
Islamic Finance

Asia 2007 Singapore

Understanding Liquidity Issues in Islamic Finance

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Outline

- Key Regions Overview
- Typical Islamic Financial Institution (IFI) Balance Sheet
- Addressing the financial architecture components
- Constituents of a good Islamic Inter Bank money market
- IIFM Efforts
- Moving Forward

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Key Region Overview - Malaysia

Malaysia 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, Islamic PDS 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 (Mudaraba Inter bank placement)

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Key Region Overview - Bahrain

- Rolling monthly programs of short-term Sukuks Al Salam and Ijarah in place since 2001 and 2005 respectively
- Short-term Sukuk complemented by regular issuance of medium to long-term Sukuk Al Ijarah
- October 2006, 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%
- Trend continues

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Key Region Overview - Pakistan

- Islamic banks managing reserve requirements by high cash reserves and low liquidity reserve
- Not a level playing field with conventional banks
 - Limited Shariah compliant securities
 - No lender of last resort
- Requirement of Islamic inter-bank market at USD 1.0-1.5 billion
- Islamic banking interest 2% in 2006 to grow 15% in 2010
- Issues of WAPDA Sukuk (USD 134 million), Al Zamin Mudaraba, Sovereign Sukuk, Sitra Chemicals and Wateen Telecoms
- USD 200 million Sukuks in the pipeline

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Key Region 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 investments institutions such as TAIB, TAP and Takaful to invest

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Typical GCC IFI Balance Sheet Snapshot- Bank A

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

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Typical GCC IFI Balance Sheet Snapshot- Bank B

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

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Comments on Balance Sheet Snapshot

- Money is not treated as a commodity in Islamic Finance
- 60% - 80% of the balance sheets of most Islamic Banks will be in Murabaha, Mudaraba type assets. Basically buy-sell agreements
- General tenor of such transactions is 6 months to a year maximum
- As a result, you cant securitize them- higher liquid assets ratio as a percentage of their overall assets
- Mismatch challenge to have enough liquidity in investment structures

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Liquid Assets Today

- More then two third of Islamic funds are from Middle East
- 1.3 billion Muslims (20% of world's populations)
- Islamic financial assets estimated at USD 100billion
- Liquid assets estimated at USD 50 billion
- Commodity Murabaha-
 - Islamic banks have mainly on commodity Murabaha for liquidity processes

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Addressing the financial architecture components

Addressing the financial component to facilitate growth through

- Working groups
- Infrastructure
- Availability of information and indicators to strengthen transparency
- Developing the money market is indispensable for monetary conduct and financial market deepening
- Call for adoption of comprehensive and integrated approach to developing money market

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Constituent of a good Islamic Inter-bank money market

- Developing well suited inter-bank instrument for active inter-bank trading or for monetary operations
- Utilizing securitization to manage the maturity and risk spectrum of assets and liabilities
- Making available hedging instruments
- Require the establishment of a lender of last resort facility
- Availability of large number of market players
 - Islamic institutions
 - Conventional institutions
 - Foreign institutions
- Short Term Sukuk issuance- important

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Constituent of a good Islamic Inter-bank money market

- Efficient transparent settlement system
- Streamlining various legal and institutional issues
- Promoting and developing an active secondary market by having:
 - Adequate and consistent documentations that transcends jurisdictions and allow easy start-up of issues
 - Issuance of constant and large number of instruments-pool of investments
 - Voluminous issues that proliferate the market
 - Starting place for a successful secondary market begins with the structure of issues and the primary market itself

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IIFM Efforts

- ISDA-IIFM Islamic Derivatives Master Agreement
- Master Agreement for Islamic Treasury Murabaha Contracts
- Islamic Capital Market (IIFM) Feasibility studies
- Islamic Unit Trust deed Template
- Liquidity Management Working Group
- Knowledge sharing through focus and specialized events
- Joint projects with International Capital Market Association (ICMA)

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Moving Forward

- More issuance of Shariah compliant issues
 - Short-term sukuks etc
 - Government papers
 - Corporate papers
- Large number of players both Islamic and Conventional institutions
- Government support – mof, Regulatory Authorities
- Support of financial institutions on IIFM efforts and initiatives
 - Members of IIFM
 - Involvement in Working Group
 - Knowledge sharing through IIFM focus events

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Thank You



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