



# 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; and
- (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.

### **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 12 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.

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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.
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 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 2.1.13, 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. 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, they attract a tailored regulatory regime that applies to the entity, i.e. an Islamic bank, that manages the PSIAs (see IFR chapter 5 for these Rules).

### **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.

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## **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** 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.

**Guidance**

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.

### **3.4 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**

1. COB section 3.2.4 sets out the meaning of "marketing material".
2. An Authorised Firm may be able to rely on the Transitional Rules in chapter 10 of GEN for the purposes of complying with some of the provisions in this module. See for example GEN Rule 10.5.1 which provides transitional relief for marketing material.

#### **Islamic window**

- 3.8.3** (1) An Authorised Person which operates an Islamic Window must, subject to (2), make the relevant disclosures required by AAOIFI FAS 18 to its Clients or any Person granted access to its facilities as is appropriate.

- (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.

**Guidance**

See Guidance 3 for the type of information required to be included in a Prospectus.

**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.

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## **4 ACCOUNTING STANDARDS**

### **4.1 Application**

**4.1.1** This chapter applies to every:

- (a) Authorised Person carrying on Islamic Financial Business; and
- (b) an auditor providing audit services to an Authorised Person carrying on Islamic Financial Business.

**4.1.2** In the case of an Authorised Person which is a Domestic Firm, any reference to an “auditor” in this chapter includes a reference to an “Auditor”.

#### **Guidance**

1. GEN chapter 8 contains the general accounting and audit requirements applying to an Authorised Person conducting conventional Financial Services. In addition, it also contains the general requirements that apply to auditors. Therefore, Authorised Persons carrying on both Islamic and conventional Financial Services must refer to that module for accounting and audit requirements relating to their conventional Financial Services. Auditor registration requirements are also in that module.
2. The definition of “Auditor” in GLO includes a partnership or company that is registered to provide audit services to Authorised Persons that are Domestic Firms.

### **4.2 Accounting standards**

- 4.2.1**
- (1) If an Authorised Person is an Islamic Financial Institution, it must prepare and maintain all financial accounts and statements in accordance with the accounting standards of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).
  - (2) If an Authorised Person operates an Islamic Window, it must prepare and maintain all financial accounts and statements in accordance with the IFRS, as supplemented by AAOIFI FAS 18, in respect of its Islamic Financial Business.

#### **Guidance**

1. AAOIFI FAS 18 sets out the accounting rules for recognising, measuring and presenting the assets managed and funds mobilised on the basis of Islamic Shari’a rules and principles in the financial accounts and statements of conventional financial institutions that offer Islamic financial services, as well as the income generated from these services. The standard also determines the necessary disclosures related to these services.
2. Under AAOIFI FAS 18, Authorised Persons which operate Islamic Windows must disclose (in their relevant financial statements) the following:

- a. whether or not they co-mingle funds related to Islamic Financial Business with funds relating to conventional financial business;
- b. the sources and applications of funds mobilised and invested through their Islamic Financial Business and the sources of funds used to cover a deficit if it occurs;
- c. any reserves of expenditures prohibited by Shari'a and the disposition of any revenues the latter shall be determined by the Shari'a Supervisory Board;
- d. any reserves deducted from the funds mobilised according to Shari'a, the purpose of such reserves and to whom the reserves shall revert in the case where the activities in respect of which the reserves were deducted have ceased; and
- e. the percentage amount of funds relating to Islamic Financial Business in comparison with the percentage amount of funds relating to conventional financial business.

### **4.3 Accounting records and regulatory returns**

#### **4.3.1** Every Authorised Person carrying on Islamic Financial Business must:

- (a) keep accounting records which are sufficient to show and explain transactions and are such as to:
  - (i) be capable of disclosing the financial position of the Authorised Person on an ongoing basis; and
  - (ii) record the financial position of the Authorised Person as at its financial year end;
- (b) maintain accounting records to enable its Governing Body to ensure that accounts prepared by the Authorised Person comply with the applicable legislation in the DIFC;
- (c) retain its accounting records for at least ten years from the date to which they relate;
- (d) make available at all reasonable times its accounting records for inspection by the DFSA or its auditor; and
- (c) ensure that its accounting records are, if requested by the DFSA, be capable of reproduction, within a reasonable period not exceeding 3 business days, in hard copy and in English.

#### **4.3.4** All regulatory returns required under this chapter must be prepared and submitted by the Authorised Person in accordance with the requirements set out in PIB or PIN module as is applicable.



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**Changes to the financial year end**

- 4.3.5**
- (1) If an Authorised Person which is a Domestic Firm intends to change its financial year end, it must obtain the DFSA's prior consent before implementing the change.
  - (2) The application for consent must include reasons for the change.
  - (3) The DFSA may require the Authorised Person to obtain written confirmation from its auditor that the change of financial year end would not result in any significant distortion of the financial position of the Authorised Firm.
  - (4) If an Authorised Person carries on both conventional Financial Services and Islamic Financial Business, that person may make the relevant application under (2) or under the equivalent provision in GEN Rule 8.3.5(2).
- 4.3.6** If an Authorised Person is not a Domestic Firm and intends to change its financial year, it must provide the DFSA with reasonable advance notice prior to the change taking effect.

**4.4 Appointment and termination of auditors**

- 4.4.1** An Authorised Person must:
- (a) notify the DFSA of the appointment of an auditor, including the name and business address of the auditor and the date of the commencement of the appointment;
  - (b) prior to the appointment of the auditor, take reasonable steps to ensure that the auditor has the required skills, resources and experience to audit the Islamic Financial Business of the Authorised Person for which the auditor has been appointed; and
  - (c) if it is a Domestic Firm, ensure that the auditor, at the time of appointment and for the duration of the engagement as auditor, is registered with the DFSA.
- 4.4.2** An Authorised Person must notify the DFSA immediately if the appointment of the auditor is or is about to be terminated, or on the resignation of its auditor, giving the reasons for the cessation of the appointment.
- 4.4.3** An Authorised Person must appoint an auditor to fill any vacancy in the office of auditor and ensure that the replacement auditor can take up office at the time the vacancy arises or as soon as reasonably practicable.
- 4.4.4**
- (1) An Authorised Person must take reasonable steps to ensure that the relevant audit staff of the auditor are independent of and not subject to any conflict of interest with respect to the Authorised Person.

- (2) An Authorised Person must notify the DFSA if it becomes aware, or has reason to believe, that the relevant audit staff members of the auditor are no longer independent of the Authorised Person, or have a conflict of interest which may affect their judgement in respect of the Authorised Person.

**Guidance**

1. The relevant staff members of an auditor are independent of the Authorised Person if their appointment or retention by the Authorised Person is not inconsistent with any applicable professional standards or ethical guidance issued by the relevant professional supervisory body.
2. An Authorised Person should consider requiring the rotation of the staff members appointed to the audit every five years to ensure that such staff members remain independent.

**4.4.5** If requested by the DFSA, an Authorised Person which carries on Islamic Financial Business through a Branch must provide to the DFSA information relating to the skills, experience and independence of its appointed or proposed auditor.

**4.4.6** Where an auditor appointed by an Authorised Person is not suitable in the opinion of the DFSA, or where an auditor has not been appointed, the DFSA may direct an Authorised Person to replace or appoint an auditor as is relevant in accordance with the requirements in this chapter.

**4.5 Co-operation with auditors**

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

- (a) provide such assistance as the auditor reasonably requires to discharge its duties;
- (b) give the auditor right of access at all reasonable times to relevant records and information;
- (c) do not interfere with the auditor's ability to discharge its duties;
- (d) do not provide false or misleading information to the auditor; and
- (e) report to the auditor of any matter which may significantly affect the financial position of the Authorised Person.

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## **4.6 Function of the auditor**

**4.6.1** An Authorised Person carrying on Islamic Financial Business must in writing require its auditor to:

- (a) conduct an audit of the Authorised Person's accounts in accordance with the requirements of the relevant standards published by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in respect of its Islamic Financial Business;
- (b) produce a report on the audited accounts which states:
  - (i) whether, in the auditor's opinion, the accounts have been properly prepared in accordance with the requirements imposed by this chapter;
  - (ii) in particular, whether the accounts give a true and fair view of the financial position of the Authorised Person for the financial year and of the state of the Authorised Person's affairs at the end of the financial year end; and
  - (iii) any other matter or opinion relating to the requirements of this chapter;
- (c) produce an Auditor's Annual Report:
  - (i) which states whether the auditor has:
    - (A) audited the Authorised Person's annual financial statements in accordance with the AAOIFI auditing standards in respect of its Islamic Financial Business;
    - (B) has carried out any other procedures considered necessary, having regard to the AAOIFI auditing standards in respect of its Islamic Financial Business; and
    - (C) received all necessary information and explanations for the purposes of preparing its report to the DFSA;
  - (ii) which contains, in the case of an Authorised Firm, the auditor's reports and opinions referred to in GEN Rules 8.6.1(c)(iv),(v),(vi),(vii) and (viii), (d), (e) and (f) so far as they are relevant or applicable to the Authorised Firm's Islamic Financial Business; and
  - (iii) which states, in the case of an Authorised Firm which carries on the Financial Service of Managing Profit Sharing Accounts, whether the firm has complied with the additional requirements in chapter 5;

- (d) submit the reports produced pursuant to Rules 4.6.1(b) and (c) above to the Authorised Person; and
- (e) notify the DFSA in writing if he resigns due to significant concerns which have previously been raised with the senior management of the Authorised Person and which have not been addressed.

**4.6.2** An Authorised Person must submit any auditor's reports and financial statements required by this chapter to the DFSA within four months of the Authorised Person's financial year end.

**4.6.3** If requested, an Authorised Person must provide to any Person a copy of its most recent audited accounts, together with the auditor's report referred to in Rule 4.6.1(b). If the copy is made available in printed form, the Authorised Person may charge a fee to cover reasonable costs incurred in providing the copy.

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## **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**

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.

**5.1.2** An Authorised Firm in prudential Category 1, 2 or 3 may only Manage a PSIA through an Islamic Window.

#### **Guidance**

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.

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**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.

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**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 in accordance with AAOIFI FAS 11 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 5.2.2, 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.

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## **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.
  - (2) 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 PIB Rules 2.2.1 and 2.3.1. These requirements are summarised in Table 1.
2. In accordance with PIB 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 PIB Rule 2.6.2 are included in the calculation of capital.
3. In accordance with PIB 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
<p><b>Category 1</b></p>	<p>Higher of</p> <ul style="list-style-type: none"> <li>Base Capital Requirement of \$10 million</li> <li>or</li> <li>125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk</li> </ul>
<p><b>Category 2</b></p>	<p>Highest of</p> <ul style="list-style-type: none"> <li>Base Capital Requirement of \$2 million</li> <li>or</li> <li>125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk</li> <li>or</li> <li>Expenditure Based Capital Minimum</li> </ul>
<p><b>Category 3</b></p>	<p>Highest of</p> <ul style="list-style-type: none"> <li>Base Capital Requirement of \$500,000</li> <li>or</li> <li>125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk</li> <li>or</li> <li>Expenditure Based Capital Minimum</li> </ul>
<p><b>Category 4</b></p>	<p>Higher of</p> <ul style="list-style-type: none"> <li>Base Capital Requirement of \$10,000</li> <li>or</li> <li>Expenditure Based Capital Minimum</li> </ul>
<p><b>Category 5</b></p>	<p>Higher of</p> <ul style="list-style-type: none"> <li>Base Capital Requirement of \$10 million</li> <li>or</li> <li>125% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if undertaking Islamic Finance Business, Displaced</li> </ul>

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**Systems and controls in relation to PSIAs****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 2.2.2, 2.2.3, 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 (Provisions and Reserves are set out in AAOIFI FAS 11) and, in respect of PSIA's, 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.

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**Displaced commercial risk****5.4.4** 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 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 Credit Risk and Market Risk of assets financed by PSIA holders, both Restricted and Unrestricted, and is calculated using the following formula:

$$\text{PSIACOM} = [\text{PSIACOMcredit} + \text{PSIACOMmarket}] \times 35\%.$$

- (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 Rules 5.4.6 – 5.4.7 and PIB chapter 4; and
- (4) PSIACOMmarket is the Market Risk of assets financed by PSIA holders and is calculated in accordance with Rule 5.4.8 and PIB chapter 5.

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

- 5.4.6** (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.

- 5.4.7** (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:  
 $\text{ICX} \times \text{ICW} \times 8\%$ .

- (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 PIB 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 PIB 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 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 PSIAs 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 PIB 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**

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 PIB 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 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	Counterparty Risk weighting in accordance with PIB 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 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)	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 PIB App4

<b>1. Islamic Contract type</b>	<b>2. Underlying investment or asset</b>	<b>3. ICW</b>
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 A4.5.4
	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 PIB 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 PIB App4
	Total amount receivable from the counterparty, pursuant to contract billings	Counterparty Risk weighting of Istisna'a buyer, in accordance with PIB App4
Salam and parallel Salam	Value of the underlying asset receivable for the Salam contract	Counterparty Risk weighting in accordance with PIB chapter 4
	Assets acquired	100%
	Balance in relevant accounts receivable	Counterparty Risk weighting in accordance with PIB chapter 4
Kefala	The amount of the guarantee	Counterparty Risk weighting in accordance with PIB 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:	ICW applicable to underlying Ijarah, Salam or Murabaha contracts, in accordance with PIB App4
	Salam Istisna'a Ijarah Murabaha Mudaraba Musharaka	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 PIB App4, whichever is higher
	Usufructs/services	ICW applicable to underlying service provider or usufruct owner, in accordance with PIB 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 PIB App4, whichever is higher
	Leased assets	The higher ICW of the underlying leased assets and that of the issuer
	Investment agency	The higher ICW of the underlying assets and that of the issuer

1. Islamic Contract type	2. Underlying investment or asset	3. ICW
	Muzara'a (share of produce of the land) Musqa (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 PIB chapter 5
Bai' Bithaman Ajil	Residential and commercial properties Plant and equipment Motor vehicles Shares Land	Counterparty Risk weighting in accordance with PIB chapter 4
Arboun	Where an Authorised Firm has made the purchase deposit	Counterparty Risk weighting in accordance with PIB 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 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 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 PIB 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 PIB Rule A4.5.4 and in accordance with PIB chapter 5.
7. In determining the ICX of a Binding Murabaha for the Purchase Orderer (MPO), as per PIB 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 PIB 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 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 Jiddiyah (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.

### **Market risk**

- 5.4.8** An Authorised Firm Managing a PSIA must calculate its PSIA COM market 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. 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 Firm may take advantage of the exemptions and partial exemptions set out in PIB 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 PIB section 4.5.

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**Exposure limits**

**5.4.15** 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 PSIA's;
- (b) 30% if financed by Restricted PSIA's; or
- (c) 40% if financed by the total of its own Capital Resources, Unrestricted PSIA's and Restricted PSIA's.

**Guidance**

1. In respect of its PSIA's, an Authorised Firm may apply to the DFSA for a modification of the limits set out in (b) and (c). 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 PIB 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.

**5.4.16** 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 PSIA's; or
- (b) 1200% for Exposures funded by Restricted PSIA's.

**5.4.17** An Authorised Firm must:

- (a) monitor and control its Exposures arising from PSIA's on a daily basis to ensure they remain within the risk concentration limits specified in Rules 5.4.8 to 5.4.14 in respect of Market Risk; 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; or
  - (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.
- (2) The requirements that apply to a conventional Fund apply equally to an Islamic Fund, except as otherwise provided in this chapter.
- (3) In this chapter, except where otherwise provided, any reference to a Fund is to an Islamic Fund or to an Islamic Sub-Fund of an Umbrella Fund 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.

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**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 other than an Exempt Fund must, subject to (2), ensure that its Fund's Constitution and Prospectus are, and remain, approved by the Fund's Shari'a Supervisory Board.
  - (2) In the case of an Exempt Fund, the Fund Manager 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 other than an Exempt 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 are not subject to the requirement for the appointment of a Shari'a Supervisory Board for an Exempt Fund, they would need to ensure that the Exempt 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 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, other than an Exempt Fund or 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 other than an Exempt Fund or 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 are not subject to the Shari'a review process required under section 6.3, they would need to ensure that the Exempt Fund continues to meet the applicable 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 other than an Exempt 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 are not subject to the specific internal Shari'a requirements under section 6.4, they would need to ensure that the Exempt 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.

- 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) the disclosures required by AAOIFI FAS 14; and
- (f) the additional disclosure, if applicable, prescribed under section A1.1 of App 1.

#### **Guidance**

1. A Fund Manager should consider providing additional information to support the statement under Rule 6.5.1(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 ijthad, 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 Additional disclosure in a Prospectus of an Islamic Fund which is a Private Fund**

#### **Guidance**

Chapter 14 and in particular Rules 14.3.2, 14.3.4 and 14.3.5 of the CIR module set out the Private Fund Prospectus requirements and, the disclosures set out in this section are additional requirements.

### **6.6.1 A Fund Manager of an Islamic Fund which is a Private 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) the disclosures required by AAOIFI FAS 14; and
- (f) the additional disclosure, if applicable, prescribed under section A1.1 of App 1.

## **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 US GAAP or AAOIFI 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 Accounting standards for Islamic Funds**

- 6.8.1** (1) The Fund Manager must in respect of an Islamic Fund prepare and maintain all financial accounts and statements in accordance with the accounting standards of the AAOIFI FAS 14.
- (2) If the Fund Manager of an Umbrella Fund operates one or more Islamic Sub-Funds, it must prepare and maintain all financial accounts and statements in accordance with the IFRS, as supplemented by AAOIFI FAS14.

### **Guidance**

AAOIFI FAS 14 sets out the accounting rules for recognising, measuring and presenting the assets managed and funds mobilised on the basis of Islamic Shari'a rules and principles in the financial accounts and statements of conventional financial institutions that offer Islamic financial services, as well as the income generated from these services. The standard also determines the necessary disclosures related to these services.

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## **6.9 Function of the Auditor of an Islamic Fund**

**6.9.1** A Fund Manager of an Islamic Fund must in writing require the Fund's Auditor to:

- (a) conduct an audit of the Fund's accounts in accordance with the requirements of the relevant standards published by the International Auditing and Assurance Standards Board (IAASB) in respect of conventional financial business and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in respect of any Islamic Funds; and
- (b) produce a report on the audited accounts which states:
  - (i) whether, in the Auditor's opinion, the accounts have been properly prepared in accordance with the requirements imposed by this chapter;
  - (ii) in particular, whether the accounts give a true and fair view of the financial position of the Fund at the end of the annual accounting period; and
  - (iii) any other matter or opinion relating to the requirements of this chapter.

### **Guidance**

The obligations under this Rule relate to an Islamic Fund. In addition to these obligations, a Fund Manager must comply with the obligations set out in chapter 4 as a firm carrying on Islamic Financial Business.

## **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 70% of the total net asset value of the Fund and such borrowings are Shari'a compliant.

**Guidance**

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.

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## **7. CONDUCT RULES FOR 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** Subject to Rule 7.2.2, Financial Accounts included in a Prospectus relating to the Offer of Islamic Securities must:
- (a) be audited by an independent, competent and qualified auditor in accordance with the standards of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) or other standards acceptable to the DFSA; and
  - (b) include audited financial accounts of the Issuer of the Securities for three completed financial years prior to the date of the Prospectus prepared in accordance with the AAOIFI standards.

- 7.2.2**
- (1) For the purposes of the requirements in Rule 7.2.1, where the Issuer is a member of a Group which prepares consolidated accounts, the requirement to present individual accounts may be dispensed with, provided that the consolidated accounts for the Group are published.
  - (2) Where the Issuer has been created for a special purpose and does not fulfil the relevant accounting pre-requisites under Rule 7.1.1, the DFSA may dispense with the requirements in Rule 7.1.1.

**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; and
- (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) a statement in bold, on the front page of the Prospectus as follows:

**"A copy of this Prospectus has been filed and registered with the Dubai Financial Services Authority (DFSA) in accordance with the Markets Law 2012 and the Markets Rules. In accordance with the Rules, the DFSA has no responsibility for the contents of the Prospectus and has not approved this Prospectus nor has it reviewed or verified the information in it, nor has it determined whether it is Shari'a compliant. If you do not understand the contents of this document you should consult an authorised financial adviser".**

## **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.

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## **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.



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**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.”