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# The DFSA Rulebook

## Islamic Finance Rules

### **(IFR)**

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## **1. INTRODUCTION**

### **1.1 Application**

**1.1.1** This module (IFR) applies to:

- (a) every Person who carries on, or holds itself out as carrying on, a Financial Service in or from the DIFC as in accordance with Shari'a;
- (b) a Domestic Fund which is operated or held out as being operated as an Islamic Fund;
- (c) a Person making an Offer in or from the DIFC relating to an Investment which is held out as Islamic or Shari'a compliant.

#### **Guidance**

1. Most of the requirements that apply to Persons conducting Financial Services or distributing Securities as Islamic or Shari'a compliant are included in this module. There are other more generic requirements relating to such Financial Services or activities that are included in other modules of the DFSA Rulebook.
2. To enable Persons carrying on or proposing to carry on Islamic finance activities to easily access the Islamic finance related requirements applicable to their activities, the DFSA has created a web-based Islamic Finance Handbook. This handbook allows electronic navigation to reach the relevant provisions in the IFR and other DFSA Rulebook modules where Islamic finance related requirements applicable to specific Islamic finance activities are located. The handbook is accessible from the DFSA web-site.
3. Investment Tokens are Investments defined in GEN A2.1.1(3). An Investment Token is likely to be held out as being Islamic or Shari'a compliant when it is referred to using terms such as 'Islamic investment token', 'Islamic security token', 'sukuk token', 'Islamic fund token' or any other name that suggests or implies it is Islamic or Shari'a compliant.

### **1.2 Overview of the IFR module**

#### **Guidance**

1. Rules in this module are made under or for the purposes of a number of laws, including the Regulatory Law 2004, the Law Regulating Islamic Financial Business 2004 and the Collective Investment Law 2010. Guidance may indicate the relevant legislation.
2. Chapters 2 and 3 contain the general requirements and obligations that apply to an Authorised Person who carries on any Financial Service as Islamic Financial Business. Chapter 4 contains the accounting and audit requirements that apply to such Persons.
3. Chapter 5 contains additional requirements that apply to an Authorised Firm that carries on the Financial Service of Managing Profit Sharing Accounts.
4. Chapter 6 contains the additional requirements that apply to a Fund Manager of an Islamic Fund.

5. Chapter 7 contains specific requirements that apply to Reporting Entities which Offer Securities as Shari'a compliant. However, the general requirements that apply to such Offers with which the Reporting Entities must comply continue to be in the Markets Rules (MKT module).
6. Chapter 8 contains the additional requirements applying to Persons who carry on Insurance Business or Insurance Intermediation as Takaful Insurance.

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## **2 ISLAMIC FINANCE**

### **2.1 Application**

- 2.1.1** This chapter applies to every Person to whom this module applies in accordance with Section 1.1.

### **2.2 Activities that constitute Islamic Financial Business**

#### **Guidance**

1. Article 10 of the Law Regulating Islamic Financial Business 2004 prescribes what constitutes Islamic Financial Business. In essence, where a Person engages in any activity that constitutes a Financial Service and carries on or holds out the activity as being conducted in accordance with Shari'a, that activity constitutes Islamic Financial Business.
2. GEN section 2.2 sets out the activities that constitute a Financial Service.

### **2.3 Conducting Islamic Financial Business**

#### **Guidance**

1. Article 9 of the Law Regulating Islamic Financial Business 2004 provides that in order to conduct Islamic Financial Business, the Authorised Person must have an endorsed Licence authorising it to conduct such business:
  - a. as an Islamic Financial Institution; or
  - b. by operating an Islamic Window.
2. Article 11 of the Law Regulating Islamic Financial Business 2004 governs the making of an application for an endorsement to conduct Islamic Financial Business.
3. Article 11(5) of the Law Regulating Islamic Financial Business 2004 governs the grant of an endorsement to conduct Islamic Financial Business as either an Islamic Financial Institution or by operating an Islamic Window. A Person must obtain the relevant endorsement before carrying on Islamic Finance Business as an Islamic Financial Institution or through an Islamic Window.
4. An Authorised Person with an endorsement to operate an Islamic Window may conduct some of its activities as a conventional Financial Service while conducting its Islamic Financial Business through the Islamic Window.
5. If Islamic Financial Business (whether through an Islamic Financial Institution or Islamic Window) is provided to Retail Clients, the Authorised Person must also have a Retail Endorsement on its Licence.
6. A Person may, subject to any restrictions in the DFSA Rules, carry on more than one Financial Service, provided that Person has the relevant authorisations or endorsements on its Licence as are applicable.

## 2.4 Islamic financial instruments and products

### Guidance

1. The DFSA regulatory regime applies to a Person carrying on any Islamic financial activities in or from the DIFC if the activity:
  - a. relates to a financial instrument or product of the kind described in Guidance Notes 3 (Profit Sharing Investment Accounts), 5 (Investments), and 7 (Takaful insurance) below; and
  - b. is conducted by way of business and not expressly excluded from regulation as a Financial Service. Note there are a number of such exclusions in GEN chapter 2.
2. The DFSA will, when considering the treatment of Islamic Financial Business arrangements, take a “substance over form” approach.
3. The issue of financial products which are Securities such as Shares, Debentures or Units as defined in GEN A2.1.2 (which are a subset of the definition of Investments – see Guidance Note 5), attracts product specific disclosure requirements such as Prospectus or Exempt Disclosure Statements. Where such products are included on an Official List of Securities or made available to the public in the DIFC, there are initial and ongoing disclosure and other obligations that apply to the Reporting Entity (generally the issuer) under the MKT module. These MKT obligations are quite distinct from the obligations that apply to Persons carrying on Financial Services in respect of such financial products.

### Profit Sharing Investment Accounts (PSIAs)

4. PSIAs do not fall within the GEN definitions of Investments. They are contractual arrangements under which Authorised Firms invest clients’ funds, often (though not always) on a pooled basis, and are generally treated by the firm as off balance sheet. They are sometimes structured under Mudaraba, so that the investor in principle bears the full investment risk. Although PSIAs have the characteristics of a Collective Investment Fund, under an express exclusion provided under CIR Rule 2.1.13, they are not treated as such. Instead, Managing a PSIA is a distinct Financial Service as defined in GEN Rules 2.2.2(r) and 2.21.
5. As Managing a PSIA is a Financial Service, the DFSA regulatory regime that applies to Persons carrying on Financial Services in or from the DIFC applies to Authorised Firms that manage PSIAs. As PSIAs are not Investments, the offer of PSIAs does not attract prospectus like disclosure. Instead, it attracts a tailored regulatory regime that applies to the entity, i.e. an Authorised Firm that manages the PSIAs (see IFR chapter 5 for these Rules). The Financial Service of Advising on Financial Products will apply to a Person giving advice on the merits of investing in a PSIA (as a PSIA is defined as a ‘financial product’ for the purposes of that activity). However, other activities such as dealing and arranging and COB requirements relating to those activities do not apply to a PSIA (as it is not an Investment as defined in GEN).

### Investments

6. Investments comprise two types of products: Securities and Derivatives. These products are defined in GEN App2. Most of the conventional Investments defined in GEN App2 can be offered as Islamic financial products, provided the relevant requirements including Shari’a principles are adhered to and in accordance with any Shari’a Supervisory Board rulings as applicable. While not an exhaustive list, conventional Investments that are commonly used as Islamic financial products

include Shares, Sukuks, Units of Islamic Funds and also Structured Products. Increasingly, Derivatives are also being developed in accordance with Shari'a, such as a contract where the rights and liabilities of the parties are determined by reference to an underlying factor such as property of any description, currency rate or index, provided that the underlying factor in itself is Shari'a compliant and the contract does not involve any fundamental uncertainty (Gharar).

7. The DFSA regulatory regime applies to Persons who carry on in or from the DIFC any Financial Services activity in relation to any Islamic financial products that fall within the definition of Investments. However, particular products or instruments such as Profit Sharing Investment Accounts (PSIAs), Takaful and Islamic Funds attract product/instrument specific additional conduct and other requirements, which are included in this module.

### **Takaful insurance**

8. Takaful insurance generally refers to an arrangement where an insurer establishes a Shari'a compliant fund, predicated for mutual protection, where participants donate a part of their contributions to the common fund which will be used to meet claims payments and any participation rights. The Takaful insurer's role is generally confined to managing the insurance activities and investing the fund assets in accordance with Shari'a.
9. Persons conducting Takaful insurance are conducting Insurance Business. There are two types of Financial Services that comprise Insurance Business, ie, Effecting Contracts of Insurance or Carrying out Contracts of Insurance. Accordingly, any Person carrying on these Financial Services activities is subject to the DFSA regime for regulating Financial Services. Where such activities are carried out as Takaful insurance, there are additional Takaful specific requirements that apply to such an insurer, which are set out in this module (see IFR chapter 8). In addition, there are certain activities relating to insurance, such as advising and arranging, which are regulated as Insurance Intermediation (see GEN section 2.19). Persons conducting those activities in relation to Takaful insurance are regulated in the same way as Persons conducting such activities in relation to conventional insurance.



## 3 GENERAL OBLIGATIONS

### 3.1 Application

**3.1.1** This chapter applies to an Authorised Person which carries on Islamic Financial Business in or from the DIFC.

#### **Guidance**

“Authorised Person” is defined in the GLO module as an Authorised Firm or Authorised Market Institution.

### 3.2 Constitution of an Islamic Financial Institution

**3.2.1** An Authorised Person which is an Islamic Financial Institution must ensure that its constitutional documents state that its entire business will be conducted in accordance with Shari’a.

#### **Guidance**

Article 10 of the Law Regulating Islamic Financial Business 2004 provides that an Islamic Financial Institution is an Authorised Person whose entire business is conducted in accordance with Shari’a.

### 3.3 Systems and controls

- 3.3.1**
- (1) An Authorised Firm conducting Islamic Finance Business must establish and maintain systems and controls which enable it to comply with the applicable Shari’a requirements.
  - (2) An Authorised Firm using a Fund Platform that has one or more Islamic Funds on the Fund Platform must ensure that the Fund Platform has systems and controls which enable the Fund Manager to comply with the applicable Shari’a requirements in respect of the Islamic Funds.

#### **Guidance**

1. This Chapter should be read in conjunction with Chapter 5 of the GEN Module.
2. Responsibility for ensuring that an Authorised Person complies with Shari’a ultimately rests with its senior management. The systems and controls required by Rule 3.3.1 will assist senior management to ensure that there is such compliance.
3. The Governing Body should, when setting the business objectives and strategies of the firm and on an on-going basis, make use of the expertise of the firm’s Shari’a Supervisory Board as appropriate.
4. Similarly, Persons Undertaking Risk Control Functions of the firm, particularly compliance and internal audit, should have easy access to the Shari’a Supervisory Board in relation to matters involving Shari’a compliance.

5. The members of the SSB should also have adequate access to the Governing Body, senior management and the Persons Undertaking Key Control Functions as appropriate to ensure that their roles can be effectively discharged.
6. Both Islamic and conventional Funds can be established on the same Fund Platform, provided the requirements relating to Shari'a compliance are met both as to investments and as to relevant operational matters, and that appropriate governance is in place to achieve this. This would generally require either all the Funds on a Fund Platform to be Islamic Funds, or the Fund Platform to operate through an Islamic Window in the same way as the Fund Manager that is using the Fund Platform.

## **3.4 Policy and procedures manual**

**3.4.1** An Authorised Person undertaking Islamic Financial Business must implement and maintain an Islamic Financial Business policy and procedures manual which addresses the following matters:

- (a) the manner in which the compliance function will be undertaken, in respect of Shari'a compliance;
- (b) the manner in which the Shari'a Supervisory Board will oversee and advise in regard to the Islamic Financial Business conducted by the Authorised Person;
- (c) the manner in which Shari'a Supervisory Board fatwas, rulings and guidelines will be recorded, disseminated and implemented and the internal Shari'a review undertaken;
- (d) the manner in which disputes between the Shari'a Supervisory Board and the Authorised Person in respect of Shari'a compliance will be addressed;
- (e) the process for approving those internal systems and controls which are in place to ensure not only that the Islamic Financial Business is carried out in compliance with Shari'a, but that information is disseminated, using an appropriate method and manner, to investors and, in the case of an Authorised Market Institution, Persons to whom access to its facilities are provided;
- (f) the manner in which conflicts of interest will be identified and managed including where prescribed; and
- (g) in respect of an Authorised Person operating an Islamic Window, the systems and controls in place to ensure the appropriate separation of the Islamic Financial Business of the Authorised Person from its conventional business.

## **3.5 Shari'a Supervisory Board**

### **Guidance**

Article 13 of the Law Regulating Islamic Financial Business 2004 requires an Authorised Person undertaking Islamic Financial Business to appoint a Shari'a Supervisory Board.

**3.5.1** When an Authorised Person appoints a Shari'a Supervisory Board, it must ensure that:

- (a) the Shari'a Supervisory Board has at least three members;
- (b) the members appointed to the Shari'a Supervisory Board are competent to perform their functions as Shari'a Supervisory Board members;
- (c) any appointments, dismissals or changes in respect of members of the Shari'a Supervisory Board are approved by the Governing Body of the Authorised Person; and
- (d) no member of the Shari'a Supervisory Board is a director or Controller of the Authorised Person.

**Guidance**

For the purposes of Rule 3.5.1, an Authorised Person should consider the previous experience and qualifications of the proposed Shari'a Supervisory Board members to assess whether the proposed Shari'a Supervisory Board member is competent to advise on the Islamic Financial Business to be undertaken by the Authorised Person.

**3.5.2** An Authorised Person must document its policy in relation to:

- (a) how appointments, dismissals or changes will be made to the Shari'a Supervisory Board;
- (b) the process through which the suitability of Shari'a Supervisory Board members will be considered; and
- (c) the remuneration of the members of the Shari'a Supervisory Board.

**3.5.3** An Authorised Person must establish and maintain, for six years, records of:

- (a) its assessment of the competency of the Shari'a Supervisory Board members;
- (b) the agreed terms of engagement of each member of the Shari'a Supervisory Board; and
- (c) the matters in Rules 3.5.1(c) and 3.5.2.

**Guidance**

The records of the assessment of competency of Shari'a Supervisory Board members should clearly indicate; at least:

- a. the factors that have been taken into account when making the assessment of competency;
- b. the qualifications and experience of the Shari'a Supervisory Board members;

- c. the basis upon which the Authorised Person has deemed that the proposed Shari'a Supervisory Board member is suitable; and
- d. details of any other Shari'a Supervisory Boards of which the proposed Shari'a Supervisory Board member is, or has been, a member.

**3.5.4** (1) The Authorised Person must ensure that the Islamic Financial Business policy and procedures manual it is required to maintain under Rule 3.4.1 provides that:

- (a) a member of the Shari'a Supervisory Board is obliged to notify the Authorised Person of any conflict of interest that such member may have with respect to the Authorised Person or, in the case of an Investment Trust, the Trustee; and
  - (b) the Authorised Person will take appropriate steps to manage any such conflict of interest so that the Islamic Financial Business is carried out appropriately and in compliance with Shari'a, the interest of a Client is not adversely affected and all Clients are fairly treated and not prejudiced by any such interests.
- (2) If an Authorised Person is unable to manage a conflict of interest as provided above, it must dismiss or replace the member as appropriate.

**3.5.5** If requested by the DFSA, an Authorised Person must provide the DFSA with information on its appointed or proposed Shari'a Supervisory Board members with regard to the qualifications, skills, experience and independence of the Shari'a Supervisory Board members.

**3.5.6** An Authorised Person must take reasonable steps to ensure that it and its Employees:

- (a) provide such assistance as the Shari'a Supervisory Board reasonably requires to discharge its duties;
- (b) give the Shari'a Supervisory Board right of access at all reasonable times to relevant records and information;
- (c) do not interfere with the Shari'a Supervisory Board's ability to discharge its duties; and
- (d) do not provide false or misleading information to the Shari'a Supervisory Board.

## **3.6 Shari'a reviews**

**3.6.1** An Authorised Person must ensure that all Shari'a reviews are undertaken by the Shari'a Supervisory Board in accordance with AAOIFI GSIFI No 2.

- 3.6.2**
- (1) An Authorised Person must commission an annual report from the Shari'a Supervisory Board which complies with AAOIFI GSIFI No 1.
  - (2) An Authorised Person must deliver a copy of the annual report of the Shari'a Supervisory Board to the DFSA within 14 days of having received it.

## **3.7 Internal Shari'a review**

**3.7.1** An Authorised Person must perform an internal Shari'a review to assess the extent to which the Authorised Person complies with fatwas, rulings and guidelines issued by its Shari'a Supervisory Board.

**3.7.2** An Islamic Financial Institution must perform the internal Shari'a review in accordance with AAOIFI GSIFI No. 3.

**3.7.3** An Authorised Person which operates an Islamic Window must, to the extent possible, perform the internal Shari'a review in accordance with AAOIFI GSIFI No. 3 and must document the manner in which it will conduct that part of the internal Shari'a review that is not conducted in accordance with AAOIFI GSIFI No. 3.

### **Guidance**

GSIFI No. (3) (Internal Shari'a Review) establishes standards and provides guidance on the internal Shari'a review in institutions that conduct business in accordance with Shari'a. The standard covers the following:

- a. objectives;
- b. internal Shari'a Review;
- c. independence and objectivity;
- d. professional proficiency;
- e. scope of work;
- f. performance of the internal Shari'a Review work;
- g. management of the internal Shari'a Review;
- h. quality assurance; and
- i. elements of an effective internal Shari'a Review control system.

**3.7.4** An Authorised Person must ensure that the internal Shari'a review is performed by the internal audit function or the compliance function of the Authorised Person and that the individuals or departments involved in performing the review are competent and sufficiently independent to assess compliance with Shari'a.

### **Guidance**

For the purposes of assessing competency of personnel or departments which perform the internal Shari'a review, an Authorised Person should consult AAOIFI GSIFI No. 3 paragraphs 9 to 16 inclusive.

## 3.8 Additional conduct requirements

### Guidance

The COB module contains conduct of business requirements that apply to Authorised Firms conducting Financial Services. The AMI module contains additional conduct standards that apply to Authorised Market Institutions. Set out below are additional conduct requirements that apply to an Authorised Person carrying out any Financial Service in accordance with Shari'a.

### Disclosure relating to Shari'a Supervisory Board

- 3.8.1**
- (1) An Authorised Firm, subject to (2), must disclose to each Client:
    - (a) at the outset of the relationship and thereafter at any time on request, details of the members of the Authorised Firm's Shari'a Supervisory Board; and
    - (b) at any time on request, details of the manner and frequency of Shari'a reviews.
  - (2) An Authorised Firm does not have to make the disclosure required under (1) if it is a Fund Manager of a Fund and is making an Offer of Units of that Fund in accordance with the disclosure requirements in the Collective Investment Law 2010, the CIR module and this module.
  - (3) An Authorised Market Institution must disclose the following information to each Person granted access to its facilities at the outset of the relationship, and thereafter whenever the information changes:
    - (a) the members of the Authorised Market Institution's Shari'a Supervisory Board; and
    - (b) if the Person granted access to its facilities requests, the manner and frequency of Shari'a reviews.

### Guidance

1. An Authorised Firm may make the initial disclosures required under Rule 3.8.1(a) by including such information in the Client Agreement provided under COB chapter 3.
2. An Authorised Firm Managing a PSIA may make additional disclosure required to be made relating to PSIA by including such information in the Client Agreement. See chapter 5 for additional disclosure for PSIA's.
3. A Fund Manager making an Offer of a Unit of a Fund it manages is required under CIR Rules 14.3.1(b) and 14.3.2(b) to include information specified in Rule 3.8.1(1) in the Prospectus which it must prepare and make available to Clients, hence the exemption in Rule 3.8.1(2). A similar exemption is available to Fund Managers with regard to key information that must be provided to a Client under COB Rule 3.3.1(e).

**Marketing material**

- 3.8.2** In addition to information required by COB 3.2, any marketing material communicated by an Authorised Firm to a Person must state which Shari'a Supervisory Board has reviewed the products or services to which the material relates.

**Guidance**

COB section 3.2.4 sets out the meaning of "marketing material".

**Islamic window**

- 3.8.3**
- (1) An Authorised Firm which operates an Islamic Window must, subject to (3), disclose to its Clients whether or not it commingles funds attributable to its Islamic Financial Business with funds attributable to conventional financial business.
  - (2) An Authorised Market Institution which operates an Islamic Window must disclose to any Person granted access to its facilities whether or not it commingles funds attributable to its Islamic Financial Business with funds attributable to conventional financial business.
  - (3) An Authorised Firm does not have to make the disclosure required under (1) if it is a Fund Manager of an Islamic Fund and is making an Offer of Units of that Fund in accordance with the disclosure requirements in the Collective Investment Law 2010, the CIR module and this module.

**Guidance**

1. See Guidance 3 for the type of information required to be included in a Prospectus. The disclosures required under Rule 3.8.3(1) and (2) should initially be made in writing at the beginning of the relationship with a Client or with a person granted access to an Authorised Market Institution's facilities. Additional disclosure should also be made if the Authorised Firm changes its policy relating to commingling of funds attributable to its Islamic Financial Business with funds attributable to conventional financial business.
2. The requirements in Rule 3.8.3 will also apply to an Authorised Firm that uses a Fund Platform and has both Islamic and conventional Funds on the Fund Platform.

**Disclosure relating to Client Money provisions**

- 3.8.4** An Authorised Firm must disclose to its Clients details about how any Client Money arising out of Islamic Financial Business is or will be held.

**3.9 Prudential requirements**

**3.9.1** An Authorised Firm in Prudential Category 1, 2, 3 or 5 which invests in or holds Islamic Contracts for purposes other than managing PSIAs must calculate its Credit Risk or Market Risk in respect of those contracts in the same way as a firm holding or investing in Islamic Contracts for the purposes of managing PSIAs as set out in section 4.4.

**Guidance**

Substantive prudential requirements in PIB which apply to conduct of Investment Business continue to apply in the same way to firms conducting Islamic Financial Business, except to the extent added to or otherwise provided in this module.



## **4 ACCOUNTING AND AUDITING**

### **4.1 Application**

**4.1.1** This chapter applies to every Authorised Person carrying on Islamic Financial Business.

#### **Guidance**

GEN chapter 8 contains the general accounting and audit requirements applying to Authorised Persons.

### **4.2 Financial statements – specific disclosures**

**4.2.1** An Authorised Person carrying on Islamic Financial Business must ensure that its financial statements required under GEN chapter 8 contain the following disclosures:

- (a) the role and authority of the Shari'a Supervisory Board in overseeing the Authorised Person's Islamic Financial Business;
- (b) the method used in the calculation of the Zakah base;
- (c) whether Zakah has been paid by the Authorised Person;
- (d) where Zakah has been paid by the Authorised Person, the amount which has been paid; and
- (e) where Zakah has not been paid by the Authorised Person, sufficient information to allow a shareholder or other investor to compute the amount of his own liability to Zakah.

**4.2.2** An Authorised Person who operates an Islamic Window must ensure that its financial statements required under GEN chapter 8 contain the following disclosures:

- (a) a detailed statement of the funds mobilised according to Shari'a rules and principles and the assets financed by those funds;
- (b) a detailed statement of the income and expenditure attributable to its Islamic Financial Business; and
- (c) whether funds attributable to Islamic Financial Business are commingled with funds attributable to conventional financial services.

**4.2.3** An Authorised Firm which is a Takaful Insurer must ensure that the financial statements required under GEN chapter 8 for each Insurance Fund contain the following disclosures:

- (a) income from contributions to the Insurance Fund;
- (b) revenues and gains from the Insurance Fund's investments;

- (c) amounts paid to the Takaful operator;
- (d) amounts paid for reinsurance cover, net of any commissions;
- (e) amounts paid to Takaful contributors as a distribution of surplus;
- (f) amount of any loan received from, or repaid to the Takaful operator;
- (g) changes in the actuarial reserves of the Insurance Fund; and
- (h) the position of the Insurance Fund at the end of the period, including actuarial reserves, policyholders' surplus and any loans outstanding.

**4.2.4** An Authorised Firm which Manages a Profit Sharing Investment Account ("PSIA") must ensure that its financial statements required under GEN chapter 8 contain the following disclosures:

- (a) an analysis of income according to types of investments and their financing by customers;
- (b) the basis for the allocation of profits between owners' equity and PSIA holders;
- (c) the equity of PSIA holders at the end of the reporting period;
- (d) the bases used to determine any Profit Equalisation Reserve or Investment Risk Reserve;
- (e) the changes which have occurred in such reserves during the reporting period;
- (f) any deductions made by the Authorised Firm from its share of income, and any expenses borne by the Authorised Firm on behalf of PSIA holders, as a contribution to increase the income of PSIA holders, if such contribution was material; and
- (g) the identity of any person to whom any remaining balances of any Profit Equalisation Reserve or Investment Risk Reserve is attributable in the event of liquidation.

## **5 MANAGING PROFIT SHARING INVESTMENT ACCOUNTS**

### **5.1 Application**

**5.1.1** This chapter applies to an Authorised Firm which conducts the Financial Service of Managing Profit Sharing Investment Accounts (PSIAs).

#### **Guidance**

1. A PSIA does not constitute a Deposit, because a PSIA is managed in relation to property of any kind, and the risk of loss of capital, to the extent of the Client's contribution, remains with the Client. Accordingly, an Authorised Firm should take great care to ensure that a PSIA is not represented as a Deposit, either directly or indirectly. The DFSA may conclude that the Authorised Firm is Accepting a Deposit instead of Managing a PSIA in certain circumstances, for example, where the Authorised Firm attaches to the investment account characteristics or facilities that are generally regarded to be those of a Deposit or current account such as providing:
  - a. an explicit or implicit guarantee to the Client against the risk of loss of capital; or
  - b. a cheque book, an ATM card or a debit card.
2. The prudential Category for Islamic Financial Institutions and other Authorised Firms Managing PSIAs is determined in accordance with the Rules in PIB. Prudential Category 5 firms are Islamic Financial Institutions whose entire business is conducted according to Shari'a and are authorised to manage Profit Sharing Investment Accounts. An Authorised Firm which manages PSIAs, whether as an Islamic Financial Institution or through an Islamic Window, must also comply with the requirements in PIB in relation to specific prudential requirements relating to Trading Book and Non-Trading Book activities, including Credit Risk, Market Risk, Liquidity Risk and Group Risk.

### **5.2 Additional disclosure requirements for PSIAs**

**5.2.1** An Authorised Firm must, prior to Managing a PSIA, provide written notice to the Client that the Client alone will bear any losses arising from the PSIA, which are limited to the amount of his contribution, unless there is negligence, misconduct or breach of contract on the part of the Authorised Firm.

#### **Client Agreement**

**5.2.2** In addition to matters referred to in COB section 3.3, an Authorised Firm must ensure that the following information is included in the Client Agreement relating to a PSIA:

- (a) how and by whom the funds of the Client will be managed and invested including details of its policy on diversification of the portfolio;
- (b) the basis for the allocation of profit between the Authorised Firm and the Client;

- (c) confirmation of the Client's investment objectives including details of any restrictions requested by the Client, as agreed between the Client and the Authorised Firm;
- (d) a summary of the policies and procedures for valuation of assets or portfolio;
- (e) a summary of policies and procedures for the transfer of funds to and from the Profit Equalisation Reserve or Investment Risk Reserve accounts, if applicable;
- (f) particulars of the management of the PSIA and of any third party to whom the Authorised Firm has or will delegate or outsource the management of the PSIA, including:
  - (i) the name of the third party;
  - (ii) the regulatory status of the third party; and
  - (iii) details of the arrangement.
- (g) details of early withdrawal, redemption or other exit arrangement and any costs to a Client as a result thereof;
- (h) details of segregation of the funds of the Client from the funds of the Authorised Firm and from any claims by the creditors of the Authorised Firm;
- (i) details of whether funds from one PSIA will be commingled with the funds of another PSIA; and
- (j) details of any applicable charges and the basis upon which such charges will be calculated including, any deductions of fees that may be made by the Authorised Firm from the profits of the PSIA.

### **Periodic Statements**

- 5.2.3**
- (1) COB section 6.10 applies to an Authorised Firm as if the Authorised Firm is an investment manager in respect of those Clients who are PSIA holders.
  - (2) In addition to the requirements of COB section 6.10, an Authorised Firm must ensure that a periodic statement provided to a Client contains the following information:
    - (a) details of the performance of the Client's investment;
    - (b) the allocation of profit between the Authorised Firm and the Client; and (c) where applicable, details of changes to the investment strategies that may affect the Client's account or portfolio

**Additional matters to be included in the policy and procedures manual**

- 5.2.4** Where an Authorised Firm Manages a PSIA, its Islamic Financial Business policy and procedures manual must address the following additional matters:
- (a) the basis upon which a PSIA will be deemed restricted or unrestricted;
  - (b) the basis for allocation of profit or loss to the PSIA;
  - (c) the basis for allocation of expenses to the PSIA;
  - (d) the manner in which an Authorised Firm's own funds, funds of restricted PSIA's and funds from unrestricted PSIA's are to be controlled;
  - (e) the manner in which the funds of each type of investment account holder will be managed;
  - (f) the manner in which it will determine priority for investment of own funds and those of holders of unrestricted PSIA's;
  - (g) how provisions and reserves against equity and assets are to be applied; and
  - (h) the manner in which losses incurred as a result of the misconduct or negligence for which the Authorised Firm is responsible will be dealt with.

**Guidance**

For the purposes of Rule 5.2.4, the policy and procedures manual should include procedures to ensure that the Authorised Firm manages the accounts of Profit Sharing Investment Account holders in accordance with their instructions.

**5.3 Funds of PSIA holders**

- 5.3.1** Unless clearly expressed in the contract between an Authorised Firm and a PSIA holder, the Authorised Firm may not use funds provided by a PSIA holder to fund its own corporate activities.

**5.4 Prudential requirements****Application and Interpretation**

- 5.4.1** (1) This section applies when calculating Credit Risk or Market Risk in respect of Islamic Contracts invested in or held by an Authorised Firm Managing a PSIA, which is an Unrestricted PSIA.

- (2) In (1), the Islamic Contracts referred to are contracts which are funded by the PSIA.
- (3) In this section, the term “investing in or holding Islamic Contracts” means investing in or holding as a principal.

### **Initial and ongoing capital requirements**

#### **Guidance**

1. An Authorised Firm undertaking Islamic Financial Business is required to maintain initial and ongoing Capital Requirements in accordance with Rules in part 2 of Chapter 3 of PIB.
2. In accordance with Rules in part 3 of chapter 3 of PIB, an Authorised Firm undertaking Islamic Financial Business is required to ensure that only the eligible components of capital are included in the calculation of capital.
3. In accordance with PIB Rule 3.15.9, an Authorised Firm undertaking Islamic Financial Business is required to exclude from T2 Capital any amount by which the total of the Profit Equalisation Reserve and the Investment Risk Reserve exceeds the Displaced Commercial Risk Capital Requirement.
4. For the purpose of calculating Capital Requirements, an Authorised Firm undertaking Islamic Financial Business or otherwise investing in or holding Islamic Contracts should give due importance to the economic substance of the transaction, in addition to the legal form of the Islamic Contracts.

### **Systems and controls in relation to PSIA**

#### **Guidance**

The requirements in Rules 5.4.2 and 5.4.3 amplify the requirements in GEN Chapter 5.

**5.4.2** In addition to PIB Rule 3.2.4, 3.2.5, GEN Rule 5.3.1 and this module, an Authorised Firm Managing a PSIA must ensure that its senior management establishes and maintains systems and controls that ensure that the Authorised Firm is financially sound and able at all times to satisfy the specific prudential requirements arising out of such business.

- 5.4.3**
- (1) In addition to Rules in 5.2.4, an Authorised Firm Managing a PSIA must set out in a written policy how it proposes to organise and control the activities that arise from such business and ensure that its activities are conducted in accordance with Shari’a.
  - (2) The policy must as a minimum address, where appropriate, the following matters:
    - (a) how the interests of shareholders and PSIA holders are safeguarded;
    - (b) how the Authorised Firm will limit exposures of PSIA holders to the Authorised Firm;
    - (c) a description of the controls to ensure that the funds of the PSIA are invested in accordance with the investment guidelines agreed in the investment contract;

- (d) the basis for allocating profits and losses to the PSIA holders;
- (e) the policy for making provisions and reserves and, in respect of PSIA, to whom these provisions and reserves revert in the event of a write-off or recovery;
- (f) the Authorised Firm's policy on the prioritisation of investment of own funds and those of Unrestricted PSIA holders;
- (g) how liquidity mismatch will be monitored;
- (h) the basis for allocating expenses to PSIA holders; and
- (i) how the Authorised Firm will monitor the value of its assets.

### **Displaced commercial risk**

**5.4.4** An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must calculate a Displaced Commercial Risk Capital Requirement in respect of its PSIA business.

#### **Guidance**

1. An Authorised Firm Managing a PSIA, on an unrestricted basis is subject to a unique type of risk referred to as Displaced Commercial Risk. This risk reflects the fact that an Authorised Firm may be liable to find itself under commercial pressure to pay a rate of return to its PSIA holders which is sufficient to induce those investors to maintain their funds with the Authorised Firm, rather than withdrawing them and investing them elsewhere. If this "required" rate of return is higher than that which would be payable under the normal terms of the investment contract, the Authorised Firm may be under pressure to forgo some of the share of profit which would normally have been attributed to its shareholders (e.g., part of the Mudarib's share). Failure to do this might result in a volume of withdrawals of funds by investors large enough to jeopardise the Authorised Firm's commercial position (or, in an extreme case, its solvency). Thus, part of the commercial risk attaching to the returns attributable to the PSIA is, in effect, transferred to the shareholders' funds or the Authorised Firm's own capital. It also reflects situations whereby an investor may be permitted to exit from an asset pool at par while the fair value of such assets may be lower than their carrying amounts and where the Authorised Firm in certain circumstances may provide for the shortfalls.
2. In an Unrestricted PSIA, the account holder authorises the Authorised Firm to invest the account holder's funds in a manner which the Authorised Firm deems appropriate without specifying any restrictions as to where, how or for what purpose the funds should be invested, provided that they are Shari' a compliant. Under this arrangement, the Authorised Firm can commingle the investment account holder's funds with its own funds or with other funds which the Authorised Firm has the right to use. The investment account holders and the Authorised Firm generally participate in the returns on the invested funds.
3. In a Restricted PSIA, the account holder imposes certain restrictions as to where, how and for what purpose the funds are to be invested. Further, the Authorised Firm may be restricted from commingling its own funds with the restricted investment account funds for purposes of investment. In addition, there may be other restrictions that the investment account holders may impose. In other words, the funds provided by holders of Restricted PSIA are managed by the

Authorised Firm which does not have the right to use or dispose of the investments except within the conditions of the contract.

4. An Authorised Firm's undertaking Islamic Financial Business is also exposed to fiduciary risk which arises where the terms of the contract between the Authorised Firm and the investor are breached and where the Authorised Firm does not act in compliance with Shari'a.
5. An Authorised Firm is required to apply the Capital Requirements specified in PIB chapters 4 and 5 to any other business it carries on.

- 5.4.5** (1) An Authorised Firm's Displaced Commercial Risk Capital Requirement is based on 35% of the CRCOM and Market Risk capital requirement of assets funded by Unrestricted PSIA holders and is calculated using the following formula:

$$\text{PSIACOM} = [\text{PSIACOM}_{\text{credit}} + \text{PSIACOM}_{\text{market}}] \times 35\%.$$

- (2) PSIACOM is the Displaced Commercial Risk Capital Requirement;
- (3) PSIACOM<sub>credit</sub> is the Credit Risk capital requirement for assets funded by Unrestricted PSIA holders and is calculated in accordance with Rules in part 3 of chapter 4 of PIB; and
- (4) PSIACOM<sub>market</sub> is the Market Risk capital requirement for assets funded by Unrestricted PSIA holders and is calculated in accordance with Rules in PIB chapter 5.

#### **Credit risk and counterparty risk for Islamic contracts**

- 5.4.6** (1) An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must calculate its PSIACOM<sub>credit</sub> in relation to all Islamic Contracts financed by Unrestricted PSIA's in the manner prescribed in this section.
- (2) An Authorised Firm must, when undertaking the calculation in (1), apply an appropriate risk weighting for the relevant Islamic Contract.

- 5.4.7** (1) In this section:
- (a) "E" represents the Exposure determined by an Authorised Firm as applicable to an Islamic Contract; and
  - (b) "CRW" represents the risk weighting or capital charge assessed by an Authorised Firm as appropriate to that Islamic Contract.

- (2) Where an Islamic Contract is in the Non-Trading Book, an Authorised Firm must determine the PSIACOM<sub>credit</sub> for that contract by applying the following formula:

$$E \times \text{CRW} \times 8\%.$$

- (3) Where an Islamic Contract is in the Trading Book, an Authorised Firm must determine the PSIACOM<sub>credit</sub> for that contract in



accordance with the methodology in PIB A4.7 and A4.8 as appropriate.

- (4) An Authorised Firm must calculate its PSIACOMcredit of all contracts by:
- (a) identifying all Islamic Contracts to which this section applies;
  - (b) valuing the underlying investment or asset of each contract and reducing the value of any such investment or asset in the manner stipulated in Section 4.9 of chapter 4 of PIB, the result of which constitutes E for that contract;
  - (c) determining the risk weighting or capital charge appropriate to each contract, which will constitute the CRW for that contract in accordance with Rules in Sections 4.10, 4.11 and 4.12 of chapter 4 of PIB;
  - (d) applying the respective formula in Rule 5.4.7(2) or (3) to determine of PSIACOMcredit in respect of each contract; and
  - (e) summing the PSIACOMcredit of each contract to determine the PSIACOMcredit applicable to the Authorised Firm.

### Guidance

1. The DFSA considers that this Guidance will assist an Authorised Firm in applying the appropriate risk weighting or capital charge to each Islamic Contract for the purpose of Rule 5.4.7. Accordingly, the DFSA expects an Authorised Firm managing PSIA, which are Unrestricted PSIA, to pay due regard to this Guidance.
2. The Rules in this section and this Guidance are also relevant to an Authorised Firm which invests in or holds Islamic Contracts, when calculating CRW for Islamic Contracts under PIB chapter 4.
3. Table 2 contains Guidance on how an Authorised Firm Managing a PSIA, which is an Unrestricted PSIA should apply risk weightings for Islamic Contracts in respect of calculating relevant E and CRW for its PSIACOMcredit component of the PSIACOM.

**Table 2**

<b>1. Islamic Contract type</b>	<b>2. Underlying investment or asset</b>	<b>3. CRW</b>
Binding Murabaha for the Purchase Orderer (MPO)	Asset with an Authorised Firm before purchase by the Counterparty	Apply the appropriate percentage from the second column in the table in PIB Rule A4.6.5
	Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts	CRW in accordance with PIB chapter 4
Murabaha and Non-binding Murabaha for the Purchase Orderer (MPO)	Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts	CRW in accordance with PIB chapter 4

<b>1. Islamic Contract type</b>	<b>2. Underlying investment or asset</b>	<b>3. CRW</b>
Mudaraba and Musharaka	Where the underlying investment meets the requirements for inclusion in the Trading Book	Market Risk Capital Requirement for the exposure associated with the underlying investment determined in accordance with PIB chapter 5
	Investment in commercial enterprise to undertake business ventures other than trading activities (or other than those which meet the requirements for inclusion in the Trading Book)	CRW of 400% on the exposure
	Investment in real estate assets and other movable assets, using underlying Ijarah and Murabaha contracts	CRW of the lessee for the underlying Ijarah contracts or the CRW of the counterparty of the underlying Murabaha contract, in accordance with PIB App4
Ijarah/Ijarah Muntahia Bittamleek	Asset with an Authorised Firm available for lease before purchase by the Counterparty – for both contracts with both binding or non-binding promise to lease	Apply the appropriate percentage from the second column in the table in PIB Rule A4.6.5
	Residential real estate where the lessee has the right to purchase property at the end of the lease and the lessor has a legally enforceable first charge over the property	Apply the appropriate percentage in accordance with PIB Rule 4.12.17
	Total estimated value of lease receivables for the whole duration of the Ijarah, less any recovery value of the leased asset	CRW of Ijarah lessee, in accordance with PIB Section 4.12
Full recourse Istisna'a -with or without parallel Istisna'a and limited / non-recourse Istisna'a with/without parallel Istisna'a	Net balance of the work-in-progress	CRW of the Istisna'a buyer, in accordance with PIB Section 4.12
	Total amount receivable from the counterparty, pursuant to contract billings	CRW of Istisna'a buyer, in accordance with PIB Section 4.12
Salam and parallel Salam	Value of the underlying asset receivable for the Salam contract	CRW in accordance with PIB Section 4.12
	Assets acquired	100%
	Balance in relevant accounts receivable	CRW in accordance with PIB Section 4.12
Kefala	The amount of the guarantee	CRW in accordance with PIB Section 4.12
Sukuk held in the Non-Trading Book	<p>Receivables from the Sukuk structure, including the principal and any returns associated with it, arising from any of the following as underlying contracts:</p> <p>Salam Istisna'a Ijarah Murabaha Mudaraba Musharaka</p>	<p>CRW applicable to underlying Ijarah, Salam or Murabaha contracts, in accordance with PIB Section 4.12</p> <p>If the Sukuk provides recourse to the issuer, CRW applicable to the issuer or CRW applicable to underlying contracts of the Sukuk is in accordance with PIB Section 4.12, whichever is higher</p>

1. Islamic Contract type	2. Underlying investment or asset	3. CRW
	Usufructs/services	CRW applicable to underlying service provider or usufruct owner, in accordance with PIB Section 4.12. If the Sukuk provides recourse to the issuer, CRW applicable to the issuer or CRW applicable to underlying service provider or usufruct owner in accordance with PIB App4, whichever is higher
	Leased assets	The higher of CRW of the underlying leased assets and that of the issuer
	Investment agency	The higher of CRW of the underlying assets and that of the issuer
	Muzara'a (share of produce of the land) Musaqa (share of produce of the trees) Mugarasa (share in the land and the trees)	100%
	Mixture of tangible and intangible assets	The higher of CRW of the underlying assets and that of the issuer
	Where the underlying investment meets the requirements for inclusion in the Trading Book	Market Risk Capital Requirement for the exposure associated with the underlying investment determined in accordance with PIB chapter 5
Bai' Bithaman Ajil	Residential and commercial properties Plant and equipment Motor vehicles Shares Land	CRW in accordance with PIB chapter 4
Arboun	Where an Authorised Firm has made the purchase deposit	CRW in accordance with PIB chapter 4
	Where an Authorised Firm has received the purchase deposit	No CRW is applicable
	Where the contract would meet the requirements for inclusion in the Trading Book	Market Risk Capital Requirement for the exposure associated with the underlying investment determined in accordance with PIB chapter 5

4. Where an Islamic Contract is not listed in Table 2, an Authorised Firm should consult with the DFSA, on a case-by-case basis, to determine the:
  - a. contract type and the underlying investments or assets to calculate the E; and
  - b. appropriate risk weighting or the capital charge for such contract to calculate the CRW.
5. In some cases, as stipulated in the relevant parts of column 3 of Table 2, the calculation of capital requirement should be carried out as prescribed in PIB Rule A4.6.5 and in accordance with PIB chapter 5.
6. In determining the E of a Binding Murabaha for the Purchase Orderer (MPO), as per PIB Rule A4.6.5, E should equal the total acquisition cost of the asset

- (purchase price and other direct costs) less market value of the asset (net of any haircut) less any security deposit provided.
7. In determining the E of Ijarah / Ijarah Munthia Bittamleek contract, as per PIB Rule A4.6.5, E should equal the total acquisition cost of the asset (purchase price and other direct costs) less the market value of the asset (net of any haircut), less any Arboun (earnest money deposit received from the potential lessee).
  8. In addition to paragraph 7 above, in the case of an Ijarah Muntahia Bittamleek contract, the exposure may be reduced by the recovery value of the leased asset, only in cases where there is a reasonable basis to conclude that the leased asset can be repossessed and effectively redeployed as a leased asset to another Counterparty. This is important because the asset leased under the Ijarah Muntahia Bittamleek contract is usually customised equipment or large pieces of equipment which are integrated with other assets of the lessee and hence are unsuitable for repossession and releasing to another lessee.
  9. In determining the E of an Istisna'a contract, the exposures arising from such a contract should not be netted off against exposures arising from a Parallel Istisna'a contract entered into by an Authorised Firm for procuring the underlying investment for the Istisna'a contract.
  10. In determining the E of a Salam contract, the exposures arising from such a contract should not be netted off against exposures arising from a Parallel Salam contract entered into by an Authorised Firm for procuring the underlying asset for the Salam contract.
  11. Off-balance sheet exposures for import or export financing contracts based on Murabaha, where the underlying goods or shipment are collateralised and insured, should attract a 20% CCF to an Authorised Firm that issues or confirms the letter of credit.
  12. Where Mudaraba and Musharaka contracts are used to invest in commercial enterprise to undertake business ventures other than trading activities (or other than those which meet the requirements for inclusion in the Trading Book), the E is measured as the amount invested in the commercial enterprise less any specific provisions. If there is a guarantee and such guarantor is not connected to the commercial enterprise, then the CRW for the guarantor will be applied for risk weighting for the amount of any such guarantee.
  13. In addition to the relevant Rules prescribed in PIB chapter 4 and PIB App4, an Authorised Firm may consider the following types of collateral as eligible collateral for Credit Risk management:
    - a. Hamish Jiddiyyah (security deposit) only for agreements to purchase or lease preceded by a binding promise;
    - b. Arboun where earnest money deposit held after a contract is established as collateral to guarantee contract performance; and
    - c. in Mudaraba investment in project finance, an Authorised Firm may use the collateralisation of the progress payments made by the ultimate customers to mitigate the exposures of unsatisfactory performance by the Mudarib.
  14. Where an Authorised Firm places funds under a Mudaraba contract, subject to a Shari`a compliant guarantee from a third party and such a guarantee relates only to the Mudaraba capital, the capital amount should be risk-weighted at CRW of the guarantor provided that the CRW of that guarantor is lower than the CRW of the Mudarib (as a Counterparty). Otherwise, the CRW of the Mudarib will apply.

15. An Authorised Firm placing liquid funds with a central bank or another financial institution on a short-term Mudaraba basis in order to obtain a return on those funds, may apply the CRW applicable to the Mudarib (as a Counterparty), provided the Mudarib effectively treats the liquid funds placement as its liability, although normally such placements are not treated as liabilities of the Mudarib.

### **Market risk**

- 5.4.8** An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must calculate its PSIA COMarket in relation to all underlying Islamic Contracts in the manner prescribed in PIB chapter 5, except as may be provided in Rules 5.4.8 to 5.4.17.
- 5.4.9** An Authorised Firm must treat Sukuk held in its Trading Book as equity for the purpose of calculating its Equity Risk Capital Requirement and determine the same in accordance with PIB Rule 5.5.2.
- 5.4.10** Where investments are made using Musharaka or Mudaraba contracts with commodities as the underlying assets, an Authorised Firm must calculate its Commodities Risk Capital Requirement in accordance with PIB Rule 5.7.2.
- 5.4.11** An Authorised Firm which is exposed to the risk of foreign currencies and gold under any Islamic Contract, must calculate its Foreign Exchange Risk Capital Requirement in accordance with PIB Rule 5.6.2.
- 5.4.12** An Authorised Firm which is exposed to commodities including precious metals but excluding gold under any Islamic Contract, must calculate its Commodities Risk Capital Requirement in accordance with PIB Rule 5.7.2.
- 5.4.13** (1) Commodities held by an Authorised Firm for selling or leasing when executing a Murabaha, non-binding MPO, Salam or Parallel Salam Contract must be included in the calculation of its Commodities Risk Capital Requirement.
- (2) Where an Authorised Firm executes Salam and parallel Salam contracts, the resultant long and short positions may be set off for calculating the net open position, provided that the positions are in the same commodity, regardless of how its Commodities Risk Capital Requirement is calculated.
- 5.4.14** Where an Authorised Firm executes Musharaka or Mudaraba contracts for investing in entities or investment vehicles that trade in foreign exchange, equities or commodities, it must include the relevant underlying assets in the calculation of its Market Risk Capital Requirement in accordance with PIB chapter 5.

### **Concentration risk**

#### **Guidance**

1. This section sets specific Large Exposure limits for assets financed by PSIA's, which are Unrestricted PSIA's. The DFSA uses these limits to provide constraints on the amount of Concentration Risk to which an Authorised Firm is subject in respect of its PSIA holdings. In assessing PSIA Large Exposures, an Authorised

Firms may take advantage of the exemptions and partial exemptions set out in PIB section A4.11.

2. An Authorised Firm has a Large Exposure where its PSIA holders' credit Exposure to a single Counterparty or issuer, or group of Closely Related or Connected Counterparties, is large in relation to the Authorised Firm's Capital Resources. Where Exposure to a Counterparty or issuer is large, PSIA holders risk a large loss should the Counterparty default.
3. Exposures arising from assets that are financed by an Authorised Firm's own funds are dealt with in PIB section 4.15.

### **Exposure limits**

**5.4.15** An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must not have an Exposure to a Counterparty or to a group of Closely Related Counterparties or to a group of Connected Counterparties that exceeds any one of the following percentages of its Capital Resources:

- (a) 25% if financed by its Capital Resources or Unrestricted PSIA's; or
- (b) 40% if financed by the total of its own Capital Resources and, Unrestricted PSIA's.

### **Guidance**

In accordance with PIB section 4.15, the aggregate of an Authorised Firm's Exposure to a Counterparty or to a group of Closely Related Counterparties may not exceed 25% of the Authorised Firm's Capital Resources.

**5.4.16** The sum of an Authorised Firm's non-exempt Large Exposures must not exceed 800% of its Capital Resources for Exposures funded by the Authorised Firm's Capital Resources and Unrestricted PSIA's.

**5.4.17** An Authorised Firm must:

- (a) monitor and control its Exposures funded by PSIA's, which are Unrestricted PSIA's, on a daily basis to ensure they remain within the concentration risk limits specified in Rule 5.4.15; and
- (b) if a breach occurs, notify the DFSA immediately and confirm it in writing.

## **6 ISLAMIC COLLECTIVE INVESTMENT FUNDS**

### **Guidance**

This chapter contains additional requirements that apply to a Collective Investment Fund operated or held out as being operated as an Islamic Fund. A Collective Investment Fund is defined in Article 11 of the Collective Investment Law 2010 (the Law). The definition in Article 11 of the Law is very wide and can capture some Islamic financial activities. However, under Article 12 of the Law, the DFSA can make Rules excluding certain arrangements or types of arrangements from constituting a Fund. Certain types of Islamic Financial Business are not regulated as Collective Investment Funds due to express exclusions provided. Key Islamic Financial Business related exclusions under the collective investment regime are Managing Insurance, participation rights evidenced by Sukuk certificates and managing PSIAs.

### **6.1 Application**

- 6.1.1** (1) This section applies in the case of a Domestic Fund:
- (a) which is an Islamic Fund, to its Fund Manager and where appointed, its Trustee;
  - (b) which is an Umbrella Fund with one or more Islamic Sub-Funds, to its Fund Manager and where appointed, its Trustee in respect of those Sub-Funds; or
  - (c) which is an Islamic Fund on a Fund Platform, to the Fund Manager using the Fund Platform, in respect of that Fund.
- (2) The requirements that apply to a conventional Fund under the Collective Investment Law 2010 and CIR apply equally to an Islamic Fund, except as otherwise provided in this chapter.
- (3) The requirements in MKT chapter 6 that apply to a conventional Listed Fund apply equally to an Islamic Fund, if it is or is to be a Listed Fund, except as otherwise provided in this chapter.
- (4) In this chapter, except where otherwise provided, any reference to a Fund is to an Islamic Fund, to an Islamic Sub-Fund of an Umbrella Fund, or to an Islamic Fund on a Fund Platform, as the case may be and any reference to a Fund Manager is a reference to a Fund Manager of such a Fund.

### **Guidance**

1. While the CIR module contains the key requirements relating to the management and operation of conventional Collective Investment Funds, this module sets out the additional requirements that apply where such a Fund is managed or held out as being managed as an Islamic Fund. There are other requirements that apply to such firms which are found in other modules of the DFSA rulebook, such as the GEN module, COB module and PIB module.
2. While section 3 contains the requirements that apply to Authorised Firms which are Fund Managers of Collective Investment Funds, the requirements in this section mainly focuses on Shari'a compliance related requirements that apply at the Fund level. For example, while the systems and controls required under

section 3.3 relate to the systems and controls that a firm must have in order to comply with its Shari'a obligations, Rule 6.1.3 sets out systems and controls that must be established and maintained at the Fund level.



### **Systems and controls**

- 6.1.2**
- (1) The Fund Manager of a Fund must establish and maintain systems and controls which ensure that its management of the Fund and the Fund Property is Shari'a compliant.
  - (2) A Fund Manager may, where it is practicable to do so, include the systems and controls required under (1) within those it is required to establish and maintain pursuant to Rule 3.3.1.

#### **Guidance**

1. Article 38 of the Collective Investment Law 2010 requires the Fund Manager to establish and maintain systems and controls, including, but not limited to, financial and risk controls to ensure sound management of the Fund in accordance with the Fund's Constitution and its most recent Prospectus, taking due account of the nature, scale and complexity of the Fund's investments and operations.
2. Rule 3.3.1 requires a Fund Manager of Islamic Funds to establish and maintain systems and controls to ensure its Shari'a compliance.

### **Fund's constitutional documents**

- 6.1.3**
- (1) The Fund Manager of a Domestic Fund that is a Public Fund must ensure that its Fund's Constitution and Prospectus are, and remain, approved by the Fund's Shari'a Supervisory Board.
  - (2) The Fund Manager of an Exempt Fund must ensure that the Fund's Constitution and Prospectus are, and remain, approved by the Fund Manager's Shari'a Supervisory Board.

#### **Guidance**

See Guidance note 3 under Rule 6.2.1.

### **Islamic Financial Business policy and procedures manual**

#### **Guidance**

A Fund Manager may, instead of having a separate Islamic Financial Business policy and procedures manual both at the firm level and at the Fund level, maintain a single Islamic Financial Business policy and procedures manual for the firm and the Funds it manages.

- 6.1.4**
- The Fund Manager of a Fund must implement and maintain an Islamic Financial Business policy and procedures manual for the Fund which addresses the following matters:
- (a) the manner in which the compliance function will be undertaken, in respect of Shari'a compliance;
  - (b) the manner in which the Shari'a Supervisory Board will oversee and advise in regard to the Islamic Financial Business conducted by the Fund Manager;
  - (c) the manner in which Shari'a Supervisory Board fatwas, rulings and guidelines will be recorded, disseminated and implemented and the internal Shari'a review undertaken;

- (d) the manner in which disputes between the Shari'a Supervisory Board and the Fund Manager in respect of Shari'a compliance will be addressed;
- (e) the process for approving those internal systems and controls which are in place to ensure not only that the Islamic Financial Business is carried out in compliance with Shari'a, but that information is disseminated to Unitholders in an appropriate manner; and
- (f) the manner in which conflicts of interest will be identified and managed, including as prescribed in Rule 6.2.4.

## **6.2 Shari'a Supervisory Board for an Islamic Fund**

- 6.2.1**
- (1) A Fund Manager of a Domestic Fund that is a Public Fund must, subject to (3), appoint a Shari'a Supervisory Board to its Fund that meets the following requirements:
    - (a) the Shari'a Supervisory Board has at least three members;
    - (b) the members appointed to the Shari'a Supervisory Board are competent to perform their functions as Shari'a Supervisory Board members of the Fund;
    - (c) any appointments, dismissals or changes in respect of members of the Shari'a Supervisory Board are approved by the Governing Body of the Fund Manager; and
    - (d) no member of the Shari'a Supervisory Board is a director or Controller of the Fund or its Fund Manager.
  - (2) A Fund Manager may comply with the requirement in (1) by appointing to the Fund the same Shari'a Supervisory Board as it has appointed to the firm in accordance with Rule 3.5.1, provided the requirements in (1) are also met.
  - (3) A Fund Manager is not required to comply with the requirement in (1) where it relies, for the purposes of making investments for the Fund, on a widely accepted Shari'a screening process such as investing in securities included in, or recognised by reference to, an Islamic index, sukuk, or treasury instruments issued by a Shari'a compliant financial services provider regulated by a Financial Services Regulator.

### **Guidance**

1. In appointing a Shari'a Supervisory Board for the purposes of Rule 6.2.1(1), the Fund Manager should consider the previous experience and qualifications of the proposed Shari'a Supervisory Board members to assess whether the proposed Shari'a Supervisory Board member is competent to advise on the activities undertaken by the Islamic Fund. If the Fund Manager is appointing the same Shari'a Supervisory Board as it has appointed to the firm pursuant to Rule

6.2.1(2), the Fund Manager should still consider whether the requirements in both Rule 3.5.1(1) and 6.2.1(1) are met in respect of that board.

2. If the Fund Manager is relying on Shari'a screening methodologies such as the Dow Jones Shari'a index, such screening is generally regarded as widely accepted and accessible. However, if less widely known methodologies are used, the Fund Manager should be able, upon request by the DFSA, to demonstrate to the satisfaction of the DFSA the grounds on which it considers the particular methodology used to be acceptable and reliable.
3. Although the Fund Managers of Exempt Funds and Qualified Investor Funds are not subject to the requirement for the appointment of a Shari'a Supervisory Board for such a Fund, they would need to ensure that the Exempt Funds or Qualified Investor Funds they manage continue to meet the applicable Shari'a requirements applicable to the Fund. They may use a member of the Shari'a Supervisory Board appointed at the firm level for the purposes of ascertaining compliance with the Shari'a requirements. The manner in which they demonstrate to the Unitholder of the Exempt Fund or Qualified Investor Fund as to how they achieve such compliance is a matter left to negotiation (i.e. subject to contractual terms) between the Unitholders and the Fund Manager.
4. An External Fund Manager may not be able to take advantage of IFR 6.2.1(2), unless it has a Shari'a Supervisory Board appointed at the firm level. In contrast the Fund Manager of an External Fund will be able to use its Shari'a Supervisory Board to meet the Shari'a Supervisory Board requirement relating to the Fund as set out in IFR 6.2.1(2).

**6.2.2** (1) Subject to (2), the Fund Manager of a Fund must document the Fund's policy in relation to:

- (a) how appointments, dismissals or changes will be made to the Shari'a Supervisory Board;
- (b) the process through which the suitability of Shari'a Supervisory Board members will be considered; and
- (c) the remuneration of the members of the Shari'a Supervisory Board.

(2) If the Fund Manager, pursuant to Rule 6.2.1(2), appoints to the Fund the same Shari'a Supervisory Board it has appointed to the firm, the documents required under Rule 6.2.2(1) must be included in or otherwise form part of the records required under Rule 3.5.2.

**6.2.3** (1) Subject to (2), the Fund Manager of a Fund must establish and retain, for six years, records of:

- (a) its assessment of the competency of the Shari'a Supervisory Board members;
- (b) the agreed terms of engagement of each member of the Shari'a Supervisory Board; and
- (c) the matters in Rules 6.2.1(1)(c) and 6.2.2.

(2) If the Fund Manager, pursuant to Rule 6.2.1(2), appoints to the Fund the same Shari'a Supervisory Board it has appointed to the

firm, the records required under Rule 6.2.3(1) must be included in or otherwise form part of the records required under Rule 3.5.3.

**Guidance**

1. The records of the assessment of competency of Shari'a Supervisory Board members should clearly indicate, at least:
  - a. the factors that have been taken into account when making the assessment of competency;
  - b. the qualifications and experience of the Shari'a Supervisory Board members;
  - c. the basis upon which the Fund Manager has deemed that the proposed Shari'a Supervisory Board member is suitable; and
  - d. details of any other Shari'a Supervisory Boards of which the proposed Shari'a Supervisory Board member is, or has been, a member.
2. If the Fund Manager is relying on Rule 6.2.1(2), then the due diligence process, and the records maintained under Rules 3.5.2 and 3.5.3, should be augmented with the matters specified under Rule 6.2.1(1).

**6.2.4** (1) The Islamic Financial Business policy and procedures manual must provide that:

- (a) a member of the Shari'a Supervisory Board is obliged to notify the Fund Manager of any conflict of interest that such member may have with respect to the Fund or the Fund Manager, and if appointed, or in the case of an Investment Trust, the Trustee; and
- (b) the Fund Manager will take appropriate steps to manage any such conflict of interest so that the Islamic Financial Business is carried out appropriately and in compliance with Shari'a, the interest of a Unitholder is not adversely affected and all Unitholders are fairly treated and not prejudiced by any such interests.

(2) If a Fund Manager is unable to manage a conflict of interest as provided above, it must dismiss or replace the member as appropriate.

**6.2.5** The Fund Manager of a Fund must provide the DFSA at its request with information on the qualifications, skills, experience and independence of the individuals who are appointed or proposed to be approved as members of the Shari'a Supervisory Board.

**6.2.6** (1) The Fund Manager of a Fund must take reasonable steps to ensure that the Fund Manager and the Fund's Employees:

- (a) provide such assistance as the Shari'a Supervisory Board reasonably requires to discharge its duties;
- (b) give the Shari'a Supervisory Board right of access at all reasonable times to relevant records and information;

- (c) do not interfere with the Shari'a Supervisory Board's ability to discharge its duties; and
  - (d) do not provide false or misleading information to the Shari'a Supervisory Board.
- (2) If appointed, the Trustee must also take reasonable steps to ensure that its Employees comply with (1)(a)-(d).

### **6.3 External Shari'a reviews and periodic reports**

**6.3.1** A Fund Manager of a Domestic Fund that is a Public Fund, other than a Fund relying on the exemption in Rule 6.2.1(3), must ensure that all Shari'a reviews of the Fund are undertaken by the Shari'a Supervisory Board in accordance with AAOIFI GSIFI No 2.

- 6.3.2**
- (1) In the case of a Domestic Fund that is a Public Fund other than a Fund relying on the exemptions in Rule 6.2.1(3), the Fund Manager must commission an interim and an annual report relating to the Fund operations from the Shari'a Supervisory Board which complies with AAOIFI GSIFI No 1.
  - (2) The Fund Manager must deliver a copy of the annual interim report referred to in (1) to the Unitholders in accordance with CIR Rule 9.4.4 and must include the report of the Shari'a Supervisory Board in the annual report required under CIR Rule 9.4.5.

#### **Guidance**

Although the Fund Managers of Exempt Funds and Qualified Investor Funds are not subject to the Shari'a review process required under section 6.3, they would need to ensure that the Exempt Fund or Qualified Investor Fund continues to meet the Shari'a requirements, particularly for the purposes of their annual and interim reports, which are required to be prepared under CIR section 9.4. However, the manner in which they demonstrate to the Unitholders of the Fund how they achieve such compliance is a matter left to negotiation (i.e. subject to contractual terms) between the Unitholders and the Fund Manager.

### **6.4 Internal Shari'a review**

- 6.4.1**
- (1) The Fund Manager of a Domestic Fund that is a Public Fund must perform an internal Shari'a review to assess the extent to which the Fund complies with fatwas, rulings and guidelines issued by the Fund's Shari'a Supervisory Board.
  - (2) The Fund Manager must perform the internal Shari'a review in accordance with AAOIFI GSIFI No. 3.
  - (3) The Fund Manager of an Umbrella Fund which has an Islamic Sub-Fund must, to the extent possible, perform the internal Shari'a review in accordance with AAOIFI GSIFI No. 3 and must document the manner in which it will conduct that part of the

internal Shari'a review that is not conducted in accordance with AAOIFI GSIFI No. 3.

#### **Guidance**

1. Although the Fund Managers of Exempt Funds and Qualified Investor Funds are not subject to the specific internal Shari'a requirements under section 6.4, they would need to ensure that the Exempt Fund or Qualified Investor Fund continues to meet the applicable Shari'a requirements. However, the manner in which they demonstrate to the Unitholders of the Fund how they achieve such compliance is a matter left to negotiation (i.e. subject to contractual terms) between the Unitholders and the Fund Manager.
2. GSIFI No. (3) (Internal Shari'a Review) establishes standards and provides guidance on the internal Shari'a review in institutions that conduct business in conformity with Shari'a. The standard covers the following:
  - a. objectives;
  - b. internal Shari'a Review;
  - c. independence and objectivity;
  - d. professional proficiency;
  - e. scope of work;
  - f. performance of the internal Shari'a Review work;
  - g. management of the internal Shari'a Review;
  - h. quality assurance; and
  - i. elements of an effective internal Shari'a Review control system.

**6.4.2** The Fund Manager must ensure that the internal Shari'a review referred to in this section is performed by the internal audit function of the Fund or the compliance function of the Fund and that the individuals or departments involved in performing the review are competent and sufficiently independent to assess compliance with Shari'a.

#### **Guidance**

For the purposes of assessing competency of personnel or departments which perform the internal Shari'a review, Fund Manager should consult AAOIFI GSIFI No. 3 paragraphs 9 to 16 inclusive.

## **6.5 Additional disclosure in a Prospectus of an Islamic Fund which is a Public Fund**

#### **Guidance**

Chapter 14 and in particular Rule 14.3.1 of the CIR module set out the Public Fund Prospectus requirements. In addition to complying with those requirements as applicable to the particular Fund, the Fund Manager of an Islamic Fund that is a Public Fund must comply with the additional requirements set out in this section. If an Islamic Fund is to be a Listed Fund, it must comply with chapter 6 of MKT and also comply with the additional requirements in this chapter.

**6.5.1** A Fund Manager of an Islamic Fund which is a Public Fund must state in the Fund's Prospectus:

- (a) that all the operations in relation to the Fund will be conducted in accordance with Shari'a;
- (b) if the Fund has a Shari'a Supervisory Board appointed to it, the names of the members of the Shari'a Supervisory Board and their qualifications and experience and, whether or not the Fund Manager's Shari'a Supervisory Board is appointed to the Fund pursuant to Rule 6.2.1(2);
- (c) if the Fund does not have a Shari'a Supervisory Board appointed to it pursuant to Rule 6.2.1(3), what widely acceptable screening methodologies are used by the Fund to ensure Shari'a compliance with respect to investments made for the Fund, and the board that has approved them;
- (d) if applicable, the manner and frequency of Shari'a reviews ;
- (e) how earnings prohibited by Shari'a will be disposed of;
- (f) whether Zakah is the responsibility of the Fund or the responsibility of the Unitholders;
- (g) the additional disclosure, if applicable, prescribed under section A1.1 of App 1; and
- (h) in place of the disclaimer required under CIR App 7 for conventional Funds, a prominent disclaimer in bold, on the front page of the Prospectus, as follows:

“The DFSA does not accept responsibility for the content of the information included in the Prospectus, including the accuracy or completeness of such information. The liability for the content of the Prospectus lies with the Issuer of the Prospectus and other Persons, such as Experts, whose opinions are included in the Prospectus with their consent. The DFSA has also not assessed the suitability of the Securities to which the Prospectus relates to any particular investor or type of investor and has not determined whether they are Shari'a compliant. If you do not understand the contents of this Prospectus or are unsure whether the Securities to which the Prospectus relates are suitable for your individual investment objectives and circumstances, you should consult an authorised financial advisor.”

- (i) If the Islamic Fund is not a Listed Fund, in addition to the disclaimer specified in (h), an additional statement that:

“The Securities to which this Prospectus relates may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of such Securities should conduct their own due diligence.”

**Guidance**

1. A Fund Manager should consider providing additional information to support the statement under Rule 6.5.1(a) as indicated in 2 and 3 below.
2. The Fund Manager should provide sufficient details setting out the basis upon which the Fund has been approved and certified as Shari'a compliant by its Shari'a Supervisory Board. Such details should include the basis of the underlying principles, i.e. the Fatwas or rulings, including reference to any relevant Ijtihad, Ijma, Qiyas or other. Where applicable, reference should be made to any Islamic indices to be used. In addition, where applicable, the screening process and any filters used should be identified.
3. The Fund Manager should set out each of the key features of the Fund and explain the rationale for determining why each of these features are considered Shari'a compliant by the Fund's Shari'a Supervisory Board.

**6.6 Deleted**
**6.7 Investments in other Funds**

- 6.7.1** (1) An Islamic Fund which is a Public Fund may invest in Units of another Fund only where the Fund Manager has taken reasonable care to determine that:
- (a) the other Fund is the subject of an independent annual audit conducted in accordance with relevant IFRS or other standards as applicable;
  - (b) the other Fund has mechanisms in place to enable Unitholders to redeem their Units within a reasonable time; and
  - (c) the other Fund is prohibited from having more than 20% of its value in the Units of Funds.
- (2) The Fund Manager must also have ascertained that there is a proper and disclosed basis for asset valuation and the pricing before investing in Units in the other Fund.

**6.8 Deleted**
**6.9 Deleted**
**6.10 Periodic Reports of an Islamic Fund**
**Guidance**

Chapter 9 of CIR sets out the periodic reports and related requirements. These are additional requirements that apply to Islamic Funds.



**6.10.1** In addition to the matters specified in CIR section 9.4, an annual report of an Islamic Fund, other than a Fund which is an Umbrella Fund, must contain the report specified in Rule 6.3.2(2).

## **6.11 Islamic Real Estate Investment Trusts (Islamic REITs)**

**6.11.1** (1) A Fund Manager must ensure that it does not call, or otherwise hold out, a Fund as being an Islamic Real Estate Investment Trust or as being an Islamic REIT unless it is a Public Property Fund which is constituted in accordance with (2).

- (2) An Islamic REIT is a Public Property Fund which:
- (a) is constituted either as an Investment Company or as an Investment Trust;
  - (b) is primarily aimed at investments in income generating Real Property which complies with Shari'a principles; and
  - (c) distributes to the Unitholders at least 80% of its audited annual net income.

**6.11.2** (1) A Fund Manager of an Islamic REIT must ensure that it distributes to the Unitholders as dividends each year an amount not less than 80% of its audited annual net income.

- (2) The Persons providing oversight functions in respect of the Fund must determine if any;
- (a) revaluation surplus credited to income, or
  - (b) gains on disposal of Real Property,

shall form part of net income for distribution to Unitholders.

**6.11.3** Where an Islamic REIT holds any Real Property via one or more Special Purpose Vehicles, the Fund Manager must ensure that each Special Purpose Vehicle distributes to the Fund all of its income as permitted by the laws and regulations of the jurisdiction where the Special Purpose Vehicle is established.

**6.11.4** (1) A Fund Manager of an Islamic REIT must ensure, subject to (2), that any investment made in respect of property under development whether on its own or in a joint venture is undertaken only where the REIT intends to hold the developed property upon completion.

- (2) The total contract value of the property under development in (1) must not exceed 30% of the net asset value of the Fund Property of the Islamic REIT.

**Guidance**

For the purposes of this Rule, the DFSA would not consider property development activities to include refurbishment, retrofitting and renovation.

- 6.11.5** A Fund Manager of an Islamic REIT may borrow either directly or through its Special Purpose Vehicle up to 65% of the gross asset value of the Fund provided that such borrowings are Shari'a compliant.

**Guidance**

1. The gross asset value of a Fund should be calculated as the total value of the Fund Property based on the most recent valuation under CIR Rule 8.4.1(1), but without making the deductions provided for in the other paragraphs of that Rule.
2. As there are no specific risks that arise by virtue of a Fund being an Islamic Fund, the prudential requirements that apply to a Category 3 firm as set out in the PIB module apply to such Fund Managers. However, if the underlying assets of the Fund are invested in financial products or instruments that are Islamic and have certain features which would raise any prudential risks, it is the responsibility of the Fund Manager to address such risks. The DFSA would provide any additional clarifications regarding such matters upon request.

## **6.12 Islamic Money Market Funds**

- 6.12.1** CIR Rules 13.8.1(2) and (3) and 13.8.2 apply to a Fund Manager of an Islamic Fund that is a Money Market Fund as if a reference to:

- (a) a Deposit or a Debenture includes an Islamic financial instrument or product with similar economic characteristics to a Deposit or a Debenture; and
- (b) an interest rate reset date is, in relation to an Islamic financial instrument or product, a reference to the date on which the rate of profit of return for that instrument or product is reset.

**Guidance**

A Fund Manager of an Islamic Money Market Fund must comply with the overriding obligation in CIR Rule 13.8.1 to ensure that the Fund's investment strategy is consistent with the investment objectives of a Money Market Fund as set out in CIR Rule 3.1.11. It must also comply with other applicable requirements for Money Market Funds such as the requirement to include a warning in the Fund Prospectus under CIR Rule 14.4.7.

## **6.13 Islamic Exchange Traded Funds ("ETFs")**

- 6.13.1** (1) A Fund is an Islamic Exchange Traded Fund or Islamic ETF if it:
- (a) is constituted as an Open-ended Public Fund;
  - (b) has its Units available for trading throughout the day on an exchange that meets the criteria in (2);
  - (c) has at least one market maker (Authorised Participant) who:

- (i) purchases and redeems 'creation Units' of the Fund from the Fund Manager; and
  - (ii) is prepared to buy and sell Units of the Fund throughout the day on the relevant exchange; and
  - (d) meets the Shari'a related requirements in this chapter.
- (2) An exchange meets the requirement in (1)(b) if it is:
- (a) operated by an Authorised Market Institution;
  - (b) regulated by a Financial Services Regulator in a jurisdiction that is a signatory to the IOSCO Multilateral Memorandum of Understanding for sharing information; or
  - (c) regulated by a Financial Services Regulator in a jurisdiction which has entered into a bilateral memorandum of understanding with the DFSA for sharing information.
- (3) A Fund Manager, or any Person making an Offer of a Unit of Fund or otherwise marketing a Fund, must not describe the Fund in its offer document or marketing material as an "Exchange Traded Fund" (or "ETF") or otherwise hold out the Fund as being an Exchange Traded Fund or ETF, unless the Fund meets the criteria in (2).
- (4) The Fund Manager of an Islamic ETF must ensure that the Fund has an investment objective and strategy, which is to track the performance of a specified index or benchmark as specified in its Prospectus.

**Guidance**

A Fund Manager of an Islamic ETF is required to comply with the requirements applicable to a conventional Fund so far as they apply to that ETF – see Rule 6.1.1.(2).

## **7. OFFERS OF ISLAMIC SECURITIES**

### **7.1 Application**

- 7.1.1**
- (1) Subject to (2), this chapter applies to any Person who Offers Islamic Securities in or from the DIFC.
  - (2) A Person making Offers of Islamic Securities in or from the DIFC must comply with the requirements in the Markets Law 2012 and the MKT module except to the extent otherwise provided in this chapter.
  - (3) Islamic Securities, for the purposes of this chapter, do not include Units of an Islamic Fund.

#### **Guidance**

1. The issue of Securities is not an activity that constitutes a Financial Service. Therefore, the activities such as the issue of Shares, Debentures (Sukuks) or Warrants do not attract the Financial Services prohibitions in the Regulatory Law 2004. However, the Offer of Securities is an activity to which the Markets Law 2012 and the MKT module apply. Under the Markets Law 2012, a Person making an Offer of Securities in or from the DIFC is subject to numerous disclosure requirements, unless exempt.
2. Offers of Islamic Securities which are Units of a Fund are not subject to the requirements in this section because the Collective Investment Law 2010 and CIR module provide for such activities to be regulated. Chapter 6 of this module sets out additional requirements that apply to the Fund Manager when Offering Units of an Islamic Fund.
3. The definition of the term Islamic Securities is in the GLO module.

### **7.2 Contents of a Prospectus for Islamic Securities**

**7.2.1** Deleted.

**7.2.2** Deleted.

**7.2.3** Where the relevant Securities are held out as being in accordance with Shari'a, the Prospectus relating to those Securities must include:

- (a) details of the members of the Shari'a Supervisory Board appointed by the Issuer who have undertaken the review of the relevant Securities;
- (b) details of the qualifications and experience of each of those Shari'a Supervisory Board members;
- (c) in the case of issuance of Sukuks:

- (i) the opinion of the Shari'a Supervisory Board in respect of whether the Securities are Shari'a compliant;
  - (ii) a description of the structure of the underlying transaction and an explanation of the flow of funds; and
  - (iii) where applicable, the disclosures required by the Shari'a Standards published from time to time by AAOIFI in respect of investment Sukuks; and
- (d) instead of the statement required under MKT Rule 2.5.1(3)(d), a prominent disclaimer in bold, on the front page of this Prospectus as follows:

“The DFSA does not accept any responsibility for the content of the information included in the Prospectus, including the accuracy or completeness of such information. The liability for the content of the Prospectus lies with the issuer of the Prospectus and other Persons, such as Experts, whose opinions are included in the Prospectus with their consent. The DFSA has also not assessed the suitability of the Securities to which the Prospectus relates to any particular investor or type of investor and has not determined whether they are Shari'a compliant. If you do not understand the contents of this Prospectus or are unsure whether the Securities to which the Prospectus relates are suitable for your individual investment objectives and circumstances, you should consult an authorised financial advisor.”

## **7.3 Continuing disclosure relating to Islamic Securities**

**7.3.1** The Reporting Entity responsible for Islamic Securities must, without delay, disclose to the markets and the DFSA details of any changes to the membership of its Shari'a Supervisory Board, the identity, qualifications and experience of any new Shari'a Supervisory Board members and the identity of any Shari'a Supervisory Board members who resign or are dismissed.

**7.3.2** A Listed Entity with Islamic Securities admitted to the Official List of Securities must make the required market disclosures in accordance with the requirements under section A2.1 and comply with the other continuing obligations under section A2.2.

## **8. TAKAFUL INSURANCE**

### **8.1 Application**

- 8.1.1**
- (1) This chapter applies to a Person who carries on or holds out as carrying on Insurance Business or Insurance Intermediation as Takaful Insurance.
  - (2) In addition to the requirements in this chapter, the requirements that apply to conventional Insurance Business or Insurance Intermediation continue to apply to such a Person.

### **8.2 Specific disclosure for Takaful insurance**

**8.2.1** Where an Insurer or an Insurance Intermediary conducts Takaful Insurance with a Retail Client, the disclosure for the purposes of COB section 7.7 must include:

- (a) the nature of the contracts between the Takaful fund and the operator;
- (b) the method of calculation of any fees or share of profits paid from the Takaful fund to the operator;
- (c) the basis on which any surpluses in the Takaful fund will be shared; and
- (d) any circumstances in which additional contributions to the Takaful fund may be required.

#### **Guidance**

1. Firms conducting Insurance Business comprising Takaful must comply with the requirements in PIN. Takaful related prudential requirements are not included in this module because of the closely integrated nature of such requirements with the requirements that apply to conventional insurance.
2. Note that structures of Takaful Insurers (including reinsurers) vary, as do the Islamic contracts governing their business. As the DFSA has not as yet thought it appropriate to limit the permissible structures and contracts, the DFSA is willing to consider modifications to its Rules to apply the most appropriate prudential regime to a Takaful entity. For many Takaful companies, this is likely to involve capital tests at the level of the Takaful participants' fund or funds, and for the firm as a whole.

**APP 1 PROSPECTUS DISCLOSURES FOR ISLAMIC FUNDS****A1.1 Shari'a approval process statement for offers of Domestic Funds from the DIFC**

**A1.1.1** In respect of the Units of an Islamic Fund which are to be offered to prospective Unitholders in Malaysia, a Fund Manager must ensure that the Prospectus set out in a prominent position the following statement:

“The Shari'a approval process which relates to this Fund has been carried out in accordance with the legislation applicable in the Dubai International Finance Centre (DIFC)”.

**A1.2 Shari'a approval process statement for offers of Foreign Funds in or from the DIFC**

**A1.2.1** In respect of an Islamic Fund which is a Fund domiciled in Malaysia and which is a Designated Fund, an Authorised Firm must ensure that the Prospectus contains in a prominent position or has attached to it the following statement:

“This Prospectus relates to an Islamic Fund, the Shari'a approval process of which is regulated by the Securities Commission of Malaysia.”

## APP 2 CONTINUING OBLIGATIONS

### A2.1 Continuing obligations – Market disclosures for listed entities

**A.2.1.1** This table forms part of Rule 7.3.2.

A.2.1.2 A Listed Entity must, on the occurrence of an event specified in column 1, make the required disclosure detailed in column 2, within the time specified in column 3, in respect of the Securities identified with a “✓” in column 4, of this Table.

<b>A2.1.1</b>											
	EVENT GIVING RISE TO DISCLOSURE OBLIGATION	DISCLOSURE REQUIRED	TIME OF DISCLOSURE	Structured Products	Shares	Warrants over Shares	Warrants over Debentures	Debentures	Certificates		Units
									Shares	Debentures	
<b>ISLAMIC SECURITIES</b>											
1.	Any material change in the Shari'a nature of its Listed Securities as determined by the Shari'a Supervisory Board	Market disclosure of the material change	As soon as possible	✓	✓	✓	✓	✓	✓	✓	✓
2.	Where there are any material changes to the structure of the Listed Securities, or the use of proceeds, then the Listed Entity must obtain and disclose a new Shari'a opinion	Market disclosure of the new Shari'a opinion	As soon as possible	✓	✓	✓	✓	✓	✓	✓	✓



## A2.2 Other continuing obligations for listed entities

**A.2.2.1** This table forms part of Rule 7.3.2.

**A.2.2.2** A Listed Entity must, on the occurrence of an event specified in column 1, undertake the requirements detailed in column 2, within the time specified in column 3, in respect of the Securities identified with a “✓” in column 4, of this Table.

<b>A2.2.1</b>											
EVENT	REQUIREMENTS	TIME	Structured Products	Shares	Warrants over Shares	Warrants over Debentures	Debentures	Certificates		Units	
								Shares	Debentures		
<b>REGISTRATION</b>											
1.	Appointment of an independent Shari’a Supervisory Board to evaluate the Shari’a compliance of the Islamic equity Securities on an annual basis	Notify the DFSA	Annually		✓	✓			✓		
2.	Any proposed decision with regard to any change in its board of directors or Shari’a Supervisory Board.	Consult with the DFSA	In advance	✓	✓	✓	✓	✓	✓	✓	✓