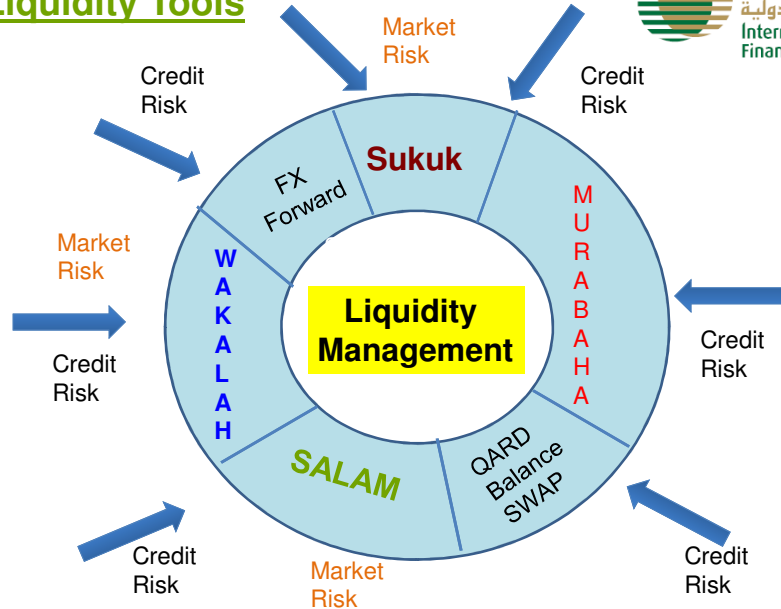


# Collateralisation Of Islamic Securities As A Liquidity Management Tool

*IIFM Industry Seminar on Islamic Financial Markets hosted by MAS  
 Pre-Conference Day, WIBC Asia Summit 2015  
 Tuesday, 2<sup>nd</sup> June 2015, Pan Pacific Hotel, Singapore*

*Ismail E. Dadabhoy  
 Advisor, IIFM*

## Liquidity Tools

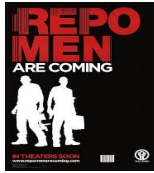


## Tools to Minimise Risk

- ✓ **COLLATERALISATION**
- ✓ **Proper Documentation**
- ✓ **Market to Market**

## You Think it is REPO ?





## Covered In the Guidance Note



السوق المالية  
الإسلامية الدولية  
International Islamic  
Financial Market

REPO?	It looks like a repo, smells like a repo But it Not a Repo
Segregation	Collateral has to be kept in a segregated account.
REUSE ?	Reuse of posted Collateral is not allowed. It is <i>Arrahan</i> ...
NO Transfer of Title	Therefore, Full economic benefit and market risk remains with the original owner
Form of Collateral	Collateral is in a form of Securities Interest.
Governing Law	MCM is based on English law. However, governing law is at the option of the parties
Two MCM Agreement	If Two way financing is required then 2 MCM agreement has to be signed. Note, Netting is an issue in many countries in the region
Form of Collateral	Netting of exposure still a question mark in some countries

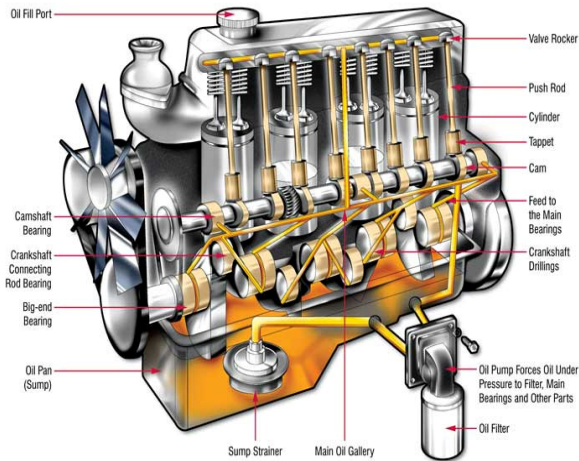
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## Collateralisation



السوق المالية  
الإسلامية الدولية  
International Islamic  
Financial Market



Oiling the Market

Cash

Sukuk

A Tool that keeps Liquidity flowing Into the Cash & Sukuk Market

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## Current Status of Collateralised *Murabahah* in International Currency



- ❑ IIFM Collateralised Standard documentation issued late last year is already becoming popular in the market place.
- ❑ IIFM initiated a survey this year with the market to receiving feed back on its Standards, its *Sukuk* Report, its Seminars amongst many other questions put forward in the survey.
- ❑ The responses received were highly encouraging and very positive for IIFM. Specially on the use of IIFM documentation

## UAE Central Bank *Shari'ah* compliant Short-Term Facility

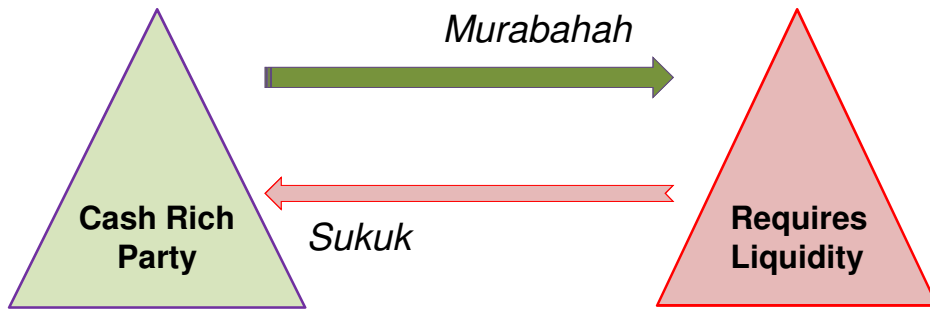


- UAE CB has started started offering overnight liquidity to Islamic Banks under Collateralised *Murabahah* structure.
- Eligible assets that can be used as collateral include *Sukuk* and other *Shari'ah* compliant securities issued by the UAE Federal Government or authorities in individual emirates, as well as banks and corporations that are based in the UAE.
- UAE CB has adopted a Tri-Party settlement structure with the Global Custodians. Securities issued by foreign governments, banks, corporate and supranational agencies will also be accepted as collateral, but must carry a minimum A rating from agencies

# Murabahah Collateralised by Sukuk



How does it Work?



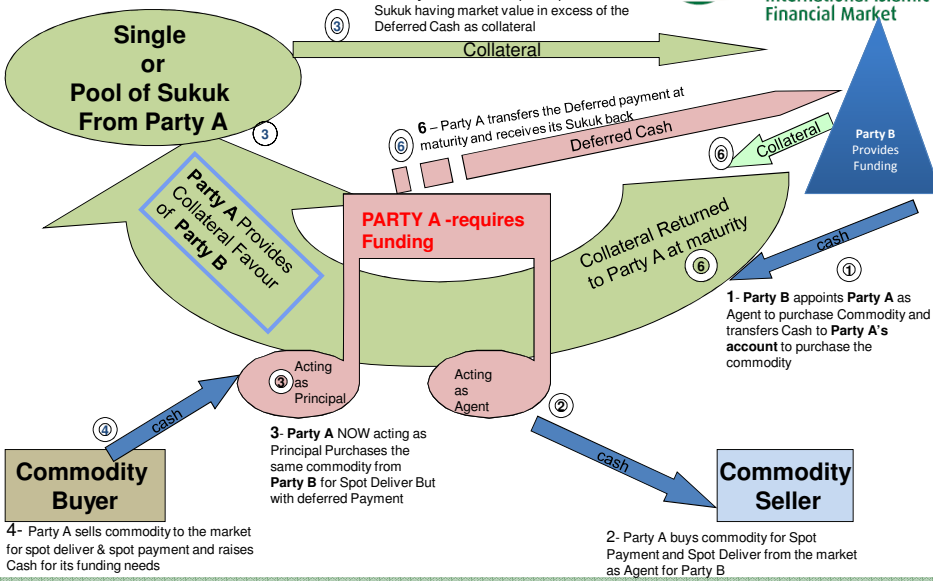
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# Collateralization Overall Transaction Flow



**Bi-Lateral Transaction**



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## Collateralized Product Benefits



### Alternative to Clean Lending

Collateralized financing offers a structure that requires some extra operational task but does provide credit enhancement as well as providing an effective liquidity management tool for use with the Collateral Management Agent.

### Credit Risk Management

As long as the extra collateral is managed, Counterparty exposure is reduced to the margin threshold plus *Sukuk* execution risk, rather than a full clean exposure. It can allow for positive capital treatment.

### Central Bank Market Intervention

CB can include Islamic Banks as part of its market liquidity actions (Add or Remove Cash from the system). Also, Islamic Financial Institutions can use this liquidity instrument to raise funds from the CB

### Liquidity Management

Having the comfort of collateral allows the institutions to finance for a longer duration and or larger quantum as the credit risk is reduced.

### Development for *Sukuk*

Allowing Financial institutions to maintain less cash and allocate more in income generating *Sukuk*. Giving rise to greater take up of *Sukuk* by Islamic investors

## Collateralisation – The Key is to Ensure Margin Maintenance



### A (1) Assuming the Collateral Value Decreases Below the Threshold Variance

- Bank to provide more (same or other) acceptable *Sukuk*
- Provide other acceptable Collateral as previously agreed
- Or Provide acceptable Letter of Credit
- To bring the collateral level back up to 110%
- If none of the above agreed instrument is delivered then the Party A will be in Default

### A (2) Assuming the Collateral Value Increases Above the Threshold Variance

- Party B will Return part of the *Sukuk* in order to bring it back down to 110% of the Finance Amount
- Or Party A may consider not to request this extra amount from Party B and may wish to leave extra buffer and save on operational cost

- Tenth Harvard University Forum on Islamic Finance  
Harvard Law School - March 24-25, 2012  
**Mahmoud Mohieldin, MD, World Bank Group,**  
Highlighted 6 challenges facing Islamic finance as the  
industry evolves into its next phase:

- ✓ **Improving regulatory oversight**
- ✓ **Strengthening insolvency frameworks**
- ✓ **Rebalancing tax treatment**
- **Promoting standardization**
- **Ensuring adequate liquidity**
- **Establishing sound risk-management practices**

## Regulatory, Legal and Other Challenges

- In the case of conventional market repo documentation, the collateral is effected through netting i.e. the ability to close out and set-off in an insolvency where the value of the collateral securities can be determined and applied in set off against the outstanding value. However, the legal framework in most of the OIC countries does not recognize this technique.
- ✓ The Islamic Industry need to assess and tackle this requirement or find a workable solution
- ❖ Certain Institutions either do not carry *Sukuk* in their portfolio or do not invest in *Sukuk*. What is the solution for them on Collateralisation?
- ✓ Answer, consider *Shari'ah* compliant Equities.  
However, there may be issues that must be addressed before entering into such transaction, specially in terms of Foreign ownership, taxation etc.

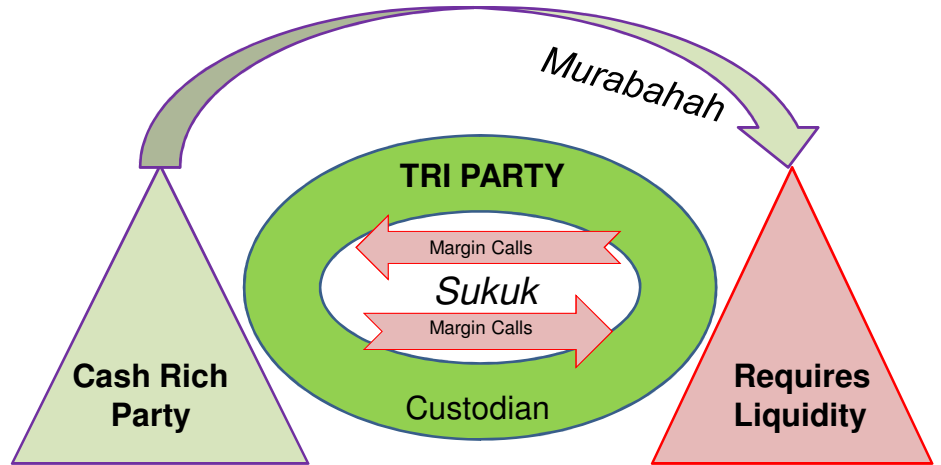
# TRI – PARTY

## What Does Tri-Party Offer ?

- Credit Enhancement** ➤ Tri- Party plays an important role by providing independent operational facility while holding underlying collateral
- Operation Out Sourcing** ❖ Allows entities to participate in Collateralised Financing even when their operation and IT capabilities cannot support due to limitation
- Credit Management** ➤ Its function is to ensure the Collateral Value are maintained by daily mark to market the Collateral, Call for additional Margin if required, ensure the Collateral is of the type and quality as per the agreement and to process Corporate actions
- Expands Client Base** ❖ Central Banks, Pension Funds, Asset Managers, Leasing Co and Corporate entities can provide extra cash liquidity to the market. Knowing the exposures are monitored by an independent entity

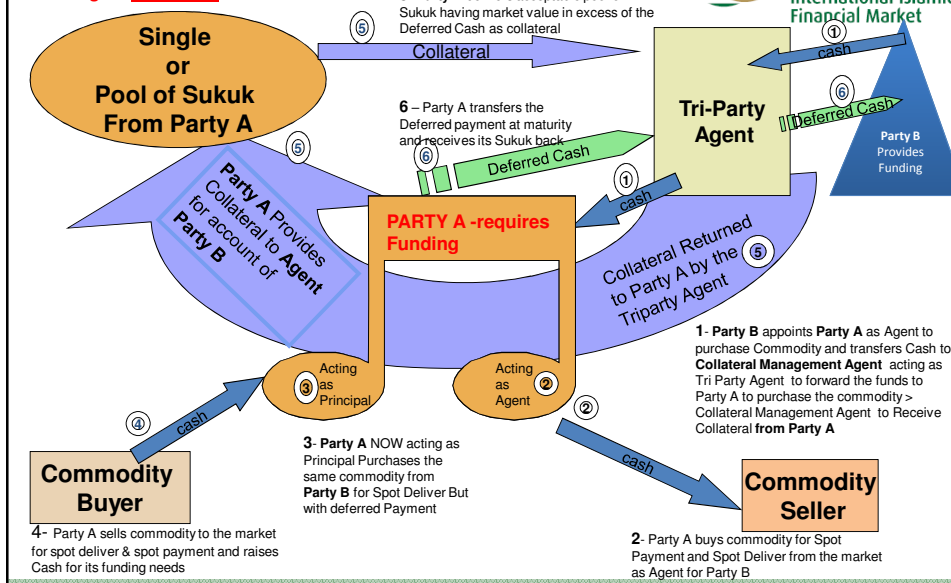


# Murabahah Collateralised by Sukuk



# Collateralization Overall Transaction Flow

## Workings of TRI - PARTY





Knowing your Exposure is Monitored independently by an engine that optimizes the Collateral pool while ensuring Credit exposure is monitored, reported and actioned

*Thank you*

**International Islamic Financial Market (IIFM)**  
Office No. 72, 7<sup>th</sup> Floor, Zamil Tower, P.O. Box: 11454, Manama, Kingdom of Bahrain  
Tel: +973 17500161 , Fax: +973 17500171, Email: info@iifm.net, Website: www.iifm.net

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