



## Liquidity Management in Islamic Finance Products & Documentation

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***International Islamic Financial Market (IIFM)***

## Key References



- "Understanding Liquidity Issues in Islamic Finance," Paper presented in Islamic Finance Asia 2007, Singapore by IIFM
- "Liquidity Management of Islamic Financial Institutions in the UAE," Paper presented to Central Bank of U.A.E., Abu Dhabi on 10<sup>th</sup> December 2005 by Mr. Iqbal Khan
- "IIFM Master Agreement for Treasury Placement (MATP) – Project & Structural Overview," Paper presented at MATP Briefing Session at DIFC on 4<sup>th</sup> November 2008 by Mr. Qudeer Latif

## Contents



### 1) Understanding Liquidity Issues in Islamic Finance

- a. General Overview
- b. Regional Overview
- c. Typical GCC Islamic Financial Institution Balance Sheet - Snap Shot

### 2) Liquidity Management - Products and Instruments

- Commodity Murabaha
- Wakala and Unrestricted Wakala
- Short-term Sukuk
- Other Short-term instruments
- Securitisation of Assets
- Constituents of Islamic Money Market

### 3) Liquidity Management - Standard Documentation

- IIFM Master Agreement for Treasury Placement

### 4) Introduction to IIFM

02

## Understanding Liquidity Issues in Islamic Finance



### a. General Overview

#### Surplus of Liquidity

- Liquid: Islamic Financial Institutions (IFI's) are generally more liquid than their conventional counterparts
- Low Returns: Limited short-term investments, hence IFI's earn low returns on liquid assets

#### Shortage of Liquidity

- Inter-Bank Market: IFI's have limited ability to tap short-term funds to meet cashflow requirements
- Lender of Last Resort: Most banking failures are due to liquidity shortages. There is a need for a "lender of last resort"

#### Maturity Mismatch

- Long-Term Assets: IFI's main investments are long-term e.g. sukuk, project finance, real estate
- Short-Term Liabilities: IFI's main funding is from short-term customer deposits
- Gap: IFI's have a mismatch risk

03

## Understanding Liquidity Issues in Islamic Finance



### b. Regional Overview

#### Malaysian Islamic Inter-Bank Money Market

- Introduced in 1994
- Short-term intermediary to provide short-term investments
- Investments: Government Investment Issues (GII), Bank Negara Malaysia Negotiable Notes (BNNN), Treasury bills, Islamic commercial papers and Islamic Negotiable Instruments
- BNNN and GII turnover of RM 32.5 billion (USD 8.6 billion) & RM 2.9 billion (USD 0.8 billion) respectively in 2006
- Money Market reached RM 81.5 billion (USD 21.5 billion) end of May 2006

04

## Understanding Liquidity Issues in Islamic Finance



### b. Regional Overview

#### Bahrain

- Rolling monthly programs of short-term Sukuk Al Salam and Ijarah in place since 2001 and 2005 respectively
- Short-term Sukuk complimented by regular issuance of medium-term Sukuk Al Ijarah
- October 2006, Central Bank of Bahrain (CBB) offered 65 issues of Sukuk Al Salam. Value of each issued raised to USD 40 million from USD 25 million previously
- August 2005, separate rolling program of monthly issue of short-term Sukuk Al Ijarah
- By October 2006, CBB offered 14 issues of Sukuk Al Ijarah each value at USD 27 million
- CBB first short-term Sukuk over-subscribed by 200%. The trend continues

05

## Understanding Liquidity Issues in Islamic Finance



### b. Regional Overview

#### Pakistan

- Islamic banks managing reserve requirements by high cash reserves and low liquidity reserve
- Not a level playing field with conventional banks
  - Limited Shari'ah compliant securities
  - No lender of last resort
- Requirement of Islamic inter-bank market at USD 1.0-1.5 billion
- Islamic industry market share in overall assets 4% in 2008, to grow to 12% in 2012
- Issues of WAPDA Sukuk (USD 134 million), Al Zamin Mudaraba, Sovereign Sukuk, Sitara Chemicals and Wateen Telecoms
- 2008: Started Ijarah based Sukuk Program for Islamic Money Market
  - first issue USD 25 million

06

## Understanding Liquidity Issues in Islamic Finance



### b. Regional Overview

#### Brunei

- Issuance of short-term Sukuk landmark for Brunei
- Short-term Sukuk issued September 2006- Al Ijarah
- First issue of USD 150 million over-subscribed in one day
- Provided opportunity for Brunei investment to institutions such as TAIB, TAP and Takaful to invest

07

## Understanding Liquidity Issues in Islamic Finance



### c. Typical GCC IFI Balance Sheet Snap Shot

Assets-2005	%Percentage	Tenure
Cash/Current account	0.17	Short-term liquid funds
Murabaha receivable	11.5	Short-term
Mudaraba	49.0	Short-term
Investment Ijarah	7.0	Long-term
Investment in associate	28.0	Long-term
<b>Liabilities</b>		
Murabaha payable	3.0	Short-term
Shareholders equity	47.3	
Share Capital	48.0	

08

## Understanding Liquidity Issues in Islamic Finance



### c. Typical GCC IFI Balance Sheet Snap Shot

Assets-2005	%Percentage	Tenure
Cash/Current account	23.0	Short-term
Murabaha receivable	15.0	Short-term
Mudaraba	29.0	Long-term
Investment Istisna	1.0	
Investment account	3.0	
Leasing assets	3.0	Long-term
<b>Liabilities</b>		
Current account	9.3	Short-term
Due to FIs	19.73	Short-term
Unrestricted investment account	42.0	Short-term

09

## Liquidity Management Products and Instruments



### Wakala and unrestricted Wakala

Wakala has been gaining momentum since 2005

#### Advantages:

- No commodity
- No brokerage
- Access more banks
- Competitive

#### Disadvantages:

- Accounting treatment not favourable to Islamic windows
- Main users are regional GCC banks

10

## Liquidity Management Products and Instruments



### Short-term Sukuks

- Liquidity issue: Generally, Sukuk are medium to long-term tenor with inactive secondary market, hence not considered as liquid instruments
- Short-term Sukuk: This essentially passes the risk and return of the Sukuk to the counterparties for short periods
- Central banks promote liquidity: CBB, Brunei, Pakistan etc

### Other Short-term Instruments

- Arab Banking Corporation's liquidity management tool (mid 1990's)
- Exchange of Qard Hassan
- CBB's recent liquidity management tool

11

## Liquidity Management Products and Instruments



### Securitisation of Assets (I) – General

- Desire for higher returns
- Opportunity in physical assets
- Securitisation

### Securitisation of Assets (II) – Asset Backed Commercial Paper

- Short-term assets
- Potential
- Issues

12

## Liquidity Management Products and Instruments



### Constituents of Islamic Money Market

- New solutions
  - Wakala
  - Unrestricted Wakala
  - Short-term Sukuk
  - Securitisation of Assets
- Developing well suited inter-bank instrument for active inter-bank trading or for monetary operations
- Making available hedging instruments
- Establishment of a lender of last resort
- A mega bank or central counter-party

### Ideal scenario

- IFI's need access to a liquid market of investments with different returns and different maturities

13

## Liquidity Management Standard Documentation



### IIFM Master Agreement for Treasury Placement (MATP)

- Universal
- Structures based on wider Shari'ah acceptability

### Standard Agreement for Shari'ah Compliant Inter-Bank Placement

- Jurisdictional (Saudi Arabia)
- One structure

14

## Liquidity Management Standard Documentation



### IIFM Master Agreement for Treasury Placement (MATP)

#### Background:

- Shari'ah compliant liquidity management - based on widely acceptable Shari'ah ruling
- Reducing burden on Shari'ah scholars – frees up time to concentrate on other products (innovate)
- Reducing transaction cost thereby price
- Improving documentation standards and mitigating risks of legal challenge
- Improving confidence

15



## Liquidity Management Standard Documentation



### IIFM Master Agreement for Treasury Placement (MATP)

#### IIFM Approach:

- Universal working group structure i.e. bring IFI's, regulators and other market participants on a common platform
- Working group members more than 40 institutions from 9 jurisdictions
- IIFM Shari'ah Panel – 8 renowned scholars

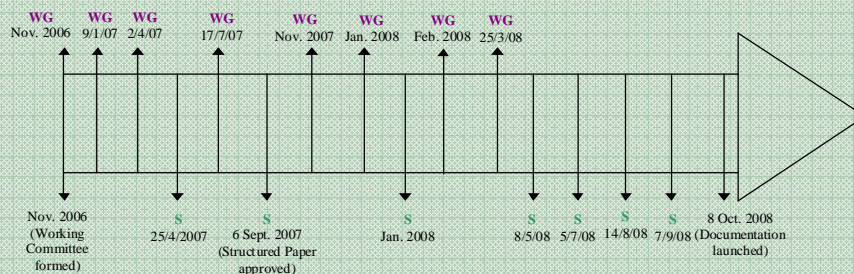
16

## Liquidity Management Standard Documentation



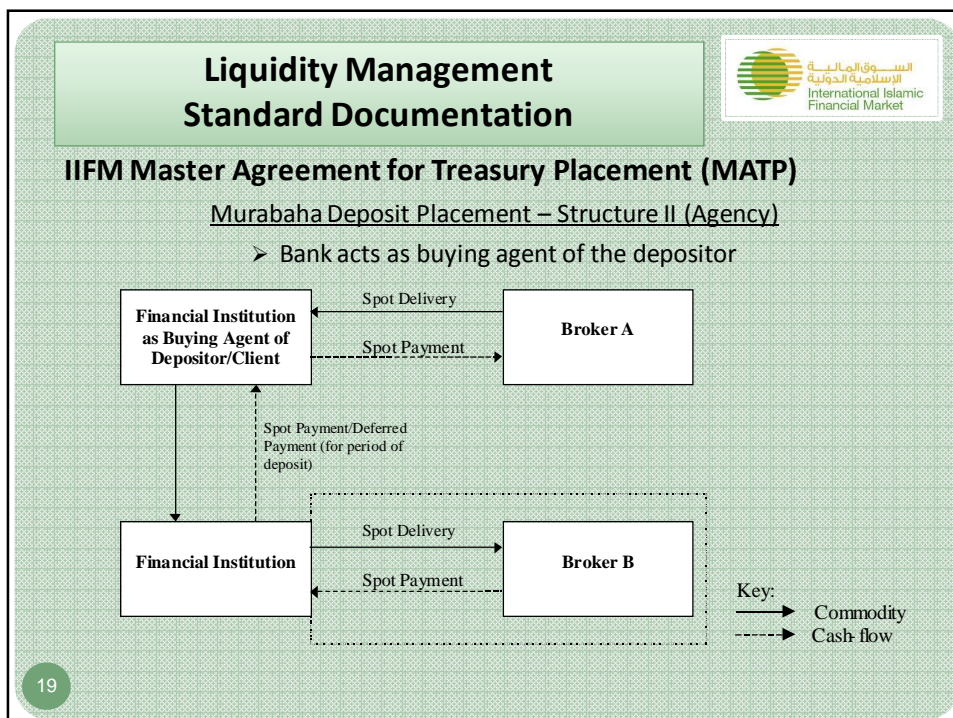
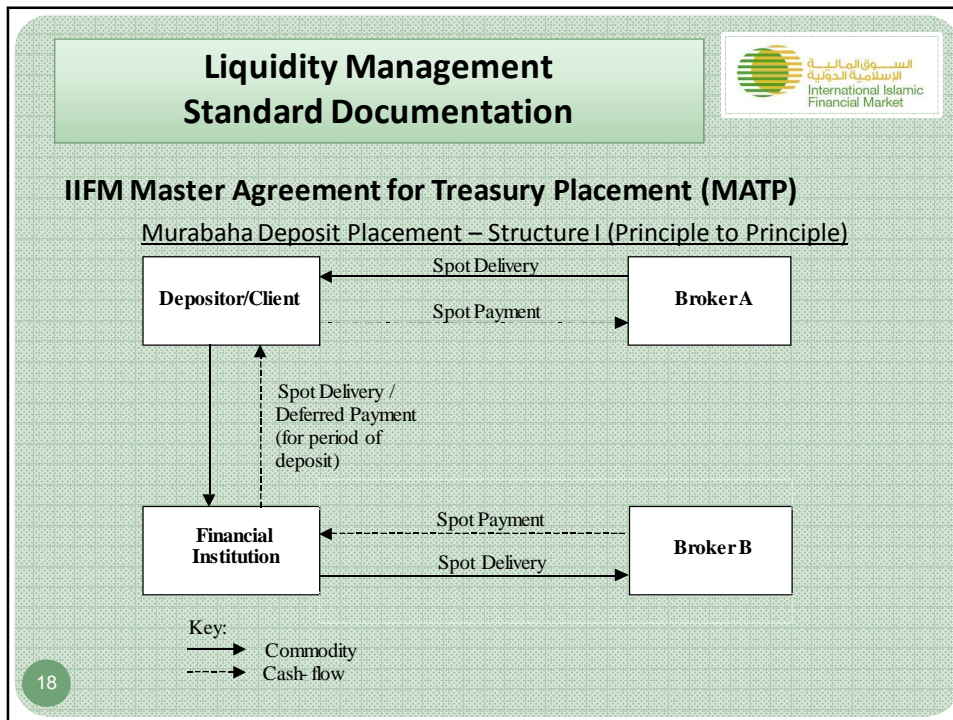
### IIFM Master Agreement for Treasury Placement (MATP)

#### Timeline



WG = Working Group  
S = Shari'a Meeting

17



## Liquidity Management Standard Documentation



### IIFM Master Agreement for Treasury Placement (MATP)

#### Documentation:

- Master Murabaha Agreement
- Master Agency Agreement for Purchase of Commodities

#### Procedure:

- Use of MATP with Shari'ah Pronouncement
- Use of MATP as reference or guidance document

#### Industry Response:

- Initial users

20

## Introduction to IIFM




IIFM is a non-profit international development institution supported by the central banks and regulatory bodies of Bahrain, Dubai, Saudi Arabia, Sudan, Pakistan, Malaysia, Indonesia and Brunei as well as number of financial institutions

The objective of IIFM is to take part in the establishment, development and promotion of the Islamic Capital and Money Market (ICMM)

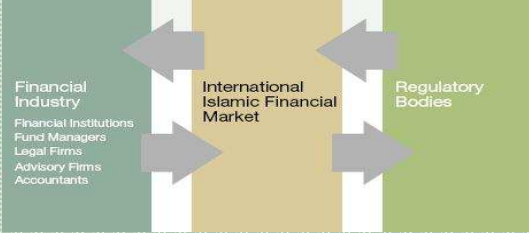
IIFM's primary focus lies in the advancement and unification of Islamic financial documents, structures, contracts, instruments, infrastructure and recommendations for the enhancement of ICMM

21

## Introduction to IIFM




**Benefits to the Industry**



- Market Body with regulatory heritage
- Wider Shari'ah Acceptance
- Uniformity & Standardization
- Knowledge Sharing
- Infrastructure Development

22

## Introduction to IIFM



**Projects Approach**

***Global Working Groups Structure***

Industry driven – bringing IFI's and other participants together to achieve uniformity on

- Documentation
- Products
- Best practices
- Infrastructure and systems

23

## Introduction to IIFM



### Projects

#### ***Initiative completed***

- IIFM Master Agreement for Islamic Treasury Placement

#### ***Initiative in progress***

- IIFM/ISDA "Ta Hawwut" (Hedging) Master Agreement

24



## ***Thank You!***

[www.iifm.net](http://www.iifm.net)

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