

KINGDOM OF SAUDI ARABIA

Capital Market Authority

INSTRUCTIONS FOR SHARIAH GOVERNANCE IN CAPITAL MARKET INSTITUTIONS

English Translation of the Official Arabic Text

**Issued by the Board of the Capital Market Authority
Pursuant to its Resolution Number 0-000-0000
Dated 00/00/1443 H. Corresponding to 00/00/2022 G.
Based on the Capital Market Law
Issued by Royal Decree No M/30 dated 2/6/1424 H.**

Arabic is the official language of the Capital Market Authority

Important Notice: the current version of these Instructions, as may be amended, can be found at the Authority website: www.cma.org.sa

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PART 1: GENERAL PROVISIONS

Article 1: Preliminary

- a) The purpose of these Instructions is to set out the rules and standards of the Shariah governance for the Capital Market Institutions, which provide, wholly or partially, products or services that are Shariah Compliant.
- b) Paragraphs (2) and (7) of Article (3) and Paragraph (6) of Article (8) of these Instructions are mandatory to the Capital Market Institutions, which provide, wholly or partially, products or services that are Shariah Compliant. The other provisions of these Instructions shall be deemed as guidance.

Article 2: Definitions

- a) Any reference to the “Law” in these Instructions shall mean the Capital Market Law issued by Royal Decree No. M/30 dated 2/6/1424 H.
- b) Without prejudice to Paragraph (C) of this Article, Expressions and terms in these Instructions have the meaning, which they bear in the Law and in the Glossary of defined terms used in the Regulations and Rules of the Capital Market Authority, unless the context indicates otherwise.
- c) For the purpose of implementing these Instructions, the following expressions and terms, shall have the meaning they bear as follows, unless the context indicates otherwise:
 - 1) **Shariah Compliant:** Compliance with Shariah decisions issued by the Capital Market Institution’s Shariah committee.
 - 2) **Shariah-Based Policy:** It is the policy that sets out the Shariah standards of the related products and services provided by the Capital Market Institution, the mechanism and procedures taken to align contracts and products with such standards, and the procedures taken in case of non-compliance.
 - 3) **Shariah Governance Framework:** It is the internal model of Shariah governance of the Capital Market Institution, which includes the requirements of the Shariah Committee work, the Shariah compliance, and the internal Shariah audit, the mechanism of report preparing on such functions and their administrative subordination, and the powers delegated by the Capital Market Institution's board -or equivalent- in relation to such activities. The Shariah Governance Framework includes, without limitation, determination of the number of the Shariah Committee members (if it is formed as a committee of the Capital Market Institution's board -or equivalent-), the term of their membership, the disclosure mechanism and forms to the Capital Market Institution's board -or equivalent- in case of conflict of independence, and the regularity in the submission of reports on which the board of directors -or equivalent- approves.
 - 4) **Relative:** Parents, husband, wife, and children.

PART 2: RESPONSIBILITIES OF THE BOARD OF DIRECTORS OR EQUIVALENT AND THE EXECUTIVE MANAGEMENT

Article 3: Responsibilities of the Board of Directors or Equivalent

The board of directors of the Capital Market Institution -or equivalent- shall be responsible for the following:

- 1) Develop and approve the Shariah-Based Policy of the Capital Market Institution. The board of directors -or equivalent- has the right to delegate the development of such policy to whomever it deems appropriate.
- 2) Develop and approve the Shariah Governance Framework of the Capital Market Institution. The board of directors -or equivalent- has the right to delegate the development of such framework to whomever it deems appropriate.
- 3) Supervise the performance of the executive management and the delegate in charge of the implementation of the Shariah Governance Framework so that the board of directors -or equivalent- is convinced that their performance is consistent with the objectives of that framework.
- 4) Determine the appropriate remunerations of the members of the Shariah Committee in accordance with the approved policy and disclose the same in the report of the board of directors of the Capital Market Institution -or equivalent-.
- 5) Disclose the curriculum vitae of the members of the Shariah Committee to the public in the report of the board of directors of the Capital Market Institution -or equivalent-.
- 6) Conduct an annual evaluation of the extent of the independence of the Shariah Committee members and ensure that there are no relationships or circumstances that affect, or may affect, such independence.
- 7) Approve the annual report of the Shariah Committee and disclose the same independently or as a part of the report of the board of directors of the Capital Market Institution -or equivalent-.
- 8) Declare the independence of the Shariah Committee and ensure the absence of any obstacles to hinder its activities.
- 9) The Shariah decisions of the Shariah Committee shall not be amended without its approval and the board of directors of the Capital Market Institution -or equivalent- shall ensure the same.

Article 4: Responsibilities of the Executive Management

The Executive Management of the Capital Market Institution shall be responsible for the following:

- 1) Determine the Shariah-related issues and refer them to the Shariah Committee to decide upon them and to provide the Shariah Committee with the required information on a timely manner.
- 2) Monitor the implementation of the Shariah decisions issued by the Shariah Committee.
- 3) Disseminate the culture of compliance with the Shariah-based governance principles throughout the Capital Market Institution.
- 4) Ensure that all transactions of the Shariah Compliant products and services are carried out in accordance with the Shariah-Based Policy of the Capital Market Institution.
- 5) Inform the Shariah Committee as soon as the executive management becomes aware that certain transactions and operations are not Shariah Compliant and provide a plan to rectify the state of non-compliance for such cases.

PART 3: SHARIAH COMMITTEE

Article 5: Formation of the Shariah Committee

- (a) A Committee referred to as the "Shariah Committee" shall be formed by the decision of the board of directors of the Capital Market Institution -or equivalent-, unless the board of directors of the Capital Market Institution -or equivalent- delegate a Shariah Committee of an external party in accordance with the provisions of Paragraph (B) of this Article.
- (b) The board of directors of the Capital Market Institution -or equivalent- may delegate a Shariah Committee of an external party to assume the duties and powers of the Shariah Committee, this shall not relieve the board of directors -or equivalent- of its responsibility for such duties and powers that it has delegated to such committee.
- (c) The following shall be considered upon the formation of the Shariah Committee or the delegation of a Shariah Committee of an external party:
 - 1) The number of members of the Shariah Committee shall be suitable for the size and nature of the Shariah Compliant products and services.
 - 2) The members of the Shariah Committee shall be independent and capable of performing their duties, expressing their opinions and voting on decisions objectively and impartially. The following negate the independence requirement for the members of the Shariah Committee:
 - a. If he/she holds (5%) or more of the shares of the Capital Market Institution or any other company within its group; or is a Relative of who owns such percentage.
 - b. If he/she is a board member of the Capital Market Institution –or one of its directors- or any other company within the group of the Capital Market Institution for which he/she is nominated to be a Shariah Committee member.
 - c. If he/she has a direct or indirect interest in the businesses and contracts executed for the Capital Market Institution’s account.
 - d. If he/she engages in a business where he/she competes with the Capital Market Institution, or conducting businesses in any of the institution’s activities.
 - 3) The term of the membership of the members of the Shariah Committee shall not exceed seven years. The members of the Shariah Committee shall not be appointed for more than two terms.

Article 6: Membership of the Shariah Committee

The member of the Shariah Committee shall be equipped with the required knowledge and experience, which shall be assessed against the following criteria:

- 1) **Shariah and Financial Knowledge:** Appropriate Shariah knowledge, in addition to the ability to read and understand financial statements and reports.
- 2) **Expertise:** Sufficient expertise in the same field or in fields related to the Islamic financial businesses.

Article 7: Meetings of the Shariah Committee

- (a) The Shariah Committee shall hold its meetings regularly, and as may be necessary.
- (b) The meetings of the Shariah Committee shall be attended by its members and the Secretary of the Shariah Committee. Neither the members of the board of directors of the Capital Market Institution –or any of its directors- nor the executive management shall be attending such meetings, unless such committee request his/her opinion or advice.

- (c) The meetings of the Shariah Committee are valid if attended by a majority of its members. and the decisions of the committee shall be issued by a majority of the votes present. in case of a tie, the chairperson of the meeting shall have the casting vote.
- (d) The meetings of the Shariah Committee shall be documented and minutes including the discussions and deliberations carried during such meetings shall be prepared. Recommendations of the committee and voting results shall be documented and retained in a special and organised register, including the names of attendees and any reservations they expressed (if any). Such minutes shall be signed by all of the attending members.

Article 8: Responsibilities of the Shariah Committee

The Shariah Committee shall be responsible for the following:

- 1) Ensure the compliance of the relevant products and services provided by the Capital Market Institution with the provisions and principles of the Shariah and contribute to the formulation and development of the contracts falling under the Shariah Governance Framework.
- 2) Issue decisions on Shariah matters related to the Shariah Compliant products and services provided by the Capital Market Institution, and approve the compliance of contracts, agreements and any other legal documents used in the related business transactions with the provisions and principles of the Shariah.
- 3) Ensure the compliance of the Shariah-Based Policy with the provisions of Islamic Shariah, and endorse such policy.
- 4) Inform the Capital Market Institution's board of directors -or equivalent- and recommend the appropriate measures, if the Shariah Committee discovers that the Capital Market Institution's activities within the scope of the Shariah Compliant products and services were not Shariah Compliant and inform the board of directors -or equivalent- as soon as it becomes aware that such activities are not remedied.
- 5) Assist the concerned parties within the Capital Market Institution and provide advice on Shariah-related matters to the parties that provide services to the Capital Market Institution, such as the legal advisor, auditor or any other consultant as requested.
- 6) Prepare an annual report on the extent of the compliance with the provisions and principles of the Shariah in the Capital Market Institution, including the approved Shariah standards of the institution, and submit it to the board of director of the Capital Market Institution -or equivalent- for approval.

Article 9: Functions and Tasks of the Chairperson of the Shariah Committee

The Chairperson of the Shariah Committee shall be in charge of leading the committee and overseeing the course of the work thereof; he/she shall be particularly responsible for the following:

- 1) Ensure that the members of the Shariah Committee obtain complete, clear, accurate and non-misleading information in due course.
- 2) Ensure that the Shariah Committee discusses all matters referred thereto.
- 3) Encourage the members of the Shariah Committee to effectively perform their duties.

Article 10: Tasks and Duties of the Members of the Shariah Committee

By virtue of their membership, the members of the Shariah Committee shall perform the following duties and tasks:

- 1) Attend the meetings of the Shariah Committee, and not being absent except for a legitimate excuse of which the chairperson of the Shariah Committee shall be notified by prior notice, or for emergency reasons.
- 2) Allocate sufficient time to fulfil their responsibilities, prepare for and attend the meetings of the Shariah Committee.
- 3) Notify the Shariah Committee fully and immediately of any interest, either direct or indirect, in the businesses and contracts that are executed for the Capital Market Institution's account, or

of his/her participation, directly or indirectly, in any businesses that may compete with the Capital Market Institution or lead to competing with the Capital Market Institution, directly or indirectly, in respect of any of its activities.

- 4) Maintain professional conduct and ethics.

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PART 4: INDEPENDENCE AND INFORMATION CONFIDENTIALITY

Article 11: Independence of the Shariah Committee

The Capital Market Institution shall maintain the independence of the Shariah Committee in performing the duties and powers thereof at all times. It shall ensure the absence of any obstacles that hinder the works of the Shariah Committee, while considering the following:

- 1) The Shariah Committee shall report directly to the board of directors of the Capital Market Institution -or equivalent-.
- 2) The board of directors of the Capital Market Institution -or equivalent- shall be informed in case the executive management fails to provide the Shariah Committee with the full and accurate required information.

Article 12: Information Confidentiality

The members of the Shariah Committee shall maintain the confidentiality of the information they obtain during the performance of their duties and shall not misuse it.

PART 5: INTERNAL CONTROL

Article 13: Shariah Compliance

The board of directors of the Capital Market Institution -or equivalent- shall define in the Shariah Governance Framework the concerned department that responsible for Shariah compliance function, such function shall include the following:

- a) Regularly verify the compliance of the Capital Market Institution with the Shariah-Based Policy and the Shariah decisions issued by the Shariah Committee, the corrective actions to resolve non-compliances, and the control mechanisms to avoid recurrences.
- b) Ensure that the Shariah compliance duties covers all Shariah Compliant products and services provided by the Capital Market Institution, including the development process of such products and services, which starts from the structure stage until the provision stage.
- c) Inform the Shariah Committee of any non-compliance cases in the Shariah Compliant products and services provided by the Capital Market Institution.

Article 14: Internal Shariah Audit

The internal Shariah audit process aims at reducing the risks of the Capital Market Institution's non-compliance with the provisions and principles of the Shariah in offering the Shariah Compliant products and services, while observing the following:

- a) The internal Shariah audit process shall be conducted periodically for areas of relative importance, based on the Capital Market Institution's risk profile. The internal Shariah audit may be conducted as part of the Capital Market Institution's audit on specialized areas, according to the level of risk and materiality of the impact of Shariah non-compliance on such areas, with the purpose of assessing the Shariah Control system.
- b) The Audit Committee of the Capital Market Institution shall determine the deliverables of the internal Shariah audit after consulting with the Shariah Committee.
- c) Internal Auditors of the Internal Audit Department of the Capital Market Institution shall conduct the internal Shariah audit, provided that they have the required knowledge and sufficient training in Shariah-related aspects. The Internal Auditors may seek the assistance of the Capital Market Institution's Shariah Experts in conducting the audit process, provided that this shall not affect the objectivity of the process.
- d) The results and observations of the internal Shariah audit shall be submitted to the Capital Market Institution's Audit Committee and the Shariah Committee. Corrective actions may be proposed to the Shairah Committee, as needed.

PART 6: DEVELOPING SHARIAH COMPLIANT PRODUCTS AND SERVICES

Article 15: Process of Developing Shariah Compliant Products and Services

The procedures of the process of developing Shariah Compliant products and services shall observe the following:

- 1) Procedures of the preapproval of Shariah Compliant Products and Services:** Refer all the Shariah-related issues regarding the products and services under development to the Shariah Committee; to ensure that the approval process of the product or service, as well as its structure and operations are supported by Shariah researches. The preapproval procedures shall also include reviewing all documents related to the new products and services, including the terms and conditions set forth in the forms, contracts, agreements and other legal documents.
- 2) Procedures of the post-approval of Shariah Compliant Products and Services:** Ensure that the post-approval stage includes the continuing Shariah compliance and regular internal Shariah audit, together with the definition of potential risks, which may cause non-compliance of a product or service with the provisions and principles of the Shariah. The functions of the Shariah compliance and the internal Shariah audit shall include proposing the appropriate corrective actions.

PART 7: PUBLICATION AND ENTRY INTO FORCE

Article 16: Publication and Entry into Force

These Instructions shall become effective upon their publication.

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