Islamic Banking Business Prudential Rules 2015 (IBANK)

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and

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(QFCRA Rules 2019-7)
Islamic Banking Business Prudential Rules 2015

made under the

Financial Services Regulations

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Part 1.1  Preliminary

Division 1.1.A  Basic concepts and declaration of regulated activities

1.1.1  Introduction

(1) These rules are the Islamic Banking Business Prudential Rules 2015 (IBANK).

(2) These rules establish the prudential framework for Islamic banking business firms. They are based on:

(a) the standards and guidelines issued by the IFSB on capital adequacy;

(b) the Basel Accords; and

(c) the Basel Core Principles for Effective Banking Supervision, issued by the Basel Committee on Banking Supervision.

Note 1 The Islamic Financial Services Board (or IFSB) is an international standard-setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry (composed of the banking, capital markets and insurance sectors) by issuing global prudential standards and guiding principles.

Note 2 The Basel Committee is the primary global standard-setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters. Its mandate is to strengthen the regulation, supervision and practices of banks and regulators worldwide and thereby enhance financial stability.

1.1.2  Commencement

These rules commence on 1 January 2016.
1.1.3 Effect of definitions, notes, examples and references

(1) A definition in Part 2 of the glossary at the back of these rules also applies to any instructions or document made under these rules. In Part 1 of that glossary, there is a list of the acronyms and abbreviations used in these rules.

(2) A note in or to these rules is explanatory and is not part of these rules. However, examples and guidance are part of these rules.

(3) An example is not exhaustive, and may extend, but does not limit, the meaning of these rules or the particular provision of these rules to which it relates.

Note Under FSR, article 17 (4), guidance is indicative of the view of the Regulatory Authority at the time and in the circumstances in which it was given.

(4) Unless the contrary intention appears, a reference in these rules to an accord, principle, standard or other similar instrument is a reference to that instrument as amended from time to time.

1.1.3A References to particular currencies

In these rules, the specification of an amount of money in a particular currency is also taken to specify the equivalent sum in any other currency at the relevant time.

1.1.4 Declaration of activities as regulated activities

For FSR, article 23 (2), each of the following activities is a regulated activity:

(a) Islamic banking business;

(b) Islamic investment business.

1.1.5 Islamic banking business

Islamic banking business includes the following activities:

(a) raising, accepting and managing deposits and other sources of funding (other than restricted PSIAs);

Note Managing restricted PSIAs is covered by INMA.
(b) entering as principal or agent into any of the following Islamic financial contracts for the purpose of providing financing facilities:

- (i) murabahah and its variations;
- (ii) salam and its variations;
- (iii) tawarruq and its variations;
- (iv) istisna and its variations;
- (v) ijarah and its variations;
- (vi) musharakah and its variations;
- (vii) mudarabah and its variations;
- (viii) qard;
- (ix) rahn;
- (x) sarf;
- (xi) any other Islamic financial contract that is recognised by the firm’s Shari’a supervisory board.

1.1.6 Islamic investment business

(1) Islamic investment business includes the following activities:

(a) buying, selling, subscribing for or underwriting any Islamic investment as principal;

Note The buying, selling etc of any Islamic investment as agent is covered by INMA, and is collectively referred to in those rules as ‘dealing in investments as agent’.

(b) entering as principal or agent into any of the following Islamic financial contracts for the purposes of buying, selling, subscribing for or underwriting any Islamic investment:

- (i) musharakah and its variations;
- (ii) mudarabah and its variations;
- (iii) any other Islamic financial contract that is recognised by the firm’s Shari’a supervisory board.
(2) **Islamic investments** means investments through any 1 or more of the kinds of Islamic financial contracts mentioned in subrule (1) (b).

1.1.7 **Islamic bank**

(1) An authorised firm is an Islamic bank if it is an Islamic financial institution that is authorised to conduct the regulated activity of Islamic banking business. No other firm may conduct Islamic banking business.

(2) A firm is an Islamic bank even if it is also authorised to conduct any other activity that is not Islamic banking business. An authorised firm does not cease to be an Islamic bank only because it conducts other activities (such as Islamic investment business and associated business) included in its authorisation, provided the firm conducts them in accordance with Shari’a.

1.1.8 **Islamic investment dealer**

(1) An authorised firm is an Islamic investment dealer if it is an Islamic financial institution:

(a) that is authorised to conduct the regulated activity of Islamic investment business; but

(b) is not an Islamic bank.

(2) A firm is an Islamic investment dealer even if it is also authorised to conduct any other activity that is not Islamic investment business. An authorised firm does not cease to be an Islamic investment dealer only because it conducts other activities in its authorisation, provided the firm conducts them in accordance with Shari’a.

1.1.9 **Islamic banking business firm**

In these rules, Islamic banking business firm means an Islamic bank or Islamic investment dealer.

**Guidance**

An Islamic banking business firm will need to consider the extent to which its business model is subject to the prudential requirements set out in these rules. These rules are designed to address the different risks that could arise from the broad range...
1.1.10 **Legal form that Islamic banking business firms must take**

(1) An Islamic bank must be:
   - (a) a limited liability company incorporated under the *Companies Regulations 2005*; or
   - (b) a branch that is registered with the QFC Companies Registration Office and that complies with subrule (3).

(2) An Islamic investment dealer must be:
   - (a) a limited liability company incorporated under the *Companies Regulations 2005*;
   - (b) a limited liability partnership incorporated under the *Limited Liability Partnerships Regulations 2005*; or
   - (c) a branch that is registered with the QFC Companies Registration Office and that complies with subrule (3).

(3) For a branch to be an Islamic banking business firm, the legal person of which it is a branch must itself conduct the whole of its business in accordance with Shari’a. Islamic banking business and Islamic investment business must not be conducted by means of an Islamic window.

*Note* If an authorised firm conducts a part (but not the whole) of its business in accordance with Shari’a, the part so conducted is an Islamic window.

(4) The Regulatory Authority will not grant an authorisation to conduct Islamic banking business or Islamic investment business unless:
   - (a) the applicant states in its application for the authorisation that it proposes to conduct its business in accordance with Shari’a; and
   - (b) the applicant’s constitutional documents require it to conduct its business in accordance with Shari’a.

(5) If the Regulatory Authority grants an authorisation to conduct Islamic banking business or Islamic investment business, the authority must...
impose on the authorisation a condition that the business must be conducted in accordance with Shari’a.

1.1.11 Application of these rules—general

Except as stated otherwise, these rules apply to an entity that has, or is applying for, an authorisation to conduct Islamic banking business or Islamic investment business.

**Guidance**

1. Rules that are of general application also apply (for example, CIPR, Governance and Controlled Functions Rules 2012 and Anti-Money Laundering and Combating Terrorist Financing Rules 2010).

2. It is possible for a firm both to be authorised as an Islamic bank under these rules and to hold an authorisation under INMA. Both these rules and INMA would apply to such a firm to some degree. In relation to such a firm, however, the capital requirements in these rules apply. If that firm complies with the capital requirements in these rules, it is taken to comply with the minimum capital and liquid assets requirements in INMA—see INMA, rule 3.3.1(2).

1.1.12 Application of these rules—branches

(1) Chapter 3 (capital adequacy and capital requirements) does not apply to an Islamic banking business firm that is a branch insofar as that Chapter would require the branch to hold capital.

(2) However, the Regulatory Authority may require a branch to have capital resources or to comply with any other capital requirement if the authority considers it necessary or desirable to do so in the interest of effective supervision of the branch.

1.1.13 Requirement for policy also requires procedures and systems

In these rules, a requirement for an Islamic banking business firm to have a policy also requires the firm to have the procedures, systems, processes, controls and limits needed to give effect to the policy.
Division 1.1.B Responsibilities of the firm and its governing body and Shari’ा supervisory board

1.1.14 Responsibility for principles

(1) An Islamic banking business firm’s governing body is responsible for the firm’s compliance with the principles and requirements set out in these rules.

(2) The governing body must ensure that the firm’s senior management establishes and implements policies to give effect to these rules. The governing body must approve significant policies and any changes to them (other than formal changes) and must ensure that the policies are fully integrated with each other.

Note 1 The significant policies relate to the adequacy of capital and the management of risks, as set out in the following Chapters.

Note 2 For the requirements for an authorised firm’s general risk management strategy, see CTRL, rule 4.1.4.

(3) The governing body must review the firm’s significant policies from time to time, taking into account changed operating circumstances, activities and risks. The interval between reviews must be appropriate for the nature, scale and complexity of the firm’s business, but must not be longer than 12 months.

(4) The governing body must ensure that the policies are made known to, and understood by, all relevant staff.

1.1.15 Responsibility for compliance with Shari’ा

(1) An Islamic banking business firm’s Shari’ा supervisory board must ensure that the whole of the firm’s business is conducted in accordance with Shari’ा. In particular, the board:

(a) must establish, implement and supervise the firm’s Shari’ा governance and compliance;
(b) must review every service or product (and any related document) that is the subject of a financial communication before the firm issues the communication.

*Note* Financial communication is defined in the glossary.

(c) must ensure that the internal Shari’a reviews carried out under rule 12.1.12 to assess the firm’s compliance with Shari’a are in accordance with the AAOFI standards; and

*Note* An internal Shari’a review includes an examination of the policies, transactions and contracts of the Islamic banking business firm. Each review forms a basis for board’s report required by paragraph (d).

(d) every year, must prepare, and give to the firm’s governing body, a report indicating whether the firm complied with Shari’a throughout the financial year;

**Guidance**

1. If appropriate, there could be 2 reports produced by the Shari’a supervisory board: a general statement of compliance that should be included in the firm’s Annual Financial Report and a more detailed account of the compliance work undertaken that is addressed specifically to the Regulatory Authority.

2. The Shari’a supervisory board should give the report or reports to the governing body sufficiently in advance of the firm’s next Annual Financial Report to allow the governing body a reasonable opportunity to rectify any non-compliance, if possible, and to consider and use it in preparing the next report. For the firm’s obligation to give to the Regulatory Authority a copy of the Shari’a supervisory board’s compliance report or reports, see rule 12.1.13.

(2) The Shari’a supervisory board is responsible for expressing binding Shari’a opinion about the extent to which the firm’s operations, products, policies, accounting practices, transactions and contracts comply with Shari’a. The board must review any matter that is assigned to it by the firm’s governing body.

*Note* Any appointment, dismissal or other change of a member of the Shari’a supervisory board must be approved by the firm’s governing body (see rule 12.1.2(5)).
Note 2 Among the policies that the governing body must establish and implement under rule 12.1.8 are policies on:
(a) how the Shari’a supervisory board will oversee and advise the firm regarding the firm’s business; and
(b) how disputes and differences of opinion between the Shari’a supervisory board and the governing body in relation to Shari’a compliance will be addressed.

1.1.16 Evaluation of information given to firm
An Islamic banking business firm’s governing body must evaluate the suitability and effectiveness of the information and reports that it and the firm’s senior management receive under these rules. The test of suitability and effectiveness is whether the information and reports are suitable for effectively overseeing and implementing the principles and requirements set out in these rules.

1.1.17 Stress-testing
In carrying out stress-testing and developing its stress-testing scenarios, an Islamic banking business firm must consider the IFSB’s guiding principles on stress-testing for institutions offering Islamic financial services and the Basel Committee’s recommended standards for stress-testing.
Part 1.2 Principles relating to Islamic banking business and Islamic investment business

1.2.1 Principle 1—capital adequacy
An Islamic banking business firm must have capital, of adequate amount and appropriate quality, for the nature, scale and complexity of its business and for its risk profile.

1.2.2 Principle 2—credit risk and problem assets
(1) An Islamic banking business firm must have an adequate credit risk management policy that takes into account the firm’s risk tolerance, its risk profile and the market and macroeconomic conditions.
(2) The firm must have adequate policies for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.

1.2.3 Principle 3—transactions with related parties
An Islamic banking business firm must enter into transactions with related parties on an arm’s-length basis in order to avoid conflicts of interest.

1.2.4 Principle 4—concentration risk
An Islamic banking business firm must have adequate policies to identify, measure, evaluate, manage and control or mitigate concentrations of risk in a timely way.

1.2.5 Principle 5—market risk
An Islamic banking business firm must have an adequate market risk management policy that takes into account the firm’s risk tolerance, its risk profile, the market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. The firm must have
adequate policies to identify, measure, evaluate, manage and control or mitigate market risk in a timely way.

1.2.6 Principle 6—operational risk
An Islamic banking business firm must have an adequate operational risk management policy that takes into account the firm’s risk tolerance, its risk profile and the market and macroeconomic conditions. The firm must have adequate policies to identify, measure, evaluate, manage and control or mitigate operational risk in a timely way.

1.2.7 Principle 7—liquidity risk
An Islamic banking business firm must have prudent and appropriate quantitative and qualitative liquidity requirements. The firm must have policies that enable the firm to comply with those requirements and to manage liquidity risk prudently.

1.2.8 Principle 8—group risk
An Islamic banking business firm must effectively manage risks arising from its membership in a group.

1.2.9 Principle 9—equity participation risk
An Islamic banking business firm must have an adequate equity participation risk management policy that takes into account the firm’s risk tolerance and its risk profile. The firm must have adequate policies to identify, measure, evaluate, manage and control or mitigate equity participation risk in a timely way (including exit strategies for its investment activities).

1.2.10 Principle 10—rate of return risk
(1) An Islamic banking business firm must have an adequate management policy for rate of return risk in the banking book that takes into account the firm’s risk tolerance, its risk profile and the market and macroeconomic conditions. The firm must have policies to identify, measure, evaluate, manage and control or mitigate rate of
Chapter 1  General
Part 1.2   Principles relating to Islamic banking business and Islamic investment business

Rule 1.2.11

(2) An Islamic banking business firm must have sound investment policies that are aligned with the risk and return expectations of its investment account holders (or IAHs), taking into account the distinction between restricted and unrestricted IAHs. The firm must be transparent in smoothing any profit payouts.

1.2.11 Principle 12—Shari’a governance and compliance

An Islamic banking business firm must have a Shari’a governance policy that is adequate for the nature, scale and complexity of its business and for its risk profile, and to ensure that the firm complies with Shari’a.

Note: For the governing body’s responsibilities relating to:

- capital adequacy—see rule 3.1.3
- credit risk and problem assets—see rule 4.1.4
- transactions with related parties—see rule 4.8.4
- concentration risk—see rule 5.1.4
- market risk—see rule 6.1.2
- operational risk—see rule 7.1.5(1)
- Shari’a compliance—see rule 7.1.5(2)
- liquidity risk—see rule 8.1.8
- group risk—see rule 9.1.4
- PSIAs—see rule 11.1.4
- rate of return risk—see rule 11.2.3.
Part 1.3 Islamic financial contracts

Division 1.3.A General

1.3.1 Introduction
This Part describes how Shari’a-compliant Islamic financial contracts are classified. The contracts and descriptions in this Part are provided for the convenience of readers only and are not intended to be an exhaustive.

1.3.2 Classification of Islamic financial contracts
Islamic financial contracts can be classified into:
(a) sale-based contracts such as murabahah and its variations;
(b) lease-based contracts such as ijarah and its variations;
(c) equity-based contracts such as musharakah and mudarabah and their variations;
(d) loan-based contracts such as qard; and
(e) service-based contracts such as wakalah and wadi’ah.

Guidance
Innovation in Islamic banking products and financial instruments has resulted in the development of varied product structures that are given unique names. Such products are structured using a combination of Shari’a-compliant terms. For the purpose of computing a firm’s capital requirements, the treatment of such a product is to be based on the analysis of the product’s risk profile rather than its name, unless the Regulatory Authority directs otherwise. For products and instruments structured using a combination of Islamic financial contracts, see rule 4.5.2 and rule 6.7.2.

Division 1.3.B Sale-based contracts

1.3.3 Murabahah and bai bithaman ajil
(1) A murabahah contract is an agreement between an Islamic banking business firm and an obligor under which the firm sells to the obligor, at an agreed fixed price, an asset owned and possessed by the firm. The price is based on the asset’s acquisition cost (purchase price and
other direct costs) to the firm and a profit margin agreed between the
firm and the obligor.

(2) The contract includes the terms for the obligor to pay the price to
the firm after taking delivery of the asset.

(3) A bai bithaman ajil contract has similar characteristics to, and
similar financing effect as, a murabahah contract. A bai bithaman ajil
involves the selling, on a deferred payment basis, of an asset owned
and received by the firm.

1.3.4 Murabahah for purchase orderer

A murabahah for purchase orderer (or MPO) contract is an
agreement between an Islamic banking business firm and an obligor
under which the firm sells to the obligor, at an agreed price, a
specified kind of asset to be acquired and received (physically or
constructively) by the firm before selling it to the obligor. The
agreement to purchase must be binding.

1.3.5 Difference between murabahah and MPO

(1) The difference between a murabahah contract and an MPO contract
is that under a murabahah contract, the firm sells an asset that it
already owns.

(2) In an MPO contract, the firm acquires and receives an asset expecting
that the obligor will purchase it. The contract will, therefore, include
terms for the obligor to pay the price to the firm after taking delivery
of the asset.

1.3.6 Tawarruq and commodity murabahah transactions

(1) Tawarruq is a commodity-based reverse murabahah that involves
3 independent sales contracts and 3 independent parties. It is
frequently used to raise funds or to provide financing in a Shari’a-
compliant manner, without involving interest (riba).

(2) The kind of tawarruq often used by Islamic banking business firms
for funding or financing is called commodity murabahah transaction
(or CMT).
(3) As a source of funding for an Islamic banking business firm, a CMT involves a customer first buying and receiving (physically or constructively) a commodity and selling it to the firm on a deferred payment basis at an agreed fixed price (with a profit margin) and then the firm itself on-selling the commodity on the spot market to an independent buyer.

(4) A firm may grant CMT-based financing in the form of commodity murabahah for liquid funds or commodity murabahah financing.

1.3.7 Commodity murabahah for liquid funds
In a commodity murabahah for liquid funds (or CMLF), an Islamic banking business firm uses CMT for interbank operations for managing short-term liquidity surplus (that is, selling and buying Shari’a-compliant commodities through murabahah transactions for the firm to invest its surplus liquid funds on a short-term basis with other market participants). CMLF is also used where the counterparty is the central bank or monetary authority acting as a Shari’a-compliant lender of last resort or offering a standing facility for effective liquidity management.

Note CMLF is commonly called ‘placement’ in conventional banking. This short-term use of a CMT for interbank transactions must be distinguished from its longer-term use for profit-seeking by raising funds (see rule 1.3.6(3)) and providing financing (see rule 1.3.8).

1.3.8 Commodity murabahah financing
In a commodity murabahah financing (or CMF), an Islamic banking business firm provides financing (through a longer-term murabahah) for a customer to buy a commodity that the customer immediately resells on the spot market.

1.3.9 Musawamah
A musawamah is a contract of sale under which an Islamic banking business firm sells to a customer a specified kind of asset for a price negotiated between the firm and the customer, without any reference to the price paid or cost incurred by the firm for the asset.
Chapter 1
General
Part 1.3
Islamic financial contracts

Rule 1.3.10

1.3.10 Salam

(1) A salam without parallel salam contract is an agreement under which an Islamic banking business firm purchases from an obligor, at a predetermined price, a specified commodity not currently available to the obligor that is to be delivered on a specified future date in a specified quantity and quality. The firm as the purchaser of the commodity pays the purchase price in full at the time the salam contract becomes binding.

(2) A salam with parallel salam contract is a back-to-back contract to sell the commodity purchased under a salam contract to another counterparty. This arrangement enables the Islamic banking business firm to mitigate the risk of holding the commodity.

1.3.11 Istimna

(1) An istimna contract is an agreement to sell to, or buy from, an obligor an asset that has not yet been manufactured or constructed. The completed asset must be delivered according to the buyer’s specifications on a specified date and at an agreed price.

(2) As a seller, an Islamic banking business firm may:
   (a) manufacture or construct the asset on its own; or
   (b) enter into a parallel istimna contract to procure the asset from another party or engage another party (other than the obligor) to manufacture or construct it.

Division 1.3.C Lease-based contracts

1.3.12 Ijarah

(1) An ijarah contract is a lease under which an Islamic banking business firm (as lessor) grants to an obligor (as lessee) the right to use an asset for an agreed period and specified rental.

(2) The firm remains the owner of the asset during the lease period. As owner, the firm assumes all the liabilities and risks pertaining to the asset, including the obligation to restore any impairment and damage
from wear and tear, or from natural causes and not due to the lessee’s misconduct or negligence.

(3) The firm may acquire the asset to be leased based on the lessee’s specifications under the agreement to lease before entering into the *ijarah* contract. The agreement to lease must be binding.

(4) In an *operating ijarah*, the firm leases an asset to a customer for an agreed period against specified instalments of rental. The price risk attached to the residual value of the leased asset at the end of the contract remains with the firm, so that the operating *ijarah* is considered an investment for the purpose of calculating capital adequacy.

1.3.13 *Ijarah muntahia bittamleek*

An *ijarah muntahia bittamleek* (or *IMB*) contract is a lease agreement similar to an *ijarah* contract. However, the lessee or lessor has the option to have ownership of the leased asset transferred by independent gift or sale at the end of the IMB contract.

1.3.14 *Al-ijarah thumma al-bai*

An *al-ijarah thumma al-bai* contract is a type of IMB contract that ends with the sale of the relevant asset to the lessee through an independent contract of sale entered into by the parties.

**Division 1.3.D  Equity-based contracts**

1.3.15 *Musharakah*

(1) A *musharakah* contract is an agreement between an Islamic banking business firm and an obligor to contribute agreed proportions of capital to an enterprise or to acquire an asset.

(2) Profits generated by the enterprise or asset are shared in accordance with the contract and losses are shared in proportion to the parties’ capital contributions. Therefore, a *musharakah* can be described as a profit-sharing and loss-sharing contract.
(3) Musharakah contracts can be classified as:
   (a) equity participation in an enterprise to undertake a business
       venture or finance a project; or
   (b) joint ownership in an asset or real estate.

1.3.16 Equity participation in commercial enterprise

   (1) An Islamic banking business firm may enter into a musharakah
       contract with an obligor to provide capital to participate in the equity
       ownership of an enterprise.

   (2) The contract may provide an exit mechanism that allows the firm and
       the obligor to divest themselves of their interest in the enterprise at
       the completion of the project or in specified circumstances. The firm
       must ensure that the contract clearly stipulates any exit mechanism.

   (3) A firm that enters into this category of musharakah contract is
       exposed to risks similar to those of an equity holder who must share
       in the losses as described in rule 1.3.15 (2).

   (4) As an equity holder, the firm would be the first loss-absorber and
       would have its rights and entitlements subordinated to the claims of
       creditors.

1.3.17 Contracts for joint ownership of asset or real estate

Musharakah contracts that are undertaken for the purpose of joint
ownership of an asset or real estate can be classified as:
   (a) musharakah contract with ijarah subcontract;
   (b) musharakah contract with murabahah subcontract; or
   (c) diminishing musharakah.
1.3.18 *Musharakah contract with ijarah subcontract*

Partners that jointly own an asset or real estate may lease it to a third party or to one of the partners under an *ijarah* contract and thus generate rental income for the partnership.

1.3.19 *Musharakah contract with murabahah subcontract*

As a joint owner of the underlying asset, an Islamic banking business firm is entitled to a share of the revenue generated from the sale of the asset under a *murabahah* contract.

1.3.20 **Diminishing musharakah**

(1) An Islamic banking business firm may enter into a diminishing *musharakah* contract with an obligor to provide finance based on the joint ownership of an asset, with the objective of transferring the ownership of the asset to the obligor.

(2) The contract allows the obligor to acquire the firm’s share of ownership in the asset or equity in the enterprise gradually over the life of the contract.

(3) As part of the mechanism for the obligor to acquire the firm’s share, the firm and the obligor may agree to lease the asset to the obligor. The rental payable can be structured to reflect the obligor’s progressive acquisition of the firm’s share, so that the obligor will eventually become full owner of the asset if the obligor continues to make the rental payments.

(4) A diminishing *musharakah* begins with the formation of a partnership, after which buying and selling of the other partner’s equity takes place at market value or the price agreed upon at the time of entering into the contract. The ‘buying and selling’ is independent of the partnership contract and must not be stipulated in the partnership contract, because the buying partner is only allowed to promise to buy.
1.3.21 Mudarabah

(1) A mudarabah contract is an agreement between an Islamic banking business firm and an obligor under which the firm contributes capital to an enterprise or business activity that is to be managed by the obligor as the entrepreneur (mudarib). The contract can be described as a partnership between work and capital, and the mudarib (who invests work but not capital) is exposed only to the loss of fruitless work.

(2) Profits are shared in accordance with the contract but losses (except losses due to negligence, misconduct, fraud or breach of contract by the mudarib) are borne solely by the firm. Therefore, a mudarabah can be described as a profit-sharing and loss-bearing contract.

Guidance

As the capital provider (rabb al-mal), the firm is at risk of losing its capital investment disbursed to the mudarib. Firms are encouraged to establish and adopt stringent criteria for negligence, misconduct, fraud and breach of contract. Losses due to negligence, misconduct, fraud or breach of contract by the mudarib are borne solely by the mudarib.

(3) Mudarabah transactions can be carried out:

(a) on a restricted basis, where the firm authorises the mudarib to make investments based on specified criteria or restrictions such as by type of instrument, sector or country exposure; or

(b) on an unrestricted basis, where the firm authorises the mudarib to exercise its discretion to invest funds and undertake business activities.

(4) Mudarabah contracts can be classified as:

(a) equity participation in an entity to undertake business ventures; or

(b) investment in project finance.

Note PSIAs are usually offered on the basis of mudarabah contracts, see rule 11.1.2.
1.3.22 **Equity participation in entity to undertake business ventures**

(1) A *mudarabah* contract for equity participation in an entity to undertake business ventures exposes the Islamic banking business firm concerned to risks similar to those of an equity holder who must solely bear the risk as described in rule 1.3.21 (2).

(2) As an equity holder, the firm would be the first loss-absorber and would have its rights and entitlements subordinated to the claims of creditors.

1.3.23 **Investment in project finance**

(1) A *mudarabah* contract for project finance provides finance to a construction project. An Islamic banking business firm, as an investor, provides funds to a construction company as *mudarib* that manages the project.

(2) The firm is entitled to share the profit of the project but must bear the full losses (if any) arising from the project.

1.3.24 **Equity participation risk**

(1) The risk of loss that arises from an Islamic banking business firm entering into *musharakah* and *mudarabah* contracts and their variations for the purpose of participating in a particular financing or business venture is *equity participation risk*.

(2) Equity participation risk, in turn, is a source of capital impairment or the loss of part or all of amount invested by the firm in a business venture or the ownership of an asset. In the case of *musharakah* and *mudarabah*, the firm could lose part or all of its capital as a result of:

(a) operating losses suffered by the enterprise; or

(b) a fall in the value of the enterprise’s assets.
Division 1.3.E  Loan-based contracts

1.3.25  **Qard**

*Qard* is a benevolent loan for a fixed period for which no interest or other direct or indirect return can be charged.

Division 1.3.F  Service-based and other contracts

1.3.26  **Wakalah**

(1) *Wakalah* is a contract of agency. A principal appoints someone else (the *wakeel* or agent) to carry out a task on the principal’s behalf, usually for a fee.

(2) Such a contract could be used in brokerage services, funds management and underwriting management in *takaful*. A principal can appoint an Islamic banking business firm as agent to conduct business on its behalf.

1.3.27  **Wadi’ah**

*Wadi’ah* are deposits held at an Islamic banking business firm for safekeeping. They are demand deposits guaranteed in capital value, but earn no return.

1.3.28  **Rahn**

(1) *Rahn* is a contract to pledge an asset as security against a debt.

(2) In a *rahn* contract, the creditor (*murtahin*) is entitled to keep custody of the asset. If the debtor defaults, the creditor may sell the asset and take payment of the debt from the proceeds of the sale.

1.3.29  **Sarf**

*Sarf* is a currency exchange contract whereby gold, silver or currency is sold in exchange for another currency. *Sarf* exists whether the currency or commodity exchanged is the same from both sides or is different (for example, whether riyals are exchanged for riyals or riyals are exchanged for dollars).
Chapter 2 Prudential reporting requirements

2.1.1 Introduction

(1) This Chapter sets out the prudential reporting requirements for an Islamic banking business firm.

(2) Prudential returns of an Islamic banking business firm must reflect the firm’s management accounts, financial statements and ancillary reports. A firm’s returns, accounts, statements and reports must all be prepared using the same standards and practices, and must be easily reconcilable with one another.

(3) A return is referred to as a solo return if it reflects 1 firm’s accounts, statements and reports.

(4) A consolidated return deals with the accounts, statements and reports of a firm consolidated with those of the other members of its financial group.

Note Financial group is defined in rule 9.1.2(2) and is used for consolidated reporting instead of ‘corporate group’.

2.1.2 Information about financial group

If directed by the Regulatory Authority, an Islamic banking business firm must give the authority the following information about its financial group:

(a) details about the entities in the group;

(b) the structure of the group;

(c) how the group is managed;

(d) any other information that the authority requires.

2.1.3 Financial group and risks

(1) If an Islamic banking business firm is part of a financial group, credit risk, market risk, operational risk, liquidity risk, equity participation
risk and ROR risk apply on a consolidated basis to the firm and the other members that make up the financial group.

(2) **Done on a consolidated basis** means done not just to include the financial activities or items of the firm but those of the other members of its financial group as well.

*Note* An Islamic banking business firm must have systems to enable it to calculate its financial group capital requirement and resources—see rule 9.1.3(3). The firm must ensure that its financial group capital resources exceed its financial group capital requirement—see rule 9.2.2.

### 2.1.4 Preparing returns

(1) An Islamic banking business firm must prepare the prudential returns that it is required to prepare by notice published by the Regulatory Authority on an approved website. Such a notice may also require Islamic banking business firms to give other information to the authority.

(2) The firm must give the return to the Regulatory Authority within the period stated in the notice.

(3) The Regulatory Authority may, by written notice:

   (a) require a firm to prepare additional prudential returns;
   (b) exempt a firm from a requirement to prepare annual, biannual, quarterly or monthly returns (or a particular return); or
   (c) extend the period within which to give a return.

(4) An exemption may be subject to 1 or more conditions. The firm must comply with any condition attached to an exemption.

(5) The firm must prepare and give prudential returns in accordance with the Regulatory Authority’s instructions. The instructions may require that the return be prepared or given through the authority’s electronic submission system.

(6) The instructions may be set out in these rules, in the return itself, in a separate document published by the authority on an approved website or by written notice. These instructions, wherever or however they
are given, are collectively referred to as *instructions for preparing returns*.

*Note* Instructions may be in the form of formulae or blank spaces that the firm must use or fill in and that automatically compute the amounts to be reported.

### 2.1.5 Giving information

1. The Regulatory Authority may, by written notice, require an Islamic banking business firm to give to the authority information additional to that required under these rules.

2. An Islamic banking business firm must give information to the Regulatory Authority in accordance with the authority’s instructions and within the period stated in the notice. The authority may extend the period within which to give the information.

3. The Regulatory Authority may exempt an Islamic banking business firm from giving information. The firm must comply with any condition attached to an exemption.

### 2.1.6 Accounts and statements to use international standards

1. An Islamic banking business firm must prepare and keep its financial accounts and statements in accordance with the accounting standards of AAOIFI or any other accounting standards approved in writing by the Regulatory Authority.

2. If the firm decides to prepare and keep its financial accounts and statements in accordance with a standard other than the one it has previously used, it must notify the authority in writing before beginning to do so.

### 2.1.7 Signing returns

1. A prudential return must be signed by 2 individuals.

2. If the individuals approved to exercise the finance function and the senior executive function for the firm are available, they must sign the return. If either or both of those individuals is or are unable to
sign, the return must be signed by 1 or 2 of the individuals approved to exercise the following functions:
(a) the risk management function;
(b) the compliance oversight function;
(c) the executive governance function.

Note The different functions mentioned are defined in the glossary as having the same meanings as in CTRL.

2.1.8 Firm to notify authority
(1) An Islamic banking business firm must notify the Regulatory Authority if it becomes aware, or has reasonable grounds to believe, that the firm has breached, or is about to breach, a prudential requirement.
(2) In particular, the firm must notify the authority as soon as practicable of:
(a) any breach (or foreseen breach) of its minimum capital requirement;
(b) any concern (including because of projected losses) it has about its capital adequacy;
(c) any indication of significant adverse change in the market pricing of, or trading in, the capital instruments of the firm or its financial group (including pressure on the firm to purchase its own equity or debt);
(d) any other significant adverse change in its capital; and
(e) any significant departure from its ICAAP.

Note For an Islamic banking business firm’s ICAAP, see rule 3.1.5.
(3) The firm must also notify the authority of any measures taken or planned to deal with any breach, prospective breach or concern.
Chapter 3  Capital adequacy

Part 3.1  General

3.1.1  Introduction

(1) This Chapter sets out capital adequacy requirements.

(2) An Islamic banking business firm’s total regulatory capital is the sum of its tier 1 capital and tier 2 capital. The categories and elements of regulatory capital, and the limits, restrictions and adjustments to which they are subject are set out in this Chapter.

(3) Capital supports the firm’s operation by providing a buffer to absorb losses from its activities and, in the event of problems, it enables the firm to continue to operate in a sound and viable manner while the problems are resolved. Capital management must be an integral part of the firm’s credit risk management process and must align the firm’s risk tolerance and risk profile with its capacity to absorb losses.

Note  For the governing body’s responsibilities in relation to capital management and capital adequacy, see rule 3.1.3.

3.1.2  Chapter 3 and its application to branches

(1) This Chapter does not apply to an Islamic banking business firm that is a branch insofar as this Chapter would require the branch to hold capital.

(2) A branch is required to comply with the reporting requirements under this Chapter. In relation to the branch’s ICAAP, the branch may rely on the head office’s ICAAP (if available) to demonstrate compliance.

3.1.3  Governing body’s responsibilities

(1) An Islamic banking business firm’s governing body must consider whether the minimum financial resources required by these rules are adequate to ensure that there is no significant risk that the firm’s liabilities cannot be met as they fall due. The firm must obtain additional financial resources if its governing body considers that the
minimum required does not adequately reflect the risks of its business.

(2) The governing body is also responsible for:

(a) ensuring that capital management is part of the firm’s overall risk management and is aligned with its risk tolerance and risk profile;

(b) ensuring that the firm has, at all times, financial resources of the kinds and amounts required by these rules;

Note Financial resources is a broader concept than capital resources. Financial resources could include liquid assets (such as cash in hand), irrevocable lines of credit and irrevocable guarantees.

(c) ensuring that the firm has capital, of adequate amount and appropriate quality, for the nature, scale and complexity of its business and for its risk profile;

(d) ensuring that the amount of capital it has exceeds its minimum capital requirement;

(e) approving the firm’s ICAAP and any significant changes to it; and

(f) monitoring the adequacy and appropriateness of the firm’s systems and controls and the firm’s compliance with them.

Guidance

1 An Islamic banking business firm’s risk management strategy will usually refer to risk tolerance although risk appetite may also be used. The terms ‘risk tolerance’ and ‘risk appetite’ embrace all relevant definitions used by different institutions and supervisory authorities. These 2 terms are used interchangeably to describe both the absolute risks a firm is open to take (which some may call risk appetite) and the actual limits within its risk appetite that a firm pursues (which some call risk tolerance).

2 If the firm is a member of a financial group, the authority expects the capital of the financial group to be apportioned among the group’s members, based on the allocation of risks between them.
3.1.4 Systems and controls

(1) An Islamic banking business firm must have adequate systems and controls to allow it to calculate and monitor its minimum capital requirement.

(2) The systems and controls must be in writing and must be appropriate for the nature, scale and complexity of its business and for its risk profile.

(3) The systems and controls must enable the firm to show, at all times, whether it complies with this Chapter.

(4) The systems and controls must enable the firm to manage available capital in anticipation of events or changes in market conditions.

(5) The systems and controls must include ICAAP, and the firm must have contingency arrangements to maintain or increase its capital in times of stress.

3.1.5 Internal capital adequacy assessment

(1) An Islamic banking business firm’s internal capital adequacy assessment process or ICAAP is the process by which the firm continuously demonstrates that it has implemented methods and procedures to ensure that it has adequate capital resources to support the nature and level of its risks.

(2) A firm’s ICAAP (and any significant changes to it) must be in writing and must have been approved by the firm’s governing body. A copy of the ICAAP must be given to the Regulatory Authority on request.

(3) An ICAAP must reflect the nature, scale and complexity of the firm’s operations and must include:

(a) adequate policies and staff to continuously identify, measure, evaluate, manage and control or mitigate the risks arising from its activities, and monitor the capital held against such risks;

(b) a strategy for ensuring that adequate capital is maintained over time, including specific capital targets set out in the context of its risk tolerance, risk profile and capital requirements;
(c) plans for how capital targets are to be met and the means available for obtaining additional capital, if required;
(d) procedures for monitoring its compliance with its capital requirements and capital targets;
(e) triggers to alert senior management to, and specified actions to avert and rectify, possible breaches of capital requirements;
(f) procedures for reporting on the ICAAP and its outcomes to the firm’s governing body and senior management, and for ensuring that the ICAAP is taken into account in making business decisions;
(g) policies about the effect on capital of significant risks not covered by explicit capital requirements;
(h) triggers, scope and procedures for reviewing the ICAAP under rule 1.1.14 (3) and in the light of changed conditions and factors affecting the firm’s risk tolerance, risk profile and capital;
(i) procedures for reporting the results of reviews;
(j) an adequate recovery plan for restoring the firm’s financial situation after a significant deterioration; and
(k) procedures for stress-testing and the review of stress scenarios.

Note For stress-testing and stress scenarios, see rule 1.1.17.

(4) In addition to the periodic review under rule 1.1.14 (3), a firm’s ICAAP must be reviewed by an appropriately qualified person at least once every 3 years. The person must be independent of the conduct of the firm’s capital management.

3.1.6 Use of internal models

(1) The Regulatory Authority’s requirements for Islamic banking business firms to maintain adequate capital and manage risk are based on the approaches set out by the IFSB in its standards and guidelines on capital adequacy and the Basel Committee on Banking Supervision in the Basel Accords. The standards, guidelines and
Accords allow firms to use internal models to assess capital adequacy and risk, and this rule governs the use of such models.

(2) A firm must not use its own model to assess capital adequacy or risk unless the Regulatory Authority has approved the model. The authority may approve a model subject to 1 or more conditions.

(3) In making its decision, the authority will take into account:
   (a) the nature, scale and complexity of the firm’s business;
   (b) the standards proposed by the firm, the rigour of its compliance with them, and the ease with which the authority can assess that compliance;
   (c) whether the model can be relied on as a reasonable reflection of the risks undertaken by the firm; and
   (d) anything else the authority considers relevant.

(4) The authority may revoke the approval if it is satisfied that the firm has failed to comply with any condition specified by the authority or any standard proposed by the firm.

(5) The firm must not stop using an approved model, or make significant changes to it, without the authority’s approval.
Part 3.2  Initial and ongoing capital requirements

Division 3.2.A  Required capital and ratios

3.2.1  Introduction

(1) An Islamic banking business firm is expected to meet minimum risk-based capital requirements for exposure to credit risk, market risk and operational risk. The firm’s capital adequacy ratios (consisting of CET 1 ratio, total tier 1 ratio and total capital ratio) are calculated by dividing its regulatory capital by total risk-weighted assets.

(2) Total risk-weighted assets of an Islamic banking business firm is the sum of:

(a) the firm’s risk-weighted on-balance-sheet and off-balance-sheet items calculated in accordance with Part 4.4; and

(b) 12.5 times the sum of the firm’s market and operational risk capital requirements (to the extent that each of those requirements applies to the firm).

Note  For the calculation of the firm’s market and operational risk capital requirements, see rule 6.1.9 and rule 7.3.1, respectively.

(3) In this Part:

consolidated subsidiary, of an Islamic banking business firm, means:

(a) a subsidiary of the firm; or

(b) a subsidiary of a subsidiary of the firm.

3.2.2  Required tier 1 capital on authorisation

(1) An entity must have, at the time it is authorised, tier 1 capital at least equal to:

(a) for an Islamic bank—QR 35 million;

(b) for an Islamic investment dealer—QR 7 million.

(2) The Regulatory Authority will not grant an authorisation unless it is satisfied that the entity complies with this requirement.
3.2.3 **Required ongoing capital**

(1) An Islamic banking business firm must have, at all times, capital at least equal to the higher of:

   (a) its base capital requirement; and
   
   (b) its risk-based capital requirement.

   *Note* A firm whose minimum capital requirement is its risk-based capital requirement is subject to the additional requirement to maintain a capital conservation buffer—see rule 3.3.2.

(2) The amount of capital that a firm must have is its *minimum capital requirement*.

3.2.4 **Base capital requirement**

The base capital requirement is:

(a) QR 35 million for an Islamic bank; and

(b) QR 7 million for an Islamic investment dealer.

3.2.5 **Risk-based capital requirement**

The *risk-based capital requirement* for an Islamic banking business firm is the sum of:

(a) its credit risk capital requirement;

(b) its market risk capital requirement; and

(c) its operational risk capital requirement.

3.2.6 **Capital adequacy ratios**

(1) An Islamic banking business firm’s capital adequacy is measured against 3 capital ratios expressed as percentages of its total risk-weighted assets.

(2) A firm’s *minimum capital adequacy ratios* are:

   (a) a CET 1 capital ratio of 4.5%;
   
   (b) a tier 1 capital ratio of 6%; and
(c) a regulatory capital ratio of 8%.

Note Under rule 3.3.2, at least 2.5% (by way of a capital conservation buffer) must be held by an Islamic banking business firm in addition to the minimum capital adequacy ratios. The firm’s CET 1 capital plus capital conservation buffer must therefore be no less than 7% of its total risk-weighted assets.

(3) The Regulatory Authority may, if it believes it is prudent to do so, increase any or all of a firm’s minimum capital adequacy ratios. The authority will notify the firm in writing about a new capital adequacy ratio and the timeframe for meeting it.

(4) A firm must maintain, at all times, capital adequacy ratios higher than the required minimum so that adequate capital is maintained in the context of the firm’s risk tolerance, risk profile and capital requirements, and as an additional buffer to absorb losses and problems from market volatility. These higher ratios are the firm’s risk-based capital adequacy ratios.

Division 3.2.B Elements of regulatory capital

3.2.7 Regulatory capital

(1) The regulatory capital of an Islamic banking business firm is the sum of its tier 1 capital and tier 2 capital.

(2) Tier 1 capital is the sum of a firm’s CET 1 capital and additional tier 1 capital. Tier 1 capital is also known as going-concern capital because it is meant to absorb losses while the firm is viable.

Note For the elements of CET 1 capital and additional tier 1 capital, see rules 3.2.8 and 3.2.10.

(3) Tier 2 capital is the sum of the elements set out in rule 3.2.12. Tier 2 capital is also known as gone-concern capital because it is meant to absorb losses after the firm ceases to be viable.

(4) For these rules, the 3 categories of regulatory capital are CET 1 capital, additional tier 1 capital and tier 2 capital.

Note PSIAs of an Islamic banking business firm do not form part of regulatory capital, because they do not satisfy the criteria for inclusion as either
CET 1, additional tier 1 or tier 2 capital. Neither are the PER and IRR part of the regulatory capital of the firm.

### 3.2.8 Common equity tier 1 capital

**Common equity tier 1 capital** (or **CET 1 capital**) is the sum of the following elements:

- (a) common shares, issued by an Islamic banking business firm, that satisfy the criteria in rule 3.2.9 for classification as common shares (or the equivalent for non-joint stock companies);
- (b) share premium (also known as stock surplus) resulting from the issue of instruments included in CET 1 capital;
- (c) retained earnings;
- (d) accumulated other comprehensive income and other disclosed reserves;
- (e) common shares, issued by a consolidated subsidiary of the firm and held by third parties, that satisfy the criteria in rule 3.2.18 for inclusion in CET 1 capital;
- (f) regulatory adjustments applied in the calculation of CET 1 capital in accordance with Division 3.2.D.

*Note 1* Retained earnings and other comprehensive income include appropriated profit or loss.

*Note 2* Even though they are called reserves, the PER and IRR are not part of tier 1 capital of an Islamic banking business firm. They are part of the equity of IAHs and, as such, do not have the requisite loss absorbency.

### 3.2.9 Criteria for classification as common shares

1. An instrument issued by an Islamic banking business firm is classified as a common share and included in CET 1 capital if all of the criteria in subrules (2) to (15) are satisfied.
2. The instrument is the most subordinated claim in case of the liquidation of the firm.
3. The holder of the instrument is entitled to a claim on the residual assets that is proportional to its share of issued capital, after all senior
claims have been repaid in liquidation. The claim must be unlimited and variable and must be neither fixed nor capped.

(4) The principal amount of the instrument is perpetual and never repayable except in liquidation. Discretionary repurchases and other discretionary means of reducing capital allowed by law do not constitute repayment.

*Note* Under rule 3.3.6, the Regulatory Authority’s approval is required for a reduction in capital.

(5) The firm does nothing to create an expectation at issuance that the instrument will be bought back, redeemed or cancelled. The statutory or contractual terms do not provide anything that might give rise to such an expectation.

(6) Distributions are paid out of distributable items of the firm (including retained earnings) and the amount of distributions:

(a) is not tied or linked to the amount paid in at issuance; and

(b) is not subject to a contractual cap (except to the extent that a firm may not pay distributions that exceed the amount of its distributable items).

(7) There are no circumstances under which the distributions are obligatory. Non-payment of distributions does not constitute default.

(8) Distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made. There are no preferential distributions and in particular none for any other elements classified as the highest quality issued capital.

(9) It is the issued capital that takes the first and proportionately greatest share of any losses as they occur. Within the highest quality capital, each instrument absorbs losses on a going-concern basis proportionately and equally with all the others.

*Note* This criterion is taken to be satisfied even if the instrument includes a permanent write-down mechanism.

(10) The paid-in amount is recognised as equity capital (rather than as a liability) for determining balance-sheet insolvency.
(11) The paid-in amount is classified as equity in accordance with the relevant accounting standards.

(12) The instrument is directly issued and paid-in, and the firm has not directly or indirectly funded the purchase of the instrument.

(13) The paid-in amount is neither secured nor covered by a guarantee of the firm or a related party, nor subject to any other arrangement that legally or economically enhances the seniority of the holder’s claim in relation to the claims of the firm’s creditors.

(14) The instrument is issued only with the approval of the owners of the firm, either given directly by the owners or, if permitted by the applicable law, given by its governing body or by other persons authorised by the owners.

(15) The instrument is clearly and separately disclosed on the firm’s balance sheet.

3.2.10 Additional tier 1 capital

Additional tier 1 capital is the sum of the following elements:

(a) instruments, issued by an Islamic banking business firm, that satisfy the criteria in rule 3.2.11 for inclusion in additional tier 1 capital (and are not included in CET 1 capital);

(b) share premium (also known as stock surplus) resulting from the issue of instruments included in additional tier 1 capital;

(c) instruments, issued by consolidated subsidiaries of the firm and held by third parties, that satisfy the criteria in rule 3.2.19 for inclusion in additional tier 1 capital (and are not included in CET 1 capital);

(d) regulatory adjustments applied in the calculation of additional tier 1 capital in accordance with Division 3.2.D.

3.2.11 Criteria for inclusion in additional tier 1 capital

(1) An instrument is included in additional tier 1 capital if all of the criteria in subrules (2) to (15) are satisfied.

(2) The instrument is paid-in.
(3) The instrument is the most subordinated claim after those of depositors, general creditors and holders of the subordinated debt of the firm.

(4) The paid-in amount is neither secured nor covered by a guarantee of the firm or a related party, nor subject to any other arrangement that legally or economically enhances the seniority of the holder’s claim in relation to the claims of the firm’s creditors.

(5) The instrument is perpetual. It has no maturity date and there are no step-ups or other incentives to redeem.

(6) If the instrument is callable by the firm, it can only be called 5 years or more after the instrument is paid-in and only with the approval of the Regulatory Authority. The firm must not do anything to create an expectation that the exercise of the option will be approved, and, if the exercise is approved, the firm:

(a) must replace the called instrument with capital of the same or better quality and at conditions sustainable for the income capacity of the firm; or

(b) must demonstrate to the authority that its capital will exceed the firm’s minimum capital requirement after the option is exercised.

(7) A repayment of principal through repurchase, redemption or other means must be approved by the Regulatory Authority. The firm must not assume, or create a market expectation, that such approval will be given.

(8) The instrument must provide for the firm to have, at all times, discretion not to make a distribution or pay a dividend or profit. The exercise of the discretion must not impose restrictions on the firm (except in relation to distributions to common shareholders) and must not constitute default.

(9) Dividends and profits must be paid out of distributable items.

(10) The instrument must not have a credit-sensitive-dividend feature under which a dividend or profit is periodically reset based (wholly or partly) on the firm’s credit standing.
(11) The instrument must not contribute to the firm’s liabilities exceeding its assets if such a balance-sheet test forms part of any insolvency law applying in the jurisdiction where the instrument was issued.

(12) An instrument classified as a liability for accounting purposes must have principal loss absorption through conversion to common shares, or a write-down mechanism that allocates losses to the instrument, at a pre-specified trigger point. The conversion must be made in accordance with rule 3.2.15.

(13) Neither the firm nor a related party over which the firm exercises control has purchased the instrument, nor has the firm directly or indirectly funded the purchase of the instrument.

(14) The instrument has no features that hinder recapitalisation. For example, it must not require the firm to compensate investors if a new instrument is issued at a lower price during a specified period.

(15) If the instrument is issued by an SPE, the proceeds are immediately available without limitation to the firm through an instrument that satisfies the other criteria for additional tier 1 capital.

Note For the treatment of instruments issued by an SPE, see rule 3.2.21.

3.2.12 Tier 2 capital

Tier 2 capital is the sum of the following elements:

(a) instruments, issued by the firm, that satisfy the criteria in rule 3.2.13 for inclusion in tier 2 capital (and are not included in tier 1 capital);

(b) share premium (also known as stock surplus) resulting from the issue of instruments included in tier 2 capital;

(c) instruments, issued by consolidated subsidiaries of the firm and held by third parties, that satisfy the criteria in rule 3.2.20 for inclusion in tier 2 capital (and are not included in tier 1 capital);

(d) regulatory adjustments applied in the calculation of tier 2 capital in accordance with Division 3.2.D;
(e) general provisions or general reserves held against future, presently unidentified losses (but only up to a maximum of 1.25% of risk-weighted assets for credit risk, calculated using the standardised approach in Part 4.3).

*Note 1* General provisions and reserves are freely available to meet losses that subsequently materialise and therefore qualify for inclusion in tier 2 capital. In contrast, provisions for identified deterioration of particular assets or known liabilities, whether individual or grouped, should be excluded because they would not be available to meet losses.

*Note 2* Even though they are called reserves, the PER and IRR are not part of tier 2 capital of an Islamic banking business firm. They are part of the equity of IAHs and, as such, do not have the requisite loss absorbency.

### 3.2.13 Criteria for inclusion in tier 2 capital

1. An instrument is included in tier 2 capital if all the criteria in subrules (2) to (11) are satisfied.
2. The instrument is paid-in.
3. The instrument is the most subordinated claim after those of depositors, general creditors and holders of the subordinated debt of the firm.
4. The paid-in amount is neither secured nor covered by a guarantee of the firm or a related party, nor subject to any other arrangement that legally or economically enhances the seniority of the holder’s claim in relation to the claims of the firm’s depositors and general creditors.
5. The original maturity of the instrument is at least 5 years.
6. The recognition in regulatory capital in the remaining 5 years before maturity is amortised on a straight line basis and there are no step-ups or other incentives to redeem.
7. If the instrument is callable by the firm, it can only be called 5 years or more after the instrument is paid-in and only with the approval of the Regulatory Authority. The firm must not do anything to create an...
expectation that the exercise of the option will be approved, and, if the exercise is approved, the firm:

(a) must replace the called instrument with capital of the same or better quality and at conditions sustainable for the income capacity of the firm; or

(b) must demonstrate to the authority that its capital will exceed the firm’s minimum capital requirement after the option is exercised.

(8) The holder has no right to accelerate future scheduled payments of profit or principal, except in bankruptcy or liquidation.

(9) The instrument does not have a credit-sensitive-dividend feature under which a dividend or profit is periodically reset based (wholly or partly) on the firm’s credit standing.

(10) Neither the firm nor a related party over which the firm exercises control has purchased the instrument, nor has the firm directly or indirectly funded the purchase of the instrument.

(11) If the instrument is issued by an SPE, the proceeds are immediately available without limitation to the firm through an instrument that satisfies the other criteria for tier 2 capital.

Note For the treatment of instruments issued by an SPE, see rule 3.2.21.

3.2.14 Mudarabah sukuk or wakalah sukuk as tier 2 capital

(1) Subject to compliance with Shari’a, an Islamic banking business firm may issue mudarabah sukuk or wakalah sukuk that qualify for inclusion in tier 2 capital under rule 3.2.13. For the sukuk, the receivables from the underlying assets are convertible to common equity at the point of non-viability.

(2) The sukuk contract must state the terms of conversion, trigger point and conversion ratio. The conversion must be made in accordance with rule 3.2.15.

Note For mudarabah sukuk, see rule 10.3.19. For wakalah sukuk, see rule 10.3.21.
3.2.15 Requirements—loss absorption at point of non-viability

(1) This rule applies to an additional tier 1 or tier 2 instrument issued by an Islamic banking business firm. It sets out additional requirements to ensure loss absorption at the point of non-viability.

(2) The terms and conditions of an instrument must give the Regulatory Authority the discretion to direct that the instrument be written-off or converted to common equity on the happening of a trigger event.

(3) The firm must be able to issue the required number of shares specified in the instrument if a trigger event happens. The issuance of any new shares because of a trigger event must happen before any public sector injection of capital so that capital provided by the public sector is not diluted.

(4) Trigger event, in relation to the firm that issued the instrument, is the earliest of:

   (a) a decision of the Regulatory Authority that a write-off (without which the firm would become non-viable) is necessary; and
   
   (b) a decision by the relevant authority in Qatar to make a public sector injection of capital, or give equivalent support (without which injection or support the firm would become non-viable, as determined by that authority).

(5) If the firm is a member of a financial group and the firm wishes the instrument to be included in the group’s capital in addition to its solo capital, the trigger event must be the earliest of:

   (a) the decision in subrule (4) (a);
   
   (b) the decision in subrule (4) (b);
   
   (c) a decision, by the relevant authority in the firm’s home jurisdiction, that a write-off (without which the firm would become non-viable) is necessary; and
   
   (d) a decision, by the relevant authority in the jurisdiction of the financial regulator that regulates the parent entity of the firm, to make a public sector injection of capital, or give equivalent support, in that jurisdiction (without which injection or support...
the firm would become non-viable, as determined by that authority).

(6) Any compensation paid to the holder of an instrument because of a write-off must be paid immediately in the form of common shares (or the equivalent for non-joint-stock companies).

(7) If the firm is a member of a financial group, any common shares paid as compensation to the holder of the instrument must be common shares of the firm or of the parent entity of the group.

**Guidance**
Conversion or write-off under this rule would be limited to the extent necessary to enable the Regulatory Authority to conclude that the firm is viable without further conversion or write-off.

### 3.2.16 Requirements for writing-off

(1) The write-off of an instrument using a *murabahah* contract must be through the investor (as creditor):

(a) making a promise (*wa’ad*) to waive rights on debts at the point of non-viability; or

(b) agreeing, in the relevant legal documents, to waive rights on debts at the point of non-viability.

(2) The write-off of an instrument using an *ijarah* contract must be through the investor (as lessor):

(a) making a promise (*wa’ad*) to transfer ownership of the underlying asset (beneficial or otherwise) to the firm without consideration; or

(b) agreeing, in the relevant legal documents, to waive rights on accrued rental at the point of non-viability.

(3) An Islamic banking business firm may apply to the Regulatory Authority for approval to use a write-off mechanism other than those in subrules (1) and (2).
Division 3.2.C  Inclusion of third parties’ interests

3.2.17  Introduction
This Division sets out the criteria and formulae for the inclusion, in an Islamic banking business firm’s regulatory capital, of interests held by third parties.

3.2.18  Criteria for third party interests—common equity tier 1 capital
(1) For rule 3.2.8 (e), a common share, issued by a consolidated subsidiary of an Islamic banking business firm and held by a third party as a non-controlling interest, may be included in the firm’s CET 1 capital if:
(a) the share would be included in the firm’s CET 1 capital had it been issued by the firm; and
(b) the subsidiary that issued the share is itself an Islamic bank or Islamic investment dealer (or an equivalent entity in its home jurisdiction).

(2) The amount to be included in the consolidated CET 1 capital of an Islamic banking business firm is calculated in accordance with the following formula:

\[ NCI - ((CET1_s - Min) \times SS) \]

where:
NCI is the total of the non-controlling interests of third parties in a consolidated subsidiary of the firm.
CET1_s is the amount of CET 1 capital of the subsidiary.
Min is the lower of:
(a) 1.07 \times (minimum CET 1 capital requirement of the subsidiary); and
(b) 1.07 \times (the part of the consolidated minimum CET 1 capital requirement that relates to the subsidiary).
SS means the percentage of the shares in the subsidiary (being shares included in CET 1 capital) held by those third parties.

3.2.19 Criteria for third party interests—additional tier 1 capital

(1) For rule 3.2.10 (c), an instrument (including a common share) issued by a consolidated subsidiary of an Islamic banking business firm and held by a third party as a non-controlling interest may be included in the firm’s additional tier 1 capital if the instrument would be included in the firm’s additional tier 1 capital had it been issued by the firm. 

Note: Any amount already included in CET 1 capital must not be included in additional tier 1 capital—see rule 3.2.10(c).

(2) The amount to be included in the consolidated additional tier 1 capital of an Islamic banking business firm is calculated in accordance with the following formula:

\[ NCI - ((T1_s - Min) \times SS) \]

where:

- \( NCI \) is the total of the non-controlling interests of third parties in a consolidated subsidiary of the firm.
- \( T1_s \) is the amount of additional tier 1 capital of the subsidiary.
- \( Min \) is the lower of:
  (a) \( 1.07 \times \) (minimum additional tier 1 capital requirement of the subsidiary); and
  (b) \( 1.07 \times \) (the part of the consolidated minimum additional tier 1 capital requirement that relates to the subsidiary).

SS means the percentage of the shares in the subsidiary (being shares included in additional tier 1 capital) held by those third parties.

3.2.20 Criteria for third party interests—tier 2 capital

(1) For rule 3.2.12 (c), an instrument (including a common share and any other tier 1 capital instrument) issued by a consolidated subsidiary of an Islamic banking business firm and held by a third party as a non-controlling interest may be included in the firm’s tier 2 capital if the
instrument would be included in the firm’s tier 2 capital had it been issued by the firm.

Note Any amount already included in CET 1 capital or additional tier 1 capital must not be included in tier 2 capital—see rule 3.2.12(c).

(2) The amount to be included in the consolidated tier 2 capital of an Islamic banking business firm is calculated in accordance with the following formula:

$$\text{NCI} - ((\text{T2}_s - \text{Min}) \times \text{SS})$$

where:

- \(\text{NCI}\) is the total of the non-controlling interests of third parties in a consolidated subsidiary of the firm.
- \(\text{T2}_s\) is the amount of tier 2 capital of the subsidiary.
- \(\text{Min}\) is the lower of:
  - (a) \(1.07 \times\) (minimum tier 2 capital requirement of the subsidiary); and
  - (b) \(1.07 \times\) (the part of the consolidated minimum tier 2 capital requirement that relates to the subsidiary).
- \(\text{SS}\) means the percentage of the shares in the subsidiary (being shares included in tier 2 capital) held by those third parties.

3.2.21 Treatment of third party interests from SPEs

(1) An instrument issued out of an SPE and held by a third party must not be included in an Islamic banking business firm’s CET 1 capital. Such an instrument may be included in the firm’s additional tier 1 or tier 2 capital (and treated as if it had been issued by the firm itself directly to the third party) if:

- (a) the instrument satisfies the criteria for inclusion in the relevant category of regulatory capital; and
- (b) the only asset of the SPE is its investment in the capital of the firm and that investment satisfies the criterion in rule 3.2.11 (15) or 3.2.13 (11) for the immediate availability of the proceeds.
(2) An instrument described in subrule (1) that is issued out of an SPE through a consolidated subsidiary of an Islamic banking business firm may be included in the firm’s consolidated additional tier 1 or tier 2 capital if the instrument satisfies the criteria in rule 3.2.19 or 3.2.20, as the case requires. Such an instrument is treated as if it had been issued by the subsidiary itself directly to the third party.

Division 3.2.D  Regulatory adjustments

Subdivision 3.2.D.1  General

3.2.22  Introduction

(1) Regulatory adjustments to an Islamic banking business firm’s capital may be required to avoid double-counting, or artificial inflation, of its capital. They may also be required in relation to assets that cannot readily be converted into cash.

(2) Adjustments can be made to all 3 categories of regulatory capital, but most of them are to CET 1 capital.

3.2.23  Approaches to valuation and adjustment

(1) An Islamic banking business firm must use the same approach for valuing regulatory adjustments to its capital as it does for balance-sheet valuations. An item that is deducted from capital must be valued in the same way as it would be for inclusion in the firm’s balance sheet.

(2) The firm must use the corresponding deduction approach and the threshold deduction rule in making adjustments to its capital.

3.2.24  Definitions for Division 3.2.D

In this Division:

entity concerned means:

(a) a financial entity (including an Islamic banking business firm and a takaful entity); or
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Rule 3.2.25

(b) any other entity over which, under the relevant accounting standards, an Islamic banking business firm can exercise control.

Guidance

1 The notion of exercising control in this Division is different from that in the definition of exercise control in the glossary. The term as defined in the glossary is used in relation to related parties and connected parties as they relate to credit risk, concentration risk and large exposures.

2 The relevant accounting standards referred to (primarily AAOIFI and IFRS) use control in a much broader sense, so that an investor should consider all relevant facts and circumstances in assessing whether it controls an investee.

3 Under IFRS 10, for example, an investor controls an investee if the investor has all of the following:

- power over the investee (that is, the investor has existing rights that give it the ability to direct the activities that significantly affect the investee’s returns)
- exposure, or rights, to variable returns from its involvement with the investee
- ability to use its power over the investee to affect the amount of the investor’s returns.

4 Another example would be control through agreement with the entity’s other shareholders or with the entity itself. The agreement could result in control even if the investor holds less than majority voting rights, so long as those rights are substantive (that is, exercisable by the investor who has the practical ability to exercise them when relevant decisions are required to be made).

significant investment, by an Islamic banking business firm in an entity concerned, means an investment of 10% or more in the common shares, or other instruments that qualify as capital, of the entity concerned. Investment includes a direct, indirect and synthetic holding of capital instruments.

Subdivision 3.2.D.2  Adjustments to common equity tier 1 capital

3.2.25  Form of adjustments

Adjustments to CET 1 capital must be made in accordance with this Subdivision. Regulatory adjustments are generally in the form of
deductions, but they may also be in the form of recognition or derecognition of items in the calculation of a firm’s capital.

3.2.26 Goodwill and intangible assets
An Islamic banking business firm must deduct from CET 1 capital the amount of its goodwill and other intangible assets (except mortgage servicing rights). The amount must be net of any related deferred tax liability that would be extinguished if the goodwill or assets become impaired or derecognised under the relevant accounting standards.

Note: For the treatment of mortgage servicing rights, see rule 3.2.43 (Deductions from common equity tier 1 capital).

3.2.27 Deferred tax assets
(1) An Islamic banking business firm must deduct from CET 1 capital the amount of deferred tax assets (except those that relate to temporary differences) that depend on the future profitability of the firm.

(2) A deferred tax asset may be netted with a deferred tax liability only if the asset and liability relate to taxes levied by the same taxation authority and offsetting is explicitly permitted by that authority. A deferred tax liability must not be used for netting if it has already been netted against a deduction of goodwill, other intangible assets or defined benefit pension assets.

Note: Any deferred tax liability that may be netted must be allocated pro rata between deferred tax assets under this rule and those under the threshold deduction rule. For the treatment of deferred tax assets that relate to temporary differences (for example, allowance for credit losses), see rule 3.2.43 (Deductions from common equity tier 1 capital).

3.2.28 Cash flow hedge reserve
In the calculation of CET 1 capital, an Islamic banking business firm must derecognise the amount of the cash flow hedge reserve that relates to the hedging of items that are not fair-valued on the balance sheet (including projected cash flows).
3.2.29 Cumulative gains and losses from changes to own credit risk

In the calculation of CET 1 capital, an Islamic banking business firm must derecognise all unrealised gains and unrealised losses that have resulted from changes in the fair value of liabilities that are due to changes in the firm’s own credit risk.

3.2.30 Defined benefit pension fund assets

(1) An Islamic banking business firm must deduct from CET 1 capital the amount of a defined benefit pension fund that is an asset on the firm’s balance sheet. The amount must be net of any related deferred tax liability that would be extinguished if the asset becomes impaired or derecognised under the relevant accounting standards.

(2) The firm may apply to the Regulatory Authority for approval to offset from the deduction any asset in the defined benefit pension fund to which the firm has unrestricted and unfettered access. Such an asset must be assigned the risk-weight that would be assigned if it were owned directly by the firm.

3.2.31 Securitisation gains on sale

In the calculation of CET 1 capital, an Islamic banking business firm must derecognise any increase in equity capital or CET 1 capital from a securitisation or resecuritisation transaction (for example, an increase associated with expected future margin income resulting in a gain-on-sale).

3.2.32 Higher capital imposed on overseas branch

(1) If an Islamic banking business firm has an overseas branch, the firm must deduct from CET 1 capital whichever is the higher of any capital requirement imposed by the Regulatory Authority or the financial regulator in the jurisdiction in which the branch is located.

(2) This rule does not apply if the overseas branch is a consolidated entity of the Islamic banking business firm. A branch is a consolidated entity if it is included in the firm’s consolidated returns.
(3) Despite subrule (2), if the financial regulator in the jurisdiction in which a branch is located imposes a capital requirement for the foreign branch, an Islamic firm must deduct from CET 1 capital the amount of any shortfall between the actual capital held by the foreign branch and that capital requirement.

3.2.33 Assets lodged or pledged to secure liabilities

(1) An Islamic banking business firm must deduct from CET 1 capital the amount of any assets lodged or pledged by the firm if:

(a) the assets were lodged or pledged to secure liabilities incurred by the firm; and

(b) the assets are not available to meet the liabilities of the firm.

(2) The Regulatory Authority may determine that, in the circumstances, the amount of assets lodged or pledged need not be deducted from the firm’s CET 1 capital. The determination must be in writing.

3.2.34 Acknowledgments of debt

(1) An Islamic banking business firm must deduct from CET 1 capital the net present value of an acknowledgement of debt outstanding issued by it to directly or indirectly fund instruments that qualify as CET 1 capital.

(2) This rule does not apply if the acknowledgement is subordinated in rank similar to that of instruments that qualify as CET 1 capital.

3.2.35 Accumulated losses

An Islamic banking business firm must deduct from CET 1 capital the amount of any accumulated losses.

Subdivision 3.2.D.3 Deductions from categories of regulatory capital

3.2.36 Deductions using corresponding deduction approach

(1) The deductions that must be made from CET 1 capital, additional tier 1 capital or tier 2 capital under the corresponding deduction
approach are set out in this Subdivision. An Islamic banking business firm must examine its holdings of index securities and any underlying holdings of capital to determine whether any deductions are required as a result of such indirect holdings.

(2) Deductions must be made from the same category for which the capital would qualify if it were issued by the Islamic banking business firm itself or, if there is not enough capital at that category, from the next higher category.

Example
If the amount of tier 2 capital is insufficient to cover the amount of deductions from that category, the shortfall must be deducted from additional tier 1 capital and, if additional tier 1 capital is still insufficient, the remaining amount must be deducted from CET 1 capital.

(3) The corresponding deduction approach applies regardless of whether the positions or exposures are held in the banking book or trading book.

3.2.37 Investments in own shares and capital instruments

(1) An Islamic banking business firm must deduct direct or indirect investments in its own common shares or own capital instruments (except those that have been derecognised under the relevant accounting standards). The firm must also deduct any of its own common shares or instruments that it is contractually obliged to purchase.

(2) The gross long positions may be deducted net of short positions in the same underlying exposure only if the short positions involve no counterparty risk. However, gross long positions in its own shares resulting from holdings of index securities may be netted against short positions in its own shares resulting from short positions in the same underlying index, even if those short positions involve counterparty risk.
3.2.38 **Reciprocal cross holdings**

An Islamic banking business firm must deduct reciprocal cross holdings in shares, or other instruments that qualify as capital, of an entity concerned.

3.2.39 **Non-significant investments—aggregate is less than 10% of firm’s common equity tier 1 capital**

1. This rule applies if:
   a) an Islamic banking business firm makes a non-significant investment in an entity concerned;
   b) the entity concerned is an unconsolidated entity (that is, the entity is not included in the firm’s consolidated returns);
   c) the firm does not own 10% or more of the common shares of the entity concerned; and
   d) after applying all other regulatory adjustments, the total of the deductions required to be made under this rule is less than 10% of the firm’s CET 1 capital.

2. An Islamic banking business firm must deduct any investments in common shares, or other instruments that qualify as capital, of an entity concerned.

3. The amount to be deducted is the net long position (that is, the gross long position net of short positions in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least 1 year).

4. Underwriting positions held for more than 5 business days must also be deducted.

5. If a capital instrument is required to be deducted and it is not possible to determine whether it should be deducted from CET 1 capital, additional tier 1 capital or tier 2 capital, the deduction must be made from CET 1 capital.
3.2.40 Non-significant investments—aggregate is 10% or more of firm’s common equity tier 1 capital

(1) This rule applies if, after applying all other regulatory adjustments, the total of the deductions required to be made under rule 3.2.39 is 10% or more of the firm’s CET 1 capital.

(2) An Islamic banking business firm must deduct the amount by which the total of the deductions required to be made under rule 3.2.39 exceeds 10% of the firm’s CET 1 capital. This amount to be deducted is referred to as the excess.

(3) How much of the excess gets to be deducted from each category of regulatory capital under the corresponding deduction approach is calculated in accordance with the following formula:

\[ Excess \times \frac{A}{B} \]

where:

- \( A \) is the amount of CET 1 capital, additional tier 1 capital or tier 2 capital of the Islamic banking business firm, as the case requires.
- \( B \) is the total capital holdings of the firm.

3.2.41 Significant investments

(1) This rule applies if:

   (a) an Islamic banking business firm makes a significant investment in an entity concerned;

   (b) the entity concerned is an unconsolidated entity (that is, the entity is not included in the firm’s consolidated returns); and

   (c) the firm owns 10% or more of the common shares of the entity concerned.

(2) An Islamic banking business firm must deduct the total amount of investments in the entity concerned (other than investments in
common shares, or other instruments that qualify as CET 1 capital, of the entity).

Note  For the treatment of investments in common shares, or other instruments that qualify as CET 1 capital, of an entity concerned, see rule 3.2.43 (Deductions from common equity tier 1 capital).

(3) The amount to be deducted is the net long position (that is, the gross long position net of short positions in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least 1 year).

(4) Underwriting positions held for more than 5 business days must also be deducted.

(5) If a capital instrument is required to be deducted and it is not possible to determine whether it should be deducted from CET 1 capital, additional tier 1 capital or tier 2 capital, the deduction must be made from CET 1 capital.

3.2.42 Firms may use estimates or exclude deductions

(1) If it is impractical for an Islamic banking business firm to examine and monitor the firm’s exposures to the capital of entities concerned (including through holdings of indexed securities), the firm may apply to the Regulatory Authority for approval to use an estimate of such exposures. The authority will grant such an approval only after the firm satisfies the authority that the estimate is conservative, well-founded and reasonable.

(2) An Islamic banking business firm may also apply to the Regulatory Authority for approval not to deduct an investment made to resolve, or provide financial assistance to reorganise, a distressed entity.

Subdivision 3.2.D.4 Threshold deduction rule

3.2.43 Deductions from common equity tier 1 capital

(1) In addition to the other deductions to CET 1 capital under this Chapter, deductions may be required to CET 1 capital under the threshold deduction rule.
(2) The threshold deduction rule provides recognition for particular assets that are considered to have some limited capacity to absorb losses. The following items come within the threshold deduction rule:

(a) significant investments in the common shares, or other instruments that qualify as CET 1 capital, of an unconsolidated entity concerned;

(b) mortgage servicing rights;

(c) deferred tax assets that relate to temporary differences (for example, allowance for credit losses).

(3) Instead of full deduction, the items that come within the threshold deduction rule receive limited recognition when calculating CET 1 capital. The total of each of the items in subrule (2) do not require adjustment from CET 1 capital and are risk-weighted at 300% (for items listed on a recognised exchange) or 400% (for items not so listed) provided that:

(a) each item is no more than 10% of the firm’s CET 1 capital (net of all regulatory adjustments except those under this Subdivision); or

(b) in total, the 3 items are no more than 15% of the firm’s CET 1 capital (net of all regulatory adjustments except those under this Subdivision).

(4) An Islamic banking business firm must deduct from CET 1 capital any amount in excess of the threshold in subrule (3) (a) or (b).
Part 3.3 Capital buffers and other requirements

3.3.1 Introduction

(1) The capital adequacy framework contains 2 additional measures for conserving capital through the capital conservation buffer and the counter-cyclical capital buffer.

(2) The capital conservation buffer promotes the conservation of capital and the build-up of a buffer above the minimum in times of economic growth and credit expansion, so that the buffer can be drawn down in periods of stress. It imposes an obligation to restrict a firm’s distributions when capital falls below the capital conservation buffer minimum.

(3) The counter-cyclical capital buffer is a macroprudential tool that can be used to mitigate the build-up of a system-wide risk such as excess aggregate credit growth. It is intended to ensure that the banking system has a buffer of capital to protect it against future potential losses.

(4) These 2 buffers and other requirements on capital are set out in this Part.

3.3.2 Capital conservation buffer

(1) An Islamic banking business firm whose risk-based capital requirement is higher than its base capital requirement must maintain a minimum capital conservation buffer of:

(a) 2.5% of the firm’s total risk-weighted assets; or
(b) a higher amount that the Regulatory Authority may, by written notice, set from time to time.
(2) A firm’s capital conservation buffer must be made up of CET 1 capital above the amounts used to meet the firm’s CET 1 capital ratio, tier 1 capital ratio and regulatory capital ratio in rule 3.2.6 (2).

Note: Capital raised through the issuance of sukuk cannot form part of the capital conservation buffer because that capital does not qualify as CET 1 capital.

3.3.3 Capital conservation ratios

(1) If an Islamic banking business firm’s capital conservation buffer falls below the required minimum, the firm must immediately conserve its capital by restricting its distributions.

Note: A payment made by a firm that does not reduce its CET 1 capital is not a distribution for the purposes of this Part. Distributions include, for example, dividends, share buybacks and discretionary bonus payments.

(2) This rule sets out, in column 3 of table 3.3.3, the minimum capital conservation ratios for Islamic banking business firms that are required to maintain a capital conservation buffer. Capital conservation ratio is the percentage of earnings that a firm must not distribute if its CET 1 capital ratio falls within the corresponding ratio in column 2 of that table.

(3) Earnings means distributable profits calculated before deducting elements subject to the restrictions on distributions. Earnings must be calculated after notionally deducting the tax that would have been payable had none of the distributable items been paid.

Note: The effect of calculating earnings after tax is that the tax consequence of the distribution is reversed out.

(4) An Islamic banking business firm must have adequate systems and controls to ensure that the amount of distributable profits and maximum distributable amount are calculated accurately. The firm must be able to demonstrate that accuracy if directed by the Regulatory Authority.

(5) If the firm is a member of a financial group, the capital conservation buffer applies at group level.
Table 3.3.3 Minimum capital conservation ratios

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 CET1 capital ratio</th>
<th>column 3 minimum capital conservation ratio (% of earnings)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4.5% to 5.125%</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>&gt; 5.125% to 5.75%</td>
<td>80</td>
</tr>
<tr>
<td>3</td>
<td>&gt; 5.75% to 6.375%</td>
<td>60</td>
</tr>
<tr>
<td>4</td>
<td>&gt; 6.375% to 7.0%</td>
<td>40</td>
</tr>
<tr>
<td>5</td>
<td>&gt; 7%</td>
<td>0</td>
</tr>
</tbody>
</table>

Examples of application of table

Assume that a firm’s minimum CET 1 capital ratio is 4.5% and an additional 2.5% capital conservation buffer (which must be made up of CET 1 capital) is required for a total of 7% CET 1 capital ratio. Based on table 3.3.3:

1. If a firm’s CET 1 capital ratio is 4.5% or more but no more than 5.125%, the firm needs to conserve 100% of its earnings.
2. If a firm’s CET 1 capital ratio is more than 5.125% or more but no more than 5.75%, the firm needs to conserve 80% of its earnings and must not distribute more than 20% of those earnings by way of dividends, share buybacks and discretionary bonus payments.
3. A firm with a CET 1 capital ratio of more than 7% can distribute 100% of its earnings.

3.3.4 Powers of Regulatory Authority

(1) The Regulatory Authority may impose a restriction on capital distributions by an Islamic banking business firm even if the amount of the firm’s CET 1 capital is greater than its CET 1 capital ratio and required capital conservation buffer.

(2) The Regulatory Authority may, by written notice, impose a limit on the period during which an Islamic banking business firm may operate within a specified capital conservation ratio.

(3) An Islamic banking business firm may apply to the Regulatory Authority to make a distribution in excess of a limit imposed by this Part. The authority will grant approval only if it is satisfied that the
firms have appropriate measures to raise capital equal to, or greater than, the amount the firm wishes to distribute above the limit.

3.3.5 Counter-cyclical capital buffer

1. If imposed by the Regulatory Authority, the counter-cyclical capital buffer would require a firm to have additional CET 1 capital against possible future losses from system-wide risks such as excess credit growth.

2. The Regulatory Authority may, by written notice, require Islamic banking business firms to have additional CET 1 capital as a counter-cyclical capital buffer. The buffer set by the authority will not exceed 2.5% of total risk-weighted assets.

3. The Regulatory Authority will notify firms of any decision to set, or increase, a counter-cyclical capital buffer within a reasonable period of not more than 1 year before the date when the decision takes effect. However, a decision to remove or decrease a counter-cyclical capital buffer will take effect immediately.

4. If a counter-cyclical capital buffer applies to a firm, the capital conservation ratios (and capital distribution restrictions) in rule 3.3.3 apply to the firm as if its minimum capital conservation buffer were increased by the amount of the counter-cyclical capital buffer.

3.3.6 Capital reductions

1. An Islamic banking business firm must not reduce its capital and reserves without the Regulatory Authority’s written approval.

   Examples of ways to reduce capital
   - a share buyback or the redemption, repurchase or repayment of capital instruments issued by the firm
   - trading in the firm’s own shares or capital instruments outside an arrangement agreed with the authority
   - a special dividend.

2. An Islamic banking business firm planning a reduction must prepare a forecast (for at least 2 years) showing its projected capital after the
reduction. The firm must satisfy the authority that the firm’s capital will still comply with these rules after the reduction.

3.3.7 Authority can require other matters

Despite anything in these rules, the Regulatory Authority may require an Islamic banking business firm to have capital resources, comply with any other capital requirement or use a different approach to, or method for, capital management. The authority may also require a firm to carry out stress-testing at any time.

*Note* Under FSR, article 16, the Regulatory Authority may modify or waive the application of a prudential requirement to an authorised firm or firms.
Part 3.4  Leverage ratio

3.4.1  Introduction

The leverage ratio is a simple, transparent, non-risk-based measure to help restrict the build-up of leverage in the Islamic banking system. Excessive leverage can expose Islamic banking businesses to higher financial risk, with potential damage to the overall financial system, and to the economy if a de-leveraging process takes place.

3.4.2  Objectives of leverage ratio requirements

The leverage ratio supplements the risk-based capital requirements of the rest of this Chapter. The objectives of limiting Islamic banking business firms’ leverage ratios are as follows:

(a) to constrain the build-up of leverage in the Islamic banking sector, to help avoid destabilising deleveraging that can damage the broader financial system and the economy;

(b) to reinforce the risk-based requirements in Parts 3.1 to 3.3 with a simple, non-risk-based backstop measure;

(c) to serve as a broad measure of the sources of leverage, both on and off the balance-sheet.

3.4.3  How to calculate leverage ratio

An Islamic banking business firm’s leverage ratio $LR$ is calculated by means of the following formula:

$$LR = \frac{\text{tier 1 capital}}{\text{total exposure measure}} \times 100$$

where:

$\text{tier 1 capital}$ has the meaning given by rule 3.2.7 (2).

$\text{total exposure measure}$ is the total amount of all the firm’s exposures, calculated in accordance with rules 3.4.5 to 3.4.8.
3.4.4  Minimum leverage ratio

(1) An Islamic banking business firm must maintain a leverage ratio of not less than 3%.

(2) The Regulatory Authority may direct an Islamic banking business firm to maintain a leverage ratio higher than 3% if the Authority considers it necessary to do so because of the firm’s risk profile or other particular circumstances.

3.4.5  How to calculate total exposure measure—general

(1) When an Islamic banking business firm calculates its total exposure measure, it must treat each exposure in accordance with the normal accounting treatment of the exposure.

(2) It must include all on-balance-sheet non-derivative exposures, net of specific provisions and valuation adjustments.

(3) It must not take into account the effect of credit risk mitigation.

(4) It must not weight on-balance-sheet exposures.

(5) It must not net financing exposures against PSIA’s or deposits.

3.4.6  Modification of calculation

(1) The Regulatory Authority may, by written notice, modify the calculation of an Islamic banking business firm’s total exposure measure by, for example:

   (a) allowing the firm not to take account of a particular exposure or class of exposures;

   (b) directing the firm to apply a different risk-weight to an exposure or class of exposures;

   (c) directing the firm to take account of an exposure or class of exposures that would not otherwise be taken account of.

(2) The Authority may give a notice under subrule (1) on the application of the firm or on the Authority’s own initiative.
3.4.7 How to calculate total exposure measure—on-balance-sheet assets

(1) When an Islamic banking business firm calculates its total exposure measure, it must include all on-balance-sheet items on the assets side of its balance-sheet, including all Shari’a-compliant repo and securities-financing transactions.

(2) AAOIFI accounting treatment must be used for taking account of such transactions. For Shari’a-compliant hedging instruments, the accounting treatment of the exposure must be used (that is, unweighted and subject to 100% credit conversion factor).

(3) Potential future exposures must be computed on an unweighted basis according to the current exposure method, as set out in Division 4.4.C.

(4) Items that are deducted completely from the firm’s tier 1 capital (such as goodwill) must also be deducted from its total exposure.

(5) The amount of an investment in the capital of an unconsolidated financial entity that is wholly or partly deducted from the firm’s CET1 or additional tier 1 capital under the approach in Subdivision 3.2.D.3 must be deducted from its total exposure. An unconsolidated financial entity is a financial entity (that is, an entity involved in banking or other financial activity, or insurance) that is not included in the firm’s consolidated returns.

(6) Liability items must not be deducted from the firm’s total exposure measure.

3.4.8 How to calculate total exposure measure—off-balance-sheet assets

(1) When an Islamic banking business firm calculates its total exposure measure, it must include all off-balance-sheet items (for example, letters of credit, guarantees, unconditionally cancellable commitments, liquidity facilities, and Shari’a-compliant repo and securities financing transactions).
(2) A 100% credit conversion factor applies to all off-balance-sheet items, except that a credit conversion factor of 10% applies to a commitment that can be unconditionally cancelled at any time without notice.

(3) Securitised assets that are de-recognised from the balance-sheet of the sponsor or originator are not to be taken into account.

3.4.9 How to calculate total exposure measure—assets financed by unrestricted PSIsAs

(1) When an Islamic banking business firm calculates its total exposure measure, it must include a proportion of assets (whether on or off the firm’s balance-sheet) financed by unrestricted PSIs.

(2) The proportion is to be calculated by multiplying the carrying value of the assets by the alpha parameter (100%) for capital adequacy purposes.

(3) Assets financed by restricted PSIsAs are not to be included.
Chapter 4  
Credit risk

Part 4.1  
General

4.1.1  
Introduction

(1) This Chapter sets out the requirements for an Islamic banking business firm’s credit risk management policy (including credit risk assessments and the use of ratings from ECRAs):

(a) to implement the risk-based framework for capital adequacy; and

(b) to ensure the early identification and management of problem assets.

(2) This Chapter also deals with the following means to determine regulatory capital and control or mitigate credit risk:

(a) the risk-weighted assets approach;

(b) CRM techniques;

(c) provisioning.

(3) To guard against abuses and to address conflicts of interest, this Chapter requires transactions with related parties to be at arm’s length.

4.1.2  
Credit risk

Credit risk is:

(a) the risk of default by counterparties; and

(b) the risk that an asset will lose value because its credit quality has deteriorated.

Guidance

Credit risk may result from on-balance-sheet and off-balance-sheet exposures, including loans and advances, investments, inter-bank lending, securities financing transactions and trading activities. It can exist in a firm’s trading book or banking book.
Examples of sources of credit risks in Islamic banking business firms

- accounts receivable in *murabahah* contracts
- counterparty risk in *salam* contracts
- accounts receivable and counterparty risk in *istisna* contracts
- lease payments receivable in *ijarah* contracts
- *sukuk* held in the banking book
- capital impairment from investments, based on *mudarabah* or *musharakah* contracts, held in the banking book.

### 4.1.3 Requirements—management of credit risk and problem assets

1. An Islamic banking business firm must manage credit risk by adopting a prudent credit risk management policy that allows its credit risk to be identified, measured, evaluated, managed and controlled or mitigated.

2. The policy must also provide for problem assets to be recognised, measured and reported. The policy must set out the factors that must be taken into account in identifying problem assets.

3. **Problem asset** includes impaired credit and other assets if there is reason to believe that the amounts due may not be collectable in full or in accordance with their terms.

### 4.1.4 Role of governing body—credit risk

An Islamic banking business firm’s governing body must ensure that the firm’s credit risk management policy gives the firm a comprehensive firm-wide view of its credit risk and covers the full credit lifecycle (including credit underwriting, credit evaluation, and the management of the firm’s business).
Part 4.2 Credit risk management policy

4.2.1 Credit risk management policy

(1) An Islamic banking business firm must establish and implement a credit risk management policy:

(a) that is appropriate for the nature, scale and complexity of its business and for its risk profile; and

(b) that enables the firm to identify, measure, evaluate, manage and control or mitigate credit risk.

(2) The objective of the policy is to give the firm the capacity to absorb any existing and estimated future losses arising from credit risk.

4.2.2 Policies—general credit risk environment

An Islamic banking business firm’s credit risk management policy must establish:

(a) a well-documented and effectively-implemented process for assuming credit risk that does not rely unduly on external credit ratings;

(b) well-defined criteria for approving credit (including prudent underwriting standards), and renewing, refinancing and restructuring existing credit;

(c) a process for identifying the approving authority for credit, given its size and complexity;

(d) effective credit risk administration, including:

(i) regular analysis of counterparties’ ability and willingness to repay; and

(ii) monitoring of documents, legal covenants, contractual requirements, and collateral and other CRM techniques;

(e) effective systems for the accurate and timely identification, measurement, evaluation, management and control or mitigation of credit risk, and reporting to the firm’s governing body and senior management;
(f) procedures for tracking and reporting exceptions to, and deviations from, credit limits or policies;

(g) prudent and appropriate credit limits that are consistent with the firm’s risk tolerance, risk profile and capital; and

(h) effective controls for the quality, reliability and relevance of data and validation procedures.

**Guidance**

Depending on the nature, scale and complexity of an Islamic banking business firm’s credit risk, and how often it provides credit or incurs credit risk, the firm’s credit risk management policy should include:

(a) how the firm defines and measures credit risk;

(b) the firm’s business aims in incurring credit risk, including:

- identifying the types and sources of credit risk that the firm will permit itself to be exposed to (and the limits on that exposure) and those that it will not
- setting out the degree of diversification that the firm requires, the firm’s tolerance for risk concentrations and the limits on exposures and concentrations
- stating the risk-return trade-off that the firm is seeking to achieve;

(c) the kinds of credit to be offered, and ceilings, pricing, profitability, maximum maturities and ratios for each kind of credit;

(d) a ceiling for the total credit portfolio (in terms, for example, of loan-to-deposit ratio, undrawn commitment ratio, maximum amount or percentage of the firm’s capital);

(e) portfolio limits for maximum gross exposures by region or country, by industry or sector, by category of counterparty (such as banks, non-bank financial entities and corporate counterparties), by product, by counterparty and by connected counterparties;

(f) limits, terms and conditions, approval and review procedures and records kept for lending to connected counterparties;

(g) types of collateral, loan-to-value ratios and criteria for accepting guarantees;

(h) the detailed limits for credit risk, and a credit risk structure, that:

- takes into account all significant risk factors, including intra-group exposures
- is commensurate with the scale and complexity of the firm’s activities
is consistent with the firm’s business aims, historical performance, and the amount of capital it is willing to risk;

(i) procedures for:

- approving new products and activities that give rise to credit risk
- regular risk position and performance reporting
- approving and reporting exceptions to limits;

(j) allocating responsibilities for implementing the credit risk management policy and monitoring adherence to, and the effectiveness of, the policy; and

(k) the required information systems, staff and other resources.

4.2.3 Policies—credit decisions

(1) An Islamic banking business firm’s credit risk management policy must require that credit decisions are free of conflicts of interest and are made on an arm’s-length basis. In particular, the credit approval and credit review functions must be independent of the credit initiation function.

Guidance

1. This rule does not prevent arrangements such as an employee loan scheme, so long as the policy ensures that the scheme’s terms, conditions and limits are generally available to employees and adequately address the risks and conflicts that arise from loans under it.

2. The credit risk management policy of an Islamic banking business firm should clearly set out who has the authority to approve loans to employees.

3. The authority of a credit committee or credit officer should be appropriate for the products or portfolio and should be commensurate with the committee’s or officer’s credit experience and expertise.

4. Each authority to approve should be reviewed regularly to ensure that it remains appropriate for current market conditions and the committee’s or officer’s performance.

5. An Islamic banking business firm’s remuneration policy should be consistent with its credit risk management policy and should not encourage officers to attempt to generate short-term profits by taking an unacceptably high level of risk.
(2) The policy must state that decisions relating to the following are made at the appropriate level of the firm’s senior management or governing body:

(a) exposures exceeding a stated amount or percentage of the firm’s capital;

(b) exposures that, in accordance with criteria set out in the policy, are especially risky;

(c) exposures that are outside the firm’s core business.

Guidance

1 The level at which credit decisions are made should vary depending on the kind and amount of credit and the nature, scale and complexity of the firm’s business. For some firms, a credit committee with formal terms of reference might be appropriate; for others, individuals with pre-assigned limits would do.

2 An Islamic banking business firm should ensure, through periodic independent audits, that the credit approval function is properly managed and that credit exposures comply with prudential standards and internal limits. The results of audits should be reported directly to the governing body, credit committee or senior management, as appropriate.

4.2.4 Policies—monitoring, testing and access

(1) An Islamic banking business firm’s credit risk management policy must provide for monitoring the total indebtedness of each counterparty and any risk factors that might result in default (including any significant unhedged foreign exchange risk).

(2) The policy must include stress-testing the firm’s credit exposures at intervals appropriate for the nature, scale and complexity of the firm’s business and for its risk profile. It must also include a yearly review of stress scenarios, and procedures to make any necessary changes arising from the review.

Note 1 The firm’s ICAAP sets out how this monitoring and testing is to be achieved. ICAAP includes procedures to continuously identify, measure, evaluate, manage and control or mitigate the risks arising from the firm’s activities, and the capital held against such risks—see rules 3.1.4 and 3.1.5.

Note 2 For stress-testing and stress scenarios, see rule 1.1.17.
(3) A firm must give the Regulatory Authority full access to information in its credit portfolio. The firm must also give the authority access to staff involved in assuming, managing and reporting on credit risk.
Part 4.3 Credit risk assessment

4.3.1 Introduction

This Part sets out a standardised approach for credit risk assessment, and requires an Islamic banking business firm to establish and implement policies to identify, measure, evaluate, manage and control or mitigate credit risk and to calculate its credit risk capital requirement.

Guidance

1 Credit risk assessment under this Part is different from the evaluation (often called credit assessment) made by a firm as part of its credit approval process.
2 Credit assessment is part of the firm’s internal commercial decision-making for approving or refusing credit; it consists of the evaluation of a prospective counterparty’s repayment ability. In contrast, credit risk assessment is carried out by the firm (using ratings and risk-weights set out in these rules) as part of calculating its credit risk capital requirement.

4.3.2 Policies—credit risk assessment

An Islamic banking business firm must establish and implement appropriate policies to enable it to assess credit risk when the credit is granted or the risk is incurred, and afterwards. In particular, the policies must enable the firm:

(a) to measure credit risk (including the credit risk of off-balance-sheet items in credit equivalent terms);
(b) to effectively use its internal credit risk assessment;
(c) to rate and risk-weight a counterparty;
(d) to monitor the condition of individual credits;
(e) to administer its credit portfolio, including keeping the credit files current, getting up-to-date financial information on counterparties, and the electronic storage of important documents;
(f) to ensure that the value of collateral and the value of the other CRM techniques used by the firm are assessed regularly;
(g) to assess whether its CRM techniques are effective; and
(h) to calculate its credit risk capital requirement.

Guidance
An Islamic banking business firm involved in loan syndications or consortia should not rely on other parties’ assessments of the credit risk involved but should carry out a full assessment based on its own credit risk management policy.

4.3.3 Categories of credits

(1) Unless an Islamic banking business firm has established something more detailed, the firm must classify credits into 1 of the 5 categories in table 4.3.3. Nothing in the table prevents an Islamic banking business firm from classifying a credit under a higher risk category than the table requires.

(2) Unless there is good reason not to do so, the same category must be given to all credit exposures to the same counterparty.

Table 4.3.3 Categories of credit

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 category</th>
<th>column 3 description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>performing</td>
<td>In this category, there is no uncertainty about timely repayment of the outstanding amounts. This category comprises credits that are currently in regular payment status with prompt payments.</td>
</tr>
<tr>
<td>column 1 item</td>
<td>column 2 category</td>
<td>column 3 description</td>
</tr>
<tr>
<td>---------------</td>
<td>-------------------</td>
<td>---------------------</td>
</tr>
</tbody>
</table>
| 2             | special mention   | This category comprises:  
(a) credits with deteriorating or potentially deteriorating credit quality that may adversely affect the counterparty’s ability to make scheduled payments on time;  
(b) credits that are 30 to 90 days in arrears;  
(c) credits showing weakness arising from the customer’s financial position;  
(d) credits affected by market circumstances or any other industry-related concerns; and  
(e) credits that have been restructured and are not classified into a higher risk category. |
| 3             | substandard       | This category comprises:  
(a) credits that show definite deterioration in credit quality and impaired repayment ability of the counterparty; and  
(b) credits that are 91 to 180 days in arrears. |
### Credit risk assessment

#### Rule 4.3.4

<table>
<thead>
<tr>
<th>item</th>
<th>category</th>
<th>description</th>
</tr>
</thead>
</table>
| 4    | doubtful | This category comprises:  
(a) credits that show significant credit quality deterioration, worse than those in the substandard category, to the extent that the prospect of full recovery of all the outstanding amounts is questionable and the probability of a credit loss is high (though the exact amount of loss cannot be determined yet); and  
(b) credits that are 181 to 270 days in arrears. |
| 5    | loss     | This category comprises:  
(a) credits that are assessed as uncollectable;  
(b) credits where the probability of recovering the amount due is very low; and  
(c) credits that are more than 270 days in arrears. |

### 4.3.4 Policies—problem assets

An Islamic banking business firm’s credit risk management policy must facilitate the firm’s collection of past-due obligations, and its management of problem assets through:  
(a) monitoring of their credit quality;  
(b) early identification and ongoing oversight; and  
(c) review of their classification, provisioning and write-offs.
4.3.5 Impaired credits

(1) **Impaired credit** means a credit that is categorised as substandard, doubtful or loss.

(2) A large exposure that is an impaired credit must be managed individually in terms of its valuation, categorisation and provisioning.

*Note* For large exposures, see rule 5.3.1. For the provisioning of impaired credits, see rule 4.7.3.

(3) The review of impaired credits and other problem assets may be done individually, or by class, but must be done at least once a month.

4.3.6 Restructuring, refinancing and re-provisioning of credits

(1) A credit is a **restructured credit** if it has been re-aged, extended, deferred, renewed, rewritten or placed in a workout program. Unless there is good reason to do so, a restructured credit can never be classified as performing.

(2) A restructured credit may be reclassified to a more favourable category, but only by 1 rating up from its category before the restructure. The credit may be reclassified 1 further category up after 180 days of satisfactory performance under the terms of the new contract.

(3) The refinancing of a special mention or impaired credit must not be used to reclassify the credit to a more favourable category.

*Note* An Islamic banking business firm must not restructure, refinance or reclassify assets with a view to circumventing the requirements on provisioning—see rule 4.7.5.

(4) The Regulatory Authority may require a special mention credit to be managed individually, and may set a higher level of provision for the credit, if the authority is of the view that market circumstances or any other industry-related concerns require such action.

*Note* For the provisioning of special mention credits, see rule 4.7.3.

4.3.7 Using external credit rating agencies

(1) An Islamic banking business firm must-use only a solicited credit risk rating determined by an ECRA.
A rating is a *solicited rating* if the rating was initiated and paid for by the issuer of the instrument, the rated counterparty or any other entity in the same corporate group as the issuer or rated counterparty.

The firm must use the ratings determined by an ECRA consistently and in accordance with these rules and its credit risk management policy.

**Example**

A firm that chooses to use ratings determined by an ECRA for exposures belonging to a class must consistently use those ratings for all the exposures belonging to that class. The firm must not selectively pick between ECRAs or ratings in determining risk-weights.

Unsolicited ratings must not be used except with the written approval of the Regulatory Authority or in accordance with a direction of the authority. The authority may give a written direction setting out conditions that must be satisfied before a firm may use an unsolicited rating.

The firm must ensure that the relevant rating takes into account the total amount of the exposure.

**Guidance**

1. In the standardised approach, external credit ratings from ECRAs are used in determining the risk-weights for exposures to:
   - sovereigns
   - central banking institutions
   - public sector enterprises
   - banks and other financial institutions
   - corporates.

   For examples of the items listed in guidance 1, see table 4.4.7B.

2. External credit ratings from ECRAs are not used in relation to:
   - regulatory retail portfolios
   - residential real estate financing
   - non-performing financing
   - high risk exposures.
4.3.8 Multiple assessments

(1) If there is only 1 assessment by an ECRA for a particular claim, that assessment must be used to determine the risk-weight of the claim.

(2) If there are 2 assessments by ECRA and the assessments map into different risk-weights, the higher risk-weight must be applied.

(3) If there are 3 or more assessments with different risk-weights, the assessments corresponding to the 2 lowest risk-weights should be referred to and the higher of those 2 risk-weights must be applied.

4.3.9 Choosing between issuer and issue ratings

(1) If an Islamic banking business firm invests in an instrument with an issue-specific rating, the risk-weight to be applied to the instrument must be based on that rating.

(2) If the firm invests in an unrated instrument and the issuer of the instrument is assigned a rating that results in a lower risk-weight than the risk-weight normally applied to an unrated position, the firm may apply the lower risk-weight to the instrument but only if the claim for the instrument has the same priority as, or is senior to, the claims to which the issuer rating relates. If the instrument is junior to the claims to which the issuer rating relates, the firm must apply the risk-weight normally applied to an unrated position.

(3) If the firm invests in an unrated instrument and the issuer of the instrument is assigned a rating that results in a higher risk-weight than the risk-weight normally applied to an unrated position, the firm must apply the higher risk-weight to the instrument if the claim for that instrument has the same priority as, or is junior to, the claims to which the issuer rating relates.

4.3.10 Ratings within financial group

An Islamic banking business firm must not use a credit risk rating for 1 entity in a financial group to determine the risk-weight for an unrated entity in the same group. If the rated entity has guaranteed the unrated entity’s exposure to the firm, the guarantee may be
recognised for risk-weighting purposes if it satisfies the criteria in Division 4.6.C.

4.3.11 **Using foreign currency and domestic currency ratings**

If an issuer rating is assigned to a counterparty and an Islamic banking business firm applies a risk-weight to an unrated position based on the rating of an equivalent exposure to the same counterparty:

(a) the firm must use that counterparty’s domestic-currency rating for any exposure denominated in the currency of the counterparty’s place of residence or incorporation; and

(b) the firm must use that counterparty’s foreign-currency rating for any exposure denominated in a foreign currency.

4.3.12 **Using short-term ratings**

(1) A short-term credit risk rating must be used only for short-term claims relating to banks and corporations (such as those arising from the issuance of commercial paper). The rating is taken to be issue-specific and must be used only to assign risk-weights for claims arising from a rated facility.

(2) If a short-term rated exposure is assigned a risk-weight of 50%, an unrated short-term exposure to the same counterparty cannot be assigned a risk-weight lower than 100%.

(3) If a short-term facility of an issuer is assigned a risk-weight of 150% based on the facility’s credit risk rating, all unrated claims of the issuer (whether long-term or short-term) must be assigned a risk-weight of 150%.
Part 4.4 Risk-weighted assets approach

Division 4.4.A General

4.4.1 Requirement to risk-weight

(1) An Islamic banking business firm must apply risk-weights to its on-balance-sheet and off-balance-sheet items using the risk-weighted assets approach.

(2) Risk-weights are based on credit ratings or fixed risk-weights and are broadly aligned with the likelihood of counterparty default. A firm may use the ratings determined by an ECRA if allowed to do so by these rules.

4.4.2 Relation to CRM techniques

If a claim or asset to which a risk-weight must be applied by an Islamic banking business firm is secured by collateral or a guarantee (or there is a Shari’a-compliant hedging instrument or netting agreement), the CRM techniques in Part 4.6 may be used to reduce the firm’s credit risk capital requirement.

4.4.3 Risk-weight to be applied

An Islamic banking business firm must apply the risk-weight set out in this Part for a claim or asset.

4.4.4 Firm must assess all credit exposures

(1) An Islamic banking business firm must assess all credit exposures (rated or unrated) to determine whether the risk-weights applied to them are appropriate. The determination must be based on each exposure’s inherent risk.

(2) If there are reasonable grounds to believe that the inherent risk of an exposure is significantly higher than that implied by the risk-weight assigned to it, the firm must consider the higher risk (and apply a higher risk-weight) in calculating the credit risk capital requirement.
(3) An Islamic banking business firm must not rely only on a rating determined by an ECRA to assess the risks associated with an exposure. The firm must also carry out its own credit risk assessment of each exposure.

4.4.5 Commitments included in calculation

An Islamic banking business firm must take into account all commitments in calculating its credit risk capital requirement, whether or not those commitments contain material adverse change clauses or other provisions that are intended to relieve the firm of its obligations under particular conditions.

4.4.6 Authority can determine risk-weights and impose requirements

(1) Despite anything in these rules, the Regulatory Authority may determine the risk-weighted amount of a particular on-balance-sheet or off-balance-sheet item of an Islamic banking business firm if the authority considers that the firm has not risk-weighted the item appropriately. The determination must be in writing.

(2) The authority may also impose specific capital requirements or limits on significant risk exposures, including those that the authority considers have not been adequately transferred or mitigated.

Division 4.4.B Risk-weighted assets approach—on-balance-sheet items

4.4.7 Calculating total risk-weighted items

(1) An Islamic banking business firm’s total risk-weighted on-balance-sheet items is the sum of the risk-weighted amounts of each of its on-balance-sheet items.

(2) The risk-weighted amount of an on-balance-sheet item is calculated by multiplying its exposure (after taking into account any applicable CRM technique) by the applicable risk-weight set out in table 4.4.7A.
(3) If column 3 of table 4.4.7A states that the risk-weight is “based on ECRA rating”, the applicable risk-weight for the claim or asset is that set out in table 4.4.7B. If a claim’s or asset’s risk-weight is to be based on the ECRA rating and there is no such rating from an ECRA, the firm must apply the risk-weight set out in the last column of table 4.4.7B.

(4) For table 4.4.7A, investment property is land, a building or part of a building (or any combination of land and building) held to earn rentals or for capital appreciation or both.

(5) Investment property does not include property held for use in the production or supply of goods or services, for administrative purposes, or for sale in the ordinary course of business. A real estate asset owned by an Islamic banking business firm as a result of a counterparty default is treated as ‘other item’ and risk-weighted at 100% but only for a period of 3 years starting from the date when the firm records the asset on its books.

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 description of claim or asset</th>
<th>column 3 risk-weight %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>cash</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) notes, gold bullion</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) cash items in the process of collection</td>
<td>20</td>
</tr>
<tr>
<td>2</td>
<td>claims on sovereigns</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(a) claims on Qatar including Qatar Central Bank</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) claims on GCC sovereigns including respective central banks</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 4.4.7A Risk-weights for on-balance-sheet items
<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 description of claim or asset</th>
<th>column 3 risk-weight %</th>
</tr>
</thead>
<tbody>
<tr>
<td>(c)</td>
<td>claims on other sovereigns including respective central banks</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>3</td>
<td>claims on public sector enterprises</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>claims on non-commercial public sector enterprises in Qatar</td>
<td>0</td>
</tr>
<tr>
<td>(b)</td>
<td>claims on non-commercial public sector enterprises in other GCC countries, denominated in the relevant enterprise’s domestic currency</td>
<td>0</td>
</tr>
<tr>
<td>(c)</td>
<td>claims on non-commercial public sector enterprises in other GCC countries, not denominated in the relevant enterprise’s domestic currency</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>(d)</td>
<td>claims on other sovereign non-commercial public sector enterprises</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>(e)</td>
<td>commercial public sector enterprises</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>4</td>
<td>claims on multilateral development banks</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>claims on multilateral development banks eligible for 0% risk-weight</td>
<td>0</td>
</tr>
<tr>
<td>(b)</td>
<td>claims on other multilateral development banks</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>column 1 item</td>
<td>column 2 description of claim or asset</td>
<td>column 3 risk-weight %</td>
</tr>
<tr>
<td>---------------</td>
<td>--------------------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td>5</td>
<td>claims on banks (financial undertakings)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) claims on banks with an original maturity of more than 3 months based on ECRA rating</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) claims on banks with an original maturity of 3 months or less based on ECRA rating</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>claims on securities and investment entities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) claims on securities and investment entities that are subject to capital requirements similar to Islamic banks based on ECRA rating</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) claims on securities and investment entities that are not subject to capital requirements similar to Islamic banks based on ECRA rating</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>claims on corporates</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>8</td>
<td>claims on small and medium enterprises</td>
<td>100</td>
</tr>
<tr>
<td>9</td>
<td>claims on securitisation exposures</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>10</td>
<td>claims secured against mortgages</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) residential mortgages</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(i) if the loan-to-value ratio is 0% to 80%</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td>(ii) if the loan-to-value ratio is more than 80% but less than 100%</td>
<td>75</td>
</tr>
<tr>
<td></td>
<td>(iii) if the loan-to-value ratio is 100% or more</td>
<td>100</td>
</tr>
<tr>
<td>column 1 item</td>
<td>column 2 description of claim or asset</td>
<td>column 3 risk-weight %</td>
</tr>
<tr>
<td>---------------</td>
<td>--------------------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td>(b)</td>
<td>commercial mortgages</td>
<td>100</td>
</tr>
<tr>
<td>11</td>
<td>Failed and unsettled transactions—delivery-versus-payment transactions</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>5 to 15 days</td>
<td>100</td>
</tr>
<tr>
<td>(b)</td>
<td>16 to 30 days</td>
<td>625</td>
</tr>
<tr>
<td>(c)</td>
<td>31 to 45 days</td>
<td>937.5</td>
</tr>
<tr>
<td>(d)</td>
<td>46 or more days</td>
<td>1250</td>
</tr>
<tr>
<td>12</td>
<td>Failed and unsettled transactions—non-delivery-versus-payment transactions</td>
<td>100</td>
</tr>
<tr>
<td>13</td>
<td>investments in funds</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>rated funds</td>
<td>based on ECRA rating</td>
</tr>
<tr>
<td>(b)</td>
<td>unrated funds that are listed</td>
<td>100</td>
</tr>
<tr>
<td>(c)</td>
<td>unrated funds that are unlisted</td>
<td>150</td>
</tr>
<tr>
<td>14</td>
<td>equity exposures</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>equity exposures that are not deducted from capital and are listed on a recognised exchange</td>
<td>300</td>
</tr>
<tr>
<td>(b)</td>
<td>equity exposures that are not deducted from capital and are not listed on a recognised exchange</td>
<td>400</td>
</tr>
<tr>
<td>15</td>
<td>investment property</td>
<td>150</td>
</tr>
<tr>
<td>16</td>
<td>all other items</td>
<td>100</td>
</tr>
</tbody>
</table>
Note for table 4.4.7A

The Basel Committee on Banking Supervision (BCBS) publishes a list of multilateral development banks that qualify for 0% risk weight. The list was originally included in the document *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version*, published by the BCBS on 30 June 2006 (available at http://www.bis.org/publ/bcbs128.pdf), and has been updated by BCBS newsletters. BCBS newsletters are available at http://www.bis.org/list/bcbs_nl/index.htm.

As at November 2016 the list is as follows:

- the African Development Bank
- the Asian Development Bank
- the Caribbean Development Bank
- the Council of Europe Development Bank
- the European Bank for Reconstruction and Development
- the European Investment Bank
- the European Investment Fund
- the Inter-American Development Bank
- the International Development Association
- the International Finance Facility for Immunization
- the Islamic Development Bank
- the Nordic Investment Bank

Examples of MDBs that do not qualify for 0% risk weight are:

- the Arab Bank for Economic Development in Africa
- the Asian Infrastructure Investment Bank
- the Black Sea Trade and Development Bank
- the Development Bank of Latin America
- the Central American Bank for Economic Integration
- the Development Bank of Central African States
- the East African Development Bank
- the Economic Cooperation Organization Trade and Development Bank
Table 4.4.7B Risk-weights based on ratings determined by ECRAs

<table>
<thead>
<tr>
<th>Item</th>
<th>description of claim or asset</th>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to BB-</th>
<th>B+ to B-</th>
<th>below B-</th>
<th>unrated</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>claims on other sovereigns including respective central banks</td>
<td>0</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>claims on non-commercial public sector enterprises in other GCC countries—non-relevant domestic currency</td>
<td>0</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: In table 4.4.7B, the ratings are given according to Standard & Poor’s conventions. If a claim or asset is not rated by Standard & Poor’s, its ratings must be mapped to the equivalent Standard & Poor’s rating.
<table>
<thead>
<tr>
<th>item</th>
<th>description of claim or asset</th>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to BB-</th>
<th>B+ to B-</th>
<th>below B-</th>
<th>unrated</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>claims on other sovereign non-commercial public sector enterprises</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>4</td>
<td>claims on commercial public sector enterprises</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>claims on multilateral development banks not eligible for 0% risk-weight</td>
<td>20</td>
<td>50</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>50</td>
</tr>
<tr>
<td>6</td>
<td>claims on banks with an original maturity of more than 3 months</td>
<td>20</td>
<td>50</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>50</td>
</tr>
<tr>
<td>7</td>
<td>claims on banks with an original maturity of 3 months or less</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>50</td>
<td>50</td>
<td>150</td>
<td>20</td>
</tr>
<tr>
<td>Item</td>
<td>description of claim or asset</td>
<td>AAA to AA-</td>
<td>A+ to A-</td>
<td>BBB+ to BBB-</td>
<td>BB+ to BB-</td>
<td>B+ to B-</td>
<td>below B-</td>
<td>unrated</td>
</tr>
<tr>
<td>------</td>
<td>-------------------------------</td>
<td>------------</td>
<td>----------</td>
<td>-------------</td>
<td>-----------</td>
<td>---------</td>
<td>---------</td>
<td>--------</td>
</tr>
<tr>
<td>8</td>
<td>claims on securities and investment entities that are subject to capital requirements similar to Islamic banks</td>
<td>20</td>
<td>50</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>50</td>
</tr>
<tr>
<td>9</td>
<td>claims on securities and investment entities that are not subject to capital requirements similar to Islamic banks</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>10</td>
<td>claims on corporates</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>150</td>
<td>100</td>
</tr>
<tr>
<td>11</td>
<td>securitisation exposures</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>150</td>
<td>250</td>
<td>150</td>
</tr>
<tr>
<td>12</td>
<td>investments in rated funds</td>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>150</td>
<td>n/a</td>
</tr>
</tbody>
</table>
4.4.8 Specialised lending

(1) A specialised lending exposure is risk-weighted at one rating less favourable than the rating that would apply, under table 4.4.7B, to the counterparty to the transaction (or to the party to whom that counterparty has the right of recourse).

(2) *Specialised lending* is a lending transaction that complies with the following requirements:

(a) the purpose of the loan is to acquire an asset;
(b) the cash flow generated by the collateral is the loan’s exclusive (or almost exclusive) source of repayment;
(c) the loan represents a significant liability in the borrower’s capital structure;
(d) the credit risk is determined primarily by the variability of the cash flow generated by the collateral (rather than the independent capacity of a broader commercial enterprise).

*Note* Specialised lending is associated with the financing of projects where the repayment depends on the performance of the underlying collateral. There are 5 subclasses of specialised lending:

(a) project finance—financing industrial projects based on the projected cash flows of the project;
(b) object finance—financing physical assets based on the projected cash flows obtained primarily through the rental or lease of the assets;
(c) commodities finance—financing the reserves, receivables or inventories of exchange-traded commodities where the exposure is paid back based on the sale of the commodity (rather than by the borrower from independent funds);
(d) income-producing real estate finance—financing real estate that is usually rented or leased out by the debtor to generate cash flow to repay the exposure; and
(e) high-volatility commercial real estate finance—financing commercial real estate which demonstrates a much higher volatility of loss rates compared to other forms of specialised lending.
4.4.9 Risk-weights for unsecured part of claim that is past due for more than 90 days

(1) The risk-weight for the unsecured part of a claim (other than a claim secured by an eligible residential mortgage) that is past due for more than 90 days is:
   (a) 150% if the specific provisions are less than 20% of the past due claim;
   (b) 100% if the specific provisions are 20% or more, but less than 50%, of the past due claim; or
   (c) 50% if the specific provisions are 50% or more of the past due claim.

(2) The risk-weight for the unsecured part of a claim secured by an eligible residential mortgage that is past due for more than 90 days is:
   (a) 100% if the specific provisions are less than 20% of the past due claim; or
   (b) 50% if the specific provisions are 20% or more of the past due claim.

(3) In this rule:
   eligible residential mortgage means a mortgage on a residential property that is, or will be:
   (a) occupied by the counterparty for residential use; or
   (b) rented out (on a non-commercial basis) for residential use.

Division 4.4.C Risk-weighted assets approach—off-balance-sheet items

4.4.10 Calculating total risk-weighted items

(1) An Islamic banking business firm’s total risk-weighted off-balance-sheet items is the sum of the risk-weighted amounts of its market-related and non-market-related off-balance-sheet items. An off-balance-sheet item must be converted to a credit equivalent amount before it can be risk-weighted.
(2) The risk-weighted amount of an off-balance-sheet item is calculated as follows:

- first, convert the notional principal amount of the item to its on-balance-sheet equivalent (credit equivalent amount).

  Note For the conversion of market-related items, see rule 4.4.11. For the conversion of non-market-related items, see rules 4.4.15 to 4.4.17.

- second, multiply the resulting credit equivalent amount by the risk-weight in Division 4.4.B applicable to the claim or asset.

(3) An Islamic banking business firm must include all market-related off-balance-sheet items (including on-balance-sheet unrealised gains on market-related off-balance-sheet items) in calculating its risk-weighted credit exposures.

(4) A market-related item must be valued at its current market price.

4.4.11 How to convert notional amounts—market-related items

(1) An Islamic banking business firm must calculate the credit equivalent amount of each of its market-related items. Unless the item is covered by an eligible netting agreement, the credit equivalent amount of a market-related off-balance-sheet item is the sum of the current credit exposure and the potential future credit exposure from the item.

(2) Current credit exposure is the absolute mark-to-market value (or replacement cost) of the item.

(3) Potential future credit exposure (also known as ‘the add-on’) is the amount calculated by multiplying the notional principal amount of the item by the relevant credit conversion factor in table 4.4.11. The notional principal amount of an item is the reference amount used to calculate payment streams between counterparties to the item.
### Table 4.4.11 Credit conversion factors for market-related off-balance-sheet items

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 description of claim or asset</th>
<th>column 3 credit conversion factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>profit rate contracts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) residual maturity 1 year or less</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>(b) residual maturity &gt; 1 year to 5 years</td>
<td>0.5</td>
</tr>
<tr>
<td></td>
<td>(c) residual maturity &gt; 5 years</td>
<td>1.5</td>
</tr>
<tr>
<td>2</td>
<td>foreign exchange, gold and silver contracts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) residual maturity 1 year or less</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>(b) residual maturity &gt; 1 year to 5 years</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>(c) residual maturity &gt; 5 years</td>
<td>7.5</td>
</tr>
<tr>
<td>3</td>
<td>equity contracts</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) residual maturity 1 year or less</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>(b) residual maturity &gt; 1 year to 5 years</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>(c) residual maturity &gt; 5 years</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>precious metal contracts (other than gold and silver)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) residual maturity 1 year or less</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>(b) residual maturity &gt; 1 year to 5 years</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>(c) residual maturity &gt; 5 years</td>
<td>8</td>
</tr>
<tr>
<td>5</td>
<td>other commodity contracts (other than precious metals)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) residual maturity 1 year or less</td>
<td>10</td>
</tr>
</tbody>
</table>
(4) A potential future credit exposure must be based on an effective, rather than an apparent, notional principal amount. If the stated notional principal amount of an item is leveraged or enhanced by the structure of the item, the firm must use the effective notional principal amount in calculating the potential future credit exposure.

(5) No potential future credit exposure is calculated for a single-currency floating/floating profit rate swap. The credit exposure from such a profit rate swap must be based on mark-to-market values.

### 4.4.12 Credit conversion factors for items with terms subject to reset

(1) For an item that is structured to settle outstanding exposures after specified payment dates on which the terms are reset (that is, the mark-to-market value of the item becomes zero on the specified dates), the period up to the next reset date must be taken to be the item’s residual maturity. For a profit rate item of that kind that is taken to have a residual maturity of more than 1 year, the credit conversion factor to be applied must not be less than 0.5% even if there are reset dates of a shorter maturity.

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 description of claim or asset</th>
<th>column 3 credit conversion factor %</th>
</tr>
</thead>
<tbody>
<tr>
<td>(b)</td>
<td>residual maturity &gt; 1 year to 5 years</td>
<td>12</td>
</tr>
<tr>
<td>(c)</td>
<td>residual maturity &gt; 5 years</td>
<td>15</td>
</tr>
<tr>
<td>6</td>
<td>other market-related contracts</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>residual maturity 1 year or less</td>
<td>10</td>
</tr>
<tr>
<td>(b)</td>
<td>residual maturity &gt; 1 year to 5 years</td>
<td>12</td>
</tr>
<tr>
<td>(c)</td>
<td>residual maturity &gt; 5 years</td>
<td>15</td>
</tr>
</tbody>
</table>
(2) For an item with 2 or more exchanges of principal, the credit conversion factor must be multiplied by the number of remaining exchanges under the item.

4.4.13 Credit conversion factors for single-name swaps

(1) The credit conversion factors for a protection buyer in a single-name total-rate-of-return swap are set out in column 3 of table 4.4.13. The credit conversion factors for a protection seller are set out in column 4 of that table.

(2) The protection seller in a single-name total-rate-of-return swap is subject to the add-on factor for a closed-out single-name swap only if the protection buyer becomes insolvent while the underlying asset is still solvent. The add-on must not be more than the amount of unpaid premiums.

(3) In this rule:

*qualifying reference obligation* includes obligations arising from items relating to:

(a) securities that are rated investment grade by at least 2 ECRAs; or

(b) securities that are unrated (or rated investment grade by only 1 ECRA), but:

(i) are approved by the Regulatory Authority, on application by the banking business firm, to be of comparable investment quality; and

(ii) are issued by an issuer that has its equity included in a main index used in a recognised exchange.
### Table 4.4.13 Credit conversion factors for single-name total-rate-of-return swaps

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 type of swap</th>
<th>column 3 protection buyer %</th>
<th>column 4 protection seller %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>with qualifying reference obligation</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>with non-qualifying reference obligation</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

#### 4.4.14 Policies—foreign exchange rollovers

1. An Islamic banking business firm must have policies for entering into and monitoring rollovers on foreign exchange transactions. The policies must restrict the firm’s capacity to enter into such rollovers, and must be approved by the Regulatory Authority.

2. The firm must notify the Regulatory Authority if it enters into a rollover outside the approved policy. The authority may direct how the rollover is to be treated for capital adequacy purposes.

3. The firm must not enter into a transaction at an off-market price, unless the transaction is a historical rate rollover on a foreign exchange transaction.

4. A historical rate rollover on a foreign exchange transaction may be entered into at an off-market price (instead of current market price).

#### 4.4.15 How to convert contracted amounts—non-market-related items

1. An Islamic banking business firm must calculate the credit equivalent amount of each of its non-market-related items. Unless the item is a default fund guarantee in relation to clearing through a central counterparty, the credit equivalent amount of a non-market-related off-balance-sheet item is calculated by multiplying the contracted amount of the item by the relevant credit conversion factor in table 4.4.15.
(2) If the firm arranges a repurchase or reverse repurchase or a securities lending or borrowing transaction between a customer and a third party and provides a guarantee to the customer that the third party will perform its obligations, the firm must calculate the credit risk capital requirement as if it were the principal.

Table 4.4.15 Credit conversion factors for non-market-related off-balance-sheet items

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 kind of item</th>
<th>column 3 credit conversion factor %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>direct credit substitutes</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>performance-related contingencies</td>
<td>50</td>
</tr>
<tr>
<td>3</td>
<td>trade-related contingencies</td>
<td>20</td>
</tr>
<tr>
<td>4</td>
<td>lending of securities, or lodging securities as collateral</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>assets sold with recourse</td>
<td>100</td>
</tr>
<tr>
<td>6</td>
<td>forward asset purchases</td>
<td>100</td>
</tr>
<tr>
<td>7</td>
<td>partly paid shares and securities</td>
<td>100</td>
</tr>
<tr>
<td>8</td>
<td>placements of forward deposits</td>
<td>100</td>
</tr>
<tr>
<td>9</td>
<td>note issuance and underwriting facilities</td>
<td>50</td>
</tr>
<tr>
<td>10</td>
<td>commitments with certain drawdown</td>
<td>100</td>
</tr>
<tr>
<td>11</td>
<td>commitments with uncertain drawdowns (for example, undrawn formal standby facilities and credit lines) with an original maturity of 1 year or less</td>
<td>20</td>
</tr>
<tr>
<td>12</td>
<td>commitments with uncertain drawdowns with an original maturity of more than 1 year</td>
<td>50</td>
</tr>
<tr>
<td>column 1 item</td>
<td>column 2 kind of item</td>
<td>column 3 credit conversion factor %</td>
</tr>
<tr>
<td>---------------</td>
<td>-----------------------</td>
<td>-----------------------------------</td>
</tr>
<tr>
<td>13</td>
<td>commitments that can be unconditionally cancelled at any time without notice (for example, undrawn overdraft and credit card facilities for which any outstanding unused balance is subject to review at least once a year)</td>
<td>0</td>
</tr>
</tbody>
</table>

(3) For item 4 of table 4.4.15, an exposure from lending securities, or lodging securities as collateral, may be treated as a collateralised transaction.

### 4.4.16 Credit equivalent amount of undrawn commitments

In calculating the credit equivalent amount of a non-market-related off-balance-sheet item that is an undrawn (or partly drawn) commitment, an Islamic banking business firm must use the undrawn amount of the commitment.

### 4.4.17 Irrevocable commitment—off-balance-sheet facilities

For an irrevocable commitment to provide an off-balance-sheet facility, the original maturity must be taken to be the period from the commencement of the commitment until the associated facility expires.

**Example**

An irrevocable commitment with an original maturity of 6 months with an associated facility that has a nine-month term is taken to have an original maturity of 15 months.
Part 4.5 Risk-weightings for Islamic financial contracts

Division 4.5.A General

4.5.1 Introduction

(1) This Part describes and sets out the risk-weights applicable to the main kinds of Islamic financial contracts.

(2) The risk-weight to be applied to the exposure under a contract of a particular type may differ:

(a) at different stages of the contract; or

(b) depending on the enterprise or asset to which the contract relates.

4.5.2 Risk-weights for hybrid contracts

If an Islamic banking product or financial instrument is structured using a combination of Islamic financial contracts, and it is not clear from this Part what risk-weight must be applied to the product or instrument, the firm must not apply a risk-weight unless the risk-weight has been approved by the Regulatory Authority.

Division 4.5.B Sale-based contracts

4.5.3 Treatment of murabahah and related contracts

(1) An Islamic banking business firm is exposed to credit risk under a murabahah contract if the obligor fails to pay the agreed selling price under the contract. Therefore, the firm is subject to a capital charge for credit risk exposure once the asset is sold and payment is due to the firm.

(2) For an MPO contract, the firm is exposed to credit risk if the obligor (purchase orderer) defaults on its obligation to purchase the asset. Because the firm has recourse against the obligor to purchase the asset at the agreed price, the credit risk exposure commences once the firm acquires the asset.
(3) In an MPO contract, the firm is also exposed to credit risk if the obligor fails to pay the agreed price in accordance with the agreed terms.

(4) *Bai bithaman ajil* and *musawamah* contracts are treated in the same way as *murabahah* contracts.

**Table 4.5.3A Credit risk-weights for *murabahah***

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>asset is available for sale and on firm’s balance sheet</td>
<td>n/a</td>
</tr>
<tr>
<td>asset has been sold and title transferred, and selling price is due to the firm</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>

**Table 4.5.3B Credit risk-weights for MPO**

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>asset available for sale and on firm’s balance sheet</td>
<td>based on the customer’s type and rating under Part 4.4, with the applicable risk-weight applied to the acquisition cost less any cash collateral</td>
</tr>
<tr>
<td>asset has been sold and title transferred, and selling price is due to firm</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>

**Table 4.5.3C Credit risk-weights for CMTs**

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>commodity available for sale and on firm’s balance sheet</td>
<td>based on the customer’s type and rating under Part 4.4, with the applicable risk-weight applied to the acquisition cost less any eligible collateral</td>
</tr>
<tr>
<td>commodity has been sold and delivered</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>
### 4.5.4 Treatment of salam and related contracts

1. Under a salam contract, an Islamic banking business firm is exposed to credit risk if the obligor fails to deliver the relevant commodity in accordance with the agreed terms.

2. An Islamic banking business firm undertaking parallel salam contracts is exposed to credit risk if the purchaser fails to pay for the relevant commodity. Nevertheless, if the seller under the first salam contract fails to deliver the commodity, the firm is not relieved of its obligation to deliver the commodity to the purchaser under the parallel salam contract.

3. The firm must not net a salam exposure against a parallel salam exposure.

#### Table 4.5.4A Credit risk-weights for salam without parallel salam

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>firm is expecting delivery of the commodity after purchase price has been paid to salam customer (seller)</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>

#### Table 4.5.4B Credit risk-weights for salam with parallel salam

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>firm is expecting delivery of the commodity after purchase price has been paid to salam customer (seller)</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>

*Note* The parallel salam does not extinguish the requirement for capital from the first salam contract.
4.5.5 **Treatment of *istisna* and related contracts**

(1) Under an *istisna* contract, an Islamic banking business firm is exposed to credit risk if the obligor fails to pay the price, whether during the manufacturing or construction stage, or on completion of the asset.

(2) Under a parallel *istisna* contract, the firm, as the purchaser of the asset, is exposed to credit risk if the seller fails to deliver the asset at the agreed time and in accordance with the initial *istisna* buyer’s specification.

(3) The parallel *istisna* seller’s failure to deliver the asset does not discharge the firm’s obligation to deliver the asset to the obligor under the initial *istisna* contract. Thus, the firm is also exposed to the potential loss of making good the shortcoming or acquiring the asset elsewhere.

(4) The firm must not net an *istisna* exposure against a parallel *istisna* exposure.

**Table 4.5.5A Credit risk-weights for *istisna* without parallel *istisna***

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>unbilled work-in-process</td>
<td>based on the ultimate counterparty’s type and rating under Part 4.4</td>
</tr>
<tr>
<td>unpaid billed work-in-process</td>
<td>based on the ultimate counterparty’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>

**Table 4.5.5B Credit risk-weights for *istisna* with parallel *istisna***

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>unbilled work-in-process</td>
<td>based on the ultimate counterparty’s type and rating under Part 4.4</td>
</tr>
<tr>
<td>unpaid billed work-in-process</td>
<td>based on the ultimate counterparty’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>
Division 4.5.C  Lease-based contracts

4.5.6  Treatment of *ijarah* and related contracts

(1) An Islamic banking business firm that is the lessor under an *ijarah* contract is exposed to credit risk if the lessee fails to pay the rental amount in accordance with the agreement to lease.

(2) In addition, the firm is exposed to credit risk if the lessee (lease orderer) defaults on its obligation to lease the asset. In this situation, the firm may lease or dispose of the asset to another party, but the firm is also exposed to credit risk if the lessee is not able to compensate it for the losses incurred arising from the disposal of the asset.

(3) In an *ijarah* contract, the underlying asset is not eligible collateral for purposes of credit risk mitigation.

(4) An IMB contract is treated as a financing agreement and must be risk-weighted in accordance with table 4.5.6.

Table 4.5.6  Credit risk-weights for IMB contracts

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>asset available for lease and on firm’s balance sheet</td>
<td>based on the lessee’s type and rating under Part 4.4, with the applicable risk-weight applied to the acquisition cost</td>
</tr>
<tr>
<td>lease contract has become binding and rental payments due from lessee</td>
<td>based on the lessee’s type and rating under Part 4.4, with the applicable risk-weight applied to net receivables (that is, total estimated value of lease receivables for the remaining period plus the residual value of the leased asset at the end of the contract)</td>
</tr>
</tbody>
</table>

(5) An operating *ijarah* is treated as an investment and must be risk-weighted in accordance with subrule (6), (7), (8) or (9), depending on the leased asset and how the investment is made.

(6) If the investment in is real estate and the investment is made by the firm itself (*direct investment exposure*), the risk-weighted amount of
the direct investment exposure must be calculated by multiplying the carrying value of the asset by 150%.

(7) If the investment is in real estate and the investment is made by the firm indirectly \((indirect \text{ investment exposure})\) through subsidiary, its share of equity investment in the capital of such subsidiary must be risk-weighted at 150% and any financing provided by the firm to the subsidiary must be risk-weighted at the same rate.

(8) If the investment is in real estate and the investment is made by the firm indirectly \((indirect \text{ investment exposure})\) through a joint venture or partnership, the indirect investment exposure must be risk-weighted at:

(a) 300% if the firm has majority ownership over the asset and can exit the investment at any time; or
(b) 400% if the firm does not have majority ownership over the asset or cannot exit the investment at any time.

(9) If the investment is in physical assets (such as commercial vehicles, passenger cars, ships, aircraft, railway machinery, computers, business machines and other types of equipment), the exposure must be risk-weighted at:

(a) 300% if the firm has majority ownership over the asset and can exit the investment at any time; or
(b) 400% if the firm does not have majority ownership over the asset or cannot exit the investment at any time.

\section*{Division 4.5.D \hspace{1cm} Equity-based contracts}

\subsection*{4.5.7 \hspace{1cm} Treatment of \textit{musharakah}}

(1) For the purpose of determining the minimum capital requirement, there are 4 categories of \textit{musharakah}:

(a) private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities;

(b) private commercial enterprise to undertake a business venture other than trading in foreign exchange, shares or commodities;
(c) joint ownership of real estate or movable assets through *musharakah* with *murabahah* subcontract; and  

(d) joint ownership of real estate or movable assets through *musharakah* with *ijarah* subcontract

(2) Except in the case of diminishing *musharakah* contracts, all *musharakah* investments are treated as equity investments.

(3) As an equity investment, a *musharakah* investment must be risk-weighted in accordance with table 4.5.7A.

### Table 4.5.7A Credit risk-weights for *musharakah* (non-diminishing)

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 description of investment</th>
<th>column 3 risk-weight %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>investments in funds</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) rated funds</td>
<td>based on ECRA rating in table 4.5.7B</td>
</tr>
<tr>
<td></td>
<td>(b) unrated funds that are listed</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>(c) unrated funds that are unlisted</td>
<td>150</td>
</tr>
<tr>
<td>2</td>
<td>equity exposures</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) equity exposures that are not deducted from capital and are listed on a recognised exchange</td>
<td>300</td>
</tr>
<tr>
<td></td>
<td>(b) equity exposures that are not deducted from capital and are not listed on a recognised exchange</td>
<td>400, except if rule 4.5.7 (4) applies</td>
</tr>
<tr>
<td>3</td>
<td>investment in real estate</td>
<td>150</td>
</tr>
</tbody>
</table>
Table 4.5.7B Risk-weights for investments in rated funds based on ECRA ratings

<table>
<thead>
<tr>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to BB-</th>
<th>B+ to B-</th>
<th>below B-</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>50</td>
<td>100</td>
<td>100</td>
<td>150</td>
<td>150</td>
</tr>
</tbody>
</table>

(4) The lower risk-weight of 300% applies to an investment that would normally be risk-weighted at 400% if, under the *musharakah* contract, the Islamic banking business firm is allowed to withdraw its participation within 5 business days after giving notice of withdrawal. In any other case, the firm may apply a risk-weight of 300% if it can demonstrate:

(a) that the lower risk-weight is appropriate for the nature, scale and complexity of the firm’s business;
(b) that the firm can effectively participate in the management of the investment and that such participation would not unduly increase operational risk;

(c) the firm’s ability to monitor the operations and performance of the investment;

(d) that the valuation methods and exit strategies used by the firm are appropriate; and

(e) that the firm has effective reporting and information-sharing systems.

4.5.8 **Treatment of diminishing musharakah**

(1) Because a diminishing musharakah contract is treated as a financing agreement, its credit risk-weight has a different basis compared to musharakah investments, depending on the category of the enterprise or asset to which the contract relates. A diminishing musharakah investment must be risk-weighted in accordance with table 4.5.8.

<table>
<thead>
<tr>
<th>Enterprise or asset</th>
<th>Credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities</td>
<td>n/a</td>
</tr>
<tr>
<td>Private commercial enterprise to undertake a business venture other than trading in foreign exchange, shares or commodities</td>
<td>Based on the customer’s type and rating under Part 4.4 (after customer agrees to buy out the firm’s share on the investment)</td>
</tr>
</tbody>
</table>

*Note* Before the customer agrees to buy out the firm’s share on the investment, the exposure is treated as an investment and must therefore be risk-weighted in accordance with table 4.5.7A.
**4.5.9 Treatment of mudarabah and related contracts**

This rule applies to risk-weighting for an exposure arising from a *mudarabah* contract, except if the Regulatory Authority examines the exposure and determines it to be an equity investment. If the authority determines that the exposure is an equity investment, the risk-weights set out in rule 4.5.7 for *musharakah* apply.

**Table 4.5.9A Credit risk-weights for mudarabah investments (other than project finance)**

<table>
<thead>
<tr>
<th>enterprise or asset</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>joint ownership of real estate or movable assets through <em>musharakah</em> with <em>murabahah</em> subcontract</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
<tr>
<td>joint ownership of real estate or movable assets through <em>musharakah</em> with <em>ijarah</em> subcontract</td>
<td>based on the lessee’s type and rating under Part 4.4</td>
</tr>
<tr>
<td>private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities</td>
<td>n/a</td>
</tr>
<tr>
<td>private commercial enterprise to undertake a business venture other than trading in foreign exchange, shares or commodities</td>
<td>before maturity: 400% of the contributed amount less any specific provisions (or 300% if the funds may be withdrawn by the firm within 5 business days after giving notice of withdrawal) on maturity: after the <em>mudarib</em> has agreed to pay back the firm’s initial investment, based on the <em>mudarib</em>’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>
Chapter 4  Credit risk  
Part 4.5  Risk-weightings for Islamic financial contracts

Rule 4.5.10

<table>
<thead>
<tr>
<th>enterprise or asset</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>placement in the interbank market</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>

Table 4.5.9B Credit risk-weights for mudarabah investments in project finance

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>before completion: unbilled work-in-process inventory</td>
<td>400% on unbilled inventory less any amount held in the repayment account</td>
</tr>
<tr>
<td>on completion: after certification from ultimate counterparty, where the amount</td>
<td>based on the ultimate counterparty’s type and rating under Part 4.4</td>
</tr>
<tr>
<td>is receivable by the firm from the mudarib (for progress payment to the mudarib</td>
<td>or</td>
</tr>
<tr>
<td>from the ultimate counterparty)</td>
<td>based on the mudarib’s type and rating under Part 4.4:</td>
</tr>
<tr>
<td></td>
<td>(a) for any amount already paid by the ultimate counterparty to the mudarib; or</td>
</tr>
<tr>
<td></td>
<td>(b) if the mudarib undertakes to bear the default risk of the ultimate counterparty</td>
</tr>
<tr>
<td></td>
<td>as part of the mudarabah contract</td>
</tr>
</tbody>
</table>

Division 4.5.E  Loan-based contracts

4.5.10  Treatment of qard

Under a qard contract, an Islamic banking business firm is exposed to credit risk if the borrower fails to repay the principal loan amount in accordance with the contract. Hence, the credit risk exposure arises at the time the contract becomes binding.

Table 4.5.10 Credit risk-weights for qard

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>amount receivable from customer</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>
Division 4.5.F  Service-based contracts

4.5.11  Treatment of *wakalah*

An Islamic banking business firm is exposed to credit risk if the firm enters into a financing agreement based on *wakalah*.

**Table 4.5.11A  Credit risk-weights for *wakalah* investments (other than project finance)**

<table>
<thead>
<tr>
<th>enterprise or asset</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities</td>
<td>n/a</td>
</tr>
<tr>
<td>private commercial enterprise to undertake a business venture other than trading in foreign exchange, shares or commodities</td>
<td>400% of the contributed amount less any specific provisions (or 300% if the funds may be withdrawn by the firm within 5 business days after giving notice of withdrawal)</td>
</tr>
<tr>
<td>placement in the interbank market</td>
<td>based on the customer’s type and rating under Part 4.4</td>
</tr>
</tbody>
</table>
### Table 4.5.11B  Credit risk-weights for *wakalah* investments in project finance

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>credit risk-weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>before completion: unbilled work-in-process inventory</td>
<td>400% on unbilled inventory</td>
</tr>
</tbody>
</table>
| on completion: after certification from ultimate counterparty, where the amount is receivable by the firm from the *wakeel* (for progress payment to the *wakeel* from the ultimate counterparty) | based on the ultimate counterparty’s type and rating under Part 4.4 or based on the *wakeel*’s type and rating under Part 4.4:
  (a) for any amount already paid by the ultimate counterparty to the *wakeel*; or
  (b) if the *wakeel* undertakes to bear the default risk of the ultimate counterparty as part of the *wakalah* contract |
Part 4.6 Credit risk mitigation

Division 4.6.A General

4.6.1 Introduction

An Islamic banking business firm is able to obtain capital relief by using Shari’a-compliant CRM techniques. The techniques must be viewed as complementary to, rather than a replacement for, thorough credit risk assessment.

*Note* Under rule 4.4.2, if a claim or asset to which a risk-weight must be applied is secured by collateral or guarantee (or there is a Shari’a-compliant hedging instrument or netting agreement), this Part on credit risk mitigation may be used to reduce the credit risk capital requirement of the firm.

4.6.2 Choice of CRM techniques

(1) **CRM techniques** include:

(a) accepting collateral, standby letters of credit and guarantees;

(b) using Shari’a-compliant hedging instruments; and

(c) using netting agreements.

*Note* Credit risk mitigation using collateral and guarantees is usually dealt with at the time credit is granted. In contrast, hedging instruments and netting agreements are often used after the credit is granted, or used to manage the firm’s overall portfolio risk.

**Guidance**

1. An Islamic banking business firm should not rely excessively on collateral or guarantees to mitigate credit risk. While collateral or guarantees may provide secondary protection to the firm if the counterparty defaults, the primary consideration for credit approval should be the counterparty’s repayment ability.

2. An Islamic banking business firm that provides mortgages at high loan-to-value ratios should consider the need for alternative forms of protection against the risks of such lending, in order to protect itself against the risk of a fall in the value of the property.

(2) In choosing a CRM technique, the firm must consider:

(a) the firm’s knowledge of, and experience in using, the technique;
(b) the cost-effectiveness of the technique;
(c) the type and financial strength of the counterparties or issuers;
(d) the correlation of the technique with the underlying credits;
(e) the availability, liquidity and realisability of the technique;
(f) the extent to which documents in common use (for example, the ISDA Master Agreement) can be adopted; and
(g) the degree of recognition of the technique by financial services regulators.

4.6.3 Requirements—CRM techniques

(1) An Islamic banking business firm’s credit risk management policy must set out the conditions under which CRM techniques may be used. The policy must enable the firm to manage CRM techniques and the risks associated with their use.

(2) The firm must analyse the protection given by CRM techniques to ensure that any residual credit risk is identified, measured, evaluated, managed and controlled or mitigated.

(3) The policy must include procedures for:
   (a) setting mark-up rates according to the risk rating of the counterparties;
   (b) taking account of governing laws for contracts relating to financing transactions; and
   (c) assessing the risks and obligations from the firm’s own exposures in parallel transactions such as those in salam and istisna.

(4) If the firm accepts collateral, its policy must state the types of collateral that it will accept, and the basis and procedures for valuing collateral.

(5) If the firm uses netting agreements, it must have a netting policy that sets out its approach. The netting policy must provide for monitoring netting agreements and must enable the firm to monitor and report netted transactions on both gross and net bases.
4.6.4 Obtaining capital relief

(1) To obtain capital relief, the CRM technique and every document giving effect to it must be binding on all parties and enforceable in all the relevant jurisdictions.

Example
When accepting collateral, an Islamic banking business firm must ensure that any necessary legal procedures have been followed, to ensure that the collateral can be enforced.

Note Under rule 4.2.2, a firm’s credit risk management policy must establish effective credit risk administration to monitor documents, legal covenants, contractual requirements, and collateral and other CRM techniques.

(2) An Islamic banking business firm must review the enforceability of a CRM technique that it uses. The firm must have a well-founded legal basis for any conclusion about enforceability, and must carry out further reviews to ensure that the technique remains enforceable.

Guidance
An Islamic banking business firm should consider whether independent legal opinion should be sought on the enforceability of documents. The documents should be ready before the firm enters into a contractual obligation or releases funds.

(3) The effects of a CRM technique must not be double-counted. The firm is not allowed to obtain capital relief if:

(a) the risk-weight for the claim or asset is based on an issue-specific rating; and

(b) the ECRA that determined the rating had taken the technique into consideration in doing so.

4.6.5 Standard haircuts to be applied

(1) An Islamic banking business firm must use the standard haircuts (expressed in percentages) set out in this rule in any calculation relating to credit risk mitigation. The haircuts are applied after risk mitigation to calculate adjusted exposures and are intended to take into account possible future price fluctuations.
(2) In table 4.6.5A:

- **other issuers** include banks, corporates, and public sector enterprises that are not treated as sovereigns.
- **sovereign** includes a multilateral development bank, and a non-commercial public sector enterprise, that has a zero per cent risk-weight.

### Table 4.6.5A Haircuts for sukuk

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 credit rating for debt securities</th>
<th>column 3 residual maturity %</th>
<th>column 4 sovereigns %</th>
<th>column 5 other issuers %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AAA to AA-/A-1 (long-term and short-term)</td>
<td>≤1 year</td>
<td>0.5</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt;1 year, ≤ 5 years</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; 5 years</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>2</td>
<td>A+ to BBB-/A-2/A-3/P-3 (long-term and short-term)</td>
<td>≤1 year</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt;1 year, ≤ 5 years</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; 5 years</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>3</td>
<td>BB+ to BB- (long-term)</td>
<td>All</td>
<td>15</td>
<td>n/a</td>
</tr>
<tr>
<td>4</td>
<td>securities issued by the State of Qatar or the Qatar Central Bank</td>
<td>≤1 year</td>
<td>1</td>
<td>n/a</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt;1 year, ≤ 5 years</td>
<td>3</td>
<td>n/a</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt; 5 years</td>
<td>6</td>
<td>n/a</td>
</tr>
</tbody>
</table>
Credit risk mitigation

**Rule 4.6.5**

*Note* Table 4.6.5A item 3, column 5: securities rated BB+ or below are eligible collateral only if issued by a sovereign or non-commercial public sector enterprise—see rule 4.6.8(1) (e) (i).

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 description of assets</th>
<th>column 3 haircut %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>main index equities (including convertible sukuk)</td>
<td>15</td>
</tr>
<tr>
<td>2</td>
<td>other equities (including convertible sukuk) listed on a recognised exchange</td>
<td>25</td>
</tr>
<tr>
<td>3</td>
<td>units in Islamic collective investment schemes</td>
<td>depending on underlying assets, as above</td>
</tr>
<tr>
<td>4</td>
<td>residential real estate if the loan-to-value ratio is ≤ 100%, subject to the conditions that:</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>(a) the firm holds a first mortgage;</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) at least 2 independent valuations of the property are obtained; and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(c) the lowest valuation is used to value the property</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>other real estate for which the firm holds a first mortgage</td>
<td>50</td>
</tr>
<tr>
<td>6</td>
<td>gold</td>
<td>15</td>
</tr>
<tr>
<td>7</td>
<td>metals other than gold</td>
<td>30</td>
</tr>
<tr>
<td>8</td>
<td>agricultural and other commodities</td>
<td>50</td>
</tr>
<tr>
<td>9</td>
<td>other physical assets pledged in accordance with rule 4.6.9</td>
<td>50</td>
</tr>
<tr>
<td>column 1 item</td>
<td>column 2 description of assets</td>
<td>column 3 haircut %</td>
</tr>
<tr>
<td>--------------</td>
<td>---------------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>10</td>
<td>units in listed trusts, undertakings for collective investments in transferable securities <em>(UCITS)</em>, mutual funds and tracker funds</td>
<td>highest haircut applicable to any security in which the entity can invest</td>
</tr>
<tr>
<td>11</td>
<td>cash collateral denominated in the same currency as the collateralised exposure</td>
<td>0</td>
</tr>
</tbody>
</table>

(3) If a CRM technique (other than a guarantee) and the exposure covered by it are denominated in different currencies (that is, there is a currency mismatch between them), the haircut that applies is:

- (a) if the mismatched currencies are both pegged to the same reference currency, or 1 of them is pegged to the other—0; or
- (b) in any other case—8%.

(4) If there is a currency mismatch between a guarantee and the exposure covered by it, the amount of the exposure that is covered must be reduced using the following formula:

\[ G \times (1 - H_{fx}) \]

where:

- \( G \) is the nominal amount of the guarantee.
- \( H_{fx} \) is the haircut appropriate for the currency mismatch between the credit protection and the underlying obligation, as follows:
  - (a) if the guarantee is revalued every 10 business days—8%;
  - (b) if the guarantee is revalued at any longer interval—the factor \( H \) calculated using the formula in subrule (5); or
  - (c) if the mismatched currencies are both pegged to the same reference currency, or if 1 of them is pegged to the other—0.
(5) If the guarantee is revalued at intervals longer than 10 business days, the 8% haircut must be scaled up using the following formula:

\[ H = 8 \left( \frac{N+9}{10} \right) \]

where:

- \( H \) is the scaled-up haircut.
- \( N \) is the number of business days between the revaluations.

### Division 4.6.B Collateral

#### 4.6.6 Capital relief from collateral

(1) An Islamic banking business firm may obtain capital relief by accepting Shari’a-compliant eligible collateral.

(2) Collateral may be lodged by the counterparty of the firm holding a credit exposure (or by a third party on behalf of the counterparty).

(3) The firm must enter into a written agreement with the party lodging the collateral. The agreement must establish the firm’s direct, explicit, irrevocable and unconditional recourse to the collateral.

**Guidance**

In the case of cash collateral, the recourse may be in the form of a contractual right of set-off on credit balances. A common-law right of set-off is, on its own, insufficient to satisfy this rule.

(4) If collateral is lodged by a third party, the third party must guarantee the counterparty’s obligation to the firm and must indemnify the firm if the counterparty fails to fulfil its obligation. The firm must ensure that the guarantee does not fail for lack of consideration.

(5) The mechanism by which collateral is lodged must allow the firm to liquidate or take possession of the collateral in a timely way. The firm must take all steps necessary to satisfy the legal requirements applicable to its interest in the collateral.

**Guidance**

1. The firm should have clear and robust procedures for the liquidation of collateral to ensure that the legal conditions for declaring default and liquidating the collateral are observed.
Chapter 4  Credit risk  
Part 4.6  Credit risk mitigation

Rule 4.6.7

2 The firm should consider whether, in the event of default, notice to the party that lodged the collateral would be needed before the firm could have recourse to it.

(6) There must not be a significant positive correlation between the value of the collateral and the credit quality of the borrower.

4.6.7 Valuing collateral

Collateral accepted by an Islamic banking business firm must be valued at its net realisable value, taking into account prevailing market conditions. That value must be monitored at appropriate intervals, and the collateral must be regularly revalued.

Guidance

1 The net realisable value of some collateral may be readily available (for example, collateral that is marked-to-market regularly). Other collateral may be more difficult to value and may require knowledge and consideration of prevailing market conditions.

2 The method and frequency of monitoring and revaluation depend on the nature and condition of the collateral (see rules 4.6.8(2) and 4.6.9(2) and (3). For example:

- securities accepted as collateral are usually marked-to-market daily while physical assets that are accepted as eligible collateral are valued less often
- commercial property might be valued every year while residential property might not need to be valued as often.

4.6.8 Eligible collateral for Islamic banking business firms

(1) The following are eligible collateral if they satisfy the criteria in subrule (2):

(a) gold bullion;

(b) cash;

Note For what is included in cash collateral, see rule 4.6.10(1).

(c) hamish jiddiyah or refundable security deposit taken by the firm against damages if:

(i) a purchase orderer in an MPO contract defaults on its obligation to purchase the asset; or
(ii) a lease orderer in an ijarah contract defaults on its obligation to lease the asset;

(d) *urbun* or earnest money held by a firm as collateral to guarantee contract performance;

(e) sukuk that are assigned, by an ECRA, a rating of:
   (i) for sovereign or non-commercial public sector enterprise securities that are eligible for zero per cent risk-weight—
       at least BB-;
   (ii) for short-term debt securities—at least A-3/P-3; or
   (iii) for any other securities—at least BBB-;

(f) subject to subrule (3), *sukuk* that have not been assigned a rating by an ECRA, if:
   (i) the securities are issued by an Islamic banking business firm (or by a conventional bank that is outside the QFC and that has an Islamic window or subsidiary operation) as senior debt and are listed on a recognised exchange;
   (ii) all rated issues of the same seniority issued by that firm or bank have a credit rating of at least BBB- (for long-term debt instruments) or A-3/P-3 (for short-term debt instruments); and
   (iii) the firm or bank and the holder of the collateral have no information suggesting that the securities should have a rating below BBB- or A-3/P-3;

(g) Shari’a-compliant equities (including convertible *sukuk*) that are included in a main index;

(h) units in Islamic collective investment schemes;

(i) tracker funds, mutual funds and undertakings for collective investments in transferable securities (*UCITS*) if:
   (i) a price for the units is publicly quoted daily; and
   (ii) the funds or UCITS are limited to investing in instruments listed in this subrule;
(j) Shari’a-compliant equities (including convertible sukuk) that are not included in a main index but are listed on a recognised exchange, and funds and UCITS described in paragraph (i) that include such equities.

(2) For collateral to be eligible collateral, it must be lodged for at least the life of the exposure, and must be marked-to-market at least once a month. The release of collateral must be conditional on the repayment of the exposure, but collateral may be reduced in proportion to the amount of any reduction in the exposure.

(3) Collateral in the form of securities issued by the counterparty or a person connected to the counterparty is not eligible collateral.

(4) Takaful contracts, unilateral promises to buy from counterparties (such as put options), and forward sales contracts or agreements (such as salam and istisna contracts) are not eligible collateral.

4.6.9 When physical assets may be eligible collateral

(1) An Islamic banking business firm may accept as eligible collateral, by way of pledge, a specified asset that can be lawfully owned, and is saleable and deliverable. The pledge must be enforceable and the asset must be free of encumbrance.

Note In an ijara contract, the underlying asset is not eligible collateral for purposes of credit risk mitigation, see rule 4.5.6(3).

(2) A physical asset accepted as eligible collateral must be valued depending on whether there is an active market for the asset. If there is such a market, the asset must be valued at least once a month.

(3) If there is no active market for the asset, it must be valued:

(a) each time there is a significant change in the market in which the asset operates; and

(b) each time there is a significant change in the condition of the asset.
4.6.10 **Forms of cash collateral**

*Cash collateral*, in relation to a credit exposure, means collateral in the form of:

(a) PSIs, notes or coins on deposit with the firm holding the exposure, if supported by an agreement that gives the firm the right of set-off against the amount of receivables due from the customer;

(b) certificates of deposit, bank bills and similar instruments issued by the Islamic banking business firm holding the exposure; or

(c) cash-funded credit-linked notes issued by the firm against exposures in its banking book, if the notes satisfy the criterion for Shari’a-compliant hedging instruments in rule 4.6.17(2).

4.6.11 **Holding eligible collateral**

(1) Eligible collateral must be held by:

(a) the Islamic banking business firm;

(b) a branch (in or outside the QFC) of the firm;

(c) an entity that is a member of the financial group of which the firm is a member;

(d) an independent custodian; or

(e) a central counterparty.

(2) The holder of cash collateral in the form of a certificate of deposit or bank bill issued by an Islamic banking business firm must keep possession of the instrument while the collateralised exposure exists.

(3) If the collateral is held by an independent custodian or central counterparty, the firm must take reasonable steps to ensure that the holder segregates the collateral from the holder’s own assets.

(4) If collateral is held by a branch of an Islamic banking business firm and the branch is outside the QFC, the agreement between the firm and the party lodging the collateral must require the branch to act in accordance with the agreement.
4.6.12 Risk-weight for cash collateral

(1) An Islamic banking business firm may apply a zero per cent risk-weight to cash collateral if the collateral is held by the firm itself.

(2) The firm may apply a zero per cent risk-weight to cash collateral held by another member of the financial group of which the firm is a member if the agreement between the firm and the party lodging the collateral requires the holder of the collateral to act in accordance with the agreement.

(3) If cash collateral is held by another Islamic banking business firm under a non-custodial arrangement, and the collateral is lodged with the firm under an agreement that establishes the firm’s irrevocable and unconditional recourse to the collateral, the exposure covered by the collateral (after any necessary haircuts for currency risk) may be assigned the risk-weight of the firm holding the collateral.

(4) If cash collateral is held by an independent custodian (other than a central counterparty), the risk-weight of the holder of the collateral must be used. However, the firm may apply a zero per cent risk-weight to notes and coins held by an independent custodian.

4.6.13 Risk-weight for claims

(1) The secured part of a claim must be risk-weighted at whichever is the higher of 20% and the risk-weight applicable to the eligible collateral. However, a risk-weight lower than 20% may be applied to the secured part if rule 4.6.14 applies.

Note Under this rule, 20% risk-weight is the minimum that can be applied to the secured part of the claim. A risk-weight of less than 20% is allowed only for some transactions—see rule 4.6.14.

(2) The unsecured part of the claim must be weighted at the risk-weight applicable to the original counterparty.

4.6.14 Risk-weights less than 20%

(1) A zero per cent risk-weight may be applied to a collateralised transaction if:

(a) there is no currency mismatch; and
(b) any one of the following applies:

   (i) the collateral is in the form of sovereign securities that are eligible for zero per cent risk-weight;

   (ii) the collateral is in the form of cash collateral on deposit with the Islamic banking business firm; or

   (iii) if the collateral is in the form of non-commercial public sector enterprise securities:

       (A) the securities are eligible for zero per cent risk-weight; and

       (B) the market value of the collateral has been discounted by 20%.

(2) A zero per cent risk-weight may be applied to an OTC Shari’a-compliant hedging transaction if there is no currency mismatch and the transaction is fully collateralised by cash and marked-to-market daily.

(3) A 10% risk-weight may be applied to an OTC Shari’a-compliant hedging transaction to the extent that the transaction is collateralised by sovereign or non-commercial public sector enterprise securities that are eligible for zero per cent risk-weight.

Division 4.6.C Guarantees

4.6.15 Capital relief from guarantees

(1) Capital relief is allowed from a guarantee if the guarantor is an eligible guarantor and the guarantee satisfies the criteria in subrules (2) to (4). Before accepting a guarantee, an Islamic banking business firm must consider the guarantor’s legal and financial ability to fulfil the guarantee.

(2) A guarantee must be a direct claim on the guarantor and must clearly state the extent of the cover. A letter of comfort is not a guarantee for the purposes of this Division.
(3) A guarantee must be irrevocable. It must not include a term or condition:
   (a) that allows the guarantor to cancel it unilaterally; or
   (b) that increases the effective cost of cover if the credit quality of the guaranteed exposure deteriorates.

   *Note* The irrevocability condition does not require that the guarantee and the exposure be maturity matched. However, it does require that the agreed maturity should not be reduced by the guarantor after the Islamic banking business firm accepts the guarantee.

(4) A guarantee must be unconditional. It must not include a term or condition (outside the direct control of the firm) that allows the guarantor not to indemnify the firm in a timely way if the counterparty defaults.

(5) If a claim on a counterparty is secured by a guarantee, the part of the claim that is covered by the guarantee may be weighted at the risk-weight applicable to the guarantor. The unsecured part of the claim must be weighted at the risk-weight applicable to the original counterparty.

   *Note* This rule applies to a guarantee that provides part coverage under which the firm and the guarantor share losses on a pro-rata basis.

### 4.6.16 Eligible guarantors

(1) *Eligible guarantor* means:

   (a) the State of Qatar, any other sovereign or any entity treated as a sovereign; or

   (b) any other entity (including a public sector enterprise not treated as a sovereign) that has:

      (i) a risk-weight of 20% or lower; and

      (ii) a lower risk-weight than the counterparty.

(2) A parent entity, subsidiary or affiliate of a counterparty may be an eligible guarantor if it has a lower risk-weight than the counterparty.
Division 4.6.D  Shari’a-compliant hedging instruments

4.6.17  Capital relief from hedging instruments

(1) Capital relief is allowed if an Islamic banking business firm uses a Shari’a-compliant hedging instrument. Each of the following is a Shari’a-compliant hedging instrument if it satisfies subrule (2):

   (a) a total-rate-of-return swap for which the firm has recorded any deterioration in the value of the underlying exposure, in addition to recording the net payments received on the swap as net income;
   
   (b) a cash-funded credit-linked note;
   
   (c) a first and second-to-default hedging instrument basket product.

(2) The hedging instrument must not include a term or condition that terminates the credit protection, or increases the firm’s costs for the protection, if the credit quality of the underlying exposure deteriorates.

(3) If a claim on a counterparty is protected by a Shari’a-compliant hedging instrument, the part of the claim that is protected may be weighted at the risk-weight applicable to the issuer of the instrument. The unprotected part of the claim must be weighted at the risk-weight applicable to the original counterparty.

Division 4.6.E  Netting agreements

4.6.18  Capital relief from netting agreements

(1) An Islamic banking business firm is able to obtain capital relief from a netting agreement with a counterparty only if the agreement is an eligible netting agreement.

(2) An Islamic banking business firm that has entered into a netting agreement must consistently net all the transactions included in the agreement. The firm must not selectively pick which transactions to net.
(3) The following kinds of transactions may be netted:
   (a) financing assets and deposits, but only if:
       (i) the firm is able to determine, at all times, the assets and deposits that are subject to netting under the agreement; and
       (ii) the deposits satisfy the criteria for eligible collateral;

   (b) securities financing transactions;

   Note Securities financing transactions are not included as part of market-related transactions.

   (c) OTC Shari’a-compliant hedging transactions.

   **Guidance**
   A netting agreement may include the netting of OTC Shari’a-compliant hedging transactions:
   - across both the banking and trading books of an Islamic banking business firm (if the netted transactions satisfy the criteria in rule 4.6.24)
   - across different market-related products to the extent that they are recognised as market-related transactions.

### 4.6.19 Criteria for eligible netting agreements

(1) To be an *eligible netting agreement*, a netting agreement:

   (a) must be in writing;

   (b) must create a single obligation covering all transactions and collateral included in the agreement and giving the Islamic banking business firm the following rights:

       (i) the right to terminate and close-out, in a timely way, all the transactions included in the netting agreement;

       (ii) the right to net the gains and losses on those transactions (including the value of any collateral) so that the firm either has a claim to receive, or an obligation to pay, only the net sum of the close-out values of the individual transactions;

   Note For swaps, options and other Shari’a-compliant hedging transactions, this right would include the positive and
negative mark-to-market values of the individual transactions.

(iii) the right to liquidate or set-off collateral if either party to the agreement fails to meet its obligations because of default, liquidation, bankruptcy or other similar circumstances;

(c) must not be subject to a walkaway clause; and

(d) must be supported by a written and reasoned legal opinion that complies with rules 4.6.21 to 4.6.23.

(2) An Islamic banking business firm must not recognise a netting agreement as an eligible netting agreement if it becomes aware that a financial services regulator of the counterparty is not satisfied that the agreement is enforceable under the laws of the regulator’s jurisdiction. This rule applies regardless of any legal opinion obtained by the firm.

(3) A netting agreement is not an eligible netting agreement if there is doubt about its enforceability.

4.6.20 Legal opinion must cover transaction

(1) An Islamic banking business firm must ensure that a netted transaction is covered by an appropriate legal opinion.

(2) In calculating the net sum due to or from a counterparty, the firm must exclude netted transactions for which it has not obtained a satisfactory legal opinion applicable in the relevant jurisdiction. An excluded transaction must be reported on a gross basis.

4.6.21 Conclusion about enforceability

(1) For rule 4.6.19 (1) (d), the legal opinion must conclude that, in the event of default, liquidation, bankruptcy or other similar circumstances of a party to the netting agreement, the Islamic banking business firm’s claims and obligations are limited to the net sum
calculated under the netting agreement in accordance with the applicable law.

**Guidance**

The Regulatory Authority expects the legal opinion to deal with the issue of which of the following laws applies to the netting:

- the law of the jurisdiction in which the counterparty is incorporated or formed (or, in the case of an individual, resides)
- if an overseas branch of the counterparty is involved—the law of the jurisdiction in which the branch is located
- the law that governs the individual transactions
- the law that governs any contract or agreement necessary to give effect to the netting.

(2) In particular, the legal opinion must conclude that, in the event of insolvency or external administration of a counterparty, a liquidator or administrator of the counterparty will not be able to claim a gross amount from the firm while only being liable to pay a dividend in insolvency to the firm (as separate money flows).

**Guidance**

In some countries, there are provisions for the authorities to appoint an administrator to a troubled bank. Under statutory provisions applying in those countries, the appointment of an administrator might not constitute a ground for triggering a netting agreement. Such provisions do not prevent the recognition of an affected netting agreement if the agreement can still take effect if the bank under administration does not meet its obligations as they fall due.

### 4.6.22 Requirements—legal opinion

(1) Before an Islamic banking business firm uses a legal opinion to support a netting agreement, the firm:

(a) must ensure that the opinion is not subject to assumptions or qualifications that are unduly restrictive;

(b) must review the assumptions about the enforceability of the agreement and must ensure that they are specific, factual and adequately explained in the opinion; and
(c) must review and assess the assumptions, qualifications and
omissions in the opinion to determine whether they give rise to
any doubt about the enforceability of the agreement.

(2) The firm must have procedures to monitor legal developments and to
ensure that its netting agreements continue to be enforceable. The
firm must update the legal opinions about the agreements, as
necessary, to ensure that the agreements continue to be eligible.

(3) The firm may rely on a legal opinion obtained on a group basis by
another member of the financial group of which it is a member if the
firm and the other member have satisfied themselves that the opinion
covers a netting agreement to which the firm is a counterparty.

(4) The firm must report a transaction on a gross basis if there is any
doubt about, or any subsequent legal development affects, the
enforceability of the agreement.

*Note* Under rule 4.6.19 (3), a netting agreement is not an eligible netting
agreement if there is doubt about its enforceability.

### 4.6.23 Relying on general legal opinions

(1) An Islamic banking business firm may rely on a general legal opinion
about the enforceability of netting agreements in a particular
jurisdiction if the firm is satisfied that the type of netting agreement
is covered by the opinion.

(2) The firm must satisfy itself that the netting agreement with a
counterparty and the general legal opinion are applicable to each
transaction and product type undertaken with the counterparty, and in
all jurisdictions where those transactions are originated.

### 4.6.24 Netting of positions across books

An Islamic banking business firm may net positions across its
banking and trading books only if:

(a) the netted transactions are marked-to-market daily; and

(b) any collateral used in the transactions satisfies the criteria for
eligible collateral in the banking book.
4.6.25 Monitoring and reporting of netting agreements

(1) If directed by the Regulatory Authority, an Islamic banking business firm must demonstrate that its netting policy is consistently implemented, and that its netting agreements continue to be enforceable.

(2) The firm must keep adequate records to support its use of netting agreements and to be able to report netted transactions on both gross and net bases.

(3) The firm must monitor its netting agreements and must report and manage:
   (a) roll-off risks;
   (b) exposures on a net basis; and
   (c) termination risks;
for all the transactions included in a netting agreement.

4.6.26 Collateral and guarantees in netting

(1) An Islamic banking business firm may take collateral and guarantees into account in calculating the risk-weight to be applied to the net sum under a netting agreement.

(2) The firm may assign a risk-weight based on collateral or a guarantee only if:
   (a) the collateral or guarantee has been accepted or is otherwise subject to an enforceable agreement; and
   (b) the collateral or guarantee is available for all the individual transactions that make up the net sum of exposures calculated.

(3) The firm must ensure that provisions for applying collateral or guarantees to netted exposures under a netting agreement comply with the requirements for eligible collateral and guarantees in these rules.
Part 4.7  Provisioning

4.7.1  Provisioning

_Provisioning_ means setting aside an amount to cover expected losses on special mention credits, impaired credits and other problem assets, based on loan-loss probability. Provisioning is made before profit is earned.

4.7.2  Policies—provisioning

Depending on the nature, scale and complexity of an Islamic banking business firm’s business, and of the credit it provides, the firm’s provisioning policy must set out:

(a) the areas of its business to which the policy applies;

(b) whether the firm uses different approaches to those areas, and the significant differences in approach;

(c) who is responsible for regularly monitoring its assets, to identify problem or potential problem assets, and the factors it takes into account in identifying them;

(d) the extent to which the value of any collateral or guarantees that the firm holds affects the need for, or the level of, provisions;

(e) the basis on which the firm makes its provisions, including the extent to which their levels are left to managerial judgement or to a committee;

(f) the methods, debt management systems or formulae used to set the levels of provisions and the factors that must be considered in deciding whether the provisions are adequate;

(g) the reports to enable the firm’s governing body and senior management to ensure that the firm maintains adequate provisions;

(h) the procedures and responsibilities for arrears management and the recovery of exposures in arrears or exposures that have had provisions made against them;
(i) the procedures for writing off and writing back provisions; and
(j) the procedures for calculating and making provisions for contingent and other liabilities (such as contingent liabilities that have crystallised from acceptances, endorsements, guarantees, performance bonds, indemnities, irrevocable letters of credit and the confirmation of documentary credits).

### 4.7.3 Making provisions

1. An Islamic banking business firm must ensure that the firm maintains provisions that, taken together, are prudent, reasonable and adequate to absorb credit losses, given the facts and circumstances. The losses covered must include losses incurred, losses incurred but not yet reported, and losses estimated but not certain to arise, extending over the life of the individual credits that make up its credit portfolio.

2. The firm must also ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions. The firm must consider all the significant factors that affect the likelihood of collecting on the transactions that make up its credit portfolio and the estimated future credit losses on those transactions.

3. The firm must make provisions that in total at least meet the requirements in table 4.7.3.

### Table 4.7.3 Provisioning requirements

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 category</th>
<th>column 3 minimum provisioning requirement (% of the unsecured part of the credit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>performing</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>special mention</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>substandard</td>
<td>20</td>
</tr>
<tr>
<td>4</td>
<td>doubtful</td>
<td>50</td>
</tr>
<tr>
<td>5</td>
<td>loss</td>
<td>100</td>
</tr>
</tbody>
</table>
(4) Provisions may be general (assessed collectively against the whole of a portfolio) or specific (assessed against individual credits), or both.

(5) The firm must take into account off-balance-sheet exposures in its categorisation of credits and in provisioning.

Note: There are 2 types of off-balance-sheet exposures: those that can be unilaterally cancelled by the firm and those that cannot. No provisioning is necessary for the former.

### 4.7.4 Review of levels

The levels of provisions and write-offs must be reviewed regularly to ensure that they are consistent with identified and estimated losses.

**Guidance**

1. A review of a firm’s write-offs can help identify whether the firm’s provisioning policy results in over-provisioning or under-provisioning.
2. The Regulatory Authority regularly assesses trends and concentrations in risk and risk build-up across financial entities in relation to problem assets. In making the assessment, the authority takes into account any observed concentration in the CRM techniques used by firms and the potential effect on the efficacy of those techniques in reducing loss. The authority would consider the adequacy of provisions for a firm (and the industry in general) in the light of the assessment.
3. The Regulatory Authority might seek the opinion of external experts in assessing the adequacy of a firm’s policies for grading and classifying its assets and the appropriateness and robustness of the levels of its provisions.

### 4.7.5 No circumventing of requirements

An Islamic banking business firm must not restructure, refinance or reclassify assets with a view to circumventing the requirements on provisioning.

### 4.7.6 Authority can reclassify assets

1. The Regulatory Authority may at any time require an Islamic banking business firm to demonstrate that the firm’s classification of its assets, and its provisions, are adequate for prudential purposes.

2. The Regulatory Authority may require the firm to reclassify its assets or increase the levels of its provisions if the authority considers that...
the asset classifications are inaccurate, or the provisions are inadequate, for prudential purposes.

**Example**

If the Regulatory Authority considers that existing or anticipated deterioration in asset quality is of concern or if the provisions do not fully reflect expected losses, the authority may require the firm to adjust its classifications of individual assets, increase its levels of provisions or capital and, if necessary, impose other remedial measures.

**4.7.7 Information to governing body**

(1) An Islamic banking business firm’s governing body must obtain timely information on the condition of the firm’s assets, including the classification of assets, the levels of provisions and problem assets.

(2) The information must include summary results of the latest asset review, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected.
Part 4.8  Transactions with related parties

4.8.1  Introduction

(1) To guard against abuses in lending to related parties and to address conflicts of interest, this Part requires transactions with related parties to be at arm’s length and subject to appropriate supervision and limits.

(2) Related-party transactions must be interpreted broadly. Related party transactions include on-balance-sheet and off-balance-sheet credit exposures, service contracts, asset purchases and sales, construction contracts, lease agreements, borrowing and write-offs.

4.8.2  Concept of related parties

(1) The concept of parties being related to an Islamic banking business firm is used in these rules in relation to parties over which the firm exercises control or parties that exercise control over the firm. The concept is primarily used in relation to the requirement that the firm’s transactions be at arm’s length.

(2) In contrast, the concept of parties being connected to one another (which is discussed with concentration risk in Chapter 5) is used in these rules to measure concentration risk and large exposures.

(3) It is of course possible for connected counterparties to be related to the banking business firm holding the exposure concerned.

Note  For purposes of concentration risk, the firm’s exposure to connected counterparties (whether related or not) is taken to be a single risk.

4.8.3  Related parties

Related parties, of an Islamic banking business firm, includes:

(a) any other member of the firm’s corporate group;

(b) any individual who is able to exercise significant influence over the firm;

(c) any affiliate of the firm; and
(d) any entity that the Regulatory Authority directs the firm to include.

Guidance
Related party is wider than a firm’s corporate group in that it includes individuals. Related parties include the banking business firm’s subsidiaries and major stockholders; members of its governing body; its senior management and key employees.

Note  Affiliate is defined in the glossary.

4.8.4 Role of governing body—related parties

(1) An Islamic banking business firm’s governing body must ensure that the firm’s policies relating to related-party transactions are complied with and that any exceptions are reported to the appropriate level of the senior management, and, if necessary, to the governing body.

(2) The governing body must also ensure that the firm’s senior management monitors transactions with related parties, takes appropriate steps to control or mitigate the risks from such transactions and writes off exposures to related parties only in accordance with the firm’s policies.

(3) The governing body must approve transactions with related parties, and the write-off of related-party exposures, if such transactions or write-off exceeds specified amounts or otherwise poses any special risk.

4.8.5 Policies—transactions with related parties

(1) An Islamic banking business firm’s policy must establish:

(a) effective systems to identify, monitor and report individual and total exposures to, and transactions with, related parties;

(b) procedures to prevent a member of the governing body, a member of the firm’s senior management or any other person who stands to gain a benefit from a related-party transaction from being part of the process of granting and managing the transaction;

(c) well-defined criteria for writing-off exposures to related parties;
(d) prudent and appropriate limits to prevent or address conflicts of interest; and
(e) procedures for tracking and reporting exceptions to, and deviations from, limits or policies.

4.8.6 Transactions must be arm’s length
A transaction with a related party must not be undertaken on terms more favourable to the party than a corresponding transaction with a non-related party.

Guidance
Favourable terms could relate to credit assessment, tenor, fees, amortisation schedule and need for collateral. An exception for beneficial terms could be appropriate if it is part of an employee’s remuneration package.

4.8.7 Limits on lending to related parties
An Islamic banking business firm must not enter into a transaction that would cause it to exceed the limits set out in table 4.8.7 unless it has the written approval of the Regulatory Authority to do so.

Table 4.8.7 Limits on banking business firms’ exposure to related parties

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 kind of exposure</th>
<th>column 3 limit (% of total assets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>exposures to a member of the governing body or senior management of the firm, or a person connected to either of them</td>
<td>0.5</td>
</tr>
<tr>
<td>2</td>
<td>the total of exposures under item 1</td>
<td>3</td>
</tr>
<tr>
<td>3</td>
<td>exposures to a significant shareholder of the firm (other than exposures to a shareholder that is an Islamic banking business firm or an equivalent entity regulated in a way comparable to an Islamic banking business firm in the QFC)</td>
<td>2</td>
</tr>
<tr>
<td>4</td>
<td>the total of exposures under item 3</td>
<td>5</td>
</tr>
</tbody>
</table>
### Rule 4.8.8

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 kind of exposure</th>
<th>column 3 limit (% of total assets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>exposures to a related party or a party connected to the related party (other than exposures to an Islamic banking business firm or an equivalent entity regulated in a way comparable to an Islamic banking business firm in the QFC)</td>
<td>2</td>
</tr>
<tr>
<td>6</td>
<td>the total of exposures under item 5</td>
<td>5</td>
</tr>
</tbody>
</table>

#### 4.8.8 Powers of Regulatory Authority

1. Despite anything in these rules, the Regulatory Authority may, in writing, set specific limits on an Islamic banking business firm’s exposures to a related party or to related parties in total.

2. The authority may direct such exposures to be deducted from regulatory capital when assessing capital adequacy or direct that such exposures be collateralised.
Chapter 5 Concentration risk and related matters

Part 5.1 General

5.1.1 Introduction

This Chapter sets out the requirements for an Islamic banking business firm’s policies to identify, measure, evaluate, manage and control or mitigate concentrations of risk. This Chapter also sets limits on the firm’s exposures to individual counterparties and connected counterparties.

Note Safeguarding against risk concentrations is an essential part of an Islamic banking business firm’s credit risk management policy—see rules 4.2.2 and 4.3.2.

5.1.2 Concept of connected parties

(1) The concept of parties being connected to one another is used in these rules in relation to counterparties or issuers to which an Islamic banking business firm has exposures. Connected counterparties are the basis for the measurement of concentration risk and large exposures.

(2) In contrast, the concept of parties being related to the Islamic banking business firm (which is discussed with credit risk in Chapter 4) is primarily used in relation to the requirement that the firm’s transactions be at arm’s length.

(3) It is of course possible for a firm’s related parties to be connected counterparties (such as when the firm has exposures to them).

Note For purposes of concentration risk, the firm’s exposure to connected counterparties (whether related or not) is taken to be a single risk.

5.1.3 Connected parties

(1) A party is connected to another party if they are linked by:

(a) cross guarantees;
(b) common ownership;
(c) common management;
(d) one having the ability to exercise control over the other, whether
direct or indirect;
(e) financial interdependency—that is, the financial soundness of
one may affect the financial soundness of the other; or
(f) any combination of the factors mentioned in paragraphs (a) to
(e).

Guidance
1 Parties would be connected if the same persons significantly influence the
governing body of each of them.
2 Parties would be connected if one of them has an exposure to the other that
was not incurred for the clear commercial advantage of both of them and is
not on arm’s length terms.
3 Parties would be connected if they are so closely linked that:
   (a) the insolvency or default of one is likely to be associated with the
       insolvency or default of the other;
   (b) it would be prudent when assessing the financial condition or
       creditworthiness of one to consider that of the other; or
   (c) there is, or is likely to be, a close relationship between their financial
       performance.
4 Parties would be connected if an Islamic banking business firm has exposures
to them and any loss to the firm on any of the exposures to one of the parties
is likely to be associated with a loss to the firm with respect to at least 1
exposure to each of the others.

(2) A counterparty may be connected to another counterparty by other
linkages that, in the Islamic banking business firm’s assessment,
connect the counterparties as constituting a single risk.

(3) A connected party can be an individual or other entity.

Guidance
1 Two or more individuals or legal persons would constitute a single risk if they
are so connected that, if one of them were to experience financial problems,
the other or others would be likely to encounter repayment difficulties.
2 Connected counterparties should be identified and the procedures to manage
the combined credit risk considered. An Islamic banking business firm may
need to monitor and report the gross exposure to connected counterparties against combined limits in addition to monitoring the exposure to each counterparty.

5.1.4 **Role of governing body—concentration risk**

(1) An Islamic banking business firm’s governing body must ensure that the firm’s concentration risk management policy gives the firm a comprehensive firm-wide view of the significant sources of concentration risk (including on-balance-sheet exposures, off-balance-sheet exposures and exposures from contingent liabilities).

(2) The governing body must also ensure that the firm’s senior management monitors the limits set in this Chapter and that those limits are not exceeded on a solo or consolidated basis.
Part 5.2  Concentration risk

5.2.1 Concentration risk

Concentration risk to an Islamic banking business firm arises if the firm is exposed to 1 counterparty, or to 2 or more counterparties that are not truly independent of each other, and the total of the exposures to the counterparty or counterparties is large enough to endanger the firm’s liquidity or solvency.

Guidance

1 Significant sources of concentration risk include:

(a) concentration of exposures to a single counterparty or connected counterparties;
(b) concentration of exposures to counterparties in the same industry, sector, region or country; and
(c) concentration of exposures to counterparties whose financial performance depends on the same activity or commodity.

2 A concentration of exposures would also arise if a firm accepts collateral or credit protection provided by a single provider (because the firm is exposed to the provider).

5.2.2 Policies—concentration risk sources and limits

(1) An Islamic banking business firm’s concentration risk policy must set limits for acceptable concentrations of risk, consistent with the firm’s risk tolerance, risk profile and capital. The limits must be made known to, and must be understood by, all relevant staff.

(2) The policy must require that:

(a) the firm’s information systems identify exposures creating risk concentrations and large exposures to single counterparties or connected counterparties, aggregate those exposures and facilitate their management; and
(b) all significant such concentrations and exposures are reviewed regularly and reported to the firm’s governing body or senior management.

**Guidance**

An Islamic banking business firm’s policies should be flexible to help the firm to identify risk concentrations. To achieve this, the systems should be capable of analysing the firm’s credit portfolio by:

- size of exposure
- exposure to connected counterparties
- product
- geography
- industry or sector (for example, manufacturing and industrial)
- account performance
- internal credit risk assessment
- funding
- outstandings versus commitments
- types and coverage of collateral.

### 5.2.3 Relation to stress-testing

When carrying out stress-testing or review of stress scenarios, an Islamic banking business firm must take into account significant risk concentrations and large exposures, and the effects of changes in market conditions and risk factors on them.

*Note* For stress-testing and stress scenarios, see rule 1.1.17.
Chapter 5  Concentration risk and related matters
Part 5.3  Management of exposures

Rule 5.3.1

Part 5.3  Management of exposures

5.3.1  Calculating exposures

1) **Large exposure** means a gross exposure to a counterparty or connected counterparties that is 10% or more of an Islamic banking business firm’s regulatory capital.

*Note*  *Regulatory capital* is defined in rule 3.2.7.

2) In this rule:

   *gross exposure* to a counterparty or connected counterparties is the total of the following exposures:

   (a) on-balance-sheet and off-balance-sheet exposures;

   (b) debt securities held by the firm;

   (c) equity exposures.

3) In calculating the gross exposure, include:

   (a) the outstanding balances of all loans and advances, including balances with other banks;

   (b) holdings of debt or equity securities;

   (c) unused off-balance-sheet commitments, whether revocable or irrevocable; and

   (d) the credit equivalent amounts of all market-related transactions (calculated in accordance with rule 4.4.11, or Division 4.6.E if netting applies).

4) However, in calculating the gross exposure, do not include:

   (a) claims, equity investments and other exposures deducted from the firm’s capital;

   (b) exposures arising in the course of settlement of market-related contracts; and

   (c) exposures to the extent that they have been written off.
(5) For this Part:

(a) an Islamic banking business firm must treat an exposure as reduced (to the extent permitted by Part 4.6) by any applicable CRM technique; and

(b) an Islamic banking business firm that is part of a financial group may offset intragroup amounts due to other deposit-takers within the group.

5.3.2 Policies—large exposures

An Islamic banking business firm’s large exposure policy must include:

(a) exposure limits, commensurate with the firm’s risk tolerance, risk profile and capital, for:
   (i) categories of counterparties (for example, sovereigns, other authorised firms and other financial entities, corporate and individual borrowers);
   (ii) connected counterparties;
   (iii) particular industries or sectors;
   (iv) particular countries; and
   (v) asset classes (for example, property holdings);

(b) the circumstances in which the exposure limits may be exceeded;

(c) the procedures for approving exceptions to, and deviations from, exposure limits or policies; and

(d) the procedures for identifying, measuring, managing and reporting large exposures.

5.3.3 Limits on exposures

(1) An Islamic banking business firm must not become exposed without limit to a single counterparty. The firm must not give a general guarantee of the obligations of a counterparty.
(2) The total of the firm’s net exposures to any 1 counterparty or any 1 group of connected counterparties must not exceed 25% of the firm’s regulatory capital.

(3) The total of all of the firm’s net large exposures must not exceed 800% of that capital.

Note Subrules (1) and (2) do not apply to a branch. A branch is not required to hold regulatory capital—rule 3.1.2(1).

(4) An Islamic banking business firm may apply to the Regulatory Authority for approval for a proposed exposure in excess of the limits set out in this Chapter. An approval will be granted only in exceptional circumstances and only after the firm satisfies the authority that the proposed exposure does not expose the firm to excessive risk.

(5) The Regulatory Authority may impose a higher capital ratio on the firm to compensate for the additional risk associated with the proposed exposure.

5.3.4 Obligation to measure

(1) An Islamic banking business firm must measure, classify and make provision for each large exposure individually.

(2) The firm must immediately notify the Regulatory Authority if the firm is concerned that risk concentrations or large exposures might significantly affect its capital adequacy. The notice must describe the firm’s proposed measures to address its concerns.
Part 5.4  Powers of Regulatory Authority

5.4.1  Authority can create relationships

If the Regulatory Authority considers it necessary or desirable to do so in the interest of effective supervision of an Islamic banking business firm, the authority may direct the firm to treat a party as connected to another party.

5.4.2  Authority can set different limits and ratios

(1) Despite anything in these rules, the Regulatory Authority may, in writing, set specific limits on an Islamic banking business firm’s exposures to particular counterparties, groups of counterparties, industries, sectors, regions, countries or asset classes on a case-by-case basis.

(2) If an Islamic banking business firm has 1 or more large exposures (excluding exposures to sovereigns and central banks) or if, in the Regulatory Authority’s opinion, the firm is exposed to a significant level of risk concentration, the authority may impose a higher capital ratio on the firm.

(3) In considering whether to increase the firm’s capital ratio, the Regulatory Authority will take into account:

(a) whether the increased capital ratio would be consistent with the firm’s concentration risk and large exposure policies;

(b) the number of exposures, and the size and nature of each; and

(c) the nature, scale and complexity of the firm’s business and the experience of its governing body and senior management.

(4) The Regulatory Authority may also direct the firm to take measures to reduce its level of risk concentration.

Note  Under FSR, article 16, the Regulatory Authority may modify or waive the application of a prudential requirement to an authorised firm or firms.
Chapter 6  Market risk
Part 6.1  General
Division 6.1.A  Governing body, trading book and policies

6.1.1  Introduction

(1) This Chapter sets out the requirements for an Islamic banking business firm’s market risk management policy to identify, measure, evaluate, manage and control or mitigate market risk. This Chapter also sets out how to calculate the firm’s market risk capital requirement.

(2) An Islamic banking business firm that operates in a market incurs risks from potential movements in market prices.

(3) In calculating its capital requirement, an Islamic banking business firm must take into account unexpected losses that may arise from market risk.

(4) In determining the value of an asset or liability, the firm must also make appropriate adjustments for uncertainties arising from market risk.

6.1.2  Role of governing body—market risk

An Islamic banking business firm’s governing body must ensure that the firm’s market risk management policy gives the firm a comprehensive firm-wide view of its market risk and takes into account the risk of a significant deterioration in market liquidity.

6.1.3  Relation to stress-testing

When carrying out stress-testing or review of stress scenarios, an Islamic banking business firm must take into account market risk exposures.

Note  For stress-testing and stress scenarios, see rule 1.1.17.
6.1.4 Requirements—capital and management of market risk

(1) An Islamic banking business firm must have capital to cover market risk from positions in its banking and trading books.

(2) The firm must also have robust market risk measurement and risk management.

6.1.5 Need for trading book

(1) An Islamic banking business firm’s trading book consists of the positions held by the firm (whether on-balance-sheet or off-balance-sheet) that must be included in the book in accordance with these rules. Other positions held by the firm must be included in its banking book.

Note A firm is required to have policies to distinguish consistently between trading activities and banking activities—see rule 6.1.8(4).

(2) An Islamic banking business firm must have a trading book if:

(a) it has positions that must be included in the trading book; and

(b) the total value of the positions described in paragraph (a) has exceeded 5% of the total of the firm’s on-balance-sheet and off-balance-sheet positions at any time in the previous 12 months.

(3) The firm must include, in the trading book, trading positions and exposures of the following kinds:

(a) a position taken to hedge an exposure in the trading book, using Shari’a-compliant hedging instruments;

(b) a principal broking position in a financial instrument, commodity or commodity Shari’a-compliant hedging instrument;

(c) an exposure from a repurchase agreement, or securities or commodities lending, that is based on a position in a security or commodity included in the trading book;

(d) an exposure from a reverse repurchase agreement, or securities and commodities borrowing, that is based on a position in a security or commodity included in the trading book;
(e) an exposure from an unsettled transaction, a free delivery or an OTC Shari’a-compliant hedging instrument;
(f) an exposure in the form of a fee, commission, interest, dividend or margin on an exchange-traded Shari’a-compliant hedging instrument directly related to a position included in the trading book.

Guidance
Whenever an Islamic banking business firm acts as principal (even in the course of an activity normally described as ‘broking’ or ‘customer business’), the resulting positions should be included in the trading book. This applies even if the nature of the business means that the only risks being incurred by the firm are counterparty risks (that is, no market risk capital requirements apply).

(4) The firm must also include in its trading book:
(a) total-rate-of-return swaps (except those that have been transacted to hedge a banking book credit exposure); and
(b) open short positions in Shari’a-compliant hedging instruments.

(5) The firm must not include in its trading book:
(a) positions held for liquidity management; and
(b) loans (unless they are used to hedge a position or transaction in the trading book).

(6) Trading position, of an Islamic banking business firm, means a position that is held:
(a) for short-term resale;
(b) with the intent of benefiting from actual or expected short-term price movements; or
(c) to lock in arbitrage profits.

6.1.6 No switching of instruments between books
(1) An Islamic banking business firm must not switch an instrument between its trading book and banking book, unless the Regulatory Authority has, in writing, allowed the firm to do so. The authority may approve a switch subject to 1 or more conditions.
The firm must not benefit from any lower regulatory capital requirement resulting from a switch approved by the authority.

**Guidance**
The authority will grant approval only in extraordinary cases. The authority will require the firm to publicly disclose the switch.

### 6.1.7 Policies—market risk environment

1. An Islamic banking business firm’s market risk management policy must establish:
   1. effective systems for the accurate and timely identification, measurement, evaluation, management and control or mitigation of market risk, and reporting to the firm’s governing body and senior management;
   2. prudent and appropriate market risk limits that are consistent with the firm’s risk tolerance, risk profile and capital, and with the management’s ability to manage;
   3. who is responsible for identifying, measuring and reporting market risk;
   4. procedures for tracking and reporting exceptions to, and deviations from, limits or policies; and
   5. procedures for including positions and exposures in the trading book.

2. The policy must ensure that all of the firm’s transactions are identified and recorded in a timely way and that their valuations are consistent and prudent.

*Note* For valuation of positions and verification of market prices and model inputs, see Division 6.1.B.

### 6.1.8 Policies—trading book

1. An Islamic banking business firm that is required to have a trading book must have clearly defined policies for keeping the book up-to-date and the positions and exposures accurate.
(2) In particular, the firm must have policies on:
   (a) what to include, or not include, in the trading book;
   (b) managing and reporting trading positions;
   (c) valuing positions, including:
      (i) clear definitions of the responsibilities of staff involved in
          the valuation;
      (ii) sources of market information, and review of their
           reliability;
      (iii) frequency of independent valuations;
      (iv) timing of closing prices;
      (v) procedures for adjusting valuations between periods;
      (vi) ad-hoc verification procedures; and
      (vii) reporting lines for the valuation function that are
           independent of the function that gave rise to the position.

(3) The policies must be approved by the firm’s governing body, and the
    firm must be able to demonstrate compliance with them if directed by
    the Regulatory Authority.

(4) The firm must also have adequate policies:
    (a) to monitor compliance with the policies and distinguish
        consistently between trading activities and banking activities;
    (b) to deal with legal, regulatory or operational restrictions on
        immediate liquidation of exposures; and
    (c) to monitor the size of its trading book.

Division 6.1.B Measurement of risk and valuation of positions

6.1.9 Standard method to be used

(1) Unless the Regulatory Authority has approved the use of an internal
    model by an Islamic banking business firm, market risk is, as a
    general rule, measured using the standard method. The standard
Method comprises a range of approaches that a firm may use to calculate capital charges from its trading activities.

Note For approval of the use of internal models, see rule 3.1.6.

(2) In the standard method, market risk capital requirement is the sum of the capital charges for:

(a) foreign exchange risk in the trading book and banking book;
(b) options risk in the trading book and banking book;
(c) commodities risk in the trading book and banking book;
(d) inventory risk in the trading book and banking book;
(e) traded equity position risk; and
(f) traded profit rate risk on sukuk and other Shari’a-compliant debt securities and profit-rate-related instruments.

Note The measurements of the risks mentioned in (2) are set out in Part 6.2 to Part 6.6.

6.1.10 Valuing positions—mark-to-market

(1) An Islamic banking business firm must use the mark-to-market method to value its positions and exposures if there is a market to mark the positions and exposures to. Mark-to-market means a valuation that is based on current market value.

Guidance

1 The Regulatory Authority would expect an Islamic banking business firm to mark-to-market listed securities, because there is a market with observable and reliable prices for such securities.

2 The firm should mark-to-market as much as possible. It should use the prudent side of a bid or offer unless the firm is a significant market maker that can close at mid-market.

3 When estimating fair value, the firm should maximise the use of relevant observable inputs and avoid the use of unobservable inputs.
(2) A position that is marked-to-market must be revalued daily, based on independently sourced current market prices.

**Guidance**

Because of the less liquid nature of many sukuk and equity positions held by an Islamic banking business firm, it is important for the firm to have prudent valuation practices.

### 6.1.11 Valuing positions—mark-to-model

(1) If it is not possible to mark-to-market (for example, in the case of unlisted securities or where the market is inactive), an Islamic banking business firm may use the mark-to-model method to value its positions and exposures. *Mark-to-model* means a valuation that has to be benchmarked, extrapolated or otherwise calculated from a market input.

(2) The firm must be able to demonstrate that its marking-to-model is prudent.

**Guidance**

An Islamic banking business firm should be extra conservative when marking-to-model. The Regulatory Authority will take into account the following in deciding if the firm’s model is prudent:

- whether senior management is aware of the positions and exposures that are marked to model and whether it understands the uncertainty this might create in reporting the risk or performance of the business
- the extent to which market inputs are sourced from market prices
- the appropriateness of the assumptions used by the firm
- the availability of generally accepted valuation methods for particular products
- who developed the model
- whether the firm holds a secure copy of the model
- the existence of formal control procedures for changing the model
- how often the model is used to check valuations
- how aware is the firm’s risk management function of the weaknesses of the model and how those weaknesses are reflected in the valuation output
- the results of comparisons between actual close out values and model outputs
the firm’s procedures for reviewing the model.

6.1.12 Independent price verification

An Islamic banking business firm must independently verify market prices and model inputs, to check that those prices and inputs are accurate. The verification must be done at least once a month.

Guidance

1 Independent price verification is different from daily mark-to-market. The object of the verification is to regularly check the accuracy of market prices or model inputs and, thereby, eliminate inaccurate daily marks. The verification should be carried out by a unit independent of whoever marked the positions or exposures.

2 The independent marking in the verification process should reveal any error or bias in pricing. It entails a higher standard of accuracy in that the market prices or model inputs are used to determine profit and loss figures, whereas daily marks are used primarily for management reporting in between reporting dates.

6.1.13 Valuation adjustments

(1) An Islamic banking business firm must consider making adjustments for positions that cannot be prudently valued (such as those that have become concentrated, less liquid or stale). For example, valuation adjustment would be appropriate if pricing sources are more subjective (such as when there is only one available broker quote).

(2) The firm must establish and maintain procedures for considering valuation adjustments. This rule applies whether:

   a) the firm uses the mark-to-market or mark-to-model method; and
   b) whether the valuation is done by the firm itself or a third party.

(3) The firm must consider the following valuation adjustments:

   a) unearned profit;
   b) close-out costs;
   c) operational risks;
   d) early termination;
   e) investing and funding costs;
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(f) future administrative costs;
(g) model risk, if relevant;
(h) any other adjustment that the firm considers appropriate.
Part 6.2 Foreign exchange risk

6.2.1 Relation to market risk

(1) In measuring its market risk, an Islamic banking business firm must include the risk of holding or taking positions in foreign currencies, gold and silver (foreign exchange risk). Foreign exchange risk may arise from the firm’s trading in the foreign exchange market and other markets; it may also arise from non-trading activities that are denominated in a foreign currency.

Guidance

1. If an Islamic banking business firm is exposed to profit rate risk on positions in foreign currencies, gold and silver, the firm must include the relevant profit rate positions in the calculation of profit rate risk in the trading book—see rule 6.6.2(4).

2. Unlike Basel II, silver and gold are treated under Shari’a as foreign exchange positions (rather than as commodity positions). In Basel II, only gold is treated in that way.

(2) If foreign currency is to be received or delivered under a binding unilateral promise, the firm must report any profit rate exposure from the other leg of the contract in accordance with Part 6.6 (profit rate risk in the trading book).

(3) If gold or silver is to be received or delivered under a binding unilateral promise, the firm must report any foreign currency or profit rate exposure from the other leg of the contract in accordance with this Part or Part 6.6, as the case requires.

6.2.2 What to include in foreign exchange risk

(1) In calculating the capital charge for foreign exchange risk, an Islamic banking business firm must include in its exposure to each foreign currency:

(a) the net spot position (that is, assets minus liabilities denominated in the currency, including accrued profit and other accrued income and accrued expenses);
(b) the net position of binding unilateral promises by the firm to buy or sell currencies on a specified future date (that are not included in the spot position);

**Examples of amounts to be received or paid**
- the principal on currency swaps not included in the spot position
- profit from swaps and other profit rate transactions.

(c) irrevocable guarantees (and similar instruments) that are certain to be called and likely to be irrecoverable; and

(d) any other items representing an exposure to risk in foreign currencies (for example a specific provision held in the currency in question where the underlying asset is held in a different currency).

(2) The firm may also include in its currency exposure any net future income or expenses that are not yet accrued but already fully hedged. If the firm includes such income or expenses, it must do so consistently and must not select only expected future flows that reduce its position.

(3) If the firm has deliberately taken a position to partly or totally protect itself against the adverse effect of a change in an exchange rate on its capital adequacy ratio, it may exclude the position from its currency exposure insofar as it relates to that hedge, if:

(a) the position is of a structural and non-trading nature;

(b) the structural position does no more than protect the firm’s capital adequacy ratio;

(c) the position cannot be traded for speculative or profit-making purposes; and

(d) the exclusion of the position is done consistently, with the treatment of the hedge remaining the same for the life of the assets or other items.

(4) A **structural position** includes:

(a) a position arising from an instrument that satisfies the criteria for inclusion as capital under Chapter 3;
(b) a position in relation to a net investment in a self-sustaining subsidiary, the accounting consequence of which is to reduce or eliminate what would otherwise be a movement in the foreign currency translation reserve; and

(c) an investment in an overseas subsidiary or other entity in the same corporate group as the firm that, under these rules, is deducted from the firm’s capital for capital adequacy purposes.

(5) The firm must also include any currency exposures arising from equity, commodity and profit rate positions.

6.2.3 Foreign exchange risk on consolidated basis

(1) If an Islamic banking business firm is assessing its foreign exchange risk on a consolidated basis, and the inclusion of the currency positions of a marginal operation of the firm is technically impractical, the firm may use, as a proxy for those positions, the internal limit in each currency that the firm applies to the operation. Marginal operation, in relation to a firm, is an operation of the firm that accounts for less than 5% of the firm’s total currency positions.

(2) The absolute values of the limits must be added to the net open position in each currency, but only if the actual positions are adequately monitored against those internal limits.

6.2.4 Capital charge—foreign exchange risk

(1) For an Islamic banking business firm that does not write options, net open position in a foreign currency is the sum of:

(a) the firm’s currency exposures under rule 6.2.2 for the currency; and

(b) the value of the options and their associated underlying assets measured using the simplified approach in Division 6.3.B.

(2) For an Islamic banking business firm that writes options, net open position in a foreign currency is the sum of:

(a) the firm’s currency exposures under rule 6.2.2 for the currency; and
(b) either:
   (i) the net delta-based equivalent of the firm’s total book of foreign currency options (with separately calculated capital charges for gamma risk and vega risk under Division 6.3.C); or
   (ii) the value of the options and their associated underlying assets under the delta-plus method in Division 6.3.C.

(3) The firm must calculate its overall foreign currency net open position by:
   (a) calculating the net open position in each foreign currency;
   (b) converting the nominal amount (or net present value) of each such net position into Qatari riyals at the current spot market exchange rate;
   (c) adding all short net positions and adding all long net positions calculated under paragraphs (a) and (b); and
   (d) selecting the greater of the absolute values of the 2 sums in paragraph (c).

(4) The firm must then calculate its net position in gold and silver by:
   (a) valuing all gold and silver positions using the US dollar current spot price (regardless of maturity);
   (b) offsetting long and short positions; and
   (c) converting the absolute value of the resulting net position into Qatari riyals.

(5) To convert the net position in gold and silver into Qatari riyals, the firm must state the position (spot plus forward) in a standard unit of measurement and then convert the net position at the current spot market exchange rate.

(6) The capital charge for foreign exchange risk of an Islamic banking business firm is the sum of:
   (a) 8% of the firm’s overall foreign currency net open position in each of the foreign currencies it holds; and
(b) 8% of its net position in gold and silver.

6.2.5 Valuing positions—binding unilateral promises

An Islamic banking business firm must value net positions of binding unilateral promises in foreign exchange transactions, gold and silver at the current spot market exchange rates.
Part 6.3 Options risk

Division 6.3.A General

6.3.1 Relation to market risk
In measuring its market risk, an Islamic banking business firm must include the risk of holding or taking positions in options contracts (options risk).

6.3.2 Measuring options risk
(1) An Islamic banking business firm that does not write options must use the simplified approach.

(2) An Islamic banking business firm that writes options must use the delta-plus method.

Note If all the written option positions are hedged by perfectly matched long positions in exactly the same options, no capital charge for options risk is required.

Division 6.3.B Simplified approach

6.3.3 Using simplified approach
An Islamic banking business firm that does not write options must calculate capital charges in accordance with:

(a) rule 6.3.4 for a position that is a ‘long cash and long put’ or ‘short cash and long call’ position; or

(b) rule 6.3.5 for a position that is a ‘long put’ or ‘long call’ position.

Guidance
In the simplified approach, the position in the option and the associated underlying asset (cash or forward) is not subject to the mark-to-market method. Instead, each
position is carved-out and is subject to a separately calculated capital charge for specific risk and general risk.

### 6.3.4 Capital charges—‘long cash and long put’ or ‘short cash and long call’

1. For a position that is ‘long cash and long put’ or ‘short cash and long call’, the capital charge is calculated by multiplying the market value of the underlying security by the sum of the specific and general risk capital charges for the underlying, and then subtracting the amount by which the option is in-the-money (bounded at zero).

#### Guidance

1. In cases (such as foreign exchange transactions) where it is unclear which side is the underlying security, the underlying should be taken to be the asset that would be received if the option were exercised. In addition, the nominal value should be used for items if the market value of the underlying instrument could be zero (such as in caps, floors and swaptions).

2. Some options have no specific risk (such as those having a profit rate, currency or commodity as the underlying security); other options on profit-rate-related instruments and options on equities and stock indices, however, would have specific risk.

2. In the simplified approach, the capital charge is:
   
   (a) 8% for options on currency; and
   
   (b) 15% for options on commodities.

3. For options with a residual maturity of less than 6 months, an Islamic banking business firm must use the forward price (instead of the spot price) if it is able to do so.

4. For options with a residual maturity of more than 6 months, the firm must compare the strike price with the forward price (instead of the current price). If the firm is unable to do this, it must take the in-the-money amount to be zero.
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Rule 6.3.5

6.3.5  Capital charges—‘long put’ or ‘long call’

(1) For a position that is ‘long put’ or ‘long call’, the capital charge is the lesser of:

(a) the market value of the underlying security multiplied by the sum of the specific and general risk capital charges for the underlying; and

(b) the market value of the option.

(2) For subrule (1) (b), the book value of the option may be used instead of the market value if the position is not included in the trading book (for example, options on particular foreign exchange or commodities positions).

Division 6.3.C  Delta-plus method

6.3.6  Using delta-plus method

(1) An Islamic banking business firm that writes options must calculate specific risk capital charges separately by multiplying the delta-equivalent value of each option by the risk-weight applicable under Division 6.4.B (equity position risk) and Part 6.6 (profit rate risk in the trading book).

(2) In calculating general risk capital charge, the firm must enter delta-weighted positions with a debt security or profit rate as the underlying into the profit rate time bands in table 6.6.8A by using a two-legged approach. Under this approach, there is 1 entry at the time the underlying contract takes effect and a second entry at the time the underlying contract matures.

(3) For an option with a debt security as the underlying, the firm must apply a specific risk capital charge to the delta-weighted position based on the issuer’s rating and in accordance with Part 6.6.

6.3.7  Relation to mark-to-market method

(1) An Islamic banking business firm that writes options must include delta-weighted option positions in measuring its market risk.
(2) The firm must report such an option as a position equal to the sum of the market values of the underlying multiplied by the sum of the absolute values of the deltas. Because delta does not cover all risks associated with option positions, the firm must calculate gamma and vega in calculating the regulatory capital charge.

Note: Gamma is the rate of change of delta with respect to a change in the price of the underlying. Vega is the sensitivity of the value of an option to a change in the volatility of the underlying.

(3) The firm must calculate delta, gamma and vega using the pricing model used by a recognised exchange, or a proprietary options pricing model approved, in writing, by the Regulatory Authority.

6.3.8 Capital charges—options

(1) The capital charge for an option with equities as the underlying must be based on the delta-weighted positions included in the measurement of specific and general risks in accordance with Division 6.4.B (equity position risk).

(2) An Islamic banking business firm that writes options must calculate the capital charge for options on foreign exchange and gold and silver positions in accordance with Part 6.2 (foreign exchange risk). For delta risk, the net delta-based equivalent of the foreign currency, gold and silver options must be included in the measurement of the exposure for the respective currency, gold or silver position.

(3) The capital charge for an option on commodities must be based on the charge calculated using the simplified approach in rule 6.4.6.

6.3.9 Gamma capital charges

(1) An Islamic banking business firm that writes options must calculate the capital charge for gamma risk (gamma capital charge) for each option position separately.
(2) To calculate gamma capital charge, calculate the gamma impact of each option in accordance with the following formula:

\[
Gamma \text{ impact} = \frac{1}{2} \times \text{gamma} \times VU^2
\]

where:

\(VU\) is:

(a) for a profit rate option:

(i) if the option has a bond as the underlying—the market value of the underlying multiplied by the risk factor applicable under column 3 of table 6.6.8A; or

(ii) if the option has a profit rate as the underlying—the market value of the underlying multiplied by the assumed changes in yield in column 4 of table 6.6.8A;

(b) for options on equities and stock indices—the market value of the underlying multiplied by 8%;

(c) for options on foreign exchange, gold and silver—the market value of the underlying multiplied by 8%; or

(d) for an option on commodities—the market value of the underlying multiplied by 15%.

(3) In calculating the gamma impact for an option mentioned in the definition of \(VU\), the firm must treat as the same underlying:

(a) for profit rates—each time band in column 2 of table 6.6.8A (with each position allocated to separate maturity ladders);

(b) for equities and stock indices—each recognised exchange;

(c) for foreign currencies, gold and silver—each currency pair, gold and silver; and

(d) for commodities—each individual commodity of a kind described in rule 6.4.2(3) (a) or (b).
(4) Each option on the same underlying described in subrules (2) and (3) will have a gamma impact that is positive or negative. The firm must add the individual gamma impacts, resulting in a net gamma impact for each underlying that is either positive or negative.

(5) To calculate the firm’s total gamma capital charge, exclude gamma impacts that are positive. The total gamma capital charge is the sum of the absolute values of the net negative gamma impacts.

6.3.10 Vega capital charges

(1) An Islamic banking business firm that writes options must calculate the capital charge for vega risk (vega capital charge) for each option position separately.

(2) To calculate vega capital charge, the firm must multiply the vega for each option mentioned in the definition of VU in rule 6.3.9(2) by a 25% proportional shift in the option’s current volatility. The results must then be summed across each underlying.

(3) The total vega capital charge is the sum of the absolute values of the vega capital charges across each underlying.
Part 6.4 Commodity risk and inventory risk

Division 6.4.A Commodities risk

6.4.1 Relation to market risk

(1) In measuring its market risk, an Islamic banking business firm must include the risk of holding or taking positions in commodities and commodities options (commodity risk).

(2) Commodities means physical or energy products that may be traded. Commodities include precious metals (other than gold and silver), base metals, agricultural products, minerals, oil, gas and electricity.

Guidance

1 If an Islamic banking business firm is exposed to foreign exchange or profit rate risk from funding commodities positions, the firm must include the relevant positions in the measurement of foreign exchange risk and profit rate risk in the trading book—see rules 6.2.2(5) and 6.6.2(4), respectively.

2 Unlike Basel II, silver and gold are treated under Shari’a as foreign exchange positions (rather than as commodity positions). In Basel II, only gold is treated in that way.

(3) If a commodity is to be received or delivered under a binding unilateral promise, the firm must report any foreign currency, equity or profit rate exposure from the other leg of the contract in accordance with Part 6.2, Division 6.4.B or Part 6.6, as the case requires.

6.4.2 Measuring commodities risk

(1) An Islamic banking business firm must use the simplified approach to measure commodities risk.

(2) To calculate open positions using this approach, the firm may report short and long positions in each commodity on a net basis. Positions are reported on a net basis by offsetting them against each other in accordance with subrule (3).
(3) Positions in the same commodity may be offset. Positions in different commodities must not be offset unless:
(a) the commodities are deliverable against each other; or
(b) the commodities are close substitutes for each other and a minimum correlation between price movements of 0.9 can be clearly established over at least the preceding year.

An Islamic banking business firm must not use the correlation-based offsetting mentioned in paragraph (b) unless the Regulatory Authority has, in writing, allowed the firm to use it.

6.4.3 Measuring net positions
An Islamic banking business firm must first state each commodity position (spot plus forward) in terms of the standard unit of measurement for the commodity (such as barrels, kilos or grams). The firm must then convert the net position in each commodity into Qatari riyals at the current spot market exchange rates.

6.4.4 What to include in commodities risk
(1) In calculating the capital charge for commodities risk, an Islamic banking business firm must include commodity Shari’a-compliant hedging instruments and off-balance-sheet positions that are affected by changes in commodity prices (such commodity swaps). The firm must include commodities risk arising from salam contracts.
(2) Options on commodities for which the options risk is measured using the delta-plus method must also be included (with their underlying assets). Options for which the options risk is measured using the simplified approach must be excluded.
(3) The firm must convert commodity Shari’a-compliant hedging instruments into notional commodities positions and assign them to maturities under rule 6.4.5.

6.4.5 Assigning notional positions to maturities
Binding unilateral promises relating to a particular commodity must be included in the measurement of commodities risk as notional
amounts in terms of the standard unit of measurement multiplied by the spot price of the commodity.

6.4.6 Capital charges—simplified approach

1) The capital charge for commodities risk of an Islamic banking business firm is the sum of:
(a) 15% on the firm’s overall net position, long or short, in each commodity; and
(b) 3% on the firm’s gross position in each commodity.

2) Gross position, of a firm in a commodity, is the sum of the absolute values of all short positions and all long positions of the firm, regardless of maturity.

3) The firm must use the current spot price to calculate its gross position in commodity Shari’a-compliant hedging instruments.

Division 6.4.B Inventory risk

6.4.7 Relation to market risk

In measuring its market risk, an Islamic banking business firm must include the risk of holding assets in inventory with a view to reselling them under a murabahah contract or for leasing them under an ijarah contract (inventory risk).

6.4.8 Measuring inventory risk

1) An Islamic banking business firm must use the simplified approach to measure inventory risk.

2) The capital charge for inventory risk of an Islamic banking business firm is 15% of the value of the assets held by the firm in inventory with a view to resale or lease.

Note: For capital charges for inventory risk that may arise for work-in-process under istisna contracts, see rule 6.7.5 and rule 6.7.6.
Part 6.5  Equity position risk

6.5.1  Relation to market risk

(1) In measuring its market risk, an Islamic banking business firm must include the risk of holding or taking positions in equities (equity position risk).

Note: For the treatment of options with equities as the underlying, see rule 6.3.8(1). Under that rule, this Part on equity position risk applies to the option, but the capital charge must be based on the delta-weighted positions included in the measurement of specific and general risks.

(2) If equities are to be received or delivered under a binding unilateral promise, the firm must report any foreign currency or profit rate exposure from the other leg of the contract in accordance with Part 6.2 or Part 6.6, as the case requires.

Guidance
If an Islamic banking business firm is exposed to profit rate risk on equity positions, the firm must include the relevant profit rate positions in the calculation of profit rate risk in the trading book—see rule 6.6.2(4).

6.5.2  Measuring equity position risk

(1) The measurement of equity position risk in the trading book applies to short and long positions in all instruments that exhibit market behaviour similar to equities.

Examples of instruments with equity-like behaviour
- common shares (whether voting or non-voting)
- investments in Islamic collective investment schemes
- convertible securities and commitments to buy or sell equity securities
- convertible sukuk that trade like equities.

(2) An Islamic banking business firm may report short and long positions in instruments relating to the same issuer on a net basis.

(3) The firm must calculate the long or short position in the equity market on a market-by-market basis. That is, the firm must make a separate capital calculation for each exchange in which it holds equities (whether or not a recognised exchange).
6.5.3 What to include in equity position risk

(1) In calculating the capital charge for equity position risk, an Islamic banking business firm must include equity Shari’a-compliant hedging instruments and off-balance-sheet positions that are affected by changes in equity prices.

(2) To calculate the charges for equity position risk for equity Shari’a-compliant hedging instruments and other off-balance-sheet positions, the firm must convert positions into notional equity positions, so that:

(a) equity Shari’a-compliant hedging instruments and off-balance-sheet positions relating to individual equities are reported at current market prices;

(b) equity Shari’a-compliant hedging instruments and off-balance-sheet positions relating to stock indices are reported as the mark-to-market value of the notional underlying equity portfolio; and

(c) equity swaps are treated as 2 notional positions.

6.5.4 Charges for specific and general risks

(1) The capital charge for equity position risk consists of 2 separately calculated charges:

(a) a charge for the specific risk of holding a long or short position in an individual equity; and

(b) a charge for the general risk of holding a long or short position in the market as a whole.

(2) The capital charge for specific risk is 8% on the gross position of an Islamic banking business firm in equities listed on a recognised exchange and 12% on the gross position of the firm in other equities. **Gross position**, of a firm in an equity market, is the sum of the absolute values of all short equity positions and all long equity positions of the firm.

(3) The capital charge for general risk is 8% on the net position of an Islamic banking business firm. **Net position**, of a firm in an equity market, is the difference between long equity positions and short equity positions of the firm.
(4) *Equity position* is the net of short and long exposures to an individual company. It is measured on the gross position across the company (rather than individual transactions).

### 6.5.5 Offsetting positions

1. If an Islamic banking business firm takes a position in depository receipts against an opposite position in the underlying equity (whether or not listed in the same country where the receipts were issued), it may offset the positions only if any costs on conversion are taken into account in full.

2. The firm may offset matched positions in an identical equity or stock index in each market, resulting in a single net long or short position to which the specific and general risk capital charges are to be applied. For this purpose, a future in an equity may be offset against an opposite physical position in the same equity.

### 6.5.6 Charges for index contracts

1. For an index contract on an index that an Islamic banking business firm considers diversified, the firm must apply a general risk capital charge of 8%, and a specific risk capital charge of 2%, to the net long or short position in the contract.

2. For any other index contract, the firm must apply a general risk capital charge of 8%, and a specific risk capital charge of 4%, to the net long or short position in the contract.

3. If required to do so by the Regulatory Authority, the firm must demonstrate why the firm considers an index to be a diversified index.

**Guidance**

An Islamic banking business firm should test diversification against the following criteria used by the European Banking Authority:

- The index must have a minimum number of equities. There must be an absolute threshold below which the index cannot be considered sufficiently diversified to ignore the specific risk completely.
- None of the equities must significantly influence the volatility of the index. Equities must not represent more than a certain percentage of the total index value.
• The index must have equities diversified from a geographical perspective.
• The index must represent equities that are diversified from an economic perspective. Different ‘industries’ must be represented in the index.
Part 6.6  Profit rate risk in the trading book

Division 6.6.A  General

6.6.1  Relation to market risk
In measuring its market risk, an Islamic banking business firm must include the risk of holding or taking positions in sukuk and other Shari’a-compliant debt securities and profit-rate-related instruments that are held in the trading book (profit rate risk in the trading book).

6.6.2  What to include in profit rate risk
(1) The measurement of profit rate risk in the trading book applies to all fixed-rate and floating-rate debt securities and other profit-rate-related instruments that exhibit market behaviour similar to debt securities.

Examples
- fixed-rate and floating-rate sukuk
- non-convertible preference shares
- convertible sukuk that trade like debt securities.

(2) A debt security that is the subject of a repurchase or securities lending agreement is taken to be owned by the lender of the security.

(3) In calculating the capital charge for profit rate risk in the trading book, an Islamic banking business firm must include profit rate exposures arising from binding unilateral promises in foreign exchange transactions and forward sales and purchases of commodities and equities.

(4) The firm must also include any profit rate exposures arising from foreign exchange, commodity and equity positions.

Note  For profit rate exposures arising from binding unilateral promises, transactions or exposures in:
- foreign currencies, see rule 6.2.1
- commodities, see rule 6.4.1
6.6.3 Capital charge—profit rate risk

The capital charge for profit rate risk in the trading book consists of 2 separately calculated charges:

(a) a charge for the specific risk of holding a long or short position in an individual instrument; and

(b) a charge for the general risk of holding a long or short position in the market as a whole.

Note 1 The capital charge for general risk is for the risk of loss arising from changes in market profit rates.

Note 2 To determine the capital charge for Shari’a-compliant hedging instrument, see rule 6.6.12.

Division 6.6.B Specific risk

6.6.4 Calculating specific risk capital charge

(1) The capital charge for specific risk arising from an on-balance-sheet or off-balance-sheet profit-rate position held in an Islamic banking business firm’s trading book is calculated by multiplying the market value of the debt security by the applicable charge set out in column 5 of table 6.6.4 for the category and residual maturity of the instrument.

(2) The firm can only offset matched long and short positions (including positions in Shari’a-compliant hedging instruments) in identical instruments with exactly the same issuer, profit rate, currency and maturity.
Table 6.6.4 Specific risk capital charges

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 category</th>
<th>column 3 external credit rating</th>
<th>column 4 residual maturity</th>
<th>column 5 specific risk capital charge %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>government</td>
<td>AAA to AA-</td>
<td></td>
<td>0.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>A+ to BBB-</td>
<td>6 months or less</td>
<td>0.25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>more than 6 months</td>
<td>1.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>and up to and</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>including 24 months</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>more than 24 months</td>
<td>1.60</td>
</tr>
<tr>
<td></td>
<td>BB+ to B- or</td>
<td></td>
<td></td>
<td>8.00</td>
</tr>
<tr>
<td></td>
<td>unrated</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Below B-</td>
<td></td>
<td></td>
<td>12.00</td>
</tr>
</tbody>
</table>
Chapter 6       Market risk  
Part 6.6       Profit rate risk in the trading book

Rule 6.6.4

<table>
<thead>
<tr>
<th>Column 1 item</th>
<th>Column 2 category</th>
<th>Column 3 external credit rating</th>
<th>Column 4 residual maturity</th>
<th>Column 5 specific risk capital charge %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>qualifying</td>
<td></td>
<td>6 months or less</td>
<td>0.25</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>more than 6 months and up to and including 24 months</td>
<td>1.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>more than 24 months</td>
<td>1.60</td>
</tr>
<tr>
<td>3</td>
<td>other</td>
<td>BB+ to BB- or unrated</td>
<td></td>
<td>8.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Below BB-</td>
<td></td>
<td>12.00</td>
</tr>
</tbody>
</table>

(3) In column 2 of table 6.6.4:

**government**, as a category, includes all forms of government paper such as bonds, treasury bills and other short-term instruments.

*Note* Financial instruments issued by the State of Qatar (whether denominated in Qatari riyals or not), or by other member states of the GCC, are risk-weighted at zero per cent.

**qualifying**, as a category, includes:

(a) securities issued by public sector enterprises and multilateral development banks;

*Note* For a list of multilateral development banks that qualify for 0% risk weight, and examples of other multilateral development banks that do not, see the note following table 4.4.7A.

(b) instruments rated investment grade by at least 2 ECRAs;
(c) instruments rated investment grade by 1 ECRA and 1 other credit rating agency that is not an ECRA; and

(d) unrated instruments, but only if:

(i) the firm has no reason to suspect that the particular instrument would have a rating less than investment grade if it were rated; and

(ii) the issuer of the instrument is rated investment grade and is regulated in its home jurisdiction in a way comparable to deposit-takers in the QFC.

Guidance

In deciding whether an issuer is regulated in a comparable way, the firm must look, in particular, at the home jurisdiction’s risk-based capital requirements and consolidated supervision.

*other*, as a category, includes:

(a) instruments issued or fully guaranteed by the central government or central bank of a state that is a member of the OECD;

(b) instruments fully collateralised by instruments described in paragraph (a); and

(c) instruments issued or fully guaranteed by the central government or central bank of a state that is not a member of the OECD, but only if:

(i) the instruments have a residual maturity of 1 year or less;

(ii) the instruments are denominated in the local currency of the issuer; and

(iii) the firm’s holdings in such instruments are funded by liabilities in the same currency.

(4) In column 3 of table 6.6.4, *external credit rating* means a long-term rating issued by an ECRA for the purpose of risk-weighting claims on rated counterparties and exposures.
6.6.5 Instruments that have no specific risk capital charge

(1) Profit rate swaps, cross-currency swaps and binding unilateral promises in foreign exchange transactions are exempt from specific risk capital charges. However, a specific risk capital charge must be calculated if the underlying is a debt security or an index representing a basket of debt securities.

(2) Forward contracts and binding unilateral promises (other than those in foreign exchange transactions) are exempt from specific risk capital charges if:
   (a) the Islamic banking business firm has a right to substitute cash settlement for physical delivery under the contract; and
   (b) the price on settlement is calculated with reference to a general market price indicator.

(3) A contract or promise that is exempt under subrule (2) must not be offset against specific securities (including those securities that make up the market index).

Division 6.6.C General risk

6.6.6 Measuring general risk

(1) General risk is measured using the maturity method. In that method, positions are allocated to a maturity ladder before the capital charge is calculated.

(2) The firm must add the absolute values of the individual net positions within each time band, whether long or short. The sum of the absolute values is the firm’s gross position.

6.6.7 Maturity method

(1) In the maturity method, long or short positions in debt securities, Shari’a-compliant hedging instruments and other sources of profit rate exposures are allocated to the time bands in table 6.6.8A (and then to the zones in table 6.6.8B) based on residual maturity and profit rate.
(2) An Islamic banking business firm must allocate:
   (a) positions in fixed-rate instruments according to their residual
term to maturity; and
   (b) positions in floating-rate instruments according to the residual
term to the next re-pricing date.

(3) The firm may offset:
   (a) long and short positions (whether actual or notional) in identical
       instruments with exactly the same issuer, profit rate, currency
       and maturity; and
   (b) matched swaps and binding unilateral promises that satisfy the
       criteria in rule 6.6.13.

6.6.8 Steps in calculating general risk capital charge
The steps to calculate the general risk capital charge are:

Step 1
Weight the positions in each time band by the risk factor correspond ing to those positions in table 6.6.8A.

<table>
<thead>
<tr>
<th>Table 6.6.8A Time Bands and risk factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>column 1 item</td>
</tr>
<tr>
<td>------------------------------------------</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>5</td>
</tr>
</tbody>
</table>
### Step 2

Offset the weighted long and short positions within each time band.

**Example**

If the sum of the weighted long positions in a time band is QR100 million and the sum of the weighted short positions in the band is QR90 million, you offset the positions to come up with a matched position of QR90 million and unmatched position of QR10 million.

<table>
<thead>
<tr>
<th>column 1 item</th>
<th>column 2 time band</th>
<th>column 3 risk factor %</th>
<th>column 4 assumed changes in yield %</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>more than 2 and up to 3 years</td>
<td>1.75</td>
<td>0.80</td>
</tr>
<tr>
<td>7</td>
<td>more than 3 and up to 4 years</td>
<td>2.25</td>
<td>0.75</td>
</tr>
<tr>
<td>8</td>
<td>more than 4 and up to 5 years</td>
<td>2.75</td>
<td>0.75</td>
</tr>
<tr>
<td>9</td>
<td>more than 5 and up to 7 years</td>
<td>3.25</td>
<td>0.70</td>
</tr>
<tr>
<td>10</td>
<td>more than 7 and up to 10 years</td>
<td>3.75</td>
<td>0.65</td>
</tr>
<tr>
<td>11</td>
<td>more than 10 and up to 15 years</td>
<td>4.50</td>
<td>0.60</td>
</tr>
<tr>
<td>12</td>
<td>more than 15 years and up to 20 years</td>
<td>5.25</td>
<td>0.60</td>
</tr>
<tr>
<td>13</td>
<td>more than 20 years</td>
<td>6.00</td>
<td>0.60</td>
</tr>
</tbody>
</table>
Step 3

For each time band, apply a 10% capital charge (vertical disallowance) on the matched position calculated in step 2.

Example

Continuing on from the example in step 2, apply the 10% on the QR90 million matched position to come up with a QR9 million vertical disallowance for the time band.

Step 4

For the unmatched positions calculated in step 2, carry out 2 further rounds of offsetting using the zones (made up of time bands) in table 6.6.8B and apply the appropriate capital charge, as follows:

(a) first between the remaining unmatched positions within each of 3 zones and subject to a charge (expressed as a percentage) as follows:

(i) matched weighted positions within zone 1 x 40%;
(ii) matched weighted positions within zone 2 x 30%;
(iii) matched weighted positions within zone 3 x 30%;

(b) subsequently between the remaining unmatched positions across the 3 different zones (in the order set out below) and subject to a capital charge as follows:

(i) matched weighted positions between zones 1 and 2 x 40%;
(ii) matched weighted positions between zones 2 and 3 x 40%;
(iii) matched weighted positions between zones 1 and 3 x 100%.

The absolute value of the net amount remaining is the net position.
Step 5
Calculate the horizontal allowance by adding the charges from paragraphs (a) and (b) of step 4.

Step 6
Calculate the general risk capital charge as the sum of:
(a) the net position calculated from steps 1 to 4;
(b) the vertical disallowance from step 3;
(c) the horizontal disallowance from steps 4 and 5; and
(d) the net charge for positions in options, where appropriate, calculated in accordance with Part 6.3.
6.6.9 Positions in currencies

(1) An Islamic banking business firm must use separate maturity ladders for positions in each currency, with capital charges calculated separately for each currency and then summed. Positions in different currencies are not to be offset.

(2) If the firm’s position in a currency is less than 5% of the value of the firm’s banking book assets, that currency is taken to be a residual currency and the firm may use a single maturity ladder for all residual currencies (instead of having to use separate maturity ladders for each currency). The firm must enter, into each appropriate time band, the net long or short position for residual currencies.

(3) The firm must apply, with no further offsets, the risk factor in column 3 of table 6.6.8A to the position in each time band for residual currencies.

6.6.10 Binding unilateral promises

(1) An Islamic banking business firm must treat a binding unilateral promise on bank or corporate debt as a long position or a short position in the underlying debt security. A binding unilateral promise that is not on bank or corporate debt must be treated as a long position or a short position in a notional government security.

(2) If a range of instruments may be delivered to fulfil a contract, the firm may choose the deliverable security to be allocated to the maturity ladder. The firm must, however, take account of any conversion factor specified by the exchange where the instrument must be delivered.

6.6.11 Swaps

(1) An Islamic banking business firm must treat a swap as 2 notional positions in government securities with maturities. Both legs of the swap must be reported at their market values.
(2) For swaps that pay or receive a fixed or floating profit rate against some other reference price (for example, a stock index), the firm must:

   (a) enter the profit rate component into the appropriate maturity category; and

   (b) include any equity component in the measurement of equity risk.

(3) Each leg of a cross-currency swap must be reported in the maturity ladder for the currency concerned. The capital charge for any foreign exchange risk arising from the swaps must be calculated in accordance with rules 6.2.2 to 6.2.5.

6.6.12 Shari’a-compliant hedging instruments

(1) In the measurement of profit rate risk in the trading book, an Islamic banking business firm must include profit rate Shari’a-compliant hedging instruments and off-balance-sheet instruments in the trading book if those instruments react to changes in profit rates.

(2) The firm must convert Shari’a-compliant hedging instruments into positions in the relevant underlying to enable the firm to calculate specific and general risk capital charges. To determine the capital charges, the value of the positions must be the market value of the underlying or notional underlying.

(3) Positions in Shari’a-compliant hedging instruments are subject to charges for general risk in the same way as cash positions. However, matched positions are exempt from the charges if the positions satisfy the criteria in rule 6.6.13 or 6.6.14.

(4) Positions in Shari’a-compliant hedging instruments must be allocated to a maturity ladder and treated in accordance with this rule and the maturity method.

6.6.13 Criteria for matching Shari’a-compliant hedging instrument positions

(1) An Islamic banking business firm may offset a matched position in Shari’a-compliant hedging instruments if the positions relate to the
same underlying instruments, have the same nominal value and are
denominated in the same currency.

(2) For swaps and binding unilateral promises:

(a) the reference rate (for floating-rate positions) must be identical
and the profit rate must differ by no more than 15 basis points; and

(b) the next profit-fixing date (or, for fixed-profit-rate positions or
binding unilateral promises, the residual maturity) must comply
with the following requirements:

(i) if either instrument has a profit-fixing date or residual
maturity up to and including 1 month in the future, the
dates or residual maturities must be the same for both
instruments;

(ii) if either instrument has a profit-fixing date or residual
maturity more than 1 month, but no more than 1 year, in
the future, the dates or residual maturities must be within
7 days of each other;

(iii) if either instrument has a profit-fixing date or residual
maturity more than 1 year in the future, the dates or
residual maturities must be within 30 days of each other.

Note 1 For paragraph (a), the separate legs of different swaps may
be ‘matched’ subject to these same conditions.

Note 2 For paragraph (b), spot or cash positions in the same currency
may be offset subject to these same conditions.

(3) An Islamic banking business firm that writes options may offset the
delta-equivalent values of options (including the delta-equivalent
value of legs arising out of the treatment of caps and floors in
accordance with rule 6.3.6).

(4) However, for offsetting between a matched position in a binding
unilateral promise and its underlying, rule 6.6.14 applies.
6.6.14 Criteria for offsetting Shari’a-compliant hedging instrument positions

(1) An Islamic banking business firm may offset long and short positions (whether actual or notional) in identical instruments with exactly the same issuer, profit rate, currency and maturity.

(2) The firm may offset a matched position in a binding unilateral promise and its corresponding underlying. The net position must be reported.

(3) The firm may offset positions in a binding unilateral promise with a range of deliverable instruments and the corresponding underlying only if:
   (a) there is a readily identifiable underlying security; and
   (b) the price of that security and the price of the binding unilateral promise move in close alignment.

(4) The firm must treat each leg of a cross-currency swap or binding unilateral promise in foreign exchange transaction as a notional position in the relevant instrument, and must include the position in the calculation for each currency.
Part 6.7 Market risk capital charges for Islamic financial contracts

Division 6.7.A General

6.7.1 Introduction
This Part describes and sets out the market risk capital charges applicable to the main kinds of Islamic financial contracts.

6.7.2 Capital charges for hybrid contracts
If an Islamic banking product or financial instrument is structured using a combination of Islamic financial contracts, and it is not clear from this Part how to calculate the capital charge for the product or instrument, the firm must not use a capital charge unless the charge has been approved by the Regulatory Authority.

Division 6.7.B Sale-based contracts

6.7.3 Treatment of murabahah and related contracts

(1) An Islamic banking business firm is exposed to market risk under a murabahah contract when the asset is available for sale and on firm’s balance sheet.

(2) The capital charge for a murabahah contract is 15% on the position. There is no capital charge for a binding MPO contract or a CMT.

Note In the case of a CMT where the firm holds on to the commodity for a longer period than normal (for example, following the customer’s refusal to honour its commitment to buy) the commodity is subject to a capital charge of 15%.

(3) Bai bithaman ajil and musawamah contracts are treated in the same way as murabahah contracts.

6.7.4 Treatment of salam and related contracts
Under a salam contract, an Islamic banking business firm is exposed to market risk after the firm has paid the purchase price to the seller and before the purchased commodity is sold and delivered to a buyer.
### Rule 6.7.5

#### Table 6.7.4A Market risk capital charge for *salam* without parallel *salam*

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>capital charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>firm has paid purchase price to <em>salam</em> customer (seller)</td>
<td>15% on the long position of <em>salam</em> exposures</td>
</tr>
<tr>
<td>firm has received purchased commodity but has not sold and delivered the commodity to a buyer</td>
<td></td>
</tr>
</tbody>
</table>

#### Table 6.7.4B Market risk capital charge for *salam* with parallel *salam*

<table>
<thead>
<tr>
<th>stage of contract</th>
<th>capital charge</th>
</tr>
</thead>
<tbody>
<tr>
<td>firm has paid purchase price to <em>salam</em> customer (seller)</td>
<td>15% on the net position (that is, after netting of <em>salam</em> exposures against parallel <em>salam</em> exposures)</td>
</tr>
<tr>
<td>firm has received purchased commodity but has not sold and delivered the commodity to a buyer</td>
<td>plus</td>
</tr>
<tr>
<td>Note The parallel <em>salam</em> does not extinguish the requirement for capital from the first <em>salam</em> contract.</td>
<td>3% on the gross position (that is, the sum of the <em>salam</em> exposures and parallel <em>salam</em> exposures)</td>
</tr>
</tbody>
</table>

#### 6.7.5 Treatment of *istikna* without parallel *istikna*

1. If an Islamic banking business firm is the seller under an *istikna* without parallel *istikna* contract, the firm is exposed to market risk when there is unbilled work-in-process inventory. The capital charge for the contract is 1.6% of the firm’s unbilled work-in-process inventory.

2. If an Islamic banking business firm is the buyer under an *istikna* without parallel *istikna* contract, the firm is exposed to market risk as it makes progress payments to the supplier. The capital charge for the contract is 15% of the work-in-process inventory.
6.7.6 **Treatment of *istiknas* with parallel *istiknas***

(1) There is no capital charge for an *istikna* with parallel *istikna* contract if there is no provision in the parallel *istikna* contract that allows the seller to increase or vary the selling price. Also, there is no capital charge if there is a written undertaking given to the firm that the contractor’s performance (including work-in-process) is the responsibility of the ultimate counterparty.

(2) However, there is a capital charge of 1.6% of the firm’s unbilled work-in-process inventory if:
   
   (a) there is a provision in the parallel *istikna* contract that allows the seller to increase or vary the selling price; or
   
   (b) there is no written undertaking that the contractor’s performance is the responsibility of the ultimate counterparty.

**Division 6.7.C Lease-based contracts**

6.7.7 **Treatment of *ijarah* and related contracts**

There is no market risk capital charge for *ijarah* contracts, but *ijarah* contracts are subject to the credit risk capital requirements under rule 4.5.6.

**Division 6.7.D Equity-based contracts**

6.7.8 **Treatment of diminishing *musharakah***

(1) The capital charge for a diminishing *musharakah* contract depends on the category of the enterprise or asset to which the contract relates.

(2) If the contract is in relation to a private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities, the capital charge depends on the underlying asset as set out in Chapter 6.

(3) If the contract is in relation to a joint ownership of real estate or movable assets through *musharakah* with *murabahah* subcontract, the capital charge is 15% (that is, the charge for the *murabahah* subcontract, as set out in rule 6.7.3).
Chapter 6  Market risk
Part 6.7  Market risk capital charges for Islamic financial contracts

Rule 6.7.9

(4) There is no capital charge if the contract is in relation to a joint ownership of real estate or movable assets through musharakah with ijarah subcontract, because there is no charge for the ijarah subcontract under rule 6.7.7.

6.7.9 Treatment of mudarabah

(1) The capital charge for a mudarabah contract depends on the category of the enterprise or asset to which the contract relates.

(2) If the contract is in relation to a private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities, the capital charge depends on the underlying asset as set out in Chapter 6.

(3) If the contract is in relation to a placement in the interbank market, there is no capital charge except if the funds are invested in foreign exchange. The capital charge for a mudarabah contract where the funds are invested in foreign exchange is that calculated in accordance with Part 6.2 (foreign exchange risk).

Division 6.7.E Loan-based contracts

6.7.10 Treatment of qard

There is no capital charge for a qard contract except if the loan is provided in a foreign currency or in the form of a commodity. For qard-based financing in a foreign currency or commodity, the capital charge is that calculated in accordance with Part 6.2 (foreign exchange risk) or Part 6.4 (commodities risk), as the case requires.

Division 6.7.F Service-based contracts

6.7.11 Treatment of wakalah

(1) If a wakalah contract is in relation to a private commercial enterprise to undertake trading activities in foreign exchange, shares or commodities, the capital charge depends on the underlying asset as set out in Chapter 6.
(2) If the contract is in relation to a placement in the interbank market, there is no capital charge except if the funds are invested in foreign exchange. The capital charge for a *wakalah* contract where the funds are invested in foreign exchange is that calculated in accordance with Part 6.2 (foreign exchange risk).
Chapter 7  Operational risk

Part 7.1  General

7.1.1  Introduction

(1) Part 7.1 to Part 7.3 of this Chapter sets out the requirements for an Islamic banking business firm’s operational risk management policy to identify, measure, evaluate, manage and control or mitigate operational risk. Part 7.4 gives guidance on operational risk as it relates to Islamic financial contracts.

(2) **Operational risk** is the risk resulting from inadequate or failed internal processes, people and systems, or from external events. It can be classified into general risk, Shari’a non-compliance risk and legal risk.

(3) Operational risk does not include strategic risk and reputational risk.

7.1.2  Operational risk—general

(1) Part of an Islamic banking business firm’s general operational risk arises from banking operations that are common to all financial institutions. For example, the firm must ensure that its critical payments are made promptly in order to avoid systemic disruptions to other payment systems and money markets.

(2) The other part arises from the asset-backed nature of its financial products. For example, *murabahah*, *salam*, *istisna* and *ijarah* may give rise to additional forms of operational risk in contract drafting and execution.

**Guidance**

Although the operational risk that could arise for Islamic banking business firms can be considered similar to that of conventional banks, the characteristics of such risk may be different, thus:

- Shari’a-compliant products may involve processing steps different from those of their conventional counterparts
- the assets held on the balance sheets of Islamic banking business firms (physical assets and real estate) are different from those of conventional banks
the requirements of Shari’a compliance result in different risks relating to information technology products and systems.

Note: For examples of the operational risks that may arise from Islamic financial contracts, see Part 7.4.

### 7.1.3 Operational risk—Shari’a non-compliance

(1) *Shari’a non-compliance risk*, of an Islamic banking business firm, is the risk of non-compliance resulting from the failure of the firm’s Shari’a compliance policy to ensure that Shari’a rules and principles (as determined by its Shari’a supervisory board) are complied with.

(2) The risk can lead to non-recognition of an Islamic banking business firm’s income, and resultant losses. For *sukuk*, the risk may adversely affect the marketability (and, therefore, the value) of the *sukuk*.

(3) Shari’a non-compliance risk can take 2 forms:

   a) the risk relating to potential non-compliance with Shari’a rules and principles in the firm’s operations, including the risk that non-permissible income is recognised; and

   b) the risk relating to the firm’s fiduciary responsibilities as *mudarib* towards fund providers under a *mudarabah* contract, according to which, in the case of negligence, misconduct, fraud or breach of contract by the *mudarib*, the funds provided by the fund providers become a liability of the *mudarib*.

**Note:** For examples of Shari’a requirements that must be complied with by an Islamic banking business firm in relation to Islamic financial contracts, see Part 7.4. Failure to comply with the requirements gives rise to Shari’a non-compliance risk.

### 7.1.4 Operational risk—legal

(1) *Legal risk*, of an Islamic banking business firm, includes exposures to fines, penalties or punitive damages resulting from supervisory actions as well as private settlements.

(2) The risk can arise from:

   a) the firm’s operations (that is, from legal risks common to all financial institutions); or
7.1.5 Role of governing body—operational risk

(1) An Islamic banking business firm’s governing body must ensure that the firm’s operational risk management policy addresses, on a firm-wide basis, all the major aspects of operational risk in the firm’s business.

(2) In particular, the governing body must ensure that a Shari’a governance mechanism is incorporated into the firm’s operational risk management policy and that there is appropriate cooperation and communication between the firm’s risk management function, governing body and the Shari’a supervisory board.

7.1.6 Powers of Regulatory Authority

Despite anything in these rules, if the Regulatory Authority identifies points of exposure or vulnerability to operational risk that are common to 2 or more Islamic banking business firms, it may impose specific capital requirements or limits on each affected firm.

Examples

- outsourcing of important operations by many banking business firms to a single provider
- severe disruption to providers of payment and settlement services.
Part 7.2 Operational risk management policy

7.2.1 Policies—compliance with Shari’a

An Islamic banking business firm must establish and implement policies to ensure that its business is conducted in accordance with Shari’a. The policies must include effective and comprehensive procedures so that the firm complies with:

(a) Shari’a (in general and in relation to the requirements for Islamic financial contracts); and

(b) the fatwas, rulings and guidelines issued by its Shari’a supervisory board.

7.2.2 Policies—business continuity

(1) An Islamic banking business firm’s operational risk management policy must include effective and comprehensive procedures for disaster recovery and business continuity.

(2) The firm must have a business continuity plan for possible scenarios of severe business disruption. The plan must provide for the firm to continue to operate as a going concern, and to minimise losses (especially those from disturbances to payment and settlement systems), in those scenarios.

Note CTRL, rule 4.1.4 (3) (c) requires an authorised firm to include, in its risk management strategy, contingency planning, business continuity and crisis management. CTRL, rule 2.2.8 requires a firm to review its business continuity procedures at least once every 18 months.

7.2.3 Policies—information infrastructure

(1) An Islamic banking business firm must establish and implement appropriate information technology policies for the accurate and timely identification, measurement, evaluation, management and control or mitigation of operational risk. In particular, the policies
must enable the firm to maintain an adequate and sound information infrastructure:

(a) that meets the firm’s current and projected requirements (under normal circumstances and in times of stress);

(b) that ensures that the data, and the system itself, remain secure and available; and

(c) that supports integrated and comprehensive risk management.

(2) The firm’s information infrastructure must enable the firm to compile and analyse operational risk data, and must facilitate reporting to the firm’s governing body and senior management and the Regulatory Authority.

(3) The firm must have appropriate reporting procedures to keep the Regulatory Authority informed of developments affecting operational risk at the firm.

7.2.4 Policies—outsourcing

(1) An Islamic banking business firm must establish appropriate policies to assess, manage and monitor outsourced activities. The management of those activities must include:

(a) carrying out due diligence for selecting service providers;

(b) structuring outsourcing arrangements;

(c) managing and reporting the risks associated with an outsourcing;

(d) ensuring effective control over an outsourcing; and

(e) contingency planning.

(2) The outsourcing policies must require the firm to have comprehensive contracts and service level agreements. The contracts and agreements must clearly state the allocation of responsibilities between service providers and the firm.

Note This rule sets out details of what an Islamic banking business firm’s outsourcing policy must include in addition to the minimum required under CTRL, rule 5.1.2.
Part 7.3  Operational risk capital requirement

7.3.1  Basic indicator approach

(1) An Islamic banking business firm must use the basic indicator approach to operational risk. *Operational risk capital requirement* is the amount of capital that the firm must have to cover its operational risk.

(2) The firm’s operational risk capital requirement is calculated in accordance with the following formula:

\[
\frac{GI \times \alpha}{n}
\]

where:

*GI* is the firm’s average annual gross income (as defined in subrule (3)) for those years (out of the previous 3 years) for which the firm’s annual gross income is more than zero.

*\( \alpha \)* is 15% or a higher percentage set by the Regulatory Authority.

*n* is the number of years out of the previous 3 years for which the firm’s gross income is more than zero.

**Guidance**

Because of the definitions of *GI* and *n*, figures for any year in which the annual gross income of a firm is negative or zero must be excluded from both the numerator and denominator when calculating the average.

(3) *Gross income*, for a year, means the total of the following income for the year:

(a) net income from financing activities, which is gross of provisions, operating expenses and depreciation of *ijarah* assets;

(b) net income from investment activities, which includes the firm’s share of profit from *mudarabah* and *musharakah*;

(c) fee income, which includes commissions and agency fees;
less the firm’s share in income attributable to IAHs and other account holders.

(4) *Gross income* excludes:

(a) realised profits from the sale of securities in the banking book;

(b) realised profits from securities in the ‘Held to Maturity’ category in the banking book;

(c) extraordinary or irregular items of income;

(d) income derived from insurance;

(e) any collection from previously written-off loans; and

(f) income obtained from the disposal of real estate and other assets during the year.
Part 7.4  Guidance on operational risks relating to Islamic financial contracts

7.4.1  Introduction

(1) This Part gives guidance on the Shari’a requirements in relation to Islamic financial contracts and on the operational risks that may arise from them.

(2) An Islamic banking business firm’s failure to comply with the requirements, or any lack of precision in contract documentation, can give rise to Shari’a non-compliance risk.

Note  The section is taken from IFSB-15: Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services, but the requirements may vary depending on the views of different Shari’a supervisory boards. Under FSR, article 17 (4), guidance is indicative of the view of the Regulatory Authority at the time and in the circumstances in which it was given.

7.4.2  Requirements for murabahah and ijarah contracts

(1) The asset is in existence at the time of sale or lease or, in the case of ijarah, the lease contract is preceded by acquisition of the usufruct of that asset (except if the asset was agreed upon based on a general specification).

(2) The asset is in the legal and constructive possession of the Islamic banking business firm when it is offered for sale or lease.

(3) The asset is intended to be used by the buyer or lessee for activities or businesses permissible by Shari’a. If the asset is leased back to its owner in the first lease period, it does not lead to a contract of ‘inah.

Note  An ‘inah (also called bay ‘inah or bay-al inah) is a double sale by which the borrower and the lender sell and then resell an asset between them, once for cash and once for a higher price whose payment is deferred. The net result is a loan with interest and, as such, is prohibited by the majority of Shari’a scholars.
(4) There is no late payment penalty fee or increase in price in exchange for extending or rescheduling the date of payment of accounts receivable or lease receivable, irrespective of whether the obligor is solvent or insolvent.

7.4.3 Requirements for salam and istisna contracts

(1) Sale and purchase contracts cannot be interdependent and interconditional on each other (such as salam and parallel salam, or istisna and parallel istisna).

(2) There is no penalty clause for delay in the delivery of a commodity that is purchased under a salam contract. However, such a penalty clause is allowed under istisna and parallel istisna.

Note An essential characteristic of a salam or istisna contract is that the subject matter does not, and is not required to, exist physically when the parties enter into the contract.

7.4.4 Requirements for mudarabah and musharakah contracts

(1) The capital of the Islamic banking business firm should be invested in Shari'a-compliant investments or business activities.

(2) A partner in musharakah cannot guarantee the capital of another partner, nor may the mudarib guarantee the capital of the mudarabah.

(3) The purchase price of another partner’s share in a musharakah with a binding promise to purchase can only be set at market value or according to an agreement entered into at the time the contract became binding. However, the agreement should not stipulate that the share be purchased at its nominal value based on the capital originally contributed.

7.4.5 Operational risks—murabahah

(1) At the time the murabahah contract becomes binding, it is required that an Islamic banking business firm has purchased the asset and had it in its legal or constructive possession before selling it to the customer. Therefore, the firm should ensure that the legal characteristics of the contract properly match the commercial intent of the transactions.
(2) If the mudarabah customer acts as the agent of the firm for purchasing the asset, title to the asset should first pass to the firm and not directly to the customer.

### 7.4.6 Operational risks—salam

(1) This section sets out some of the operational risks that may arise when an Islamic banking business firm purchases from a customer, under a salam contract, goods against advanced payment.

(2) If the underlying goods delivered are of an inferior quality to that specified in the contract, the Islamic banking business firm (as buyer) should:
   - (a) reject the goods; or
   - (b) accept them at the originally agreed price.

   In the latter case, the firm may suffer loss if it sells the goods at a lower price than would have been obtained for those specified in the contract.

   **Note** In case of a parallel salam, however, the buyer of the commodity from the Islamic banking business firm may (but is not obliged to) agree to accept the goods at the contract price. In such a case, the firm does not suffer any loss of profit.

(3) The underlying goods may be delivered by the customer before the agreed date. If the goods delivered meet the contract specifications, the Islamic banking business firm (as buyer):
   - (a) normally has to accept the goods before the agreed delivery date; and
   - (b) may incur additional costs for storage, takaful cover and deterioration (if the goods are perishable) before the goods are resold.

(4) The salam contract may include a provision for restitution to be made to the firm for any loss suffered under subsection (2) or costs incurred under subsection (3).
(5) The firm may face legal risk if the goods in a parallel *salam* cannot be delivered to the parallel *salam* buyer because of:

(a) late delivery by the *salam* seller (the customer); or

(b) delay by the firm itself.

For legal risk not to arise in such a case, the parallel *salam* buyer will have to agree to change the delivery date of the goods.

**7.4.7 Operational risks—*istik*na**

(1) In the case of *istik*na with parallel *istik*na, an Islamic banking business firm contracts to deliver a constructed or manufactured asset and enters into a contract with a subcontractor to construct or manufacture the asset.

(2) The reliance of the firm on the subcontractor can expose it to various operational risks such as those set out in subsections (3) to (6). These risks need to be managed by a combination of:

(a) legal precautions;

(b) due diligence in choosing subcontractors; and

(c) selection of suitably qualified consultants and staff to carry out the contract with the subcontractor and, ultimately, deliver the constructed or manufactured asset to the customer.

(3) In case of late delivery by the subcontractor, the firm may be unable to deliver the asset to the ultimate counterparty on the agreed date, and can, therefore, be subject to penalties for late delivery.

(4) In case of cost overruns during the construction or manufacturing process (because of increases in the prices of raw materials, increases in manufacturing or production costs or delays by the subcontractor), additional costs may have to be absorbed wholly or partly by the firm, in the absence of an agreement in advance with the ultimate counterparty.

(5) If the subcontractor fails to meet quality standards or other specifications agreed with the ultimate counterparty, the firm may
face legal risk if no agreement is reached with the subcontractor and the ultimate counterparty:

(a) forremedying the defects; or
(b) for reducing the contract price.

(6) If the subcontractor fails to complete the asset on time, the firm may have to find a replacement from the market and can, therefore, be subject to additional costs.

7.4.8 Operational risks—*ijarah* and IMB contracts

(1) In an *ijarah* or IMB contract, an Islamic banking business firm (as lessor) may face, during the period of lease, the operational risks set out in this section.

(2) The ultimate use of the *ijarah* asset should be Shari’a-compliant. Otherwise, the firm will be exposed to non-recognition of the *ijarah* income as non-permissible, and the firm will be required to repossess the asset and find a new lessee.

(3) If the lessee damages the asset in its possession and refuses to pay for the damage, the firm will have to repossess the asset and take legal action to cover damages. This might involve operational and litigation costs.

(4) If the asset is severely damaged or destroyed without the fault of the lessee, the firm (as lessor) is required to provide a replacement to the lessee. If the asset is not insured, the firm will have to bear the cost of buying the new asset.

(5) Further, if the firm fails to provide the lessee with a replacement, the lessee may terminate the *ijarah* contract without paying the rentals for the remaining period.

(6) If the asset is damaged without the fault of the lessee, but can still be used, the firm (as lessor) is required to decrease the amount of the rentals. The decrease should be proportionate to the decrease in the utility of the asset.
(7) In the event of default or misconduct by the lessee, the firm may face legal risk in relation to the enforcement of its contractual right to repossess the asset.

7.4.9 Operational risks—musharakah

(1) In a musharakah contract, an Islamic banking business firm provides financing on the basis of a profit-sharing and loss-sharing contract.

(2) The firm may fail to carry out adequate due diligence on the customer or the financed venture.

(3) During the period of the investment, the firm may fail to monitor the venture’s financial performance adequately or may not receive the required information from the customer.

7.4.10 Operational risks—mudarabah

(1) In a mudarabah contract, an Islamic banking business firm provides financing on the basis of a profit-sharing and loss-bearing contract.

(2) The firm’s customer (as mudarib) is not required to bear any losses, in the absence of negligence, misconduct, fraud or breach of contract on its part. The customer is required to act in a fiduciary capacity as the manager of the firm’s funds.

(3) The absence of the firm’s right to control the management of the enterprise as capital provider (rabb al-mal) may give rise to operational risk.

(4) The customer may fail to provide the firm with regular, adequate and reliable information about the financial performance of the venture.

(5) The firm may fail to carry out adequate due diligence on the customer or the financed venture.
Chapter 8  Liquidity risk

Part 8.1  Liquidity risk management—introductory

Division 8.1.A  Preliminary

8.1.1  Introduction—Chapter 8

(1) This Chapter sets out an Islamic banking business firm’s obligations:
   (a) to adopt prudent practices in managing liquidity risk;
   (b) to maintain adequate liquidity to meet its obligations as they fall due across a wide range of operating circumstances; and
   (c) to have adequate sources of stable long-term funding.

(2) In general terms, this Chapter requires an Islamic banking business firm:
   (a) to have a risk management framework to measure, monitor and manage liquidity risk that is appropriate for the nature, scale and complexity of the firm’s operations;
   (b) to maintain a portfolio of high-quality liquid assets sufficient to enable the firm to withstand a severe liquidity stress;
   (c) to maintain a robust funding structure appropriate for the nature, scale and complexity of the firm’s operations;
   (d) to limit maturity mismatches between its assets and its liabilities; and
   (e) to inform the Regulatory Authority promptly about liquidity concerns.

8.1.2  Categorisation of firms in terms of liquidity management obligations

(1) For the purposes of this Chapter, Islamic banking business firms are either liquidity risk group A Islamic banking business firms or liquidity risk group B Islamic banking business firms.
8.1.3 Designation of firms as liquidity risk group A Islamic banking business firms

(1) The Authority may designate an Islamic banking business firm as a liquidity risk group A Islamic banking business firm by written notice if the Authority is satisfied that:

(a) the firm meets any of the criteria in subrule (2); or
(b) it is necessary to do so for any other reason.

(2) The criteria are the following:

(a) the firm is active internationally;
(b) it is significant to the general stability and effective working of the financial system;
(c) there is significant liquidity risk associated with it;
(d) it is systemically linked to another liquidity risk group A Islamic banking business firm or a liquidity risk group A banking business firm;
(e) it (first firm) is so connected to another liquidity risk group A Islamic banking business firm (second firm) that, if the first firm were not a liquidity risk group A Islamic banking business firm, the connection would or might adversely affect either or both of the following:

(i) the second firm’s calculation of its LCR;
(ii) the first firm’s calculation of its MLR.

Note For LCR, see rule 8.4.1; for MLR, see rule 8.5.2.
8.1.4 **Application of Chapter 8**

The Parts of this Chapter apply to Islamic banking business firms as set out in table 8.1.4.

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**Division 8.1.B Principles**

8.1.5 **Principle 1—sound management of liquidity risk**

An Islamic banking business firm is responsible for the sound management of its liquidity risk, and must have a robust framework to manage that risk.

8.1.6 **Principle 2—maintaining sufficient liquidity to meet obligations as they fall due**

An Islamic banking business firm must at all times maintain sufficient liquidity to meet its obligations as they fall due, and must hold a minimum level of high-quality liquid assets to survive a severe liquidity stress.
8.1.7 Principle 3—stable sources of funding
An Islamic banking business firm must ensure that its activities are funded with stable sources of funding on an ongoing basis.

8.1.8 Principle 4—informing the Regulatory Authority of liquidity concerns
An Islamic banking business firm must inform the Regulatory Authority as soon as possible of any concerns that the firm has about its current or future liquidity, and its plans to address these concerns. In particular, if an Islamic banking business firm experiences a severe liquidity stress, it must notify the Authority immediately, and must describe the action that is being taken to address the situation.

Guidance
Individual rules in this Chapter that require the Authority to be notified “immediately” specify what is meant by “immediately”.

8.1.9 Responsibilities of governing body and senior management
(1) An Islamic banking business firm’s governing body is ultimately responsible for the sound and prudent management of the firm’s liquidity risk. An Islamic banking business firm must maintain a liquidity risk management framework that is appropriate for the level and extent of liquidity risk to which the firm is exposed.

(2) The governing body must ensure that:
   (a) the firm’s senior management and other relevant personnel have the necessary experience to manage liquidity risk; and
   (b) the firm’s liquidity risk management framework and liquidity risk management practices are documented, and are reviewed at least annually.

(3) The governing body must review regular reports on the firm’s liquidity and, as necessary, information on new or emerging liquidity risks.
An Islamic banking business firm’s senior management must do all of the following:

(a) develop a liquidity management strategy, policies and processes in accordance with the liquidity risk tolerance approved by the firm’s governing body;

Note: For liquidity risk tolerance, see rule 8.3.1.

(b) ensure that the firm maintains sufficient liquidity at all times;

(c) determine the structure, responsibilities and controls for managing liquidity risk, and for overseeing the liquidity positions, of the firm and all of its branches and subsidiaries in all of the jurisdictions in which the firm and its branches and subsidiaries are active, and set out that structure and those responsibilities and controls clearly in the firm’s liquidity policies;

(d) ensure that the firm has adequate internal controls to ensure the integrity of its liquidity risk management processes;

(e) ensure that stress tests, contingency funding plans and holdings of high-quality liquid assets are effective and appropriate for the firm;

(f) establish reporting criteria specifying the scope, manner and frequency of reporting for various recipients (such as the firm’s governing body and senior management and any relevant committee of the governing body) and fix who is responsible for preparing the reports;

(g) establish the specific procedures and approvals necessary for making exceptions to policies and limits, including the escalation procedures and follow-up actions to be taken for breaches of limits;

(h) closely monitor current trends and potential market developments that may present challenges for managing liquidity risk, so that appropriate and timely changes to the liquidity management strategy can be made as needed;
(i) continuously review information on the firm’s liquidity developments and report to the governing body regularly.

(5) The firm’s governing body and senior management must be able to demonstrate a thorough understanding of:

(a) the links between funding liquidity risk (the risk that the firm may not be able to meet its financial obligations as they fall due) and market liquidity risk (the risk that liquidity in financial markets, such as the market for debt securities, may decline significantly); and

(b) how risks of other kinds, such as credit risk, market risk, operational risk and reputational risk, affect the firm’s liquidity risk management strategy.

Guidance

1 An Islamic banking business firm needs a robust Shari’a governance system to ensure that there is effective independent oversight of Shari’a compliance within the firm. One of the major parts of that system is the firm’s Shari’a supervisory board. Members of the board should take an active role in issues of compliance with Shari’a that the firm faces in managing liquidity risk.

2 IFSB—10 (Guiding Principles on Shari’ah governance systems for institutions offering Islamic financial services, published by the Islamic Financial Services Board in December 2009, highlights the role of an Islamic banking business firm’s Shari’a supervisory board in the firm’s Shari’a governance processes. Some areas related to liquidity risk management where the board can play an important role include:

- approving new Shari’a-compliant liquidity risk management products and mechanisms, including Shari’a-compliant hedging products
- ensuring that the firm’s products and mechanisms are properly executed, in association with the firm’s internal Shari’a compliance and audit functions
- controlling and verifying the non-commingling of funds between Islamic subsidiaries and parent conventional entities
- controlling and verifying the extent of the firm’s investments with conventional financial institutions.

3 For more on the Shari’a supervisory board and its responsibilities, see Division 1.1.B of these Rules, and ISFI, Chapter 6.
8.1.10 Relation to internal capital adequacy assessment

An Islamic banking business firm must be able to demonstrate to the Regulatory Authority that its ICAAP adequately captures liquidity risk, even if the effect of liquidity risk on the firm’s capital is indirect (for example, by reducing the value of the firm’s assets at the time they are realised).

*Note* For *ICAAP*, see rule 3.1.5.
Part 8.2 Guidance on liquidity risks arising from Islamic financial contracts

Note for Part 8.2
This Part applies to all Islamic banking business firms—see rule 8.1.4.

8.2.1 Introduction
This Part gives guidance on the liquidity risks that may arise from various Islamic financial contracts. An Islamic banking business firm should look into risk transformation in these contracts during their various stages, because such transformations may directly or indirectly affect the liquidity of the contracts.

Note Under FSR, article 17 (4), guidance is indicative of the view of the Regulatory Authority at the time and in the circumstances in which it was given.

8.2.2 Liquidity risks—murabahah
In a murabahah contract, an Islamic banking business firm’s liquidity may be affected by late payment or non-payment by the customer.

8.2.3 Liquidity risks—commodity murabahah
(1) An Islamic banking business firm may offer commodity murabahah accounts as a means of raising funds. Because raising funds in this way requires the firm to pay back the principal and agreed share of profit to the customer on maturity, the firm may be exposed to liquidity risk.

(2) If commodity-murabahah-based funds (which are usually short-term in nature) are used by the firm to finance longer-term assets, a maturity mismatch will result. Such a mismatch may become acute if the firm has a high reliance on such deposits to fund its assets.
8.2.4 Liquidity risks—salam

In a salam contract, the illiquidity of commodity markets and the non-permissibility of exiting the contract before delivery can give rise to liquidity risk for an Islamic banking business firm.

8.2.5 Liquidity risks—ijarah

In an ijarah contract, an Islamic banking business firm may be exposed to liquidity risk because of:

(a) late payment or non-payment of instalments by the customer;
(b) the inability to sell or lease the asset to a new customer at the end of an earlier contract; or
(c) default by the customer.

8.2.6 Liquidity risks—mudarabah and musharakah

In a mudarabah or musharakah contract, an Islamic banking business firm may be exposed to liquidity risk because of:

(a) late payment or non-payment of profit payments during the contract; or
(b) non-payment by the customer of the remaining principal at the end of the contract.

8.2.7 Liquidity risks—PSIAs

An Islamic banking business firm may be affected by panic withdrawals of funds by IAHs. Such withdrawals may result from rate of return risk, Shari’a non-compliance risk or reputational risk.

8.2.8 Liquidity risks—qard

An Islamic banking business firm may offer unremunerated current accounts on the basis of qard, under which the firm guarantees the nominal amount of the accounts. The firm should pay back the full amount on demand and should therefore ensure that sufficient funds are available to do so as and when the demand arises.
Part 8.3 Liquidity risk management—firms’ obligations in detail

Note for Part 8.3
This Part applies to all Islamic banking business firms—see rule 8.1.4.

8.3.1 Liquidity risk tolerance

(1) An Islamic banking business firm’s liquidity risk tolerance defines the level of liquidity risk that the firm is willing to assume.

Guidance
An Islamic banking business firm’s risk management strategy usually refers to risk tolerance although risk appetite may also be used. The 2 terms are used interchangeably to describe both the absolute risks a firm is open to take (by some called risk appetite) and the actual limits within its risk appetite that a firm pursues (by some called risk tolerance).

(2) An Islamic banking business firm’s liquidity risk tolerance must be appropriate for the firm’s operations and strategy and its role in the financial systems in which it operates.

(3) The firm must review its liquidity risk tolerance at least annually to reflect the firm’s financial condition and funding capacity.

(4) The firm’s governing body and senior management must ensure that the firm’s liquidity risk tolerance allows the firm to effectively manage its liquidity in such a way that the firm can withstand prolonged liquidity stress.

(5) The firm must document its liquidity risk tolerance in a way that clearly states the trade-off between risks and profits.

8.3.2 Liquidity risk management framework—structure and basic content

(1) An Islamic banking business firm’s liquidity risk management framework must include:

(a) a statement of the firm’s liquidity risk tolerance, approved by the firm’s governing body;
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(b) a statement of the firm’s liquidity risk management strategy and policy, approved by the governing body;

(c) a statement of the firm’s operating standards (in the form of policies, procedures and controls) for identifying, measuring, monitoring and controlling its liquidity risk in accordance with its liquidity risk tolerance;

(d) a statement of the firm’s funding strategy, approved by the governing body; and

(e) a contingency funding plan.

(2) The framework must clearly set out the firm’s organisational structure as it relates to liquidity risk management, and must define the responsibilities and roles of senior management involved in managing liquidity risk.

(3) The framework must be formulated to ensure that the firm maintains sufficient liquidity to withstand a range of liquidity stress events (whether specific to the firm, market-wide, or a combination of the two), including the loss or impairment of both unsecured and secured funding sources.

(4) The framework must be well integrated into the firm’s overall risk management process.

(5) The liquidity risk management framework must be subject to ongoing effective and comprehensive independent review.

Guidance
In most cases, the independent reviews could be facilitated by the firm’s internal audit function but may require the engagement of independent experts outside that function.

8.3.3 Liquidity risk management—oversight

(1) An Islamic banking business firm’s liquidity risk management oversight function must be operationally independent. It must be staffed with personnel who have the skills and authority to challenge the firm’s treasury and other liquidity management functions.
Chapter 8  Liquidity risk  
Part 8.3  Liquidity risk management—firms’ obligations in detail  

Rule 8.3.4

(2) The firm must have adequate policies, procedures and controls to ensure that the firm’s governing body and senior management are informed immediately of new and emerging liquidity concerns.

**Guidance**

Those concerns could include:

- increasing funding costs or concentrations
- increases in funding requirements
- shortage of other sources of liquidity
- material or persistent breaches of limits
- significant decline in the firm’s holdings of unencumbered liquid assets
- changes in market conditions that could signal future difficulties.

(3) The firm’s senior management must be satisfied that all of the firm’s business units whose activities affect the firm’s liquidity:

(a) are fully aware of the firm’s liquidity risk management strategy; and

(b) operate in accordance with the firm’s approved policies, procedures, limits and controls.

8.3.4 **Liquidity management strategy**

(1) An Islamic banking business firm’s liquidity management strategy must include specific policies on liquidity management, such as:

(a) the composition and maturity of assets and liabilities;

(b) the diversity and stability of funding sources;

(c) the firm’s approach to managing liquidity in different currencies, across borders, and across business lines and legal entities; and

(d) the firm’s approach to intraday liquidity management.

(2) The strategy must take account of the firm’s liquidity needs both under normal conditions and during periods of liquidity stress. The strategy must include quantitative and qualitative targets.
(3) The strategy must be appropriate for the nature, scale and complexity of the firm’s operations. In formulating the strategy, the firm must consider its legal structure, its key business lines, the breadth and diversity of its markets and products, the jurisdictions in which it operates, and regulatory requirements.

(4) The firm’s senior management must communicate the following throughout the firm:

   (a) the strategy;
   (b) the firm’s key policies for implementing it;
   (c) the firm’s liquidity management structure.

8.3.5 Liquidity risk management—processes

(1) An Islamic banking business firm must have a sound process for identifying, measuring, monitoring and controlling liquidity risk. The process must include a robust framework for comprehensively projecting cashflows arising from assets, liabilities and off-balance-sheet items over an appropriate set of time horizons.

(2) An Islamic banking business firm must set limits to control its liquidity risk exposure and vulnerabilities. The limits and the corresponding escalation procedures must be reviewed regularly.

(3) The limits must be relevant to the business in terms of its location, the complexity of its operations, the nature of its products, and the currencies and markets it serves. If a limit is breached, the firm must implement a plan of action to review the exposure and reduce it to a level that is within the limit.

(4) An Islamic banking business firm must actively manage its collateral positions, distinguishing between encumbered and unencumbered assets. The firm must monitor the legal entity in which, and the physical location where, collateral is held and how collateral can be mobilised in a timely manner.

(5) An Islamic banking business firm must design a set of early warning indicators to help its daily liquidity risk management processes to identify the emergence of increased risk or vulnerabilities in its
liquidity risk position or potential funding needs. The indicators must be structured so as to help identify negative trends in the firm’s liquidity position and to lead to an assessment and a potential response by management to mitigate the firm’s exposure to the trends.

(6) An Islamic banking business firm must have a reliable management information system that provides the governing body, senior management and other appropriate personnel with timely and forward-looking information on the firm’s liquidity position.

(7) An Islamic banking business firm must actively manage its intraday liquidity positions to meet payment and settlement obligations on a timely basis under both normal and stressed market conditions, thus contributing to the orderly functioning of payment and settlement systems.

(8) An Islamic banking business firm must develop and implement a costs and benefits allocation process for funding and liquidity. The process must appropriately apportion the costs of prudent liquidity management to the sources of liquidity risk, and must provide appropriate incentives to manage liquidity risk.

(9) An Islamic banking business firm that is active in multiple currencies:
   (a) must assess its aggregate foreign currency liquidity needs and determine an acceptable level of currency mismatches; and
   (b) must undertake a separate analysis of its strategy for each significant currency, considering possible constraints during periods of liquidity stress.

*Note* Such a firm must also maintain a portfolio of high-quality liquid assets consistent with the distribution of its liquidity needs by currency—see rule 8.4.6 (3).

(10) For subrule (9) (b), a currency is *significant* for an Islamic banking business firm if the firm’s liabilities denominated in it amount to 5% or more of the firm’s total liabilities.
8.3.6 **Funding strategy**

(1) An Islamic banking business firm:
   
   (a) must develop and document a 3-yearly funding strategy;
   
   (b) must maintain a continuing presence in its chosen funding markets;
   
   (c) must maintain strong relationships with funds providers; and
   
   (d) must regularly estimate its capacity to raise funds quickly.

(2) The firm must identify the main factors that affect its ability to raise funds, and must monitor those factors closely to ensure that its estimates of its fund-raising capacity remain valid.

(3) The strategy must be approved by the firm’s governing body, and must be supported by robust assumptions in line with the firm’s liquidity management strategy and business objectives.

(4) The funding strategy must be reviewed at least annually, and must be updated as necessary in light of changed funding conditions or changes in the firm’s business model.

(5) The firm must give a copy of the funding strategy to the Regulatory Authority on request. The firm must also inform the Authority of any significant change to the strategy.

8.3.7 **Stress testing**

(1) An Islamic banking business firm must carry out stress tests regularly for a variety of short-term and long-term liquidity stress scenarios (firm-specific and market-wide, separately and in combination) to identify sources of potential liquidity stress and to ensure that the firm’s exposures continue to be in accordance with its liquidity risk tolerance.

(2) The tests must enable the firm to analyse the effect of stress scenarios on its liquidity positions, and on the liquidity positions of individual business lines.
(3) The scenarios and related assumptions must take into account the particular features specific to Islamic financial business.

**Guidance**
For guidance on those features and how they should be taken into account, see IFSB–13, *Guiding principles on stress testing for institutions offering Islamic financial services [excluding Islamic insurance (takaful) institutions and Islamic collective investment schemes]*, published by the Islamic Financial Services Board in March 2012.

(4) The test scenarios and related assumptions must be well documented, and must be reviewed together with the test results. The results, the vulnerabilities found and any resulting actions must be reported to, and discussed with, the firm’s governing body and the Regulatory Authority.

(5) The test outcomes must be used to adjust the firm’s liquidity management strategy, policies and positions, and to develop effective contingency plans to deal with liquidity stress.

(6) The results of the tests must be integrated into the firm’s strategic planning process and its day-to-day risk management practices. The results must be explicitly considered in the setting of internal limits.

(7) The firm must decide how to incorporate the results in assessing and planning for possible funding shortfalls in its contingency funding plan.

### 8.3.8 Contingency funding plan

(1) An Islamic banking business firm must have a formal contingency funding plan that clearly sets out the firm’s strategies for addressing liquidity shortfalls in emergency situations. The plan:

(a) must outline policies to manage a range of liquidity stress situations;

(b) must establish clear lines of responsibility; and

(c) must include clear escalation procedures.
(2) The plan must be appropriate to the nature, scale and complexity of the firm’s operations and the firm’s role in the financial systems in which it operates.

(3) The plan must provide a framework with a high degree of flexibility so that the firm can respond quickly in a variety of liquidity stress situations.

(4) The plan must set out:
   (a) available sources of contingency funding and an estimate of the amount of funds that can be obtained from each source;
   (b) clear procedures for escalation and prioritisation, setting out when and how each of the actions in the plan can and must be activated; and
   (c) the lead time needed to obtain additional funds from each of the sources.

(5) The plan’s design, scope and procedures must be closely integrated with the firm’s continuing analysis of liquidity risk and with the assumptions used in its stress tests and the results of those tests. The plan must address issues over a range of different time horizons, including intraday.

(6) The firm must review and test the plan regularly to ensure that the plan remains effective and operationally feasible. The firm must review and update the plan for the governing body’s approval at least annually (or more often, as changing business or market circumstances require).
Part 8.4  
**Liquidity coverage ratio—liquidity risk group A Islamic banking business firms**

### Notes for Part 8.4

1. Much of this Part is based on:
   - Guiding Principles on Liquidity Risk Management for Institutions Offering Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes], published by the Islamic Financial Services Board in March 2012 (*IFSB–12*)
   - Guidance Note on Quantitative Measures for Liquidity Management in Institutions Offering Islamic Financial Services [Excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes], published by the Islamic Financial Services Board in April 2015 (*IFSB GN 6*).

2. This Part applies only to liquidity risk group A Islamic banking business firms—see rule 8.1.4.

#### Division 8.4.A  
**Introductory**

#### 8.4.1  
**Introduction—Part 8.4**

(1) This Part requires a liquidity risk group A Islamic banking business firm to maintain a portfolio of high-quality liquid assets (*HQLA portfolio*) that can be monetised to meet the firm’s liquidity needs for 30 calendar days under severe liquidity stress. This Part sets out:

(a) what assets qualify as high-quality liquid assets;
(b) how much the portfolio must be able to raise if monetised;
(c) how assets must be valued for inclusion in the portfolio; and
(d) how much of the portfolio’s value may be made up of assets of different kinds.

**Guidance**

To obtain liquidity, a firm could monetise an asset by, for example, sale or repo.
(2) This Part also requires an Islamic banking business firm to maintain a specified ratio (liquidity coverage ratio or LCR) of HQLA to its predicted need for liquidity over a 30-calendar-day period.

(3) The purpose of requiring Islamic banking business firms to maintain the HQLA portfolio, and to meet the LCR requirement, is to ensure that such firms are resilient, in the short term, to liquidity risk. The LCR requirement is intended to ensure that such a firm always holds unencumbered assets that can be readily converted into sufficient cash to meet the firm’s liquidity needs for 30 calendar days even under severe liquidity stress.

(4) An Islamic banking business firm is required to maintain its HQLA portfolio, and to meet the minimum LCR, at all times. Therefore, such a firm should frequently calculate:
   (a) its liquidity needs for the coming 30 calendar days; and
   (b) the value of its HQLA portfolio.

(5) Nothing in this Part prevents an Islamic banking business firm from holding HQLA in excess of the amounts required by this Part.

8.4.2 Application of Part 8.4

(1) This Part applies to an Islamic banking business firm on a solo basis.
   Note For the application of this Part to a firm that is a branch (and the global liquidity concession), see rule 8.4.58.

(2) However, if an Islamic banking business firm is a member of a financial group that is subject to consolidated supervision by the Regulatory Authority, the Authority may direct the financial group as a whole to comply with this Part.
   Note For the application of this Part to a financial group, see rule 8.4.5.
8.4.3 Definitions for Part 8.4

In this Part:

*financial institution* includes an Islamic banking business firm and an authorised firm of any other kind, and any of the following kinds of entity established outside the QFC:

(a) a bank;
(b) a securities firm;
(c) an insurance company;
(d) a fiduciary (that is, a legal entity that is authorised to manage assets on behalf of a third party, including an asset-management entity such as a pension fund or collective investment vehicle);
(e) a beneficiary (that is, a legal entity that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract).

*high-quality liquid assets* has the meaning given by rules 8.4.8 to 8.4.13.

*HQLA* means high-quality liquid assets.

*LCR* means liquidity coverage ratio.

*liquidity coverage ratio* for an Islamic banking business firm means the ratio calculated in accordance with rule 8.4.20.

8.4.4 References in Part 8.4 to encumbered and unencumbered assets

(1) For this Part:

*unencumbered*, in relation to an asset, means free of legal, regulatory, contractual or other restrictions on liquidation, sale, transfer, or assignment.

(2) For this Part, an asset is *encumbered* if it is lodged (either explicitly or implicitly) to secure, collateralise or credit-enhance a transaction, or is designated to cover operational costs (such as rents and salaries).
(3) However, assets received by an Islamic banking business firm in reverse-repo and securities financing transactions are taken to be unencumbered if the assets:
   (a) are held at the firm;
   (b) have not been re-hypothecated; and
   (c) are legally and contractually available for the firm’s use.

(4) In addition, assets that have been pre-positioned or deposited with, or lodged with, a central bank or a public sector entity may be treated as unencumbered if the assets:
   (a) otherwise qualify as HQLA; and
   (b) have not been used to generate liquidity.

8.4.5 Application of LCR to financial group

(1) For calculating a consolidated LCR for a financial group, HQLA held to meet liquidity needs at the firm level may be included in the consolidated parent entity’s HQLA portfolio only so far as the related liabilities are also reflected in the parent entity’s LCR. Any surplus of HQLA held at the firm may be treated as forming part of the parent entity’s HQLA portfolio only if those assets would be freely available to the parent entity during a period of liquidity stress.

(2) When calculating its LCR on a consolidated basis, a cross-border banking group must, subject to subrule (3), apply its home jurisdiction’s rules to all the legal entities that are being consolidated.

(3) The firm must treat deposits by retail and small business customers with a consolidated entity according to the rules in the jurisdiction in which that entity operates. The firm must also apply those rules to decide whether a particular deposit qualifies as a deposit by a retail customer or a small business customer.

(4) A cross-border banking group must not take excess liquidity into account in calculating its consolidated LCR if there is reasonable
doubt about whether the liquidity would be available during a period of liquidity stress.

**Guidance**
Liquidity transfer restrictions (for example, ring-fencing measures, non-convertibility of local currency, and foreign exchange controls) in jurisdictions in which an Islamic banking group operates would affect the availability of liquidity by restricting the transfer of HQLA and funds flows within the group. The consolidated LCR should reflect the restrictions consistently with this Part. For example, HQLA held to meet a local LCR requirement by a subsidiary that is being consolidated can be included in the consolidated LCR to the extent that the HQLA are used to cover the total net cash outflows of that subsidiary, even if the assets are subject to restrictions on transfer to the parent entity. If the HQLA held in excess of the total net cash outflows are not transferable, the firm should not count that surplus liquidity.

**Division 8.4.B  HQLA portfolio—makeup and value**

**8.4.6  Requirement for HQLA portfolio—basic rules**

1. An Islamic banking business firm must maintain an HQLA portfolio sufficient to meet its funding needs for at least 30 calendar days under severe liquidity stress.

   *Note* The value of the HQLA portfolio must bear a minimum ratio to the firm’s outflows over the 30-calendar-day period. That minimum ratio is the liquidity coverage ratio or LCR—see rules 8.4.16 and 8.4.20.

2. The assets in the portfolio must be appropriately diversified in terms of type, issuer, currency and counterparty.

3. The firm must be able to meet its liquidity needs in each currency in which it has significant exposure. The portfolio must be similar in composition (in terms of the currencies in which the assets are denominated) to its liquidity needs.

4. For subrule (3), an Islamic banking business firm has *significant exposure* in a currency if 5% or more of the firm’s total liabilities are denominated in the currency.
8.4.7 HQLA portfolio—general operational requirements

(1) An Islamic banking business firm’s HQLA portfolio must be under the control of the specific function or functions charged with managing the firm’s liquidity. That function must always have the authority, and must always be legally and operationally able, to monetise any asset in the portfolio.

Guidance
For the firm to be operationally able to monetise assets, the firm must have the necessary procedures and appropriate systems, and must have access to all the necessary information. The function must actually be able to monetise any of the assets within the standard settlement period for the asset class.

(2) That control must be shown by:
(a) maintaining the portfolio in a separate pool managed by the function solely as a source of contingent funds; or
(b) showing that the function can monetise any asset in the portfolio at any time, and that the proceeds of doing so are available to the function throughout the following 30-calendar-day period, consistently with the firm’s business and risk-management strategies.

(3) The firm must monetise a representative part of the portfolio periodically (at least annually):
(a) to test the firm’s access to the market, the effectiveness of its processes for liquidation and the availability of the assets; and
(b) to minimise the risk of giving a negative signal during a period of actual liquidity stress.

8.4.8 What assets are HQLA

(1) An asset is HQLA if it falls within any of rules 8.4.10 to 8.4.12, or is approved by the Regulatory Authority as HQLA under rule 8.4.13.

Guidance
Assets that fall within any of rules 8.4.10 to 8.4.12 are HQLA because such assets can be monetised easily and immediately with little or no loss of value.
Chapter 8
Liquidity risk
Part 8.4
Liquidity coverage ratio—liquidity risk group A Islamic banking business firms

Rule 8.4.9

(2) An Islamic banking business firm must not include an asset in its HQLA portfolio if the asset is encumbered.

Note For the meaning of encumbered, see rule 8.4.4 (2).

(3) The firm must not include an asset in the portfolio if the firm could not, for any operational, legal, regulatory or other reason, monetise it at any time and receive the proceeds within 30 calendar days.

Guidance

1 For example, the firm should not include an asset if:
   • the asset was hypothecated to the firm and the asset’s beneficial owner has the right to withdraw it
   • the sale of the asset without replacement would remove a hedge so as to create an open risk position in excess of the firm’s internal risk limit.

2 When considering whether to include a particular asset, a firm should take into account any possible delays in the settlement of a sale.

3 Subrule (3) would not prevent assets received as collateral for Shari’a-compliant hedging transactions from being included in the portfolio provided that:
   • the assets are not segregated and are legally able to be re-hypothecated
   • the firm records an appropriate outflow for the associated risks.

8.4.9 Classification of HQLA

(1) HQLA are classified as either level 1 HQLA or level 2 HQLA. Level 1 HQLA are the highest-quality, most liquid assets, and level 2 HQLA are other high-quality liquid assets.

(2) Level 2 HQLA are further classified as either level 2A HQLA or level 2B HQLA.

Guidance

All classes of HQLA (other than cash and Central Bank reserves) are Shari’a-compliant marketable securities that are traded in large, deep and active repo or cash markets with a low level of concentration.

8.4.10 Level 1 HQLA

Level 1 HQLA consists of:

(a) currency notes and coins;
(b) reserves held with the Qatar Central Bank, to the extent that they are capable of being drawn down immediately during a period of liquidity stress;

(c) sukuk and other Shari’a-compliant marketable securities that satisfy all of the following conditions:
   
   (i) they are issued or guaranteed by a sovereign, a central bank, a public sector entity, an MDB or the IILMC;
   
   (ii) they are assigned a risk weight of 0% under Part 4.4;
   
   (iii) they are not an obligation of a financial institution nor of a related party of a financial institution;
   
   (iv) they are traded in large, deep and active repo or cash markets with a low level of concentration;
   
   (v) they have a proven record as a reliable source of liquidity in the markets (repo or sale) even under stressed market conditions; and

(d) sukuk and other Shari’a-compliant marketable securities that are not assigned a risk weight of 0% under Part 4.4, but:
   
   (i) meet the conditions in paragraphs (c) (iii), (iv) and (v); and
   
   (ii) are either:

   (A) sovereign or central bank securities issued in the domestic currency of either the jurisdiction in which the firm’s liquidity risk is taken or the firm’s home jurisdiction; or
   
   (B) sovereign or central bank securities issued in a foreign currency, up to the amount of the firm’s stressed net cash outflows in that currency stemming from the firm’s operations in the jurisdiction in which the firm’s liquidity risk is taken.

*Note* The Regulatory Authority may approve assets of other kinds as level 1 HQLA—see rule 8.4.13.
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Part 8.4  Liquidity coverage ratio—liquidity risk group A Islamic banking business firms

Rule 8.4.11

8.4.11  Level 2A HQLA

Level 2A HQLA consists of:

(a)  *sukuk* and other Shari’a-compliant marketable securities that represent claims on, or claims guaranteed by, a sovereign, a central bank, a public sector entity or an MDB, and meet all of the following conditions:

(i)  they are assigned a risk weight of 20% under Part 4.4;
(ii)  they are traded in large, deep and active repo or cash markets with a low level of concentration;
(iii)  they have a proven record as a reliable source of liquidity in the markets (repo or sale) even under stressed market conditions (that is, they showed no more than 10% decline in price (or 10 percentage points increase in haircut) over a 30-calendar-day period of significant liquidity stress);
(iv)  they are not an obligation of a financial institution nor of a related party of a financial institution; and

(b)  *sukuk* and other Shari’a-compliant marketable corporate securities (including Shari’a-compliant commercial paper) that meet all of the following conditions:

(i)  they are not an obligation of a financial institution nor of a related party of a financial institution;
(ii)  they are rated no lower than AA- (long-term) or A-1 (short-term) by Standard & Poor’s (or the equivalent by another ECRA);
(iii)  they are traded in large, deep and active repo or cash markets with a low level of concentration;
(iv)  they have a proven record as a reliable source of liquidity in the markets (repo or sale) even under stressed market conditions (that is, they showed no more than 10% decline
in price (or 10 percentage points increase in haircut) over a 30-calendar-day period of significant liquidity stress).

Note  The Regulatory Authority may approve assets of other kinds as level 2A HQLA—see rule 8.4.13.

8.4.12 Level 2B HQLA

Level 2B HQLA consists of:

(a) *sukuk* and other Shari’a-compliant marketable securities that are backed by Shari’a-compliant residential mortgages, and meet all of the following conditions:

(i) they were not issued by, and the underlying assets were not originated by, the firm itself or a related party of the firm;

(ii) the underlying asset pool does not contain structured products;

(iii) they are rated no lower than AA (long-term) or A-1 (short-term) by Standard & Poor’s (or the equivalent by another ECRA);

(iv) the securitisations are subject to rules that require issuers to retain an interest in assets that they securitise;

(v) they are traded in large, deep and active repo or cash markets with a low level of concentration;

(vi) they have a proven record as a reliable source of liquidity in the markets (repo or sale) even under stressed market conditions (that is, they showed no more than 20% decline in price (or 20 percentage points increase in haircut) over a 30-calendar-day period of significant liquidity stress);

(b) *sukuk* and other Shari’a-compliant marketable securities that do not fall within paragraph (a), and meet all of the following conditions:

(i) they were not issued by a financial institution nor a related party of a financial institution;
(ii) they are rated no lower than BBB- (long-term) or A-3 (short-term) by Standard & Poor’s (or the equivalent by another ECRA);

(iii) they are traded in large, deep and active repo or cash markets with a low level of concentration;

(iv) they have a proven record as a reliable source of liquidity in the markets (repo or sale) even under stressed market conditions (that is, they showed no more than 20% decline in price (or 20 percentage points increase in haircut) over a 30-calendar-day period of significant liquidity stress);

(c) Shari’a-compliant equity shares that meet all of the following conditions:

(i) they were not issued by a financial institution nor a related party of a financial institution;

(ii) they are exchange-traded and centrally cleared;

(iii) they are a constituent of the QE Index or of an index that the Regulatory Authority accepts as a major stock index for the recognised exchange on which the shares are listed;

(iv) they are denominated in the currency of the firm’s home jurisdiction or the currency of the jurisdiction where the firm’s liquidity risk is taken;

(v) they are traded in large, deep and active repo or cash markets with a low level of concentration;

(vi) they have a proven record as a reliable source of liquidity in the markets (repo or sale) even under stressed market conditions (that is, they showed no more than 40% decline in price (or 40 percentage points increase in haircut) over a 30-calendar-day period of significant liquidity stress);

(d) sukuk and other Shari’a-compliant marketable securities that are issued by a sovereign or a central bank, are rated BBB+ to BBB- by an ECRA, and are not level 1 HQLA.
8.4.13 Regulatory Authority approval of other types of HQLA

(1) The Regulatory Authority may approve assets of types that do not fall within rules 8.4.10 to 8.4.12 as being eligible to be included in an Islamic banking business firm’s HQLA portfolio to meet the firm’s LCR requirement.

(2) If the Authority approves assets under subrule (1), it must specify whether they are to be treated as level 1, level 2A or level 2B HQLA.

8.4.14 Make-up of HQLA portfolio

(1) The whole of an Islamic banking business firm’s HQLA portfolio may be made up of level 1 HQLA.

(2) In the portfolio the firm may include level 2 HQLA only up to the following limits:
   (a) level 2 HQLA (including both level 2A HQLA and level 2B HQLA)—no more than 40% of the total value of the portfolio;
   (b) level 2B HQLA—no more than 15% of the total value of the portfolio.

(3) For calculating the total value of the portfolio and the percentages of its value made up of each category of HQLA, the value of an asset is taken to be its market value and is subject to the appropriate haircut set out in rule 8.4.15.

(4) If an asset is involved in a transaction that matures within 30 calendar days and involves the exchange of HQLA:
   (a) the transaction may be treated as having been unwound; and
   (b) the asset may be included in the portfolio.

(5) Only assets held or owned by the firm on the day of calculation may be included in the calculation, regardless of their residual maturity.

(6) If an asset in the firm’s portfolio that was formerly eligible as HQLA becomes ineligible (for example, because of a rating downgrade), the firm may continue to treat the asset as HQLA for a further 30 calendar days.
days after it ceases to be eligible as HQLA, to allow the firm time to adjust its portfolio.

8.4.15 **Haircuts for assets in HQLA portfolio**

For calculating the value of an Islamic banking business firm’s HQLA portfolio:

(a) level 1 HQLA must be valued at their market value;
(b) level 2A HQLA must be valued at 85% of their market value; and
(c) level 2B HQLA must be valued at the following percentages of their market value:
   (i) *sukuk* and other Shari’a-compliant securities that are backed by Shari’a-compliant residential mortgages—75%;
   (ii) other level 2B HQLA referred to in rule 8.4.12—50%;
   (iii) other assets approved by the Regulatory Authority as level 2B HQLA—the percentage that the Authority specifies.

**Division 8.4.C   Liquidity coverage ratio**

**Subdivision 8.4.C.1   Liquidity coverage ratio generally**

8.4.16 **Liquidity coverage ratios required**

(1) Subject to rule 8.4.18, a liquidity risk group A Islamic banking business firm must maintain its LCR:

(a) in the calendar year 2018—at 90% or higher; and
(b) in each subsequent calendar year—at 100% or higher.

*Note* Rule 8.4.18 allows an Islamic banking business firm to monetise part of its HQLA portfolio during a period of liquidity stress.

**Guidance**

Rule 8.4.16 sets minimum levels and is not intended to limit the generality of the requirements in rule 8.4.6.
(2) The requirement for the firm to maintain the LCR required by subrule (1) is called the firm’s **LCR requirement**.

**Guidance**

An authorised firm must be continually aware of its LCR because of the requirements for the firm to maintain its LCR, and to report to the Regulatory Authority if the LCR falls below the firm’s LCR requirement. How often the firm needs to calculate its LCR depends on the nature of the firm’s business. Some relevant factors would be:

- how volatile the values of the firm’s assets and exposures are
- how actively the firm trades.

For the requirement to report if the firm’s LCR falls below its LCR requirement, see rule 8.4.19.

**8.4.17 Adjustment of firms’ LCR by Regulatory Authority**

The Regulatory Authority may, by written notice to an Islamic banking business firm, do any 1 or more of the following:

(a) change the firm’s LCR requirement;

(b) change the method for calculating the LCR requirement, or the assumptions or parameters for the purposes of that calculation;

(c) impose additional requirements based on the Authority’s assessment of the firm’s exposure to liquidity risk.

**8.4.18 Monetising HQLA during periods of liquidity stress**

During a period of liquidity stress, an Islamic banking business firm may monetise part of its HQLA portfolio, and may use the cash so generated to cover cash outflows. It may allow its LCR to fall below the level required by rule 8.4.16 to the extent necessary to deal with cash outflows during that period.

**8.4.19 Obligation to notify Regulatory Authority if LCR requirement not met**

(1) An Islamic banking business firm must notify the Regulatory Authority in writing immediately (but within 3 business days) if the
firm ceases to meet its LCR requirement (or becomes aware of circumstances that may result in its ceasing to meet that requirement).

(2) In the notification the firm must clearly explain:
   (a) why it ceased to meet, or thinks it may cease to meet, the requirement;
   (b) when it expects to again be able to meet the requirement; and
   (c) what it has done, and will do, to ensure that it meets the requirement in future, or continues to meet it, as the case requires.

**Guidance**

An Islamic banking business firm that gives such a notification should discuss with the Regulatory Authority what further steps it should take to deal with the situation.

**Subdivision 8.4.C.2 Calculating LCR**

**8.4.20 How to calculate LCR**

(1) An Islamic banking business firm’s LCR is calculated by means of the following formula:

\[
LCR = \frac{VP}{TC30} \times 100
\]

where:

\(TC30\) is the firm’s total net cash outflow over the next 30 calendar days (all outflows, or outflows in the relevant currency, as the case requires), calculated in accordance with rule 8.4.21.

\(VP\) is the total value of the assets in the firm’s HQLA portfolio, calculated in accordance with rule 8.4.15.

*Note* For calculating the value of the portfolio, the market value of an asset in the portfolio is taken to be the asset’s market value, subject to a haircut—see rule 8.4.15.

(2) The firm must calculate its LCR both overall, and separately for each significant currency in which it has liabilities. A currency is
**significant** for the firm if the firm’s liabilities denominated in it amount to 5% or more of the firm’s total liabilities.

**Guidance**

An Islamic banking business firm that is active in several currencies:

- should maintain an HQLA portfolio consistent with the distribution of its liquidity needs by currency
- should assess its aggregate foreign currency liquidity needs and determine an acceptable level of currency mismatches
- should separately analyse its strategy for each significant currency, considering possible constraints during a period of liquidity stress.

### 8.4.21 How to calculate total net cash outflow over next 30 calendar days

1. On any day, an Islamic banking business firm’s total net cash outflow over the next 30 calendar days is the difference between:
   - its total expected gross cash outflow over that 30-calendar-day period; and
   - the lesser of:
     - 75% of its total expected gross cash outflow over that period; and
     - its total expected cash inflow over that period.

**Guidance**

Subrule (1) (b) ensures that, for the purposes of the calculation, the firm’s cash inflow can never be greater than 75% of its total expected gross cash outflow.

2. For that calculation:
   - the firm’s total expected gross cash outflow is to be calculated in accordance with Subdivisions 8.4.C.3 to 8.4.C.5; and
   - the firm’s total expected cash inflow is to be calculated in accordance with Subdivisions 8.4.C.6 to 8.4.C.8.
Subdivision 8.4.C.3 Calculating total expected gross cash outflows—general

8.4.22 How to calculate total expected gross cash outflow

(1) Total expected gross cash outflow over a period is calculated by:

(a) first, multiplying the outstanding balance of each category of liability or off-balance-sheet commitment by the rate at which it is expected to run off or be drawn down during the period; and

(b) then, adding up the balances so calculated.

Note Rules 8.4.23 to 8.4.42 specify runoff rates for many kinds of cash outflow and give interpretative provisions. Those rules are based on Basel III LCR, IFSB–12 and IFSB GN 6. The interpretive provisions provide only minimal explanation of the reasons why particular kinds of outflow receive the runoff rates specified. For a fuller explanation, consult Basel III LCR (in particular, paragraphs 69–141), IFSB–12 and IFSB GN 6.

(2) For that calculation, if profit is payable on the outstanding balance of a liability or off-balance-sheet commitment, any profit that is expected to be paid during the relevant period must be added to the balance.

Subdivision 8.4.C.4 Calculating total expected gross cash outflows—runoff rates for retail deposits, wholesale unsecured funding and secured funding

8.4.23 Treatment of retail deposits generally

(1) The runoff rates for retail deposits generally are as set out in table 8.4.23.

(2) However, this rule does not apply to:

(a) a PSIA (whether restricted or unrestricted) (see rule 8.4.24);

(b) a deposit or PSIA that falls within rule 8.4.26; or
(c) unsecured wholesale funding that falls within rule 8.4.27.

Note Rule 8.4.25 allows the Regulatory Authority to direct that a higher runoff rate must be applied to deposits or PSIAs that would otherwise fall within rule 8.4.23 or 8.4.24 but have unusual features.

(3) In the case of a deposit or PSIA that is pledged as security for a financing facility, this rule is subject to rule 8.4.28.

Table 8.4.23 Retail deposits—runoff rates

<table>
<thead>
<tr>
<th>Kind of deposit</th>
<th>Runoff rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail demand deposits (other than CMT-based deposits), and term deposits with maturity of 30 calendar days or less:</td>
<td></td>
</tr>
<tr>
<td>• stable deposits (see subrule (4)) covered by a Shari’a-compliant deposit insurance scheme that meets all of the additional criteria in subrule (7)</td>
<td>3</td>
</tr>
<tr>
<td>• other stable deposits</td>
<td>5</td>
</tr>
<tr>
<td>• less stable deposits (see subrules (8), (9))</td>
<td>10</td>
</tr>
<tr>
<td>CMT-based deposits from retail and small business customers</td>
<td>20</td>
</tr>
</tbody>
</table>

Note 1 CMT-based deposits from non-financial corporates, sovereigns, central banks, MDBs and public sector entities are treated as unsecured wholesale funding—see rule 8.4.27 (16).

Note 2 CMT-based deposits create particular liquidity risks:

“In such transactions, the customer first buys a commodity and sells it to [an Islamic banking business firm] on a deferred payment basis at an agreed price with a profit margin. As the funds raised by [the firm] on the basis of CMT effectively require it to pay back the principal and agreed profit to the customer on maturity, the [firm] may be exposed to liquidity risk .... If CMT-based funds, which are usually short-term in nature, are used by the [firm] to finance longer-term assets, a maturity-mismatch will result. Such a mismatch may become acute if [the firm]
has a high reliance on such deposits to fund its assets.” (IFSB–12, paragraph 51).

For the meaning of IFSB–12, see the note at the beginning of Part 8.4.

(4) **Stable deposits** are deposits that are fully insured (see subrule (5)) (or are covered by a public guarantee that provides equivalent protection), and for which either of the following is true:

(a) the depositor has other established relationships with the firm that make withdrawal highly unlikely;

(b) the deposit is in a transactional account (for example, an account into which the depositor’s salary is automatically deposited).

(5) A deposit is **fully insured** if 100% of the deposit amount, up to the applicable deposit insurance limit, is covered by an effective (see subrule (6)) Shari’a-compliant deposit insurance scheme. Deposit balances up to the limit are treated as fully insured even if the depositor’s balance is over the limit. However, any amount over the limit is to be treated as a less stable deposit.

**Guidance**

For example, if a depositor has a deposit of 150 that is covered by a deposit insurance scheme that has a limit of 100, so that the depositor would receive at least 100 from the scheme if the firm were unable to pay, then 100 would be considered fully insured and treated as a stable deposit, and 50 would be treated as a less stable deposit. However, if the scheme covered only a percentage of the deposit amount (for example, 90% of the deposit amount up to a limit of 100), the entire 150 deposit would be treated as a less stable deposit.

(6) A Shari’a-compliant deposit insurance scheme is **effective** if all of the following are true:

(a) the scheme guarantees that it can make payouts promptly;

(b) its coverage is clearly defined;

(c) the provider has formal legal powers to fulfil the scheme’s mandate, and is operationally independent, transparent and accountable;
(d) public awareness of the scheme is high.

**Guidance**
For *Shari’a-compliant deposit insurance*, see IFSB–12 paragraph 162, and IFSB GN 6, section 2.3.1.2, para 57.

(7) The additional criteria (for a Shari’a-compliant deposit insurance scheme) mentioned in table 8.4.23 are the following:

(a) the scheme is pre-funded by periodic levies on entities with insured deposits;

(b) the scheme has ready access to additional funding in the event of a large call on its reserves (for example, an explicit and legally binding guarantee from its government, or a standing authority to borrow from its government);

(c) depositors have access to insured deposits quickly if the scheme is called on.

(8) A deposit that does not fall within subrule (4) is a *less stable deposit*.

(9) If the firm cannot readily identify a term deposit as stable, it must treat the full amount of the deposit as less stable.

(10) The firm may exclude, from total expected cash outflows, the cash outflow related to a term deposit with residual maturity, or a notice period for withdrawal, longer than 30 calendar days only if:

(a) the depositor has no legal right to withdraw the deposit within the 30-calendar-day period; or

(b) early withdrawal would result in a significant reduction of profit that is materially greater than the loss of profit for the period.

(11) However, if the practice of the firm is to allow depositors to withdraw such deposits within the 30-calendar-day period without imposing the corresponding reduction of profit, each such deposit must be treated in full as a demand deposit unless the Regulatory Authority approves otherwise.
Rule 8.4.24

8.4.24 Treatment of maturing PSIs

(1) The runoff rates for PSIs that mature with the relevant 30-calendar-day period are as set out in table 8.4.24.

Table 8.4.24 Maturing PSIs—runoff rates

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of PSIA</th>
<th>Runoff rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Restricted PSIs:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• stable (covered by a Shari’a-compliant deposit insurance scheme that meets all of the additional criteria in rule 8.4.23 (7))</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>• other stable (according to the criteria in rule 8.4.23 (4))</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>• less stable</td>
<td>10</td>
</tr>
<tr>
<td>2</td>
<td>Unrestricted PSIs:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• stable (covered by a Shari’a-compliant deposit insurance scheme that meets all of the additional criteria in rule 8.4.23 (7))</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>• other stable (according to the criteria in rule 8.4.23 (4))</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>• less stable</td>
<td>10</td>
</tr>
</tbody>
</table>

(2) If a firm cannot readily identify a PSIA as stable in accordance with the criteria in rule 8.4.23 (4), it must treat the full amount of the PSIA as less stable. A PSIA of which the returns are not subject to smoothing (for example, by the use of a PER or an IRR) must be treated as less stable.
(3) The firm may exclude from total expected cash outflows the cash outflows related to PSIs with residual maturity, or a notice period for withdrawal, longer than 30 calendar days only if:

(a) the IAH concerned has no legal right to withdraw the PSIA within the 30-calendar-day period; or

(b) early withdrawal would result in a significant reduction of profit that is materially greater than the loss of profit for the period.

(4) However, if the practice of the firm is to allow IAHs to withdraw such PSIs within the 30-calendar-day period without imposing the corresponding reduction of profit, each such PSIA must be treated in full as a demand deposit unless the Regulatory Authority approves otherwise.

8.4.25 Treatment of deposits and PSIs with unusual features
Despite anything in rule 8.4.23 or 8.4.24, the Regulatory Authority may direct that a higher run-off rate must be applied to a deposit or PSIA, or a class of deposits or PSIs, that falls within either of those rules but presents unusual features.

8.4.26 Treatment of deposits and PSIs not in Qatari riyals, and deposits by non-residents of Qatar
(1) This rule applies to:

(a) deposits by, and PSIs held by, residents of Qatar, not denominated in Qatari riyals; and

(b) deposits by, and PSIs held by, non-residents of Qatar, regardless of the currency of denomination.

(2) The run-off rate for deposits and PSIs to which this rule applies is the rate that the Regulatory Authority directs.

8.4.27 Treatment of unsecured wholesale funding
(1) The runoff rates for unsecured wholesale funding are as set out in table 8.4.27.
(2) In the case of a deposit or PSIA that is pledged as security for a financing facility, this rule is subject to rule 8.4.28.

(3) **Wholesale funding** consists of liabilities and general obligations, raised from legal entities, of which any 1 or more of the following is true:

(a) the funding is callable within 30 calendar days;

(b) the funding has its earliest possible contractual maturity date within 30 calendar days (for example, a maturing term deposit or an unsecured debt security); or

(c) the funding has an undetermined maturity.

**Guidance**

*Wholesale funding* includes funding that the provider has the option of withdrawing within the 30-calendar-day period (but not funding that is callable by the funds provider subject to a contractually defined and binding notice period longer than 30 calendar days).

(4) **Unsecured wholesale funding** is wholesale funding that is not collateralised by legal rights to specifically designated assets. Unsecured wholesale funding does not include obligations related to Shari’a-compliant hedging contracts.

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of funding</th>
<th>Runoff rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Demand and term deposits (other than operational deposits), with maturity of 30 calendar days or less, provided by small business customers:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• stable deposits (see subrule (5))</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>• less stable deposits (see subrule (5))</td>
<td>10</td>
</tr>
<tr>
<td>Item</td>
<td>Kind of funding</td>
<td>Runoff rate (%)</td>
</tr>
<tr>
<td>------</td>
<td>-----------------</td>
<td>-----------------</td>
</tr>
<tr>
<td>2</td>
<td>Operational deposits (see subrules (6)–(11)) (including CMT-based deposits):</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• any part covered by Shari’a-compliant deposit insurance</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>• otherwise</td>
<td>25</td>
</tr>
<tr>
<td>3</td>
<td>Unsecured wholesale funding from cooperative banks in an institutional network (qualifying deposits with the central institution) (see subrules (12)–(14))</td>
<td>25</td>
</tr>
<tr>
<td>4</td>
<td>Unsecured wholesale funding provided by non-financial corporates, and sovereigns, central banks, MDBs, and public sector enterprises (see subrule (15)):</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• if the entire amount is fully covered by Shari’a-compliant deposit insurance</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>• otherwise</td>
<td>40</td>
</tr>
<tr>
<td>5</td>
<td>CMT-based deposits (other than operational deposits) from non-financial corporates, sovereigns, central banks, MDBs and public sector entities:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• if the entire amount is fully covered by Shari’a-compliant deposit insurance</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>• otherwise</td>
<td>40</td>
</tr>
<tr>
<td>6</td>
<td>CMT-based deposits (other than operational deposits) from financial institutions</td>
<td>100</td>
</tr>
</tbody>
</table>
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### Rule 8.4.27

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of funding</th>
<th>Runoff rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Unsecured wholesale funding provided by other legal entity customers (see subrules (16)–(19))</td>
<td>100</td>
</tr>
</tbody>
</table>

Note  
For an explanation of the particular treatment of CMT-based deposits, see note 2 following table 8.4.23.

(5) In table 8.4.27, **stable deposit** and **less stable deposit** have the same respective meanings as in rule 8.4.23. However, a PSIA of which the returns are not subject to smoothing (by, for example, the use of a PER or an IRR) must be treated as a less stable deposit.

(6) **Operational deposits** are deposits placed or left with the firm by a customer to facilitate the customer’s access to, and ability to use, payment and settlement systems and otherwise make payments for the purposes of clearing, custody or cash management services that meet all of the following criteria:

(a) the customer is reliant on the firm to perform the services as an independent third party intermediary;

Guidance  
This condition would not be met if the firm were aware that the customer had adequate back-up arrangements.

(b) the services are provided under a legally binding agreement;

(c) the termination of the agreement is subject to:

   (i) a notice period of 30 calendar days or more; or

   (ii) significant costs (such as transaction costs, costs related to information technology, or early termination or legal costs) that must be borne by the customer if the deposit is moved before the end of 30 calendar days.

Guidance

1 **Clearing** is a service that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Such services are limited to the following activities:

- transmission, reconciliation and confirmation of payment orders
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- daylight overdraft, overnight financing and maintenance of post-settlement balances
- determination of intra-day and final settlement positions.

2 **Custody** is the provision of safekeeping, reporting and processing of assets, or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral, and the provision of custody-related cash management services.

3 **Custody** also includes the receipt of dividends and other income and client subscriptions and redemptions, and extends to asset and corporate trust servicing, treasury, escrow, funds transfer, stock transfer and agency services, (including payment and settlement services, but not correspondent banking), and depository receipts.

4 **Cash management** is the provision of cash management and related services to customers—that is, services provided to a customer to manage its cash flows, assets and liabilities, and conduct financial transactions necessary to its operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds.

5 **Correspondent banking** is an arrangement under which a bank holds deposits owned by other banks, and provides payment and other services to settle foreign currency transactions.

(7) The firm may treat a deposit as an operational deposit only if the deposit meets all of the following requirements:

(a) it is a by-product of the underlying services provided by the firm;

(b) it is not offered by the firm in the wholesale market for the sole purpose of offering profit income;

(c) it is held in a specifically-designated account;

(d) it is priced so as not to give customers an economic incentive to leave excess funds in the account.

(8) Excess balances that could be withdrawn without jeopardising those clearing, custody or cash management activities are not to be treated as operational deposits.
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(9) The firm must determine how to identify such excess balances. If the firm is unable to identify how much of a deposit is an excess balance, the firm must assume that the entire deposit is excess and therefore not operational.

**Guidance**
The identification should be sufficiently granular to adequately assess the risk of withdrawal in an idiosyncratic stress situation. The method should take into account relevant factors such as the likelihood that wholesale customers have above-average balances in advance of specific payment needs, and should consider appropriate indicators (for example, ratios of account balances to payment or settlement volumes or to assets under custody) to identify customers that are not actively managing account balances efficiently.

(10) A deposit that arises out of correspondent banking, or from the provision of prime brokerage services, is not to be treated as an operational deposit.

**Guidance**
*Prime brokerage services* is a package of services offered to large active investors, particularly institutional hedge funds. The services usually include:

- clearing, settlement and custody
- consolidated reporting
- financing (margin, repo or synthetic)
- securities lending
- capital introduction
- risk analytics.

(11) Any part of an operational deposit that is fully covered by *Shari’a*-compliant deposit insurance may be treated as a stable retail deposit.

(12) An *institutional network of cooperative banks* is a group of legally separate banks with a statutory framework of cooperation with a common strategic focus and brand, in which certain functions are performed by a central institution or a specialised service provider.

(13) A *qualifying deposit* is a deposit by a member institution with the central institution or specialised central service provider:

(a) because of statutory minimum deposit requirements; or
(b) in the context of common task-sharing and legal, statutory or contractual arrangements (but only if both the depositor and the bank that receives the deposit participate in the network’s scheme of mutual protection against illiquidity and insolvency).

(14) The following are not qualifying deposits:

(a) deposits resulting from correspondent banking activities;
(b) deposits placed at the central institution or a specialised service provider for any reason other than those set out in subrule (13);
(c) deposits for the operational purposes of clearing, custody, or cash management.

(15) **Unsecured wholesale funding provided by non-financial corporates and sovereigns, central banks, MDBs, and public sector enterprises** comprises all deposits and other extensions of unsecured funding (other than those specifically for operational purposes) from:

(a) non-financial corporate customers (except small business customers); and

(b) domestic and foreign customers that are sovereigns, central banks, MDBs and public sector enterprises.

(16) **Unsecured wholesale funding provided by other legal entity customers** consists of deposits and other funding (other than operational deposits) not falling within subrules (1) to (15), such as funding provided by:

(a) another financial institution; or

(b) a related party of the firm.

(17) All *sukuk* issued by the firm are to be treated as unsecured wholesale funding provided by other legal entity customers regardless of the holder.

(18) However, securities that are sold exclusively in the retail market and held in retail accounts (or small business customer accounts), may be treated in the appropriate retail or small business customer deposit category. For securities to be treated in that way, there must be
limitations preventing them being bought and held other than by retail or small business customers.

(19) Customers’ cash balances arising from the provision of prime brokerage services must be treated as separate from any balances required to be segregated under a statutory client protection regime, and must not be netted against other customer exposures. Such offsetting balances held in segregated accounts are to be treated as inflows and must not be counted as HQLA.

8.4.28 Treatment of deposits and PSIAs pledged as security

(1) This rule applies to a deposit or PSIA that is pledged as security for a financing facility if:

(a) the facility will not mature or be settled within the relevant 30-calendar-day period; and

(b) the pledge is subject to a legally enforceable contract under which the deposit cannot be withdrawn before the facility is fully settled or repaid.

(2) If no part of the facility has been drawn, the runoff rate is the higher of:

(a) the rate that would apply under rule 8.4.23 or 8.4.27 (as the case requires); and

(b) a rate equal to the rate applicable to the facility under rule 8.4.39.

(3) However, if some part of the facility has been drawn, only that part of the deposit or PSIA in excess of the outstanding balance of the facility is to be counted. The applicable runoff rate is the rate that applies under rule 8.4.23 or 8.4.27 (as the case requires).

8.4.29 Treatment of maturing secured funding

(1) The runoff rates for secured funding that matures within the relevant 30-calendar-day period are as set out in table 8.4.29.
(2) **Secured funding** is an Islamic banking business firm’s liabilities and general obligations collateralised by the grant of legal rights to specific assets owned by the firm.

**Guidance**

This scenario assumes that the firm has lost its secured funding on short-term financing transactions. In this scenario, the firm could continue to transact securities financing transactions only if the transactions were backed by HQLA or were with the firm’s domestic sovereign, public sector enterprise or central bank.

<table>
<thead>
<tr>
<th>Table 8.4.29 Maturing secured funding—runoff rates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Kind of funding</strong></td>
</tr>
<tr>
<td>---------------------</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>5</td>
</tr>
<tr>
<td>6</td>
</tr>
</tbody>
</table>

(3) Collateral swaps, and any other transactions of a similar form, are to be treated as repo or reverse repo agreements. Collateral lent to the firm’s customers to effect short positions is to be treated as secured funding.

(4) The firm must apply the factors to all outstanding secured funding transactions with maturities within 30 calendar days, including
customer short positions that do not have a specified contractual maturity.

(5) The amount of outflow is the amount of funds raised through the transaction, and not the value of the underlying collateral.

**Subdivision 8.4.C.5 Calculating total expected gross cash outflows—runoff rates for other funding**

**8.4.30 Treatment of net Shari’a-compliant hedging cash outflows**

(1) The runoff rate for net Shari’a-compliant hedging cash outflows is 100%.

(2) The firm must calculate those outflows in accordance with its usual valuation methods. The outflows may be calculated on a net basis by counterparty (that is, inflows offsetting outflows) only if a valid master netting agreement exists.

(3) From the calculation, the firm must exclude liquidity needs that would result from increased collateral needs because of falls in the value of collateral lodged or market value movements.

*Note* For how to treat such liquidity needs, see rules 8.4.32 and 8.4.36.

(4) The firm must assume that an option will be exercised if it is in the money.

(5) If Shari’a-compliant hedging payments are collateralised by HQLA, the cash outflows are to be calculated net of any corresponding cash or collateral inflows that would result, all other things being equal, from contractual obligations to lodge cash or collateral with the firm.

(6) However, subrule (5) applies only if, after the collateral were received, the firm would be legally entitled and operationally able to re-hypothecate it.
8.4.31 Treatment of increased liquidity needs related to downgrade triggers

(1) The runoff rate for increased liquidity needs related to downgrade triggers in financing transactions, Shari’a-compliant hedging instruments and other contracts is 100% of the amount of collateral that the firm would be required to lodge for, or the contractual cash outflow associated with, any downgrade up to and including a 3-notch downgrade.

**Guidance**

A *downgrade trigger* is a contractual condition that requires an Islamic banking business firm to lodge additional collateral, draw down a contingent facility or repay existing liabilities early if an ECRA downgrades the firm. Contracts governing Shari’a-compliant hedging instruments and other transactions often have such conditions. The scenario therefore requires a firm to assume that for each contract that contains downgrade triggers, 100% of the additional collateral or cash outflow will have to be lodged for a downgrade up to and including a 3-notch downgrade of the firm’s long-term credit rating.

(2) The firm must assume that a downgrade trigger linked to the firm’s short-term rating will be triggered at the corresponding long-term rating.

8.4.32 Treatment of increased liquidity needs related to possible valuation changes on lodged collateral

The runoff rate for increased liquidity needs related to possible valuation changes on collateral lodged by an Islamic banking business firm to secure Shari’a-compliant hedging instruments and other transactions is 20% of the value of any lodged collateral that is not level 1 HQLA (net of collateral received on a counterparty basis, if the collateral received is not subject to restrictions on re-use or re-hypothecation).

**Guidance**

Most counterparties to Shari’a-compliant hedging transactions are required to secure the mark-to-market valuation of their positions. If level 1 HQLA are lodged as collateral, no additional stock of HQLA need be maintained for possible valuation changes. However, if the firm secures such an exposure with other
collateral, 20% of the value of such lodged collateral will be added to the firm’s required stock of HQLA to cover the possible loss of market value on the collateral.

8.4.33 Treatment of increased liquidity needs related to excess non-segregated collateral

The runoff rate for increased liquidity needs related to excess non-segregated collateral that is held by an Islamic banking business firm, and could contractually be recalled at any time by a counterparty, is 100% of the value of the excess collateral.

8.4.34 Treatment of increased liquidity needs related to contractually-required collateral when counterparty has not yet demanded that collateral be lodged

The runoff rate for increased liquidity needs related to contractually-required collateral, due from an Islamic banking business firm on transactions for which the counterparty has not yet demanded that the collateral be lodged, is 100% of the value of the collateral that is contractually due.

8.4.35 Treatment of increased liquidity needs related to contracts that allow substitution of non-HQLA collateral

(1) This rule applies to the following kinds of transaction:

(a) transactions where:

   (i) an Islamic banking business firm holds HQLA collateral;
   (ii) the counterparty has the right to substitute non-HQLA collateral for some or all of the HQLA collateral without the firm’s consent; and
   (iii) the collateral is not segregated;

(b) transactions where:

   (i) an Islamic banking business firm has the right to receive HQLA collateral;
Rule 8.4.36

(ii) the counterparty has the right to deliver non-HQLA collateral instead of some or all of the HQLA collateral without the firm’s consent; and

(iii) the collateral is not segregated.

(2) The runoff rate for increased liquidity needs related to such a transaction is 100% of the value of HQLA collateral for which non-HQLA collateral can be substituted or delivered, as the case requires.

8.4.36 Treatment of increased liquidity needs related to market valuation changes on Shari’a-compliant hedging instruments

(1) The runoff rate for increased liquidity needs related to market valuation changes on Shari’a-compliant hedging instruments is 100% of the largest absolute net collateral flow (based on both realised outflows and inflows) in a 30-calendar-day period during the previous 24 months.

Guidance
Market practice requires collateralisation of mark-to-market exposures on Shari’a-compliant hedging instruments. Islamic banking business firms face potentially substantial liquidity risk exposures to changes in the market valuation of such instruments.

(2) Inflows and outflows of transactions executed under the same master netting agreement may be treated on a net basis.

8.4.37 Treatment of loss of funding on maturing asset-backed securities and other structured financing instruments

The runoff rate for loss of funding on asset-backed securities and other structured financing instruments that mature within the relevant 30-calendar-day period is 100% of the maturing amount.

Guidance
The scenario assumes that there is no refinancing market for the maturing instruments.
8.4.38 Treatment of loss of funding on maturing asset-backed commercial paper, conduits, structured investment vehicles etc

The runoff rate for loss of funding on asset-backed commercial paper, conduits, structured investment vehicles and other similar financing arrangements that mature within the relevant 30-calendar-day period is 100% of the total of:

(a) the maturing amount;
(b) if the arrangement allows assets to be returned within that period—the value of the returnable assets; and
(c) if under the arrangement the firm could be obliged to provide liquidity within that period—the total amount of liquidity that the firm could be obliged to provide.

Guidance

Islamic banking business firms that use asset-backed commercial paper, conduits, structured investment vehicles and other similar financing arrangements should fully consider the associated liquidity risk. The risks include:

- being unable to refinance maturing debt
- Shari’a-compliant hedging instruments that would allow the return of assets, or require the firm to provide liquidity, within the 30-calendar-day period.

If the firm’s structured financing activities are carried out through a special purpose entity (such as a conduit or structured investment vehicle), the firm should, in determining its HQLA requirements, look through to the maturity of the instruments issued by the entity and any embedded options in financing arrangements that could trigger the return of assets or the need for liquidity, regardless of whether the entity is consolidated.

8.4.39 Treatment of drawdowns on committed financing and liquidity facilities

(1) The runoff rates for drawdowns on committed financing and liquidity facilities are as set out in table 8.4.39.

(2) A financing facility is a Shari’a-compliant contractual agreement or obligation to extend funds in the future to a retail or wholesale
counterparty. For this rule, a facility that is unconditionally revocable is not a financing facility.

*Note*  Unconditionally revocable facilities (in particular, those without a precondition of a material change in the borrower’s credit condition) are included in *contingent funding obligations* (see rule 8.4.41).

(3) A **liquidity facility** is an irrevocable, undrawn financing facility that would be used to refinance the debt obligations of a customer if the customer were unable to roll over the obligations in financial markets.

**Guidance**

General working capital facilities for corporate borrowers (for example, revolving financing facilities for general corporate or working capital purposes) are to be treated as financing facilities.

**Table 8.4.39 Drawdowns on committed financing and liquidity facilities—runoff rates**

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of facility</th>
<th>Runoff rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Financing and liquidity facilities provided to retail and small business customers</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Financing facilities provided to non-financial corporates, sovereigns, central banks, MDBs, and public sector enterprises</td>
<td>10</td>
</tr>
<tr>
<td>3</td>
<td>Liquidity facilities provided to non-financial corporates, sovereigns, central banks, MDBs, and public sector enterprises (see subrule (7))</td>
<td>30</td>
</tr>
<tr>
<td>4</td>
<td>Financing and liquidity facilities provided to banks that are subject to prudential supervision (see subrule (7))</td>
<td>40</td>
</tr>
<tr>
<td>5</td>
<td>Financing facilities provided to other financial institutions</td>
<td>40</td>
</tr>
<tr>
<td>6</td>
<td>Liquidity facilities provided to other financial institutions (see subrule (7))</td>
<td>100</td>
</tr>
</tbody>
</table>
### Item | Kind of facility | Runoff rate (%)
--- | --- | ---
7 | Financing and liquidity facilities provided to legal entities of any other kind (see subrule (7)) | 100

(4) For a facility, the relevant runoff rate is to be applied to the undrawn part of it.

(5) The undrawn portion of a financing facility or liquidity facility is to be calculated net of any HQLA lodged or to be lodged as collateral if:

(a) the HQLA have already been lodged, or the counterparty is contractually required to lodge them when drawing down the facility;

(b) the firm is legally entitled and operationally able to re-hypothecate the collateral in new cash-raising transactions once the facility is drawn down; and

(c) there is no undue correlation between the probability of drawing down the facility and the market value of the collateral.

(6) The firm may net the collateral against the outstanding amount of the facility to the extent that the collateral is not already counted in the firm’s HQLA portfolio.

(7) The amount of a liquidity facility is to be taken as the amount of outstanding debt issued by the customer concerned (or a proportionate share of a syndicated facility) that matures within the relevant 30-calendar-day period and is backstopped by the facility. Any additional capacity of the facility is to be treated as a committed financing facility.

(8) The firm must treat a facility provided to a hedge fund, money market fund or SPE, or an entity used to finance the firm’s own assets, in its entirety as a liquidity facility to a financial institution.
8.4.40 **Treatment of other contractual obligations to extend funds within 30 calendar days**

(1) The runoff rate for other contractual obligations to extend funds within 30 calendar days is 100%.

(2) *Other contractual obligations to extend funds within 30 calendar days* covers all contractual obligations to extend funds within 30 calendar days that do not fall within rules 8.4.23 to 8.4.39.

(3) The runoff rate of 100% is to be applied to:
   (a) for obligations owed to financial institutions—the whole amount of such obligations; and
   (b) for obligations owed to customers that are not financial institutions—the difference between:
      (i) the total amount of the obligations; and
      (ii) 50% of the contractual inflows from those customers over the relevant 30-calendar-day period.

8.4.41 **Treatment of other contingent funding obligations**

(1) The runoff rates for other contingent funding obligations are as set out in table 8.4.41.

(2) *Contingent funding obligations* covers obligations arising from guarantees, letters of credit, unconditionally revocable financing and liquidity facilities, outstanding debt securities with remaining maturity of more than 30 calendar days, and trade finance (see subrule (3)). It also covers non-contractual obligations, including obligations arising from any of the following:
   (a) potential liquidity draws from joint ventures or minority investments in entities;
   (b) debt-buy-back requests (including related conduits);
   (c) structured products;
   (d) managed funds;
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Rule 8.4.41

(e) the use of customers’ collateral to cover other customers’ short positions.

Table 8.4.41 Contingent funding obligations—runoff rates

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of obligation</th>
<th>Runoff rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Unconditionally revocable uncommitted financing and liquidity facilities</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Non-contractual obligations related to potential liquidity drawdowns from joint ventures or minority investments in entities</td>
<td>100</td>
</tr>
<tr>
<td>3</td>
<td>Trade-finance-related obligations (including letters of guarantee and letters of credit) (see subrules (3) and (4))</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>Guarantees and letters of credit not related to trade finance obligations</td>
<td>5</td>
</tr>
<tr>
<td>5</td>
<td>Sukuk (more than 30 calendar days maturity)</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Non-contractual obligations where customer short positions are covered by other customers’ collateral</td>
<td>50</td>
</tr>
<tr>
<td>7</td>
<td>Any other non-contractual obligations not captured above (such as expected returns on profit-sharing accounts)</td>
<td>5</td>
</tr>
</tbody>
</table>

(3) **Trade finance** means trade-related obligations directly related to the movement of goods or the provision of services, such as the following:

(a) documentary trade letters of credit, documentary collection and clean collection, import bills, and export bills;

(b) guarantees directly related to trade finance obligations, such as shipping guarantees.
(4) However, lending commitments, such as direct import or export financing for non-financial corporate entities, are to be treated as committed financing facilities (see rule 8.4.39).

8.4.42 Treatment of other contractual cash outflows

(1) The runoff rate to be applied to other contractual cash outflows is 100%.

(2) Other contractual cash outflows includes outflows to cover unsecured collateral borrowings and uncovered short positions, and outflows to cover dividends and contractual profit payments, but does not include outflows related to operating costs.

Subdivision 8.4.C.6 Calculating total expected cash inflow

8.4.43 How to calculate total expected cash inflow

(1) Total expected cash inflow over a period is calculated by, for each contracted cash inflow over the period, multiplying it by the applicable inflow rate (giving the adjusted inflow), and then taking the total of all the adjusted inflows over the period.

Note Rules 8.4.44 to 8.4.48 specify inflow rates for many kinds of cash inflow, and give any necessary interpretative provisions. Those rules are based on Basel III LCR, IFSB–12 and IFSB GN 6. The interpretive provisions include only minimal explanation of why a particular kind of inflow receives the rate specified. For a fuller explanation, consult Basel III LCR (in particular, paragraphs 142–160), IFSB–12 and IFSB GN 6.

Guidance

An inflow rate does not represent an assumption about the risk of a default—instead, it represents the likelihood that the relevant obligation will be rolled over (so that the firm does not actually receive the cash) or that no cash will be received for some other reason. (The possibility of default is excluded by rule 8.4.43 (2) (a), which allows only inflows from performing exposures to be included.) Inflows for
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which an inflow rate of 0% is specified are effectively treated as not being receivable.

(2) When an Islamic banking business firm is calculating its cash inflows:

(a) it may include a contractual inflow from an exposure only if the exposure is classified under rule 4.3.3 as performing, and there is no reason to expect a default within the relevant period;

Note In rule 4.3.3, the category performing excludes exposures classified as special mention.

(b) it must not include any contingent inflow; and

Guidance for subrule (2) (b)

Contingent inflow would include expected returns on profit-sharing instruments.

(c) it must not include any inflow that would be received from an asset in the firm’s HQLA portfolio.

Guidance for subrule (2) (c)

In a stressed situation, the assets in the firm’s HQLA portfolio would already have been monetised. That is the purpose of those assets—to be monetised to provide liquidity. Consequently, in a scenario of liquidity stress, the contracted cash inflows from them would no longer be available to the firm.

Note When a firm calculates its total net cash outflows over a period for the purpose of calculating its LCR, it cannot include cash inflows over 75% of its total gross cash outflows over the period—see rule 8.4.21 (1) (b).

(3) The firm may include, in cash inflows during a period, profit payments that it expects to receive during the period.

Subdivision 8.4.C.7 Calculating total expected cash inflows— inflow rates for secured lending and committed facilities

8.4.44 Treatment of maturing secured lending

The inflow rates for secured lending that matures during the relevant 30-calendar-day period are as set out in table 8.4.44.
Table 8.4.44 Maturing secured lending—infow rates

<table>
<thead>
<tr>
<th>Item</th>
<th>Source of inflow</th>
<th>Inflow rate (%)</th>
<th>if collateral not re-hypothecated</th>
<th>if collateral re-hypothecated</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Maturing secured lending transactions (including margin lending) backed by:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• level 1 HQLA</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• level 2A HQLA</td>
<td>15</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• level 2B HQLA that are Shari’a-compliant residential-mortgage-backed securities</td>
<td>25</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• other level 2B HQLA</td>
<td>50</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Maturing margin lending backed by any other collateral</td>
<td>50</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Maturing secured lending (other than margin lending) backed by collateral that is not HQLA</td>
<td>100</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

8.4.45 Treatment of financing and liquidity facilities

(1) The inflow rate for financing facilities and liquidity facilities provided to the firm is 0%.

(2) *Financing facility* and *liquidity facility* have the same respective meanings as in rule 8.4.39.
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Subdivision 8.4.C.8  
Calculating total expected cash inflows— 
inflow rates for other cash inflows

8.4.46  
Treatment of operational deposits
(1) The inflow rate for operational deposits by the firm held at other financial institutions (including deposits held at the centralised institution of a network of co-operative banks) is 0%.
(2) Operational deposit has the same meaning as in rule 8.4.27 (6).

8.4.47  
Treatment of net Shari’a-compliant hedging cash inflows
(1) The inflow rate for net Shari’a-compliant hedging cash inflows is 100%.
(2) The firm must calculate those inflows in accordance with its usual valuation methods. The inflows may be calculated on a net basis by counterparty (that is, inflows offset outflows) only if a valid master netting agreement exists.
(3) From the calculation, the firm must exclude liquidity needs that would result from increased collateral needs because of market value movements or falls in the value of collateral lodged.
(4) The firm must assume that an option will be exercised if it is in the money to the buyer.
(5) If Shari’a-compliant hedging cash inflows are collateralised by HQLA, the inflows are to be calculated net of any corresponding cash or collateral outflows that would result from contractual obligations for the firm to lodge cash or collateral.
(6) However, subrule (5) applies only if, after the collateral were received, the firm would be legally entitled and operationally able to re-hypothecate it.

8.4.48  
Treatment of other contractual inflows
(1) The inflow rates for other contractual inflows are as set out in table 8.4.48.
Table 8.4.48 Other contractual inflows—inflow rates

<table>
<thead>
<tr>
<th>Item</th>
<th>Source of inflow</th>
<th>Inflow rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Amounts to be received from retail counterparties</td>
<td>50</td>
</tr>
<tr>
<td>2</td>
<td>Amounts to be received from non-financial wholesale counterparties</td>
<td>50</td>
</tr>
<tr>
<td>3</td>
<td>Amounts to be received from financial institutions and central banks</td>
<td>100</td>
</tr>
<tr>
<td>4</td>
<td>Other contractual cash inflows</td>
<td>100</td>
</tr>
</tbody>
</table>

(2) The firm must assume that inflows will be received at the latest possible date, based on the contractual rights available to counterparties.

(3) The following inflows are not to be included:

(a) inflows (except for minimum payments of principal, fee or profit) from loans that have no specific maturity;

(b) inflows related to non-financial revenues.

Division 8.4.D  Treatment of special cases

Subdivision 8.4.D.1  Firms with unduly concentrated cash flows

8.4.49  What if firm’s cash inflows are unduly concentrated

If the Regulatory Authority considers that an Islamic banking business firm is overly reliant on cash inflows from a single wholesale counterparty or a small number of wholesale counterparties, the Authority may direct the firm as to how such cash flows are to be treated in the calculation of its LCR.
Subdivision 8.4.D.2 Firms with access to parent entities’ funds

8.4.50 Use of funding facility from parent entity
The Regulatory Authority may allow an Islamic banking business firm that is a branch, or is a subsidiary of an entity established outside the QFC, to recognise, as cash inflow, access to its parent entity’s funds by way of a committed funding facility, up to a limit specified in the facility documentation. The facility:
(a) must be an irrevocable commitment; and
(b) must be appropriately documented.

Division 8.4.E Alternative liquidity approaches

8.4.51 Introduction—Division 8.4.E
(1) This Division sets out certain other ways in which an Islamic banking business firm can meet its LCR requirement.
(2) This Division is intended to be applied by an Islamic banking business firm only if there is a shortage of HQLA denominated in Qatari riyals compared to the total stock of firms’ liabilities denominated in that currency.

Guidance
An Islamic banking business firm is required to hold an HQLA portfolio that is similar in composition (in terms of currencies) to its liabilities (see rule 8.4.6 (3)). Apart from any other considerations, the Regulatory Authority would not approve the application of an option described in this Division by an Islamic banking business firm unless the Authority were satisfied that the supply of HQLA denominated in Qatari riyals was insufficient to meet the demand for such assets from Islamic banking business firms when compared to the total of firms’ liabilities denominated in that currency.

8.4.52 Regulatory Authority approval required
An Islamic banking business firm may apply an option described in this Division only if the Regulatory Authority so approves.
8.4.53 References to Qatari riyals—Division 8.4.E

Each reference in this Division to Qatari riyals may be read as a reference to United States dollars while the exchange rate between the Qatari riyal and the United States dollar is fixed.

8.4.54 Option 1—contractual committed liquidity facility from central bank

(1) Option 1 is for an Islamic banking business firm to have a liquidity facility that complies with subrule (2).

(2) A liquidity facility complies with this subrule if it meets all of the following conditions:

(a) it is established by a Shari’a-compliant contract between the firm and a central bank;
(b) on any day, its maturity date falls outside the 30-calendar-day period for the relevant LCR calculation;
(c) the contract is irrevocable before its maturity;
(d) there is no requirement for any financing decision by the central bank;
(e) there is a fee or profit share for the facility;
(f) the fee is set so that the net profit return on the assets used to secure the facility is not higher than the net profit return on a representative portfolio of level 1 HQLA and level 2 HQLA, after adjusting for any material differences in credit risk.

(3) If the Regulatory Authority approves an Islamic banking business firm’s application of option 1, then:

(a) the firm may treat the liquidity facility as providing no more than a percentage directed by the Authority of the value of the firm’s HQLA portfolio required to be denominated in Qatari riyals; and
(b) the remainder of the firm’s HQLA portfolio denominated in Qatari riyals must be level 1 HQLA denominated in that currency.
8.4.55 Option 2—HQLA in foreign currency to cover liquidity needs in Qatari riyals

(1) **Option 2** is for an Islamic banking business firm:

(a) to hold, as part of its HQLA portfolio, HQLA denominated in a particular foreign currency in an amount that is significantly greater than the amount of its liabilities that are denominated in that currency; and

(b) to match the excess of HQLA denominated in the foreign currency against liabilities denominated in Qatari riyals.

**Guidance**

When considering whether to approve a firm’s use of option 2, the Regulatory Authority would take into account:

- whether the levels of relevant HQLA are consistent with the firm’s foreign exchange risk management capacity and needs
- whether the foreign currency is freely and reliably convertible into Qatari riyals
- whether the firm is effectively managing its positions in the HQLA, and the positions would not pose undue risk to its financial strength.

(2) If the Regulatory Authority approves an Islamic banking business firm’s application of option 2, then:

(a) for calculating the value of the firm’s HQLA portfolio, the excess of HQLA denominated in the foreign currency is subject to the haircut directed by the Authority;

**Guidance**

The minimum haircut for HQLA denominated in a currency other than United States dollars would be 8%, as required by Basel III LCR, paragraph 60. A lower haircut might be permitted for HQLA denominated in United States dollars because the Qatari riyal is pegged to the dollar.

(b) the firm may treat HQLA denominated in the foreign currency as providing no more than a percentage directed by the Authority of the required value of the firm’s HQLA portfolio denominated in Qatari riyals; and
(c) the remainder of the firm’s HQLA portfolio must be level 1 HQLA denominated in Qatari riyals.

8.4.56 Option 3—level 2A HQLA in part-substitution for level 1 HQLA

(1) **Option 3** is for an Islamic banking business firm to hold, as part of its HQLA portfolio denominated in Qatari riyals, level 2A HQLA to a greater extent than is permitted by rule 8.4.14 (2) (a).

(2) If the Regulatory Authority approves an Islamic banking business firm’s application of option 3, then:

(a) for calculating the value of the firm’s HQLA portfolio, the additional level 2A HQLA are subject to a haircut of 20%;

<table>
<thead>
<tr>
<th>Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Therefore, the haircuts applicable to level 2A HQLA in the firm’s HQLA portfolio are as follows:</td>
</tr>
<tr>
<td>● 15% for level 2A HQLA up to 40% of the value of the portfolio</td>
</tr>
<tr>
<td>● 20% for additional level 2A HQLA.</td>
</tr>
</tbody>
</table>

(b) the firm may treat level 2A HQLA as providing no more than a percentage directed by the Authority of the required value of its HQLA portfolio denominated in Qatari riyals; and

(c) the remainder of the firm’s HQLA portfolio denominated in that currency must be level 1 HQLA.

8.4.57 Combinations of options 1, 2 and 3

If the Regulatory Authority approves an Islamic banking business firm’s application of more than 1 of options 1, 2 and 3 in relation to its HQLA portfolio denominated in Qatari riyals, level 1 HQLA must make up at least the percentage that the Authority directs of the value of the firm’s HQLA portfolio denominated in that currency.
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Part 8.4  Liquidity coverage ratio—liquidity risk group A Islamic banking business firms

Rule 8.4.58

Division 8.4.F  Treatment of branches

8.4.58  Global liquidity concession—branches

(1) A liquidity risk group A Islamic banking business firm that is a branch may apply to the Regulatory Authority for a global liquidity concession.

(2) In its application the firm must satisfy the Authority that:

(a) the firm complies with all the applicable requirements in Parts 8.1 and 8.3 in relation to liquidity systems and controls;

(b) in the jurisdiction where the firm’s head office is established, there are no legal constraints on the provision of liquidity to the firm; and

(c) the head office is subject to liquidity requirements that are equivalent to, or more restrictive than, those imposed under these rules.

Guidance

1  In considering whether to grant such a concession, the Authority would take into account:

- the requirements, as to managing, monitoring and controlling liquidity risk, of the regulator responsible for the firm’s head office
- the systems and controls used by the head office to ensure that the firm’s liquidity remains adequate
- any written assurance from the head office that:
  - it will ensure that, at all times, enough liquidity is available to support the firm
  - it will notify the Authority, at the same time as it notifies its home regulator, of any material issues concerning the firm’s exposure to liquidity risk or its compliance with applicable liquidity limits, including its liquidity coverage ratio
  - in the event of a liquidity crisis, it will give the Authority all relevant information on the whole firm’s liquidity, and a list of any known constraints (legal or otherwise) on the head office’s providing the firm with liquidity
• any notification from the head office’s home regulator:
  • either stating that the regulator has no objection to the firm’s obtaining the concession, or acknowledging that the application has been made
  • giving information about, and confirming, the quality of the liquidity risk systems and controls and the liquidity exposures at the head office.

2 Under rule 8.4.58 (2) (b), the Authority would take into account restrictions (for example, ring-fencing measures, non-convertibility of local currency, or foreign exchange controls) that would affect the transfer of HQLA and funds within the firm or its group.

(3) If the Authority grants the concession, the firm need not comply with a requirement of this Part specified by the Authority.

(4) The Authority may specify the period for which the concession is valid. If no period is so specified, the concession is valid until the Authority revokes it.

(5) The firm:
  (a) must give the Authority, at least quarterly, a copy of the LCR calculation for the firm, as submitted by its head office to its home regulator;
  (b) must notify the Authority immediately (but within 3 business days), in writing, of:
    (i) the results of every assessment by its home regulator that relates to the quality of liquidity systems and controls at the firm’s head office;
    (ii) any adverse finding or action taken by the firm’s home regulator;
    (iii) any change or potential change in the firm’s funding strategy or business model, or material change or material potential change in the structure of its balance-sheet; and
    (iv) any changes that affect its compliance with the requirements referred to in subrule (2).
Chapter 8  Liquidity risk
Part 8.4  Liquidity coverage ratio—liquidity risk group A Islamic banking business firms

Rule 8.4.58

(6) On the basis of the Authority’s assessment of the firm’s liquidity risk exposures, the Authority may, at any time, by written notice, do any 1 or more of the following:
(a) modify or exclude any of the requirements under subrule (5);
(b) impose additional requirements;
(c) revoke the concession.
Part 8.5
Minimum liquidity ratio—liquidity risk group B Islamic banking business firms

Note for Part 8.5
This Part applies only to liquidity risk group B Islamic banking business firms—see rule 8.1.4.

Division 8.5.A
Minimum liquidity ratio—general

8.5.1 Introduction—Part 8.5
(1) This Part sets out alternative approaches to maintaining liquidity that are intended to be appropriate for liquidity risk group B Islamic banking business firms. Such firms, because of their business model, could not meet a requirement to maintain a liquidity coverage ratio in accordance with Part 8.4.

(2) For certain liquidity risk group B Islamic banking business firms that are branches, rule 8.5.17 provides for a global liquidity concession.

8.5.2 How to calculate MLR
The minimum liquidity ratio or MLR for an Islamic banking business firm is calculated as follows:

\[ MLR = \frac{NLA}{NQL} \times 100 \]

where:

\( NLA \) means the firm’s net liquefiable assets.

Note For how to calculate the firm’s net liquefiable assets, see rule 8.5.13.

\( NQL \) means the firm’s net qualifying liabilities.

Note For how to calculate the firm’s net qualifying liabilities, see rule 8.5.16.
8.5.3 **When firms must calculate MLR**
A liquidity risk group B Islamic banking business firm must calculate its MLR for each working day.

8.5.4 **Requirement to maintain MLR**
A liquidity risk group B Islamic banking business firm must maintain, during each calendar month, an MLR of at least the percentage that the Regulatory Authority directs the firm to maintain.

8.5.5 **Valuation of assets, liabilities, off-balance-sheet items and cash flows measured at fair value**

(1) If under this Part an Islamic banking business firm is required to value an asset, liability, off-balance-sheet item or cash flow at fair value, the firm must establish and maintain systems, controls and procedures that are effective to ensure that such a valuation is prudent and reliable.

(2) For subrule (1), the firm must, if appropriate, adjust such a valuation to account for:
   - (a) the limitations of the valuation model or methodology and the data used in the valuation process;
   - (b) the liquidity of the asset, liability, off-balance-sheet item or cash flow; and
   - (c) other factors that might reasonably be expected to affect the prudence and reliability of the valuation.

(3) To avoid doubt, adjustments that the firm makes in accordance with this rule may exceed adjustments that it makes in accordance with the firm’s financial reporting standards.
8.5.6 Interbank assets and liabilities

(1) For a liquidity risk group B Islamic banking business firm, *net due from banks* and *net due to banks* are ways of expressing the difference between:

(a) the total of the firm’s 1-month assets due from Islamic banking business firms and banks outside the QFC; and

(b) the total of the firm’s 1-month liabilities due to Islamic banking business firms and banks.

(2) If the calculation described in subrule (1) shows that a net amount is due to the firm, the firm is said to have *net due from banks*. If the calculation shows that a net amount is due from the firm, the firm is said to have *net due to banks*.

Guidance

Interbank assets and liabilities (of an Islamic banking business firm due from other banks, or *vice versa*) would include:

- deposits and placements of funds
- loans and advances.

8.5.7 Assets that are liquefiable assets

(1) Assets of the following kinds are *liquefiable assets*:

(a) assets that fall within a class of assets specified in table 8.5.9A or 8.5.9B;

(b) for an Islamic banking business firm that has net due from banks—all or part of the net due from banks, in accordance with subrule (2);

(c) assets of another kind approved by the Regulatory Authority as liquefiable assets.

(2) An Islamic banking business firm that has net due from banks may treat as a liquefiable asset no more of the net due from banks than an
amount equal to 40% of the total weighted principal amount of the firm’s qualifying liabilities.

(3) An Islamic banking business firm must treat any amount of net due from banks greater than the amount permitted by subrule (2) as a deduction from the firm’s net qualifying liabilities.

8.5.8 Assets that can be counted for calculating MLR

(1) An Islamic banking business firm must not include an asset in its liquefiable assets for calculating its MLR unless the asset meets all of the following criteria:

(a) it is readily monetisable;
(b) it is not overdue nor in default;
(c) it is unencumbered and there are no regulatory, legal, contractual or other restrictions that prevent it being liquidated, sold, transferred or assigned;
(d) its value is readily identifiable and measurable;
(e) subject to subrule (2), it is freely transferable and available to the firm and is not subject to any liquidity transfer restriction;
(f) it is not a subordinated debt security;
(g) if it is a structured financial instrument, its structure is simple and standardised;
(h) it is denominated in Qatari riyals or in a currency that is freely convertible into Qatari riyals.

(2) If an asset is held by a member of the financial group of a liquidity risk group B Islamic banking business firm and is subject to a liquidity transfer restriction, the firm may include the asset in its liquefiable assets for the calculation of its MLR only to the extent that the qualifying liabilities (after deductions) of the member are also included in the calculation.
8.5.9 **Liquidity conversion factors for liquefiable assets**

(1) The liquidity conversion factors for liquefiable assets (other than net due from banks) are as set out in tables 8.5.9A and 8.5.9B.

(2) In table 8.5.9A:

*marketable debt security* means a debt security for which there is an established secondary market on which the security can be readily monetised. To avoid any doubt, *sukuk* are debt securities for the purposes of this definition.

*qualifying ECRA issuer rating* for the issuer of an asset means a long-term rating no lower than BBB-, or a short-term rating no lower than A-3, by Standard & Poor’s (or the equivalent by another ECRA).

*qualifying ECRA issue-specific rating* for an asset means a long-term rating no lower than BBB-, or a short-term rating no lower than A-3, by Standard & Poor’s (or the equivalent by another ECRA).

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of asset</th>
<th>Liquidity conversion factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Marketable debt securities issued or guaranteed by the State, the Qatar Central Bank, or a domestic public sector entity:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) with a remaining term to maturity of not more than 1 year</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>(b) with a remaining term to maturity of more than 1 year</td>
<td>95</td>
</tr>
<tr>
<td>2</td>
<td>Marketable debt securities issued or guaranteed by an Islamic banking business firm or a bank in the State:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) with a remaining term to maturity of not more than 30 calendar days</td>
<td>100</td>
</tr>
</tbody>
</table>
Item | Kind of asset | Liquidity conversion factor (%)  
--- | --- | ---  
(b) | with a remaining term to maturity of more than 30 calendar days but not more than 1 year | 95  
(c) | with a remaining term to maturity of more than 1 year | 90  
3 | Marketable debt securities issued or guaranteed by the central bank or central government of a country, a multilateral development bank, if the security has a qualifying ECRA issue-specific rating, or its issuer or guarantor has a qualifying ECRA issuer rating, and the security has a remaining term to maturity of: |  
(a) | not more than 1 year | 100  
(b) | more than 1 year | 95  
4 | Marketable debt securities with a qualifying ECRA issue-specific rating, issued or guaranteed by a bank outside the QFC, with a remaining term to maturity of: |  
(a) | not more than 30 calendar days; | 100  
(b) | more than 30 calendar days, but not more than 1 year; | 95  
(c) | more than 1 year; | 90
### Rule 8.5.9

### Kind of asset

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of asset</th>
<th>Liquidity conversion factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Marketable debt securities with a qualifying ECRA issue-specific rating, issued or guaranteed by a regional government of a country or other entity, with a remaining term to maturity of:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) not more than 1 year;</td>
<td>90</td>
</tr>
<tr>
<td></td>
<td>(b) more than one year but not more than 5 years;</td>
<td>85</td>
</tr>
<tr>
<td></td>
<td>(c) more than 5 years;</td>
<td>80</td>
</tr>
<tr>
<td>6</td>
<td>Marketable debt securities without a qualifying ECRA issue-specific rating, issued or guaranteed by a bank outside the QFC, if the debt security or instrument has a remaining term to maturity of not more than 30 calendar days</td>
<td>100</td>
</tr>
<tr>
<td>7</td>
<td>Marketable debt securities without a qualifying ECRA issue-specific rating, issued or guaranteed by a bank outside the QFC that has a qualifying ECRA issuer rating</td>
<td>80</td>
</tr>
<tr>
<td>8</td>
<td>Marketable debt securities without a qualifying ECRA issue specific rating, issued or guaranteed by a regional government of a country that has a qualifying ECRA issuer rating</td>
<td>80</td>
</tr>
</tbody>
</table>
### Minimum liquidity ratio—liquidity risk group B Islamic banking business firms

**Rule 8.5.9**

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of asset</th>
<th>Liquidity conversion factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>Marketable debt securities not included elsewhere in this table that are re-discountable with the Qatar Central Bank or the central bank of a country that has a qualifying ECRA issuer rating</td>
<td>80</td>
</tr>
<tr>
<td>10</td>
<td>Marketable debt securities not included elsewhere in this table with a remaining term to maturity of not more than 30 calendar days</td>
<td>80</td>
</tr>
<tr>
<td>11</td>
<td>Residential mortgage-backed securities approved as liquefiable assets by the Authority</td>
<td>80</td>
</tr>
<tr>
<td>12</td>
<td>Other marketable debt securities approved as liquefiable assets by the Authority</td>
<td>80</td>
</tr>
</tbody>
</table>

**Table 8.5.9B Liquidity conversion factors—other liquefiable assets**

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of asset</th>
<th>Liquidity conversion factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Currency notes and coins</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>Gold bullion</td>
<td>90</td>
</tr>
<tr>
<td>3</td>
<td>Claims on, or reserves maintained with, the Qatar Central Bank or another central bank that are repayable overnight, on demand, or on notice that expires on the first day of the relevant MLR period</td>
<td>100</td>
</tr>
</tbody>
</table>
### 8.5.10 Approval of other assets as liquefiable assets

(1) An Islamic banking business firm may apply to the Regulatory Authority for approval to include, in the firm’s calculation of its MLR, an asset that is:

   (a) a residential mortgage-backed security; or

   (b) a marketable debt security of a kind not mentioned in table 8.5.9A or 8.5.9B.

(2) The Authority may approve the inclusion of the asset if it is satisfied that:

   (a) the asset meets the criteria in rule 8.5.8 (1) applicable to it; and

   (b) the treatment of the asset as a liquefiable asset would not adversely affect the firm’s calculation of its MLR, taking into account the risks associated with holding the asset.
(3) The Authority may grant such an approval subject to any condition that the Authority thinks appropriate.

(4) The Authority may at any time impose a condition on such an approval, or amend or revoke a condition already imposed.

8.5.11 **Management of liquefiable assets and related risks by Islamic banking business firm**

(1) An Islamic banking business firm must have, and must maintain, adequate systems and controls, and procedures, for the on-going assessment and management of its liquefiable assets to ensure that:

   (a) each asset satisfies all the requirements of this Division (so far as applicable);

   (b) an asset that ceases to satisfy a requirement of this Division applicable to it is identified as soon as is practicable; and

   (c) an asset so identified is promptly excluded from the firm’s liquefiable assets.

(2) An Islamic banking business firm must have, and must maintain, adequate systems and controls, and procedures, to monitor and control the risks (in particular, liquidity risk) associated with its holdings in liquefiable assets.

8.5.12 **Regulatory Authority directions about liquefiable assets**

(1) The Regulatory Authority may by written notice direct Islamic banking business firms generally not to treat, as a liquefiable asset, a specified asset, or assets in a specified class of assets, if the Authority is satisfied that the asset or such an asset:

   (a) is not capable of generating liquidity for an Islamic banking business firm within 30 calendar days; or

   (b) is not, or is no longer, sufficiently liquid in private markets, or readily monetisable by other means, to be treated as a liquefiable asset.
(2) The Authority may by written notice direct a particular Islamic banking business firm:

(a) to cease treating a specified asset as a liquefiable asset if the Authority is satisfied that the asset does not satisfy a specified provision of this Division; or

(b) to make specified changes to its liquefiable assets if the Authority is satisfied that:

(i) the firm has failed to comply with rule 8.5.11; and

(ii) the changes are necessary to mitigate the liquidity risk associated with the firm’s failure.

8.5.13 Calculating net liquefiable assets

(1) An Islamic banking business firm’s net liquefiable assets is the difference between:

(a) the total value of its liquefiable assets, minus the total value of the assets that are to be deducted (see subrule (3)); and

(b) the total value of its net qualifying liabilities.

Note For how to calculate the firm’s net qualifying liabilities, see rule 8.5.16.

(2) For this rule, the value of an asset is taken to be its principal amount multiplied by the appropriate liquidity conversion factor. The principal amount of an asset on a day is taken to be:

(a) for gold bullion or a marketable security—the asset’s fair value at the close of business on the previous working day; and

Note In relation to an asset’s fair value and adjustments that may be required, see rule 8.5.5.

(b) for any other asset—its book value (including accrued interest, if any) at the close of business on the previous working day.

(3) The kinds of asset whose values must be deducted are the following:

(a) every debt security issued by the firm that has a remaining term to maturity of 30 calendar days or less and will not, on maturity, be rolled over or refinanced;
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Liquidity risk
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Minimum liquidity ratio—liquidity risk group B Islamic banking business firms

Rule 8.5.14

(b) any asset that the Regulatory Authority has directed the firm to deduct;
(c) if the Authority has approved the deduction of an asset—that asset.

(4) The liquidity conversion factor to be applied to the assets that are to be deducted is 100%.

Division 8.5.C Net qualifying liabilities

8.5.14 Liabilities that are qualifying liabilities

(1) Liabilities of the following kinds are qualifying liabilities for an Islamic banking business firm:
   (a) 1-month liabilities to the Qatar Central Bank or another central bank;
   (b) if the firm has net due to banks, the total amount of the firm’s 1-month liabilities to other banking business firms, and to banks outside the QFC;

   Note For net due to banks, see rule 8.5.6.

   (c) other 1-month liabilities.

(2) The liquidity conversion factor for a qualifying liability is 100%.

8.5.15 Deduction from qualifying liabilities if net due to banks

If an Islamic banking business firm has net due to banks, the firm must treat, as a deduction from the firm’s qualifying liabilities, the total amount of the 1-month liabilities, due and payable within 24 hours, to the firm of:
   (a) other Islamic banking business firms; and
   (b) banks outside the QFC.

8.5.16 Calculating net qualifying liabilities

(1) An Islamic banking business firm’s net qualifying liabilities is the difference between the total value of its qualifying liabilities and the
total of the amounts that it must deduct from that total value (see rule 8.5.15 and table 8.5.16).

(2) For this rule, the **principal amount** of a liability on a day is taken to be its book value (including accrued interest, if any) at the close of business on the previous working day.

*Note* In relation to the fair value of a liability and adjustments that may be required, see rule 8.5.5.

### Table 8.5.16 Deductions from qualifying liabilities and liquidity conversion factors

<table>
<thead>
<tr>
<th>Item</th>
<th>Deduction from qualifying liabilities</th>
<th>Liquidity conversion factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total 1-month liabilities of the Qatar Central Bank and other central banks to the firm (other than any amount that falls within item 3 of table 8.5.9B)</td>
<td>100</td>
</tr>
<tr>
<td>2</td>
<td>If the firm has net due to banks, the total amount of the firm’s 1-month assets due from other Islamic banking business firms and banks outside the QFC</td>
<td>100</td>
</tr>
<tr>
<td>3</td>
<td>Any amount of the firm’s net due from banks that must be treated as a deduction under rule 8.5.15</td>
<td>100</td>
</tr>
<tr>
<td>4</td>
<td>Eligible loan repayments</td>
<td>80</td>
</tr>
</tbody>
</table>

(3) In table 8.5.16:

**eligible loan repayment** means a loan repayment in relation to which all of the following conditions are met:

(a) the date on which the repayment is due is fixed, and is within 30 calendar days;

(b) the firm is not committed to continuing the loan, by renewal or otherwise;
Rule 8.5.17

(c) the loan is fully performing and the firm has no reason to expect a default.

Division 8.5.D Treatment of branches

8.5.17 Global liquidity concession—branches

(1) A liquidity risk group B Islamic banking business firm that is a branch may apply to the Regulatory Authority for a global liquidity concession.

(2) In its application the firm must satisfy the Authority that:

(a) because of its business model and in the market conditions prevailing at the time of application, the firm has no reasonable prospect of being able to comply with the other requirements of this Part;

(b) the firm complies with all the applicable requirements in Parts 8.1 and 8.3 in relation to liquidity systems and controls;

(c) in the jurisdiction where the firm’s head office is established, there are no legal constraints on the provision of liquidity to the firm; and

(d) the head office is subject to liquidity requirements that are equivalent to, or more restrictive than, those imposed under these rules.

Guidance

1 In considering whether to grant such a concession, the Authority would take into account:

- the requirements, as to managing, monitoring and controlling liquidity risk, of the regulator responsible for the firm’s head office
- the systems and controls used by the head office to ensure that the firm’s liquidity remains adequate
- any written assurance from the head office that:
  - it will ensure that, at all times, enough liquidity is available to support the firm
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- it will notify the Authority, at the same time as it notifies its home regulator, of any material issues concerning the firm’s exposure to liquidity risk or its compliance with applicable liquidity limits, including its liquidity coverage ratio
- in the event of a liquidity crisis, it will give the Authority all relevant information on the whole firm’s liquidity, and a list of any known constraints (legal or otherwise) on the head office’s providing the firm with liquidity
- any notification from the head office’s home regulator:
  - either stating that the regulator has no objection to the firm’s obtaining the concession, or acknowledging that the application has been made
  - giving information about, and confirming, the quality of the liquidity risk systems and controls and the liquidity exposures at the head office.

2 Under rule 8.5.17 (2) (b), the Authority would take into account restrictions (for example, ring-fencing measures, non-convertibility of local currency, or foreign exchange controls) that would affect the transfer of HQLA and funds within the firm or its group.

(3) If the Authority grants the concession, the firm need not comply with a requirement of this Part specified by the Authority.

(4) The Authority may specify the period for which the concession is valid. If no period is so specified, the concession is valid until the Authority revokes it.

(5) The firm must notify the Authority immediately (but within 3 business days), in writing, of:
  (i) the results of every assessment by its home regulator that relates to the quality of liquidity systems and controls at the firm’s head office;
  (b) the results of every assessment by its head office that relates to the quality of liquidity systems and controls at the firm;
  (c) any adverse finding or action taken by the firm’s home regulator or head office;
(d) any change or potential change in the firm’s funding strategy or business model, or material change or material potential change in the structure of its balance-sheet; and

(e) any changes that affect its compliance with the requirements referred to in subrule (2).

(6) On the basis of the Authority’s assessment of the firm’s liquidity risk exposures, the Authority may, at any time, by written notice, do any 1 or more of the following:

(a) modify or exclude any of the requirements under subrule (5);
(b) impose additional requirements;
(c) revoke the concession.
Part 8.6  Net stable funding ratio—liquidity risk group A Islamic banking business firms

Notes for Part 8.6
1  This Part applies only to liquidity risk group A Islamic banking business firms—see rule 8.1.4.
2  For more detail and explanation see:
   • the document Basel III: the Net Stable Funding Ratio, published by the Basel Committee on Banking Supervision in October 2014 and available at http://www.bis.org/bcbs/publ/d295.pdf
   • IFSB GN 6, referred to in the note at the beginning of Part 8.4.

Division 8.6.A  General

8.6.1  Introduction—Part 8.6
(1) The requirement for an Islamic banking business firm to maintain a net stable funding ratio is one of the Basel Committee’s key reforms to promote a more resilient banking sector. The requirement will oblige firms to maintain a stable funding profile in relation to the composition of their assets and off-balance-sheet activities.
(2) A stable funding profile is intended to reduce the likelihood that disruptions to a firm’s regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure, and might lead to broader systemic stress.
(3) The requirement is intended to limit firms’ reliance on short-term wholesale funding, promote funding stability, and encourage better assessment of funding risk on and off firms’ balance-sheets.

8.6.2  Definitions for Part 8.6
(1) In this Part:

ASF for a liquidity risk group A Islamic banking business firm means the amount of its available stable funding, calculated in accordance with this Part.
8.6.3 What NSFR is

(1) A liquidity risk group A Islamic banking business firm’s NSFR, expressed as a percentage, is:

\[
\frac{ASF}{RSF} \times 100.
\]

(2) The ASF and RSF are to be calculated in accordance with this Part.

8.6.4 Obligation to maintain NSFR

A liquidity risk group A Islamic banking business firm must maintain an NSFR of at least 100%. That is, its ASF must always be equal to or greater than its RSF.
8.6.5 **Obligation to notify Regulatory Authority if NSFR requirement not met**

(1) A liquidity risk group A Islamic banking business firm must notify the Regulatory Authority in writing immediately (but within 3 business days) if the firm ceases to meet its NSFR requirement (or becomes aware of circumstances that may result in its ceasing to meet that requirement).

(2) In the notification the firm must clearly explain:
   
   (a) why it ceased to meet, or thinks it may cease to meet, the requirement;
   
   (b) when it expects to again be able to meet the requirement; and
   
   (c) what it has done and will do to ensure that it meets the requirement in future, or continues to meet it, as the case requires.

**Guidance**

An Islamic banking business firm that gives such a notification should discuss with the Regulatory Authority what further steps it should take to deal with the situation.

8.6.6 **Application of NSFR to financial group**

(1) For calculating a consolidated NSFR for a financial group, assets held to meet an Islamic banking business firm’s NSFR may be included in the parent entity’s stable funding only so far as the related liabilities are reflected in the parent entity’s NSFR. Any surplus of assets held at the firm may be treated as forming part of the parent entity’s stable funding only if those assets would be freely available to the parent entity during a period of stress.

(2) When calculating its NSFR on a consolidated basis, a cross-border Islamic banking group must apply the rules of its home jurisdiction to all the legal entities being consolidated, except for the treatment of retail and small business deposits. Such deposits for a consolidated entity must be treated according to the rules in the jurisdiction in which the entity operates.
(3) A cross-border Islamic banking group must not take excess stable funding into account in calculating its consolidated NSFR if there is reasonable doubt about whether the funding would be available during a period of stress.

**Guidance**

Asset transfer restrictions (for example, ring-fencing measures, non-convertibility of local currency, foreign exchange controls) in jurisdictions in which an Islamic banking group operates would affect the availability of liquidity by restricting the transfer of assets and funding within the group. The consolidated NSFR should reflect the restrictions consistently with this Part. For example, assets held to meet a local NSFR requirement by a subsidiary that is being consolidated can be included in the consolidated NSFR to the extent that the assets are used to cover the funding requirements of that subsidiary, even if the assets are subject to restrictions on transfer. If the assets held in excess of the total funding requirements are not transferable, the firm should not count that funding.

**8.6.7 Determining maturity of instruments when calculating NSFR**

(1) When an Islamic banking business firm is determining the maturity of an equity or liability instrument, it must assume that a call option will be exercised at the earliest possible date that is permissible under Shari’a.

(2) In particular, if the market expects a liability to be exercised before its legal final maturity date, the firm must assign the liability to the category that is consistent with the market expectation.

(3) For long-dated liabilities, the firm may treat only the part of cash flows falling at or beyond the 6-month and 1-year time horizons as having an effective residual maturity of 6 months or more and 1 year or more, respectively.

**8.6.8 Calculating NSFR Shari’a-compliant hedging liability amounts**

(1) An Islamic banking business firm must calculate the value of a Shari’a-compliant hedging liability based on the replacement cost for
the contract (obtained by marking to market) if the contract has a negative value.

(2) If there is a netting agreement with the counterparty that satisfies both of the conditions in subrule (3), and all of the other conditions in subrule (4) are met, the replacement cost for the set of exposures covered by the agreement is taken to be the net replacement cost.

(3) The conditions for the netting agreement are as follows:

(a) under the agreement the firm would have a claim to receive, or an obligation to pay, only the net amount of the mark-to-market values of the transactions if the counterparty were to fail to perform;

(b) the agreement does not contain a walkaway clause.

(4) The other conditions are as follows:

(a) the firm holds a written, reasoned legal opinion that the relevant courts and administrative authorities would find the firm’s exposure to be the net amount referred to in subrule (3) (a) under each of the following laws:

(i) the law of the jurisdiction in which the counterparty is established;

(ii) if a foreign branch of the counterparty is involved, the law of the jurisdiction in which the branch is located;

(iii) the law that governs the individual transactions;

(iv) the law that governs the netting agreement (and any other agreement necessary to effect the netting);

(b) the firm has procedures to ensure that netting arrangements are kept under review in the light of possible changes in the relevant law;

(c) the Regulatory Authority is satisfied that the netting agreement is enforceable under all of the laws referred to in paragraph (a).
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Part 8.6  Net stable funding ratio—liquidity risk group A Islamic banking business firms

Rule 8.6.9

(5) Collateral lodged in the form of variation margin in connection with Shari’a-compliant hedging contracts, regardless of the asset type, must be deducted from the negative replacement cost amount.

8.6.9 Determining maturity of assets

(1) When determining the maturity of an asset, an Islamic banking business firm must assume that any option to extend that maturity will be exercised.

(2) In particular, if the market expects the maturity of an asset to be extended, the firm must assign the asset to the category that is consistent with the market expectation.

(3) For an amortising loan, the firm may treat the part that comes due within 1 year as having residual maturity of less than 1 year.

8.6.10 What assets should be included

(1) Subject to subrule (2), when determining its RSF, an Islamic banking business firm:

(a) must include financial instruments, foreign currencies and commodities for which a purchase order has been executed; but

(b) must not include financial instruments, foreign currencies and commodities for which a sales order has been executed;

even if the transactions have not been reflected in the firm’s balance-sheet under a settlement-date accounting model.

(2) Subrule (1) applies only if:

(a) the relevant transactions are not reflected as Shari’a-compliant hedging or secured financing transactions in the firm’s balance-sheet; and

(b) the effects of the transactions will be reflected in the firm’s balance-sheet when settled.
8.6.11 **Treatment of securities financing transactions**

(1) When determining its RSF, an Islamic banking business firm must not include securities that the firm has borrowed in securities financing transactions (such as reverse repos and collateral swaps) if the firm does not have beneficial ownership.

(2) However, the firm must include securities that it has lent in securities financing transactions if it retains beneficial ownership of them.

(3) The firm must also not include securities that it has received through collateral swaps if those securities do not appear on the firm’s balance-sheet.

(4) The firm must include securities that it has encumbered in repos or other securities financing transactions, if the firm has retained beneficial ownership of the securities and they remain on the firm’s balance-sheet.

8.6.12 **Netting of securities financing transactions with a single counterparty**

When determining its RSF, an Islamic banking business firm may net securities financing transactions with a single counterparty only if all of the following conditions are met:

(a) the transactions have the same explicit final settlement date;

(b) the right to set off the amount owed to the counterparty with the amount owed by the counterparty is legally enforceable both currently in the normal course of business and in the event of default, insolvency or bankruptcy;

(c) one of the following applies:

(i) the counterparties intend to settle net;

(ii) the counterparties intend to settle simultaneously;
(iii) the transactions are subject to a settlement mechanism that results in the functional equivalent of net settlement.

**Guidance**

*Functional equivalent of net settlement* means that the cash flows of the transactions are equivalent to a single net amount on the settlement date. To achieve that equivalence, both transactions are settled through the same settlement system and the settlement arrangements are supported by cash or intraday financing facilities intended to ensure that settlement of both transactions will occur by the end of the business day and that the linkages to collateral flows do not result in the unwinding of net cash settlement.

### 8.6.13 Calculating NSFR Shari’a-compliant hedging asset amounts

1. When determining its RSF, an Islamic banking business firm must calculate the value of a Shari’a-compliant hedging asset first based on the replacement cost for the contract (obtained by marking to market) if the asset has a positive value.

2. If there is a netting agreement with the counterparty that satisfies both of the conditions in rule 8.6.8 (3), and all of the other conditions in rule 8.6.8 (4) are met, the replacement cost for the set of exposures covered by the agreement is taken to be the net replacement cost.

3. Collateral received in connection with a Shari’a-compliant hedging contract does not offset the positive replacement cost amount, regardless of whether or not netting is permitted under the bank’s accounting or risk-based framework, unless:
   - the collateral is received in the form of cash variation margin; and
   - all of the conditions in subrule (4) are met.

4. The conditions are the following:
   - either:
     - the trades are cleared through a qualifying central counterparty (see subrule (6)); or
(ii) the cash received by the counterparty is not segregated;

(b) the variation margin is calculated and exchanged every day, based on mark-to-market valuation of the relevant positions;

(c) the variation margin is received in the same currency as the currency of settlement of the contract;

(d) the variation margin exchanged is the full amount that would be necessary to fully extinguish the mark-to-market exposure of the contract subject to the threshold and minimum transfer amounts applicable to the counterparty;

(e) Shari’a-compliant hedging transactions and variation margins are covered by a single master netting agreement (MNA) between the counterparties;

(f) the MNA explicitly stipulates that the counterparties agree to settle net any payment obligations covered by the agreement, taking into account any variation margin received or provided if a credit event occurs involving either counterparty;

(g) the MNA is legally enforceable and effective in all the relevant jurisdictions, including in the event of default, bankruptcy or insolvency.

(5) Any remaining balance-sheet liability associated with:

(a) variation margin received that does not meet all of the conditions in subrule (4); or

(b) initial margin received;

does not offset Shari’a-compliant hedging assets and receives a 0% ASF factor.

(6) For subrule (4) (a) (i), a qualifying central counterparty is an entity that meets all of the following requirements:

(a) it is licensed or authorised to operate as a central counterparty in relation to the instruments concerned;
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(b) the financial regulator that is responsible for its prudential supervision:

(i) has established rules and regulations for central counterparties that are consistent with Principles for Financial Market Infrastructures, published by the International Organization of Securities Commissions in July 2011; and

(ii) has publicly indicated that it applies those rules and regulations to the entity on an ongoing basis.


8.6.14 Calculating ASF

The amount of a liquidity risk group A Islamic banking business firm’s ASF is calculated as follows:

(a) first, assign each of the firm’s capital items and liabilities to 1 of the 5 categories set out in rules 8.6.15 to 8.6.19;

(b) next, for each category add up the carrying values of all the capital items and liabilities assigned to the category;

(c) next, for each category multiply the total carrying values of the capital items and liabilities assigned to the category by the category’s ASF factor (also set out in rules 8.6.15 to 8.6.19), giving the weighted amounts;

(d) finally, add up the weighted amounts.

8.6.15 Category 1: liabilities and capital that receive 100% ASF factor

(1) The following liabilities and capital receive a 100% ASF factor:

(a) the total amount of the firm’s regulatory capital (as set out in Divisions 3.2.B and 3.2.C), excluding any tier 2 instrument with residual maturity of less than 1 year, before the application of capital deductions;
(b) any other capital instrument that has an effective residual maturity of 1 year or more (except any instrument with an explicit or embedded option that, if exercised, would reduce the expected maturity to less than 1 year);

(c) the total amount of secured and unsecured borrowings and liabilities (including deposits and unrestricted PSIAs) with effective residual maturities of 1 year or more.

(2) For subrule (1) (c), cash flows falling within the 1-year horizon but arising from liabilities with final maturity of more than 1 year do not qualify for the 100% ASF factor.

8.6.16 Category 2: Liabilities that receive 95% ASF factor

The liabilities that receive a 95% ASF factor are stable (as defined in rule 8.4.23 (4)) deposits and unrestricted PSIAs with residual maturities of less than 1 year provided by retail and small-business customers.

8.6.17 Category 3: Liabilities that receive 90% ASF factor

The liabilities that receive a 90% ASF factor are less stable (as defined in rule 8.4.23 (8)) deposits and unrestricted PSIAs with residual maturities of less than 1 year provided by retail and small-business customers.

8.6.18 Category 4: Liabilities that receive 50% ASF factor

The following liabilities receive a 50% ASF factor:

(a) funding (secured and unsecured) with residual maturity of less than 1 year, from corporate customers that are not financial institutions;

(b) operational deposits (as defined in rule 8.4.27 (6));

(c) funding with residual maturity of less than 1 year from sovereigns, public sector entities, MDBs and national development banks;
(d) other funding (secured or unsecured) not falling within paragraphs (a) to (c), with residual maturity of between 6 months and 1 year, including funding from central banks and financial institutions.

**8.6.19 Category 5: Liabilities that receive 0% ASF factor**

The following liabilities receive a 0% ASF factor:

(a) capital not falling within rule 8.6.15;

(b) liabilities and equity not falling within rules 8.6.15 to 8.6.18;

**Guidance**

Funding from central banks and financial institutions with residual maturity of less than 6 months would fall within paragraph (b).

(c) other liabilities without a stated maturity, except that:

(i) a deferred tax liability must be categorised according to the nearest possible date on which it could be realised; and

(ii) minority interest must be treated according to the term of the instrument, usually in perpetuity.

**Guidance for paragraph (c)**

1. *Other liabilities without a stated maturity* could include short positions, positions with open maturity and deferred tax liabilities.

2. A liability referred to in paragraph (c) would receive either a 100% ASF factor if its effective maturity were 1 year or more (see rule 8.6.15), or a 50% ASF factor if its effective maturity were between 6 months and 1 year (see rule 8.6.18).

(d) NSFR Shari’a-compliant hedging liabilities net of NSFR Shari’a-compliant hedging assets, if NSFR Shari’a-compliant hedging liabilities are greater than NSFR Shari’a-compliant hedging assets;

**Note** For how to calculate NSFR Shari’a-compliant hedging liabilities, see rule 8.6.8. For how to calculate NSFR Shari’a-compliant hedging assets, see rule 8.6.13.
(e) trade-date payables arising from purchases of financial instruments, foreign currencies and commodities that:

(i) are expected to settle within the standard settlement cycle or period that is customary for the relevant exchange or type of transaction; or

(ii) have failed to settle, but are still expected to do so.

### 8.6.20 Calculating RSF

The amount of an Islamic banking business firm’s RSF is calculated as follows:

(a) first, assign each of the firm’s assets to 1 of the 8 categories set out in rules 8.6.21 to 8.6.28;

(b) next, for each category add up the carrying values of all the assets assigned to the category;

(c) next, for each category multiply the total carrying values of the assets assigned to the category by the category’s RSF factor (also set out in rules 8.6.21 to 8.6.28), giving the weighted amounts;

(d) next, multiply the amounts of each of the firm’s off-balance-sheet exposures by the exposure’s RSF factor (set out in rule 8.6.31), giving the OBS weighted amounts;

(e) finally, add the weighted amounts and the OBS weighted amounts.

### 8.6.21 Category 1: assets that receive 0% RSF factor

Subject to rule 8.6.29 (for certain encumbered assets), assets of the following kinds receive a 0% RSF factor:

(a) currency notes and coins immediately available to meet obligations;

(b) central bank reserves (including required reserves and excess reserves);
(c) claims on central banks with residual maturities of less than 6 months;
(d) trade-date receivables arising from sales of financial instruments, foreign currencies and commodities that:
   (i) are expected to settle within the standard settlement cycle or period that is customary for the relevant exchange or type of transaction; or
   (ii) have failed to settle, but are still expected to do so.

8.6.22 **Category 2: assets that receive 5% RSF factor**
The assets that receive a 5% RSF factor are unencumbered level 1 HQLA (except assets that receive a 0% RSF under rule 8.6.21).

8.6.23 **Category 3: assets that receive 10% RSF factor**
The assets that receive a 10% RSF factor are unencumbered loans to financial institutions, with residual maturities of less than 6 months, that are secured against level 1 HQLA that the firm can freely re-hypothecate during the loans’ life.

8.6.24 **Category 4: assets that receive 15% RSF factor**
Assets of the following kinds receive a 15% RSF factor:
   (a) unencumbered level 2A HQLA;
   (b) unencumbered loans to financial institutions, with residual maturities of less than 6 months, that do not fall within rule 8.6.23.

8.6.25 **Category 5: assets that receive 50% RSF factor**
Assets of the following kinds receive a 50% RSF factor:
   (a) unencumbered level 2B HQLA;
   (b) HQLA that are encumbered for between 6 months and 1 year;
   (c) loans, with residual maturity of between 6 months and 1 year, to financial institutions and central banks;
(d) operational deposits (as defined in rule 8.4.27 (6)) held at other financial institutions;
(e) all other non-HQLA with residual maturity of less than 1 year, including loans to non-financial corporate clients, loans to retail customers and small business customers, and loans to sovereigns and public sector entities.

8.6.26 Category 6: assets that receive 65% RSF factor
Assets of the following kinds receive a 65% RSF factor:
(a) unencumbered residential-real-estate-secured financing, with residual maturity of 1 year or more, that qualify under rule 4.4.7 for a risk weight of 35% or lower;
(b) other unencumbered loans (except loans to financial institutions), with residual maturity of 1 year or more, that qualify under rule 4.4.7 for a risk weight of 35% or lower.

8.6.27 Category 7: assets that receive 85% RSF factor
(1) Subject to rule 8.6.29 (for certain encumbered assets), assets of the following kinds receive an 85% RSF factor:
(a) cash, securities or other assets lodged as initial margin for Shari’a-compliant hedging contracts, and cash or other assets provided to contribute to the default fund of a central counterparty;
(b) unencumbered performing loans (except loans to financial institutions), with residual maturity of 1 year or more, that do not qualify under rule 4.4.7 for a risk weight of 35% or lower;
(c) unencumbered securities with residual maturity of 1 year or more;
(d) exchange-traded equities that are not in default and do not qualify as HQLA;
(e) physical traded commodities, including gold.
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(2) Despite subrule (1) (a), if securities or other assets lodged as initial margin for Shari’a-compliant hedging contracts would otherwise receive a higher RSF factor than 85%, they retain that higher factor.

8.6.28 Category 8: assets that receive 100% RSF factor

Assets of the following kinds receive a 100% RSF factor:

(a) assets that are encumbered for 1 year or more;

(b) NSFR Shari’a-compliant hedging assets, net of NSFR Shari’a-compliant hedging liabilities, if NSFR Shari’a-compliant hedging assets are greater than NSFR Shari’a-compliant hedging liabilities;

Note For how to calculate NSFR Shari’a-compliant hedging liabilities, see rule 8.6.8. For how to calculate NSFR Shari’a-compliant hedging assets, see rule 8.6.13.

(c) all other assets not falling within categories 1 to 7 (including non-performing loans, loans to financial institutions with residual maturity of 1 year or more, non-exchange-traded equities, fixed assets, items deducted from regulatory capital, retained profit, insurance assets, subsidiary interests and defaulted securities);

(d) 20% of NSFR Shari’a-compliant hedging liabilities as calculated in accordance with rule 8.6.8 (before deducting variation margin lodged).

8.6.29 Treatment of encumbered assets

(1) Assets encumbered for between 6 months and 1 year that would, if unencumbered, receive an RSF factor of 50% or lower receive a 50% RSF factor.

(2) Assets encumbered for between 6 months and 1 year that would, if unencumbered, receive an RSF factor higher than 50% receive that higher RSF factor.

(3) Assets encumbered for less than 6 months receive the same RSF factor as an unencumbered asset of the same kind.
8.6.30 Treatment of encumbered assets—exceptional central bank liquidity operations

The Regulatory Authority may direct an Islamic banking business firm that, for the purposes of calculating the firm’s NSFR, assets that are encumbered for exceptional central bank liquidity operations receive a specified lower RSF factor than would otherwise apply.

Guidance

In general, exceptional central bank liquidity operations are considered to be non-standard, temporary operations conducted by a central bank to achieve its mandate at a time of market-wide financial stress or exceptional macroeconomic challenges.

8.6.31 Off-balance-sheet exposures—RSF factors

The RSF factors for off-balance-sheet exposures are as follows:

(a) irrevocable and conditionally revocable financing and liquidity facilities—5% of the undrawn portion;

(b) contingent funding obligations—as set out in table 8.6.31.

Table 8.6.31 Contingent funding obligations—RSF factors

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of obligation</th>
<th>RSF factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Irrevocable or conditionally revocable liquidity facilities</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Irrevocable or conditionally revocable financing facilities</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>Unconditionally revocable liquidity facilities</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>Unconditionally revocable financing facilities</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>Trade-finance-related obligations (including guarantees and letters of credit)</td>
<td>3</td>
</tr>
<tr>
<td>6</td>
<td>Guarantees and letters of credit unrelated to trade finance obligations</td>
<td>5</td>
</tr>
</tbody>
</table>
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<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of obligation</th>
<th>RSF factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td>Other non-contractual obligations including:</td>
<td></td>
</tr>
<tr>
<td></td>
<td>● potential requests related to sukuk and other Shari’a-compliant structured investment vehicles and other such financing arrangements</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>● structured products where customers anticipate ready marketability</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>● managed funds that are marketed with the objective of maintaining a stable value</td>
<td>0</td>
</tr>
</tbody>
</table>

**Division 8.6.B  Treatment of branches**

**8.6.32 Global net stable funding concession—branches**

(1) A liquidity risk group A Islamic banking business firm that is a branch may apply to the Regulatory Authority for a global net stable funding concession.

(2) In its application the firm must satisfy the Authority that:

(a) in the jurisdiction where the firm’s head office is established, there are no legal constraints on the provision of funding to the firm; and

(b) its head office is subject to net stable funding requirements that are equivalent to, or more restrictive than, those imposed under these rules.

**Guidance**

In considering whether to grant such a concession, the Authority would take into account:

- the requirements, as to managing, monitoring and controlling stable funding, of the regulator responsible for the firm’s head office
- the systems and controls used by the head office to ensure that the firm’s stable funding remains adequate
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- any written assurance from the head office that:
  - it will ensure that, at all times, enough stable funding is available to support the firm
  - it will notify the Authority, at the same time as it notifies its home regulator, of any material issues concerning its exposure to liquidity risk and any issues in relation to its compliance with applicable stable funding limits, including its required NSFR
  - in the event of a stable funding crisis, it will give the Authority all relevant information on the whole firm’s stable funding situation, and a list of any known constraints (legal or otherwise) on the head office’s providing the firm with stable funding
- any notification from the head office’s home regulator:
  - either stating that the supervisor has no objection to the firm’s obtaining the concession, or acknowledging that the application has been made
  - giving information about, and confirming, the quality of the stable funding at the head office.

(3) If the Authority grants the concession, the firm need not comply with a requirement of this Part specified by the Authority.

(4) The Authority may specify the period for which the concession is valid. If no period is so specified, the concession is valid until the Authority revokes it.

(5) The firm:
   (a) must give the Authority, at least quarterly, a copy of the NSFR calculation for the firm, as submitted by its head office to its home regulator;
   (b) must notify the Authority immediately (but within 3 business days), in writing, of:
      (i) the results of every assessment by its home regulator of the quality of stable funding at the firm’s head office;
      (ii) any adverse finding or action taken by that regulator;
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(iii) any change or potential change in the firm’s funding strategy or business model, or material change or material potential change in the structure of its balance-sheet; and

(iv) any changes that affect its compliance with the requirements referred to in subrule (2).

(6) The Authority may at any time, by written notice, do any 1 or more of the following (based on its assessment of the firm’s stable funding situation):

(a) modify or exclude any of the requirements under subrule (5);

(b) impose additional requirements;

(c) revoke the concession.
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Note for Part 8.7
This Part applies only to liquidity risk group B Islamic banking business firms—see rule 8.1.4.

Division 8.7.A  General

8.7.1  Introduction—Part 8.7

(1) The requirement for an Islamic banking business firm to maintain a net stable funding ratio is one of the Basel Committee’s key reforms to promote a more resilient banking sector. The requirement will oblige firms to maintain a stable funding profile in relation to the composition of their assets and off-balance-sheet activities.

(2) A stable funding profile is intended to reduce the likelihood that disruptions to a firm’s regular sources of funding will erode its liquidity position in a way that would increase the risk of its failure and might lead to broader systemic stress.

(3) The requirement is intended to limit firms’ reliance on short-term wholesale funding, promote funding stability, and encourage better assessment of funding risk on and off firms’ balance-sheets.

(4) This Part sets out an alternative approach to the maintenance of stable funding that is intended to be appropriate for certain Islamic banking business firms that, because of their business model, could not meet a requirement to maintain a net stable funding ratio in accordance with Part 8.6.

8.7.2  Definitions for Part 8.7

Expressions used in this Part that are defined in Part 8.4 or 8.6 have the same respective meanings in this Part as in Part 8.4 or 8.6, as the case may be.
8.7.3 What NSFR is

(1) A liquidity risk group B Islamic banking business firm’s NSFR, expressed as a percentage, is:

$$\frac{ASF}{RSF} \times 100.$$  

(2) The ASF and RSF are to be calculated in accordance with this Part.

8.7.4 Obligation to maintain NSFR

A liquidity risk group B Islamic banking business firm must maintain, during each calendar month, an average NSFR of at least the percentage that the Regulatory Authority directs the firm to maintain.

8.7.5 Obligation to notify Regulatory Authority if NSFR requirement not met

(1) A liquidity risk group B Islamic banking business firm must notify the Regulatory Authority in writing immediately (but within 3 business days) if the firm ceases to meet its NSFR requirement (or becomes aware of circumstances that may result in its ceasing to meet that requirement).

(2) In the notification the firm must clearly explain:

(a) why it ceased to meet, or thinks it may cease to meet, the requirement;

(b) when it expects to again be able to meet the requirement; and

(c) what it has done and will do to ensure that it meets the requirement in future, or continues to meet it, as the case requires.

Guidance

An Islamic banking business firm that gives such a notification should discuss with the Regulatory Authority what further steps it should take to deal with the situation.
8.7.6 Application of certain rules in Part 8.6

For calculating its NSFR, a liquidity risk group B Islamic banking business firm must apply rules 8.6.7 to 8.6.13 (so far as relevant).

8.7.7 Calculating ASF—liquidity risk group B Islamic banking business firms

The amount of a liquidity risk group B Islamic banking business firm’s ASF is calculated as follows:

(a) first, for each of the firm’s capital items and liabilities, multiply its carrying value by the ASF factor set out in table 8.7.7 for a capital item or liability of that kind and maturity (giving the weighted amounts);

(b) finally, add up the weighted amounts.

Table 8.7.7 ASF factors

<table>
<thead>
<tr>
<th>Item no.</th>
<th>Kind of capital item or liability</th>
<th>ASF factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>With maturity (months)</td>
<td>no maturity</td>
</tr>
<tr>
<td></td>
<td>&lt; 6</td>
<td>6 – &lt; 12</td>
</tr>
<tr>
<td>1</td>
<td>Capital items and instruments:</td>
<td></td>
</tr>
<tr>
<td>(a)</td>
<td>regulatory capital (excluding tier 2 instruments)</td>
<td>100</td>
</tr>
<tr>
<td>(b)</td>
<td>other capital instruments not included in item (a)</td>
<td>0</td>
</tr>
<tr>
<td>(c)</td>
<td>minority interest</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>Marketable debt securities</td>
<td>0</td>
</tr>
</tbody>
</table>
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<table>
<thead>
<tr>
<th>Item no.</th>
<th>Kind of capital item or liability</th>
<th>ASF factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>With maturity (months)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&lt; 6</td>
</tr>
<tr>
<td>3</td>
<td>Non-bank-customer deposits</td>
<td>80</td>
</tr>
<tr>
<td>4</td>
<td>Other types of funding</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>Trade debts payable</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>Net derivative liabilities</td>
<td>0</td>
</tr>
<tr>
<td>7</td>
<td>Other liabilities not listed</td>
<td>0</td>
</tr>
</tbody>
</table>

8.7.8 Calculating RSF—liquidity risk group B Islamic banking business firms

The amount of a liquidity risk group B Islamic banking business firm’s RSF is calculated as follows:

(a) first, for each of the firm’s assets and off-balance-sheet items, multiply its carrying value by the RSF factor set out in table 8.7.8A or 8.7.8B for an asset or item of that kind and maturity (giving the weighted amounts);

(b) finally, add up the weighted amounts.

Table 8.7.8A RSF factors—on-balance-sheet assets

<table>
<thead>
<tr>
<th>Item no.</th>
<th>Kind of asset</th>
<th>RSF factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>With maturity (months)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&lt; 6</td>
</tr>
<tr>
<td>1</td>
<td>On-balance-sheet assets (excluding assets treated as liquefiable assets for the calculation of the firm’s MLR)</td>
<td>0</td>
</tr>
</tbody>
</table>
### Table 8.7.8B RSF factors—off-balance-sheet items

<table>
<thead>
<tr>
<th>Item no.</th>
<th>Kind of item</th>
<th>RSF factor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>With maturity (months)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&lt; 6</td>
</tr>
<tr>
<td>1</td>
<td>Undrawn portions of irrevocable and conditionally revocable financing facilities and liquidity facilities</td>
<td>5</td>
</tr>
<tr>
<td>2</td>
<td>Undrawn portions of unconditionally revocable financing facilities and liquidity facilities</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>Trade-related contingencies</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Non-trade-related contingencies (including guarantees and letters of credit not included in item 3)</td>
<td>10</td>
</tr>
<tr>
<td>5</td>
<td>Other off-balance-sheet items</td>
<td>0</td>
</tr>
</tbody>
</table>
Division 8.7.B  Treatment of branches

8.7.9  Global net stable funding concession—branches

(1) A liquidity risk group B Islamic banking business firm that is a branch may apply to the Regulatory Authority for a global net stable funding concession.

(2) In its application the firm must satisfy the Authority that:

(a) in the jurisdiction where the firm’s head office is established, there are no legal constraints on the provision of funding to the firm; and

(b) its head office is subject to net stable funding requirements that are equivalent to, or more restrictive than, those imposed under these rules.

Guidance

In considering whether to grant such a concession, the Authority would take into account:

- the requirements, as to managing, monitoring and controlling stable funding, of the regulator responsible for the firm’s head office
- the systems and controls used by the head office to ensure that the firm’s stable funding remains adequate
- any written assurance from the head office that:
  - it will ensure that, at all times, enough stable funding is available to support the firm
  - it will notify the Authority, at the same time as it notifies its home regulator, of any material issues concerning its exposure to liquidity risk and any issues in relation to its compliance with applicable stable funding limits, including its required NSFR
  - in the event of a stable funding crisis, it will give the Authority all relevant information on the whole firm’s stable funding situation, and a list of any known constraints (legal or otherwise) on the head office’s providing the firm with stable funding
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(3) If the Authority grants the concession, the firm need not comply with a requirement of this Part specified by the Authority.

(4) The Authority may specify the period for which the concession is valid. If no period is so specified, the concession is valid until the Authority revokes it.

(5) The firm:
   (a) must give the Authority, at least quarterly, a copy of the NSFR calculation for the firm, as submitted by its head office to its home regulator;
   (b) must notify the Authority immediately (but within 3 business days), in writing, of:
       (i) the results of every assessment by its home regulator of the quality of stable funding at the firm’s head office;
       (ii) any adverse finding or action taken by that regulator;
       (iii) any change or potential change in the firm’s funding strategy or business model, or material change or material potential change in the structure of its balance-sheet; and
       (iv) any changes that affect its compliance with the conditions referred to in subrule (2).

(6) The Authority may at any time, by written notice, do any 1 or more of the following (based on its assessment of the firm’s stable funding situation):
   (a) modify or exclude any of the requirements under subrule (5);
   (b) impose additional requirements;
   (c) revoke the concession.
Part 8.8  Limits on net cumulative maturity mismatch

Note for Part 8.8
This Part applies to all Islamic banking business firms—see rule 8.1.4.

8.8.1  Introduction—Part 8.8
The maturity mismatch approach set out in this Part assesses an Islamic banking business firm’s liquidity by measuring the maturity mismatch between its assets and its liabilities (in each case, with a specified maturity of 30 calendar days or less) within the time-bands:

(a) sight–7 calendar days; and

(b) 8–30 calendar days.

Guidance
1 A liability is said to be payable at sight if payment is due immediately on presentation. For example, a cheque is usually payable at sight.

2 On a particular day, the sight–7 calendar days time-band covers assets maturing, or liabilities payable, on presentation or within 7 calendar days. The 8–30 calendar days time-band covers assets maturing, or liabilities payable, from 8 to 30 calendar days later.

3 This Part takes no account of assets or liabilities with an unspecified maturity, or a specified maturity that is more than 30 calendar days in the future.

8.8.2  Application—Part 8.8
This Part applies to all Islamic banking business firms.

8.8.3  Determining net cumulative maturity mismatch
An Islamic banking business firm determines its net cumulative maturity mismatch for each time-band by:

(a) determining what assets and liabilities are to be taken into account, and their maturities;

(b) assigning each asset and each liability to a time-band;

(c) adding up the values of the assets and the liabilities assigned to each time-band; and
(d) subtracting liabilities from assets in each time-band.

8.8.4 **Assigning liabilities to time-bands**
(1) A liability must be assigned to a time-band according to its earliest contractual maturity.

(2) A contingent liability must be included in the firm’s liabilities unless the conditions necessary to crystallise it are unlikely to be fulfilled.

**Guidance for subrule (2)**
In deciding whether it is likely that the conditions necessary to crystallise a contingent liability will be fulfilled, an authorised firm could rely on general market information, its knowledge of the counterparty and general behavioural analysis.

8.8.5 **Assigning assets to time-bands**
(1) An asset must be assigned to a time-band according to its latest contractual maturity, except that:
   (a) an undrawn committed standby facility provided by another Islamic banking business firm is to be treated as being at sight;
   (b) readily marketable assets (see subrule (2)) are to be treated as being at sight; and
   (c) assets that have been lodged as collateral are not to be included.

(2) An asset is *readily marketable* if all of the following are true:
   (a) the currency in which it is denominated is freely tradeable;
   (b) prices are regularly quoted for it;
   (c) it is regularly traded;
   (d) it can readily be monetised on a recognised exchange.

(3) On a case by case basis, the Regulatory Authority may allow an Islamic banking business firm to include, in the sight–7 calendar days time-band, a longer-term asset that is relatively easy to monetise.

8.8.6 **Haircuts for readily marketable assets**
(1) The haircuts to be applied to readily marketable assets of each kind are as set out in table 8.8.6. The haircut for an asset is to be applied to the mark-to-market value of the asset.
(2) For the table, an asset is *investment grade* if it is rated no lower than BBB- (long-term) or A-3 (short-term) by Standard & Poor’s (or the equivalent by another ECRA).

(3) In the table:

*MDB* means multilateral development bank.

*Note* For a list of multilateral development banks that qualify for 0% risk weight, and examples of other multilateral development banks that do not, see the note following table 4.4.7A.

*PSE* means public sector enterprise.

### Table 8.8.6 Haircuts for assets

<table>
<thead>
<tr>
<th>Item</th>
<th>Kind of asset</th>
<th>Haircut (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Sovereign, central bank, non-commercial PSE and MDB investment-grade securities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A.1</td>
<td>Marketable securities with 12 months’ or less residual maturity, issued or guaranteed by a sovereign, a central bank, a non-commercial PSE or an MDB</td>
<td>0</td>
</tr>
<tr>
<td>A.2</td>
<td>Marketable securities with more than 12 months’ but not more than 5 years’ residual maturity, issued or guaranteed by a sovereign, a central bank, a non-commercial PSE or an MDB</td>
<td>5</td>
</tr>
<tr>
<td>A.3</td>
<td>Marketable securities with more than 5 years’ residual maturity, issued or guaranteed by a sovereign, a central bank, a non-commercial PSE or an MDB</td>
<td>10</td>
</tr>
<tr>
<td><strong>B. Sovereign, central bank, non-commercial PSE and MDB non-investment-grade securities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B.1</td>
<td>Marketable securities issued by a sovereign, a central bank, a non-commercial PSE or an MDB, where the credit exposure is to the issuer, regardless of maturity</td>
<td>20</td>
</tr>
</tbody>
</table>
### Rule 8.8.7

**Calculating net cumulative maturity mismatch position**

An Islamic banking business firm must determine its net cumulative maturity mismatch position in relation to deposits (including unrestricted PSIAs) as follows:

\[
\frac{NCM}{TD} \times 100
\]

(4) The Regulatory Authority may vary the haircut for an asset to reflect the conditions of a particular market or institution.
where:

\[ NCM \] is the net cumulative maturity mismatch.

\[ TD \] is the firm’s total deposits (including unrestricted PSIAs).

### 8.8.8 Limit on net cumulative maturity mismatch position

(1) The limits on an Islamic banking business firm’s net cumulative maturity mismatch position are as follows:

- for the sight–7 calendar days time-band—negative 15%;
- for the sight–30 calendar days time-band—negative 25%.

(2) If an Islamic banking business firm’s net cumulative maturity mismatch position exceeds the relevant limit set out in subrule (1), the firm must notify the Regulatory Authority about the matter in writing immediately (but within 3 business days), clearly explaining what steps it will take to bring the position back within the limit.

### 8.8.9 Recognition of funding facility from parent entity

(1) This rule applies to an Islamic banking business firm that is a branch, or is a subsidiary of an entity established that is outside the QFC.

(2) The Regulatory Authority may allow such a firm to recognise, as an asset, access to its parent entity’s funds by way of a committed funding facility, up to a limit specified in the facility documentation. The facility:

- must be an irrevocable commitment; and
- must be appropriately documented.
Part 8.9 Monitoring

Note for Part 8.9
This Part applies to all Islamic banking business firms—see rule 8.1.4.

Division 8.9.A Introductory

8.9.1 Introduction—Part 8.9
(1) This Part imposes requirements for Islamic banking business firms to monitor certain indicators of their liquidity.

(2) The indicators are:
   (a) contractual maturity mismatches;
   (b) concentration of funding;
   (c) available unencumbered assets; and
   (d) LCR by significant currencies.

8.9.2 What monitoring requires
A requirement in this Part for an Islamic banking business firm to monitor an indicator requires the firm to be continuously aware of the indicator, and to re-evaluate it as often as necessary, given:

(a) the nature, scale and complexity of the firm’s business; and
(b) the prevailing market conditions.

Division 8.9.B Monitoring maturity mismatches

8.9.3 Purpose of monitoring
The monitoring of an Islamic banking business firm’s contractual maturity mismatches is intended to identify gaps between contractual inflows and outflows in particular time-bands, and to reveal the extent to which the firm relies on maturity transformation.
8.9.4 Contractual maturity mismatch

(1) An Islamic banking business firm:

(a) must monitor its contractual maturity mismatches, according to time-bands directed by the Regulatory Authority; and

(b) must carry out its own maturity mismatch analyses, based on realistic, going-concern assumptions about the behaviour of inflows and outflows of funds in both normal situations and stress situations.

(2) The analyses should be based on the firm’s strategic and business plans and must be shared with, and discussed with, the Authority.

(3) The firm must be able to show how it plans to bridge any identified gaps in its internally generated maturity mismatches, and to explain any differences between the assumptions applied and the contractual terms.

Division 8.9.C Monitoring concentration of funding

8.9.5 Purpose of monitoring

The monitoring of the concentration of an Islamic banking business firm’s funding is meant:

(a) to identify sources of the firm’s wholesale funding that are of such significance that the withdrawal of that funding could cause liquidity problems for the firm; and

(b) therefore, to encourage the firm to diversify its sources of such funding.

8.9.6 What is to be monitored

An Islamic banking business firm must monitor:

(a) concentration of funding by counterparty;

(b) concentration of funding by instrument or product; and

(c) concentration of funding by currency.
8.9.7 Concentration of funding by counterparty

(1) An Islamic banking business firm must calculate its concentration of funding by counterparty as a percentage for each significant counterparty or significant group of connected counterparties, by means of the following formula:

\[ \frac{N}{T} \times 100 \]

where:

- \( N \) is the total, for the counterparty or group, of:
  - (a) all liabilities to the counterparty or group; and
  - (b) all other direct borrowings, both secured and unsecured (such as by overnight commercial paper or certificates of deposit) from the counterparty or group.

- \( T \) is the firm’s total balance-sheet.

(2) For subrule (1):

  - (a) a counterparty or group is **significant** if liabilities to it account in total for more than 1% of the firm’s total liabilities; and
  - (b) a **group of connected counterparties** is 2 or more counterparties that are connected (as defined in rule 5.1.3).

(3) For this rule, if the firm is a member of a corporate group, the firm must treat intra-group deposits and deposits from related parties as deposits by a single counterparty.

**Guidance**

Deposits from within the group and from related parties are to be identified because of the possible limitations on intra-group transactions under stressed conditions.

8.9.8 Concentration of funding by instrument or product

(1) An Islamic banking business firm must calculate its concentration of funding by instrument or product as a percentage for each significant...
instrument or significant product (or significant type of instrument or significant type of product), by means of the following formula:

\[
\frac{N}{T} \times 100
\]

where:

- \(N\) is the total, for the instrument or product (or type of instrument or type of product) of all liabilities arising from the instrument, product or type of instrument or product.
- \(T\) is the firm’s total balance-sheet.

(2) For subrule (1), an instrument or product, or a type of instrument or product, is \textit{significant} if it accounts in total for more than 1% of the firm’s total liabilities.

8.9.9 \textbf{Concentration of funding by currency}

(1) An Islamic banking business firm must monitor its concentration of funding by currency by maintaining a list of its liabilities, maturing in each time-band, denominated in each significant currency.

(2) For subrule (1):

(a) a currency is \textit{significant} for the firm if liabilities denominated in it account in total for more than 5% of the firm’s total liabilities; and

(b) the time-bands are as follows:

(i) less than 1 month;
(ii) 1-3 months;
(iii) 3-6 months;
(iv) 6-12 months;
(v) more than 12 months;
(vi) unspecified maturity.
Division 8.9.D Monitoring available unencumbered assets

8.9.10 Purpose of monitoring
The monitoring of an Islamic banking business firm’s available unencumbered assets and collateral is meant to track assets and collateral:

(a) that could be used in secondary markets as collateral to raise additional HQLA (as defined in rule 8.4.3) or secured funding; or

(b) that would be eligible as collateral for a central bank’s standing facility.

8.9.11 What is to be monitored
(1) In this rule:

unencumbered has the meaning given by rule 8.4.4.

(2) An Islamic banking business firm must monitor all of the following:

(a) the amount, type and location of the firm’s available unencumbered assets that are useable as collateral in secondary markets;

(b) collateral, received from customers, that the firm is permitted to deliver or re-pledge, and how much of such collateral it is delivering or re-pledging;

(c) the firm’s available unencumbered assets that are eligible as collateral for central banks’ standing facilities;

(d) the estimated haircut that the secondary market or relevant central bank would require for each asset;

(e) the costs likely to be involved.

(3) In doing so, the firm must categorise its available unencumbered assets and collateral by significant currency. A currency is significant if the firm’s stock of available unencumbered assets and collateral
denominated in the currency amounts to 5% or more of the firm’s total amount of such assets and collateral.

(4) The firm must monitor:

(a) the expected monetised value of such assets and collateral (rather than their notional amount); and

(b) where the assets or collateral are held (in terms of both their location and what business lines have access to them).

**Division 8.9.E Monitoring LCR by significant currencies**

**8.9.12 Purpose of monitoring**

The monitoring of an Islamic banking business firm’s LCR (as defined in rule 8.4.3) by significant currencies is meant to track possible currency mismatches.

**8.9.13 What is to be monitored**

(1) An Islamic banking business firm must monitor:

(a) its stock of HQLA (as defined in rule 8.4.3) in each significant currency; and

(b) its expected total net cash outflows (net of any hedges) in each such currency over the next 30 calendar days.

(2) For subrule (1):

(a) the firm’s total net cash outflows over the next 30 calendar days are to be calculated in accordance with rule 8.4.21; and

(b) a currency is *significant* for the firm if liabilities denominated in it amount to 5% or more of the firm’s total liabilities.
Chapter 9  Group risk

Part 9.1  General

9.1.1  Introduction

(1) This Chapter sets out the requirements for an Islamic banking business firm’s management of corporate group risk and the measurement of financial group capital requirement and resources.

(2) Group membership can be a source of both strength and weakness to an Islamic banking business firm. The purpose of group risk requirements is to ensure that the firm takes into account the risks related to its membership of a corporate group and maintains adequate capital resources so as to exceed its financial group capital requirement.

9.1.2  Corporate group and financial group

(1) An Islamic banking business firm’s corporate group is made up of:
   (a) the firm;
   (b) any parent entity of the firm;
   (c) any subsidiary (direct or indirect) of the firm; and
   (d) any subsidiary (direct or indirect) of a parent entity of the firm.

(2) An Islamic banking business firm’s financial group is made up of:
   (a) the firm;
   (b) any subsidiary (direct or indirect) of the firm, if the subsidiary belongs to a sector of the financial industry; and
   (c) any entity that the Regulatory Authority directs the firm to include.

(3) An Islamic banking business firm may apply to the Regulatory Authority for approval to exclude an entity from its financial group. The authority will grant such an approval only after the firm satisfies
the authority that inclusion of the entity would be misleading or inappropriate for the purposes of supervision.

Guidance

The Regulatory Authority would consider a range of factors when requiring an Islamic banking business firm to treat another entity as part of its financial group. These factors would include regulatory risk factors, including direct and indirect participation, influence or contractual obligations, interconnectedness, intra-group exposures, intra-group services, regulatory status and legal framework.

9.1.3 Requirements—group risk

(1) An Islamic banking business firm must effectively manage risks arising from its membership in a corporate group.

(2) An Islamic banking business firm that is a member of a corporate group must establish and maintain systems and controls to monitor:
   (a) the effect on the firm of its membership in the group;
   (b) the effect on the firm of the activities of other members of the group;
   (c) compliance with group supervision and reporting requirements; and
   (d) funding within the group.

Guidance

An Islamic banking business firm may take into account its position within its corporate group. It would be reasonable for a small firm within a larger group to place some reliance on its parent to ensure that there are appropriate systems and controls to manage group risk.

(3) The firm must also have systems to enable it to calculate its financial group capital requirement and resources. The systems must include a means of analysing realistic scenarios and the effects on the financial group’s capital requirement and resources if those scenarios occurred.

9.1.4 Role of governing body—group risk

An Islamic banking business firm’s governing body must ensure that the firm’s group risk management policy addresses, on a group-wide
basis, all risks arising from the firm’s relationship with every other member of its group.
Chapter 9  
Part 9.2  
Group capital requirement and resources  

Rule 9.2.1

Part 9.2  
Group capital requirement and resources

9.2.1 Application of Part 9.2

(1) This Part does not apply to an Islamic banking business firm if:

(a) the firm is already subject to group prudential supervision by the Regulatory Authority because another member of its group is an authorised firm; or

(b) the Regulatory Authority has confirmed in writing, in response to an application from the firm, that the authority is satisfied that the group is the subject of consolidated prudential supervision by an appropriate regulator.

(2) An Islamic banking business firm that has received confirmation must immediately inform the authority in writing if any circumstance on which the confirmation was based changes.

9.2.2 Financial group capital requirement and resources

(1) An Islamic banking business firm must ensure, at all times, that its financial group capital resources exceed its financial group capital requirement.

(2) In calculating its financial group capital resources, the firm must not include capital resources or adjusted capital resources (as the case may be) of subsidiaries or participations of that group to the extent that those capital resources or adjusted capital resources exceed the capital requirement for that subsidiary or participation and are not freely transferable within the group.

Guidance

1 Capital resources or adjusted capital resources would not be freely transferable if they are subject to an obligation to maintain minimum capital requirements to comply with domestic solvency requirements, or to comply with debt covenants.

2 If an Islamic banking business firm breaches rule 9.2.2(1), the Regulatory Authority would take into account the circumstances of the case, including any
9.2.3 Solo limits to apply to group

Unless the Regulatory Authority directs otherwise, a prudential limit in these rules that applies to an Islamic banking business firm also applies to the firm’s financial group.

Examples

1. The restriction in rule 5.3.3(2) (that the total of an Islamic banking business firm’s net exposures to a counterparty or connected counterparties must not exceed 25% of its regulatory capital) applies to the firm’s financial group, so that the group’s net exposures to a counterparty or connected counterparties must not exceed 25% of the group’s regulatory capital.

2. Similarly, the restriction in rule 5.3.3(3) (that the total of all of the firm’s net large exposures must not exceed 800% of its regulatory capital) applies to the firm’s financial group, so that the group’s total large exposures to counterparties or connected counterparties must not exceed 800% of the group’s regulatory capital.

remedial steps taken by another regulator or the firm, in deciding what enforcement action to take.
Chapter 10  Treatment of sukuk

Part 10.1  General

10.1.1  Introduction

(1) This Chapter sets out the minimum capital requirements to cover:

(a) the credit risk and market risk arising from the holding, by an Islamic banking business firm, of sukuk in the banking book; and

(b) the firm’s other sukuk-related exposures arising from the firm being (or acting in the capacity of) an originator, issuer, provider of credit enhancement or provider of a liquidity facility in a securitisation.

Note  For credit risk arising from sukuk in the firm’s trading book, Chapter 4 applies. For market risk arising from sukuk in the firm’s trading book, Chapter 6 applies.

(2) This Chapter also sets out the requirements for allowing capital relief to an Islamic banking business firm.

10.1.2  Sukuk

(1) Sukuk are certificates that represent a holder’s proportionate ownership in an undivided part of an asset or pool of assets where the holder assumes all rights and obligations to the asset or pool.

(2) The assets that may be the subject of sukuk include:

(a) tangible assets (including istisna assets);

(b) intangible assets;

(c) financial assets;

(d) usufructs (including ijarah lease assets);

(e) services;

(f) equity participation in business ventures (such as mudarabah and musharakah);
(g) a pool of the kinds of assets mentioned in paragraphs (a) to (d); and

\textit{Note} The pooling of different kinds of assets allows for greater mobilisation of funds. For example, an SPE would be able to issue tradeable \textit{sukuk} for financial assets that would not normally be tradeable on their own, if the SPE packages a pool made up of a proportion of financial assets and tangible assets.

(h) any other asset approved in writing by the Regulatory Authority.

(3) The assets that are the subject of \textit{sukuk} must be Shari’a-compliant and readily identifiable. The assets may be in a specific project or investment activity that must itself be Shari’a-compliant.

10.1.3 \textbf{Tradeability of \textit{sukuk}}

\textit{Sukuk} are not tradeable unless their trading is in accordance with Shari’a.

\textbf{Guidance}

1 As a general principle, \textit{sukuk} with underlying financial assets solely in the form of receivables (debts) are not tradeable.

2 \textit{Sukuk} that are made up of financial assets may be traded by a firm if:

\begin{itemize}
  \item[(a)] the financial assets are combined with tangible assets and the value of tangible assets in the pool is not less than the percentage determined by the firm’s Shari’a supervisory board (this kind of \textit{sukuk} is sometimes called \textit{sukuk al-istithmar}); or
  \item[(b)] the firm is selling all of its assets (or a pool of assets with a standing financial obligation) and the financial assets are incidental to the tangible assets or usufructs being sold and are unavoidably included in the sale.
\end{itemize}

10.1.4 \textbf{Categories of \textit{sukuk} according to ownership of assets}

\textit{Sukuk} may also be categorised, based on the \textit{sukuk} holders’ ownership of the underlying assets, into:

\begin{itemize}
  \item[(a)] \textit{asset-backed \textit{sukuk}} where legal and beneficial ownership of the underlying assets are transferred to the \textit{sukuk} holders; and
(b) *asset-based sukuk* where only beneficial ownership of the underlying assets is transferred (through a trust) to the *sukuk* holders.
Part 10.2  Securitisation and re-securitisation

Division 10.2.A  General

10.2.1  Securitisation

(1)  **Securitisation**, in relation to an Islamic banking business firm, is the process of creating and issuing *sukuk* or tranches of *sukuk*. In securitisation:

(a) payments of the principal and profits are derived from the cash flows generated by the securitised assets (that is, by the assets underlying the *sukuk*); and

(b) legal or beneficial ownership to the underlying assets is transferred to the investors in the form of *sukuk*.

A reference to securitisation includes re-securitisation.

(2) The structure of a securitisation must be Shari’a-compliant.

Note  Under rule 10.1.2 (3), the assets that are the subject of *sukuk* (and the specific project or investment activity where the assets are) must also be Shari’a-compliant.

10.2.2  Parties to securitisation

(1) For purposes of calculating an Islamic banking business firm’s capital requirements, the parties to a securitisation are the originator, the issuer and the investors.

Note  Depending on the securitisation structure, an Islamic banking business firm may be (or act in the capacity of) originator, issuer, investor or any 1 or more of the following:

(a) a manager of the *sukuk* issuance;
(b) a sponsor of the *sukuk* issuance;
(c) an adviser to the *sukuk* issuance;
(d) an entity to place the securities with investors;
(e) a provider of credit enhancement;
(f) a provider of a liquidity facility;
(g) a servicer to carry out certain activities usually carried out by the manager of the sukuk issuance in relation to the underlying assets.

Note 2 An Islamic banking business firm may act as sponsor of a sukuk issuance or similar programme involving assets of a customer. As sponsor, the firm earns fees to manage or advise on the programme, place the securities with investors, provide credit enhancement or provide a liquidity facility.

Note 3 Depending on the securitisation structure, a servicer (instead of the manager of the sukuk or issuer) may carry out the following activities:

(a) handling related taxes;
(b) managing escrow accounts;
(c) remitting payments;
(d) obtaining takaful;
(e) maintaining the underlying assets on behalf of the lessor (sukuk holders) in ijarah or IMB sukuk.

Note 4 The originator of a sukuk issuance may act as servicer of the underlying assets.

(2) The contractual terms of the sukuk issuance determine the rights of the sukuk holders to the securitised assets.

Note For the rights of sukuk-holders, see rule 10.2.10 (Effects of true sale on sukuk holders).

10.2.3 Firm acting as originator

An Islamic banking business firm that acts as originator of a sukuk issuance must transfer (through an SPE) the ownership of assets held by it to sukuk holders.

Guidance

1 As an originator, an Islamic banking business firm may obtain either or both of the following benefits:

(a) increased liquidity, since a relatively illiquid asset (such as an asset held as lessor in an ijarah or IMB contract) is converted into cash paid by the investors;

(b) reduced capital requirements, insofar as the securitisation permits the firm to exclude, from the calculation of its risk-weighted assets, exposures relating to the underlying assets.
To obtain the benefit of reduced capital requirements, the firm must ensure that the securitisation structure enables it to derecognise, from its balance sheet, the underlying assets. For the criteria for derecognition, see rule 10.2.26.

### 10.2.4 Firm acting as issuer

An Islamic banking business firm may act as issuer of sukuk.

**Guidance**

1. An Islamic banking business firm may act as issuer of asset-backed sukuk by packaging assets into a pool and transferring legal and beneficial ownership of the assets to sukuk holders by true sale under rule 10.2.8.

2. An Islamic banking business firm may act as issuer of asset-based sukuk by packaging assets into a pool and transferring only beneficial ownership of the assets to sukuk holders because there is some obstacle to the transfer of legal ownership. Such an obstacle would, for example, exist if the assets were purchased by the firm from the central government of a state and the transfer of full ownership would require special legislation.

### 10.2.5 Collateral security structure

1. A collateral security structure may be used in some sukuk, such as those based on project financing. The security interest arising from the structure must be perfected (or perfectible) and that interest must be the only claim on the collateral.

   **Note** In this rule, collateral:

   (a) arises from the structure (for example, the asset or project that is the subject of financing in a joint venture between the SPE and another party); and

   (b) is used to mitigate the underlying exposures of the securitisation.

2. The collateral security structure must be supported by a written and reasoned opinion of a qualified legal counsel. The legal opinion must conclude that the security interest is perfected (or perfectible) and that there are no prior or subsequent claims on the collateral.

3. The legal opinion must address:

   (a) the nature of the security interest;

   (b) the enforceability of the security interest against third parties;

   (c) perfection requirements (such as notices and registration); and
(d) the effects of the issuer’s bankruptcy on perfection.

**Guidance**
The Regulatory Authority expects the legal opinion to consider that, in many jurisdictions:
- *rahn* (mortgage or other pledge of assets) is possessory in nature so as to make perfection a particularly difficult issue
- bankruptcy laws, the concept of perfection and the priorities in the distribution of assets are not well developed.

### Division 10.2.B  Securitisation process

#### 10.2.6 Sukuk securitisation

The process of a *sukuk* securitisation is:

(a) first, the origination of assets;

(b) second, the transfer of the assets to an SPE which is created to issue the securities and manage the assets on behalf of the *sukuk* holders; and

(c) third, the issuance of the *sukuk* to investors.

#### 10.2.7 Special purpose entities

(1) A *special purpose entity* (or *SPE*) is a legal entity that is created solely for a particular financial transaction or series of transactions.

(2) An SPE may take the form of a limited partnership, limited liability company, corporation, trust or collective investment fund. An SPE may also be established under a special law that allows the creation of SPEs.

(3) Most *sukuk* securitisations require the creation of an SPE to:

(a) hold the assets transferred by the originator;

(b) issue *sukuk* based on the assets; and

(c) act as intermediary between the originator and the *sukuk* holders.

**Guidance**

1. In conventional securitisations, the SPE must not have any other business. In a *sukuk* securitisation, the SPE can be organised, for example, as a *mudarabah*,
musharakah or wakalah, but the requirement for the SPE to have no other business continues to apply.

2 By its nature, an SPE is a legal shell with only the specific assets transferred by the originator (that is, the SPE has no other property in which any other party could have an interest). The transferred assets are effectively owned, legally or through a trust, by the sukuk holders.

(4) An SPE must be bankruptcy-remote from the originator. It must not be consolidated with the originator for tax, accounting or legal purposes.

10.2.8 Criteria for true sale

(1) For asset-backed sukuk, ownership of the underlying assets must be transferred to the sukuk holders (or to an SPE for their benefit) by a true sale under Shari’a.

(2) The 4 main criteria for a true sale are:

(a) the transfer must be such that:
   (i) it cannot be re-characterised by a court or other body as a secured loan; or
   (ii) it cannot be avoided in a bankruptcy or insolvency proceeding involving the originator of the assets;

   Example
   The sale should not be a fraudulent transfer in anticipation of bankruptcy or a preference payment

(b) the bankruptcy or insolvency of the originator must not affect the assets transferred and the issuer of the sukuk must be able to enforce collection and other rights against the source of the income without any hindrance resulting from the bankruptcy or insolvency of the originator;

(c) the transfer must be perfectible at the election of the issuer; and

(d) the sale must be free and clear of all prior overriding liens.
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Rule 10.2.9  

(3) The transfer of assets must be evidenced by a written contract for their sale to the sukuk holders.  

Note For the covenants and declarations that must be included in the transaction documents, see rule 10.2.27.  

10.2.9 Effects of true sale on originator  
For asset-backed sukuk, the effects of a true sale on the originator include:  

(a) derecognition, from the originator’s balance sheet, of the assets sold, so that the assets become bankruptcy-remote (and therefore not subject to claw back by a liquidator in the event of the originator’s liquidation); and  

(b) the originator ceasing to have any financial liability to the sukuk holders in relation to the assets.  

10.2.10 Effects of true sale on sukuk holders  
For asset-backed sukuk, the effects of a true sale on sukuk holders include:  

(a) giving the holders a legally recognised ownership interest over the underlying assets;  

(b) giving the holders realisable security over the underlying assets;  

(c) giving the holders a right to payments of the principal and profits;  

(d) insulating the holders from exposure to any financial problems of the originator;  

(e) exposing the holders (as owners) to losses in the event of impairment of the assets; and  

(f) in case of a default of the sukuk (for example, because ijarah lessees of the assets fail to pay what is due), giving the holders a claim to the assets (but not to the originator).  

Note In contrast to rule 10.2.10 (f), recourse to the originator is possible in some asset-based sukuk (see rule 10.2.14 (2) (b) (iii))
10.2.11 Prohibition against advanced undertaking to repurchase

(1) If a sukuk issuance satisfies the criteria for a true sale of the assets, the risks to the sukuk holders of the payments of the principal and profits must depend on the performance of the underlying assets and not on any other mechanism such as a repurchase undertaking.

*Note*  In a sukuk securitisation, the applicable risks are those of the underlying assets, and these will, in principle, be reflected in any credit rating issued by an ECRA.

(2) The mudarib (investment manager), sharik (partner) or wakeel (agent) must not undertake in advance to repurchase the underlying assets at maturity for their nominal or par value.

(3) A repurchase undertaking to cover risks arising from mudarabah sukuk, musharakah sukuk or wakalah sukuk may be built into the structure of the sukuk only if the mudarib, sharik or wakeel undertakes to repurchase the assets at maturity for:

(a) their net value;
(b) their market value;
(c) their fair value; or
(d) a price to be agreed at the time of repurchase.

(4) However, the originator (as lessee) of a securitisation of a pool of ijarah assets may undertake to purchase the assets at maturity for their nominal or par value, but only if the originator is not also a mudarib, sharik or wakeel in relation to the securitisation.

(5) In this rule:

*repurchase undertaking* means a unilateral binding promise, made by the originator to the issuer or trustee, to purchase the sukuk assets at a future date or on the occurrence of certain events (such as maturity of the sukuk or exercise of early redemption right by sukuk holders).
Division 10.2.C  Risk management of securitisation

10.2.12  Role of governing body—securitisation

(1) An Islamic banking business firm’s governing body must oversee the firm’s securitisation exposures.

(2) The governing body:
   (a) must understand, and set the scope and purpose of, the firm’s sukuk securitisation; and
   (b) must be aware of the risks and other implications associated with sukuk securitisation.

(3) The governing body must ensure that the firm’s senior management establishes and implements securitisation policies that include:
   (a) appropriate risk management systems to identify, measure, monitor, report on and control or mitigate the risks arising from the firm’s involvement in securitisation; and
   (b) how the firm monitors, and reports on, the effect of securitisation on its risk profile.

10.2.13  Policies—Shari’a compliance

An Islamic banking business firm must establish and implement policies to ensure that the firm’s offer documents for sukuk are sufficiently clear and precise to eliminate the risk of gharar or any other activity prohibited by Shari’a.

Note  Under rule 7.2.1 an Islamic banking business firm must establish and implement policies to ensure that its business is conducted in accordance with Shari’a. The policies must include effective and comprehensive procedures so that the firm complies with Shari’a (in general and in relation to the requirements for Islamic financial contracts) and with the fatwas, rulings and guidelines issued by its Shari’a supervisory board.

10.2.14  Risk management of complex sukuk

(1) For the issuance of complex sukuk structured in the form of convertible sukuk or hybrid sukuk, an Islamic banking business firm must evaluate:
(a) the risks underlying the issuance;
(b) the nature of the contracts or structures being combined; and
(c) any legal risks applicable to the structure.

**Example of legal risk**

risk arising from the interaction between a Shari’a contract and civil law

(2) Other issues that the firm must evaluate include:
(a) whether the underlying assets comply with Shari’a;
(b) the recourse available to holders:
   (i) against the underlying assets;
   (ii) against an obligor such as the issuer or a guarantor; or
   (iii) for asset-based *sukuk*—against the assets or obligors in subparagraph (i) or (ii), or against the originator (who retained legal title to the assets); and
(c) valuation and provisioning required (if necessary) for tranches held by the firm.

**10.2.15 Relation to internal capital adequacy assessment**

An Islamic banking business firm must be able to demonstrate to the Regulatory Authority that the firm’s ICAAP captures the following specific risks relating to securitisation:
(a) credit risk, market risk, liquidity risk and reputation risk for each securitisation exposure;
(b) potential delinquencies and losses on the exposures;
(c) risks arising from the provision of credit enhancements and liquidity facilities; and
(d) risks arising from guarantees provided by monoline insurers and other third parties.
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Division 10.2.D  Credit enhancement

10.2.16  Credit enhancement

(1) Credit enhancement, of sukuk, is the raising of the credit quality of the sukuk above that of the underlying assets. The mechanisms for credit enhancement include:

(a) over-collateralisation;

(b) excess spread;

(c) cash collateral; and

(d) takaful protection.

(2) The purpose of credit enhancement is for the sukuk to obtain higher credit rating from ECRAs (and thereby reduce both the credit risk to the sukuk holders and the funding cost of the securitisation for the originator).

Note  For the use of ECRAs, see rules 4.3.7 and 4.3.8 and Division 10.2.E.

10.2.17  Providing credit enhancement

(1) Credit enhancement in a sukuk structure may be provided:

(a) internally, through an issuer-provided credit enhancement structure such as an excess spread reserve, over-collateralisation or a cash collateral account; or

(b) externally, through a third-party guarantee credit enhancement structure such as takaful or a cash collateral account.

(2) In an issuer-provided credit enhancement, the issuer would provide credit enhancement by assuming part of the credit risk of the underlying assets.

(3) In a third-party guarantee credit enhancement, a party (the guarantor) other than the issuer assumes (indefinitely or for a fixed period) all or
part of the credit risk. The guarantor must not have a right of recourse to the originator.

(4) Unless the terms of the guarantee provide otherwise, a claim must first be made on the underlying assets before any claim is made against the guarantor.

Note For the treatment of credit enhancement provided by sukuk structure, see rule 10.4.5.

10.2.18 Credit enhancement—over-collateralisation

An originator may retain a small equity participation in a pool of securitised assets to provide over-collateralisation.

Example
The originator of a securitisation of a pool of ijarah lease assets might securitise 90% of the pool and retain 10% as an equity position (that is, a residual claim). The sukuk holders would be entitled to income based on 90% of the rental income from the pool, and the originator would be entitled to income based on the remaining 10%.

10.2.19 Credit enhancement—excess spread

(1) Excess spread is the difference between:

(a) the expected periodic net income from the securitised assets; and
(b) the periodic amounts payable to the sukuk holders.

(2) Excess spread may be built into a sukuk structure by the issuer retaining a percentage of the periodic net income if the net income is in excess of the target level of the periodic payments to the sukuk holders. The issuer must keep any amount retained in an excess spread reserve.

(3) If the net income for a period falls below the level required to meet the target level of the payments to the sukuk holders, the issuer may release an amount from the excess spread reserve to make good, in whole or in part, the shortfall.

(4) The issuer must not establish an excess spread reserve unless:

(a) the reserve is disclosed in the transaction documents;
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Rule 10.2.20

(b) a summary of the policies for transferring funds to and from the reserve is included in the transaction documents; and

(c) the firm’s governing body has approved the basis for computing the amounts to be transferred to and from the reserve.

10.2.20 Credit enhancement—cash collateral account

(1) Cash collateral account is a segregated trust account that is funded when a new series of sukuk is issued. The purpose of the account is to cover any shortfall (when the excess spread falls below zero) in the payment of coupons, principal or servicing expenses.

(2) The account may be funded:

(a) by the issuer; or

(b) more commonly, by the originator or another third party through qard.

(3) The pooling and servicing agreements of the sukuk issuance must state the amount of the cash collateral based on a specified percentage of the sukuk issued.

(4) The amount in the account may be invested in high-rated sukuk to generate profits.

10.2.21 Credit enhancement—takaful protection

A third party may provide takaful protection to sukuk holders against losses due to defaults or rating downgrades of sukuk.

Example of default

In ijarah sukuk, non-payment of rentals or redemption price by the lessee (originator).

Note  Takaful protection against losses due to defaults or downgrades is permitted, because it is not a credit default swap in any way. The takaful participants have an insurable interest in the form of their credit exposures.
Division 10.2.E  External ratings

10.2.22  External credit rating agencies

(1) Depending on the securitisation structure, 1 or more ECRAs may be involved in rating the sukuk securitisation. An Islamic banking business firm must use only ECRAs to risk-weight securitisation exposures.

Note  For the use of ECRAs in general, see rules 4.3.7 and rule 4.3.8.

(2) Because investors are not concerned with the credit strength of the originator or issuer in a sukuk securitisation, an ECRA that is rating the sukuk must assess the quality of the underlying pool of assets and the robustness of the structure. In assigning a rating, the ECRA must consider:

(a) the quality of the asset portfolio;
(b) the solvency of the originator or the issuer;
(c) the perfection of the legal structure;
(d) the tax risks;
(e) the title to the securitised assets;
(f) the risks of set-off and prepayment;
(g) the nature and structure of the sukuk.

Note  A change in the rating for a sukuk issue may be due to deterioration in the performance of the collateral, heavy utilisation of credit enhancement or downgrade of a supporting rating (for example, a takaful company that was underwriting takaful on the pool of the assets).

(3) For asset-based sukuk (where only beneficial ownership of the underlying assets is transferred), the rating will depend on a combined view of:

(a) the strength of the rating of the originator or issuer; and
(b) the quality of the asset pool.

10.2.23  Ratings must be publicly available

(1) A credit rating assigned by an ECRA must be publicly available.
(2) The loss and cash flow analysis for the securitisation, and the sensitivity of the rating to changes in the assumptions on which it was made, must also be publicly available.

Guidance

Information required under this rule should be published in an accessible form for free. Information that is made available only to the parties to a securitisation is not considered publicly available.

10.2.24 Ratings must be applied consistently

(1) A credit rating assigned by an ECRA must be applied consistently across a given type of securitisation exposure.

(2) An Islamic banking business firm must not use an ECRA’s (the first ECRA’s) credit rating for 1 or more tranches and another ECRA’s rating for other tranches within the same securitisation structure (whether or not those other tranches are rated by the first ECRA).

Note Under rule 4.3.8:

(a) if there are 2 different assessments by ECRAs, the higher risk-weight must be applied; and

(b) if there are 3 or more different assessments by ECRAs, the assessments corresponding to the 2 lowest risk-weights should be referred to and the higher of those 2 risk-weights must be applied.

10.2.25 Effect of ratings of issuer and issue

If the issuer of sukuk is rated (but the issue is not), any eligible collateral may be used for credit risk mitigation. If the issue is rated, collateral included as part of the sukuk structure must not be used for credit risk mitigation.
**Division 10.2.F  Risk transference, bankruptcy remoteness and credit risk assessment**

**10.2.26 Recognition of risk transference (asset derecognition criteria)**

The originator of a sukuk issuance may exclude, from the calculation of its risk-weighted assets, exposures relating to the securitised assets only if:

(a) the immediate transferee of the underlying assets is an SPE, and the holders of the legal or beneficial interests in the SPE have the right to pledge or exchange such interests without restriction;

(b) substantially all credit risks (and price risk, if any) associated with the securitised assets have been transferred;

(c) the originator has no direct or indirect control over the securitised assets;

(d) the securitised assets are bankruptcy-remote from the originator;

(e) the securitised assets held by the issuer cannot be consolidated with the assets of the originator or the issuer’s parent in case of bankruptcy of any of them;

(f) a qualified legal counsel (whether external or in-house) has given a written reasoned opinion that paragraphs (c) to (e) are satisfied;

(g) clean-up calls:

   (i) must be at the discretion of the issuer;

   (ii) must not provide credit enhancement; and

   (iii) may be exercised only when 10% or less of the purchase consideration for the securitised assets remains to be paid; and

*Note* A clean-up call is an option that permits the securitisation exposures to be called before all of the underlying exposures or securitisation exposures have been repaid.
(h) sukuk holders have a claim only on the securitised assets, and have no claim against the originator.

Note Under rule 10.4.1, an originator that meets the requirements set out in this rule must, however, hold regulatory capital against any exposures that it retains in relation to the securitisation (including exposures arising from the provision of credit enhancements and liquidity facilities).

10.2.27 Conditions for bankruptcy remoteness

(1) The conditions for bankruptcy remoteness include those set out in subrules (2) to (5).

(2) If the issuer becomes bankrupt, the issuer’s assets are to be distributed in accordance with the law or a court order (rather than in accordance with the contractual arrangements involving the issuer).

(3) The transaction documents for the sale of the underlying assets to the sukuk holders must include:

(a) separateness covenants to ensure:
   (i) bankruptcy remoteness of the issuer’s assets; and
   (ii) non-consolidation of the securitised assets held by the issuer with the assets of the originator or the issuer’s parent in case of bankruptcy of any of them;

(b) non-competition declarations under which the investors and the issuer agree that neither will compete against the other in filing for bankruptcy; and

(c) bankruptcy declarations under which the originator, investors, providers of credit enhancements, providers of liquidity facilities and other parties agree not to initiate involuntary bankruptcy proceedings against the issuer.

(4) The issuer must declare, in its constitutional documents and in the transaction documents, not to initiate voluntary bankruptcy proceedings.

(5) The covenants and declarations in this rule must be supported by a written and reasoned opinion of a qualified legal counsel. The legal
opinion must conclude that the covenants and declarations are enforceable.

10.2.28 **Need for credit risk assessment**

1. An Islamic banking business firm must carry out credit risk assessment of its securitisation exposures in accordance with this rule. This rule applies to securitisation exposures in the firm’s banking book and trading book.

2. The firm must, on an ongoing basis, have a clear understanding of the nature and features of each securitisation exposure (including the risk characteristics of the assets underlying the exposure). This requirement applies whether the exposure is on-balance-sheet or off-balance-sheet.

3. Because payments of the principal and profits to sukuk holders depend on the performance of the underlying assets, the firm must assess the performance of the sukuk on an ongoing basis.

   *Note* To properly assess the performance of sukuk, the firm must have on-going and timely access to performance information about the underlying assets. The information should include exposure type, percentage of financing 30, 60 and 90 days past due, default rates, prepayment rates, financings in foreclosure, property type, occupancy, average credit score, progress of underlying project, average financing-to-value ratio, industry diversification and geographic diversification.

4. The firm must, at all times, understand the sukuk’s structural features that may materially affect the performance of its securitisation exposures (such as credit enhancements, liquidity facilities, triggers, and deal-specific definitions of default).

5. While the firm may rely on external credit risk assessments, it must ensure that external assessments do not substitute for the firm’s own due diligence and credit risk assessment.

   *Note* For the use of ECRAs, see rules 4.3.7 and 4.3.8 and Division 10.2.E.

6. If the firm fails to comply with this rule in relation to a securitisation exposure, the Regulatory Authority may direct the firm:

   (a) to apply a risk-weight of 1,250% to the exposure; or
(b) to deduct the amount of the exposure from its regulatory capital.

10.2.29 Capital treatment to be based on economic substance

(1) The capital treatment of a securitisation exposure must be determined on the basis of the economic substance, rather than the legal form, of the securitisation structure. If an Islamic banking business firm is uncertain about whether a transaction is a securitisation, the firm must consult with the Regulatory Authority.

(2) Despite anything in these rules, the Regulatory Authority may look through the structure and economic substance of the transaction, and:

(a) vary the capital treatment of a securitisation exposure; or

(b) reclassify a transaction as a securitisation and impose a capital requirement or limit on the transaction.
Part 10.3  Capital requirements for holdings of sukuk

10.3.1  Rated sukuk

The risk-weights for sukuk rated by an ECRA are those in accordance with table 4.4.7A and table 4.4.7B.

10.3.2  Unrated sukuk

(1) The risk-weights for unrated sukuk (that is, sukuk that are not rated or sukuk that are rated by a rating agency that is not an ECRA) must be determined based on the underlying structure and assets, in accordance with this Part.

(2) For unrated sukuk that use a combination of the Shari’a-compliant contracts, the capital requirement must be calculated taking into account the risk implications of the overall structure and assets.

10.3.3  Sukuk issued by Qatar

Sukuk issued by the State of Qatar or the Qatar Central Bank are subject to a risk-weight of 0%.

10.3.4  Sukuk issued by IILMC

(1) Sukuk issued by the International Islamic Liquidity Management Corporation (or IILMC) must be risk-weighted as if they were claims on short-term banking exposure.

(2) Rated sukuk issued by IILMC are subject to the risk-weights based on their ratings, as set out in table 10.3.4. Unrated sukuk issued by IILMC are subject to 20% risk-weight.
Rule 10.3.5

**Table 10.3.4 Risk-weights for sukuk issued by IILMC**

*Note* In the table, the ratings are given according to Standard & Poor’s conventions. If a claim or asset is not rated by Standard & Poor’s, its ratings must be mapped to the equivalent Standard & Poor’s rating.

<table>
<thead>
<tr>
<th>AAA to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to BB-</th>
<th>B+ to B-</th>
<th>below B-</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>20</td>
<td>50</td>
<td>50</td>
<td>150</td>
</tr>
</tbody>
</table>

**10.3.5 Sukuk awaiting transfer of assets**

For sukuk where the legal transfer of assets has not taken place, the risk-weight is that of the originator (based on the ratings issued by an ECRA), subject to any Shari’a-compliant credit enhancement by the issuer. If the originator is unrated, the risk-weight is 100%.

**10.3.6 Sukuk with combination of assets**

(1) Sukuk comprising a combination of different kinds of assets (such as shares, leasable assets, receivables from murabahah and receivables from salam) must be risk-weighted according to the respective percentages of the assets allocated in the investment.

(2) If the Islamic banking business firm or the Regulatory Authority does not have any reliable information to determine the nature or basis of the underlying assets of the sukuk, a risk-weight of 100% must be applied if the sukuk are listed or 400% if the sukuk are unlisted.

**10.3.7 Salam sukuk**

(1) Salam sukuk represent fractional ownership of the capital of a salam transaction, where the salam capital is constituted by an advance payment to a counterparty as supplier of a commodity (the subject matter) to be delivered at a future date.

(2) The gross return to the sukuk holders consists of the margin or spread between the purchase price of the subject matter and its selling price after delivery.

(3) In some sukuk issues, a third party gives an undertaking that the subject matter will be sold at a price exceeding the purchase price by...
a specified margin. The undertaking may be achieved by means of a parallel salam transaction in which a third party purchases the subject matter for delivery on the same delivery date as in the original salam contract.

10.3.8 Treatment of salam sukuk without parallel salam

(1) The risk-weight for salam sukuk without parallel salam must be based on the counterparty (salam supplier) unless the salam capital is guaranteed by a third party.

(2) If the salam capital is guaranteed by a third party, the risk-weight must be based on the guarantor, but only if the guarantor’s risk-weight is lower than that of the salam supplier. The risk-weight for an unrated salam supplier or an unrated guarantor is 100%.

(3) The market risk capital charge for salam sukuk without a parallel salam contract or other hedge is 15% on the long position of salam exposures (that is, the charge for the underlying salam contract, as set out in rule 6.7.4).

10.3.9 Treatment of salam sukuk with parallel salam

(1) The risk-weight for salam sukuk with parallel salam must be based on the counterparty (salam supplier) unless the salam capital is guaranteed by a third party.

(2) If the salam capital is guaranteed by a third party, the risk-weight must be based on the guarantor, but only if the guarantor’s risk-weight is lower than that of the salam supplier. The risk-weight for an unrated salam supplier or an unrated guarantor is 100%.

(3) A salam sukuk issuance that is structured with an undertaking from the issuer that the underlying commodity will be sold to a third party at a specified selling price (by means of a parallel salam contract) must carry the risk-weight of the third party.

(4) There is no capital charge for market risk that consists of basis and forward gap risks (namely, the risk that the hedge may be impaired because the underlying commodity delivered may be of inferior quality or may be delivered later than the contractual date). This is
because the underlying commodity is normally traded on an exchange that eliminates the risk of late delivery, non-delivery or delivery of a commodity that is of inferior quality.

(5) The capital charge for salam sukuk with a parallel salam contract or other hedge is 15% on the net position of the salam exposures plus 3% on the gross position of those exposures.

### 10.3.10 Istisna sukuk

(1) *Istisna sukuk* represent fractional shares in the financing of a project to construct an asset at a price to be paid in future instalments. The total of those instalments equals the face value of the sukuk plus mark-up.

(2) The sukuk can be in the form of serial notes or certificates with different maturity dates that match the progress schedule of instalments as agreed between the sukuk issuer (as manager on behalf of the sukuk investors) and the construction firm.

### 10.3.11 Treatment of *istisna sukuk* without parallel *istisna*

(1) The risk-weight for istisna sukuk where there is no parallel istisna must be based on the issuer.

(2) If a third party provides a guarantee, the risk-weight for the istisna sukuk must be based on the guarantor, but only if the guarantor’s risk-weight is lower than that of the issuer. The risk-weight for an unrated issuer or an unrated guarantor is 100%.

(3) To account for the price risk to which the underlying istisna is exposed, a risk-weight of 20% must be added in calculating the credit risk capital charge.

(4) A risk-weight of 400% applies if the returns to the sukuk holder come from the cash flow of the underlying asset (for example, a toll road or other infrastructure project).

### 10.3.12 Treatment of *istisna sukuk* with parallel *istisna*

(1) In the case of istisna sukuk with parallel istisna, the relevant asset may be constructed on behalf of an ultimate counterparty or off-taker
with whom the Islamic banking business firm enters into the parallel *istisna* contract. In this case, there is a credit risk exposure to the ultimate counterparty for the payment due under the parallel contract.

(2) The credit risk starts at the commencement of the construction work until the whole amount or all the instalments are paid by the ultimate counterparty.

(3) The risk-weight for the credit exposure must be based on the ultimate counterparty.

(4) If a third party provides a guarantee, the risk-weight must be based on the guarantor, but only if the guarantor’s risk-weight is lower than that of the ultimate counterparty. The risk-weight for an unrated customer or an unrated guarantor is 100%.

(5) A risk-weight of 400% applies if the returns to the *sukuk* holder come from the cash flow of the underlying asset (for example, a toll road or other infrastructure project).

### 10.3.13 *Murabahah sukuk*

(1) In *murabahah sukuk*, the originator (and, in some cases, the issuer) of the *sukuk* is the buyer (on credit) of the *murabahah* asset and the *sukuk* investors are the sellers (on credit) of that asset. The funds provided by the *sukuk* investors (and received by the issuer) represent the *murabahah* selling price of the asset.

(2) The *sukuk* holders own the *murabahah* and are entitled to receive payment of that receivable (the selling price of the asset) either in instalments or in a lump sum at the end of the *murabahah* contract.

### 10.3.14 Treatment of *murabahah sukuk*

(1) The risk-weight for *murabahah sukuk* must be based on the issuer or other obligor (as rated by an ECRA). If the issuer or obligor is unrated, the risk-weight is 100%.

(2) If the *sukuk* structure involves funding of an asset purchase in foreign currency, the relevant exposure must be calculated in accordance with Part 6.2 (foreign exchange risk).
10.3.15 **Ijarah and IMB sukuk**

(1) *Ijarah* and IMB *sukuk* represent the holder’s proportionate ownership in leased assets where the *sukuk* holders collectively assume the rights and obligations of the lessor. The *sukuk* holders are entitled to a share of the lease rentals in proportion to their ownership shares in the leased assets.

(2) As a proportionate owner, an *ijarah* or IMB *sukuk* holder assumes a proportionate share of:
   - any loss, if the leased asset is destroyed; or
   - the cost of meeting the obligation to provide an alternative asset.

   **Note** If the *ijarah* or IMB *sukuk* holders fail to provide an alternative asset if the original leased asset is destroyed, the lessee can terminate the lease without paying future rentals.

10.3.16 **Treatment of Ijarah and IMB sukuk**

The risk-weight for *ijarah* or IMB rentals must be based on the lessee’s counterparty credit risk, because the residual value risk of the underlying asset is not borne by the *sukuk* holders.

10.3.17 **Musharakah sukuk**

*Musharakah sukuk* represent the direct proportionate ownership shares of the holders in the assets of a private commercial enterprise or project, where the subscription money is normally used to purchase non-liquid assets.

   **Note** *Musharakah sukuk* are profit-sharing and loss-sharing instruments where the exposures are of the nature of equity positions in the banking book, except in the case of investments (normally short-term) in assets for trading purposes.

10.3.18 **Treatment of musharakah sukuk**

(1) The treatment of *musharakah sukuk* must be based on the intent of the underlying investments in *musharakah* as set out in this rule.
(2) For a private commercial enterprise that undertakes trading activities, the risk-weight must be as set out in Division 4.5.D (equity-based contracts) and Chapter 6 (market risk).

(3) For a private commercial enterprise that undertakes a business venture or project (other than an enterprise that undertakes trading activities), the risk-weight for equity participation risk in respect of an equity exposure in a business venture or project must be measured according to Division 4.5.D (equity-based contracts) and Chapter 6 (market risk).

(4) For a joint ownership of real estate or movable assets as income-producing musharakah investments with murabahah subcontracts, the risk-weight must be based on the murabahah subcontracts and the counterparties in those contracts.

(5) For a joint ownership of real estate or movable assets as income-producing musharakah investments through leasing to third parties by means of ijarah, the risk-weight must be based on the counterparty (that is, the lessee).

10.3.19 Mudarabah sukuk

(1) In mudarabah sukuk, the sukuk holders subscribe to the certificates issued by a mudarib. The holders share the profits and bear any losses arising from the mudarabah operations.

(2) The returns to the holders depend on the revenue produced by the underlying investment.

10.3.20 Treatment of mudarabah sukuk

(1) The treatment of mudarabah sukuk must be based on the intent of the underlying investments in mudarabah as set out in this rule.

(2) For a private commercial enterprise that undertakes trading activities, the risk-weight must be as set out in Division 4.5.D (equity-based contracts) and Chapter 6 (market risk).

(3) For a private commercial enterprise that undertakes a business venture or project (other than an enterprise that undertakes trading
activities), the risk-weight for equity participation risk in respect of an equity exposure in a business venture or project must be measured according to Division 4.5.D (equity-based contracts) and Chapter 6 (market risk).

10.3.21 **Wakalah sukuk**

1. In *wakalah sukuk*, the *sukuk* holders provide the capital for Shari’a-compliant investment activities, and the investment agent (*wakeel*) undertakes to invest the funds. These *sukuk* entitle the holders to a return in proportion to their investment in the underlying assets and a right (under a purchase undertaking) to buy all or a proportion of the underlying assets if specified conditions are fulfilled.

2. In *wakalah sukuk*, the SPE acting as the principal on behalf of the *sukuk* holders appoints a *wakeel* to invest funds provided by the *sukuk* holders into a pool of assets. The *wakeel* lends its expertise and manages those investments on behalf of the SPE for a particular period, in order to generate a return for the *sukuk* investors.

3. The SPE and the *wakeel* enter into a *wakalah* agreement to govern the appointment, scope of services and fees payable to the *wakeel*, if any.

4. The pool of assets may comprise a broad range of Shari’a-compliant assets that selected by the *wakeel* for a period corresponding to the duration of the *sukuk* (for example, Shari’a-compliant equities, Shari’a-compliant assets such as real estate and cars, *murabahah*, *istisna*, other *sukuk*).

**Note** While the *wakalah* structure has some similarities to the *mudarabah* structure, the ways in which holders receive their share of profits differ:

- *wakalah sukuk* holders receive the return on their investments less the management fees payable to the *wakeel*
- in a *mudarabah* structure, the profits are divided between the parties according to agreed ratios.

10.3.22 **Treatment of wakalah sukuk**

1. The treatment of *wakalah sukuk* must be based on the intent of the underlying investments in *wakalah* as set out in this rule.
(2) For investments in trading activities in foreign exchange, shares or commodities, the risk-weight must be as set out as set out in Division 4.5.F (service-based contracts) and Chapter 6 (market risk).

(3) For investments in assets that can be leased or sold on a *murabahah* basis as income-producing *wakalah* investments with *murabahah* subcontracts, the risk-weight must be based on the *murabahah* subcontracts and the counterparties in those contracts.

(4) For investments in assets that can be leased or sold on a *murabahah* basis as income-producing *wakalah* investments through leasing to third parties by means of *ijarah*, the risk-weight must be based on the counterparty (that is, the lessee).
Part 10.4  
Capital requirements where firm is originator or issuer

10.4.1  Retained securitisation exposures

(1) An Islamic banking business firm that acts as originator of a sukuk issuance may, despite having transferred the underlying assets, continue to be exposed (through retained securitisation exposures) in relation to the securitisation. The firm must hold regulatory capital against all of its retained securitisation exposures.

(2) The sources of retained securitisation exposures include:

(a) investments in the securitisation (including the investment required under subrule (3));

(b) credit enhancements provided by the firm; and

(c) liquidity facilities provided by the firm.

A repurchased securitisation exposure must be treated as a retained securitisation exposure.

Note 1  For paragraph (a), the exposure arising from investments by an Islamic banking business firm in a securitisation originated by the firm is an on-balance sheet exposure.

Note 2  For paragraphs (b) and (c), the exposures arising from the provision of credit enhancements and liquidity facilities by an Islamic banking business firm in relation to a securitisation originated by the firm are off-balance sheet exposures.

(3) An Islamic banking business firm that acts as originator of a sukuk issuance must retain 5% of the total issuance.

10.4.2  Treatment of on-balance sheet retained securitisation exposures

(1) The risk-weighted asset amount of an on-balance sheet retained securitisation exposure is calculated by multiplying the exposure by the applicable risk-weight in table 10.4.2.
Table 10.4.2 Risk-weights based on ECRA rating

*Note* In the table, the ratings are given according to Standard & Poor’s conventions. If a claim or asset is not rated by Standard & Poor’s, its ratings must be mapped to the equivalent Standard & Poor’s rating.

<table>
<thead>
<tr>
<th>long-term rating</th>
<th>securitisation exposure</th>
<th>re-securitisation exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA to AA-</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>A+ to A-</td>
<td>50%</td>
<td>100%</td>
</tr>
<tr>
<td>BBB+ to BBB-</td>
<td>100%</td>
<td>225%</td>
</tr>
<tr>
<td>BB+ to BB-</td>
<td>350%</td>
<td>650%</td>
</tr>
<tr>
<td>B+ and below or unrated</td>
<td>As directed by the Regulatory Authority, apply 1,250% risk-weight or deduct the amount of the exposure from the firm’s regulatory capital (see rule 10.4.2 (2))</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>short-term rating</th>
<th>securitisation exposure</th>
<th>re-securitisation exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>A-1</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>A-2</td>
<td>50%</td>
<td>100%</td>
</tr>
<tr>
<td>A-3</td>
<td>100%</td>
<td>225%</td>
</tr>
<tr>
<td>Below A-3</td>
<td>As directed by the Regulatory Authority, apply 1,250% risk-weight or deduct the amount of the exposure from the firm’s regulatory capital (see rule 10.4.2 (2))</td>
<td></td>
</tr>
</tbody>
</table>

(2) If an exposure is to be deducted from the firm’s regulatory capital, the amount of the deduction may be calculated net of any specific provision taken against the exposure.

10.4.3 **Treatment of off-balance sheet retained securitisation exposures**

For off-balance-sheet retained securitisation exposures, an Islamic banking business firm must apply the relevant credit conversion...
Chapter 10  Treatment of sukuk
Part 10.4  Capital requirements where firm is originator or issuer

Rule 10.4.4

...factor, then must multiply the resulting credit equivalent amount by the applicable risk-weight in table 10.4.2.

*Note* For the treatment of off-balance sheet exposures arising from:

(a) a credit enhancement provided by the firm, see rule 10.4.4;
(b) a credit enhancement provided by *sukuk* structure, see rule 10.4.5; and
(c) a liquidity facility provided by the firm, see rule 10.4.6.

10.4.4 **Treatment of credit enhancement provided by firm that is also originator or issuer**

If an Islamic banking business firm that is the originator or issuer of a *sukuk* issuance also provides credit enhancement in relation to the *sukuk*, the risk-weight of the exposure from the enhancement must be calculated as if the firm were an investor in the *sukuk* securitisation, so that:

(a) if the enhancement is provided in relation to an asset-backed *sukuk* issuance (that is, an issuance where there is transfer of both legal and beneficial ownership over the assets)—the firm must treat the enhancement provided based on the risk of the underlying assets; or

(b) if the enhancement is provided in relation to an asset-based *sukuk* issuance (that is, an issuance where there is transfer of only beneficial ownership over the assets)—the firm must treat the enhancement provided based on the ECRA rating of the firm as originator.

10.4.5 **Treatment of credit enhancement provided by structure**

(1) An exposure in a credit enhancement structure must be risk-weighted as set out in table 10.4.5.
Table 10.4.5 Risk-weights for exposures arising from structure  

*Note* In the table, the ratings are given according to Standard & Poor’s conventions. If a claim or asset is not rated by Standard & Poor’s, its ratings must be mapped to the equivalent Standard & Poor’s rating.

<table>
<thead>
<tr>
<th>AAA to AA-</th>
<th>A+ to A-</th>
<th>BBB+ to BBB-</th>
<th>BB+ to BB-</th>
<th>B+ and below or unrated</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>50</td>
<td>100</td>
<td>350</td>
<td>As directed by the Regulatory Authority, apply 1,250% risk-weight or deduct the amount of the exposure from the firm’s regulatory capital (see rule 10.4.5 (2))</td>
</tr>
</tbody>
</table>

(2) If an exposure is to be deducted from the firm’s regulatory capital, the amount of the deduction may be calculated net of any specific provision taken against the exposure.

10.4.6 Treatment of liquidity facility provided by firm that is also originator or issuer

(1) If an Islamic banking business firm that is the originator or issuer of a *sukuk* issuance also provides a liquidity facility in relation to the *sukuk*, the risk-weight of the exposure from the facility (other than an eligible servicer cash advance facility) must be calculated by:

(a) applying:

(i) a 50% credit conversion factor (regardless of the maturity of the liquidity facility) if the facility provided is an eligible liquidity facility; or

(ii) a 100% credit conversion factor if the facility provided is not an eligible liquidity facility; and
(b) multiplying the resulting credit equivalent amount by the applicable risk-weight in table 10.4.2, depending on the credit rating of the firm (or by 100% if the firm is unrated).

However, if an ECRA rating of the facility is itself used for risk-weighting the facility, a 100% credit conversion factor must be applied.

Note For eligible liquidity facility, see rule 10.4.6 (4).

(2) For an eligible servicer cash advance facility, a zero percent risk-weight must be applied. **Eligible servicer cash advance facility** is a liquidity facility under which the servicer grants, to the SPE, an advance (through an interest-free loan or *qard*) to ensure timely payment to sukuk holders.

Note Shari’a requires that a servicer cash advance facility must remain separate from the sukuk undertaking and that the separation must be properly documented. For servicer, see note 1 (g) and note 3 under rule 10.2.2.

(3) **Liquidity facility**, for sukuk, is a commitment from the facility provider to provide liquid funds if:

(a) funds are needed to meet contractual payments to sukuk holders; and

(b) there is a delay between the date of collection of the related cash flows and the date on which the payment to the sukuk holders is due.

**Example**

Timing mismatches between cash collections from the underlying assets (such as *ijarah* rentals) and the scheduled payments to the sukuk holders in certain sukuk structures may require liquidity facilities to be built into the structures.

(4) To be an **eligible liquidity facility**:

(a) the commitment to provide liquid funds must be in writing and must clearly state the circumstances under which the facility may be availed of and the limits for any draw down;

(b) drawdowns must be limited to the amount that is likely to be repaid fully from the liquidation of the underlying exposures and any seller-provided credit enhancements;
(c) the facility must not cover any losses incurred in the underlying pool of exposures before a drawdown;

(d) the facility must not be structured in such a way that drawdowns are certain;

(e) the facility must be subject to an asset quality test that precludes it from being availed of to cover credit risk exposures that are past due for more than 90 days;

(f) if the exposures that the facility is required to fund are ECRA-rated securities, the facility can only be used to fund securities that are rated, by an ECRA, investment grade at the time of funding; and

(g) the facility cannot be availed of after all applicable credit enhancements (whether transaction-specific or programme-wide enhancements), from which the liquidity would benefit, have been exhausted.
Part 10.5  
**Effect of CRM techniques on capital requirements for sukuk**

10.5.1  
**Capital relief from CRM techniques obtained by firm**

(1) An Islamic banking business firm that has obtained a CRM technique (such as eligible collateral, an eligible credit derivative, a guarantee from an eligible guarantor or an eligible netting agreement) applicable to a securitisation exposure may reduce its capital requirement for the exposure.

(2) Collateral pledged by an SPE as part of the securitisation may be used as a CRM technique if it is eligible collateral.

*Note* For eligible collateral see rules 4.6.8 and 4.6.9.
Chapter 11  Treatment of PSIAs and associated risks

Part 11.1  General

11.1.1  Introduction
(1) Islamic banking business firms typically raise funds through PSIAs, because interest-bearing deposits are not permitted by Shari’a.
(2) This Chapter sets out the treatment of unrestricted PSIAs and the risks (rate of return risk, withdrawal risk and displaced commercial risk) that are associated with PSIAs.
(3) This Chapter also sets out:
   (a) the responsibilities of an Islamic banking business firm as unrestricted PSIA manager;
   (b) the requirements for policies, warnings, terms of business, contracts and financial and other periodic statements in relation to PSIAs; and
   (c) the techniques available to the firm to mitigate the risks associated with PSIAs.

11.1.2  PSIAs
(1) A profit-sharing investment account (or PSIA) is an account, portfolio or fund that satisfies the following conditions:
   (a) it is managed by an authorised firm in accordance with Shari’a and is held out as being Shari’a-compliant;
   (b) under a management agreement with the firm, the IAH concerned and the firm agree to share any profit in a specified ratio and the IAH agrees to bear any loss not caused by the firm’s negligence, misconduct, fraud or breach of contract.

(2) A PSIA may be unrestricted or restricted. An unrestricted PSIA is a PSIA for which the IAHs authorise the PSIA manager to invest the IAHs’ funds in a way that the manager considers appropriate, without
any restriction as to where, how or for what purpose the funds may be invested (provided that the investments are Shari’a-compliant).

(3) A restricted PSIA is one where the IAHs authorise the firm to invest the IAHs’ funds, with specified restrictions as to where, how and for what purpose the funds may be invested.

Note 1  For the treatment of restricted PSIs, see INMA, Chapter 9.

Note 2  For guidance on the treatment of PSIAs as restricted or unrestricted, see paragraphs 12 and 13 of AAOIFI’s Statement of Concepts of Financial Accounting for Islamic Banks and Financial Institutions. See also Appendix D of Financial Accounting Standard FAS 5.

Note 3  In an unrestricted PSIA, the manager can mix the IAHs’ funds with the manager’s own funds or with other funds that the manager has the right to use.

(4) The contractual relationship between an Islamic banking business firm and the IAHs under the PSIA requires the IAHs to bear the commercial risks associated with the assets funded by the PSIA. The firm is responsible for managing the investment of the assets and has the fiduciary duty to safeguard the interest of the IAHs through sound and prudent policies in the management of the assets.

Note  A PSIA is usually offered by the firm on the basis of a mudarabah partnership between the firm as the entrepreneur or mudarib and the IAH as the investor or rabb al-mal.

11.1.3  Powers of Regulatory Authority

Despite anything in these rules, the Regulatory Authority may direct an Islamic banking business firm to treat, or not to treat, an arrangement between the firm and a party (for example, by way of wakalah or musharakah) to be a PSIA.

11.1.4  Role of governing body—PSIAs

(1) An Islamic banking business firm’s governing body must ensure that the firm has policies that enable the firm to prudently manage assets and risks associated with PSIAs.

(2) It is the responsibility of the governing body to provide effective oversight and monitoring to ensure that PSIAs are managed in the
Treatment of PSIAs and associated risks

Chapter 11

General

Part 11.1

Rule 11.1.5

best interests of the IAHs. In particular, the governing body must oversee:

(a) the financing and investment activities undertaken on behalf of IAHs;

(b) the fiduciary duties performed by the firm to ensure that they are in accordance with the terms and conditions of the contracts between the firm and its IAHs; and

(c) the level of reserves, to ensure that the level is appropriate and as fair as possible to existing and new IAHs.

11.1.5 Policies—PSIAs

An Islamic banking business firm’s policies must include the following:

(a) how to ensure that PSIAs are managed in accordance with their IAHs’ instructions;

(b) how to ensure that the funds of each PSIA are invested in accordance with the relevant terms of business;

(c) the priority of the investment of each PSIA owner’s funds and those of the IAHs;

(d) how the interests of the IAHs are safeguarded;

(e) the basis for allocating expenses and profits or losses to IAHs;

(f) how provisions and reserves against equity and assets will be applied;

(g) to whom those provisions and reserves would revert in the event of a write-off or recovery;

(h) how liquidity mismatch will be monitored;

(i) how the value of each PSIA’s assets will be monitored;

(j) how any losses incurred as a result of negligence, misconduct, fraud or breach of contract on the part of the firm will be dealt with;
Chapter 11  Treatment of PSIAs and associated risks
Part 11.1  General
Rule 11.1.6

(k) an acknowledgment of the right of IAHs to monitor the performance of their investments and the associated risks, and how IAHs can exercise that right.

11.1.6  Warnings to investment account holders
An Islamic banking business firm must warn a prospective IAH in writing that:
(a) the IAH bears the risk of loss to the extent of the IAH’s investment; and
(b) the IAH would not be able to recover that loss from the firm, except in the case of negligence, misconduct, fraud or breach of contract on the part of the firm.

11.1.7  Terms of business
An Islamic banking business firm must ensure that the following information is included in the terms of business given to an IAH:
(a) how and by whom the funds of the IAH will be managed and invested;
(b) the PSIA’s investment objectives and details of its policy on diversification;
(c) the basis for allocating profits and losses;
(d) a summary of the policies for valuing the PSIA’s assets;
(e) if the firm uses PER or IRR as a smoothing technique, a summary of the policies for transferring funds to and from the reserve;
(f) particulars of the management of the PSIA;
(g) particulars of the management of any other person to whom the owner has outsourced, or will outsource, the management of the PSIA, including:
   (i) the person’s name;
   (ii) the person’s regulatory status; and
   (iii) details of the arrangement;
(h) details of any arrangement for early withdrawal, redemption or other exit and any costs to an IAH as a result;

(i) confirmation of the IAH’s investment objectives;

(j) whether funds from the PSIA will be mixed with the funds of any other PSIA;

(k) any applicable charges and the basis on which such charges will be calculated;

(l) any fees that the firm can deduct from the profits of the PSIA;

(m) how the IAH can monitor the performance of investments and associated risks.

11.1.8 Form of contracts for PSIAs

(1) The terms and conditions of a contract for a PSIA must be clear, concise and easily understandable by an IAH. The contract must state the type, purpose, terms and period of the contract and the profit-sharing ratio agreed at the time of the opening of the account.

(2) The following must also be stated in the contract:

(a) the rights and liabilities of both parties—in particular, in the circumstances where losses are to be borne by the IAH;

(b) the implications for the IAH of early withdrawal, early redemption or other exit;

(c) the duty of the firm to disclose accurate, relevant and timely information to the IAH on the investment of funds, including its performance, investment strategies, valuation, and frequency of valuation of the PSIA’s assets;

(d) how any losses incurred as a result of negligence, misconduct, fraud or breach of contract on the part of the firm will be dealt with;

(e) how any subsequent changes in the profit-sharing ratio will be disclosed;

(f) any smoothing techniques that the firm uses.
11.1.9 **Financial statements—specific disclosures**

(1) An Islamic banking business firm must ensure that its financial statements contain the following disclosures:

(a) the role and authority of the Shari’a supervisory board in overseeing the firm’s business;
(b) the method used in the calculation of the zakat base;
(c) if zakat has been paid, the amount that has been paid;
(d) if zakat has not been paid, information to allow an IAH or prospective IAH to compute its liability to zakat.

(2) The financial statements must also contain the following disclosures in relation to each PSIA managed by the firm:

(a) an analysis of its income according to types of investments and their financing;
(b) the basis for allocating profits between the owner and the IAHs;
(c) the equity of the IAHs at the end of the reporting period;
(d) the basis for determining any PER or IRR;
(e) the changes that have occurred in any of those reserves during the reporting period;
(f) to whom any remaining balances of any of those reserves is attributable in the event of liquidation.

(3) Any deductions by the firm from its share of income, and any expenses borne by the firm on behalf of the IAHs, as a contribution to the income of IAHs must also be disclosed in the firm’s financial statements if the contribution is significant.

11.1.10 **Periodic statements**

(1) An Islamic banking business firm must give each IAH of a PSIA a periodic statement about the PSIA at intervals stated in the contract or terms of business. The interval must not be longer than 6 months.
(2) The firm must ensure that the periodic statement contains the following information as at the end of the period covered by the statement:

(a) the number, description and value of investments held by the PSIA;
(b) the amount of cash held by the PSIA;
(c) details of applicable charges (including any deductions of fees that the firm is allowed to deduct from the profits of the PSIA) and the basis on which the charges are calculated;
(d) the total of any dividends and other benefits received by the firm for the PSIA;
(e) the total amount, and particulars, of all investments transferred into or out of the PSIA;
(f) details of the performance of the IAH’s investment;
(g) the allocation of profit between the owner and the IAH;
(h) any changes to the investment strategies that could affect the IAH’s investment.

11.1.11 PSIA accounts to be kept separate
An Islamic banking business firm must keep its accounts for unrestricted IAHs separate from accounts for restricted IAHs. The firm must record all its transactions in investments for those accounts separately.
Part 11.2  Rate of return and other risks

11.2.1  Introduction

(1) *Rate of return risk* (or *ROR risk*) is the risk that an increase in benchmark rates may result in IAHs’ having expectations of a higher rate of return. It is the risk of facing a lower rate of return on assets than currently expected by an Islamic banking business firm’s IAHs.

(2) Rate of return risk may result in withdrawal risk and displaced commercial risk. It can give rise to liquidity problems in the firm.

(3) An Islamic banking business firm must manage the expectations of its shareholders and IAHs. If market rates of return of competitors’ IAHs are higher than those of the firm’s IAHs, the firm must evaluate the nature and extent of the expectations of its IAHs and assess the amount of the gap between competitors’ rates and its own IAHs’ expected rates.

11.2.2  Withdrawal risk and displaced commercial risk

(1) Many Islamic banking business firms consider their IAHs as behaving like conventional depositors who might withdraw their funds in the case of lower-than-expected profit rates (*withdrawal risk*). The withdrawal of funds by IAHs can expose a firm to liquidity risk.

(2) Another consequence of rate of return risk may be *displaced commercial risk* (or *DCR*), which is the risk resulting from competitive pressures on a firm to attract and retain IAHs as fund providers. The firm may be under market pressure to pay a return that exceeds the rate that has been earned on assets financed by IAHs when the return on those assets is under-performing compared with competitors’ rates.

*Note 1*  For example, an Islamic banking business firm that acts as *mudarib* for an IAH may give up a part of its *mudarib* share or its profit to the IAH in order to smooth profit payouts. The risk of the firm being obliged to give up the share or profit for commercial or other reasons is a DCR.
Note 2  The term ‘displaced’ is used because, initially, the risk from the volatility of returns is to be borne by the IAH as *rabih-al-mal* but that risk has been displaced onto the firm.

Note 3  If a firm is able to manage the distribution of returns on PSIAs entirely through adjustments to its PER (that is, without having to give up part or all of its *mudarib* share of profits and without making any unilateral transfer to IAHs from the shareholders’ current or retained profits), there is no DCR and there is no requirement for the firm to support an additional capital charge for that risk.

### 11.2.3 Role of governing body—rate of return risk

1. An Islamic banking business firm’s governing body must ensure that the firm’s rate of return risk management policy:
   (a) gives the firm a comprehensive firm-wide view of the significant sources of rate of return risk; and
   (b) is consistent with the firm’s risk profile and systemic importance.

2. The governing body must also ensure that the firm has adequate policies and staff to identify, measure, evaluate, manage and control or mitigate its rate of return risk.

3. The governing body must approve the basis for computing the amounts to be set aside by the firm for the PER or IRR.

4. The governing body must regularly review the firm’s investment policies and the performance of the assets in which IAHs’ funds are invested.

### 11.2.4 Policies—rate of return risk

An Islamic banking business firm’s rate of return risk management policy:

(a) must describe the approach to managing the firm’s rate of return risk and any resulting withdrawal risk or DCR;

(b) must establish procedures to assess:
   (i) the contractual and behavioural maturity profiles of IAHs;
(ii) the impacts of market factors affecting rates of return on assets in comparison with the expected rates of return for IAHs; and

(iii) the effect of the level of the firm’s dependence on current account holders’ funds;

Note Although no returns are expected on current account holders’ funds, the sudden withdrawal of such funds would have an adverse impact on the overall rate of return for the firm.

(c) must state the basis, and procedures, for any decision to give up part or all of its share of profits in favour of IAHs;

(d) must set the firm’s risk tolerance for DCR; and

(e) must include requirements for provisioning, and transfers to and from reserves, in accordance with the agreed contractual terms and conditions for IAHs.

11.2.5 Smoothing techniques

(1) To mitigate withdrawal risk and DCR, an Islamic banking business firm may use one or more of the following techniques. The objective of smoothing techniques is to satisfy and retain fund providers and dissuade them from withdrawing their funds.

Guidance

Even before using smoothing techniques, an Islamic banking business firm is encouraged to employ balance sheet techniques to minimise its exposures to rate of return risk. Examples of the strategies that the firm might use include:

- determining and varying future profit ratios according to expectations of market conditions
- developing new Shari’a-compliant instruments
- issuing securitisation tranches of Shari’a-permissible assets.

(2) The firm may give up part or all of its mudarib share of profits. The decision to give up part or all of its mudarib share of profits in favour of IAHs is a commercial decision.

(3) The firm may make unilateral transfers (by means of hibah) to IAHs from the shareholders’ current or retained profits. Hibah is the
unilateral transfer of ownership of a property or its benefit to another without any counter-value from the recipient.

(4) The firm may establish a profit equalisation reserve (or PER) by setting aside amounts from the investment profits, before allocating the profit between the IAHs and the firm and before calculating its mudarib fees. The PER is to maintain a level of return on investment for IAHs.

Guidance
An Islamic banking business firm should develop and maintain an informed judgement about an appropriate level of the balances of its PER. The nature of the reserve implies that there will be years in which the balance of the reserve will be increased, and others in which it will be depleted.

(5) The firm may establish an investment risk reserve (or IRR) by setting aside amounts from the investment profits of IAHs, after allocating PER (if any) and deducting the firm’s mudarib share of profits and fees. The IRR is to cushion against future investment losses for IAHs and must not be used for any other purpose.

11.2.6 Calculating rate of return

(1) An Islamic banking business firm must use the gapping method to allocate positions into time bands based on remaining maturities or repricing dates.

(2) Fixed-rate and floating-rate assets of the firm must be classified according to their receivable dates because the returns on these receivables represent the IAHs’ direct and beneficial ownership of the assets. Actual cash flows may indicate a gap for a particular time band, affecting the rate of return for that period.

(3) Depending on the nature, scale and complexity of the firm’s business, the firm may employ techniques ranging from simple gap to advance simulation or dynamic approaches to assess future cash flow variability and net income.

Guidance
1 The estimates derived from selected approaches might provide acceptable approximations of periodic future earnings’ variability, and the outcomes would yield different levels of expected returns to IAHs.
Chapter 11  Treatment of PSIAs and associated risks
Part 11.2  Rate of return and other risks

Rule 11.2.7

2 The measurement of rate of return risk highlights the importance of cash flow forecasting for instruments and contracts where the firm is required to simulate and assess their behavioural maturity, underlying assumptions and parameters, which should be reviewed periodically for reliability. The significance of potential threats to future earnings and the usefulness of the resulting information should be considered in determining the type and extent of forecasted behaviour for the firm.

11.2.7 Relation to stress-testing

When carrying out stress-testing or review of stress scenarios, an Islamic banking business firm must take into account the firm’s vulnerability to loss under adverse benchmark rate movements.

11.2.8 Calculation of capital adequacy ratio—no smoothing

If an Islamic banking business firm does not smooth profit payouts to IAHs, the firm’s capital adequacy ratio is calculated by dividing the firm’s regulatory capital by the amount calculated in accordance with the following formula:

\[
\frac{(TRC + TRM + TRO) - (PRC + PRM)}{}
\]

where:

- **TRC** is total risk-weighted assets adjusted for credit risk.
- **TRM** is total risk-weighted assets adjusted for market risk.
- **TRO** is total risk-weighted assets adjusted for operational risk.
- **PRC** is total risk-weighted assets financed by PSIAs, adjusted for credit risk.
- **PRM** is total risk-weighted assets financed by PSIAs, adjusted for market risk.

**Guidance**

If an Islamic banking business firm does not smooth profit payouts to IAHs, the firm is not required to hold regulatory capital against credit or market risks arising from assets funded by the PSIAs. The RWAs funded by such accounts are excluded in respect of those risks in calculating the denominator of the firm’s CAR, leaving only operational risk.
11.2.9 Calculation of capital adequacy ratio—smoothing

If an Islamic banking business firm smooths profit payouts to IAHs, the firm’s capital adequacy ratio is calculated by dividing the firm’s regulatory capital by the amount calculated in accordance with the following formula:

\[(TRC + TRM + TRO) - (PRC^R + PRM^R) - ((1 - \alpha) (PRC^U + PRM^U) - \alpha (PRC^V + PRM^V))\]

where:

- \(\alpha\) represents the proportion of assets funded by unrestricted PSIAs, and is set at 1 by the QFCRA.
- \(TRC\) is total risk-weighted assets adjusted for credit risk.
- \(TRM\) is total risk-weighted assets adjusted for market risk.
- \(TRO\) is total risk-weighted assets adjusted for operational risk.
- \(PRC^R\) is total risk-weighted assets financed by restricted PSIAs, adjusted for credit risk.
- \(PRM^R\) is total risk-weighted assets financed by restricted PSIAs, adjusted for market risk.
- \(PRC^U\) is total risk-weighted assets financed by unrestricted PSIAs, adjusted for credit risk.
- \(PRM^U\) is total risk-weighted assets financed by unrestricted PSIAs, adjusted for market risk.
- \(PRC^V\) is total risk-weighted assets financed by the PER and IRR for unrestricted PSIAs, adjusted for credit risk.
- \(PRM^V\) is total risk-weighted assets financed by the PER and IRR for unrestricted PSIAs, adjusted for market risk.

Guidance

If an Islamic banking business firm smooths profit payouts to IAHs, the firm is required to hold regulatory capital against credit or market risks arising from assets funded by the PSIAs, to cater for DCR. In this approach, credit and market risks of assets financed by unrestricted PSIAs are considered to be borne proportionately by both the IAHs and the firm. Therefore, a proportion of the RWAs funded by unrestricted PSIAs is required to be included in the denominator of the CAR.
Chapter 12  Compliance with Shari’a

12.1.1  Introduction

(1) This Chapter sets out the requirements for an Islamic banking business firm’s compliance with Shari’a in relation to its Shari’a supervisory board, policies, disclosure and reporting obligations, financial communications and reviews.

(2) The components of sound Shari’a governance include:
   (a) competence and independence of the members of the Shari’a supervisory board;
   (b) clear terms of reference regarding board’s mandate, reporting line and responsibility;
   (c) well-defined operating procedures (including confidentiality and consistency, when appropriate);
   (d) clear lines of reporting; and
   (e) good understanding by the members of, and familiarity with, professional ethics and conduct.

12.1.2  Appointment of Shari’a supervisory board

(1) An Islamic banking business firm must have a Shari’a supervisory board that is made up of at least 3 members.

(2) A person must not be appointed as a member of the Shari’a supervisory board unless the person is fit and proper to exercise the functions of such a member. Each member must be capable of exercising strong and independent oversight, and adequate objective judgment, of Shari’a-related matters.

(3) In assessing a person’s fitness and propriety, the firm’s governing body must take into account:
   (a) the person’s good character (honesty, integrity, fairness and reputation);
(b) the person’s competence, diligence, capability and soundness of judgment; and
(c) any other relevant criteria.

(4) The following are not eligible for appointment as a member of the Shari’a supervisory board of an Islamic banking business firm:
(a) a controller (within the meaning of the General Rules 2005) of the firm;
(b) a member of the firm’s governing body.

(5) Any appointment, dismissal or other change of a member of the Shari’a supervisory board must be approved by the firm’s governing body.

12.1.3 Assessing good character

In assessing a person’s good character, the firm’s governing body must consider:

(a) whether the person has been convicted of a criminal offence, particularly an offence relating to dishonesty, fraud or financial crime;
(b) whether the person has been the subject of any adverse findings or any settlement in civil proceedings, particularly in connection with banking or other financial business, misconduct or fraud;
(c) whether the person, or any business in which the person is a controlling shareholder or has a controlling interest or exercises significant influence, has been investigated and disciplined or suspended by a regulatory or professional body, a court or tribunal, whether publicly or privately;
(d) whether the person has been the owner, manager or director of a company, partnership or other entity that has been refused registration, authorisation, membership or a licence to conduct trade, business or profession or has had that registration, authorisation, membership or licence revoked, withdrawn or terminated, resulting in the person being refused the right to
Chapter 12  Compliance with Shari’a

Rule 12.1.4

carry on a trade, business or profession requiring such a licence, registration or other authorisation;

(e) whether the person has been a director, partner or otherwise involved in the management of a business that has gone into receivership, insolvency or compulsory liquidation while the person was connected with that organisation or within 1 year after the person’s departure from the entity;

(f) whether the person has been dismissed, asked to resign, or resigned from employment or from a position of trust, fiduciary appointment or similar position because of questions about honesty and integrity;

(g) whether the person has ever been disqualified from acting as a director or serving in a managerial capacity because of wrongdoing;

(h) whether the person has not been fair, truthful and forthcoming in dealings with customers, superiors, auditors and regulatory authorities in the past and has been the subject of any justified complaint relating to regulated activities;

(i) whether the person demonstrates a readiness and willingness to comply with the requirements and standards of the regulatory system and other legal, regulatory, or professional requirements and standards; and

(j) anything else the firm considers relevant.

12.1.4  Assessing competence

(1) To be eligible for appointment as a member of the Shari’a supervisory board, a person must be able to demonstrate competence and ability to understand the technical requirements of the business, the risks inherent to the firm, and the processes required to conduct the firm’s operations effectively.
(2) In assessing a person’s competence and capability, the firm’s governing body must consider:

(a) whether the person has demonstrated, through qualifications and experience, the capacity to successfully undertake the responsibilities of the position;

(b) whether the person is physically, mentally and emotionally fit to perform the duties of the position;

(c) whether the person has ever been disciplined by a professional, trade or regulatory body, or dismissed or requested to resign from any position or office for negligence, incompetence, fraud or mismanagement;

(d) whether the person has a sound knowledge of the business and the responsibilities of the position; and

(e) anything else the firm considers relevant.

**Guidance**

1. The Regulatory Authority expects an Islamic banking business firm to carry out background checks and verify that a person to be appointed as a member of the firm’s Sharia supervisory board has at least the minimum qualifications and experience set out in Appendix 4 of IFSB 10: Guiding Principles on Shari’a Governance Systems for Institutions offering Islamic Financial Services.

2. So far as possible, the firm should use the fitness and propriety criteria and factors in this Chapter when appointing a person to exercise the Shari’a compliance function and internal Shari’a review function. In addition, the person is expected to have:

- adequate training in Shari’a
- additional qualifications in finance
- good communication skills to enable them to liaise and work effectively with the Shari’a supervisory board
- organisational skills.
12.1.5 Adequate records to be kept

(1) An Islamic banking business firm must maintain records of:
   (a) its assessment of the competence of each member of its Shari’a supervisory board; and
   (b) the terms of appointment of each member;
       for at least 6 years after the person ceases to be a member of the board.

(2) The records of the assessment of the competence of each member must include:
   (a) the factors that have been taken into account when making the assessment;
   (b) the qualifications, skills and experience of the member;
   (c) the basis on which the member has been considered competent; and
   (d) details of any other Shari’a supervisory boards of which the member is, or has been, a member.

12.1.6 Firm’s obligations to Shari’a supervisory board

(1) An Islamic banking business firm must take reasonable steps to ensure that the members of its Shari’a supervisory board are independent of the firm, and not subject to any conflict of interest with it.

Guidance
A Shari’a supervisory board can only be considered independent if none of its members has a blood or close relationship with the firm, the firm’s officers or related parties, that could interfere (or be reasonably perceived to interfere) with the exercise by the board of independent judgment.

(2) The firm and its employees:
   (a) must provide such assistance as the Shari’a supervisory board reasonably requires to perform its duties;
   (b) must give the board right of access at all reasonable times to relevant records and information;
(c) must not interfere with the board’s ability to perform its duties; and
(d) must not provide false or misleading information to the board.

12.1.7 Firm must provide information

(1) If requested by the Regulatory Authority, an Islamic banking business firm must provide the authority with information about the qualifications, skills, experience and independence of the members or proposed members of its Shari’a supervisory board.

(2) The firm must give the Authority full access to the board and relevant staff and records (including internal reviews) in order to monitor compliance with these rules.

12.1.8 Policy and procedures manual

An Islamic banking business firm must maintain a policy and procedures manual that addresses the following matters:

(a) how the compliance oversight function will be exercised in relation to compliance with Shari’a;
(b) how the Shari’a supervisory board will oversee and advise the firm regarding the firm’s business;
(c) how fatwas, rulings and guidelines issued by the board will be recorded, disseminated and implemented;
(d) how an internal Shari’a review will be carried out;

Note For the requirement to carry out an internal Shari’a review, see rule 12.1.12.

(e) how disputes and differences of opinion between the Shari’a supervisory board and the governing body in relation to Shari’a compliance will be addressed;
(f) how significant policies and any changes to them (other than formal changes) are approved;
(g) how information will be disclosed to customers;
Rule 12.1.9
(h) how conflicts of interest and potential conflicts of interest will be identified and managed.

12.1.9 Policies—members of Shari’a supervisory board
An Islamic banking business firm must have policies on:
(a) how appointments, dismissals or changes will be made to the Shari’a supervisory board;
(b) the process by which the eligibility of proposed members will be considered; and
(c) the remuneration of the members.

12.1.10 Disclosures that must be made by Islamic banking business firm
(1) An Islamic banking business firm must disclose to each customer that it is an Islamic banking business firm whose business must be conducted in accordance with Shari’a.

(2) The firm must also disclose:
(a) the names of the members of its Shari’a supervisory board; and
(b) if the customer requests, how reviews to assess the firm’s compliance with Shari’a are carried out, and the frequency of those reviews.

(3) The firm must disclose the information to a customer:
(a) before conducting business with or on behalf of the customer; and
(b) thereafter, whenever the information changes.

Guidance
An Islamic banking business firm may include the information required by this rule in the terms of business provided to customers.

12.1.11 Financial communication
Before an Islamic banking business firm issues a financial communication, it must ensure that, in addition to the information required by CIPR, the communication states which Shari’a
supervisory board reviewed the service or product subject of the communication.

Note For the obligation of the Shari’a supervisory board to review every service or product (and any related document) that is the subject of a financial communication before the communication is issued by the firm, see rule 1.1.15(1) (b). Financial communication is defined in the glossary.

12.1.12 Internal Shari’a reviews

(1) An Islamic banking business firm must from time to time carry out an internal Shari’a review to assess the extent to which the firm complies with Shari’a and with the fatwas, rulings and guidelines issued by its Shari’a supervisory board. The interval between reviews must be determined by the firm’s Sharia supervisory board taking into account the nature, scale and complexity of the firm’s business.

Note Under rule 7.2.1, an Islamic banking business firm’s policies must include effective and comprehensive procedures so that the firm complies with:

(a) Shari’a (in general and in relation to the requirements for Islamic financial contracts); and

(b) the fatwas, rulings and guidelines issued by its Shari’a supervisory board.

(2) The objective of the review is to ensure that the governing body and senior management of the firm carry out their responsibilities in relation to Shari’a (as determined by the firm’s Shari’a supervisory board).

(3) The review must be carried out, in accordance with the AAOIFI standards relating to Shari’a governance, by:

(a) the firm as part of its internal audit function; or

(b) an entity that is competent and independent to do so.

Guidance

1 For the purposes of assessing competency of personnel or entities that carry out the internal Shari’a review, the firm should consult the AAOIFI Standards on Governance (GSIFI No. 3) and Appendix 4 of IFSB 10: Guiding Principles on Shari’a Governance Systems for Institutions offering Islamic Financial Services.
Chapter 12  Compliance with Shari’a

Rule 12.1.13

2 IFSB 3 states that fatwas, rulings, pronouncements and resolutions issued by the Shari’a supervisory board should be strictly adhered to. A person should not be assigned to carry out an internal Shari’a review unless the person:

- is adequately trained in Shari’a compliance
- has a competent grasp of the review process.

(4) The results of each review (including any instance of non-compliance) must be recorded, and the firm must ensure that any non-compliance is, so far as possible, rectified.

(5) The function or entity that carried out the review or reviews during a period must report on its findings in time for the next meeting of the Shari’a supervisory board. If the function or entity did not conduct any review during the period preceding a meeting, it must notify the board of the fact.

12.1.13 Firm must give copy of report

An Islamic banking business firm must give the Regulatory Authority a copy of the report or reports prepared by the firm’s Shari’a supervisory board under rule 1.1.15 (1) (d). The report or reports must be given within 3 months after the day the relevant financial year of the firm ends.

Example

If a financial year of an Islamic banking business firm ends on 31 December in a year, the report of the Shari’a supervisory board must be given to the Regulatory Authority before 1 April in the next year. The Shari’a supervisory board’s compliance report usually forms part of the firm’s Annual Financial Report, but there could also be a second more detailed report of the compliance work undertaken addressed specifically to the Regulatory Authority.
Chapter 13  

13.1.1 Definitions for Chapter 13  

*modification* means a declaration by the Regulatory Authority under FSR, article 16 (1) (a).  

*waiver* means a declaration by the Regulatory Authority under FSR, article 16 (1) (b).  

13.1.2 Authorised firms to remain authorised  

(1) An entity that was an authorised firm immediately before 1 January 2016 continues to be an authorised firm in accordance with this rule.  

(2) An Islamic financial institution that is a deposit-taker is taken to be an Islamic bank.  

(3) An Islamic financial institution that is an Islamic financial manager is taken to be an Islamic bank.  

(4) An Islamic financial institution that is an investment dealer is taken to be an Islamic investment dealer.  

13.1.3 Conditions, modifications and waivers  

Any condition, modification or waiver in relation to an authorised firm to which this Chapter applies continues to have effect according to its terms.  

13.1.4 Powers of Regulatory Authority not diminished  

Nothing in this Chapter prevents the Regulatory Authority from withdrawing a firm’s authorisation or revoking a condition, waiver or modification.
### Glossary

(see r 1.1.3)

#### Part 1

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Part 2  Definitions

**absolute value** of a number means the value of the number irrespective of sign.

**accounting standards** include accounting rules, principles, practices and conventions.

**additional tier 1 capital** has the meaning given by rule 3.2.10.

**affiliate**, of a party, means any entity of which the party holds 10% or more, but less than a majority, of the voting power.

**approved website** means a website that is approved under the Interpretation and Application Rules 2005, rule 3.1.2.

**authorisation** means an authorisation granted under FSR, Part 5.

**authorised firm** (or **firm**) means a person that has an authorisation.

**base capital requirement** has the meaning given by rule 3.2.4.

**Basel III LCR**: see Part 8.4, note.

**Basel Accords** is the collective name for Basel I, Basel II and Basel III, which are a set of reform measures issued by the Basel Committee on Banking Supervision to improve the regulation, supervision, risk management and capital adequacy of financial institutions.

**branch** means the local office in the QFC of a legal person incorporated outside the QFC.

**business day** means a day that is not a Friday, a Saturday, or a public or bank holiday in Qatar.

**capital adequacy ratio** has the meaning given by rule 3.2.6.

**capital conservation buffer** has the meaning given by rule 3.3.1 (2).

**capital relief** is the reduction, in the credit risk capital requirement for an exposure, obtained from the use of a CRM technique.

**cash collateral** has the meaning given by rule 4.6.10.

**commodity murabahah transaction** (or **CMT**) has the meaning given by rule 1.3.6 (2).
**common equity tier 1 capital** (or **CET 1 capital**) has the meaning given by rule 3.2.8.

**compliance oversight function** has the same meaning as in CTRL.

**connected**, in relation to a party, has the meaning given by rule 5.1.3.

**corporate group** has the meaning given by rule 9.1.2 (1).

**counter-cyclical capital buffer** has the meaning given by rule 3.3.1 (3).

**counterparty** means any person with or for whom an Islamic banking business firm conduct, or intends to conduct, Islamic banking business, Islamic investment business or associated business.

**credit enhancement**, of **sukuk**, has the meaning given by rule 10.2.16.

**credit risk** has the meaning given by rule 4.1.2.

**credit risk capital requirement** means the amount of capital that an Islamic banking business firm must have to cover its credit risk.

**customer** means a person to whom an Islamic banking business firm provides, has provided or offers to provide a service or product, and includes a business customer of the firm (within the meaning given in CIPR).

**day** means a period of 24 hours starting at midnight.

**displaced commercial risk** (or **DCR**) has the meaning given by rule 11.2.2 (2).

**eligible collateral** means collateral that complies with the requirements in rule 4.6.8 or rule 4.6.9.

**eligible guarantor** has the meaning given by rule 4.6.16.

**eligible netting agreement** has the meaning given by rule 4.6.19.

**entity** means any kind of entity, and includes, for example, any person.

**equity participation risk** has the meaning given by rule 1.3.24 (1).

**excess spread** has the meaning given by rule 10.2.19.

**executive governance function** has the same meaning as in CTRL.
exercise control: an entity (entity A) exercises control over another (entity B) if:

(a) entity A holds 10% or more of the shares of entity B, or is entitled to exercise or control the exercise of 10% or more of the voting power in entity B;

(b) entity A holds 10% or more of the shares in a parent entity of entity B or is entitled to exercise or control the exercise of 10% or more of the voting power in a parent entity of entity B; or

(c) entity A is able to exercise significant influence over the management of entity B or a parent entity of entity B because of entity A’s shareholding or voting power, or by contractual or other arrangements.

exposure means the maximum loss that an Islamic banking business firm might suffer as a result of the default or failure of a counterparty, connected counterparties, issuer or connected issuers.

external credit rating agency (or ECRA) means:

(a) Moody’s Investors Service;

(b) Fitch Ratings;

(c) Standard & Poor’s;

(d) a rating agency that is affiliated with one of the agencies mentioned in paragraphs (a) to (c);

(e) Islamic International Rating Agency, B.S.C; and

(f) any other agency approved by the Regulatory Authority.

finance function has the same meanings as in CTRL.

financial communication, by an Islamic banking business firm, means any communication (made through any medium including brochures, telephone calls and presentations) the purpose or effect of which is:

(a) to promote or advertise the firm’s services or products; or

(b) to invite or induce any person to enter into an agreement with any person in relation to those services or products.
**Glossary**

**financial group** has the meaning given by rule 9.1.2 (2).

**governing body** of an entity means its board of directors, committee of management or other governing body (whatever it is called).

**home jurisdiction**, for an entity, means the jurisdiction where the entity’s authorisation or licence was granted.

**home regulator**, for an entity, means the financial regulator in the jurisdiction in which the entity’s authorisation or licence was granted.

**IFSB–12**: see Part 8.4, note.

**IFSB GN 6**: see Part 8.4, note.

**ijarah muntahia bittamleek** (or **IMB**) has the meaning given by rule 1.3.13.

**impaired credit** has the meaning given by rule 4.3.5 (1).

**internal audit function** has the same meaning as in CTRL.

**internal capital adequacy assessment process** (or **ICAAP**) has the meaning given by rule 3.1.5.

**investment grade** means a rating of at least BBB- or equivalent.

**investment risk reserve** (or **IRR**) has the meaning given by rule 11.2.5 (5).

**investments** includes Islamic investments.

**Islamic bank** has the meaning given by rule 1.1.7.

**Islamic banking business** has the meaning given by rule 1.1.5.

**Islamic banking business firm** has the meaning given by rule 1.1.9.

**Islamic financial contract** includes the contracts for raising funds or providing financing in a Shari’a-compliant manner described in Part 1.3.

**Islamic financial institution** means an authorised firm whose authorisation includes a condition that the whole of the firm’s business must be conducted in accordance with Shari’a.

**Islamic investment business** has the meaning given by rule 1.1.6.

**Islamic investment dealer** has the meaning given by rule 1.1.8.
Islamic investments has the meaning given by rule 1.1.6 (2).

jurisdiction means any kind of legal jurisdiction, and includes, for example:
(a) the State of Qatar;
(b) a foreign country (whether or not an independent sovereign jurisdiction), or a state, province or other territory of such a foreign country; and
(c) the QFC or a similar jurisdiction.
large exposure has the meaning given by rule 5.3.1.
legal person means an entity (other than an individual) on which the legal system of a jurisdiction confers rights and imposes duties, and includes, for example, any entity that can own, deal with or dispose of property.

liquidity facility, for sukuk, has the meaning given by rule 10.4.6 (3).
liquidity risk has the meaning given by rule 8.1.1 (3).
mark-to-market has the meaning given by rule 6.1.10 (1).
mark-to-model has the meaning given by rule 6.1.11 (1).
minimum capital requirement has the meaning given by rule 3.2.3 (2).
monetise means convert into cash (whether by sale, repo or in any other way).
month means calendar month—that is, the period beginning at the start of any day of one of the 12 named months of the year and ending:
(a) at the end of the day before the corresponding day of the next named month; or
(b) if there is no corresponding day—at the end of the last day of next named month.
murabahah for purchase orderer contract (or MPO contract) has the meaning given by rule 1.3.4.

parent entity, for a legal person (A), means any of the following:
(a) a legal person that holds a majority of the voting power in A;
(b) a legal person that is a member of A (whether direct or indirect, or though legal or beneficial entitlement) and alone, or together with 1 or more legal persons in the same corporate group, holds a majority of the voting power in A;

(c) a parent entity of any legal person that is a parent entity of A.

Note Legal person and corporate group are defined in this glossary.

definition:

person means:

(a) an individual (including an individual occupying an office or position from time to time); or

(b) a legal person.

potential future credit exposure has the meaning given by rule 4.4.11 (3).

problem asset has the meaning given by rule 4.1.3 (3).

profit equalisation reserve (or PER) has the meaning given by rule 11.2.5 (4).

profit-sharing investment account (or PSIA) has the meaning given by rule 11.1.2.

profit rate risk in the trading book has the meaning given by rule 6.6.1

qard has the meaning given by rule 1.3.25.

rate of return risk (or ROR risk) has the meaning given by rule 11.2.1 (1).

recognised exchange means an exchange set out in Schedule 1 or in a notice published by the Regulatory Authority on an approved website.

regulated activity means an activity that is a regulated activity under FSR.

Regulatory Authority means the Qatar Financial Centre Regulatory Authority.

regulatory capital has the meaning given by rule 3.2.7.
related party, of an Islamic banking business firm, has the meaning given by rule 4.8.3.

restricted PSIA has the meaning given by rule 11.1.2 (2).

retained securitisation exposure has the meaning given by rule 10.4.1.

risk-based capital requirement has the meaning given by rule 3.2.5.

risk management function has the same meanings as in CTRL.

Rules means rules made by the Regulatory Authority under FSR, article 15 (1), and includes:

(a) any standard, principle or code of practice made by the authority; and

(b) any other instrument made or in force under any Rules.

senior executive function has the same meanings as in CTRL.

Shari’a supervisory board, of an Islamic banking business firm, means the board appointed for the firm under rule 12.1.2.

special purpose entity or SPE has the meaning given by rule 10.2.7.

subsidiary: a legal person (A) is a subsidiary of another legal person (B) if B is a parent entity of A.

sukuk has the meaning given by rule 10.1.2.

tawarruq has the meaning given by rule 1.3.6 (1).

terms of business (of an Islamic banking business firm for a customer) means a statement or statements in writing of the terms on which the firm will conduct business with or for the customer.

tier 2 capital has the meaning given by rule 3.2.12.

total risk-weighted assets has the meaning given by rule 3.2.1 (2).

unrestricted PSIA has the meaning given by rule 11.1.2 (2).

withdrawal risk has the meaning given by rule 11.2.2 (1).

writing means any form of writing, and includes, for example, any way of representing or reproducing words, numbers, symbols or
anything else in legible form (for example, by printing or photocopying).
Endnotes

1 Abbreviation key

a = after         ins = inserted/added
am = amended      om = omitted/repealed
amdt = amendment  orig = original
app = appendix    par = paragraph/subparagraph
art = article     prev = previously
att = attachment  pt = part
b = before        r = rule/subrule
ch = chapter      renum = renumbered
def = definition  reloc = relocated
div = division    s = section
g = guidance      sch = schedule
glos = glossary  sdiv = subdivision
hdg = heading     sub = substituted

2 Rules history

Islamic Banking Business Prudential Rules 2015

made by

Islamic Banking Business Prudential Rules 2015 (QFCRA Rules 2015-2)
Made 13 December 2015
Commenced 1 January 2016
Version No. 1

as amended by

Islamic Banking Business Prudential (Securitisation) Amendments Rules 2017 (QFCRA Rules 2017–1, sch 1 and sch 2)
Signed 29 March 2017
Commenced 1 April 2017
Version No. 2
Islamic Banking Business Prudential (Liquidity Risk and Miscellaneous) Amendments Rules 2018 (QFCRA Rules 2018–2, sch 1)
Signed 25 March 2018
Commenced 1 May 2018
Version No. 3

Miscellaneous Amendments Rules 2019 (QFCRA Rules 2019–1, sch 5)
Made 26 March 2019
Commenced 28 March 2019
Version No. 4

Islamic Banking Business Prudential Rules 2015 (QFCRA Rules 2019–4, sch 2, pt 2.2)
Made 26 March 2019
Commenced 01 January 2020

and

Islamic Banking Business Prudential (Leverage Ratio) Amendments Rules 2019 (QFCRA Rules 2019-7, sch 1)
Made 26 June 2019
Commenced 01 January 2020
Version No. 5

3 Amendment history

References to particular currencies
r. 1.1 3A ins Rules 2019-7

Application of these Rules—General
r 1.1.11 g am Rules 2019-4

Accounts and statements to use international standards
r 2.1.6 am Rules 2019-1

References to particular currencies and ratings
r 3.1.7 om Rules 2019-7

Criteria for inclusion in additional tier 1 capital
r 3.2.11 am Rules 2017-1
r 3.2.11 n am Rules 2017-1

Criteria for inclusion in tier 2 capital
r 3.2.13 am Rules 2017-1
r 3.2.13 n am Rules 2017-1
Endnotes

Treatment of third party interests from SPEs
r 3.2.21 hdg sub Rules 2017-1
r 3.2.21 am Rules 2017-1

Capital conservation ratios
r 3.3.3 am Rules 2018-2

Leverage ratio
pt 3.4 sub Rules 2019-7

Calculating total risk-weighted items
r 4.4.7 am Rules 2018-2

Calculating specific risk capital charge
r 6.6.4 am Rules 2018-2

Liquidity risk
ch 8 sub Rules 2018-2

Liquidity conversion factors for liquefiable asset
r 8.5.9 table B am Rules 2019-1

Introduction
r 10.1.1 sub Rules 2017-1

Sukuk
r 10.1.2 ins Rules 2017-1

Tradeability of sukuk
r 10.1.3 ins Rules 2017-1

Categories of sukuk according to ownership of assets
r 10.1.4 ins Rules 2017-1

Securitisation and re-securitisation
pt 10.2 sub Rules 2017-1

Capital requirements for holdings of sukuk
pt 10.3 hdg sub Rules 2017-1

Wakalah sukuk
r 10.3.21 ins Rules 2017-1

Capital requirements where firm is originator or issuer
pt 10.4 ins Rules 2017-1

Effects of CRM techniques on capital requirements for sukuk
pt 10.5 ins Rules 2017-1

Financial Communication
r 12.1.11 am Rules 2019-4
Glossary, Part 1
am Rules 2017-1; Rules 2018-2; Rules 2019-4

Glossary, Part 2
def *Basel III LCR* ins Rules 2018-2
def *credit enhancement* ins Rules 2017-1
def *customer* sub Rules 2019-4
def *day* ins Rules 2018-2
def *excess spread* ins Rules 2017-1
def *executive governance function* am Rules 2018-2
def *home jurisdiction* sub Rules 2018-2
def *home regulator* ins Rules 2018-2
def *IFSB–12* ins Rules 2018-2
def *IFSB GN 6* ins Rules 2018-2
def *liquidity facility* ins Rules 2017-1
def *monetise* ins Rules 2018-2
def *operating entity* om Rules 2018-2
def *qard* ins Rules 2017-1
def *retained securitisation exposure* ins Rules 2017-1
def *special purpose entity* or *SPE* ins Rules 2017-1
Endnotes

\textit{def sukuk} sub Rules 2017-1