ISLAMIC FINANCIAL SERVICES BOARD

EXPOSURE DRAFT GN-11

GUIDANCE NOTE ON CLIMATE-RELATED FINANCIAL RISKS FOR INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES (BANKING SEGMENT)

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Comments on this Exposure Draft should be sent to the IFSB Secretariat no later than 8 May 2025 by email to public_consultation@ifsb.org

Contents

ABBREVIATIONS

BCBS	: Basel Committee on Banking Supervision
BOD	: Board of Directors
DCR	: Displaced commercial risk
FSB	: Financial Stability Board
GN	: Guidance Note
IAH	: Investment account holder(s)
ICAAPs	: Internal capital adequacy assessment processes
IFSB	: Islamic Financial Services Board
IFSI	: Islamic financial services industry
IIFS	: Institution(s) offering Islamic financial services
ILAAPs	: Internal liquidity adequacy assessment processes
ISSB	: International Sustainability Standards Board
PSIA	: Profit-sharing investment account(s)
RPSIA	: Restricted profit-sharing investment account(s)
ROR	: Rate of return risk
RSAs	: Regulatory and supervisory authorities
UPSIA	: Unrestricted profit-sharing investment account(s)

1. INTRODUCTION

1.1. Background

1. Climate change may result in physical and transition risks that have adverse impacts on the resilience of institutions offering Islamic financial services (IIFS) in the banking sector, both individually and systemically. Such risks may be transmitted across the financial system through various channels[1]. Given the potential of climate-related financial risks to cause large shifts in the values of both investments and financed assets and catastrophic losses from extreme weather events, prudential policies need to be adopted to recognise and address material climate-related financial risks[2] in IIFS's governance and risk management frameworks.

2. Several international bodies, such as the Basel Committee on Banking Supervision (BCBS),[3] the Financial Stability Board (FSB),[4] and the International Sustainability Standards Board (ISSB)[5] have issued guidance on climate-related financial risks. While these are relevant to IIFS, this Guidance Note (GN) identifies and addresses the specificities of Islamic banking in terms of additional considerations in the management and supervision of climate-related financial risks.

3. The IFSB has issued a number of other standards for the banking sector that address Islamic banking specificities that are also relevant to this GN. This GN complements and should be read alongside other relevant IFSB standards.

1.2. Objective

4. The primary objective of the GN is to provide guidance to regulatory and supervisory authorities (RSAs) on the application of the BCBS Principles[6] to IIFS, taking into consideration the specific characteristics and nature of Islamic banking operations.

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[1] The transmission channels are elaborated in Section 2 of this document. For further details on how climate-related financial risks can be transmitted across the financial system, refer to BCBS (2021), Climate-related risk drivers and their transmission channels, Available at https://www.bis.org/bcbs/publ/d517.pdf,

[2] For further explanation on the potential adverse impact of climate change on the financial system, refer to IMF (2019), Climate Change and Financial Risk, Available at https://www.imf.org/external/pubs/ft/fandd/2019/12/pdf/climate-change-central-banks-and-financial-risk-grippa.pdf

[3] BCBS (2022), Principles for the effective management and supervision of climate-related financial risks, Available at: https://www.bis.org/bcbs/publ/d532.htm

[4] FSB (2023), FSB Roadmap for Addressing Financial Risks from Climate Change, Progress report, Available at: https://www.fsb.org/2023/07/fsb-roadmap-for-addressing-financial-risks-from-climate-change-2023-progress-report/

[5] ISSB (2023), IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information, Available at: https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements/; and IFRS S2: Climate-related Disclosures. Available At https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/

[6] BCBS (2022), Principles for the effective management and supervision of climate-related financial risks, Available at: https://www.bis.org/bcbs/publ/d532.htm. (For the purpose of this GN, BCBS, (2022) will be referred to as ``the BCBS Principles``).

1.3. Scope of Application

5. The GN complements BCBS *Principles for the effective management and supervision of climate-related financial risks,* hereafter referred to as the 'BCBS Principles'. The GN offers additional guidance to regulatory and supervisory authorities to address specific characteristics of Islamic banking that may result in differences in how climate-related risk drivers impact the risk profile of an IIFS. It does not duplicate guidance in the BCBS Principles that are equally applicable to IIFS. This GN should, therefore, be read alongside the BCBS Principles.

6. The guidance is intended primarily for full-fledged Islamic banks, including those that are subsidiaries of conventional banks as well as Islamic windows of conventional banks. For the purposes of this GN, an Islamic window[7] is defined as part of a conventional financial institution (which may be a branch or dedicated unit of that institution) that provides both Sharī'ah-compliant current and investment accounts (PSIA), and financing while ensuring the segregation of funds from the host institution.

7. The BCBS Principles are written primarily for large internationally active banks[8] and recognise the need for proportionality in their application. This GN applies similar to the BCBS Principles, taking into account the size, complexity and risk profile of the IIFS, subject to RSAs` discretion.

2. TRANSMISSION CHANNELS

8. Transmission channels are the causal chains linking climate risk drivers, both physical and transition, to the financial risks faced by banks and the banking sector. Transmission channels can be classified into two categories[9]:

- Microeconomic transmission channels include the causal chains through which climate risk drivers affect banks' individual counterparties, potentially resulting in climate-related financial risk to banks and to the financial system. These channels also include the direct effects on banks themselves, arising from impacts on their operations and their ability to fund themselves. Microeconomic transmission channels also capture the indirect effects on specific financial assets held by banks.

- Macroeconomic transmission channels are the mechanisms through which climate risk drivers affect macroeconomic factors such as labour productivity and economic growth and, in turn, may have an impact on banks through an effect on the economy they operate in.

[7] Islamic banking windows are dealt with in several IFSB Standards; IFSB-17: Principle 32 provides a high-level view of key provisions relating to windows.
[8] For further details, refer to paragraphs 5 and 6 of BCBS (2022) Principles for the effective management and supervision of climate-related financial risks. Available at: https://www.bis.org/bcbs/publ/d532.htm,
[9] See: BCBS (2021), Climate-related risk drivers and their transmission channels. Available at https://www.bis.org/bcbs/publ/d517.pdf

Macroeconomic transmission channels also capture the effects on macroeconomic market variables such as benchmark rates, inflation, commodities, and foreign exchange rates.

9. The BCBS in April 2021 published an analysis of transmission channels[10] which, while recognising considerable uncertainties, offers a framework for analysing how physical and transition risks might be translated into the traditional risk categories. It recognises that in any specific case the impact would depend on a number of factors including geographical location, the business model, and sectoral and geographical concentrations.

10. This GN draws attention to the specificities of IIFS which may lead to differences in the microeconomic transmission channels for such institutions. The Islamic finance specific risks that might be triggered by climate-related events are elaborated in Section 3.

3. SPECIFICITIES OF IIFS OPERATIONS IN RELATION TO CLIMATE-RELATED FINANCIAL RISKS

11. This section identifies the specificities of IIFS which might lead to differences in the way IIFS manage climate-related financial risks as compared to conventional banks. The implications of these specificities for the implementation of the BCBS Principles are dealt with in Section 3.

3.1. Financing Structures

12. If IIFS are exposed to risks similar to those considered in the BCBS Principles, such as credit, market, liquidity and operational risks, conventional metrics and models may be used for risk assessment purposes.[11] The following paragraphs focus on the specificities of IIFS that should be additionally considered in managing climate-related financial risks.

13. An IIFS can be exposed to market risk in the form of inventory risk[12] on assets held by the IIFS for sale under a *murābahah*[13] contract (in so far as the promise to purchase is non-binding or the asset has not yet been delivered) or for lease under an operating *ijārah*[14] contract. Climate-related financial risks, in this case, may arise from damage to the assets or from changes in their value.

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[10]See previous footnote.
[11] See IFSB 23 (Section 5)
[12] Inventory risk is discussed in IFSB-23: Section 4.2.5.4. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf
[13] *Murābahah* is discussed at length in IFSB-23: Section 5.1.2. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf
[14] Operating *Ijārah* is discussed at length in IFSB-23: Section 5.5.2. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf

14. IIFS can also have exposure to completion risk associated with *istiṣnā'*[15] used to finance the construction of an asset which the IIFS will supply to its client[16]. Where the asset under construction is exposed to physical risks, the IIFS's exposure to completion risk may increase. This may lead to higher exposure to market risk in *istisnā`* contracts. Some of that risk could be mitigated by parallel Istisna'.

15. When IIFS use *salam*[17] contracts for financing commodities, they are exposed to: (a) the credit risk of not receiving the purchased commodity after disbursing the purchase price to the seller; and (b) market risk incurred by the IIFS from the date of execution of the contract through the contract period and beyond maturity as long as the commodity remains in the ownership of the IIFS. Both risks may be impacted by acute climate risk drivers.

16. IIFS use investment contracts[18], such as *mushārakah* and *muḍārabah*, for venture purposes, and diminishing *mushārakah* for Islamic mortgages. These contracts create an equity right in the value of the assets. IIFS in this case are exposed to capital impairment risk[19], representing the risk of losing the amount invested in an enterprise or in the ownership of an asset. Depending on the structure of the transaction, this may be the risk of an entire business or of a specific element of it. Climate-related financial risks, both physical and transition, may be relevant to such an investment and will need to be analysed in the specific business context. The capital impairment risk will be different from the risks associated with any equity investments made by a conventional bank, since the latter are likely to be in traded securities that can in practice be sold and for which a market price is available.

17. Market risk arising from a change in the value of a commodity as a result of climate-related factors is limited for commodity *murābahah*[20] but cannot be ruled out. The impact of climate-related risk drivers on the supply or price of commodities could disrupt specific commodity markets to the extent that IIFS cannot rely on them for the transaction volumes they need. This would pose an operational risk to the IIFS, the extent of which would depend on the availability of alternative commodity markets on which the IIFS is able to transact.

3.2. Investment Assets

18. IIFS hold assets for investment purposes, often in the form of securities. They can be analysed using conventional financial methods and metrics as they share many financial characteristics with their conventional counterparts. This extends to some *ṣukūk* which have risk profiles primarily dependent on the creditworthiness of an ultimate obligor. However, should IIFS be invested in *ṣukūk* with a materially

[15] *Istisnā`* is discussed at length in IFSB-23: Section 5.4.3. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf

[16] In conventional project financing, the completion risk is normally borne by the project sponsor/contractor, and not by the bank.

[17] *Salam* is discussed at length in IFSB-23: Section 5.3.1. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf

[18] Investment contracts are discussed at length in IFSB-23: Sections 5.6 and 5.7. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf

[19] Capital impairment risk is discussed in IFSB-23: Section 4.1.3.9.1. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf

[20] Commodity *murābahah* is discussed at length in IFSB-23: Section 5.2. Available at https://www.ifsb.org/wp-content/uploads/2023/10/IFSB-23_En.pdf

different risk profile, for example, one where the returns are linked to the performance/residual value of the underlying asset, then a bespoke analysis may be necessary as to how that investment may be affected by climate-related financial risks.

3.3. Profit-Sharing Investment Accounts

19. Profit-sharing investment accounts (PSIA), especially unrestricted profit-sharing investment accounts (UPSIA), are one of the most distinctive products of Islamic banking. In principle, investment account holders (IAH) share in all or some of IIFS` financing and investment activities, and their returns reflect the outcome of those activities, in distinction to a conventional bank's account holders who are normally remunerated through interest. For an IIFS, where UPSIAs is a source of funding, the impacts are in principle transmitted directly to IAH returns (though this risk transmission may in some cases be reduced through the use of smoothing reserves). If an IIFS at its discretion, chooses to supplement IAH returns, it assumes exposure to Displaced Commercial Risk (DCR), where the risks originally borne by the IAH are, either wholly or partially, absorbed by the IIFS. The impact of climate-related financial risks on the capital adequacy of an IIFS may vary, depending on how PSIAs are treated for capital adequacy purposes in the jurisdiction.[21] Climate-related financial risks may also impact liquidity risk of the IIFS in the case of a sustained impact on returns to IAH, which may lead to higher run-off rates.[22]

3.4. Risk Mitigants

20. Climate-related financial risks may be harder to manage for IIFS due to more restricted risk mitigants (e.g. Sharī'ah-compliant hedging tools) compared to conventional banks.

4. SPECIFIC RECOMMENDATIONS FOR EFFECTIVE MANAGEMENT OF CLIMATE-RELATED FINANCIAL RISKS FOR IIFS

21. This section provides specific recommendations for IIFS and RSAs on the application of the BCBS Principles for IIFS, given the Islamic finance specificities discussed in Section 3. It references those Principles but does not repeat them and does not comment on those Principles where there is nothing material to add. The BCBS Principles that are not addressed in this document are equally applicable to conventional banks and IIFS. Where recommendations are addressed to IIFS, it will be for RSAs to decide how far to impose these by regulation.

4.1. Corporate Governance

[21] See IFSB-23 Revised Capital Adequacy Standard For Institutions Offering Islamic Financial Services.
[22] See GN-6 Guidance Note on Quantitative Measures for Liquidity Risk Management for Institutions Offering Islamic Financial Services

Recommendation 1 (BCBS Principle 2): The BOD and senior management should have a clear understanding of the distinctive nature of Islamic finance specificities and climate-related financial risks.

22. Responsibilities for managing climate-related financial risks, considering the distinctive nature of Islamic finance operations as well as the fiduciary responsibility towards IAH[23] , should be clearly assigned to the BOD and its committees[24]. This role should be documented within the IIFS's governance framework.

23. The IIFS`s BOD, senior management and relevant committees should have an appropriate understanding of climate-related financial risks and how they are transmitted to IIFS, considering the distinctive nature of Islamic contracts used, as discussed in Section 3. If necessary, IIFS should build capacity and train the Board and senior management on Islamic finance and climate-related issues.

4.2. Internal Control Framework

Recommendation 2 (BCBS Principle 4): IIFS should ensure that staff in internal control functions have an adequate understanding of how Islamic finance specificities affect the transmission of climate-related financial risks.

24. When incorporating climate-related financial risks into their internal control frameworks across the three lines of defence, IIFS should ensure that staff in these lines of defence have adequate understanding of the ways in which Islamic specificities may affect the transmission of these risks. This includes awareness and understanding of how climate-related financial risks can impact the IIFS and their IAH, considering the specific nature of contracts used, the available Sharīʻah-compliant investment assets, and the treatment of PSIAs, as discussed in Section 3.

4.3. Capital and Liquidity Adequacy

Recommendation 3 (BCBS Principle 5): When incorporating climate-related financial risks into ICAAPs and ILAAPs, IIFS should ensure that they reflect the specific risk profile of the IIFS's operations.

25. The incorporation of climate-related financial risks into IIFS` ICAAPs and ILAAPs should reflect the specificities of IIFS operations. As IIFS have different balance sheet structures, and use different contracts compared to their conventional counterparts, the ICAAP/ILAAP has to capture such

[23] For further elaboration on the BODs fiduciary responsibility towards IAH, refer to IFSB 30, Section 2.1.1. Available at https://www.ifsb.org/wp-content/uploads/2024/01/IFSB-30-Revised-Guiding-Principles-on-Corporate-Governance-for-IIFS.pdf

[24] As per BCBS Principle 2, climate-related responsibilities should be assigned to members and/or committees. For further explanation on the need for other specialised committees focusing on emerging risks such as climate-related financial risks and sustainability, refer to IFSB-30: Revised Guiding Principles on Corporate Governance for Institutions Offering Islamic Financial Services (Banking Segment) Section (2.3.3.5); Available at https://www.ifsb.org/wp-content/uploads/2024/01/IFSB-30-Revised-Guiding-Principles-on-Corporate-Governance-for-IIFS.pdf

differences when assessing how climate-related financial risks may impact the IIFS (see section 3). This includes a separate analysis of the climate-related financial risks attributable to IAH.

4.4. Risk Management Process

Recommendation 4 (BCBS Principle 6): IIFS' risk management framework should incorporate climate-related financial risks, considering the nature of contracts used, the treatment of PSIA, and the available Sharīʻah-compliant risk mitigation instruments.

26. When incorporating climate-related financial risks into their risk management framework as described in BCBS Principle 6, IIFS should take account of product structures, as discussed in Section 3.

27. IIFS should consider the ways in which the risks involved in Islamic finance transactions change over the lifetime of the transaction. Because of the role played by tangible assets in Islamic finance, and the relative complexity of some Islamic finance structures, the risk exposures may change in ways different from the nearest conventional counterpart.[25] Those engaged in risk management need to be clear on what exposures the IIFS has at any given time and how these may be affected by climate-related financial risks. This is particularly true where the IIFS is directly exposed to business activities or the value of physical assets. The principle of materiality should, however, be applied in some instances where the exposures are of short duration.

28. IIFS should determine that risks attributable to IAH are monitored and managed separately. This will involve separately evaluating the impact of climate-related financial risks on PSIAs, particularly UPSIAs, and ensuring that there is equitable treatment of IAH when there are choices to be made about how climate-sensitive investments are attributed between IAH and shareholders.[26] Where equalisation reserves are permitted and utilised, climate-related financial risks will need to be considered in any decisions about the appropriate levels of those reserves.

29. IIFS' risk management frameworks should consider exposures by contract and by sector to identify any specific risk management arrangements for particular contract types, as should IIFS investment portfolio strategies. This may also be applicable to full-fledged Islamic banks and Islamic windows of conventional banks. In the case of Islamic windows, however, risk aggregations between the windows and their conventional parents will also need to be considered.

30. As discussed in section 3.4 of this GN, IIFS should consider the limited availability of Sharīʻah-compliant mitigation tools and the Sharīʻah-compliant assets available for investment when incorporating material climate-related financial risks into their risk management framework.

[25] These changing risk exposures are discussed at length, and for a wide variety of contract forms, in Section 5 of IFSB-23

4.5. Management, Monitoring, and Reporting

Recommendation 5 (BCBS Principle 7): IIFS should ensure that climate-related financial risks are incorporated in their internal monitoring and reporting system considering the various types of contracts used.

31. Data availability is an important component to ensure effective management of climate-related financial risks. As set out in the BCBS Principles, IIFS may actively engage with clients and counterparties to gain a better understanding of transition strategies and risks. Priority should be given to counterparties in equity-based financing, as well as to those creating longer-term exposures. This covers counterparties financed from PSIA as well as those financed from other resources.

32. Where proxies are used, these may be similar to the ones used by conventional banks, but some care may be necessary in ensuring that the proxies used are appropriate to IIFS. As an obvious example, some high-level aggregate proxies may include sectors that IIFS could not finance for Sharīʻah reasons and that have different risk characteristics from sectors that are permissible.

4.6. Comprehensive Management of Credit Risk

Recommendation 6 (BCBS Principle 8): IIFS should ensure that their credit risk management systems and processes have adequately considered material climate-related credit risks arising from the specific contracts used.

33. IIFS should identify, evaluate and monitor credit risk arising at various stages, considering the specific Islamic finance contracts used. IIFS should have in place adequate mitigation measures against any material climate-related credit risk arising from the specificities discussed in section 3, such as capital impairment risk from profit-sharing financing contracts, treated as credit risk in IFSB-23.

34. For *sukuk* exposures in the banking book, it may be necessary to consider the impact of climate-related risks on the specific assets underlying the *sukuk*, and/or on parties other than the originator. Identifying the relevant impacts needs to be based on a proper understanding of the IIFS's exposures, following an analysis of the kind set out in Section 6 of IFSB-23.

4.7. Comprehensive Management of Market, Liquidity, Operational and Other Risks

Recommendation 7 (BCBS Principle 9): IIFS should understand the impact of climate-risk drivers on their market risk position considering Islamic finance specificities and consider any material climate-related financial risks in their market risk management systems and processes.

35. IIFS should understand how climate-related risk drivers can affect market risk for IIFS, depending on the type of contracts used as discussed in section 3. Adequate policies and measures should be in place for effective assessment of the impact of climate-related financial risks on the IIFS exposures to market risk based on the nature of contracts.

36. For sukuk held in the trading book, BCBS Principle 9 is equally applicable. In addition to the impact of climate risks on the originator, the IIFS may, in some circumstances, need to consider the impact of those risks on the specific assets underlying the sukuk and on the ultimate obligor, where this is different from the originator.

Recommendation 8 (BCBS Principle 10): In evaluating and managing the impact of climate-related risk drivers on their liquidity risk profiles, IIFS should take account of risks related to IAH and any limitations in the Sharīʿah-compliant liquidity risk management tools available.

37. IIFS should assess the possible impact of climate-related financial risks on IAH[27] run-off rates which may lead to a deterioration of the IIFS's liquidity position and incorporate these impacts into the calibration of their liquidity buffers and liquidity risk management frameworks.

38. IIFS should consider the availability of Sharīʿah compliant liquidity risk management tools to manage liquidity risks arising from climate-related financial risks and address any potential limitations within their liquidity risk management framework[28].

Recommendation 9 (BCBS Principle 11): IIFS should consider in their operational risk management systems and processes, possible disruptions to commodity markets as a result of climate risks that may affect their ability to conduct certain Islamic finance transactions.

39. IIFS should understand the impact of physical and transition risks on the commodities underpinning commodity *murābahah* transactions. As noted in Section 3.1, these risks may, in extreme cases, disrupt the market for one or more commodities that could impact its use for commodity *murābahah* transactions. IIFS should have adequate processes to identify potential vulnerabilities that may disrupt the commodity markets and prepare risk mitigation strategies which may, for example, include having arrangements in place to transact in alternative commodities.

4.8. Scenario Analysis

Recommendation 10 (BCBS Principle 12): Where appropriate, IIFS may make use of scenario analysis that appropriately reflects Islamic finance specificities[29].

40. When conducting climate scenario analysis. IIFS should consider the risks related to the various types of Islamic contracts used[30], as well as the available Sharīʿah compliant risk mitigation tools. The

[27] See Section 3.3.
[28]For example, the absence of lender of last resort facilities for IIFS or a limited supply of High Quality Liquid Assets denominated in the domestic currency.
[29] As stated in the BCBS report Climate-related financial risks - measurement methodologies, scenario analysis is a tool that challenges assumptions made for the purposes of risk analysis. A key feature of the scenarios analysed is to explore alternatives that may significantly alter the basis for "business-as-usual" assumptions. Accordingly, they need to consider extreme but plausible scenarios.
[30] Although it does not cover climate-related financial risks specifically IFSB Technical Note 2, available at TN-2-December-2016_En.pdf, provides guidance on the incorporation of Islamic specificities in stress testing and scenario analysis, including the treatment of PSIA.

assessment should also include a separate analysis of the position of IAH.[31] Subject to materiality, the scenarios should cover all the sectors they are exposed to, either via financing or investment. Where the scenario analysis requires the use of proxy data, this should, as far as possible, exclude economic sectors/businesses that are non-Sharīʻah compliant[32].

41. Climate scenario analysis is an evolving area and practices of IIFS may evolve as it develops. Given the relatively small size of most IIFS, they, like many conventional banks, are likely to require some support from their respective RSAs to conduct such analysis.

4.9. Prudential Regulatory and Supervisory Requirements for IIFS

Recommendation 11 (BCBS Principle 14): Supervisors should determine that IIFS can adequately identify, monitor and manage material climate-related financial risks, taking proper account of the specific risk profile of the IIFS.

42. Supervisors should review the extent to which IIFS consider Islamic finance specificities in their assessment, monitoring and management of climate-related financial risks. This may include ensuring that the IIFS's risk management framework takes into account all material climate-related financial risks to which they are exposed, considering the specific nature of contracts used, the available Shariah-compliant investment assets and treatment of PSIAs as discussed in Section 3.

43. Regulatory practices for Islamic windows vary from jurisdiction to jurisdiction. In principle, these practices should be informed by the manner in which capital and liquidity are made available to the window. This includes, for example, whether the window has the ability to raise capital or liquidity independently from the conventional bank. Some supervisory authorities require Islamic windows to maintain a separate amount of capital and to follow the applicable minimum capital adequacy ratio requirements, while also requiring regulatory capital requirements to be met at the parent level. In other jurisdictions, there is no specific requirement for Islamic windows to maintain a separate amount of capital or to meet separate regulatory capital requirements. Treatment may also depend on whether the parent is based in the same or a different jurisdiction.[33] Broadly similar differences exist in relation to liquidity, and GN-6 para 33(d) discusses briefly liquidity provision from a parent to an Islamic window. Whether or not separate capital and/or liquidity requirements are applied to the window, consolidation should take place at the level of the conventional parent[34] and at higher levels within a group where appropriate. The approach to climate-related financial risks, like other financial risks, should be aligned with the regulatory treatment of the window. Potential effects on Islamic windows due to the impact of climate-related financial risks on the conventional parent's operations, or vice versa,

[31] The position of IAH depends on how the PSIA are treated. For further elaboration on PSIA treatments, refer to GN 6, Section 2.3.1.1.Available at, https://www.ifsb.org/wp-content/uploads/2023/10/GN-6-GN-on-LRM-April-2015-final.pdf

[32] Excluding Shariah non-compliant sectors may be needed to ensure accuracy when assessing climate-risk scenarios, as IIFS are not involved in such activities.

[33] See IFSB-23 Section 2.7 for a fuller discussion.

[34] IFSB-17, CPIFR 32, Essential Criterion 6.

depend on those issues discussed earlier as well as how windows are treated in insolvency.[35] At a minimum, the supervisor should ensure that climate-related financial risks, like other risks, are managed at the level of the parent as well as that of the window.

Recommendation 12 (BCBS Principle 15): Supervisors should determine the extent to which IIFS considers any limitations in available risk mitigation tools and whether these are adequately addressed in managing climate-related financial risks. Supervisors should determine that, where appropriate, IIFS apply climate scenario analysis that considers specific types of contracts and the position of IAH.

44. Supervisors should determine that IIFS has considered the availability of appropriate Sharī'ah compliant mitigation tools to manage and control climate-related risks. This may include assessing the adequacy of the available Sharī'ah compliant mitigation techniques and the possible need to amend IIFS's strategies, for example through diversification, where climate-related financial risks cannot otherwise be adequately mitigated.

45. Supervisors should determine that IIFS' scenario analyses consider Islamic finance specificities, including the types of contracts used and the position of IAH. This should be done on a proportionate basis, depending on the size and complexity of their business model.

4.10. Responsibilities, Powers and Functions of Supervisors

Recommendation 13 (BCBS Principle 18): Where supervisors use climate-related scenario analysis, the requirements placed on individual IIFS should take proper account of the Islamic finance specificities, including the position of IAH. Where system-wide exercises are undertaken, they should consider carefully the interactions between the Islamic and conventional financial sectors.

46. When supervisors require IIFS to undertake climate scenario analyses and stress tests, IIFS should be required to consider the effects on the Islamic contracts used, their balance sheet structures, in particular the use of PSIA and the structure of assets available for investment, and the risk mitigants available[36].

47. Where such tests are undertaken to assess impacts on the banking system as a whole, it may, in some circumstances, be appropriate to consider how far IIFS transact with conventional banks in order to assess how shocks may be transmitted. Supervisors should also consider whether any

[35] For example, whether a court or other relevant body would determine that the assets of the window are available to pay debts of the conventional parent, or vice versa, See IFSB-17, CPIFR 32, in particular Essential Criteria 7 and 10.
[36] Although it does not cover climate-related financial risks specifically, IFSB Technical Note 2 - TN-2-December-2016_En.pdf, provides guidance on the incorporation of Islamic specificities in stress testing, including the treatment of PSIAs.

limitations in the supply of Sharīʻah-compliant risk mitigation tools may be exacerbated in the circumstances of a system-wide shock.

APPENDIX

Mapping between BCBS Principles and ED-GN-11

BCBS Principles	IFSB Recommendations
Principle 1	-
Principle 2	Recommendation 1
Principle 3	-
Principle 4	Recommendation 2
Principle 5	Recommendation 3
Principle 6	Recommendation 4
Principle 7	Recommendation 5
Principle 8	Recommendation 6
Principle 9	Recommendation 7
Principle 10	Recommendation 8
Principle 11	Recommendation 9
Principle 12	Recommendation 10
Principle 13	-
Principle 14	Recommendation 11
Principle 15	Recommendation 12
Principle 16	-
Principle 17	-
Principle 18	Recommendation 13

DEFINITIONS

The following definitions provide a general understanding of the terms used in this document. The glossary is by no means exhaustive.

Climate-related financial risks	The set of potential risks that may result from climate change and that could potentially impact the safety and soundness of individual financial institutions and the financial stability of the banking system. These risks are typically classified as physical and transition risks. Physical impacts include the potential economic costs and financial losses resulting from the increasing severity and frequency of extreme climate-change related events, and longer-term progressive shifts in the climate. Transition impacts relate to the process of adjusting to a low-carbon economy.
Commodity murābahah	A murābaḥah transaction based on the purchase of a commodity from a seller or a broker and its resale to the customer on the basis of deferred murābaḥah, followed by the sale of the commodity by the customer for a spot price to a third party for the purpose of obtaining liquidity, provided that there are no links between the two contracts
Fiduciary risk	The risk that arises from an institution's failure to perform in accordance with explicit and implicit standards applicable to its fiduciary responsibilities.
Ijārah	A contract made to lease the usufruct of a specified asset for an agreed period against a specified rental. It could be preceded by a unilateral binding promise from one of the contracting parties. An ijārah contract is binding on both contracting parties.
Ijārah Muntahiyah bi al-Tamlīk	A lease contract combined with a separate promise from the lessor giving the lessee a binding promise to own the asset at the end of the lease period either by purchase of the asset through a token consideration, or by the payment of an agreed-upon price or the payment of its market value. This can be done through a promise to sell or to donate, or through a contract of conditional donation.
Istisnā`	The sale of a specified asset, with an obligation on the part of the seller to manufacture/construct it using his/her own materials and to deliver it on a specific date in return for a specific price to be paid in one lump sum or instalments.
Sharī`ah supervisory board	Specific body set up or engaged by the IIFS to carry out and implement its Sharī`ah Governance System.
Sharī`ah	Divine Islamic law as revealed in the Qur'an and the Sunnah.

Maqāṣid al-Sharīʿah	The fundamental objective of Sharīʿah, which is to promote and protect the interests of all human beings and to avert any harm that may affect their wellbeing.
Muḍārabah	A partnership contract between the capital provider (rabb al-māl) and an entrepreneur (muḍārib) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence, or breach of contracted terms.
Murābahah	A sales contract whereby the institution sells a specified asset to a customer, and the selling price is the sum of the cost price and an agreed profit margin. The murābaḥah contract can be preceded by a promise to purchase from the customer.
Mushārakah	The participation of two or more partners in owning an asset either voluntarily or obligatorily. The profit/loss-sharing ratio will be based on the equity of each partner.
Parallel Salam	A second salam contract with a third party to acquire for a specified price a due and described commodity of known type, quantity and attributes, which corresponds to the specifications of the commodity in the first salam contract without the presence of any links between the two contracts.
Restricted investment accounts	The account holders authorise the institution offering Islamic financial services to invest their funds based on muḍārabah or agency contracts with certain restrictions as to where, how, and for what purpose these funds are to be invested.
Salam	The sale of a specified commodity that is of a known type, quantity and attributes for a known price paid at the time of signing the contract for its delivery in the future in one or several batches
Transmission Channels	The causal chains that explain how climate risk drivers give rise to financial risks that impact banks directly or indirectly through their counterparties, the assets they hold, and the economy where they operate.
Unrestricted investment accounts	The account holders authorise the IIFS to invest their funds based on muḍārabah or wakālah (agency) contracts without imposing any restrictions. The IIFS can commingle these funds with their own funds and invest them in a pooled portfolio.

TECHNICAL COMMITTEE

Chairman

H.E. Dr. Fahad Ibrahim AlShathri – Saudi Central Bank (until April 2024)

Mr. Saud Al Busaidi – Central Bank of Oman (since August 2024)

Deputy Chairman

Mr. Saud Al Busaidi – Central Bank of Oman (until April 2024)

Mr. Mohamed Abou Moussa, Central Bank of Egypt (since August 2024)

Members*

Mr. Syed Faiq Najeeb	Islamic Development Bank
Mr. Shahriar Siddiqui	Bangladesh Bank
Mrs. Shireen Abdulkarim Al Sayed	Central Bank of Bahrain
Mr. Haji Muhammad Shukri bin Haji Ahmad (until April 2024)	Brunei Darussalam Central Bank
Dr. Mariawati Omar (since July 2024)	Brunei Darussalam Central Bank
Dr. Jardine Husman (until April 2024)	Bank Indonesia
Dr. Rifki Ismal (since July 2024)	Bank Indonesia
Mrs. Nyimas Rohmah	Otoritas Jasa Keuangan, Indonesia
Dr. Alireza Naserpour (until April 2024)	Securities and Exchange Organization of Iran
Mr. Ahmed Yousif Kadhim Al-Helli (until April 2024)	Central Bank of Iraq
Mr. Mustafa Abd Nazzal (since July 2024)	Central Bank of Iraq
Mr. Mahmoud Ibrahim Moh'd Alsbeihat (until April 2024)	Central Bank of Jordan
Mr. Anuar Kaliyev (until April 2024)	Astana Financial Services Authority
Dr. Mohammad Bader Al Khamees	Central Bank of Kuwait
Dr. Ali Abusalah Elmabrok Amreeghah	Central Bank of Libya
Mr. Nik Faris Nik Sallahuddin	Bank Negara Malaysia

Mrs. Sharifatul Hanizah Bin Said Ali	Securities Commission Malaysia
Dr. Mohammed Zougari Laghrari (since July 2024)	Bank Al-Maghrib
Mr. Muhammad Hamisu Musa (until April 2024)	Central Bank of Nigeria
Dr. Abdurrahman Abdullahi (since July 2024)	Central Bank of Nigeria
Mr. Ahmad Usman Kollere (since July 2024)	National Insurance Commission (NAICOM), Nigeria
Mr. Ghulam Muhammad Abbasi (until April 2024)	State Bank of Pakistan
Ms. Nighat Tanveer (since July 2024)	State Bank of Pakistan
Mr. Hisham Saleh Al-Mannai	Qatar Central Bank
Mr. Bader Abdulmohsen Alissa (until April 2024)	Capital Market Authority, Saudi Arabia
Mr. Walid Alzahrani (since July 2024)	Saudi Central Bank
Dr. Muhammed Habib DOLGUN (since July 2024)	Central Bank of the Republic of Türkiye
Dr. İlker KOÇ's	Banking Regulation and Supervision Agency, Türkiye
Mrs. Emine Nur Ozturk Alkan (until April 2024)	Insurance and Private Pension Regulation and Supervision Agency of Türkiye
Mr. Abdulaziz Saoud Al Mualla	Central Bank of United Arab Emirates

*** In alphabetical order of the country the member's organisation represents, except international organisations, which are listed first.**

WORKING GROUP FOR THE GUIDANCE NOTE ON CLIMATE-RELATED FINANCIAL RISKS FOR INSTITUTIONS OFFERING ISLAMIC FINANCIAL SERVICES (BANKING SEGMENT)

Chairman

Mr. Muhammad Hamisu Musa – Nigeria Deposit Insurance Corporation (Until February 2024)

Deputy Chairman

Mrs. Nyimas Rohmah - Otoritas Jasa Keuangan

Members*

Mr. Yahya Aleem-ur-Rehman	Islamic Development Bank
Ms. Noof Adel AlBalooshi	Central Bank of Bahrain
Mr. Izhar Ul Haq Tahiri	Da Afghanistan Bank
Mr. Mohammad Delowar Hossain	Bangladesh Bank
Mr. Tarik Tunckol	Central Bank of Turkish Republic of Northern Cyprus
Ms. Intan Natasha Putri	Otoritas Jasa Keuangan
Ms. Risa Fadila	Bank Indonesia
Mr. Vidi Adyatma Nugraha	Bank Indonesia
Mr. Ali abdulazeez Abbas	Central Bank of Iraq
Mrs. Nesreen Khalid Qashou	Central Bank of Jordan
Ms Noura Waleed AL-Bader	Central Bank of Kuwait
Ms. Loong Sok Sim	Bank Negara Malaysia
Mr. Abdul Basir Khan	State Bank of Pakistan
Ms. Bushra Shafiq	State Bank of Pakistan
Ms. Joanne Cortez	Bangko Sentral ng Pilipinas
Ms. Sundos H. Al-Twaijri (until March 2024)	Saudi Central Bank
Ms. Raghad Ababtain (since March 2024)	Saudi Central Bank

Mr. Meshal Alyahya (since March 2024)	Saudi Central Bank
Ms. Nagwa Sheikh Eldin Mohamed Hussien	Central Bank of Sudan
Ms. Canan Ozkan	Central Bank of the Republic of Turkey
Dr. İlker Koç	Banking Regulation and Supervision Agency, Turkey
Ms. Salama Obaid Altamimi	Central Bank of the United Arab Emirates
Mr. Abdulla Saud Al-Thani	Qatar Central Bank
Ms. Marie Medgee Lauricourt (Until June 2024)	Bank of Mauritius
Ms. Urvashi Chuttarsing-Soobarah	Bank of Mauritius
Dr. Ndeye Djiba Ndiaye	Banque Centrale Des Etats de L'afrique de L'ouest (BCEAO)
Mr. Sadiq Yau Kanya	Central Bank of Nigeria

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THE SHARĪ‘AH BOARD

Chairman

Dr. Mohamed Ali Ibrahim Elgari

Deputy Chairman

Dr. Nizam Muhammad Saleh Yaquby

Members

Dr. Aznan Hasan	Member
Mufti Muhammad Hassan Kalim	Member
Dr. Sa’id Adekunle Mikail	Member

SECRETARIAT, ISLAMIC FINANCIAL SERVICES BOARD

Dr. Ghiath Shabsigh	Secretary-General
Dr. Bello Lawal Danbatta (until January 2024)	Secretary-General
Mrs. Aminath Amany Ahmed	Acting Assistant Secretary-General, Research and Standard Development
Dr. Hechem Ajmi	Member of the Secretariat, Research and Standard Development
Mr. Peter Casey	Consultant