



**AAOIFI's Governance Standard on Shari'ah
Compliance & Fiduciary Rating for IFIs
&
Islamic International Rating Agency ("IIRA") Rating
Methodology**

- IIRA was set up as an infrastructure institution for Islamic Finance in 2002
- Islamic Development Bank was the founder shareholder
- Two key objectives were and are relevant
 - Growth of national and international sukuk markets through ratings in Islamic countries where rating culture is not well developed
 - Providing a value added service to Islamic investing by formalizing a view on Shari'ah compliance

IIRA Ratings – Niche

- **IIRA provides ratings for all types of issuers and issues**
 - Shari’ah Compliance and Fiduciary Rating
 - Sovereign Ratings
 - Issuer Ratings
 - Sukuk Ratings
 - Takaful Financial Strength and Fiduciary Ratings
 - Participation Banks Fiduciary Ratings
 - Governance Ratings
 - Waqf Assessment (Development in progress)
 - Collective Investment Scheme (CIS) Ratings
- Financial Data Portal (available through Subscription)
- Rating and training workshops

**Core
Services**

GCC

- Bahrain
- Kingdom of Saudi Arabia
- United Arab Emirates
- Oman

Levant

- Egypt
- Jordan
- Lebanon
- Syria
- Turkey

Africa

- Sudan
- Tunisia
- South Africa
- Algeria
- Nigeria

South & South East Asia

- Malaysia
- Pakistan

IIRA's Presence in Islamic Markets

Be an alternate voice in international ratings

Customized approach to rating Islamic Financial Institutions

Facilitate Development of Sukuk markets through National Scale Ratings

Facilitating Cross-border Transactions

Form local base in key OIC member economies

Wide coverage of Sovereign Ratings in OIC Countries

**IIRA –
Primary
Objectives**

- IIRA provides ratings for all types of issuers and issues through a value added methodology that incorporates the element of Shari’ah governance in all of its ratings through its “Fiduciary Ratings”
- IIRA’s Fiduciary Ratings appeal to the diverse needs of investors, with greater information regarding institutional financial strength, in addition to governance infrastructure, while giving specific coverage to Shari’ah governance

IIRA’s Fiduciary Ratings

- How are Fiduciary Ratings differentiated from conventional ratings?
 - Two-dimensional assessment – recognizes the mutually dependent nature of credit & Fiduciary risks in an IFI
 - ❖ Poorly governed institutions – may be more susceptible to the risk of credit failure
 - ❖ Credit event could be triggered by perception regarding Shari’ah Governance
 - Credit ratings may be faced with downward pressure on account of developments in terms of fiduciary capacity

Fiduciary Ratings

- Market participants recognize the need of investors to discern the level of compliance with generally accepted standards
- Hence a standard focused on providing such information
- Encapsulates all areas of coverage laid out in GSIFI 10 to be finalized shortly
- Comprehensive guidance for best practices, resulting in a continuously evolving framework of governance for Islamic financial institutions.

**IIRA'
Shari'a
Rating
Standard
Objective**

- The Standard and methodology envisages the institutionalization of a system of review of IFIs' adherence to Shari'ah related guidance and standards.
- Issues an independent opinion
- The final output in the form of an Alpha-numeric symbol is indicative of the rank order classification of a financial institution in terms of compliance of and fulfillment of the Fiduciary responsibilities of Shari'ah based investing.

**Rating
Outcome**

- The fundamental objective of ratings is to evaluate the process of compliance to a pronouncement, as put in place, more than evaluate the ‘correctness’ of the underlying structure itself.
- IIRA further evaluates Islamic financial services or products of an institution against a ‘hierarchy of standards of Compliance’, being ‘international’, ‘local’ or ‘institution’ level
 - International best practices
 - Country level guidance
 - institutional approvals or guidance

Hierarchy of Compliance

- Best practices remain universal; ratings will be benchmarked to international best practices (save in areas where regulations or commercial law bars an institution from instituting such practices).
- In terms of product structure and design, where permitted practices are notably weaker than internationally relevant guidance, ratings may be relatively lower rating than those of an institution which follows international best practices.
- Rating evaluation is conducted annually to capture both positive and adverse developments on a timely basis

Scope

- Reflects a combined assessment of an IFI's relative state of compliance, duly reflected on a rating scale, with standards, regulations and best practices (collectively called benchmarked practices) with regard to
 - (A) Compliance with Shari'ah principles and rules
 - (B) Shari'ah Governance Framework
 - (C) Corporate Governance Practices
 - (D) Transparency and Disclosures
 - (E) Ethics and Values
 - (F) Fiduciary Responsibility and Performance.

Key Parameters of Assessment

Compliance with Shari'ah principles and rules-

- A.1 Compliance with Shari'ah principles and rules in terms of product structure,
- A.2 Adherence to approved structures and policies as also evidenced in the generation of non-halal income as a consequence of inconsistent implementation of A.1 above,
- A.3 Asset Manager Quality, i.e. quality of business generated and avoidance of unnecessary risk backed by a sound, business screening process, reflected in risks and return characteristics vis-à-vis peers.

Shari'ah Governance Framework

- B.1 Empowerment, Independence, Competence and Integrity of Providers of Shari'ah Guidance through Shari'ah Supervisory Board and Management engaged in the enabling of Shari'ah compliant finance,
- B.2 Organization wide acceptance and respect for faith based finance,
- B.3 System of checks and balances through internal and external audit, enabling the roll out of Shari'ah principles in business.

**Key Pillars
described**

Corporate Governance framework

- C.1 Empowerment, Independence, Competence and Integrity of Leadership to enable a system for protection of rights of stakeholders including unrepresented shareholders, and most significantly investment account holders
- C.2 System of Internal Control enabling A.3 and C.1 above

Transparency and disclosure

- D.1 Disclosure of practices and performance through published and web based media,
- D.2 Investor engagement and in particular communication with takaful participants in Takaful firms and investment account holders in Islamic banks, by recognizing the difference in nature of claim of investment account holders in IFIs vis-à-vis that of depositors in conventional banks.

**Key Pillars
described**

Ethics and Values

- E.1 A code of ethics and values should be adopted at all levels within the organization,
- E.2 An appreciation of environmental and social ecosystems as a tenet of faith based investing should be incorporated in investment screening processes,
- E.3 Entity level adoption of practices that respect the environment and social causes.

Fiduciary Responsibility and Performance

- F.1 Methods employed for distributing returns,
- F.2 Comparison of returns or losses transferred to investors.

**Key Pillars
described**

AAA (SCFR) –conforms to the highest level of standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance AA (SCFR)

AA (SCFR) - Conforms to very high level of standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance

A (SCFR)–conforms to high level of standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance

BBB (SCFR) –conforms moderately to standards in terms of fulfilling fiduciary obligations of Shari’ah compliant Finance and has few weaknesses in some areas of Shari’ah compliant Finance

BB (SCFR) –conforms to satisfactory level of standards of Shari’ah requirements and has notable weaknesses in some areas of Shari’ah compliant Finance.

B (SCFR)– Does not conform adequately to Shari’ah requirements and has notable weaknesses in several areas of Shari’ah compliant Finance

Rating Definitions

- On the panel of approved rating agencies of IDB
- Recognized as an External Credit Assessment Institution (ECAI) by:
 - Central Bank of Bahrain (CBB)
 - Central Bank of Jordan (CBJ)
 - Banking Regulation & Supervisory Agency (BRSA), Turkey
 - Central Bank of Sudan (CBoS)
- Recognized as an External Credit Rating Agency (ECRA)
 - Astana Financial Services Authority (AFSA), Kazakhstan
 - The Securities and Exchange Commission of Pakistan (SECP)
- IIRA is also an approved rating agency by the National Insurance Regulatory Authority, Sudan
- IIRA is also licensed to operate as a rating agency in Sultanate of Oman

- Rating Committee consists of
 - Core members
 - Shari'a experts.

All members are completely independent with no conflict of interest

- IIRA's website www.iirating.com makes full disclosure regarding its ownership, management, rating methodology for all its services and rating scales and definitions

**IIRA's
Competitive
Edge –
(Cont'd.....)**

**THANK
YOU**