MFSA Guidance Note for Shariah Compliant Funds

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Introduction

• To give background of legal and regulatory framework
• Issued in 2010
• New dimension to successful business model
• Malta as an alternative fund domicile, adding layer upon layer of fund products and services
• “Streamlined framework that recognises financing techniques more frequently used in Islamic financing in a Maltese legal and regulatory setting”
• Opportunity to provide asset managers specialised in Islamic funds with access to European market and, through it, global market
• Full access to EU financial markets and physical and cultural proximity to North African and Middle Eastern markets
Purpose

- Guidance to fund promoters
- Set out issues MFSA expects Islamic funds to address as part of licence conditions
Licensing Framework (1)

- Islamic **equity** funds may be set up as
  - Retail (UCITS or non-UCITS)
  - PIF
- **Ijarah, Commodity** and **Murabaha** funds
  - Only PIF

*Composition of investment funds by asset class*

Source: KFH Research.
Licensing Framework (2)

- **Level playing field** – regulated in same manner as conventional funds in same category
- Risk-spreading principle (except if exempt under proviso)
- Fund’s managing body responsible for compliance with Shariah principles
- Shariah guidelines must also comply with prevailing regulatory and statutory requirements
Shariah Advisory Board (1)

- Appointed by Manager
- At least 2 internationally recognised Shariah Scholars
  - (AAOIFI recommends 3)
- Independent from Manager
- Can appoint legal entity, in turn appoints SAB
Shariah Advisory Board (2)

- Role and Function
  - Guidance and not investment advice
  - Approve fund structure and investment methodology
  - Review contractual relationships
  - Approve all matters pertaining to Shariah-compliance
  - Provide ongoing services – including monitoring
  - Report to investors on annual basis in audited financial statements expressing opinion on Shariah compliance
Disclosures in OM

- Details on members of the SAB
- Terms of appointment of SAB
- Reference to review carried out prior to launch and SAB’s opinion
- Main features of Shariah-guidelines
- Disclaimer than Directors and Manager are responsible for ensuring compliance with Shariah principles and that MFSA has not assessed the competence of members of SAB or assessment or value judgment on accuracy/completeness of statements/opinions with respect to compliance
- Risks associated with Shariah-compliance
- Treatment of investments no longer Shariah-compliant
Disclosure in Audited FS

- Report by SAB with opinion on whether fund complied with Shariah principles and guidelines during period under review
- Distribution of income to entities other than investors in fund and circumstances which led to distributions and recipients of such funds
Conclusion

• Only EU regulator that has issued such formal guidance notes
• Unfortunately, industry not widely aware
• No focus on purification of assets
• Should be backed by a dedicated team within MFSA to deal with the establishment of Shariah-compliant funds coupled by promotion efforts by Government and Practitioners
• Corporate governance issues – conflicts of interest if “connected” to the fund or serves another function within the fund