

FINANCIAL SERVICES REGULATORY AUTHORITY
سلطة تنظيم الخدمات المالية

Islamic Finance Rules (IFR)

*In this attachment underlining indicates new text and striking through indicates deleted text.

1. INTRODUCTION

1.1 Application

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Guidance

Certain of the requirements that apply to Authorised Persons Conducting Islamic Financial Business or distributing Shari'a-compliant Securities are included in these Islamic Finance Rules. An Authorised Person that has a Financial Services Permission to operate as an Islamic Financial Institution or that has a Financial Services Permission to operate an Islamic Window will also be subject to the requirements relating to such Regulated Activity or specified category of Regulated Activity that are included in other ~~module~~ Rulebooks of the ADGM Rulebook as required by the terms of that Authorised Person's Financial Services Permission.

1.2 Overview of the IFR ~~module~~ Rulebook

References in these Islamic Finance Rules to numbered IFRs are references to specific numbered chapters of these Islamic Finance Rules.

Guidance

- (i) The rules in these Islamic Finance Rules are made under, or for the purposes of, the Financial Services and Markets Regulations 2015. Guidance may indicate any additional rulebook ~~module~~ to which these Islamic Finance Rules relate.

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- (v) IFR 7 contains specific requirements that apply to Reporting Entities that Offer Securities that are expressed to be Shari'a-compliant. Reporting Entities that Offer Securities that are expressed to be Shari'a-compliant will also be subject to the general requirements that apply to Offers of Securities and reporting entities must comply with such requirements as set out in the Markets Rules (MKT Rulebook ~~module~~).

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2. ISLAMIC FINANCE

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2.4.1 Unless otherwise stated in these Islamic Finance Rules, an Authorised Person (whether acting as an Islamic Financial Institution or through an Islamic Window) will be entitled to carry on any Regulated Activity or specified category of Regulated Activity as Islamic Financial Business provided that:

- (a) it has complied with all other applicable provisions of the ADGM Rulebook in relation to the Regulated Activity or specified category of Regulated Activity to be carried on as Islamic Financial Business; and

- (b) the carrying on of such Regulated Activity or specified category of Regulated Activity as an Islamic Financial Business has been approved by its Shari'a Supervisory Board.

Guidance

- (i) ...
- (vii) The issue of financial products which are securities such as shares, bonds (falling under paragraphs 88 or 90 of Schedule 1 to the Financial Services and Markets Regulations 2015), Sukuk or units in a Collective Investment Fund (in each case as defined in the Financial Services and Markets Regulations 2015) attracts product-specific disclosure requirements such as the publication of a Prospectus or an Exempt Disclosure Statement. Where such securities are included on an Official List of securities or made available to the public in the ADGM, there are initial and ongoing disclosure and other obligations that apply to the Reporting Entity (generally the issuer) under the MKT ~~module~~ Rulebook. These MKT obligations are distinct from the obligations that apply to Persons carrying on Regulated Activities in respect of such Securities.

Profit Sharing Investment Accounts (PSIAs)

- (viii) PSIAs do not fall within the definitions of Dealing in Investments, Arranging Deals in Investments or Advising on Investments or Credit in Schedule 1 to the Financial Services and Markets Regulations 2015 or the definition of Investments in the Glossary ("GLO") ~~module~~. 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 the Shari'a principle of Mudaraba, the guiding principle of which is that the investor bears the full investment risk. Although PSIAs have the characteristics of a Collective Investment Fund, under an express exclusion provided under paragraph 63 of Schedule 1 to the Financial Services and Markets Regulations 2015, they are not treated as such. Instead, Managing a PSIA is a distinct Regulated Activity as defined in paragraph 64 of Schedule 1 to the Financial Services and Markets Regulations 2015.
- (ix) Because Managing a PSIA is a Regulated Activity, the ADGM regulatory regime that applies to Authorised Persons carrying on Regulated Activities in the ADGM applies to Islamic Financial Institutions and Islamic Windows 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 COBS requirements (such as a suitability assessment). Instead, they attract a tailored regulatory regime under these Islamic Finance Rules that applies to the Authorised Person that Manages the PSIA (see IFR 5).

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Takaful

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- (xiv) Any Authorised Persons conducting Takaful activities shall, for the purposes of the ADGM Rulebook, be deemed to be conducting insurance business. There are two types of Regulated Activities that comprise insurance business: Effecting Contracts of Insurance as principal or Carrying Out Contracts of Insurance as Principal. Accordingly, any Authorised Person carrying on these Regulated Activities is subject to the ADGM regime for regulating Regulated Activities. Where an Authorised Person carries out the activities described under Effecting Contracts of Insurance or Carrying Out Contracts of Insurance as Principal in connection with Takaful such Authorised Person will be subject to the ADGM regime for regulating Regulated Activities and, in addition, will be subject to the Takaful-specific requirements set out in this ~~module~~ Rulebook (see IFR 8). In addition, there are certain activities relating to insurance, such as advising and arranging, which are regulated as Insurance Intermediation as defined in Chapter 4 of Schedule 1 to the Financial Services and Markets Regulations 2015. Authorised Persons conducting those activities in relation to Takaful are regulated in the same way as Authorised Persons conducting such activities in relation to conventional insurance.

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3.8 Additional conduct requirements**Guidance**

COBS contains conduct of business requirements that apply to Authorised Persons conducting Regulated Activities. Set out below are additional conduct requirements that apply to an Authorised Person carrying out any Regulated Activity in accordance with Shari'a.

Disclosure relating to Shari'a Supervisory Board

- 3.8.1 (a) An Authorised Person, must, subject to IFR 3.8.1(b) below, disclose to each client:

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Guidance

- (i) An Authorised Person may make the initial disclosures required under IFR 3.8.1(a) by including such information in the Client Agreement provided under COBS 3.
- (ii) An Authorised Person Managing a PSIA may make additional disclosure required to be made relating to that PSIA by including such information in the Client Agreement. See IFR 5 for additional disclosure for PSIA's.
- (iii) A Fund Manager making an Offer of a Unit of an Islamic Fund it manages is required to include information specified in IFR 3.8.1(a) in the Prospectus

which it must prepare and make available to clients, hence the exemption in IFR 3.8.1. A similar exemption is available to Fund Managers with regard to key information that must be provided to a client under COBS 3.3.1(e).

Marketing material

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

Guidance

COBS 3.2.4 sets out the meaning of "marketing material".

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Client Agreement

- 5.2.2 In addition to matters referred to in COBS 3.3, an Authorised Person must ensure that the following information is included in the Client Agreement relating to a PSIA:

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Periodic Statements

- 5.2.3 (a) COBS 5.11 applies to an Authorised Person as if the Authorised Person is an Investment Manager in respect of those clients who are PSIA holders.
- (b) In addition to the requirements of COBS 5.11, an Authorised Person must ensure that a periodic statement provided to a client contains the following information:

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5.4 Prudential requirements

Application and Interpretation

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Initial and ongoing capital requirements

Guidance

- (i) An Authorised Person undertaking Islamic Financial Business is required to meet initial and ongoing Capital Requirements in accordance with the Rules in Part 3~~part 2~~ of Chapter 3 of PRU.
- (ii) In accordance with the Rules in Part 4~~part 3~~ of chapter 3 of PRU, an Authorised Person undertaking Islamic Financial Business is required to ensure that only the eligible components of capital are included in the calculation of capital.
- (iii) In accordance with PRU Rule 3.12~~5.9~~, an Authorised Person undertaking Islamic Financial Business is required to exclude from T2 Capital any amount

by which the total of the Profit Equalisation Reserve and the Investment Risk Reserve exceeds the Displaced Commercial Risk Capital Requirement.

- (iv) For the purpose of calculating Capital Requirements, an Authorised Person undertaking Islamic Financial Business or otherwise investing in or holding Islamic Contracts should give due importance to the economic substance of the transaction contemplated by an Islamic Contract, in addition to the legal and Shari'a form of the Islamic Contract.

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

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

- (b) PSIACOM is the Displaced Commercial Risk Capital Requirement;
- (c) PSIACOM_{credit} is the Credit Risk capital requirement for assets funded by Unrestricted PSIA holders and is calculated in accordance with PRU ~~Rule~~ Section 4.8; and
- (d) PSIACOM_{market} is the Market Risk capital requirement for assets funded by Unrestricted PSIA holders and is calculated in accordance with PRU ~~Rule~~ Chapter 5.

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- 5.4.7 (a) In this IFR 5:

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Table 2

1. Islamic Contract type	2. Underlying investment or asset	3. CRW
Binding Murabaha for the Purchase Orderer (MPO)	Asset with an Authorised Person before purchase by the Counterparty	Apply the appropriate percentage from the second column in the table in PRU Rule A4.6.5
	Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts	CRW in accordance with PRU Chapter 4

1. Islamic Contract type	2. Underlying investment or asset	3. CRW
Murabaha and Non-binding Murabaha for the Purchase Orderer (MPO)	Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts	CRW in accordance with PRU Chapter 4
Mudaraba and Musharaka	Where the underlying investment meets the requirements for inclusion in the Trading Book	Market Risk Capital Requirement for the exposure associated with the underlying investment determined in accordance with PRU Chapter 5
	Investment in commercial enterprise to undertake business ventures other than trading activities (or other than those which meet the requirements for inclusion in the Trading Book)	CRW of 400% on the exposure
	Investment in real estate assets and other movable assets, using underlying Ijarah and Murabaha contracts	CRW of the lessee for the underlying Ijarah contracts or the CRW of the counterparty of the underlying Murabaha contract, in accordance with PRU App4
Ijarah/Ijarah Muntahia Bittamleek	Asset with an Authorised Person 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 PRU Rule A4.6.5
	Residential real estate where the lessee has the right to purchase property at the end of the lease and the lessor has a legally enforceable first charge over the property	Apply the appropriate percentage in accordance with PRU Rule 4.12.17

1. Islamic Contract type	2. Underlying investment or asset	3. CRW
	Total estimated value of lease receivables for the whole duration of the Ijarah, less any recovery value of the leased asset	CRW of Ijarah lessee, in accordance with PRU Rule 4.12
Full recourse Istisna'a – with or without parallel Istisna'a and limited / non-recourse Istisna'a with/without parallel Istisna'a	Net balance of the work-in-progress	CRW of the Istisna'a buyer, in accordance with PRU Rule 4.12
	Total amount receivable from the counterparty, pursuant to contract billings	CRW of Istisna'a buyer, in accordance with PRU Rule 4.12
Salam and parallel Salam	Value of the underlying asset receivable for the Salam contract	CRW in accordance with PRU Rule 4.12
	Assets acquired	100%
	Balance in relevant accounts receivable	CRW in accordance with PRU Rule 4.12
Kefala	The amount of the guarantee	CRW in accordance with PRU Rule 4.12
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: <ul style="list-style-type: none"> ● Salam ● Istisna'a ● Ijarah ● Murabaha ● Mudaraba ● Musharaka 	CRW applicable to underlying Ijarah, Salam or Murabaha contracts, in accordance with PRU Rule 4.12 If the Sukuk provides recourse to the issuer, CRW applicable to the issuer or CRW applicable to underlying contracts of the Sukuk is in accordance with PRU Rule 4.12 whichever is higher
	Usufructs/services	CRW applicable to underlying service provider or usufruct

1. Islamic Contract type	2. Underlying investment or asset	3. CRW
		owner, in accordance with PRU Rule 4.12. If the Sukuk provides recourse to the issuer, CRW applicable to the issuer or CRW applicable to underlying service provider or usufruct owner in accordance with PRU App4, whichever is higher
	Leased assets	The higher of CRW of the underlying leased assets and that of the issuer
	Investment agency (Wakala)	The higher of CRW of the underlying assets and that of the issuer
	Muzara'a (share of produce of the land) Musaqā (share of produce of the trees) Mugarasa (share in the land and the trees)	100%
	Mixture of tangible and intangible assets	The higher of CRW of the underlying assets and that of the issuer
	Where the underlying investment meets the requirements for inclusion in the Trading Book	Market Risk Capital Requirement for the exposure associated with the underlying investment determined in accordance with Chapter 5 of PRU
Bai' Bithaman Ajil	Residential and commercial properties Plant and equipment Motor vehicles Shares Land	CRW in accordance with PRU Chapter 4
Arboun	Where an Authorised Person has made the purchase deposit	CRW in accordance with PRU Chapter 4

1. Islamic Contract type	2. Underlying investment or asset	3. CRW
	Where an Authorised Person has received the purchase deposit	No CRW is applicable
	Where the contract would meet the requirements for inclusion in the Trading Book	Market Risk Capital Requirement for the exposure associated with the underlying investment determined in accordance with PRU Chapter 5

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Exposure limits

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

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

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6.1 Application

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Guidance

- (i) The Fund Rules ~~module~~ contains the key requirements relating to the management and operation of conventional Collective Investment Funds. These Islamic Finance Rules set 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 Authorised Persons managing Islamic Funds which are found in other modules of the ADGM Rulebook, such as the GEN ~~module~~ Rulebook, COBS ~~module~~ Rulebook and PRU ~~module~~ Rulebook.

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6.8.5 (a) A Fund Manager of an Islamic REIT may obtain financing either directly or through its Special Purpose Vehicle up to 65% of the total gross asset value of the Fund provided that such financing is provided in a Shari'a-compliant manner.

(b)

Guidance

1. Remedial action may not require the disposal of Fund assets to pay off part of the borrowings where such disposal would be prejudicial to the interest of Unitholders.
2. As there are no specific risks that arise by virtue of a Fund being an Islamic Fund, the prudential requirements that apply to a Category 3 firm as set out in the PRU ~~module~~ Rulebook 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 Regulator would provide any additional clarifications regarding such matters upon request.

7. OFFERS OF ISLAMIC SECURITIES

7.1 Application

- 7.1.1 (a) Subject to IFR 7.1.1(b) below, this IFR 7 applies to any Authorised Person who Offers Islamic Securities in the ADGM.
- (b) A Person making Offers of Islamic Securities in the ADGM must comply with the requirements in the Financial Services and Markets Regulations 2015 and the MKT ~~module~~ Rulebook except to the extent otherwise provided in this IFR 7.
- (c) Islamic Securities, for the purposes of this IFR 7, do not include Units of an Islamic Fund.

Guidance

- (i) IFR 7 applies to any Authorised Person that Offers Islamic Securities irrespective of whether such Authorised Person is an Islamic Financial Institution, acts through an Islamic Window or is a conventional institution. A conventional institution may be held to offer Islamic Securities where it acts as the underwriter of an issuance of Sukuk or where it elects to act as the obligor under a Sukuk issuance.
- (ii) The issue of Securities is not an activity that constitutes a Regulated Activity. Therefore, the activities such as the issue of Shares, Debentures (Sukuk) or Warrants do not attract the Regulated Activity prohibitions in the Financial Services and Markets Regulations 2015. However, the Offer of Securities is an activity to which the Financial Services and Markets Regulations 2015 and the MKT ~~module~~ Rulebook apply. Under the Financial Services and Markets Regulations 2015, a Person making an Offer of Securities in the ADGM is subject to numerous disclosure requirements, unless exempt.
- (iii) Offers of Islamic Securities which are Units of a Fund are not subject to the requirements in this IFR 7 because the Financial Services and Markets Regulations 2015 and Fund Rules provide for such activities to be regulated. IFR 6 sets out additional requirements that apply to the Fund Manager when Offering Units of an Islamic Fund.
- (iv) The definition of the term Islamic Securities is in ~~the GLO module~~.

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7.2 Contents of a Prospectus for Islamic Securities

7.2.1 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;

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- (e) instead of the statement required under MKT Rule ~~24~~.5.1(3)(d), a prominent disclaimer in bold, on the front page of this Prospectus as follows:

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8.2 Specific disclosure for Takaful

8.2.1 Where an insurer or an insurance intermediary conducts Takaful with a retail client, the disclosure for the purposes of COBS 6.7 must include:

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