General Council for Islamic
Banks And Financial Institutions

Affiliated Institution to the OIC
Established under Royal Decree No 23 -2001

CIBAFI

المجلس العام للبنوك
والمؤسسات المالية الإسلامية

مؤسسة منتمية لمنظمة التعاون الإسلامي
تأسست بمرسوم ملكي رقم ٢٣ لسنة ٢٠٠١م

Ref. 1216/1963/AR
30th December 2016

Jaseem Ahmed
Secretary – General
Islamic Financial Services Board
Level 5, Sasana Kijang
2, Jalan Dato' Onn
50480
Kuala Lumpur
Malaysia

Dear Mr. Ahmed,

السلام عليكم ورحمة الله وبركاته،،،

CIBAFI Comments of the IFSB Exposure Draft 19

The General Council for Islamic Banks and Financial Institutions (CIBAFI) compliments the Islamic Financial Services Board (IFSB) and takes this opportunity to express its appreciation of the work that the IFSB does to promote and enhance the Islamic financial services industry.

CIBAFI is the official umbrella for all Islamic financial institutions, and acts as the voice of the Islamic finance industry, where our members comprise banks and non-bank financial institutions, both large and small, and reach over 120 members from 30 countries and jurisdictions.

We would like to express our thanks to the IFSB for its great effort and commitment with respect to developing standards that accommodate the interests of the global Islamic finance industry. We noted the request for comments on the IFSB's Exposure Draft – 19,

هاتف: ٣٠١ – ٣٠٠ ٣٥٧ ١٧ ٩٧٣+ فاكس : ٩٠٢ ٣٢٤ ١٧ / ٣٠٧ ٣٥٧ ١٧ ٩٧٣+ ص.ب: ٤٥٦ ٢٤ المنامة مملكة البحرين
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Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Sukuk and Islamic Collective Investment Schemes) and welcome this opportunity to offer our comments and recommendations. The comments contained in this letter represent the general views of CIBAFI Secretariat and feedback of our members. CIBAFI's perspective on the ED–19 reflects our mission and the needs of our members, and others, who engage in capital market activities, both on the issuing side and the investor side. We are also attaching as an Appendix other detailed comments for the IFSB's consideration.

Firstly, we note that from Islamic banks' (or issuers') perspectives, disclosure requirements principles would be of far greater value to Islamic banks if they were issued as separate drafts one for Sukuk and one for ICIS - with more comprehensive coverage, and provided more clarity of each of the Islamic Capital Market products (Sukuk and Islamic Collective Investment Schemes). We strongly encourage IFSB to consider having a separate set of disclosure requirements principles for ICIS while undertaking more in-depth work on ICIS. We are of the opinion that the industry expects a set of disclosure guidelines that are transparent and easy to follow. We notice that the ICIS section seems to have been given insufficient attention in this draft and in particular the treatment of disclosure requirements for Exchange Traded Funds (ETFs), property funds, money market funds, Private Equity/Venture Capital (PE/VC) funds and coverage of commodity funds is superficial.

Secondly, we note that ED-19 has set out the guiding principles on disclosure requirements for Islamic Capital Market (ICM) products without superseding the previous IOSCO standards and guiding principles. IFSB's complementary role is addressed in Paragraphs 11, 58, 160-161 which aims to complement those standards by dealing with issues specific to ICM products, and by setting out guiding principles specific to disclosure requirements for Sukuk and ICIS. CIBAFI believes that greater clarity and detail should be given concerning when an issuer or investor should consider IOSCO standards in conjunction with IFSB standards and when it should not and the guiding principles need to be explicit in its coverage of this point. For instance, one of the issues relating to disclosure for Sukuk relates to the uncertainty over whether IOSCO standards

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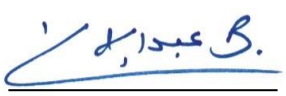
should apply or not, especially in the case of equity-based Sukuk structures. Much greater clarity is needed on this point.

Thirdly, we note that the ED offers the possibility of exemption from disclosure requirements based on the nature of the offering or of the offeror. We believe that full exemptions on disclosure requirements should not be given in respect of disclosures simply based on the nature of the offeror. Experience tells us that if there are no disclosure requirements, issuers will not disclose sufficient material information necessary for the making of informed investment decisions.

Sukuk represent a dynamic part of the Islamic financial industry and the underlying assets make Sukuk unique and differentiate them from their conventional counterparts. Therefore, identification of assets for sovereign or multilateral Sukuk issuances is essential. The exemptions could provide incentive for not disclosing certain material information which will create challenges in cross-border offerings. On the other hand, limiting disclosure exemptions in standardization could play a vital role in harmonizing the practices and will help cross-border market acceptability with the dual benefit of international confidence and strong legal backing to ensure investor protection.

We remain at your disposal should you need any further clarifications on the above or on the attached appendix.

Yours sincerely,



Abdelilah Belatik
Secretary General

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Appendix

CIBAFI Comments on IFSB ED-19: Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Sukuk And Islamic Collective Investment Schemes)

SECTION 1.3., SCOPE AND COVERAGE, PARAGRAPH 4

Paragraph 4 states that "Reflecting current practice in the ICM, the standard has been aimed primarily at those *ṣukūk* that are economically analogous to conventional bonds". We recommend that the statement, "**economically analogous to conventional bonds**" shall be revised as follows "**the standard has been primarily targeted at those Sukuk that share a similar credit risk with conventional bonds**" because of differences of Sukuk from conventional bonds in terms of their substance and Shariah basis.

SECTION 1.6., IMPLEMENTATION DATE, PARAGRAPH 14

Paragraph 14 states that "RSAs are expected to start implementation of this standard in their jurisdictions by 1st July 2018". As suggested in the letter, we recommend IFSB to consider separating Sukuk and ICIS standards and issue a detached comprehensive set of disclosure requirements for ICIS. In view of that, **IFSB should consider extending the implementation deadline, particularly specific to disclosure requirements for ICIS.**

SECTION 2.1.2., PRINCIPLE G.2: SUFFICIENT INFORMATION, PARAGRAPH 27

Footnote 6 in paragraph 27 states that "In Turkey the word "participation" is often a signal that an investment claims *Sharī'ah* compliance. The use of some Arabic terms, particularly where the language otherwise used is not Arabic, may also signal at least an implicit claim to Sharī`ah compliance". We recommend deleting statement, "For Example, in Turkey the word "participation" is often a signal that an investment claims Sharī'ah compliance" from the footnote. **The word "participation/katilim" has been**

used in Turkey since 2005 following a regulatory amendment. Participation banks were previously known as "special finance houses/özel finans kurumları" and were excluded from Turkish banking law.

SECTION 2.1.2., PRINCIPLE G.2: SUFFICIENT INFORMATION, PARAGRAPH 29

Paragraph 29 states that "The regulatory framework should impose a standard format for disclosure under prospectuses. A typical standard format would require the disclosure of information under specific headings". ED-19 should provide a template for disclosure requirements as to what information has to be provided and in what format. **We recommend that IFSB-19 provides such guidance and details on the format or template for the disclosure which could be used in offerings by institutions.**

SECTION 2.1.3., PRINCIPLE G.3: TIMELY INFORMATION, PARAGRAPHS 34-41

In seeking to articulate guidance for timely disclosures under section 2.1.3, the standard provides generic timelines and uses expressions such as 'reasonable', 'as soon as practicable', 'appropriate timescales'. **It would be advisable to give some approximate guidelines in this respect.** The standard quotes conventional standards and regulatory regimes that provide appropriate timescales, but does not give any such guidance for timely disclosure of information which is material to the investment decision.

SECTION 2.2.1., APPLICATION TO CROSS-BORDER OFFERINGS, PARAGRAPHS 47-50

We notice that the disclosure requirements in the ED-19 do not explicitly deal with **the issues of international transferability**. Some of the following issues should make clear: (i) That some Sukuk issued in certain jurisdictions (e.g. Malaysia) will not hold their resale value if sold in other jurisdictions (e.g. GCC countries) and this should be a subject

for disclosure. (ii) That some Sukuk issued in some currencies (e.g. Pakistani Rupee) are only likely to hold their value if sold to investors with an existing exposure to that currency and this should be a subject for disclosure.

SECTION 2.2.2., PRINCIPLE S.1: GENERAL DISCLOSURE PRINCIPLES APPLICABLE TO SUKUK, PARAGRAPH 59

Paragraph 5 states that "Examples include the use of Arabic terms (in a non-Arabic text) for contracts (*aqd*) and references to Sharī'ah". **We believe that disclosure requirements should be written in clear language, because sometimes including the use of Arabic terms is misleading to investors in non-Arab speaking countries. We request IFSB to elaborate on this point for reasons of clarity.**

SECTION 2.2.3., PRINCIPLE S.2: PURIFICATION OF COMPENSATION PAYMENTS, PARAGRAPHS 72-73

Paragraphs 72 and 73 of the disclosure requirements state that the detailed breakdown of purification payments made, such as rate of payment and the circumstances in respect of non-Shariah compliant income should be provided. **We believe that details of purification payment such as these would be unnecessary as long as these payments are made and disclosed**. The disclosures requirements for Sukuk **can be similar to those suggested for ICIS** in paragraphs 145 and 146.

SECTION 2.2.3., PRINCIPLE S.2: OTHER SHARIAH-RELATED PAYMENTS, PARAGRAPHS 74-75.

Paragraphs 74 and 75 can be combined in one paragraph. **We recommend adding the statement**, "**payment obligations arising from acquiring, holding or disposing of the Sukuk**" to paragraph 74 and removing of paragraph 75.

SECTION 2.2.4., PRINCIPLE S.3., STRUCTURE AND CONTRACTS, PARAGRAPH 88

Paragraph 88 states that "A summary of the principal contracts that comprise the Sukuk structure should be disclosed. In particular, terms with legal significance and allocations or transfers of risks (e.g. any *kafālah* or guarantee or *takāful* or insurance arrangements) should be described".

The statement, "terms with legal significance" in this paragraph can be revised as follows "terms with shariah and legal significance". **We believe that the principle can be made clearer with this revision.**

SECTION 2.2.4., PRINCIPLE S.3: STRUCTURE-RELATED DISCLOSURES FOR SUKUK, PARAGRAPHS 89-96

Paragraph 90 (f) mentions disclosure requirements for ijarah Sukuk arangements as follows: "the arrangements, if any, for takāful or insurance of the leased asset". ED-19 sets out related takaful/insurance arrangements in a general manner in some parts of the draft, particularly in paragraphs 88 and 100. However, disclosure of Takaful/Insurance arrangements is mentioned **specifically only under Ijarah Sukuk arrangement**. **We recommend mentioning specific disclosure requirements regarding takaful or insurance arrangements for other types of Sukuk structures and not only for disclosure requirements for Ijarah Sukuk.**

SECTION 2.2.4., PRINCIPLE S.3: STRUCTURE-RELATED DISCLOSURES FOR SUKUK, PARAGRAPHS 89-96

We notice that ED-19 covers some specific Sukuk contracts and arrangements such as ijarah, istisna, musharakah, mudarabah, wakalah bil istithmar, and salam. We believe that it shall also cover other types of Sukuk contracts. **IFSB may want to clarify the reason for providing only these Sukuk contracts and cover (near) exhaustive list of**

contracts for their disclosure requirements and not only some specific Sukuk contracts and arrangements.

SECTION 2.2.4., PRINCIPLE S.3: STRUCTURE-RELATED DISCLOSURES FOR SUKUK, PARAGRAPH 90

Paragraph 90 mentions specific disclosure matters related to ijarah Sukuk. **We believe that following items should be added under the ijarah Sukuk arrangement**. They are: (i) "Recourse to the asset and its disposal thereof in case of default", (ii) "Ownership of the asset", (iii) Recording of title of the asset, late payment penalties, (iv) "Responsibility for maintenance and insurance", (v) "What happens in case of partial and total loss of the asset", (vi) "Responsibilities of the lessee as service agent and related indemnities" and (vii) "Any relevant undertakings (purchase or sale)".

SECTION 2.2.4., PRINCIPLE S.3: STRUCTURE-RELATED DISCLOSURES FOR SUKUK, PARAGRAPH 91

Paragraph 91 states that specific matters should be disclosed relating to istisna (or parallel istisna) Sukuk arrangement. **We believe that the same points as above regarding paragraph 90 would apply for istisna too. In addition to this, the following items should be disclosed**. They are: (i) "The methodology for calculation of price", (ii) "The possibility of changing the price", (iii) "Calculation of damages in case of delay or non-delivery, and if such damages are liquidated damages, and the formula for such a calculation".

SECTION 2.2.4., PRINCIPLE S.3: STRUCTURE-RELATED DISCLOSURES FOR SUKUK, PARAGRAPH 93

Paragraph 91 states that specific matters should be disclosed relating to muḍarabah arrangement. We believe that "On Balance sheet" and "Off Balance sheet" treatments of

muḍarabah should be disclosed. **We believe that this disclosure requirement will protect investors and mitigate possible risks.**

SECTION 2.2.4., PRINCIPLE S.3: DEFAULT, ACCELERATION, ENFORCEMENT, RESTRUCTURING AND INSOLVENCY, PARAGRAPH 114

Paragraph 114 states that "If there is uncertainty as to how courts in the relevant jurisdiction might interpret or enforce key provisions in *ṣukūk* contracts that are legally untested (e.g. relating to insolvency or post-default asset transfers), this risk must be disclosed." There are unknown risks and legally untested cases. **We believe that this disclosure requirement would require input from solicitors/legal experts and disclosures should warn investors of these risks.**

SECTION 2.2.4., PRINCIPLE S.3: ONGOING DISCLOSURE, PARAGRAPH 115

Paragraph 115 states that ongoing disclosure requirements should include any amendments to contracts, any changes of matters and material (assets, investments, and/or activities) and any appointments about trustee etc. We believe that **ongoing disclosure should be made only if it involves strong potential event of default including a change in the Shariah-compliant status**. Otherwise, the requirement for ongoing disclosure on periodic basis will add more work, time and cost to the issuer and will make Sukuk less attractive. **If the standard requires, unnecessary and ongoing disclosures this will prove costly and issuers will move away from it**.

SECTION 2.3.4., PRINCIPLE C.3: SPECIALİST ICIS DISCLOSURE

This section covers disclosure requirements related to special types of ICIS but do not sufficiently cover some types of ICIS and their disclosure requirements, such as Exchange Traded Funds (ETFs), Property Funds, Money Market Funds, Private Equity/Venture Capital Funds and Commodity Funds. The disclosure requirements for

these ICIS types are too superficial, and lack detailed disclosures which might prove to be inadequate to issuing institutions. **We believe that each one of these segments requires a comprehensive and functional set of disclosure principles**. Otherwise, we run the risk of the segment's growth being held back.

SECTION 2.3.2., PRINCIPLE C.1: SHARIAH-RELATED DISCLOSURES FOR ICIS, INVESTMENTS, SHARIAH REVIEW AND GOVERNANCE, PARAGRAPH 141

Paragraph 141 states that "An ICIS should disclose in its prospectus the processes for internal and/or external Sharī'ah audit". However, we believe that this standard is not articulating shariah audit disclosures with respect to Sukuk. **We recommend addressing same disclosures for Sukuk.**

SECTION 2.3.4., PRINCIPLE C.3: PROPERTY FUNDS, PARAGRAPHS 154-156

Paragraphs 154-156 state the disclosure requirements regarding property funds. **We believe that the document should address property funds that invest in financing real estate such as Mortgage REITs both with 'recourse' and 'without recourse' as well as sub-ordinated financing which may include the option to buy the property**. Also it should address the **possibility of partnerships with third parties, financing third parties or leasing from/to third parties who may resort to conventional financing**. In such cases the relationship with the third party should be clear as well as any association that the fund may have with regard to conventional lenders.

SECTION 2.3.4., PRINCIPLE C.3: PROPERTY FUNDS, PARAGRAPH 155

Paragraph 155 states that "Property funds that invest only in tradeable securities pose no particular disclosure issues." **Our view is that Shariah screening criteria should be**

applicable to such securities to be disclosed. For example, some banks use the "NAV" (Net Asset Value) concept as opposed to "Market Capitalization" in their screening ratio for investing in REITs, unlike tradeable equities.

SECTION 2.3.4., PRINCIPLE C.3: SPECIALIST ICIS DISCLOSURE, ISLAMIC REITs, PARAGRAPH 156 - 157

Paragraph 157 states disclosure requirements for Islamic REITs, and paragraph 156/iii refers to disclosure of processes for Mortgages in which funds are invested. However, **we recommend addressing more disclosure requirements for Mortgage REITs.**