



## **ISLAMIC FINANCIAL SERVICES BOARD**

### **CORE PRINCIPLES FOR ISLAMIC FINANCE REGULATION (ISLAMIC CAPITAL MARKET SEGMENT) [CPIFR-ICM] [IFSB-21]**

#### **SUMMARY OF COMMENTS RECEIVED DURING PUBLIC CONSULTATION AND THE IFSB SECRETARIAT RESPONSES**

<b>Release Date of Comments</b>	<b>: December 2018</b>
<b>Public Consultation Period</b>	<b>: 28 March 2018 to 28 May 2018</b>
<b>Release Date of IFSB-21</b>	<b>: December 2018</b>
<b>Web URL of IFSB-21</b>	<b>: <a href="https://www.ifsb.org/download.php?id=4969&amp;lang=English&amp;pg=/index.php">https://www.ifsb.org/download.php?id=4969&amp;lang=English&amp;pg=/index.php</a></b>

## **BACKGROUND**

1. On 6 December 2018, the Council of the IFSB, in its 33rd Meeting, resolved to approve the issuance of the Core Principles for Islamic Finance Regulation (Islamic Capital Markets segment) (IFSB-21).

2. IFSB-21 sets out 38 high-level core principles and their associated assessment methodology which sets out a broad general framework for the regulation of Islamic capital markets (ICM). The core principles in the new standard take into consideration the specificities of Islamic finance, while complementing the existing international standards, principally 'Objectives and Principles of Securities Regulation' and its 'Methodology' (May 2017) issued by the International Organization of Securities Commissions (IOSCO).

3. Prior to the issuance of IFSB-21, the IFSB issued the corresponding Exposure Draft (ED-21) for public consultation from 28 March to 28 May 2019. The IFSB is now publishing the summary of the feedback received during the public consultation period, along with responses by the Secretariat. The feedback received comprised not only written feedback but also verbal comments shared during a Public Hearing and a Webinar on ED-21 held on 10 April and 7 May 2018, respectively.

4. The IFSB received a total of 48 comments on ED-21 during the Public Consultation. This document is released as a summary of the main feedback on ED-21 received during the Public Consultation process, along with the key actions undertaken by the Working Group that prepared the Standard.

**COMMENTS ON ED-21\***

<b>S. No.</b>	<b>Name of Institution/Body/Individual**</b>	<b>Membership Type</b>
1	Central Bank of Djibouti	Full Member
2	Central Bank of Kuwait	Full Member
3	Central Bank of Nigeria	Full Member
4	Central Bank of the Republic of Turkey	Full Member
5	Capital Market Authority, Saudi Arabia	Full Member
6	International Monetary Fund (IMF)	Associate Member
7	Bank of Korea	Associate Member
8	Kuwait Capital Markets Authority	Associate Member
9	Labuan Financial Services Authority (Labuan FSA)	Associate Member
10	Bangko Sentral ng Pilipinas	Associate Member
11	Qatar Financial Centre Regulatory Authority	Associate Member
12	Securities and Commodities Authority, UAE	Associate Member
13	Da Afghanistan Bank	Observer Member
14	Bahrain Islamic Bank	Observer Member
15	CIMB Islamic Bank Berhad	Observer Member
16	International Centre for Education in Islamic Finance INCEIF	Observer Member
17	Kuwait Turkish Participation Bank Inc	Observer Member
18	Masraf Al Rayan, Qatar	Observer Member
19	Maybank Islamic Berhad	Observer Member

20	RHB Islamic Bank Berhad	Observer Member
21	Securities and Exchange Commission of Pakistan (SECP)	Observer Member
22	Securities and Futures Commission, Hong Kong	Observer Member
23	The Hong Kong Association of Banks	Observer Member
24	Global Banking Corporation, Bahrain	Non-Member
25	Investment Dar Bank, Bahrain	Non-Member
26	International Investment Bank, Bahrain	Non-Member
27	Venture Capital Bank, Bahrain	Non-Member
28	Financial Services Commission, Mauritius	Non-Member

*\* The IFSB conducted public hearings for ED-21 on 10th April 2018 in Jakarta, Indonesia and then on 7th May 2018. The latter was broadcasted globally via Webinar from the IFSB HQ in Kuala Lumpur, Malaysia. The feedback from these events is included in this report.*

*\*\* Arranged in alphabetical order as per Membership Type*

## Summary of Main Comments and the IFSB's Responses

No	Theme	Issues / Comments	IFSB's Responses
1.	<b>Hedge Funds</b>	Given the presence of a small number of hedge funds that have claimed Sharī'ah-compliance, subject to an examination of whether or not the funds are indeed Sharī'ah-compliant, the principle on hedge funds should be retained and amended to consider specificities of Sharī'ah principles.	<p>The approach to hedge funds in ED-21 was based on Sharī'ah restrictions on hedge funds as they are generally understood, and the conclusion of the Sharī'ah board to this effect.</p> <p>However, noting that there is no widely agreed definition of a Sharī'ah-compliant hedge fund, the following footnote addition was made to the below statement in paragraph 12:</p> <p>“Principle 28 on hedge funds. This reflects the fact that Sharī'ah restrictions on, for example, short-selling and the use of derivatives make it generally impossible within the ICM to structure a hedge fund as commonly understood (Footnote).</p> <p>Footnote: “<i>There is no internationally agreed definition of a hedge fund, though the term usually implies the use of leverage, derivatives and/or short selling. The IOSCO Methodology discusses this at greater length. Currently, there are a small number of funds that self-identify as Sharī'ah-compliant hedge funds, but it has not been possible to confirm how far they follow such strategies.</i>”</p>
2.	<b>Supplementary versus Comprehensive</b>	The CPICM should deal with issues that are only specific for ICM. This would help ensure that the IFSB would not be required to make revisions in the future whenever the IOSCO revises its Principles, which are applicable to both conventional and Islamic capital markets.	The issue of whether CPICM should deal with issues that are only specific for ICM was discussed extensively by the Working Group and the consensus of the Working Group was to cover all the IOSCO Principles, thus creating a comprehensive set of Principles for the ICM. This is also consistent with the approach taken for the banking sector in the Core Principles for Islamic Finance Regulation (CPIFR) for the banking segment (IFSB-17)

3.	<b>Sharī'ah Governance</b>	Given the recent case of Dana gas, there should be appropriate guidance on addressing such issues. In our opinion, regulators should not allow the firms to declare their own issuance to be Sharī'ah non-compliant without the approval of the Sharī'ah board that has approved it earlier. In countries with central Sharī'ah advisory, the matter should be approved by the central Sharī'ah board. In any other dispute except for non-compliance, firms can approach the court directly. This would save the Islamic financial industry from reputational risk and also force the Sharī'ah board to be more accountable.	<p>CPICM 10 on Sharī'ah Governance looks to address such issues implicitly – particularly KQs 1, 2, 3 and 5(a) as, in the case of ṣukūk, does CPICM 20, particularly KQs 2(f), 2(g) and 2(i).</p> <p>Post-issuance questions of compliance are dealt with in more detail in <i>IFSB-19: Guiding Principles On Disclosure Requirements for Islamic Capital Market Products (Ṣukūk and Islamic Collective Investment Schemes)</i> particularly paragraphs 76 and 77, which the CPICM seek to reflect at high level.</p>
4.	<b>Rating Agencies</b>	Rating agencies should be made more responsible and accountable. For instance, if a rating agency gives an issuance an 'AAA' or 'BBB', rating agency should be held partially accountable in case of early default. Regulators may penalize the rating agency in case of insufficient explanation of good rating to a bad issuer.	<p>This is a general capital market issue which is not specific to the ICM. The IFSB's position for CPIFR-ICM has been to complement IOSCO in matters which do not require Sharī'ah or ICM-specific revisions.</p> <p>Issue of rating agencies is discussed in CPICM 24 KQ 3 which deals with enforcement/sanctions.</p>
5.	<b>Principles Relating to the Regulator</b>	Islamic finance is known for its salient features on an enhanced transparency requirement for every transaction and service. However, the proposed CPICM 5 has required provision relating to confidentiality without providing adequate standards and guidelines on confidentiality	CPICM 5 / IOSCO 5 are only about the staff (including senior management) of the regulator. So far as the project team is aware, there are no Sharī'ah issues around the observance of confidentiality by RSAs and their staff, nor were any raised when the corresponding principles for banking were discussed. Islamic finance products and instruments and their related transparency and

		<p>which should not be contradictory to the inherent transparency requirement of Islamic finance. It must be noted that paragraph 145 supporting CPICM 5 is referring only to the integrity of the regulator and its staff which is not fully ancillary to the confidentiality proposed by CPICM 5.</p>	<p>confidentiality rules are discussed appropriately in different relevant CPICM, as are transparency and confidentiality in respect of Shari’ah governance.</p>
6.	<b>Principle Relating to Self-Regulation</b>	<p>Suggest to clarify if Self-Regulatory Organisations (SRO) can have responsibility of issuing its own criteria and framework for Shari’ah screening of products. The design of an SRO framework can be coordinated with the relevant regulator in the financial system to ensure consistency and harmonious criteria for Shari’ah screening of products. Additional guidelines may also be provided for jurisdictions which is just starting to introduce or develop Islamic capital markets.</p>	<p>The IOSCO Principles do not attempt to dictate what powers may be delegated to SROs – and currently KQ 3(d) recognises the possibility that SROs may have responsibility for issuing their own criteria and framework for the Shari’ah screening of products, provided the regulator has oversight of this.</p>
7.	<b>Principles relating to Shari’ah Governance</b>	<p>Please elaborate if the approval process would and could be streamlined as per the existing process for non-capital market space such as in banking</p>	<p>It would be much more difficult to streamline the approval process for the ICM compared to the banking sector, given that the entities involved are more diverse and some, for example issuers of securities, are not always required to have in-built Shari’ah governance systems. In this respect the ICM differs materially from the banking and takaful sectors.</p> <p>CPICM 10 provides high level principles that aim to support standardised intra-jurisdictional approval processes/requirements or as a minimum, disclosures to the stakeholder regarding these processes.</p>

8.	<b>Conflicts of interest</b>	<p>CPICM 10 identified the conflict of interest situation where Sharī'ah scholars may sit in both the central Sharī'ah board and those in the market place. We suggest to provide any relevant safeguards or clarifications on what can be an acceptable approach of handling such situations or the recommended best practices on allowing concurrent positions in the Sharī'ah boards.</p> <p>It is proposed that the Core Principles address issues related to potential or perceived conflicts in the context of Sharī'ah scholars being paid by institutions that arrange Şukūk transactions. The potential or perceived conflicts are exacerbated in situations where the Sharī'ah scholars are appointed on an ad-hoc basis for specific transactions.</p>	<p>The necessary discussions on these aspects are in IFSB-10 which is IFSB's Standard dedicated to Sharī'ah Governance Systems.</p> <p>The following footnote was added to paragraph 241 to address this comment:</p> <p><i>"The IFSB's Standard no. 10 on Sharī'ah Governance discusses this specific issue in detail in paragraphs 13, 19, 25 and 44. Appendix 3 of IFSB-10 also provides the 'Basic Professional Ethics and Conduct for Members of the Sharī'ah Board'."</i></p>
9.	<b>Role of Sharī'ah in interpretation of Şukūk</b>	<p>In CPICM 20, Key Issue 2 refers to: "the role of Sharī'ah in interpretation of the Şukūk contract, particularly in default, enforcement, amendment or restructuring. In jurisdictions where courts are not bound to apply Sharī'ah in interpreting contracts, disclosure should state that courts would be expected to apply the relevant national law rather than Sharī'ah principles in interpreting the Şukūk contracts. Where this is the case, disclosures should also</p>	<p>The approach to the application of Sharī'ah in contractual interpretation is dependent upon the prevailing judicial system in different jurisdictions and is normally outside the responsibility of financial services regulators.</p> <p>The regulatory function can, however, require adequate disclosures in this respect, and hence it is disclosure requirements that are stipulated in this CPICM.</p>



		<p>clarify that the resulting interpretation may not be consistent with Sharī'ah principles "</p> <p>For certainty, there should be a common, agreed upon position in a particular jurisdiction on this point, to avoid confusion if different positions are taken</p> <p>Please elaborate further on the extent of interpretation and the impact on any national law ruling to the ones issued by Sharī' ah.</p> <p>It is submitted that such an approach to disclosure on this very important point would lead to significant uncertainty with regard to the legal status of Şukūk in the relevant jurisdictions. IFSB should consider an approach that provides more certainty in such circumstances.</p>	<p>It is not possible to provide certainty about legal interpretation where none exists, but reasonable that investors should be aware of the lack of certainty.</p>
10.	<b>Disclosures for Şukūk</b>	<p>"The ultimate source(s) of funds used to make distributions on a Şukūk..."</p> <p>Would suggest that this requirement be consistent with the relevant IOSCO principle, if any.</p> <p>Unless there is strong Sharī' ah justification for prescribing this disclosure, it is submitted that paragraph 3(f) should be deleted or amended.</p>	<p>The Key Issue and corresponding Key Question is based on Disclosure requirements for Şukūk set out in IFSB-19, specifically, para 108, and the underlying point is about how far these funds derive from the underlying assets or from another source (the more general business of the obligor).</p> <p>This CPICM is an addition to the IOSCO Core Principles to address the specificities of Şukūk and there is no equivalent IOSCO principle. A cross reference has been included in the text to clarify.</p>

11.	<b>Principles relating to Islamic Collective Investment Schemes</b>	Regulators should require the Sharī'ah boards to have a proper procedure to guide the ICIS firms in cases where any of the Islamic Collective Investment Schemes (ICIS) stocks become non-compliant. It should include liquidation procedure: handling of gains from the non-compliant stock/stocks and cases of loss (situation where a stock is trading below the price at which the ICIS managers bought it). The procedure should be transparent and made available to the public through website, prospectus etc.	<p>The combination of requirements from CPICM 10, KQ 4 and CPICM 28 KQ 13 and KQ 14 are related to this aspect.</p> <p>The issues mentioned in relation to non-compliance of ICIS are covered in IFSB-19, paragraphs 146 and 147. In CPICM 28, Key Issue 7 and Key Questions 13 and 14 as mentioned above are intended to cover the disclosure requirements that are set out in IFSB-19 including processes to deal with non-compliance and issues related to purification of tainted income.</p> <p>However, for greater clarity, the relevant paragraphs from IFSB-19 has been cross-referenced against KQs 13 and 14 in the explanatory notes.</p>
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