

### Facilitating the Implementation of the IFSB Standards Workshops

# CORE PRINCIPLES FOR EFFECTIVE ISLAMIC DEPOSIT INSURANCE SYSTEMS

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**Organised by:** 





# **Agenda**











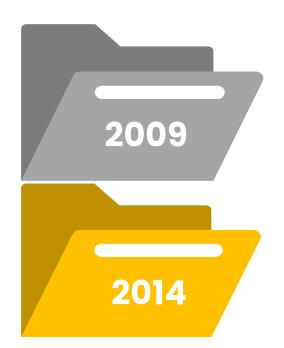


**Background** 





Core Principles for Effective Deposit Insurance Systems





Methodology for assessing compliance

Core Principles for regulation in the financial sector have become standard tools to guide regulatory and supervisory authorities (RSAs) in developing their regulatory regimes and practices.



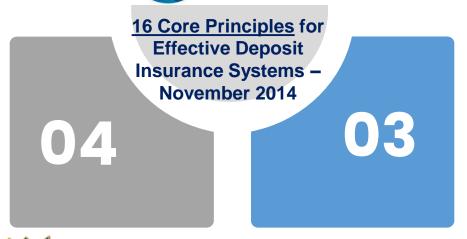
# **General approach of CPIDIS**

Principal objectives of depositor protection and financial stability are compliant with objectives of Shari'ah and IDIS.



Design features such as governance, membership, coverage, etc. are generally consistent but not fully applicable.

Modifications required to take into account into account the Sharī'ah requirements and heterogeneities of Islamic banking.



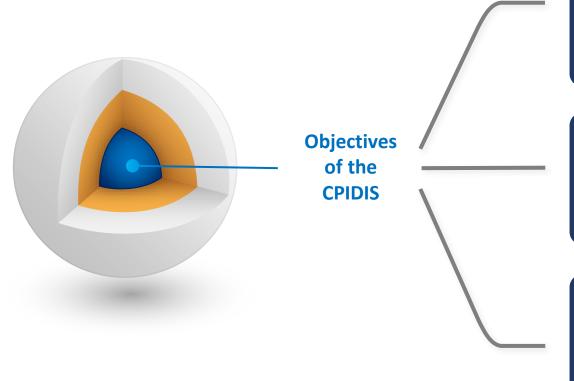
Moral hazard issues, operating environment and the other considerations discussed in the IADI CPs are also relevant to IDIS.

Ident application application

Identify areas the 16 IADI CPs not fully applicable for Islamic finance and Islamic deposit insurance



# **Objectives of the CPIDIS**





Serve as a benchmark international framework to facilitate the development and implementation of effective IDIS;



Enable existing IDIS to identify best-practice gaps in their current modalities; and



Facilitate an independent, third-party or self assessment of the compliance of an IDIS with CPIDIS



# **Operating environment**

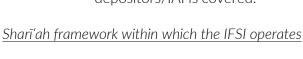
#### Macroeconomic conditions:

market volatility can lead to destabilising creditor runs (including depositor runs). Moreover, uncertainties about future movements in relative prices, including asset prices and exchange rates, can make it difficult to determine the medium-term viability of an institution.

01

#### Structure of the IFSI:

- health of Islamic banks based on an evaluation of capital adequacy, liquidity and credit quality of the Islamic financial system;
- number, type and characteristics of Islamic banks, and types of deposits/investment accounts and depositors/IAHs covered.



The implementation of the IDIS in a dual banking system where Islamic banks operate alongside the conventional banks

Well-functioning Islamic money and capital markets

Pre-existing consumer protection arrangements

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#### The Accounting and Disclosure Regime:

- accurate, reliable and timely information enables management, depositors, the market and authorities to make decisions regarding the risk profile of an institution;
- independent audits ensures that the users of financial statements have an independent assurance that the accounts provide a true and fair view of the financial position of the Islamic banks.

#### The Legal and Judicial Framework:

a well-developed legal framework should incorporate a system of business laws, including corporate, insolvency, contract, creditor rights, consumer protection, anti-corruption/fraud and private property laws;

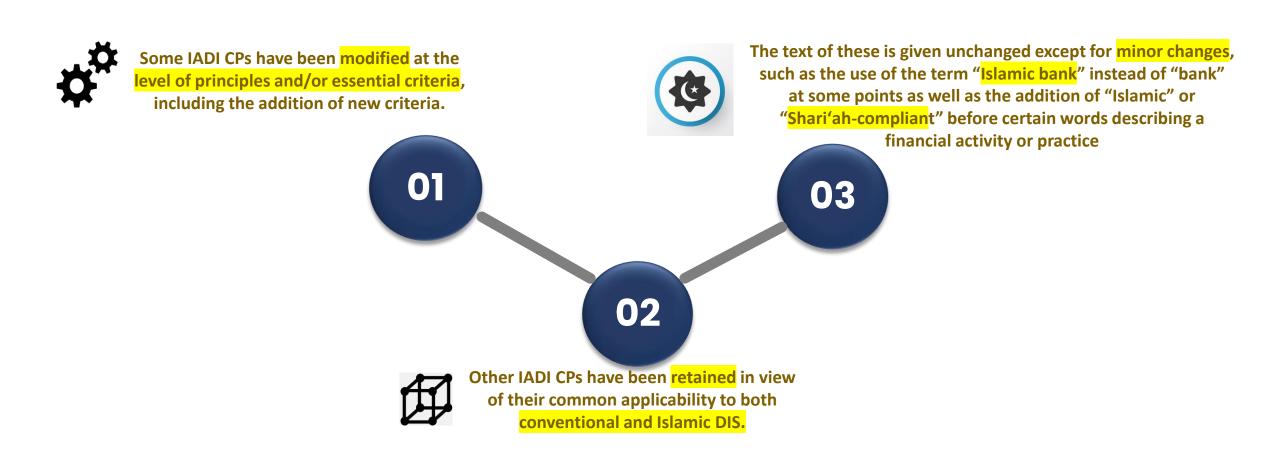
- weakness in the legal framework can undermine the effectiveness of the safety-net in general and the deposit insurance system in particular.

#### Prudential Regulation, Supervision and Resolution:

- institution's weaknesses are promptly identified and corrected;
- fiduciary risk is particularly important in Islamic banks.



# Revisions at the level of Core principles





MANDATE AND POWERS **GOVERNANCE RELATIONSHIPS WITH OTHER SAFETY-NET PARTICIPANTS CROSS-BORDER ISSUES DEPOSIT INSURER'S ROLE IN CONTINGENCY** PLANNING AND CRISIS MANAGEMENT **MEMBERSHIP** COVERAGE **SOURCES AND USES OF FUNDS PUBLIC AWARENESS LEGAL PROTECTION DEALING WITH PARTIES AT FAULT EARLY DETECTION AND TIMELY** INTERVENTION **FAILURE RESOLUTION REIMBURSING DEPOSITORS RECOVERIES SHARIAH GOVERNANCE** 

**CPIDIS 1:** The principal public policy objectives for Islamic deposit insurance systems are to protect depositors and contribute to financial stability. These objectives should be formally specified and publicly disclosed. The design of the Islamic deposit insurance system should reflect the system's public policy objectives while being in conformity with Sharī'ah requirements.

4 Essential Criteria

- Modification to reflect the design features of an IDIS are Shari'ah-compliant
- Modification to incorporate feedback from the Shari'ah Board during review of an IDIS





**CPIDIS 2:** The mandate and powers of the deposit insurer should support the public policy objectives and be clearly defined and formally specified in legislation.



Modification to reflect where an IDIF is not owned by IDIS due to its Shari'ah-compliant design, the IDIS has clearly specified authorisation in legislation to utilise the funds for carrying out its duties.



loss minimiser

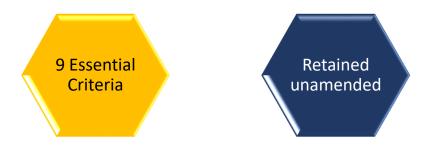
risk minimiser



accountable

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**CPIDIS 3:** The deposit insurer should be operationally independent, well-governed, transparent, accountable, and insulated from external interference.



independent wellgoverned transparent



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**CPIDIS 4:** In order to protect depositors and contribute to financial stability, there should be a formal and comprehensive framework in place for the close coordination of activities and information sharing, on an ongoing basis, between the deposit insurer and other financial safety-net participants.







PUBLIC POLICY OBJECTIVES

MANDATE AND POWERS

**GOVERNANCE** 

RELATIONSHIPS WITH OTHER SAFETY-NET PARTICIPANTS

CROSS-BORDER ISSUES

DEPOSIT INSURER'S ROLE IN CONTINGENCY PLANNING AND CRISIS MANAGEMENT

**MEMBERSHIP** 

COVERAGE

SOURCES AND USES OF FUNDS

**PUBLIC AWARENESS** 

**LEGAL PROTECTION** 

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EARLY DETECTION AND TIMELY INTERVENTION

**FAILURE RESOLUTION** 

REIMBURSING DEPOSITORS

**RECOVERIES** 

SHARIAH GOVERNANCE

**CPIDIS 5:** Where there is a material presence of foreign Islamic banks in a jurisdiction, formal information sharing and coordination arrangements should be in place among deposit insurers in relevant jurisdictions.



Addition to incorporate cross-border coordination arrangements that seek clarity regarding the type of Islamic deposits protected by the IDIS in each respective jurisdiction.

Information sharing arrangements and/or bilateral or multilateral agreements clarify the type of covered deposits, including, but not limited to, investment accounts,33 and also differences in treatment (if any) due to different Sharī'ah interpretations by respective Sharī'ah boards



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**CPIDIS 6:** The deposit insurer should have in place effective contingency planning and crisis management policies and procedures to ensure that it is able to effectively respond to the risk of, and actual, Islamic bank failures and other events. The development of system-wide crisis preparedness strategies and management policies should be the joint responsibility of all safety-net participants. The deposit insurer should be a member of any institutional framework for ongoing communication and coordination involving financial safety-net participants related to system-wide crisis preparedness and management.



Addition to reflect the IDIS is compliant with Shari'ah rules and principles in its contingency planning and crisis management

The deposit insurer complies with Sharī'ah rules and principles in its contingency planning and crisis management activities, as reviewed and endorsed by the Sharī'ah governance system outlined in CPIDIS 17.



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**CPIDIS 7:** Membership in an Islamic deposit insurance system should be compulsory for all Islamic banks.



Modification to reflect membership of IDIS includes Islamic banking windows



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**CPIDIS 8:** Policymakers should define clearly the level and scope of coverage. Coverage should be limited and credible, and cover the large majority of depositors, but leave a substantial amount of deposits exposed to market discipline. Coverage should be consistent with the Islamic deposit insurance system's public policy objectives and related design features.



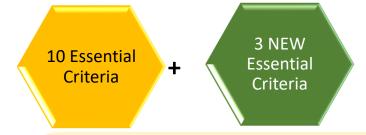
- ❖ Addition to incorporate clarity on protection status for "investment accounts" when offered by Islamic banks
- Modification to reflect equality in coverage limit when a single DIS offers both CDIS and IDIS.

The coverage status of investment accounts is clearly and publicly defined based on public policy objectives. If an investment account is covered, the deposit insurer ensures appropriate design features are in place for such coverage in line with the Sharī'ah rulings of the relevant Sharī'ah



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**CPIDIS 9:** The deposit insurer should have readily available funds and all funding mechanisms necessary to ensure prompt reimbursement of depositors' claims, including assured liquidity funding arrangements. Responsibility for paying the cost of deposit insurance should be borne by Islamic banks and, where applicable, IAHs.



- ❖ Addition to incorporate clarity on sources of funds for protection of investment accounts.
- Modification to reflect initial/seed-funding from CDIS to IDIS and its repayment without any interest payment on principal.
- Modification to reflect need for Shari'ah-compliant arrangement for sources of emergency funding.
- Modification to reflect the target fund-size for IDIS to be determined separately from CDIS
- Modification to reflect need for Shari'ah-compliant arrangements for investment of IDIF.
- Modification for accounting for sound and responsible Shari'ah-compliant arrangement of IDIF, and proper separation of records and expenditure allocations for CDIF and IDIF, when maintained by a single deposit insurer.
- Modifications to reflect funds placed by the IDIF with central bank(s) is through a Shari'ah-compliant mechanism



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**CPIDIS 10:** In order to protect depositors and contribute to financial stability, it is essential that the public be informed on an ongoing basis about the benefits and limitations of the Islamic deposit insurance system.



Modification to reflect public awareness on the mandate of the IDIS and the Shari'ah-compliant nature of its operations, investment policy and sources of funding

communication plan

timeliness and accuracy



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**CPIDIS 11:** The deposit insurer and individuals working both currently and formerly for the Islamic deposit insurer in the discharge of its mandate must be protected from liability arising from actions, claims, lawsuits or other proceedings for their decisions, actions or omissions taken in good faith in the normal course of their duties. Legal protection should be defined in legislation.

4 Essential Criteria

Modification to incorporate the role of Shari'ah Advisors / Shari'ah Board Members for legal protection.



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**CPIDIS 12:** The deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in an Islamic bank's failure.







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**CPIDIS 13:** The deposit insurer should be part of a framework within the financial safety-net that provides for the early detection of, and timely intervention in, troubled Islamic banks. The framework should provide for intervention before the Islamic bank becomes non-viable. Such actions should protect depositors and contribute to financial stability.



Modification to reflect other risks specific to Islamic banks and used to trigger timely intervention or corrective action

defined in law

safety and soundness indicators

reviewed periodically



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**SHARIAH GOVERNANCE** 

**CPIDIS 14:** An effective failure resolution regime should enable the deposit insurer to provide for protection of depositors and contribute to financial stability. The legal framework should include a special resolution regime.

9 Essential Criteria

- Modification to reflect resolution regime complies with Shari'ah framework as applied in the jurisdiction.
  - Modification to reflect Shari'ah-compliant resolution options available to the IDIS.
- Modification to reflect depositor hierarchy in resolution procedures complies with Shari'ah rules and principles



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**CPIDIS 15:** The Islamic deposit insurance system should reimburse depositors' insured funds promptly, in order to contribute to financial stability. There should be a clear and unequivocal trigger for protected depositor reimbursement.







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**CPIDIS 16:** The deposit insurer should have, by law, the right to recover its claims including claims of the Islamic deposit insurance fund under its management, in accordance with the statutory creditor hierarchy.



❖ Modification to account for IDIS design where IDIF is not in ownership of IDIS, but the IDIS has rights to recover claims of the IDIF under its management (i) by being recognised as a creditor through subrogation; (ii) by having same rights in law as that of a creditor or depositor in estate of failed Islamic bank; (iii) by having right to access information from the liquidator



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**CPIDIS 17:** The Islamic deposit insurance system should have in place a comprehensive and properly functioning Shari'ah governance system.

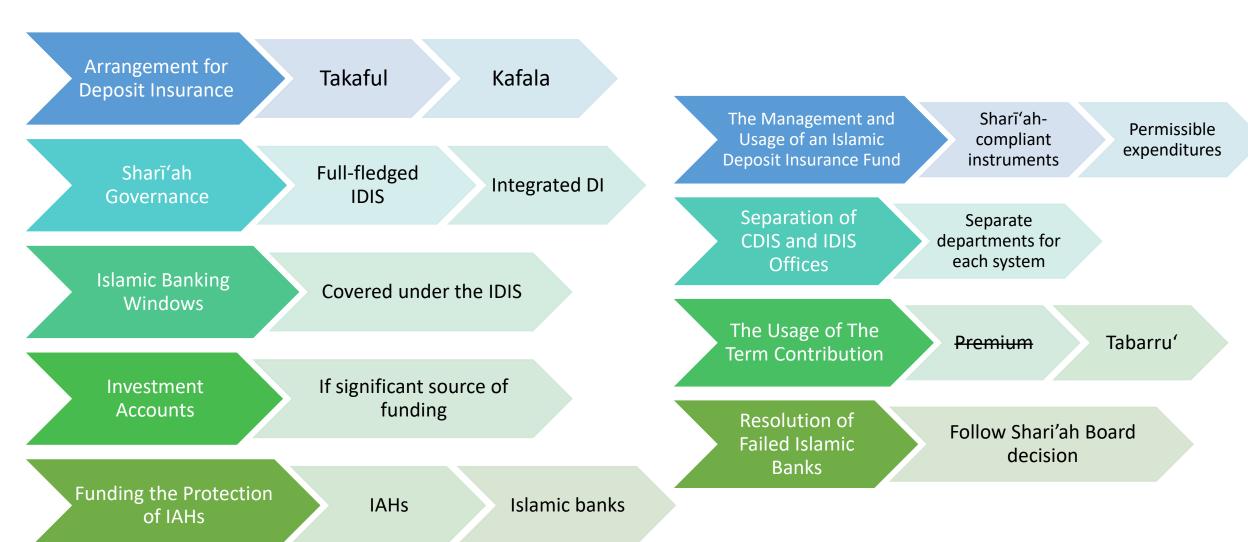
Shari'ah governance system Shari'ah Board competent & independent

Disclosures to stakeholders

Activities are Shari'ah compliant



# Shari'ah requirements and specificities for IDIS design





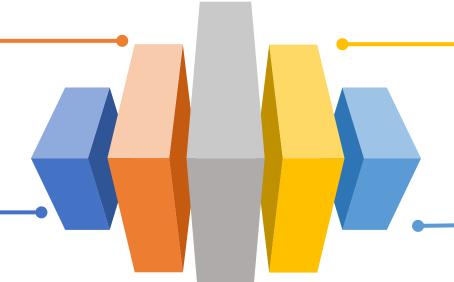
# Key considerations for Investment Accounts under an IDIS

#### **COVERAGE**

- set equally for all its Islamic bank members;
- protected amount of investment accounts is the outstanding balance.

# SOURCES AND USES OF THE FUND

 party responsible for funding the protection of investment accounts – IAH or Bank?



#### **PUBLIC AWARENESS**

whether or not investment accounts are covered.

#### **FAILURE RESOLUTION**

- hierarchy for reimbursement of IAHs;
- deposit insurer segregates the disposal proceeds;
- deposit insurer distributes any outstanding PER and IRR.

#### **RECOVERIES**

 investment accounts protection fund is a separate legal and financial entity THEN it is creditor.



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# Thank you

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