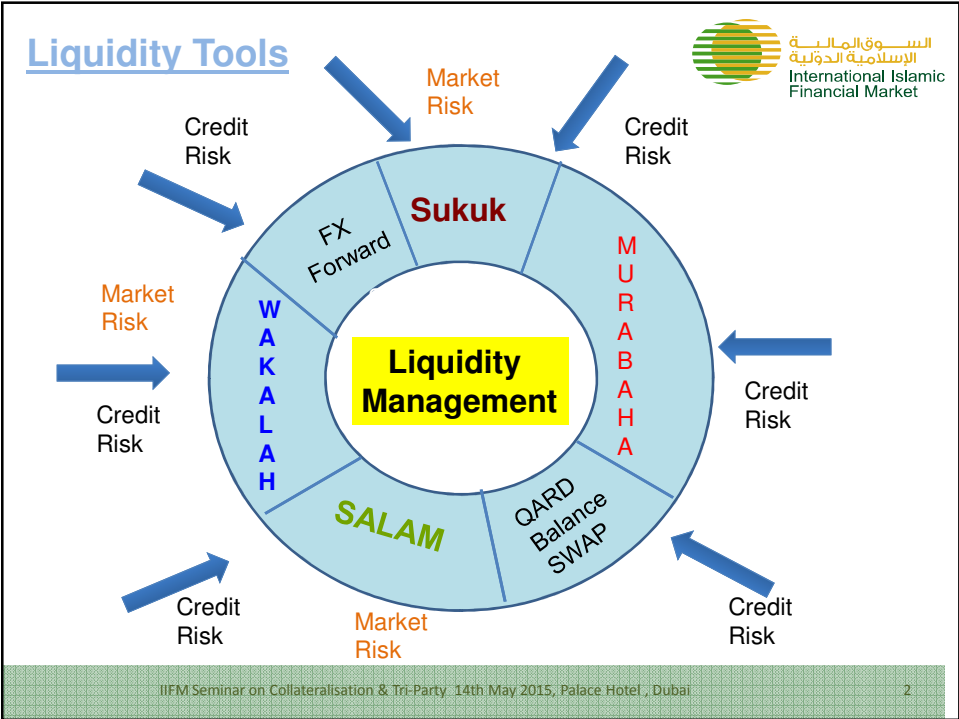


Sharia Compliant Liquidity Management Tool Collateralisation & Tri Party

IIFM Industry Seminar
Hosted by Natixis – Dubai ,
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Ismail Dadabhoy
Advisor - IIFM



Tools to Minimise Risk

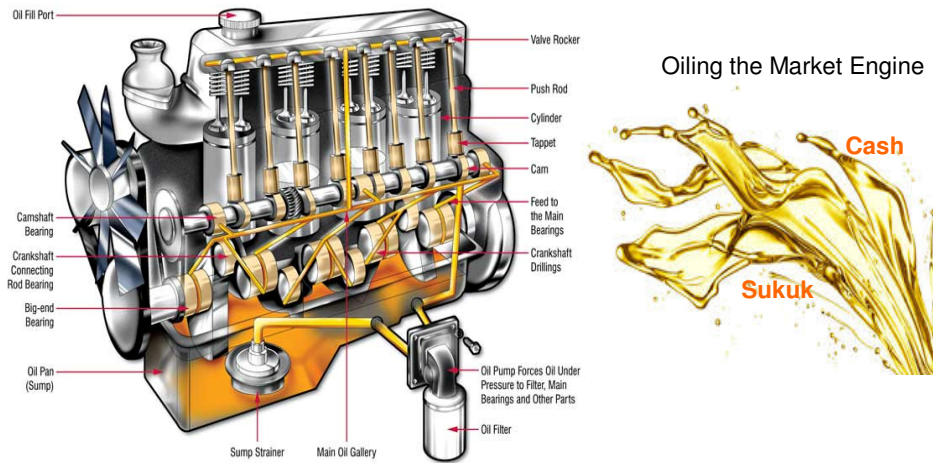
- ✓ **COLLATERALISATION**
- ✓ **Proper Documentation**
- ✓ **Market to Market**



It is NOT a REPO

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

Collateralisation



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

Current Status of Collateralised Murabaha 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 was highly encouraging and very positive for IIFM. Specially on the use of IIFM documentation

UAE Central Bank Sharia compliant Short-term Facility



Central Bank Liquidity

UAE CB has started offering overnight liquidity to Islamic Banks under Collateralised Murabaha structure.

Acceptable Collateral Type

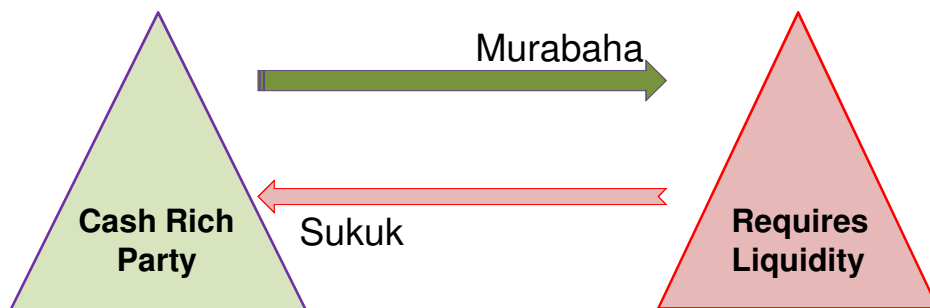
Eligible assets that can be used as collateral include Sukuk and other Sharia compliant securities issued by the UAE Federal Government or authorities in individual emirates, as well as banks and corporations that are based in the UAE.

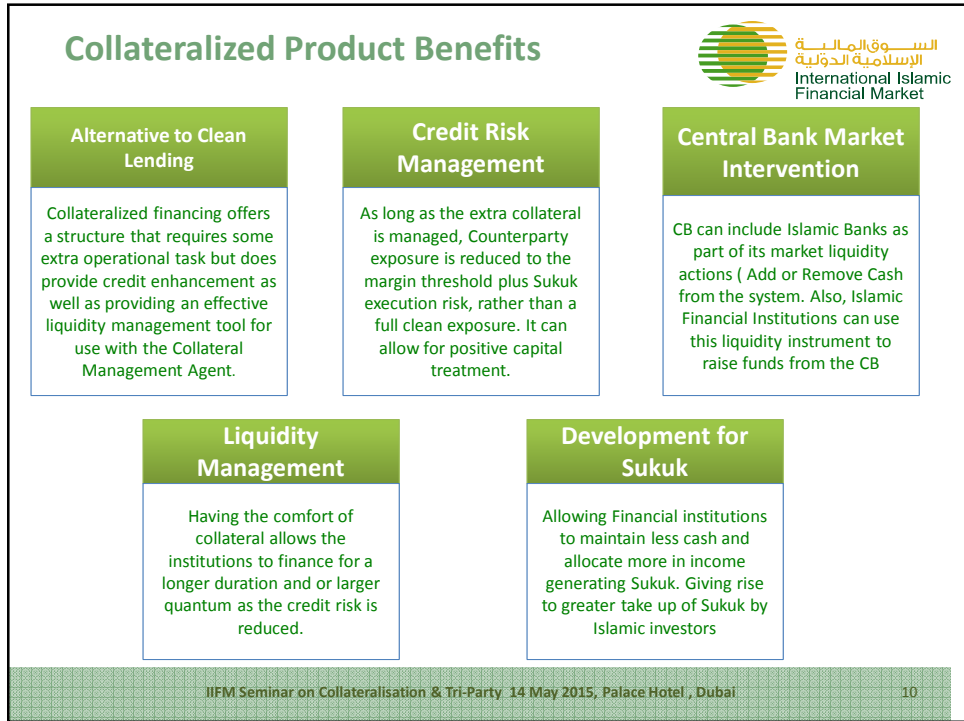
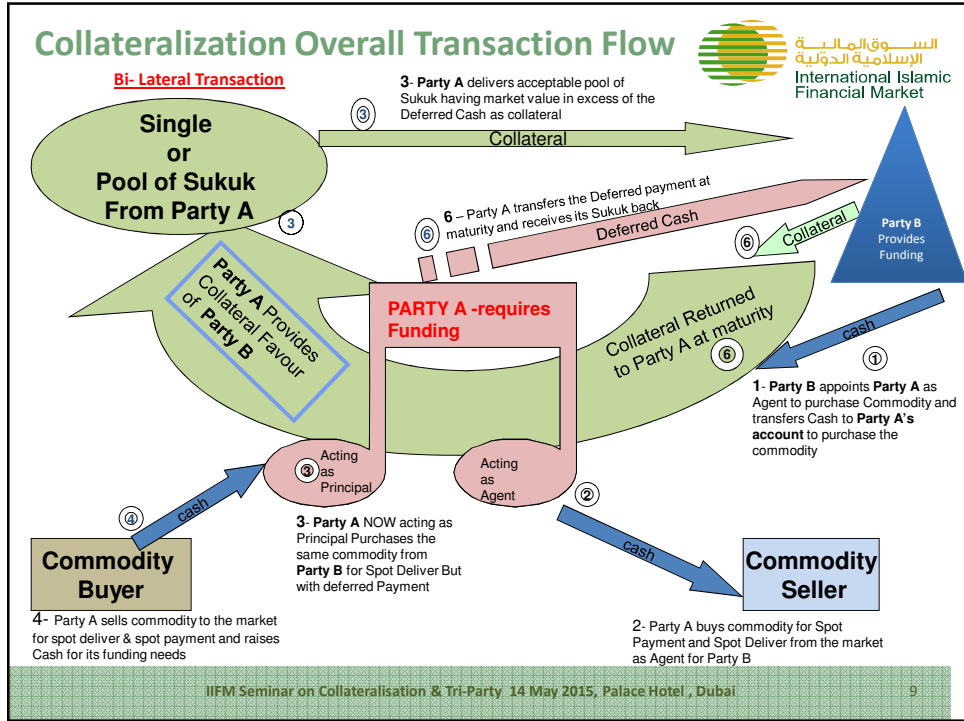
Tri-Party & Acceptable Foreign Issuers

UAE CB has adopted a Tri- Party settlement structure with the Global Custodians . Securities issued by foreign governments, banks, -corporates and supranational agencies will also be accepted as collateral, but must carry a minimum A rating from agencies

Murabaha Collateralised by Sukuk

How does it Work?





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, Managing Director, 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 & other Challenges

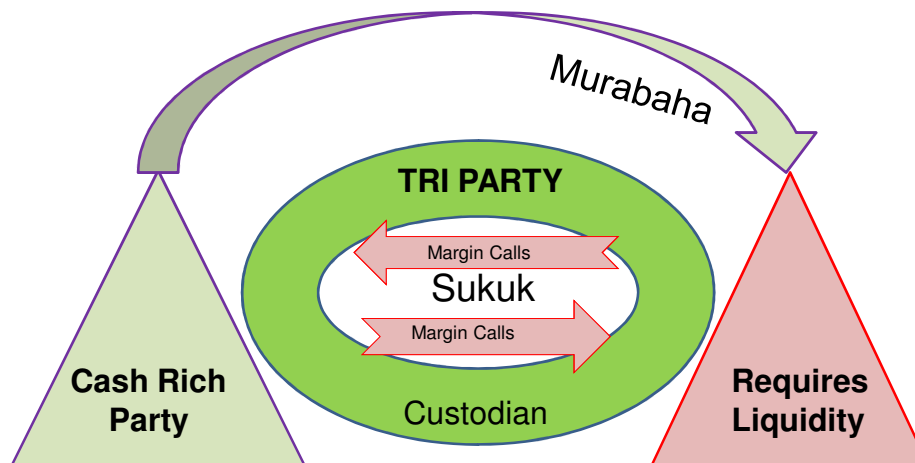
- In the case of conventional market repo documentation, the collateral is effected through netting i.e. the ability to close out and set-off in an insolvency where the value of the collateral securities can be determined and applied in set off against the outstanding value. However, the legal framework 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 Sharia compliant Equities.
However, there may be issues that must be addressed before entering into such transaction, specially in terms of Foreign ownership, taxation etc.

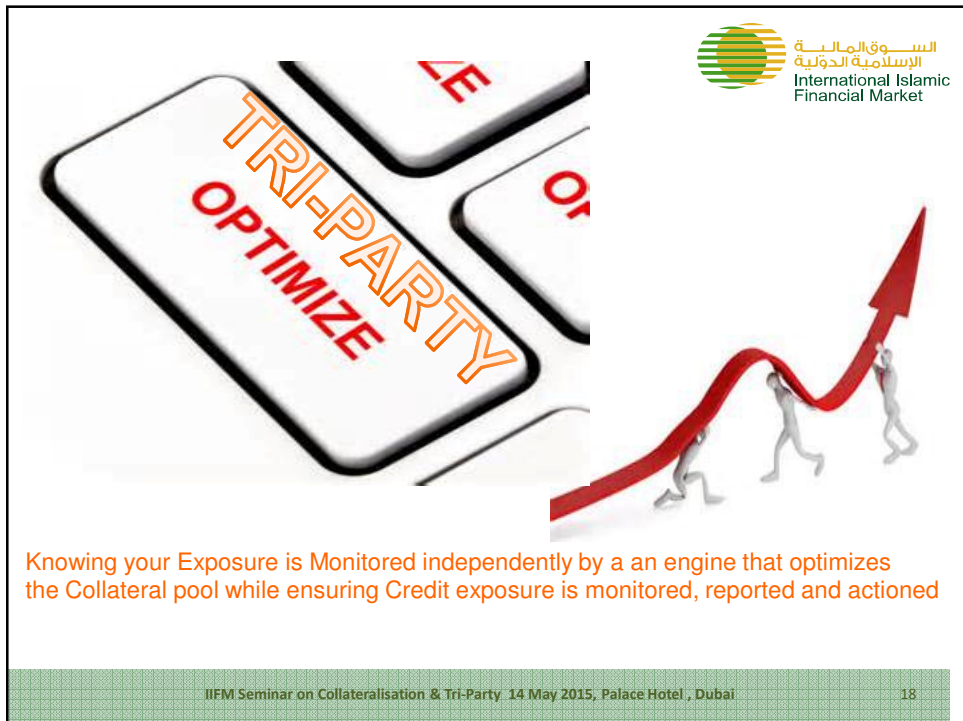
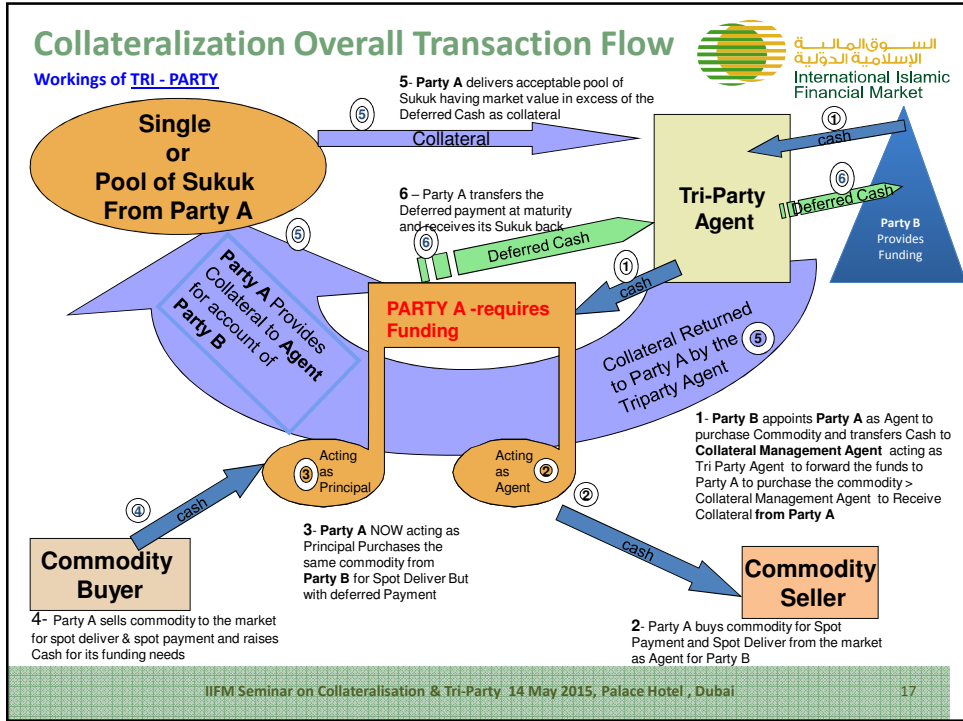
TRI – PARTY

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

Murabaha Collateralised by Sukuk





Thank you

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