

Appendix 5

In this annex underlining indicates new text and striking through indicates deleted text.



Notice of Amendments

Islamic Finance Rules

(IFR)

in relation to Consultation Paper No. 83

5 MANAGING PROFIT SHARING INVESTMENT ACCOUNTS

5.1 Application

5.1.1 This chapter applies to an Authorised Firm which conducts the Financial Service of Managing Profit Sharing Investment Accounts (PSIAs).

Guidance

1. A PSIA does not constitute a Deposit, because a PSIA is managed in relation to property of any kind, and the risk of loss of capital, to the extent of the Client's contribution, remains with the Client. Accordingly, an Authorised Firm should take great care to ensure that a PSIA is not represented as a Deposit, either directly or indirectly. The DFSA may conclude that the Authorised Firm is Accepting a Deposit instead of Managing a PSIA in certain circumstances, for example, where the Authorised Firm attaches to the investment account characteristics or facilities that are generally regarded to be those of a Deposit or current account such as providing:
 - a. an explicit or implicit guarantee to the Client against the risk of loss of capital; or
 - b. a cheque book, an ATM card or a debit card.

5.1.2 ~~An Authorised Firm in prudential Category 1, 2 or 3 may only Manage a PSIA through an Islamic Window.~~

Guidance

2. ~~The prudential Category for Islamic Financial Institutions and other Authorised Firms Managing PSIAs is determined in accordance with the Rules in PIB.~~ Prudential Category 5 firms are Islamic Financial Institutions whose entire business is conducted according to Shari'a and are authorised to manage Profit Sharing Investment Accounts. An Authorised Firm which manages PSIAs, whether as an Islamic Financial Institution or through an Islamic Window, must also comply with the requirements in PIB in relation to specific prudential requirements relating to Trading Book and Non-Trading Book activities, including Credit Risk, Market Risk, Liquidity Risk and Group Risk.

5.2 Additional disclosure requirements for PSIAs

5.2.1 An Authorised Firm must, prior to Managing a PSIA, provide written notice to the Client that the Client alone will bear any losses arising from the PSIA, which are limited to the amount of his contribution, unless there is negligence, misconduct or breach of contract on the part of the Authorised Firm.

Client Agreement

5.2.2 In addition to matters referred to in COB section 3.3, an Authorised Firm must ensure that the following information is included in the Client Agreement relating to a PSIA:

- (a) how and by whom the funds of the Client will be managed and invested including details of its policy on diversification of the portfolio;

- (b) the basis for the allocation of profit between the Authorised Firm and the Client;
- (c) confirmation of the Client's investment objectives including details of any restrictions requested by the Client, as agreed between the Client and the Authorised Firm;
- (d) a summary of the policies and procedures for valuation of assets or portfolio;
- (e) a summary of policies and procedures for the transfer of funds to and from the Profit Equalisation Reserve or Investment Risk Reserve accounts, if applicable;
- (f) particulars of the management of the PSIA and of any third party to whom the Authorised Firm has or will delegate or outsource the management of the PSIA, including:
 - (i) the name of the third party;
 - (ii) the regulatory status of the third party; and
 - (iii) details of the arrangement.
- (g) details of early withdrawal, redemption or other exit arrangement and any costs to a Client as a result thereof;
- (h) details of segregation of the funds of the Client from the funds of the Authorised Firm and from any claims by the creditors of the Authorised Firm;
- (i) details of whether funds from one PSIA will be commingled with the funds of another PSIA; and
- (j) details of any applicable charges and the basis upon which such charges will be calculated including, any deductions of fees that may be made by the Authorised Firm from the profits of the PSIA.

Periodic Statements

- 5.2.3**
- (1) COB section 6.10 applies to an Authorised Firm as if the Authorised Firm is an investment manager in respect of those Clients who are PSIA holders.
 - (2) In addition to the requirements of COB section 6.10, an Authorised Firm must ensure that a periodic statement provided to a Client contains the following information:
 - (a) details of the performance of the Client's investment;
 - (b) the allocation of profit between the Authorised Firm and the Client; and (c) where applicable, details of changes to the investment strategies that may affect the Client's account or portfolio.

Additional matters to be included in the policy and procedures manual

- 5.2.4** Where an Authorised Firm Manages a PSIA, its Islamic Financial Business policy and procedures manual must address the following additional matters:
- (a) the basis upon which a PSIA will be deemed restricted or unrestricted;
 - (b) the basis for allocation of profit or loss to the PSIA;
 - (c) the basis for allocation of expenses to the PSIA;
 - (d) the manner in which an Authorised Firm's own funds, funds of restricted PSIA's and funds from unrestricted PSIA's are to be controlled;
 - (e) the manner in which the funds of each type of investment account holder will be managed;
 - (f) the manner in which it will determine priority for investment of own funds and those of holders of unrestricted PSIA's;
 - (g) how provisions and reserves against equity and assets in accordance with AAOIFI FAS 11 are to be applied; and
 - (h) the manner in which losses incurred as a result of the misconduct or negligence for which the Authorised Firm is responsible will be dealt with.

Guidance

For the purposes of Rule 5.2.2, the policy and procedures manual should include procedures to ensure that the Authorised Firm manages the accounts of Profit Sharing Investment Account holders in accordance with their instructions.

5.3 Funds of PSIA holders

- 5.3.1** Unless clearly expressed in the contract between an Authorised Firm and a PSIA holder, the Authorised Firm may not use funds provided by a PSIA holder to fund its own corporate activities.

5.4 Prudential requirements

Application and Interpretation

- 5.4.1** (1) This section applies when calculating Credit Risk or Market Risk in respect of Islamic Contracts invested in or held by an Authorised Firm Managing a PSIA, which is an Unrestricted PSIA.
- (2) In (1), the Islamic Contracts referred to are contracts which are funded by the PSIA.
- (~~2-3~~) In this section, the term "investing in or holding Islamic Contracts" means investing in or holding as a principal.

Initial and ongoing capital requirements

Guidance

1. An Authorised Firm undertaking Islamic Financial Business is required to maintain initial and ongoing Capital Requirements in accordance with ~~PIB Rules in part 2 of Chapter 3 of PIB, 2.2.1 and 2.3.1. These requirements are summarised in Table 1.~~
2. In accordance with ~~PIB Rules in part 3 of chapter 3 of PIB-2.6.1,~~ an Authorised Firm undertaking Islamic Financial Business is required to ensure that only the eligible components of capital ~~which are set out in the table in PIB Rule 2.6.2~~ are included in the calculation of capital.
3. In accordance with PIB Rule ~~3.15~~ 2.9.4, an Authorised Firm undertaking Islamic Financial Business is required to exclude from ~~Tier Two e~~Capital any amount by which the total of the Profit Equalisation Reserve and the Investment Risk Reserve exceeds the Displaced Commercial Risk Capital Requirement.
4. For the purpose of calculating Capital Requirements, an Authorised Firm undertaking Islamic Financial Business or otherwise investing in or holding Islamic Contracts should give due importance to the economic substance of the transaction, in addition to the legal form of the Islamic Contracts.

Table 1

Category	Capital Requirement
Category 1	Higher of <ul style="list-style-type: none"> Base Capital Requirement of \$10 million OR 12% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk
Category 2	Highest of <ul style="list-style-type: none"> Base Capital Requirement of \$2 million OR 12% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk OR Expenditure Based Capital Minimum
Category 3	Highest of <ul style="list-style-type: none"> Base Capital Requirement of \$500,000 OR 12% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if Managing a PSIA, Displaced Commercial Risk OR Expenditure Based Capital Minimum
Category 4	Higher of <ul style="list-style-type: none"> Base Capital Requirement of \$40,000 OR Expenditure Based Capital Minimum
Category 5	Higher of <ul style="list-style-type: none"> Base Capital Requirement of \$10 million OR 12% of Credit Risk Capital Requirement; Market Risk Capital Requirement and, if undertaking Islamic Finance Business,

Systems and controls in relation to PSIAs

Guidance

The requirements in Rules 5.4.2 and 5.4.3 amplify the requirements in GEN Chapter 5.

- 5.4.2** In addition to PIB Rule ~~23.2.42~~, ~~23.2.53~~, GEN Rule 5.3.1 and this module, an Authorised Firm Managing a PSIA must ensure that its senior management establishes and maintains systems and controls that ensure that the Authorised Firm is financially sound and able at all times to satisfy the specific prudential requirements arising out of such business.
- 5.4.3**
- (1) In addition to Rules in 5.2.4, an Authorised Firm Managing a PSIA must set out in a written policy how it proposes to organise and control the activities that arise from such business and ensure that its activities are conducted in accordance with Shari'a.
 - (2) The policy must as a minimum address, where appropriate, the following matters:
 - (a) how the interests of shareholders and PSIA holders are safeguarded;
 - (b) how the Authorised Firm will limit exposures of PSIA holders to the Authorised Firm;
 - (c) a description of the controls to ensure that the funds of the PSIA are invested in accordance with the investment guidelines agreed in the investment contract;
 - (d) the basis for allocating profits and losses to the PSIA holders;
 - (e) the policy for making provisions and reserves (Provisions and Reserves are set out in AAOIFI FAS 11) and, in respect of PSIA's, to whom these provisions and reserves revert in the event of a write-off or recovery;
 - (f) the Authorised Firm's policy on the prioritisation of investment of own funds and those of Unrestricted PSIA holders;
 - (g) how liquidity mismatch will be monitored;
 - (h) the basis for allocating expenses to PSIA holders; and
 - (i) how the Authorised Firm will monitor the value of its assets.

Guidance

Guidance on the conditions for treatment of PSIA as restricted or unrestricted is found in paragraphs 12 and 13 of the AAOIFI's Statement of Concepts of Financial Accounting for Islamic Banks and Financial Institutions, and Appendix D of Financial Accounting Standard FAS 5.

Displaced commercial risk

5.4.4 An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must calculate a Displaced Commercial Risk Capital Requirement in respect of its PSIA business.

Guidance

1. An Authorised Firms Managing a PSIA, ~~whether on a restricted basis or~~ an unrestricted basis is subject to a unique type of risk referred to as Displaced Commercial Risk. This risk reflects the fact that an Authorised Firm may be liable to find itself under commercial pressure to pay a rate of return to its PSIA holders which is sufficient to induce those investors to maintain their funds with the Authorised Firm, rather than withdrawing them and investing them elsewhere. If this “required” rate of return is higher than that which would be payable under the normal terms of the investment contract, the Authorised Firm may be under pressure to forgo some of the share of profit which would normally have been attributed to its shareholders (e.g., part of the Mudarib’s share). Failure to do this might result in a volume of withdrawals of funds by investors large enough to jeopardise the Authorised Firm’s commercial position (or, in an extreme case, its solvency). Thus, part of the commercial risk attaching to the returns attributable to the PSIA is, in effect, transferred to the shareholders’ funds or the Authorised Firm’s own capital. It also reflects situations whereby an investor may be permitted to exit from an asset pool at par while the fair value of such assets may be lower than their carrying amounts and where the Authorised Firm in certain circumstances may provide for the shortfalls.
2. In an Unrestricted PSIA, the account holder authorises the Authorised Firm to invest the account holder’s funds in a manner which the Authorised Firm deems appropriate without specifying any restrictions as to where, how or for what purpose the funds should be invested, provided that they are Shari’ a compliant. Under this arrangement, the Authorised Firm can commingle the investment account holder’s funds with its own funds or with other funds which the Authorised Firm has the right to use. The investment account holders and the Authorised Firm generally participate in the returns on the invested funds.
3. In a Restricted PSIA, the account holder imposes certain restrictions as to where, how and for what purpose the funds are to be invested. Further, the Authorised Firm may be restricted from commingling its own funds with the restricted investment account funds for purposes of investment. In addition, there may be other restrictions that the investment account holders may impose. In other words, the funds provided by holders of Restricted PSIA’s are managed by the Authorised Firm which does not have the right to use or dispose of the investments except within the conditions of the contract.
4. An Authorised Firms undertaking Islamic Financial Business is also exposed to fiduciary risk which arises where the terms of the contract between the Authorised Firm and the investor are breached and where the Authorised Firm does not act in compliance with Shari’a.
5. An Authorised Firm is required to apply the Capital Requirements specified in PIB chapters 4 and 5 to any other business it carries on.

5.4.5 (1) An Authorised Firm’s Displaced Commercial Risk Capital Requirement is based on 35% of the CRCOM Credit Risk and Market Risk capital requirement of assets funded financed by Unrestricted PSIA holders, ~~both Restricted and Unrestricted~~, and is calculated using the following formula:

$$\text{PSIACOM} = [\text{PSIACOM}_{\text{credit}} + \text{PSIACOM}_{\text{market}}] \times 35\%.$$

(2) PSIACOM is the Displaced Commercial Risk Capital Requirement;

- (3) ~~PSIACOMcredit is the Credit Risk capital requirement of~~ PSIACOMcredit is the Credit Risk capital requirement of ~~for assets funded~~ for assets funded ~~financed by Unrestricted PSIA holders and is calculated in accordance with Rules in part 3 of chapter 4 of~~ financed by Unrestricted PSIA holders and is calculated in accordance with Rules in ~~5.4.6 – 5.4.7 and PIB chapter 4; and~~ 5.4.6 – 5.4.7 and PIB chapter 4; and
- (4) ~~PSIACOMmarket is the Market Risk capital requirement for~~ PSIACOMmarket is the Market Risk capital requirement for ~~of assets~~ of assets ~~financed funded by Unrestricted PSIA holders and is calculated in accordance with Rules in~~ financed funded by Unrestricted PSIA holders and is calculated in accordance with Rules in ~~5.4.8 and PIB chapter 5.~~ 5.4.8 and PIB chapter 5.

Credit risk and counterparty risk for Islamic contracts

- 5.4.6** (1) An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must calculate its PSIACOMcredit in relation to all Islamic Contracts financed by Unrestricted the PSIAs in the manner prescribed in this section.

- (2) An Authorised Firm must, when undertaking the calculation in (1), apply an appropriate risk weighting for the relevant Islamic Contract.

- 5.4.7** (1) In this section:

- (a) “ICX” represents the Exposure determined by an Authorised Firm as applicable to an Islamic Contract; and
- (b) “ICRW” represents the risk weighting or capital charge assessed by an Authorised Firm as appropriate to that Islamic Contract.

- (2) Where an Islamic Contract is in the Non-Trading Book, an Authorised Firm must determine the PSIACOMcredit for that contract by applying the following formula:

$$\text{ICX} \times \text{ICRW} \times 810\%$$

- (3) Where an Islamic Contract is in the Trading Book, an Authorised Firm must determine the PSIACOMcredit for that contract in accordance with the methodology in PIB A4.5, A4.76 and A4.87 as appropriate.

- (4) An Authorised Firm must calculate its PSIACOMcredit of all contracts by:
 - (a) identifying all Islamic Contracts to which this section applies;
 - (b) valuing the underlying investment or asset of each contract and reducing the value of any such investment or asset in the manner stipulated in Section 4.9 of chapter 4 of PIB Rule 4.3.2(e), the result of which constitutes the ICX for that contract;
 - (c) determining the risk weighting or capital charge appropriate to each contract, which will constitute the ICRW for that contract in accordance with Rules in Sections 4.10, 4.11 and 4.12 of chapter 4 of PIB;
 - (d) applying the respective formula in Rule 5.4.7(2) or (3) to determine of PSIACOMcredit in respect of each contract; and

- (e) summing the PSIACOMcredit of each contract to determine the PSIACOMcredit applicable to the Authorised Firm.

Guidance

1. The DFSA considers that this Guidance will assist an Authorised Firm in applying the appropriate risk weighting or capital charge to each Islamic Contract for the purpose of Rule 5.4.7. Accordingly, the DFSA expects an Authorised Firm managing PSIA, which are Unrestricted PSIAs to pay due regard to this Guidance.
2. The Rules in this section and this Guidance are also relevant to an Authorised Firm which invests in or holds Islamic Contracts, when calculating CRW ~~Credit Risk~~ for Islamic Contracts under PIB chapter 4.
3. Table 2 contains Guidance on how an Authorised Firm Managing a PSIA, which is an Unrestricted PSIA should apply risk weightings for Islamic Contracts in respect of calculating relevant ICXE and ICRW for its PSIACOMcredit component of the PSIACOM.

Table 2

1. Islamic Contract type	2. Underlying investment or asset	3. <u>ICW</u> CRW
Binding Murabaha for the Purchase Orderer (MPO)	Asset with an Authorised Firm before purchase by the Counterparty	Apply the appropriate percentage from the second column in the table in PIB Rule A4.5.4-4.6.5
	Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts	<u>CRW</u> Counterparty Risk weighting in accordance with PIB chapter 4
Murabaha and Non-binding Murabaha for the Purchase Orderer (MPO)	Accounts receivable for the contract, i.e. amounts due from the Counterparty less any provision for doubtful debts	<u>CRW</u> Counterparty Risk weighting in accordance with PIB chapter 4
Mudaraba and Musharaka	Where the underlying investment meets the requirements for inclusion in the Trading Book	<u>Market Risk Capital Requirement for the exposure associated with the underlying investment</u> Contract risk weighting determined in accordance with PIB chapter 5
	Investment in commercial enterprise to undertake business ventures other than trading activities (or other than those which meet the requirements for inclusion in the Trading Book)	<u>ICRW</u> of 400% on the exposure

1. Islamic Contract type	2. Underlying investment or asset	3. <u>ICW</u> <u>CRW</u>
	Investment in real estate assets and other movable assets, using underlying Ijarah and Murabaha contracts	<u>ICRW</u> of the lessee for the underlying Ijarah contracts or the <u>ICRW</u> of the counterparty of the underlying Murabaha contract, in accordance with PIB App4
Ijarah/Ijarah Muntahia Bittamleek	Asset with an Authorised Firm available for lease before purchase by the Counterparty – for both contracts with both binding or non-binding promise to lease	Apply the appropriate percentage from the second column in the table in PIB Rule A4.5.4 <u>4.6.5</u>
	Residential real estate where the lessee has the right to purchase property at the end of the lease and the lessor has a legally enforceable first charge over the property	<u>50%</u> Apply the appropriate percentage in accordance with PIB Rule 4.12.17.
	Total estimated value of lease receivables for the whole duration of the Ijarah, less any recovery value of the leased asset	<u>CRW</u> <u>counterparty Risk weighting</u> of Ijarah lessee, in accordance with PIB <u>Section 4.12 App4</u>
Full recourse Istisna'a -with or without parallel Istisna'a and limited / non-recourse Istisna'a with/without parallel Istisna'a	Net balance of the work-in-progress	<u>CRW</u> <u>counterparty Risk weighting</u> of the Istisna'a buyer, in accordance with PIB <u>Section 4.12 App4</u>
	Total amount receivable from the counterparty, pursuant to contract billings	<u>CRW</u> <u>counterparty Risk weighting</u> of Istisna'a buyer, in accordance with PIB <u>Section 4.12 App4</u>
Salam and parallel Salam	Value of the underlying asset receivable for the Salam contract	<u>CRW</u> <u>counterparty Risk weighting</u> in accordance with PIB <u>Section 4.12 chapter 4</u>
	Assets acquired	100%
	Balance in relevant accounts receivable	<u>CRW</u> <u>counterparty Risk weighting</u> in accordance with PIB <u>Section 4.12 chapter 4</u>
Kefala	The amount of the guarantee	<u>CRW</u> <u>counterparty Risk weighting</u> in accordance with PIB <u>Section 4.12 chapter 4</u>

1. Islamic Contract type	2. Underlying investment or asset	3. <u>ICR</u> <u>CRW</u>
Sukuk held in the Non-Trading Book	Receivables from the Sukuk structure, including the principal and any returns associated with it, arising from any of the following as underlying contracts: Salam Istisna'a Ijarah Murabaha Mudaraba Musharaka	<p><u>ICR</u>W applicable to underlying Ijarah, Salam or Murabaha contracts, in accordance with PIB Section 4.12 App4</p> <p>If the Sukuk provides recourse to the issuer, <u>ICR</u>W applicable to the issuer or <u>CR</u>W applicable to underlying contracts of the Sukuk is in accordance with PIB Section 4.12 App4, whichever is higher</p>
	Usufructs/services	<p><u>ICR</u>W applicable to underlying service provider or usufruct owner, in accordance with PIB Section 4.12 App4. If the Sukuk provides recourse to the issuer, <u>ICR</u>W applicable to the issuer or <u>ICR</u>W applicable to underlying service provider or usufruct owner in accordance with PIB App4, whichever is higher</p>
	Leased assets	The higher of <u>ICR</u> W of the underlying leased assets and that of the issuer
	Investment agency	The higher of <u>ICR</u> W of the underlying leased assets and that of the issuer
	Muzara'a (share of produce of the land) Musaqa (share of produce of the trees) Mugarasa (share in the land and the trees)	100%
	Mixture of tangible and intangible assets	The higher of <u>ICR</u> W of the underlying leased assets and that of the issuer

1. Islamic Contract type	2. Underlying investment or asset	3. ICW <u>CRW</u>
	Where the underlying investment meets the requirements for inclusion in the Trading Book	<u>Market Risk Capital Requirement for the exposure associated with the underlying investment</u> Contract risk weighting determined in accordance with PIB chapter 5
Bai' Bithaman Ajil	Residential and commercial properties Plant and equipment Motor vehicles Shares Land	CRW <u>Counterparty Risk weighting</u> in accordance with PIB chapter 4
Arboun	Where an Authorised Firm has made the purchase deposit	CRW <u>Counterparty Risk weighting</u> in accordance with PIB chapter 4
	Where an Authorised Firm has received the purchase deposit	No ICW <u>CRW</u> is applicable
	Where the contract would meet the requirements for inclusion in the Trading Book	<u>Market Risk Capital Requirement for the exposure associated with the underlying investment</u> Contract risk weighting determined in accordance with PIB chapter 5

4. Where an Islamic Contract is not listed in Table 2, an Authorised Firm should consult with the DFSA, on a case-by-case basis, to determine the:
 - a. contract type and the underlying investments or assets to calculate the EICX; and
 - b. appropriate risk weighting or the capital charge for such contract to calculate the ICRW.
5. ~~In Table 2, where "Counterparty Risk weighting" is determined in accordance with PIB Chapter 4 and App4, ICW should be regarded to have the same value as CPW.~~
65. In some cases, as stipulated in the relevant parts of column 3 of Table 2, the calculation of capital requirement ~~charge~~ should be carried out as prescribed in PIB Rule A4.6.5-4 and in accordance with PIB chapter 5.
76. In determining the ~~ICXE~~ of a Binding Murabaha for the Purchase Orderer (MPO), as per PIB Rule A4.6.5-4, EICX should equal the total acquisition cost of the asset (purchase price and other direct costs) less market value of the asset (net of any haircut) less any security deposit provided.
87. In determining the EICX of Ijarah / Ijarah Munthia Bittamleek contract, as per PIB Rule A4.6.5-4, EICX should equal the total acquisition cost of the asset (purchase price and other

direct costs) less the market value of the asset (net of any haircut), less any Arboun (earnest money deposit received from the potential lessee).

98. In addition to paragraph 78 above, in the case of an Ijarah Muntahia Bittamleek contract, the exposure may be reduced by the recovery value of the leased asset, only in cases where there is a reasonable basis to conclude that the leased asset can be repossessed and effectively redeployed as a leased asset to another Counterparty. This is important because the asset leased under the Ijarah Muntahia Bittamleek contract is usually customised equipment or large pieces of equipment which are integrated with other assets of the lessee and hence are unsuitable for repossession and releasing to another lessee.
109. In determining the EICX of an Istisna'a contract, the exposures arising from such a contract should not be netted off against exposures arising from a Parallel Istisna'a contract entered into by an Authorised Firm for procuring the underlying investment for the Istisna'a contract.
110. In determining the EICX of a Salam contract, the exposures arising from such a contract should not be netted off against exposures arising from a Parallel Salam contract entered into by an Authorised Firm for procuring the underlying asset for the Salam contract.
121. Off-balance sheet exposures for import or export financing contracts based on Murabaha, where the underlying goods or shipment are collateralised and insured, should attract a 20% CCF credit conversion factor to an Authorised Firm that issues or confirms the letter of credit.
132. Where Mudaraba and Musharaka contracts are used to invest in commercial enterprise to undertake business ventures other than trading activities (or other than those which meet the requirements for inclusion in the Trading Book), the ICXE is measured as the amount invested in the commercial enterprise less any specific provisions. If there is a guarantee and such guarantor is not connected to the commercial enterprise, then the ICRW for the guarantor will be applied for risk weighting for the amount of any such guarantee.
143. In addition to the relevant Rules prescribed in PIB chapter 4 and PIB App4, an Authorised Firm may consider the following types of collateral as eligible collateral for Credit Risk management:
- a. Hamish Jiddiyah (security deposit) only for agreements to purchase or lease preceded by a binding promise;
 - b. Arboun where earnest money deposit held after a contract is established as collateral to guarantee contract performance; and
 - c. in Mudaraba investment in project finance, an Authorised Firm may use the collateralisation of the progress payments made by the ultimate customers to mitigate the exposures of unsatisfactory performance by the Mudarib.
154. Where an Authorised Firm places funds under a Mudaraba contract, subject to a Shari'a compliant guarantee from a third party and such a guarantee relates only to the Mudaraba capital, the capital amount should be risk-weighted at ICRW of the guarantor provided that the ICRW of that guarantor is lower than the ICRW of the Mudarib (as a Counterparty). Otherwise, the ICRW of the Mudarib will apply.
165. An Authorised Firm placing liquid funds with a central bank or another financial institution on a short-term Mudaraba basis in order to obtain a return on those funds, may apply the ICRW applicable to the Mudarib (as a Counterparty), provided the Mudarib effectively treats the liquid funds placement as its liability, although normally such placements are not treated as liabilities of the Mudarib.

Market risk

- 5.4.8** An Authorised Firm Managing a PSIA, which is an Unrestricted PSIA, must calculate its PSIACOMmarket in relation to all underlying Islamic Contracts in the manner prescribed in PIB chapter 5, except as may be provided in Rules 5.4.8 to 5.4.17.
- 5.4.9** An Authorised Firm must treat Sukuk held in its Trading Book as equity for the purpose of calculating its Equity Risk Capital Requirement and determine the same in accordance with PIB Rule 5.5.2.
- 5.4.10** Where investments are made using Musharaka or Mudaraba contracts with commodities as the underlying assets, an Authorised Firm must calculate its Commodities Risk Capital Requirement in accordance with PIB Rule 5.7.2.
- 5.4.11** An Authorised Firm which is exposed to the risk of foreign currencies and gold under any Islamic Contract, must calculate its Foreign Exchange Risk Capital Requirement in accordance with PIB Rule 5.6.2.
- 5.4.12** An Authorised Firm which is exposed to commodities including precious metals but excluding gold under any Islamic Contract, must calculate its Commodities Risk Capital Requirement in accordance with PIB Rule 5.7.2.
- 5.4.13** (1) Commodities held by an Authorised Firm for selling or leasing when executing a Murabaha, non-binding MPO, Salam or Parallel Salam Contract must be included in the calculation of its Commodities Risk Capital Requirement.
- (2) Where an Authorised Firm executes Salam and parallel Salam contracts, the resultant long and short positions may be set off for calculating the net open position, provided that the positions are in the same commodity, regardless of how its Commodities Risk Capital Requirement is calculated.
- 5.4.14** Where an Authorised Firm executes Musharaka or Mudaraba contracts for investing in entities or investment vehicles that trade in foreign exchange, equities or commodities, it must include the relevant underlying assets in the calculation of its Market Risk Capital Requirement in accordance with PIB chapter 5.

Concentration risk**Guidance**

1. This section sets specific Large Exposure limits for assets financed by PSIA, which are Unrestricted PSIAs. The DFSA uses these limits to provide constraints on the amount of Concentration Risk to which an Authorised Firm is subject in respect of its PSIA holdings. In assessing PSIA Large Exposures, an Authorised Firm may take advantage of the exemptions and partial exemptions set out in PIB section A4.811.
2. An Authorised Firm has a Large Exposure where its PSIA holders' credit Exposure to a single Counterparty or issuer, or group of Closely Related or Connected Counterparties, is large in relation to the Authorised Firm's Capital Resources. Where Exposure to a Counterparty or issuer is large, PSIA holders risk a large loss should the Counterparty default.

3. Exposures arising from assets that are financed by an Authorised Firm's own funds are dealt with in PIB section 4.15.

Exposure limits

5.4.15 An Authorised Firm Managing a PSIA, ~~which is an Unrestricted PSIA,~~ must not have an Exposure to a Counterparty or to a group of Closely Related Counterparties or to a group of Connected Counterparties that exceeds any one of the following percentages of its Capital Resources:

- (a) 25% if financed by its Capital Resources or Unrestricted PSIA's;
- (b) 30% if financed by Restricted PSIA's; or
- ~~(c)~~(b) 40% if financed by the total of its own Capital Resources and, Unrestricted PSIA's ~~and Restricted PSIA's.~~

Guidance

- ~~1. In respect of its PSIA's, an Authorised Firm may apply to the DFSA for a modification of the limits set out in (b) and (c). The Authorised Firm will have to demonstrate to the DFSA that it has met some or all of the following conditions:~~
 - ~~a. the Authorised Firm has very limited (or no) discretion regarding the manner in which the funds will be invested;~~
 - ~~b. the PSIA holders are fully aware of how their money is to be invested;~~
 - ~~c. the PSIA holders are provided with monthly net asset valuations; or~~
 - ~~d. the accounts of the PSIA are externally audited.~~
2. In accordance with PIB section 4.15, the aggregate of an Authorised Firm's Exposure to a Counterparty or to a group of Closely Related Counterparties may not exceed 25% of the Authorised Firm's Capital Resources.

5.4.16 The sum of an Authorised Firm's non-exempt Large Exposures must not exceed ~~the following percentage of its Capital Resources:~~

- (a) 800% of its Capital Resources for Exposures funded by ~~an~~ the Authorised Firm's Capital Resources and Unrestricted PSIA's; ~~or~~
- (b) 1200% for Exposures funded by Restricted PSIA's.

5.4.17 An Authorised Firm must:

- (a) monitor and control its Exposures ~~funded by arising from~~ PSIA's, ~~which are~~ Unrestricted PSIA's, on a daily basis to ensure they remain within the risk concentration risk limits specified in Rules 5.4.158 to 5.4.144 ~~in respect of~~ Market Risk; and
- (b) if a breach occurs, notify the DFSA immediately and confirm it in writing.