

AAOIFI's Standards on Capital Market Products

Reality Check and Way Forward



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AAOIFI Standards | Capital Market Products



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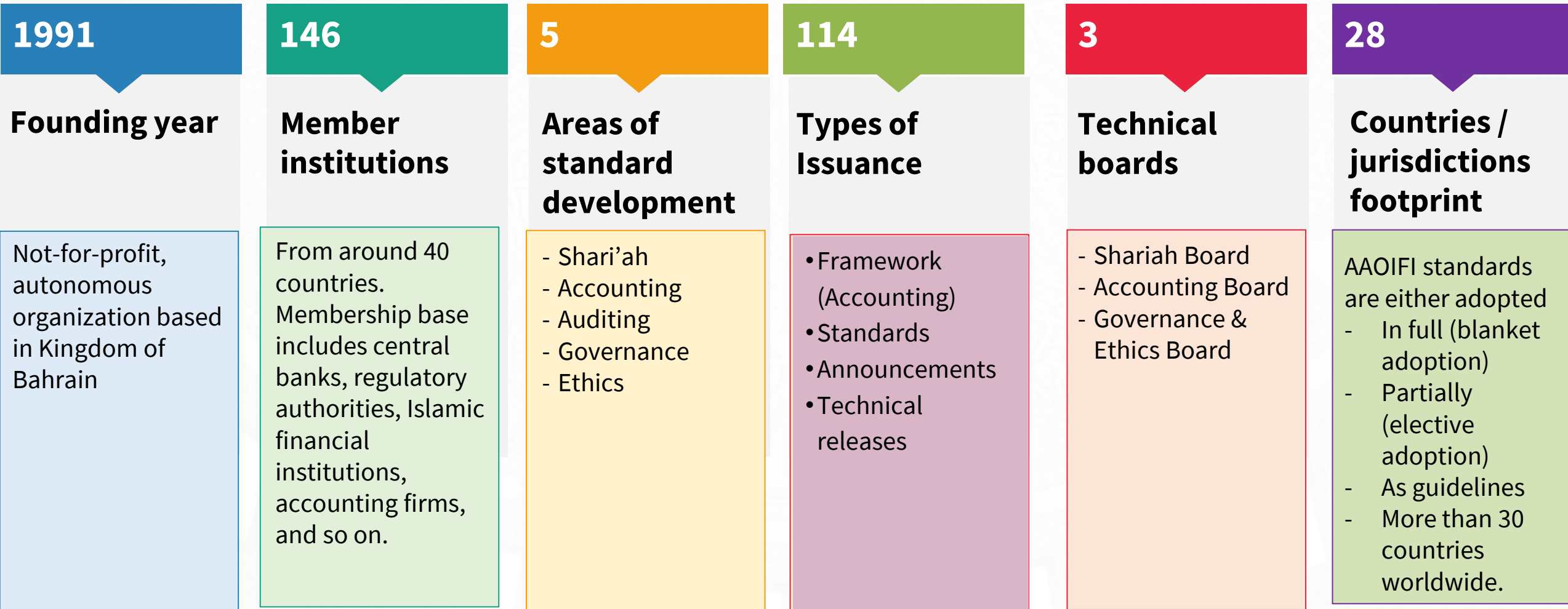
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AAOIFI – An Overview



Snapshot

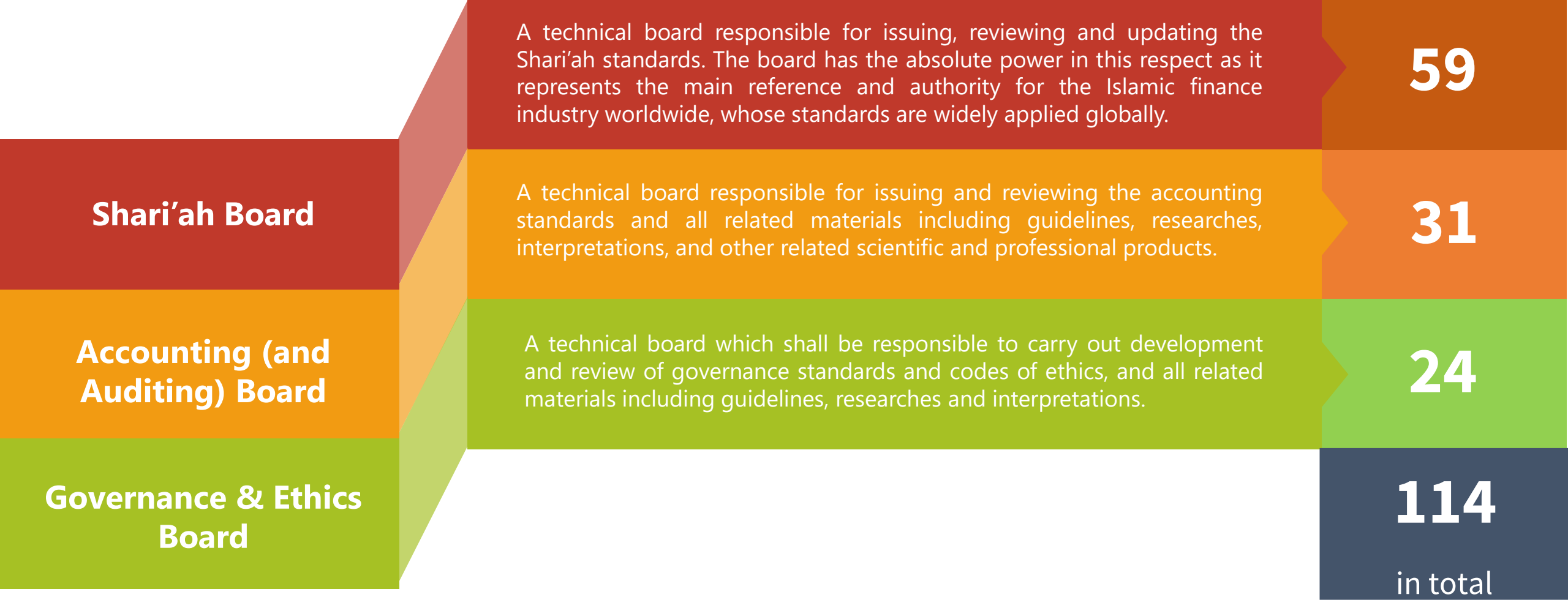




Background- AAOIFI Standards



AAOIFI Standards Setting



Standards Development - Main Areas

1 **Shari'ah Standards:**

- Products: Murabaha, Mudaraba, Salam, etc.
- Contractual instruments: Khiyar, Waad, etc.
- Methodology: Profit distribution, capital protection, Zakah, etc.

2 **Accounting Standards:**

- Products/ transactions: both sides of balance sheet.
- Contractual instruments: Khiyar, Waad, etc.
- Presentation and disclosures for products, transactions + framework

3 **Governance Standards:**

- Shariah governance framework
- Processes and governance mechanism.
- Governance for instruments: Sukuk

4 **Auditing Standards:**

- Shari'ah audit (internal and external)

5 **Ethics:**

- Codes of ethics for employees, functions, marketing, etc.

6 **Public Interest Monitoring Committee**

- Overseeing the development of AAOIFI's technical standards and ensuring the protection of the public interest and that standards are developed free from undue influence.

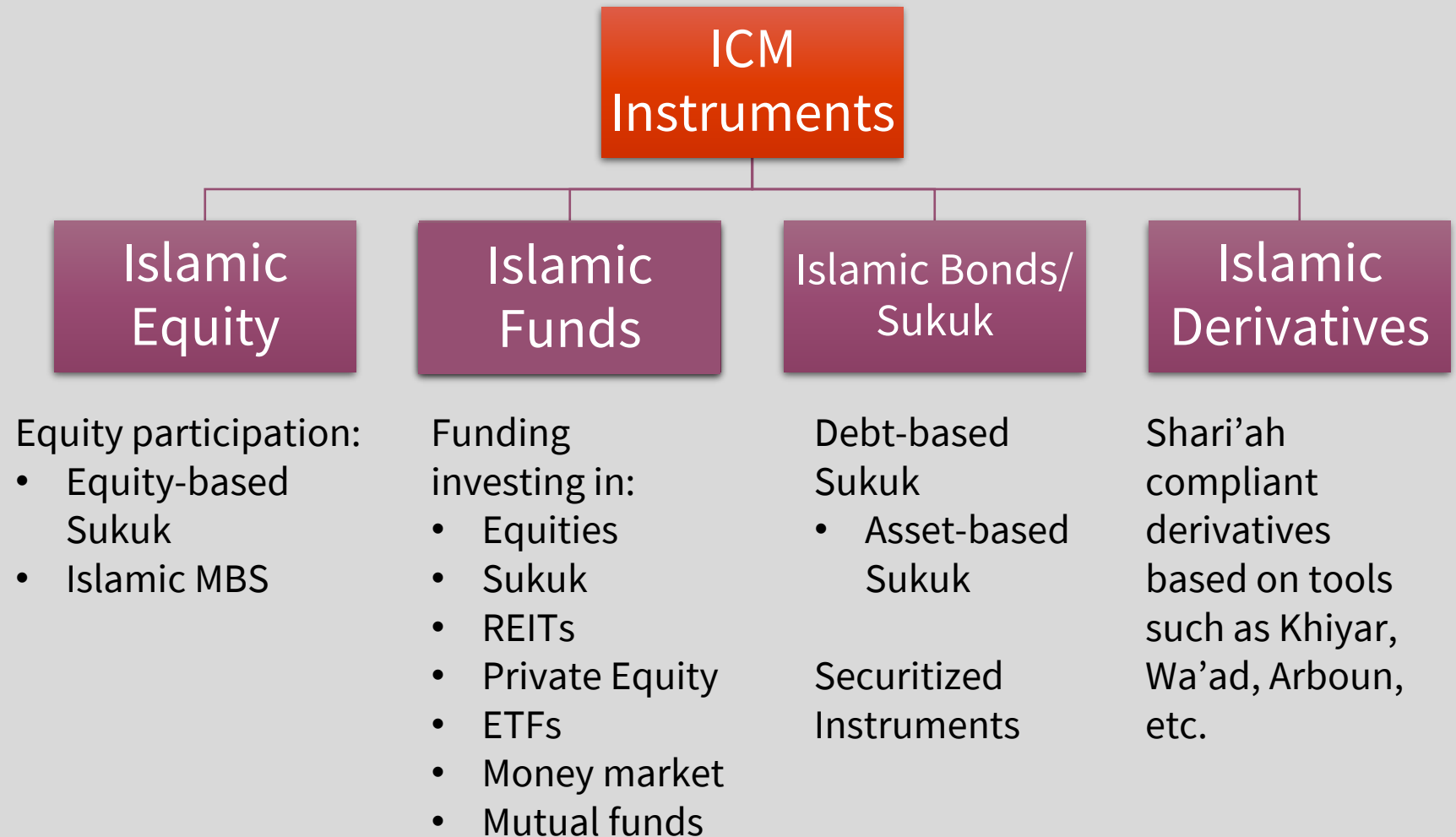


Islamic Capital Market: Peculiarity and Main Products



Islamic Capital Markets (ICDs) : Structure by Instruments

- ICD provides instruments that assist buyers (surplus units) and sellers (deficit units) in coming together and carrying out investing activities in a Shari'ah compliant manner.



• Sukuk:

- Ijarah Sukuk
- Mudarabah Sukuk
- Musharakah Sukuk
- Hybrid Sukuk, multiple tranches
- AAOIFI's approach:
 - Accounting
 - Shari'ah
 - Governance

• Funds:

- Mutual Funds:
- Islamic Unit Trust Funds
- Islamic REITs
- AAOIFI's existing standards:
 - FAS 14 (Inv. Funds)
 - GS (Mutual funds governance framework – in pipeline)
 - SS (Gap)
- Unit Trust and REITS (Gap)

• Shares/ Equity:

- Shari'ah compliant stocks like those of an Islamic bank, Takaful firm, etc.)
- Screened equity/ stocks
- AAOIFI's existing standards:
 - SS 21 (Fin Securities)
 - FAS 25/ FAS 33
 - GS (Gap)

Islamic Capital Markets (ICMs): Peculiarity

Origin and development:



East Asia:

- *Islamic REITs*
- *Islamic ETF*
- *Islamic bonds*

Middle East (late 1980s):

- *Governments supported development of ICMs in the regions, GCC.*
- *globally, 1st Islamic mutual fund: Amana Income Fund (Indiana, USA, 1990)*

Standardization is key

- Standardization provides underpinnings for development of ICM and its products, regionally and globally.
- Standardization builds on Shari'ah basis for differentiation between permissible and impermissible structures, products, mechanisms, etc.
- Standardization also takes into consideration global best practices that don't contravene Shari'ah precepts.
- Standardization enables cross-border transactions and flows of capital.
- Standardization is a multi-partite/ collective process that involves industry stakeholders, and in the case of ICMs, it shall involve exchanges and financial market authorities and players.

Standardization is Key

Embedded Shari'ah Compliance

- Compliance is built in and provides for harmonized practices.

Cost efficiency

- Compliance comes at a cost.
- Standardization can save costs at the level of adopters and jurisdiction at large.

Seamless capital movement/ flows

- Cross-border
- Inter-sectoral

“

In many jurisdictions, the Islamic Capital Market (ICM) co-exists with the conventional capital market. However, in ICM market transactions are subject to a distinct set of guidelines and in a Shari'ah compliant manner.

Shari'ah Compliance: an essence

ICM instruments and institutions must comply with Shariah principles, literally:

- Prohibition of riba in all its forms (pecuniary, non-pecuniary, etc.)
- Application of real transactions/ al bai' (trade and commerce)
- Prohibition of all forms of maysir (gambling)
- Elimination of excessive gharar (ambiguity/ uncertainty/ asymmetry of information) in contractual agreements
- Opting out of dealing in prohibited underlying assets and business (e.g., commodities such as liquor, pork, tobacco, etc.)



Standards on Capital Market Products

AAOIFI Standards- Inventory Taking

Shari’ah Standards

- SS 12 (Sharikah)
- SS 13 (Mudaraba)
- SS 17 (Investment Sukuk)-
Currently being revised.
- SS 20 (Sale of Commodities in
Organized Markets)
- SS 21 (Financial Securities:
Shares and Bonds)
- SS 45 (Protection of Capital
and Investments)
- SS 46 (Investment Agency)
- SS 57 (Gold and Shari’ah
Parameters)
- SS 59 (Sale of Debt)

Accounting Standards

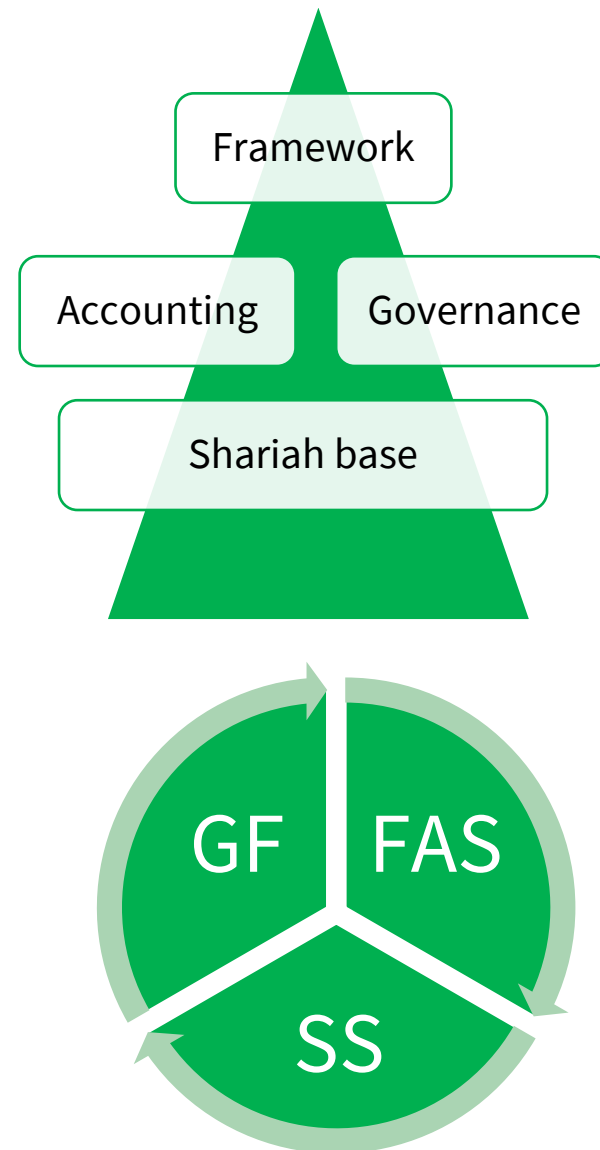
- FAS 3 (Mudaraba)
- FAS 4 (Musharaka)
- FAS 14 (Investment Funds)
- FAS 25 (Investment in Sukuk,
Shares and Similar
Instruments) (superseded by
FAS 33- same title)
- FAS 29 (Sukuk in the Books of
Issuers)- Not issued yet.
- FAS 34 (Financial Reporting for
Sukuk Holders)
- FAS 36 (Waad, Khiyar and
Tahawwut)

Governance Standards

- GS 12 Sukuk Governance
- GS (x) Fiduciary Rating for
Instruments

AAOIFI Standards – 360 Approach: Sukuk as an Example

Sukuk as an asset class have successfully established itself as a key player in Islamic financial and capital markets. AAOIFI has adopted a comprehensive approach as to developing a full set of standards that thoroughly cover Sukuk.



Assets

Liabilities, Equity

FAS 34: Financial Reporting for Sukuk-Holders

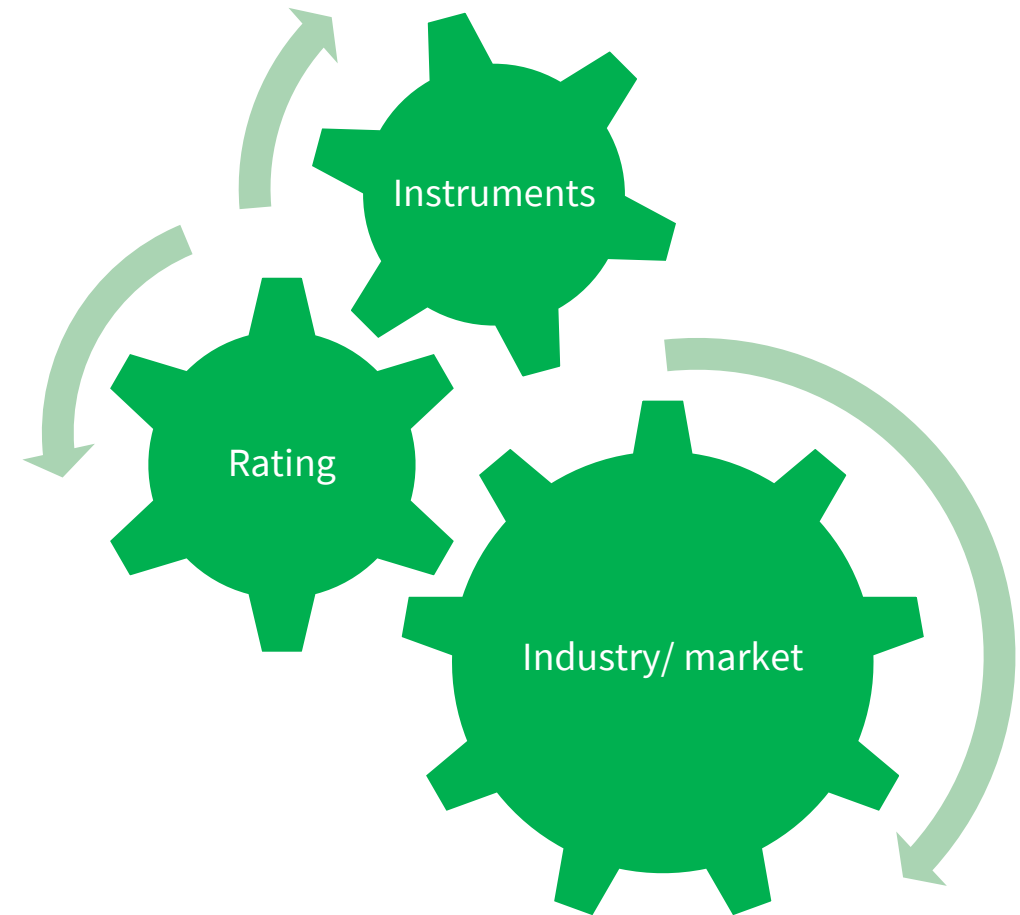
- Accounting principles and reporting requirements for underlying assets of Sukuk.
- Sukuk are classified as business Sukuk or non-business Sukuk.
- For each type, the standard prescribes its own accounting treatment and financial reporting.

FAS 29: Sukuk in the Books of the Issuer

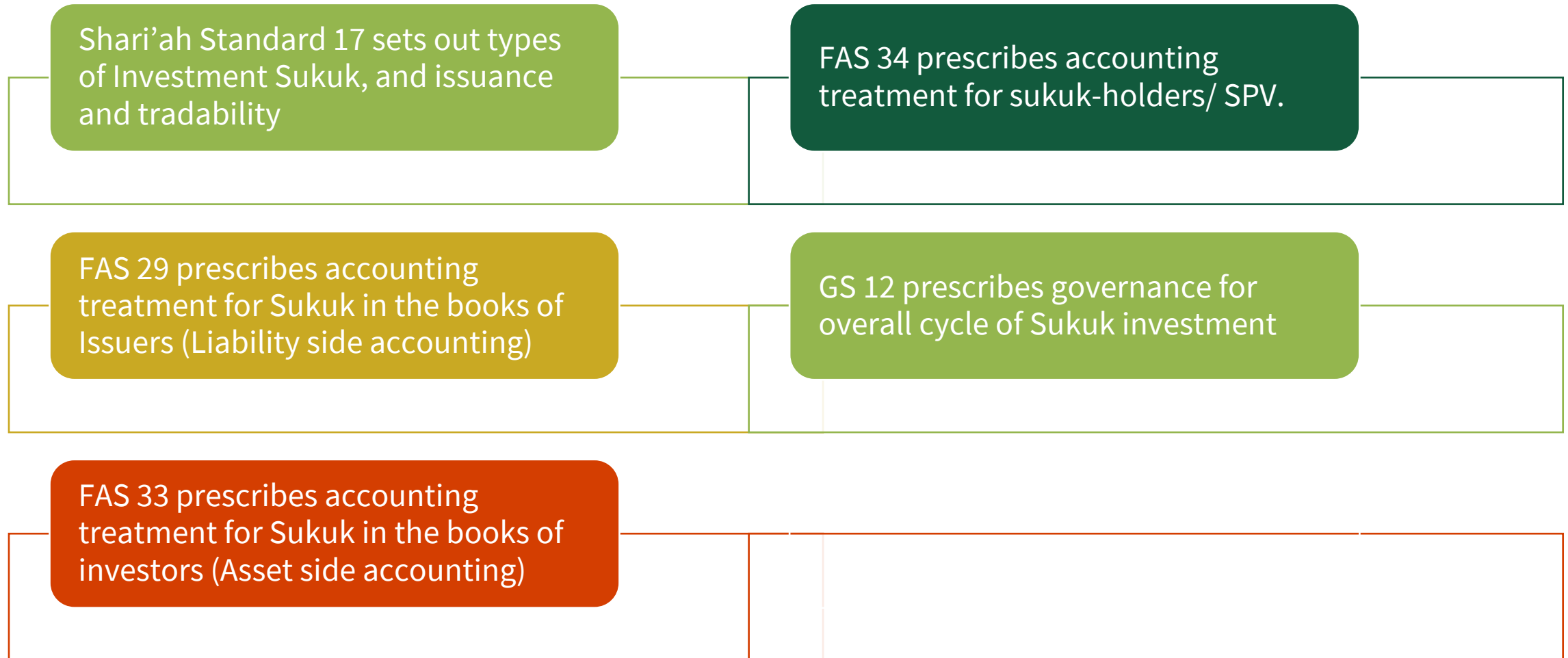
- Accounting issues in classification of Sukuk issuance in the issuer's books based on Sukuk structure.
- Presentation requirements/ related disclosure of information in financials.
- Guidance on off-balance sheet Sukuk for issuers.
- Product-specific and hybrid Sukuk are subject to respective FAS.
- Equity-type Sukuk
- Quasi-equity-type Sukuk
- Debt-Type Sukuk
- “Control” as a determinant of Sukuk type

AAOIFI Standards – 360 Approach: Sukuk as an Example

- In Sukuk governance, rating plays a crucial role in improving market discipline and enhancing the level of transparency in the broader industry.
- AAOIFI is set to develop governance standard on fiduciary rating for instruments, like Sukuk.



AAOIFI Standards – 360 Approach: Sukuk as an Example





Final Remarks



Islamic Capital Market: Way Forward

Standardization Standards provide underpinnings for development of viable products

Product-specific Product specific standards are key. Example: gold-linked products and other applications

360 Approach Full-circle approach in developing standards in all relevant areas for specific products

Islamic Capital Market: Way Forward

Need

- Need for standards has to be identified (identification of gaps and areas where standards are particularly needed)

Engagement

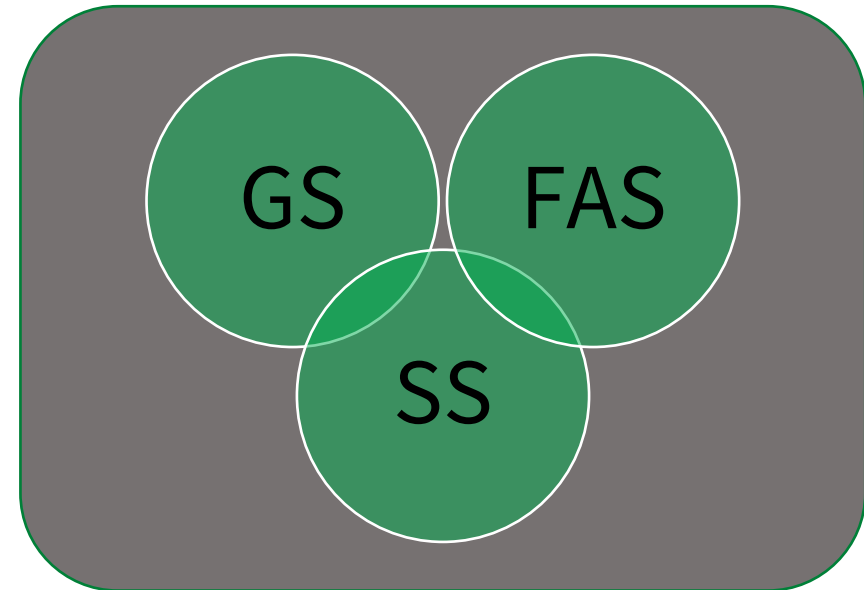
- Development of ICM standards with engagement of the broader stakeholders

Assessment

- Existing products/ relevant standards have to be assessed in accordance with need, and with support from the industry.

Industry Support

- Industry support may come in the form of developing a comprehensive set of standards for a particular product, with assistance (technical/ financial) from a reliable stakeholder (s).
- The model paid off for a project on Waqf, with support from Istithmar Al-Mustaqbal.



Industry support can bring about:

- Synergies
- Focused outcomes.
- Better interaction with stakeholders
- Time and cost savings in the development process.

والحمد لله في الأولى والآخرة

“Thank You” for your time and kind attention

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AAOIFI

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