



# **Islamic Financial Business Handbook**

**Guide for viable business  
models**

**December 2018**



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# 1 Introduction

This handbook intends to provide useful guidance to prospective applicants aspiring to establish Islamic financial services firms in the AIFC. The handbook primarily intends to provide detailed guidance in respect of the various regulatory requirements and eligibility criteria which need to be fulfilled for each of the plausible and viable business models which are also Shari'ah-compliant. It is important to note that this handbook only outlines an indicative set of possible business models for Islamic finance firms and does not provide an exhaustive portfolio all possible business models for Islamic finance firms. So, an applicant aspiring to set up an Islamic finance business in the AIFC is encouraged to consider innovative business models which are not discussed in this handbook and not view the business models in this handbook as limiting their potential. The AFSA, as the regulatory body is open to discussing with potential applicants the admissibility of their business models and provide relevant guidance to fulfil the regulatory requirements for the licensing and ongoing operations of such businesses.

This handbook focusses on providing information about the regulator requirements and the risks faced by the business models covered. The information provided regarding potential target markets and target customer profiles are for illustrative purposes only and need not be seen as limiting conditions for the implementation of those business models.

## 2 Islamic Asset Management (IAM) Firm

### 2.1 Business Model

An Islamic Asset Management (IAM) firm would typically be involved in providing asset management services to a range of clients in a Shari'ah-compliant manner. The IAM firm will be using only Shari'ah-compliant investment vehicles for providing its asset management services. An IAM firm proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 2.2 Services & Products

The IAM firm will typically offer the following products/services, though a specific IAM firm may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Managing Restricted Profit-Sharing Investment Accounts (Restricted PSIAs)
- Real Estate Investment Management
- Private Equity



- Asset Management

The firm's asset management services may include both managing on a discretionary basis as well as on non-discretionary basis, assets belonging to another legal person.

The IAM firm's product portfolio in real estate investments may include a Real Estate Fund which will be a professionally managed portfolio of diversified real estate holdings. The firm can also employ Islamic REITs which will invest in properties through real estate investment trusts (REITs) or RE funds. The IAM firm can manage private equity investments by providing a vehicle for investors to invest in equities of unlisted companies. These funds or REITs used as vehicles for real estate or private equity investments may be located in the AIFC, but can also be domiciled in any other jurisdiction. If such funds or REITs are domiciled in the AIFC, they would be subject to the provisions of the CIR rules of the AIFC.

### 2.3 Managing Restricted PSIAs

An IAM firm's activities would include managing Restricted PSIA which does not constitute a deposit, because a PSIA is managed in relation to property of any kind. The IAM firm can raise funds for investment in the form of a discretionary (mandate based) Restricted PSIA. There are no specific limitations or requirements on the number of accounts or investors for inclusion in the Restricted PSIA pool to be operated by the IAM firm. The restricted PSIA will typically be based on Mudarabah contracts which will specify the objectives and constraints for the investment account or pool by way of a documented mandate.

Such contractual mandate would typically address the following aspects

- Sector Exposure – size, share, nature and Shari'ah-compliant
- Size of Exposure

The Mudarabah contract will define the size of exposure in specific industry depending upon documented risk appetite and ticket size of available investments. Portfolios and investment allocation to agreed blocks shall be further in line with the constitutional documents prepared for each type of accounts,

- Quality of Investment (risk, rating and return)

The IAM firm's investment strategy would typically be based on a set of clearly defined fundamental criteria that seeks to identify assets which meet those criteria. The quality assessment would be made based on soft and hard criteria.

- Fundamental criteria

The asset or instrument must be Shari'ah-compliant. Investment assets should not be involved in businesses or activities that are considered unlawful, or haram (such as businesses that sell alcohol or

pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values). Investments shall not involve uncertain event in the future or in nature is not a speculative transaction.

The IAM firm will share profit with the restricted PSIA account holder (IAH) during the life of the investment. Policies and procedures related to each of these products should be outlined in a detailed manuals and operational procedures.

## 2.4 Activities & operations to deliver the services/products

The primary components of the activities of an IAM would be

- Business Development
- Assistance to clients in setting up their investment vehicles and accounts
- Developing the investment objectives and risk profile of the client
- Develop an investment strategy and get it approved by the client
- Managing the assets – execution of the strategy
- Investment research – if needed, based on the type of investments and strategy

The investment advisory service will include setting up appropriate strategies to manage the investment assets as per the investment objectives, financial goals and time limits determined. Identifying proper asset/projects for investment and ensuring good performance of the asset/project in the long-term is a significant element of asset management activities.

Investment process to be followed will be based on investment banking best practices and in compliance with AFSA guidelines as provided in detail in Conduct of Business (COB) Rulebook. The process includes Strategic Planning and business partner selection, detailed market study, selection and analysis by Investment committee, strategy execution, operational performance review and optimizing exits. The IAM firm will typically be responsible for continuously monitoring all the aspects of the investment to ensure the objectives of the investment are achieved. It is also expected to carefully analyze the market situation and look into the development prospects of each one of its clients' assets, taking into account the investors' investment objectives, risk profile and time limits. Identifying the proper asset and ensuring good performance of the asset in the long-term is a significant component of the Company's asset management procedure.

### 2.4.1 Providing investment advice

The IAM firm's activities typically also include providing generic as well as specific investment advice to investors or potential investors, where the intention is to influence the investor, in making a decision, to select a particular financial product or an interest in a particular financial product. The firm's generic advice would include information about a particular financial product, or market or outlook about a market or asset class.

## 2.5 Target clients

The firm will target corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region.

The IAM firm can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IAM firm deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 2.6 Target markets

The AIFC being an international financial centre, the IAM firm can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IAM firm licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IAM firm may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 2.7 Revenue streams

The primary revenue streams for an IAM firm would be

- Asset management fees – typically calculated as a specific percentage of the Assets Under Management (AUM) and paid by the client.
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.
- Mudarib's share of the profits earned from the PSIA pool.
- A share of the profits, if the performance of the investment portfolio or fund exceeds a pre-defined threshold – for funds.

- Capital gains arising from carried interest allocated to the IAM, in case of private equity investments.

## 2.8 Regulatory requirements

### 2.8.1 Basic requirements and Legal status

An IAM firm needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The IAM firm is also required to locate its principal & head office in the AIFC.

### 2.8.2 AFSA Licenses required

An IAM firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Managing Investments
- Managing a Restricted Profit Sharing Investment Account (RPSIA)
- Advising on Investments

In addition to these core activities, an IAM firm may also be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Providing Custody
- Arranging Custody
- Dealing in Investments as Agent
- Providing Trust Services
- Providing Fund Administration
- Arranging Deals in investments
- Arranging Credit

Since these activities are not essential to the operation of the IAM business model, the IAM firms need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out.

In some cases, the operating model of an IAM firm may result in the firm being involved in carrying out activities which fall under the definition of the regulated activity of “Dealing in Investments as Agent”. In such cases, the relevant IAM firm may have to seek and obtain the relevant license.

### 2.8.3 Capital requirements

The IAM firm will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AFSA’s PRU (INV) rules or any other requirement that may be notified by the regulator in due course. An IAM firm is required to ensure that its Capital Resources as defined in Chapter

3 of the PRU (INV) rules would always be in excess of its base capital and requirement. For an IAM firm which is licensed for the core activities as listed above, would be USD 500,000.

In addition, the IAM firm is also required to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules. In order to meet this, the IAM firm is required to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the PRU(INV) rules.

#### 2.8.4 Authorised Individuals

The IAM firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer,
4. Money Laundering Reporting Officer; and
5. Such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The IAM firm needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IAM firm are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the IAM firm need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IAM firm before their appointment are provided in Section 2.3 of the AFSA GEN rules.

#### 2.8.5 Shari'ah Compliance requirements

An Islamic asset management firm would be subject to the provisions of the IFR rules of the AIFC. The IAM firm is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

## 2.8.6 Shari'a Supervisory Board

The IAM Firm needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IAM firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

## 2.8.7 Shari'ah Governance

The IAM Firm needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 2.9 Key risks

A typical IAM firm would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Suitability of investment advice and appropriateness of products
3. Conduct of business risks – Managing conflicts
4. Conduct of business risks – Protecting client money and client assets
5. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
6. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern
7. Liquidity risks – risk of failing to ensure availability of liquid funds to pay expenses and meet liabilities as and when they fall due.

## 2.10 Applicable rules and regulations

The primary obligations faced by the IAM in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IAM firm would also be expected to be in compliance with the laws and rules administered by the AIFC Authority, including but not limited to Companies laws and regulations.

The IAM firm would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IAM firm needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical IAM firm would be

1. GEN Rules
2. IFR Rules
3. COB Rules
4. AML Rules
5. PRU (INV) Rules
6. CIS Rules

## 3 Islamic Investment Advisory (IIA) Firm

### 3.1 Business Model

An Islamic Investment Advisory (IIA) firm would typically be involved in providing investment advisory services to a range of clients in a Shari'ah-compliant manner. The IIA firm will consider only Shari'ah-compliant investment products, funds or securities for recommendation to its clients. An IIA firm proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 3.2 Services & Products

The IIA firm will typically offer the following products/services, though a specific IIA firm may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Financial planning & Investment advisory services
- Recommendations on investing in Restricted PSiAs
- Investment advice for Real Estate Investments, private equity investments etc

The IIA firm's product portfolio in real estate investments may include a Real Estate Fund which will be a professionally managed portfolio of diversified real estate holdings. The firm can also recommend or advice on investing in Islamic REITs which invest in properties through real estate investment trusts (REITs) or RE funds. These funds or REITs used as vehicles for real estate or private equity investments may be located in the AIFC, but can also be domiciled in any other jurisdiction. If such funds or REITs are domiciled in the AIFC, they would be subject to the provisions of the CIR rules of the AIFC.

### 3.3 Activities & operations to deliver the services/products

The primary components of the activities of an IIA would be

- Business Development
- Assistance to clients in setting up their investment vehicles and accounts
- Developing the investment objectives and risk profile of the client
- Preparing financial plans for the client
- Develop an investment strategy and get it approved by the client
- Investment research – if needed, based on the type of investments and strategy
- Provide investment advice and recommendations on investment options
- Arrange the execution of trades on the basis of client's choice

The investment advisory service will include setting up appropriate strategies to manage the investment assets as per the investment objectives, financial goals and time limits determined. Identifying proper



asset/projects for investment and ensuring good performance of the asset/project in the long-term is a significant element of asset management activities. Investment advisory process to be followed will be based on best practices and in compliance with AFSA guidelines as provided in detail in Conduct of Business (COB) Rulebook. The IIA firm will typically be responsible for continuously monitoring all the aspects of the investment to ensure the objectives of the investment are achieved.

### 3.3.1 Arranging investments and arranging credit

The IIA firm's activities could also include making arrangements, making invitations, or engaging in any other conduct with a view to influence clients in regards to the buying, selling, subscribing to Shari'ah-compliant investment products, funds or securities. The IIA firm could also arrange for underwriting or borrowing money by way of a Credit Facility.

### 3.3.2 Providing investment advice

The IIA firm's activities typically also include providing generic as well as specific investment advice to investors or potential investors, where the intention is to influence the investor, in making a decision, to select a particular financial product or an interest in a particular financial product. The firm's generic advice would include information about a particular financial product, or market or outlook about a market or asset class.

## 3.4 Target clients

The firm will target corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region. The IIA firm can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IIA firm deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 3.5 Target markets

The AIFC being an international financial centre, the IIA firm can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IIA firm licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IIA firm may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 3.6 Revenue streams

The primary revenue streams for an IIA firm would be

- Fees for providing investment advisory services – typically calculated as a specific percentage of the AUM and paid by the client.
- Fees for arranging investment transactions or for arranging credit facilities – typically calculated as a percentage of the amount involved in the credit facility arranged.
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.

## 3.7 Regulatory requirements

### 3.7.1 Basic requirements and Legal status

An IIA firm needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The IIA firm is also required to locate its principal & head office in the AIFC.

### 3.7.2 AFSA Licenses required

An IIA firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Advising on Investments
- Arranging Deals in investments
- Arranging Credit

In addition to these core activities, an IIA firm may also be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Providing Custody
- Arranging Custody
- Providing Fund Administration

Since these activities are not essential to the operation of the IIA business model, the IIA firms need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out.

In some cases, the operating model of an IIA firm may result in the firm being involved in carrying out activities which fall under the definition of the regulated activity of “Dealing in Investments as Agent”. In such cases, the relevant IIA firm may have to seek and obtain the relevant license.

### 3.7.3 Capital requirements

The IIA firm will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AFSA’s PRU(INV) rules or any other requirement that may be notified by the regulator in due course. An IIA firm is required to ensure that its Capital Resources as defined in Chapter 3 of the PRU (INV) rules would always be in excess of its base capital and requirement. For an IIA firm which is licensed for the core activities as listed above, would be USD 200,000.

In addition, the IIA firm is also required to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules. In order to meet this, the IIA firm is required to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the PRU(INV) rules.

### 3.7.4 Authorised Individuals

The IIA firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The IIA firm needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IIA firm are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the IIA firm need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and

ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IIA firm before their appointment are provided in Section 2.3 of the AFSA GEN rules.

### 3.7.5 Shari'ah Compliance requirements

An Islamic asset management firm would be subject to the provisions of the IFR rules of the AIFC. The IIA firm is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 3.7.6 Shari'a Supervisory Board

The IIA Firm needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IIA firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

### 3.7.7 Shari'ah Governance

The IIA Firm needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 3.8 Key risks

A typical IIA firm would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Suitability of investment advice and appropriateness of products

3. Conduct of business risks – Managing conflicts
4. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
5. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern
6. Liquidity risks – risk of failing to ensure availability of liquid funds to pay expenses and meet liabilities as and when they fall due.

### 3.9 Applicable rules and regulations

The primary obligations faced by the IIA in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IIA firm would also be expected to be in compliance with the laws and rules administered by the AIFC Authority, including but not limited to Companies laws and regulations.

The IIA firm would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IIA firm needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical IIA firm would be

1. GEN Rules
2. IFR Rules
3. COB Rules
4. AML Rules
5. PRU (INV) Rules
6. CIS Rules

## 4 Islamic Corporate Finance Advisory (ICFA) Firm

### 4.1 Business Model

An Islamic Corporate Finance Advisory (ICFA) firm would typically be involved in providing financial advisory services to corporate clients in respect of managing their financing, investment and divestment transactions, in a Shari'ah-compliant manner. The ICFA firm's advice as well as arranging services will be restricted to Shari'ah-compliant investment products and investment vehicles only. An ICFA firm proposed to be set up in the AIFC would seek to leverage the growing corporate, sub-sovereign and sovereign entities involved in the massive investment into energy and infrastructure sector, among others.

### 4.2 Services & Products

The ICFA firm will typically offer the following products/services, though a specific ICFA firm may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Providing advice on financial strategies related to investments, divestments or raising financial resources
- Preparing financial plans, investment evaluation & pricing services
- Recommendations on investment opportunities and terms of investment
- Advice on structuring securities for raising funds – debt or equity or hybrid securities
- Advice on structuring and negotiating Shari'ah-compliant credit facilities with banks

The ICFA firm can provide advice to a broad range of clients on a broad range of financial transactions, which cannot be outlined comprehensively. The information provided in this section is generic and is intended to be taken as an illustrative example and not an exhaustive set of possibilities.

### 4.3 Activities & operations to deliver the services/products

The primary components of the activities of an ICFA would be

- Business Development
- Assistance to clients in setting up their investment /financing vehicles and accounts
- Developing the investment objectives and risk profile of the client
- Develop an investment strategy and get it approved by the client
- Investment research – if needed, based on the type of investments and strategy
- Develop and implement funding strategies for the client

- Advice the client on structuring Sukuk and pricing them

The investment advisory service will include setting up appropriate strategies to manage the investment assets as per the investment objectives, financial goals and time limits determined. Identifying proper asset/projects for investment and ensuring good performance of the asset/project in the long-term is a significant element of asset management activities.

#### 4.3.1 Arranging Credit

The ICFA firm's activities could also include making arrangements, making invitations, or engaging in any other conduct with a view to influence clients in regards to the buying, selling, subscribing or underwriting and borrowing money by way of a Credit Facility.

#### 4.3.2 Providing investment advice

The ICFA firm's activities typically also include providing generic as well as specific investment advice to investors or potential investors, where the intention is to influence the investor, in making a decision, to select a particular investment opportunity or a business asset. The firm's generic advice would include information about a particular financial product, or market or outlook about a market or asset class.

### 4.4 Target clients

The firm will target corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region. The ICFA firm can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the ICFA firm deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

### 4.5 Target markets

The AIFC being an international financial centre, the ICFA firm can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an ICFA firm licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The ICFA firm may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 4.6 Revenue streams

The primary revenue streams for an ICFA firm would be

- Fees for providing investment advisory services – typically calculated as a specific percentage of the value of the transaction or the investment opportunity involved and paid by the client.
- Fees for arranging investment transactions or for arranging credit facilities – typically calculated as a percentage of the amount involved in the credit facility arranged.

## 4.7 Regulatory requirements

### 4.7.1 Basic requirements and Legal status

An ICFA firm needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The ICFA firm is also required to locate its principal & head office in the AIFC.

### 4.7.2 AFSA Licenses required

An ICFA firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Advising on Investments
- Arranging Deals in investments
- Arranging Credit

### 4.7.3 Capital requirements

The ICFA firm will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AFSA's PRU(INV) rules for Category IIIC firms or any other requirement that may be notified by the regulator in due course. An ICFA firm is required to ensure that its Capital Resources as defined in Chapter 3 of the PRU (INV) rules would always be in excess of its base capital and requirement. For an ICFA firm which is licensed for the core activities as listed above, would be USD 200,000.

In addition, the ICFA firm is also required to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules. In order to meet this, the ICFA firm is required to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the PRU(INV) rules.



#### 4.7.4 Authorised Individuals

The ICFA firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The ICFA firm needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an ICFA firm are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the ICFA firm need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an ICFA firm before their appointment are provided in Section 2.3 of the AFSA GEN rules.

#### 4.7.5 Shari'ah Compliance requirements

An Islamic asset management firm would be subject to the provisions of the IFR rules of the AIFC. The ICFA firm is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

#### 4.7.6 Shari'a Supervisory Board

The ICFA Firm needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The ICFA firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

#### 4.7.7 Shari'ah Governance

The ICFA Firm needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

#### 4.8 Key risks

A typical ICFA firm would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Suitability of investment advice and appropriateness of products
3. Conduct of business risks – Managing conflicts
4. Conduct of business risks – Protecting client money and client assets
5. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
6. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern
7. Liquidity risks – risk of failing to ensure availability of liquid funds to pay expenses and meet liabilities as and when they fall due

#### 4.9 Applicable rules and regulations

The primary obligations faced by the ICFA in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the ICFA firm would also be expected to be in compliance with the laws and rules administered by the AIFC Authority, including but not limited to Companies laws and regulations.

The ICFA firm would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the ICFA firm needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan

2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical ICFA firm would be

1. GEN Rules
2. IFR Rules
3. COB Rules
4. AML Rules
5. PRU (INV) Rules
6. CIS Rules

## 5 Islamic Financing Company (IFC)

### 5.1 Business Model

An Islamic Financing Company (IFC) would typically be involved in providing Islamic financing to a range of clients in a Shari'ah-compliant manner. The IFC firm will be using only Islamic financial contracts for providing financing. An IFC firm proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 5.2 Services & Products

The IFC firm will typically offer the following products/services, though a specific IFC firm may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Provide financing
- Advising on credit facilities
- Arranging credit facilities – either as the lead financier of a syndicate or pool of lenders

### 5.3 Activities & operations to deliver the services/products

The primary components of the activities of an IFC would be

- Business Development & sourcing financing opportunities
- Assessment of credit risk and approval of financing
- Measurement of credit risk and pricing the credit facility
- Negotiate the terms of the covenant for the credit facility
- Operations for delivery of financing

#### 5.3.1 Arranging Credit

The IFC firm's activities could also include making arrangements, making invitations, or engaging in any other conduct with a view to influence clients in regards to the buying, selling, subscribing for or underwriting and borrowing money by way of a Credit Facility. Such credit facilities need not be related to or linked to the client's investments which are managed by the IFC firm.

#### 5.3.2 Providing advice on credit facilities

The IFC firm's activities typically also include providing generic as well as specific advice to investors in relation to credit facilities and the relative merits of the terms of such facilities, with the aim of providing

adequate information to the client and assisting the client in making a decision regarding the credit facility. The firm's generic advice would include information about a particular credit facility, or a specific market.

## 5.4 Target clients

The IFC will target almost all types of clients ranging from retail clients, corporate and other institutional clients, High Net worth Individuals across its target markets. The IFC firm can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IFC firm deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 5.5 Target markets

The AIFC being an international financial centre, the IFC firm can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IFC firm licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IFC firm may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 5.6 Revenue streams

The primary revenue streams for an IFC firm would be

- Profits earned from financings provided
- Fees for various services provided along with the delivery of financing – like arranging a credit facility.
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.

## 5.7 Regulatory requirements

### 5.7.1 Basic requirements and Legal status

An IFC firm needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The IFC firm is also required to locate its principal & head office in the AIFC.

### 5.7.2 AFSA Licenses required

An IFC will essentially be required to hold a license for only one regulated activity defined in Schedule 1 of the AIFC GEN rules – Providing Islamic Financing. An IFC will be classified as an Islamic Financing Company as defined in AIFC IBB rules. The IFC will be treated as an Islamic Financing Company in the AIFC even if it is also authorised to conduct any other activity that is not Islamic Banking Business. The IFC does not cease to be an Islamic Financing Company because it conducts other activities included in its authorisation. The IFC may act as an Islamic Broker Dealer in Shari'ah-compliant investments or assets, if it receives the necessary licenses from the AFSA.

An IFC firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules.

- Providing Islamic financing
- Advising on a Credit Facility
- Arranging a Credit Facility

In addition to these core activities, an IFC may also be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Providing Custody
- Arranging Custody
- Dealing in Investments as Agent
- Advising on deals in investments
- Arranging Deals in investments

Since these activities are not essential to the operation of the IFC business model, the IFC firms need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out.

### 5.7.3 Capital requirements

The IFC, by virtue of its license to provide Islamic financing and classification as an Islamic Financing Company (IBB rules), will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AIFC IBB rules. Although the IFC is not an Islamic Bank, effectively it is required to comply with practically a vast majority of the IBB rules relating to prudential, risk management and capital adequacy requirements.

The IFC is required to meet the initial and ongoing capital requirements specified in chapter 4 of the AIFC IBB rules. The initial Base capital requirement for an IFC is USD 2 million as specified in IBB rule 4.7. An

IFC must meet this requirement with CET1 capital at the time of its authorisation. The risk capital requirement for the IFC will be the sum of its credit risk capital requirement, its market risk capital requirement and its operational risk capital requirement, which are defined in chapter 4 of the IBB rules.

The IIB is expected to maintain at all times, the following capital adequacy ratios

- CET1 capital ratio of 4.5% of total risk-weighted assets (RWAs)
- Tier 1 capital ratio of 6% of total risk-weighted assets (RWAs)
- Total capital ratio of 8% of total risk-weighted assets (RWAs)

In addition, the IFC is also expected to meet capital conservation buffer requirement of 2.5% of its total RWAs or any higher amount that the AFSA may set out by way of a written notice, from time to time. The capital adequacy framework including the capital conservation buffer set out in the AIFC IBB rules is fully consistent with the Basel III capital adequacy framework. The IIB is also required to comply with all the risk management and governance requirements spelt out in the AIFC IBB rules including the liquidity risk management requirements.

#### 5.7.4 Authorised Individuals

The IFC firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The IFC firm needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IFC firm are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the IFC firm need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IFC firm before their appointment are provided in Section 2.3 of the AFSA GEN rules.

### 5.7.5 Shari'ah Compliance requirements

The IFC would be subject to the provisions of the IFR rules of the AIFC, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 5.7.6 Shari'ah Supervisory Board

The IFC Firm needs to appoint a Shari'ah Supervisory Board to oversee the implementation of its Shari'ah systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'ah compliant accounts. The IFC firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

### 5.7.7 Shari'ah Governance

The IFC needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'ah specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 5.8 Key risks

A typical IFC firm would be exposed to the following material risk exposures

1. Credit risk & Counterparty credit risk
2. Concentration risk – in its credit portfolio
3. Market risk
4. Liquidity risk
5. Operational risk
6. Conduct of business risks – risk of failing to treat the customers fairly
7. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
8. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern



## 5.9 Applicable rules and regulations

The primary obligations faced by the IFC in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IFC firm would also be expected to be in compliance with the laws and rules administered by the AIFC Authority, including but not limited to Companies laws and regulations.

The IFC firm would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IFC firm needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical IFC firm would be

1. GEN Rules
2. IBB Rules
3. IFR Rules
4. COB Rules
5. AML Rules

## 6 Islamic Wealth Management (IWM) Firm

### 6.1 Business Model

An Islamic Wealth Management (IWM) Firm would typically be involved in providing asset management services to a range of clients in a Shari'ah-compliant manner. The IWM firm will be using only Shari'ah-compliant investment vehicles for providing its asset management services. An IWM firm proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 6.2 Services & Products

The IWM firm will typically offer the following products/services, though a specific IWM firm may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Managing Restricted Profit Sharing Investment Accounts (Restricted PSIAs)
- Real Estate Investment Management
- Private Equity
- Asset Management

The firm's asset management services may include both managing on a discretionary basis as well as on non-discretionary basis, assets belonging to another legal person.

The IWM firm's product portfolio in real estate investments may include a Real Estate Fund which will be a professionally managed portfolio of diversified real estate holdings. The firm can also employ Islamic REITs will invest in properties through real estate investment trusts (REITs) or RE funds. The IWM firm can manage private equity investments by providing a vehicle for investors to invest in equities of unlisted companies. These funds or REITs used as vehicles for real estate or private equity investments may be located in the AIFC, but can also be domiciled in any other jurisdiction. If such funds or REITs are domiciled in the AIFC, they would be subject to the provisions of the CIR rules of the AIFC.

### 6.3 Managing Restricted PSIAs

An IWM firm's activities would include managing Restricted PSIA which does not constitute a deposit, because a PSIA is managed in relation to property of any kind. The IWM firm can raise funds for investment in the form of a discretionary (mandate based) Restricted PSIA. There are no specific limitations or requirements on the number of accounts or investors for inclusion in the Restricted PSIA pool to be operated by the IWM firm. The restricted PSIA will typically be based on Mudarabah contracts which will specify the objectives and constraints for the investment account or pool by way of a documented mandate.

Such contractual mandate would typically address the following aspects

- Sector Exposure – size, share, nature and Shari’ah-compliant
- Size of Exposure

The Mudarabah contract will define the size of exposure in specific industry depending upon documented risk appetite and ticket size of available investments. Portfolios and investment allocation to agreed blocks shall be further in line with the constitutional documents prepared for each type of accounts,

- Quality of Investment (risk, rating and return)

The IWM firm`s investment strategy would typically be based on a set of clearly defined fundamental criteria that seeks to identify assets which meet those criteria. The quality assessment would be made based on soft and hard criteria.

- Fundamental criteria

The asset or instrument must be Shari’ah-compliant. Investment assets should not be involved in businesses or activities that are considered unlawful, or haraam (such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values). Investments shall not involve uncertain event in the future or in nature is not a speculative transaction.

The IWM firm will share profit with the restricted PSIA account holder (IAH) during the life of the investment. Policies and procedures related to each of these products should be outlined in a detailed manuals and operational procedures.

## 6.4 Activities & operations to deliver the services/products

The primary components of the activities of an IWM would be

- Business Development
- Assistance to clients in setting up their investment vehicles and accounts
- Developing the investment objectives and risk profile of the client
- Develop an investment strategy and get it approved by the client
- Managing the assets – execution of the strategy
- Investment research – if needed, based on the type of investments and strategy

The investment advisory service will include setting up appropriate strategies to manage the investment assets as per the investment objectives, financial goals and time limits determined. Identifying proper asset/projects for investment and ensuring good performance of the asset/project in the long-term is a significant element of asset management activities.

Investment process to be followed will be based on investment banking best practices and in compliance with AFSA guidelines as provided in detail in Conduct of Business (COB) Rulebook. The process includes Strategic Planning and business partner selection, detailed market study, selection and analysis by Investment committee, strategy execution, operational performance review and optimizing exits. The IWM firm will typically be responsible for continuously monitoring all the aspects of the investment to ensure the objectives of the investment are achieved. It is also expected to carefully analyze the market situation and look into the development prospects of each one of its clients' assets, taking into account the investors' investment objectives, risk profile and time limits. Identifying the proper asset and ensuring good performance of the asset in the long-term is a significant component of the firm's asset management procedure.

#### 6.4.1 Arranging Credit

The IWM firm's activities could also include making arrangements, making invitations, or engaging in any other conduct with a view to influence clients in regards to the buying, selling, subscribing or underwriting and borrowing money by way of a Credit Facility. Such credit facilities need not be related to or linked to the client's investments which are managed by the IWM firm.

#### 6.4.2 Providing investment advice

The IWM firm's activities typically also include providing generic as well as specific investment advice to investors or potential investors, where the intention is to influence the investor, in making a decision, to select a particular financial product or an interest in a particular financial product. The firm's generic advice would include information about a particular financial product, or market or outlook about a market or asset class.

### 6.5 Target clients

The firm will target corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region. The IWM firm can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IWM firm deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

### 6.6 Target markets

The AIFC being an international financial centre, the IWM firm can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IWM firm licensed

to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IWM firm may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 6.7 Revenue streams

The primary revenue streams for an IWM firm would be

- Asset management fees – typically calculated as a specific percentage of the AUM and paid by the client.
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.
- Mudarib's share of the profits earned from the PSIA pool
- A share of the profits, if the performance of the investment portfolio or fund exceeds a pre-defined threshold – for funds
- Capital gains arising from carried interest allocated to the IWM, in case of private equity investments

## 6.8 Regulatory requirements

### 6.8.1 Basic requirements and Legal status

An IWM firm needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The IWM firm is also required to locate its principal & head office in the AIFC.

### 6.8.2 AFSA Licenses required

An IWM firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Managing Investments
- Managing a Restricted Profit Sharing Investment Account (RPSIA)
- Advising on Investments

In addition to these core activities, an IWM firm may also be involved in carrying out the following regulated activities depending on its chosen business model and the range of products it intends to provide.

- Providing Custody
- Arranging Custody

- Dealing in Investments as Agent
- Providing Trust Serviced
- Providing Fund Administration
- Arranging Deals in investments
- Arranging Credit

Since these activities are not essential to the operation of the IWM business model, the IWM firms need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out. In some cases, the operating model of an IWM firm may result in the firm being involved in carrying out activities which fall under the definition of the regulated activity of “Dealing in Investments as Agent”. In such cases, the relevant IWM firm may have to seek and obtain the relevant license.

### 6.8.3 Capital requirements

The IWM firm will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AFSA’s PRU(INV) rules for Category IIIC firms or any other requirement that may be notified by the regulator in due course. An IWM firm is required to ensure that its Capital Resources as defined in Chapter 3 of the PRU (INV) rules would always be in excess of its base capital and requirement. For an IWM firm which is licensed for the core activities as listed above, would be USD 500,000.

In addition, the IWM firm is also required to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules. In order to meet this, the IWM firm is required to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the PRU(INV) rules.

### 6.8.4 Authorised Individuals

The IWM firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The IWM firm needs to apply for the Approved Individual status for every

employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IWM firm are also required to obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the IWM firm need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IWM firm before their appointment are provided in Section 2.3 of the AFSA GEN rules.

### 6.8.5 Shari'ah Compliance requirements

An Islamic asset management firm would be subject to the provisions of the IFR rules of the AIFC. The IWM firm is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 6.8.6 Shari'a Supervisory Board

The IWM Firm needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IWM firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

### 6.8.7 Shari'ah Governance

The IWM Firm needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 6.9 Key risks

A typical IWM firm would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Suitability of investment advice and appropriateness of products
3. Conduct of business risks – Managing conflicts
4. Conduct of business risks – Protecting client money and client assets
5. Shari’ah non-compliance risks – risk of failing to ensure compliance with Shari’ah
6. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern
7. Liquidity risks - risk of failing to ensure availability of liquid funds to pay expenses and meet liabilities as and when they fall due.

## 6.10 Applicable rules and regulations

The primary obligations faced by the IWM in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IWM firm would also be expected to be in compliance with the laws and rules administered by the AIFC Authority, including but not limited to Companies laws and regulations.

The IWM firm would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IWM firm needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical IWM firm would be

1. GEN Rules
2. IFR Rules
3. COB Rules
4. AML Rules
5. PRU (INV) Rules
6. CIS Rules



## 7 Islamic Trust Services Provider (ITS)

### 7.1 Business Model

An Islamic Trust Services Provider (ITS) would typically be involved in providing trust services and in acting as a trustee, to a range of clients in a Shari'ah-compliant manner. The ITS firm will be using only Shari'ah-compliant investment vehicles for providing its asset management services. An ITS firm proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 7.2 Services & Products

The ITS firm will typically offer the following products/services, though a specific ITS firm may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Providing trust services – setting up trusts and managing them
- Acting as a trustee for a collective investment fund
- Acting as a trustee for other investment vehicles – for real estate & PE assets
- Asset Management

The ITS firm can provide its services to funds or REITs used as vehicles for real estate or private equity investments which are located either in the AIFC or in any other jurisdiction. If such funds or REITs are domiciled in the AIFC, they would be subject to the provisions of the CIR rules of the AIFC. Similarly, the ITS firm can act as a trustee to any collective investment fund domiciled in any other jurisdiction apart from those based in the AIFC.

### 7.3 Activities & operations to deliver the services/products

The primary components of the activities of an ITS would be

- Business Development
- Assistance to clients in setting up trusts under the AIFC legal framework
- Assistance in operating the trusts and representing the interests of the investors in the trusts
- Operational activities related to protecting the assets of the trusts
- Acting as an independent trustee for a collective investment fund or for any other investment vehicle

The trust services will include setting up trusts which are appropriate to the needs of the client and the investors in the trusts. The services will aim to identify and implement all relevant measures to ensure the safekeeping of the assets included in the trust, collecting all the benefits and payments due to the trust, maintaining accounts of the trusts and reporting to the clients in a periodic manner.

### 7.3.1 Providing investment advice

The ITS firm's activities typically also include providing generic as well as specific investment advice to investors or potential investors, where the intention is to provide adequate information on the various steps to be taken, options available and choice of the investor, in making a decision regarding the trust to be established and the various service providers to the trust.

## 7.4 Target clients

The ITS firm will typically target collective investment funds, real estate investment vehicles, corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region. The ITS firm can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the ITS firm deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 7.5 Target markets

The AIFC being an international financial centre, the ITS firm can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an ITS firm licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The ITS firm may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 7.6 Revenue streams

The primary revenue streams for an ITS firm would be

- Trust services fees – for providing trust services
- Fees for acting as a Trustee

## 7.7 Regulatory requirements

### 7.7.1 Basic requirements and Legal status

An ITS firm needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The ITS firm is also required to locate its principal & head office in the AIFC.

### 7.7.2 AFSA Licenses required

An ITS firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Providing Trust Services
- Acting as a Trustee of a Fund

In addition to these core activities, an ITS firm may also be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Managing Investments
- Managing a Restricted Profit Sharing Investment Account (RPSIA)
- Providing Custody
- Arranging Custody
- Dealing in Investments as Agent
- Providing Fund Administration
- Advising on Investments
- Arranging Deals in investments
- Arranging Credit

Since these activities are not essential to the operation of the ITS business model, the ITS firms need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out. In some cases, the operating model of an ITS firm may result in the firm being involved in carrying out activities which fall under the definition of the regulated activity of “Acting as a Trustee of a fund”. In such cases, the relevant ITS firm may have to seek and obtain the relevant license.

### 7.7.3 Capital requirements

The ITS firm will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AFSA’s PRU(INV) rules or any other requirement that may be notified by the regulator in due course. An ITS firm is required to ensure that its Capital Resources as defined in Chapter 3 of the PRU (INV) rules would always be in excess of its base capital and requirement. For an ITS firm which is licensed for the core activities as listed above, would be USD 200,000. In addition, the ITS firm is

also required to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules. In order to meet this, the ITS firm is required to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the PRU(INV) rules.

#### 7.7.4 Authorised Individuals

The ITS firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The ITS firm needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an ITS firm are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the ITS firm need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an ITS firm before their appointment are provided in Section 2.3 of the AFSA GEN rules.

#### 7.7.5 Shari'ah Compliance requirements

The ITS firm would be subject to the provisions of the IFR rules of the AIFC. The ITS firm is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 7.7.6 Shari'a Supervisory Board

The ITS Firm needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The ITS firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

### 7.7.7 Shari'ah Governance

The ITS Firm needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 7.8 Key risks

A typical ITS firm would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Suitability of investment advice and appropriateness of products
3. Conduct of business risks – Managing conflicts
4. Conduct of business risks – Protecting client money and client assets
5. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
6. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern
7. Liquidity risks - risk of failing to ensure availability of liquid funds to pay expenses and meet liabilities as and when they fall due.

## 7.9 Applicable rules and regulations

The primary obligations faced by the ITS in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the ITS firm would also be expected to be in compliance with the laws and rules administered by the AIFC Authority, including but not limited to Companies laws and regulations.

The ITS firm would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the ITS firm needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical ITS firm would be

1. GEN Rules
2. IFR Rules
3. COB Rules
4. AML Rules
5. PRU (INV) Rules
6. CIS Rules

## 8 Islamic Liquidity Management Company (ILMC)

### 8.1 Business Model

An Islamic Liquidity Management Company (ILMC) would aim to support the operations and growth of Islamic financial institutions by providing a viable avenue for managing their liquidity needs, though its services can be offered to conventional banks and investment banks as well. An ILMC typically provides short-term Shari'ah-compliant liquidity to its clients as part of wider liquidity management services to a range of Islamic financial institutions in a Shari'ah-compliant manner. An ILMC proposed to be set up in the AIFC would aim to address the liquidity needs of the growing Islamic finance sector in the Central Asian region, extending to GCC and eventually to other Asian markets.

### 8.2 Services & Products

The ILMC will typically offer the following products/services, though a specific ILMC may choose to offer a wider or a narrower set of products or services within this domain.

- Managing Restricted Profit Sharing Investment Accounts (Restricted PSIAs)
- Asset Management
- Arranging & advising on credit facilities

The primary focus of the ILMC will be to:

1. Arrange credit facilities, but not extend credit;
2. Arrange Murabahah facilities for short term liquidity management from banks;
3. Advise on Islamic structures, and Islamic liquidity management;
4. Manage the liquid assets of Islamic banks, by investing them in Shari'a compliant vehicles, such as Murabahah funds or commodity Murabaha's or Mudarabah funds to earn a return;
5. Managing Restricted PSIAs (as an investment vehicle only for liquidity management).
6. Commodity Murabahah facilities.

The ILMC may also hold the commodities directly as part of its activities in providing commodity Murabahah facilities. However this activity does not constitute dealing as Principal as the direct investment in commodities will not fall under the category of Investments as defined in AFSA rulebook. The ILMC will not be involved in any deposit taking business. An ILMC which uses unrestricted PSIAs in contrast to the restricted PSIA route discussed here, would need to be licensed as an Islamic bank which is discussed separately in this handbook. The ILMC will be involved purely in liquidity management.

The ILMC will not enter into Mudarabah for the purpose of providing an investment deposit account, but may enter into Mudarabah contracts as a basis for its restricted PSIA offering or for its liquid assets fund. The ILMC will not guarantee any profits, and the structure of the ILMC's model is not to provide investment accounts to retail or other customers.

### 8.3 Managing Restricted PSIAs

An ILMC's activities would include managing Restricted PSIA which does not constitute a deposit. The ILMC uses restricted PSIA as an instrument to offer liquidity management service. There are no specific limitations or requirements on the number of accounts or investors for inclusion in the Restricted PSIA pool to be operated by the IFM firm. The restricted PSIA will typically be based on Mudarabah contracts which will specify the objectives and constraints for the investment account or pool by way of a documented mandate. Being accounts focussed on managing liquidity, the investment strategy would typically be focussed on a high level of credit quality. This emphasis on credit quality would be reflected in the criteria employed to identify assets for investment. The quality assessment would be made based on soft and hard criteria. The asset or instrument must be Shari'ah-compliant.

The ILMC will share profit with the restricted PSIA account holder (IAH) during the life of the investment. Policies and procedures related to each of these products should be outlined in a detailed manuals and operational procedures.

The ILMC will not extend credit nor will enter into financing arrangements of any kind, including those based on Ijarah contracts. Its activities will be limited to advising and managing assets as Mudarib for the specific purpose of facilitating liquidity management of its clients. Financial activities that are conducted will not be linked to banking or deposit taking activity within the meaning of GEN. The core business of the ILMC will be the use of Islamic structures for liquidity management, using primarily Commodity Murabahah contracts.

### 8.4 Activities & operations to deliver the services/products

The primary components of the activities of an ILMC would be

- Business Development
- Assistance to clients on liquidity management advice and strategy
- Develop an investment strategy and get it approved by the client
- Managing the assets – execution of the strategy

Investment process to be followed will be based on best practices in liquidity management and in compliance with AFSA guidelines. The process includes Strategic Planning and business partner selection, detailed market study, selection and analysis by Investment committee, strategy execution and, ongoing performance review. The ILMC will typically be responsible for continuously monitoring all the aspects of the investment to ensure the objectives of the investment are achieved.



### 8.4.1 Arranging Credit

The ILMC's activities could also include making arrangements, making invitations, or engaging in any other conduct with a view to influence clients in regards to the buying, selling, subscribing for or underwriting and borrowing money by way of a Credit Facility. Such credit facilities need not be related to or linked to the client's liquidity management needs which are managed by the ILMC.

### 8.4.2 Providing advice on liquidity management

The ILMC's activities would typically include providing generic as well as specific advice to its institutional clients from Islamic banking and IFI sector, with the aim of providing options and recommendations to the clients in respect of investing their liquid resources and to managing their liquidity needs. The ILMC's generic advice would include information about the market outlook and economic trends in the relevant geography.

## 8.5 Target clients

A typical ILMC's target clients will be Islamic banks and other Islamic financial institutions which are involved in handling funds on both the assets and liabilities side of their balance sheet. An ILMC will not deal with any retail clients.

## 8.6 Target markets

The AIFC being an international financial centre, the ILMC can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an ILMC licensed to operate in the AIFC, may find it suitable and attractive to target Islamic banks from almost any geography which need liquidity in USD as the funding currency. In particular, the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia will be key target markets.

## 8.7 Revenue streams

The primary revenue streams for an IFM firm would be

- Asset management fees – typically calculated as a specific percentage of the AUM and paid by the client.
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.
- Mudarib's share of the profits earned from the PSIA pool

## 8.8 Regulatory requirements

### 8.8.1 Basic requirements and Legal status

An ILMC must be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The proposed ILMC would be required to be incorporated as a limited company in the AIFC, if its business model involves the use of Unrestricted PSIA's and their management. The ILMC is also required to locate its principal & head office in the AIFC.

### 8.8.2 AFSA Licenses required

An IFM firm will typically be involved in providing the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Managing Investments
- Managing a Restricted Profit Sharing Investment Account (RPSIA)
- Arranging Deals on investments or in credit
- Advising on Investments and credit
- Arranging Custody

In addition to these core activities, an ILMC may also be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Providing Custody
- Dealing in Investments as Agent
- Providing Fund Administration

Since these activities are not essential to the operation of the ILMC business model, the ILMC firms need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out. In some cases, the operating model of an ILMC may result in the firm being involved in carrying out activities which fall under the definition of the regulated activity of "Dealing in Investments as Agent". In such cases, the relevant ILMC may have to seek and obtain the relevant license.

### 8.8.3 Capital requirements

The ILMC will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AFSA's PRU(INV) rules or any other requirement that may be notified by the regulator in due course. An ILMC is required to ensure that its Capital Resources as defined in Chapter 3

of the PRU (INV) rules would always be in excess of its base capital requirement of USD 500,000 or its Minimum Capital Requirement, whichever is higher.

In order to execute its chosen business model, if the ILMC seeks and obtains a license for dealing in investments as an agent, it will be classified as a PRU Dealing Investment Firm in accordance with AIFC PRU(INV) rule 1.3. Because of such a classification, the ILMC will also be required to meet risk capital requirements addressing its exposures to credit, market and operational risks which together with its Base Capital Requirement will form its Minimum Capital Requirement, as defined in AIFC PRU(INV) rule 3.3.

In addition, an ILMC is also required to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules. In order to meet this, the ILMC is required to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the PRU(INV) rules.

### Authorised Individuals

The IFM firm must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are controlled functions and Approved Individuals to hold those functions need to be authorised by the AFSA. The ILMC needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IFM firm are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals as well. In the case of Designated Individuals, the ILMC need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by the ILMC before their appointment are provided in Section 2.3 of the AFSA GEN rules.

#### 8.8.4 Shari'ah Compliance requirements

The ILMC is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

#### 8.8.5 Shari'a Supervisory Board

The ILMC Firm needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IFM firm needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

#### 8.8.6 Shari'ah Governance

An ILMC needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

### 8.9 Key risks

A typical ILMC would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Suitability of investment advice and appropriateness of products
3. Conduct of business risks – Managing conflicts
4. Conduct of business risks – Protecting client money and client assets (If providing custody)
5. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
6. Capital adequacy risks – risk of failing to manage counterparty credit risk from its clients,
7. Capital adequacy risks – risk of failing to manage market risk exposures during the trading period and pre-settlement period (in the event of a client default)

8. Liquidity risks - risk of failing to ensure availability of liquid funds to meet liabilities to counterparties and/or clients as and when they fall due.
9. Liquidity risks - risk of failing to ensure availability of cash to expenses like salaries and other operating expenditure.

## 8.10 Applicable rules and regulations

The primary regulatory obligations faced by the ILMC in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the ILMC would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the ILMC needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical IFM firm would be

1. GEN Rules
2. IFR Rules
3. COB Rules
4. AML Rules
5. PRU (INV) Rules
6. CIS Rules

## 9 Islamic Brokerage Company (IBC)

### 9.1 Business Model

The Islamic Brokerage Company (IBC) would typically be involved in providing intermediation services in any of the asset markets including but not limited to financial assets like equities, fixed income, exchange traded assets, OTC assets, derivatives, commodities, currencies and investment funds, in a Shari'ah-compliant manner. The IBC will follow only processes and procedures which are Shari'ah-compliant while it can deal with clients and counterparties who need not always be Shari'ah-compliant. An IBC proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity presented by various asset markets in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 9.2 Services & Products

The IBC will typically offer the following products/services, though in a specific instance an IBC may choose to offer a wider or a narrower set of products or services within the Islamic asset management space.

- Brokerage & intermediation services
- Investment advisory
- Arranging trades

### 9.3 Broking in wholesale markets

Given the nature of AIFC, it is more likely that a typical IBC in the AIFC would be focussed on dealing in wholesale markets, both listed and OTC. An IBC would operate as an intermediary in wholesale financial markets facilitating the trading activities of its clients, in particular commercial and investment banks. An IBC will only operate as an intermediary in any asset markets and not as a market maker or on a proprietary basis. The IBC will also arrange transactions between two or more parties. The IBC will never be counterparty to any transaction it arranges.

### 9.4 Activities & operations to deliver the services/products

The primary activities of the IBC would be

- Business Development
- Assistance to clients in buying or selling the assets they wish to buy or sell by getting the best execution in the relevant markets

- Complete the post-trade processes of clearing and settlement of trades
- Assist the clients in preparing for post-trade processes by arranging custody and/or help in opening bank and settlement accounts
- In case the IBC provides custody of client assets, ensure safe custody of client assets in compliance with all applicable AIFC COB rules relating to client assets.
- Investment research – to support the brokerage business and provide additional information to clients on an independent basis

The core brokerage activity will be based on best practices in the market and in compliance with AIFC COB rules which mandate requirements relating to best execution,

In addition, the IBC will also seek and obtain the relevant licenses and/or memberships required to trade on any of the exchanges where it wishes to trade. For example, if the IBC wishes to trade on AIX, it would seek and obtain the membership from AIX by making necessary application and meeting the requirements specified by AIX for its trading members. The IBC would always ensure that various aspects of its operations are well organised and robust, in order to sustain its compliance with various requirements it faces from the exchange regulators as well as from the AFSA.

#### 9.4.1 Executing trades as a Broker

The IBC can participate in any of the financial markets, both exchanges and OTC markets, with the aim of fulfilling the orders of its clients. The IBC will ensure that these processes would be in compliance with the relevant rules in AIFC COB rules, specifically those relating to order execution and order handling in Chapter 6 of AIFC COB rules. In addition, the IBC would also be prepared to complete the post-trade processes of clearing and settlement for the client, if required. If the client is organised to take care of their post-trade processes, the IBC can hand over the trade after execution.

#### 9.4.2 Providing independent research

The IBC can provide independent sell-side research to any of its clients in order to support its brokerage services. In such cases, the IBC will establish and implement effective systems and controls to manage potential conflicts arising from the provision of such research and ensure such services are in compliance with relevant AFSA rules on managing conflicts.

### 9.5 Target clients

The IBC will aim to service the brokerage requirements of corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region. The IBC can provide the regulated financial

services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IBC deciding to provide these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 9.6 Target markets

The AIFC being an international financial centre, the IBC can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IBC licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IBC's capabilities in addressing markets would also be restricted to the memberships and licenses it holds to operate as a broker in the asset markets. The IBC may also wish to utilize its capabilities and potential in specific asset classes or market segments and focus their strategy on those segments.

## 9.7 Revenue streams

The primary revenue streams for an IBC would be

- Brokerage commissions and fees – calculated either as a specific percentage of the trade executed or as an absolute amount for each trade and paid by the client.
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.

## 9.8 Regulatory requirements

### 9.8.1 Basic requirements and Legal status

An IBC needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. The IBC firm is also required to locate its principal & head office in the AIFC.

### 9.8.2 AFSA Licenses required

An IBC firm will need to be licensed for the following regulated activities as defined in Schedule 1 of the AIFC GEN rules

- Dealing in Investments as Agent
- Advising on Investments
- Arranging deals in Investments



In addition to these core activities, an IBC may also need the following licenses depending on the range of its products and the business model it employs in its brokerage business.

- Providing Custody
- Arranging Custody
- Providing Trust Services
- Providing Fund Administration
- Advising on a Credit Facility
- Arranging a Credit Facility

Since these activities are not essential to the operation of the IBC business model, an IBC need not necessarily be licensed for carrying out these additional regulated activities. Only in the event of them being involved in any of these activities, they would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out. For example, an IBC may decide to provide Trust services in addition to its brokerage business, probably because its clients in the brokerage business also need services to set up investment trusts of various kinds

### 9.8.3 Capital requirements

The IBC is required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AIFC PRU(INV) rules or any other requirement that may be notified by the regulator in due course. An IBC firm is required to ensure that its Capital Resources as defined in Chapter 3 of the AIFC PRU (INV) rules would always be in excess of its base capital requirement of USD 500,000 or its Minimum Capital Requirement, whichever is higher. By virtue of holding a license for dealing in investments as an agent, the IBC will be classified as a PRU Dealing Investment Firm in accordance with AIFC PRU(INV) rule 1.3. Because of such a classification, the IBC will also be required to meet risk capital requirements addressing its exposures to credit, market and operational risks which together with its Base Capital Requirement will form its Minimum Capital Requirement, as defined in AIFC PRU(INV) rule 3.3.

In addition, the IBC is also expected to meet the Liquid Assets Requirement as defined in Chapter 4 of the PRU(INV) rules, which requires the IBC to have, at all times, liquid assets of at least equal to 25% of its annual operating expenditure. The liquid assets and annual operating expenditure for this purpose are defined in Chapter 4 of the AIFC PRU(INV) rules.

### 9.8.4 Authorised Individuals

The IBC must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and

3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are mandatory controlled functions and so an IBC must appoint Approved Individuals to hold those functions who are authorised by the AFSA. The IBC needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IBC are also required to obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals, who need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IBC for their assessment are provided in Section 2.3 of the AFSA GEN rules.

### 9.8.5 Shari'ah Compliance requirements

An IBC would be subject to the provisions of the AIFC IFR rules and is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 9.8.6 Shari'a Supervisory Board

The IBC needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IBC needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AFSA IFR rules.

### 9.8.7 Shari'ah Governance

The IBC needs to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah

- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 9.9 Key risks

A typical IBC would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – Failure to provide Best execution
3. Conduct of business risks – ensuring order handling and record retention
4. Conduct of business risks – Managing conflicts
5. Conduct of business risks – Protecting client money and client assets
6. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
7. Capital adequacy risks – risk of failing to manage counterparty credit risk from its clients,
8. Capital adequacy risks – risk of failing to manage market risk exposures during the trading period and pre-settlement period (in the event of a client default)
9. Liquidity risks - risk of failing to ensure availability of liquid funds to meet liabilities to counterparties and/or clients as and when they fall due.
10. Liquidity risks - risk of failing to ensure availability of cash to expenses like salaries and other operating expenditure.

## 9.10 Applicable rules and regulations

The primary regulatory obligations faced by the IBC in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IBC would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IBC needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a typical IAM firm would be

1. GEN Rules
2. IFR Rules

3. COB Rules
4. AML Rules
5. PRU (INV) Rules

## 10 Islamic Investment Bank (IIB)

### 10.1 Business Model

An Islamic Investment Bank (IIB) would typically be dealing in Investments as principal in a Shari'ah-compliant manner. In the terminology defined in AIFC IBB rules, it would be an Islamic Broker Dealer. The distinguishing features of its business model would be that the IIB will be making proprietary investments and hold assets on its balance sheet and may raise funds using Islamic Financial Contracts. However, the IIB must not manage UPSIAs, which would need an Islamic banking license. An Islamic Broker Dealer proposed to be set up in the AIFC would seek to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

### 10.2 Services & Products

The IIB in its purest form, may be organized as an entity to trade in various asset markets and make proprietary investments using its own capital and liabilities generated by way of market borrowings. In this manner, the IIB may not be involved in providing any services to external clients apart from serving its own needs. Such entities are often seen in many markets around the world. However, IIBs providing investment management, wealth management and brokerage services to external clients are also seen in many of the developed financial centres.

The IIB offering services to external clients will typically be involved in the following products/services, though a specific IIB may choose to offer a wider or a narrower set of products or services within the Islamic investment banking space.

- Asset Management
- Managing Restricted Profit Sharing Investment Accounts (Restricted PSIAs)
- Real Estate Investment Management
- Private Equity
- Brokerage services
- Investment advisory and arranging transactions

The IIB's asset management services may include both managing on a discretionary basis as well as on non-discretionary basis, assets belonging to another legal person. The IIB may also provide Islamic financing. In case of all the products or activities referred above, the IIB is expected to seek and obtain the necessary licenses from the AFSA. The IIB's product portfolio in real estate investments may include a Real Estate Fund which will be a professionally managed portfolio of diversified real estate holdings. The firm can also employ Islamic REITs will invest in properties through real estate investment trusts (REITs) or RE funds. The IIB can also manage private equity investments by providing a vehicle for investors to invest in equities of unlisted companies. These funds or REITs used as vehicles for real estate or private

equity investments may be located in the AIFC, but can also be domiciled in any other jurisdiction. If such funds or REITs are domiciled in the AIFC, they would be subject to the provisions of the CIR rules of the AIFC.

### 10.3 Managing Restricted PSIAs

The IIB may also manage Restricted PSIAs which do not constitute a deposit, because a PSIA is managed in relation to property of any kind. The IIB can raise funds for investment in the form of a discretionary (mandate based) Restricted PSIA but must not manage UPSIAs. There are no specific limitations or requirements on the number of accounts or investors for inclusion in the Restricted PSIA pool to be operated by an IIB. The restricted PSIA will typically be based on Mudarabah contracts which will specify the objectives and constraints for the investment account or pool by way of a documented mandate. Such contractual mandate would typically address the following aspects

- Sector Exposure – size, share, nature and Shari’ah-compliant
- Size of Exposure

The Mudarabah contract will define the size of exposure in specific industry depending upon documented risk appetite and ticket size of available investments. Portfolios and investment allocation to agreed blocks shall be further in line with the constitutional documents prepared for each type of accounts,

- Quality of Investment (risk, rating and return)

The IIB’s investment strategy would typically be based on a set of clearly defined fundamental criteria that seeks to identify assets which meet those criteria. The quality assessment would be made based on soft and hard criteria.

- Fundamental criteria

The asset or instrument must be Shari’ah-compliant. Investment assets should not be involved in businesses or activities that are considered unlawful, or haram (such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values). Investments shall not involve uncertain event in the future or in nature is not a speculative transaction. The IIB will share profit with the restricted PSIA account holder (IAH) during the life of the investment. Policies and procedures related to each of these products should be outlined in a detailed manuals and operational procedures.

### 10.4 Activities & operations to deliver the services/products

The primary components of the activities of an IIB operating only as a principal for its proprietary investments would be dealing in markets for buying and selling its assets or investments, completion of all

necessary post-trade activities like clearing and settlement processes, ensuring that its transactions with other market participants do not harm the integrity of the market in any way. An IIB offering a wider set of activities as referred above would be in the following:

- Business Development
- Assistance to clients in setting up their investment vehicles and accounts
- Developing the investment objectives and risk profile of the client
- Develop an investment strategy and get it approved by the client
- Managing the assets – execution of the strategy
- Investment research – if needed, based on the type of investments and strategy

The investment advisory service will include setting up appropriate strategies to manage the investment assets as per the investment objectives, financial goals and time limits determined. Identifying proper asset/projects for investment and ensuring good performance of the asset/project in the long-term is a significant element of asset management activities. Investment process to be followed will be based on investment banking best practices and in compliance with AFSA guidelines as provided in detail in Conduct of Business (COB) Rulebook. The process includes Strategic Planning and business partner selection, detailed market study, selection and analysis by Investment committee, strategy execution, operational performance review and optimizing exits. The IIB will typically be responsible for continuously monitoring all the aspects of the investment to ensure the objectives of the investment are achieved. It is also expected to carefully analyze the market situation and look into the development prospects of each one of its clients' assets, taking into account the investors' investment objectives, risk profile and time limits. Identifying the proper asset and ensuring good performance of the asset in the long-term is a significant component of the firm's asset management procedure.

## 10.5 Target clients

The IIB offering services to external clients can target corporate and other institutional clients, High Net worth Individuals in the Middle East and North Africa region. The IIB can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IIB deciding to provide some of these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 10.6 Target markets

The AIFC being an international financial centre, the IIB domiciled in the AIFC stands to gain from the advantage of being able to operate in any of the asset markets in any geography, as long as it is able to obtain the necessary licenses and memberships in those markets. The membership requirements are

particularly applicable to exchanges while OTC markets are typically available to all IIBs domiciled in the AIFC. IIBs serving external clients can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IIB licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IIB may also wish to utilize its capabilities and potential in specific asset classes, market segments or industrial sectors and focus their strategy on those segments.

## 10.7 Revenue streams

The primary revenue streams for an IIB serving external clients would be

- Asset management fees – typically calculated as a specific percentage of the AUM and paid by the client.
- Brokerage commissions or fees for executing trades for its clients
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.
- Mudarib's share of the profits earned from the PSIA pool
- A share of the profits, if the performance of the investment portfolio or fund exceeds a pre-defined threshold – for funds
- Capital gains arising from carried interest allocated to the Islamic Broker Dealer, in case of private equity investments

For an IIB restricted to dealing for its proprietary book, the revenues would be limited to income and capital gains from the portfolio of its investments.

## 10.8 Regulatory requirements

### 10.8.1 Basic requirements and Legal status

An Islamic Broker Dealer needs to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC if it is an Islamic Financial Institution or an Islamic Window, that is authorised to conduct the Regulated Activity of Dealing in Investments as principal in a Shari'ah-compliant manner and it is not an Islamic bank, as defined in the Prudential Islamic Banking Rules. The Islamic Broker Dealer is also required to locate its principal & head office in the AIFC.

### 10.8.2 AFSA Licenses required

An IIB will essentially be required to hold a license for only one regulated activity defined in Schedule 1 of the AIFC GEN rules - Dealing in Investments as principal.



Because an IIB is authorised to operate as an Islamic Financial Institution as defined in IFR rules, it will be classified as an Islamic Broker Dealer by virtue of the definition in AIFC IBB rules. The IIB will continue to be treated as an Islamic Broker Dealer in the AIFC even if it is also authorised to conduct any other activity that is not Islamic Banking Business. The IIB does not cease to be an Islamic Broker Dealer only because it conducts other activities included in its authorisation. The IIB may provide financing using Islamic Financial Contracts, if it receives the license to conduct the regulated activity of Providing Islamic Financing as defined in AIFC GEN rules.

In addition to these core activities, the IIB may choose to be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Managing Investments
- Managing a Restricted Profit Sharing Investment Account
- Advising on Investments
- Providing Custody
- Arranging Custody
- Dealing in Investments as Agent
- Providing Trust Services
- Providing Fund Administration
- Arranging Deals in investments
- Arranging Credit

Since these activities are not essential to the operation of their business model, the IIBs need not necessarily be licensed for carrying out these additional regulated activities in all instances. Only in the event of an IIB being involved in any of these activities, it would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out. In some cases, the operating model of an IIB may result in the firm being involved in carrying out activities which fall under the definition of the regulated activity of “Dealing in Investments as Agent”. In such cases, the relevant IIB may have to seek and obtain the relevant license.

### 10.8.3 Capital requirements

The IIB, by virtue of its license to deal in investments as a principal and classification as an Islamic Broker Dealer, will be required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AIFC IBB rules. Although the IIB is not an Islamic Bank, effectively it is required to comply with practically a vast majority of the IBB rules relating to prudential, risk management and capital adequacy requirements.

The IIB being an Islamic Broker Dealer is required to meet the initial and ongoing capital requirements specified in chapter 4 of the AIFC IBB rules. The initial Base capital requirement for an IBB is USD 2 million as specified in IBB rule 4.7. An IIB must meet this requirement with CET1 capital at the time of its authorisation. The risk capital requirement for the IIB will be the sum of its credit risk capital requirement, its market risk capital requirement and its operational risk capital requirement, which are defined in chapter 4 of the IBB rules.

The IIB is expected to maintain at all times, the following capital adequacy ratios

- CET1 capital ratio of 4.5% of total risk-weighted assets (RWAs)
- Tier 1 capital ratio of 6% of total risk-weighted assets (RWAs)
- Total capital ratio of 8% of total risk-weighted assets (RWAs)

In addition, the IIB is also expected to meet capital conservation buffer requirement of 2.5% of its total RWAs or any higher amount that the AFSA may set out by way of a written notice, from time to time. The capital adequacy framework including the capital conservation buffer set out in the AIFC IBB rules is fully consistent with the Basel III capital adequacy framework.

The IIB is also required to comply with all the risk management and governance requirements spelt out in the AIFC IBB rules including the liquidity risk management requirements.

#### 10.8.4 Authorised Individuals

The IIB must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are mandatory controlled functions and so an IIB must appoint Approved Individuals to hold those functions who are authorised by the AFSA. The IIB needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IIB are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals, who need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective

candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IIB for their assessment are provided in Section 2.3 of the AFSA GEN rules.

### 10.8.5 Shari'ah Compliance requirements

The IIB is subject to the provisions of the IFR rules of the AIFC and is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 10.8.6 Shari'a Supervisory Board

The IIB needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IIB also needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AIFC IFR rules.

### 10.8.7 Shari'ah Governance

The IIB is required to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 10.9 Key risks

A pure IIB operating only as a proprietary investor would only be exposed to a limited set of risks ranging from capital adequacy and solvency risks to prevent harming its counterparties or causing market instability and conduct of business compliance to ensure that it operates in full compliance with the rules of the markets where it operates and to ensure the integrity of those markets.

An IIB serving external clients would be exposed to the following material risk exposures

1. Conduct of business risks – risk of failing to treat the customers fairly
2. Conduct of business risks – best execution and other brokerage standards
3. Conduct of business risks – protecting client money and client assets
4. Conduct of business risks – managing conflicts
5. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
6. Capital adequacy or solvency risks – risk of failing to ensure adequate capital for the firm to be a going concern
7. Liquidity risks - risk of failing to ensure availability of liquid funds to pay expenses and meet liabilities as and when they fall due.

## 10.10 Applicable rules and regulations

The primary regulatory obligations faced by the IIB in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IIB would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IBC needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations

The key AIFC laws and rules applicable to a pure IIB would be

1. GEN Rules
2. IBB Rules
3. IFR Rules
4. COB Rules
5. AML Rules
6. Markets Rules

In addition, an IIB involved in offering products and services to external clients would also be subject to other rules of the AIFC like the CIS Rules and any other rules depending on its portfolio of services.

## 11 Islamic Bank (IB)

### 11.1 Business Model

An Islamic Bank (IB) can adopt a variety of business models to address the banking business needs of a range of customers, spread across various business segments. This is very much in common with the conventional banking business landscape in any country or market. Much like conventional Banks, IBs set up in the AIFC can adopt various business models which include but are not limited to a pure commercial bank, a typical corporate investment bank, retail oriented bank, online bank or a universal bank which has various divisions addressing each of these segments.

An IB, irrespective of the business model adopted by it would be one of most complex financial services entities operating in the AIFC. This would be reflected in the higher level of regulatory obligations faced by an IB, the risk profile of such IBs as assessed by the AFSA and consequent higher supervisory oversight from the AFSA. This is consistent with risk-based supervisory approach followed by the AFSA.

However, all IBs established in the AIFC under the regulatory framework for Islamic Banks in the AIFC are required to meet a few critical defining characteristics, which are specified in the AIFC IBB rules. They need to operate in a fully Shari'ah-compliant manner and conduct activities which meet the definition of the regulated activity of Islamic Banking Business. Islamic Banking Business is defined in the AIFC GEN rules as providing financing using Shari'ah-compliant contracts or making investments by entering as principal or agent into any Islamic financial contract while raising funds for those activities through either or both of the following:

- (a) raising, accepting and managing funds or money placements;
- (b) managing Unrestricted Profit Sharing Investment Accounts (UPSIA);

The distinguishing features of an IB's business model would be its involvement in raising funds using UPSIA accounts and/or using any Islamic financial contracts, for example Wakalah contracts to accept fund placements or reverse Commodity Murabahah transactions and using such funds to provide financing using Islamic financial contracts. The funds raised by an IB in this manner can also be used by it to make proprietary investments and hold assets on its balance sheet. The ability to manage UPSIAs and raise funds using Islamic financial contracts distinguishes it from Islamic Broker Dealers as defined in AIFC GEN rules. IBs established in the AIFC can try to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

## 11.2 Services & Products

An IB's services & products portfolio would depend on its business model and business strategy, as the banking licence allows a wide range of possibilities including a universal bank which can address all banking business segments from commercial banking to investment banking and retail banking. An IB is expected to have two main groups of products apart from a range of incidental banking services usually provided by banks operating in any market. Such incidental banking services like operating current accounts, facilitating payments, cross-border remittances, fund transfers, accepting inflows for clients can be provided by the IB operating in the AIFC. The IBs operating in the AIFC would primarily be operating with US Dollar as their primary currency of operations while also being capable of serving customers in any other currency including the KZT and other regional and global convertible currencies like EUR or JPY.

Apart from banking services, an IB can also be licensed to conduct any of the other regulated activities defined in Schedule 1 of the AIFC GEN rules, except Accepting Deposits and providing credit. These two activities are not Shari'ah-compliant and instead an IB can conduct Islamic Banking Business or provide Islamic financing as defined in the GEN rules. This regulatory framework is flexible to accommodate almost all of the Islamic banking business models currently in operation in almost all the markets across the world. The regulations in AIFC do not pose any limitation on IBs to serve retail clients as is the case with some of the other international financial centres. Therefore, an IB can offer any or all of the following products/services:

- Asset Management
- Wealth management
- Managing Restricted Profit Sharing Investment Accounts (Restricted PSIAs)
- Real Estate Investment Management
- Brokerage services
- Investment advisory and arranging transactions
- Providing trust services
- Providing fund administration
- Custody services
- Arranging and advisory services

The IB's asset management services may include both managing on a discretionary basis as well as on non-discretionary basis, assets belonging to another legal person. In case of all the products or activities referred above, the IIB is expected to seek and obtain the necessary licenses from the AFSA. The IB's product portfolio in real estate investments may include a Real Estate Fund which will be a professionally managed portfolio of diversified real estate holdings. The IB can also employ Islamic REITs will invest in properties through real estate investment trusts (REITs) or RE funds. These funds or REITs used as vehicles for real estate or for managing collective investment funds may be located in the AIFC, but can

also be domiciled in any other jurisdiction. If such funds are domiciled in the AIFC, they would be subject to the provisions of the CIR rules of the AIFC.

### 11.3 Islamic Banking Business

As defined earlier, the Islamic Banking Business of an IB may involve funding with UPSIAs or other Islamic financial contracts and financing or investments using Islamic financial contracts. The assets side of the business is very much dependent of the chosen business strategy and the business model adopted, in terms of customer segments (corporate or retail or SME), geographical markets to be addressed, maturity profile of financings offered and channels employed to access potential financing opportunities and acquire exposures. The IB can provide financing for retail clients like car loans, mortgage financing to fund the acquisition of various real estate assets from residential real estate, to commercial real estate and farmlands, as well as corporate financing. Corporate financing may include but need not be limited to, project financing, equipment leasing, working capital financing, providing financing to acquire raw material, construction financing and the like. In addition, an IB may also provide off-balance sheet contingent financing products like LCs or bank guarantees. All financings have to be provided using Islamic financial contracts and can only be made to finance activities or assets which are Shari'ah-compliant.

The IB can raise liabilities using UPSIAs wherein the IB will accept funds placed in UPSIA accounts on the basis of a generic investment objective and mandate, which will not specify clear restrictions on the sector or asset types to be financed. The funds raised by way of UPSIAs can be commingled with own funds of the IB as well as with other Shari'ah-compliant liabilities raised by the IB. In addition, AIFC based IBs can also accept funds placed with them through savings and current accounts operated by them, for which IBs may not be paying any compensation or returns to the investors placing those funds.

All the funds raised by an IB using Islamic financial contracts and other Shari'ah compliant avenues can be used by an IB in a manner very much similar to the way conventional banks manage their fund resources. All the funds are placed in a pool and managed in consideration of the need to manage ALM risks, duration mismatch risk, profit rate risk in the banking book and, liquidity risk.

### 11.4 Providing Custody

Given the natural profile of an IB in terms of its size, scale and complexity and the need to make significant investments in IT and other capabilities, IBs are well positioned to offer custody services. IBs, very much like conventional banks, are expected to accept funds from customers and manage them in a fiduciary capacity including the obligation to keep those funds in a safe manner. Therefore, IBs are likely to be naturally amenable to providing custody services wherein they can leverage much of their capabilities and infrastructure set up by them for conducting Islamic banking business. Under the AIFC IBB rules, an IB

operating in the AIFC can offer custody services to its clients in a Shari'ah-compliant manner, subject to compliance with applicable AIFC COB rules.

## 11.5 Managing Restricted PSIA's

The IB may also manage Restricted PSIA's which do not constitute a deposit. In addition to its ability to raise and manage UPSIA accounts, an IB can raise funds for investment in the form of a discretionary (mandate based) Restricted PSIA accounts. There are no specific limitations or requirements on the number of accounts or investors for inclusion in the Restricted PSIA pool to be operated by an IB. The restricted PSIA will typically be based on Mudarabah contracts which will specify the objectives and constraints for the investment account or pool by way of a documented mandate. Such contractual mandate would typically address the following aspects

- Sector Exposure – size, share, nature and Shari'ah-compliant
- Size of Exposure

The Mudarabah contract will define the size of exposure in specific industry depending upon documented risk appetite and ticket size of available investments. Portfolios and investment allocation to agreed blocks shall be further in line with the constitutional documents prepared for each type of accounts. The IB's investment strategy would typically be based on a set of clearly defined fundamental criteria that seeks to identify assets which meet those criteria. The quality assessment would be made based on soft and hard criteria.

The asset or instrument must be Shari'ah-compliant. Investment assets should not be involved in businesses or activities that are considered unlawful, or haram (such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values). Investments shall not involve uncertain event in the future or in nature is not a speculative transaction. The IB will share profit with the restricted PSIA account holder (IAH) during the life of the investment. Policies and procedures related to each of these products should be outlined in a detailed manuals and operational procedures.

## 11.6 Activities & Operations to deliver the services/products

The primary activities of an IB would be raising funds using UPSIA accounts or other Islamic financial contracts, using those funds to provide financing to a range of clients and making investments in various Shari'ah-compliant financial assets. In addition, an IB will also provide all the banking services like payments, remittances, cross-border fund transfers, revenue collections, cash management services for corporate clients, offering non-fund based services like opening L/Cs, providing bank guarantees, clearing & settlement services for cash as well as securities, operating current and savings accounts, cheque



clearing and , participation in domestic payment systems. The IB's business activities would include the following:

- Identifying potential clients, converting such prospects into clients
- Business Development efforts with initiatives to develop the business franchise
- Execution of various products and services like brokerage
- Operational activities to ensure delivery of various products and services
- Managing the assets – execution of the strategy
- Investment research – if needed, based on the type of investments and strategy

The IB will ensure that operational activities and delivery of services like managing assets, provision of trust services, brokerage services, providing custody and investment research are carried out in compliance with relevant AFSA COB rules.

### 11.7 Target clients

An IB domiciled in the AIFC can offer services to clients ranging from corporate and other institutional clients, High Net worth Individuals to retail clients. The IB can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the IB deciding to provide some of these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

### 11.8 Target markets

The AIFC being an international financial centre, the IB domiciled in the AIFC stands to gain from the advantage of being able to operate in any of the geographies, subject to compliance with all relevant local laws and regulations. The IB may have to obtain local licenses in some cases to provide its products and services to clients in certain countries. IIBs can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, an IB licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including Turkey and Russia. The IB may also wish to utilize its capabilities and potential in specific client segments, market segments or industrial sectors and focus their strategy on those segments.

### 11.9 Revenue streams

The primary revenue streams for an IB would be the following:

- Income from Islamic financing – this would include profits from sale-based contracts like Murabahah, Salaam etc.
- Share of profits from assets acquired using profit-sharing modes like Mudarabah and Musharakah
- Fees for providing services as a Mudarib – Wakalah contracts,
- Other fees received for providing various services including banking services like operating accounts, payments and receipts, clearing and remittances
- Brokerage commissions or fees for executing trades for its clients
- Fees for providing and/or arranging custody - typically calculated as a specific percentage of the AUM and paid by the client.
- Mudarib's share of the profits earned from the PSIA pool
- A share of the profits, if the performance of the investment portfolio or fund exceeds a pre-defined threshold – for funds

## 11.10 Regulatory requirements

### 11.10.1 Basic requirements and Legal status

An IB is required to be incorporated as a legal entity in the AIFC, using one of the permissible legal forms of organizations in the AIFC. An IB is usually required to be domiciled in the AIFC though the AIFC IBB rules permit Islamic banking business activity through an Islamic Window. The IB is also required to locate its principal & head office in the AIFC.

### 11.10.2 AFSA Licenses required

An IB, by definition, is required to hold a license for the regulated activity of Islamic banking business. This license would allow the IB to conduct all of its core activities like raising funds, providing financing and providing various banking services. When an IB wishes to carry out any of the other regulated activities defined in Schedule 1 of the AIFC GEN rules, it needs to seek and obtain the relevant license to conduct the regulated activities it intends to pursue as outlined in its regulatory business plan. In addition to these core activities, the IIB may choose to be involved in carrying out the following regulated activities depending on its chosen business model and the range of products and services it intends to provide.

- Managing Investments
- Managing a Restricted Profit Sharing Investment Account
- Advising on Investments
- Providing Custody
- Arranging Custody
- Dealing in Investments as Agent
- Providing Trust Services

- Providing Fund Administration
- Arranging Deals in investments
- Arranging Credit

Since these activities are not essential to the operation of their business model, the IBs need not necessarily be licensed for carrying out these additional regulated activities in all instances. Only in the event of an IB being involved in any of these activities, it would be required to seek and obtain the license from AFSA for the specific activities they intend to carry out.

### 11.10.3 Capital requirements

The IB is required to comply with all the prudential, risk management and capital adequacy requirements prescribed in AIFC IBB rules. Under the AIFC IBB rules, the IB is required to meet the initial and ongoing capital requirements specified in chapter 4 of the AIFC IBB rules. The initial Base capital requirement for an IB is USD 10 million as specified in IBB rule 4.7. An IB must meet this requirement with CET1 capital at the time of its authorisation. The risk capital requirement for the IB will be the sum of its credit risk capital requirement, its market risk capital requirement and its operational risk capital requirement, which are defined in chapter 4 of the IBB rules.

The IB is expected to maintain at all times, the following capital adequacy ratios

- CET1 capital ratio of 4.5% of total risk-weighted assets (RWAs)
- Tier 1 capital ratio of 6% of total risk-weighted assets (RWAs)
- Total capital ratio of 8% of total risk-weighted assets (RWAs)

In addition, the IB is also expected to meet capital conservation buffer requirement of 2.5% of its total RWAs or any higher amount that the AFSA may set out by way of a written notice, from time to time. The capital adequacy framework including the capital conservation buffer set out in the AIFC IBB rules is fully consistent with the Basel III capital adequacy framework. The IB is also required to comply with all the risk management and governance requirements spelt out in the AIFC IBB rules including the liquidity risk management requirements.

### 11.10.4 Authorised Individuals

The IB must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and

3. Compliance Officer.
4. Money Laundering Reporting Officer; and
5. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are mandatory controlled functions and so an IB must appoint Approved Individuals to hold those functions who are authorised by the AFSA. The IB needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions as defined in chapter 2 of the AIFC GEN rules. Members of the Board of an IB are also required to be obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals, who need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by an IB for their assessment are provided in Section 2.3 of the AFSA GEN rules.

#### 11.10.5 Shari'ah Compliance requirements

The IB is subject to the provisions of the IFR rules of the AIFC and is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

#### 11.10.6 Shari'a Supervisory Board

The IB needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The IB also needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AIFC IFR rules.

#### 11.10.7 Shari'ah Governance

The IB is required to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.

- Ongoing monitoring through a compliance monitoring programme for Shari’ah
- Periodic review by independent Shari’a specialists to assess the extent to which the firm is complying the fatwa’s and guidelines issued by its SSB
- External review by the SSB to assess the extent of overall compliance with Shari’ah.

### 11.11 Key risks

An IB, being one of the most complex financial services operations in the AIFC, would be exposed to a wide range of risks ranging from capital adequacy and solvency risks to conduct of business risks and financial crime risks. An IB would be exposed to the following material risk exposures

1. Credit risk
2. Concentration risk
3. Market risk
4. Liquidity risk
5. Operational risk
6. Profit rate risk in the banking book
7. Conduct of business risks – risk of failing to treat the customers fairly
8. Conduct of business risks – managing conflicts
9. Shari’ah non-compliance risks – risk of failing to ensure compliance with Shari’ah
10. Financial crime risks – AML/CFT and fraud risks

### 11.12 Applicable rules and regulations

The primary regulatory obligations faced by the IB in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the IB would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the IBC needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules
7. AIFC Insolvency Regulations
8. AIFC currency regulations

The key AIFC laws and rules applicable to a pure IIB would be

1. GEN Rules

2. IBB Rules
3. IFR Rules
4. COB Rules
5. AML Rules

## 12 Takaful Operator

### 12.1 Business Model

A Takaful Operator licensed to operate in the AIFC can adopt any Takaful model to operate its Takaful business to provide protection against a wide range of risks to a range of customers, spread across various business segments. This flexibility to use any Takaful model is subject to two conditions:

- (i) the requirement that it is approved by the Takaful Operator's Shari'ah Supervisory Board that the model adopted is in full compliance with Shari'ah.
- (ii) The restriction that a Takaful Operator cannot operate both Family Takaful and General Takaful business simultaneously, unless the General Takaful is restricted to Categories 1 (accident) and 2 (health).

In essence, a Takaful Operator can be a Family Takaful operator who can also provide Takaful cover for accident and health risks or be a General Takaful operator who cannot operate a Family Takaful business.

The Family Takaful operator can enter into and carry out Takaful contracts of all three categories of Family Takaful listed in App 2 of this handbook. Similarly, a General Takaful operator can enter into and carry out Takaful contracts belonging to any of the 18 categories listed in App 1 of this handbook. The flexibility offered by the regulations applicable to Takaful business to Takaful operators to choose a suitable Takaful model for their businesses is significant competitive advantage to potential operators who can use their legacy models so long as they are Shari'ah compliant.

The regulatory framework for any Takaful Business carried out in the AIFC or carried out by a Takaful operator licensed by the AIFC would be defined by AIFC Takaful & Retakaful rules (TRR rules). A Takaful Operator, irrespective of the business model adopted by it would be one of most complex financial services entities operating in the AIFC. This would be reflected in the higher level of regulatory obligations faced by a Takaful Operator, the risk profile of such Takaful Operator as assessed by the AFSA and consequent higher supervisory oversight from the AFSA. This is consistent with risk-based supervisory approach followed by the AFSA.

However, all Takaful Operators established in the AIFC are required to meet a few critical defining characteristics, which are specified in the AIFC TRR rules. They need to operate in a fully Shari'ah-compliant manner and conduct activities which meet the definition of the regulated activity of Takaful Business. The regulated activity of Takaful Business for the AIFC is defined in the AIFC GEN rules as the business of conducting either or both of the following activities: (a) effecting Contracts of Insurance as Principal; (b) carrying on Contracts of Insurance as Principal, in a Shari'ah-compliant manner.

The distinguishing features of a Takaful Operator's business model would be its ability to enter into and/or carry out Takaful contracts. Takaful Operators established in the AIFC can try to leverage the huge and emerging market opportunity in the Central Asian region, Russia and other erstwhile CIS states as well as in the wider Asian markets.

## 12.2 Services & Products

A Takaful Operator's services & products portfolio would depend on its business model in terms of it being either a Family Takaful operator or a General Takaful operator. The General Takaful license offers significant levels of flexibility to enter into Takaful contracts to cover risks in any of the 18 categories listed in App 2 of this handbook. The Family Takaful license from the AIFC would allow a Takaful operator to write Takaful business only in respect of risks in categories 1 & 2 in App 1 of this handbook. So, in addition to family protection, a Family Takaful operator can operate Takaful funds to provide protection against health and accident risks. A Takaful operator, either Family or General, is not allowed to carry out any other regulated activities in the AIFC, apart from the Takaful business referred above. In particular, a Takaful operator must not carry on any activity other than Takaful Business unless the activity is directly connected with, or carried on for the purposes of Takaful Business. Specifically, managing investments is not considered as an activity directly connected with, or carried on for the purposes of, Takaful business.

The following activities carried out by a Takaful Operator, will normally be considered as directly connected with, or carried on for the purposes of, Takaful Business:

- a. Investing or reinvesting as investor and for the Takaful Operator's own account, that of its subsidiary, its holding company or any subsidiary of its holding company but not any other party, in shares, debt instruments, investment accounts, units in collective investment schemes, or other forms of investments that are intended to earn profit or return for the investor;
- b. Rendering other services related to Takaful business operations including actuarial, risk assessment, loss prevention, safety engineering, data processing, accounting, claims handling, loss assessment, appraisal and collection services;
- c. Acting as agent for another Takaful operator in relation to Takaful Contracts in which both the principal and the agent participate;
- d. Establishing subsidiaries or associates engaged or organised to engage exclusively in 1 or more of the businesses mentioned in a. to c.;
- e. Takaful mediation.

In addition to this generic guidance provided in the TRR rules, the AFSA may give individual guidance on other business activities that may be taken to be directly connected with, or carried on for the purposes of, Takaful Business carried on by A Takaful Operator.



## 12.3 Activities & Operations of a Takaful Operator

The primary activities of a Takaful Operator would be:

- Promoting its business by creating awareness of its products among likely beneficiaries and target customers through suitable business development efforts.
- Identifying potential clients, converting such prospects into clients.
- Execution of various operations, processes and procedures like pricing, underwriting etc.
- Operational activities to ensure delivery of various products and services.
- Collecting relevant information about the customer and the risk to be covered so that sufficient risk analysis is performed and risk appropriately priced.
- Provide a price for the Takaful cover and once accepted enter into a Takaful Contract.
- Collect contributions payable by the Takaful participants to the Operator.
- Managing the investments of contributions collected.
- Carry out the obligations related to the Takaful contract entered into by it, including but not limited to receipt, management and payout of claims related to such Takaful contracts.

The Takaful Operator will ensure that all aspects of its operational activities and delivery of services to customers are carried out in compliance with relevant AIFC COB rules.

## 12.4 Target clients

A Takaful Operator domiciled in the AIFC can offer services to clients ranging from corporate and other institutional clients, High Net worth Individuals to retail clients. The Takaful Operator can provide the regulated financial services described above in this section to all types of clients – retail clients, professional clients and market counter parties. In the event of the Takaful Operator deciding to provide some of these products and services to retail clients, the firm needs to take note of the relatively more stringent conduct of business rules that would apply to the firm to protect the interests of the retail clients.

## 12.5 Target markets

The AIFC being an international financial centre, the Takaful Operator domiciled in the AIFC stands to gain from the advantage of being able to operate in any of the geographies, subject to compliance with all relevant local laws and regulations. The Takaful Operator may have to obtain local licenses in some cases to provide its products and services to clients in certain countries. Takaful Operators can target potential clients from any geography subject to being consistent with its internal business strategy. Typically, a Takaful Operator licensed to operate in the AIFC, may find it suitable and attractive to target potential clients from the Central Asian region, the Middle East and North Africa (MENA) region, Eurasian region including

Turkey and Russia. The Takaful Operator may also wish to utilize its capabilities and potential in specific client segments, market segments or industrial sectors and focus their strategy on those segments.

## 12.6 Revenue streams

The primary revenue streams for a Takaful Operator would be the following:

- Fees for managing Takaful funds – Mudarib fees or fees for Wakil, depending on the contract used to structure the Takaful fund.
- Fees for providing services as a Mudarib – Wakalah contracts,
- Other fees received for providing various services including premium collections and investments etc.

## 12.7 Regulatory requirements

### 12.7.1 Basic requirements and Legal status

A Takaful Operator is required to be incorporated as a legal entity in the AIFC, using the Limited liability corporate form of organizations in the AIFC. A Takaful Operator is usually required to be domiciled in the AIFC though the AIFC TRR rules permit Islamic Takaful business activity through an Islamic Window. The Takaful Operator is also required to locate its principal & head office in the AIFC.

### 12.7.2 AFSA Licenses required

A Takaful Operator, by definition, is required to hold a license for the regulated activity of Islamic Takaful business. This license would allow the Takaful Operator to enter into and/or carry out Takaful contracts covering the relevant categories of risks.

### 12.7.3 Capital requirements

The Takaful Operator is required to comply with all the prudential, risk management and solvency requirements prescribed in AIFC TRR rules. All references to a Takaful Operator or an AIFC-incorporated Takaful Operator in the TRR Rules specifying capital adequacy and other prudential requirements must be read as referring also to a Takaful Fund.

Under the AIFC TRR rules, the Takaful Operator is required to meet a Minimum Capital Requirement (MCR), both at the time of licensing and on an ongoing basis. The MCR and other capital requirements are specified in schedules 5 & 6 of the AIFC TRR rules. A Takaful Operator must meet its MCR with common equity capital at the time of its authorisation. Eligible Capital for a Takaful Operator must be calculated using the eligibility criteria and formulae set out in schedule 4 of the AIFC TRR rules. An AIFC-Incorporated

Takaful Operator must at all times have Eligible Capital equal to or higher than the amount of its MCR. The Takaful Operator is expected to maintain at all times, adequate Eligible Capital to exceed its prescribed capital requirement (PCR) which is calculated as the higher of the following:

- 150% of the AIFC-incorporated Takaful Operator's MCR; and
- AIFC-incorporated Takaful Operator's Risk-Based Capital requirement.

The Risk-Based Capital requirement (RBC) for the Takaful Operator is defined in schedule 6 of the AIFC TRR rules and is calculated as the sum of its own RBC and the RBC for each of the Takaful funds it operates. The RBC for a Takaful fund or the Takaful operator, as the case may be, is calculated as the sum of the following components:

- (i) Investment risk requirement;
- (ii) Takaful risk requirement; and
- (iii) Operational risk capital requirement,

all of which are defined in schedule 6 of the AIFC TRR rules.

The Takaful Operator is also required to comply with all the risk management and governance requirements spelt out in the AIFC TRR rules including but not limited to the operational risk management requirements.

#### 12.7.4 Own risk and Solvency Assessment (ORSA) process

In addition to the MCR and PCR requirements described in the previous section, an AIFC-incorporated Takaful Operator is required to complete an ORSA process which is defined in the TRR rules, with the aim of assessing the actual risk exposures faced by the Takaful Operator. The Takaful Operator is expected to use the risk profile arrived at using this exercise to calculate its own estimate of capital required to maintain its solvency in all plausible future scenarios. In this exercise, the capital requirements for the shareholders' fund of the Takaful Operator must be reflective of the risks directly borne by the Takaful Operator, whilst the capital requirements for the individual Takaful Funds managed by it must be reflective of the risks borne by those Takaful Funds.

#### 12.7.5 Need for Qard

If the Eligible Capital available in a Takaful Fund is not adequate to meet the applicable Capital Requirements as defined in the TRR Rules, the resulting deficit in capital should be considered as an estimate of the potential Qard that may need to be extended by the Takaful Operator to ensure capital adequacy of the relevant Takaful Fund. The Eligible Capital available in the shareholders' fund of a Takaful Operator must only be available to support risks borne by the Takaful Operator as well as any potential Qard it may need to provide to its Takaful Funds, as described in (2) above. It is useful to note here that the AIFC TRR rules do not include any obligation or mandatory requirement for a Takaful Operator to

provide Qard support to any of its Takaful funds. However, it is possible that the AFSA may exercise its supervisory powers as part of its normal supervision or as a consequence of the outcome of the ORSA process to require a Takaful Operator to provide capital support to any of its Takaful funds in distress, using the Qard mechanism.

The Eligible Capital available in a Takaful Fund must only be used to support the risk exposures of that Takaful Fund and should be available only to reduce the potential Qard that may need to be extended by its Takaful Operator. The capital adequacy and other prudential requirements as well as the methodologies for determining them, as specified in the TRR Rules must be applied to the Takaful Operator or to the individual Takaful Funds it manages, as applicable in the relevant context, to achieve the overall objectives of the TRR Rules and to comply with the specific Rules in chapter 5 of the AIFC TRR rules.

### 12.7.6 Use of Internal Models

An AIFC incorporated Takaful Operator may be allowed to use its own internal model for calculating its PCR or any of the components of PCR, only if it seeks and obtains an explicit approval in writing from the AFSA for the use of such an internal model. The AFSA will evaluate the internal model using the criteria and eligibility conditions set out in chapter 5 of the AIFC TRR rules. In the event of the AFSA being satisfied about the ability of the internal model to meet its eligibility criteria, the AFSA may provide a written approval for the use of that internal model. It is also useful to understand the current position of the AFSA that it may not be able to entertain any applications for the use of such internal models till it has accumulated adequate data to test the validity and appropriateness of such internal models/

### 12.7.7 Authorised Individuals

The Takaful Operator must make the following appointments and ensure that they are held by one or more Approved Individuals at all times:

1. Senior Executive Officer;
2. Finance Officer; and
3. Compliance Officer.
4. Money Laundering Reporting Officer
5. Risk Manager; and
6. such other role or function as the AFSA may direct from time to time.

The positions 1 to 3 above are mandatory controlled functions and so a Takaful Operator must appoint Approved Individuals to hold those functions who are authorised by the AFSA. The Takaful Operator needs to apply for the Approved Individual status for every employee it intends to appoint to Controlled Functions

as defined in chapter 2 of the AIFC GEN rules. Members of the Board of a Takaful Operator are also required to obtain the approval of the AFSA to be an Approved Individual.

Functions 4 & 5 above are designated functions and so they may be filled by Designated Individuals, who need not seek or obtain the approval of the AFSA. It is the responsibility of the firm to assess the prospective candidate for the Designated Function and ensure their fitness and propriety. The definition of Designated Individuals and the criteria to be employed by a Takaful Operator for their assessment are provided in Section 2.3 of the AIFC GEN rules.

### 12.7.8 Shari'ah Compliance requirements

The Takaful Operator is subject to the provisions of the IFR rules of the AIFC and is required to comply with all provisions of the IFR rules, which include detailed requirements in respect of ensuring effective Shari'ah compliance. These include the need for a dedicated Shari'ah Supervisory Board (SSB), internal Shari'ah reviews and other obligations for Shari'ah governance.

### 12.7.9 Shari'a Supervisory Board

The Takaful Operator needs to appoint a Shari'a Supervisory Board to oversee the implementation of its Shari'a systems and to provide the relevant fatwa's and approvals for its business activities and operations. An example of such an approval would be the approval of the overall investment guidelines of its Shari'a compliant accounts. The Takaful Operator also needs to carry out a detailed due diligence on the Shari'ah Scholars it intends to appoint to its SSB to ensure their fitness and propriety. The requirements regarding the SSB are detailed in the AIFC IFR rules.

### 12.7.10 Shari'ah Governance

The Takaful Operator is required to implement a process to ensure Shari'ah compliance which should have the following steps, though they are not limited to the following:

- Preparation of documentation and distribution of the pre-approved investment guidelines and related fatwa's issued by the SSB.
- Ongoing monitoring through a compliance monitoring programme for Shari'ah.
- Periodic review by independent Shari'a specialists to assess the extent to which the firm is complying the fatwa's and guidelines issued by its SSB.
- External review by the SSB to assess the extent of overall compliance with Shari'ah.

## 12.8 Key risks

A Takaful Operator, being one of the most complex financial services operations in the AIFC, would be exposed to a wide range of risks ranging from capital adequacy and solvency risks to conduct of business risks and financial crime risks. A Takaful Operator would be exposed to the following material risk exposures:

1. Underwriting risk
2. Pricing risk
3. Reserving risk
4. Takaful risk
5. Shari'ah non-compliance risks – risk of failing to ensure compliance with Shari'ah
6. Risks arising from segregation of Takaful funds
7. Claims settlement risk
8. Credit risk
9. Market risk
10. Investment risk
11. Liquidity risk
12. Operational risk, including legal and outsourcing risks
13. Technology risk, including Cyber risk
14. Asset-Liability management risk
15. Retakaful risk
16. Conduct of business risks – risk of failing to treat the customers fairly
17. Conduct of business risks – managing conflicts
18. Financial crime risks – AML/CFT and fraud risks

## 12.9 Applicable rules and regulations

The primary regulatory obligations faced by the Takaful Operator in its status as an Authorised Firm in the AIFC would come from the AFSA laws and rules. In addition, the Takaful Operator would be subject to the overarching legislative framework defining the AIFC, as they set the legal backdrop and provide the basis for the incorporation and functioning of all types of entities in the AIFC. Therefore, the Takaful Operator needs to be compliant with the wider legislative framework which includes, but not limited to:

1. Constitutional Statute of the Republic of Kazakhstan
2. AIFC Financial Services Framework Regulations
3. AIFC Companies Rules
4. AIFC Companies Regulations
5. Fees Rules
6. AIFC Insolvency Rules

7. AIFC Insolvency Regulations
8. AIFC currency regulations
9. AIFC regulations relating to Special Purpose companies or trusts

The key AIFC laws and rules applicable to a pure IIB would be

1. GEN Rules
2. TRR Rules
3. IFR Rules
4. COB Rules
5. AML Rules

## Appendix 1      Categories of General Takaful Insurance

A Contract of Insurance will be a General Insurance Contract if it falls within one or more of the following categories:

### General Insurance Category 1: Accident

Contracts of Insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of the Person insured:

- sustaining injury as the result of an accident or of an accident of a specified class;
- dying as a result of an accident or of an accident of a specified class; or
- becoming incapacitated in consequence of disease or of disease of a specified class,

including contracts relating to industrial injury and occupational disease but excluding contracts falling within Family Takaful Category 4 (Permanent Health).

### General Insurance Category 2: Sickness

Contracts of Insurance providing fixed pecuniary benefits or benefits in the nature of indemnity (or a combination of both) against risks of loss to the Persons insured attributable to sickness or infirmity but excluding contracts falling within Family Takaful Category 4 (Permanent Health).

### General Insurance Category 3: Land vehicles

Contracts of Insurance against loss of or damage to vehicles used on land, including motor vehicles but excluding railway rolling stock.

### General Insurance Category 4: Railway rolling stock

Contract of Insurance against loss of or damage to railway rolling stock.

### General Insurance Category 5: Aircraft

Contracts of Insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.



## General Insurance Category 6: Ships

Contracts of Insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.

## General Insurance Category 7: Goods in transit

Contracts of Insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.

## General Insurance Category 8: Fire and natural forces

Contracts of Insurance against loss of or damage to property (other than property to which categories 3 to 7 relate) due to fire, explosion, storm, natural forces other than storm, nuclear energy or land subsidence.

## General Insurance Category 9: Damage to property

Contracts of Insurance against loss of or damage to property (other than property to which General Insurance Categories 3 to 7 relate) due to hail or frost or any other event (such as theft) other than those mentioned in General Insurance Category 8 (Fire and natural forces).

## General Insurance Category 10: Motor vehicle liability

Contracts of Insurance against damage arising out of or in connection with the use of motor vehicles on land, including third-party risks and carrier's liability.

## General Insurance Category 11: Aircraft liability

Contracts of Insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.

## General Insurance Category 12: Liability of ships

Contracts of Insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.

## General Insurance Category 13: General liability

Contracts of Insurance against risks of the persons insured incurring liabilities to third parties, the risks in question not being risks to which General Insurance Categories 10, 11 or 12 relate.

## General Insurance Category 14: Credit

Contracts of Insurance against risks of loss to the Persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

## General Insurance Category 15: Suretyship

Contracts of Insurance against the risks of loss to the Persons insured arising from their having to perform contracts of guarantee entered into by them.

Fidelity bonds, performance bonds, administration bonds, bail bonds or customs bonds or similar contracts of guarantee, where these are:

- effected or carried out by a Person not carrying on the business of Accepting Deposits;
- not effected merely incidentally to some other business carried on by the Person effecting them; and
- effected in return for the payment of one or more premiums.

## General Insurance Category 16: Miscellaneous financial loss

Contracts of Insurance against any of the following risks, namely:

- risks of loss to the Persons insured attributable to interruptions of the carrying on of business carried on by them or to reduction of the scope of business so carried on;
- risks of loss to the Persons insured attributable to their incurring unforeseen expense (other than loss such as is covered by contracts falling within General Insurance Category 18 (Assistance)); or
- risks which do not fall within sub-paragraph (1) or (2) and which are not of a kind such that Contracts of Insurance against them fall within any other General Insurance Category.

## General Insurance Category 17: Legal expenses

Contracts of Insurance against risks of loss to the Persons insured attributable to their incurring legal expenses (including costs of litigation).

## General Insurance Category 18: Assistance

Contracts of Insurance providing either or both of the following benefits, namely:

- assistance (whether in cash or in kind) for Persons who get into difficulties while travelling, while away from home or while away from their permanent residence; or
- assistance (whether in cash or in kind) for Persons who get into difficulties otherwise than as mentioned in sub-paragraph (1).

## Appendix 2: Categories of Family Takaful

A Contract of Insurance will be a Family Insurance Contract if it falls within one or more of the following categories:

### Family Takaful Category 1: Life and annuity

Contracts of Insurance on human life or contracts to pay annuities on human life, but excluding (in each case) contracts within Family Takaful Category 3.

### Family Takaful Category 2: Marriage and birth

Takaful Contract to provide a sum on marriage or on the birth of a child, being contracts expressed to be in effect for a period of more than one year.

### Family Takaful Category 3: Linked long term

Takaful Contract on human life or contracts to pay annuities on human life where the benefits are wholly or partly to be determined by references to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

### Family Takaful Category 3: Permanent health

Takaful Contract providing specified benefits against risks of Persons becoming incapacitated in consequence of sustaining injury as a result of an accident or of an accident of a specified class or of sickness or infirmity, being contracts that:

- are expressed to be in effect for a period of not less than five years, or until the normal retirement age for the Persons concerned, or without limit of time; and
- either are not expressed to be terminable by the Takaful Operator, or are expressed to be so terminable only in special circumstances mentioned in the contract.