



ISLAMIC FINANCIAL
SERVICES BOARD

The Islamic Financial Services Board: Setting Standards for Islamic Finance

The IAASB Consultative Advisory Group Meeting

Date : 7-8 March 2017

Venue : New York, USA

OUTLINE

1

Overview of the IFSB and its Mandate

2

Recent Developments in Islamic Finance

3

Islamic Finance: Regulatory Challenges

4

Implementation of IFSB Standards

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IFSB Strategic Performance Plan 2016-2018

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Going Forward: New Challenges

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Going Forward: New Challenges

THE IFSB IS BASED IN MALAYSIA



We were established in 2003. Visit by IMF's Deputy Managing Director, Mr. Mitsuhiro Furusawa last week.

Sasana Kijang, Bank Negara Malaysia, where the IFSB is based.



IFSB PROMOTES SOUNDNESS AND STABILITY

- Serves as an international standard-setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital market and *Takāful*

OBJECTIVES

- **Develop** standards & **recommend** implementation
- **Provide guidance** on effective supervision and regulation & develop risk management & disclosure criteria
- Establish **cooperation with international standard-setting bodies** & member countries
- Enhance and coordinate initiatives to **develop instruments & procedures for efficient operation** & risk management
- Encourage cooperation among member countries
- Facilitate **capacity-building** & development of human capital
- Undertake research
- Establish database

- To this end, the work of the IFSB complements those of BCBS, IOSCO and IAIS



INTERNATIONAL MEMBERSHIP

The IFSB's members have increased from 9 in 2003 to 188 members as of December 2016

<i>By membership type</i>	<i>Total</i>
Full Members	31
Associate Members	22
Observer Members	125
	188

<i>By organisational demarcation</i>	<i>Total</i>
Regulatory/ supervisory authorities	70
Inter-governmental organizations	8
Financial institutions & professional firms	106
Self-regulatory organizations	4
	188

Bank of England
joined the IFSB as
an Associate
member.

Second supervisory
authority from
Europe after
**Banque Centrale
du Luxembourg**

IFSB'S KEY GOAL: CONSISTENCY IN REGULATION AND SUPERVISION

Unifying Themes

New Standards supporting **orderly development of Islamic finance** at national level benchmarked against comparators

Implementation of harmonised or common set of prudential Standards for **resilient cross border growth**

Facilitating Islamic finance's **integration into the global economy** and global financial stability surveillance framework

COLLABORATION WITH GLOBAL COUNTERPARTS



Basel Committee
on Banking Supervision

- **IFSB Is a member of the Basel Consultative Group**
 - Provides feedback on global regulatory developments
 - Submitted Note on Impact of Liquidity Reforms on IIFS on LCR (2012); NSFR (2014); Credit Risk (2016)
- **BCBS' participation in the IFSB's Working Groups**
 - Special Issues in Capital Adequacy (2008-2009)
 - Core Principles for Islamic Finance Regulation- Banking (2012-2014)



IAIS

INTERNATIONAL ASSOCIATION OF
INSURANCE SUPERVISORS

A **joint paper** with IAIS on Insurance Core Principles and the *Takāful* Sector (2006)

A **joint project** on *Microtakāful* published in November 2015



IOSCO

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

An ongoing **joint collaboration** with IOSCO on transparency and disclosure in Islamic capital markets launched in 2012



International
Federation
of Accountants

IFSB collaborating with IFAC on raising awareness of Islamic finance
IFSB is an active member of CAGs of IAASB and IESBA

IFSB & AAOIFI: COMPLEMENTARY MANDATES

IFSB's Mandate

Prudential standard setter across three sectors – Islamic banking, Takaful (Islamic insurance) and Islamic Capital Market

Facilitate Implementation of Standards and Capacity Building: Workshops, Technical Assistance and Annual Implementation Surveys

Promote Cross Border Cooperation on stability and resilience issues: Publications and awareness building

IFSB & AAOIFI have issued complementary standards on transparency, disclosure and consumer protection for risk sharing investment account holders

Both IFSB & AAOIFI are members of IASB's Consultative Advisory Group on Islamic Finance.

AAOIFI's Mandate

Development of accounting and auditing Standards relevant to Islamic Finance activities

Dissemination of accounting and auditing standards through trainings, seminars and certificate programmes

Prepare Shari'ah standards on Islamic finance products

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WIDENING INTEREST IN ISLAMIC FINANCE IN RECENT YEARS



Sovereign *Sukūk* issuances by UK, Luxembourg, Hong Kong, South Africa etc.



UK government establishes Global Islamic Finance and Investment Group - London as IF global hub (*IFSB is a member*).

Bank of England joins IFSB (2015).

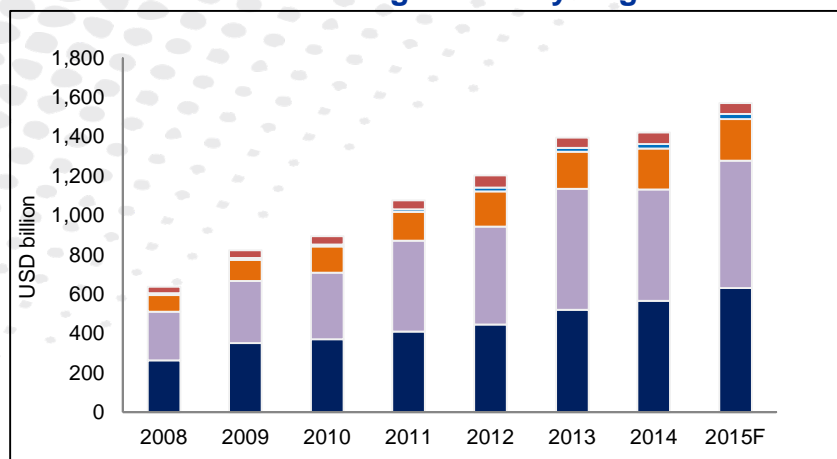


Press Release 21 February 2017: Board will consider adopting IFSB Core Principles as a global standard under IMF/WB Standards and Codes Review

IMF External Advisory Group (EAG) on Islamic Finance (*IFSB is a member*).

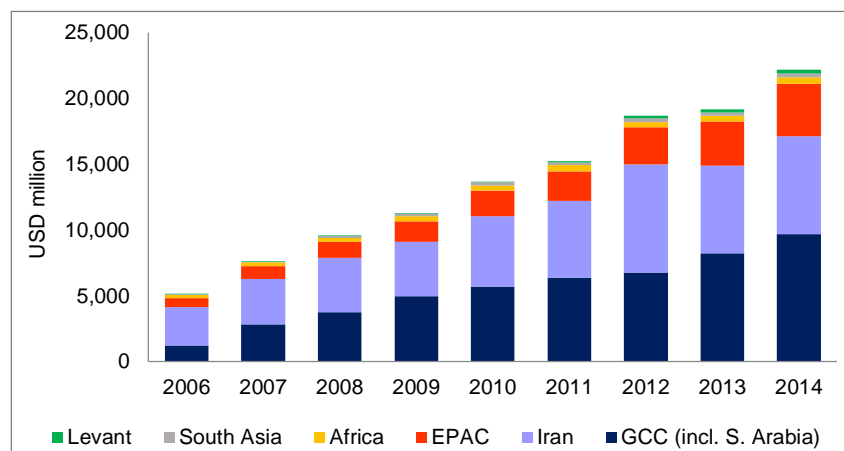
REFLECTS RAPID GROWTH OF ISLAMIC FINANCE ...

Islamic Banking Assets by Region



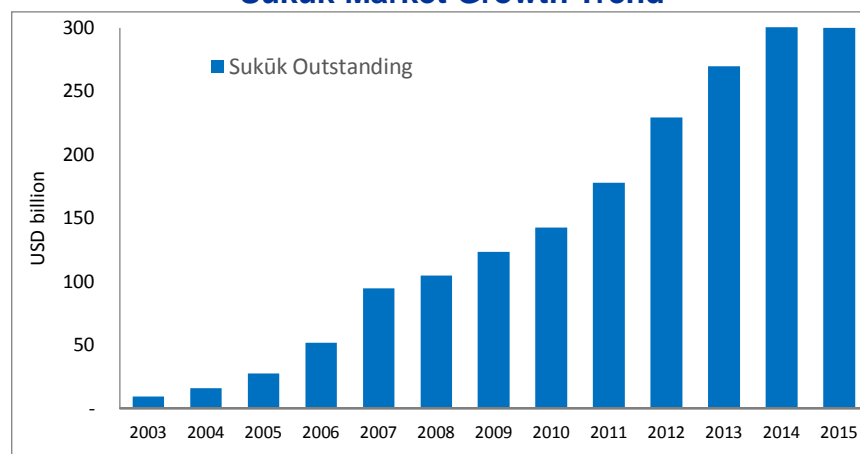
Note: The Islamic banking sector expanded at a CAGR of 14.4% during 2008-2014. The annual growth rate in 2009 is particularly high as many new Islamic banks / subsidiaries were set up at this time.

Takāful Gross Contributions



Note: Total *Takāful* contributions reached at USD22.1 bln in 2014.

Sukuk Market Growth Trend



Note: *Sukūk* outstanding grew at a CAGR of 16.1% during 2008-2015.

Islamic Financial Assets by Region (USD bln)

Region	Banking Assets	Sukūk Outstanding	Islamic Funds Assets	Takāful Contribution
Asia	209.3	174.7	23.2	5.2
GCC	598.8	103.7	31.2	10.4
MENA (exc. GCC)	607.5	9.4	0.3	7.1
Sub-Saharan Africa	24	0.7	1.4	0.5
Others	56.9	2.1	15.2	--
Total	1,496.5	290.6	71.3	23.2

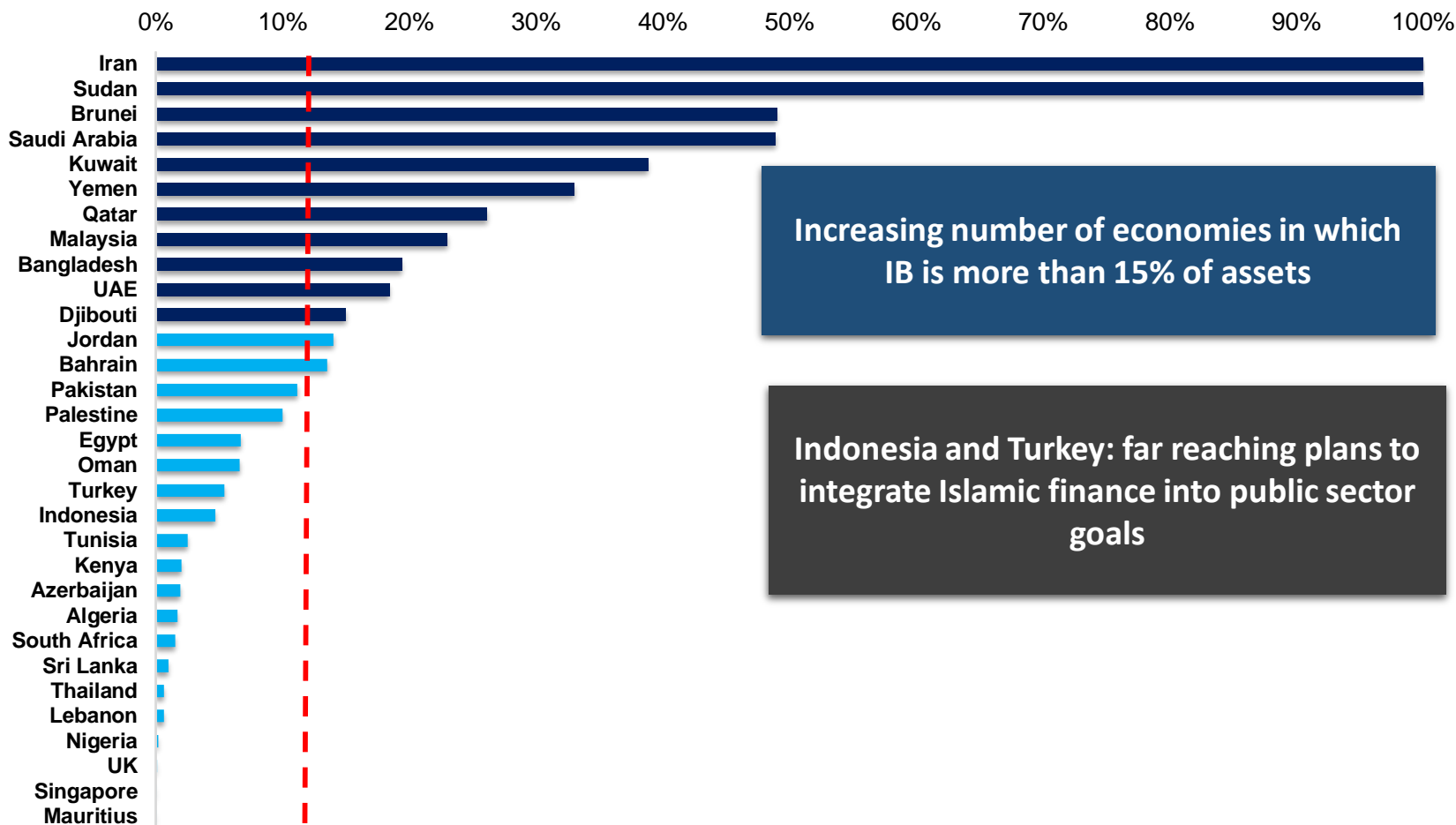
Note: Data for banking and *Takāful* is as of 1H2015 while *Sukūk* and funds as of 11M15.

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... EMERGENCE OF SYSTEMIC IMPORTANCE IN SOME VERY DIVERSE ECONOMIES

Islamic Banking Share in Total Banking Assets by Jurisdiction (1H2015)



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ISLAMIC FINANCE: REAL ECONOMY, ETHICAL CONDUCT, SOCIAL RESPONSIBILITY

Overarching Principles (Islamic Law)

- Towards achieving the objectives of :
 - High ethical values - justice, fairness, trust, honesty and integrity
 - More equitable distribution of wealth
 - Principle of stewardship

Materiality and Validity of Transactions

- Economically productive underlying activities
- Avoidance of interest-based transactions
- No involvement in illegal and unethical activities
- Avoidance of gambling, and excessive uncertainty and speculation



Embedded Governance

Materiality and Validity of Transactions

- Entitlement of profit contingent upon risk taking
- Sharing of risks – emphasis on equity
- Honouring both substance and form of contract



Disclosure and Transparency



ISLAMIC FINANCE: DISTINCTIVE ASPECTS

A distinctive approach serves financial and social stability



Profit sharing, loss bearing investment accounts in banks

Risk sharing financing infrastructure + housing

Insurance based on risk sharing, not premiums

Voluntary exclusion from formal interest based financial system

ISLAMIC BANKS EMBODY IF PRINCIPLES...BUT RISK MANAGEMENT A CHALLENGE

RESILIENCE

Robust financing: High quality loss absorbent capital (Tier 1 common equity) +Capital adequacy above regulatory requirements

Cautious conduct – lack of exposure to toxic mortgage securities prior to global financial crisis

All products and activities reviewed by Shariah Advisory Committee – an internal audit function

Highly liquid assets – mainly cash – reflecting underdeveloped IF financial markets and investment opportunities. Adverse risk management & profitability implications

- New BASEL requirements for high quality capital similar to IF. But BASEL standards for high quality liquid assets (HQLA) following global financial crisis (LCR, NSFR) pose challenges to IF because of underdeveloped markets and lack of tradable securities.
- Need for regular sovereign *Sukūk* issuances + by Central banks – would provide more *Shari'ah*-compliant short-term liquid instruments; interim options under BASEL alternative liquidity approaches (ALA) - central bank lines of credit.

KEY LEGAL & REGULATORY CHALLENGES

Overarching issue: IF contracts involve both Islamic and secular law: ramifications for introduction of IF + its regulation and supervision; sources of law and governing law will shape strategy

Applying capital and liquidity standards to Islamic banks: numerous IFSB standards

Investment accounts – systemic challenges: IFSB standards covering transparency, measurement, calibration; need for consistent application

Shari'ah governance: IFSB standard is a benchmark; but leaves room for differences of view on law

Financial safety nets; LOLR + SCDIS; Insolvency law and its application to Islamic finance

ADDRESSING THE CHALLENGES: THE IFSB'S STANDARDS + RESEARCH



Banking sector Standards first; gradual expansion to other sectors



Post crisis: alignment with Basel III + Core Principles + Soundness Indicators



New programme of 8 standards for 2016 -18



Research to support key issues: Safety Net + Resolution/AMLFT/Macroprudential

IFSB STANDARDS: INITIAL FOCUS ON BANKING THEN EXPANDED COVERAGE



18
Standards

6
Guidance
Notes

2 Technical
Notes

Banking

Pre-Crisis

IFSB-1: Risk Management

IFSB-2: Capital Adequacy

IFSB-3: Corporate Governance for IIFS

IFSB-4: Transparency & Market Discipline

IFSB-5: Supervisory Review Process

IFSB-7: Special Issues in Capital Adequacy

Post-Crisis

IFSB-12: Liquidity Risk Management

IFSB-13: Stress Testing

IFSB-15: Revised Capital Adequacy Standard

IFSB-16: Revised Supervisory Review Process

IFSB-17: Core Principle for Islamic Banks

GN-6: Quantitative Measures for Liquidity Risk

Capital Market

IFSB-6: Governance of Islamic CIS

Takaful

IFSB-8: Corporate Governance for Takaful

IFSB-11: Solvency for Takaful Undertakings

IFSB-14: Risk Management for Takaful

IFSB-18: Guiding Principles on Retakaful

Cross-sector

IFSB-9: Conduct of Business

IFSB-10: *Shari'ah* Governance System

Expected New Standards

Apr-2017

Disclosure Requirements ICM Products

MAJOR FOCUS ON CAPITAL, IAH + NEW ISSUES

Published Guidance Notes

Mar 2008	←	GN-1: Capital Adequacy (Credit Ratings Assessments)
Dec 2010	⎵	GN-2: Capital Adequacy (Commodity <i>Murabahah</i> Transactions)
		GN-3: Smoothing the Profits Payout to IAH
Mar 2011	⎵	GN-4: Capital Adequacy (Determination of Alpha Factor)
		GN-5: Takaful and <i>Retakaful</i> (Credit Ratings Assessments)
April 2015	←	GN-6: GN on Quantitative Measures for Liquidity Risk

Published Technical Notes

Mar 2008	←	TN-1: Issues in Strengthening Liquidity Management of Institutions Offering IFS
Dec 2016	←	TN-2: Stress Testing for Institutions Offering Islamic Financial Services (IIFS)

Published Research

April 2014	←	WP-01: WP on Strengthening the Financial Safety Net: Role of SLOLR Facilities
Nov 2014	←	WP-02: WP on Evaluation of Core Principles Relevant to IF Regulation
Oct 2015	⎵	WP-03: WP on Financial Consumer Protection in Islamic Finance
		WP-04: Comparative Study on the Implementation of Selected IFSB Standards
Mar 2016	⎵	WP-05: WP on <i>Shari'ah</i> Non-Compliance Risk in the Banking Sector
		WP-06: WP on Strengthening the Financial Safety Net: The Role of SCDIS

Banking

Takaful

Cross-sector

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ACCELERATING THE EFFECTIVE IMPLEMENTATION OF IFSB STANDARDS

Implementation Is Accelerating – Challenge And Opportunity...

IFSB Standards as benchmark to promote
consistent regulatory and supervisory
practices



Helps identify constraints and challenges
through Implementations Surveys, QIS etc.



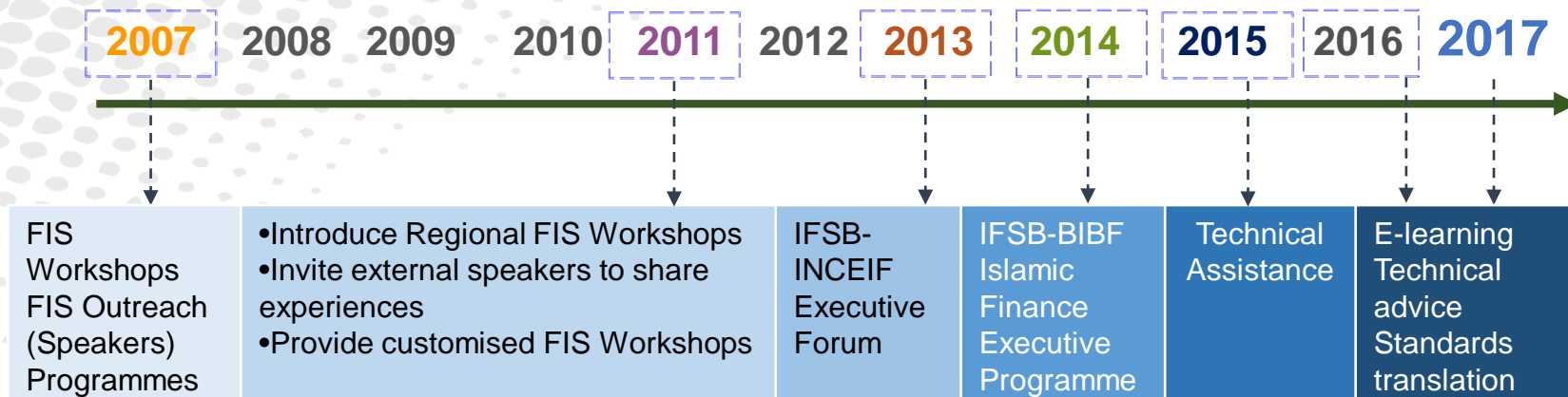
**A sustained framework to
support an orderly growth of IFSI
globally**



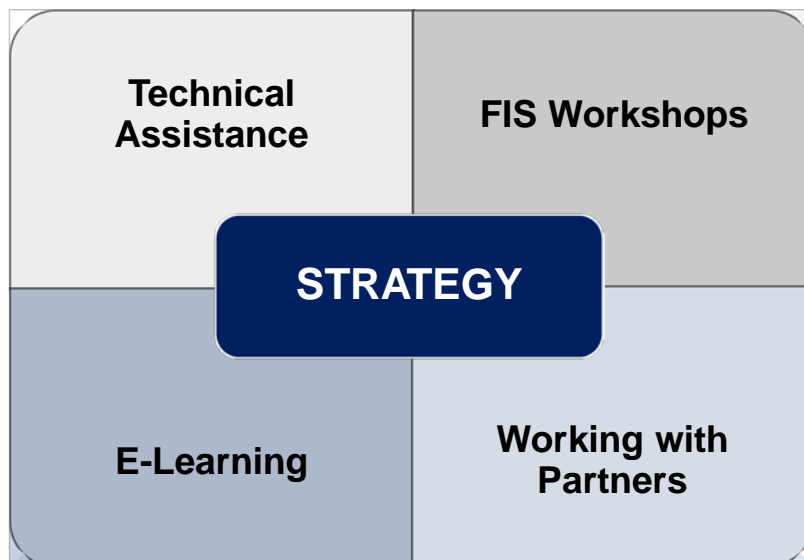
IFSB's Transition Challenge

Moving from achieving ex-ante consistency in understanding to ex-post consistency in implementation in
diverse jurisdictions

IMPLEMENTATION: SIGNIFICANT RESOURCES



Review of the FIS Workshops Initiatives (2007 –2016)	
Countries	39
Number of Workshops	167
Number of Participants	2,880

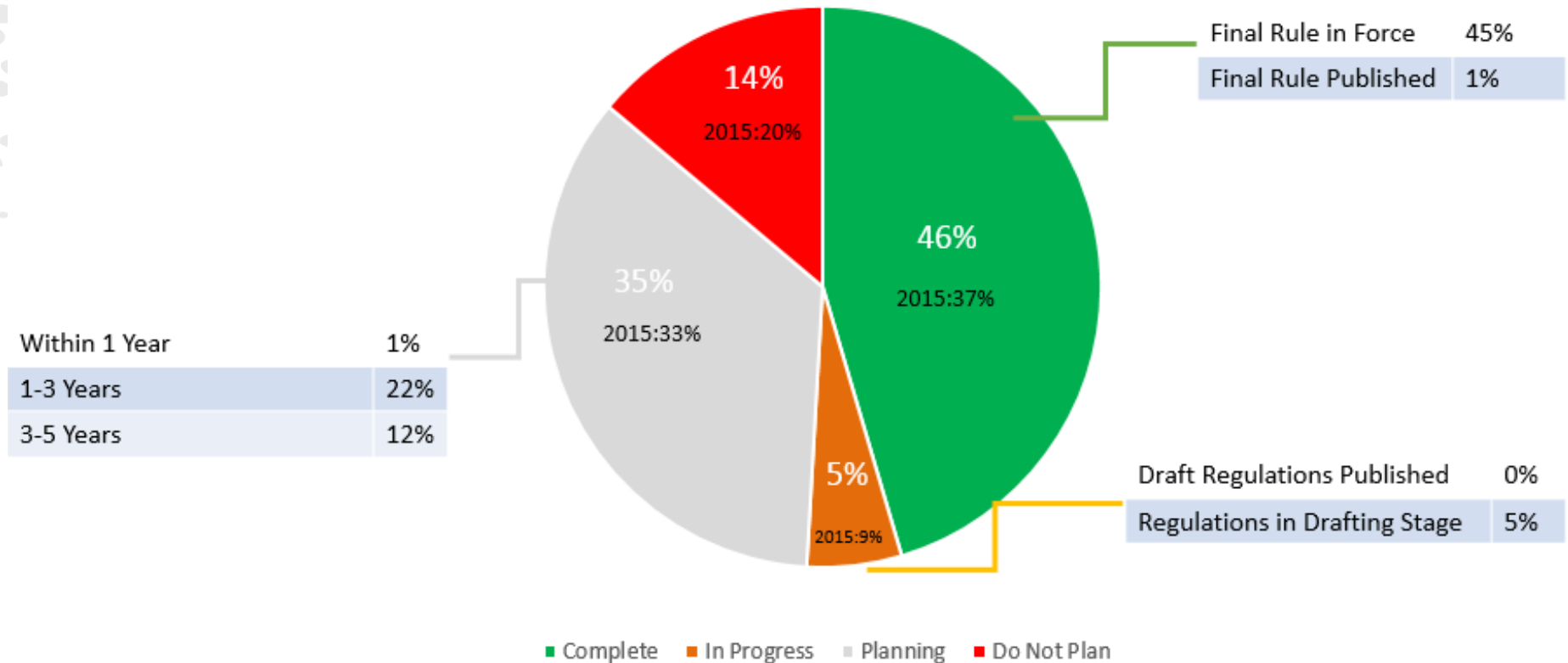




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IMPLEMENTATION PROGRESS – IFSB SURVEY 2016

The overall implementation status is consistent with 2015 survey with minor differences in completion



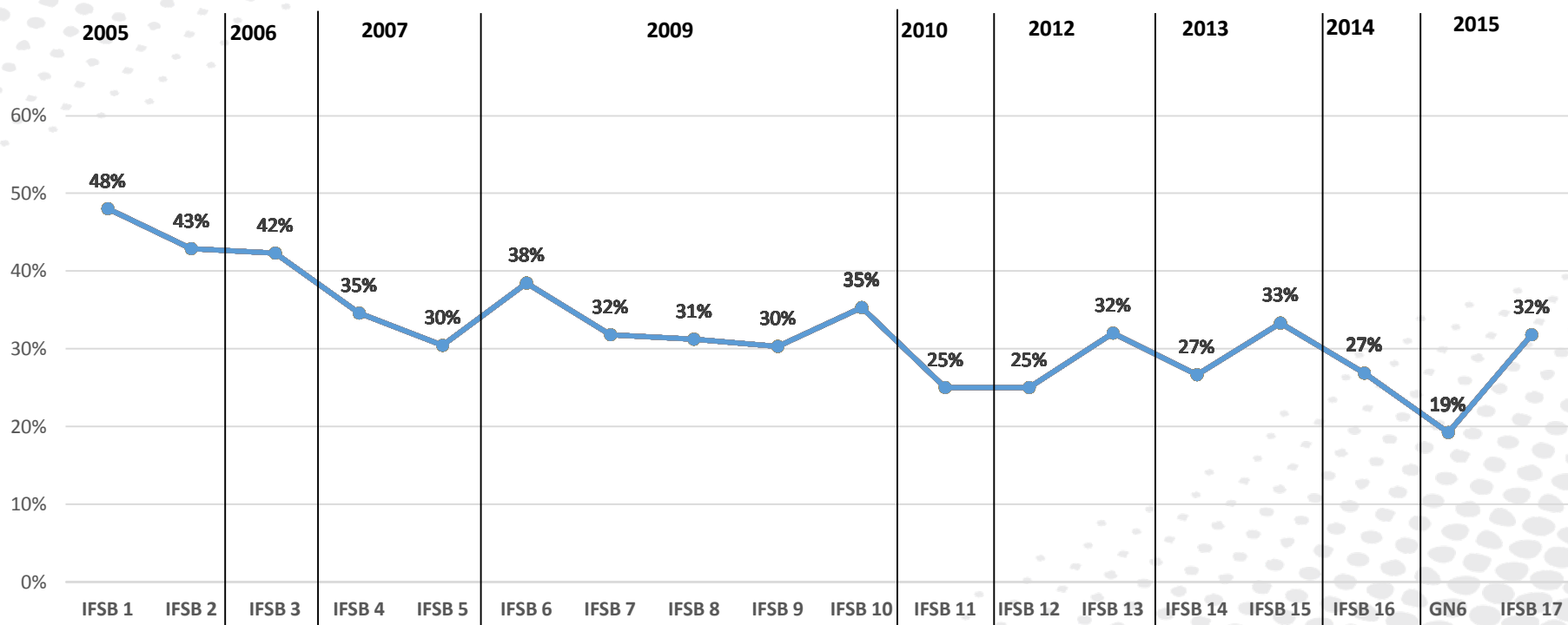
- Jurisdictions indicating they have 'Completed' implementation is higher by 9% and while those that indicate they are in the 'Planning' stages has increased by 2%
- Those that indicate they 'Do Not Plan' to implement has decreased by 6% and those that are 'In Progress' has reduced by 4%

Base: All Respondents, N=22

Q8a) Please record the most applicable implementation status

STANDARDS COMPLETED BY TIMELINE

- Earliest standards have highest implementation rate
- Basel III related standards have strong pickup in recent years



Average Rate of RSA Implementation Per 1 Year

4	4	4	4	3	4	4	4	4	4	4	5	6	7	8	9	10	16
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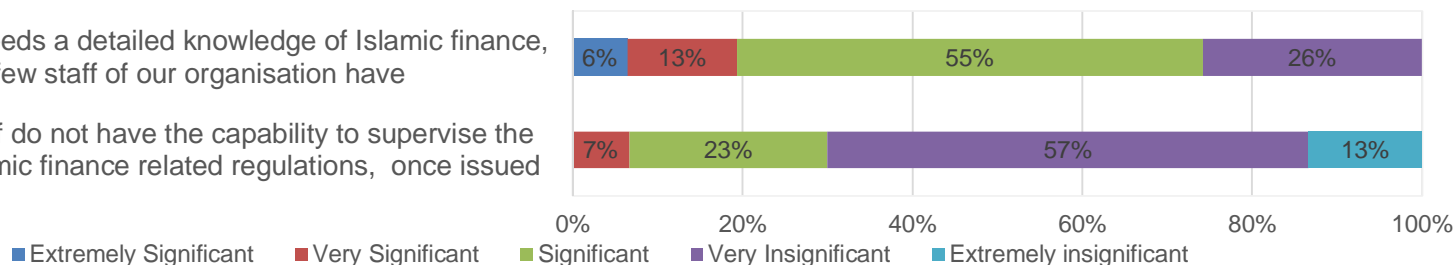
CHALLENGES IN IMPLEMENTATION

- The lack of staff with detailed knowledge of Islamic finance for implementation of standards is identified as a major challenge faced by RSAs.
- The need for changing or adapting existing statutory/legal frameworks was also identified as the major constraint hindering standards' implementation.

Human Resources and Capacity Building

Implementation needs a detailed knowledge of Islamic finance, which few staff of our organisation have

Our supervisory staff do not have the capability to supervise the compliance with Islamic finance related regulations, once issued



Other Factors

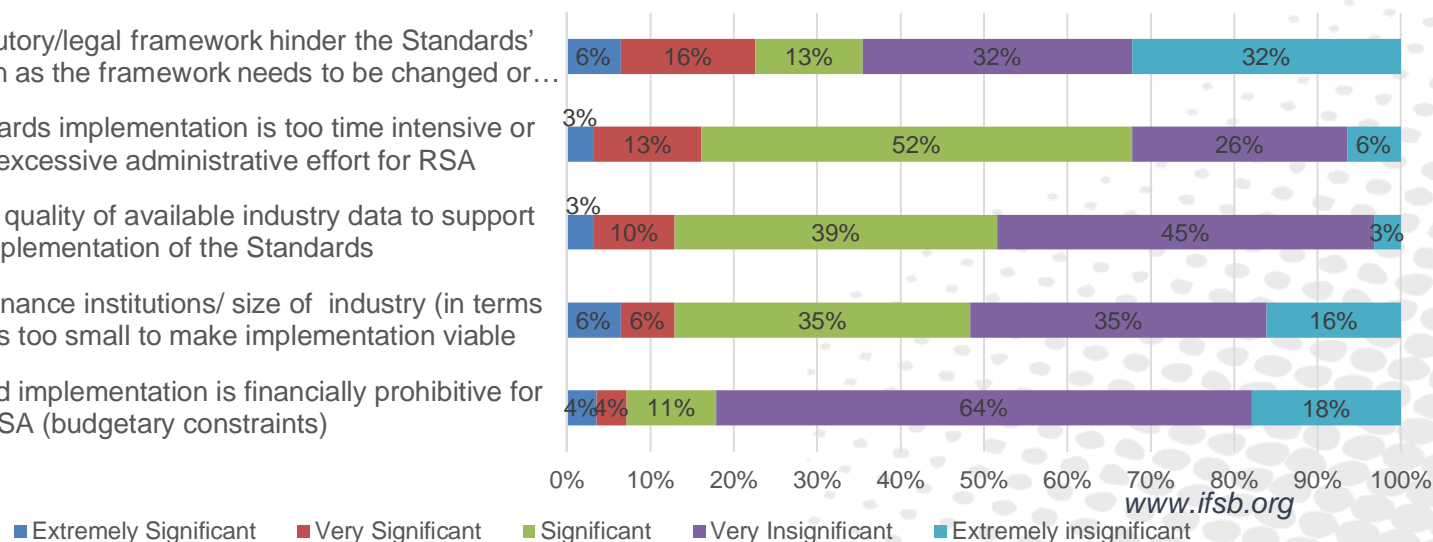
Existing statutory/legal framework hinder the Standards' implementation as the framework needs to be changed or...

Process of standards implementation is too time intensive or requires an excessive administrative effort for RSA

Lack of or poor quality of available industry data to support implementation of the Standards

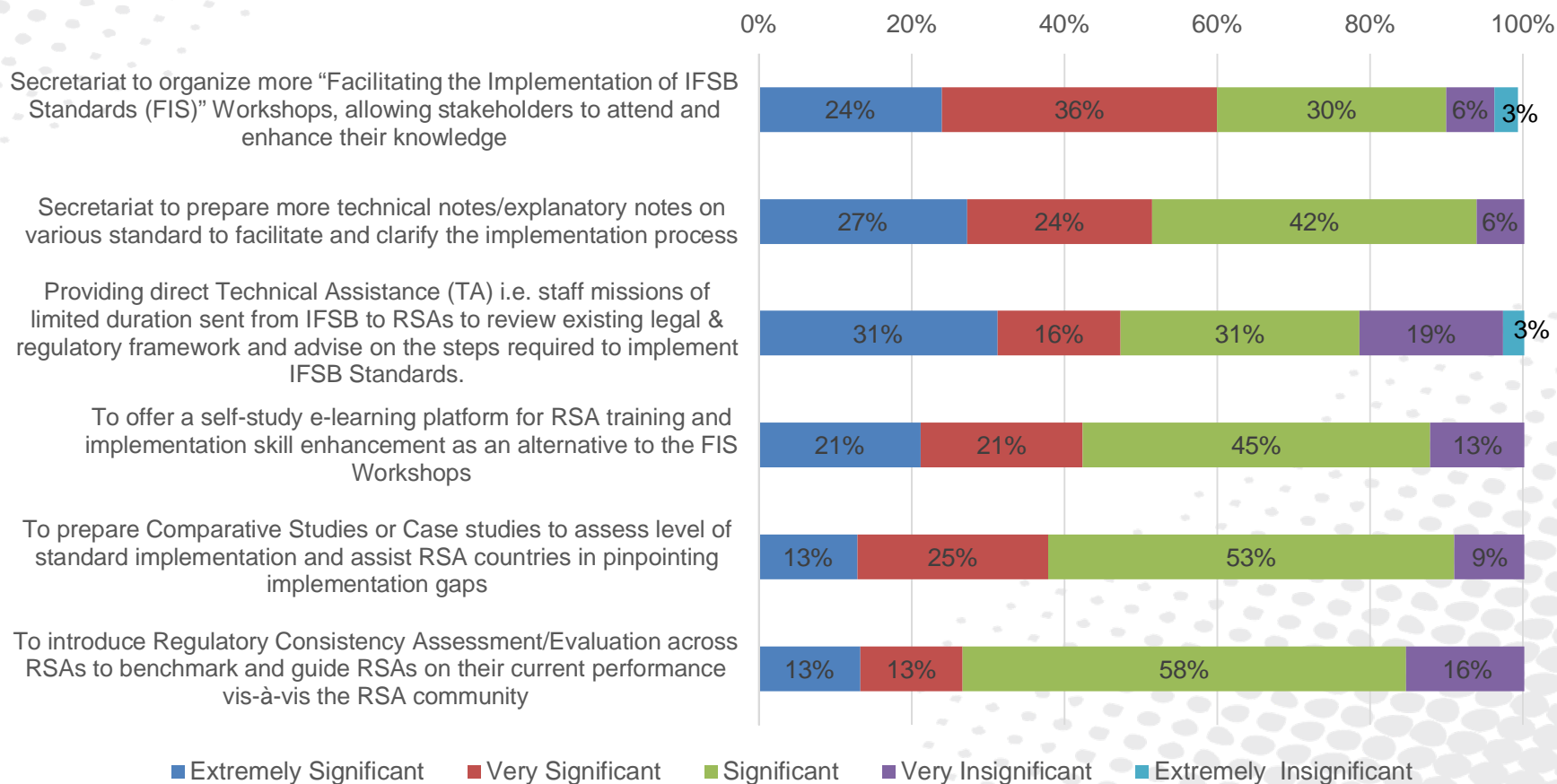
Number of Islamic finance institutions/ size of industry (in terms of market share) is too small to make implementation viable

Process of standard implementation is financially prohibitive for RSA (budgetary constraints)



TYPE OF SUPPORT NEEDED IN IMPLEMENTING STANDARDS

- **Most RSAs require more FIS Workshops with 24% of the respondents finding it extremely significant and 36% finding it very significant.**
- **Preparation of more Technical Notes and providing direct Technical Assistance (TA) to RSAs were ranked second and third respectively in terms of their significance.**



KEY ASPECTS OF NEW STRATEGY

- The findings of the implementation survey feeds into the IFSB's future Strategy and work

- ✓ **Greater engagement** with jurisdictions in the Middle East, as well as with other regions, to help new jurisdictions to build awareness about Islamic finance from the stability, resilience and regulatory perspective

- ✓ A **membership drive**, combined with a prioritisation of the needs of our members and of the wider set of stakeholders in the IFSI.

- ✓ Ramp up **support for the implementation** of the IFSB existing standards
 - *E-Learning Modules and longer-term engagement with members*

- ✓ **Working with global partners** and enhanced collaboration on areas of common interest
 - *Integrating Islamic finance into global surveillance framework (Core Principles)*

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THE IFSB'S NEW STRATEGIC PERFORMANCE PLAN 2016-2018

SPP 2016 – 2018

To provide greater coverage of the needs of its key stakeholders, the IFSB has identified four Strategic Key Result Areas (SKRAs) over the 2016-2018 period.

SKRA	Outcome
SKRA 1: Formulation and Issuance of Prudential Standards and Studies for the Regulation of the IFSI	Outcome 1 (OC1): Enhanced Guidance on Prudential Supervision of IFSI Outcome 2 (OC2): Expansion of Coverage of IFSI issue areas
SKRA 2: Facilitating the Implementation of Prudential Standards and Capacity Development	Outcome 3 (OC3): Increased implementation of the IFSB standards in member jurisdictions Outcome 4 (OC4): Enhanced Capacity of Member Jurisdictions to Understand the Enabling Factors for an Effective Regulatory and Supervisory System
SKRA 3: Increased Awareness and Knowledge Sharing	Outcome 5 (OC5): Improved awareness of stakeholders on the growth and soundness of the IFSI Outcome 6 (OC6): Enhanced knowledge sharing through the dissemination of information
SKRA 4: Enhancing Cooperation with the Islamic Finance Stakeholders	Outcome 7 (OC7): Improved Cooperation with Members' of the IFSB Outcome 8 (OC8): Increased satisfaction of Members' with the services provided by the IFSB

TARGETS FUTURE STANDARDS DEVELOPMENT 2016 - 2018

No	Project	Sector	Development Period
1.	Key Elements in the Supervisory Review Process of Takāful / Retakāful Undertakings	<i>Takāful</i>	2016 – 2018
2.	Core Principles for Islamic Finance Regulation (Islamic Capital Market Segment)	ICM	2016 – 2019
3.	Disclosure to Promote Transparency and Market Discipline in Islamic Banking (Revised IFSB-4 with focus on Consumer Protection)	Banking	2016 – 2019
4.	Microfinance and Financial Inclusion	Banking	2017 – 2020
5.	Consumer Protection in Capital Markets	ICM	2017 – 2020
6.	Disclosure to Promote Transparency and Market Discipline for Takāful / Retakāful Undertakings	<i>Takāful</i>	2017 – 2020
7.	Operational Risk, Market Risk, Revised Approach to Credit Risk, Rate of Return Risk and Leverage Ratio (Revised IFSB-15 with group of topics undertaken as a single project)	Banking	2018 – 2020
8.	Core Principles for Islamic Finance Regulation (Takāful Segment)	<i>Takāful</i>	2018 – 2021



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SUPPORTED BY RESEARCH 2016 - 2018

No	Project	Sector	Development Period
1.	Issues Arising from Changes in <i>Takāful</i> Capital Requirements (surplus, capital instruments, etc)	<i>Takāful</i>	2016 – 2017
2.	Systemic Links and Macroprudential Issues for Islamic Banks	Banking	2016 – 2018
3.	Resolution and Recovery	Cross-Sectoral	2016 – 2018
4.	Anti-Money Laundering / Counter Terrorism Financing	Banking	2017 – 2018
5.	Capital Market Intermediaries	ICM	2017 – 2018
6.	Risk-Sharing Instruments in Islamic Banking	Banking	2017 – 2019
7.	Consumer Protection in <i>Takāful</i>	<i>Takāful</i>	2017 – 2019
8.	Profit Sharing Investment Accounts: Cross-Country Analysis	Banking	2018 – 2019
9.	Group Consolidation	Banking	2018 – 2019
10.	Islamic Hedging Instruments	Cross-Sectoral	2018 – 2019
11.	Research on Issues Arising from <i>Takāful</i> Windows Operation	<i>Takāful</i>	2018 – 2020

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SUMMARY OF IFSB PERFORMANCE AND FUTURE WORK



A Range of cross sectoral standards that aim to provide a consistent and robust prudential framework comparable to international standards issued by global comparators

Major programme to align Islamic finance with new global regulatory architecture

Sustained effort to assist implementation of IFSB standards across countries

Launch of Core Principles for Islamic Finance Regulation to facilitate integration into global surveillance framework



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Thank you

Jaseem Ahmed

Secretary-General

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