



Astana Financial Services Authority

Consultation Paper

No. 10 of 2018

Proposed Amendments to Islamic Finance Rules

September 27, 2018

Introduction

1. The Astana Financial Services Authority (AFSA) has issued this Consultation Paper to invite public comments on the proposed amendments to AIFC Islamic Finance Rules intended to enhance the regulatory framework for Islamic financial institutions.
2. The proposals in this Consultation Paper will be of interest to Authorised Persons, and individuals, financial organizations and investors who are interested in doing business in the AIFC. In particular, the proposed amendments presented for consultation by way of this paper will be of interest to Islamic financial institutions or investors interested in establishing business in the AIFC.
3. All comments should be in writing and sent to the address or email specified below. If sending your comments by email, please use "Consultation Paper No 10" in the subject line. You may, if relevant, identify the organisation you represent when providing your comments. The AFSA reserves the right to publish, including on its website, any comments you provide, unless you expressly request otherwise. Comments supported by reasoning and evidence will be given more weight by the AFSA.
4. The deadline for providing comments on the proposals is **26 October 2018**. Once we receive your comments, we shall consider if any refinements are required to this proposal.
5. Comments to be addressed by post:

Policy and International Relations
Astana Financial Services Authority (AFSA)
8 Kunayev Street, Building B, Astana, Kazakhstan
or emailed to: consultation@afsa.kz
Tel: +8 7172 613781
6. The remainder of this Consultation Paper contains the following:
 - (a) Background to the proposals;
 - (b) Key elements of the proposed amendments;
 - (c) Annex 1: The draft of proposed amendments relating to Central Shari'ah Board
 - (d) Annex 2: The draft of proposed amendments relating to the definition of Islamic Financial Institution

Background

1. In 2015 Astana was designated by the President of Kazakhstan as the location of the Astana International Financial Centre (“AIFC”). He stated the need to establish the AIFC on the base of the Expo-2017 infrastructure and to confer a special status on the AIFC. The AIFC participants, bodies and organisations will enjoy a special tax regime, special migration regime, special currency exchange regulation regime.
2. According to Article 2 of the Constitutional Statute of the Republic of Kazakhstan “On the Astana International Financial Centre” (the “Constitutional Statute”), the purpose of the AIFC is to establish a leading international centre for financial services. The objectives of the AIFC are as follows:
 - (1) attracting investment into the economy of the Republic of Kazakhstan by creating an attractive environment for investment in the financial services sphere;
 - (2) developing a securities market in the Republic of Kazakhstan and integrating it with international capital markets;
 - (3) developing insurance markets, banking services, and *Islamic financing*, in the Republic of Kazakhstan;
 - (4) developing financial and professional services based on international best practice;
 - (5) achieving international recognition as a financial centre.
3. Further development of the AIFC requires the enhancement of regulatory framework for the provision of the full range of financial services by Islamic financial institutions and ensuring compliance with international standards on Islamic finance.
4. The proposals in this paper result from the recommendations made by AIFC Advisory Council on Islamic Finance (ACIF). The ACIF recommended: (1) amending the Central Supervisory Shariah Board concept in the AIFC Islamic Finance Rules as it contradicted to the Central Shari’ah Board Standard (GSIFI 8) of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)” and (2) amending current definition of Islamic Financial Institutions (IFI) as Authorised Firm did not cover capital market players.

KEY ELEMENTS OF THE PROPOSED RULES

A Proposal relating to Central Shari'ah Board

5. In December 2017, the AFSA adopted the Islamic Finance Rules setting special provisions on functions of Central Shari'ah Board in the AIFC, including supervisory functions and providing services to Islamic Financial Institutions.
6. In December 2017, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), an international organisation setting shariah, accounting, governance and ethical standards for Islamic financial institutions, issued a new governance standard No 8 "Central Shari'ah Board" providing guidance on the definition, scope of work, responsibilities, appointments, compositions, independence, terms of reference of a Central Shari'ah Board and other relevant issues.
7. According to the Standard, Central Shari'ah Board (CSB) – a broad level board or similar body of specialised jurists in Islamic commercial jurisprudence and experts in Islamic banking, finance, economics, law, accounting, etc. providing guidance and advice on Shari'ah matters with limited supervision, that is established in a specific country or jurisdiction for providing uniformity and harmony in the products and practices with regard to Islamic finance through Fatwas, rulings and guidelines. The CSB decision are applicable on a broader base in the jurisdiction rather than a single institution. The CSB shall focus on harmony of Islamic banking and finance practices:
 - (a) globally, through adoption of AAOIFI Shari'ah standards and /or other widely accepted Shari'ah standards, which do not conflict with AAOIFI Shari'ah standards;
 - (b) locally, by providing principles, rulings, guidelines and other functional support as prescribed in the Standard, primarily considering global practice and having regard to the local context.

The Standard encourages that all CSBs should primarily have advisory function coupled with a limited level of supervisory authority. The function of the Board may be divided in three broad categories which are

- (a) advisory and Fatwa;
- (b) regulations; and
- (c) oversight and limited supervision.

Most of the functions of a CSB related to advisory and Fatwa are passive in nature, i.e. the board provides Fatwa or advice or guidance only when asked for it by the appointing authority or the regulator. The board shall be proactive in nature when, and only when, the following conditions are met:

- (a) it concludes that a major non-compliance of Shari'ah principles and rules has occurred which has not being taken care of by the appointing authority;
- (b) it concludes that a perception in the market exists that such non-compliance is in the knowledge of, or with the due approval of, the board; and
- (c) it concludes that unless a proactive step is taken with respect to such matter, the larger stakeholders' interest will be compromised.

8. In this regard, we propose to remove provisions related to supervisory functions of the AIFC Central Shariah Board and Shariah Supervisory Board functions for Islamic Financial Institutions.
9. In addition, considering that Central Shariah Board should perform advisory functions, we propose to include guidance that the AFSA may request the AIFC Central Shari'ah Board to provide guidance or advice on Shari'ah matters. The proposed amendments are presented in Annex 1.

Questions:

- (1) *Do you have any concerns relating to our proposals to remove provisions related to supervisory functions of the AIFC Central Shariah Board? If so, what are they, and how should they be addressed?*
- (2) *Do you have any concerns relating to our proposals to remove provisions related to Shariah Supervisory Board functions for Islamic Financial Institutions? If so, what are they, and how should they be addressed?*
- (3) *Do you have any concerns relating to our proposals to include guidance that the AFSA may request the AIFC Central Shari'ah Board to provide guidance or advice on Shari'ah matters? If so, what are they, and how should they be addressed?*

B Proposal relating to Islamic Financial Institution Definition

10. In December 2017, the AFSA adopted the Islamic Finance Rules where the Islamic Financial Institution is defined as an Authorised Firm whose license or authorisation includes a specific condition that the whole of its business is conducted in a manner fully compliant with Shari'ah. The current definition of Islamic Financial Institutions (IFI) does not cover capital market players as they may conduct both conventional and Islamic businesses.
11. In 2016 Bursa Malaysia (Exchange) launched Bursa Malaysia-i delivering the world's first end-to-end integrated Islamic securities exchange platform that offers investors the choice to invest and trade Shariah-compliant products via a Shariah-compliant platform. Bursa Malaysia-i incorporates the full range of Shariah-compliant exchange-related services including listing, trading, clearing, settlement and depository services, to underscore Bursa Malaysia's leadership as the global marketplace for Shariah listing and investments.
12. Considering the international experience, we propose to extend the current definition of Islamic Financial Institutions by including Authorised Market Institutions to regulate Islamic exchanges, Islamic Private E-currency Trading Facility and other market institutions. The proposed amendments are presented in Annex 2.

Question:

- (4) *Do you have any concerns relating to our proposals to extend the definition of Islamic Financial Institutions by including Authorised Market Institutions? If so, what are they, and how should they be addressed?*

In this section, the underlining indicates a new text and the striking through indicates deleted text in the proposed amendments to the AIFC Islamic Finance Rules

5. SHARI'AH SUPERVISORY BOARD

5.1 Appointment of Shari'ah Supervisory Board (SSB)–

- (1) An Islamic Financial Institution must appoint a Shari'ah Supervisory Board (SSB).
- ~~(2) An Islamic Financial Institution may use the services of a Centralised Shari'ah Supervisory Board (CSSB) established for addressing the Islamic Finance Business activities in the AIFC and recognised by AFSA, for the purpose of complying with the provisions in this chapter and in this IFR Rules.~~
- ~~(3) For such an Islamic Financial Institution employing the services of the CSSB, for complying with the IFR Rules, all references to Shari'ah Supervisory Board or SSB are to be read as references to the Centralised Shari'ah Supervisory Board or CSSB, as applicable.~~
- (2) An Islamic Financial Institution must ensure that:
 - (a) its SSB consists of at least 3 members; and
 - (b) the members appointed to the SSB are competent to perform their functions as SSB members taking into account their qualifications and previous experience; and
 - (c) any appointments, dismissals or changes in respect of members of the SSB are approved by the Governing Body of the Islamic Financial Institution; and
 - (d) no member of the SSB is a director or controller of the Islamic Financial Institution.

Guidance: The AFSA may request the AIFC Central Shari'ah Board to provide guidance or advice on Shari'ah matters.

5.12. ~~SSB's relationship with CSSB.~~

- ~~(1) An Islamic Financial Institution employing the services of its own dedicated SSB, must comply with the Shari'ah pronouncements and opinions issued by the CSSB.~~

- ~~(2) In case of a conflict between the opinion or interpretation of the CSSB and the SSB of the Islamic Financial Institution with respect to any Shari'ah matter, the opinion of the CSSB shall prevail.~~
- ~~(3) An Islamic Financial Institution must comply with the Shari'ah rules and principles as expressed in AAOIFI Shari'ah standards and in the rulings of the CSSB, wherever applicable.~~
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In this section, the underlining indicates a new text and the striking through indicates deleted text in the proposed amendments to the AIFC Islamic Finance Rules

1.7 Islamic Financial Institution

- (1) An Islamic Financial Institution is an Authorised ~~Firm~~ Person whose license or authorisation includes a specific condition that the whole of its business is conducted in a manner fully compliant with Shari'ah.
- (2) An Islamic Financial Institution must ensure that its constitutional documents state that its entire business will be conducted in a manner fully compliant with Shari'ah.