

[Exposure Draft (AGEB 4 /2022) v10.0 of the]

Governance Standard __

**Development and Governance of Shari’ah Compliant Benchmark
Rates**

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AAOIFI Governance Standard ____ “Development and Governance of Shari’ah Compliant Benchmark Rates” is set out in paragraphs 1-58.

Where the context so requires, the use of the masculine gender shall include the feminine gender and the singular shall include the plural and vice versa and the word “person” shall include any institution, corporation, firm, partnership, body corporate or other forms of association. The table of contents and headings do not form part of the text of the standard and are for the purpose of convenience and ease of understanding and may, at times, help in the interpretation of text only.

Preface

- PR1 Islamic finance evolved primarily because of prohibition of Riba (and other impermissible transactions) and replaces interest bearing transactions with commercial transactions involving exchange of economic resources.
- PR2 Commercial transactions in Islamic finance involve pricing of economic value of economic resources (e.g., assets, commodities, usufruct, services and entrepreneurship). These are fundamentally different from interest bearing transactions. However, primarily due to co-existence with conventional finance in an economic system which is not meant specifically for Islamic finance, historically, conventional interest rate benchmarks have been predominantly used in Islamic finance transactions and structures, as a necessary evil.
- PR3 The recent cessation of LIBOR (and similar regional rates) and transition to risk free rates has created an opportunity that the Islamic finance industry may now detach itself from interest-based benchmarks to manage reputational risk and achieve distinction by aligning the benchmark rates with the real economic factors, which is the true essence of Islamic finance. This standard is an effort towards this objective by providing the core principles for establishing such Shari'ah compliant benchmark rates.
- PR4 The outcome of this project includes illustrative models of Shari'ah compliant benchmark rates [to be included as appendix to this standard, being currently under development] and will also include a governance standard on the standard on the governance principles for administration and publishing of such benchmarks [currently under development].

Introduction

Overview

- IN1 This standard provides an opportunity to the global Islamic finance industry to replace the conventional interest rate based benchmark rates currently being applied for pricing Islamic finance transactions and structures with Shari'ah compliant benchmark rates, by establishing principle based guidance in respect of development and governance of Shari'ah compliant benchmark rates.
- IN2 The standard addresses the core principles in respect of establishing criteria for selection, computation, governing and administering, publishing and applying benchmark rates for Islamic finance transactions and structures, in a transparent manner.

Rationale for issuing this standard

- IN3 AAOIFI Governance and Ethics Board (AGEB / the board) in line with the views of AAOIFI Shari'ah Board, believes that Islamic finance transactions and structures shall be priced, where applicable, based on the Shari'ah compliant benchmark rates that reflect the economic reality of the transaction, instead of conventional interest rate benchmarks. This is expected to not only improve the level of Shari'ah compliance, but also to avoid one of the most significant reputation risks to the global Islamic finance industry. Unfortunately, out of necessity and due to lack of alternatives, LIBOR or similar regional interest rate benchmarks have always been the common pricing benchmarks for Islamic finance.
- IN4 The recent cessation of, and eventual transition from LIBOR (and similar regional benchmark rates established on similar principles) to risk free rates, was necessitated due to apparent weak governance and loopholes in benchmark administration and computation methodology. After the cessation of LIBOR, Islamic finance industry also needs to decide on the alternate benchmark rates. It is observed that the risk free rates (which are also based on interest rates, although the computation methodology differs significantly from that of LIBOR), also have severe issues from Shari'ah perspective. Not only that they are interest-based, but they also raise another issue of Gharar in pricing when applied to the Islamic finance transactions, due to their nature of being backward looking and requiring retrospective adjustments to pricing. Certain transactions observed in the market to address such Gharar element are also not free from criticism, in respect of their level of Shari'ah compliance. Similarly, the reputation risk continues to apply, in case of use of these conventional risk free rates.
- IN5 Accordingly, the board decided to develop this standard containing the core principles, as well as, illustrative models of Shari'ah compliant benchmark rates [to be included in the second phase, after due evaluation], as well as, another standard on the governance principles for administration and publishing of such benchmarks.

AAOIFI Governance Standard _____

Development and Governance of Shari'ah Compliant Benchmark Rates

Objective of the standard

1. The objective of this standard to provide principle based guidance in respect of development and governance of Shari'ah compliant benchmark rates, including principles for establishing criteria for selection, computation, governing and administering, publishing and applying benchmark rates for Islamic finance transactions and structures, in a transparent manner.

Scope of the standard

2. This standard shall apply to any benchmark rate(s) proclaimed to be complying with Shari'ah principles and rules, in respect of its development and governance, including principles for establishing criteria for selection, computation, governing and administering, publishing and applying such benchmark rates to Islamic finance transactions and structures.

Definitions

3. For the purpose of clarity and interpretation of this standard, the following short definitions are relevant:
 - a. Administrator – is an organisation or legal person that controls the creation and operation of the administration process for a benchmark rate. It has responsibility for all stages of the benchmark administration process, including:
 - i. the calculation of the benchmark;
 - ii. determining and applying the benchmark methodology; and
 - iii. disseminating the benchmark;
 - b. Benchmark rate – is a rate of return (normally denoted in percentage terms) over a particular period, which can be used as anchor in pricing a financing transaction;
 - c. Shari'ah compliant benchmark rate – in the specific context of this standard, is a benchmark rate established in line with the requirements of this standard.

Part A: Application of benchmark rates in Islamic finance transactions and structures

Preferred treatment

4. The pricing for Islamic finance transactions and structures shall reflect true economic value of the transactions of exchange of economic resources (e.g, in trade, lease and other Shari'ah compliant modes of financing), as well as, the market dynamics, including demand and supply situations. Such pricing shall be based on the Shari'ah compliant benchmark rates established in line with the requirements of this standard. On the contrary, a direct reference to the conventional benchmark rates which are not compliant with Shari'ah principles and rules, shall be avoided.

Treatment allowed as a consequence of necessity

5. In cases where the preferable treatment of benchmark rate selection (in line with the requirements of paragraph 4) cannot be maintained due to reasons, including inter alia, the counterparty refusal, laws or regulations of the respective jurisdictions, data unavailability over shorter horizons, etc., conventional benchmark rates may be applied to Islamic finance transactions and structures, in line with and to the extent of, permissibility and the manner of application, as defined in relevant AAOIFI Shari'ah Standards.

Part B: Development of a Shari’ah compliant benchmark rate for Islamic finance transactions and structures

Need and responsibility

Need

6. A Shari’ah compliant benchmark rate (or combination of such rates) shall be used for pricing of Islamic finance transactions and structures, insofar as possible, by:
 - a. all IFIs in respect of all of their Shari’ah compliant products and services; and
 - b. all other institutions, entities, governments and central banks offering a Shari’ah compliant instrument(s) / product(s), e.g., Sukuk.

Responsibility and systemic importance

7. In every jurisdiction where Islamic finance achieves a level of systemic importance within the financial sector, a (or a combination of) Shari’ah compliant benchmark rate(s) shall be developed:
 - a. preferably, by an administrator appointed / authorised for such purpose by the respective regulator; or
 - b. in the absence of the regulator’s initiative in this regard, in line with the requirement of paragraph 7(a), by an administrator collectively appointed by the Islamic finance industry, with due approval of the regulator.
8. The systemic importance for the purpose of the requirements of paragraph 8 shall be considered, in the specific perspective of a regulator’s jurisdiction, when any of the following conditions is met:
 - a. Islamic banking’s total assets comprise at least 15 percent of total assets of the banking sector in the jurisdiction [In case of larger economies¹ such ratio shall be at least 10 percent of total assets]; or
 - b. Sukuk and other Shari’ah compliant sovereign securities comprise at least 10 percent of total local government financings in the jurisdiction; or

¹ It is presumed that the larger economies mainly include the countries in G20 and D8 groups. The G20 or Group of Twenty is an intergovernmental forum comprising 19 countries and the European Union (EU). It is composed of most of the world's largest economies. The D8 or Developing-8, is an organisation for development cooperation among the following (Muslim) countries: Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkiye.

- c. at least 50 percent of the banks in such jurisdiction (in terms of numbers) offer Islamic finance products and services, either being a full-fledged Islamic bank or through an Islamic finance window.

Minimum characteristics of a Shari'ah compliant benchmark rate

- 9. In order to be considered Shari'ah compliant, a benchmark rate shall comply with the Shari'ah compliance criteria in line with the requirements of paragraphs 12-31, as the minimum requirements for Shari'ah principles and rules, for this purpose.
- 10. In addition to the requirements of paragraph 9, a Shari'ah compliant benchmark rate shall also comply with the suitability criteria in line with the requirements of paragraphs 32-57, for the purpose of determination of its suitability for generalised, mass-scale application in the respective jurisdiction(s).

Shari'ah compliance criteria

- 11. The Shari'ah compliance criteria for the development of a Shari'ah compliant benchmark rate are enumerated in paragraphs 12-31.

Shari'ah compliance of base data: underlying transactions or activities

- 12. For a benchmark rate to be considered distinctly Shari'ah compliant, it is vital to ensure that the underlying transactions or activities from which the benchmark rate is derived and determined are Shari'ah compliant, such that:
 - a. the underlying transactions or activities shall be compliant with Shari'ah principles and rules (and hence, free from Riba, Maysir or excessive Gharar and other Shari'ah prohibitions); and
 - b. if the underlying transactions are derived from Islamic financial market(s), then the structure of such transactions (and their combinations, as applicable) shall be in line with the Shari'ah principles and rules.
- 13. Notwithstanding the requirements of paragraph 12, in case of a benchmark rate based on macro-economic indicators / data, it may not be considered necessary to bifurcate the impacts related to the impermissible activities and services at the overall level of the jurisdiction's economy.

Time value of economic resources vs. time value of money

- 14. The foundations of Islamic finance are based on the replacement of interest-based transactions with transactions that are based on trade and commerce. This intrinsically eliminates the time value of money from the transactions and replaces the same with the concept of the time value of different economic resources e.g., assets, commodities, services and entrepreneurship.
- 15. In view of the same, a Shari'ah compliant benchmark rate shall be based on the time value of such resources (individually, or in the form of a combination of the same). Different

benchmarks may be developed for different types of economic resources, which are considered preferred, or a combination of rates may be developed based on micro- or macro-economic variables.

16. Shari'ah compliant benchmark rate needs to avoid reference to time value of money. As long as the rate is determined from underlying real economic transactions or activities, it shall be a reflection of the time value of economic resources rather than the pure time value of money.

Types of Shari'ah compliant benchmark rates: Reflection of economic factors: financial market vs. economic reality

17. Shari'ah compliant benchmark rates may include, in the level of respective priorities:
 - a. specific benchmark rates based on micro-economic indicators and observable market data – to be applied in respect of specific types of Islamic finance transactions and structures;
 - b. general benchmark rates based on macro-economic indicators – to be applied generally for all or certain classes of Islamic finance transactions and structures; and
 - c. general benchmark rates based on Islamic financial market data – to be applied either for the Islamic financial market transactions in addition to (a) and / or (b), or in the absence of the same, for all Islamic finance transactions and structures. (see paragraph 29).
18. Examples of micro-level acceptable economic indicators include:
 - a. growth rate in nominal or real value of production in individual sectors, such as agriculture, manufacturing, construction and services;
 - b. expected rate of return estimated through single and multi-factor asset pricing models, such as Capital Asset Pricing Model (CAPM), Fama-French Three Factor Model, Fama-French Five Factor Model etc.;
 - c. housing price index and rental index for pricing real estate and rentals;
 - d. using asset allocation methods of depreciation, such as units of production method to amortise principal and using price return for the profit part with profit derived from real economic activity;
 - e. weighted average accounting rates of return of corporations, such as return on assets (ROA), return on equity (ROE), return on capital employed (ROCE) etc.; and
 - f. combining accounting and financial market information to derive returns, such as by using Tobin's Q and its variation calculated at firm, industry or sector level.

19. Examples of acceptable macro-level economic indicators include:
- a. growth rate in nominal or real aggregate value of production, such as gross domestic product (GDP) or gross national product (GNP);
 - b. growth rate in aggregate price index, such as consumer price index (CPI), wholesale price index (WPI) etc., measured with overall basket or without food and energy (core inflation); and
 - c. price return on index representing overall market portfolio of stocks, commodities and Sukuk.
20. Examples of acceptable Islamic financial market indicators include:
- a. weighted average return on Shari'ah compliant Islamic financial market transactions;
 - b. weighted average yield on investment grade sovereign Sukuk or price return on Sukuk indices; and
 - c. price return on a composite portfolio or weighted average yield of Shari'ah compliant mutual funds representing return on stocks and / or Sukuk of government owned enterprises and / or investments in sovereign securities.

Reflecting real risks in the transactions

21. Islamic finance transactions are generally based on either of the following:
- a. transfer of risks and rewards (e.g., Murabaha and other sales); or
 - b. absorption of risks and rewards of the relevant assets (e.g., in case of Ijarah), commodities (e.g., in case of Murabaha) etc.; or
 - c. sharing of risks and rewards (e.g., in case of participatory transactions).
22. Hence, an Islamic finance transaction can never be completely risk-free, and accordingly, any benchmark rate or combination of benchmark rates, shall always take into consideration the real risk(s) inherent in the transactions.
23. Notwithstanding the foregoing, at times, certain Islamic finance transactions and structures reduce such risks to a significantly low level by applying Shari'ah compliant risk mitigation mechanism.
24. For a benchmark rate to be useful to the financial institutions and users at large, it shall be ensured that the distinct Shari'ah compliant benchmark needs to be determined while eliminating the relevant risks related to the market activity or being specific to the customers or nature of transaction.

Shari'ah compliant application methodology: avoiding price uncertainty

25. A Shari'ah compliant benchmark rate shall be developed in a manner so that its application and / or implementation in Islamic finance transactions and structures does not cause Shari'ah non-compliance, e.g., through creating Gharar (excessive uncertainty in the subject-matter or determination of pricing of the transaction or lack of information in this respect), in a transaction which is otherwise considered to be in line with the Shari'ah principles and rules. As an example, a backward looking benchmark rate (reflecting historic data only) or a spot rate (reflecting current data only) having a methodology of retrospective price adjustments (e.g., to an already established Murabaha price, or to an Ijarah rental on retrospective basis) in the financial transactions shall not be considered compliant with Shari'ah principles and rules.
26. Shari'ah principles and rules require transparency and avoiding uncertainty related to pricing in the contracts. In this regard, it is important that:
- a. sales (and similar) transactions are executed at once without deferment as in the case of conventional forward and futures. The Shari'ah compliant benchmark rate needs to avoid excessive Gharar in pricing. The price needs to be known at the time of entering into the contract. The contract shall not be considered valid unless the price is known at the outset to both the contracting parties without any ambiguity; and
 - b. in transactions on ongoing basis or those executed in future or those executed for shorter future periods on an ongoing basis, if the Ijarah (or participatory or other similar contract) needs to use a floating rate pricing formula, then the basis of adjustment and details of when and how such changes will affect pricing in rentals (or profit ceilings, service charges etc.) needs to be clearly agreed upon in the contract. Moreover, the same shall be before commencement of the respective period.

Forward looking benchmark rate / periodic rate

27. In case, the respective Shari'ah compliant benchmark rate is based on past or current transaction data, and converted into a periodic / forward looking rate through additional data analysis (e.g., through forward transactions data), both sets of data shall comply with the requirements of this standard. In addition, such rate shall exclude market related price elements (e.g., inter-bank credit risk, liquidity and other considerations) as far as possible.

Shari'ah governance framework

28. The ongoing compliance of a Shari'ah compliant benchmark rate with relevant Shari'ah principles and rules, as well as, the requirements of this standard cannot be ensured in the absence of an appropriate Shari'ah governance framework. Accordingly, an administrator shall, at all times, ensure to have in place an effective Shari'ah governance framework, in

line with the requirements of this standard read with [ED of] GS ____ “Governance and Administration for Shari’ah Compliant Benchmark Rates”.²

Shari’ah compliant benchmark rate based on the Islamic financial market data

29. In line with the requirements of paragraph 17(c), a Shari’ah compliant benchmark rate may be based on the data from Islamic financial markets, instead of the economic indicators, if and only if, it is:
- a. developed and implemented as a secondary benchmark rate, in addition to a primary benchmark rate based on economic data, to be used in the situations whereby the application of the former may have practical implications; or
 - b. developed and implemented as a sole benchmark rate for the Islamic finance transactions and structures, if the development and implementation of a Shari’ah compliant benchmark rate based on economic data is impracticable due to the inherent limitations on account of any or a combination of the following:
 - i. the availability and reliability of economic data;
 - ii. the volatility of economic indicators;
 - iii. lack of resources for administering such benchmark rate; and / or
 - iv. regulatory restrictions.
30. A benchmark rate based on the Islamic financial market data shall be acceptable, if and only if, it fulfils the following conditions:
- a. the source data used for determination of such rate relates only to the Shari’ah compliant transactions taking place in the Islamic financial market;
 - b. the benchmark rate reflects the role of Islamic financial institutions as a financial intermediary engaged in real economy based transactions in real assets, transactions, investments and services, including transactions amongst themselves; and
 - c. the benchmark rate reflects primarily the real transactions and is not directly, or indirectly, linked with the conventional benchmark rates, except for the transition period [Explanation: The data reflecting real-life Islamic finance transactions, which as a matter of necessity, are based on conventional benchmark rates shall not be considered eligible for the purpose of determination of such rate, as it creates an indirect circular reference to the same conventional benchmark rate. However, in the commencement phase, a transition period of up to 3 years may be provided in the computation methodology during which a phase-out approach will be used to

² The referred GS is currently under development and is expected to be finalised alongside the final version of this standard.

reduce and eventually eliminate the indirect reference to the conventional benchmark rate].

31. Islamic financial institutions take on a unique role of intermediary wherein they are engaged in real economic activities, yet they do it in order to provide Shari'ah compliant financing solutions to the customers under various Shari'ah compliant products and services. In this regard, it is essential that:
- a. the pure risk free rate is not appropriate in reflecting the true nature of risks borne by Islamic financial institutions. Hence, there is need for a balanced approach in reflecting the true nature of risks in Islamic finance products and services;
 - b. any alternative distinct Shari'ah compliant benchmark rate shall be grounded in real economy based transactions;
 - c. the Shari'ah compliant benchmark rate shall not be based on the conventional derivatives market transactions. However, the market data based on Shari'ah compliant alternatives may be considered acceptable; and
 - d. the distinct Shari'ah compliant benchmark rate while complying with Shari'ah principles and rules needs to ensure that it reflects a rate of return which is relevant and compatible with the financial market and the level of exposure inherent in the transaction.

Suitability criteria

32. A Shari'ah compliant benchmark rate developed in accordance with the requirements of the paragraphs 12-31 shall not be considered suitable for general, mass-scale application for Islamic finance transactions and structures, unless it meets the following suitability criteria as enumerated in paragraphs 33-57.

Compliance with the requirements of global best practices

33. A benchmark rate, and the overall governance and control mechanism in respect of its development and publishing, shall always comply in respect of its design and methodology with the requirements of this standard. Moreover, it shall also always remain in compliance with other global best practices in this respect (including, but not limited to the requirements of IOSCO³, FCA⁴, BMR⁵ and the respective jurisdiction's regulations) insofar as the same are not in contradiction with the requirements of this standard.

³ Principles for Financial Benchmarks, Final Report, IOSCO 2013.

⁴ Financial Conduct Authority, UK Technical Standard (Benchmark Regulations) 2019.

⁵ Benchmark Regulations 2021.

Practicality – serving market needs and expectations

34. In order for a Shari’ah compliant benchmark rate to be widely accepted, it needs to meet genuine market needs to ensure coverage of relevant risks and to provide a stable benchmark. In this regard, it is important that:
- a. the benchmark needs to avoid high volatility which may render it difficult to be adopted by market participants who are looking to ensure effective risk management;
 - b. the Shari’ah compliant benchmark rate needs to reflect relevant risks, yet avoid too much volatility which increases the rate of return risk for the users; and
 - c. the Shari’ah compliant benchmark rate shall have the ability to reflect changes in the market in the short term as well.

Frequency of publication of Shari’ah compliant benchmark rate

35. It is fundamentally important that a benchmark rate is available (and updated) at a suitable frequency, to ensure that such rate remains relevant and efficient. Such frequency shall be:
- a. in case of an “Islamic financial market data based Shari’ah compliant benchmark rate”, preferably on a daily basis, but in no case more than a weekly basis; and
 - b. in case of an “economic indicators based Shari’ah compliant benchmark rate”, preferably on a weekly basis, but in no case more than a monthly basis.
36. Adequate mechanism shall be incorporated in the design of the Shari’ah compliant benchmark rate, and its respective methodology, to ensure collection and processing of data on real-time basis, and making predictions as necessary, to enable publishing of such benchmark rates according to the defined frequency of publication of rate.

Arbitrage risk management

37. One of the biggest challenges for regulators in order to implement a separate Shari’ah compliant benchmark rate, in addition to an already prevalent conventional benchmark rate, is the risk of arbitrage by the market participants who may transact in both, Shari’ah compliant and conventional regimes. If different benchmarks are used with significant differences in pricing risks across financing contracts, then there may arise a risk of arbitrage opportunities by swapping assets or liabilities.
38. This risk is expected to be mitigated significantly by the transaction costs, front- and back-end loads, and certain measures that may be taken by the regulators, in case the two benchmark rates are not significantly different. However, in case of such rates being significantly different, the risk of arbitrage increases.
39. Accordingly, the design of the Shari’ah compliant benchmark rate needs to incorporate necessary measures to avoid creating arbitrage opportunities.

Jurisdiction and regional specificity

40. A benchmark rate shall generally be developed, and be applicable, specific to:
- a. a regulator's jurisdiction (normally, a regulator's jurisdiction comprising a country or a similar jurisdiction), considering that the economic factors and the market data and other data inputs as applicable closely correlate within a specific jurisdiction;
 - b. a country whereby multiple regulators' jurisdictions may exist within such country, considering that the economic data and macro-economic indicators and other data inputs may be available only at an overall level of the respective country; or
 - c. a region comprising of multiple countries and regulators' jurisdictions, particularly where the countries within the region are economically inter-connected, and have a single financial market or inter-connected financial markets.

Single currency

41. Considering the risks associated with different currencies, and respective limitations with regard to the availability of data, the assessment of economic indicators and developing the necessary projections, it is imminent that Shari'ah compliant benchmark rates are developed separately for each currency.
42. If a single currency benchmark rate is developed, the implementation mechanism for its use for any currency different from such currency shall be clearly defined in the implementation guidelines.

Tolerable volatility

43. For large scale applicability of a benchmark rate, it is imminent that the design of the benchmark rate provides limits on volatility, to keep it within the tolerable limits. For this purpose, the benchmark rate design shall include:
- a. definition of tolerance limits for volatility;
 - b. the general approach towards managing volatility;
 - c. progressive, step-by-step approach for incorporating changes over and above tolerable limits;
 - d. exclusion of off-limit data from the available or submitted data;
 - e. weightage based mechanism incorporating multiple economic indicators and data sources, hence limiting the overall volatility; and
 - f. reflection of relevant risks, yet avoiding too much volatility which increases the rate of return risk for the users.

Transparency of inputs in a direct data based benchmark

44. Where a benchmark is based on direct data obtained from a collecting agent or original source, administrators should promote the integrity of inputs by:
- a. verifying that the data is received from the officially accepted channels of authority after necessary approvals with date and time stamp;
 - b. the data is obtained in the prescribed format, units and with no ambiguity;
 - c. the data is obtained through officially accepted channels of communication in case it is received from a collecting agent; and
 - d. avoiding errors in inputs and detecting and monitoring outliers before publication and use of the data input in calculating benchmark.

Transparency of inputs in a contributed data based benchmark

45. Where a benchmark is based on submissions, administrators should promote the integrity of inputs by:
- a. ensuring as far as possible that the submitters comprise an appropriately representative group of participants taking into consideration the underlying market activity measured by the benchmark;
 - b. employing a system of appropriate measures so that, to the extent possible, the submitters comply with the submission guidelines including the quality and integrity standards for submission;
 - c. specifying how frequently submissions should be made and specifying that inputs or submissions should be made for every benchmark determination; and
 - d. establishing and employing measures to effectively monitor and scrutinise inputs or submissions. This should include pre-compilation or pre-publication monitoring to identify and avoid errors in inputs or submissions, as well as, ex-post analysis of trends and outliers.

Transparency and disclosure: in respect of design and methodology

46. A Shari'ah compliant benchmark rate shall be transparent, and its design and methodology elements shall be disclosed in reasonable detail, sufficient for enabling the regulators and the qualified users and other stakeholders, to evaluate as to how the benchmark design works and what is its overall methodology. The minimum disclosures, may include:
- a. the sources of data, and the number of transactions / data sources and characteristics of the samples (where applicable), and specific exclusions etc.;
 - b. data processing and benchmark rate calculation methodology;
 - c. the data processing protocols;

- d. the benchmark rate publishing protocols;
- e. the data used and assumptions applied, where applicable, to develop a forward looking benchmark rate, from the data available primarily for developing a spot or backward looking benchmark rate; and
- f. the extent to which and the basis upon which expert judgment if any, is used in both, the design and / or the methodology for development of benchmark rate.

Transparency – publishing perspective

47. The publishing mechanism of a Shari’ah compliant benchmark rate shall be transparent and free from any biases and shall provide an equal opportunity to the stakeholders and users to apply the same.

Transparency and objectivity: in administration

48. For ensuring credibility and confidence of stakeholders in a Shari’ah compliant benchmark rate, transparency and objectivity in benchmark administration is vital in all steps from data collection to publishing of the benchmark rate. The minimum requirements in this respect shall include the following:
- a. the administration process shall be independent and shall be subject to adequate controls to manage risks impacting the transparency and objectivity of the benchmark rate design and the methodology, at all times;
 - b. the benchmark design and methodology, and relevant elements / organs of the process shall ensure transparency and objectivity and shall be free from all forms of conflict of interest; and
 - c. data dissemination shall be quick, seamless and widely visible so as to minimise the chances of manipulation, misinformation or arbitrage.

Governance framework for administration

49. An administrator shall, at all times, ensure to have in place an effective governance framework, in line with the global best practices as referred to in paragraph 33, as well as, the requirements of this standard read with [ED of] GS ____ “Governance and Administration for Shari’ah Compliant Benchmark Rates”.⁶

Design of the benchmark rate: certain suitability aspects

50. Benchmark design should take into account the following generic non-exclusive features, along with other factors should be considered, as appropriate to the particular market activity:
- a. adequacy of the sample used to represent the market activity;

⁶ The referred GS is currently under development and is expected to be finalised alongside the final version of this standard.

- b. size and liquidity of the relevant market (for example whether there is sufficient trading to provide observable, transparent pricing);
- c. relative size of the underlying market in relation to the volume of trading in the market that references the benchmark;
- d. the distribution of trading among market participants (market concentration as measured by concentration ratio or Herfindahl–Hirschman Index); and
- e. relevance of the benchmark to reflect changes to the assets underpinning a benchmark.

Data sufficiency and stable dissemination

51. The data used to construct a benchmark rate should be sufficient to accurately and reliably represent the market activity measured by the benchmark rate and should:
 - a. be based on prices, rates, indices or values that have been formed by the competitive forces of supply and demand in order to provide confidence that the price discovery system is reliable; and
 - b. be anchored by observable transactions entered into at arm's length between buyers and sellers in the market so that the benchmark remains a credible indicator of prices, rates, indices or values.
52. Provided that an active market exists, conditions in the market on any given day might require the administrator to rely on different forms of data tied to observable market data as an adjunct or supplement to transactions. Depending upon the administrator's methodology, this could result in an individual benchmark determination being based predominantly, or exclusively, on bids and offers or extrapolations from prior transactions.
53. Benchmark administrators can use executable bids or offers as a means to construct benchmarks where anchored in an observable market consisting of bona fide, arms-length transactions.
54. The data sufficiency in terms of depth, volume and capturing relevant risks is vital for a distinct Shari'ah compliant benchmark rate to be successful. In order to ensure data sufficiency, the following principles are vital:
 - a. it needs to be ensured that there is enough reliable data for different tenors so that the alternate benchmark rate can serve the benchmarking needs of different transactions of different maturities;
 - b. the data shall be updated regularly enough to reflect the market reality and changes in the market; and

- c. the benchmark methodology shall stipulate whether it captures maturity / liquidity risk premium and credit risk premium and if it does, it shall explain how the premium or spread is calculated.

Acceptance and hierarchical prioritisation of data and application of judgment in using data inputs

- 55. Transparent guidelines shall be established and published or made available regarding:
 - a. the characteristics essential for data acceptance;
 - b. the hierarchy of data inputs; and
 - c. the exercise of expert judgment in data collection, processing and benchmark rate development methodology.
- 56. For the purpose of determination of benchmark rates dependent on submissions of data, the hierarchy of data inputs should include, the following in the manner of priority:
 - a. submitters' own concluded arm's length transactions in the underlying market or related markets;
 - b. reported or observed concluded arm's length transactions in the underlying market;
 - c. reported or observed concluded arm's length transactions in related markets;
 - d. firm (executable) bids and offers; and
 - e. other market information or expert judgments.
- 57. Provided that the data sufficiency principle is met with an active market, the methodology may include defined level of flexibility to use inputs consistent with the administrator's approach to ensure the quality, integrity, continuity and reliability of its benchmark determinations.

Effective date

- 58. This standard shall be effective from 1 January 2026. Earlier application is encouraged.

Appendices

Appendix A: Adoption of the standard

This standard was presented for the approval in the AAOIFI Governance and Ethics Board (AGEB) meeting No. _____, corresponding to _____ and was duly approved and adopted.

Members of the board

1. Mr. Mohammad Farrukh Raza (chairman)
2. Dr. Walid Hegazy (deputy chairman)
3. Dr. Abdulbari Mashal
4. Mr. Abdullah AlMoqbel
5. Mr. Abozer Magzoub
6. Dr. Ahmet AlBayrak
7. Dr. Ali AlSartawi
8. Mr. Ebrahim Sidat
9. Ms. Ibtihal Al-Shamali
10. Dr. Kabir Hassan
11. Mr. Moosa Khoory
12. Mr. Muzammil Kasbati
13. Mr. Sohaib Umar
14. Mr. Wael Merza
15. Dr. Zahid ur Rehman Khokher

Reservation

The standard was approved unanimously.

Working group and team

1. Dr. Kabir Hassan (chairman)
2. Mr. Abdul Awwal Sarker
3. Dr. Abideen Adeyemi Adewale
4. Dr. Ahmet Albayrak
5. Sh. Dr. Aznan Hasan
6. Dr. Azmi Omer

7. Dr. Anwar Hasan Abdullah Othman
8. Dr. Hechem Ajmi
9. Mr. Ijlal Alvi
10. Mr. Khalifa Al Faheem
11. Mr. Mohammad Atiqur Rahman Khan Khadem
12. Dr. Mohammad Elbeltagi
13. Mr. Moosa Khoory
14. Mr. Mustafa Adil
15. Dr. Saad Azmat
16. Dr. Sami Al-Suwailem
17. Mr. Shah Mohammad Wali Ullah
18. Mr. Salman Syed Ali
19. Mr. Sohail Zubairi
20. Mr. Wael Merza

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Ms. Zahra Jassim (AAOIFI)
3. Ms. Alyaa Adel (AAOIFI)
4. Dr. Salman Shaikh (senior research associate)

Appendix B: Basis of conclusion

BC1 [To be updated.]

Appendix C: Illustrative models of Shari’ah compliant benchmark rates

[Under evaluation process. To be published after finalisation of core principles.]

Appendix D: Brief history of the preparation of the standard

- H1 The working group held one meeting on 27 Rabi' I 1443H, corresponding to 2 November 2021, via video conferencing. The members discussed the preliminary study and the approach to the development of the standard.
- H2 The working group held two additional meetings on 2 Rabi' II 1443H, corresponding to 7 November 2022 and 9 Rabi' II 1443H, corresponding to 14 November 2022, via video conferencing. The members discussed the different approaches to the Islamic benchmark rate and they agreed on conceptual issues.
- H3 AGEB held its 23rd meeting on 29-30 Rajab 1443H, corresponding to 2-3 March 2022, via video conferencing to discuss the progress taken by the working group. The board further discussed the discontinuation of LIBOR and the consequential transition to different benchmark rates.
- H4 AGEB held its 24th meeting on 29-30 Rajab 1443H, corresponding to 2-3 March 2022, via video conferencing to discuss the progress taken by AAOIFI secretariate. The board also elaborated on the main challenges related to the development of this standard and agreed on the way forward.
- H5 Following the guidance of the board, the working group held two meetings to discuss the first version of the exposure draft. The meetings were held on 12 Ramadan 1443H, corresponding to 13 April 2022 and 26 Ramadan 1443H, corresponding to 27 April 2022. The working group approved the exposure draft and recommended presenting it to the board.
- H6 AGEB held its 25th meeting on 16-17 Shawwal 1444H, corresponding to 17-18 May 2022, via video conferencing and directed the secretariat to make the necessary changes and approved the exposure draft after the review of the "Shari'ah Committee of the Shari'ah Board for Review of Accounting and Governance Standards". After due process, the exposure draft was issued on 2 Jumada II 1444H, corresponding to 26 December 2022.