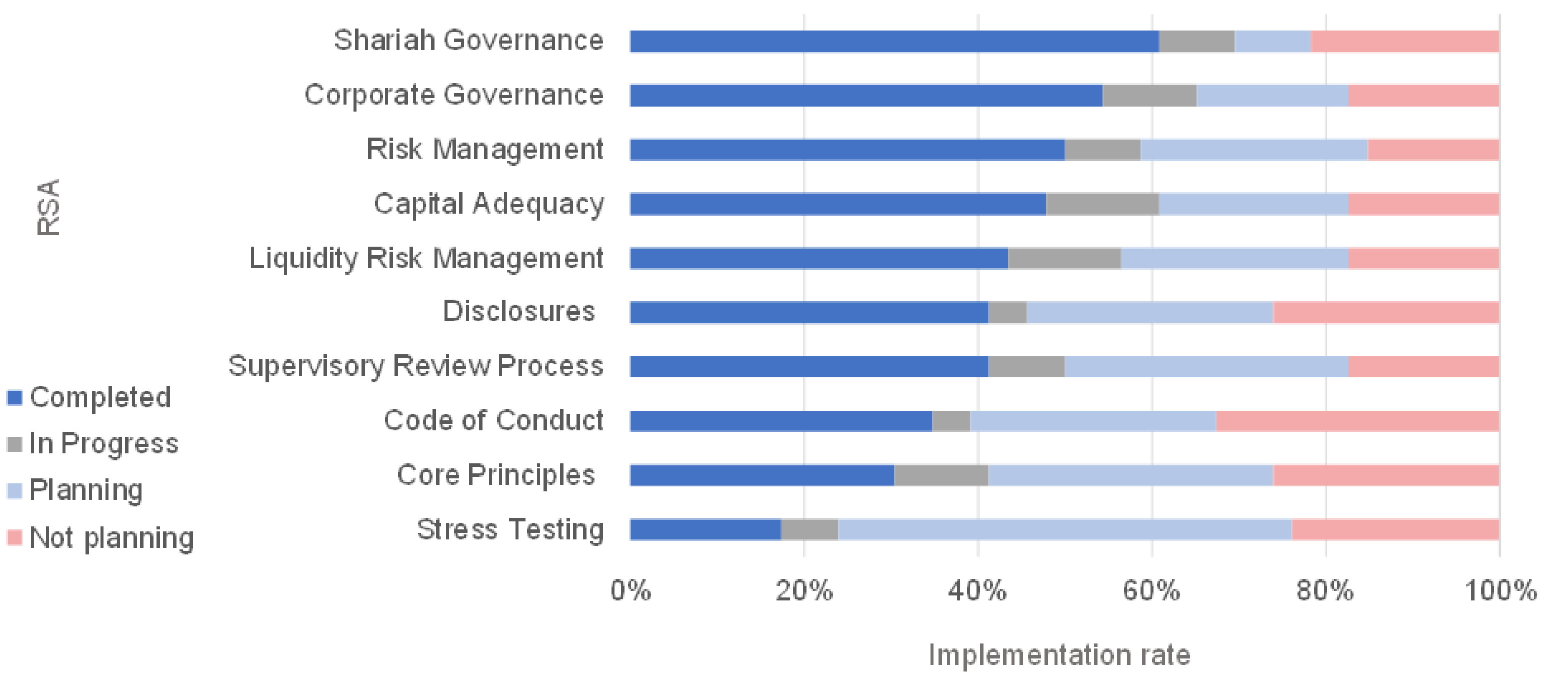
The 2023 Implementation Survey focuses on analysing the implementation status of specific Islamic banking standards among the 46 RSA members responsible for regulating the Islamic banking sector. According to the Implementation Survey finding, the completion rate currently stands at 42%.

CHART 1: OVERALL ISLAMIC BANKING STANDARDS IMPLEMENTATION RATE, 2023



The most widely adopted standards among the 46 surveyed RSAs is the Shari'ah Governance standard which has been implemented by 28 RSAs, accounting for a 61% implementation rate. The Corporate Governance standard follows closely, with 25 RSAs implementing it, resulting in a 54% implementation rate. The Risk Management standard has been adopted by 23 RSAs, achieving a completion rate of 50%, while the Capital Adequacy standard ranks fourth, being implemented by 22 RSAs with a 48% completion rate.

CHART 2: THE MOST IMPLEMENTED ISLAMIC BANKING STANDARD BY KEY AREAS, 2023



Section 3: Implementation Challenges

The implementation of global financial standards plays a vital role in preserving the stability and resilience of financial sectors. However, the adoption of these global standards, including the IFSB standards within the IFSI, is not without its challenges. This section delves into the implementation challenges as encountered from the Implementation Survey.

1 Lack of knowledge in Islamic finance by RSA staff

The results from the Annual Implementation Survey consistently reveal a significant obstacle: the shortage of expertise in Islamic finance among the staff of member RSAs. This deficiency poses a substantial challenge for jurisdictions aiming to comprehensively implement the relevant IFSB standards. Even when regulators are committed to fostering the growth of the Islamic finance sector, the absence of adequate skills and expertise can impede the effective implementation of the essential practices and principles of IIFS. The pressing question then becomes how RSAs address and overcome this specific issue.

2 Identifying gaps between the existing regulatory framework and IFSB standards

Internally identifying and addressing gaps between the existing regulatory framework of jurisdiction and IFSB standards is instrumental in facilitating smoother implementation and compliance processes. Conducting a thorough gap analysis and initiating remediation processes are vital, as they entail necessary change initiatives and provide a comprehensive assessment of RSAs' readiness to introduce proposed changes. However, RSAs may encounter challenges in conducting these gap analysis procedures internally, primarily due to a shortage of staff who possess expertise in both local regulation and the relevant IFSB standards, as indicated earlier, which subsequently may hinder the rate of successful implementation.

3 The process of standards implementation is too time-intensive

Various jurisdictions encounter distinct challenges when it comes to the application of IFSB standards. Among these challenges is the time-consuming nature of the IFSB standards implementation process, which necessitates coordination among various departments within the implementing RSA and the governing organization, and cooperation with external entities, including Shari'ah scholars, consultants, and market participants, among others.

4 Lack of industry data to support implementation of the standards

Ensuring compliance with IFSB standards necessitates that IIFS have swift and convenient access to centralised and precise data. Effective data management holds substantial importance for meeting prudential requirements. To obtain an accurate assessment of the positions held by IIFS, regulators, institutions, and the market must all have access to data that is both up-to-date and consistent. The presence of timely, high-quality regulatory data is crucial for ensuring the practicality and effectiveness of implemented IFSB standards.

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

Another notable challenge that jurisdictions encounter in the implementation of IFSB standards pertains to human resources and capacity building. Establishing an effective supervision system necessitates developing and maintaining a suitable assessment approach by the regulator. However, in supervising Islamic finance-related requirements, some RSAs may find it challenging to create a dedicated Islamic finance supervisory department or unit. This can result in staff members, who are primarily accustomed to overseeing conventional banks, being tasked with assessing the compliance of IIFS without possessing a comprehensive understanding of the regulatory distinctions involved.

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

Shari‘ah scholars, being experts in the realm of Islamic commercial jurisprudence, hold a crucial role in ensuring the compliance of IIFS with their Shari‘ah competence. However, certain jurisdictions may confront a shortage of Shari‘ah scholars who possess a deep understanding of and can effectively uphold, the fundamental tenets of Shari‘ah principles in guiding RSAs on matters related to Islamic finance regulation. The scarcity of locally qualified professionals who meet the selection criteria for Shari‘ah scholars can potentially impede the growth of Islamic finance by limiting the available expertise and capacity in this domain.

7 Size of the industry is too small to make implementation viable

In cases where jurisdictions possess a relatively small share of the Islamic finance market, they view less urgency to initiate an extensive implementation process for inclusive IFSB standards. Consequently, one of the recommendations put forth by the IFSB is that the applicability of the standards' requirements should align with the size, nature, and complexity of IIFS within the jurisdiction. This approach ensures that regulatory expectations are proportionate to the scale and characteristics of the IIFS operating in that specific context, promoting a more tailored and practical implementation process.

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

Certain jurisdictions have regulatory legacies in which the legal framework of Islamic financial institutions is not distinct from that of their conventional counterparts. In such cases, national regulations may need to be modified to establish parallel requirements. Additionally, RSAs might hesitate to adopt IFSB standards if various challenges complicate the implementation process, rendering it difficult to undertake. Regardless of the situation, RSAs will need to address this issue if they opt to implement IFSB standards.

9 Lack of financial resources to implement standards

For each jurisdiction, determining the most cost-effective approach for implementing IFSB standards is a crucial matter. However, it's important to recognise that the implementation costs can vary significantly from one country to another, potentially posing a substantial obstacle to the effective implementation of IFSB standards.

Recognizing the inherent challenges, the IFSB has proactively devised a suite of implementation tools aimed at aiding its members. Table 3 delineates IFSB recommendations tailored to address each of the aforementioned challenges.

Table 3: IFSB recommendations for implementation challenges

No	Challenges	IFSB Initiatives	Recommendation to RSA
1.	Lack of knowledge in Islamic finance by RSA staff	• Providing capacity-building workshops and online consultations. • Providing the E-learning platform for the convenience of IFSB members to get online based knowledge on IFSB standards.	• Establishing a dedicated team, which will be carrying Islamic finance R&D function. • Providing staff with additional Islamic finance and IFSB standards relating to course.
2.	Identification of gaps between the existing regulatory framework and IFSB standards	• Implementing ToT Programme. • Creating a database of experts to support the implementation. • Introducing the ICAP to assist RSAs in identifying regulatory gaps.	• Improving and adapting the legal and regulatory framework to the context of Islamic law and the regulatory environment of the jurisdictions.
3.	Process of standards implementation is too time-intensive	• Providing direct Technical Assistance and Policy Advice.	• Developing Strategic plans on IFSB standards implementation in the jurisdiction.

No	Challenges	IFSB Initiatives	Recommendation to RSA
4.	Lack of or poor quality of available industry data to support implementation of the standards	• Establishing a credible, consistent, and accurate database for Islamic finance for both micro and macroprudential oversight of the IFSI. The Prudential and Structural Islamic Financial Indicators (PSIFIs) project, available through the IFSB, is actively addressing this specific challenge. • Publishing the Implementation Guidelines Report as another valuable source of information, equipping members of RSAs with essential data and prerequisites necessary for the effective implementation of standards.	• Engaging in IFSB's surveys and actively contributing to the PSIFIs data project are essential ways to support the development and progress of the IFSI.
5.	Supervisory staff lack of capacity to supervise and assess compliance with Islamic finance-related regulations and guidelines	• Providing direct Technical Assistance and Policy Advice.	• Establishing a dedicated team, which will be carrying Islamic finance R&D function. • Providing staff with additional Islamic finance and IFSB standards relating to courses.
6.	Lack of Shariʻah scholars to advise RSA on regulations related to Islamic Finance	• Assisting jurisdictions by connecting them with external Shariʻah experts who can provide valuable advice and guidance on matters related to Shariʻah compliance and Islamic finance.	• To enhance Shariʻah compliance and expertise within the jurisdiction, consider relying on external Shariʻah advisors, and foreign Shariʻah advisory firms, while also nurturing and developing local Shariʻah scholars who meet the fit and proper criteria.

No	Challenges	IFSB Initiatives	Recommendation to RSA
7.	Size of the industry	• Promoting the IFSB and Islamic Finance worldwide.	• Increasing public awareness and reinforcement of financial education in the area of Islamic finance. • Providing a legal and regulatory framework to boost the growth of Islamic finance.
8.	The existing statutory/legal framework does not support the implementation of standards	• To address the challenges stemming from the existing legal framework, and facilitate the 'Sharing of Experiences' among RSAs regarding the implementation of standards. • Tailored Technical Assistance and Policy Advice to IFSB members within RSAs, further supporting their efforts in implementing and complying with the standards effectively.	• Enhancing and customizing the legal and regulatory framework to align with the principles of Islamic law and the specific regulatory environment of each jurisdiction.
9.	Lack of financial resources to implement standards	• Tools such as, again, Technical Assistance and Policy Advice offered by IFSB, are among the cost-effective means in identifying priority areas for RSAs to commence the process of implementing standards.	• Enhancing and customizing the legal and regulatory framework to align with the principles of Islamic law and the specific regulatory environment of each jurisdiction. • Conducting a comprehensive cost-benefit analysis is crucial, with a specific focus on individual areas tailored to each jurisdiction. It should take into account proposals from internal experts and the guidance provided by the IFSB Secretariat to ensure effective decision-making in the implementation process.

Section 4: Implementation Guidelines

The implementation of IFSB standards may pose challenges in certain jurisdictions where detailed implementation guidelines are lacking. IFSB standards provide comprehensive technical principles across various regulatory and supervisory domains, requiring the appropriate infrastructure and proactive measures by RSAs for effective implementation. In response to this challenge, the IFSB issued the first edition of its Implementation Guidelines report in 2021. The report offered member RSAs insights on developing regulations and guidelines aligned with IFSB standards, drawing from the experiences of countries that have successfully implemented a significant portion of these standards.

The Implementation Guidelines aim at:

- Facilitating Implementation: Providing member jurisdictions with a straightforward guide to enhance their implementation rates by leveraging the experiences of other member countries.

- Documentation and Reporting: Documenting and reporting the progress of the Islamic banking sector in jurisdictions where RSAs have effectively implemented IFSB standards.

- Highlighting Challenges and Solutions: Identifying and highlighting the primary challenges encountered by member RSAs during the implementation of IFSB standards (where applicable) and presenting strategies employed to overcome these challenges.

This second edition of the Implementation Guidelines publication is designed to document and report the experiences of four jurisdictions: Indonesia, Nigeria, Pakistan, and Sudan. This report focuses on critical areas that contributed to the development of Islamic banking in these jurisdictions and outlines the essential steps taken by RSAs to achieve a greater implementation rate. The key areas addressed in the Implementation Guidelines are outlined in Table 4 below.

Table 4: Kea areas covered in Implementation Guidelines

No	Key Areas	Remarks
1.	Legislation and Laws	A fundamental prerequisite for fostering the growth of the Islamic financial services industry within a country is the establishment of a legal framework that is conducive to Islamic finance. This framework should support and facilitate the expansion of institutions offering Shari'ah-compliant services. In many instances, jurisdictions undertake the introduction of new laws or modifications to existing laws to accommodate the specificities of Islamic finance. These legislative changes may occur gradually, considering the high-priority goals of the country. The Implementation Guidelines report sheds light on how the participating jurisdictions introduced new laws or amended existing legislation to facilitate the development of the Islamic banking sector. The report illustrates varied approaches, including those aimed at laying the foundation for the inaugural *Sukuk* in the country and ensuring a level playing field for both Islamic and conventional banks.
2.	Shari'ah Governance	Establishing an effective system of rules, practices, and processes for directing and controlling IIFS is crucial to ensure their business operations align with Shari'ah rules and principles. Recognizing the need for flexibility, RSAs may customize the Shari'ah Governance System adopted by Islamic banks to suit market realities and the developmental stage of their Islamic finance sector. Jurisdictions with a long and successful history of Islamic finance are systematically reinforcing their Shari'ah Governance Framework. This Implementation Guidelines report offers a summary of diverse practices in enforcing Shari'ah Governance requirements on Islamic banks in different jurisdictions. Clarity on the Shari'ah Governance System imposed within jurisdictions aids in determining Shari'ah compliance guidance for structures and processes that should be followed by Islamic financial institutions. Existing requirements related to the Shari'ah Board, issuance of Shari'ah standards, Shari'ah pronouncements/resolutions, or their absence can be subjects for further discussion between jurisdictions and the IFSB, potentially leading to Technical Assistance or Policy Advice.

No	Key Areas	Remarks
3.	Development of Liquidity Management Infrastructure	The development of a robust national liquidity infrastructure is crucial, 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 withstand a liquidity crunch depends on access to a robust liquidity management infrastructure, which is still underdeveloped in some jurisdictions offering Islamic banking products and services. The lack of access to Shariʻah-compliant liquidity instruments can result in inefficiencies during normal times (due to low returns on liquid assets) and may pose potential systemic risks in times of crisis due to the relatively limited liquidity of the instruments involved. This Implementation Guidelines report highlights the experience of building a Shariʻah-compliant liquidity infrastructure in jurisdictions with a mature Islamic sector. Since not all jurisdictions have Shariʻah-compliant means to manage liquidity, this area becomes significant for review within the Implementation Guidelines. It identifies challenges, proposes initiatives to overcome those obstacles, and showcases positive experiences in building a Shariʻah-compliant liquidity management infrastructure.
4.	Financial Safety Nets	Financial safety nets play a crucial role for RSAs in ensuring the soundness and stability of the financial system, serving as the main crisis prevention strategy. Designing a crisis management framework for the Islamic banking industry necessitates a robust structure for banking supervision, encompassing a liquidity regime, capital adequacy, stress testing, and an effective recovery and resolution regime. Implementing well-designed mechanisms of the financial safety net is particularly challenging for the Islamic banking system, given the specificities of Shariʻah contracts and funding structures of financial institutions. Provisions of financial safety nets for Islamic banks must be Shariʻah-compliant, such as Shariʻah-compliant Lender of Last Resort (SLOLR) and Shariʻah-compliant Deposit Insurance (SCDIS). However, the introduction experience of SLOLR and SCDIS remains sparse among RSAs regulating the Islamic banking sector due to certain conditions necessary for these mechanisms to be effective. The existence or absence of SLOLR and SCDIS can have an impact on the Islamic banking sector in jurisdictions, and this can be assessed and documented in the Implementation Guidelines.
5.	Effective Crisis Management and Resolution Framework	The crisis and management resolution framework is crucial in defining 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. Jurisdictions offering Islamic financial services face the challenge of adapting the crisis management and resolution framework to the specific circumstances of the IFSI while ensuring compatibility with Shariʻah principles. Therefore, it is essential to develop a Shariʻah-compliant framework for crisis management and resolution to restore stability and confidence in the IFSI, should the need arise.

No	Key Areas	Remarks
6.	Governance, Accounting & Auditing	Islamic financial institutions are required to adhere to internationally accepted governance, accounting, and auditing standards to ensure a level playing field with conventional institutions. The IFSB has issued a standard on Guiding Principles on Corporate Governance, aiming to facilitate Islamic Financial Institutions (IFIs) in identifying areas where appropriate governance structures and processes are required and recommending best practices to address these issues. The Implementation Guidelines report provides insights into how the four participating jurisdictions have addressed governance, accounting, and auditing in institutions offering Islamic banking products and services.
7.	Disclosure Requirements	Market discipline is a key objective of financial sector regulation, and providing meaningful information about key risk metrics to market participants is crucial for a sound banking system. The IFSB has issued standards on Disclosures to Promote Transparency and Market Discipline, aiming to specify key principles and practices to be followed by Islamic financial institutions in the banking sector. Islamic banks and Islamic windows, due to the nature of their business, are required to provide a different set of disclosures compared to conventional banks. This includes disclosures related to Investment Account Holders (IAHs), Shari'ah governance, risk management, and exposures, among other things. The Implementation Guidelines Report provides a summary of disclosures required from Islamic banks in the four participating jurisdictions, covering aspects such as Shari'ah Governance, Islamic windows, and Investment Account Holder-related disclosures. The report helps identify potential gaps in requirements among the participating jurisdictions and serves as a benchmark for other IFSB members.
8.	Rating of Islamic Financial Institutions and Shari'ah-compliant Instruments	The IFSB's Capital Adequacy Standards mandate RSAs to identify eligible External Credit Assessment Institutions (ECAIs) whose ratings can be used by IIFS to determine the risk weightings of Shari'ah-compliant assets. IIFS may utilize credit ratings issued by ECAIs when assigning risk weights and calculating their capital ratios. This underscores the crucial role played by ECAIs in facilitating the capital and risk calculations of IIFS, as national supervisory authorities delegate to them an important function in this regard. The selection and recognition of suitable ECAIs become paramount in ensuring the accuracy and reliability of capital assessments for IFIs.

No	Key Areas	Remarks
9	Capacity Building and Talent Development	The Implementation Guidelines report highlights the crucial role of competent, independent, and experienced professionals as the backbone of the Islamic finance sector. Developing the Islamic finance industry and implementing IFSB standards pose significant challenges in ensuring a sufficient pool of human resources with the requisite knowledge and skills to support the sector's growth. Creating conditions for a more comprehensive Islamic finance industry involves factors such as universities offering Islamic finance courses, establishing cooperation between market players, regulators, and Islamic finance experts, and promoting capacity building and talent development. The report showcases how participating RSAs successfully built capacity and developed talents to meet the needs of the Islamic banking sector in their respective jurisdictions.
10	Challenges in Implementing IFSB Standards	The identification and analysis of challenges faced by jurisdictions in the implementation of IFSB standards are another added value of the Implementation Guidelines report. This key area provides substantial input, allowing a comprehensive understanding of the issues and concerns encountered during the implementation process. Jurisdictions that have not specified significant challenges typically exhibit a mature Islamic financial system and consistency in following the strategy of implementing IFSB standards. As part of its mandate, the IFSB emphasises its commitment to providing necessary support to member jurisdictions, assisting them in overcoming any challenges associated with the implementation of IFSB standards.

Section 5: Indonesia

Otoritas Jasa Keuangan – Financial Services Authority of Indonesia

1 Background

1.1 Indonesia has one of the biggest economies and contains the largest Muslim population of all countries in the world [1]. It is home to a big traditional banking sector, where the share of Islamic banking, while not dominant domestically, remains quite substantial and considered in the top 10 Islamic banking jurisdictions globally [2].

1.2 The Indonesian Government announced deregulation of the banking system in 1983, providing banks with more flexibility to set interest rates. Although this initiative witnessed the emergence of more conventional banks, it also paved the way for the first Islamic banking models, as several regional Shariʻah-compliant banking businesses appeared during that period, including "Bait At-Tamwil Salman ITB" and "Koperasi Ridho Gusti".

1.3 In 1990, the Indonesian Ulema Council (Majelis Ulama Indonesia) mobilised a special Task Force with the purpose of setting up the first Islamic Bank in Indonesia – Bank Muamalat Indonesia, which was established in 1992.

1.4 The legal ground for Islamic banks was provided under the Act of the Republic of Indonesia No 7 of 1992. However, that law did not include any specific details and was subject to amendment in 1998 and became Act No 10 of 1998 with the clear statement that commercial banks henceforth can base their activities on conventional and/or Shariʻah principles.

1.5 This resulted in establishing the first Islamic windows in 1999 – Bank IFI [3], Bank BNI and Bank Jabar. The latter two were transformed into full-fledged Islamic banks in 2010.

[1] *https://www.indonesia-investments.com/culture/religion/islam/item248.*
[2] IFSB Islamic Financial Services Industry Stability Report 2021.
[3] Liquidated in 2009 along with its conventional bank.

1.6 There are three categories of Islamic bank entities operating in Indonesia: Islamic commercial banks (Shari‘ah Commercial Banks), Islamic-windowed banks (Shari‘ah Business Units), and Islamic rural banks. Currently, there are 14 fully-fledged Islamic commercial banks, 20 Islamic windows of conventional banks, and 163 Islamic rural banks [4].

1.7 As of January 2023, the total market share of Islamic banking in Indonesia was 7.1%, amounting to 52.24 billion USD. According to IFSB’s Stability report, the Indonesian Islamic banking sector recorded the highest y-o-y growth rates in the Southeast Asia region in terms of assets, finance, and deposits and registered assets growth increased by 17% y-o-y in Q3’21.

1.8 Despite the constant support of the Islamic banking sector by the Indonesian Government and by regulators, the penetration rate of Islamic banking products in the country remains relatively limited at 5%-10%.

1.9 From a regulation perspective, before 2011 Bank Indonesia (the Central Bank of Indonesia) was playing a main role in supervising and regulating of Islamic banking in Indonesia. However, with the amendments of Act 21 of 2011, the regulatory and supervisory duties are now under the Otoritas Jasa Keuangan (OJK, the Financial Services Authority of Indonesia).

1.10 The OJK is the sole authority charged with overseeing both conventional and Islamic financial services activities in banking, capital markets, insurance, and other non-banking financial institutions, such as pension funds and leasing companies.

1.11 To harmonise and promote Islamic economic development in Indonesia and particularly the financial services industry in the Islamic banking sector, OJK developed the Indonesia Islamic Banking Development Roadmap 2015-2019. Subsequently, building upon these initiatives, OJK formulated the Roadmap for 2020-2027 as a seamless continuation of its efforts.

[4] Islamic rural banks offer limited type of banking products compared to full-fledged Islamic banks and Islamic windows and operate on a small scale in certain “rural” areas.

2 Legislation and Laws

2.1 Before 2008, Islamic banking was regulated by the Act of the Republic of Indonesia No. 10 of 1998, mostly legislatively applicable to conventional finance. In 2008, the Government provided Islamic banking with its separate Act with the enactment of Act No 21 of 2008 on Islamic Banking of 16 July 2008.

2.2 New aspects of this law are related to corporate governance, prudential principles, risk management, dispute resolution, fatwa (ruling) authority and Shari'ah committees, as well as Islamic banking development and supervision.

2.3 With the amendment of the Income Tax Act in 2010, the tax treatment of Shari'ah-based commercial activities has been set out and is governed by Government Regulation No 25/2009. However, this regulation covers high-level matters only and, therefore, in 2011 the Ministry of Finance of Indonesia issued two additional documents: Income Tax Treatment of Sharia-based Financing Activities (No 136/PMK.03/2011) and Income Tax Treatment of Sharia Banking (No 137/PMK.03/2011) to provide more detailed clarity on tax treatment.

2.4 Taxable aspects of *Murabahah* financing have also been resolved by introducing a special tax treatment to support the Islamic finance industry. To avoid double value-added taxation (VAT) on *Murabahah* transactions, the Government revised Act No 42/2009 on the Value-added Tax of Goods and Services and Luxury Goods and removed the double VAT for Islamic banks. The provision stipulates that there is no inventory-holding risk in *Murabahah*, therefore profit from this contract is not treated as profit from value-added goods, but considered as profit from financing instead.

2.5 It is important to mention that before 2006, the resolution of disputes between Islamic banks and consumers by litigation in Indonesia was under the jurisdiction of the Civil Courts. However, after Act No. 7 of 1989 relating to the Religious Court was amended by Act No. 3 of 2006, significant changes were brought in by extending the jurisdiction of the Religious Court to cover Islamic economic matters, including Islamic banking. Later, in 2008, the jurisdiction of the Religious Court to settle Islamic banking disputes was further consolidated in section 55 (1) of Act No. 21 of 2008.[5]

5.6 Indonesia also has an alternative dispute settlement institution for arbitration – it is Badan Arbitrase Syariah Indonesia (National Shari‘ah Arbitration Body, “BASYARNAS”), established in 1993 by the initiative of the Indonesian Ulema Council, which resolves Islamic banking and finance disputes and whose decisions are final and binding.

3 Shari'ah Governance

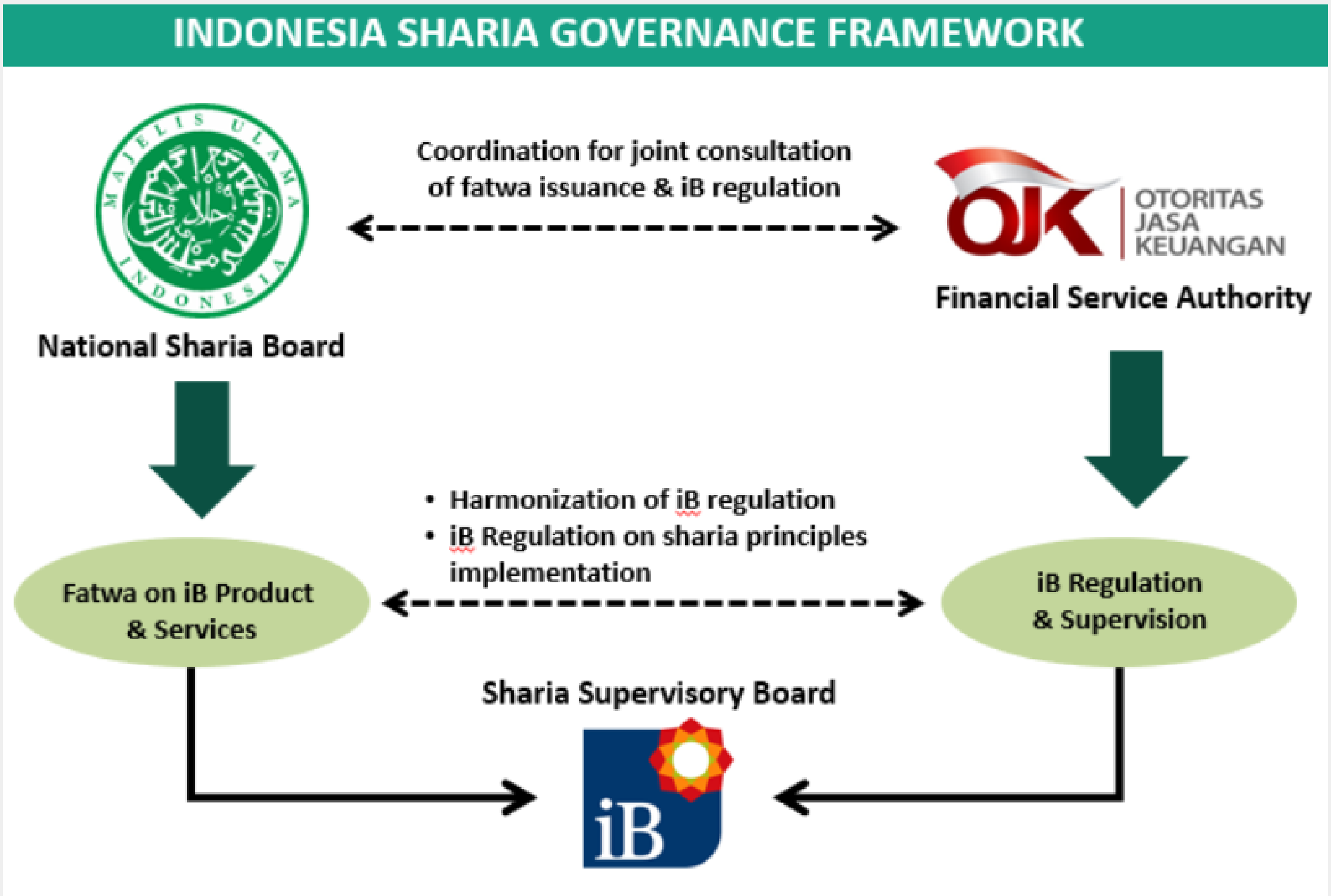
3.1 The Shari‘ah governance framework in Indonesia adopts two levels of Shari‘ah supervision. The first level of supervision is the National Shari‘ah Board established on a national level and formed by the Indonesian Ulema Council, and the second is the Shari‘ah Supervisory Board set up at the company level to supervise both bank’s new product development process and its activities.

3.2 According to Law No. 21 (2008) and explanations provided under the Bank Indonesia’s Regulation No 11/33/PBI/2009 concerning the Implementation of Good Corporate Governance for Shari‘ah Commercial Banks and Shari‘ah Business Units, any Islamic or conventional banks that open an Islamic window (Shari‘ah Business Unit) must form a Shari‘ah Supervisory Board that is in charge of providing guidance and advice to the Board of Directors and of overseeing the banks activities to comply with Shari‘ah rules and principles.

[5] Rasyid, Abdul and Zulhuda, Sonny (2011) Legal reform on the dispute resolution mechanism in Islamic banking and finance in Indonesia: issues and challenges, *http://irep.iium.edu.my/8774/1/Legal_Reform_on_The_Dispute_Resolution_Mechanism_in_Islamic_Banking_and_Finance_in_Indonesia.pdf*

3.3 One of the duties of the Shari'ah Supervisory Board is to check whether the contract used in a new product has received a fatwa issued by the National Shari'ah Board. The fatwa issued by the National Shari'ah Board specifically related to financial transactions carries a binding nature for Islamic banks as stipulated in Article 26 of Act No 21 (2008). If there is a ruling, Shari'ah Supervisory Board will analyse the suitability of the new product agreement with the ruling. If there is no ruling, the Shari'ah Supervisory Board will propose to the Board of Directors to complete the new product contract with a ruling from the National Shari'ah Board. Shari'ah Supervisory Board can also request a ruling from the National Shari'ah Board for new products that do not yet have a fatwa.

Figure 1: Indonesia Sharia Governance Framework



3.4 The compliance and internal audit functions are also part of the Shari'ah Governance used to supervise the assessment of the implementation of Shari'ah principles. The compliance function and/or internal audit function reports are one of the sources of data used for Shari'ah Supervisory Board supervision analysis to ensure consistency with Shari'ah rules and principles in Islamic banks.

3.5 In Indonesia, governance practices for Islamic banks are regulated by Bank Indonesia Regulation No 11/33/PBI/2009 concerning the Implementation of Good Corporate Governance for “Sharia Commercial Banks” and “Sharia Business Units”. Yet it states quite briefly about the required expertise of a Shari'ah Board member of an Islamic bank: who should at least have competency, knowledge, and experience in the field of Shari'ah *muamalah* and knowledge in banking and/or finance in general.

3.6 The same regulation states that the personnel assigned to the compliance and internal audit functions at least should have knowledge and/or understanding of Islamic banking, without a requirement for knowledge in the field of Shari'ah.

3.7 With regards to the independence of the Shari'ah Supervisory Board, although there is no specific regulation, the above-mentioned regulation asserts that members are prohibited from using Islamic banking for personal, family and/or other party interests that can reduce assets or reduce Islamic banking profits. In addition, it is also stated that Shari'ah Supervisory Board members are prohibited from taking and/or receiving personal benefits from Islamic banking.

3.8 To avoid making decisions that have the potential to reduce assets or reduce Islamic banking profits, Islamic banks must have and implement an internal policy on:

- arrangements regarding the handling of conflicts of interest that bind every Islamic banking management and employees, including, among other things, procedures for making decisions; and
- administration of recording, documentation, and disclosure of conflicts of interest as referred to in the minutes of meetings.

3.9 The Shari'ah-related information of an Islamic bank is to be disseminated to the public in a general form. Meanwhile a more detailed information, such as Shari'ah pronouncements/resolutions issued by the Islamic bank's Shari'ah Supervisory Board, will be disclosed to the OJK in full. Although there are no specific requirements on upholding confidentiality by all organs of Shari'ah Governance, this mentioned stipulation on disclosure also serves to maintain discretion.

3.10 The OJK in its turn also supervises the Shari'ah Supervisory Boards of each Islamic banking institution, requiring the Shari'ah Supervisory Board's report to be included in the Islamic banks' annual reports.

4 Development of Liquidity Management Infrastructure

4.1 There are a wide range of liquidity management solutions offered by Bank Indonesia within the liquidity management framework for Islamic banks. Liquidity management infrastructure available in Indonesia could serve as a solution for any short-term liquidity shortage and excess, among them Islamic money market, Shari'ah-compliant monetary operations, Shari'ah-compliant intra-day liquidity facility, Shari'ah short-term liquidity financing, and others.

4.2 There are various instruments available with tenor from overnight to 1 year with the details are following [6]:

- Interbank *Mudharabah* Investment Certificate (*Sertifikat Investasi Mudhabarah Antarbank*/ *SIMA*) introduced in 2000 based on *Mudarabah*;

[6] Bank Indonesia Regulation Number 22/9/PBI/2020 concerning Interbank Money Market Based on Sharia Principles

- Commodity Trading Certificate Based on Interbank Sharia Principles (*Sertifikat Perdagangan Komoditi Berdasarkan Prinsip Syariah Antarbank/ SiKA*) introduced in 2012 based on *Murabahah*;
- Certificate of Fund Management Based on Interbank Sharia Principles (*Sertifikat Pengelolaan Dana Berdasarkan Prinsip Syariah Antarbank/ SiPA*) introduced in 2020 based on *Wakalah bi al-ististmar*; and
- Islamic Repo, introduced in 2015 based on al *Ba'i ma'al wa'd bi al-syira*.

4.3 The vast Shari'ah-compliant instruments issued by the Indonesia Government and Bank Indonesia serve a crucial role in supporting bank liquidity management, such as State Sharia Securities (Surat Berharga Syariah Negara/SBSN) and Certificate of Bank Indonesia Syariah (Sertifikat Bank Indonesia Syariah/SBIS).

4.5 In addition, Islamic banks can also utilise other Shari'ah-compliant instruments contained in the capital market, such as *Sukuk* issued by the private sector.

5 Financial Safety Nets

5.1 Indonesia is among those few countries that have introduced both a Shari'ah-compliant Lender of Last Resort (SLOLR) mechanism and a Shari'ah Compliance Deposit Insurance Scheme within their jurisdiction.

5.2 The SLOLR mechanism is provided by Bank Indonesia to Islamic banks, particularly the full-fledged bank, using the Shari'ah Short-term Liquidity Financing product (Pinjaman Likuiditas Jangka Pendek Syariah). The facility's term can be extended from 14 days up to 90 days and is available in 3 main structures: 1) *Al-Muqaradhah bi Dhaman Ra's al-Mal*, 2) *Al-Bai' ma'a al-Wa'd bi al-Syira'*, and 3) *Al-Tas-hilat bi al-Tautsiq*.

[7] LPS Regulation No 1/2020 concerning Implementation of Sharia Bank Guarantees and Resolutions.

5.3 The first type of the structure *Al-Muqaradhah bi Dhaman Ra's al-Mal* (الْمُقَارَضَةُ بِضَمَانِ رَأْسِ الْمَالِ) is a form of profit-sharing financing from Bank Indonesia provided to Islamic bank to overcome its difficulties with short-term liquidity, which to be returned on pre-agreed time under the commitment (iltizam). It is based on profit-sharing and is guaranteed by collateral, where Islamic banks can use Bank Indonesia certificates, sovereign *Sukuk* or bond, high-quality corporate *Sukuk*/bond, and financing by a high-quality bank for that purpose.

5.4. The second structure is *Al-Bai' ma'a al-Wa'd bi al-Syira'* (البَيْعُ مَعَ الْوَعْدِ بِالشِّرَاءِ) also a form of financing given to Islamic banks by selling Islamic securities to Bank Indonesia issued by a bank, which must be returned based on a repurchase agreement (earlier *Wa`d* contract) of Islamic securities by bank at a specified time.

5.5. And the third type of financing *Al-Tas-hilat bi al-Tautsiq* (اَلتَّسْهِيْلَاتُ بِالتَّوْثِيْق), by which Islamic Bank acquires funds from Bank Indonesia using collateral and should return those funds at predetermined time back.

5.6 Another financial safety net in place is the Shari‘ah Compliant Deposit Insurance Scheme, which was conducted by Indonesia Deposit Insurance Corporation (Lembaga Penjamin Simpanan/IDIC) since 2005 to guarantee a portion of savings for both conventional and Islamic banks. More recently in 2020, the IDIC enacted a specific regulation for Islamic banks which guarantees depositors’ savings based on Shari‘ah principles though Kafala contract [8]. The scheme ensures Islamic deposits as *Wadi’ah* current and saving accounts, *Mudarabah*-based savings accounts, and term deposits.

5.7 Currently the OJK and IDIC are discussing possible Islamic deposit insurance solutions for restricted types of investment accounts (Sharia Restricted Intermediary Account) since only unrestricted investment accounts (URIA) are covered by the existing Shari‘ah Compliant Deposit Insurance Scheme [8].

[8] With the consideration that these URIA are treated as deposits, not investments.

6 Effective Crisis Management and Resolution Framework

6.1 Indonesia has in place a reliable crisis management and resolution framework. However, it does not recognise the specificities of Islamic finance, and therefore, applies to both conventional and Islamic banking systems.

6.2 The framework covers all main issues, including bank insolvency laws as well as arrangements for dealing with non-performing assets bank restructuring and bank recapitalisation. It is presented by two documents: Act No 9 of 2016 concerning Financial System Crisis Prevention and Handling and OJK's regulation 15/POJK.03/2017 on Exit Policy for Commercial Banks.

6.3 The mentioned Act serves as a robust legal foundation for authorities to prevent and manage financial system crises. It mandates the formation of the Financial System Stability Committee (Komite Stabilitas Sistem Keuangan/KSSK), composed of the Ministry of Finance, Bank Indonesia, OJK, and IDIC. Additionally, the Act provides criteria for systemically important banks, outlines collateral policies, and offers resolution options.

7 Governance, Accounting and Auditing

7.1 Indonesia sets out certain obligations for Islamic banks in Indonesia to implement the Corporate Governance Framework and submit GCG reports. There are Bank Indonesia's regulation No 11/33/PBI/2009 dated 7 December 2009 and Circular Letter No 12/13/DPbS concerning the Implementation of Good Corporate Governance for Sharia (Islamic) Commercial Banks and Sharia Business Units (Islamic windows), which promote principles of transparency, accountability, responsibility, professional, and fairness.

7.2 The GCG must at least consist of the following elements:

- implementation of the duties and responsibilities of the Board of Commissioners and the Board of Directors;
- completeness and implementation of duties of the committees and functions that carry out the internal control of Islamic banks;

- implementation of duties and responsibilities of the Shari‘ah Supervisory Board;
- implementation of compliance, internal audit and external audit functions;
- the maximum limit for distribution of funds; and
- transparency of Islamic banks’ financial and non-financial conditions.

7.3 Islamic banks in Indonesia have different accounting standards/reporting methods compared to conventional banks, which is regulated by the Sharia Accounting Standards (*Standar Akuntansi Syariah*/*SAS*). The SAS was issued by the Indonesian Shari‘ah Accounting Standards Board and developed by adjusting the existing Indonesian Financial Accounting Standards based on the fatwa from the Indonesian Ulema Council in order to fulfil Shari‘ah rules and principles.

7.4 This SAS applies to all entities that provide Shari‘ah transactions, including Islamic and non-Islamic financial institutions. It consists of several Statements of Financial Accounting Standards (Pernyataan Standar Akuntansi Keuangan/PSAK) that provides accounting regime for different types of Islamic financial contracts, such as *Murabahah*, *Salam*, *Mudarabah*, *Musharakah*, *Ijarah*, *Takaful*, *Sukuk* and many more.

7.5 Additional support to Islamic banks from the accounting perspective is provided by the Indonesian Sharia Banking Accounting Guidelines (*Pedoman Akuntansi Perbankan Syariah Indonesia*/*PAPSI*), which contains further elaboration of several PSAK relevant to the Islamic banking industry.

7.6 In terms of audit, there are no Shari‘ah-specific internal audit requirements for Islamic banks in Indonesia.

8 Disclosure Requirements

8.1 As in most jurisdictions, Islamic banks operating in Indonesia are required to have a separate disclosure consideration compared to their conventional counterparts.

8.2 For General governance disclosures, Islamic banks are supposed to explain any departure from complying with the applicable financial reporting standards. They are required to disclose their corporate governance arrangements and practices as well as related party transactions and treatment of material events by Islamic banks.

8.3 The following disclosures on Shari‘ah governance are explicitly included in OJK’s regulation: statement on the governance arrangements, systems and controls employed by the IIFS to ensure Shari‘ah compliance; qualifications and areas of expertise of each Shari‘ah Board member; appointment and change of members of the SSB during the financial year; Shari‘ah Board’s opinion on the IIFS’s state of compliance with Shari‘ah rules and principles; and disclosures of Shari‘ah pronouncements/resolutions issued by the Islamic bank’s Shari‘ah Board.

8.4 Other Shari‘ah disclosures on articulating the Board of Directors (BOD’s) responsibility and accountability over the Shari‘ah Governance of the Islamic bank and on the independence of members of the Shari‘ah Board or an advisory firm appointed by the Islamic bank to act as a Shari‘ah Board are part of the Good Corporate Governance (GCG) assessment process to be presented in the GCG report.

8.5 The OJK requires banks both conventional and Islamic to disclose any non-compliance events and total number of violations, but these requirements are not specific to Shari‘ah non-compliance cases and more of a general compliance matter.

8.6 For Islamic window disclosures, financial statements of conventional banks are required to contain notes on Islamic window's financial statement; a mechanism established to provide Shari'ah oversight of the activities of the Islamic window; and disclosures related to Profit Sharing Investment Accounts (PSIA).

8.7 Since there are no regulations on profit smoothing techniques, respective Islamic banks that practice these techniques will depend on their internal policies.

8.8 There are no specific investment account holders (IAHs) related disclosures due to the treatment of IAHs accounts as a deposit rather than an investment.

9 Rating of Islamic Financial Institutions and Shari'ah-Compliant Instruments

9.1 Indonesia has its External Credit Assessment Institution (ECAIs) which provides ratings on Islamic banks and Shari'ah-compliant instruments.

9.2 There is a special Circular Letter No 37/SEOJK.03/2016 regarding Rating Agencies and Ratings recognized by the OJK that specifies criteria used as a reference in evaluating rating agencies on independence, objectivity, disclosure, rating transparency, resources, and credibility.

9.3 The regulation concerning ECAI also implies publication on the OJK's official website of an updated rating agencies list periodically, which has been renewed based on performed assessment and monitoring.

9 Capacity building and Talent development

10.1 Even though OJK recognises that the quality and quantity of talent pool supporting Islamic banking industry in the jurisdiction is improving over the years, there are still certain actions that should be taken to increase the human resources potential.

10.2 The particular difficulties faced by market players, where vacancies in Islamic banks might be given to conventional bankers with no experience or knowledge of Islamic banking specificities due to the insufficiency of human resources.

10.3 To have more competent, independent, and experienced professionals such as accountants, auditors, and lawyers who are skilled in the field of Islamic finance, the OJK suggests introducing mandatory continuing professional development with a special focus on Shari'ah aspects.

10.4 The OJK's Indonesia Islamic Banking Development Roadmap 2020-2025 also envisaged the strategy of enlarging the human capital pool for Islamic banking by introducing a competency certification that will be compulsory for all Islamic bankers. The workshops for market players, the enforcement of regulation on implementation to enhance the capacity of human resources for market players, and support of the Shari'ah Insurance Professional Institute on implementing competency certification in the field of Islamic insurance are also included in the vision.

10.5 Within the OJK there is a specific department in charge of capacity building and talent development for the Islamic finance industry – "OJK Institute". One of its responsibilities includes developing human resource competencies in the financial services sector through OJK's recycling program, including capacity-building programs for the financial services industry, and increasing competency standards for players in the financial services sector.

10.6 There are also dedicated teams of the Islamic Banking Supervision Department, Islamic Banking Regulation and Licensing Section, and Sharia Non-Bank Financial Institutions Department, responsible for Islamic finance regulation and supervision in the OJK.

10.7 There are multiple universities in Indonesia that are offering programme/

courses on Islamic finance under the bachelor’s degree: 75 universities providing Islamic economics programs, 9 universities providing Islamic finance programme, and 42 universities providing Islamic banking programmes.

10.8 The OJK is also developing a curriculum and modules for capacity building, targeting ICM players to match the growing pace of the Islamic finance sector. In 2020 OJK issued guidelines for universities to deliver ICM-related materials, which was supported by lecturing materials and training of trainers.

10.9 The regulators’ staff also benefited from Facilitating the Implementation of IFSB Standards (FIS) Workshops provided by the Secretariat under the membership programs.

11 Challenges in Implementing IFSB Standards

11.1 Currently, OJK has implemented most of the IFSB’s Islamic banking standards. Among some of the IFSB requirements that OJK is not planning to adopt shortly are LCR and NSFR considerations for Islamic banks. The regulator does not yet see any urgency or need to adopt these requirements from an industry development perspective.

11.2 Another example is IFSB-13 on Guiding Principles on Stress Testing for Islamic Institutions offering Islamic Financial Services, the existing stress-testing regulation in Indonesia applies to both conventional and Islamic banks with the criteria relevant to each sector and therefore OJK is not yet planning to issue a separate regulation.

11.3 The OJK acknowledged that Indonesia has adopted the latest standards issued by international standard-setting organisations like IFSB, BCBS, IOSCO, and IAIS. However, the challenges in adoption of IFSB standards is followed by difficulties in developing regulations that suits the size, uniqueness and complexity of the Indonesian Islamic banking industry through adjusting implemented international standards in order to address Shari‘ah specificities and principles based on the National Sharia Board resolutions.

11.4 To avoid any regulatory arbitrage and provide a level playing field for both conventional and Islamic banking sectors, before the adoption any of IFSB’s standards the regulator takes into account a number of considerations such as Indonesia’s financial stability, Islamic finance industry development, market conditions and maturity, and readiness of market players.

11.5 One of the OJK’s main strategies in developing prudential support for the Islamic finance industry is to identify any gaps between conventional finance regulation and existing Islamic finance regulation. Any identified gap will be addressed through necessary adjustments in accordance with the Shari‘ah principles and Islamic finance industry’s characteristics. IFSB standards serve as one of the references used in the process.

11.6 Any new standard put into place in Indonesia will be followed up by supervisory process aimed to monitoring the industry impact and outcomes.

Section 6: Nigeria

Central Bank of Nigeria

1 Background

1.1 Islamic banking in Nigeria is referred to as "non-interest banking" (NIB). The history of NIBs in Nigeria dates back to the 1990s when the Banking Act of 1969 was replaced by the Banks and Other Financial Institutions Decrees 24 and 25 of 1991, providing the conditions for the establishment of NIB in the jurisdiction. Following this development, Habib Nigeria Bank Limited (later became Bank PHB and Keystone Bank) pioneered its non-interest banking services in 1999 on a "window basis".[9] Historically, the first Islamic bank was introduced in 1961 – the Muslim Bank of West Africa Limited. However, it had to close down in 1962 under the directives of the Ministry of Finance.

1.2 The Central Bank of Nigeria (CBN) approved the establishment of several NIBs in the country: in 2019 and 2021 the CBN granted licenses to TajBank Limited and Lotus Bank Limited to operate as NIBs. Before that, in 2012 Jaiz Bank transformed its operations into an Islamic banking service and became the first full-fledged Islamic non-interest bank in the country.

1.3 The size of the Nigerian Islamic finance industry is estimated at USD2.9 billion at end-2022, with outstanding sukuk being the largest segment at 57%, followed by Islamic banks at 42% (total assets), and the remaining 1% between Islamic funds (total assets) and Takaful (total contributions). The long-term potential is significant as Nigeria has the largest Muslim population in Africa with a large unbanked population. However, there are certain challenges on the way moving forward, including a limited Islamic banking footprint and low public awareness of Islamic products.[10]

[9] Obiyo, O. C. (Year). Islamic financing/banking in the Nigerian economy: Is it workable? A review of related issues and prospects. Department of Accounting, University of Port Harcourt, Port Harcourt, Nigeria.
[10] Nigerian Islamic Finance Industry to Continue Growth on Policy Push, *https://www.fitchratings.com/research/islamic-finance/nigerian-islamic-finance-industry-to-continue-growth-on-policy-push-25-01-2023*

1.4 Despite the highlighted challenges, the stakeholders are constantly striving to drive the industry forward. The CBN as a banking regulator and supervisor actively finds ways to enhance the regulations and come up with necessary solutions, such as Shari'ah-compliant lender of last resort facilities, intervention schemes, and Shari'ah-compliant deposit insurance schemes.

1.5 In 2020, the CBN issued the Exposure Draft of the Review of the Guidelines for the Operation of Non-Interest Financial Institutions' Instruments (and the Framework for the Operationalisation of Central Bank of Nigeria Non-Interest Asset Back Securities. As the participation by non-interest financial institutions in these instruments continues to increase, the CBN issued the Draft Review of NIFI Instrument Guidelines to these instruments more effective in addressing contemporary development in the industry.[11]

1.6 Market players in their turn also actively participate in removing the obstacles. One of their latest initiatives is the formation of an association to develop the industry through critical initiatives (such as interbank funds transfer framework) which will enhance the asset-liquidity management process for the NIBs.

1.7 From the legal framework perspective, the CBN was established under the Central Bank of Nigeria Act 1958 (No 24), which was later amended through the Banking Decree of 1969. Subsequently, the Bank and Other Financial Institutions Decrees (BOFID) 24 and 25 of 1991 repealed the Banking Decree of 1969 and all its amendments. As a result, the CBN was strengthened to cover new institutions like NIBs. The power of the CBN was enhanced to make effective monetary policy, regulation, and supervision of banks and other financial institutions. The current legal framework of the CBN is based on the CBN Act of 2007, which gives full autonomy to the CBN to promote stability and continuity in economic management. Given this enabling legal provisions for the CBN, it now controls, regulates and supervises all banks and non-banking institutions in the economy.[12]

[11] *https://www.lexology.com/library/detail.aspx?g=d0476a63-1a42-4e75-8fa4-e2891ea59f72*
[12] *Daud, M., Yussof, I.M., & Adewale, A. (2011). The establishment and operation of Islamic banks in Nigeria: Perception study on the role of the Central bank of Nigeria. Australian Journal of Business and Management Research, 1(2), 14-29.*

2 Legislations and Laws

2.1 As it was mentioned, it was the Banks and Other Financial Institutions Act (BOFIA) of 1991 that for the first time introduced the profit-sharing principle and gave way for NIBs. This act is the overriding law regulating the banking business in Nigeria, and has been amended several times to the current version of BOFIA 2020. The current amendment provides many provisions relating to Islamic banking. These include:

- details of Shari'ah scholars that will serve in its Advisory Committee of Experts on an application for a license;
- the CBN will only invest the capital of Islamic banks in non-interest-bearing securities or similar non-interest banking compliant products or investments;
- admission of non-interest instruments as part of reserves banks may hold with the CBN and for liquidity ratio determination purposes;
- discretionary limit on single obligor limits;
- requirement of a statement of Shari'ah compliance by the Advisory Committee of Experts in the annual accounts;
- appointment of experts to advise the CBN Governor on Islamic banking matters.

2.2 In 2011, the CBN issued a long-awaited Framework for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria (CBN Framework), which remains the main regulatory instrument for Islamic banking in Nigeria.

2.3 Additionally, the CBN introduced Guidelines on Shari'ah Governance for Non-Interest Financial Institutions in Nigeria and Guidelines on Non-Interest Window and Branch Operations of Conventional Banks and Other Financial Institutions in December 2010. Later, two other documents, issued in 2015, became the main Shari'ah Governance regulatory guidelines for all NIBs: the

Guidelines on the Governance of Financial Regulation Advisory Council of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria and Guidelines on the Governance of Advisory Committees of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria Issued.

2.4 The Guidelines for the operation of non-interest financial instruments were issued in 2012 and later revised in 2022 by the CBN to facilitate the NIBs on liquidity management and assist in effective monetary policy implementation.

2.5 The Federal Inland Revenue Service published the Non-Interest Finance (NIFs) Taxation Regulations (Regulation) in 2022, which aims to provide a framework for the taxation of financial institutions offering non-interest financial products and services in Nigeria. The Regulations address the tax implications for different types of Islamic financial products.

2.6 For example, in the *Murabaha* contract, the Regulation requires the financial institution to treat the initial purchase price as a loan to the customer. Further, the resale price, excluding the markup, will be treated as a loan repayment and will not be subject to value-added tax (VAT), stamp duties, and capital gains tax. However, the markup element will be treated as interest payable on the loan and subject to withholding tax (WHT). Similarly, the purchase of the asset from the vendor will be subject to both VAT and WHT respectively.[13]

2.7 The CBN also introduced Guidance Notes on Regulatory Capital for Non-Interest Financial Institutions in Nigeria in 2019, to compute Capital Adequacy Ratio by NIBs, which is based on the IFSB's Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services IFSB-15.

2.8 The country's Constitution allows to have Shari'ah courts where required. However, they have no jurisdiction over banking matters and mainly manage

[13] *https://kpmg.com/ng/en/home/insights/2022/11/firs-issues-regulations-for-taxation-of-institutions-offering-no.html*

Islamic personal relationships, which does not include Islamic banking matters. The High Courts, however, have the constitutional power to entertain banking matters in Nigeria but do not apply Islamic law. Therefore in case of any disputes between NIBs and consumers, they should be resolved using the conventional arrangements.

3 Shari'ah Governance

3.1 The Shariah governance framework in Nigeria was introduced in 2011 under the Guidelines on Shari'ah Governance for Non-Interest Financial Institutions in Nigeria. The Guidelines state that all licensed NIBs should have an internal Shari'ah compliance review mechanism and a Shari'ah Advisory Committee subject to the approval by the CBN as part of their governance structure.

3.2 Later however, due to regulatory restrictions, the CBN changed the "Shari'ah Advisory Committee" to an "Advisory Committee of Experts" under the Guidelines on the Governance of Advisory Committees of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria issued in 2015, mandating every NIB to establish such committee which should be approved by the CBN.

3.3 Following the provision within the CBN Framework of 2011, the CBN established a national advisory body on Islamic banking and finance in 2013 – the CBN Shari'ah Council, which later had been transformed to be named the "Financial Regulation Advisory Council of Experts" (FRACE) following the issued "Guidelines on the Governance of Financial Regulation Advisory Council of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria, 2015".

3.4 Having both national and institutional Shari'ah governance bodies, brings Nigeria to two levels of Shari'ah supervision within the governance framework.

3.5 The FRACE is the highest Shari'ah governance body in Nigeria for NIBs.

Its role is to supervise Shari'ah related matters on a national level: examining the Shari'ah compliance of the Islamic financial products that are being offered by NIBs, issuing Shari'ah resolutions and decisions, approving the instruments and activities of NIBs, advising the CBN on matters relating to Islamic commercial jurisprudence for the effective regulation and supervision, approving the institutional-level Shari'ah Boards members known as Advisory Committee of Experts (ACE).

3.6 The FRACE is also providing Shari'ah matters related assistance to the Securities and Exchange Commission of Nigeria, the National Insurance Commission of Nigeria and other regulatory agencies of the Nigerian financial system.

3.7 The role of the ACE is to ensure that a NIB is compliant with principles of Islamic Commercial Jurisprudence at all times though advising the NIS's Board, providing Shari'ah expertise, reviewing and endorsing policies and guidelines, and so on.

3.8 To support an institutional level Shari'ah Board – ACE, the Guidelines require NIBs to have a dedicated Internal Shariah Compliance Unit comprising officer(s) with appropriate qualifications and experience in Islamic Commercial Jurisprudence and conventional finance to serve as the first point of reference for Shariah compliance issues.

3.9 The CBN Guidelines provide comprehensive coverage of the compositions of the FRACE and ACE, the duties and responsibilities of their members, the minimum qualification for their members, knowledge criteria, and tenure and termination terms.

3.10 The reporting lines of both FRACE and ACE are also clearly stated in the regulation. The FRACE shall report to the Governor of the CBN and ACE report to the NIB's Board of Directors and also have a dotted reporting line relationship to the Managing Director or the CEO. In cases where Shari'ah non-compliance can not be resolved within the institution, the ACE shall inform the CBN accordingly.

3.11 The independence and confidentiality-related matters are also highlighted in the Guidelines for ACE.

3.12 Recently, in 2023, the CBN issued Corporate Governance Guidelines for Commercial, Merchant, Non-interest, and Payment Services Banks in Nigeria which also have provisions related to an ACE, internal Shariʻah audit, and Shariʻah compliance function.

4 Development of Liquidity Management Infrastructure [14]

4.1 There are six liquidity management instruments introduced by the CBN that are available for NIBs for liquidity purposes. These instruments provide various liquidity support for Islamic banks. The framework for the administration of liquidity support for Islamic banks is managed by the financial markets department of the CBN, which is also responsible for providing lender-of-last-resort facilities to all banks in Nigeria.

4.2 These non-interest financial instruments provided by the CBN include:

- CBN Safe Custody Account;
- CBN Non-interest Note;
- CBN Non-interest Asset-backed Securities;
- CBN Non-interest Special Bills;
- Intra-day Facility;
- Funding for Liquidity Facility.

4.3 The CBN Safe Custody Account is based on a contract of safe custody of funds – *Wadi'ah* – between a financial institution and the CBN as a custodian. The tenor can be on an overnight, 3-day, and 7-day basis.

4.4. CBN Non-interest Note is a financial paper issued by the CBN evidencing an initial interest-free loan instrument between an authorised

[14] Drafter based on the CBN's latest Guidelines for the operation of non-interest financial instruments.

financial institution (lender) and the CBN (borrower). This note entitles the authorised financial institutions to, subsequently, raise a corresponding interest-free loan from the CBN within 12 months after the maturity of the initial interest-free loan. In the subsequent transaction, the CBN becomes the lender, and the authorized financial institution is the borrower. The note is not discountable, but transferrable at par and has a tenor of 30, 60, 91, and 180 days.

4.5 The CBN Non-interest Asset-backed Securities involve the securitisation of CBN's holdings in *Sukuk* and any other Islamic financial instruments and assets issued by multilateral organisations in which Nigeria is a member. This facility's tenor is flexible and based on the tenor of an underlying asset.

4.6 CBN Non-interest Special Bills are considered interest-free loans drawn from the Cash Reverse Requirement account of the eligible authorised financial institution (lender) by the CBN (borrower). To confirm with the principles of non-interest banking, it entitles the lender to subsequently borrow 10% of the matured bill, within 30 days after the maturity of the instrument for a period equivalent to 1/3 of the original tenor. Therefore, the tenor is being determined by the CBN.

4.7 The other two facilities – Intra-day Facility and Funding for Liquidity Facility – are explained in the section below.

4.8 The NIBs in Nigeria also started to benefit from access to a substantial pool of tradeable sovereign sukuk, enhancing their ability to effectively manage liquidity. The primary challenge in liquidity management lies in automating the initiation and delivery of liquidity support for NIBs by the CBN, as the current process is predominantly manual. The central bank is actively addressing this issue.

5 Financial Safety Nets

5.1 Nigeria stands out as one of the few jurisdictions to implement both a Shari'ah-compliant Lender of Last Resort (SLOLR) mechanism and a Shari'ah-compliant Deposit Insurance Scheme within its jurisdiction.

5.2 In August 2017, the CBN introduced two lender-of-last-resort instruments that can be accessed by NIBs – Intra-day Facility and Funding for Liquidity Facility.

5.3 The Intra-day Facility provides for liquidity shortfalls within stipulated periods during the business day and the avoidance of gridlocks on the settlement system. The CBN provided this facility for the settlement on the same business day using *Qard* contract.

5.4 The other facility – Funding for Liquidity Facility – is an overnight facility available to authorised financial institutions, to bridge short-term liquidity gaps. It is also structured using the *Qard* mechanism.

5.5. In 2016, the Nigeria Deposit Insurance Corporation introduced the Framework for Non-interest Bank Deposit Insurance Scheme.

5.6 The non-interest deposits covered under the scheme include safe keeping deposits (*Wadi'ah*); deposits for investment (*Qard*); profit sharing/loss-bearing deposits (*Mudarabah*); profit and loss-sharing deposits (*Musharakah*), and other deposit types that are non-interest based and approved by the CBN.

5.7 The Maximum Deposit Insurance Coverage for all NIBs is the same as the Deposit Money Banks in conventional banks, which is presently NGN500,000 per Depositor per account and NGN200,000 per Depositor per account for Microfinance banks.

6 Effective Crisis Management and Resolution Framework

6.1 Presently, both conventional and Islamic banks – NIBs – in Nigeria adhere to same crisis management and resolution framework.

7 Governance, Accounting and Auditing

7.1 Islamic banks, NIBs, in Nigeria have to comply with the Corporate Governance Guidelines for Commercial, Merchant, Non-interest, and Payment Services Banks in Nigeria that were issued in 2023 by the CBN following the CBN Act 2007 and the BOFIA 2020. When developing these guidelines, the CBN incorporated relevant principles and recommended practices from the Nigerian Code of Corporate Governance (2018) issued by the Financial Reporting Council, along with global corporate governance standards and other related CBN documents.

7.2 The Guidelines introduce crucial aspects for effective corporate governance for NIBs, including the requirements for having a robust Shari'ah governance mechanism that is commensurate with the size and complexity of a NIB through establishing ACE in each NIB.

7.3 It also indicates the importance of overseeing Profit-Sharing Investment Accounts concerning its holders ensuring that their funds are invested and managed in their best interest in line with the provisions of the existing Guidelines on the Management of Investment Account Holders for Non-Interest Financial Institutions in Nigeria issued in 2019.

7.4 Moreover, the Guidelines suggest that a NIB should collaborate with its ACE to establish a policy on income smoothing towards returns paid to Profit-sharing investment account holders in line with the provisions of the existing Guidelines on the Practice of Smoothing, the Profit Pay-out to Investment Account Holders for Non-Interest Financial Institutions in Nigeria issued in 2019 as well.

7.5 Regarding accounting standards and reporting methods, the CBN and the Monetary Agencies in Nigeria require NIBs to comply with the Financial Accounting Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

8 Disclosure Requirements

81. Similar to many jurisdictions, NIBs in Nigeria must adhere to distinct disclosure requirements, differing from those applicable to conventional banks.

8.2 In 2019 the CBN issued the Guidance Notes on Disclosure Requirements to Promote Transparency & Market Discipline for Non-Interest Financial Institutions in Nigeria based on the IFSB disclosure requirements standards (IFSB-22)

8.3 The Guidelines aimed for market participants, particularly the Investment Account Holders (IAHs), to access relevant, reliable, and timely information on risk exposures and risk management policies and procedures of a NIBs. The regulation sets out the disclosure requirements concerning procedure, frequency, and content of information to be disclosed.

8.4 NIBs in Nigeria should have a formal disclosure policy approved by the BOD. The NIBs have to implement a process for assessing the appropriateness of their disclosures, including validation and frequency. Also, NIBs have to establish a Governance Committee to oversee governance issues relating to IAHs to enhance the transparency of returns and risks and of the underlying factors that affect them, as required by CBN *Guidelines on Income Smoothing and Management of Profit-Sharing Investment Accounts.*

9 Rating of Islamic Financial Institutions and Shari'ah Compliant Instruments

91. There are several External Credit Assessment Institutions (ECAIs) established in Nigeria that provide ratings for banking institutions, including NIBs.

9.2 The Securities and Exchange Commission of Nigeria regulates and outlines the functions and registration requirements for credit rating agencies.

10 Capacity building and Talent development

10.1 The CBN has played a pivotal role in fostering capacity-building and talent development initiatives within the Islamic banking sector. Acknowledging the critical importance of a skilled workforce in advancing the growth and resilience of Islamic banking, the CBN has actively implemented diverse initiatives to enhance expertise and knowledge in Shariʻah-compliant financial practices.

10.2 In collaboration with industry experts, the CBN has also spearheaded the development of specialised workshops tailored to the unique requirements of the non-interest banking sector. Importantly, the Central Bank's commitment to capacity building extends beyond academic pursuits, actively promoting continuous learning and professional development.

10.3 CBN staff actively contribute to the advancement of the Islamic banking sector by actively participating in IFSB workshops and capacity-building programs. Their engagement enhances the knowledge base within the central bank, contributing to the ongoing improvement of the Islamic banking landscape in Nigeria.

10.4 Crucially, within this jurisdiction, there is a notable abundance of human resources possessing the requisite knowledge and skills to robustly support the Islamic finance sector. This availability of skilled professionals further enhances the overall capacity and capability of the sector, reinforcing its position as a key player in the financial landscape of Nigeria.

11 Challenges in Implementing IFSB Standards

11.1 According to the CBN, the implementation of IFSB standards posed several challenges, primarily centered around the adaptation of the non-interest banking returns template and the refinement of systems and processes within the non-interest banking framework. The adaptation of the returns template required a comprehensive adjustment to align with the specific requirements of Islamic finance, ensuring accurate and relevant reporting.

11.2 Additionally, enhancing the systems and processes inherent to non-interest banking demanded a thorough review and modification to ensure seamless integration with the IFSB standards. Overcoming these challenges has been essential to achieving compliance and fostering the effective implementation of IFSB standards within our jurisdiction.

11.3 The combination of stakeholder engagement, IFSB's workshops, and a meticulous pilot-run strategy proved instrumental in overcoming the challenges associated with implementing IFSB standards.

11.4 The CBN is formulating a strategic plan for the seamless implementation of IFSB standards which will facilitate a smoother transition to compliance and ensure the sustained alignment of the non-interest banking framework with international Islamic finance best practices in the jurisdiction.

11.5 According to the CBN, the implementation of IFSB standards has yielded noticeable positive outcomes. Notably, there has been a significant improvement in the measurement of risk and capital adequacy, providing a more robust framework for financial institutions. Additionally, the adoption of IFSB standards has enhanced disclosure practices, contributing to increased transparency and accountability within the financial sector.

Section 7: Pakistan

State Bank of Pakistan

1 Background

1.1 In Pakistan, the steps for the transformation of conventional banking and financial system into an Islamic system were initiated in 1980s. Pakistan was among the few countries worldwide that had been trying to implement interest-free banking at a national level. In early 1980s, numerous measures were taken to introduce interest-free banking and different banking, and other relevant laws were amended to facilitate an interest-free banking system in the country. However, these efforts could not produce desired results due to various reasons. Subsequently, a gradual approach for transformation of banking system into Shari'ah compliant banking was adopted at the start of this millennium.

1.2 In 2001, State Bank of Pakistan (SBP) introduced a three-pronged strategy for promotion of Islamic banking: 1) allowing new full-fledged Islamic banks in the private sector; 2) allowing the conventional banks to set up Islamic banking subsidiaries; and 3) allowing the existing conventional banks to open standalone Islamic banking branches. In 2002, Meezan Bank Limited was established as the first full-fledged Islamic banking institution in the country.

1.3 Currently, there are five full-fledged Islamic commercial banks and 17 conventional banks having standalone Islamic banking branches are operating in the country. Islamic banking industry in Pakistan has acquired a market share of 20.2% in terms of assets as of December 31, 2022. Therefore, Islamic banking segment in Pakistan is considered systemically important according to IFSB criteria, which is 15%. Additionally, the market share of deposits and financing of Islamic banking stood at 19.4% and 25.7% respectively and advances of overall banking industry, as of December 31, 2021.

1.4 Assets and deposits of Islamic banking industry stood at PKR 5,577 billion (USD 31.6 billion) and PKR 4,269 billion (USD 23.9 billion), respectively by end of 2021.

During the last five years (2017-21), the compound annual growth rate of Islamic banking industry's assets and deposits recorded at 25.2% and 22.3%, respectively, indicating a robust growth and potential.

1.5 In April 2021, SBP has unveiled the third five-year Strategic Plan for the development of Islamic banking in the country. The plan covering 2021-25 aims at setting a strategic direction for banking to strengthen the existing growth momentum and lead banking to the next level of growth. The Strategic Plan envisages achieving the aforementioned specified targets by focusing on six strategic pillars namely: 1) strengthening legal landscape, 2) enhancing conduciveness of regulatory framework, 3) reinforcing comprehensive Shari'ah governance framework, 4) improving liquidity management framework, 5) expanding outreach and market development, and 6) bolstering human capital & raising awareness.

1.5 The plan also set headline targets for Islamic banking to be achieved by 2025. These include: 1) achieving 30% share in both assets and deposits of overall banking, 2) boosting to 35% share in branch network of overall banking, and 3) acquiring 10% and 8% share of SMEs and agriculture financing respectively, in private sector financing of the Islamic banking industry.

2 Legislations and Laws

2.1 The regulation of both Islamic and conventional banks in Pakistan is governed by the Banking Companies Ordinance (BCO) of 1962, which has been amended from time to time in order to support Islamic banking.

2.2 SBP is among the few regulators that have introduced a comprehensive regulatory framework for the Islamic banking industry. Furthermore, SBP has issued various specific regulations/instructions for Islamic banking institutions from time to time. These regulations/instructions mainly cover areas like: guidelines and criteria of setting up Islamic banking institutions and commencement of Shari'ah compliant business and operations by development finance institutions; essential and model agreements for Islamic modes of financing; guidelines for Islamic microfinance business; risk management guidelines for Islamic banking institutions; instructions on Shari'ah non-compliance risk management, guidelines for of a conventional bank into an Islamic bank; criteria for conversion of conventional branch into an Islamic; instructions for profit & loss distribution and pool management for Islamic banking institutions; Shari‘ah governance framework for Islamic banking institutions; instructions on Islamic banking windows operations, among others.

2.3 SBP has taken various legislative measures with respect to Islamic banking during 1980s and early 2000. These measures mainly include the addition of definition of Islamic modes of finance in existing banking laws, acceptance of deposits on profit and loss basis, establishment of Islamic banking subsidiary, etc. Meanwhile, the corporate law, bankruptcy law, consumer protection, and private property laws for conventional and Islamic banks are almost same.

2.4 Banking ombudsman and banking courts resolve disputes between banks (including Islamic banks) and consumers. However, currently there are no separate Islamic banking branches at banking courts.

2.5 Tax neutrality for Shari‘ah-compliant banking is an essential component of the overall policy of SBP for development of Islamic banking and finance and to ensure a level-playing field for Islamic banking institutions. In this context, the Government of Pakistan on the SBP’s recommendation has made certain changes/amendments in the related tax laws to provide tax neutrality to Islamic banking industry through Finance Act 2017. The major changes made in the taxation laws were related to, among others: exemption of trade-based modes from the definition of supply, equal tax treatment of customers availing financing under *Musharaka* and Diminishing *Musharaka* compared to conventional financing products, and allowing benefit of depreciation on *Ijarah* financing.

2.6 In addition, SBP is working to make some amendments in the existing legal framework with respect to Islamic banking.

3 Shari'ah Governance

3.1 SBP has been endeavouring to ensure that operations of Islamic banking institutions remain in conformity with Shari'ah principles. By observing the developments that have been taken place in the Islamic banking industry over the years, SBP issued a comprehensive Shari'ah Governance Framework (SGF) for Islamic Banking Institutions (IBIs) in 2015 and later revised in 2018.

3.2 The framework explicitly outlines the roles and responsibilities of various organs of IBIs towards Shari'ah compliance including: Board of Directors (BOD), Executive Management, Shari'ah Board (SB), Resident Shari'ah Board Member, Shari'ah Compliance Department, and internal and external audit.

3.3 The framework outlines that every IBI shall have a SB comprising at least three Shari'ah scholars appointed by the BOD of the bank as per fit and proper criteria prescribed by SBP. The appointment of the SB members requires prior written clearance of SBP.

3.4 The SB is empowered to consider, decide, and supervise all Shari'ah related matters of the IBI. All decisions, rulings, and *fatawa* of the SB shall be binding on the IBI whereas SB shall be responsible and accountable for all its Shari'ah related decisions.

3.5 The SB of an IBI is also responsible of approving all the procedure manuals, product programs/structures, process flows, related agreements, marketing, and advertisement. The board is also responsible to prepare a report of the Shari'ah-compliance environment and conditions within the respective Islamic banking institution, and to publish the outcome in the annual report. Additionally, the framework requires the establishment of Shari'ah Compliance Department, Product Development Department/Unit, along with internal Shari'ah Audit Unit. The framework also covers instructions on external Shari'ah Audit in order to have an independent and objective assessment of the conformity of IBI's operations with Shari'ah rules and principles.

3.6 The Shari'ah Governance Framework also explicitly provides guidance on the following:

- Constitution of the SB and Appointment of SB Members;
- SB Meetings, Quorum, Minutes;
- Independence of SB;
- Report of SB;
- Conflict Resolution;
- Competence of the Organs Dealing with Shari'ah Governance Framework

3.7 Additionally, Shari'ah Governance Framework prescribes fit and proper criteria for appointment of Shari'ah scholars as member of SB of an Islamic banking institution. The criteria broadly cover areas like academic qualification; experience and exposure; track record; solvency and financial integrity; honesty and reputation; conflict of interest; and declaration of fidelity and secrecy.

3.8 It is mandatory for each SB member to sign and submit declaration with respect to fidelity and secrecy to promote confidentiality by all organs of Shari'ah Governance including the SB and Shari'ah Secretariat.

3.9 SBP provided regulation guidance on best practices to ensure consistency in terms of the professionalism of members of the SB, which is crucial in enhancing their credibility and confirming their integrity.

4 Development of Liquidity Management Infrastructure

4.1 Considering that, SBP is working on providing multiple liquidity management solutions for the industry. In addition, SBP is providing support to

Government of Pakistan in issuing various international sovereign *Sukuk* and domestic *Sukuk* (varying size and tenors) [15].

4.2 SBP has also been conducting Shari'ah-compliant Open Market Operations (OMOs) by utilising *Bai-mu'ajjal* (sale with deferred price) of *Sukuk* issued by the Government of Pakistan. This mechanism is provided within Statutory Liquidity Ratio eligibility. Government of Pakistan also uses this mechanism to offer investment avenue to Islamic banking industry.

4.3 Pakistan Domestic *Sukuk* Company Limited, a public sector company, has been issuing Government of Pakistan *Sukuk* in the domestic market since 2008. *Sukuk* have been issued on the basis of *Ijarah* for a period of 3 to 5 years and are tradable. SBP coordinates with the Ministry of Finance and supports it in issuing *Sukuk* when required.

4.4 Recently, with a view to provide a liquidity management framework for Islamic banking institutions and enhance the effectiveness of monetary policy implementation, SBP has introduced Shari'ah Compliant Standing Ceiling Facility – *Mudarabah* based Financing Facility (MFF) in December 2021. Further, in order to enhance monetary policy transmission and improve management of market liquidity, SBP has introduced Shari'ah Compliant *Mudarabah* Based Open Market Operations (OMO-Injections) for Islamic banking institutions in December, 2021.

5 Financial Safety Nets

5.1 SBP has introduced regulations for Lender of Last Resort (LOLR) facility, which also includes financing for Islamic banking institutions under Shari'ah-compliant mode.

5.2 Pakistan offers Shari'ah-compliant deposit insurance through Deposit

[15] SBP does not issue *Sukuk* or other securities. However, Government of Pakistan and other different corporate/quasi sovereign entities issue Shari'ah compliant securities (mainly *Sukuk*).

Protection Corporation which has been established as a subsidiary of the SBP under the Deposit Protection Corporation Act, 2016 (the Act). The objective of the Corporation is to protect depositors and compensate them to the extent of their protected deposits in the event of failure of a member bank.

5.3 A Deposit Protection (DP) Waqf is established under this scheme for the protection of depositors of Islamic banking institutions. The structure of the DP *Waqf* is based on *Waqf-Wakalah* model. All deposit categories (current, saving, and fixed) are covered under the scheme. As per Deposit Protection Act, each Islamic banking institution is required to pay a contribution amount from their own sources with no cost to the depositors. The Corporation is responsible for the management of the DP *Waqf*. The Corporation acts as Manager/Agent (Wakeel) of the DP *Waqf* under the *Wakalah* relationship. Under this arrangement, as per Shari'ah principles, the DP Waqf shall be the Principal and the Corporation shall act as its Agent. However, the Corporation shall not be an agent of any member.

6 Effective Crisis Management and Resolution Framework

6.1 Currently, crisis management and resolution frameworks are the same for conventional and Islamic banks. However, SBP is working to make suitable amendments/changes in the existing legal framework with respect to Islamic banking, which also covers some changes regarding priority of payments.

7 Governance, Accounting and Auditing

7.1 A comprehensive corporate governance regulatory framework is in place, which is applicable to all type of banking institutions including Islamic banks. The main elements/features of framework include fit and proper test criteria for the Sponsor Shareholders, members of the BODs, Presidents/CEOs and Key Executives of banks and other regulatory requirements. Apart from that, it provides instructions with respect to dealing with directors, major shareholders, and employees.

7.2 To some extent, Islamic banking institutions have different accounting standards/reporting methods compared to conventional banks. In addition to accounting and reporting standards which are applicable to all banks, Islamic banking institutions also follow two Islamic Financial Accounting Standards (IFAS) i.e. *IFAS-1-Murabaha* and *IFAS-2-Ijarah*. Moreover, SBP has defined some additional financial disclosure requirements for Islamic banking institutions.

8 Disclosure Requirements

8.1 SBP has prescribed the following disclosure requirements on Islamic banking:

a. General Governance Disclosures including (applicable for both conventional and Islamic banks):

- Disclosure and explanation of any departure from complying with the applicable financial reporting standards;
- Disclosures of the Corporate Governance arrangements and practices;
- Disclosure of all related party transactions and treatment of material events.

b. Shari'ah Governance Disclosures Requirement including (SB Report):

- Compliance with Shari'ah rules and principles in the light of *fatawa*, rulings, and guidelines issued by its SB;
- Compliance with directives, regulations, instructions and guidelines related to Shari'ah compliance issued by SBP in accordance with the rulings of SBP's Shari'ah Board;
- Whether or not the bank has a comprehensive mechanism in place to ensure Shari'ah compliance in their overall operations;
- Whether or not the bank has a well-defined system in place which is

sound enough to ensure that any earnings realized from sources or by means prohibited by Shari'ah have been credited to the charity account and are being properly utilised;

- Compliance with the SBP instructions on profit and loss distribution and pool management;
- The level of awareness, capacity, and sensitization of the staff, management, and the BOD in appreciating the importance of Shari'ah compliance in the products and processes of the bank;
- Whether or not the SB has been provided adequate resources enabling it to discharge its duties effectively;
- List of the significant Shari'ah-related issues of the bank which have been taken up with its management and are still outstanding.

General

- IBIs are required to provide, frequently asked questions (FAQs) on Islamic banking on their website.
- Disclosure of information related to charity funds in financial statements;

c. Islamic Windows disclosures including:

- Financial statements of conventional banks contain separate notes on Islamic window (separate balance sheet and profit & loss for Islamic banking operations in the form of notes);

d. Investment Account Holder (IAHs) related disclosures including:

Disclosure in Financial Statements

- The number and nature of pools maintained by the IBI along with their key features and risk & reward characteristics;
- Avenues/sectors of economy/business where *Mudaraba* based deposits have been deployed;
- *Mudarib* Share (in amount and Percentage of Distributable income);
- Amount and percentage of *Mudarib* share transferred to the depositors through Hiba (if any);

- Profit rate earned vs. profit rate distributed to the depositors during the year.

Disclosure on IBI's website and notice board of each branch:

- Percentage of *Mudarib* Share for the period concerned and at least two previous periods in each category of deposits;
- Weightages assigned to each category of deposits for period concerned and at least two previous periods;
- The actual monthly/periodic profit/loss distributed to each category of deposits during the last 2 years;
- PER and IRR policies (if in place).

9 Rating of Islamic Financial Institutions and Shari'ah Compliant Instruments

9.1 The Securities Exchange Commission of Pakistan (SECP) regulates credit rating companies under the Securities Act 2015. At present, two credit rating companies are functioning in Pakistan namely Pakistan Credit Rating Agency Limited and JCR-VIS Credit Rating Company Limited [16].

10 Capacity Building and Talent Development

10.1 Capacity Building of the Islamic finance industry is one of the important strategic pillars of SBP's policy for the development of Islamic banking and finance in the country. Consequently, SBP has provided sufficient resources with the required knowledge and skills.

10.2. SBP is actively engaged in capacity building of the industry through various awareness and training programs. In this regard, financial and technical support of reputable domestic and international organizations (for example: IFSB) are being mobilised. In addition, SBP has facilitated the industry not only by conducting programs on its own and through its training subsidiary (National Institute of Banking and Finance), but also provided assistance to initiatives taken by other stakeholders.

[16] *https://www.secp.gov.pk/data-and-statistics/capital-markets/credit-rating-agencies/*

10.3 The training programs on Islamic banking and finance have been designed to benefit a wide diverse group of participants including industry players, Shari'ah scholars, academicians, judges, governmental officials, as well as students at universities and colleges.

10.4 In collaboration with key stakeholders, SBP has helped in establishing three Centres of Excellence at leading business schools including the Institute of Business Administration (IBA), Karachi; Lahore University of Management Science (LUMS), Lahore; and Institute of Management Sciences (IMSciences), Peshawar. These Centres are working efficiently to improve the quality of human resources in the industry and to provide the much-needed boost to the emerging Islamic finance industry by conducting dedicated research to address major challenges faced by the industry.

10.5 Apart from the above, some other universities/institutes are also offering courses on Islamic finance. In addition, SBP is also coordinating with other universities/institutes through various forums for the inclusion of Islamic finance in their curriculum.

11 Challenges in Implementing IFSB Standards

11.1 Being a member of the IFSB, SBP makes efforts to support and implement prudential standards issued by the IFSB. The adoption of these standards is one of the essential areas of the regulatory and supervisory framework of SBP.

11.2 Furthermore, the implementation of IFSB standards has remained a key component of the five-year strategic plans rolled out by SBP for the Islamic banking industry in the country. SBP assesses local market dynamics and conducts impact assessment before adoption/adaption of standards.

11.3 The rolling out of IFSB's standards is helping SBP not only in building a robust Islamic banking regulatory framework, but also in bringing local industry at par with global regulatory standards.

11.4 The list of IFSB standards that are adopted includes four standards related to banking sector. These standards are IFSB-1 (Guiding Principles of Risk Management), IFSB-3 (Corporate Governance), and IFSB-4 (Disclosures to Promote Transparency and Market Discipline), and IFSB-10 (Shariʻah Governance). Additionally, 3 banking-related standards have been assessed and reviewed for adoption in the near future namely IFSB-9 (Conduct of Business), IFSB-15 (Revised Capital Adequacy) and IFSB-22 (Revised Standard on Disclosures to Promote Transparency and Market Discipline).

11.5 SBP is planning to continue adopting the remaining IFSB standards within the next 1-3 years.

11.6 In terms of implementation challenges, SBP has not faced any major challenges in the adoption/adaption of IFSB standards except IFSB-15 (Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services), where it has been facing few challenges on the legal front in particular. Specifically, this legal challenge is related to the determination of the "*alpha factor*" [17] when calculating the capital adequacy ratio (CAR) since the current legal framework does not explicitly cover definitions for investment accounts that can be divided into restricted and unrestricted investment accounts. This makes it difficult to distinguish these accounts from other deposit accounts in terms of risk-sharing level and risk transfer, and that requires changes in the current relevant legal framework.

11.7 In this regard, SBP is working to make suitable amendments/changes

[17] Supervisory authorities should assess the extent of risks borne by PSIA and reflect these assessments in the computation of capital adequacy for IIFS in their jurisdiction. The main challenge facing IIFS and their supervisors in this connection is to assess the risk-sharing level between IIFS' own capital (shareholders' funds) and that of the investment account holders (IAHs). Within the capital adequacy ratio (CAR) context, the proportion of risk-weighted assets (RWAs) that needs to be included in the CAR to cater for the transfer of risk from investment account holders (IAH) to the IIFS is denoted by "alpha".

in the existing legal framework with respect to Islamic banking specifically to incorporate definitions of investment accounts (like restricted and unrestricted accounts). The clear definitions of both accounts along with clearly determining the risk-sharing level of each would help in addressing the challenge with respect to implementation of IFSB-15 and other IFSB standards.

11.8 IFSB workshops serve as another effective tool utilized by SBP and other industry players. These workshops, especially whenever conducted in Pakistan, have proven beneficial in enhancing understanding of IFSB standards among participants.

Section 8: Sudan

Central Bank of Sudan

1 Background

1.1 Sudan has a long history of Islamic banking that goes back to 1977 when Faisal Islamic Bank was established, being one of the few first fully-fledged Islamic banks in the world and the first Islamic bank in the African continent. Faisal Islamic Bank achieved a significantly higher performance than other previously established conventional banks. This was followed by 5 more Islamic banks within the following 6 years.

1.2 In 1984, the government decided to turn the banking system gradually and informally into an Islamic banking system in line with the Islamic orientation of the country. The first step was changing the regulation of the Central Bank of Sudan (CBoS) to make it Islamic. The decision took effect in 1991 when the Bank of Sudan issued the Banking Business Act 1991, which stated that all banking finance transactions for all banks in Sudan must be managed according to Shari'ah. However, the real turning point in the history of Sudan's financial system was after the breakaway of Southern Sudan in 2011 where a fundamental reengineering of the whole financial system was adopted by the government, which resulted in a total Islamic banking system.

1.3 Currently, there are 38 fully-fledged Islamic commercial banks in Sudan along with 87 Islamic banking windows spanning over 850 branches. The total market share of the Sudanese banking system exceeded 7.2 billion USD as of June 2021. According to IFSB data, Sudan registered a 48% y-o-y growth in Islamic banking assets in 3Q-2020.

1.4 In early 2021, CBoS announced that it would commence a dual banking system to attract international banking corporations to Sudan and to reintegrate with the global economy. This decision was expected to change the banking market structure in the country, allowing for more competition among Islamic and conventional banks thus impacting positively on aspects like stability, efficiency, and cost of intermediation.

2 Legislations and Laws

2.1 The Banking Business Act 2004, which nullified the Act of 1991, is currently the backbone of the banking system in Sudan. However, with the recent adoption of a dual banking system, Sudanese authorities are currently amending the banking regulations to suit the new banking system following international banking practices.

2.2 The changes that have been made to the Banking Business Act focus on adopting a risk-based supervision approach, corporate governance, and resolutions in the bank, along with regulations regarding the dual banking system instead of an entirely Islamic banking system. The new Banking Business Act is being finalised.

2.3 Generally, Sudan has an efficient and independent judiciary that recognizes the Islamic finance rules and principles. If the disputes cannot be resolved by CBoS, then the civil court will be the last resort to resolve the disputes.

2.4 Since the current banking system in Sudan is entirely Islamic, no tax neutrality laws have been introduced yet in the country.

3 Shari‘ah Governance

3.1 Upon the introduction of Islamic banking in Sudan, Shari‘ah governance was solely regulated by the internal Shari‘ah committees of the Islamic banks. This began with the establishment of the first Islamic bank in Sudan in 1977 and continued up to 1991.

3.2 In 1991, Sudan became the first country in the world to form a Supreme Shari‘ah Council. The Central Bank of Sudan and the Ministry of Finance established the High Shari‘ah Supervisory Authority (HSSA) as a regulatory body to supervise the development of the banking system and its compliance with Islamic law.

3.3. The HSSA is responsible for *fatwas*, contract specimens, arbitrage, consultations relating to Islamic legal aspects, training, research, lectures, and seminars. The authority also assists Shari‘ah boards and Shari‘ah departments in each bank to overcome any challenge, along with directing, guiding, and leading the whole industry to comply with Shari‘ah regulation.

3.4 Shari‘ah boards of Islamic banks and other Islamic financial institutions are obliged to coordinate and communicate with the HSSA in order to be updated on its decisions and directives. CBoS, Islamic Banks, and other Islamic financial institutions must abide by the fatwas, which are issued by the HSSA on jurisdictional disputes related to banking or finance. CBoS oversees Islamic banks and other Islamic financial institutions, and it may also penalize them financially or administratively for any violation of Shari‘ah rules.

3.5 According to the law, the HSSA has minimum seven members and maximum eleven members, and most of them must be Shari‘ah scholars and the rest can be scholars from other disciplines such as economics, banking, law and/or accounting. The term of membership of the commission shall be five years, subject to renewal.

3.6 The formation of the HSSA triggered a new wave of Shari‘ah unity and cooperation in the country and paved the way for other countries to follow suit by establishing their versions of similar bodies within their jurisdictions. Though variations might exist, other countries adopted their own councils serve as a clear indication of the creativity and advancement of the Sudanese model and experience.

3.7 The Sudanese experience also reiterates the value of a High Council, which regulates Shari‘ah banking and finance activities at the national level. Hence, it has proved the case for the existence of a supreme council that can bring unity and prevent Islamic financial institutions from conflicting fatwas from different Shari‘ah boards.

4 Development of Liquidity Management Infrastructure

4.1 One way to promote better liquidity management in Sudan is the Liquidity Management Fund established by CBoS. The business model of the fund is based on *Takaful* concept between commercial banks who contribute to the fund by paying a specific amount of Sukuk and cash. Whenever a bank faces a liquidity deficit, the Sukuk should be liquidated to assist that bank in obtaining the required liquidity.

4.2 CBoS collaborates with the Ministry of Finance to issue various *Sukuk* for liquidity management which Islamic banks can invest in. There are two types of these Sukuk. First, *Shahama* certificate, which is based on the *Musharaka* contract, with a maturity of 1 year and a profit about 18% annually. Each certificate represents a share of the net investment allocated by the government for this purpose from selected investment units. The second is *Sarah* certificate, which is based on *Mudarabah* contract, with the same maturity and profit between 16-17% annually. It is worth mentioning also that both instruments can be used as a warranty to obtain financing from banks.

4.3 Among the challenges that face Sudanese authorities in managing liquidity are the very limited Shari'ah-compliant liquidity management tools including interbank tools considering the conservative perspective of the Shari'ah authorities towards such tools. In this regard, it is worth mentioning that Sudan is also exceptional regarding the impermissibility of *Tawarruq* transactions in Islamic banking. As it became very common and overwhelmingly used to boost the liquidity level of Islamic banks, *Tawarruq* is not being accepted by some of the Shari'ah scholars. Hence, Sudan has not allowed *Tawarruq* transactions in its jurisdiction.

5 Financial Safety Nets

5.1 The Liquidity Management Fund, previously discussed in the liquidity management infrastructure, also serves as a “Bail-in lender of last resort” to offer financial safety nets for the Islamic bank in Sudan. Operating on the principle of *Takaful*, where the fund contribution comes from the commercial banks, it reinforces market discipline among industry players and reduces dependence on the central bank for liquidity needs.

5.2 Regarding deposit insurance, Sudan has established The Deposit Guarantee Fund where all the commercial banks contribute to the Fund. Specifically, the contribution is based on a proportion of the total funding of the bank, including funding received as investment accounts. Whenever any of the banks fail or faces a crisis, the Fund will interfere to reimburse the depositors as well as investment account holders (IAHs).

6 Effective Crisis Management and Resolution Framework

6.1 Sudan has in place a reliable Shari'ah-compliant crisis management and resolution framework. The framework deals with bank insolvency laws, arrangements for dealing with non-performing assets, bank restructuring, and bank recapitalization.

6.2 The recovery and resolution framework recognizes the specificities of Islamic finance and outlines how IAHs will be treated, the issuance of *Sukuk* by institutions offering Islamic financial services (IIFS) as capital instruments (mostly equity-based Sukuk) along with the rights of *Sukuk* holders, and the priorities among creditors of a defaulted institution.

6.3 With the adoption of a dual banking system, Sudanese authorities are in the process of introducing new regulations related to resolution. Moreover, the current crisis management regulation is being updated to comply with IFSB standards.

7 Governance, Accounting and Auditing

7.1 The corporate governance framework for Sudanese public listed corporations is outlined in a special Act issued by the Khartoum Stock Exchange in 2016. The Act regulates various aspects related to corporate governance like rights of shareholders, general assembly, disclosure and transparency, board of directors and executive management, and subordinated management (risk management, compliance management, internal audit, Shari‘ah board).

7.2 As for international standards, Sudan is among the countries that implement AAOIFI’s standards and guidelines related to accounting and auditing, Shari‘ah, and governance. Nevertheless, it is noted that more focus is on accounting standards compared to Shari‘ah and governance standards. Additionally, Sudan implements IFSB’s Guiding Principles on Corporate Governance (IFSB-3).

7.3 The use of audit committees and internal audit functions as well as the establishment of Shari‘ah Supervisory Board (SSB) is mandatory. However, there seems to be no criteria to evaluate the effectiveness of SSB members themselves [18].

7.4 Governance is a main aspect of the new banking regulation (Act of Business) that is expected to be issued soon. Therefore, it is envisaged that the level of corporate governance within Sudanese banks will improve.

8 Disclosure Requirements

8.1 CBoS imposes various disclosure requirements on Islamic banking institutions. The general governance disclosure requirement includes the disclosure and explanation of any departure from complying with the applicable financial reporting standards, the bank’s corporate governance arrangements and practices, along with disclosing transactions and treatment of material events.

8.2 As for the Shari‘ah governance disclosure, Sudanese Islamic financial institutions are required to disclose statements related to the governance arrangements, systems, and controls employed by the IIFS to ensure Shari‘ah compliance. Additionally, they are required to clearly articulate the

[18] Sulub, S. A.; Salleh, Z.; Hashim, H. (2018). Corporate governance, SSB strength and the use of internal audit function by Islamic banks Evidence from Sudan. Journal of Islamic Accounting and Business Research Vol. 11 No. 1, 2020 pp. 152-16.

Board of Directors (BOD's) responsibility and accountability over the Shari'ah governance of the Islamic bank, along with the qualifications and areas of expertise of each Shari'ah Board member, and appointment and change of members of the Shari'ah Board during the financial year.

8.3 The disclosure of Shari'ah non-compliance events that do not result in financial implications to the Islamic bank and their customers, and Shari'ah non-compliance events leading to financial implications, are also among the requirements.

8.4 Islamic windows are required to disclose Profit Sharing Investment Accounts (PSIAs) and any profit smoothing, while disclosure related to IAHs in general include bases of allocation of assets, expenses, and profit in relation to IAHs funds.

9 Rating of Islamic Financial Institutions and Shari'ah Compliant Instruments

9.1 Currently, there is no effective External Credit Assessment Institution (ECAI) in Sudan that provides ratings on Islamic banks and Shari'ah-compliant instruments which are necessary inputs for implementing IFSB capital adequacy standards. The sole local assessment agency is not operating effectively, and there is no international ECAI operating in the country. This is mainly due to the absence of regulations that govern such institutions besides the sanctions imposed on Sudan that hinder the existence of global ECAI within the Sudanese market. However, authorities are working on a draft to allow new ECAI to operate in the market which will help IIFS in implementing IFSB capital adequacy and liquidity standards along with facilitating effective disclosures and enhancing market discipline.

10 Capacity Building and Talent Development

10.1 Sudan has been benefiting from the technical assistance and capacity building from IFSB including workshops and other awareness initiatives. In addition, it has been receiving technical assistance from various international organizations including IMF and World Bank to build up its capacity and develop human resources working in the banking sector. The focus of the technical assistance is on the banking law system, banking reforms, corporate governance, and anti-money laundering.

10.2 Among the leading capacity-building institutions in Sudan is the Sudan Academy for Banking and Financial Sciences (SABFS) an educational and human capital development institution for the banking sector. SABFS started in 1963 with the establishment of the “Institute of Banking Studies” as a result of joint efforts exerted by the CBoS and commercial and specialised banks to provide banks’ staff with the skills and knowledge required to cope with the banking system and economic and financial transactions in the country. The curriculum was initially designed to focus on conventional banking and modern technological systems. With the Islamisation notion which took place in Sudan during 1980s, the Islamic curriculum was integrated within the syllabus in 1993 and the institute was renamed to “High Institute for Banking and Financial Studies”. In 2006, the need for further development was realised when the institution was transferred to SABFS. The main role of SABFS is to lead three main centres namely: the academic programs centre, the banking and financial training centre, and the research publishing and consultancy centre. SABFS provides various undergraduate and postgraduate programs in banking and financial studies, economics, and financial information systems.

10.3 In addition to SABFS, two training centres offer programs related to Islamic finance and banking. The first centre is under CBoS supervision, while the second follows the Sudanese Banking Union.

11 Challenges in Implementing IFSB Standards

11.1 Currently, Sudan is implementing seven IFSB standards covering areas like risk management (IFSB-1), corporate and Shari‘ah governance (IFSB-3 & IFSB-10), supervisory review process (IFSB-5), capital adequacy

(IFSB-2, IFSB-7 & IFSB-15).

11.2 Among the main challenges that face the implementation of IFSB standards in Sudan is the high inflation rate that has existed for many years causing considerable problems and issues in applying some IFSB standards. For example, with the continuous increase in prices and its impact on banks' financial data, conducting stress testing is a real challenge considering the difficulties in creating assumptions and scenarios for the stress tests besides making predictions inaccurate. Similarly, high inflation negatively affects high-quality liquid assets (HQLA) in terms of real values, especially with the lack of such assets. This renders the implementation of IFSB standards that are related to liquidity risk management more difficult and less effective.

11.3 Nevertheless, it is expected that the inflation rate will be more stable in the coming years as a result of removing the sanctions on Sudan and the political situation improves. Moreover, the new monetary policy in 2021 has liberalized the exchange rate of the Sudanese pound to reflect the real demand and supply dynamics, and thus, achieve a more stable inflation rate. This will allow Sudan to implement more IFSB standards in a more effective way.

11.4 Low capital adequacy is another challenge in implementing IFSB standards in Sudan. The high inflation rate negatively affects the real value of banks' capital components (Tier 1 and 2). In addition, calculating the market risk that is used in identifying risk-weighted assets within the capital adequacy formula is not an easy task considering the instability in prices and market conditions. In this regard, Sudan is willing to raise paid capital of all banks to enhance their capital adequacy in line with its endeavours to combat high inflation.

11.5 The absence of ECAIs is a challenge for implementing, in particular, IFSB standards related to capital adequacy. The ratings provided by ECAIs are important inputs for IIFS to determine the risk weight of Shari'ah-compliant asset. In other words, IIFS may use credit ratings issued by ECAIs when assigning risk weights and calculating their capital ratios. In this regard, Sudan is currently in the process of a new draft that regulates and facilitates the existence of ECAIs.

11.6 Another challenge in implementing IFSB standards stems from the fact that the Central Bank of Sudan is a shareholder in many commercial banks in Sudan as a result of liquidity injection by CBoS to these banks which turned later into equity (shares) in these banks. This renders the assessment of the regulatory capital that is eligible for capital adequacy a difficult task. However, the CBoS is planning to quit these banks by selling its shares.

11.7 A gap analysis has been conducted by CBoS to address the regulatory gap between IFSB standards and the current banking practices. The output of the analysis is used to amend several circulations to be more compliant with the IFSB standards. For example, Circulation (1/2008) about financial insolvency was amended according to the relevant IFSB standard. The new Banking Business Act is also expected to help minimising the challenges facing the implementation of IFSB standards.