



الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

**Shari'ah
Governance Ratings**

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Beyond Traditional Credit Rating Products

- In October 2017, the International Organization of Securities Commissions (IOSCO) published a report that analyzes 'Other' products offered by credit rating agencies (OCPs);
- These non-traditional products, IOSCO cites, may include, for example, private ratings, indicative ratings, prospective ratings, provisional ratings, one-time ratings, national ratings, point-in-time ratings, scoring, credit default swap spreads, bond indexes, portfolio assessment tools, credit assessments, fund ratings, research or other tools;
- IOSCO (Leading International Policy Forum for Securities Regulators) believes that these non-conventional products, although distinct from traditional 'ratings' , assists market participants in making investment and other credit-related decisions. Issuers & Obligors may use these OCPs to make a decision on obtaining Traditional Credit Ratings from a particular Rating Agency;
- Apart from products covered in IOSCO Report, a few CRAs are also involved in assessments like Corporate Governance Ratings, ESG Sustainability Ratings (Environment, Social and Governance), Smart Assessments in Microfinance sector;
- The users of such OCPs related information may include investors, regulatory and standard setting bodies, employees or other stakeholders.

Other CRAs Products (OCPs)

Conventional Credit Ratings in Islamic Finance

- In Islamic Finance the Core importance is given to level of Shari'a adherence and Governance in an IFI;
- Islamic finance being faith-based, failures in terms of Shari'a Governance could be a catalyst in triggering a credit event;
- Globally used credit rating methodologies for Sukuks or IFIs either completely overlook the Shari'a Governance aspects or have limited assessments;
- Ignoring Shari'a Governance assessment in credit rating process for IFIs and Sukuks may lead to information asymmetry, portrayal of unrealistic PDs and eventual unexpected credit events;
- IFC is part of the Smart Microfinance Campaign where Client protection is the main Goal. Rating Agencies are also a part of this Certification of MFIs. The Campaign promotes **transparency and responsible pricing, terms of the product offering, respectful collection practices, complaint process, client data confidentiality and prevention of over indebtedness.**

The global Islamic financial services industry is valued at USD1.89 trillion in 2016

Islamic Finance Factsheet

No. of Islamic Banks / Windows

480

Current size of Awqaf Assets

USD 100B -1T ?

No. of Takaful / Retakaful Operators

322

Value of Sukuk Outstanding

USD 341,923M

Number of Other IFIs

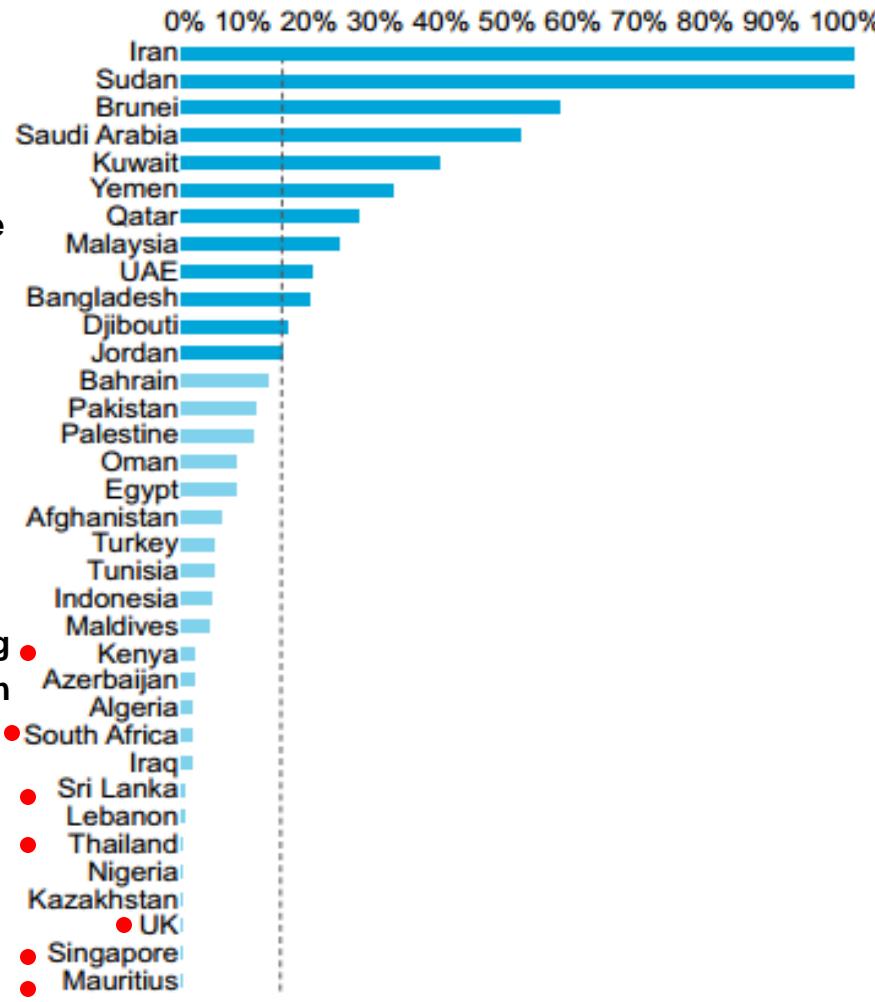
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State of the Global Islamic Financial Services Industry ... Expansion Beyond Core Markets

- The global Islamic financial services industry valued at USD1.89 trillion in 2016 (IFSI Stability Report 2017)
- Islamic banking continues to dominate the IFSI
- The 12 most active jurisdictions collectively, host 88% of the global Islamic banking assets and 84% of the global Sukuk outstanding
- Non-OIC jurisdictions
- Untapped potential of integrating Awqaf (currently largely based on property) with the global IFSI

Islamic Banking Share in Total Banking Assets by Jurisdiction (1H2016)



Source: IFSB, 2017

Why is it important to have Shari'ah governance ratings?

- Adaption of policy frameworks to Islamic finance, in line with Shari'ah governance standards issued by AAOIFI and IFSB remains uneven across countries;
- Licensing requirements have not been effectively used to ensure that licensed IBs have in place key structures that address risks **stemming from Shari'ah non-compliance** in their operations;
- IBs in Djibouti, Kenya, Nigeria and UK, for example, are licensed based on a standard banking license that applies the same criteria as for conventional banks;
- While many of the licensing criteria for conventional banks have the key elements to ensure best practices, it is important to ensure ex-ante and ex-post robust Shari'ah governance framework;
- Failure to do so could lead to a Shari'ah and reputational-risk-induced credit event.



What benefits can be expected from such ratings?

- Adherence to Shari'ah tenets and principles is the foundation of Shari'ah conscious investors' decision towards Islamic finance;
- Shariah governance rating would bring confidence to the general public and the financial markets on the credibility of Islamic finance operations.



Shall these ratings be mandatory by regulatory requirements?

- Given the underdeveloped nature of capital markets and therefore insufficient market discipline and competitive pressure in majority of OIC member countries, regulation is required initially to protect stakeholders' interests. Particularly for retail investors who are less sophisticated than corporate or institutional investors;
- The transparency provided by ratings is beneficial to markets.

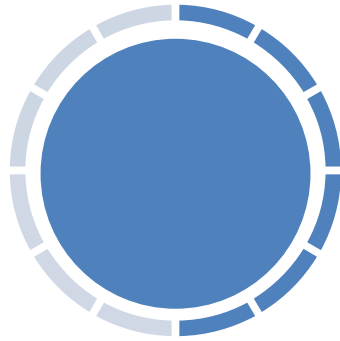


Shall these ratings have an impact on the credit ratings?

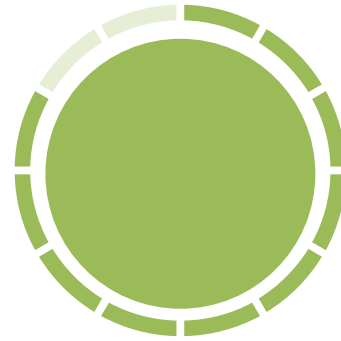
- Shari'ah governance rating shall complement credit ratings;
- IFI's paying ability and financial strength are not the only factors leading to a credit event;
- Failure to incorporate Shari'ah governance in credit rating assessments undermines the accuracy of analysis to IFI stakeholders;
- Should also be a part as an input in the process of determining a Traditional Credit Rating, as this could not be converted into a Traditional Credit Ratings.



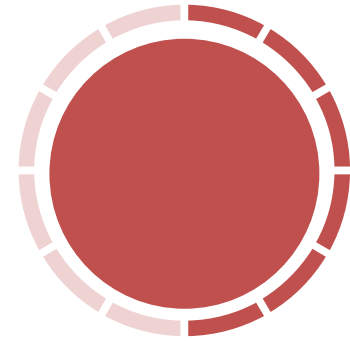
Fiduciary ratings



Corporate Governance



Shari'ah Governance



Asset Manager Quality

- An analytical framework that accommodates the unique features of IFIs and recognizes the mutually dependent nature of credit and fiduciary risks in an IFI;
- Appeal to varying needs of investors, with greater information for investors regarding institutional strength, in addition to governance capabilities, while giving specific coverage to Shari'ah governance.



**Thank
You**