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# **CORE PRINCIPLES FOR EFFECTIVE ISLAMIC DEPOSIT INSURANCE SYSTEMS**

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July 2021

## **ABOUT THE INTERNATIONAL ASSOCIATION OF DEPOSIT INSURERS (IADI)**

The International Association of Deposit Insurers (IADI) is the global standard-setting body for deposit insurance systems. IADI was formed in May 2002 to enhance the effectiveness of deposit insurance systems by promoting guidance and international cooperation. IADI conducts research and produces guidance for the benefit of those jurisdictions seeking to establish or improve a deposit insurance system. IADI's standards, outlined in its Core Principles for Effective Deposit Insurance Systems, are part of the Financial Stability Board's Key Standards for Sound Financial Systems, and are used in the Financial Sector Assessment Program (FSAP) reviews conducted by the International Monetary Fund and the World Bank. Members also share their knowledge and expertise through participation in international conferences and other forums. IADI currently represents 85 deposit insurers. IADI is a non-profit organisation constituted under the Swiss Law and is domiciled at the Bank for International Settlements in Basel, Switzerland.

For more information about IADI, please visit [www.iadi.org](http://www.iadi.org).

## **ABOUT THE ISLAMIC FINANCIAL SERVICES BOARD (IFSB)**

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

For more information about the IFSB, please visit [www.ifsb.org](http://www.ifsb.org).

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## ABBREVIATIONS

BCBS	Basel Committee on Banking Supervision
BCP	BCBS Core Principles for Effective Banking Supervision
CDIF	Conventional deposit insurance fund
CDIS	Conventional deposit insurance system(s)
CPIDIS	Core Principles for Effective Islamic Deposit Insurance Systems
EC	Essential criteria
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
IADI	International Association of Deposit Insurers
IAH	Investment account holder
IBW	Islamic banking window
IDB	Islamic Development Bank
IDIF	Islamic deposit insurance fund
IDIS	Islamic deposit insurance system(s)
IFSB	Islamic Financial Services Board
IFSB CPs	IFSB Core Principles for Islamic Finance Regulation (Banking Segment)
IFSI	Islamic financial services industry
IIFS	Institution offering Islamic financial services
IMF	International Monetary Fund
IRTI	Islamic Research and Training Institute
JWG	Joint working group
KAs	Key Attributes of Effective Resolution Regimes for Financial Institutions
OECD	Organisation for Economic Co-operation and Development
ROSC	Reports on the Observance of Standards and Codes
RSAs	Regulatory and supervisory authorities
SRR	Special resolution regime

## SECTION 1: INTRODUCTION

### 1.1 Background: The Need for CPIDIS

1. A conventional deposit insurance system (CDIS) has been established in many jurisdictions, but the business model of Islamic banks calls for certain adjustments in the way such a system is structured and operationalised. The business model of an Islamic bank differs from conventional banks on both sides of the balance sheet.<sup>1</sup> Designing appropriate protection for depositors therefore requires careful consideration of Sharī'ah issues.<sup>2</sup>

2. The implementation of a well-designed Islamic deposit insurance system (IDIS) for Islamic banks is particularly challenging given the characteristics of the Sharī'ah contracts and funding structures of Islamic banks. Nonetheless, an IDIS has the potential to promote stability and resilience in the Islamic financial services industry (IFSI), as it enhances depositor<sup>3</sup> confidence during times of economic shocks and market stress. Such confidence is critical in preventing panic-induced bank runs that may lead to failures of otherwise sound Islamic banks. Premised on this, some jurisdictions have already established an IDIS for the protection of Islamic deposits, while a number of others are in the process of introducing the same.

3. The International Association of Deposit Insurers (IADI) and the Basel Committee on Banking Supervision (BCBS) issued the Core Principles for Effective Deposit Insurance Systems (hereafter "IADI CPs") in June 2009. A Compliance Assessment Methodology for the Core Principles was completed in December 2010. Although the IADI CPs,<sup>4</sup> revised in November 2014, are generally applicable to IDIS, there are specificities of Islamic banks and Sharī'ah governance

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<sup>1</sup> See Annex 1 for further details.

<sup>2</sup> See section 2 "Definitions of Key Terms", to ascertain the differences between general "Islamic deposits" and "investment accounts" / "investment account holders (IAHs)".

<sup>3</sup> The term "depositor" or "deposits" has been used in the *Core Principles for Effective Islamic Deposit Insurance Systems* (CPIDIS) in a general sense where it encompasses all types of funds collected by Islamic banks from individual and business customers. However, the type of deposit and investment account products covered by the IDIS varies between jurisdictions, and not all types of fund providers are necessarily accorded coverage by the IDIS. The CPIDIS duly discuss additional considerations that are specific to investment accounts and IAHs in this document, while the other discussions are from a general depositor and/or deposit perspective (see subsection 1.4.2 of this document).

<sup>4</sup> Available at <https://www.iadi.org/en/assets/File/Core%20Principles/cprevised2014nov.pdf>.

requirements that need to be defined separately, thus confirming the need to develop a separate standard for IDIS.

4. In view of the above, the Council of the IFSB, in its 31<sup>st</sup> meeting held on 11 December 2017, and the IADI's Executive Council, in its 54<sup>th</sup> meeting held on 31 January 2018, agreed for the Secretariats of both the IFSB and IADI to collaborate and develop the IADI–IFSB *Core Principles for Effective Islamic Deposit Insurance Systems (CPIDIS)*.<sup>5</sup>

## 1.2 Main Premises and Objectives of this Work

5. The main objective of the CPIDIS is to provide a set of guidance in the form of core principles for the development and implementation of an effective IDIS, taking into consideration the specificities of Islamic banks, and drawing from the existing IADI CPs. In particular, the objectives of the CPIDIS are to:

- a. serve as a benchmark international framework to facilitate the development and implementation of an effective IDIS;
- b. enable the existing IDIS to identify best-practice gaps in their current modalities; and
- c. facilitate an independent, third-party or self-assessment of the compliance of an IDIS with the CPIDIS.

6. IADI and the IFSB envisage that jurisdictions will use the CPIDIS and their compliance assessment methodology as a benchmark for assessing the quality of their IDIS and for identifying gaps in their Islamic deposit insurance practices, including measures to address them. The CPIDIS are also envisaged to be used by the International Monetary Fund (IMF) and the World Bank, in the context of the Financial Sector Assessment Program (FSAP), to assess the effectiveness of jurisdictions' Islamic deposit insurance systems and practices. The CPIDIS may

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<sup>5</sup> To support the preparation of this guidance, the formation of a joint working group (JWG) was also approved comprising nominated experts from among the IADI and IFSB member institutions, including international financial organisations. It is this JWG, under the direction and guidance of the IFSB Technical Committee, and also the IADI Islamic Deposit Insurance Technical Committee, which has developed the CPIDIS and the associated assessment methodology, building upon IADI CPs. The work has further been informed by a public consultation process involving key regulatory and supervisory stakeholders, as well as a Sharī'ah review of the complete document on more than one occasion by the designated Sharī'ah board.



also assist IADI and IFSB member jurisdictions in: (a) self-assessment; (b) reviews conducted by third parties; and (c) peer reviews.

7. Overall, the CPIDIS will promote further integration of Islamic deposit insurance into the international architecture for financial stability. Given the importance of consistent and effective standards implementation, IADI and the IFSB stand ready to encourage work at the national level to implement the CPIDIS in conjunction with other financial safety-net participants. IADI and the IFSB invite international financial institutions and other agencies to use the CPIDIS in assisting individual jurisdictions to develop, implement and/or strengthen their IDIS. IADI and the IFSB will continue to collaborate closely with those institutions and agencies, and remain committed to further enhancing interaction with IDIS operating in non-member jurisdictions.

### 1.3 General Approach of the CPIDIS

8. The starting point for development of the CPIDIS has been a best-practice benchmark against IADI CPs. A thorough and careful analysis has been conducted in order to identify the Islamic finance areas where the IADI CPs do not fully apply to the specificities of Islamic finance in general, and to Islamic deposit insurance in particular. The principal objectives of a deposit insurance system (i.e. to provide protection for depositors and to promote the stability of the financial system) are compliant with the objectives of Sharī'ah and the IDIS.<sup>6</sup> The design features set out in the IADI CPs, such as governance, membership, coverage, and sources and uses of funds, are generally consistent with the features of an effective IDIS. However, some modifications are required to take into account the Sharī'ah requirements that define the heterogeneities of Islamic banking operations and the specificities of an IDIS. Moral hazard issues, operating environment and the other considerations discussed in the IADI CPs are also relevant to IDIS and are discussed from a CPIDIS context in section 3 of this document.

9. Based on the above, one new core principle has been developed for CPIDIS concerning Sharī'ah governance, while some IADI CPs have been modified at the level of principles and/or essential criteria, including the addition of new criteria. Other IADI CPs have been retained in view of their common applicability to both CDIS and IDIS. The text of these is given unchanged except

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<sup>6</sup> Financial safety-nets, including deposit insurance systems, aim to promote financial stability and prevent disorderly bank failures and are therefore essentially tools to protect an economy from output losses and depositors from losing their funds. Thus, the underlying objective of such schemes is in compliance with Sharī'ah, which includes "protection of wealth" among the five essential necessities of *maqāṣid al-Sharī'ah*.

for certain modifications, such as the use of the term “Islamic bank” instead of “bank” at some points as well as the addition of “Islamic” or “Sharī‘ah-compliant” before certain words describing a financial activity or practice. Besides, it is not permissible from a Sharī‘ah perspective to grant a higher claim to one creditor over other creditors, rather each creditor should receive an amount pro-rata to his or her proportion of the debt.<sup>7</sup> The table in the Appendix indicates the approach that has been taken and provides a mapping between the IADI CPs and the CPIDIS.

10. The CPIDIS are neutral with regard to different modalities<sup>8</sup> for structuring Islamic deposit insurance by jurisdictions, so long as the overarching objectives (defined in section 1.2) are achieved. The CPIDIS are reflective of, and designed to be adaptable to, a broad range of jurisdictional circumstances, settings and structures. Hence, regardless of the different modalities utilised to structure an IDIS, the guidelines of the CPIDIS are applicable to the Islamic deposit insurer.

11. The CPIDIS are intended as a framework supporting effective Islamic deposit insurance practices. National authorities are free to put in place supplementary measures that they deem necessary to achieve effective Islamic deposit insurance in their jurisdictions. The CPIDIS are not designed to cover all the needs and circumstances of every Islamic financial system. Instead, specific jurisdiction circumstances should be more appropriately considered in the context of assessments and in the dialogue between assessors and jurisdiction authorities.

12. Each CPIDIS is supported by assessment criteria. A comprehensive, credible and action-oriented assessment should focus on the IDIS and its relationship to the financial safety-net functions that support it. The assessment of broader safety-net functions (i.e. operating environment) is mostly outside the responsibility of the deposit insurer. However, it can have a direct effect on the deposit insurer’s ability to fulfil its mandate. The assessment of an IDIS should identify strengths and weaknesses in the existing system, and form a basis for remedial measures by deposit insurers and policymakers (e.g. government authorities or, if it is primarily a private

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<sup>7</sup> An exception to the above is secured creditors and parties that have sold assets to the institution offering Islamic financial services (IIFS), not received disbursements and their assets remain unaltered. These creditors and parties should be given a higher claim subject to the value of their collateral and sold assets.

<sup>8</sup> IDIS may be administered as follows:

- a. on a full-fledged basis – for example, a deposit insurer that solely implements a Sharī‘ah-compliant system; or
- b. on an integrated basis – that is, the IDIS and CDIS are administered separately by a single deposit insurer that is a separate entity or as a function or unit within a central bank or supervisory authority.

system, its member Islamic banks), after taking into account the structural, institutional and legal features of each national IDIS.

## 1.4 Specific Approach of the CPIDIS

13. In approaching the guidelines in this document, the CPIDIS have undertaken certain approaches that are related to the specificities of Islamic finance. While they are duly discussed appropriately in various stages of this document, and are also backed by detailed insights in the appendices, some level of clarification at an early stage is useful to enable an informed reading, usage and implementation of the CPIDIS.

### 1.4.1 Scope of Islamic Banks

14. **“Islamic bank”**<sup>9</sup> refers to any legal entities licensed by competent authority that undertake intermediary activities by accepting Sharī‘ah-compliant deposits and/or repayable funds (see subsection 1.4.2, “Treatment of Investment accounts”, below) from the public and/or investors and channelling the funds to provide financing activities and investment services (see also definition of Islamic bank in section 2). The entity complies with the rules and principles of Sharī‘ah, as overseen and determined by a Sharī‘ah governance mechanism (see subsection 1.4.3, “Sharī‘ah governance”, below). The CPIDIS are also applicable to financial institutions that may not be explicitly called an “Islamic bank”, but offer Sharī‘ah-compliant banking services (e.g. “participation banks” or “non-interest banks”, etc.).

15. In practice, Islamic banks include full-fledged Islamic banks that are licensed and established to operate as such. However, there are also separately established Islamic banking subsidiaries of conventional banks that are registered and operated as separate entities, but which have ownership ties and financial consolidation links to the parent conventional banks.

16. There are also **“Islamic banking windows”** (IBWs), which are part of a conventional financial institution (either a branch or a dedicated unit of that financial institution) but provide deposit-taking and financing/investment services on principles that comply with Sharī‘ah. These

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<sup>9</sup> Islamic bank entities generally comprise full-fledged Islamic banks, Islamic banking subsidiaries, Islamic banking windows, Islamic investment banking, and Islamic financial institutions with a wide array of products and services offered to the customers. Through the use of various Islamic finance concepts, the products and services revolve around *murābahah* (sales with mark-up) *ijārah* (leasing), *muḍārabah* (profit sharing for both financing and deposit products), *mushārahah* (partnership), *wadr’ah* (saving accounts), and trade activities based on *wakālah* (agency).

are not a separate legal entity and are consolidated and reported within the accounts of the conventional bank's business. It is important that profit and loss accounting for IBWs is performed separately from that of their conventional parents.<sup>10</sup> There are some differences in approach to guidelines, particularly between Islamic banks/Islamic banks' subsidiaries of conventional banks and IBWs.

17. The specific approach of the CPIDIS is that the guidelines are applicable to all types of Islamic banks (including full-fledged banks, subsidiaries of conventional banks, and windows of conventional banks). However, where needed, a distinction is made and additional guidance provided for IBWs, owing to their unique classification. This is due to the fact that IBWs are present in a majority of the jurisdictions where Islamic finance is operating, and the supervisory practices vary considerably across jurisdictions, especially the capital requirements regulation. This diversity of operations of windows raises a number of issues on supervision, as well as DIS membership, which are substantially different from those raised by full-fledged IIFS – in particular, from a corporate and Sharī'ah governance perspective.

#### 1.4.2 Treatment of Investment Accounts<sup>11</sup>

18. The funding profile of Islamic banks also includes a specific account termed an “**investment account**”, with funds being placed by an IAH. This entails pooling of investable funds by the IAH with the bank for the purpose of undertaking investments carried out by the bank acting as an entrepreneur (*muḍārib*) or agent (*wakīl*). The profits<sup>12</sup> are accordingly shared by the Islamic bank as *muḍārib* and the IAHs, or an agency fee is duly paid to the bank as *wakīl* under a *wakālah* contract,<sup>13</sup> premised on the principles of Sharī'ah governing the transaction and contracts utilised to support the investment account.

19. The regulatory and prudential treatment of investment accounts varies between jurisdictions, with some treating them as “Islamic deposits” (due to the requirements of existing

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<sup>10</sup> This can be done by ensuring that IBWs' operations are not intertwined with those of the parent. However, profits generated by the Islamic window in its capacity as *muḍārib* or *wakīl* can be transferred to the conventional parent as the owner of the Islamic window.

<sup>11</sup> Also refer to Annex 2.

<sup>12</sup> In the case of *muḍārabah*, it is profit sharing and loss bearing by the capital provider, as in normal cases only the capital-contributing party bears financial loss while the entrepreneur (*mudarib*) bears the loss of his or her efforts. However, the entrepreneur (*muḍārib*) is liable to bear part of the financial losses due to his or her negligence, misconduct or breach of conditions as stipulated by the capital provider.

<sup>13</sup> In the case of a *wakālah* contract, where the principal appoints an institution as agent (*wakīl*) to carry out the business on his behalf. As generally practised, the contract is a fee-based contract.

legal frameworks which do not recognise investment accounts) while others recognise them as investment accounts, a separate category from deposits.<sup>14</sup> This difference in treatment has important implications, as an “Islamic deposit” product is normally provided a guarantee by the Islamic bank while also enjoying deposit insurance coverage by the Islamic deposit insurer. However, where jurisdictions have recognised investment accounts as such and given them separate treatment, they may or may not have deposit insurance coverage. For instance, in some jurisdictions, the law explicitly mentions the term “investment accounts”; however, the regulatory and prudential treatment accorded to them is that of bank “deposits”.

20. Under the CPIDIS, the term “depositor” or “deposits” or “deposit insurance” has been used in a general sense where it encompasses all types of funds (i.e. Islamic deposits and investment accounts) collected by Islamic banks from individual and business customers. However, where necessary, the CPIDIS may duly discuss additional considerations that are specific to investment accounts and IAHS in this document, while the other discussions are from a general depositor and/or deposits perspective. See also the detailed discussion in Annex 2 of this document pertaining to the IDIS coverage of investment accounts.

#### 1.4.3 *Sharī'ah Governance*

21. Islamic finance activities must be under the ongoing Sharī'ah supervision by qualified experts who are well versed in the principles of Islamic finance and Sharī'ah. Accordingly, “Sharī'ah governance” refers to the set of institutional and organisational arrangements through which an Islamic bank ensures that there is effective independent oversight of Sharī'ah compliance over each of the undertaken activities, structures and processes. The activities/institutions may be supervised by either a Sharī'ah advisor or a Sharī'ah board / Shari'ah committee (the terms “Sharī'ah board” and “Sharī'ah committee” can be used interchangeably), with the particular requirements for Sharī'ah supervision differing between jurisdictions.

22. For IDIS, a number of different Sharī'ah governance models are currently practised, including an embedded Sharī'ah board within the entity (i.e. IDIS); a centralised board outside the IDIS that has recognised authority over matters of Islamic finance (e.g. the Sharī'ah board of the

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<sup>14</sup> It is important to note, however, that the treatment of investment accounts as Islamic deposits is not a Sharī'ah-compliant practice due to the nature of the contract and relationship between an IIFS and a customer. However, providing an investment account with deposit insurance coverage is possible as long as the mechanism is Sharī'ah compliant. The treatment and implication of IAHS as determined by the supervisory authorities is referred to in the IFSB *Core Principles for Islamic Finance Regulation (Banking Segment)* (IFSB CPs) (see IFSB-17: CPIFR).

central bank); and an external Sharī'ah advisory firm<sup>15</sup> guiding the entity (i.e. IDIS) in terms of the Sharī'ah compliance of its operations, products and services.

23. The specific recommendations of the CPIDIS in relation to the Sharī'ah governance function for the Islamic deposit insurer are provided in CPIDIS 17.

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<sup>15</sup> In the case of Sharī'ah governance of IDIS, this option is only applicable for countries that will not be able to meet the first two options (an embedded or centralised Sharī'ah board), and subject to terms and conditions such as confidentiality, independence, avoidance of conflict of interest, etc. See CPIDIS 17 for details.

## SECTION 2: DEFINITIONS OF KEY TERMS

“**Blanket guarantee**” is defined as a declaration by authorities that, in addition to the protection provided by limited coverage deposit insurance or other arrangements, certain deposits and perhaps other financial instruments will be protected.

“**Bridge bank**” refers to an entity that is established to temporarily take over and maintain certain assets, liabilities and operations of a failed bank as part of the resolution process.

“**Conventional deposit insurance system**” refers to the deposit insurer and its relationships with the financial safety-net participants that support conventional deposit insurance functions and resolution processes.

“**Deposit insurance**” is defined as a system established to protect depositors against the loss of their insured deposits in the event that a bank is unable to meet its obligations to the depositors.

“**Deposit insurer**” refers to the specific legal entity responsible for providing deposit insurance, deposit guarantees or similar deposit protection arrangements.

“**Differential contribution system**” (or “**risk-based contribution**”) refers to a contribution assessment system that seeks to differentiate contributions on the basis of criteria such as individual bank risk profiles.

“**Displaced commercial risk**” refers to a situation where an institution acting as a *muḍārib* donates a part of its profit to the investment account holders in order to smooth the returns payable to them.

“**Ex ante contributions**” refers to the regular collection of contributions, with the aim of accumulating a fund to meet future obligations (e.g. reimbursing depositors) and cover the operational and related costs of the deposit insurer.

**“Ex post contribution”** refers to systems in which funds to cover deposit insurance obligations are only collected from surviving banks after an Islamic bank failure in line with a Sharī’ah-compliant mechanism.<sup>16</sup>

**“Financial safety-net”** is defined to include the functions of prudential regulation, supervision, resolution, lender of last resort and deposit insurance. In many jurisdictions, a department of government (generally, a Ministry of Finance or Treasury responsible for financial sector policy) is included in the financial safety-net.

**“Fit and proper”** refers to fitness tests that usually seek to assess the competence of boards of directors and boards of commissioners and their capacity to fulfil the responsibilities of their positions, while propriety tests seek to assess their integrity and suitability. Formal qualifications, previous experience and track record are some of the elements focused on by authorities when determining competence. To assess integrity and suitability, elements considered include criminal record, financial position, civil actions against individuals to pursue personal debts, refusal of admission to, or expulsion from, professional bodies, sanctions applied by regulators of other similar industries, and previous questionable business practices.

**“Integrated deposit insurance system”** refers to IDIS and CDIS administered separately under a single deposit insurer, for the purpose of this CPIDIS.

**“Investment accounts”** refers to investors’ funds placed with an Islamic bank in a pool or multiple pools on the basis of *muḍārabah* for the purpose of profit sharing and loss bearing by the capital provider or *mushārah* for the purpose of profit and loss sharing between the Islamic bank and investors. Where investment accounts are managed under a *wakālah bi al-istishmār* contract, the relationship between an Islamic bank and the investors is an agency relationship, with the Islamic bank earning a flat fee instead of sharing the profit (the *wakil* may also be entitled to additional performance-related incentives).

- “Restricted investment accounts” refers to the accounts whose holders authorise the investment of their funds based on *muḍārabah*, *mushārah* or *wakālah* contracts while

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<sup>16</sup> Although the use of ex post contributions, in addition to ex ante contributions, is permissible according to the IADI Core Principles for Effective Deposit Insurance Systems, relying solely on ex post contributions in a CPIDIS is not in compliance with the CPs and moreover raises Sharī’ah concerns emanating from compelling the surviving banks to reimburse depositors of a failed Islamic bank. From a Sharī’ah perspective this is not permissible except in the case whereby Islamic banks enter into a prior agreement among themselves to reimburse the depositors of a failed Islamic bank when such a failure occurs.



adhering to certain restrictions as to where, how and for what purpose these funds are to be invested.

- “Unrestricted investment accounts” refers to the accounts whose holders authorise the investment of their funds based on *muḍārabah*, *mushārah* or *wakālah* contracts without imposing any restrictions. The institutions can commingle these funds with their own funds and invest them in a pooled portfolio.

“**Islamic bank**” includes full-fledged Islamic banks as well as separately established Islamic banking subsidiaries of conventional banks. It also includes Islamic banking windows subject to the country’s legal framework and regulatory provisions. See discussion in subsection 1.4.1.

“**Islamic banking window**” is defined as part of a conventional financial institution (which may be a branch or a dedicated unit of that financial institution) that provides deposits/investment accounts to deploy/invest in financing and investment in a Sharī’ah-compliant manner under their legal and regulatory framework.

“**Islamic deposit**” is a product offered by Islamic banks to clients that entails a contractual obligation on the bank to repay either the full principal amount or part of it, as demanded by the clients from time to time, from their deposited funds with the bank.

“**Islamic deposit insurance**” is defined as a system established with the Sharī’ah-compliant design features to protect depositors against the loss of their insured Islamic deposits in the event that an Islamic bank is unable to meet its obligations to the depositors.

“**Islamic deposit insurance system**” refers to the deposit insurer and its relationships with the financial safety-net participants that support Islamic deposit insurance functions and resolution processes.

“**Kafālah**” refers to a guarantee – for example, when a person guarantees a liability or duty (especially debt) of another person.

“**Liquidation**” (or “**receivership**”) refers to the winding-down (or “winding-up”, as used in some jurisdictions) of the business affairs and operations of a failed bank through the orderly disposition of its assets after its licence has been revoked and it has been placed in liquidation. In some jurisdictions, it is synonymous with “receivership”.

**“Liquidator”** (or **“receiver”**) refers to the legal entity that undertakes the winding-down of the failed bank and the disposition of its assets.

**“Mandate”** of the deposit insurer refers to the set of official instructions describing its roles and responsibilities. There is no single mandate or set of mandates suitable for all deposit insurers. When assigning a mandate to a deposit insurer, jurisdiction-specific circumstances must be taken into account. Mandates can range from narrow “pay box” systems to those with extensive responsibilities, such as preventive action and loss or risk minimisation/management, with a variety of combinations in between. These can be broadly classified into four categories:<sup>17</sup>

- a. a “pay box” mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits;
- b. a “pay box plus” mandate, where the deposit insurer has additional responsibilities, such as certain resolution functions (e.g. financial support);
- c. a “loss minimiser” mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies; and
- d. a “risk minimiser” mandate, where the insurer has comprehensive risk minimisation functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases prudential oversight responsibilities.

**“Moral hazard”** arises when parties have incentives to accept more risk because the costs that arise from the risk are borne, in whole or in part, by others.

**“Muḍārabah”** refers to a profit-sharing partnership contract between the capital provider (*rabb al-māl*) and an entrepreneur (*muḍārib*) whereby the capital provider would contribute capital to an enterprise or activity that is to be managed by the entrepreneur. Profits generated by that enterprise or activity are shared in accordance with the percentage specified in the contract, while losses are to be borne solely by the capital provider unless the losses are due to misconduct, negligence or a breach of contract terms.

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<sup>17</sup> When the deposit insurer has a mandate and additional responsibilities including providing financial support, the transfer of assets and liabilities, the sale of assets, the establishment of a temporary bridge bank and other resolution mechanisms that are in line with Sharī'ah rules and principles, which require the use of its own funds that have been collected from the contributions paid by the member Islamic banks, such usage should be clearly stated.

**“Mushārahah”** refers to a partnership contract in which the partners agree to contribute capital to an enterprise, whether existing or new. Profits generated by that enterprise are shared in accordance with the percentage specified in the *mushārahah* contract, while losses are shared in proportion to each partner’s share of capital.

**“Public policy objectives”** refers to the goals that the deposit insurance system is expected to achieve.

**“Resolution”** refers to the disposition plan and process for a non-viable/failed bank. Resolution may include liquidation and depositor reimbursement, transfer of assets and liabilities, sale of assets, the establishment of a temporary bridge institution, and the conversion to equity. Resolution may also include the application of procedures under insolvency law to parts of an entity in resolution, in conjunction with the exercise of resolution powers provided that Sharī’ah rules and principles are followed.

**“Resolution authority”** is defined as a public authority that, either alone or together with other authorities, is responsible for the resolution of financial institutions established in its jurisdiction (including resolution planning functions).

**“Sharī’ah”** in this document refers to the rulings deduced from legitimate Islamic sources: the Qur’an, Sunnah, consensus (*ijmā*), analogy (*qiyās*) and other approved sources of the Sharī’ah rules that are applicable within the Sharī’ah compliance framework of the IDIS of a jurisdiction.

**“Subrogation”** is the substitution of one party (e.g. the deposit insurer) for another (e.g. the protected depositor) with reference to a lawful claim, demand or right, so that the party that substitutes succeeds to the rights of the other in relation to the debt or claim, and its rights and remedies.<sup>18</sup>

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<sup>18</sup> It is permissible from a Sharī’ah perspective for the Islamic deposit insurer to subrogate protected depositors, after reimbursing them, in relation to their rights associated with a debt or a claim against a failed Islamic bank’s assets. As an example of the implementation of subrogation in a *takāful*-based IDIS, member Islamic banks commit to donate periodic contributions to the Islamic deposit insurer who then commits to offering coverage to any member Islamic bank in the event of its failure. If a member Islamic bank fails, the Islamic deposit insurer will reimburse protected depositors directly and replace them to the extent of the coverage amount (which is equivalent to the value of protected deposits) as a claimant against the failed Islamic bank’s assets in liquidation.

**“Takāful”** refers to a mutual guarantee in return for the commitment to donate an amount in the form of a specified contribution to the participants’ risk fund, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks.

**“Target fund size”** refers to the size of the ex ante deposit insurance fund, typically measured as a proportion of the assessment base (e.g. total or insured deposits), sufficient to meet the expected future obligations and cover the operational and related costs of the deposit insurer.

**“Wakālah”** refers to an agency contract where the customer (principal) appoints an institution as agent (*wakīl*) to carry out the business on his behalf. The contract can be with or without a fee.

## SECTION 3: MORAL HAZARD, OPERATING ENVIRONMENT AND OTHER CONSIDERATIONS

### 3.1 Minimising Moral Hazard

24. A well-designed financial safety-net contributes to the stability of the financial system. However, if poorly designed, it may increase risks, notably moral hazard. Moral hazard arises when parties have incentives to accept more risk because the costs are borne, in whole or in part, by others. In the context of deposit insurance, protecting depositors from the threat of loss (e.g. through explicit limited deposit insurance or the belief by some parties that banks will not be exposed to failure (referred to as implicit protection) can insulate them from the consequences of unsafe and unsound bank practices, and can lead to greater risk taking by banks than might otherwise be the case.

25. The greater risk taking by Islamic banks may be more prevalent in jurisdictions that provide IDIS coverage for IAHs, particularly when the contributions for the investment account coverage are not provided by the Islamic banks in some jurisdictions (see discussion in Annex 2 of this document).

26. The IDIS, therefore, must be designed to mitigate the impact of moral hazard on the behaviour of shareholders, Islamic bank management and depositors, while recognising that most depositors are typically less able to differentiate between safe and unsafe Islamic banks. Such mitigation is a function of the overall design of the system. Moral hazard is also mitigated by other safety-net participants.

27. More specifically, key design features of the IDIS, described in these CPs, aim at mitigating moral hazard. Examples include, but are not restricted to: limited coverage levels and scope; differential contributions; and timely intervention and resolution by the deposit insurer or other participants with such powers in the safety-net.

28. The financial safety-net creates and supports appropriate incentives to mitigate moral hazard through several mechanisms, including: the promotion of good corporate governance and sound risk management at individual banks; holding the parties at fault responsible for losses; effective market discipline; and the frameworks for, and enforcement of, strong prudential regulation, supervision, resolution, and laws and regulations.

29. The assessment of the extent to which moral hazard affects a deposit insurance system is based on an overall evaluation of the effectiveness of supervision, the legal framework, and the early warning, intervention and resolution regimes.

## 3.2 Operating Environment

30. The effectiveness of an Islamic deposit insurance system is influenced not only by its design features but also by the environment within which it operates. The operating environment includes macroeconomic conditions, the strength of the sovereign, the financial system structure, prudential regulation and supervision, liquidity framework, Sharī'ah governance regime, the legal and judicial framework, and the accounting and disclosure system. The operating environment is largely outside the scope of authority of the deposit insurer. However, it influences the deposit insurer's ability to fulfil its mandate and determines, in part, its effectiveness in protecting depositors and contributing to a jurisdiction's financial stability.

31. While the operating environment is not formally assessed and there is no corresponding compliance determination, it forms the foundation for the assessment of compliance with the CPIDIS. The conditions outlined in this section must be thoroughly analysed in order to make an accurate assessment of the appropriateness and effectiveness of the design and operation of the overall system. Identically designed deposit insurance systems may have a very different impact on financial stability and depositor protection, reflecting differences in the environment within which they operate.

### 3.2.1 Macroeconomic Conditions

32. Macroeconomic conditions influence the effectiveness of markets, the ability of the financial system to intermediate resources, and economic growth. Persistent instability hampers the functioning of markets, and such conditions affect the ability of financial institutions to absorb and manage their risks. In periods of economic instability, market volatility can lead to destabilising creditor runs (including depositor runs). Moreover, uncertainties about future movements in relative prices, including asset prices and exchange rates, can make it difficult to determine the medium-term viability of an institution.

33. In stable periods, the CPIDIS provide guidance on minimum features for an effective IDIS. The IDIS supports depositor confidence in the face of idiosyncratic Islamic bank failures. In the face of persistent macroeconomic instability, however, the CPIDIS provide guidance on areas that

an IDIS will need to reinforce, in order to provide robust support to depositors in general. The system may require a variety of enhancements, including larger-than-usual reserves, stronger emergency funding options, and close coordination and participation with other safety-net participants in reinforcing financial stability. Introduction of an IDIS under these conditions, however, will have to be considered carefully, as the new system, if it is not supported by the necessary institutional reforms, could be discredited and fail to bolster depositor confidence.

34. Evaluations of the macroeconomic conditions in a jurisdiction are found in the jurisdiction reports of international organisations such as the IMF, the World Bank and the Organisation for Economic Co-operation and Development (OECD). These reports often include an analysis of recent conditions and projections of the likely path for macroeconomic variables.

### *3.2.2 Structure of the IFSI*

35. The soundness of a financial system influences the appropriate design features of a deposit insurance system. Any assessment of an IDIS should consider the health and structure of the Islamic financial sector, and the range of possible demands on the deposit insurer. Elements for consideration include:

- a. An assessment of the health of Islamic banks based on an evaluation of capital adequacy, liquidity and credit quality of the Islamic financial system. The resources of the deposit insurer, its ability to identify emerging threats, and its relationships with other safety-net participants must be strong. Similarly, the location or currency composition of deposits, and related coverage and reimbursement rules, will influence how resources are maintained by the insurer.
- b. The structure of the Islamic financial system in terms of the number, type and characteristics of Islamic banks, and types of deposits/investment accounts and depositors/IAHs covered. This information has implications for the assessment of the strength and effectiveness of the deposit insurer. The extent of interconnectedness, competition and concentration within the system will all influence the possibilities for contagion and systemic shocks. The presence of poorly supervised Islamic banks can lead to unidentified risks to the financial system that materialise unexpectedly. The deposit insurance system should be designed to take account of these risks.

- c. Any pre-existing depositor protection arrangements (e.g. institutional protection arrangements) and the effect of these arrangements on the introduction or reform of a deposit insurance system.

36. The assessment of an IDIS would also depend on the following considerations regarding the structure of the IFSI:

*a. Sharī'ah framework within which the IFSI operates*

A robust Sharī'ah framework in a jurisdiction will facilitate the effective implementation of Islamic finance, including an IDIS. The framework should, among other things, provide mechanisms for how the differing Sharī'ah opinions within a jurisdiction can be resolved so as to promote greater acceptability of Islamic finance practices and to avoid confusion.

*b. The implementation of the IDIS in a dual banking system where Islamic banks operate alongside the conventional banks*

In a jurisdiction with a dual banking system and where the IDIS and the CDIS are implemented separately, both systems should be designed in such a way as to promote a level playing field and avoid regulatory arbitrage.<sup>19</sup> The deposit insurer needs to understand, among other things, the number, types and characteristics of Islamic banks, as well as the types of deposits and depositors to be covered for the purpose of determining the appropriate coverage level.

*c. Well-functioning Islamic money and capital markets*

To sustain Islamic banks' health in terms of capital and liquidity management, the Islamic money and capital markets must be functioning well to ensure that a broad range of Sharī'ah-compliant financial instruments are available to the Islamic banks. This would also apply to the IDIS, since the deposit insurer would also require the availability of such financial instruments for investment purposes. In

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<sup>19</sup> An example of regulatory arbitrage risk would be if there are differences in risk-based pricing and/or coverage levels between the IDIS and CDIS. This would create implications for prudential requirements upon respective members of the IDIS and CDIS (i.e. Islamic banks vis-à-vis conventional banks).



many jurisdictions, Sharī'ah-compliant money markets and secondary markets for trading Islamic financial instruments are underdeveloped or even absent.

*d. Pre-existing consumer protection arrangements*

The effect of these arrangements on the introduction or reform of an IDIS (e.g. institutional protection arrangements, and the treatment for an IAH's assets that are managed separately).

37. The assessment and description of the IFSI including Islamic banks can come from a variety of sources. The jurisdiction itself should evaluate and assess the strength and soundness of the Islamic financial system, although institution-specific information may not be publicly available. In addition, country reports by international organisations such as the IMF or the World Bank, or the IFSB's annual *IFSI Stability Report* will also contain a description of the Islamic financial sector and recommendations to address any risks and deficiencies.

*3.2.3 Prudential Regulation, Supervision and Resolution*

38. The strength of prudential regulation, supervision and the resolution regime influence the functions and effectiveness of a deposit insurance system. Strong prudential regulation and supervision ensure that an institution's weaknesses are promptly identified and corrected. Implementation of corrective measures is monitored and, where such measures are deficient, early intervention and an effective resolution regime can help to lower the costs associated with bank failures.

39. The strength of prudential regulation and supervision is a critical factor in mitigating moral hazard. Fiduciary risk is particularly important in Islamic banks since it can arise due to both financial and non-financial reasons. The latter would include cases when Islamic banks fail their fiduciary duties of carrying out operations in accordance with Sharī'ah principles (which can lead to withdrawal of funds by religious-sensitive stakeholders). If shareholders and management of an institution feel they can operate their institution in an unsafe or unsound manner without effective market discipline, supervisors become the last defence against poor practices. In the absence of strong regulation and supervision, the risks to the deposit insurer cannot be fully understood or mitigated. Intervention in weak banks comes late, increasing the cost of resolution and the cost to the deposit insurer.

40. The supervisory authority should have an effective licensing or chartering regime for new institutions, conduct regular and thorough examinations of individual Islamic banks, and have an effective early warning system. All Islamic banks within the safety-net should be subject to an effective resolution regime. Sound governance of agencies comprising the safety-net should also be in place, to strengthen the financial system's architecture and contribute directly to financial stability. Any proportionality in the prudential treatment with a view to supporting the development of Islamic banks should also be weighed against the need for financial stability.

41. The system of prudential regulation, supervision and resolution should be in compliance with international standards, including the IFSB's *Core Principles for Islamic Finance Regulation (Banking Segment)*,<sup>20</sup> the BCBS's *Core Principles for Effective Banking Supervision* and the Financial Stability Board's (FSB's) *Key Attributes of Effective Resolution Regimes*. In the absence of recent external reviews, such as FSAP or FSB reviews, jurisdictions may also have useful self-assessments or reports laying out the existing structure and gaps compared to international standards.

#### 3.2.4 *The Legal and Judicial Framework*

42. Deposit insurance systems cannot be effective if relevant and comprehensive laws do not exist or if the legal regime is characterised by significant inconsistencies. The legal framework has an impact on the activities of the deposit insurance system. A well-developed legal framework should incorporate a system of business laws, including corporate, insolvency, contract, creditor rights, consumer protection, anti-corruption/fraud and private property laws. These laws guide financial transactions and ensure that norms exist and are enforced. The legal system should be supported by a well-functioning judiciary. For the deposit insurance system, the legal framework must lay out its appropriate powers and enable it to compel member banks to comply with their obligations to the deposit insurer.

43. Effective bank insolvency laws include a special resolution regime (SRR) for banks that is separate from the general corporate insolvency laws.<sup>21</sup> Corporate insolvency laws may allow for negotiated settlement, in which the weak firm can restructure its finances, reorganise its operations, reduce debt obligations and modify payment terms. These measures give a

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<sup>20</sup> Available at <https://www.ifsb.org/download.php?id=4373&lang=English&pg=/index.php>.

<sup>21</sup> This principle is consistent with the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*, 2011.

corporation time to rebuild profitability. However, the financial position of a bank can deteriorate rapidly, causing contagion to other financial institutions and undermining financial stability. When these institutions are resolved via general corporate insolvency law, there is normally an opportunity for shareholders and/or creditors to challenge the action. Many jurisdictions' general corporate insolvency laws allow a number of weeks for shareholders and/or creditors to make such a challenge, and additional weeks for a bankruptcy court judge to make a ruling on the challenge. In such cases, this introduces a de facto deposit moratorium, increasing the potential for contagion and depositor runs at other (and potentially all) institutions.

44. An SRR, therefore, is needed so that the resolution authorities can act in a timely manner, limiting contagion and maintaining financial stability. Such a regime would allow the resolution authority to deal with financial contracts, unsettled payment and securities transactions, and financial collateral, as well as appoint an administrator and/or liquidator. Moreover, a special insolvency law can allow the subrogation of the deposit insurance agency to the claims of depositors for the amounts it has paid them. An SRR can also be important in ensuring consistency between the supervisory and insolvency-related functions of the safety-net authorities. Reliance on an SRR places decision-making in the hands of relevant experts, allowing them to move quickly. Shareholders and creditors should still have due process and an opportunity for judicial review; however, any successful challenge must be limited to monetary compensation, and must not involve reversal of the supervisory or resolution authority's action(s).

45. The legal system may have a number of weaknesses that limit its effectiveness. For example, legal uncertainties can aggravate financial distress and lead to contagion or creditor flight. Weakness in the legal framework can undermine the effectiveness of the safety-net in general and the deposit insurance system in particular. Weaknesses may exist in laws governing property rights, creditor rights, bank insolvency and resolution. The impact of such weaknesses includes delays in decision-making, uncertainties about the finality of decisions, and informal dispute resolution, all of which can result in less than expected recoveries in asset liquidation, thus increasing losses/costs to the deposit insurance system. Thus, a robust and effective legal framework is required to mitigate moral hazard.

46. The effectiveness of a legal system is often highlighted in reports by international organisations such as the IMF, World Bank and FSB. Local attorneys also have insight about the length of time cases take, the ability or authority of courts to reverse decisions by regulators, the

credibility of the legal process, and the appropriateness of the legal system for modern financial markets.

### *3.2.5 The Accounting and Disclosure Regime*

47. Sound accounting and disclosure regimes are necessary for the effective evaluation of risks by deposit insurance systems. Accurate, reliable and timely information enables management, depositors, the market and authorities to make decisions regarding the risk profile of an institution, and thereby increase market, regulatory and supervisory discipline. A sound accounting and disclosure regime includes comprehensive and well-defined accounting principles and rules that command wide international acceptance.

48. A system of independent audits ensures that the users of financial statements have an independent assurance that the accounts provide a true and fair view of the financial position of the Islamic banks. They also ensure that reports are prepared according to established accounting principles, with auditors held accountable for their work. The lack of strong accounting and disclosure regimes can make risk identification difficult. All financial safety-net participants, including the Islamic deposit insurer, need to have timely access to reliable financial information.

## SECTION 4: CORE PRINCIPLES AND COMPLIANCE ASSESSMENT<sup>22</sup>

### CPIDIS 1: PUBLIC POLICY OBJECTIVES

**The principal public policy objectives for Islamic deposit insurance systems are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The design of the Islamic deposit insurance system should reflect the system’s public policy objectives while being in conformity with Sharī’ah requirements.**

#### **Essential criteria**

1. The public policy objectives of the Islamic deposit insurance system are clearly and formally specified and made public, for example, through legislation or documents supporting the legislation.
2. The design of the Islamic deposit insurance system is consistent with the system’s public policy objectives while being in conformity with Sharī’ah rules and principles, as reviewed and endorsed through a Sharī’ah governance system outlined in CPIDIS 17.3.
3. There is a review of the extent to which an Islamic deposit insurance system meets its public policy objectives<sup>23</sup>. This involves both an internal review conducted on a regular basis by the governing body and an external review conducted periodically by an external body (e.g. the body to which the deposit insurer is accountable or an independent entity with no conflicts of interest, such as an auditor general). Any review must take into consideration the views of key stakeholders.
4. If additional public policy objectives are incorporated, they do not conflict with the two principal objectives of protecting depositors and contributing to the stability of the financial system.

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<sup>22</sup> Annexes in the document are not standards and therefore not subject to compliance assessment.

<sup>23</sup> The timing of regular reviews will depend on jurisdiction-specific factors but should occur at least every five years, or more frequently as deemed necessary.

## CPIDIS 2: MANDATE AND POWERS

**The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.**

### Essential criteria

1. The mandate and powers of the deposit insurer are formally and clearly specified in legislation, and are consistent with stated public policy objectives.
2. The mandate clarifies the roles and responsibilities of the deposit insurer and is aligned with the mandates of other safety-net participants.
3. The powers of the deposit insurer support its mandate and enable the deposit insurer to fulfil its roles and responsibilities.
4. The powers of the deposit insurer include, but are not limited to:
  - a. determining and collecting contributions, and other charges;<sup>24</sup>
  - b. transferring deposits to another Islamic bank, when necessary without breaching the rights of depositors;
  - c. acquiring, holding, managing and/or investing the financial resources that conform to Sharī'ah principles<sup>25</sup>;
  - d. reimbursing protected depositors;
  - e. obtaining directly from Islamic banks timely, accurate and comprehensive information necessary to fulfil its mandate;
  - f. receiving and sharing timely, accurate and comprehensive information within the safety-net, and with applicable safety-net participants in other jurisdictions;
  - g. compelling Islamic banks to comply with their legally enforceable obligations to the deposit insurer (e.g. to provide access to depositor information), or

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<sup>24</sup> Any charges imposed by deposit insurance must be Sharī'ah compliant.

<sup>25</sup> IDIS can be implemented under different Sharī'ah arrangements (see Annex 1 page 50: Sharī'ah Requirements and Specificities for IDIS Design/ 1. Arrangement for Deposit Insurance). CPIDIS 2 requires that it should be clearly and formally specified in legislation, and approved by the respective Sharī'ah governance in the jurisdiction, that the deposit insurer is allowed to utilise the IDIF for the beneficiaries.

requesting that another safety-net participant do so on behalf of the deposit insurer;

- h. setting operating budgets, policies, systems and practices of the deposit insurer;  
and
- i. entering into contracts.

## CPIDIS 3: GOVERNANCE<sup>26</sup>

**The deposit insurer should be operationally independent, well-governed, transparent, accountable, and insulated from external interference.**

### Essential criteria

1. The deposit insurer is operationally independent. It is able to use its powers without interference from external parties to fulfil its mandate. There is no government, central bank, supervisory or industry interference that compromises the operational independence of the deposit insurer.
2. The governing body of the deposit insurer<sup>27</sup> is held accountable to a higher authority.
3. The deposit insurer has the capacity and capability (e.g. human resources, operating budget and salary scales sufficient to attract and retain qualified staff) to support its operational independence and the fulfilment of its mandate.
4. The deposit insurer is well-governed and subject to sound governance practices, including appropriate accountability, internal controls, transparency and disclosure regimes. The institutional structure of the deposit insurer minimises the potential for real or perceived conflicts of interest.
5. The deposit insurer operates in a transparent and responsible manner. It discloses and publishes appropriate information for stakeholders on a regular basis.<sup>28</sup>

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<sup>26</sup> CPIDIS 3 does not include in its scope the aspects of “Sharī’ah governance” which is introduced and discussed separately in CPIDIS 17. The separation is maintained in case a jurisdiction does not have a Sharī’ah governance system due to jurisdiction-specific circumstances, but has an effective and robust general governance framework – in this scenario it should not fail assessment of CPIDIS 3. However, it will be assessed appropriately on Sharī’ah governance matters in CPIDIS 17.

<sup>27</sup> This document refers to a governance structure composed of a governing body such as a board of directors. There are significant differences across jurisdictions in the legislative and regulatory frameworks covering these functions. Some jurisdictions use a two-tier board structure, in which the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other jurisdictions, by contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific governing body structure.

<sup>28</sup> Examples of appropriate information include reports on strategic objectives and plans, governance structure and practices, and annual reports that contain financial statements and describe activities during the reporting period.



6. The governing statute or other relevant laws and policies governing the deposit insurer specify that:
  - a. the governing body and management are “fit and proper” persons;
  - b. members of the governing body and the senior management<sup>29</sup> of the deposit insurer (with the exception of ex-officio appointees) are subject to fixed terms, which are staggered;<sup>30</sup>
  - c. there is a transparent process for the appointment and removal of the members of the governing body and head(s) of the deposit insurer. Members of the governing body and head(s) of the deposit insurer can be removed from office during their term only for reasons specified or defined in law, internal statutes or rules of professional conduct, and not without cause; and
  - d. members of the governing body are subject to high ethical standards and comprehensive codes of conduct to minimise the potential for real or perceived conflicts of interest.<sup>31</sup>
7. The deposit insurer is regularly assessed on the extent to which it meets its mandate, and is subject to regular internal and external audits.
8. The composition of the governing body minimises the potential for real or perceived conflicts of interest. To maintain operational independence, representatives of the other financial safety-net organisations that participate in the governing body do not serve as chair or constitute a majority.
9. The governing body holds regular meetings to oversee and manage the affairs of the deposit insurer (e.g. on a quarterly basis, or more frequently as deemed necessary).

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<sup>29</sup> In this document, the terms “governing body” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction”.

<sup>30</sup> An arrangement whereby only a certain number of members of a governing body are appointed/elected in any given year. For example, a governing body may have 11 members serving staggered terms, where 2 new members are appointed each year.

<sup>31</sup> See also CPIDIS 11, Essential Criterion 3.



## CPIDIS 4: RELATIONSHIPS WITH OTHER SAFETY-NET PARTICIPANTS

**In order to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants.<sup>32</sup>**

### **Essential criteria**

1. Ongoing information sharing and the coordination of actions is explicit and formalised through legislation, regulation, memoranda of understanding, legal agreements or a combination thereof.
2. Rules regarding confidentiality of information apply to all safety-net participants and the exchange of information among them. Confidentiality of information is protected by law or through agreements so as not to prevent information sharing within the safety-net.
3. Safety-net participants exchange information on an ongoing basis, and in particular when material supervisory actions are being taken in respect of member Islamic banks.
4. In situations where there are multiple deposit insurers operating in the same national jurisdiction, appropriate information sharing and coordination arrangements among those deposit insurers are in place.

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<sup>32</sup> The financial safety-net participants include the central bank or relevant regulatory and supervisory authorities (RSAs), the deposit insurer, the Ministry of Finance, and any other relevant government authorities. The financial safety-net participants may vary across jurisdictions.

## CPIDIS 5: CROSS-BORDER ISSUES

**Where there is a material presence of foreign Islamic banks in a jurisdiction, formal information sharing and coordination arrangements should be in place among deposit insurers in relevant jurisdictions.**

### **Essential criteria**

1. Where there is a material presence of foreign Islamic banks (i.e. subsidiaries of conventional banks or branches), formal information sharing and coordination arrangements are in place among relevant deposit insurers and relevant safety-net participants, subject to confidentiality provisions.
2. In circumstances where a deposit insurer is responsible for coverage of deposits in a foreign jurisdiction, or where more than one deposit insurer is responsible for coverage in a jurisdiction, bilateral or multilateral agreements exist to determine which deposit insurer(s) is/are responsible for the reimbursement process, setting levies and contributions, and public awareness.
3. Information sharing arrangements and/or bilateral or multilateral agreements clarify the type of covered deposits, including, but not limited to, investment accounts,<sup>33</sup> and also differences in treatment (if any) due to different Sharī'ah interpretations by respective Sharī'ah boards.

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<sup>33</sup> See CPIDIS 8, Essential Criterion 2.

## **CPIDIS 6: DEPOSIT INSURER'S ROLE IN CONTINGENCY PLANNING AND CRISIS MANAGEMENT**

**The deposit insurer should have in place effective contingency planning and crisis management policies and procedures to ensure that it is able to effectively respond to the risk of, and actual, Islamic bank failures and other events. The development of system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety-net participants. The deposit insurer should be a member of any institutional framework for ongoing communication and coordination involving financial safety-net participants related to system-wide crisis preparedness and management.**

### **Essential criteria**

1. The deposit insurer has its own effective contingency planning and crisis management policies and procedures in place to ensure that it is able to effectively respond to the risk of, and actual, Islamic bank failures and other events.
2. The deposit insurer develops and regularly tests its own contingency planning and crisis management plans.
3. The deposit insurer is a member of any institutional framework for ongoing communication and coordination involving safety-net participants related to system-wide crisis preparedness and management.
4. The deposit insurer participates in regular contingency planning and simulation exercises related to system-wide crisis preparedness and management involving all safety-net participants.
5. The deposit insurer participates in the development of pre- and post-crisis management communication plans involving all safety-net participants, to ensure comprehensive and consistent public awareness and communications.
6. The deposit insurer complies with Sharī'ah rules and principles in its contingency planning and crisis management activities, as reviewed and endorsed by the Sharī'ah governance system outlined in CPIDIS 17.

## CPIDIS 7: MEMBERSHIP

**Membership in an Islamic deposit insurance system should be compulsory for all Islamic banks.**

### Essential criteria

1. Membership in an Islamic deposit insurance system is compulsory for all Islamic banks, including Islamic banking windows<sup>34</sup> and state-owned Islamic banks, and all Islamic banks are subject to sound prudential regulation and supervision.<sup>35</sup>
2. If upon entry to a newly established Islamic deposit insurance system, an Islamic bank does not comply with all the supervisory or membership requirements, it is required to have a credible plan to address any deficiencies within a prescribed time frame (e.g. one year).
3. The conditions, process and time frame for attaining membership are explicitly stated and transparent.
4. If the deposit insurer is not responsible for granting membership in the Islamic deposit insurance system, the law or administrative procedures prescribe a clear and reasonable time frame within which the deposit insurer is consulted or informed in advance, and is given sufficient information about an application for a new licence.
5. When membership is cancelled upon the revocation or surrender of an Islamic bank's licence, immediate notice is given to depositors to inform them that existing deposits will continue to be insured up to a specified deadline.<sup>36</sup>
6. When membership is terminated by the deposit insurer, arrangements are in place to coordinate the immediate withdrawal of the Islamic bank's deposit-taking licence by the relevant authority. Upon termination, immediate notice is given to depositors to inform them that existing deposits will continue to be covered up to a specified deadline.

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<sup>34</sup> For the purpose of the CPIDIS, the IBWs are members of the IDIS to protect their deposits.

<sup>35</sup> The determination of "sound prudential regulation and supervision" is made by ensuring there is high compliance with the IFSB CPs (see IFSB-17: CPIFR).

<sup>36</sup> See also CPIDIS 10, "Public Awareness".

## CPIDIS 8: COVERAGE

**Policymakers should define clearly the level and scope of coverage. Coverage should be limited and credible, and cover the large majority of depositors, but leave a substantial amount of deposits exposed to market discipline. Coverage should be consistent with the Islamic deposit insurance system's public policy objectives and related design features.**

### Essential criteria

1. Insured deposits are clearly and publicly defined in law or regulation and reflect the public policy objectives. This definition includes the level and scope of coverage. If certain types of deposits and depositors are ineligible for deposit protection, they are clearly specified, easily determined and do not affect the speed of reimbursement.<sup>37</sup>
2. The coverage status of investment accounts is clearly and publicly defined based on public policy objectives. If an investment account is covered, the deposit insurer ensures appropriate design features are in place for such coverage in line with the Sharī'ah rulings of the relevant Sharī'ah board.<sup>38</sup>
3. The level and scope of coverage are limited and are designed to be credible, so as to minimise the risk of runs on Islamic banks and do not undermine market discipline. The level and scope of coverage are set so that the large majority of depositors across Islamic banks are fully protected while leaving a substantial proportion of the value of deposits unprotected.<sup>39</sup> If a substantial proportion of the value of deposits is protected, moral hazard is mitigated by strong regulation and supervision, as well as by the other design features of the Islamic deposit insurance system.<sup>40</sup>
4. The deposit insurer applies the level and scope of coverage equally to all its member Islamic banks. The coverage limit by a deposit insurance agency applies equally to both the conventional deposit insurance system and the Islamic deposit insurance system.
5. The deposit insurer does not incorporate coinsurance.

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<sup>37</sup> In particular, some specific types of deposits may be excluded or considered ineligible for protection. These may include: interbank deposits; deposits of government departments and of regional, provincial and municipal governments and other public bodies; deposits of individuals who are regarded as responsible for the deterioration of an institution, including deposits belonging to the directors, managers, large shareholders and auditors of banks.

<sup>38</sup> The key considerations for investment accounts under the IDIS are provided in Annex 2.

<sup>39</sup> For additional guidance on setting coverage limits, scope and foreign currency deposits coverage, see IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Deposit Insurance Coverage* (2013).

<sup>40</sup> Strong regulation and supervision are demonstrated by a high level of compliance with the IFSB CPs (see IFSB-17: CPIFR).

6. The level and scope of coverage are reviewed periodically (e.g. at least every five years) to ensure that they meet the public policy objectives of the Islamic deposit insurance system.
7. In the event of, or prior to, a merger or amalgamation of separate Islamic banks that are members of the same Islamic deposit insurance system, depositors of the merged or amalgamated Islamic banks enjoy separate coverage (up to the maximum coverage limit) for each of the banks for a limited but publicly stated period, as defined in law or regulation. Merging Islamic banks must be held responsible for notifying the affected depositors, including informing them of the date on which the separate coverage will expire.
8. The residency status or nationality of depositors has no effect on coverage.
9. Where there are multiple deposit insurers operating in the same national jurisdiction, any differences in coverage across banks operating within that jurisdiction do not adversely affect overall deposit insurance system effectiveness and financial stability.
10. Foreign currency deposits are insured if they are widely used in a jurisdiction.
11. In cases where there is a blanket guarantee in place, there is a credible plan to transition from that blanket guarantee to a limited coverage deposit insurance system. This includes:
  - a. an assessment of the economic environment as it affects the financial system, which is conducted before a jurisdiction begins the transition from a blanket guarantee to limited coverage;
  - b. the pace of the transition to limited coverage is consistent with the state of the financial industry, prudential regulation and supervision, the legal and judicial framework, and accounting and disclosure regimes;
  - c. policymakers have effective communication strategies to mitigate adverse public reaction to the transition; and
  - d. where there is a high level of capital mobility, and/or a regional integration policy, the decision to lower coverage limits and/or scope considers the effects of different jurisdictions' protection levels and related policies.



## CPIDIS 9: SOURCES AND USES OF FUNDS

**The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by Islamic banks and, where applicable, IAHS.**

### Essential criteria

1. Funding for the Islamic deposit insurance system is provided on an ex ante basis. Funding arrangements are clearly defined and established in law or regulation.
2. Funding the Islamic deposit insurance system is the responsibility of the member Islamic banks.
3. If investment accounts<sup>41</sup> are covered in line with Sharī'ah rulings as determined by the relevant Sharī'ah board, the relevant regulation determines the source of contributions for such coverage.<sup>42</sup>
4. Initial "start-up" or "seed" funding (e.g. from the conventional deposit insurance system under an integrated system administered by a deposit insurer, government or international donor organisations) is permitted to help establish an Islamic deposit insurer. Any start-up funding provided by a government should be fully repaid (without any interest payment on the principal funding amount in line with Sharī'ah requirements), before the Islamic deposit insurance system reduces any or all Islamic banks' contributions.
5. Emergency funding arrangements for the Islamic deposit insurance system, including pre-arranged and assured sources of Sharī'ah-compliant liquidity funding, are explicitly set out (or permitted) in law or regulation. Sources may include inter-fund borrowing,<sup>43</sup> a funding agreement with the government, the central bank or market-based financing. If market-based financing or inter-fund borrowing is used, it is through Sharī'ah-compliant mechanisms and is

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<sup>41</sup> Key considerations for investment accounts are provided in Annex 2.

<sup>42</sup> Please refer to Annex 1 on the views of Sharī'ah scholars regarding the party responsible for funding the protection of investment accounts.

<sup>43</sup> Inter-fund borrowing is a potential source of funding for a deposit insurer that administers multiple funds – for example, borrowing by the Islamic fund from the conventional fund, or borrowing from a fund for the protection of Islamic deposits for the fund for the protection of investment accounts when these are managed separately. In all cases, the borrowing mechanism must be Sharī'ah compliant.

not the sole source of funding.<sup>44</sup> The arrangement for emergency liquidity funding is set up in advance, to ensure effective and timely access when required.

6. After establishing an ex ante Islamic deposit insurance fund:
  - a. the target fund size is determined on the basis of clear, consistent and transparent criteria, which are subject to periodic review;
  - b. a reasonable time frame is set to achieve the target fund size;
  - c. the target size of the IDIF is determined separately from that of the CDIF; and
  - d. the policy for the treatment of surplus in the case of *takāful*-based IDIFs is clearly and formally specified in line with the Sharī'ah rulings of the relevant Sharī'ah board.
7. The deposit insurer has the responsibility for the sound investment of the IDIF, including complying with Sharī'ah rules and principles. The deposit insurer has a defined investment policy for its funds that aims at ensuring:
  - a. the preservation of fund capital and maintenance of liquidity; and
  - b. that adequate risk management policies and procedures, internal controls, and disclosure and reporting systems are in place.
8. The deposit insurer has the responsibility for the sound management of the IDIF, including complying with Sharī'ah rules and principles. Where both conventional and Islamic deposit insurance systems operate, the deposit insurer segregates the IDIF from the CDIF, and ensures that records, officers, and assets/accounts for each fund are separate. The deposit insurer also uses an appropriate basis<sup>45</sup> to allocate the general and common expenditures between the IDIF and CDIF.
9. The deposit insurer may hold funds at the central bank in conformity with Sharī'ah rules and principles. The deposit insurer establishes and complies with rules to limit significant investments in Islamic banks.

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<sup>44</sup> Where applicable (e.g. the European Union), deposit insurers may borrow from each other's funds.

<sup>45</sup> An appropriate basis may include actual costing, or allocation of expenditures based on the proportionate size of the income or size of the fund of the IDIF vis-à-vis the CDIF. The deposit insurer's accounting and information technology (IT) systems should make it possible, ex ante, to separate the expenditures to be charged under each of the funds (IDIF and CDIF).

10. Where the deposit insurer is not the resolution authority, it has the option, within its legal framework, to authorise the use of its funds for resolution of member Islamic banks other than by liquidation.<sup>46</sup> In such situations, the following conditions are met:
- a. the deposit insurer is informed and involved in the resolution decision-making process;
  - b. the use of the deposit insurer's funds is transparent and documented, and is clearly and formally specified;
  - c. where an Islamic bank is resolved through a resolution process other than liquidation, the resolution results in a viable, solvent and restructured bank, which limits the exposure of the deposit insurer to contribute additional funding in respect of the same obligation;
  - d. contributions are restricted to the costs the deposit insurer would otherwise have incurred in a payout of protected depositors in a liquidation net of expected recoveries;
  - e. contributions are not used to recapitalise resolved institutions unless shareholders' interests are reduced to zero, and uninsured, unsecured creditors are subject to *pari passu* losses in accordance with the legal claim priority;
  - f. the use of the deposit insurer's funds is subject to an independent audit and the results are reported back to the deposit insurer; and
  - g. all resolution actions and decisions using the deposit insurer's funds are subject to *ex post* review, including a review by the Sharī'ah board or an entity delegated by the Sharī'ah board to act on its behalf in reviewing the Sharī'ah aspects of these actions and decisions.
11. Should deposit insurer income/revenue (e.g. contributions received, recoveries from failed Islamic banks and profit accrued on investment funds) be taxed by the government, the relevant authorities should make sure that it is at a rate that is neither punitive nor disproportionate to other corporate taxation, and does not unduly hinder the accumulation of

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<sup>46</sup> Such use may be compulsory under national law.

the deposit insurance fund. Any remittances to the government by the deposit insurer are limited to repayment of government-provided start-up funding and government-provided liquidity funding through a mechanism that complies with Shari'ah requirements.

12. If the deposit insurer uses differential contributions within the Islamic banking system:<sup>47</sup>
  - a. the system for calculating contributions is transparent to all participating Islamic banks;
  - b. the scoring categories are significantly differentiated between Islamic banks;<sup>48</sup> and
  - c. the ratings and rankings resulting from the system pertaining to individual Islamic banks are kept confidential.
13. It should be clearly and formally specified in the legislation, and approved by the respective Shari'ah governance<sup>49</sup> in the jurisdiction, that the deposit insurer is allowed to utilise the IDIF for the beneficiaries.

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<sup>47</sup> See IADI, *General Guidance for Developing Differential Premium Systems* (2011).

<sup>48</sup> For Islamic banking windows, the deposit insurer should determine their scoring categories separately based on the differential contribution system for Islamic banks.

<sup>49</sup> See CPIDIS 17: Shari'ah Governance for further details.

## CPIDIS 10: PUBLIC AWARENESS

**In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the Islamic deposit insurance system.**

### **Essential criteria**

1. The deposit insurer is responsible for promoting public awareness of the Islamic deposit insurance system, using a variety of communication tools on an ongoing basis as part of a comprehensive communication programme.
2. In the event of an Islamic bank failure, the deposit insurer must notify depositors, as appropriate and as described in law, via media such as press releases, print advertising, websites and other media outlets, of the following details:
  - a. where, how and when protected depositors will be provided with access to their funds;<sup>50</sup>
  - b. the information that a protected depositor must provide in order to obtain payment;
  - c. if advance or interim payments are being made;<sup>51</sup> and
  - d. whether any depositors will lose funds, and procedures whereby unprotected depositors can submit claims to the liquidator for their unprotected portion.
3. The public awareness programme or activities convey information about the following:
  - a. the scope (i.e. which types of financial instruments and depositors and/or investment accounts/IAHs are covered by deposit insurance, and which are not);
  - b. a list of which Islamic banks are members and how they can be identified;
  - c. deposit insurance coverage level limits; and
  - d. other information, such as the mandate of the deposit insurer and its compliance with Shari'ah requirements.
4. The objectives of the public awareness programme (e.g. target awareness levels) are clearly defined and consistent with the public policy objectives and mandate of the Islamic deposit insurance system.

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<sup>50</sup> For example, whether an assuming/agent bank will assume deposits and reimburse or otherwise make them available, or whether reimbursement is provided through the deposit insurer.

<sup>51</sup> For example, in the case of unavoidable prolonged delays such as a "surprise" bank failure where there has been no opportunity for advance preparation.

5. The deposit insurer sets a long-term strategy to meet its public awareness objectives and makes budget allocations to build and maintain a target level of public awareness about deposit insurance.
6. The deposit insurer works closely with Islamic banks and other safety-net participants to ensure the consistency and accuracy of the information provided to depositors and to maximise awareness on an ongoing basis. Law or regulation requires Islamic banks to provide information about deposit insurance in a format/language prescribed by the deposit insurer.
7. The deposit insurer monitors, on an ongoing basis, its public awareness activities and arranges, on a periodic basis, independent evaluations of the effectiveness of its public awareness programme or activities.
8. Depositors in jurisdictions affected by cross-border banking arrangements conducted through foreign bank branches or subsidiaries of Islamic and conventional banks are provided with clear information on the existence and identification of the deposit insurer legally responsible for reimbursement, and the limits and scope of coverage.

## CPIDIS 11: LEGAL PROTECTION

**The deposit insurer and individuals working both currently and formerly for the Islamic deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.**

### **Essential criteria**

1. Legal protection is specified in legislation and provided to the deposit insurer, its current and former directors, officers and employees, and any individual<sup>52</sup> (including, where applicable, Shaṛī'ah advisors/Shari'ah board members) currently or previously retained or engaged by the deposit insurer, for decisions made and actions or omissions taken in good faith in the normal course of their duties.
2. Legal protection precludes damages or other awards against such individuals, and covers costs, including funding defence costs as incurred (and not just reimbursement after a successful defence).
3. The operating policies and procedures of the deposit insurer require individuals with legal protection to disclose real or perceived conflicts of interest and to adhere to relevant codes of conduct, to ensure that they remain accountable.
4. Legal protections do not prevent depositors or other individual claimants or Islamic banks from making legitimate challenges to the acts or omissions of the deposit insurer in public or administrative review (e.g. civil action) procedures.

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<sup>52</sup> A contractual indemnity in an individual's contract of employment or engagement with the deposit insurer and/or private insurance is not a substitute for legal protection defined in legislation or recognised in law.

## CPIDIS 12: DEALING WITH PARTIES AT FAULT IN AN ISLAMIC BANK FAILURE

**The deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in an Islamic bank's failure.**

### **Essential criteria**

1. The conduct of parties responsible for, or contributing to, the failure of an Islamic bank (e.g. officers, directors, managers, owners), as well as the conduct of related parties and professional service providers (e.g. auditors, accountants, lawyers and asset appraisers) is subject to investigation. The investigation of the conduct of such parties may be carried out by one or more of the following: the deposit insurer, supervisor or regulatory authority, criminal or investigative authorities, or any other professional or disciplinary body, as applicable.
2. The relevant authority takes the appropriate steps to pursue those parties that are identified as culpable for the failure of the Islamic bank. The culpable parties are subject to sanction and/or redress. Sanction or redress may include personal or professional disciplinary measures (including fines or penalties), criminal prosecution and civil proceedings for damages.
3. The deposit insurer, or other relevant authority, has policies and procedures in place to ensure that insiders, related parties and professional service providers acting for the failed Islamic bank are appropriately investigated for wrongdoing and for possible culpability in an Islamic bank failure.



## CPIDIS 13: EARLY DETECTION AND TIMELY INTERVENTION

**The deposit insurer should be part of a framework within the financial safety-net that provides for the early detection of, and timely intervention in, troubled Islamic banks. The framework should provide for intervention before the Islamic bank becomes non-viable. Such actions should protect depositors and contribute to financial stability.**

### **Essential criteria**

1. The deposit insurer is part of an effective framework within the financial safety-net that provides for the early detection of, and timely intervention in, Islamic banks in financial difficulty before the bank becomes non-viable.<sup>53</sup>
2. Safety-net participants have the operational independence and power to perform their respective roles in the framework for early detection and timely intervention.
3. The framework includes a set of clearly defined qualitative and/or quantitative criteria that are used to trigger timely intervention or corrective action. The criteria:
  - a. are clearly defined in law, regulation or agreements;
  - b. include safety and soundness indicators such as the Islamic bank's capital, asset quality, management, earnings, liquidity, sensitivity to market risk; and
  - c. are reviewed periodically, and the procedure for this review is formalised.

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<sup>53</sup> The degree of implementation and effectiveness of an early detection and timely intervention framework is determined through an assessment of the IFSB CPs, the *Basel Core Principles for Effective Banking Supervision* (BCPs) and *Key Attributes of Effective Resolution Regimes* (KAs) where applicable.

## CPIDIS 14: FAILURE RESOLUTION

**An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.**

### Essential criteria

1. The deposit insurer has the operational independence and sufficient resources to exercise its resolution powers<sup>54</sup> consistent with its mandate.
2. The resolution regime ensures that all Islamic banks are resolvable through a broad range of powers and options. These options are consistent with the Sharī'ah framework as applied in the jurisdiction.
3. Where there are multiple safety-net participants responsible for resolution, the legal framework provides for a clear allocation of objectives, mandates and powers of those participants, with no material gaps, overlaps or inconsistencies. Clear arrangements for coordination are in place.
4. Resolution and depositor protection procedures are not limited to depositor reimbursement. The resolution authority/ies has/have effective resolution tools designed to help preserve critical Islamic bank functions and to resolve banks. These include, but are not limited to, powers to replace and remove senior management, terminate contracts,<sup>55</sup> transfer assets and liabilities, sell assets, convert debt to equity and/or establish a temporary bridge institution in line with Sharī'ah rules and principles.
5. One or more of the available resolution methods allows the flexibility for resolution at a lower cost than otherwise expected in a liquidation net of recoveries.
6. Subject to compliance with the Sharī'ah framework as applied in the jurisdiction, resolution procedures follow a defined creditor hierarchy in which protected depositors are protected from sharing losses and shareholders take first losses.
7. The resolution regime does not discriminate against depositors on the basis of their nationality or residence.

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<sup>54</sup> Please refer to the definition of resolution in section 2.

<sup>55</sup> Contracts in this context refer to non-deposit and non-financing contractual relationships. Resolution authorities may suspend such contracts, rights and obligations at liquidation on the condition that the affected parties receive compensation for the actual harm.

8. The resolution regime is insulated against legal action that aims at the reversal of decisions related to the resolution of non-viable Islamic banks. No court can reverse such decisions. The legal remedy for successful challenges is limited to monetary compensation.
9. The resolution regime keeps the period between depositors losing access to their funds and implementation of the selected resolution option (e.g. depositor reimbursement) as short as possible.

## CPIDIS 15: REIMBURSING DEPOSITORS

**The Islamic deposit insurance system should reimburse depositors' insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for protected depositor reimbursement.**

### Essential criteria

1. The deposit insurer is able to reimburse most<sup>56</sup> protected depositors within seven working days. If the deposit insurer cannot currently meet this target, the deposit insurer has a credible plan in place to do so.
2. To be credible, the reimbursement plan:
  - a. has a clear time frame for implementation (e.g. within two years);
  - b. is supported by relevant laws, regulations, systems and processes (e.g. intervention and resolution manuals); and
  - c. has clear and measurable deliverables.
3. In situations where reimbursement is triggered and there may be extended delays in reimbursements, the deposit insurer may make advance, interim or emergency partial payments.
4. To provide depositors with prompt access to their funds, the deposit insurer:
  - a. has access to depositors' records at all times, which includes the authority to require Islamic banks to maintain depositor information in a format prescribed by the deposit insurer to expedite protected depositor reimbursement;
  - b. has the authority to undertake advance or preparatory examinations (e.g. on-site and independently or in conjunction with the supervisory authority) on the reliability of depositor records, and has tested member institutions' IT systems and data to ensure the capability to produce such records; and

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<sup>56</sup> The term "most" is used to recognise that there may be some types of deposits which would be operationally difficult to reimburse within seven working days, such as trust accounts with multiple beneficiaries.

- c. has a range of reimbursement options.<sup>57</sup>
5. The deposit insurer has the capacity and capability to promptly carry out the reimbursement process, including:
  - a. adequate resources and trained personnel (in-house or contractors) dedicated to the reimbursement function and supported with reimbursement manuals;
  - b. information systems to process depositor information in a systematic and accurate manner;
  - c. pre- and post-closing activities specified in closing documentation or manuals; and
  - d. scenario planning and simulations, including simulations on Islamic bank closings with supervisory and resolution authorities.
6. A review (e.g. post mortem) following an Islamic bank failure is performed to determine and analyse elements of the reimbursement process (including the resolution procedures where applicable) that were successful or unsuccessful.
7. An independent party conducts a periodic audit of the reimbursement process to confirm that appropriate internal controls are in place.
8. If set-off of insured deposits against past due claims (e.g. repayment obligations and arrears) or matured financing is applied, such application is timely and does not delay prompt reimbursement of protected depositors' claims or undermine financial stability.
9. Working arrangements and/or agreements are in place with relevant clearing and settlement system agencies and liquidators to ensure that transit items are dealt with in an appropriate, consistent and timely manner.<sup>58</sup>
10. In cases where the deposit insurer does not have the authority to act as a liquidator, the liquidator is obliged by law or regulation to cooperate with the deposit insurer to facilitate the reimbursement process.

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<sup>57</sup> These may include cheque payments, electronic transfers, payment agents, cash payments, and the transfer of deposits through closed-bank purchase and assumption (P&A) transactions.

<sup>58</sup> For more extensive guidance on ensuring prompt reimbursement, see IADI, *Enhanced Guidance for Effective Deposit Insurance Systems: Reimbursement Systems and Practices* (2013).

## CPIDIS 16: RECOVERIES

**The deposit insurer should have, by law, the right to recover its claims including claims of the Islamic deposit insurance fund under its management,<sup>59</sup> in accordance with the statutory creditor hierarchy.**

### **Essential criteria**

1. The deposit insurer's role in the recovery process is clearly defined in law. The deposit insurer or the Islamic deposit insurance fund is clearly recognised as a creditor of the failed Islamic bank by subrogation.
2. The deposit insurer or Islamic deposit insurance fund has at least the same creditor rights or status as a depositor in the treatment in law of the estate of the failed Islamic bank.
3. The deposit insurer, in its capacity as a creditor, or the Islamic deposit insurance fund has the right of access to information from the liquidator so that it can monitor the liquidation process.
4. The management and disposition of the assets of a failed Islamic bank in its asset management and recovery approaches are guided by commercial and economic considerations.
5. Those working on behalf of the deposit insurer, other financial safety-net participants and third-party professional service providers providing resolution services are not permitted to purchase assets from the liquidator.

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<sup>59</sup> Please refer to footnote no. 18 on subrogation from a Sharī'ah perspective.

## CPIDIS 17: SHARĪ'AH GOVERNANCE

**The Islamic deposit insurance system should have in place a comprehensive and properly functioning Sharī'ah governance system.**

### **Essential criteria**

1. The Islamic deposit insurance system has an adequate Sharī'ah governance system to ensure its design, procedures and operations are in compliance with Sharī'ah principles, along with ongoing monitoring mechanisms to ensure the system's continued compliance.
2. The Sharī'ah governance system (e.g. in the form of a Sharī'ah board):
  - a. has member(s) with appropriate knowledge, skills, competence and expertise;
  - b. acts in an independent and transparent manner, and any potential conflicts of interest are appropriately managed;
  - c. is adequately resourced and serviced to carry out its duties diligently; and
  - d. abides by codes of ethics and confidentiality to ensure that internal information obtained in the course of its duties is kept confidential.
3. The Islamic deposit insurance system enables the Sharī'ah governance body to conduct its activities in an independent manner and facilitates the process of effective deliberations and Sharī'ah pronouncements on operational matters of the system.
4. The Islamic deposit insurance system provides adequate information and disclosures to stakeholders (including the board of directors as well as the general public) as to how Sharī'ah governance is being practised by the organisation.
5. The Islamic deposit insurance system ensures Sharī'ah compliance of its activities through a number of structures and processes that may include:
  - a. issuance of relevant Sharī'ah pronouncements/resolutions;
  - b. dissemination of information on such Sharī'ah pronouncements/resolutions to the operative personnel of the IIFS who monitor the day-to-day compliance with the Sharī'ah pronouncements/resolutions;
  - c. an internal Sharī'ah compliance review/audit for verifying that Sharī'ah compliance has been satisfied, during which any incident of non-compliance will be recorded and reported, and as far as possible, addressed and rectified;
  - d. an annual Sharī'ah compliance review/audit for verifying that the internal Sharī'ah compliance review/audit has been appropriately carried out and its findings have been duly noted by the Sharī'ah board.

## Annex 1: Specificities of IDIS

### The Uniqueness of Islamic Banking

Islamic and conventional banks share a common financial intermediary role. What differentiates them is the requirement for the former to comply with Sharī'ah principles. Sharī'ah principles include the prohibition of interest-based (*ribā*) transactions, excessive uncertainty (*gharar*), speculation (*qimār*) and gambling (*maysir*), and the enhancement of risk sharing, ethical banking, social justice and fairness. These principles define the uniqueness of Islamic banking operations, which is reflected in their institutional set-up, the products and services they offer (including the purpose of offering these products and services), and the different types of relationships between the banks and their customers. Conventional banks, on the other hand, structure their assets and liabilities mainly on a contract based on interest.

On the asset side, financing contracts include sales at profit margin and deferred payments (*murābahah*), lease-based financing (*ijārah*), manufacturing or construction financing contracts (*istiṣnā'*) and the forward sale of fungible goods for immediate payment (*salam*).

For partnership arrangements, the Islamic banks provide financing through a joint partnership with customers for a specific economic activity based on a pre-specified profit and loss sharing arrangement. The contracts include the profit and loss bearing by the capital provider (*muḍārabah*) and the profit and loss sharing (*mushārahah*) contracts. Another form of transaction is a fee-based arrangement, which includes the contract of *wakālah* and service fees (*ujr*).

On the liability side, the funding structure of the Islamic banks can be categorised into principal guaranteed deposit contracts (e.g. *qard*-based accounts) and non-principal guaranteed deposits (investment accounts<sup>60</sup>). Unlike conventional banks that operate on the basis of borrowing and lending with pre-specified interest rates, deposit contracts for demand and current accounts do not attract interest rate; and for investment accounts, the IAHs receive returns that are determined ex post, based on the actual returns generated by the underlying assets funded by their funds.

Due to the uniqueness of their balance sheets, Islamic banks face other risks in addition to the common ones inherent in conventional banking. Among the unique risks are Sharī'ah non-compliance risk, displaced commercial risk and equity investment risk.

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<sup>60</sup> "Investment account" refers to a funding product where Islamic banks accept these funds for investment purposes. The contracts normally used for this account are profit and loss sharing (*mushārahah*), profit sharing and loss bearing (*muḍārabah*), and agency (*wakālah*). There are two forms of investment accounts: restricted and unrestricted accounts. In various jurisdictions, investment accounts are treated either as a liability, a partial liability or an investment product, depending on the prevailing legal framework. However, from the Sharī'ah perspective, investment accounts should be treated as an investment product, and not as a liability.



The Islamic window structure provides an avenue for a conventional bank to offer Islamic finance services. The window may be a branch or a dedicated unit of a conventional bank. The window is not separately incorporated, but both its assets and liabilities should be required to be segregated from conventional business. This structure requires the bank to establish appropriate firewalls to avoid commingling of Islamic and conventional funds. The treatment of windows differs from one jurisdiction to another, depending on the legal and regulatory framework.

### **Sharī'ah Requirements and Specificities for IDIS Design**

The objective of implementing an IDIS is consistent with the objective of Sharī'ah, which is to protect wealth. The attainment of such an objective requires the IDIS to be Sharī'ah compliant.

The operations of an IDIS are different from a CDIS in the following ways:

#### *1. Arrangement for Deposit Insurance*

The implementation of an IDIS must be based on certain types of Sharī'ah arrangements. Other arrangements may also be adopted in consultation with or based on advice from Sharī'ah scholars.

The application of different Sharī'ah arrangements may result in different operational features. For instance, under the *takāful* approach, funding for deposit insurance is provided through donations by the Islamic banks and other parties. The fund is not owned by the IDIS, which acts as a fund manager, but is owned collectively by the fund contributors or by the fund itself (if it has a separate legal or financial status). Although Sharī'ah boards and standards do not permit the use of the *kafālah* model, the applicable Sharī'ah standards and regulations in certain jurisdictions permit its use, where funding is paid by each Islamic bank to obtain the deposit insurer's guarantee and the fund is owned by the deposit insurer.

#### *2. Sharī'ah Governance*

The level of compliance with Sharī'ah principles would depend on the institutional set-up. A full-fledged IDIS needs to have in place a comprehensive Sharī'ah governance framework to govern its business and operations.

However, for a deposit insurer administering both the IDIS and CDIS, the implementation of Sharī'ah principles to the IDIS operations is limited to the following areas: the sources and uses of

funds, including surplus, the resolution of a failed Islamic bank, and the reimbursement of depositors/IAHs. Sharī'ah laws do not apply to the operations of a CDIS. The list is presented in Table 1.

**Table 1: Operational Aspects that are Subject to Sharī'ah Governance**

Operational Aspects	Full-fledged IDIS	Integrated DI	
		IDIS	CDIS
Sources and uses of funds			
(i) Contributions received from the Islamic bank are maintained separately in the IDIF.	Yes	Yes	No
(ii) Only permissible expenditures are charged to the IDIF.	Yes	Yes	No
(iii) Investments are made in Sharī'ah-compliant instruments.	Yes	Yes	No
(iv) Investment returns that are generated from non-Sharī'ah-compliant instruments are treated appropriately based on the Sharī'ah scholar's rulings – for example, distributions to charitable bodies.	Yes	Yes	No
(v) Surplus generated by the IDIF should be dealt with in a Sharī'ah-compliant manner.	Yes	Yes	Not applicable
(vi) Sources of external funds (if any) and their uses are Sharī'ah compliant. For instance, if the deposit insurer borrows from the government, the agreement between the deposit insurer and the government does not contain an interest (ribā) element.	Yes	Yes	Not applicable
<i>Failure resolution</i>			
Resolutions of a failed Islamic bank take into account the unique characteristics of the institution and retain the Sharī'ah-compliant status of the business.	Yes	Yes	No
<i>Reimbursing depositors (Coverage)</i>			
Payments to protected depositors and IAHs are made from the IDIF.	Yes	Yes	No

Operational Aspects	Full-fledged IDIS	Integrated DI	
		IDIS	CDIS
Priority of payments to the depositors and IAHS.	Yes	Yes	No

### 3. *Islamic Banking Windows*

The deposits accepted by an Islamic banking window of a conventional bank that is a member of the CDIS should be covered under the IDIS, and not the CDIS. Appropriately, the window should be deemed as a member of the IDIS and should therefore be required to contribute to the IDIF (similar to the Islamic bank). Nonetheless, the guidelines in this CPIDIS account for various jurisdictional arrangements as discussed in CPIDIS 7, Essential Criterion 1; subsection 1.4.1.

### 4. *Investment Accounts*

Investment accounts, a non-principal guaranteed product, are unique to Islamic banking. If the account is a significant source of funding for an Islamic bank, the deposit insurer may cover this account for the purpose of financial stability. The coverage of investment accounts may influence the design features of the IDIS with respect to, among other things, funding for such coverage, maintenance of the fund, and the priority of payments in the winding-down of a failed Islamic bank.

### 5. *Funding the Protection of IAHS*

The views of Sharī'ah scholars differ as to who should be the responsible party to fund the protection of investment accounts under an IDIS. Based on the practices of the jurisdictions that have implemented an IDIS, some require IAHS to make contribution payments; by contrast, few Sharī'ah boards permit the Islamic bank to insure the total deposits (current accounts and investment accounts) in a format that covers both.

### 6. *The Management and Usage of an Islamic Deposit Insurance Fund*

The IDIF must be invested in Sharī'ah-compliant instruments and its usage must be for permissible expenditures. In the event of an Islamic bank failure, the fund will be used to reimburse the failed bank's protected depositors or to carry out other resolution options.

Where a deposit insurer administers both the IDIS and CDIS, the IDIF must be maintained and managed separately from the CDIF in compliance with Sharī'ah requirements. Subject to the ex ante advice of the Sharī'ah governance function, where the IDIF is deficient when carrying out a resolution, the deposit insurer may finance such deficiency through borrowings from the CDIF without interest or any other sources, provided the mechanism in all circumstances is Sharī'ah compliant.

#### 7. Separation of CDIS and IDIS Offices

Ideally, the separation of the Islamic and conventional systems should be extended to having separate departments for each system.

#### 8. *The Usage of The Term Contribution*

The IADI CPs discuss a differential “premium” system. However, for an Islamic deposit insurance system (IDIS), the term “premium” is not appropriate as in essence the Sharī'ah arrangements and underlying contracts in the IDIS are based on the concept of mutual welfare, and not that of a commercial exchange-based contact. Under this arrangement, all member Islamic banks of the IDIS would participate to make committed donations (*tabarru'*) into a pool for helping any member Islamic bank which may run into insolvency/other issues requiring the IDIF's support to reimburse depositors. Nonetheless, in all cases, regulatory requirements may in fact have the same effect for “contributions” in IDIS as is for “premiums” in CDIS, since membership of, and making “contributions” to the IDIF would be obligatory upon the Islamic banks. To that extent, the use of “contributions” as opposed to “premiums” in the CPIDIS does not change the impact and underlying objectives.

#### 9. *Resolution of Failed Islamic Banks*

For deposit insurers with the mandate to resolve failed Islamic banks, the resolution mechanisms may differ from those used to resolve a conventional bank, depending on the ex ante advice from the Sharī'ah board and applicable international standards and guidelines for Islamic banks. Certain resolution options may also be conducted differently for particular types of Islamic products.<sup>61</sup>

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<sup>61</sup> Please refer to footnote no. 20 on Sharī'ah-compliant resolution mechanisms.

## Annex 2: Key Considerations for Investment Accounts under an IDIS

1. The deposit insurer may protect investment accounts under an IDIS if such protection contributes to financial stability and if it is consistent with IDIS public policy objectives. This view can be formed based on, among other things, the following reasons:
  - a. There is evidence that the IAHS have behaved, or will potentially behave,<sup>62</sup> similarly to depositors, either as a reaction to poor performance of underlying assets or a bank's (*muḍārib*) negligence, or in an idiosyncratic or system-wide crisis situation. This is due to the fact that IAHS bear commercial risk associated with the assets financed by the funds provided by them.
  - b. Investment accounts are treated as deposits by regulators due to prevailing legal framework provisions through, among other things, priority of claims in the legal framework of the jurisdiction, capital treatment, liquidity requirement, product classification or accounting treatment, and product disclosure. This treatment will lead to an investment account posing risks similar to those experienced by depositors.<sup>63</sup>
2. Apart from the objective of contributing to financial stability, the deposit insurer may set additional objectives for the protection of investment accounts provided that they do not conflict with the overall financial stability objective. For instance, the deposit insurer may decide to:
  - a. provide protection to the Islamic banks' customers equal to that accorded to the customers of conventional banks;
  - b. avoid regulatory arbitrage and preserve the competitiveness of the Islamic banks' products.
3. The deposit insurer excludes a restricted investment account from IDIS coverage if it is not detrimental to financial stability and consumer protection.
4. All principles and essential criteria set out in the CPIDIS that concern the protection of deposits under an IDIS are also applicable to the protection of investment accounts. Nonetheless, the exceptions and additional considerations are as follows:

- *Coverage*

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<sup>62</sup> See also general discussions on challenges associated with investment accounts from a market behaviour perspective in IFSB Guidance Note 3 on the *Practice of Smoothing the Profits Payout to Investment Account Holders (December 2010)*.

<sup>63</sup> Please refer to footnote no. 14 that indicated the impermissibility of treating investment accounts as deposits.

- a. The level of coverage for unrestricted investment accounts is set equally for all its Islamic bank members so as to promote confidence in the IAHS.
- b. The protected amount of investment accounts is the outstanding balance as at the time of trigger action initiated by the resolution authority.

• *Sources and Uses of the Fund*

- a. The party responsible for funding the protection of investment accounts under an IDIS is subject to the views of each jurisdiction's Sharī'ah governance system.<sup>64</sup>
- b. Where the protection for investment accounts is not funded by Islamic banks, the deposit insurer considers the following:
  - i. Moral hazard, in that an Islamic bank is motivated to assume greater risks when investing IAHS' funds, since it does not bear the IDIS costs, particularly in the absence of a robust regulatory and supervisory framework. If there is evidence of moral hazard, the deposit insurer implements measures to mitigate such incidence.
  - ii. Effective provision of incentives to Islamic banks for sound risk management practices through a differential or risk-based contributions system. For example, if the high-risk profile of an Islamic bank is translated into higher contributions payable.
- c. Where the protection for investment accounts is funded by IAHS (from investment profits), the deposit insurer considers the following:
  - i. the Sharī'ah board's views on whether the contributions can be commingled with, or maintained separately from, contributions paid by the Islamic bank for the protection of deposits;
  - ii. if the contributions are maintained separately, the need for the deposit insurer to prepare separate records for the investment accounts protection fund and deposits protection fund;

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<sup>64</sup> Please refer to annex 1 on the views of Sharī'ah scholars regarding the party responsible for funding the protection of investment accounts.

- iii. effective implementation of a target fund framework, especially when the time frame to achieve the target fund size requires an increment in the contribution rate to be imposed on IAHS; and
  - iv. where the objective of the protection for investment accounts is to promote the growth of such a product, the need for the deposit insurer to assess whether such funding structure is costly to IAHS and hinders achievement of the objective.
- *Public Awareness*
    - a. A public awareness programme must include information about whether or not investment accounts are covered by the IDIS.
  - *Failure Resolution*
    - a. Where investment accounts are managed in a pool with Islamic banks' funds, the deposit insurer working with the lawmaker formally and clearly specifies in the legislation the hierarchy for reimbursement of IAHS in the event of a winding-down.<sup>65</sup>
    - b. In the winding-down, where investment accounts are managed separately from Islamic banks' funds and the assets funded by such accounts are properly tagged or ring-fenced, the deposit insurer segregates the disposal proceeds of such assets from the assets of Islamic banks. The deposit insurer formally and clearly specifies in the legislation the allocation of such proceeds to IAHS. For instance, if there are certain costs to be deducted prior to allocating the residual proceeds to IAHS, the costs are specified.
    - c. In the winding-down, the deposit insurer distributes any outstanding share of profit equalisation reserve (PER) to the IAHS and the Islamic bank, and distributes any outstanding investment risk reserve (IRR) to the IAHS only, based on the method determined by the resolution authority.
  - *Recoveries*

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<sup>65</sup> The shares of the IAHS in the investment pool should not be used to pay the depositors' funds. However, the shares of the shareholders in the investment pool can be used. Furthermore, from a Sharī'ah perspective, IAHS should be given a higher claim in relation to their shares in the value of the assets in the investment pool.

- a. Where the investment accounts protection fund is a separate legal and financial entity, the fund is treated as follows:
  - i. it is clearly recognised as a creditor of the failed Islamic bank by subrogation;<sup>66</sup> and
  - ii. the fund has at least the same creditor rights after final liquidation, or status as an IAH by law, in the treatment of the assets funded by the IAH.
  
- b. The management and disposition of the assets funded by investment accounts in Islamic banks are guided by commercial and economic considerations.

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<sup>66</sup> It is permissible from a Sharī'ah perspective for the deposit insurer to subrogate the protected IAHs after reimbursing them in relation to their rights associated with their shares in the value of the assets in the investment pool, which would be paid to them on account provided that it is to be offset with the proceeds of the final liquidation. As an example of the implementation of subrogation in a *takāful*-based IDIS, the party responsible for the protection of the IAHs commits to donate periodic contributions to the Islamic deposit insurer who then commits to offering coverage equivalent to the value of protected IAHs. If the party responsible for the protection of IAHs is the failed Islamic bank, it will assign the debt of the IAHs to the Islamic deposit insurer to enable it to reimburse them directly. On the other hand, if the party responsible for the protection of IAHs is the IAHs, the Islamic deposit insurer will reimburse the protected IAHs directly. In both cases, the Islamic deposit insurer will then replace the IAHs to the extent of the coverage amount (which is equivalent to the value of protected IAHs) as a claimant against the failed Islamic bank's assets in liquidation. It is important to note that in case the amount paid on account to the IAHs is more than their share based on the proceeds of the final liquidation, the extra amount should be returned to the Islamic deposit insurer except in the case of the Islamic deposit insurer waiving its right to the amount.



### Annex 3: Assessment of Compliance with the CPIDIS

This annex presents guidance and a format for compliance assessment and the structure of the assessment reports.<sup>67</sup>

#### Compliance Assessment

The primary objective of an assessment should be to evaluate compliance with the CPIDIS after taking into account the structural, legal and institutional features of each national deposit insurance system. The assessment should review the functions inherent in providing an effective IDIS, as opposed to an assessment of just the deposit insurer. In so doing, the assessment will identify the strength(s) of the IDIS, and the nature and extent of any weaknesses. Importantly, the assessment is a means to an end, not an objective in itself. The assessment process should help the deposit insurer and policymakers benchmark their IDIS against the CPIDIS to judge how well the system is meeting its public policy objectives. The assessment, in turn, can also aid the deposit insurer and policymakers in making improvements to the IDIS and financial safety-net, as necessary.

The methodology proposes a set of essential criteria for each CPIDIS. The essential criteria are the only elements on which to gauge full compliance with the CPIDIS. Assessments by external parties follow a five-grade scale as follows:<sup>68</sup>

- **Compliant:** The essential criteria are met without any significant deficiencies.<sup>69</sup>
- **Largely compliant:** Only minor shortcomings are observed and the authorities are able to achieve full compliance within a prescribed time frame.
- **Materially non-compliant:** Severe shortcomings which cannot be rectified easily.
- **Non-compliant:** No substantive implementation of the CPIDIS.
- **Not applicable:** Not considered given the structural, legal and institutional features of the deposit insurance system.

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<sup>67</sup> This format was recommended by the IMF and the World Bank for use by assessors in the context of Financial Sector Assessment Program (FSAP) or Offshore Financial Center (OFC) program missions. In order to maintain comparability and consistency, the format was also recommended for stand-alone assessments or self-assessments by a jurisdiction. See *Core Principles for Effective Banking Supervision* (2012).

<sup>68</sup> This scale is used for external assessments in the IFSB's CPs and the Basel Committee's Core Principles Methodology (Banking Supervision), available at [www.bis.org/publ/bcbs130.htm](http://www.bis.org/publ/bcbs130.htm).

<sup>69</sup> In order to achieve a "Compliant" grade, it is not always necessary to achieve compliance on all essential criteria for each CPIDIS. For example, if an IDIS is compliant with eight out of nine essential criteria for a specific CPIDIS but is not compliant in a relatively minor area, then the overall compliance rating could be designated "Compliant". Assessors must exercise judgement in these situations.

Grading is not an exact science and the CPIDIS can be met in different ways. The assessment criteria should not be seen as a checklist approach to compliance, but as a qualitative exercise. The number of criteria in compliance, and the commentary that should accompany each criterion, will be weighed in the scoring process for each CPIDIS. However, not all criteria will carry equal weight. It is critical for the assessors to receive training on the consistent application of the methodology. The CPIDIS are benchmarks for effective deposit insurance practice. In implementing them, deposit insurers and policymakers will need to take into account jurisdiction-specific factors.

Assessors should pay close attention to the adequacy of the operating environment and include their opinion on gaps and weaknesses in the environment and actions that policymakers could take to mitigate those weaknesses. The assessment of compliance with individual CPIDIS could flag those Islamic core principles that are likely to be primarily affected by external conditions considered to be weak, after factoring in specific jurisdiction circumstances, mandate and structures of the deposit insurance system. However, assessors should not undertake to assess compliance with the operating environment themselves. Instead, wherever possible, assessors should rely on the results of recent IMF/World Bank FSAP reports and, where relevant, FSB peer reviews. If a report has not been conducted recently, assessors should request from the authorities that they are provided with updates on any changes since the previous FSAP report. If no such reports on preconditions are available, assessors should assign an “Insufficient Information” rating to the operating environment review. Recommendations with regard to the operating environment should not be part of the action plan associated with the CPIDIS assessment but should be included in other general recommendations for strengthening the deposit insurance system.

In order to assist assessors in interpreting the methodology and identifying CPIDIS that may or may not be applicable in all types of arrangements of IDIS, a *Handbook Guide for Assessors of CPIDIS* will be developed.<sup>70</sup> This document includes supporting guidance to assist assessors in applying the criteria to specific jurisdictional settings and structures. The handbook will be updated over time to take into account the experiences and lessons learned in conducting compliance assessments.

### **Use of the Methodology**

The methodology can be used in multiple contexts: (i) self-assessment performed by the deposit insurer; (ii) IMF and World Bank assessments of the quality of deposit insurance systems – for example, in the context of the FSAP or Technical Assistance (TA) projects; (iii) peer reviews conducted, for example, within IADI regional committees or through the FSB peer review process; and (iv) reviews conducted by private third parties such as consulting firms. Both IADI and the IFSB will be active in

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<sup>70</sup> IADI and the IFSB will jointly develop this handbook in due course following release of the final set of CPIDIS.

interpreting the CPIDIS and providing training; this includes guidance on best practices during the assessment process.

Whether conducted by a deposit insurer (self-assessment) or an outside party, a fully objective assessment of compliance with the CPIDIS should be performed by suitably qualified parties who bring varied perspectives to the process. It is beneficial that the parties be made up of suitably qualified persons, including individuals with experience of working in an IDIS and dealing with Islamic bank failures. A fair assessment of the IDIS also requires the cooperation of all relevant authorities. The process of assessing each of the 17 CPIDIS requires a judgemental weighting of numerous elements that only qualified assessors with practical, relevant experience can provide. To the extent that the assessment requires legal and accounting expertise in the interpretation of compliance with the CPIDIS, these legal and accounting interpretations must be in relation to the legislative and accounting structure of the relevant jurisdiction. The assessment must be comprehensive and in sufficient depth to allow a judgement on whether criteria are fulfilled in practice, not just in theory. Similarly, laws and regulations need to be sufficient in scope and depth. There must also be effective enforcement of and compliance with those laws and regulations on the part of regulators, supervisors and the deposit insurer. Finally, the assessment of compliance with the CPIDIS will build upon any recent work in similar areas such as the FSAPs.

## **Assessment Report**

The assessment report should include the following:

- A general section that provides background information on the assessment conducted, including information on the organisation being assessed and the context in which the assessment is being conducted.
- A section on the information and methodology used for the assessment.
- An overview of the institutional and macroeconomic setting and market structure.
- A review of the operating environment, including Sharī'ah compliance mechanism/Shari'ah governance framework for an effective IDIS.
- A compliance table, summarising the assessment results (Table 1).
- A recommended action plan (including Sharī'ah-compliant resolution and contingency planning) providing principle-by-principle recommendations for actions and measures to improve the IDIS and practices (Table 2).
- A detailed principle-by-principle assessment, describing the system with reference to a particular principle, a grading or "assessment", and a "comments" section (Table 3).

- A section for authorities' comments (including the Sharī'ah authority's opinion/ruling on the overall Sharī'ah compliance environment of the IDIS).

## Compliance Assessment and Summary Tables

**Table 1**  
**Summary of Compliance with the IADI–IFSB Core Principles for Effective IDIS Detailed Assessments**

Core Principle	Grade	Comments
Reference CPIDIS 1	C, LC, MNC, NC, NA <sup>71</sup>	
Repeat for all 17 CPIDIS	C, LC, MNC, NC, NA	

**Table 2**  
**Recommended Action Plan to Improve Compliance with the IADI–IFSB Core Principles for Effective IDIS**

Reference Principle	Recommended Action
CPIDIS 1	Description of deficiency Suggested course of action
CPIDIS 2	Description of deficiency Suggested course of action
Repeat for all CPIDIS with a recommended action	Description of deficiency Suggested course of action

<sup>71</sup> Compliant (C), Largely Compliant (LC), Materially Non-Compliant (MNC), Non-Compliant (NC), Not Applicable (NA).

<b>Table 3</b>	
<b><i>Core Principles for Effective IDIS Detailed Assessment Table</i></b>	
CPIDIS 1: (repeat verbatim text of CPIDIS 1)	
Description	
Assessment	C, LC, MNC, NC, NA
Comments	
For each Essential Criterion:	
Description	
Assessment	C, LC, MNC, NC, NA <sup>72</sup>
Comments	
Repeat for all 17 CPIDIS	

### **Practical Considerations in Conducting a Compliance Assessment**

In addition to the format for conducting a compliance assessment, the following practical considerations should be taken into account:

1. The assessor should have access to a range of information and interested parties. This may include published information, more sensitive information (i.e. previously completed self-assessments, information on the health of insured institutions such as supervisory examination results), and operational guidelines for the deposit insurer. This information should be provided as long as it does not violate legal requirements for the deposit insurer to hold such information confidential. The assessor should also meet with a range of individuals and organisations, including other financial safety-net participants and relevant government ministries, commercial bankers and auditors. Special note should be made of instances when any required information is not provided, as well as of what effect this might have on the accuracy of the assessment.

Assessors should set out the range of information required from the authorities involved and, at the initial meeting with the individuals involved, explain how the assessment will proceed.

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<sup>72</sup> It is recommended that each essential criterion be graded by the assessor. However, the assessment grade for each essential criterion should not be included in the FSAP's final *Reports on the Observance of Standards and Codes* (ROSC) provided to authorities.

This should include the process to be followed in the assessment for the review of the operating environment.

2. The assessment of compliance with each CPIDIS requires the evaluation of a chain of related requirements, such as laws, prudential regulation and supervisory guidelines, including instructions related to Sharī'ah compliance. The assessment must ensure that the requirements are or can be put into practice. For example, policymakers must ensure that the deposit insurer has the necessary operational independence, skills and resources to fulfil its public policy objectives.
3. In addition to identifying deficiencies, the assessment should also highlight positive features and key achievements.
4. Cooperation and information sharing among safety-net participants is necessary for the effectiveness of the deposit insurance system. The assessor should be able to judge whether such information sharing occurs. Depending on the materiality of cross-border banking, it is also important that the assessor is able to judge whether information sharing occurs between deposit insurers and other safety-net participants in different jurisdictions.

## Appendix: Mapping the IADI CPs: The CPIDIS Approach

IADI Core Principles	CPIDIS Approach: Revised CPs in the Form of CPIDIS Reflecting the Specificities of Islamic Banks	Islamic Finance Specificities Addressed by New Additions / Changes
<b>CP 1: Public Policy Objectives</b>	CPIDIS 1 – Amended <ul style="list-style-type: none"> <li>• Modified the main principle</li> <li>• Modified two ECs</li> </ul>	<ul style="list-style-type: none"> <li>• The main principle is modified due to the design of IDIS complying with Sharī'ah requirements for an effective IDIS for respective jurisdictions, while remaining consistent with the system's public policy objectives.</li> <li>• The modification of the main principle has implications on EC 2 and EC 3 whereby the design as well as the governance of the IDIS has to comply with Sharī'ah requirements and be endorsed through a Sharī'ah governance system.</li> </ul>
<b>CP 2: Mandate and Powers</b>	CPIDIS 2 – Amended <ul style="list-style-type: none"> <li>• Modified one EC</li> </ul>	EC 4 is modified due to the power of deposit insurers to manage their financial resources and the need to observe Sharī'ah principles. In addition, the IDIS has clearly specified authorisation in legislation to utilise the funds for carrying out its duties.
<b>CP 3: Governance</b>	CPIDIS 3 – Retained unamended	-
<b>CP 4: Relationships With Other Safety-Net Participants</b>	CPIDIS 4 – Retained unamended	-
<b>CP 5: Cross-Border Issues</b>	CPIDIS 5 – Amended <ul style="list-style-type: none"> <li>• Introduced one new EC</li> </ul>	The introduction of a new EC is required due to different Sharī'ah interpretations across jurisdictions which may pose conflicts among relevant deposit insurers from different jurisdictions. The new EC gives greater clarity on the kinds of coordination arrangements that can take place among the relevant parties.
<b>CP 6: Deposit Insurer's Role in Contingency Planning and Crisis Management</b>	CPIDIS 6 – Amended <ul style="list-style-type: none"> <li>• Introduced one new EC</li> </ul>	The introduction of a new EC is required to ensure that the contingency planning and crisis management activities comply with Sharī'ah requirements, and are endorsed by a Sharī'ah governance system.
<b>CP 7: Membership</b>	CPIDIS 7 – Amended <ul style="list-style-type: none"> <li>• Modified one EC</li> </ul>	The modification of EC 1 is needed to recognise the Islamic Banking Window as part of the Islamic banking system in relevant jurisdictions.
<b>CP 8: Coverage</b>	CPIDIS 8 – Amended <ul style="list-style-type: none"> <li>• Introduced one new EC</li> <li>• Modified one EC</li> </ul>	<ul style="list-style-type: none"> <li>• Introduction of a new EC under EC 2 is required in order for the coverage status of investment accounts to be cognizant with Sharī'ah rules and principles, as well as public policy objectives.</li> </ul>



		<ul style="list-style-type: none"> <li>• EC 4 is modified to ensure equal treatment for both CDIS and IDIS.</li> </ul>
<b>CP 9: Sources and Uses of Funds</b>	CPIDIS 9 – Amended <ul style="list-style-type: none"> <li>• Introduced one new EC</li> <li>• Modified six ECs</li> </ul>	<ul style="list-style-type: none"> <li>• EC 3 is introduced to recognise the investment accounts protection in determining the source of contributions.</li> <li>• Six ECs are modified to take account of these considerations: <ul style="list-style-type: none"> <li>- EC 4: To ensure an absence of interest payment on the principal funding amount to comply with Sharī'ah requirements.</li> <li>- EC 5: To recognise a Sharī'ah-compliant market-based financing mechanism as part of emergency funding arrangements.</li> <li>- EC 6: To reflect that the target of the IDIF is determined separately from the conventional counterparts (CDIFs).</li> <li>- EC 7: Ensuring sound investment decisions of the IDIF that comply with Sharī'ah requirements.</li> <li>- EC 8: To ensure separate arrangements for the IDIF where both conventional and Islamic deposit insurance systems operate.</li> <li>- EC 9: To ensure the conformity with Sharī'ah principles for the deposit insurer that holds the funds at the central bank.</li> </ul> </li> </ul>
<b>CP 10: Public Awareness</b>	CPIDIS 10 – Amended <ul style="list-style-type: none"> <li>• Modified one EC</li> </ul>	The modification in EC 3 is to reflect the public awareness of the mandate of the IDIS that covers the scope, the Islamic banking members, deposit insurance coverage limits, and any other information.
<b>CP 11: Legal Protection</b>	CPIDIS 11 – Amended <ul style="list-style-type: none"> <li>• Modified one EC</li> </ul>	The modification in EC 1 is to recognise the presence of the Sharī'ah board in the legal protection governance.
<b>CP 12: Dealing with Parties at Fault in an Islamic Bank Failure</b>	CPIDIS 12 – Retained unamended	-
<b>CP 13: Early Detection and Timely Intervention</b>	CPIDIS 13 – Amended <ul style="list-style-type: none"> <li>• Modified one EC</li> </ul>	EC 3 is modified to reflect other risks specific to Islamic banks by adding the criteria of management, earnings, liquidity, sensitivity to market risks for safety and soundness indicators.
<b>CP 14: Failure Resolution</b>	CPIDIS 14 – Amended <ul style="list-style-type: none"> <li>• Modified three ECs</li> </ul>	Three ECs are modified to take account of these considerations: <ul style="list-style-type: none"> <li>- EC 2: To reflect that the resolution regime complies with the Sharī'ah framework as applied in the jurisdiction.</li> </ul>

		<ul style="list-style-type: none"> <li>- EC 4: To reflect Sharī'ah-compliant resolution options available to the IDIS.</li> <li>- EC 6: To reflect that the depositor hierarchy in resolution procedures complies with Sharī'ah rules and principles.</li> </ul>
<b>CP 15: Reimbursing Depositors</b>	CPIDIS 15 – Retained unamended	-
<b>CP 16: Recoveries</b>	CPIDIS 16 – Amended <ul style="list-style-type: none"> <li>• Modified the main principle</li> <li>• Modified three ECs</li> </ul>	<ul style="list-style-type: none"> <li>• Modification to account for IDIS design where the IDIF is not in ownership of the IDIS, but the IDIS has rights to recover claims of the IDIF under its management (i) by being recognised as a creditor through subrogation; (ii) by having the same rights in law as that of a creditor or depositor in the estate of a failed Islamic bank; (iii) by having the right to access information from the liquidator.</li> </ul>
<b>Additional Core Principles</b>		
<b>Sharī'ah Governance</b>	<b>New: CPIDIS 17</b>	This CP addition is crucial due to the fact that apart from the legal governance in dealing with IDIS, the Sharī'ah governance has to be recognised in order to be in harmony with the legal system in the respective jurisdictions.

**Note: EC = Essential Criteria**

**Abbreviations**

IDIS = Islamic Deposit Insurance System

CDIS = Conventional Deposit Insurance System

IDIF = Islamic Deposit Insurance Fund(s)

CDIF = Conventional Deposit Insurance Fund(s)

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Michel Cadelano	Fonds de Garantie des Dépôts et de Résolution, France
Mu'taz I. Barbour	Jordan Deposit Insurance Corporation, Jordan
Patrick Déry	Autorité des marchés financiers, Québec, Canada
Piotr Tomaszewski	Bank Guarantee Fund, Poland
Rafiz Azuan Abdullah	Malaysia Deposit Insurance Corporation, Malaysia

## IADI ISLAMIC DEPOSIT INSURANCE TECHNICAL COMMITTEE

### Chairperson

Dr Ronald Rulindo – Indonesia Deposit Insurance Corporation, Indonesia

### Members

Abdel Gadir Mohamed Ahmed Salih	Bank Deposit Security Fund, Sudan
Mahraoui Mohamed	Moroccan Deposit Insurance Corporation, Morocco
Mohd Sobri bin. Mansor	Malaysia Deposit Insurance Corporation, Malaysia
Muhiddin Güllal	Savings Deposit Insurance Fund of Turkey
Mu'taz I. Barbour	Jordan Deposit Insurance Corporation, Jordan
Osama Alnaas	Depositor's Insurance Fund, Libya
Richard Kwach	Kenya Deposit Insurance Corporation, Kenya
Rosemary Tesha	Tanzania Deposit Insurance Fund, Tanzania

Tijjani Sule Yakasai	Nigeria Deposit Insurance Corporation, Nigeria
Yelnur Shalkibayev	Kazakhstan Deposit Insurance Fund, Kazakhstan

## IFSB TECHNICAL COMMITTEE

### Chairperson

Mr. Khalid AlKharji – Central Bank of United Arab Emirates  
(until 15 September 2020)

Mr. Waleed Al Awadhi – Central Bank of Kuwait  
(until 4 June 2020)

### Deputy Chairperson

Mrs. Madelena Mohamed – Bank Negara Malaysia

### Members\*

Dr. Gaffar A. Khalid	Islamic Development Bank
Mrs. Shireen Al Sayed	Central Bank of Bahrain
Mr. Abu Farah Md. Nasser (until 7 February 2019)	Bangladesh Bank
Mr. A. K. M. Amjad Hussain (until 10 December 2019)	Bangladesh Bank
Mr. Md. Rezaul Islam (from 11 December 2019)	Bangladesh Bank
Ms. Rafezah Abd Rahman	Autoriti Monetari Brunei Darussalam
Mr. Mohamed Aboumoussa	Central Bank of Egypt
Dr. Jardine Husman	Bank Indonesia
Mr. Ahmad Soekro Tratmono (until 3 June 2020)	Indonesia Financial Services Authority
Mr. Deden Firman Hendarsyah (from 4 June 2020)	Indonesia Financial Services Authority
Dr. Jafar Jamali	Securities & Exchange Organization, Iran
Prof. Dr. Mahmood Dagher (until 3 June 2020)	Central Bank of Iraq
Dr. Ammar Hamad Khalaf (from 4 June 2020)	Central Bank of Iraq
Mr. Arafat Al Fayoumi	Central Bank of Jordan
Mr. Alibek Nurbekov	Astana Financial Services Authority, Kazakhstan
Dr. Ali Abusalah Elmabrok (from 11 December 2019)	Central Bank of Libya
Mr. Mohd Zabidi Md. Nor (until 5 December 2018)	Bank Negara Malaysia
Datuk Zainal Izlan Zainal Abidin (until 1 April 2019)	Securities Commission Malaysia
Mr. Noraizat Shik Ahmad (from 29 April 2019)	Securities Commission Malaysia
Mr. Mohamed Triqui	Bank Al-Maghrib, Morocco
Mr. Muhammad Wada Mu'azu Lere (until 13 November 2018)	Central Bank of Nigeria
Mr. Ibrahim Sani Tukur (from 29 April 2019)	Central Bank of Nigeria

Dr. Salisu Hamisu <i>(from 29 April 2019)</i>	Nigeria Deposit Insurance Corporation (NDIC)
Mr. Saud Al Busaidi <i>(from 29 April 2019)</i>	Central Bank of Oman
Mr. Ghulam Muhammad Abbasi	State Bank of Pakistan
Mr. Hisham Saleh Al-Mannai	Qatar Central Bank
Dr. Sultan Alharbi <i>(until 10 December 2019)</i>	Saudi Central Bank
Mr. Ahmed Asery <i>(from 11 December 2019)</i>	Saudi Central Bank
Mr. Mohammed Al-Madhi <i>(until 14 March 2019)</i>	Capital Market Authority, Saudi Arabia
Mr. Abdulrahman Al-Hussayen <i>(from 29 April 2019)</i>	Capital Market Authority, Saudi Arabia
Mrs. Somia Amir Osman Ibrahim	Central Bank of Sudan
Mr. Ömer Çekin	Banking Regulation and Supervision Agency of Turkey
Mr. Yavuz Yeter <i>(until 10 December 2019)</i>	Central Bank of the Republic of Turkey
Mr. Ali Çufadar <i>(from 11 December 2019)</i>	Central Bank of the Republic of Turkey
Mrs. Ilic Basak Sahin <i>(until 29 April 2019)</i>	Capital Markets Board, Republic of Turkey

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

## IADI-IFSB JOINT WORKING GROUP

### Co-Chairpersons

Ronald Rulindo – Indonesia Deposit Insurance Corporation

Shireen Al Sayed – Central Bank of Bahrain

### Members\*

Housseem Eddine Bedoui	Islamic Development Bank
Hjh Shahdina Binti DP Hj Omar	Brunei Darussalam Deposit Protection Corporation
Tan Chi Hong	Brunei Darussalam Deposit Protection Corporation
Stephan Strauss	BAFIN (Germany)
Yasmine Mohamed Mahmoud Soliman	Central Bank of Egypt
Ansyori Abdullah	Indonesia Financial Services Authority
Ali Sattar Jabbar	Central Bank of Iraq
Tahseen Mosleh	Jordan Deposit Insurance Corporation
Madina Tukulova	Astana Financial Services Authority
Kuanyshbek Abzhanov	Kazakhstan Deposit Insurance Fund
Richard Otieno Kwach Jr.	Kenya Deposit Insurance Corporation
Tahseen Mosleh	Jordan Deposit Insurance Corporation
Dalya Al Salem	Central Bank of Kuwait
Noussayma El Tabch	Banque Du Liban
Hamim Syahrum Ahmad Mokhtar	Bank Negara Malaysia
Mohd Sobri Mansor	Malaysia Deposit Insurance Corporation
Mohammed Zougari Laghrari	Bank Al-Maghrib
Mohamed Mahraoui	Morocco Deposit Insurance Corporation
Hussaini Yakubu Mohammed	Nigeria Deposit Insurance Corporation
Salisu Hamisu	Nigeria Deposit Insurance Corporation
Raja Salim Al Hadhrami	Central Bank of Oman
Muhammad Islam Ahmed	State Bank of Pakistan
Winnie Claire L. Jamoner	Bangko Sentral ng Pilipinas
Sara Althenyan	Saudi Arabian Monetary Authority
Rashid S. Mrutu	Deposit Insurance Board of Tanzania

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## IFSB SHARĪ'AH BOARD

### Chairman

Sheikh Dr. Hussein Hamed Hassan (*Late*)  
(*until 19 August 2020*)

### Deputy Chairman

Sheikh Dr. Abdulsattar Abu Ghuddah (*Late*)  
(*until 23 October 2020*)

### Members\*

H.E. Sheikh Abdullah Bin Sulaiman Al-Meneea	Member
Sheikh Dr. Mohamed Raougui	Member
Sheikh Mohammad Ali Taskhiri ( <i>Late</i> ) ( <i>until 18 August 2020</i> )	Member
Sheikh Dr. Muhammad Syafii Antonio	Member
Sheikh Muhammad Taqi Al-Usmani	Member

\*Names in alphabetical order

## SECRETARIAT, INTERNATIONAL ASSOCIATION OF DEPOSIT INSURERS

David Walker	Secretary General
Kumudini Hajra	Senior Policy and Research Advisor
Ramadhian Moetomo	Senior Policy Analyst

## SECRETARIAT, ISLAMIC FINANCIAL SERVICES BOARD

Bello Lawal Danbatta	Secretary-General
Zahid Ur Rehman Khokher ( <i>until 31 December 2018</i> )	Assistant Secretary-General
Jamshaid Anwar Chattha ( <i>until 31 August 2019</i> )	Assistant Secretary-General
Rifki Ismal ( <i>from 1 July 2020</i> )	Assistant Secretary-General
Syed Faiq Najeeb ( <i>until 16 August 2019</i> )	Member of the Secretariat, Technical and Research
Jhordy Kashoogie Nazar ( <i>until 28 March 2021</i> )	Member of the Secretariat, Technical and Research