



ISLAMIC FINANCIAL SERVICES BOARD

IFSB- 24

GUIDING PRINCIPLES FOR INVESTOR PROTECTION IN ISLAMIC CAPITAL MARKETS

December 2020

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 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 research and 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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ABBREVIATIONS

ADR	Alternative Dispute Resolution
BOD	Board of Directors
CPICM	Core Principles for the Islamic Capital Market
CPIFR	Core Principles for Islamic Finance Regulation
DLT	Distributed Ledger Technology
ICIS	Islamic Collective Investment Scheme
ICM	Islamic Capital Market
IFSB	Islamic Financial Services Board
IOSCO	International Organization of Securities Commissions
MiFID	Markets in Financial Instruments Directive
MOU	Memorandum of Understanding
P2P	Peer-to-Peer
RSA	Regulatory and Supervisory Authority

SECTION 1: INTRODUCTION

1.1 Background

1. Investor protection plays a crucial role in the development and integrity of capital markets. In the context of this standard, it deals with the protection of investors against misconduct by financial intermediaries, misleading claims of Sharī'ah compliance, and the misuse of clients' assets; enhancing transparency and information provided to investors; the protection of minority shareholders; and providing effective means of redress or resolution of disputes in the case of misconduct. Investor confidence and trust in a well-functioning market for financial services is crucial in promoting financial stability, growth, efficiency and innovation over the long term. The regulatory and supervisory frameworks adopted by oversight bodies contribute to the protection of investors, which has been often and increasingly recognised as a major objective of these bodies, together with financial stability.

2. The regulation of selling practices and investor information is aimed at reducing the potential information asymmetry and market power imbalances between the industry and investors on the one hand, and between product providers and distributors on the other hand, that are encountered particularly with fairly complex or innovative investment products. Regulation also reduces potential incentives for misselling by helping to clarify conflicts of interest and the costs borne by investors. Such regulation plays a major role in developing investor confidence and facilitating investment strategies adapted to the needs of customers and should lead to the establishment of more efficient Islamic capital markets and increased confidence of investors in the Islamic capital markets (ICM).

3. In the context of Islamic finance, several elements pertaining to protection of investors underlie its foundational values, including ensuring fairness and certainty in transactions and avoiding exploitation between transacting parties. These values serve, among others, to ensure that investors are not disadvantaged, misled or defrauded by a product issuer/distributor or by service providers, as well as emphasising the need for meaningful and timely disclosure of information. Other inherent features of Sharī'ah-compliant financing relevant to investor protection include the promotion of ethical conduct in business, such as ensuring justice and fair dealing.

4. Conversely, there are issues specific to Islamic finance. Some of these derive from products, particularly *shukūk*, that are not identical to their nearest conventional counterparts, and which may not be well understood by all investors (particularly retail investors). Other issues derive from the fact that many investors can be assumed to be concerned about Sharī'ah compliance, but may not be able to

evaluate the product for themselves or even to evaluate the statements made about it. Still others derive from operational issues in what is often an intermediated market.

5. Broadly, the ICM consists of three principal product markets: (i) the Islamic equities market (facilitated by the availability of relevant indices); (ii) the *ṣukūk* market; and (iii) the Islamic collective investment scheme (ICIS) market. In some of the more developed markets, a wider range of ICM products may be available, such as Islamic structured products, Islamic venture capital, or private equity and Islamic peer-to-peer (P2P) financing, among others. There are certain practices in the conventional capital market that, for Sharī'ah reasons, are not a feature of the ICM, such as short selling and the use of derivatives. These practices are therefore not addressed by this standard. The ICM is also generally characterised by a diverse set of intermediaries – for example, those that are in the business of managing individual portfolios, executing orders, and dealing in or distributing securities. The regulatory status of these intermediaries may vary. For instance, in some jurisdictions an investment adviser that deals on behalf of clients and/or is permitted to hold client assets would be classified as a market intermediary. In other jurisdictions, investment advisers are treated separately from market intermediaries. In addition, market intermediaries may fulfil other functions essentially invisible to retail customers. Some may trade on their own account or underwrite securities issues. There are other specialist functions, such as custodians and fund administrators. In practice, many market intermediaries in dual financial systems will deal with both Sharī'ah-compliant and non-Sharī'ah-compliant products. For example, a brokerage firm may be willing to execute client orders for securities whether or not these are designated as Sharī'ah-compliant. A financial advisory firm may be willing to advise on both Islamic and conventional collective investment schemes. However, some intermediaries may make a specific claim to Sharī'ah compliance, either in the products on which they advise or in their own operations, or both. In all these cases, issues such as clarity regarding any claim of Sharī'ah compliance made by a firm and, in particular, ensuring that firms that deal with both Sharī'ah-compliant and non-Sharī'ah-compliant products/services have adequate segregation of their Islamic and conventional activities/operations within the firm (e.g. the presence of a dedicated staff or unit, depending on the firm's size) are important considerations.

1.2 Objectives

6. This standard is intended to set out minimum requirements to be applied in the ICM for the protection of investors and the promotion of financial stability.

7. The principles set forth in this standard aim to achieve the following objectives:

- (i) to address the Islamic finance-specific issues that need to be considered within regulatory frameworks for investor protection;
- (ii) to define best practices for investor protection in relation to the ICM;

- (iii) to support the development of robust investor protection frameworks for the ICM; and
- (iv) to increase harmonisation of regulatory practice, to support the development of the international ICM.

1.3 The Scope of Application

8. This standard is intended to apply to:

- (i) ICM products, including, but not limited to, *ṣukūk*, ICIS and Sharīʿah-compliant equities; and
- (ii) market intermediaries operating in the ICM (referred to as “firms” in the standard), particularly those that are interfacing with clients (e.g. brokers, asset managers, portfolio managers, investment advisers, etc.), including those that are involved in:
 - (a) offering investment advice to clients,
 - (b) offering, recommending or selling investment products or services to clients,¹
 - (c) managing clients’ portfolios,
 - (d) executing clients’ orders on financial instruments,
 - (e) reception and transmission of orders on financial instruments,
 - (f) market making and underwriting,
 - (g) placing of financial instruments,
 - (h) operating multilateral trading facilities (i.e. other than exchanges),
 - (i) crypto-asset platforms,²
 - (j) P2P financing platforms,
 - (k) equity crowdfunding platforms, and
 - (l) online retail trading and investment platforms (e.g. robo-advisers, online brokerage platforms, online asset management platforms, etc.).

9. In many jurisdictions, some types of crypto-assets are treated as securities, conveying an interest in the assets or earnings of a business. Others may be treated as currencies and regulated differently. This category of crypto-assets is the subject of Sharīʿah debate and is not addressed in this

¹ These firms are referred to as “distributors” in the standard.

² See paragraph 10 and the Annex.

standard. The Annex to this standard sets out a taxonomy that attempts to distinguish between the different types of crypto-assets.

10. The provisions in this standard for crypto-assets refer only to those assets mentioned in the fourth category of the taxonomy in the Annex – that is, security tokens (digital tokens) which confer ownership rights in underlying assets that provide a right to future profits, dividends or a residual interest in a business, where these are approved by the relevant Sharī'ah boards in the jurisdiction. Such tokens are characterised by elements similar to traditional financial products in the “investment” category in that they involve: (i) the investment of capital; (ii) the promise/expectation of a financial return; and (iii) the assumption of a risk directly connected and related to the investment of capital. Tokens are also intended to be traded in one or more trading systems (e.g. in exchanges, or “secondary markets”). The other categories mentioned in the Annex are not within the scope of this standard and are the subject of Sharī'ah debate.

11. In certain jurisdictions, some crypto-assets have been brought within the existing framework for securities regulation and normal securities provisions have been applied to them (e.g. for prospectuses and continuous disclosures). The specific provisions in this standard for crypto-assets apply where the existing framework for securities regulation (e.g. for equities) has not been applied or where the specific Sharī'ah compliance requirements set out in this standard are relevant.

12. Regulatory and supervisory authorities (RSAs) should consider proportionality in applying this standard by taking into consideration the nature, scale and complexity of intermediaries in the ICM, of the Islamic capital markets in the jurisdiction and of the broader environment in which they operate. However, the application of proportionality should always be mindful of the ultimate goal of ensuring effective investor protection.

1.4 Approach of the Standard

13. This standard on investor protection in the ICM does not have a direct equivalent in a conventional standard that covers a substantially similar scope. The International Organization of Securities Commissions' (IOSCO's) *Objectives and Principles of Securities Regulations* provides a conventional standard that addresses at a high level the safeguards that need to be in place to ensure investor protection. The Islamic Financial Services Board's IFSB-21: *Core Principles for Islamic Finance Regulation (Islamic Capital Market Segment)* (CPIFR, or “Core Principles”) builds on these for the ICM and addresses the specificities for Islamic finance, but at a similarly high level. This standard deals with investor protection in more depth (but in line with the IFSB's Core Principles) by addressing those areas where guidance is needed on Islamic finance specificities. It draws on and, where relevant, complements more detailed guidance contained in other IOSCO documents on specific areas relevant

to investor protection.³ It also draws on international good practice as expressed in particular regulatory regimes, notably (but by no means exclusively) in the European Union under the Markets in Financial Instruments Directive (MiFID).⁴ It provides recommended best practices that are benchmarked against these but which address the specificities of ICM. Best practices in this standard are therefore largely intended to focus on areas where guidance is needed on Islamic finance-specific issues, but also includes some generally applicable provisions that need to be mentioned in order for the standard to provide a reasonably coherent investor protection framework.

14. The standard identifies a number of key elements that should be in an effective investor protection framework and addresses principles related to compliance with Sharī'ah principles, product governance, disclosures for Sharī'ah-compliant equities and market intermediaries in the ICM, conduct of business, protection of clients' assets, complaints handling and dispute resolution, as well as investor education.

15. The standard deals with some aspects of disclosure, particularly in relation to market intermediaries, but it does not repeat the material on disclosures related to *shukūk* and ICIS contained in IFSB-19: *Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Shukūk, and Islamic Collective Investment Schemes)*. Nor does it deal comprehensively with disclosures in relation to equities, except in those areas specifically relevant to assertions of Sharī'ah compliance.

16. There are other areas of the ICM that can be considered relevant to investor protection – such as securities exchanges, clearing and settlement, and corporate governance of issuers – that are not covered in this standard. These areas are, however, addressed in the CPIFR.

1.5 Implementation Date

17. To encourage consistency in implementation of IFSB standards across jurisdictions, it is recommended that RSAs implement the standard in their jurisdiction effective from January 2023 onwards, taking into account an adequate pre-implementation period starting from the issuance date of this standard for the Guiding Principles to be embedded into national regulations and guidelines and, where applicable, implemented into supervisory practices. RSAs are encouraged to implement the standard earlier than this date, where they are able to do so.

³ IOSCO Report (2014), *Recommendations Regarding the Protection of Client Assets*; IOSCO Report (2009), *Protection of Minority Shareholders in Listed Issuers*; IOSCO Report (2009), *Fit and Proper Assessment – Best Practice*; IOSCO Report (2013), *Suitability Requirements with Respect to the Distribution of Complex Financial Products*; IOSCO Report (2007), *Market Intermediary Management of Conflicts that Arise in Securities Offerings*; IOSCO Report (2014), *Strategic Framework for Investor Education and Financial Literacy*; IOSCO Consultation Report (2019), *Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms*.

⁴ *Markets in Financial Instruments Directive (MiFID II) 2014/65/EU*.

18. The level of implementation of the standard in a particular jurisdiction may be dependent upon, and be without prejudice to, the general legal framework of that jurisdiction.

SECTION 2: THE GUIDING PRINCIPLES

2.1 General Principles of Investor Protection

Principle 1: Regulators should require that market intermediaries operating in the Islamic capital market act honestly, fairly and professionally in accordance with the best interests of investors.

19. To ensure the highest level of investor protection and conduct, firms may develop or adopt a code of ethics governing the conduct of ICM professionals. Ethical behaviour and professionalism are fundamental to the success of the Islamic financial services industry and, as such, ICM professionals should practise the highest ethical standards and professional conduct in all aspects of their activities, aligning their business practices with ethical behaviour as well as with Sharī'ah rules and principles where firms explicitly or implicitly make such a claim.

20. This principle is applicable to firms as defined in section 1.3 and to all existing and potential clients of the firm regardless of client categorisation.

Recommended Best Practices

21. The fundamental basis for the conduct of firms is the observation of the principles of honesty, fairness, integrity and the significance of client interest. Regulators should encourage firms to strictly and consistently apply these values and cultural principles to enhance the standard of investor protection and prevent market abuse. In this regard, regulators should require that firms operating in the ICM have in place robust policies on conduct to ensure that they do not either intentionally or as a result of negligence provide any information that is potentially misleading to clients or manipulate prices through any means (such as making a false market, issuing misleading price-sensitive information, making undisclosed profits at the expense of investors such as through churning assets, and so on). Additionally, a firm should not issue any information to clients that is misleading regarding the Sharī'ah compliance of the firm's products or services. Principles of conduct for firms should ensure that any material information is not withheld from clients. With regard to fairness and honesty, firms should also be expected to have appropriate procedures in relation to whistle-blowers as well as dealing with complaints fairly and openly.

22. The regulatory regime should also require firms to act with due care and diligence in the best interests of their clients. As such, firms should have in place appropriate safeguards against behaviour that constitutes a lack of due care and diligence.

23. In addition to maintaining the general standards of conduct, firms should also consider the principles of Sharī'ah – in particular, the following elements:

- (i) *Moral screen.* To be acceptable under Sharī'ah, a contractual relationship must be morally sound. This implies the prohibition of contracts based on substantial ignorance and uncertainty (*gharar*), misleading information, obvious imbalances in the respective obligations of the parties, and bad faith in implementation. Investments and/or products offered by a firm must also avoid those elements that are immoral from a Sharī'ah perspective, such as alcohol and cigarettes, pornography, casinos, pork production and distribution, etc.
- (ii) *The prohibition of interest (riba).* Technically, interest is defined as an increase in return for deferment in a *qard* contract (*ribā al-nasī'ah*) or exchange contract (*ribā al-faḍl*).
- (iii) *Sanctity of contracts.* Islamic teachings uphold contractual obligations and the disclosure of information as a duty. This is intended to reduce the risk of asymmetric information and moral hazard.

24. As a means of supporting their commitment to ethical behaviour, regulators may expect that firms establish their own codes of ethics, including consideration within them of Islamic values and principles where firms claim a Sharī'ah-compliant business.

25. As an example, IOSCO recommends that a code of ethics⁵ for firms engaged in the financial services industry should include the following ethical principles:

- (i) *Integrity and truthfulness of parties in a business relationship.* "Integrity" refers to honesty and the adherence to values and principles despite the costs and consequences. Integrity also demands forthrightness and candour, which must not be subordinated to personal gain or advantage.
- (ii) *Promise keeping.* The ability to keep one's word, regardless of whether there is a legal obligation to do so, which is the key to being an ethical professional or an ethical business.
- (iii) *Loyalty.* Managing and fully disclosing conflicts of interest covers any conduct that could compromise loyalty to one's company or clients. Although certain conflicts may be inevitable, to the extent feasible they should be avoided or at least appropriately managed. For example, while not necessarily sufficient to cure a conflict, firms, at a minimum, would ensure full, fair, accurate, timely and understandable disclosure.
- (iv) *Fairness.* Being impartial, objective and honest.

⁵ IOSCO (2006), *Model Code of Ethics*. <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD217.pdf>

- (v) *Doing no harm.* Avoiding conduct that jeopardises investors' trust and confidence.
- (vi) *Maintaining confidentiality.* Developing a relationship of personal trust and confidence with clients by safeguarding information entrusted to the professional. A professional must refrain from using, or appearing to use, confidential information for unethical or illegal advantage.

26. The benefit of a code of ethics is that it provides a high standard of commercial honour and just and equitable principles of trade that are in accordance with the values prescribed by the Sharī'ah.

27. Such a written code of ethics may be made available to the public. It should be a living document that provides an ethical culture of self-policing and self-compliance that guides the conduct of the firm's employees and representatives in carrying out their duties and responsibilities, and in delivering fair and honest services to the firm's clients as required by the Sharī'ah. It is particularly important in areas that explicit rules may not be able to address fully.

2.2 Compliance with Sharī'ah Principles

Principle 2: There should be appropriate policies, procedures, resources, systems and controls in place for Sharī'ah governance if a firm offers products or services that make an implicit or explicit claim of Sharī'ah compliance.

28. Given that ICM products and services are based on a claim of Sharī'ah compliance, there should be appropriate and proportionate processes and mechanisms in place to ensure that a claim of Sharī'ah compliance is true. The Sharī'ah governance requirements that are set out in IFSB-6,⁶ the IFSB standard on Sharī'ah governance,⁷ and IFSB-21 (CPICM 10)⁸ are also applicable to the ICM and should be implemented along with the requirements set out in this standard to ensure effective investor protection. These Sharī'ah governance requirements include appropriate systems and mechanisms for monitoring ex-ante and ex-post Sharī'ah compliance to ensure:

- (i) consistent compliance with Sharī'ah rules and principles in the daily operations of the firm;
- (ii) that any products offered to clients have gone through appropriate Sharī'ah approval and/or screening processes;
- (iii) periodic reviews of Sharī'ah compliance status; and

⁶ IFSB-6: *Guiding Principles on Governance for Islamic Collective Investment Schemes.*

⁷ *Revised Sharī'ah Governance Framework.*

⁸ IFSB-21: *Core Principles for Islamic Finance Regulation (Islamic Capital Market Segment).* CPICM 10: *Principle Relating to Sharī'ah Governance.*

(iv) purification of any tainted income.⁹

29. In addition to the above, there should be sufficient transparency in all Sharī'ah governance processes that are in place through appropriate disclosures to the public. The mechanisms that are put in place by a firm to ensure compliance with Sharī'ah principles should be made available to clients and potential clients through appropriate channels and offering documents.

30. There should also be appropriate record-keeping of the arrangements and the processes undertaken to ensure compliance with Sharī'ah rules and principles, and an effective and appropriate written policy for it.

31. The board of directors (BOD) and senior management should have effective oversight over the policies and procedures for Sharī'ah governance. The BOD should be responsible for ensuring that an appropriate Sharī'ah governance framework is approved and implemented by the firm.

32. All provisions of the Sharī'ah governance principle are equally applicable regardless of the categorisation of the client.

Recommended Best Practices

33. In establishing a comprehensive and effective Sharī'ah governance system, firms should ensure in particular that the following processes are observed:

- (i) There is an independent body, such as a Sharī'ah advisory firm or a Sharī'ah board, providing *fatāwā* that govern all relevant operations of the firm and the products and services it offers.
- (ii) The BOD has ultimate responsibility for appointing the Sharī'ah adviser/board, but the appointment may require approvals from shareholders in a general meeting, where relevant.
- (iii) Where the firm issues financial products for which it claims Sharī'ah compliance, there is a product governance process that includes Sharī'ah approval by the Sharī'ah adviser/board as part of its product approval processes in line with the provisions set out in Principle 4.
- (iv) The Sharī'ah adviser/board has the necessary competencies and qualifications as set out by the regulator and does not have any conflict of interest.

⁹ If this involves channelling the tainted income to charity, it should be carried out under the supervision of a Sharī'ah board/adviser and the basis on which distributions are made, and the bodies to which they are made, should be disclosed.

- (v) The Sharī'ah adviser/board is given all the necessary and material information to make its decisions.
- (vi) There is adequate transparency regarding the constitution of the Sharī'ah adviser/board, as well as the decisions made by the adviser/board and the areas of the firm's operations, services and products that the Sharī'ah adviser/board has reviewed in making a statement on Sharī'ah compliance.
- (vii) There are written policies regarding Sharī'ah governance processes and rules with which employees and representatives of a firm must comply.
- (viii) There is a designated Sharī'ah compliance function or officer responsible for monitoring the following:
 - (a) day-to-day compliance with Sharī'ah principles of all products and services offered by the firm that are marketed as Sharī'ah-compliant;
 - (b) day-to-day compliance with Sharī'ah principles of all the firm's relevant internal operations related to the provision of financial services, where the firm presents itself to be Sharī'ah-compliant; and
 - (c) where relevant, the implementation of any specific *fatāwā* issued by the Sharī'ah board/adviser.
- (ix) There is an internal Sharī'ah audit function that verifies on a periodic basis that Sharī'ah compliance requirements have been met. This could be an internal Sharī'ah audit conducted by a Sharī'ah compliance officer separately from the daily monitoring function for small-sized firms.¹⁰
- (x) The BOD and senior management, as well as the Sharī'ah board/adviser, should be informed of the results of the internal Sharī'ah audit.
- (xi) Depending on the size of a firm, it may undertake an external Sharī'ah audit review, which can independently verify that the internal Sharī'ah audit has met the required standards. The Sharī'ah board or an independent Sharī'ah advisory firm could be responsible for this process.
- (xii) External Sharī'ah reports should be shared with the public. Where there is no external Sharī'ah report, a summary of the internal Sharī'ah report may be shared with the public instead. There should nevertheless be appropriate disclosures to investors if any material change occurs that affects the Sharī'ah compliance of products or the firm's operations.

¹⁰ As defined by each jurisdiction.

(xiii) There are clearly defined written policies, procedures and remedial actions in place to handle any incidence of Sharī'ah non-compliance, and such policies and processes (including methodologies for purification of income, where relevant) should be made available to investors.

(xiv) With respect to the above processes, their application by firms should be based on the proportionality principle, depending on the size of the firm and its range of ICM activity. For example, firms that are very small in size or have a very small proportion of ICM activity may not need to undertake an external Sharī'ah audit review, given that this might be more resource-intensive, provided that they have an established mechanism for internal Sharī'ah audit.¹¹

(xv) Where a firm carries out both Islamic and conventional capital market activities, there should be a segregation of its conventional and Islamic activities, such as a dedicated staff or unit for Islamic activities, depending on the size both of the firm and of its Islamic activities.

34. Products offered by a firm should undergo approval by a competent Sharī'ah board/adviser and/or a Sharī'ah screening process (for relevant products), which should be in conformance with the concerned jurisdiction's centralised Sharī'ah guidelines (if applicable and available). The Sharī'ah screening methodology and criteria and the relevant *fatwā* issued by the Sharī'ah board/adviser should be transparent and made available to investors in an easily understandable format.

35. In the case of P2P financing, equity crowdfunding platforms, crypto-asset platforms, robo-advisers and other online retail trading and investment platforms, where a claim is made of Sharī'ah compliance regarding the platform itself and the investments offered through it, or with respect only to some of the individual investments, there should also be in place all the basic elements of Sharī'ah governance described above (subject to the principle of proportionality and the specific nature and type of activity).

36. In relation to P2P financing or equity crowdfunding, where a firm markets individual investments that make a claim of Sharī'ah compliance to investors that wish to invest only in Sharī'ah-compliant investments, regulators should also require the firm to make clear the extent to which it has examined any claim for Sharī'ah compliance made by an investee company.

37. Where a firm is marketing a product by an issuer in a foreign jurisdiction and the Sharī'ah compliance claim relies on the screening criteria set out by a centralised Sharī'ah board of the foreign

¹¹ For Sharī'ah governance functions, the standard recognises a proportionate approach especially for smaller-sized firms that may utilise shared centralised services. This would involve outsourcing the Sharī'ah governance functions to a professional services entity in exchange for a fee. The firm will benefit from the entity's expertise while saving on the costs of having in-house Sharī'ah governance functions. For smaller firms, an option for reducing the costs of operations may be to rely on a single Sharī'ah adviser, or for a number of such firms to collectively engage one adviser or a Sharī'ah consultancy firm.

jurisdiction, the firm must disclose clearly the screening methodology used and the authority that issued the screening criteria.

38. Where a firm is marketing a product by an issuer in a foreign jurisdiction that makes a claim of Sharī'ah compliance but does not have a centralised Sharī'ah governance system in the jurisdiction, the firm must disclose clearly the basis on which the issuer has made a claim of Sharī'ah compliance (e.g. screening criteria, the Sharī'ah board/adviser and the relevant resolutions). If such information is not available from the issuer, then this fact should also be disclosed to clients.

39. Issuers of instruments for which they claim Sharī'ah compliance should provide to firms that distribute the product the details of the Sharī'ah approval process, the Sharī'ah board/adviser involved and the basis for the claim of Sharī'ah compliance, and disclose immediately to distributors when there is a change in Sharī'ah compliance status.

40. Regulators should also be aware of practices such as the use of high-speed algorithmic trading systems or other complex mechanisms that may contravene Sharī'ah parameters in regards to the buying and selling of securities. In particular, some such practices are likely to involve transactions that may contravene the Sharī'ah principle that a person should not sell securities that he does not possess, where possession implies not only that a purchase has been agreed but that the transaction has been settled by delivery of the securities.

2.3 Product Governance

2.3.1 Client Categorisation

Principle 3: Measures to protect investors should be adapted to the particularities of defined categories of investors.

41. Investors may be categorised into retail and other categories (e.g. sophisticated, professional, institutional, qualified, eligible counterparties, etc.)¹² to whom varying levels of investor protection provisions may apply depending on criteria defined by the regulator with respect to knowledge and expertise, monetary thresholds, investment experience, and capability to make investment decisions in Sharī'ah-compliant instruments and to properly assess the specific risks they incur.

42. However, to ensure a strong investor protection framework applicable to the provision of ICM services, it is appropriate to make it clear that the general principles to act honestly, fairly and professionally, and to ensure compliance with principles of Sharī'ah where such claims are made, and

¹² There is no international standard for client classification, and this standard does not intend to suggest one. It simply records the existence of different practices in this regard.

the obligation to be clear and not misleading, apply to the relationship with all clients irrespective of their category.

43. Firms must be required to inform their clients of such classifications and the specific category in which the client has been classified, as well as of any limitations on protection that the categorisation would involve and, where relevant, their right to request a different categorisation. This information will help clients to understand the basis on which they are categorised, what it means in terms of the level of investor protection provisions that are applicable to them, and their options concerning that categorisation.

Recommended Best Practices

44. Retail clients are entitled to the highest degree of investor protection. This may imply, for example, in particular situations, restrictions on the products that can be marketed to them, enhanced requirements for suitability or appropriateness, clearer risk warnings, and plain-language disclosures.

45. Other client categories may be given more flexibility by a regulator with regard to investor protection provisions where relevant. Depending on the categorisation established by the regulator, clients classified as, for example, professional, qualified, sophisticated or institutional clients are typically assumed to possess more experience, knowledge and expertise to make their own investment decisions and to properly assess the risks they incur. Some jurisdictions also distinguish a third category of market counterparties, or accredited investors, typically including firms, other regulated financial institutions, ICIS, pension funds, national and public bodies, and other institutional investors, which are assumed to be able to deal with regulated financial institutions essentially as equals.

46. There should normally be an assessment of the suitability or appropriateness of an investment for a particular retail client by the firm, whereas professional/sophisticated or institutional clients are assumed to have the necessary experience and knowledge to understand the risks involved in relation to particular Sharī'ah-compliant investments or transactions. This does not, however, preclude the application of (usually more limited) suitability or appropriateness assessments at this level.

47. The regulatory system should make clear under what circumstances, if any, clients having initially been classified in a particular way may “opt up” to a higher category or “opt down” to receive a higher degree of regulatory protection. It should also make clear whether this may be done generally, or for specific types of products or transactions.

48. In relation to the above, investors not initially categorised as retail may elect to be categorised as such if they have limited knowledge of Sharī'ah-compliant instruments or transactions, thereby being subject to the application of a higher level of regulatory protection.

49. The firm should inform the client in writing of the client's classification, and whether this relates to one or more particular services or transactions or one or more types of product or transaction.

50. For clients to move upwards between categories, a firm may be expected to conduct a qualitative assessment of the client's expertise, experience and knowledge to ensure that the client is capable of making their own investment decisions and understands the risks involved. The regulator may set more detailed criteria for such an assessment. The firm should be required to give a clear written warning of the protection and investor compensation rights the client will lose in this case. The client should also, in a separate document from the contract, state that they are aware of the consequences of waiving the relevant protections.

2.3.2 Product Governance Arrangements

Principle 4: Where firms offer Sharī'ah-compliant financial instruments to clients, and in particularly complex products, regulators should require firms to ensure that products are designed to meet the needs of an identified target market within the relevant categories of clients, that they undergo appropriate Sharī'ah and product approval processes, and that reasonable steps are taken to ensure that the financial instrument is distributed to the identified target market.

51. The product governance principle is aimed at reducing misselling risk and applies not only to Sharī'ah-compliant financial products but also to investment services offered by firms that claim to be Sharī'ah-compliant. However, the measures set out in this principle should be applied to jurisdictions with consideration of the size and development of the sector and of the size of the firms in question, so that it is appropriate and proportionate.

52. Firms that are originators of Sharī'ah-compliant financial products, particularly complex products, should maintain appropriate product governance policies, procedures, systems and controls as part of their organisational arrangements, including both Sharī'ah and product approval processes, to ensure that investment products are compliant with Sharī'ah principles and that they are designed appropriately, consistent with the needs of identified target markets, are distributed to the right target market, and that the specific risks arising from such products are sufficiently assessed.

53. A firm that designs or develops or issues Sharī'ah-compliant financial instruments/products, including those advising corporate issuers on the launch of new financial instruments/products, should ensure that the product¹³ approval processes are based on an assessment of the end-clients for whose needs and objectives the instrument/product is intended, taking into consideration the nature of the

¹³ While there is no formal international definition, in general, the term "financial instrument" is used for simpler instruments (e.g. an equity or a *sukuk*) issued or initiated by firms that need not themselves be financial services firms, whereas "financial product" tends to be used for slightly more complex structures created by financial services firms. A collective investment fund would more usually be described as a "product", as would more complex structures. Product approval processes are relevant to both of the above.

instrument/product and charging structures, among other things, to ensure that the instrument/product is in the best interest of the intended investor.

54. A firm that distributes (offers or sells) Sharī'ah-compliant financial instruments and services should obtain confirmation from the originators or issuers of Sharī'ah-compliant financial instruments that there are appropriate product and Sharī'ah approval processes in place and a target market has been identified. Firms that are distributors need this information in order to understand the product and ensure it is suitable for the firm's own target market, and to provide appropriate and sufficient disclosures to its clients with regard to the Sharī'ah-compliant financial products.

55. This principle is applicable to retail and professional/sophisticated client categories, but not to market counterparties.

Recommended Best Practices

56. Firms that are originators or issuers of complex Sharī'ah-compliant financial instruments should be able to make available to the distributors of the product all appropriate information on the financial instrument and the product approval process, including the resolutions of the Sharī'ah board/adviser, as well as the identified target market of the financial instrument.

57. Firms that are distributors of Sharī'ah-compliant products should ensure that their knowledge and understanding of the products allows them to match products to the needs of their clients.

58. Distributors may also regularly review the products they market to assess whether they remain consistent with Sharī'ah principles and fit the needs of the identified target market, and whether the distribution strategy remains appropriate. Where a firm offers or recommends financial instruments of which it is not the originator, it should have in place adequate arrangements to obtain information that will enable it to understand the specific characteristics of the product and the identified target market for each Sharī'ah-compliant financial instrument.

59. Firms may also establish governance processes, including board oversight, to ensure effective control over the product development and issuance process. They should also ensure that staff possess the necessary expertise to understand the characteristics and risks of any Sharī'ah-compliant financial instruments they intend to develop/issue or distribute.

60. Firms should also have in place procedures and arrangements to ensure that conflicts of interest are properly managed.

61. The compliance function should have oversight of and monitor the development and periodic review of product development and governance arrangements in order to detect any risk of failure by the firm to comply with Sharī'ah requirements and other product governance obligations.

62. Firms may also devise an appropriate stress-testing mechanism to assess how extreme circumstances would impact the performance of the product, taking into account the specific features and characteristics of a Sharī'ah-compliant product to ensure that it does not present a threat to the orderly functioning or stability of the ICM and the financial markets in general.

63. Firms may also have in place a process to ensure that products will be reviewed on at least an annual basis to ensure they are being sold appropriately and remain consistent with the identified target market, and that they remain Sharī'ah-compliant.

2.3.3 Product Intervention

Principle 5: Regulators may undertake temporary product intervention measures where a product claimed as Sharī'ah-compliant creates a significant investor protection concern.

64. A regulator may temporarily prohibit or restrict activities in or from their jurisdiction, such as the marketing, distribution or sale of a financial instrument with certain specified features, or a type of financial activity or practice, if it is satisfied on reasonable grounds that:

- (i) the financial instrument or practice gives rise to significant investor protection concerns, raises significant Sharī'ah non-compliance issues, or poses a threat to the orderly functioning and integrity of financial markets or to the stability of the financial system;
- (ii) the regulatory requirements in the jurisdiction that are applicable to the relevant financial instrument or activity do not address the threat, and the issue would not be better addressed by improved supervision or enforcement of existing requirements;
- (iii) the action is proportionate, taking into account the nature of the risks identified, the level of sophistication of investors or market participants concerned, and the likely effect of the action on investors and market participants who may hold, use or benefit from the financial instrument; and
- (iv) for cross-border activities, the regulator has consulted regulators in other jurisdictions that may be significantly affected by the action.¹⁴

65. Where the conditions set out above are fulfilled, a regulator may impose the prohibition or restriction on a precautionary basis before the product has been marketed, distributed or sold to investors.

¹⁴ This may be facilitated by a memorandum of understanding (MOU) or other arrangements between jurisdictions to ensure prompt intervention.

66. Where the concerns raised have not been addressed adequately within a stipulated period, or the product is deemed to pose a significant risk to investor protection and the stability of the financial system, the regulator may put into effect permanent product intervention measures in relation to that product.

Recommended Best Practices

67. The regulator may undertake product intervention taking into account a number of criteria and factors in determining whether there is a significant investor protection concern or a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system. The criteria or factors that could be used by regulators in assessing the need for product intervention (which are non-exhaustive) may include:

- (i) the degree of complexity of a Sharī'ah-compliant financial product;
- (ii) the type of investor to whom it is marketed and sold;
- (iii) the size of the potential problem or detriment;
- (iv) the degree of innovation of the Sharī'ah-compliant product, activity or practice;
- (v) particular features or underlying components of the Sharī'ah-compliant product or transaction; and
- (vi) selling practices associated with the product.

68. Product intervention can be used as a tool by regulators, together with product governance obligations to prevent any risks to investor protection, including significant Sharī'ah compliance issues, if they have been identified by the regulator.

2.4 Disclosure and Transparency

2.4.1 Sharī'ah-Compliant Equities

Principle 6: A robust disclosure regime for Sharī'ah-compliant equities should be in place to promote transparency, give shareholders the ability to exercise their ownership rights on an informed basis and protect minority investors.

69. There should be timely and accurate disclosure on all material matters regarding the corporation, including its financial situation, ownership and governance.

70. These matters should include disclosures about capital structures and arrangements that allow particular shareholders to obtain a degree of control that is disproportionate to their equity ownership.¹⁵

71. These disclosures are applicable in relation to Sharī'ah-compliant equities and should apply equally to all categories of investors.

Recommended Best Practices

72. If there are classes of shares or other features that would affect investors' decisions to invest, these should be disclosed.¹⁶

73. Minority shareholders have a right of timely access to the financial statements, books and/or records of an issuer. Issuers should be required to disclose publicly, on a timely basis, any material transactions or events affecting them or the value of their outstanding shares.

74. Issuers should also be required to disclose in their financial statements, or in other documents, any related party or other transactions that could have adversely affected the interests of shareholders or the value of their shares.

75. Issuers should be required to publicly disclose material contracts to which they are party. Regulators should also prohibit selective disclosure of non-public material information to certain market participants and not to others (e.g. advance warnings of earnings results to securities analysts or selected institutional investors, or both, before making full disclosure of the same information to the public). Whenever an issuer or a person acting on its behalf discloses material non-public information to selected persons (e.g. securities markets professionals or holders of the issuer's securities who may well trade on the basis of that information), the issuer must make public disclosure of that same information simultaneously (for intentional disclosures) or promptly (for non-intentional disclosures).

76. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

¹⁵ Such disclosure might include information regarding any major shareholders and others that, directly or indirectly, control or may control the company through special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, significant cross-shareholding relationships, etc. In some jurisdictions and companies, it may be possible that a shareholder or group of shareholders are in a controlling position that is not closely related to their equity ownership. Devices such as pyramid structures, cross-shareholdings, and shares with limited or multiple voting rights can be used to diminish the ability of non-controlling shareholders to influence corporate policy, and should therefore be disclosed. Such arrangements should not result in a financial privilege or breach of rights of other shareholders.

¹⁶ Such classes of shares or other features should not result in establishing a priority in receiving dividends or priority in liquidation or breach of other shareholders' rights.

77. Shareholders should have the opportunity to participate effectively and to vote in general shareholder meetings, and should be informed of the rules, including voting procedures, that govern general shareholder meetings, so that shareholders can exercise their rights.

78. The disclosure requirements for Sharī'ah-compliant equities that are set out in CPICM 17, 18 and 19 of IFSB-21 should be implemented by regulators to ensure investor protection.

Principle 7: Where equities are labelled as Sharī'ah-compliant by, or on behalf of, an RSA or exchange, there should be adequate disclosures relating to the Sharī'ah-screening methodology that is applied, a regular review of the screening methodology, and sufficient disclosures regarding any change in an equity's Sharī'ah-compliant status.

79. Where equities have been officially classified as Sharī'ah-compliant, there should be adequate disclosures, in language that is easy to understand for retail investors, regarding the qualitative and quantitative screening methodology used to classify an equity as Sharī'ah-compliant.

80. There should be a review of the screening methodologies used. Where there are any changes in screening methodology, these should be disclosed to investors.

81. These disclosures are applicable in relation to all Sharī'ah-compliant equities and should apply equally to all categories of investors.

Recommended Best Practices

82. Equities classified as Sharī'ah-compliant should undergo a periodic review against the screening criteria to ensure that Sharī'ah compliance has not changed. Any changes to the Sharī'ah-compliance status of equities that have previously been classified as compliant should be disclosed to investors in a timely manner.

83. In so far as crypto-assets resemble equities (as in category (iv) of the Annex), all relevant regulations for traditional equities will also apply to them. Therefore, the above-specified disclosures related to Sharī'ah screening for equities also apply to crypto-assets where these offer an ownership interest in a business that claims to be Sharī'ah-compliant.

84. In addition to the normal disclosures required for listed companies, regulators should require companies that wish to be listed as Sharī'ah-compliant to disclose adequate information, as needed, regarding the company's operations to enable accurate non-permissible income screening.

85. A body should not classify an equity as Sharī'ah-compliant unless it has access to adequate information from the issuer to determine its status with confidence. If such information is not (or ceases to be) available, the equity should be excluded from the list of compliant stocks.

2.4.2 Intermediaries in the Islamic Capital Market

Principle 8: Intermediaries in the Islamic capital market should be required to provide appropriate information in good time to clients or potential clients with regard to the firm and its services, as well as the mechanisms in place for Sharī'ah governance where a claim of Sharī'ah compliance is made.

86. Firms should provide sufficient information to clients or potential clients in relation to:
- (i) all costs and related charges;
 - (ii) the Sharī'ah governance mechanisms in place;
 - (iii) any Sharī'ah-compliant financial instruments or products offered;
 - (iv) the proposed investment strategies;
 - (v) execution venues; and
 - (vi) any conflicts of interest.
87. When a firm is providing investment advice only, it should inform the client in good time as to whether:
- (i) the advice is provided on an independent basis, in a clear and concise way;
 - (ii) the advice is based on a broad or a more restricted analysis of different types of Sharī'ah-compliant financial instruments, and in particular, whether it is limited to financial instruments that are issued or provided by entities that are closely linked with the firm or have any other legal or economic relationship that would pose a risk of affecting the independence of the advice provided; and
 - (iii) the firm will provide the client with a periodic assessment of the suitability of financial instruments that are recommended to the client.
88. These disclosures are applicable in relation to all firms that make a claim of Sharī'ah compliance in their operations or that offer some Sharī'ah-compliant products, and should apply equally to all categories of investors, except when otherwise indicated.

Recommended Best Practices

89. The information provided to investors with regard to Sharī'ah-compliant financial products and proposed investment strategies used may include appropriate guidance on the specific risks associated with particular investments or in respect of particular investment strategies. The firm should also inform

clients whether a financial instrument is intended for retail clients or sophisticated/qualified/institutional/professional clients (based on the classification used in the jurisdiction). This can include: (i) how the financial products function and perform in both positive and negative market conditions; (ii) information in relation to any restrictions or impediments on disinvestment (e.g. illiquid assets); (iii) an adequate description of the legal nature of Sharī'ah-compliant financial products and their risks; (iv) the scope and nature of any guarantee or capital protection incorporated in the structure of the financial instruments, and any Sharī'ah resolution in this respect; and (v) information about any third-party guarantor.

90. Information provided to clients on costs and any associated charges should cover ancillary as well as investment services, including the cost of advice and, where relevant, the cost of the Sharī'ah-compliant financial product that is recommended or marketed to the client, and how the client may pay for it, including any third-party payments. The information on all costs and charges that are payable by the client or which impact on the value of the investment should be aggregated to allow the client to understand the overall cost as well as the cumulative effect on return of the investment. Where applicable, such information should be provided to clients on a regular basis (at a minimum, annually) during the life of the investment. Where the firm has standard scales of fees, charges and commissions, these may be made available to actual and potential investors on the firm's website or any other medium through which the firm communicates with its existing and potential clients. Firms should provide clients with information on all costs and associated charges in good time before they provide the relevant service to the client.

91. The detailed information on costs can be made available to retail clients as well as professional/sophisticated and institutional clients. However, regulators may allow firms to agree with the client a limited application of such detailed disclosure requirements when providing services to professional clients or market counterparties, except where services of investment advice or portfolio management are provided. Investment advisers and portfolio managers can be expected to provide the aforementioned disclosures to all categories of clients.

92. The disclosure of information should be provided in a comprehensible form in such a manner that clients or potential clients are reasonably able to understand the nature and risks of the investment service and of the specific type of Sharī'ah-compliant financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. The regulator may require the information to be provided in a standardised format.

93. When providing portfolio management, a firm should not accept and retain fees, commissions, or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients. However, where the firm receives minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair compliance with the firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients,

this may be allowed, but should be clearly disclosed to investors. Any inducements should be separately disclosed on an annual basis.

94. Where applicable, the firm should also inform the client about mechanisms to transfer to the client the fee, commission, monetary or non-monetary benefit received in relation to the provision of the investment or ancillary service to the client. Payment or benefit that enables or is necessary for the provision of investment services, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by its nature, does not give rise to conflicts with the firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients, is not subject to the aforementioned requirements. Clients need to be accurately and, where relevant, periodically informed about all the fees, commissions and benefits the firm has received in connection with the investment services provided.

95. When an investment service is offered together with another service or product as part of a package¹⁷ or as a condition for the same agreement or package, provided that the package does not result in stipulating a contract within another contract, the firm may be required to inform the client whether it is possible to buy the different components separately and provide separate evidence of the costs and charges of each component. Where the risks resulting from such an agreement or package offered to a retail client are likely to be different from the risks associated with the components taken separately, the firm may be required to provide an adequate description of the different components of the agreement or package and the way in which its interaction modifies the risks. The regulator should also require the firm to provide information to clients that all components of the package are Sharī'ah-compliant and have undergone a Sharī'ah review, including the resolutions made by the Sharī'ah board/adviser.

96. Reporting obligations for firms providing portfolio management are applicable with respect to all categories of clients, not only retail clients. However, the type and level of information may be different from professional/sophisticated clients. For example, firms may agree with institutional clients the content and timing of reports to the client.

97. Reporting should be quarterly at a minimum and include all the activities undertaken and the performance of the portfolio during that period. The report should, in addition to the aforementioned content, also indicate how the portfolio is in compliance with Sharī'ah principles, and whether the firm's operations that are related to the management of the Sharī'ah-compliant portfolio are in conformity with Sharī'ah.

98. The firm should also disclose to clients information on client assets, how they are handled, and whether or not they are held in Sharī'ah-compliant institutions or accounts. Where money is being held in a Sharī'ah-compliant account, the firm should disclose to clients the type of Sharī'ah-compliant

¹⁷ For example, investment planning with a view to inheritance in which will-writing services are provided along with the investment advice.

investment and its associated risks. If client money is held in conventional accounts or institutions,¹⁸ the firm should disclose the reasons for this and obtain the consent of the client to hold their money in non-compliant accounts or institutions. In the case where client money is held in conventional accounts with the consent of the client, any accrued interest¹⁹ should be distributed to charity under the supervision of a Sharī'ah board/adviser, and the basis on which disbursements to charity are made, and the bodies to which they are made, should be disclosed to clients. In the case of financial instruments that would normally be held by a custodian, the custodian does not itself need to be an Islamic institution, but must exercise its custody functions over the client's assets without violating Sharī'ah principles and there must be adequate disclosures to the client regarding the holding of client financial instruments.

99. Firms should be required to inform their clients clearly and simply about the requirement for the firm to conduct a suitability assessment and its purpose, which is to enable the firm to act in the client's best interest. This should include a clear explanation that it is the firm's responsibility to conduct the assessment, so that clients understand the reason why they are asked to provide certain information and the importance of such information being up to date, accurate and complete. This information may be provided to clients in a standardised format.

100. Information about the suitability assessment should help clients to understand the purpose of the requirements. It should also encourage them to provide accurate and sufficient information about their knowledge, experience, financial situation (including their ability to bear losses) and investment objectives (including their risk tolerance). Firms may be required to highlight specifically to their clients that it is important to gather complete and accurate information so that they can recommend suitable products or services for the client.

101. When providing investment advice, a firm should, before the transaction is made, provide the client with a statement on suitability that specifies the advice given and how it meets the Sharī'ah and other preferences, objectives and other characteristics of the client.

102. Where a firm provides portfolio management or has informed the client that it will carry out a periodic assessment of suitability, the periodic report should contain an updated statement of how the investment meets the client's objectives and preferences, including Sharī'ah compliance, and other characteristics of the retail client.

103. Where a firm uses technology-based platforms to provide investment advice, such as robo-advisory services for Sharī'ah-compliant investments, in order to address potential gaps in clients' understanding of the services provided through robo-advice, regulators should require firms to inform clients, in addition to other required information, of the following:

¹⁸ Due to the unavailability of Sharī'ah-compliant options in a jurisdiction.

¹⁹ If current accounts that do not accrue interest are not available when money is held in a conventional institution.

- (i) a very clear explanation of the exact degree and extent of human involvement, and if and how the client can ask for human interaction;
- (ii) the mechanisms used to ensure that the robo-advice provided regarding investments in financial instruments is within Shari'ah compliance parameters if it is claimed as such, and the degree to which its level of accuracy can be guaranteed with respect to Shari'ah compliance;
- (iii) an explanation that the answers clients provide will have a direct impact in determining the suitability of the investment decisions recommended or undertaken on their behalf;
- (iv) a description of the sources of information used to generate an investment advice or to provide the portfolio management service (e.g. if an online questionnaire is used, firms should explain that the responses to the questionnaire may be the sole basis for the robo-advice or whether the firm has access to other client information or accounts); and
- (v) an explanation of how and when the client's information will be updated with regard to their situation, personal circumstances, etc.

104. For firms that deal with crypto-assets, the regulator should require adequate disclosures, including basic disclosures such as all charges and fees, as well as disclosures regarding Shari'ah compliance where such a claim is made. Firms that deal with crypto-assets should also disclose all material risks associated with their products, services and activities, as well as the specific risks associated with the Shari'ah-compliant mechanisms/structures used. Regulators may also put in place pre- and post-trade transparency requirements for firms that trade crypto-assets for clients.

105. In jurisdictions with P2P financing or equity crowdfunding that claims Shari'ah compliance either in terms of the jurisdiction itself or of individual investments,²⁰ regulators should require the crowdfunding/P2P platforms to have adequate transparency, including disclosures related to the investments and the platform. These may include detailed disclosures related to:

- (i) Shari'ah governance mechanisms that have been put in place, as well as the basis for the claim of Shari'ah compliance made by the platform (if any), and any claim made for each individual investment. With respect to P2P financing, this should also include compliance of the financing mechanism used. The disclosure may be, for example, in the form of a statement or resolution of a Shari'ah board/adviser;

²⁰ Regulatory approaches to these activities vary. While equity crowdfunding is usually regarded as part of the capital market, practice is less consistent in relation to P2P funding, which in some jurisdictions falls under the banking regulator. This standard applies in so far as the activities are regarded as part of the capital market (whether or not they have yet been brought within regulation).

- (ii) the main characteristics of the Sharī'ah-compliant investments and/or instruments that are provided on the platform so as to allow potential investors to assess the nature and risks of those instruments;
- (iii) all of the specific risks for investors (without downplaying any of the risks or warnings);
- (iv) clear and comparable default data on financing portfolios, such as expected and actual default rates on past and future performance;
- (v) sufficient fee and cost transparency, which may include a description of the cost of the service;
- (vi) a fair description of the likely actual return, taking into account fees, charges and default rates;
- (vii) a description of the criteria and procedures used to select projects proposed to investors;
- (viii) the characteristics of each business receiving investment. Depending on matters such as the size of financing raised and/or the type of investor, regulators may permit the use of disclosure statements that are less detailed than a prospectus. They should, however, include information about the promoters/controlling shareholders and directors;
- (ix) a description of the rules that apply to the service provision;
- (x) a description of the conflicts of interest policy;
- (xi) information on the depositing of client assets and the risks particular thereto, especially in situations where the client assets are deposited with a third party;
- (xii) for equity crowdfunding, descriptions of shareholders' rights in a manner that is clear and understandable by the investor. The disclosure should be expected to include information on the investors' rights of withdrawal or disinvesting, including where the start-up's controlling shareholders transfer their controlling stake to a third party after the offer;
- (xiii) the creditworthiness assessment of the issuer that was carried out by the platform/firm, where investors have a choice to invest in specific P2P agreements;
- (xiv) the procedure for an investor to access their money before the term of the P2P agreement has expired, including any arrangements for investors to trade their investments;

- (xv) the procedures that are in place for dealing with the default of one of the companies in which participants are invested, including clear information and explanations to investors on how the platform, in normal operation, would deal with late payment or default;
- (xvi) the procedures for resolution of disputes between the platform and an investor in normal operation, and whether or not investors have access to dispute resolution schemes that take into account Shari'ah issues; and
- (xvii) the resolution plans that are in place in the event of the failure of the P2P financing or equity crowdfunding platform itself, to minimise damage and loss to investors. Where a platform collapses and investors are left with small investments in a range of companies, disclosures should include details on how investors can, in practice, exercise their rights to receive payment, vote as shareholders, etc.

106. Other requirements outlined in this section for intermediaries in the ICM are also applicable to P2P financing or equity crowdfunding where it is relevant, and regulators may take into account the specific nature of the firm and its size in relation to the applicability of the recommended disclosures.

2.5 Conduct of Business

2.5.1 Assessment of Suitability and Appropriateness²¹

Principle 9: Intermediaries in the Islamic capital market that provide investment advice or portfolio management should establish, implement and maintain adequate policies and procedures (including appropriate tools) to enable them to understand the essential facts and characteristics about their clients, including their preference for Sharī'ah-compliant investments.

107. The assessment of suitability and appropriateness is one of the key requirements for investor protection and an essential element of a regulatory toolkit. This section applies to the provision of investment advice and portfolio management by firms that make a claim of Sharī'ah compliance, as well as non-advised services (such as execution only). It is relevant to retail clients as well as, in applicable circumstances, professional/sophisticated clients.

108. To undertake suitability assessments, a firm offering investment advice or portfolio management services in Sharī'ah-compliant instruments should be expected to obtain the necessary information in relation to:

- (i) the client or potential client's knowledge and experience in the ICM and Sharī'ah-compliant instruments and services;
- (ii) the financial situation of the client, including the ability to bear losses; and
- (iii) the client's investment objectives, including risk tolerance and preference for Sharī'ah-compliant investments;

so as to enable the firm to recommend to the client or the potential client, investment services and Sharī'ah-compliant financial instruments that are suitable for the client.

109. The quality of the advice given to clients plays a crucial role in ensuring the consistency of the transaction with the client's profile, including meeting their Sharī'ah or ethical investment preferences. Thus, the assessment of the client's profile and the consequent match with the Sharī'ah-compliant transactions recommended (in the case of advice) or concluded (in the case of portfolio management) by the firm is of importance.

²¹ These terms are used in the context of MiFID II, but do not have more generally agreed international definitions. Both terms embrace the concept of whether a product fits the client's financial situation and needs, taking into account matters such as the client's investment objectives, risk tolerance, knowledge, experience, etc. Where a distinction is made, "suitability" generally implies that a full assessment has been made, taking into account other products that might meet the client's needs; while "appropriateness" implies a less full assessment, based on a view that the client is in a position to make some types of investment decision themselves.

110. Regulators should require firms to ensure that the assessment of information collected about their clients is done in a consistent way irrespective of the means used to collect such information.

111. If a firm provides investment advice recommending a package of services or products that are bundled, the overall bundled package should be suitable for the client, with all products or services in the bundled package meeting Sharī'ah compliance requirements as well as the risk tolerance of the client.

112. Regulators should expect firms to have policies and procedures that enable them to collect, assess and retain all information necessary to conduct a suitability assessment for each client, while taking into account the elements mentioned above. For example, firms could use questionnaires completed by their clients or information collected during discussions with them. Firms should ensure that the questions they ask clients are likely to be understood correctly and that any other method used to collect information is designed to get the information required for a suitability assessment. When designing the questionnaires aimed at collecting information about their clients for the purpose of a suitability assessment, firms should be aware of and consider the most common reasons why investors could fail to answer questionnaires correctly. In particular, attention should be given to the clarity, exhaustiveness and comprehensibility of the questionnaire, avoiding misleading, confusing, imprecise and excessively technical language.

Recommended Best Practices

Suitability

113. The regulator may require firms to consider non-financial elements when gathering information on the client's investment objectives, such as information on the client's preferences on Sharī'ah compliance, and ethical, environmental, social and governance factors.

114. Firms may also be expected to take reasonable steps to assess the client's understanding of investment risk, as well as the relationship between risk and return on investments, to enable firms to act in accordance with the client's best interest when conducting the suitability assessment. When presenting questions in this regard, firms should explain clearly and simply that the purpose of answering them is to help assess clients' attitude to risk (risk profile), and therefore the types of financial instruments (and risks attached to them) that are suitable for them.

115. Information necessary to conduct a suitability assessment includes different elements that may affect, for example, the analysis of the client's financial situation (including their ability to bear losses) or investment objectives (including their risk tolerance). For example, a client's tolerance to non-capital-guaranteed Sharī'ah-compliant instruments, such as those based on *mushārah* and *mudārah* as opposed to capital-guaranteed instruments such as *murābahah*-based instruments, may need to be assessed.

116. It is also good practice for firms to appraise the client's understanding of basic financial notions such as investment risk (including concentration risk) and risk–return trade-off. To this end, firms should consider using indicative, comprehensible examples of the levels of loss/return that may arise depending on the level of risk taken, and should assess the client's response to such scenarios.

117. Firms could design their questionnaires so that they are able to gather the necessary information about their client. This may be particularly relevant for firms providing robo-advice services in Sharī'ah-compliant instruments given the limited human interaction. In order to ensure their compliance with the requirements concerning that assessment, firms may be encouraged to take into account factors such as whether:

- (i) the information collected through the online questionnaire allows the firm to conclude that the advice provided is suitable for their clients on the basis of their knowledge and experience, their financial situation, and their investment objectives and needs;
- (ii) the questions in the questionnaire are sufficiently clear, and/or whether the questionnaire is designed to provide additional clarification or examples to clients when necessary (e.g. through the use of design features such as tool-tips or pop-up boxes);
- (iii) some human interaction (including remote interaction via emails or mobile phones) is available to clients when responding to the online questionnaire; and
- (iv) steps have been taken to address inconsistent client responses (such as incorporating in the questionnaire design features to alert clients when their responses appear internally inconsistent and suggest they reconsider such responses; or implementing systems to automatically flag apparently inconsistent information provided by a client for review or follow-up by the firm).

118. To ensure the consistency and accuracy of suitability assessments that are conducted through automated tools (even in the case of interactions with clients not being through automated systems), firms should be expected to regularly monitor and test the algorithms that underpin the suitability of the transactions recommended and undertaken on behalf of clients so that, for example, Sharī'ah non-compliant instruments are not offered to clients who have indicated their strict preference for Sharī'ah-compliant investments. When defining such algorithms, firms can take into account the specific nature and characteristics of Sharī'ah-compliant financial products included in their offer to clients. For example, firms could at a minimum:

- (i) establish an appropriate system-design documentation that clearly sets out the purpose, scope and design of the algorithms. Decision trees or decision rules should form part of this documentation, where relevant;

- (ii) have a documented test strategy that explains the scope of testing of algorithms. This should include test plans, test cases, test results, defect resolution (if relevant) and final test results;
- (iii) have in place appropriate policies and procedures for managing any changes to an algorithm, including monitoring and keeping records of any such changes. This includes having security arrangements in place to monitor and prevent unauthorised access to the algorithm;
- (iv) review and update algorithms to ensure that they reflect any relevant changes (e.g. market changes and changes in the applicable regulation or law) that may affect their effectiveness;
- (v) have in place policies and procedures that enable any error within the algorithm to be detected and dealt with appropriately, including, for example, suspending the provision of advice if that error is likely to result in unsuitable advice and/or a violation of Sharī'ah rules and principles and/or a breach of a relevant law/regulation;
- (vi) have in place resources, including human and technological resources, to monitor and supervise the performance of algorithms through an adequate and timely review of the advice provided;
- (vii) have in place an oversight and review process by a Sharī'ah board or Sharī'ah adviser to ensure that the inputs into system design, and the advice or outputs of the robo-advice services, are indeed Sharī'ah-compliant; and
- (viii) have in place an appropriate internal sign-off process to ensure that the steps above have been followed.

Appropriateness

119. When a firm provides investment services other than investment advice or portfolio management (non-advised services), it should be expected to ask the client, or the potential client, to provide information regarding the client's knowledge and experience in the investment field in relation to the specific product or service offered or requested, including with respect to Sharī'ah-compliant products and their structures and specificities, so as to enable the firm to make an assessment of whether the investment service or product envisaged is appropriate for the client. Where a bundle of services or products is envisaged, the assessment should consider whether the overall bundled package is appropriate, in addition to taking into consideration the conditions stipulated in paragraph 95.

120. Where the appropriateness test applies, a firm may be required to seek information from a client on the client's ability to understand the risks of a specific type of Sharī'ah-compliant investment product or service (i.e. the knowledge and experience of the client). This is to enable the firm to determine whether that investment product or service is appropriate for the client. (Unlike the requirements for suitability, there are no specific requirements to assess the client's financial situation or investment objectives.)

121. Where firms provide investment services consisting of execution only or reception and transmission of client orders with or without ancillary services, they can provide those investment services without the need to obtain information or to make a determination of appropriateness where the following conditions are met:

- (i) The services are related to non-complex Sharī'ah-compliant financial instruments.
- (ii) The service is provided at the initiative of the client or potential client.
- (iii) The client or potential client has been clearly informed that, in the provision of that service, the firm is not required to assess the appropriateness of the financial instrument or service provided or offered, and that therefore the client does not benefit from the corresponding protection of the relevant conduct-of-business rules.
- (iv) The firm complies with its obligations under conflict-of-interest rules.

122. Where a jurisdiction regulates P2P financing or equity crowdfunding platforms that make a claim of Sharī'ah compliance either in relation to the platform itself or where it markets individual investments for which a claim of Sharī'ah-compliance is made either by the platform or by the business promoters, prospective clients should be subject to an appropriateness assessment (to assess an investor's knowledge and experience of P2P and equity crowdfunding investments and Sharī'ah-compliant investments), in line with paragraph 119, where no advice has been given to the investor. In case a platform concludes that the service is not appropriate for the client, it should be expected to provide warning of this to the client. If an operator provides an auto-financing or auto-investing system, it must disclose prominently to investors who use the facility that no assessment is made that any financing or investment selected by the system is appropriate for the investor. In all cases, investment advice provided by a robo-adviser should not be considered a Sharī'ah resolution/*fatwā*.

Extent of information to be collected from clients for suitability and appropriateness assessment (proportionality)

123. Before providing investment advice or portfolio management services, firms should be expected to collect all "necessary information" about the client's knowledge and experience, financial situation and investment objectives. The extent of necessary information may vary and has to take into account

the features of the investment advice or portfolio management services to be provided, the type and characteristics of the investment products to be considered, and the characteristics of the clients.

124. In determining what information is “necessary”, firms should be expected to consider, in relation to a client’s knowledge and experience, financial situation and investment objectives, the type of financial instrument or transaction the firm may recommend or enter into (including the complexity and level of risk), the nature and extent of the service the firm may provide, and the needs and circumstances of the client as well as the type of client.

125. While the level of information collected by a firm should be proportionate to the products and services it offers or on which the client requests specific investment advice or portfolio management services, this should not lower the level of protection that is due to clients.

126. Whereas information about a client’s financial situation will always need to be collected, the extent of information to be collected may depend on the type of financial instrument to be recommended or entered into. For example, for illiquid Shari’ah-compliant financial instruments, the necessary information to be collected may include a number of additional elements as necessary to ensure whether the client’s financial situation allows them to invest or be invested in such instruments.

127. Additionally, in determining the information to be collected from clients, firms should take into account the nature of the service to be provided and its specificities and the information that is relevant to it. Practically, this means:

- (i) When investment advice is to be provided, firms should collect sufficient information in order to be able to assess the ability of the client to understand the specific risks, nature, structure and mechanisms of each Shari’ah-compliant financial instrument that the firm envisages recommending to that client.
- (ii) When portfolio management is to be provided, as investment decisions are to be made by the firm on behalf of the client, the level of knowledge and experience needed by the client with regard to all the Shari’ah-compliant financial instruments that can potentially make up the portfolio may be less detailed than the level the client should have when an investment advice service is to be provided. Nevertheless, even in such situations, the client should at least understand the overall risks of the portfolio and possess a general understanding of the risks linked to each type of financial instrument that can be included in the portfolio.

128. Similarly, the extent of the service requested by the client may also impact the level of detail of information collected about the client. For example, firms should collect more information about clients asking for investment advice covering their entire financial portfolio, than about clients asking for specific advice on how to invest a given amount of money that represents a relatively small part of their overall portfolio.

129. Firms should be expected to take into account the nature of the client when determining the information to be collected. For example, more in-depth information would usually need to be collected for potentially vulnerable clients, such as inexperienced clients asking for investment advice or portfolio management services for the first time.

130. Where a firm provides investment advice or portfolio management services to a professional/sophisticated client (who has been correctly classified as such), the firm is entitled to assume that the client has the necessary level of experience and knowledge, and therefore is not required to obtain information on these aspects.

131. Where the investment service consists of the provision of investment advice to a client who has been categorised as professional/sophisticated, the firm is also entitled to assume that the client is financially able to bear any related investment risks consistent with their investment objectives, and therefore is not generally required to obtain information on the financial situation of the client. Regulators should, however, require such information to be obtained where the client's investment objectives demand it. For example, where the client is seeking to hedge a risk, the firm will need to have detailed information on that risk in order to be able to propose an effective Sharī'ah-compliant hedging instrument.²²

Reliability of client information

132. Firms should be required to take reasonable steps and have appropriate tools to ensure that the information collected about their clients is reliable and consistent, without unduly relying on clients' self-assessment. Self-assessment should be counterbalanced by objective criteria, taking into account not only what the client has told the firm but also anything else that the firm knows, or reasonably ought to know, about the client.

133. Clients are expected to provide correct, up-to-date and complete information necessary for the suitability assessment. However, firms should be required to take reasonable steps to check the reliability, accuracy and consistency of information collected about clients. Firms are responsible for ensuring they have the necessary information to conduct a suitability assessment.

134. When assessing the risk tolerance of their clients through a questionnaire, firms should not only investigate the desirable risk–return characteristics of future investments but should also take into account the client's risk perception. To this end, while self-assessment for the risk tolerance should be avoided, explicit questions on the client's personal choices in case of risk uncertainty could be presented.

²² Refer to OIC Fiqh Academy Resolution no. 238 (9/24) regarding hedging mechanisms in Islamic financial institutions and AAOIFI Sharī'ah standard no. 45 on protection of capital and investments.

135. Regulators may encourage firms to adopt mechanisms to address the risk that clients may tend to overestimate their knowledge and experience – for example, by including questions that would help firms assess clients’ overall understanding of the characteristics and risks of the different types of Sharī’ah-compliant financial instruments. Such measures may be particularly important in the case of robo-advice, since the risk of overestimation by clients may be higher when they provide information through an automated (or semi-automated) system, especially in situations where very limited or no human interaction at all between clients and the firm’s employees is foreseen.

Arrangements necessary to understand Sharī’ah-compliant investment products

136. Regulators should require firms to ensure that the policies and procedures implemented by the firm to understand the characteristics, nature and features (including costs and risks) of Sharī’ah-compliant investment products allow them to recommend suitable investments, or to invest in suitable products on behalf of their clients.

137. Firms should also be expected to adopt robust and objective procedures, methodologies and tools that allow them to appropriately consider the different characteristics and relevant risk factors (such as credit risk, market risk, liquidity risk, etc.) of each Sharī’ah-compliant investment product they may recommend or invest in on behalf of clients. This should include taking into consideration the firm’s analysis conducted for the purposes of the product governance obligations outlined in section 2.3.

2.5.2 “Fit and Proper” Criteria

Principle 10: Intermediaries in the Islamic capital market must be able to demonstrate to authorities that natural persons giving investment advice or providing investment or ancillary services to clients, as well as those performing key control functions, possess the necessary knowledge and competence to fulfil their obligations, and regulators may publish criteria to be used for assessing such knowledge and competence.

138. Firms should be expected to ensure that staff know and understand and apply the firm’s internal policies and procedures designed to maintain compliance with Sharī’ah governance requirements. In order to achieve a proportionate application of knowledge and competence requirements, firms should be required to ensure that staff have the necessary levels of knowledge and competence to fulfil their obligations, which reflect the scope and degree of the relevant services provided.

139. Firms should also be required to ensure that all staff providing relevant services in the ICM products and services possess the necessary knowledge and competence to meet the relevant regulatory and legal requirements.

140. The level and depth of knowledge and competence expected from those providing investment advice should be higher than for those only giving information on investment products and services.

141. The compliance function should assess and review compliance with “fit and proper” requirements, and the review should be included in the report to the management body on the implementation and effectiveness of the overall control environment for Sharī‘ah-compliant investment services and activities.

142. This principle is applicable to firms that make a claim of Sharī‘ah compliance and to services provided to all clients regardless of client categorisation.

Recommended Best Practices

Criteria for staff providing investment information and investment advice

143. Firms should be required to ensure that staff giving information about investment products, investment services or ancillary services that are available through the firm have the necessary knowledge and competence to understand:

- (i) the key characteristics, risks and features of Sharī‘ah-compliant products available through the firm. Particular care has to be taken in giving information with respect to products that are characterised by higher levels of complexity;
- (ii) the total amount of costs and charges to be incurred by the client in the context of transactions in an investment product, investment service or ancillary service;
- (iii) the characteristics and scope of Sharī‘ah-compliant investment services or ancillary services;
- (iv) how financial markets function, and how they affect the value and pricing of the Sharī‘ah-compliant investment products on which they provide information to clients;
- (v) the data and information relevant to Sharī‘ah-compliant investment products on which they provide information to clients, such as Key Information Documents, prospectuses, financial statements or financial data;
- (vi) specific market structures for Sharī‘ah-compliant products on which they provide information to clients and, where relevant, their trading venues or the existence of any secondary markets;
- (vii) the basic valuation principles relating to the type of Sharī‘ah-compliant product about which information is provided; and

(viii) key relevant features of the regulatory regime applicable to the firm and products.

144. Firms should be required to ensure that staff giving investment advice have, in addition to the above requirements, the necessary knowledge and competence to:

- (i) fulfil the obligations required by firms in relation to the suitability requirements;
- (ii) understand how the type of investment product provided by the firm may not be suitable for the client, having assessed the relevant information provided by the client against the changes that have occurred since that information was gathered;
- (iii) understand the impact of economic figures and national/regional/global events on markets and on the value of investment products being offered or recommended to clients;
- (iv) understand the difference between past performance and future performance scenarios, as well as the limits of predictive forecasting; and
- (v) understand the fundamentals of managing a Sharī'ah-compliant investment portfolio, including being able to understand the implications of diversification regarding individual investment alternatives, Sharī'ah screening processes, and Sharī'ah purification and how it is calculated.

Along with the above requirements, staff should fulfil all other “fit and proper” criteria, including honesty, integrity, fairness and ethical behaviour. In addition to ensuring that standards of fitness and propriety are met before an individual is permitted to advise or provide information to clients, the firm should be required to provide ongoing training and development to ensure that the individual’s skills and expertise remain up to date.

“Fit and proper” criteria for key control functions

145. Regulators should require firms to assess fitness and propriety of staff involved in control functions such as internal audit, compliance and risk management functions. In general, the considerations may include: (i) honesty, integrity and reputation; (ii) competence and capability; and (iii) financial soundness. In determining competence and capability, firms should be required to assess whether the person satisfies the relevant training and competence requirements set by the regulator in relation to a control function that includes an appropriate level of relevant training in Islamic finance and Sharī'ah-compliant transactions; and whether the person has demonstrated by experience and training that they are suitable, or will be suitable, if approved to perform a control function.

146. In assessing fitness and propriety, the activities of the firm for which the control function is performed and the markets in which it operates should be considered. This includes consideration of the nature, scale and complexity of its business, the nature and range of Sharī'ah-compliant financial

services and activities undertaken in the course of that business, and whether the staff has the necessary knowledge, skills and experience to perform the specific role, particularly whether they have adequate knowledge of Islamic finance.

Qualifications of firm staff that undertake suitability assessments

147. Firms are required to ensure that staff involved in material aspects of the suitability process have an adequate level of skills, knowledge and expertise, including in Sharī'ah-compliant instruments and Islamic finance and the ICM.

148. Staff must understand the role they play in the suitability assessment process and possess the skills, knowledge and expertise necessary, including sufficient knowledge of the relevant regulatory requirements and procedures, to discharge their responsibilities.

149. Staff giving investment advice or information about Sharī'ah-compliant financial instruments, investment services or ancillary services to clients on behalf of the firm (including when providing portfolio management) must possess the necessary knowledge and competence, including with regard to suitability assessment.

150. Other staff that do not directly face clients but who are involved in the suitability assessment in any other way must still possess the necessary skills, as well as the Sharī'ah knowledge and expertise required, depending on their particular role in the suitability process. This may cover, for example, those responsible for setting up the questionnaires, defining algorithms governing the assessment of suitability or other aspects necessary to conduct the suitability assessment, and controlling compliance with the suitability requirements.

151. Where relevant, when employing automated tools (including hybrid tools – i.e. those with some human involvement), firms should ensure that their staff involved in the activities related to the definition of these tools: (i) have an appropriate understanding of the technology and algorithms used to provide digital advice (in particular, that they are able to understand the rationale, risks and rules behind the algorithms underpinning the digital advice); and (ii) are able to understand and review the digital/automated advice generated by the algorithms.

152. Firms should be required to set out the responsibilities of staff and to ensure that, where relevant, in accordance with the services provided by the firm and its internal organisation, there is a clear distinction in the description of responsibilities between the roles of giving advice and giving information.

153. Firms should be required to carry out an internal or external review, on at least an annual basis, of staff members' development and experience needs, and to assess regulatory developments and take any action necessary to comply with these requirements. This review should also ensure that the

relevant staff (where necessary) possess an appropriate qualification and maintain and update their knowledge and competence by undertaking continuous professional development or training for the appropriate qualification, as well as specific training required in advance of any new Sharī'ah-compliant products being offered by the firm.

Principle 11: Senior management and the board of directors of intermediaries in the Islamic capital market that make a claim of Sharī'ah compliance should collectively possess the necessary knowledge and competence to fulfil their obligations.

154. Given that the legal frameworks in most jurisdictions hold the BOD ultimately responsible for governance of the firm, which would include Sharī'ah governance and ensuring the firm's conformity with Sharī'ah rules and principles, it is important that the board meets "fit and proper" criteria with respect to carrying out this responsibility. The BOD would need to be cognisant of the risk of Sharī'ah non-compliance and the reputational risks involved. The BOD should therefore be required to introduce the mechanisms and risk management and governance systems necessary to safeguard the interests of investors and to maintain the Sharī'ah compliance of the firm.

155. The BOD collectively should have knowledge and past experience of Islamic finance, and an understanding of the specificities of Sharī'ah-compliant products and transactions, and the specific risks associated with them, and of the risk management and Sharī'ah governance processes required to perform the board's role.

156. The BOD and senior management should also meet all other general "fit and proper" criteria, including competency and capability in all other aspects relevant to the role of the BOD with respect to the firm's business, such as honesty, integrity, fairness and ethical behaviour, and financial soundness and solvency.

157. The senior management team should also demonstrate an adequate level of knowledge and competence to carry out its functions, particularly with respect to Sharī'ah governance and the implementation of the necessary systems and processes to ensure Sharī'ah compliance across all the firm's operations and activities.

Recommended Best Practices

158. Regulators should require "fit and proper" assessments to be conducted by the firm to ensure that members of the BOD and senior management are competent to undertake the relevant class of regulated activities, including, where appropriate, having detailed knowledge of the structure, purpose and risks of the Sharī'ah-compliant products and services associated with the activity.

159. The nature and extent of the competence required may depend upon the Shari'ah-compliant services being offered or to be offered.

160. The BOD and senior management should also fulfil the criteria of honesty, diligence, integrity, fairness and ethical behaviour, which is essential to the good reputation and trustworthiness of the ICM in general and of individual entities in particular. In determining the honesty, integrity and reputation of the key person, factors that may be considered include, among other things, whether they have been convicted on indictment, of dishonesty, fraud, money laundering, theft or financial crime within the past 10 years.

161. The financial soundness of members of the BOD or senior management may be assessed in terms of whether the regulated person can maintain solvency and prudent financial control. This may include whether they are able to meet liabilities as they become due and ensure adequate control over financial risks on a continuing basis. Financial soundness is an important element in determining fitness and probity.

2.5.3 Best Execution

Principle 12: When executing orders, intermediaries in the Islamic capital market should be required to take all sufficient steps to obtain the best possible result for their clients, taking into account the price, costs, speed, likelihood of execution and settlement, size, nature, any considerations necessary to ensure Shari'ah compliance or any other consideration relevant to the execution of the order.

162. Regulators should require firms to establish and implement effective arrangements to ensure that they comply with the best execution requirements whenever a firm owes a contractual or agency obligation to the client. In particular, each firm may be required to have an order execution policy to allow it to obtain the best possible result for client orders in accordance with the factors listed in Principle 12.

163. When a firm executes the order on behalf of a retail client, the best possible result shall be determined in terms of the total consideration, representing the price of the financial instrument and the costs relating to execution, which shall include all expenses incurred by the client that are directly relating to the execution of the order, including execution venue fees, clearing and settlement fees, and any other fees paid to third parties involved in the execution of the order. In more volatile market conditions, it is likely that clients might give higher priority to speed of execution because of the increased risk of a price change during any delay. Therefore, regulators may recommend that client preferences need to be considered dynamically by firms executing client orders, especially in volatile markets. Market volatility also increases the potential adverse consequences of any failures in areas like the order in which client instructions are executed. Regulators may advise firms to take this into

account and to pay particular attention during such periods to ensure that orders are executed in the best interest of clients.

164. The regulatory regime should ensure that the firm does not receive any remuneration, discount or non-monetary benefit for routing client orders to a particular trading venue or execution venue, which would infringe the requirements on conflicts of interest or inducements.

165. Firms should also be expected to provide appropriate information to their clients on their order execution policy. That information should be expected to explain clearly, in sufficient detail and in a way that can be easily understood by clients, how orders will be executed by the firm for the client.

166. This section applies to firms and is relevant to retail clients with higher protections, as well as to professional/sophisticated clients.

Recommended Best Practices

167. Rules for best execution apply to retail clients as well as other categories of clients. In determining best execution when executing an order on behalf of a retail client, the costs relating to the execution should include a firm's own commissions or fees charged to the client where more than one venue listed in a firm's execution policy is capable of executing a given order. The relevant costs of execution on each of the eligible execution venues should be taken into account in order to assess and compare the results for the client of using each potential venue. For retail clients, judged on a case-by-case basis of whether a specific order execution gives rise to a reasonable implication related to Sharī'ah compliance, the factors considered for best execution may include, where it is relevant, whether there are available any specific facilities or a dedicated Islamic securities exchange platform for Sharī'ah-compliant transactions at a specific venue. Where such a venue is available, the firm may determine whether it serves the best execution objective from a Sharī'ah compliance perspective with respect to trade and post-trade services (e.g. settlement through Islamic financial institutions, collaterals for margin financing²³ that is Sharī'ah-compliant, etc.). Retail clients must also be informed of any material difficulties relevant to the proper carrying out of their order(s) promptly upon becoming aware of the difficulty.

168. For professional, qualified or sophisticated clients, it may not be necessary to prioritise the overall costs of the transaction as being the most important factor in achieving best execution if the client has indicated other categories. The burden of disclosures regarding execution of orders can be slightly lower for market counterparties compared to retail clients.

²³ Sharī'ah-compliant margin financing is a *qard* provided by an intermediary without imposing any monetary or non-monetary excess on the principal. Collateral is normally required. However, if it includes a hidden interest in the form of fees or restricting the right of the client to act, then it would be impermissible.

169. The criteria for determining the relative importance of the different factors that may be taken into account for determining the best possible result given the size and type of order and the category of the client are as follows:

- (i) characteristics of the client, including their categorisation as retail or professional/sophisticated, etc.;
- (ii) characteristics of the client order;
- (iii) characteristics of the Sharī'ah-compliant financial instrument involved in the order; and
- (iv) characteristics of the available execution venues to which the order can be directed.

170. Regulators should require firms to make periodic public reports, at least on an annual basis, on the quality of execution obtained, the execution venue, and other details, which may include:

- (i) how the price, costs, speed and likelihood of execution are factored in the overall assessment of execution quality achieved;
- (ii) whether close connections to venues, conflicts of interest or shared ownership of venues have influenced execution quality;
- (iii) whether (non-)monetary benefits have been received; and
- (iv) whether, where applicable, any changes occurred regarding the execution venues listed in the best execution policy.

171. Regulators should also require firms that execute client orders to monitor the effectiveness of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, they may assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether they need to make changes to their execution arrangements and if there are any Sharī'ah compliance implications of trading on different venues.

172. It is also good practice for firms to notify clients with whom they have an ongoing client relationship of any material changes to their order execution arrangements or execution policy, as well as be able to demonstrate to their clients, at their request, that they have executed their orders in accordance with the firm's execution policy, and to demonstrate to the regulator how the execution and other factors are considered as part of all sufficient steps to obtain best execution.

173. Firms should be expected to clarify how they can satisfy best execution requirements when using a single venue or entity for execution. Where a firm transmits or places orders with a single entity for execution, the firm may be required to be able to determine that selecting only one entity complies with the overarching best execution requirement and is able to reasonably expect that the entity it

selects will enable the firm to obtain results for its clients that are at least as good as the results that it reasonably could expect from using alternative entities.

174. A regulator may also apply the aforementioned principles on best execution in relation to trading of crypto-assets, where applicable. Firms that trade crypto-assets on electronic trading platforms on behalf of clients should be expected to ensure that the execution and settlement of transactions are conducted in a timely, efficient and transparent manner. For retail investors, best price and timeliness of execution that are applicable to the traditional forms of order execution discussed above are also equally applicable to order execution for crypto-assets.

2.5.4 Marketing and Promotion

Principle 13: All information, including marketing communications, addressed by the firm to clients or potential clients shall be fair, clear and not misleading, and marketing communications shall be clearly identifiable as such.

175. If a firm makes a claim, explicitly or implicitly, in its marketing and promotions, such a claim should be fair, clear and not misleading to investors. The specific features and risks associated with Sharī'ah-compliant instruments or services marketed by the firm should be clearly and prominently outlined in its promotional materials when any benefits of such instruments or services are mentioned therein.

176. The principle is applicable to firms and to all categories of clients.

Recommended Best Practices

177. Regulators should require firms to ensure that financial promotions made by the firm fulfil the following requirements:

- (i) For a Sharī'ah-compliant product or service that puts the client's capital at risk (such as equities, ICIS investing in equities, or instruments such as *mudārabah* and *mushārahah*), the promotion makes this clear.
- (ii) If it quotes a prospective rate of return, it provides an accurate impression of both short- and long-term prospects for the investment.
- (iii) If it promotes an investment or service whose charging structure is complex, or in relation to which the firm will receive more than one element of remuneration, it includes the information necessary to ensure that it is fair, clear and not misleading, and contains sufficient information taking into account the recipients.

- (iv) A promotion that offers packaged products not developed by the firm gives a fair, clear and not misleading impression of the issuer of the product or the manager of the underlying investments, the Sharī'ah compliance of the products, and the basis on which this is claimed.

178. Firms should be required to ensure that a financial promotion does not describe a feature or a product or service as “guaranteed”, “protected” or “secure”, or use a similar term unless the term is capable of being a fair, clear and not misleading description of it, and if this description/feature of the product is not in contradiction with the Sharī'ah compliance claim made regarding the product. Regulators may also require firms to communicate all necessary information and present it in a sufficiently clear and prominent manner.

179. Firms should also be expected to ensure that a financial promotion addressed to a client is clearly identifiable as such.

180. Regulators should also require firms to ensure that when communicating with retail clients, they provide sufficient details, including the name of the firm, and a fair, accurate and prominent indication of all of the specific features and any relevant risks when referencing the potential benefits of a Sharī'ah-compliant investment.

181. Regulators should also expect firms to ensure that the information is up to date, and sufficient for and presented in a way that is likely to be understood by the average member of the group to which it is directed or by whom it is likely to be received. It should not disguise, diminish or obscure any important items, statements or warnings.

182. In deciding whether, and how, to communicate information to a particular target audience, a firm may be encouraged to take into account the nature of the Sharī'ah-compliant product or business, the specific risks involved, the client's commitment, the likely information needs of the average recipient, and the role of the information in the sales process. When communicating information, a firm should consider whether omission of any relevant fact will result in the information being insufficient, unclear, unfair or misleading to a client.

183. Where a jurisdiction has P2P financing or equity crowdfunding platforms, the above requirements also apply in that no false or misleading information may be given to investors in the marketing of crowdfunding. Specifically, for the purpose of a considered assessment of a crowdfunding recipient and the specific offer, the crowdfunding recipient must disclose true and sufficient information about factors that are likely to materially influence a company's value or its repayment ability, before starting to acquire funds, as well as any relevant Sharī'ah issues that may be of importance to investors' decisions.

2.5.5 Conflicts of Interest

Principle 14: Regulators should ensure that firms have in place effective policies and procedures to identify actual or potential conflicts of interest, prevent them as far as possible, and if they cannot be prevented, manage the impact of conflicts of interest and disclose them to clients.

184. The growing range of activities undertaken by intermediaries in the ICM increases the potential for conflicts of interest between those different activities and the interests of their clients. It is therefore necessary to provide rules to ensure that such conflicts do not adversely affect the interests of their clients.

185. Ensuring high standards of conduct and avoiding or managing conflicts of interest are vital in the ICM. Beyond the generally applicable provisions to manage conflicts of interest within operations of firms in the capital market, an additional consideration with respect to the ICM is the need to ensure that the firm's Sharī'ah governance structures also do not give rise to any conflicts of interest.

186. Regulators should require firms to properly manage all conflicts that could arise between clients and themselves or their staff, or between separate clients. This should include a comprehensive, board-approved policy for managing conflicts of interest at the firm level, initiating conflict management and, where avoidance or mitigation is not possible, disclosing any potential conflicts to clients. It may also involve restrictions on staff behaviour – for example, on own-account dealing. Regulators must emphasise that the reliance by a firm on disclosure should rank below the management of risks of conflict of interest to prevent those conflicts occurring, or mitigating the potential impact of any conflicts. Firms should be accountable to document and demonstrate to the regulator how conflicts – or potential conflicts – of interest have been managed. However, where some residual risk of detriment to the client's interests remains, the firm should be required to clearly disclose to the client in a timely manner the general nature and/or sources of the conflict of interest.

187. The principle is applicable to firms and to all categories of clients.

Recommended Best Practices

188. Regulators should require firms to take all appropriate steps to identify and prevent or manage conflicts of interest between themselves (including their managers, employees and tied agents, or any person directly or indirectly linked to them by control) and their clients, or between one client and another, that arise in the course of providing any investment and ancillary services, or combinations thereof. This includes those conflicts of interest caused by the receipt of inducements from third parties or by the firm's own remuneration and other incentive structures. Members of the BOD and Sharī'ah

board members should also not have any conflicts of interest in relation to any of the products or services offered by the firm.

189. Regulators should require a firm to consider and identify where conflicts may arise in the course of their business between the firm (including its managers, employees and tied agents, or any person directly or indirectly linked to the firm) and its clients, and between different clients. The circumstances that need to be considered as giving rise to a conflict of interest include cases where there is a conflict between the interests of the firm or certain persons connected to the firm or the firm's group and the duty the firm owes to a client. It can also be when there is a conflict between the differing interests of two or more of its clients, to whom the firm owes in each case a duty. In these circumstances, it is not enough that the firm may gain a benefit if there is not also a possible disadvantage to a client, or that one client to whom the firm owes a duty may make a gain or avoid a loss without there being a concomitant possible loss to another such client.

190. Where organisational or administrative arrangements made by the firm to prevent conflicts of interest from adversely affecting the interest of its client are not sufficient to ensure with reasonable confidence that risks of damage to client interests will be prevented, the firm shall clearly disclose to the client the general nature and/or sources of conflicts of interest and the steps taken to mitigate those risks before undertaking business on its behalf. The disclosure shall include sufficient detail, taking into account the nature of the client, to enable that client to make an informed decision with respect to the service in the context of which the conflict of interest arises.

191. Where a firm informs the client that investment advice is provided on an independent basis, that firm shall:

- (i) assess a sufficient range of financial instruments available on the market which must be sufficiently diverse with regard to their type and issuers or product providers to ensure that the client's investment objectives can be suitably met and must not be limited to financial instruments issued or provided by:
 - (a) the firm itself or by entities having close links with the firm; or
 - (b) other entities with which the firm has such close legal or economic relationships, such as contractual relationships, as to pose a risk of impairing the independent basis of the advice provided;
- (ii) except as described in paragraph 193, not accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients.

192. With respect to providing portfolio management, the regulator should require that the firm does not accept and retain fees, commissions, or any monetary or non-monetary benefits paid or provided

by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients, except as described in paragraph 193.

193. Notwithstanding paragraphs 191 and 192, firms may be allowed to accept and retain minor non-monetary benefits where these are:

- (i) demonstrably capable of enhancing the quality of the service provided to the client;
- (ii) of a scale and nature that it could not be judged to impair the firm's compliance with its duty to act honestly, fairly and professionally in the best interests of the client;
- (iii) reasonable, proportionate and of a scale that is unlikely to influence the firm's behaviour in any way that is detrimental to the interests of the relevant client; and
- (iv) clearly disclosed prior to the provision of the relevant service to the client, where appropriate in a generic way.

194. The firm should also be required to keep and regularly update a record of actual and potential conflicts of interest.

195. The regulator should require firms to put in place organisational and administrative structures and arrangements with a view to taking all reasonable steps to prevent conflicts of interest from adversely affecting the interests of clients, and document this in a conflicts-of-interest policy. The conflicts-of-interest policy should be appropriate to the size and organisation of the firm and the nature, scale and complexity of its business. Such policies and measures should take into account the specificities and differences in Sharī'ah-compliant products or transactions where special instances of conflict of interest occur as a result of the unique structuring of ICM products.

196. Where these organisational/administrative measures do not allow a firm to have reasonable confidence that the risk of damage to clients' interests will be prevented, the firms should make disclosure to clients containing sufficient detail regarding the general nature or source of conflicts of interest, or both, and the steps taken to manage/mitigate those risks so that clients can make an informed decision before conducting business with the firm. Firms must be encouraged to treat disclosure of conflicts as a measure of last resort to be used only where the effective organisational and administrative arrangements established by the firm to prevent or manage its conflicts of interest are not sufficient to ensure that risks of damage to the interests of the client will be prevented.

197. A firm that provides investment services to clients shall ensure that it does not remunerate or assess the performance of its staff in a way that conflicts with its duty to act in the best interests of its clients. In particular, it shall not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to its staff to recommend a particular financial instrument to a retail client when the firm could offer a different financial instrument that would better meet that client's needs.

198. A formal remuneration policy should be approved and overseen by senior management. The policy should be aimed at the alignment of remuneration structures, including incentive schemes, internal rewards and sales targets for those firms operating in both the retail and professional markets, that will encourage responsible business conduct and fair treatment of clients and avoid conflicts of interest.

199. Crypto-asset trading platforms sometimes perform functions that are more than that of traditional trading venues, such as the functions typically performed by intermediaries for normal securities, including onboarding of retail clients, providing custody of assets, and acting as transfer agents and clearing houses. In the case of intermediaries in the ICM dealing with such assets, regulators should be particularly alert to the possibility of conflicts of interest and put in place rules to avoid such conflicts. This may include rules prohibiting or restricting the performance of multiple functions by the same entity. Any possible conflicts of interest related to the Sharī'ah-governance functions involved should also be considered.

200. Where a jurisdiction has online retail investment and trading platforms (e.g. online brokerage firms, robo-advisers, online asset management platforms, etc.) that make a claim of Sharī'ah compliance regarding itself or in relation to individual investments offered by it, the regulator should seek to establish rules to address the risk of conflicts of interest, considering issues specific to such platforms. One such example is where a platform is fully automated, providing no choice to the investor in where they invest, or where investors can use an automated service offered by the platform where investments are automated through the platform's own matrix. In the case of automated information platforms or automated advice, conflicts of interest may emerge if, for instance, the underlying algorithm is programmed to direct investors towards a specific range of preferred investment alternatives or intermediaries for which the platform or its affiliates receive higher commissions or other forms of compensation. In such cases, there could be a conflict of interest or misalignment of incentives involved in these transactions. Regulators should therefore seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed by addressing the issues specific to the type and nature of the online platform that is being regulated.

2.6 Client Assets

Principle 15: Regulators should require firms to make adequate arrangements to safeguard the rights of clients in client assets, minimise the risk of loss, diminution and misuse of clients' assets, disclose sufficient information to clients, maintain accurate and up-to-date records, and, where it is reasonably possible, ensure that clients' assets are held in a Sharī'ah-compliant manner.

201. Client assets include both client funds and securities or other financial instruments. Regulators should require firms to ensure that any client financial instruments deposited with a third party are identifiable separately from the financial instruments belonging to the firm or to that third party, by means

of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection.

202. Regulators should require that client funds deposited in a central bank, a bank or a qualifying money market fund are held in an account or accounts identified separately from any accounts used to hold funds belonging to the firm, and that, to the extent possible, these are Sharī'ah-compliant.²⁴

203. Firms should also be expected to have in place adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

204. Regulators should require a firm, when holding Sharī'ah-compliant financial instruments belonging to clients, to make adequate arrangements so as to safeguard the ownership rights of clients, especially in the event of the firm's insolvency, and to prevent the use of a client's financial instruments on own account except with the client's express consent.

205. Similarly, when holding funds belonging to clients, a firm should be required to make adequate arrangements to safeguard the rights of clients and prevent the use of client funds for its own account. In holding client funds, the firm should ensure that they are held in a Sharī'ah-compliant manner to the extent reasonably possible (except, for example, where a Sharī'ah-compliant option is not available in that jurisdiction and a client has confirmed in writing their acceptance of holding their funds in a non-Sharī'ah-compliant account, provided that any accrued interest will be distributed to charity in line with the requirements set out in paragraph 98).

206. Regulators should also require adequate segregation and protection of client assets, including through use of custodians and/or depositories that are, in appropriate circumstances, independent.

207. As part of its ongoing supervision, the regulator should require that, within its jurisdiction, there are mechanisms that best achieve the overall objective of client asset protection, taking into account its insolvency and investment services laws, regulations and practices, and the objectives of market efficiency and investor protection.

208. Regulators should require that, where third-party custodians are used, client assets are identified as such to any third-party custodian and equivalent protection is afforded to such assets. The regulatory system should ensure that such risks to investors are duly addressed through statutes, rules or mandatory arrangements.

209. Firms should be required to establish systems and controls for maintaining accurate and up-to-date records and accounts of client assets that readily establish the precise nature, amount, location and ownership status of client assets and the clients for whom the client assets are held, and, where relevant, whether or not client funds are being held in a Sharī'ah-compliant account. The firm's records

²⁴ See paragraph 98 in relation to keeping the client's money in conventional accounts/institutions.

should be maintained in a way that appropriately distinguishes among the client assets accounts of different clients of the firm and separates them from the assets of the firm itself. The records should also be maintained in such a way that they may be used as an audit trail. In this regard, the firm's records should be sufficient to permit an external party (such as a regulator or an external auditor/Shari'ah auditor or insolvency practitioner) to verify the amount, location, ownership status and identity of assets held and whether or not the assets are held in a Shari'ah-compliant manner. Where client assets are held with a third party, records should also include the location and the terms and conditions on which the third party holds the client assets.

210. Regulators should also require firms to provide a statement to each client on a regular basis detailing the client assets held for or on behalf of such client. The statement the firm provides should be a statement of account or other report to clients showing their asset holdings and money balances as of a reasonably recent date. Where a client requests a statement from the firm in relation to its assets, the firm should respond reasonably promptly to the request.

211. Where a firm places or deposits client assets in a foreign jurisdiction, the firm should be required to understand and take into account the foreign regime to the extent necessary to achieve compliance with applicable domestic requirements.

212. A firm should also be required to ensure that there is clarity and transparency in the disclosure of the relevant client asset protection regime(s) and arrangements and the consequent risks involved. Consistent with the requirements of the home jurisdiction, a firm should be required to ensure that its agreements with clients contain adequate and appropriate information about the arrangements for client asset protection and the ways in which the firm holds or deposits different types of client assets and the attendant risks. These disclosures should: (i) be appropriate in light of the relationship between the client asset and the client's rights in the asset; and (ii) take account of the fact that the ownership status of the client assets may affect the degree of protection. Any required disclosure should be in writing and be prepared in clear, plain, concise and understandable language, avoiding any legal or financial jargon not commonly understood.

213. Where the regulatory regime permits clients to waive or to modify the degree of protection applicable to client assets or otherwise to opt out of the application of the client asset protection regime, such arrangements should be subject to the following safeguards:

- (i) The arrangement should only take place with the client's explicit, recorded consent.
- (ii) Before such consent is obtained, the firm should ensure that the client has been provided with a clear and understandable disclosure of the implications and risks of giving such consent.
- (iii) If such arrangements are limited to particular categories of clients, clear criteria delineating those clients that fall within such categories should be defined, including, in particular, any

instances in which the client agrees to have client money held in a Sharī'ah non-compliant account, which is subject to the requirements set out in paragraph 98 related to the distribution of any accrued interest to charity.

214. Regulators should oversee a firm's compliance with the applicable domestic requirements to safeguard client assets.

215. Where a firm places or deposits client assets in a foreign jurisdiction, the regulator should, to the extent necessary to perform its supervisory responsibilities concerning applicable domestic requirements, consider information sources that may be available to it, including information provided to it by the firms it regulates and/or assistance from local regulators in the foreign jurisdiction.

216. There should be governance arrangements in the firm concerning custody and safeguarding of clients' assets, such as having a dedicated officer (who may, where appropriate, be the compliance officer) to take overall responsibility for clients' assets and funds and to ensure that they are held in a Sharī'ah-compliant manner.

217. In jurisdictions where investment advisers are treated separately from market intermediaries, investment advisers that deal on behalf of clients or that are permitted to have custody of client assets should be licensed. If an investment adviser does not deal, but is permitted to have custody of client assets, regulation should provide for the protection of client assets, including segregation and periodic or risk-based inspections (either by the regulator or an independent third party).

218. If a firm has control of, or is otherwise responsible for, assets belonging to a client that it is required to safeguard, there should be regulations that require proper protection for them (e.g. segregation and identification of those assets) by the firm. The measures should facilitate the transfer of positions and assist in the orderly winding-up in the event of insolvency and the return of client assets.

219. The regulator should have the power to take appropriate actions (which are in line with Sharī'ah rules and principles) in terms of:

- (i) restricting activities of the firm with a view to minimising damage and loss to investors;
- (ii) requiring the firm to take specific actions – for example, moving client accounts to another firm; and
- (iii) applying available measures intended to minimise client, counterparty and systemic risk in the event of a firm's failure, such as client and settlement *takāful* schemes or guarantee funds established by a third party.²⁵

²⁵ Bearing in mind that providing third-party guarantee funds in return for a fee is not Sharī'ah-compliant unless it is based on actual and direct cost.

220. This principle is applicable to firms and is regardless of client categorisation.

Recommended Best Practices

221. The firm's systems and controls for record-keeping of the handling of clients' assets should provide for reconciliations on a regular basis, consistent with the volume of activity in the accounts, between internal accounts and records in relation to the client assets and those of any third party with whom such client assets are held. In the context of reconciliations between a firm and a central securities depository, such reconciliations should take place on a daily basis.

222. The records and accounts held by the firm with regard to client assets should enable a firm, on a daily basis, to specify each client's rights and the firm's obligations to each client with respect to client assets.

223. Accounts held with a third party for the benefit of clients should be titled in such a way as to clearly distinguish assets held for clients from assets held for the firm. Where separate accounts at a third party are held for each client of the firm, the accounts should be titled in such a way as to clearly distinguish assets held for one client from assets held for any other client or for the firm itself.

224. Where client assets are placed with a third party (whether in the same jurisdiction or in a foreign jurisdiction, and whether an unrelated or affiliated party), the regulatory regime should require a firm to exercise all due skill, care and diligence in the selection and appointment (where applicable), and periodic review of the third party and of the arrangements for safeguarding the client assets, and should consider:

- (i) the legal requirements or market practices related to the holding of client assets that could adversely affect clients' rights during business as usual and in the event of resolution or insolvency of the firm or the third party;
- (ii) the ability of the third party to provide Shari'ah-compliant services with respect to holding client assets;
- (iii) the financial condition, expertise and market reputation of the third party;
- (iv) protection, or lack thereof, attendant upon the regulatory status of the third party; and
- (v) the need for diversification and mitigation of risks, where appropriate, by placing client assets with more than one third party.

225. Where a firm places client assets with a third party, the firm should, to the extent necessary to achieve compliance with applicable domestic requirements, understand the material effects of the contractual provisions governing that arrangement on the clients' rights in respect of such client assets,

including how those contractual provisions would operate in the jurisdiction where such assets are held, including in the event of the resolution or insolvency of the firm, the third party, or both.

226. A firm should be required to be aware of the effect of liens and other encumbrances on client assets and take appropriate steps to ensure that any such lien or encumbrance is granted only to the extent it is not in conflict with Shariah rules and principles and is permitted by the regulatory regime, including with respect to any requirement for client consent. To the extent it has a choice in agreeing to liens or encumbrances, firms should consider the best interest of the clients.²⁶

227. Regulators should require that security interests, liens or rights of set-off over client financial instruments or funds enabling a third party to dispose of a client's financial instruments or funds in order to recover debts that do not relate to the client or provision of services to the client are not permitted except where this is required by applicable law in a foreign jurisdiction in which the clients' funds or financial instruments are held. In all cases, Shari'ah rules and principles should be taken into consideration and if this is not possible, disclosure should be made about any differences in respect to the protection of client assets to enable clients to make informed decisions about their investments.

228. Regulators may require firms, where the firm is obliged to enter into agreements that create such security interests, liens or rights of set-off, to disclose that information to clients, indicating to them the risks associated with those arrangements. Where security interests, liens or rights of set-off are granted by the firm over client financial instruments or funds, or where the firm has been informed that they are granted, they shall be recorded in client contracts and the firm's own accounts to make clear the ownership status of client assets, such as in the event of an insolvency.

229. To the extent that the home regime imposes requirements on a firm that places or deposits client assets in a foreign jurisdiction, the firm may face challenges in ensuring its compliance with such domestic requirements. Accordingly, the firm should have sufficient knowledge of the domestic as well as foreign regimes where it places client assets to the extent necessary to ensure such compliance. This means that the firm has the responsibility to understand the client asset protection regimes and arrangements in every jurisdiction (including its home jurisdiction) in which client assets are kept, to the extent necessary to ensure compliance with the domestic requirements.

230. Where client assets are to be held or placed in a foreign jurisdiction and will be subject to the client asset protection and/or insolvency regimes of that foreign jurisdiction, the firm should inform the clients of that fact. The firm should, in advance, clearly and in an understandable manner, disclose the risks associated with such client asset custody arrangements and that there may be material differences between the home country and foreign jurisdiction protections and the potential consequences of such differences. In all cases, the protection and/or insolvency regimes of the home and foreign jurisdictions should not be in conflict with Shari'ah rules and principles; if such conflicts exist, any relevant

²⁶ The phrase *best interest of the clients* should not be interpreted to suggest the application of a fiduciary standard beyond the extent required by a relevant jurisdiction. In some common law jurisdictions, certain intermediaries may be subject to the duty to act fairly, honestly and in good faith, while not being technically subject to a fiduciary standard of care.

divergences in relation to client asset protection should be disclosed so that the client can make an informed decision concerning its investment.

231. Regulators should have and use adequate tools to effectively monitor a firm's compliance with the domestic client asset protection regime. Such tools may include, among other things, regulatory measures such as:

- (i) mandatory reports to the regulator from a firm, whether sent on a periodic basis or upon the occurrence of specific events, as to the nature, amount, location, value and ownership status of client assets held and whether they are held in a Sharī'ah-compliant manner to the extent possible, as well as the status of the firm's compliance with the applicable requirements and any separate client asset protections that apply where client assets are invested;
- (ii) mandatory periodic or occurrence-related reports to the regulator from self-regulatory organisations (if any) as to the status of the firm's compliance with the applicable requirements;
- (iii) mandatory reports sent to the regulator from independent external auditors, provided at least annually, as to the adequacy of the firm's controls in safeguarding client assets;
- (iv) ad hoc inspection visits to assess the adequacy of the firm's controls and risk management in safeguarding client assets; and
- (v) the establishment of whistle-blowing programmes to provide an additional mechanism for the monitoring of a firm's compliance.

232. The regulator should consider using a risk-based, internal controls focused approach to supervise its firms' compliance with the applicable domestic client asset protection requirements. Such a risk-based analysis should focus on firms that pose the greatest regulatory concerns and should, where practicable, consider:

- (i) the value of client assets held by the firm (as an indication of the impact the insolvency of the firm would have on clients and the market);
- (ii) the location of the client assets (as an indication of the impact of concentration risk on that particular firm or third party);
- (iii) the prudential/capital health and liquidity of the firm (as an indication of the likelihood of the insolvency of the firm); and
- (iv) the firm's risk profile, including the status of its general governance and Sharī'ah-governance arrangements, risk management systems and internal control arrangements,

regulatory history and complexity of its business, markets in which it operates and customer profile (as an indication of potential internal compliance risk posed by the firm).

233. Where a jurisdiction requires firms to meet specific qualifications in order to be considered eligible to place or deposit client assets in foreign jurisdictions, the regulatory regime should define clear criteria to delineate those qualifications.

234. To the extent necessary to perform their supervisory responsibilities concerning applicable domestic requirements, regulators should use available information sources in performing those responsibilities with respect to firms placing or depositing client assets in foreign jurisdictions.

235. Where the regulator has the power to require this, it may obtain from a firm information on the operation of the client asset regime in the foreign jurisdiction (or, where relevant, jurisdictions) where the firm places or deposits client assets, and may require such a firm to demonstrate that it has complied with any applicable client communication requirements.

236. Where a regulator has the power to request information regarding the nature, amount, location, value and ownership status of client assets, it should request such information from regulated firms to the extent necessary to perform its supervisory responsibilities.

237. Regulators should endeavour to respond to requests from foreign regulators regarding their client asset protection regime and/or insolvency regime, as far as the request falls within their remit. The local regulator may be in a better position to outline the standards in its jurisdiction and to explain how the client asset protection regime works generally as well as in default scenarios.

238. Regulators should consider seeking assistance from the local regulator in the foreign jurisdiction to obtain information concerning how the client asset protection regime in that jurisdiction operates. The local regulator may have access to better information and records than the home regulator and, in some cases, may be able to verify the location of client assets (e.g. where permitted by applicable law or regulation, by cross-checking records or through on-site inspections).

239. Regulators should consider any confidentiality and/or data protection issues that may prevent information sharing (especially in a cross-border context). Regulators should consider whether existing MOUs (including side letters) cover, or new MOUs should be agreed to address, confidentiality or other concerns.

240. To the extent consistent with any confidentiality and/or data protection rules, the regulator should be able to share information with respect to a particular firm or particular client asset as necessary. This could include, where permitted by applicable law or regulation, verifying the existence of particular assets or the holdings of a particular firm if necessary (e.g. through an on-site inspection or by cross-checking records) and/or sharing information about the firm's risk management processes, internal controls, risk profile and record of compliance with client asset protection rules.

241. Regulators should require that firms make information pertaining to clients' financial instruments and funds readily available to the following entities: the RSA, appointed insolvency practitioners and those responsible for the resolution of failed institutions. The information to be made available shall include the following:

- (i) related internal accounts and records that readily identify the balances of funds and financial instruments held for each client;
- (ii) where client funds are held by firms, details of the accounts in which client funds are held, their Sharī'ah compliance, and the relevant agreements with those firms (including any specific Sharī'ah-related features of those accounts that may be relevant);
- (iii) where financial instruments are held by firms, details of the accounts opened with third parties and of the relevant agreements with those third parties, as well as details of the relevant agreements with those firms;
- (iv) details of third parties carrying out any related (outsourced) tasks, and details of any outsourced tasks;
- (v) key individuals of the firm involved in related processes, including those responsible for oversight of the firm's requirements in relation to the safeguarding of client assets; and
- (vi) agreements relevant to establish client ownership over assets.

242. Regulators may allow firms to deposit financial instruments held by them on behalf of their clients into an account or accounts opened with a third party, provided that the firms exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those financial instruments, including the Sharī'ah compliance of those arrangements.

243. Regulators may require firms to take into account the expertise and market reputation of the third party, as well as any legal requirements related to the holding of those financial instruments that could adversely affect clients' rights. The requirement for the clients' financial instruments to be held in a Sharī'ah-compliant way and the protection of clients' rights in line with Sharī'ah principles should, however, be regarded as overriding.

244. Where a firm proposes to deposit client financial instruments with a third party, the regulator should ensure that the firm only deposits financial instruments with a third party in a jurisdiction where the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision, and that the third party is subject to this specific regulation and supervision.

245. When firms place client funds into one or more accounts opened with a central bank, an Islamic bank or a qualifying Sharī'ah-compliant money market fund, they should exercise due skill, care and

diligence in the selection, appointment and periodic review of the Islamic bank or Sharī'ah-compliant money market fund where the funds are placed, and in the arrangements for the holding of those funds, and consider the need for diversification of these funds as part of their due diligence. Firms should be required to take into account the expertise and market reputation of such institutions or qualifying money market funds (where holding client money in such funds is allowed in a jurisdiction),²⁷ as well as their Sharī'ah governance mechanisms, policies and procedures, with a view to ensuring the protection of clients' rights, as well as any legal, Sharī'ah governance or regulatory requirements, or market practices related to the holding of client funds that could adversely affect clients' rights. The requirement for protection of clients' rights in line with Sharī'ah principles should be regarded as overriding.

246. Regulators should require that firms do not deposit financial instruments held on behalf of clients with a third party in a foreign jurisdiction that does not regulate the holding and safekeeping of financial instruments for the account of another person unless one of the following conditions is met:

- (i) the nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that foreign jurisdiction; or
- (ii) where the financial instruments are held on behalf of a professional client, that client requests the firm in writing to deposit them with a third party in that foreign jurisdiction.

247. Regulators should not allow firms to use such financial instruments for their own account or the account of any other person or client of the firm, unless both of the following conditions are met:

- (i) the client has given their prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively executed by signature or equivalent; and
- (ii) the use of that client's financial instruments is restricted to the specified terms to which the client consents.

248. With respect to crypto-assets, where they are present in the jurisdiction the requirements for handling client assets are applicable. For example, for investor protection purposes, the regulator may require separation of trading platforms from the custody function, as well as segregation of client funds from proprietary funds.

249. Client asset provisions are also applicable to P2P and equity crowdfunding platforms that make a claim of Sharī'ah compliance in relation to the platform itself or individual investments offered by it. Regulators should require platforms to ensure, at a minimum, that client funds are kept separate from

²⁷ If a jurisdiction permits client monies to be held in money market funds, this should be only with the explicit consent of the client and on the basis that these funds meet the following conditions: a qualifying money market fund should, at minimum, be a regulated Sharī'ah-compliant fund that invests in high-quality Sharī'ah-compliant money market instruments, that has an investment objective of maintaining the net asset value of the undertaking to be at least the value of the investors' initial capital, and that provides redemption on a same-day or next-day basis.

the platform's own funds and that they are held in a Shari'ah-compliant account, where possible, taking into account the requirements set out in paragraph 98.

2.7 Complaints Handling and Dispute Resolution

Principle 16: Regulators should require firms to have in place an efficient, accessible and fair mechanism to address investor complaints and ensure that firms make available to investors adequate means of redress or dispute resolution mechanisms that take into account Shari'ah-related issues, and that clients of the firm are informed of the availability of such mechanisms.

250. In undertaking their role to protect investors' interests, regulators need to ensure that investors' complaints against firms are adequately addressed. Thus, regulators should ensure that regulated firms in the ICM make available to investors a means to first seek resolution from the firm. In particular, the complaints-handling function of a firm should ensure that staff undertaking this function have adequate knowledge of the specific features of the Shari'ah-compliant products and transactions undertaken by the firm, and of any relevant Shari'ah resolutions issued by the firm's Shari'ah board prior to issuance/offering of a product or service, as well as a general understanding of the Shari'ah issues involved, in order to adequately address an investor's complaint that is related to Shari'ah issues.

251. While an accessible, fair, accountable and efficient complaints-handling and redress mechanism is important, if a complaint cannot be resolved by these internal routes, it may be referred to an external mediator for arbitration, or for some other form of alternative dispute resolution (ADR). A currently popular model is that of an ombudsman²⁸ service. It is particularly important that the processes and means for seeking redress and any non-judicial dispute resolution mechanisms offered to investors take into account the relevant features of Shari'ah-compliant contracts and the Shari'ah-related issues involved, to provide an appropriate resolution for the investors. Regulators should ensure that such a mechanism is available or, alternatively, offer their own dispute resolution service. Access to any form of ADR should be made possible through electronic means so that the investor's physical presence is not obligatory and they do not have to physically travel in order to gain redress.

252. The regulator should require a firm to have a documented complaints management policy for clients or potential clients. Firms should be required to establish and maintain a complaints management function, in line with their policy, which enables complaints to be investigated. The regulator should also expect firms to publish the details of the process to be followed when handling a complaint.

253. These requirements are also applicable to crypto-asset platforms, P2P financing and equity crowdfunding, and robo-advisers or other online/digital platforms that provide Shari'ah-compliant investment services. Appropriate complaint procedures should be available to investors to resolve any

²⁸ A person officially appointed to resolve clients' disputes, usually with the ability to make rulings binding on firms.

issues arising from these services in a fair and timely manner, taking into consideration any Sharī'ah issues involved.

254. The principle in respect of complaints handling applies to both retail and professional/sophisticated clients. ADR schemes may, however, be limited in their coverage and/or in the size of the awards they can make.

Recommended Best Practices

255. The complaints management policy of a firm should be required to be formally documented and to be approved by the BOD. It should provide clear, accurate and up-to-date information about the complaints-handling process.

256. Information that firms are required to provide to clients regarding their complaints-handling process should include a copy of the complaints management policy and the contact details of the complaints management function. This information should also be provided by a firm to clients or potential clients on request, or when acknowledging a complaint. Clients and potential clients of firms should be able to submit complaints to a firm free of charge.

257. In cases where complaints are related to the non-Sharī'ah compliance of products or processes, the system should interact with the Sharī'ah governance bodies of the financial firm up to its Sharī'ah board.

258. Communications by firms to clients in relation to the complaints-handling process should be in plain language that is clearly understood. Firms should also be required to provide a response to the complaint without any delay.

259. It should be required by the regulator that a firm's compliance function undertakes a periodic analysis of complaints and complaints-handling data to ensure that they identify and address any emerging risks or issues.

260. Firms should be required to explain to the client or potential client the firm's position on the complaint and set out the client's or potential client's options and, where relevant, that they may be able to refer the complaint to an ADR entity.

261. Where relevant, a regulator should require firms to have in place internal dispute resolution systems and procedures that take into account Sharī'ah-related issues that arise from ICM contracts. These mechanisms and procedures should be documented appropriately by a firm, and the clients and users of the firm's services should be informed of their availability.

262. It would enhance the quality of investor protection efforts if the members of dispute resolution institutions (judges, arbitrators, ombudsmen, etc.) have a good understanding of Sharī'ah concepts and contracts, as well as Islamic finance products. The judge, arbitrator or ombudsman should know (by themselves, or with the help of advisers) about the peculiarities of Islamic contracts and possible alternatives that the firm should have considered before offering the disputed product.

263. Where an investor's complaint over an Islamic finance arrangement has not been settled internally by a firm's complaint-handling mechanism because the firm or investor insists on a particular Sharī'ah interpretation, the external institution for dispute resolution should be able to understand whether the Sharī'ah stance of the firm/investor is well-founded.

264. Any proposal for the solution of a dispute, or a judgment in favour of the investor, should be in line with Sharī'ah rules and principles.

265. The remedies, enforcement mechanisms and dispute resolution alternatives should be sufficiently reliable, and in line with Sharī'ah rules and principles, to inspire investor confidence in the overall integrity of the ICM.

2.8 Investor Education

Principle 17: Regulators should play an active role in promoting the education and understanding of investors and other market participants in relation to the Islamic capital markets.

266. Investor education can take many forms depending on the specific objectives the regulator intends to achieve, the types of ICM entities and instruments concerned, the experience and sophistication of the investors, and the resources available to the regulator.

267. A "one size fits all" approach to investor education programmes may be less effective because ICM investors, even among the retail class of investors, may have different levels of experience and financial sophistication. Investor education programmes may also be targeted to the specific needs of specific groups of investors.

268. Investor education provides investors with knowledge and tools to assess the benefits and risks associated with investment in Sharī'ah-compliant products. In developing tools to help investors assess risk, regulators must take care to avoid providing investors with specific investment advice. Securities regulators should not recommend the purchase or sale of particular securities by individual investors, nor particular strategies to guide their investment decisions. Investor education may be undertaken in the context of promoting better investor understanding of prospectus disclosure, so that investors can make well-informed investment decisions. An educated investor can better relate the disclosed risks specific to a Sharī'ah-compliant investment to their individual financial needs and preferences. By

helping investors make appropriate investments for themselves, the regulator may avoid a loss of public confidence in the markets.

269. Investor education also allows investors to protect themselves against fraud and other abuses. Educated investors can better monitor certain activities of the ICM in which they invest (or in which they are considering an investment) and assist the regulator in spotting abuses. For example, investors who understand the requirements of an ICM offering will be able to alert the regulator to illegal offerings or Sharī'ah non-compliant offerings where they are claimed to be such. Investor education should also help investors to understand their rights and options in the event of a dispute and may assist the regulator in correcting any wrongdoing.

270. Through investor education, a regulator can explain to the public the regulator's role with respect to the ICM. Investor education also can help the public to understand what the regulator can and cannot do for them. For example, some regulators provide information about which ICM entities have been authorised by the regulator. At the same time, a regulator can explain to investors what the authorisation of ICM entities in that jurisdiction says about the ICM entity and its Sharī'ah compliance status, whether there is a centralised Sharī'ah governance system or screening criteria set by the regulator, and/or the responsibilities of authorised entities.

271. In addition, a regulator may provide investors with information describing certain of the regulatory requirements applicable to the ICM, such as the need for a Sharī'ah adviser and Sharī'ah governance process and for certain disclosure requirements in a prospectus or other document. Regulators should also stress to investors the importance of reading and understanding the prospectus before making an investment in the ICM.

272. All investor education and financial literacy resources and materials offered to the public should be relevant, understandable and accessible.

Recommended Best Practices

273. Investor education efforts should generally target existing and potential investors who lack experience or financial sophistication, as well as those investors who have limited knowledge of Islamic finance and the ICM. The focus of investor education and financial literacy programmes may be on improving retail investor knowledge of basic core competencies for investing in the ICM, and on raising awareness and promoting understanding of the types of Sharī'ah-compliant investment products and services that are available. Basic core competencies may include how to avoid investment fraud, basic numerical concepts such as percentages, and narrative descriptions of expected risk and return. Basic core competencies may also include understanding the fees and costs associated with Sharī'ah-compliant products, screening methodologies and purification processes, and features of common Sharī'ah-compliant products.

274. Investor education and financial literacy programmes should be developed to meet the needs of specific audiences. Such programmes are usually most effective when based on particular retail investor segments – for example, age, life event, risk or behavioural profile, or level of financial knowledge. The choice of media for delivering investor education and financial literacy programmes may depend on the target investor or investor segment. To achieve the widest exposure, securities regulators may use a range of media such as distributing written materials (e.g. brochures and fact sheets), face-to-face meetings, website calculators, financial tools, training seminars, podcasts, videos, engagement with the media, town hall meetings and workshops.

275. Specifically, some of the areas that may be covered, at a minimum, in an investor protection programme for the ICM include:

- (i) basic Islamic finance and general financial concepts, to increase investors' knowledge of Islamic finance and its basic fundamentals and principles, as well as general financial concepts such as inflation, financial and non-financial assets, portfolio structuring and risk diversification, which are also applicable to Islamic finance;
- (ii) Sharī'ah-compliant product attributes, including factors affecting the price of Sharī'ah-compliant financial instruments, as well as fees, risks and returns to enhance investors' understanding of the specific risk characteristics of Sharī'ah-compliant products, particularly when the investment product is more complex than or structurally different from conventional products, or to appreciate the impact of fees on long-term returns;
- (iii) suitability, since retail investors may be unable to assess the suitability of Sharī'ah-compliant investment products and services for their own unique set of personal circumstances. They may also not be aware of specific product features of Sharī'ah-compliant products that could impede their exit from the investment if their circumstances change;
- (iv) avoiding fraud, including the use of alerts to protect retail investors who continue to be susceptible to investment scams or frauds, including misleading or incorrect claims of Sharī'ah compliance;
- (v) investor rights and responsibilities to assist retail investors to understand their rights with respect to Sharī'ah-compliant investments and transactions under their jurisdiction's legal framework, or to be aware of the importance of researching intermediaries and Sharī'ah-compliant investment products offered; and
- (vi) complaint handling and recourse so that investors know whom to contact, or how to file a complaint, or what action to take, if they suspect wrongdoing or fraud, or believe they have been treated unfairly or were mis-sold an investment product.

276. In addition to the above, education programmes may include those related to enhancing financial skills and competence of investors, including:

- (i) working with intermediaries in the ICM, since many retail investors are unaware of tools and resources that can help them to check the background and assess the qualifications of financial and investment professionals;
- (ii) financial planning and money management in accordance with Islamic finance principles; and
- (iii) critical thinking, since retail investors may not have the knowledge, experience or access to tools needed to determine whether the advice they receive is accurate, suitable and consistent with their goals.

277. Regulators may also consider insights gathered from research when developing effective and relevant investor education and financial literacy programmes that meet the information needs of investors in Shari'ah-compliant products in their jurisdiction.

278. Ideally, investor education and financial literacy programmes should have clear and measurable outcomes and, where possible, be reviewed or evaluated on an ongoing basis. Programme monitoring and evaluation is important for assessing its effectiveness, identifying areas for improvement, and verifying whether the programme makes good use of resources. It can also help inform the development of future programmes.

279. Regulators may encourage collaboration with other public, private, not-for-profit and educational institutions, or with self-regulatory organisations and investor associations, to deliver investor education programmes. Partnerships with industry associations or professional bodies may also be beneficial in targeting a specific group of retail investors where such an association has particular knowledge of the needs of a certain target retail investor audience or is better placed to interact with investors.

280. If the regulator is partnering with the financial industry in developing and delivering investor education and financial literacy programmes (e.g. with industry associations, professional bodies, intermediaries, financial institutions, and other market participants that have particular knowledge of the needs of a certain target retail investor audience or are better placed to have interactions with investors), it is important that securities regulators avoid conflicts of interest or the appearance of conflicts of interest. Investor education and financial literacy programmes provided by securities regulators should be independent, fair and unbiased, and be clearly distinguished from promotional or commercial materials.

281. In addition to ongoing investor education, regulators should issue investor alerts to announce any major or new information that is relevant for investors, such as recent investment scams and frauds,

investor warnings, market closure or any other matters. This may be particularly important under novel or volatile market conditions.

DEFINITIONS

Islamic Collective Investment Scheme (ICIS)	<p>Any structured financial scheme that, fundamentally, meets all the following criteria:</p> <ul style="list-style-type: none"> (a) Investors have pooled their capital contributions in a fund (whether that fund is in a separate legal entity, or is held pursuant to a contractual arrangement) by subscribing to units or shares of equal value. Such units or shares constitute, in effect, claims of ownership of the undivided assets of the fund (which can consist of financial or non-financial assets), and give rise to the right or obligation to share in the profits or losses derived from those assets. Whether or not the Islamic collective investment scheme is managed by the institutions that established or sponsored it, it is financially accountable separately from those institutions (i.e. it has its own assets and liabilities profile), but excluding <i>şukūk</i>. (b) The fund is established and managed in accordance with Sharī'ah rules and principles.
Sharī'ah Adviser	<p>An individual or entity that, depending on its size and capacity, provides Sharī'ah advisory services, including Sharī'ah review, as well as advice on Sharī'ah-compliant product development, as part of its professional services.</p>
Şukūk	<p>Certificates that represent a proportional undivided ownership right in tangible assets, or a pool of tangible assets and other types of assets. These assets could be in a specific project or specific investment activity that is Sharī'ah-compliant.</p>

ANNEX: Taxonomy of Crypto-Assets

Understanding the underlying characteristics of crypto-assets is important both for defining regulatory approaches to them and for considering any Shari'ah issues that may arise in relation to them. There is no generally agreed set of definitions, but "crypto-assets" are generally understood to be digital tokens created, kept and transferred by means of innovative technologies such as distributed ledger technology (DLT).

DLT is a term for IT technologies and protocols that use a ledger that is shared, distributed, replicable, simultaneously accessible, and with an architecture decentralised on cryptographic bases. Such technologies and protocols allow the recording, validation, updating and storage of data in a non-encrypted form, as well as in an encrypted form for additional protection, allowing verification of data by every participant, with data remaining non-alterable and non-editable. Blockchain is the best-known form of DLT, but there are others.

Crypto-assets can be classified into four categories as outlined in the table below.²⁹ Some of these types would not typically fall under the scope of securities regulators.

Type	Purpose	Inherent Value
Cryptocurrency	Cryptocurrencies are digital tokens or coins based on DLT, such as Bitcoin. They currently operate independently of a central bank and are intended to function as a medium of exchange, although there has been interest in cryptocurrencies backed by central banks and effectively replicating a fiat currency in DLT form.	None – value is derived based on supply and demand.
Asset-backed token	An asset-backed token is a digital token based on DLT that signifies and derives its value from something that does not exist on a distributed ledger but instead is a representation of ownership of a physical asset (e.g. natural resources such as minerals or oil).	Value is derived based on the underlying asset.
Utility token	Utility tokens are digital tokens based on DLT that provide users with access to a product or service and derive their value from that right. Utility tokens give holders no ownership in a company's platform or assets and, although they might be traded between holders, they are not primarily used as a medium of exchange	Value is derived from the demand for the issuer's service or product.

²⁹ This table is based on one originally published by PwC in <https://www.pwc.com/gx/en/audit-services/ifrs/publications/ifrs-16/cryptographic-assets-related-transactions-accounting-considerations-ifrs-pwc-in-depth.pdf>.

Security token	Security tokens are digital tokens based on DLT that are similar in nature to traditional securities. They provide an economic stake in a legal entity and sometimes the ability to vote in company decisions.	Value is derived from the success of the entity, since the holder of the token shares in future profits or receives cash, dividends or residual interest in a business.
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Some crypto-assets may exhibit elements of two or more of the identified subclasses (just as, for example, a traditional share in a company could confer rights to its product or service). Hybrid crypto-assets need further assessment and are not addressed by this standard.

Regulatory approaches to crypto-assets vary between jurisdictions. However, there appears to be a growing consensus that security tokens should be regarded as analogous to traditional securities and regulated in a broadly similar way in respect both to initial offerings and to subsequent trading. There is less consensus with regard to other types of crypto-assets and they are the subject of Sharī'ah debate.

APPENDIX: Gap Analysis and the IFSB’s Approach

G-20 High-Level Principles of Financial Consumer Protection	Investor Protection Framework for Islamic Finance	Guiding Principles	Summary of Specific Additional Issues Addressed for ICM	Directly Equivalent Conventional Standard	Relevant Core Principles in IFSB CPIFR (ICM)*	Good Practice Benchmarks	Relevant IOSCO Reports	Addressed by Other IFSB Standards
High Level (Conventional/ General for all Sectors)	Detailed [Guiding Principles and Best Practices Specific for ICM]			Nil	High Level	Regulatory Level	Reports (Conventional)	Areas Not Covered in this Standard
Equitable and Fair Treatment of Consumers	General Principles of Investor Protection	Principle 1: Duty to act fairly, honestly and professionally and with due care and diligence	Application of principles of Shari’ah and Islamic values in the conduct of firms and in the establishment of a code of ethics	–	–	–	IOSCO (2006), <i>Model Code of Ethics</i>	–
–	Compliance with Shari’ah Principles	Principle 2: Shari’ah governance	Shari’ah governance policies, processes and requirements specific to intermediaries in the ICM Addresses both traditional intermediaries in the ICM as well as those that deal with Shari’ah-compliant crypto-assets, P2P and equity crowdfunding, algorithmic trading, and online platforms such as robo-advisers	–	CPICM 10	–	–	–
–	Product Governance	Principle 3: Client categorisation	Additional considerations for client categorisation for investors for whom Shari’ah compliance is a material issue	–	–	MiFID II	–	–
		Principle 4: Product governance arrangements	Additional considerations for product governance within product approval processes, as well as for distributors of Shari’ah-compliant products	–	–	MiFID II	–	–
		Principle 5: Product intervention	Additional considerations for product intervention measures	–	–	MiFID II	–	–

Disclosure and Transparency	Disclosure and Transparency	Principle 6: Disclosures for Sharī'ah-compliant equities (protection of minority investors)	Specific disclosures for Sharī'ah compliance equities	–	CPICM 17, CPICM 18	–	IOSCO Report (2009), <i>Protection of Minority Shareholders in Listed Issuers</i>	IFSB-19: <i>Disclosure and Transparency for Şukūk and ICIS</i>
		Principle 7: Sharī'ah screening methodologies	Disclosures related to Sharī'ah screening methodologies and classification of equities as Sharī'ah-compliant	–	–	–	–	–
		Principle 8: Intermediaries in the Islamic capital market	Additional disclosures for intermediaries in the ICM wherever they make a claim of Sharī'ah compliance Includes disclosures for intermediaries in the ICM dealing with crypto-assets, and detailed disclosures for P2P and equity crowdfunding platforms that make a claim of Sharī'ah compliance	–	CPICM 32	MiFID II and other good practices	IOSCO Consultation Report (2019), <i>Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms</i>	–

Responsible Business Conduct of Financial Services Providers and Authorised Agent	Conduct of Business	Principle 9: Suitability and appropriateness	Specific requirements for suitability assessments of investors for whom Shari'ah compliance is a material issue	–	CPICM 32	MiFID II and other good practices	IOSCO Report (2013), <i>Suitability Requirements with Respect to the Distribution of Complex Financial Products</i>	–
		Principle 10: “Fit and proper” criteria for persons giving advice/services and those performing control functions	Requirements for adequate knowledge of Islamic finance and Shari'ah-compliant products and the specific types of ICM services the firm provides, so as to ensure competence to perform a specific role	–	CPICM 30	MiFID II and other good practices	IOSCO Report (2009), <i>Fit and Proper Assessment – Best Practice</i>	–
		Principle 11: “Fit and proper” criteria for senior management and BOD						
		Principle 12: Best execution	Considerations to ensure compliance with best execution requirements, including any additional considerations necessary to ensure Shari'ah compliance Also relevant to intermediaries in the ICM dealing with crypto-assets that make a claim of Shari'ah compliance	–	–	MiFID II	–	–
		Principle 13: Conflicts of Interest	Ensuring that there are effective policies and procedures to prevent, manage or disclose conflicts of interest, including additional consideration of any conflicts of interest arising from the Shari'ah governance functions Addresses, additionally, managing conflicts of interest related to crypto-asset trading platforms and online retail investment platforms that make a claim of Shari'ah compliance	–	CPICM 8	MiFID II and other good practices	IOSCO Report (2007), <i>Market Intermediary Management of Conflicts that Arise in Securities Offerings</i>	–
		Principle 14: Marketing and promotion	Additional considerations for marketing and promotion of products or services that make a claim of Shari'ah compliance	–	–	MiFID II and other good practices	–	–

			Includes marketing of P2P and equity crowdfunding platforms that make a claim of Sharī'ah compliance					
Protection of Consumer Assets against Fraud and Misuse	Client Assets	Principle 15: Protection of client assets	Additional requirements to ensure that client funds are held in a Sharī'ah-compliant manner where possible Applicable to crypto-asset trading platforms, P2P and equity crowdfunding platforms that make a claim of Sharī'ah compliance	–	CPICM 32	MiFID II and other good practices	IOSCO Report (2014), <i>Recommendations Regarding the Protection of Client Assets</i>	–
Complaints Handling and Redress	Complaints Handling and Dispute Resolution	Principle 16: Complaints handling and dispute resolution mechanisms	Considerations with respect to providing complaints handling and dispute resolution options that take into account Sharī'ah-related issues and ensuring that clients are aware of them Applicable to crypto-asset trading platforms, P2P, and equity crowdfunding and online retail investment platforms that make a claim of Sharī'ah compliance	–	CPICM 32 [^]	–	–	–
Financial Education and Awareness	Investor Education	Principle 17: Investor education	Regulators' role in enhancing the education and understanding of ICM	–	–	–	IOSCO Report (2014), <i>Strategic Framework for Investor Education and Financial Literacy</i>	–
Legal, Regulatory and Supervisory Framework	Addressed at high level in CPICM 6 and 7							
Role of Oversight Bodies								
Protection of Consumer Data and Privacy	Beyond the scope of the standard and of securities regulators							
Competition								

* The Core Principles in IFSB CPIFR (ICM) is benchmarked against the IOSCO Objectives and Principles of Securities Regulation (May 2017).

[^] Does not include Sharī'ah considerations in relation to complaints handling and dispute resolution.