

## **Eighth: Offering of Islamic Financial Services by Commercial Banks**

Commercial banks wishing to offer Islamic financial services should open an independent Islamic branch according to the following rules:

### **1- Legal and Shariaa Rules**

1/1 QCB's approval should be obtained before opening an Islamic branch according to the relevant application form. More than one Islamic branch can be opened in more than one location provided that they should be treated as an integrated financial position of a single Islamic branch.

1/2 Banks should review their statute from the legal perspective to define their adequacy to conduct the new activities.

1/3 A Shariaa board, consisting of minimum two Shariaa scholars, should be appointed to oversight and approve all Islamic activities of the bank's branches in compliance with the Islamic Shariaa rules and principles.

1/4 A Shariaa auditing body should be appointed to audit all activities of the branches from the Islamic point of view, reporting to the Shariaa board.

### **2- Banking Activities offered by Islamic Branches**

#### 2/1 On-balance Sheet Items

Sources and usages of funds included in the unrestricted Mudaraba pool which their business results shall be finally defined at the end of the financial year, including:

##### 2/1/1 Sources of Funds

###### A- Current Accounts

Demand deposits guaranteed by the bank without paying returns.

###### B- Unrestricted Investment Accounts

All funds received by the branch from various customers in terms of unrestricted investment accounts based on unrestricted Mudaraba

contacts to be invested in the general pool of the branches fund without any restrictions from the account holder's.

C- Self Sources

Balances due to the headquarter.

D- Any other type of fund sources in compliance with Shariaa rules, agreed by QCB.

2/1/2 Usages of Funds

A- Granting credit facilities in compliance with Shariaa according to the following controls:

- Binding Murabaha for the purchase orderer with obligation to fulfill the promise.
- Binding Ijarah Muntahia Bittamleek with obligation to fulfill the promise.
- Mudaraba finance for value and period-defined contracts for not more than five years.
- Diminishing Musharakah for value and period-defined contracts for not more than five years.
- Istisna finance against parallel Istisna.
- Islamic financing instruments (Sukoks).

B- Deposits with banks and financial institutions in compliance in Shariaa.

C- Shariaa compliant financial investments.

D- Any other type of fund usages in compliance with Shari'a rules, agreed by QCB.

2/2 Off-balance Sheet Items

2/2/1 Sources of funds that are not based on the unrestricted Mudaraba contracts:

They are funds received by the branch from the customers in terms of investment portfolio or accounts based on the restricted Mudaraba or agency contracts, or any other Shariaa-compliant contracts with exception of the unrestricted Mudaraba contracts, to be invested on customers behalf with certain restrictions separately from pool of funds belongs to

the unrestricted Mudaraba contracts. The result and returns of such funds should be defined according to the terms of the contracts and have nothing to do with the results and returns of the unrestricted Mudaraba Fund. Accordingly, they are called "Restricted Investment Accounts".

2/2/2 Usages of funds included in the restricted investment accounts:

This shall be defined according to types of investment agreed in the contracts as stated in the above-mentioned paragraph no. (2/2/1).

2/2/3 Contingent Liabilities

This includes the letters of credit, guarantees, and other indirect liabilities that are Shariaa compliant.

### **3- Risk Management**

#### **3/1 Banking Risk**

3/1/1 Banks and their Islamic branches shall implement all QCB's instructions on requirements of liquidity and capital adequacy, monetary reserve, all ceilings, supervisory ratios of concentrations, and other banking risks on a consolidated basis.

3/1/2 Banks should manage the banking risk of their Islamic branches and determine separately an independent branch, in addition to manage risks on a consolidated basis. Banks should put policies and procedures to mitigate different risks of services and activities offered by Islamic branches and to evaluate their assets and liabilities. Accordingly, banks should comply with the following:

3/1/2/1 Allocate a proper capital to the Islamic branches.

3/1/2/2 The total amounts due to the headquarter should not exceed 30% of the bank's capital and reserves. The headquarter's total amount due includes:

Capital allocated to Islamic branches minus fixed assets plus headquarter's balance due from the branch.

**3/1/2/3 Concentration risk at Islamic branches:**

The bank should define a ceiling for a single customer's credit concentration and ceilings for the Islamic branches' investment concentration so that these ceilings should be suitable for volume of these branches' invested funds. Accordingly, banks should not depend upon the total ceilings defined by QCB on the level of the bank as a whole, as these total ceilings may pose a severe concentration in the Islamic branches' assets. Each bank should inform QCB with the concentration ceilings defined for its Islamic branches.

**3/1/2/4 Total balances of finance using Murabaha and Diminishing Musharakah contracts should not, at any time, exceed 20% of total Islamic finance portfolio offered by the Islamic branches.**

**3/1/2/5 Islamic branches are not permitted to own real estates, assets or commodities even for purpose of investment, except for purpose of financing.**

**3/1/2/6 While conducting the Islamic financial operations, the branch should use the appropriate hedging instruments which prevent ownership of the assets and purchase of goods, and prevent from being exposed to different risks, such as market and amortization risk and others (such as purchase operations with the right of recession in case of Murabaha, and insurance in case of Ijarah contracts and of parallel Istisna hedging Istisna risk, and other instruments).**

**3/2 Managerial and Accounting Controls**

**3/2/1 Banks should establish an organizational management structure of the Islamic branches including directors, executive departments and divisions highly-qualified, experienced and trained in the field of Islamic financial services.**

**3/2/2 Accounts of the bank's branch should be separated by establishing accounting divisions and records, an independent accounting system for the**

branch, and independent vouchers and documentations from which an independent financial position and income statement could be calculated without any conflict with other accounts of the bank. Accordingly, the accounting system should depend upon the financial accounting standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) when classifying and disclosing the branch's financial statements and business results.

3/2/3 Contracts and documentations of the Islamic branch's different transactions conducted with customers and others should be ratified by the Shariaa board from the legal and Shariaa perspectives.

3/2/4 The Islamic branch should comply with QCB's instructions when calculating and distributing profits to depositors, and bearing losses, especially the instructions stating that the banks should not increase subsidize of return rate more than the accrued shares of the Mudaraba contracts.

3/2/5 The bank should prepare a monthly financial position of the bank and its Islamic branches on a consolidated basis, in addition to an independent financial position of the Islamic branches. All financial positions should be monthly sent to QCB in conformity with the forms mentioned in pages no. (352-353).

3/2/6 The bank should prepare its consolidated financial statements at the end of the year and on a periodic basis in conformity with the Financial Reporting Standards. The bank should disclose its Islamic financial activities and services offered through the Islamic branch. The bank should also disclose methods of risk management and its effect on the bank's financial position on a consolidated basis.

3/2/7 Risk reserve shall be calculated on a consolidated basis for the credit portfolio of the bank as a whole and be fully included within the bank's consolidated balance sheet under the "Shareholder's Equity" item.

These instructions shall come into effect as of December 2007. Accordingly, banks violating such instructions should take the necessary actions for implementations accommodate their positions within six months as of December 2007.