

**Appendix 3**

In this appendix underlining indicates new text and striking through indicates deleted text.



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# The DFSA Rulebook

## Islamic Finance Rules

### **(IFR)**

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## **2 ISLAMIC FINANCE**

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### **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.
- ~~2.~~ 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 Offered Securities Rules (OSR) module. These OSR 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)**

- ~~3.~~ 4. PSIAs do not fall within the GEN definitions of Investments. They are contractual arrangements under which Islamic banks invest clients’ funds, often (though not always) on a pooled basis, and are generally treated by the bank as off balance sheet. They are generally 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 2.3.6, 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.
  - ~~4.~~ 5. Because 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 Islamic banks that manage PSIAs. As PSIAs are not financial products, the issue of PSIAs, or any advising or arranging activities conducted in relation to PSIAs, especially by a third party, do not attract prospectus like disclosure or any advising or dealing related COB requirements (such as a suitability assessment). Instead,
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they attract a tailored regulatory regime that applies to the entity, i.e. an Islamic bank, that manages the PSIA's (see IFR chapter 5 for these Rules).

### **Investments**

- ~~5-~~ 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).
- ~~6-~~ 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 (PSIA's), Takaful and Islamic Funds attract product/instrument specific additional conduct and other requirements, which are included in this module.

### **Takaful insurance**

- ~~7-~~ 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.
- ~~8-~~ 9. Persons conducting Takaful insurance are conducting Insurance Business. There are two types of Financial Service that comprise Insurance Business, i.e. 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, ~~relating to insurance~~ 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.
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