

GOVERNMENT OF PAKISTAN
SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

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Islamabad the 1st March, 2018

NOTIFICATION

S.R.O. 273 (I)/2018.- The following draft Shariah Governance Regulations, 2018 proposed to be made by Securities and Exchange Commission of Pakistan in exercise of the powers conferred by section 512 read with section 451 of the Companies Act, 2017 (XIX of 2017) are hereby published for information of all persons likely to be affected thereby and notice is hereby given that objections and suggestions, if any, received within fourteen days from the date of its placement on the Commission's website, shall be taken into consideration, namely:-

DRAFT REGULATIONS

**CHAPTER I
PRELIMINARY**

1. Short title and Commencement.- (1) These Regulations shall be called Shariah Governance Regulations, 2018.

(2) These Regulations shall be applicable on Shariah compliant companies, Shariah compliant securities and Islamic financial institutions.

(3) They shall come into force at once.

(4) The provisions of these regulations shall be in addition to and not in derogation of any other relevant laws, rules or regulations applicable to Shariah compliant companies, Shariah compliant securities and Islamic financial institutions.

2. Definitions.- (1) In these Regulations unless there is anything repugnant in the subject or context-

- (a) **"Act"** means the Companies Act, 2017 (XIX of 2017);
- (b) **"Commission"** means the Securities and Exchange Commission of Pakistan established under section 3 of the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997);
- (c) **"Exchange"** means the Pakistan Stock Exchange Limited;
- (d) **"Islamic financial institution"** means a financial institution which is Shariah compliant including Modarabas, Non-Banking Financial Institutions, Takaful operators/ window takaful operators and any

other Shariah compliant financial company or entity notified by the Commission from time to time;

- (e) **“securities”** shall have the same meaning as assigned to it in clause (61) of sub-section (1) of section (2) of the Act;
- (f) **“Shariah Advisor”** means a Shariah Advisor as defined in Shariah Advisors Regulations , 2017;
- (g) **“Shariah Advisory Board”** means the Shariah Advisory Board constituted by the Commission;
- (h) **“Shariah compliant company”** means a company as defined in the Act and which complies with these Regulations;
- (i) **“Shariah opinion”** means an approval, a certificate, a fatwa (فتوى) or an opinion issued by a Shariah Advisor for the purpose of section 451 of the Act in the manner as specified in these regulations; and
- (j) **“Shariah Review Report”** means a report issued by the Shariah Advisor under these regulations.

(2) Words and expressions used but not defined in these Regulations shall have the same meanings as are assigned to them in the the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997) or any administered legislation.

CHAPTER II CERTIFICATION PROCEDURE

3. Certification of a Shariah compliant company or Islamic financial institution.-

No company or notified entity shall be called a Shariah compliant company or Islamic financial institution unless it obtains a certificate of Shariah compliance from the Commission under these regulations:

Provided that this regulation shall not apply to Takaful and Modaraba companies.

4. Application to obtain certification.- (1) A company or Islamic financial institution desirous of operating as a Shariah compliant company or Islamic financial institution shall make an application to the Commission as set out in Form A, to obtain a certificate of Shariah compliance, providing information as required therein, along with all the relevant documents and receipt evidencing the payment of non-refundable processing fee as prescribed in Schedule I.

(2) The Commission, while assessing an application made to it under sub-regulation (1) shall have regard to the Shariah Screening Criteria as provided in these Regulations and any other condition as may be specified by the Commission from time to time.

5. Grant of certificate of Shariah compliance.- (1) The Commission may, if it is satisfied that the company seeking permission to operate as a Shariah compliant company has fulfilled the minimum criteria, grant a certificate of Shariah compliance.

(2) The certificate of Shariah compliance granted under this regulation shall not be valid for the purpose of availing tax rebate under criteria prescribed in Income Tax Ordinance, 2001.

6. Scope of certificate of Shariah compliance.- The scope of certificate of Shariah compliance shall be limited only to the areas identified as per Shariah Screening Criteria and shall not cover other activities of the company or notified entity.

7. Certification of Shariah compliant security.- No security shall be called a Shariah compliant security unless a certificate of Shariah compliance has been issued by the Commission under these regulations.

8. Application for issuance of Shariah compliant security.- (1) Any company or notified entity intending to issue a Shariah compliant security shall make an application to the Commission as set out in Form B, for obtaining certificate of Shariah compliant security, providing information as required therein, along with all the relevant documents and receipt evidencing the payment of non-refundable processing fee as prescribed in Schedule I.

(2) The Commission shall, while assessing an application duly made under sub-regulation (1) have regard to the underlying structure of the security under the permissible modes of Islamic financing and such other matters that the Commission may consider relevant.

9. Grant of certificate of Shariah compliance for Shariah compliant security.- The Commission may, if it is satisfied that the company seeking permission to issue a Shariah compliant security has fulfilled the Shariah requirements, grant a certificate of Shariah compliance.

10. Power to impose, vary or revoke restrictions or conditions imposed on a certificate of Shariah compliance.- The Commission may at any time impose, vary or revoke restrictions or conditions on a certificate of Shariah compliance issued to a Shariah compliant company, Islamic financial institution or a company issuing a Shariah compliant security.

11. Cancellation of certificate of Shariah compliance: (1) A certificate of Shariah compliance shall be cancelled, if-

- (a) the Shariah compliant company or Islamic financial institution is pursuing aims, or carrying on its operations, business affairs and activities contrary to Shariah;
- (b) the company is not following the approved structure of the Shariah compliant security;
- (c) the certificate of Shariah compliance was issued based on information in support of an application that was found to be false, misleading, inaccurate or incomplete;
- (d) any regulation or condition of the certificate of Shariah compliance is not adhered to;
- (e) the Shariah compliant company or Islamic financial institution has been liquidated;
- (f) all of the assets and liabilities of a Shariah compliant company, Islamic financial institution or a company issuing a Shariah compliant security are transferred or merged into another company;
- (g) a Shariah compliant company, Islamic financial institution or a company issuing a Shariah compliant security, ceases to be a going concern; or
- (h) there exist sufficient reasons to believe that Shariah compliance is not being observed.

(2) Prior to the cancellation of a certificate of Shariah compliance, the Commission shall provide an opportunity of hearing.

12. Surrender of certificate of Shariah compliance: (1) A Shariah compliant company, Islamic financial institution or a company issuing Shariah compliant security shall surrender its certificate of Shariah compliance to the Commission if it becomes Shariah non-compliant.

(2) The company shall intimate to the Commission, as well as to its shareholders, at least 30 days prior to the surrender of the certificate of Shariah compliance and shall be deemed cancelled after thirty days from the date of intimation.

13. Effect of revocation, surrender, and expiry: Where a certificate of Shariah compliance has been cancelled, the Commission shall remove the name from the register of Shariah compliant companies, Islamic financial institutions and Shariah compliant securities and the Commission's website, and the company, notified entity or security shall cease to be Shariah compliant.

CHAPTER III SHARIAH SCREENING CRITERIA

14. Shariah screening criteria: The following minimum Shariah criteria shall be followed by all persons for Shariah screening of companies and notified entities,-

- (a) **Core business:** The core business should not violate any principle of Shariah;
- (b) **Interest Bearing Debt to Total Assets:** The Interest Bearing Debt to Assets ratio should be less than 37%;
- (c) **Non-Shariah Compliant Investments to Total Assets:** The ratio of Non-Shariah compliant investments to total Assets should be less than 33%;
- (d) **Non- Shariah Compliant to Total revenue:** The ratio of Non- Shariah compliant income to total revenue should be less than 5%;
- (e) **Illiquid Assets to Total Assets:** The ratio of illiquid assets to total Assets should be at least 25%; and
- (f) **Net Liquid Assets per Share vs. Market Price per Share (for listed companies only):** Market Price per share should be at least equal to or greater than net liquid assets per share.

Calculated as:

Net Liquid Assets = Liquid Assets – Current Liabilities

15. Exchange to conduct the Shariah screening process: (1) The Exchange shall conduct the Shariah screening for listed companies on the basis of regulation 14 for the purpose of a Shariah index and shall ensure that all such companies comply with these Regulations within three months of the date of notification of these Regulations;

(2) The Exchange shall review the Shariah compliance of companies and securities on a bi-annual basis;

(3) The Exchange shall exclude a company or security from the index as and when it becomes Shariah non-compliant; and

(4) The Exchange shall not outsource the function of Shariah screening to any person.

16. Disposal of non-Shariah compliant securities: Shariah compliant companies/Islamic financial institutions shall divest the non-Shariah compliant securities within a period of four months or when the market value of the security equals the cost of investment, whichever is earlier.

17. Technical screening criteria.- In addition to the Shariah screening criteria the following technical criteria shall also be followed:

- (a) The Company which is on the Defaulters' Counter and/or its trading is suspended, declared Non-Tradable (i.e. NT) in preceding 6 months from the date of re-composition shall not be considered for inclusion in Shariah compliant index;
- (b) The Company shall be eligible for inclusion in a Shariah compliant index if its securities are available in the Central Depository System;
- (c) The Company should have a formal listing history of at least two months on PSX;
- (d) The Company must have an operational track record of at least one financial year;
- (e) The Company should have minimum free-float shares of 5% of total outstanding shares;
- (f) The Company will be eligible if its securities are traded for 75% of the total trading days; and
- (g) The Mutual Funds (both Open-Ended and Closed-Ended) are ineligible for inclusion in the Index.

CHAPTER IV SHARIAH ADVISOR

18. Shariah Advisor: (1) A Shariah compliant company, Islamic financial institution, or a company intending to issue a Shariah compliant security, shall appoint a Shariah Advisor on the terms and conditions as it may deem fit who shall report to the board of directors.

(2) The Commission shall be informed of the appointment of the Shariah Advisor within 14 days from the date of appointment.

(3) A vacancy caused by the resignation or termination of the Shariah Advisor shall be filled within 30 days of the resignation or termination as the case may be and the intimation thereof shall be made to the Commission as in (2).

19. Functions and responsibilities of the Shariah Advisor:- (1) The Shariah Advisor shall *inter alia* perform the following duties and functions to-

- (a) introduce a mechanism which will strengthen Shariah compliance in letter and spirit and ensure that the systems, procedures and policies adopted are in line with the Shariah principles;
- (b) ensure that the inflows and outflows of resources are free from: Riba (interest, usury or any other form), Qimar (Gambling), Gharar (Uncertainty) and other vices prohibited by the Shariah;

- (c) advise on regular basis that the business, transactions and investments made are in accordance with the principles of Shariah and goals and objectives of *Maqasid-al-Shariah* are achieved;
- (d) review financial instruments and services before submission to the Commission for final approval;
- (e) make recommendations for potential improvements and the formulation of policies in line with the Shariah principles;
- (f) advise on any Shariah related matter referred by the chief executive or the board of directors; and
- (g) review and approve the Shariah compliant security's structure, constitutive documents and contractual relationship with relevant parties and ensure utilization of the proceeds as per the Shariah principles.

Explanation:- for the purposes of this regulation, the expression “*Maqasid-al-Shariah*” means to promote the well-being of all mankind, which lies in safeguarding their faith (deen), their human self (nafs), their intellect (aqal), their posterity (nasl) and their wealth (maal).

(2) The Shariah Advisor shall prepare a report, regarding affairs of the Shariah compliant company, Islamic financial institution or company issuing Shariah compliant security, to be called “Shariah Review Report” which shall cover the overall Shariah compliance for the financial year and shall be made part of the annual financial statements.

(3) The Shariah Advisor of the Shariah compliant company, Islamic financial institution or a company issuing Shariah compliant security, shall confirm the following in the “Shariah Review Report.

- (a) whether or not in their opinion, the transactions, the relevant documentation” and the procedures adopted have been in accordance with principles of Shariah;
- (b) whether or not in their opinion, the affairs have been carried out in accordance with rules and principles of Shariah, and specific Shariah opinion issued by the Shariah Advisor from time to time; and
- (c) whether or not in their opinion, any earnings that have been realized from sources or by means prohibited by Shariah have been credited to the charity account where applicable.

(4) The Shariah Advisor shall have right of access to the books, papers, accounts, vouchers, record, information, agreements and reports of the Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security, whether kept at

the registered office or elsewhere and shall be entitled to require from the directors and other officers, such information and explanation as they may require for the performance of their duties.

CHAPTER V SHARIAH AUDIT

20. External Shariah Audit: (1) Every Shariah compliant company, Islamic financial institution and company issuing Shariah compliant security shall be subject to Shariah Audit for every financial year which is undertaken by an independent External Shariah Auditor.

(2) For the purpose of these Regulations, the provisions of Sections 223 and 247 of the Act, shall be followed with regard to external Shariah audit and the external Shariah auditor, respectively and the audit firm shall preferably have expertise in Islamic finance.

(3) The scope of External Shariah Audit shall include an independent and objective assessment of compliance of operations with the Shariah.

(4) The External Shariah Auditor shall assess compliance of a Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security, financial arrangements, contracts, and transactions with the Shariah principles in light of *inter alia* the following:

- (a) rules, regulations and directives issued by the SECP from time to time;
- (b) pronouncements of Shariah Advisory Board;
- (c) shariah Standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), as adopted by the Commission, if any;
- (d) requirements of the applicable Islamic Financial Accounting Standards as notified by the Commission; and
- (e) approvals and rulings given by the Shariah Advisor of a Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security are in line with the regulations and in accordance with the rulings of Shariah Advisory Board.

(5) The External Shariah Auditor shall prepare a report for the Board of Directors giving their opinion on:

- (a) the status of Shariah compliance of the entity;
- (b) the risks associated with the Shariah non-compliance;

- (c) the capacity and quality of the entity's risk management system to measure, manage and mitigate the Shariah risks;
- (d) the level of awareness and sensitivity of the management and the Board of Directors in addressing the Shariah risks; and
- (e) any other issues deemed significant by the external auditors with respect to Shariah.

21. Internal Shariah Audit: (1) Every Islamic financial institution shall strengthen its internal audit department either by appointing an Internal Shariah Audit resource having relevant qualification or expertise in Islamic banking and finance or train at least one of its employees in the internal audit department for the purpose of Internal Shariah Audit from a reputable training institute.

(2) The scope and methodology of Internal Shariah Audit shall be reviewed and approved by the Board of Directors.

(3) The Internal Shariah Audit resource shall follow the same reporting norms, as are applicable on the internal auditor under the International Standards of Auditing as adopted by ICAP.

(4) The duties, inter alia, of the Internal Shariah Auditor with respect to Islamic financial institutions, shall be to verify that:

- (a) transactions entered into are consistent with the pronouncements, rulings and guidelines of the Shariah Advisor, SECP directives, rules and regulations and with the pronouncements of the Shariah Advisory Board;
- (b) financing agreements entered into are Shariah compliant and are on the formats as approved by the Commission and all the related conditions are met;
- (c) offering documents, investments and contracts have been reviewed by the Shariah Advisor;
- (d) product structure, process flow and operations are duly vetted by the Shariah Advisor;
- (e) process for purification of income has been carried out and non-Shariah compliant income has been transferred in charity account and distributed to approved charitable institutions;
- (f) findings are shared with the management and Shariah Advisor in respect of all the above items including irregularities, inadequacy in risk management, governance and internal controls which are necessary to avoid non-Shariah compliant business transactions; and
- (g) investments of the Islamic financial institution in the shares and other instruments are as per approved list of the Shariah compliant companies and securities.

(5) The Internal Shariah Auditor shall submit an Internal Shariah Audit report annually to the Board of Directors.

(6) The Internal Shariah Auditor shall maintain liaison with the Shariah Advisor and may seek his guidance in ensuring Shariah compliance.

22. Shariah compliance officer: (1) Every Islamic financial institution shall appoint or designate a Shariah compliance officer suitably qualified, trained and experienced in Islamic finance. The Shariah compliance officer shall work under the overall guidance and supervision of the compliance department.

(2) The Shariah compliance officer shall- coordinate between the Shariah Advisor and management.

(3) He/she shall review all the product proposals and related agreements, contracts, manuals, process flows before presenting these to the Shariah Advisor for approval.

(4) The Shariah compliance officer shall ensure that Islamic financial institution's operations are in conformity with pronouncements and guidelines issued by the Shariah Advisor, and with the regulations, directives and instructions issued by the Commission.

(5) The Shariah compliance officer shall periodically submit a Shariah compliance report to the management on the overall Shariah compliance environment.

CHAPTER VI GENERAL MATTERS

23. Register of Shariah Compliant companies and securities.- The Commission shall maintain a register of Shariah Compliant companies and securities in the manner it deems fit.

24. Takaful coverage.- A Shariah compliant company, Islamic financial institution or company issuing Shariah compliant securities shall obtain reasonable Takaful coverage.

25. Submission of information and documentation.- A Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security shall submit such information and documentation, as may be required by the Commission from time to time.

26. Advertising.- Prior to dissemination of any material for promotion of a product or service, a Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security, must ensure that the material states the name of the Shariah Advisor who reviewed the product, service and contents of advertisement.

27. Disclosure requirements.- A Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security shall meet disclosure requirements as prescribed in Schedule IV of the Act.

28. Constitutive Documents.- A Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security shall ensure that its constitutive documents state that its core business does not violate any principle of the Shariah.

29. Dispute Resolution.- In case of any dispute or difference of opinion on the matters relating to Shariah interpretation, the same shall be referred to the Shariah Advisor for the decision. The pronouncements of the Shariah Advisor shall be binding. In case of difference of opinion between the Shariah Advisor and the management, the matter shall be referred to the Shariah Advisory Board, whose decision shall be final.

30. Systems and Controls.- A Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security shall endeavor to establish systems and controls to ensure compliance with Sharia including but not limited to the following:

- (a) the manner in which the compliance function will be undertaken, in respect of Shariah compliance;
- (b) the manner in which the Shariah Advisor will oversee and advise in regard to the Islamic financial business;
- (c) the manner in which Shariah Advisor's pronouncements and guidelines will be recorded, disseminated and implemented and the internal Shariah review undertaken;
- (d) the manner in which disputes between the Shariah Advisor and the Shariah compliant company, Islamic financial institution or company issuing a Shariah compliant security in respect of Shariah compliance will be addressed;
- (e) the process for approving those internal systems and controls which are in place to ensure not only that the Islamic financial business is carried out in compliance with the Shariah, but that information is disseminated to investors in an appropriate manner; and
- (f) the manner in which conflicts of interest will be identified and managed.

31. Underwriting.- If any issue is underwritten, it shall be ensured that the Shariah Advisor approves the underwriting agreements and processes.

32. Accounting, Auditing and Governance Standards.- A Shariah compliant company, Islamic financial institution or a company issuing Shariah compliant security shall prepare its accounts in accordance with all the applicable Shariah and other standards, notified by the Commission for adoption, from time to time.

33. Penalty.- Where a company, entity or any person contravenes or fails to comply with any provision of these regulations, or is not in compliance with any condition or directive, circular or order issued by the Commission, the Commission may, after providing a reasonable opportunity of representation, impose a penalty as provided in sub-section (4) of section 451 of the Act.

34. Fees.- A Shariah compliant company, Islamic financial institution or a company issuing Shariah compliant security shall be subject to such fees as provided in Schedule - I of these Regulations.

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SCHEDULE I

Amount of fees

S. No.	Subject of Application	Amount (in Rs.)
Form A	Application to operate as Shariah compliant company or Islamic financial institution (Listed)	10,000
	Application to operate as Shariah compliant company or Islamic financial institution (Unlisted)	5,000
	Application for annual renewal	5,000
Form B	Application for issuance of Shariah Compliant Security (Listed)	10,000
	Application for issuance of Shariah Compliant Security (Unlisted)	5,000

FORM-A

Application for grant of certificate of Shariah Compliant Company

Dated: _____

The Islamic Finance Department,
Securities and Exchange Commission of Pakistan (SECP),
Head Office, Islamabad.

Dear Sir/Madam,

1. We hereby apply for grant of a certificate of Shariah compliance under Shariah Governance Regulations 2018 to operate as Shariah complaint company under the name and style of -----

2. We hereby furnish the following information/documents:

- (a) Certified copies of Certificate of Incorporation, certificate of commencement of Business (where applicable) Memorandum and Articles of Association;
- (b) Certified copy of latest Form-29 (list of directors);
- (c) Profile of Directors and Chief Executive covering, inter alia, their educational qualifications and professional experience;
- (d) A Shariah Review Report from the Shariah Advisor on the status of the company; whether it meets the Shariah Screening criteria as per Shariah Governance Regulations 2018;
- (e) Names and addresses of associated companies if any;
- (f) Names of Bankers of the company;
- (g) Annual Audited Accounts for the last three years; and
- (h) Challan evidencing payment of fee (Schedule I).

Yours faithfully,

Company Secretary

FORM-B

Application for grant of Certificate of Shariah Compliant Security

Dated: _____

The Islamic Finance Department
Securities and Exchange Commission of Pakistan (SECP),
Head Office, Islamabad.

Dear Sir/Madam,

We hereby apply for grant of Certificate of Shariah Compliance under Shariah Governance Regulations, 2018 to issue Shariah complaint instrument under the name and style of -----


2. We hereby furnish the following information/documents:

- (a) Vetting of the Shariah compliant security by Shariah Advisor;
- (b) A copy of the security structure, offering document along with legal documents and contracts thereto;
- (c) Names of Bankers to the issue;
- (d) Certified copies of Certificate of Incorporation, certificate of commencement of Business (where applicable) Memorandum and Articles of Association;
- (e) Certified copy of latest Form-29 (list of directors);
- (f) Profile of Directors and Chief Executive covering, inter alia, their educational qualifications and professional experience;
- (g) A Shariah Review Report from the Shariah Advisor on the status of the company whether it meets the Shariah Screening criteria as per Shariah Governance Regulations 2018;
- (h) Names and addresses of associated companies if any;
- (i) Names of Bankers of the company;
- (j) Annual Audited Accounts for the last three years; and
- (k) Challan evidencing payment of fee (Schedule I).

Yours faithfully,

Company Secretary

No. Sy/SECP/8/13


(Bilal Rasul)
Secretary to the Commission