Appendix 5

All provisions shown as struck through in this appendix have been moved to the Islamic Finance Rules Module of the DFSA Rulebook. Please see the destination table for further information.

The DFSA Rulebook

Prudential – Investment, Insurance Intermediation and Banking Module

(PIB)

1 GENERAL REQUIREMENTS

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1.7 Report to the DFSA

Table 4

APPLICATION OF RULES TO CATEGORIES OF AUTHORISED FIRMS

Guidance

1. This is the Table referred to in Guidance note 3 under Rule 1.1.1. This table is for guidance purposes only. The Rules apply to Authorised Firms in accordance with Chapter 1 and the application Rules in each chapter.

2. With regard to Authorised Firms carrying on Islamic Financial Business, there are additional matters that should be included in their report to the DFSA which are in the Islamic Finance Rules (IFR) module (see section 5.4 of IFR module).

Chapter		Category 1	Category 2	Category 3	Category 4	Category 5
1	General requirements					
1.1	Application	✓	✓	✓	✓	✓
1.2	Financial resources	✓	✓	✓	✓	✓
1.3	Categories of Authorised Firms	✓	✓	✓	✓	✓
1.4	The trading book	✓	✓	✓	✓	✓
1.5	Reporting	✓	✓	✓	✓	✓
1.6	Submission of returns	✓	✓	✓	✓	✓
1.7	Report to the DFSA	✓	✓	✓	✓	✓
App1		✓	✓	✓	✓	✓
2	Capital					
2.1	Application	✓	✓	✓	✓	✓
2.2	Basic requirements	✓	✓	✓	✓	✓
2.3	Initial and ongoing Capital Requirements	✓	✓	✓	✓	✓
2.4	Base Capital Requirement	✓	✓	✓	✓	✓
2.5	Expenditure Based Capital Minimum		✓	✓	✓	
2.6	Calculation of Capital Resources	✓	✓	✓	✓	✓
2.7	Components of capital	✓	✓	✓	✓	✓
2.8	Limits on the use of different forms of Capital	✓	✓	✓	✓	✓
~~2.9~~	~~Components of capital specific to an Authorised Firm Managing a PSIA~~	~~✓~~ *	~~✓~~ *	~~✓~~ *		~~✓~~
2.10	Subordinated debt	✓	✓	✓	✓	
App2		✓	✓	✓	✓	✓
~~3~~	~~Islamic Contracts and PSIAs~~					
~~3.1~~	~~Application~~	~~✓*~~	~~✓*~~	~~✓*~~		~~✓~~
~~3.2~~	~~Initial and ongoing capital requirements~~	~~✓*~~	~~✓*~~	~~✓*~~		~~✓~~
~~3.3~~	~~Systems and controls in relation to~~	~~✓*~~	~~✓*~~	~~✓*~~		~~✓~~

Chapter		Category 1	Category 2	Category 3	Category 4	Category 5
	~~PSIAs~~					
~~3.4~~	~~Displaced commercial risk~~	~~✓*~~	~~✓ *~~	~~✓*~~		~~✓~~
~~3.5~~	~~Credit Risk and Counterparty Risk for Islamic contracts~~	~~✓*~~	~~✓*~~	~~✓*~~		~~✓~~
~~3.6~~	~~Market Risk~~	~~✓*~~	~~✓*~~	~~✓*~~		~~✓~~
~~3.7~~	~~Concentration Risk~~	~~✓*~~	~~✓*~~	~~✓*~~		~~✓~~
4	Credit Risk					
4.1	Application	✓	✓	✓		✓
4.2	Credit Risk systems and controls	✓	✓	✓		✓
4.3	Credit Risk in the Non-Trading Book	✓	✓	✓		✓
4.4	Counterparty Risk in the Trading Book	✓	✓	✓		✓
4.5	Concentration Risk	✓	✓	✓		✓
4.6	Collateral	✓	✓	✓		✓
4.7	Netting	✓	✓	✓		✓
4.8	Securitisation	✓	✓	✓		✓
4.9	Credit Derivatives	✓	✓	✓		✓
4.10	Application of Credit Risk methodology to Islamic Contracts	✓*	✓*	✓*		✓
App4		✓	✓	✓		✓
5	Market Risk					
5.1	Application	✓	✓	✓		✓
5.2	Market Risk systems and controls	✓	✓			✓
5.3	Use of internally developed Market Risk models	✓	✓			✓
5.4	Interest Rate Risk Capital Requirement	✓	✓			
5.5	Equity Risk Capital Requirement	✓	✓			✓
5.6	Foreign Exchange Risk Capital Requirement	✓	✓	✓		✓
5.7	Commodity Risk Capital Requirement	✓	✓			✓
5.8	Option Risk Capital Requirement	✓	✓			✓
5.9	Securities Underwriting Capital Requirement	✓	✓			✓
App5		✓	✓	✓		✓
6	Liquidity Risk					
6.1	Application	✓	✓			✓
6.2	Liquidity systems and controls	✓	✓			✓
6.3	Liquidity requirements	✓				✓
App6		✓	✓			✓
7	Group Risk					
7.1	Application	✓**	✓**	✓**	✓**	✓**
7.2	Systems and controls requirements	✓** +	✓** +	✓** +		✓** +
7.3	Financial Group Capital Requirements and Financial Group Capital Resources	✓**	✓**	✓**		✓**
7.4	Financial Group Concentration Risk limits	✓**	✓ **	✓**		✓**
8	Operational Risk					
App7	Forms	✓	✓	✓	✓	✓

Chapter					
	Category 1	Category 2	Category 3	Category 4	Category 5
* Where the Authorised Firm operates an Islamic Window or invests in or holds Islamic Contracts.					
** The requirements apply where the Authorised Firm is a member of a Financial Group					
+ The requirements apply where the Authorised Firm is a member of a Group					

2.3 Initial and ongoing capital requirements

2.3.1 An Authorised Firm's Capital Requirement is the highest of:

(a) the applicable Base Capital Requirement as set out in section 2.4;

(b) in respect of an Authorised Firm in Category 2, 3 and 4, the Expenditure Based Capital Minimum as set out in section 2.5; or

(c) 125% of the sum of the Credit Risk Capital Requirement, the Market Risk Capital Requirement and, for an Authorised Firm Managing a PSIA, the Displaced Commercial Risk Capital Requirement<u>, calculated in accordance with chapter 5 of the Islamic Finance Rules (IFR) Module</u>.

Guidance

1. An Authorised Firm will need to refer to chapters 4 and 5 to determine whether it is required to calculate a Credit Risk Capital Requirement and a Market Risk Capital Requirement, respectively. The Market Risk Capital Requirement will generally not be applicable to an Authorised Firm in Category 4.

2. The Displaced Commercial Risk Capital Requirement will only apply to an Authorised Firm Managing a PSIA.

3. An Authorised Firm will also need to consider the relevant provisions in <u>IFR chapter 5</u> ~~chapter 3~~ when calculating its Credit Risk and Market Risk for Islamic Contracts.

2.3.3 An Authorised Firm must calculate its Credit Risk Capital Requirement as the sum of:

(a) the Credit Risk Capital Component; and

(b) the Counterparty Risk Capital Component.

Guidance

1. Detailed Rules and Guidance in respect of the Credit Risk Capital Requirement are contained in chapter 4.

2. Rules and Guidance in respect of calculating Credit Risk for Islamic Contracts are contained in <u>IFR chapter 5</u> ~~chapter 3~~.

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2.3.4 …………

Guidance

1. Detailed Rules and Guidance in respect of the Market Risk Capital Requirement and the components set out in Rule 2.3.4 are contained in chapter 5.

2. Rules and Guidance in respect of calculating Market Risk for Islamic Contracts are contained in IFR chapter 5 ~~chapter 3~~.

Displaced commercial risk

2.3.5 An Authorised Firm Managing a PSIA must calculate its Displaced Commercial Risk Capital Requirement in accordance with IFR chapter 5 ~~chapter 3~~.

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2.8.4 For the purposes of Rule 2.8.3:

(a) an Authorised Firm's Non-Trading Book Capital Requirement must be calculated as the sum of the following components, regardless of whether they were calculated taking into account Non-Trading Book items or Trading Book items:

(i) Credit Risk Capital Component calculated in accordance with section 4.3;

(ii) subject to Rule 2.8.5, the Foreign Exchange Risk Capital Requirement calculated in accordance with section 5.6; and

(iii) subject to Rule 2.8.6, Displaced Commercial Risk Capital Requirement calculated in accordance with IFR section 5.4 ~~section 3.4~~; and

………….

2.9.1 An Authorised Firm must exclude from Tier Two capital any amount by which the total of the Profit Equalisation Reserve and the Investment Risk Reserve exceeds the Displaced Commercial Risk Capital Requirement calculated in accordance with IFR Rule 5.4.4 ~~3.4.1~~.

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3 NOT CURRENTLY IN USE ~~ISLAMIC CONTRACTS AND PSIA~~

~~3.1 Application~~

~~3.1.1 (1) This chapter applies to an Authorised Firm in Category 1, 2, 3, or 5:~~

~~(a) When Managing a PSIA; or~~

~~(b) when investing in or holding Islamic Contracts, whether for the purpose of a PSIA or not, when calculating Credit Risk or Market Risk in respect of the Islamic Contracts.~~

~~(2) In this chapter the term “investing in or holding Islamic Contracts” means investing in or holding as a principal.~~

~~3.1.2 Only an Authorised Firm in Category 1, 2 or 3 may Manage a PSIA through an Islamic Window.~~

~~**Guidance**~~

~~An Islamic Financial Institution and an Authorised Firm which operates 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.~~

~~3.2 Initial and ongoing capital requirements~~

~~**Guidance**~~

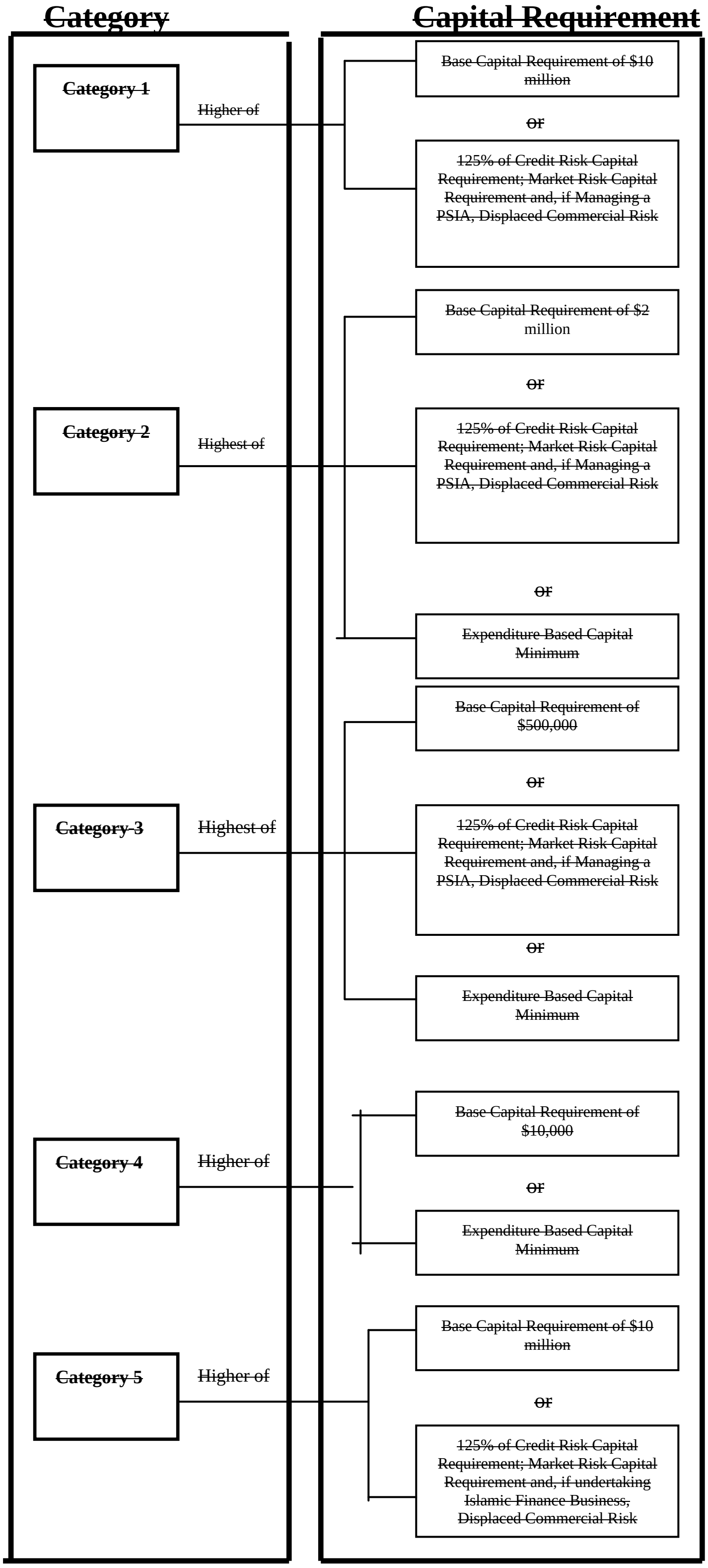
~~1. An Authorised Firm undertaking Islamic Financial Business is required to maintain initial and ongoing Capital Requirements in accordance with Rules 2.2.1 and 2.3.1. These requirements are summarised in Table 1.~~

~~2. In accordance with Rule 2.6.1, an Authorised Firm undertaking Islamic Financial Business is required to ensure that only the components of capital which are set out in the table in Rule 2.6.2 are included in the calculation of capital.~~

~~3. In accordance with Rule 2.9.1, an Authorised Firm undertaking Islamic Financial Business is required to exclude from Tier Two 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.~~

~~Table 1~~


~~Category~~
~~Capital Requirement~~
~~Category 1~~
~~Higher of~~
~~Base Capital Requirement of $10 million~~
~~or~~
~~125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk~~
~~Category 2~~
~~Highest of~~
~~Base Capital Requirement of $2~~ million
~~or~~
~~125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk~~
~~or~~
~~Expenditure Based Capital Minimum~~
~~Category 3~~
~~Highest of~~
~~Base Capital Requirement of $500,000~~
~~or~~
~~125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk~~
~~or~~
~~Expenditure Based Capital Minimum~~
~~Category 4~~
~~Higher of~~
~~Base Capital Requirement of $10,000~~
~~or~~
~~Expenditure Based Capital Minimum~~
~~Category 5~~
~~Higher of~~
~~Base Capital Requirement of $10 million~~
~~or~~
~~125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if undertaking Islamic Finance Business, Displaced Commercial Risk~~

~~3.3 Systems and controls in relation to PSIAs~~

~~Guidance~~

~~The requirements in section 3.3 amplify the requirements in GEN Chapter 5.~~

~~**3.3.1** In addition to Rule 2.2.2, 2.2.3, GEN Rule 5.3.1, and the Rules in chapter 4 of the ISF 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.~~

~~**3.3.2** (1) In addition to ISF section 4.2, 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 (Provisions and Reserves are set out in AAOIFI FAS 11) and, in respect of PSIAs, 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.~~

~~**Guidance**~~

~~Guidance on the conditions for treatment of PSIA as restricted or unrestricted is found in paragraphs 12 and 13 of the AAOIFI's Statement of Concepts of Financial Accounting for Islamic Banks and Financial Institutions, and Appendix D of Financial Accounting Standard FAS 5.~~

~~3.4 Displaced commercial risk~~

~~**3.4.1** An Authorised Firm Managing a PSIA must calculate a Displaced Commercial Risk Capital Requirement in respect of its PSIA business.~~

~~**Guidance**~~

1. ~~An Authorised Firms Managing a PSIA, whether on a restricted basis or 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 PSIAs 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 Firms 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 chapters 4 and 5 to any other business it carries on.~~

~~3.4.2 (1) An Authorised Firm's Displaced Commercial Risk Capital Requirement is based on 35% of the Credit Risk and Market Risk of assets financed by PSIA holders, ,both Restricted and Unrestricted, and is calculated using the following formula:~~

~~PSIACOM = [PSIACOMcredit + PSIACOMmarket] x 35%.~~

~~(2) PSIACOM is the Displaced Commercial Risk Capital Requirement;~~

~~(3) PSIACOMcredit is the Credit Risk of assets financed by PSIA holders and is calculated in accordance with section 3.5 and chapter 4; and~~

~~(4) PSIACOMmarket is the Market Risk of assets financed by PSIA holders and is calculated in accordance with section 3.6 and chapter 5.~~

~~3.5 Credit risk and counterparty risk for Islamic contracts~~

~~3.5.1 (1) An Authorised Firm Managing a PSIA must calculate its PSIAComcredit in relation to all Islamic Contracts financed by the PSIA 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.~~

~~3.5.2 (1) In this section:~~

~~(a) "ICX" represents the Exposure determined by an Authorised Firm as applicable to an Islamic Contract; and~~

~~(b) "ICW" 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 PSIACOMcredit for that contract by applying the following formula:~~

~~ICX x ICW x 8%.~~

~~(3) Where an Islamic Contract is in the Trading Book, an Authorised Firm must determine the PSIACOMcredit for that contract in accordance with the methodology in A4.5, A4.6 and A4.7 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 Rule 4.3.2(c), the result of which constitutes the ICX for that contract;~~

~~(c) determining the risk weighting or capital charge appropriate to each contract, which will constitute the ICW for that contract;~~

~~(d) applying the respective formula in Rule 3.5.2(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** [Added][RM57][VER14/07-08]~~

~~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 3.5.2. Accordingly, the DFSA expects an Authorised Firm specified under Rule 3.1.1 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 Credit Risk for Islamic Contracts under chapter 4.~~

~~3. Table 2 contains Guidance on how an Authorised Firm Managing a PSIA should apply risk weightings for Islamic Contracts in respect of calculating relevant ICX and ICW for its PSIACOMcredit component of the PSIACOM.~~

~~**Table 2** [Deleted & Replaced][RM57][VER14/07-08]~~

~~**1.** **Islamic Contract type**~~	~~**2.** **Underlying investment or asset**~~	~~**3.** **ICW**~~
~~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 Rule A4.5.4~~
	~~Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts~~	~~Counterparty Risk weighting in accordance with 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~~	~~Counterparty Risk weighting in accordance with chapter 4~~
~~Mudaraba and Musharaka~~	~~Where the underlying investment meets the requirements for inclusion in the Trading Book~~	~~Contract risk weighting determined in accordance with 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)~~	~~ICW of 400% on the exposure~~
	~~Investment in real estate assets and other movable assets, using underlying Ijarah and Murabaha contracts~~	~~ICW of the lessee for the underlying Ijarah contracts or the ICW of the counterparty of the underlying Murabaha contract, in accordance with App4~~

~~1.~~ ~~**Islamic Contract type**~~	~~2.~~ ~~**Underlying investment or asset**~~	~~3.~~ ~~**ICW**~~
~~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 Rule A4.5.4~~
	~~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~~	~~50%~~
	~~Total estimated value of lease receivables for the whole duration of the Ijarah, less any recovery value of the leased asset~~	~~Counterparty Risk weighting of Ijarah lessee, in accordance with App4~~
~~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~~	~~Counterparty Risk weighting of the Istisna'a buyer, in accordance with App4~~
	~~Total amount receivable from the counterparty, pursuant to contract billings~~	~~Counterparty Risk weighting of Istisna'a buyer, in accordance with App4~~
~~Salam and parallel Salam~~	~~Value of the underlying asset receivable for the Salam contract~~	~~Counterparty Risk weighting in accordance with chapter 4~~
	~~Assets acquired~~	~~100%~~
	~~Balance in relevant accounts receivable~~	~~Counterparty Risk weighting in accordance with chapter 4~~
~~Kefala~~	~~The amount of the guarantee~~	~~Counterparty Risk weighting in accordance with chapter 4~~
~~Sukuk held in the Non-Trading Book~~	~~Receivables from the Sukuk structure, including the principal and any returns associated with it, arising from any of the following as underlying contracts:~~ ~~Salam~~ ~~Istisna'a~~ ~~Ijarah~~ ~~Murabaha~~ ~~Mudaraba~~ ~~Musharaka~~	~~ICW applicable to underlying Ijarah, Salam or Murabaha contracts, in accordance with App4~~ ~~If the Sukuk provides recourse to the issuer, ICW applicable to the issuer or CPW applicable to underlying contracts of the Sukuk is in accordance with App4, whichever is higher~~
	~~Usufructs/services~~	~~ICW applicable to underlying service provider or usufruct owner, in accordance with App4. If the Sukuk provides recourse to the issuer, ICW applicable to the issuer or ICW applicable to underlying service provider or usufruct owner in accordance with App4, whichever is higher~~
	~~Leased assets~~	~~The higher ICW of the underlying leased assets and that of the issuer~~

~~1.~~ ~~Islamic Contract type~~	~~2.~~ ~~Underlying investment or asset~~	~~3.~~ ~~ICW~~
	~~Investment agency~~	~~The higher ICW 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 ICW of the underlying assets and that of the issuer~~
	~~Where the underlying investment meets the requirements for inclusion in the Trading Book~~	~~Contract risk weighting determined in accordance with chapter 5~~
~~Bai' Bithaman Ajil~~	~~Residential and commercial properties~~ ~~Plant and equipment~~ ~~Motor vehicles~~ ~~Shares~~ ~~Land~~	~~Counterparty Risk weighting in accordance with chapter 4~~
~~Arboun~~	~~Where an Authorised Firm has made the purchase deposit~~	~~Counterparty Risk weighting in accordance with chapter 4~~
	~~Where an Authorised Firm has received the purchase deposit~~	~~No ICW is applicable~~
	~~Where the contract would meet the requirements for inclusion in the Trading Book~~	~~Contract risk weighting determined in accordance with 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 ICX; and~~

~~b. appropriate risk weighting or the capital charge for such contract to calculate the ICW.~~

~~5. In Table 2, where "Counterparty Risk weighting" is determined in accordance with Chapter 4 and App4, ICW should be regarded to have the same value as CPW.~~

~~6. In some cases, as stipulated in the relevant parts of column 3 of Table 2, the calculation of capital charge should be carried out as prescribed in Rule A4.5.4 and in accordance with chapter 5.~~

~~7. In determining the ICX of a Binding Murabaha for the Purchase Orderer (MPO), as per Rule A4.5.4, ICX 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.~~

~~8. In determining the ICX of Ijarah / Ijarah Munthia Bittamleek contract, as per Rule A4.5.4, ICX 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).~~

~~9. In addition to paragraph 8 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.~~

~~10. In determining the ICX 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.~~

~~11. In determining the ICX 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.~~

~~12. 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% credit conversion factor to an Authorised Firm that issues or confirms the letter of credit.~~

~~13 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 ICX 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 ICW for the guarantor will be applied for risk weighting for the amount of any such guarantee.~~

~~14. In addition to the relevant Rules prescribed in chapter 4 and 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.~~

~~15. 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 ICW of the guarantor provided that the ICW of that guarantor is lower than the ICW of the Mudarib (as a Counterparty). Otherwise, the ICW of the Mudarib will apply.~~

~~16. 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 ICW 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.~~

~~3.6 Market risk~~

~~**3.6.1** (1) An Authorised Firm Managing a PSIA must calculate its PSIACOMmarket in relation to all underlying Islamic Contracts in the manner prescribed in chapter 5, except as may be provided in this section.~~

~~(2) An Authorised Firm must calculate its Market Risk Capital Requirement in respect of Islamic Contracts it invests in or holds, other than through Managing a PSIA, in the manner prescribed in chapter 5, except as may be provided in this section.~~

~~**3.6.2** 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 Rule 5.5.2.~~

~~**3.6.3** 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 Rule 5.7.2.~~

~~**3.6.4** 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 Rule 5.6.2.~~

~~**3.6.5** 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 Rule 5.7.2.~~

~~**3.6.6** (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.~~

~~**3.6.7** 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 chapter 5.~~

~~3.7 Concentration risk~~

~~**Guidance**~~

~~1. This section sets specific Large Exposure limits for assets financed by PSIAs. 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 section A4.8.~~

~~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 section 4.5.~~

~~Exposure limits~~

~~**3.7.1** An Authorised Firm Managing a 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 PSIAs;~~

~~(b) 30% if financed by Restricted PSIAs; or~~

~~(c) 40% if financed by the total of its own Capital Resources, Unrestricted PSIAs and Restricted PSIAs.~~

~~**Guidance**~~

~~1. In respect of its PSIAs, an Authorised Firm may apply to the DFSA for a modification of the limits set out in (b) and (c) of the Rule 3.7.1. The Authorised Firm will have to demonstrate to the DFSA that it has met some or all of the following conditions:~~

~~a. the Authorised Firm has very limited (or no) discretion regarding the manner in which the funds will be invested;~~

~~b. the PSIA holders are fully aware of how their money is to be invested;~~

~~c. the PSIA holders are provided with monthly net asset valuations; or~~

~~d. the accounts of the PSIA are externally audited.~~

~~2. In accordance with section 4.5, 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.~~

~~**3.7.2** The sum of an Authorised Firm's non-exempt Large Exposures must not exceed the following percentage of its Capital Resources:~~

~~(a) 800% for Exposures funded by an Authorised Firm's Capital Resources and Unrestricted PSIAs; or~~

~~(b) 1200% for Exposures funded by Restricted PSIAs.~~

~~**3.7.3** An Authorised Firm must:~~

~~(a) monitor and control its Exposures arising from PSIAs on a daily basis to ensure they remain within the risk concentration limits specified in section 3.6; and~~

~~(b) if a breach occurs, notify the DFSA immediately and confirm it in writing.~~

4 CREDIT RISK

4.1 Application

4.1.1 This chapter applies to an Authorised Firm in Category 1, 2, 3 or 5.

Guidance

1. Rule 2.3.3 provides that the Credit Risk Capital Requirement of an Authorised Firm is calculated as the sum of:

   a. the Credit Risk Capital Component; and

   b. the Counterparty Risk Capital Component.

2. This chapter sets out the manner in which each of those components must be calculated, monitored and controlled by an Authorised Firm.

3. In addition to complying with the applicable Rules in chapter 4, an Authorised Firm investing in or holding Islamic Contracts whether or not for the purpose of a PSIA will need to take account of the provisions under IFR Rules 5.4.6 and 5.4.7 ~~section 3.5~~ to calculate the Credit Risk for those Islamic Contracts.

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4.5.2 Subject to IFR Rule 5.4.8 ~~3.6.1~~, an Authorised Firm must ensure that Exposures in its Non-Trading Book to a Counterparty or to a group of Closely Related Counterparties or to a group of Connected Counterparties do not exceed 25% of its Capital Resources.

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4.5.4 Subject to IFR Rule 5.4.9 ~~3.6.2~~, an Authorised Firm must ensure that the sum of its non-exempt Large Exposures does not exceed 800% of its Capital Resources.

4.10 Application of credit risk methodology to Islamic Contracts

4.10.1 For any Islamic contracts that are funded by an Authorised Firm (including its own investments via any PSIAs) the Authorised Firm must calculate a CRCOM on the basis set out in IFR Rules 5.4.4, 5.4.5, 5.4.6 and 5.4.7 ~~sections 3.4 and 3.5~~ as if the contracts were PSIA funded assets except that the 35% weighting must be replaced by a 100% weighting.

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5 MARKET RISK

5.1 Application

5.1.1 ………….

Guidance

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3. In addition to complying with the applicable Rules in chapter 5, an Authorised Firm investing in or holding Islamic Contracts whether or not for the purpose of a PSIA will need to take account of the provisions under IFR Rules 5.4.8 to 5.4.14 ~~section 3.6~~ to calculate the Market Risk for those Islamic Contracts.

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App4 CREDIT RISK

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A4.10 Securitisation

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A4.10.30 A Sponsor dealing in the Securities issued by the SPV must include these Securities in the calculation of its Capital Requirement.

Synthetic securitisations

Guidance

Synthetic Securitisations differ from the traditional Securitisations discussed in this section in that they use Credit Derivatives to transfer the Credit Risk associated with the underlying pool of assets to a SPV. The SPV, in turn, issues notes, thus passing the Credit Risk to third party investors. As the underlying assets are not legally transferred to the SPV as in a traditional Securitisation – although the Originators continue to benefit from a similar degree of credit protection – the resulting structure is said to be 'synthetic'. Effective transfer of Credit Risk is still required to be demonstrated. Therefore, an Authorised Firm entering into Synthetic Securitisations should comply with the relevant provisions in IFR chapter 5 ~~chapter 3~~ and this appendix in relation to traditional Securitisations and Credit Derivatives.

A4.11.22 Where an asset is protected in full or in part by an unfunded Credit Derivative:

(a) the Protection Buyer may treat the Reference Asset as though guaranteed by the Protection Seller in accordance with IFR chapter 5 ~~chapter 3~~ and may choose to replace the risk weighting of the protected asset with the risk weighting of the Counterparty to the Credit Derivative contract; and

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