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S T A T U T O R Y I N S T R U M E N T S

2018 No. 2.

**THE FINANCIAL INSTITUTIONS (ISLAMIC BANKING)
REGULATIONS, 2018.**

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S T A T U T O R Y I N S T R U M E N T S

2018 No. 2.

The Financial Institutions (Islamic Banking) Regulations, 2018

(Under sections 3(f), 115A (5), 115B (3) and 131(m) of the Financial Institutions Act, 2004, Act No. 2 of 2004)

IN EXERCISE of the powers conferred upon the Central Bank by sections 3(f), 115A (5), 115B (3) and 131(m) of the Financial Institutions Act, 2004, and in consultation with the Minister responsible for finance, these Regulations are made this day of, 2018.

PART I—PRELIMINARY

1. Title.

These Regulations may be cited as the Financial Institutions (Islamic Banking) Regulations, 2018.

2. Purpose of Regulations.

The purpose of these Regulations is—

- (a) to provide for the regulation of financial institutions conducting Islamic financial business;
- (b) to provide a regulatory framework for Islamic financial business;
- (c) to provide for the licensing and operation of Islamic financial business; and
- (d) to ensure that financial institutions conducting Islamic financial business conduct their operations in accordance with the Shari’ah.

3. Interpretation.

In these Regulations, unless the context otherwise requires—

“Act” means the Financial Institutions Act, 2004;

“capital adequacy” has the meaning assigned to it in the Financial Institutions (Capital Adequacy Requirements) Regulations, 2005;

“corporate governance” has the meaning assigned to it in the Financial Institutions (Corporate Governance) Regulations, 2005;

“credit classification and provisioning” has the meaning assigned to it in the Financial Institutions (Credit Classification and Provisioning) Regulations, 2005;

“credit concentration and large exposure” has the meaning assigned to it in the Financial Institutions (Limits on Credit Concentration and Large Exposures) Regulations, 2005;

“deposit” has the meaning assigned to it in section 4(4) of the Act and for the purposes of Islamic financial business, includes sums of money held in a profit earning investment account, a profit sharing investment account and a non-profit-bearing deposit account;

“insider lending” has the meaning assigned to it in the Financial Institutions (Insider-Lending Limits) Regulations, 2005;

“Islamic contract” has the meaning assigned to it in the Act;

“Islamic financial business” has the meaning assigned to it in the Act;

“Islamic financial institution” means a company licensed to carry on financial institution business in Uganda whose entire business comprises Islamic financial business and which has declared to the Central Bank that its entire operations are and will be conducted in accordance with the Shari’ah;

“Islamic window” means the section of a financial institution, other than an Islamic financial institution, which conducts Islamic financial business;

“liquidity” has the meaning assigned to it in the Financial Institutions (Liquidity) Regulations, 2005;

“ownership and control” has the meaning assigned to it in the Financial Institutions (Ownership and Control) Regulations, 2005.

“placement” means the depositing of funds with one financial institution by another financial institution for purposes of settlement of payments and business operations.

PART II—LICENCE TO CONDUCT ISLAMIC FINANCIAL BUSINESS

4. Licence to conduct Islamic financial business

(1) A person intending to establish an Islamic financial institution shall apply for a licence in accordance with the Financial Institutions (Licensing) Regulations, 2005.

(2) For the purposes of section 115A (1) of the Act, an already licensed financial institution may apply to the Central Bank, for approval to carry on Islamic financial business through an Islamic window.

PART III—DEPOSITS IN ISLAMIC FINANCIAL BUSINESS

5. Deposits in Islamic financial business

An Islamic financial institution or a financial institution carrying on Islamic financial business may accept deposits from customers in the following accounts—

- (a) a profit sharing investment account;
- (b) a profit earning investment account; or
- (c) a non-profit-bearing deposit account.

6. Profit sharing investment account

(1) A profit sharing investment account is an account managed by a financial institution conducting Islamic financial business—

- (a) in relation to property of any kind, including currency specified by the Central Bank, held for or within the account;
- (b) as part of its Islamic financial business; or
- (c) under terms of an agreement where—
 - (i) the account holder agrees that any deposit amounts are to be applied by the financial institution on behalf of the account holder as specified by agreement, which may be restricted by reference to a specified purpose or unrestricted where no particular purpose is specified;
 - (ii) the account holder agrees to share any profit with the financial institution as manager of the account in accordance with a pre-determined specified percentage or ratio; and
 - (iii) the account holder agrees that he or she will bear any losses in the absence of negligence or breach of contract on the part of the financial institution.

(2) Where an account holder bears losses in accordance with the terms of the account, the financial institution shall make payments to the account holder of amounts equal to any losses in order to maintain public confidence in that financial institution and the financial institution shall ensure it has in place appropriate procedures for such payments.

(3) Where money is deposited by a financial institution conducting Islamic financial business in a profit sharing investment account of another financial institution, the deposit shall be considered a placement.

7. Profit earning investment account.

(1) Deposits in a profit earning investment account in an Islamic financial institution or a financial institution conducting Islamic financial business through an Islamic window shall be treated in the same manner as deposits generally and all references to deposits in the Act and regulations made under the Act shall be construed accordingly.

(2) A profit earning investment account is an account managed by a financial institution under an agreement—

- (a) under which the account holder agrees that the deposit amounts are to be applied by the financial institution on behalf of the account holder in the purchase of an asset to be sold to the financial institution at a price not less than the deposit amount used in the initial purchase of that asset on behalf of the account holder, with the difference in the prices representing the profit earned on the investment of those deposit amounts as agreed between the financial institution and the account holder; and
- (b) under which there is no exposure on the part of the account holder or the financial institution to changes in the market value of the asset;

(3) A financial institution shall repay to the holder of a profit earning investment account the full amount deposited by the account holder into that account, together with the agreed profit earned on the relevant investment, less any agreed fees, costs and other expenses, in accordance with the account terms.

(4) An Islamic financial institution or a financial institution conducting Islamic financial business through an Islamic window shall minimise any risks associated with the purchase and sale of the underlying assets for the purposes of any profit earning investment account in order to avoid exposure to changes in the market value of those assets.

8. Non-profit-bearing deposit account

(1) In accordance with section 4(4) of the Act, non-profit-bearing deposits of an Islamic financial institution or a financial institution operating an Islamic window shall be treated in the same manner as deposits generally of a financial institution and all references to deposits in the Act and in regulations made under the Act.

(2) An Islamic financial institution or a financial institution operating an Islamic window offering any form of non-profit-bearing deposit shall ensure that those deposits are clearly marketed as deposits on non-profit-bearing accounts.

PART IV—CAPITAL ADEQUACY, LIQUIDITY AND PROFITS

9. Maintenance of capital adequacy and liquidity requirements

(1) Notwithstanding the Financial Institutions (Capital Adequacy Requirements) Regulations, 2005, an Islamic financial institution or financial institution operating an Islamic window shall, in the computation of the capital adequacy requirements, include the sum of any accrued losses in the profit sharing investment accounts as part of its contingent claims.

(2) Notwithstanding the Financial Institutions (Liquidity) Regulations, 2005, the computation of the Liquid Assets requirement of an Islamic financial institution or a financial institution operating an Islamic window shall include the sum of any accrued losses in the profit sharing investment accounts.

10. Requirements relating to profits to be shared with holders of profit sharing investment accounts

(1) A financial institution carrying on Islamic financial business or a financial institution operating an Islamic window shall—

- (a) keep a record of any profits to be shared with the holders of profit sharing investment accounts; and
- (b) appropriate to a reserve account, an amount to be used to cater for possible losses arising out of projects financed by profit sharing investment account holders.

(2) The amount appropriated to a reserve account under subregulation (1)(b) shall comprise of profits accrued before sharing profits with the holders of profit sharing investment accounts.

(3) The reserve account under subregulation (1)(b), shall qualify as a general reserve in accordance with the Financial Institutions (Capital Adequacy Requirements) regulations, 2005.

(4) A financial institution carrying on Islamic financial business or a financial institution operating an Islamic window shall disclose in its annual financial statements, the amounts held in and paid out of the reserve account during that year.

PART V—CREDIT PROVISION IN ISLAMIC FINANCIAL BUSINESS

11. Credit provision

(1) Financing arrangements under Islamic financial business may include the making available of any credit provision in accordance with the Act and these Regulations.

(2) A credit provision referred to in subregulation (1) may take the form of—

- (a) equity partnership financing;
- (b) lease based financing; or
- (c) sale based financing.

(3) Equity partnership financing referred to in subregulation (2)(a), includes—

- (a) *musharakah*, that is, a profit and loss sharing partnership;
- (b) *Musharakah mutanaqisah*, that is, a diminishing partnership in which the interests of one of the partners, being the financial institution, are gradually acquired by the other partner over time, and by which assets are owned jointly by a financial institution and its customer;
- (c) equity financing, including *mudarabah*, that is—

- (i) a profit sharing partnership by which capital is provided by a financial institution to its customer; and
- (ii) managed and applied by the customer for a specified purpose; and the profits arising from the management of the capital shared between the financial institution as capital provider and the customer in accordance with the agreement.

(4) Lease based financing, referred to in subregulation (2)(b), including *al-ijarah* (lease), *al-ijarah muntahia bi al-tamlik* (lease followed by ownership of the leased assets) and *al-ijarah thumma al-bai* (lease with an option to acquire the leased assets), is an arrangement where assets may be purchased by a financial institution and leased to its customer.

(5) Sale based financing referred to in subregulation (2)(c), is an arrangement where assets are purchased by a financial institution and sold to a customer at a price greater than the cost price at which the asset was purchased by the financial institution.

(6) For purposes of subregulation (5) a financial institution shall put in place measures to ensure that the financial institution does not suffer exposure to changes in the value of the relevant asset underlying the sales based financing arrangement.

PART VI—SHARI’AH ADVISORY BOARD

12. Shari’ah Advisory Board

(1) Every financial institution which conducts Islamic financial business shall appoint and maintain a Shari’ah Advisory Board in accordance with section 115B of the Act.

(2) The Shari’ah Advisory Board shall be appointed by the board of directors of the financial institution in accordance with the Act and the rules and policies of the financial institution.

(3) The Shari'ah Advisory Board shall comprise of not less than three members and not more than five members.

(4) The Shari'ah Advisory Board shall be answerable to the board of directors of the financial institution.

13. Approval of members of Shari'ah Advisory Board by Central Bank

(1) A financial institution shall apply to the Central Bank for its approval, of a person nominated to be appointed as a member of the financial institution's Shari'ah Advisory Board.

(2) The Central Bank shall in considering an application for approval under subregulation (1), take into consideration whether the person proposed for appointment—

- (a) possesses sufficient qualifications and experience in Shari'ah and Islamic banking;
- (b) possesses sufficient experience of the financial services industry; and
- (c) in respect of the Chairperson, has served on the Shari'ah Advisory Board of another reputable financial institution conducting Islamic financial business.

(3) The Central Bank shall after considering an application under subregulation (2), give or withhold its approval of the applicant as a member of the Shari'ah Advisory Board.

14. Functions of the Shari'ah Advisory Board

(1) The Shari'ah Advisory Board shall advise, approve and review the Islamic financial business of a financial institution in order to ensure that the Islamic financial business of the financial institution complies with the Shari'ah.

(2) The Shari'ah Advisory Board of a financial institution shall be independent of all other functions of the financial institution.

15. Shari’ah audit

(1) A financial institution carrying on Islamic financial business or a financial institution operating an Islamic window shall conduct a Shari’ah audit on a periodical basis

(2) The Shari’ah audit may be performed by internal auditors with adequate knowledge and training in banking and Shari’ah-related matters.

(3) A financial institution carrying on Islamic financial business or a financial institution operating an Islamic window may engage experts to conduct the audit.

(4) A Shari’ah audit shall be designed to enable the financial institution—

- (a) to assess whether a sound and effective internal control system for Shari’ah compliance has been implemented;
- (b) to understand the business activities of the institution to allow for better scoping of an audit exercise, including auditability and relevance of activities;
- (c) to develop a comprehensive internal Shari’ah audit program or plan and shall include objectives, scope, personnel assignment, sampling, control and duration as well as establish proper audit processes, policies and procedures of the financial institution’s operations;
- (d) to obtain and make reference to relevant sources including decisions of the Shari’ah Advisory Board;
- (e) to communicate results of any assessment or findings arising from the Shari’ah audit to the Shari’ah Advisory Board; and
- (f) to provide recommendations on corrective measures for addressing the identified shortcomings.

(5) The auditors referred to in this regulation shall report to—

- (a) the Shari’ah Advisory Board in relation to its functions; and
- (b) the management of the financial institution in relation to its administrative arrangements.

16. Removal of member of Shari’ah Advisory Board.

A member of a Shari’ah Advisory Board may be removed only by the board of directors of the financial institution or at the direction of the Central Bank.

17. Board of directors to report on Shari’ah compliance.

The board of directors of a financial institution which conducts Islamic financial business shall—

- (a) in respect of the financial statements of the financial institution, report at least once a year, on the Shari’ah compliance of the financial institution; and
- (b) in respect of the financial statements of the financial institution, disclose the remuneration paid to the members of Shari’ah Advisory Board.

PART VII—CENTRAL SHARI’AH ADVISORY COUNCIL

18. Central Shari’ah Advisory Council.

The Central Shari’ah Advisory Council established in the Central Bank by the Act shall—

- (a) advise the Central Bank on matters of regulation and supervision of Islamic banking systems in Uganda; and
- (b) approve any product to be offered by financial institutions conducting Islamic banking.

19. Composition of the Central Shari’ah Advisory Council.

(1) The Central Shari’ah Advisory Council shall comprise not less than five members who shall include—

- (a) the Governor, who shall be the Chairperson of the Council;
- (b) the executive director responsible for supervision in the Central Bank who shall be the secretary to the Council;
- (c) the head of the legal department of the Central Bank; and
- (d) two Shari’ah scholars who shall be appointed by the Board of Directors of the Central Bank.

(2) A Shari’ah scholar appointed to the Central Shari’ah Advisory Council shall hold office on such terms and conditions as may be provided in his or her letter of appointment, and may be eligible for re-appointment.

20. Qualifications of Shari’ah scholars.

A Shari’ah scholar appointed to the Central Shari’ah Advisory Council shall have—

- (a) knowledge and experience in Shari’ah, Islamic Banking or such related disciplines as the Central Bank may specify;
- (b) experience in the financial services industry;
- (c) good standing, reputation and recognition in Uganda or any other country;
- (d) experience in serving on the Shari’ah Advisory Board of any reputable institution conducting Islamic financial business.

PART VIII—REMEDIAL MEASURES AND SANCTIONS

21. Remedial measures and administrative sanctions.

(1) Where the Central Bank determines that a financial institution conducting Islamic financial business is not in compliance with these Regulations, the Central Bank may impose any or all of the corrective actions prescribed in Part IX and section 126 (2) of the Act.

(2) The Central Bank may, in addition to the remedial measures prescribed in sub regulation (1), impose any or all of the following administrative sanctions—

- (a) suspension of the licence of an Islamic financial institution;
- (b) revocation of the licence of an Islamic financial institution;
- (c) suspension of the approval to carry on Islamic financial business through an Islamic window;
- (d) cancellation of the approval to carry on Islamic financial business through an Islamic window; or
- (e) suspension or prohibition from providing any new Islamic financial business products.

Cross References

1. Financial Institutions Act, Act No.2 of 2004
2. Financial Institutions (Capital Adequacy Requirements) Regulations, S.I No. 42 of 2005
3. Financial Institutions (Corporate Governance) Regulations, S.I No. 47 of 2005
4. Financial Institutions (Credit Classification and Provisioning) Regulations, S.I No. 43 of 2005
5. Financial Institutions (Insider-Lending Limits) Regulations, S.I No.45 of 2005
6. Financial Institutions (Licensing)Regulations, S.I No. 41 of 2005
7. Financial Institutions (Limit on Credits Concentration and Large Exposures) Regulations, S.I No. 44 of 2005
8. Financial Institutions (Liquidity)Regulations, S.I No. 46 of 2005
9. Financial Institutions (Ownership and Control) Regulations, S.I No. 48 of 2005

PROFESSOR EMMANUEL TUMUSIIME-MUTEBILE,
Governor, Bank of Uganda.