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Global Islamic Liquidity Management Report 2023

Building a Robust and Resilient Ecosystem

INTERNATIONAL ISLAMIC LIQUIDITY MANAGEMENT CORPORATION

LSEG DATA & ANALYTICS

Contents

Message from the International Islamic Liquidity Management Corporation

DR. UMAR OSENI

CHIEF EXECUTIVE OFFICER,
THE INTERNATIONAL ISLAMIC
LIQUIDITY MANAGEMENT CORPORATION

The International Islamic Liquidity Management Corporation (IILM) is proud to collaborate with the London Stock Exchange Group (LSEG) to produce the **Global Islamic Liquidity Management Report 2023: Building a Robust and Resilient Ecosystem**. The report represents the IILM's sustained commitment towards serving the Islamic finance industry in addressing its liquidity needs.

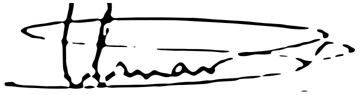
Liquidity management has been an ongoing concern for many Islamic financial institutions and there have been initiatives by central banks to provide institutions such as Islamic banks and asset managers with avenues to deploy their excess cash. To gain comprehensive perspectives from various key stakeholders, we have conducted exclusive interviews with central banks, Islamic finance standard-setters as well as Islamic and conventional banks. These interviews provide much-needed focus on key issues in Islamic liquidity management from the perspectives of these industry stakeholders. The key issues identified include limited Shariah-compliant instruments, inconsistent regulatory frameworks, infrastructure challenges and variations in Shariah opinions. Addressing these concerns, they have also offered solutions and suggestions for improvements.

The report also explores key liquidity management instruments serving the global Islamic finance industry across key and nascent markets, whether issued by their respective central banks or through alternative means. Special attention is given to Islamic repurchase agreements (repos) through case specific studies in key Islamic finance markets accompanied by essential Shariah and regulatory considerations in structuring such instruments.

These insights are complemented with a study on the liquidity landscape in key Islamic finance markets, including an examination of the impact of recent events such as tightening monetary policies, on the liquidity positions of Islamic financial institutions. Additionally, the report addresses main risk management considerations for Islamic banks aligning with Basel III standards.

The IILM was established to address the liquidity management challenges faced by Islamic financial markets and as a response to the heightened need to monitor liquidity risk. This report gains significance as we celebrate our 10-year anniversary since our inaugural short-term Sukuk issue in 2013, showcasing a decade-long track record in this domain. In 2023, cumulative international Sukuk issuances of US$11.52 billion and cumulative issuance of US$100.94 billion since inception, the IILM stands among the top global international Sukuk issuers. The final chapter of the report delves into how the IILM and its Sukuk programme seamlessly integrate into the broader liquidity management landscape of the Islamic finance industry.

We are confident that the insights presented in this report will contribute towards fortifying the Islamic finance industry.



Dr. Umar Oseni

CEO, The International Islamic
Liquidity Management Corporation

H.E. PERRY WARJIYO

CHAIRMAN OF THE IILM GOVERNING BOARD IN 2024

GOVERNOR, BANK INDONESIA

“Since its inception in 2010, the IILM has been dedicated to fortifying the underlying ecosystem of the Islamic finance industry. This commitment is embodied in the development of its cross-border Sukuk programme tailored to address the liquidity requirements of Islamic financial institutions.”

As 2023 draws to a close, the global financial industry grapples with heightened stress due to a range of diverse factors. The banking crisis during the first quarter of 2023 affecting the United States and Europe reverberated across global markets. The resonance was felt profoundly when real estate funds suffered withdrawals amid rising interest rates, adversely impacting property valuations and underscoring the critical importance of robust liquidity management.

Islamic financial institutions were not spared from such events, as seen in the case of the “bank run” that affected Islamic banks in Bangladesh in 2022. These events underscore a pressing need for the development of effective liquidity management solutions. They also serve as stark reminders that weak liquidity buffers can heighten vulnerabilities to deposit runs, emphasising the imperative of prudential oversight.

Since its inception in 2010, the IILM has been dedicated to fortifying the underlying ecosystem of the Islamic finance industry. This commitment is embodied in the development of its cross-border Sukuk programme tailored to address the liquidity requirements of Islamic financial institutions. As expounded in this report, Islamic finance participants seek high-quality Shariah-compliant liquid assets, which are in demand as reflected in the oversubscription rates of various IILM Sukuk issues.

The report, featuring insights from leading industry stakeholders, sheds light on their evaluation of current instruments’ effectiveness in meeting industry requirements as well as their perspectives on necessary steps to address existing challenges.

In navigating the post-COVID-19 era and responding to the U.S. Federal Reserve’s tightening monetary policy, the IILM remains resolute in its commitment to serve the Islamic finance industry, leveraging its decade-long track record.

In the face of uncertainties, the IILM continues to explore innovative tools to address the industry’s evolving liquidity management needs. The most recent initiative, the one-year international Sukuk, is a testament to this commitment, strategically aligned with the rising market demand.

With the release of this report, we aim to catalyse further innovation and initiatives in Islamic liquidity management, fostering resilience and sustainability in the ever-changing financial landscape.

H.E. Perry Warjiyo

Chairman Of The IILM Governing Board In 2024
Governor, Bank Indonesia

Message from the London Stock Exchange Group

The global Islamic finance industry may be on an impressive growth path—assets increased by 11% to US$4.5 trillion in 2022 and we expect this figure to surpass US$6.7 trillion by 2027—but liquidity management remains a perennial issue.

A set of factors collectively hinder the growth of Islamic liquidity management solutions that are both authentic to Islamic principles and commercially viable. We have found that some of these barriers include unsupportive national regulations, Shariah compliance issues, a lack of standardisation, the small number of market players such as Islamic banks, and limited Sukuk supply in some regions.

While there are instruments available for Islamic liquidity management, such as Wakala and Commodity Murabaha in some markets, their utility is limited due to the lack of depth in these jurisdictions' Islamic interbank markets, Commodity Murabaha's tradability, and the unresolved issues surrounding their level of Shariah authenticity.

To address these challenges and provide an updated picture of Islamic liquidity management, we have worked with the IILM, a leading stakeholder in this area, to develop what we hope is a meaningful report for the industry.

The "Global Islamic Liquidity Management Report 2023: Building a Robust and Resilient Ecosystem" is the first-of-its kind study. It covers the current market landscape and market size, the role of central banks and key liquidity programmes, and the role of the IILM Sukuk programme to address the industry's liquidity management needs.

What also makes this report exclusive is that we also provide a snapshot of industry views via case studies and exclusive interviews with key participants of the industry, whether Islamic financial institutions, regulators or other stakeholders, on different topics including liquidity challenges, solutions, perspectives on the IILM Sukuk programmes and AAOIFI standards.

Mustafa Adil

Head of Islamic Finance

The London Stock Exchange Group

MUSTAFA ADIL

HEAD OF ISLAMIC FINANCE

THE LONDON STOCK EXCHANGE GROUP

IILM.COM

INTERNATIONAL ISLAMIC LIQUIDITY MANAGEMENT CORPORATION

CELEBRATING 10 YEARS WITH THE IILM SUKUK PROGRAMME

The Largest Issuer of Short-Term USD Sukuk

In facilitating effective Islamic liquidity management, the IILM has issued approximately USD 100 billion worth of short-term Ṣukūk to date, since the inaugural issuance of USD 490 million 3-month Ṣukūk in August 2013.

Executive Summary

Heightened importance of liquidity management for the Islamic finance industry

The global Islamic finance industry is projected to grow to US$6.7 trillion in assets by 2027. This development is significant in the light of tightening monetary policies in most jurisdictions since 2022 and an expected global economic slowdown. After a string of springtime banking failures that made headlines this year, liquidity management is becoming more important for financial institutions.

For the Islamic finance industry, the dearth of Islamic liquidity management instruments has been a constant challenge despite the industry's growth and maturity in some regions of the world. The liquidity level for the biggest Islamic banks in top Islamic finance markets averaged 12% in 2022, as indicated by their share of liquid assets to total assets. This average is the same as conventional banks in the same markets.

Both conventional and Islamic banks behave similarly in their split between the components of liquid assets: most of their liquidity are held in cash that are low-return, high-quality liquid assets (HQLA) used to meet Basel III requirements. For Islamic banks especially, these are the preferred methods to manage liquidity because placements in other institutions do not meet the HQLA criteria as interbank deposits are subject to counterparty risk.

Different liquidity situations prevail across markets. While it has been more or less "business as post-pandemic usual" in most places, in Saudi Arabia, banks are adjusting their positions as the government continues to channel oil receipts away from them and into the sovereign wealth fund for strategic investments and in Bangladesh, some Islamic banks were hit in 2022 by a "bank run" that was triggered by negative reports about their practices.

Recent global macro developments are also putting pressure on liquidity. Demand-supply mismatches during the post-Covid recovery was met with geopolitical conflicts that put upward pressures on inflation, resulting in central banks tightening their monetary policies. In turn, banks are facing increasing costs of funding that are impacting their liquidity positions. This has also heightened the importance of strong liquidity management for other financial institutions such as asset managers as indicated by the fund withdrawals for property funds based in Europe following the depression of property valuations after the rise in interest rates.

Range of tools available for Islamic liquidity management, yet challenges remain

The Islamic finance industry has seen positive signs and progress with the introduction of new tools to manage liquidity in many markets and it is clear that the development of liquidity instruments by authorities such as central banks serve as an integral component in the overall advancement of the Islamic financial industry.

From our study of the global Islamic finance industry for this report, central banks continue to issue tradable instruments that work for monetary policy practice while facilitating liquidity management for Islamic banks. These instruments range from Sukuk and Islamic deposit accounts to standing liquidity facilities. The development of such instruments can be found in the biggest Islamic finance markets as well as in some nascent ones. We discuss this in the chapter addressing 'Key Liquidity Instruments'. However, what we have also found is that despite these developments, short-term Sukuk by governments are limited in supply and central bank facilities carry low yields.

> "The global Islamic finance industry is projected to grow to US$6.7 trillion in assets by 2027. This development is significant in the light of tightening monetary policies in most jurisdictions since 2022 and an expected global economic slowdown."

In the money markets, Islamic interbank instruments and Islamic repurchase agreements (repos) are also available but they are not without their challenges. There is currently no one Shariah-compliant structure or contract that the industry agrees on for cross-border transactions largely because of a lack of Shariah consensus. Islamic financial institutions in most markets have been slow to take advantage of Islamic repos despite efforts to revamp the instrument through documentation by industry bodies and the introduction of new instruments in some markets. However, there are promising developments, as we highlight in the chapter on 'Islamic Repo Instruments', that may be able to support the growth of the industry as it internationalises. But even as we speak of some markets driving the growth of Islamic finance beyond their domestic businesses, there are still shallow Islamic interbank markets in countries with low numbers of Islamic banks.

Across all of these markets, Islamic lender of last resort facilities are also important to meet the liquidity management needs of Islamic banks in times of stress. Yet, there is an absence of lender of last resort facilities in many jurisdictions. This has resulted in some banks holding high levels of liquid assets. From our analysis of the top Islamic finance markets, we see that while the Islamic banks comfortably meet Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR), some markets have shown excessively high LCR, which points to lower returns from a higher level of undeployed funds. This is why there have been instances of regulators such as the State Bank of Pakistan concentrating on a liquidity management framework in its 2021 to 2025 Strategic Plan for the Islamic Banking Industry.

It is clear that despite progress and developments, the industry is still in need of deep and active markets for interbank placements and liquidity instruments.

The IILM addresses the liquidity needs of Islamic finance markets

Considering the different liquidity challenges facing Islamic financial institutions domestically and across borders, the IILM was established in 2010 by central banks and a multilateral organisation to address the creation and issuance of high-quality Islamic liquidity instruments.

The organisation has a proven 10-year track record since its first Sukuk issue in 2013, with 234 Sukuk issues reaching a value of US$100.94 billion up to December 2023. The IILM Sukuk have played an important role in shaping the global Sukuk industry and according to LSEG, the IILM is ranked among the top Sukuk issuers globally, especially in terms of international issues. The IILM Sukuk also has a significant impact in the supply of HQLA Islamic liquidity tools as it is considered one of the limited amount of Sukuk that can be considered globally. There are several reasons for the popularity of IILM Sukuk. The IILM's Wakala Sukuk structure is well-designed to meet market needs with the highest tangibility ratio of 79%. This makes it tradable and compliant with AAOIFI standards and widely accepted globally. The IILM Sukuk programmes' asset portfolio is backed by Shariah compliant assets originated from sovereigns, government-related entities and supranational entities that are highly rated.. As a result, the IILM Sukuk are always very well-subscribed by a diverse pool of global investors, not only Islamic, but also conventional investors.

Given the growing importance of IILM Sukuk issues to the industry, the organisation has responded by introducing new tenors, with the 1-month in 2019 and the latest being the 1-year Sukuk that debuted in June 2022. It was released when issuances were slowing as market participants waited for central banks to respond to high inflation rates that prevailed at the time. The introduction of longer tenor Sukuk has been also addressing the needs of central banks for HQLA Islamic securities to back their offering of Islamic liquidity instruments in their local currencies (securitisation through Wakala short-term issuances or deposits). The 1-year Sukuk will help build a benchmark yield curve up to 12 months to address the different liquidity needs of Islamic banks and other institutions globally.

Executive Summary (cont.)

Islamic Liquidity Management Tools

- Islamic Deposit Account with Central Banks
- Standing Liquidity Facility with Central Banks
- Sukuk and Instruments Based on Securitisation
- Islamic Interbank Market
- Islamic Repurchase Agreements
- Lender of Last Resort

Challenges Facing Islamic Liquidity Management

- Limited Shariah-Compliant Instruments
- Shallow Secondary Market
- Inconsistent Regulatory Frameworks
- Lack of Interbank Market Infrastructure and Counterparties
- Shortage of Market Players
- Shortage of Sukuk Supply
- Shortage of HQLAs
- Shariah Compliance Complexities
- Zero or Lower Return Facilities
- Fragmentation of the Islamic Finance Industry
- Currency and FX Risk

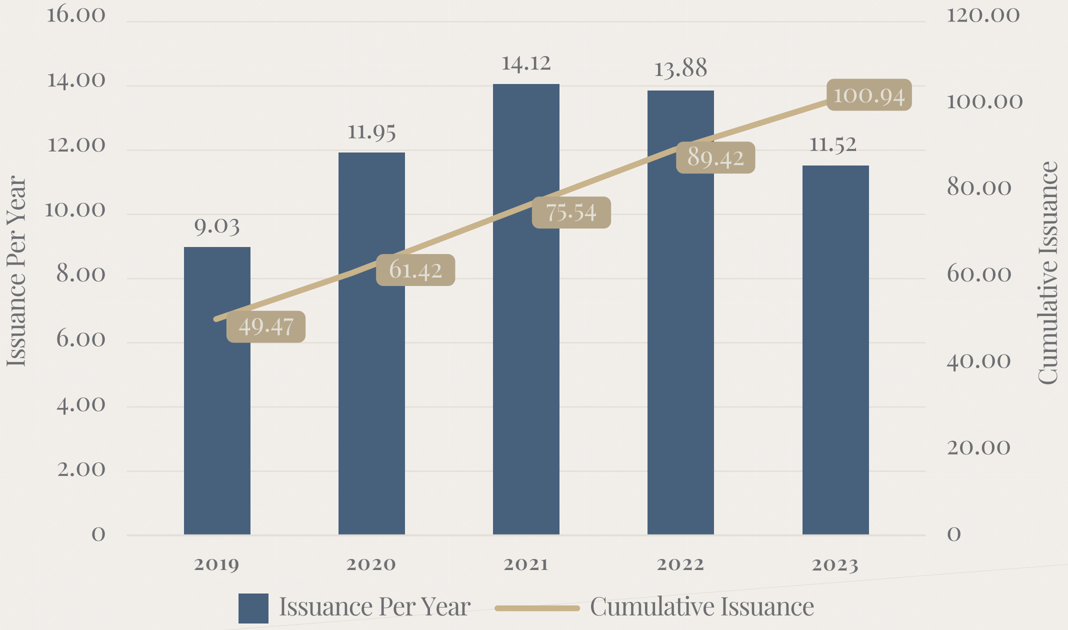
Solutions to Address Islamic Liquidity Management

- Standardisation and Harmonisation of Regulatory Treatment and Frameworks
- Diversification of Islamic Liquidity Management Tools
- Enhanced Market Infrastructure
- Capacity Building, Education and Communication
- Push by Regulators and Monetary Authorities to Supply HQLA Islamic Tools
- Shariah Standardisation and Harmonisation
- Use Other Structures for Lender of Last Resort
- International Collaboration and Industry Bodies

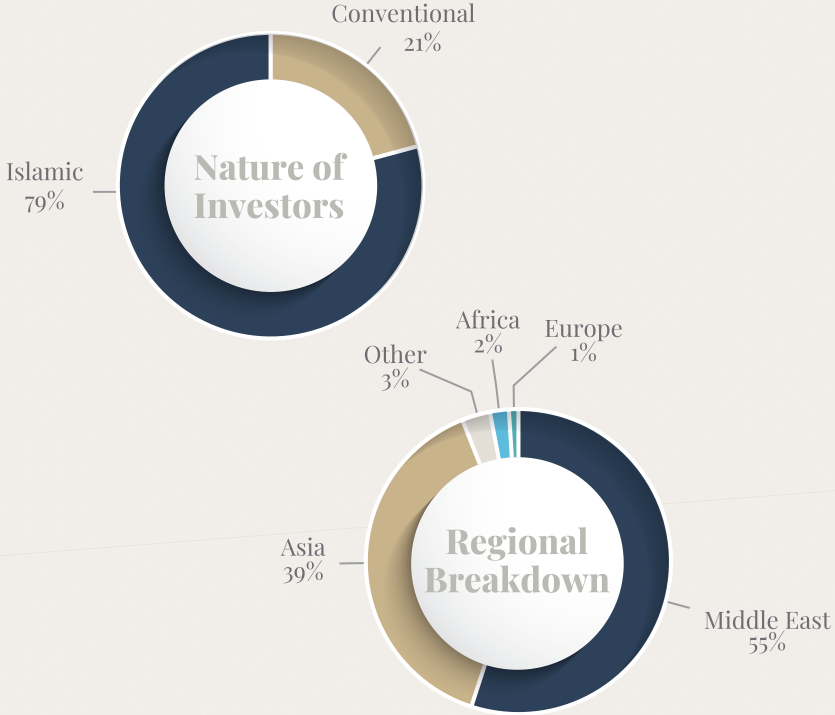
IILM Snapshot

Total Issuance Amount Since Inception (2013 – 2023)	Tool Used	Primary Objective
234 Sukuk issues of total value of US$100.94 billion	Sukuk Issuance based on Wakala Structure. Fully-compliant with AAOIFI Standards	Provide Shariah-compliant financial instruments for effective cross-border liquidity management

IILM Sukuk Issues
(USD Billion, 2019 – up to end 2023)



Nature of Investors
(As of November 2023)



Introduction to Islamic Finance

Islamic Finance Overview

Sustained growth momentum by the global Islamic finance industry

The modern Islamic finance industry emerged in the mid-1970s when new banks started providing Shariah-compliant products in response to the pan-Islamic zeitgeist.

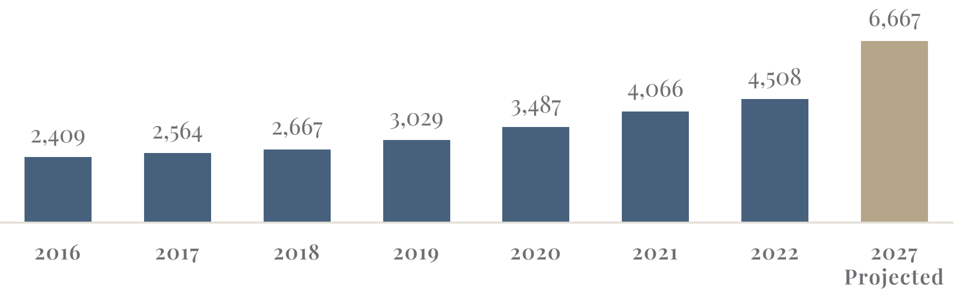
In the past decade, the industry recorded strong growth, expanding by 163% in assets from 2012 to 2022 according to the ICD-LSEG Islamic Finance Development Report 2023 (IFDI 2023). Global Islamic financial assets also rose by 11% to US$4.5 trillion in 2022 from 2021.

The biggest contributor to the growth of Islamic finance is the Islamic banking sector that in 2022 accounted for 72%, or US$3.2 trillion, of total global industry assets. Among the factors contributing to the growth of the Islamic banking sector is its operational efficiency and its partnerships with FinTechs in recent years, as well as the high demand for Islamic banking in many parts of the world. Sukuk also plays an important role in shaping the industry. The use of Sukuk gained momentum in the last few years as more sovereigns and corporates started showing interest and subsequently issuing more of the instrument.

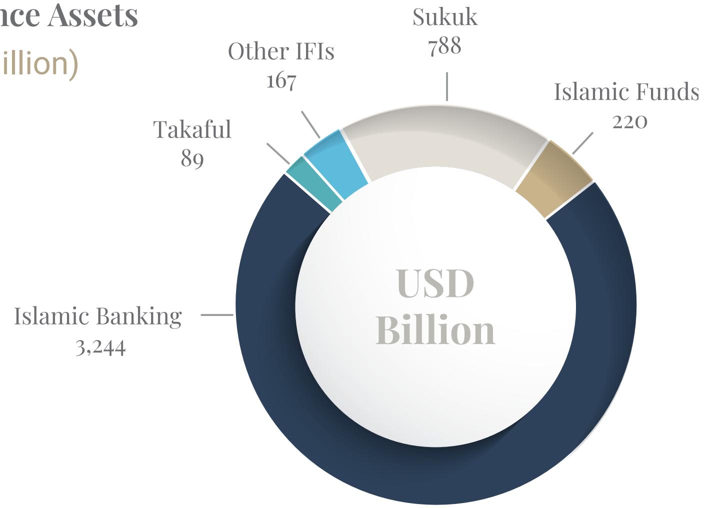
However, not all Islamic finance asset classes have consistently recorded growth. Islamic funds' assets under management dropped in 2022 largely due to the hit to funds investing in equity as a result of the global economic slowdown that followed the rise in interest rates. This also impacted the investment performance of some Islamic banks and Takaful operators.

Despite these bumps, the industry is expected to continue on its growth trajectory as many countries include Islamic finance in their finance roadmaps or economic strategies and strengthen their supporting ecosystem, as indicated by IFDI 2023. The industry is projected to grow to US$6.7 trillion by 2027.

Islamic Finance Assets Growth
(2016 – 2022, USD Billion)



Islamic Finance Assets
(2022, USD Billion)



Source: ICD – LSEG Islamic Finance Development Report 2023

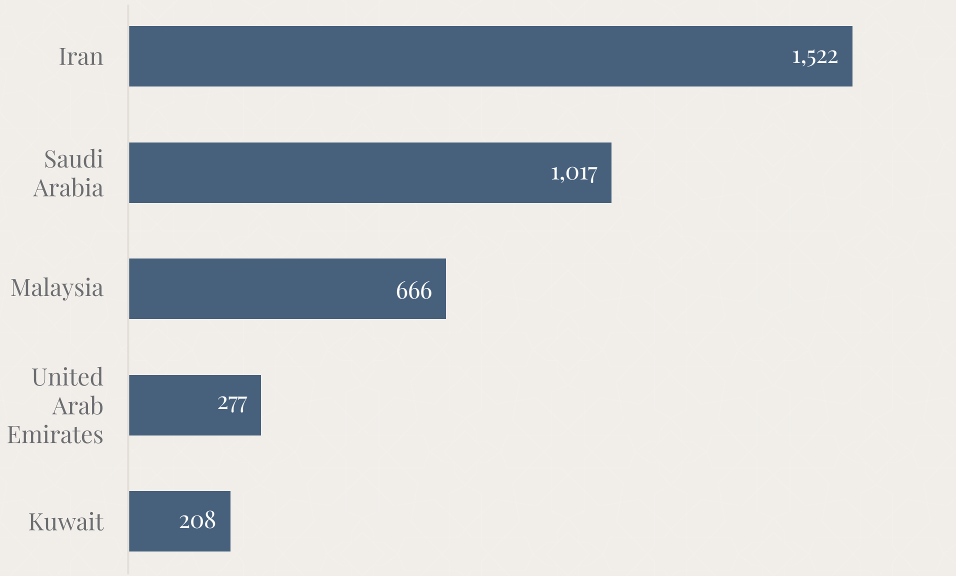
Islamic finance seen developing around the world

Over 1,850 Islamic financial institutions operate in 90 countries. According to IFDI 2023, the largest Islamic finance markets are based in the GCC, Southeast Asia and South Asia. Sukuk outstanding are held in 29 countries while Islamic funds are managed by asset managers based in 28 countries. The industry is heavily concentrated in the top markets: the top five countries account for 82% of total global assets and the top ten countries are home to 95% of total industry assets. The highest growth during 2022 is in the regions that only recently started adopting Islamic finance, such as Sub-Saharan Africa and Central Asia.

Among the ways to strengthen the Islamic finance ecosystem is the introduction of regulatory measures to govern some sectors and asset classes of the industry. This can be seen in the 56 countries that have at least one Islamic finance regulation covering its sector or asset classes such as Islamic banking or Sukuk. The global industry ecosystem is driven and supported by over 1,300 Shariah scholars who represent Islamic financial institutions in 54 countries. 20 countries have centralised Shariah boards.

Among the other important indicators of the development of the Islamic finance industry is the availability of Islamic liquidity management instruments, which has been a challenge throughout the industry's history. Relatively few instruments are able to meet the industry's needs and this will be explored throughout the rest of this report.

Top Countries in Islamic Finance Assets
(2022, USD Billion)



Source: ICD – LSEG Islamic Finance Development Report 2023

Islamic Finance Industry and its Supporting Ecosystem in 2022

Financial Performance

- **Total Islamic Finance Assets**
  USD 4.5 Trillion
- **YoY Growth of IF Assets**
  11%
- **Islamic Financial Institutions**
  Over 1,850

Governance

- **Countries Islamic Finance Regulation**
  56
- **Countries with Central Shariah Committee Presence**
  20
- **Number of Shariah Scholars**
  Over 1,300

Interview with Islamic Development Bank

H.E. DR. MUHAMMAD AL JASSER

CHAIRMAN, ISLAMIC DEVELOPMENT BANK (ISDB) GROUP

Dr. Muhammad Al Jasser assumed office as Chairman of the Islamic Development Bank Group on August 9, 2021. Before that, he served as the Minister of Economy and Planning and Governor and Board Chairman of the Saudi Arabian Monetary Agency (now the Saudi Central Bank (SAMA)). Prior to that, he was an Executive Director at the International Monetary Fund. He has extensive leadership experience in the public and private sectors, having held senior positions in several institutions.

Dr. Al Jasser holds a PhD in economics and a master's degree in economics from the University of California and a bachelor's degree in economics with honours from San Diego State University.

From your perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

Historically, liquidity management in Islamic finance has faced significant challenges because of the limited options of Shariah-compliant instruments. In response, industry players have developed various solutions to address these challenges. The Islamic Development Bank (IsDB) is leading the innovation and promotion of Islamic finance worldwide. Here are some major aspects of the current state of Islamic liquidity management solutions:

- Commodity Murabaha and Wakala are among the most popular Islamic liquidity management tools. They have emerged as effective money market instruments that many Islamic financial institutions use to manage short-term liquidity in compliance with Shariah principles.

The two products are the Islamic alternatives to conventional interbank money market deposits. They are straightforward and simple to execute. The IsDB has been spearheading these products for about four decades.

> “Historically, liquidity management in Islamic finance has faced significant challenges because of the limited options of Shariah-compliant instruments. In response, industry players have developed various solutions to address these challenges.”

Currently, our Bank has expanded the Commodity Murabaha Deposits business in Europe, Africa, the Americas, Australia and Asia. Over the years, the IsDB has signed agreements in major conventional financial hubs, including London, New York, Singapore and Paris.

- Islamic financial market participants and players have been dynamic to better address the challenges in liquidity management and regulatory requirements. The International Islamic Liquidity Management Corporation (IILM)’s innovative short-term Sukuk programme has been greatly supporting the liquidity management needs of the Islamic financial industry. The frequency and various securities issued by the IILM are helping banks and other financial institutions address key financial ratios, such as the Liquidity Coverage Ratio (LCR).
- Market participants have also devised the “Islamic Repo” (also referred to as Collateralised Murabaha) to act as a liquidity management instrument in the industry. This is a Shariah-compliant alternative to the Conventional Repo instrument. The Islamic Repo market has also been a vibrant liquidity management platform for Islamic financial institutions. In simple terms, Wakala transactions are money market placements transacted among Islamic financial institutions.
- Other liquidity management tools available in the Islamic financial sector include Islamic Commercial Papers and Islamic Certificates of Deposits. Many banks are intensively using these instruments as part of their liquidity management.

As a multilateral institution that engages with entities across markets, in your opinion, what are the main concerns of Islamic banks and related institutions about the current Islamic liquidity management landscape?

From our interactions in the global financial market, we understand that the concerns of Islamic banks and related institutions regarding liquidity management essentially revolve around the following issues:

- Limited Shariah-Compliant Instruments: We acknowledged earlier that we need to do more to create more instruments and push innovative ones in the market. Islamic banks need more Shariah-compliant instruments to manage their liquidity effectively. However, the availability of suitable tools is often very limited, yielding suboptimal results. Therefore, we see this lack of diversity as a major concern for Islamic banks.
- Shallow Secondary Market: Islamic liquidity management is also hindered by the relatively shallow secondary market. A deep, vibrant secondary market is crucial for the efficient management of liquidity; hence, the current situation, where the secondary market lacks depth, poses a challenge for Islamic banks.

- Inconsistent Regulatory Frameworks: One of the most intractable challenges faced by Islamic banks seeking to operate across multiple borders is the lack of uniformity in regulatory regimes. It is not unusual to find two or more countries with different – and sometimes even inconsistent – regulatory frameworks. This lack of standardisation in regulations and practices across jurisdictions creates uncertainty and complexity for Islamic banks operating in multiple markets.
- Lack of Interbank Market Infrastructure: Islamic banks often rely on interbank markets for liquidity management purposes. However, in comparison with the conventional banking system, the infrastructure for interbank transactions and liquidity management in the Islamic finance industry is not well-developed. This can limit the effectiveness of liquidity management strategies and increase costs for Islamic banks.
- Currency and Foreign Exchange Risk: Islamic banks operating in multiple jurisdictions face currency and foreign exchange (FX) risk when managing their liquidity. Fluctuations in exchange rates can impact the stability and profitability of their liquidity management activities. Managing these risks while adhering to Shariah principles can be a concern for Islamic banks.

How are some of the challenges related to Islamic liquidity management holding the industry back, and what needs to be done to address these concerns?

To address the aforementioned challenges and concerns and promote effective and efficient Islamic liquidity management, several steps can be taken:

- **Standardisation and Regulatory Frameworks:** Regulators and industry bodies should work towards developing standardised liquidity management frameworks and guidelines. This would help create a common understanding of best practices and facilitate consistency across jurisdictions. Collaboration among regulators and standard-setting bodies is essential for promoting uniformity in Shariah-compliant liquidity management practices.
- **Diversification of Islamic Liquidity Management Tools:** Efforts should be made to expand the range of Shariah-compliant instruments available for liquidity management. This can be achieved through product innovation and the introduction of short-term instruments, interbank facilities, and money market instruments tailored to the needs of Islamic financial institutions.
- **Enhanced Market Infrastructure:** Developing a well-functioning secondary market for Islamic financial instruments is crucial. Measures such as creating liquidity facilities, encouraging market makers, and promoting electronic trading platforms can help enhance liquidity and tradability. Building robust infrastructure will attract more participants and facilitate efficient liquidity management.
- **Capacity Building and Education:** Strengthening the knowledge and expertise of market participants, regulators, and Shariah scholars is essential. Training programmes, workshops and educational initiatives should be conducted to deepen understanding of Islamic liquidity management principles and practices. This will help ensure effective implementation and compliance across the industry.
- **International Collaboration:** Encouraging collaboration and knowledge-sharing among Islamic finance jurisdictions can accelerate the development of liquidity management capabilities. International forums and platforms should be utilised to exchange experiences, discuss challenges and identify common solutions.

Liquidity Management Landscape

Liquidity Landscape and Recent Events

Cash and balances constitute the biggest share of liquid assets for conventional and Islamic banks to meet HQLA requirements

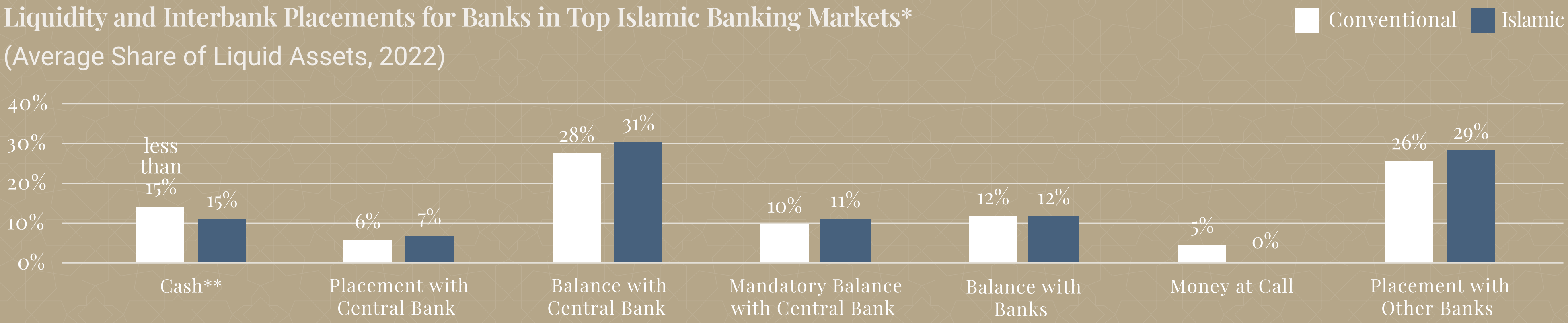
When it comes to liquidity, the biggest worry for Shariah-compliant banks in the main Islamic finance markets is investing their excess liquid funds with sufficient yields. In this regard, Islamic banks share the same concern as conventional banks. Yet, conventional banks separate asset-liability management, treasury and investment desks while Islamic banks mostly focus on yield than liquidity. Analysing the share of liquid assets to total assets for a sample of top banks in the biggest Islamic finance markets*, both Islamic and conventional banks have a share of 12% as a global average.

The Islamic and conventional banks also behave similarly in the split between the components of liquid assets such as cash and balances along with placements. They stand at an average of 65% cash and 35% placements globally. Most of their liquidity is held in cash, central bank and other bank balances that are low-return, high-quality liquid assets (HQLA) used to meet Basel III liquidity requirements. These are the preferred methods to manage liquidity because placements in other institutions do not meet the HQLA criteria as interbank deposits are subject to counterparty risk. Interbank deposits are not considered as Level 1 HQLA and so they face a counterparty risk.

A point of difference in some markets is that conventional banks hold fewer liquid assets (defined by the items in the chart below) to total assets as they include Treasury bills while the options for such instruments are limited for Islamic banks as Treasury bills are not Shariah-compliant and hence cannot be used by Islamic banks. In addition, regulatory liquidity requirements for Islamic banks are lower than for conventional banks in some countries such as Bangladesh. This is partly due to the limited availability of Islamic liquidity instruments. The IILM has been increasing its supply to address these specific needs. However, the lack of harmonisation on Level 1 HQLA assets with 0% risk-weight prevents Islamic banks in certain jurisdictions to hold more of the IILM Sukuk. A cap of maximum amount of the instruments the banks can hold is determined depending on the local regulator as a regulatory treatment of Level 2A/2B assets.

Liquidity and Interbank Placements for Banks in Top Islamic Banking Markets*

(Average Share of Liquid Assets, 2022)



Source: LSEG Analysis. *The sample uses top five conventional and Islamic banks in each country. The top Islamic finance markets represent 95% of total global Islamic finance assets: Bahrain, Bangladesh, Indonesia, Kuwait, Malaysia, Oman, Pakistan, Qatar, Saudi Arabia, Türkiye and the UAE. Coverage of liquid assets is limited to cash and placement with other financial institutions. **Cash is not always reported as a separate item as some banks reported cash and balances with central bank together, others reported cash with balances with banks.

Different market situations, different liquidity levels

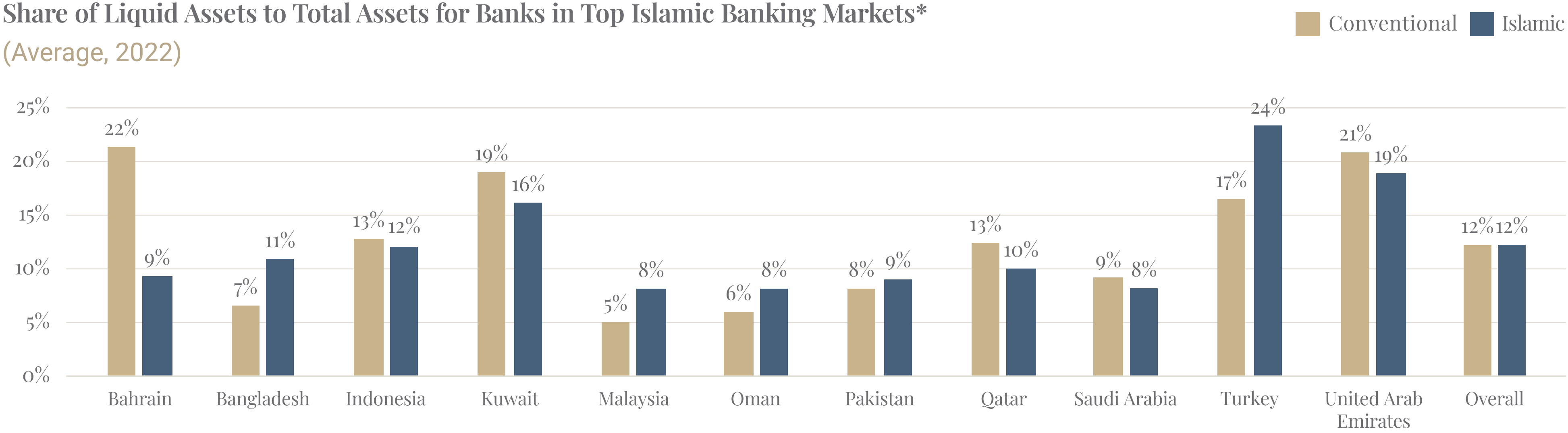
The unique situations of each country determine how much liquidity their banks hold. Compared to Shariah-compliant banks in other markets, Islamic banks in Türkiye, referred to as participation banks in the country, hold the biggest proportion of liquid assets to total assets, most of which are cash and balances. The Turkish banking sector is reliant on external funding. What this means for the sector is that the rise of interest rates could potentially underpin a liquidity crunch. At a time of high domestic inflation, negative market sentiment could force an outflow of investor capital and impact Turkish banks. Hence, such banks hold more liquid assets as a buffer.

In Saudi Arabia, the largest Islamic banking market in the GCC, liquidity in the banking sector is becoming less abundant after the Saudi government started channelling more of its oil receipts to its sovereign wealth fund, the Public Investment Fund (PIF), than to the banking sector in order to spur strategic investments. Saudi banks also saw a rapid growth in lending that led to liquidity constraints in 2022. With oil prices remaining high, banks will rely on non-oil sector activities to create opportunities for corporate lending. However, with the rise of interest rates, other segments for lending, such as mortgages, may see slowed growth.

The proportion of liquid assets to total assets for conventional and Islamic banks in Saudi Arabia in 2022 was 9% and 8%, respectively. With the exception of Oman, this is lower than for banks in the rest of the GCC. Both Islamic and conventional banks in Saudi Arabia have cash and balances holdings that are on average over 70% of total liquid assets but Islamic banks have a higher proportion of cash holdings compared to conventional banks. As for placements, both Murabaha and Wakala are the most used forms of interbank placements in Saudi Arabia, as is the case in most Islamic finance markets.

Share of Liquid Assets to Total Assets for Banks in Top Islamic Banking Markets*

(Average, 2022)



Source: LSEG Analysis. The sample uses top five conventional and Islamic banks in each country. Coverage of liquid assets is limited to cash and placement with other financial institutions. *The top Islamic finance markets used represent 95% of total global Islamic finance assets, excluding Iran.

Recent events highlight importance of liquidity management for Islamic asset managers

For the asset management industry, liquidity needs to be managed effectively as investors must have the option to withdraw their investment funds whenever required and at accurate prices that reflect their value. For this to happen, holding sufficient cash and HQLAs can accommodate inflows and outflows instead of having to transact the underlying portfolio of assets. Poor liquidity management of assets poses a risk for market stability and investors, which may lead to regulatory intervention.

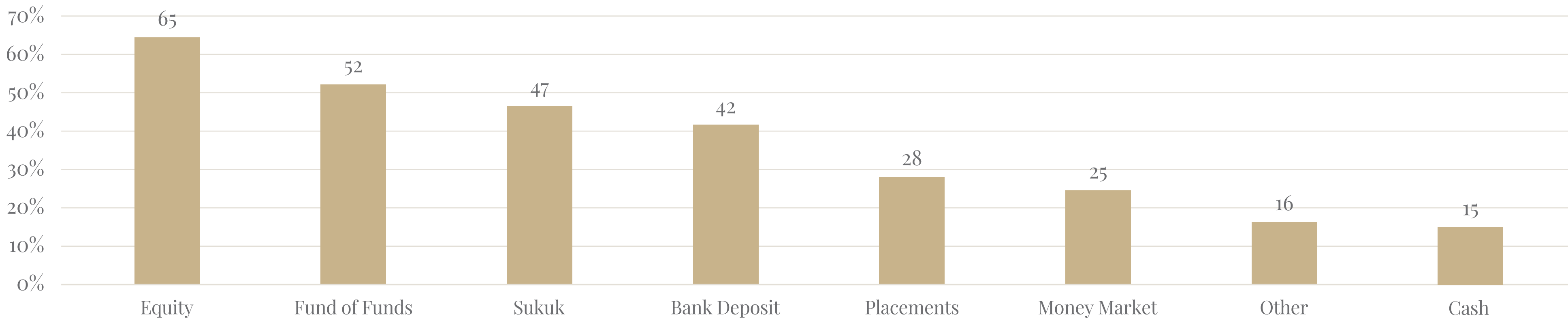
The financial industry was again reminded of the need for solid liquidity management when in early 2023 fund withdrawals affected some property fund managers in Europe after investors became worried about market conditions such as the rise in inflation and interest rates that depressed property valuations. Some fund managers struggled with redemption requests that they were forced to delay. This came as regulators called for a clampdown on commercial property funds to prevent a liquidity crisis.

With regards to asset allocation of Islamic funds of different universes (mutual funds, pension funds, Takaful funds and exchange traded funds) the average share of funds allocated to cash is 15%, but deposits form the largest average share of the liquid assets. Asset managers allocated 47% on average to Sukuk (some of which are Islamic Treasury bills) as some of these Islamic funds are more focused on fixed income investments. Other Islamic funds that have top holdings in Sukuk focus on mixed assets or money market investments.

It is worth noting that with regards the top holdings of the Islamic funds, 13% of these funds have liquid assets such as cash, deposits, placements or money market as their top holdings.

Average Asset Allocation by Islamic Funds

(Percentage Share, H1 2023)



Source: LSEG Lipper covering 1,411 Islamic funds that have reported asset allocation breakdown. Others include commodities, real estate and others.

Monetary policies impact effective liquidity management, especially for Islamic banks

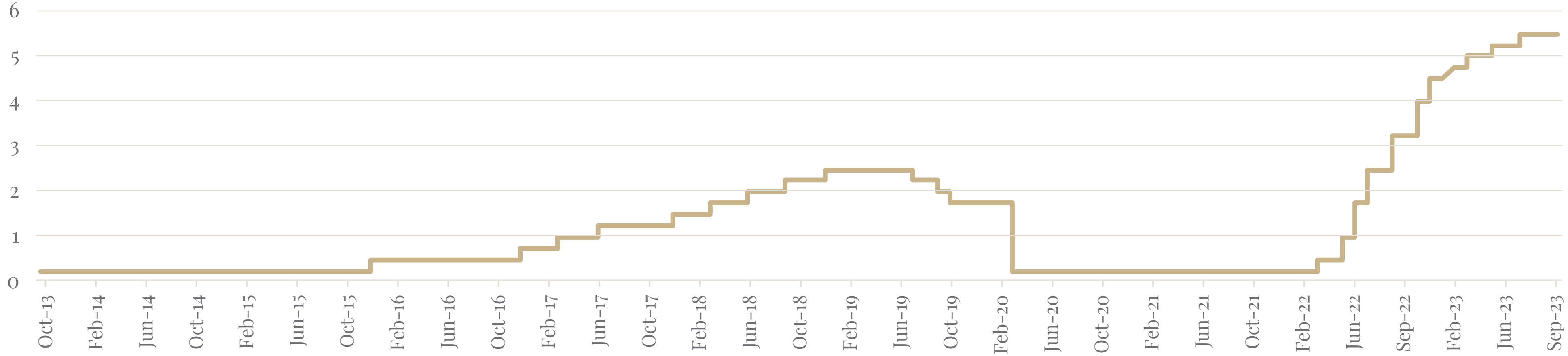
Different post-Covid events that hit markets, such as the increase in oil prices and interest rates, were accompanied by specific impacts in countries like Türkiye and Saudi Arabia as mentioned earlier. These have impacted the overall liquidity of Islamic banks in these markets given the result of changes in the sources of liquidity such as deposits, as well as uses of liquidity such as financing.

Responding to rising inflation—triggered by the soaring energy prices following the Russian invasion of Ukraine and re-opening of economies following Covid lockdowns—governments raised interest rates. In the GCC, the largest Islamic banking region, central banks' ability to control monetary policy is limited as they track the US Federal Reserve's policy rate because their currencies are pegged to the US dollar. This means that uses of liquidity, such as to provide financing, will drop as costs rise for clients, while funds will migrate to term deposits instead of current and saving accounts as retail and corporate clients put their excess liquidity to work. This will increase the cost of funding for banks, thus reducing their profitability, and impacting their liquidity.

For this, banks need to effectively manage their liquidity risk and maintain suitable liquidity positions. Banks need only look as far back as March 2023 to the collapse of Silicon Valley Bank and Credit Suisse to be reminded that they need to manage interest rates and liquidity in a more integrated manner. In addition, interest rates determine the money supply that will impact the amount of savings deposited in banks.

For Islamic banks, the benchmark rates they use to determine the margin and profit-sharing rates in financing and deposit products are influenced by the broader interest rate environment. Deposits that are based on profit-sharing by Islamic banks cannot offer a fixed rate on deposits whose profits are paid out monthly or annually. This could make deposits offered by conventional banks more attractive compared to Islamic banks when interest rates are high, particularly for consumers who are indifferent to the Shariah compliance of their banking services. This poses an additional challenge for Islamic banks that need to increase their sources of liquidity.

US Federal Reserve Target
(2013 – 2023)



Source: LSEG Workspace

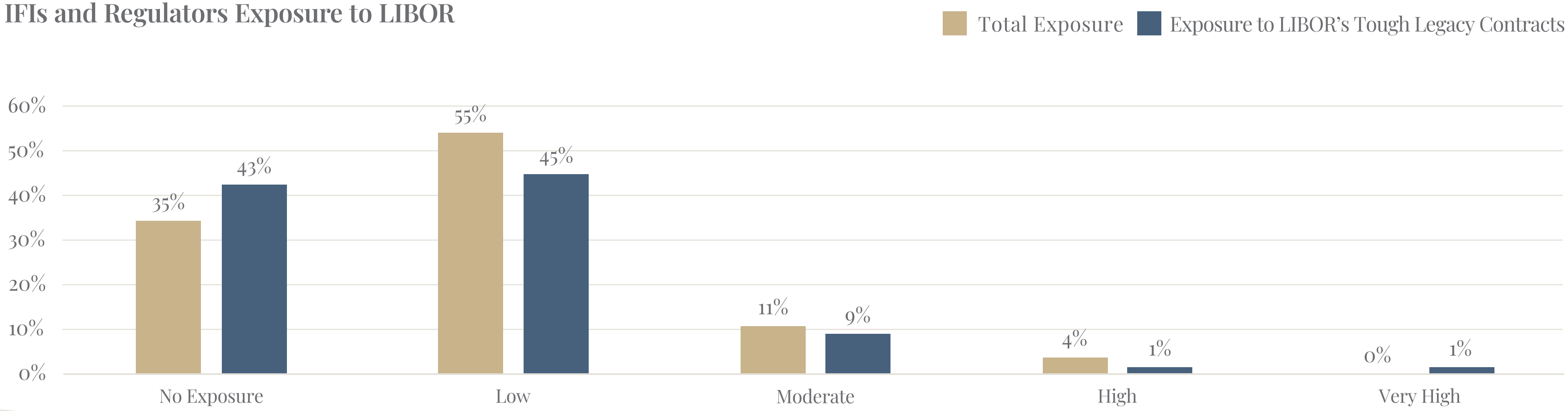
Limited impact of transition to Risk-Free Rates on Islamic financial institutions' liquidity due to low exposure to LIBOR

Another important move that needs to be considered by Islamic financial institutions and regulators is the transition from the London Interbank Offered Rate (LIBOR) to Risk-Free Rates (RFRs). LIBOR represents the interest rates that large banks offer when lending to each other on an unsecured basis. It is used as a reference rate for several financial contracts, bonds and loans globally. LIBOR represents average submissions by a panel of banks. Most LIBOR panels have been phased out (the USD settings stopped by June 2023) following scandals involving manipulation among the rate-setting banks that were uncovered in 2012.

The huge reliance on USD LIBOR benchmarks by financial markets has been recognised by the Islamic financial industry to pose a risk to financial stability. According to an Islamic Financial Services Board (IFSB) survey in 2022 that studied the impact of the transition from LIBOR, 16% of 11 regulatory and supervisory authorities and 64 Islamic banking institutions from various jurisdictions said that liquidity is among the major risks that the Islamic banking industry might face when shifting to RFRs. The lack of proper pricing will lead to wrongly accounted investment decisions and liquidity risk will increase as banks will not be able to handle short- and long- term obligations due to mismatches in income or insufficient funds raised. This will lead to insolvency issues.

Yet, in terms of total exposure to LIBOR, most of the respondents have low exposure to the benchmark rate and most do not have significant exposure to LIBOR-linked contracts as most of them use fixed or domestic rates. Such an observation was mainly noted in foreign currency floating rate instruments. In addition, in terms of LIBOR's tough legacy contracts, most Islamic financial institutions have no or low exposure to it. This is because few Islamic financial institutions have investments or repurchase agreements (repos) based on LIBOR. There was also a low level of Sukuk issuance and investment that were dependent on LIBOR, given that most USD Sukuk are fixed rate, some of which matured before USD LIBOR was discontinued. The transition risk is mitigated by the inclusion of fallback provisions.

IFIs and Regulators Exposure to LIBOR



Source: IFSB Survey, IFSB Working Paper Series WP-26/12/2022, December 2022

Liquidity Management Challenges for Islamic Financial Institutions

Shariah compliance complexities hinder development of Islamic liquidity management tools

Among the main challenges limiting the development of Islamic liquidity management is the different interpretations of Shariah aspects. For instance, many Islamic banks in key Islamic finance markets utilise Murabaha and Wakala for Islamic interbank placements. Yet, Tawarruq is only permitted on a need-only basis according to AAOIFI Shariah standard no. 30 and it is prohibited in countries such as Oman, Morocco and Jordan.

Another aspect of liquidity management impacted by Shariah rulings is the trading of Sukuk in the secondary market, as some scholars prefer 33% of Sukuk face value to be based on tangible assets while others require more.

While Shariah aspects can be interpreted differently, one consensus is the impermissibility of Islamic banks placing funds with their conventional counterparts. This is despite Islamic banks placing Commodity Murabaha placements with conventional banks. This means that Islamic banks are limited in their counterparty choice and so this lowers the depth of Islamic interbank markets compared to the conventional sector.

Shariah compliance complexities also result in additional administrative processes, which increase costs for these banks.

Shortage of market players, Sukuk supply and HQLAs complicate Shariah-compliant liquidity management

The restriction in dealing with conventional banks is an issue for liquidity management that is especially apparent in countries where there are small numbers of Islamic banks. Hence, in markets where Islamic finance is slow to develop, a Catch-22 scenario unfolds: not only does the lack of liquidity tools impact Islamic banks but the small number of financial institutions also pose a challenge for effective liquidity management.

Another shortage impacting the development of liquidity management tools for Islamic banks is in the supply of Sukuk. Additionally, the secondary market for Sukuk is illiquid given that most Sukuk are held to maturity, although some Sukuk such as the IILM's, are traded. There are some Sukuk that have large tangibility ratio still barely trade at the secondary market due to the low amount of issuances and number of market players.

With this, it is important to have conventional investors participating to the Islamic interbank money market to enhance its liquidity. Further, high-quality long-term Sukuk such as sovereign issues have long-term maturities that do not serve the liquidity needs of Islamic banks.

Our analysis of the liquid assets of sample Islamic banks reveals that most of the HQLAs, which are used to meet Basel III liquidity coverage ratio (LCR) requirements, are cash and reserves (even mandatory reserves) that are HQLA level 1 Islamic banks can draw on in times of distress. There are inadequate tools that meet the HQLA criteria such as sovereign Sukuk that can be converted into cash without the loss of value. Unlike conventional banks, Shariah-compliant financial institutions in most markets cannot easily undertake repurchase agreements, or repo transactions, that help facilitate liquidity management. Islamic repo is discussed in Chapter 4 of this report.

Interview with Standard Chartered Bank

KHURRAM HILAL

CHIEF EXECUTIVE OFFICER AND HEAD, GROUP ISLAMIC PRODUCTS AT STANDARD CHARTERED SAADIQ – THE GLOBAL ISLAMIC BANKING BUSINESS OF STANDARD CHARTERED BANK (SCB)

Khurram has more than two decades of core Islamic banking experience across consumer, wealth management, private banking, transaction banking and financial markets. He has led the development and roll out of the bank's Islamic banking proposition across SCB footprint in Asia, Africa, Middle East, Europe and North America. He has been an active contributor to the Islamic banking industry and regularly provides advice to regulators and industry bodies. Khurram have worked alongside some of the top scholars in the Islamic finance industry.

Khurram has an MBA from Institute of Business Administration (IBA), Pakistan and successfully passed the CFA examination from the CFA Institute, Charlottesville, USA. He is currently pursuing advanced studies in classical Islamic jurisprudence.

From your perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

While the availability and diversity of Islamic liquidity management solutions remains a long-standing industry challenge, we have seen considerable positive progress in their development over the past few years in key Islamic finance markets. We have seen the introduction of local currency government treasury Sukuk programmes in many markets (the most recent being the UAE Federal Government AED Sukuk programme) and the rolling out of liquidity facilities by central banks (e.g. Bank of England's Alternative Liquidity Facility programme). The IILM has also played a pioneering role by introducing short-term USD denominated Sukuk to help Islamic banks manage their global liquidity.

In addition, there is now wider acceptance of Islamic repo products and some countries such as Saudi Arabia have adopted a standardised model for the entire country (through the Double Wa'ad agreement). There is also increased adoption of the Wakala agreement for Islamic interbank placements between Islamic banks, developed by the International Islamic Financial Market (IIFM). All these measures have certainly boosted the liquidity management avenues for Islamic banks, especially in the key Islamic finance hubs of the GCC, Türkiye and Southeast Asia.

With the global Islamic finance and Islamic banking markets growing at double digits, there is still ample room for Islamic liquidity management solutions to ramp-up and catch-up with the growth in the overall Islamic finance market.

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As a leading global Islamic bank, in your opinion, what are the key challenges faced by Islamic banks related to Islamic liquidity management, and how have these changed over the last decade?

Standard Chartered Bank has a long-standing presence in Islamic banking, serving all client segments across multiple geographies and product offerings. We are proud to be a banker to Islamic banks, as we serve them for all their banking needs, from managing their cash, helping their trade business and raising funding for them through syndications and Sukuk. From our experience working with Islamic banks, we see a few challenges when it comes to liquidity management.

The first is either lack of solutions or reduced availability of those solutions compared to those available to conventional banks in the same markets e.g. limited government Sukuk issuances, no short-term Sukuk, zero or lower return deposit facilities by central bank, lack of counterparties for placing or borrowing funds in interbank markets. These put Islamic banks at a disadvantage compared to conventional competitors.

The second challenge is diverse Shariah views across different scholars and different markets. These hinder the development or adoption of globally standardised solutions that can be transported across markets. While industry bodies such as IIFM and the Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI) have contributed to standardisation efforts, we still have some way to go before we can be on par with the conventional industry in this respect.

In regions where Islamic finance is still in its initial phase of growth or is being introduced, they face a different set of challenges such as (i) lack of or weak Islamic finance laws, (ii) limited Islamic banks in the country (so limited counterparties), (iii) no government Sukuk or central bank deposit facilities.

From your perspective, what do Islamic banks need to do to address these challenges?

I think there are multiple stakeholders that all need to come together and work cohesively to address these challenges:

- **Industry bodies:** The industry bodies such as AAOIFI, IIFM, etc are doing important work to standardise Shariah structures as well as products and documentation. All these bodies need to work together with the Islamic banks and financial institutions across various geographies to ensure that the structures and products they come up with are widely acceptable across different jurisdictions.
- **Shariah scholars:** Scholars are the most important stakeholders as all products used by individual Islamic banks need to be approved by them. The support and understanding from scholars across markets for new products such as repos and hedging instruments would go a long way to boost this market.
- **Local regulators:** Local regulators/central banks/governments should provide support in terms of issuing new instruments across the tenor curve, or deposit and repo facilities at competitive pricing so Islamic banks are not at a disadvantage. They can also provide some flexibility to Islamic banks in terms of liquidity ratios etc. to compensate for the paucity of instruments.
- **Forums and communication:** Finally, industry dialogue on this topic needs to be enhanced through industry forums, to increase knowledge flow and sharing among stakeholders and resolve any market-wide challenges. SCB has successfully conducted its first Shariah Majlis in 2022 to bring renowned Islamic scholars together and discuss the challenges that the Islamic finance industry faces and their potential solutions. We also held regional Islamic finance industry forums this year for our clients, and we would be happy to work with industry players to organise such forums in the future.

Key Liquidity Instruments

Liquidity Programmes and Instruments Issued by Central Banks

Examples of Liquidity Instruments and Programs Issued by Central Banks in Main Islamic Finance Markets

Country	Product	Tenor	Liquidity
All Central Banks	Central Bank Reserves	Overnight – 1 year (not all central banks offer returns)	Not tradable
Bahrain	Sukuk Al Salam	91 days	Not tradable
	Sukuk Al Ijara	180 days	Tradable
	Wakala Intra-Day Credit Facility	Overnight and 1 week	Theoretically tradable, not traded in practice
Bangladesh	Mudaraba Sukuk	Up to 364 days	Tradable
	Islamic Banks Liquidity Facility – Mudaraba	14 days	Not tradable
Brunei	Islamic Treasury Bills – Ijara	14 days	Tradable
	Sukuk Ijara	3,12, 36, 60 months	Tradable
Gambia	Sukuk Al-Salam Bills	3 – 12 months	Not tradable
Indonesia	Bank Indonesia Sukuk Instrument (SuKBI) – Musharaka	1 week – 12 months	Tradable
	Bank Indonesia Shariah Certificate (SBIS) – Jualah	1 week – 12 months	Tradable
	Bank Indonesia Foreign Currency Sukuk (SUVBI) – Musharaka	1, 3 and 6 months	Tradable
Kuwait	Tawarruq with Central Bank	3 and 6 months	Not tradable

Country	Product	Tenor	Liquidity
Malaysia	Malaysia Islamic Treasury Bills based on Murabaha	Up to 12 months	Traded based on Bai' Al Dayn Principle
	Bank Negara Monetary Notes-I based on Murabaha, Ijarah and Istithmar	Up to 3 years	Tradable
	Wadi'ah Acceptance	Overnight – 3 months	Not tradable
Mauritania	Islamic Treasury Bills	Up to 180 days	Tradable
Nigeria	CBN Non-Interest Note	Up to 12 months	Transferrable at par
	CBN Non-Interest Asset-Backed Securities	Up to 12 months	Tradable
	CBN Non-Interest Special Bills	Determined by Central Bank	Not tradable
Oman	Wakala Money Market Instrument	Up to 3 months	Theoretically tradable, not traded in practice
Pakistan	Standing Ceiling Facility – Mudarabah based Financing Facility	Overnight	Not tradable
	Mudarabah Based Open Market Operations – Injections	Determined by Central Bank	Not tradable
Türkiye	Short-Term Government Lease Certificates – Ijara	Up to 12 months	Tradable
UAE	Collateralised Murabaha Facility	Overnight – 3 months	Not tradable
	Wakala Deposit by Central Bank in Islamic Banks	Perpetual	Not tradable
	Islamic Certificate of Deposit	1 week – 1 year	Not tradable
	Dirham T-Sukuk – Ijara	2, 3 and 5 years	Tradable
UK	Alternative Liquidity Facility – Wakala	Seven calendar days	Theoretically tradable, not traded in practice

Source: LSEG Analysis, October 2023

Central bank instruments are essential for Islamic financial institutions to manage liquidity

The Islamic money market instruments available to Islamic banks and other Islamic financial institutions to manage liquidity consists of transactions with other Islamic financial institutions, special Shariah-compliant arrangements with conventional banks, and government instruments. The development of liquidity instruments by authorities such as central banks serves is integral in the overall advancement of the Islamic financial industry, and the biggest Islamic financial markets are leading the way.

The right combination for central banks is to use market-based monetary operations to issue tradable instruments that can benefit the central bank itself in terms of monetary management while facilitating liquidity management for Islamic banks. They can be in the form of Sukuk or remunerative accounts or facilities.

IFSB defines such instruments as:

Low risk	Can be issued on a regular basis and sufficient volume	Can set a benchmark for other instruments	Can be held by all financial institutions, Islamic or conventional

Source: Islamic Financial Services Board (IFSB)

Liquidity facilities used with the central banks are Islamic deposit accounts and standing liquidity facilities. These are available in Bangladesh, the GCC, Indonesia, Malaysia, Nigeria, Pakistan and the UK. The facilities can be Murabaha, Wakala or Mudaraba or in the form of facilities that do not charge interest or profit.

CASE STUDY: Malaysia's experience in Islamic liquidity management

The Islamic finance industry in Malaysia is the most developed globally, according to the ICD- LSEG Islamic Finance Development Report 2023. Having a robust Islamic liquidity management framework is among important aspects that Malaysia has taken into consideration to build its Islamic financial system. Among the measures that contributed towards its advancement in its Islamic liquidity management framework is the development of its deep Islamic money market, since 1994, with MYR 5.9 trillion (US$ 1.3 trillion) in trading volume in 2021 according to BNM. It is also the largest Sukuk market globally with US$33.8 billion in Sukuk issues and US$299.3 billion in Sukuk outstanding in H1 2023.

Malaysia has a distinctive Islamic money market operations as its settlement of large amounts for the Islamic banking sector is conducted using separate Islamic accounts maintained at BNM. This ensures the Shariah compliance of such operations. The liquidity is also linked with conventional banking sector given the third-party payments between banking consumers in both sectors as well as involvement of conventional banks in Islamic banking through windows.

The Central Bank uses Qardh acceptance and Commodity Murabaha to manage liquidity. The Commodity Murabaha program uses palm-oil as underlying commodity transactions. In addition, the Bank uses Bank Negara Monetary Notes-i (BNMN-i) based on Murabaha, Ijarah and Istithmar. This allows the expansion of Shariah concepts used in the monetary operations while diversifies the instruments.

In August 2023, the BNM issued its Liquidity Risk Exposure Draft which is also applicable to licensed Islamic banks and international Islamic banks. The draft sets out the requirements to manage liquidity risk so financial institutions have appropriate measures to address their liquidity needs. The Islamic Financial Services Act 2013 are among the legal provisions to support the requirements in this document. The draft is also refers to the Guiding Principles on Liquidity Risk Management for Institutions Offering Islamic Financial Services by the IFSB. Among its policy requirements is that Shariah limitations must be taken into consideration when a financial institution needs to transfer liquidity across entities within its group and business lines.

CASE STUDY: UK example highlights the need for 'Alternative Liquidity Facility' for Islamic banks in non-core markets

The Alternative Liquidity Facility (ALF) provided by the Bank of England (BoE) in the UK was launched at the end of 2021 following six years of work, planning and development involving a feasibility study, public consultation and fine-tuning its approach. The move shows commitment by the UK government in developing its Islamic finance industry.

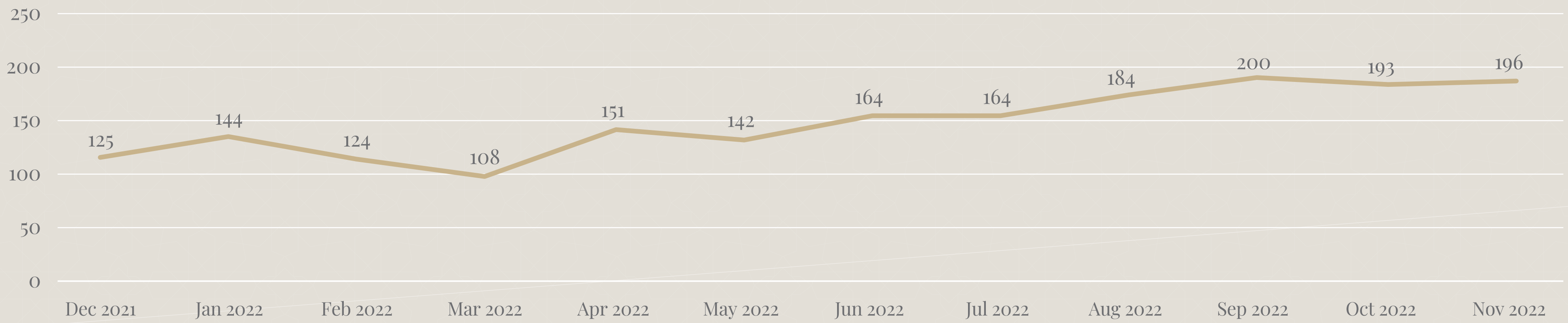
The ALF represents the BoE's efforts to place Islamic banks in the country on a level playing field with the conventional banks with regards to access to central bank deposit facilities while enabling greater flexibility in meeting regulatory requirements under Basel III prudential rules (i.e. HQLA buffer).

Islamic banks in the UK used to hold high stocks of cash at nil return or illiquid, higher-yielding Sukuk. Shariah-compliant liquidity tools in UK Sterling were limited and in addition, some of the tools available are subject to GBP/USD currency exchange volatility, such as dollar-denominated Sukuk. Prior to the ALF, Islamic banks' efforts were mainly concentrated on bank placements and deposits.

The Islamic liquidity facility is based on a Wakala model whereby Islamic banks in the country can deposit cash with the central bank and receive returns based on an underlying portfolio of high-quality Sukuk such as those from the Islamic Development Bank. The return from such an instrument is net from operating and hedging costs, and may be paid to depositors as expected profit rate. In order to manage currency risk, a cross-currency swap is used with its maturity aligned with the Sukuk. The facility started with GBP 200 million and with the expansion of Islamic banks in the country and the growing needs of consumers who seek Shariah-compliant saving options with best deposit rates, an extension of the facility size looks imminent.

According to the Bank of England Alternative Liquidity Facility Limited Annual Report and Accounts, the total deposits made by participant banks were GBP 140 million at end of February 2023 as opposed to GBP 95 million at the end of 2022. The BoE also stands as co-depositor for outstanding capacity in the facility. It amounted to GBP 60 million in February 2023, compared to GBP 105 million in 2022.

Monthly Average Aggregate Deposits in the Alternative Liquidity Facility (GBP Millions)



Source: Bank of England Analysis

Despite shortage, short-term Sukuk provide Islamic financial institutions with liquidity management options

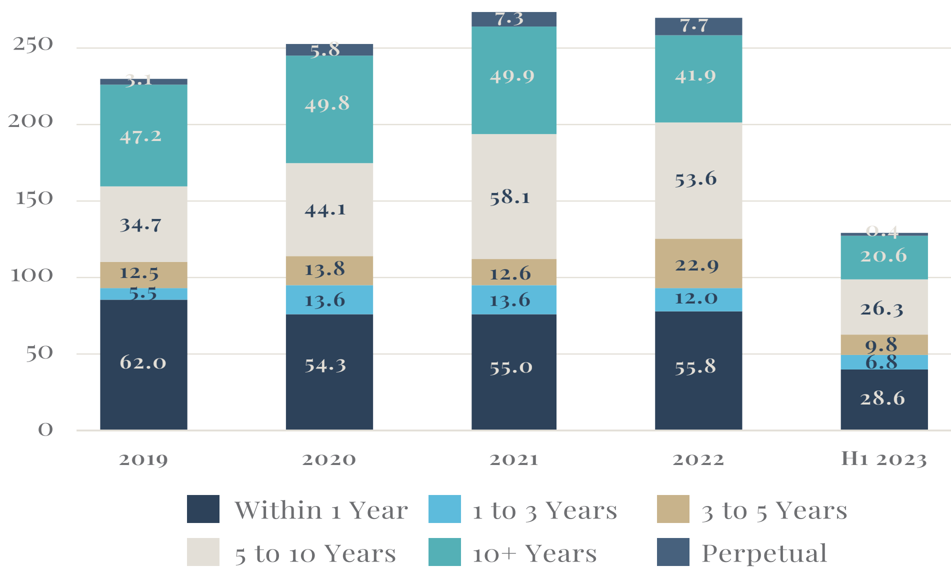
Among the instruments used by central banks is Sukuk that serve short-term liquidity management purposes. Despite low, but expanding, short-term Sukuk supply (as compared to longer tenor instruments), the experience of several countries indicate that Sukuk and instruments that are based on securitisation of government finance contracts, such as investment certificates, are some of the most suitable for Islamic interbank money markets. They can be designed into regular issuance programmes that can build market liquidity. Authorities need to bear in mind that public Islamic debt management requires the coordination not just of funding and expenditure decisions but also of monetary operations and public debt operations.

Short-term Sukuk is employed by governments such as Bahrain, Bangladesh, Brunei, Gambia, Indonesia, Malaysia and Türkiye. For instance, the Central Bank of Bahrain (CBB) issues Sukuk Al-Salam that uses aluminium as the underlying commodity. The CBB also issues Sukuk Ijara, a sale and leaseback transaction, that has an underlying tangible asset. The IILM's international Sukuk is another source for liquidity management that will be discussed in the final section of this report.

Bank Indonesia's foreign currency Sukuk (SUVBI) is a notable recently introduced short-Sukuk instrument. The Sukuk is expected to improve Indonesian Rupiah's exchange rate stability and will support the money market deepening in foreign currencies to support monetary policy and financial system stability. The Sukuk can be purchased by Islamic banks and windows in the primary market and be transferable in the secondary market. SUVBI can be owned by residents and non-residents in the secondary market.

Global Sukuk Issuance by Tenor

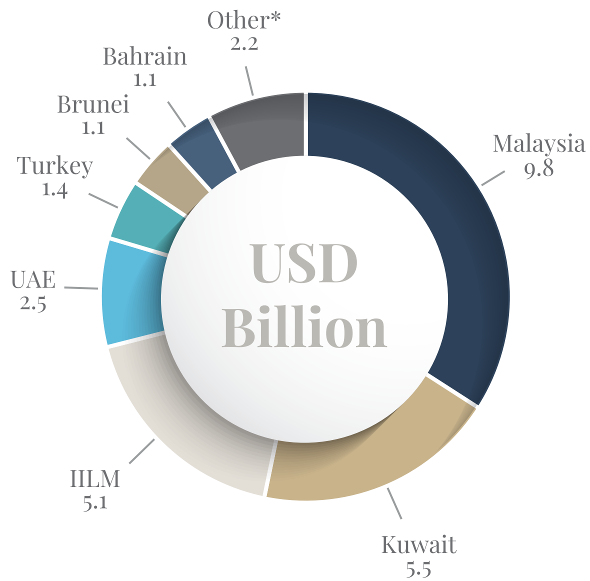
(2019 – H1 2023, USD Billion)



Source: LSEG Workspace

Short Term Sukuk by Country of Issuance

(H1 2023, USD Billion)



*Other include Pakistan, Bangladesh, Indonesia and the Gambia

Absence of an Islamic lender of last resort facility poses a challenge for Islamic banks in times of stress

Another important liquidity risk management mechanism for central banks is the lender of last resort facility that Islamic banks can turn to for their liquidity needs especially in times of stress and crisis. Islamic banks facing liquidity challenges, while maintaining solvency, have the option to utilise lender of last resort facilities offered by central banks at their discretion. These include emergency and collateralised financing. For the latter, HQLAs should be considered as suitable collateral. Yet, insolvent Islamic banks might often liquidate HQLAs to raise cheaper financing in the market. Assets that can be used as collateral include sovereign, quasi-sovereign and multilateral institutions' Sukuk.

The concept of a lender of last resort is rooted in the pivotal role of the banking system in the economy. In the event of a substantial failure of a bank that has repercussions for other banks, various sectors of the economy may also face adverse effects. For Islamic banks, this applies to markets where Shariah-compliant banking is systemically important to the functioning of the banking system, for example in the GCC. For these reasons, the lender of last resort facility allows central banks to lend at a certain penalising rate against a collateral. The rate used is an indication that the lending is transacted as a last resort. This applies to banks that are solvent and can repay the amount. However, if the case was otherwise, other measures need to be taken. Given the lack of Shariah-compliant lender of last resort facilities in markets such as Egypt, Jordan, Morocco, Nigeria and Oman, Islamic banks hold more liquid assets.

The IFSB defines Qard with direct administration fees, collateralised Commodity Murabaha, and Mudaraba or Wakala as Islamic lender of last resort facilities with tenors of overnight, up to 1-week lending and longer-term liquidity that can be 30 days or longer for each of these facilities, respectively. Islamic repo can be considered as well for longer terms up to one year.

CASE STUDY: Liquidity shortage in Bangladesh Islamic banks resulted in central bank's intervention

Some Islamic banks may also be impacted by a contagion effect causing a "bank run" unravelling in a country. An example from Bangladesh involved the excess liquidity of six Islamic banks (among eight private banks) turning negative. This was after panicked depositors rushed to these banks to withdraw their deposits due to negative reports about their practices. This impacted the banks' cash reserves and statutory liquidity ratios. The banks needed to secure a large amount of emergency liquidity support from Bank Bangladesh, the central bank.

In anticipation of an adverse response on the part of bank customers to the negative news about these Islamic banks that had been circulating in 2022, the central bank in December that year introduced a special liquidity solution called "Islamic Bank Liquidity Facility" to allow these banks to take up short-term loans. The tenor for the special arrangement is 14 days. Apart from this, some of these banks opted to borrow from a conventional bank in the country via the interbank money market, but based on a higher commercial lending rate given their situation. This raised a Shariah issue as highlighted by a Shariah board member of one of the Islamic banks.

Such a shock shows an extension of the central bank's normal open market operations activity. It also triggers the need for Islamic lender of last resort facilities by central banks to be prepared with Shariah oversight and communicated appropriately to the market. The facility could be in the form of standing facilities, discretionary facilities for individual support, and discretionary facilities for systemic use as highlighted by the IFSB in its Lender of Last Resort Guidance Note.

Islamic Interbank Placements

Examples of Interbank Financing Products Used in Main Islamic Finance Markets

Country	Product	Liquidity
GCC countries except Oman	Commodity Murabaha	Not tradable
Kuwait and Saudi Arabia	Compensating Mutual Balances	Not tradable
GCC countries	Interbank Mudaraba	Theoretically tradable, not traded in practice
	Interbank Wakala	Theoretically tradable, not traded in practice
Malaysia	Interbank Mudaraba	Tradable
	Interbank Murabaha	Tradable

Source: LSEG Analysis, October 2023

Shallow Islamic interbank market makes it the least preferred method for liquidity management in some markets

Islamic interbank liquidity instruments are based on Mudaraba, Wakala or Commodity Murabaha. They can range from overnight to one year. They are short-term and liquid, giving them a better chance of being traded in markets where there are sufficient Islamic banks. Yet, according to the IFSB, Islamic interbank placements are less preferred for Islamic banks to manage liquidity when compared to central bank instruments as deposits need to be placed in HQLAs. In addition, the liquidity positions of Islamic banks tend to synchronise during recessions or other periods of stress. For instance, Islamic banks in the GCC pushed down their liquidity positions when oil prices were low.

For Commodity Murabaha, where it is used in countries that have a mix of Islamic banks and Islamic windows that operate within conventional banks, the institutions can receive and place funds from Islamic in addition to conventional banks, because the subject of the transaction's Commodity Murabaha is a Shariah-compliant asset and not the balance sheet of the counterparty bank. In Malaysia for instance, interbank Tawarruq rose by a compound annual growth rate of 71% from MYR 6.7 billion in 2019 to MYR 33.1 billion in 2022, proving its popularity. Yet, Commodity Murabaha is at a disadvantage as it needs to improve on its execution costs and different Shariah opinions mean that it is prohibited in markets such as Oman. This is because some Shariah scholars argue that Commodity Murabaha is not based on real economic activity.

There were also some volatilities in the commodity markets that affected Commodity Murabaha transactions. For instance, the military actions in Ukraine that were followed by the imposition of sanctions on Russia affected the supply of metals such as nickel in early 2022. Meanwhile, Covid-induced border closures affected palm oil production in Malaysia that depends on the commodity for Tawarruq transactions.

A suitable alternative to Commodity Murabaha is interbank Wakala, considering how the industry is advancing initiatives to use it. Wakala does not involve sourcing back commodities to the transactions, so these are cheaper in theory. Yet the Wakala structure cannot guarantee returns, so some Islamic banks opt out of it and use Commodity Murabaha instead. As for interbank Mudaraba placement, it is based on the profit-sharing principle so it is not guaranteed as well. These types of instruments are not negotiable, meaning that they may not be best suited for active secondary market trading, which impacts the development of the Islamic money market in a country.

Interview with Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

OMAR MUSTAFA ANSARI

SECRETARY GENERAL, ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCIAL INSTITUTIONS (AAOIFI)

Omar is responsible for managing the overall affairs of AAOIFI as the organisation's operational head. He is also leading the process of development of accounting, auditing, governance and ethics standards for the global Islamic finance industry while coordinating and supporting its technical boards.

His key areas of expertise include regulations and standards related to Islamic finance, banking and takaful. In addition to assurance and advisory services to Islamic financial institutions, including Islamic accounting advisory, Shariah audits, corporate finance advisory, and other areas.

Mr. Ansari is a fellow member of the Institute of Chartered Accountants of Pakistan (ICAP). In his previous role, he was Partner – Assurance & Head of Islamic Finance (Pakistan & Afghanistan) at Ernst & Young Ford Rhodes Sidat Hyder – a member firm of Ernst & Young. He is a member of Securities & Exchange Commission of Pakistan's (SECP) Shariah Advisory Committee (SAC).

From an AAOIFI standards compliance perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

Islamic liquidity management solutions aim to provide Islamic financial institutions with Shariah-compliant short and medium-term financial instruments, to assist them in managing liquidity related challenges. The Islamic finance industry has made significant progress in developing such solutions. Some jurisdictions and/or institutions have developed comprehensive and sophisticated liquidity management tools, whereas others have developed more basic solutions. However, efforts are ongoing to improve and expand the range of Islamic liquidity management tools available to the Islamic finance industry. Typically, these solutions involve Sukuk, Islamic interbank money markets and Islamic repo markets.

However, as can be seen, Islamic finance is a deposit-heavy industry, primarily due to a large retail depositor base, and secondarily, due to industry participants' ingrained conventional banking mindset. It is true that solutions to address and develop this area have been limited thus far, including challenges associated with cross-border market access and regulatory obstacles.

Moreover, there are challenges regarding the Shariah compliance (level) of products used to manage liquidity. In many jurisdictions, for instance, conventional bonds are still used for Islamic liquidity management, while others depend heavily on controversial products. Certain products are controversial by design e.g. Tawarruq-based products, while others may be acceptable from the design perspective but have weak Shariah compliance controls on their implementation side. There is also overdependence on government

> "Islamic liquidity management solutions aim to provide Islamic financial institutions with Shariah-compliant short and medium-term financial instruments, to assist them in managing liquidity related challenges."

securities, which raises concerns about their availability to meet market demand. Furthermore, not many jurisdictions have central banking windows to facilitate these transactions. On the other hand, the corporate Sukuk market is not robust enough to meet the liquidity management portfolio's needs.

Despite the growing interest in leveraging technology to develop digital Islamic liquidity management solutions, such as blockchain-based platforms that can facilitate cross-border transactions, significant progress has not yet been made. In a nutshell, there is a need for new and improved products in this area.

What was the objective and impact of some of the recent AAOIFI standards, including SS59 on different Islamic instruments and the broader industry?

The primary objective of the AAOIFI standards is to safeguard and enhance the integrity of the Islamic finance industry. This not only protects the interests of all industry stakeholders but also promotes the industry's sustainable growth and development over the long-term.

One of the ways of accomplishing this objective is by providing Islamic financial institutions with a common operating framework in the form of standards, technical releases and guidance notes. One such standard that was issued by AAOIFI was Shariah standard 59 "Sale of Debt".

This standard affects certain transactions currently practised by the banking and Sukuk markets in terms of tangibility ratios, the practice of debt rollover and instruments structured using Tawarruq (which unfortunately is widely practised by market players and in a manner that is inconsistent with AAOIFI Shariah standards). Earlier AAOIFI standards also had these requirements, but this standard challenges certain contemporary practices and provides greater clarity on them.

We observed that a large number of scholars and experts from the global Islamic finance industry responded positively to this standard, and it was well received and much appreciated. However, it was also noted that certain experts and advisers challenged certain requirements of the standard by considering them too prohibitive and against market needs, further creating a false impression that the standard would impede the development and growth of the Sukuk industry. This was largely due to focus on the short-term impact of the standard on certain Sukuk structures, without consideration to its long-term benefits to the growth and development of the industry through greater acceptability levels.

Given your experience and market engagement, what do you think should be done to promote greater adoption of some of the more authentic alternatives in the industry?

Promoting greater adoption of more authentic alternatives in the Islamic finance industry involves collective and strategic efforts of all stakeholders. Some of the key initiatives that may be undertaken to accomplish this goal may include the following:

- Having global acceptability of the structures and underlying products for Islamic finance and hence mitigating the risk of non-acceptability of such instruments by a large number of Shariah scholars, experts and certain markets that criticise and reject certain controversial products such as those based on organised Tawarruq, etc. and eventually opening doors for global harmonisation and eventually cross-border investments and financing transactions, with full confidence with regard to Shariah compliance;

- Changing the mindset of the industry stakeholders and raising awareness about the principles of Islamic finance, and how they differ from conventional finance could be beneficial. This would help avoid blanket imitation of conventional finance and aspiring for a greater level of Shariah compliance in products, transactions and operations;

- In addition, it is necessary to create a more favourable legal and regulatory environment and to provide Islamic finance products and services a level playing field, according to their true nature. Mostly the legal and regulatory frameworks have been developed considering the needs and structures of conventional finance, and hence do not provide a conducive environment. A part of this problem can be resolved through adoption of relevant AAOIFI and IFSB standards, along with necessary amendments in the laws and regulations to provide room for Islamic finance; and

- Not least of all, market participants must make a concerted effort to discontinue the use of controversial products in the industry, which may have been initially approved decades ago to provide market push. In other words, products that are not approved by global standards-setting bodies such as AAOIFI should be discontinued, and regulatory and supervisory authorities, in particular, should take note of this and encourage gradual withdrawal of these products. This can be accomplished through standardisation and harmonisation of best practices in Islamic finance by adopting AAOIFI standards, which were the result of consensus among industry leaders over the past 30 years and more.

Despite its limited resources, I am pleased to see that AAOIFI is contributing in each of the aforementioned areas. To foster the right mindset, AAOIFI promotes best practices in the industry through its market engagements and advocacy and awareness programmes, such as conferences and events, as well as through its capacity-building initiatives and activities.

On the regulatory and legal front, AAOIFI engages with regulatory and supervisory authorities through various initiatives such as capacity-building and roundtable conversations to facilitate the implementation of its standards in their respective jurisdictions. In the Kingdom of Bahrain, for instance, the AAOIFI standards have not only been adopted by the central bank but also codified into law.

Interview with Sheikh Dr. Mohamed Elgari

SHEIKH DR. MOHAMED ELGARI

SHARIAH COMMITTEE CHAIRMAN, THE IILM

Dr. Elgari is a member of the Shariah Council of AAOIFI as well as AAOIFI Board of Trustees. He also serves as the chairman for several Shariah boards including Dubai Islamic Bank, Emirates NBD, the IILM and other organisations. He is an advisor to numerous Shariah boards of Islamic banks and takaful companies worldwide in addition the Central Bank of Bahrain and Dow Jones Islamic Markets Index.

Dr. Elgari holds PhD in Economics and Master in Economics from the University of California, the United States. He obtained his Bachelor in Economics from King Abdul-Aziz University.

Dr Elgari is the recipient of the Islamic Development Bank Prize in Islamic Banking and Finance and holds the KLIFF Islamic Finance Award for Most Outstanding Contribution to Islamic Finance.

From a Shariah compliance perspective and given your market interactions, what do you consider to be the state of current instruments being used in the industry for liquidity management?

Conventional tools and instruments that have been developed over time by the financial sector came about to fill a need. This need could be to manage a risk or make profit or secure stability and sustainability.

These are legitimate needs from the Shariah point of view and therefore deserve to be met. The solutions provided by conventional banking need not be rejected wholesale. There is no basis for this in Shariah. As long as we face the same problem and we, too, need a solution, we should explore all possibilities, including from the conventional system.

If it turns out that the conventional solution includes elements that are prohibited from the Shariah point of view, all we need to do is restructure the same instrument to deliver the same economic outcome but with Shariah acceptable contractual relationships. A case in point is the repurchase agreement (repo). Repo is one of the most important tools to manage liquidity. Clearly, the conventional structure cannot be accepted because it is interest-based lending. But this instrument itself is very effective in meeting a legitimate need. We were able to reformulate the structure from "loan" to "sale", thus benefiting from the accumulated experience and knowledge in the field of repo liquidity management but without violating the Shariah.

So, we are always up to date in developing and utilising the best and latest practices. Shariah is never a hindrance to progress.

"Conventional tools and instruments that have been developed over time by the financial sector came about to fill a need."

What are some of the key Shariah concerns related to Commodity Murabaha, which is the most commonly used liquidity management instrument across markets? Also, given your experience and market engagement, what do you consider to be some of the more authentic alternatives for the industry, and what should be done to promote greater adoption of these instruments by Islamic banks?

Contrary to what some people believe, the basic structure of the Tawarruq transaction, which is commonly referred to as "Commodity Murabaha," has a solid Shariah foundation. Concerns are sometimes raised about the actual implementation of the procedures for concluding a Commodity Murabaha. This was a problem when Tawarruq was initially launched two decades ago. Now the Commodity Murabaha is supported by standardised procedures, which significantly reduces possibilities of flawed Shariah transactions.

Having said that, I must also emphasise that innovation was and should remain the cornerstone of success and growth of Islamic finance.

Commodity Murabaha has and is serving the purpose of Islamic finance. But we must not be captives of Commodity Murabaha forever. We need to come up with new alternatives and innovative solutions. Not that Commodity Murabaha is questionable from the Shariah point of view, but because it leaves much to be desired with respect to efficiency.

Many Islamic bankers would say an alternative is next to impossible. But it is not so, at least for one part of the use of Commodity Murabaha.

The bulk of Commodity Murabaha transactions in Islamic banking today goes to corporate finance. I am a firm believer that the contract of Mudaraba can be a perfect substitute from any respect. Mudaraba is a partnership in profit. Bankers believe it is not bankable. This is correct in the context of current knowledge. However, I believe there is ample room to develop a form of Mudaraba contract that is both Shariah compatible and bankable.

Islamic Repo Instruments

Islamic Repo Still Waiting For Take-Off To Cross Borders

Differences in opinion and varying Islamic finance practices limit access to liquidity between jurisdictions

Repurchase agreements, or repos, allow banks and other financial institutions to manage their liquidity in the short-term—typically from overnight to three years—and use the instrument as a source of alternative funding. In the United States alone an estimated US$2 – $4 trillion are transacted daily as market participants raise repos—which in the conventional system are essentially collateralised short-term borrowing and lending—to optimise, maximise and safeguard their liquidity. The instrument is seen as a ready solution for Islamic liquidity management provided its structure and operations are Shariah-compliant.

However, Shariah-compliant repos have been slow to take off in most markets, even after concerted efforts to harmonise structures and documentation by industry infrastructure bodies and the introduction of new instruments from the early 2010s. In tandem with the varying practices in Islamic banking and finance, each jurisdiction has been moving at its own pace according to its own domestic needs, and progress has been imperceptible for cross-border repos largely due to a lack of consensus among Islamic financial institutions, scholars and regulators on which structures would be easy to implement within their borders, and are both Shariah-permissible and financially effective. This is a more significant disadvantage for smaller and developing Islamic finance markets, such as Jordan and Morocco, that do not have Islamic repo facilities, than the big jurisdictions such as Malaysia (where MYR39.4 billion in Islamic repos were transacted in 2021, representing around 1% of the total Islamic money market volume, according to the central bank) and Saudi Arabia that have available instruments, and deeper and more liquid repo markets.

Periods of tight liquidity and stress, for example when oil prices collapsed in April and May 2020 and economies were hit during the Covid-19 pandemic, show up the very real need for active and deep cross-border Islamic repo markets that can help Islamic banks manage their liquidity and access an additional source of short-term funding on a secure and low-risk basis.

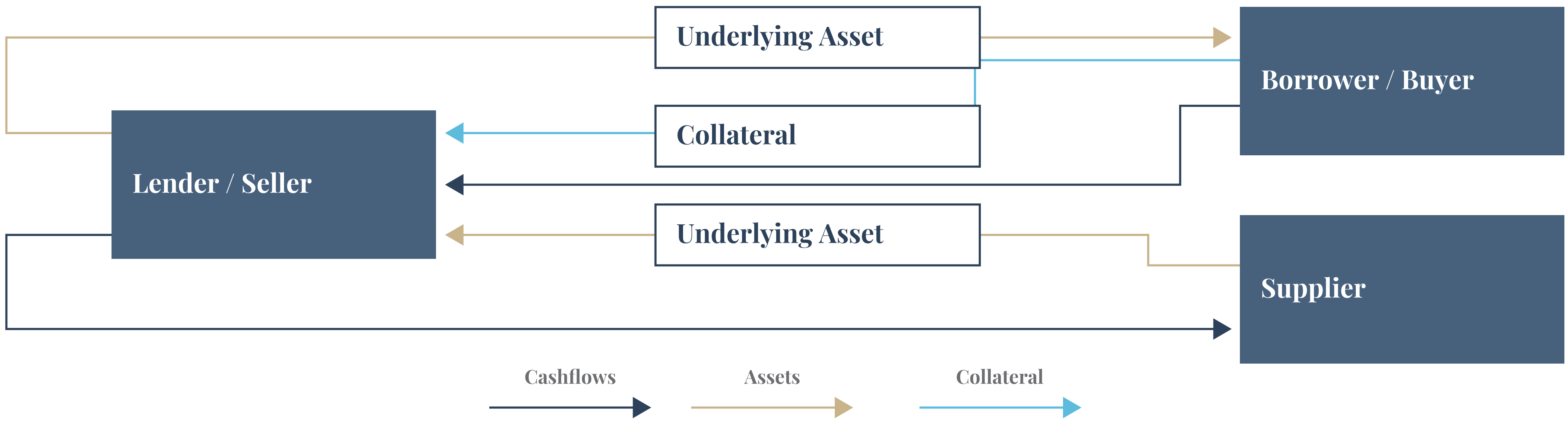
Under-developed, shallow Islamic repo markets hold back growth of Islamic finance overall

Apart from facilitating liquidity management for banks, repos also trigger a ripple across inter-connected markets. As an instrument of the money market, which is the cornerstone for fixed income markets, a liquid Islamic repo market stimulates demand for securities, such as Sukuk and shares of Shariah-compliant companies that could be Islamic financial institutions or companies that have Shariah-compliant certified activities, of varying maturities that can be used for sale or collateral. This could encourage the issuance of more Sukuk that could then contribute to secondary market liquidity. This would be a welcome growth as the Sukuk market is typically dominated by buy-and-hold investors.

The development of an Islamic repo market is also important to facilitate the role of market makers—who buy and sell Shariah-compliant securities—in improving secondary market liquidity. A well-functioning Islamic repo market also welcomes non-financial corporations as participants. This means it supports liquidity in other markets, contributing to a more efficient allocation of capital in the real economy. However, the realisation of these growth areas are contingent on the development of the overall financial system in the country to begin with.

For example, the interbank repo market in Indonesia is purely cash-driven and provides no support to the securities market, the International Capital Market Association found in March 2022. This lack of an active interbank repo market has contributed to the past underperformance of Indonesia's securities markets relative to its neighbours. For context, Islamic banks in Indonesia only started transacting interbank Shariah-compliant repos in 2016, most of Indonesia's interbank transactions are currently in unsecured overnight markets, and a central counterparty clearing house is still in the works with Bank Indonesia expecting its establishment by early 2024.

Murabaha-based Repo Flow Example



CASE STUDY: Saudi National Bank Islamic Repo Structure Gaining Wider Acceptance

Saudi Arabia's largest bank by assets developed a Shariah-compliant repo structure based on two separate Wa'ads—a promise to purchase and a separate promise to sell—to avoid the use of Muwa'adah that it considers impermissible. The structure has gained wide acceptance among Saudi banks and the central bank. SNB believes its Islamic repo retains the merits of conventional repos with regards high liquidity and rehypothecation, hence making it competitive with conventional repos in price and risk.

SNB's first concern was that the collateralised Murabaha structure that underpins a lot of Islamic interbank placements has a rehypothecation issue, as the pledged security based on Rahn cannot be resold or sold forward. Without rehypothecation, the repo carries more risk and becomes costlier. SNB's Islamic repo instrument involves a true sale of a security, which solves the rehypothecation issue. In the case of selling securities to the buyer, legally the ownership of the securities is transferred to the buyer. From a legal point of view, any taxes or Zakat on the securities falls on the buyer because it is registered under their name.

Secondly, if the security in the repo transaction is a Sukuk, coupon payments will be involved. Under the SNB Islamic repo structure, the coupon payment is built into the sale price. Even if the other party would like to receive the payments when the coupon is paid, it can be structured so that the coupon payment is made as instalments in the future sale price. SNB stresses that its structure allows for "similar" securities at the repurchase leg of the transaction. In this regard, it is not a 'true repo' as the party is not buying back the exact same thing that it first sold.

Thirdly, addressing the biggest risk: In the case of default and the first party does not buy back the security at the agreed higher price, the harm inflicted on the counterparty goes beyond the market price of the security that was subject to market movements and may have lost value. SNB's Islamic repo factors in compensation for the actual harm inflicted, which in addition to the market price of the security is the missed opportunity to receive the price exactly as mentioned in the undertaking, hence fairly compensating the other party in case of default. In the case of conventional repos, they are checked every day to see if their value has changed. If the value has dropped, the buyer of the repo must top up to cover the difference, i.e. the margin call that is based on an agreed-upon amount.

Differences and Convergence: Key Shariah and regulatory considerations

The central Shariah and regulatory considerations for structuring Islamic repos surround the ownership of the security in the two legs involving Party A selling the security to Party B to raise liquidity or short-term funding, and then Party A repurchasing it from Party B at an agreed future date. Due to different Shariah opinions and varying practices, the Islamic repo structures that have been introduced each has its own unique characteristics and features. The better known and more widely used ones include Saudi National Bank's double Wa'ad structure (see Case Study) and Collateralised Murabaha (CM, based on Rahn). The biggest difference between the SNB structure versus the CM is that a true sale must happen for the SNB structure but not for CM. For example, in the case of Malaysia's Collateralised Commodity Murabaha (CCM) there is no sale of the underlying asset, which remains with the original party. If there was only a transfer of legal title and ownership of the security was never transferred, then Party B's access or rights over the security are more limited than under the SNB method.

For many years, the contention with one of the earliest Islamic repo instruments, the Sale and Buy Back Agreement (SBBA) in Malaysia, was its use of Bai' Al Inah that is not accepted by most scholars in the Middle East where there is a large concentration of Islamic financial institutions. Malaysia's central bank released Guidance Notes for the SBBA in 2013, and in the following year the Securities Commission tightened rules to stress that the two legs of the transaction—sale and then buy back—must be executed and completed separately, and that ownership of the asset must actually be transferred. The SBBA is still being used in Malaysia, and local authorities are working on a standard SBBA agreement and Practice Note to make it easier for the Malaysian market and offshore Islamic financial institutions to use the instrument. The standard SBBA agreement is meant to meet the globally accepted Global Market Repurchase Agreement (GMRA) standards to allow for margining, netting practices and other key features in a repo transaction. These are meant to address counterparty and market risk faced by both parties in an Islamic repo, according to Bank Negara Malaysia in its April 2023 Malaysian Islamic Financial Market Report.

The other key Shariah consideration for Islamic repos has been the use of Wa'ad in a sale transaction. With regards an Islamic repo involving the sale and repurchase of the same asset, a bilateral Wa'ad between Party A and Party B in respect of the same one asset is considered to be equivalent to a contract, where both countervalues are deferred. This is prohibited under Shariah. Hence, the Case Study of the Saudi National Bank Islamic Repo in this chapter outlines the use of two separate Wa'ads.

Regulatory considerations would focus on disclosure and reporting, and capital adequacy requirements. Chiefly, there must be a legal framework with clear guidelines for the structuring and documentation of Islamic repos, defining the rights and obligations of the parties involved, addressing dispute resolution mechanisms, and mechanisms to protect investor interests. In this regard, there is also the need to establish or appoint a trusted intermediary; in the conventional repo markets, risk is reduced for repo transactions that are conducted by a third party such as a clearing house or a bank that provides a layer of security for both the buyer and the seller of the security or asset.

CASE STUDY: Large ESG Repos add to much-needed market activity and depth

We have officially entered the era of Shariah-compliant banks using Islamic repo to raise funds for ESG assets. The most recent recorded transaction, as of this writing, was in mid-2022 when CIMB Islamic entered into a MYR1 billion Sustainable Collateralised Commodity Murabaha (CCM) transaction with Standard Chartered Saadiq Malaysia. The CCM was secured with high-quality Sukuk and proceeds were earmarked for eligible Shariah-compliant assets within CIMB Group's Sustainable Development Goals (SDG) Bond and Sukuk Framework.

Shariah considerations: The key feature in the collateral arrangement is that the buyer in the Commodity Murabaha transaction transfers the legal and beneficial title/ownership of the securities to the seller. CIMB Islamic CEO Ahmad Shahriman Mohd Shariff explained in August 2023 to LSEG that one of the Shariah concerns was that the collateral would no longer be under the Rahn concept under paragraph 14.10 of the Rahn Policy Document issued by Bank Negara Malaysia (BNM) that implies that an arrangement of collateral under Rahn should not involve any legal transfer of title. CIMB Islamic's Board Shariah Committee proposed to BNM's Shariah Advisory Council (SAC) that although the legal title of the underlying collateral is transferred, the arrangement is still within Rahn based on the justifications as approved by the Committee. The SAC at its meeting on February 26, 2019 ruled that the proposed CCM product using scriptless financial assets as collateral that incorporates Tawarruq and Rahn is allowed, subject to a few requirements, according to the CIMB Islamic CEO.

Legal considerations: The legal issues that were addressed included the enforceability of the CCM under Malaysian law, the enforceability of close-out netting in counterparty insolvency, the regulatory capital treatment of the CCM, and the recharacterisation risk in connection with the title transfer mechanism of the collateral.

Apart from CIMB Islamic's ESG repo, in November 2021, Standard Chartered Bank executed its first ESG 'Use of Proceeds' repo with the Saudi National Bank. At the time, the US$250 million transaction was the first-of-its-kind in the Middle East, North Africa and Pakistan region. The funds were raised to benefit several large renewable energy projects and green initiatives in Saudi Arabia and the wider GCC region.

There are two primary benefits served by these ESG Repo transactions. Firstly, the SDGs funding gap for countries of the Organisation of the Islamic Cooperation (OIC) was estimated to be around US$1 trillion in 2019, which requires a lot more of a variety of funds and financing to narrow. Secondly, more types of Shariah-compliant repos will encourage the development of a more active and deeper Islamic repo market. These ESG repos also meet the growing demand for high-quality sustainable or ESG financing solutions as governments and businesses commit to sustainability targets.

"We have officially entered the era of Shariah-compliant banks using Islamic repo to raise funds for ESG assets. The most recent recorded transaction, as of this writing, was in mid-2022."

Surface level resemblances to conventional repos and innovative approaches

There is always the call from communities of Islamic finance practitioners for more innovation to develop “true” Shariah-compliant instruments without basing them on conventional finance. However, market participants impatient for efficient products at par with conventional instruments hark back to financial realities. Malaysia’s experience with regards the Sell and Buy Back Agreement (SBBA) is particularly telling: Apart from the contention with the use of Bai’ Al-Inah that we outlined in earlier pages, the SBBA does not replicate the specificities of conventional repo, such as the ability of the seller to still enjoy the coupon on the securities which have been sold, and hence the instrument falls short of investor expectations. Malaysia then developed the Collateralised Commodity Murabaha (CCM) that was more of a replication of the conventional repo in the various specificities that the parties wanted and expected.

The IILM's 5th Shariah Roundtable in 2021: Focusing on Shariah-Compliant Repo Market

During the IILM's Fifth Shariah Roundtable in 2021, more than 20 prominent Shariah scholars, policymakers, Islamic finance practitioners and leading experts from Bahrain, Kuwait, Malaysia, Nigeria, Qatar, Saudi Arabia, Türkiye, United Arab Emirates and the United Kingdom gathered virtually to discuss and debate on various aspects of the Shariah-compliant repo market.

The roundtable webinar, organised in collaboration with major international Islamic finance bodies the Islamic Development Bank (IsDB), the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Board (IFSB), the International Islamic Financial Market (IIFM), and the International Shariah Research Academy for Islamic Finance (ISRA), raised a number of pertinent topics such as the heightened need for Islamic repo facilities particularly given the Covid-19 pandemic, key implementation challenges faced by global Islamic banks, Shariah rulings in relation to cross-border Islamic repo facilities as well as legal and structuring challenges faced by the industry.

Among the key findings from the roundtable were:

- Despite previous efforts on repo transactions in different jurisdictions and institutions, Shariah issues surrounding repo still exist when executing cross-border liquidity management using repos.
- AAOIFI may have introduced a Shariah standard on the product, however, the implementation remains a challenge for institutions that issue short-term certificates. This implies that the standard needs to be revisited and standardised in a more flexible manner that can help Islamic institutions.
- IIFM team may have proposed a workable structure (Collateralisation/Collateralised Murabaha) as an alternative for the conventional repo. Nevertheless, it may need to be revisited as well, due to the lack of meeting with cross-border requirements.
- Malaysian Sell and Buy Back Agreement (SBBA) based on Bai' Al Inah and Wa'ad may be considered locally, however, there are constraints when implementing it in a cross-border manner. This is also applicable to Indonesia's Triparty repo facility. Islamic financial institutions face several constraints to raise funding through repo markets, and these constraints include differences in Shariah interpretation, lack of standardisation and regulatory hurdles.
- After long deliberations and discussions, the most accepted structure, which has gained wide acceptance among Shariah scholars from different jurisdictions, is the Shariah-compliant repo structure based on two separate Wa'ads introduced by Saudi National Bank.
- The scholars believe that the SNB repo structure can be further improved and implemented in a cross-border manner, as an alternative to previous repo structures that face Shariah issues.

“The scholars believe that the SNB repo structure can be further improved and implemented in a cross-border manner, as an alternative to previous repo structures that face Shariah issues.”

Interview with CIMB Islamic

AHMAD SHAHRIMAN MOHD SHARIFF

CEO, CIMB ISLAMIC BANK BERHAD
ACTING CEO, CIMB FOUNDATION

Ahmad Shahriman Mohd Shariff was appointed the Chief Executive Officer of CIMB Islamic Bank Berhad on 1 October 2019. In this role, he heads the Group Islamic Banking business of CIMB Group including Islamic wholesale banking, Islamic consumer banking, Islamic commercial banking and Islamic asset management and investment across key markets such as Malaysia, Singapore and Indonesia.

He is also a board member of the CIMB Islamic Bank and Secretary of the Association of Islamic Banking and Financial Institutions Malaysia (AIBIM). He is currently the Acting CEO of CIMB Foundation as of 8 May 2023.

Ahmad Shahriman has over two decades of experience in the corporate and financial service sectors, of which 17 years were in Islamic banking and finance-related leadership roles at HSBC Amanah Malaysia Berhad as Director of Wholesale Banking and Citigroup where he served as Head of Islamic Banking, Citibank Berhad amongst others.

From your perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

Over the years, the total trading volume in the Malaysian money markets has exhibited a steady increase, reaching MYR15.5 trillion at the end of 2021. This amount comprised MYR9.6 trillion in the conventional money market and MYR5.9 trillion in the Islamic money market. In 2022, the Islamic interbank money market experienced significant activity, representing approximately 28% of the total turnover in the interbank money market. On a global scale, money market instruments held the highest share in Islamic fund assets in 2021, constituting 39.4%. The second most significant asset class was equity, accounting for 28.6%. This underscores the importance of money market instruments in the Islamic financial markets (Bank Negara Malaysia (BNM), 2023).

To further support the Islamic liquidity market, BNM in April 2023 issued its first US Dollar Bank Negara Interbank Bills Foreign – Islamic (BNIBFI) under the Shariah principle of Murabaha. The issuances of BNIBFI were issued for onshore foreign currency liquidity management by licensed banks. The total issuances, all with tenors of 3 months, stood at US$430 million.

> We believe that the standardisation of agreements and Shariah concepts to encapsulate specific repo features among market participants can promote Islamic repo.

The International Islamic Liquidity Management Corporation (IILM) has demonstrated exceptional performance and leadership in this area. In 2022, their remarkable achievement of supplying in excess of US$13.88 billion across 37 Sukuk series, accounting for 39% of the total global US dollar Sukuk issuances, is truly commendable. Their continued success in 2023, with US$4.35 billion in Sukuk issuances till May 2023 accounted for 26% of the total global volume of US dollar Sukuk, further showcasing their significant contribution to the financial landscape. The IILM's dedication to promoting liquidity and stability in the Islamic financial market is noteworthy and sets them apart as a prominent institution in the field.

On the other hand, the market-wide development of Islamic repo has been slow-moving. For Collateralised Commodity Murabaha (CCM), we saw some market traction starting in late 2021 and last year, in 2022, many new additional players entered this space. CIMB Islamic alone initiated 10 Master Collateralised Murabaha Agreement (MCMA) negotiations with new bank counterparties. This year we are seeing many non-bank financial institutions (NBFI) expressing interest in the CCM space, and CIMB Islamic has started negotiating MCMAs with some of them. BNM has also impressed upon NBFIs, particularly the insurance companies in Malaysia, to develop repos (both conventional and Islamic) as an additional funding avenue that can be used as part of the Contingency Funding Plan setup for financial institutions. As for Sale and Buy Back Agreement (SBBA), most of the traction comes from BNM trades with one or two banks dealing with NBFI counterparties. There was a minimal amount of interbank activity in the SBBA space.

Balanced Sukuk supply and demand is also vital for managing Islamic liquidity. The remarkable growth of Malaysia's Sukuk market in 2022 was impressive, with Sukuk outstanding reaching RM1.2 trillion, representing a substantial 63% of the total Sukuk and bonds outstanding in the Malaysian market (Securities Commission, 2022). Malaysia's deep Sukuk market that accounted for 41.6% of the global outstanding Sukuk as at the end of the first half of 2022, is a testament to the country's commitment to promoting and fostering Islamic finance on an international scale (BNM, 2022).

At the global level, the Sukuk supply and demand model by LSEG projected the supply-demand gap to narrow to US$81.4 billion in 2022 and then expand to US$101.4 billion in 2027. This would be mainly due to 52% of presently outstanding Sukuk maturing by the end of 2027. Therefore, addressing the supply-demand gap in the global Sukuk market is of utmost importance to ensure the continued growth and stability of Islamic finance via Islamic liquidity management.

In your opinion, how important is it for the industry to develop and promote Islamic repo instruments, and what are some of the challenges related to this?

The development and reinforcement of Islamic repo as a product suite is integral to the Islamic finance industry where it acts as an effective funding tool as well as a high-quality liquid assets (HQLA) management tool for Islamic financial institutions. It also provides liquidity for Sukuk traders and promotes efficiency and vibrancy of the Sukuk market.

We believe that the standardisation of agreements and Shariah concepts to encapsulate specific repo features among market participants can promote Islamic repo. A standardised agreement such as the Global Master Repurchase Agreement (GMRA) can spur adaptation of Islamic repo globally. Some differences of interpretation between Shariah scholars, particularly between those in the Middle East and Asia may occasionally pose a challenge to the development of Islamic repo.

Regulations also need to be in sync with the rapid pace of development in the Islamic repo market. This allows Islamic financial institutions to apply the correct treatments to the Islamic repo in their balance sheet.

Other than regulation, Islamic financial institutions' system and operation readiness needs to be addressed. For SBBA in Malaysia, certain risk-centric features such as margining and netting practices are uncommon.

As a leading Islamic banking institution, please describe some of your recent activities in the Islamic Repo market, and suggest what more can be done to increase the uptake by Islamic banks?

CIMB Islamic's recent and notable activities in the Islamic repo space include the landmark MYR floating rate ESG Collateralised Commodity Murabaha (CCM) with another Islamic financial institution, positioning CIMB Islamic as a market leader in sustainable finance as well as Islamic treasury and capital markets. Other than that, we have also transacted a cross-currency CCM using Risk-Free Rates (RFR) as a benchmark. This is the first cross-currency CCM transacted in the market and showcases an innovative solution by CIMB Islamic in meeting clients' requirements.

One of the first steps that the market is able to take is the standardisation in the Islamic Repo Agreement, similar to GMRA in the conventional market that is acceptable globally or at least within a geography, much like the Master Commodity Murabaha Agreement (MCMA) in Malaysia. This can spur the adaptation of Islamic repo similar to what the Tahawwut Master Agreement has done for the Islamic derivatives market.

In addition, simplification of selected trade documentation under Islamic repo is required, for example reducing the number of schedules to complete a trade. Currently, there are four schedules under CCM that must be completed.

Another suggestion for further development of Islamic repo would be for the central bank's window for Islamic repo to implement a tendering system for the interbank players, similar to conventional repo. This is crucial in providing liquidity in the Islamic repo market and would encourage more Islamic banks to participate.

Lastly, more issuances of Sukuk by global central banks, federal/state governments and agencies are also welcomed, as this will help further develop Islamic repo through the availability of acceptable assets to facilitate such Shariah-compliant transactions.

Liquidity Risk Management by Islamic Financial Institutions

Liquidity Risk Management by Islamic Financial Institutions

Industry still in need of active, deep markets in interbank and liquidity instruments

In the IFSB's Islamic Financial Services Industry Development Ten-year Review released in May 2023, a survey revealed that more than 50% of Islamic banking respondents cited a lack of active and deep markets in interbank and liquidity instruments. Across the industry, one of the Review's 18 recommendations was to enhance the liquidity infrastructure for all Islamic finance segments—Islamic Capital Market, Islamic banking, Takaful, and non-bank financial institutions—to ensure their growth. Among the recommended actions are: creation of a liquidity infrastructure and ecosystems for Islamic money and capital markets; increase Sukuk issuances that can be used for liquidity management and traded across borders; and develop instruments for risk mitigation and short-term liquidity management.

Tools Used by IFIs to Mitigate Liquidity Risk

Instrument	Tenor	Currency	Tradability	Rating
Central bank Islamic instruments	3 months – 3 years	Local	Limited	Unrated
Short-term Sukuk	3 months – 1 year	Local	Limited	Unrated
Commodity Murabaha	1 week – 6 months	Any	No	Counterparty
Interbank Mudaraba	Overnight – 1 month	Any	No	Counterparty
Interbank Wakala	1 – 3 months	Any	No	Counterparty
Islamic repo	Overnight – 1 month	Local	No	Unrated
IILM Sukuk	1 day to 364 days	Can be issued in any reserve currency	Yes	A1 and F1

Sources: "An Alternative Approach to Liquidity Risk Management of Islamic Banks", Muhammed Habib Dolgun, Abbas Mirakhor (De Gruyter, 2021); IILM

CASE STUDY: Philippines building Islamic liquidity infrastructure for nascent industry

In May 2021, Bangko Sentral Ng Pilipinas issued guidelines on the management of liquidity risk by Islamic banks and Islamic bank units operating in the country. An observation period of three and a half years, until December 31 2024, was adopted to give Islamic financial institutions time to adapt as necessary. Because of the lack of Islamic liquidity management instruments, Islamic banks and Islamic bank units are only required to comply with Basel III 100% LCR and NSFR rules from January 1, 2025.

The guidelines emphasise Shariah compliance in liquidity risk management, including the choice of instruments or tools to mitigate liquidity risk. They also offer guidance on the treatment of Islamic banking accounts such as profit and loss sharing investment accounts.

It was as recent as 2019 that the Philippines signed a new Islamic banking law. Since then, apart from the new liquidity risk management guidelines, it has taken other steps to develop the industry, including signing a cooperation agreement with AAOIFI in 2021 and approving the prudential reporting framework for Islamic banks and Islamic banking units in 2022. There is currently one Islamic bank in the Philippines, the state-owned Al Amanah Islamic Investment Bank of the Philippines, which is a subsidiary of the Development Bank of the Philippines. The country is also planning to issue its maiden Sukuk as it currently seeks alternative funding sources for its budget.

Basel III Requirements for Liquidity Management for Islamic Financial Institutions

IFIs well-covered with short-term and long-term liquidity buffers

Under Basel III rules, all financial institutions—conventional and Islamic—must meet two liquidity ratios: the Liquidity Coverage Ratio (LCR) must be at least 100%, which means holding an amount of HQLAs that are equal or greater than net cash flow over a 30-day stress period; and the Net Stable Funding Ratio (NSFR) must be at least 100% on an ongoing basis to reduce funding risk over a longer time horizon. Complementing each other, the LCR focuses on the quality and liquidity of assets while the NSFR focuses on the quality and stability of liabilities. HQLAs are essentially assets that can be easily and immediately converted into cash with no or little loss of value during a time of stress.

The Bank of International Settlements' Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools document of 2013 grants the financial authorities of each jurisdiction the discretion to define what Shariah-compliant financial products can be acceptable as HQLAs.

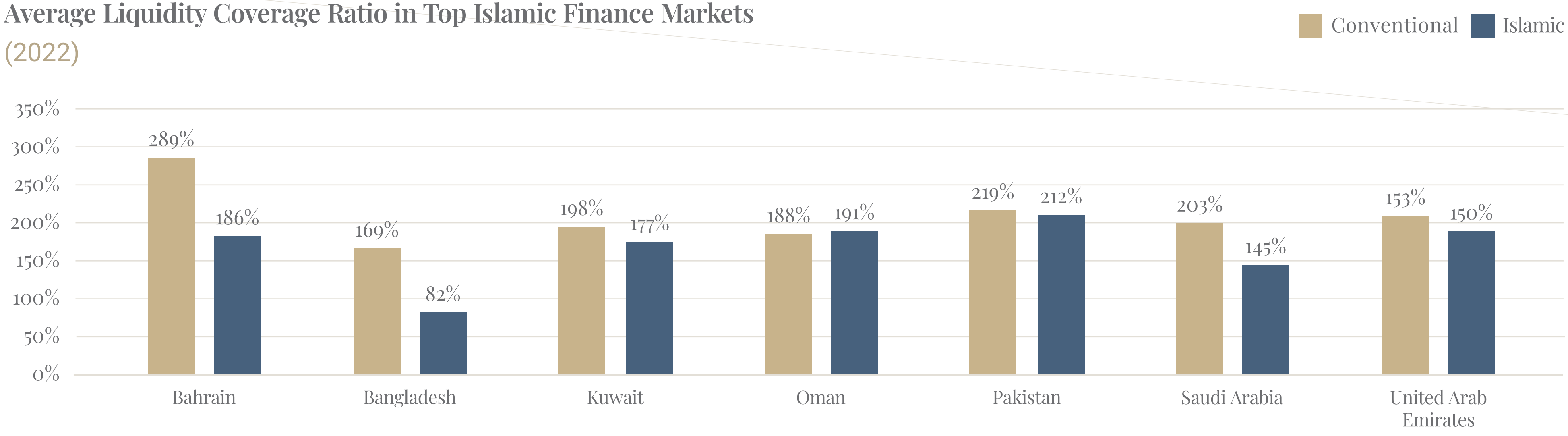
In 2015, the Islamic Financial Services Board's (IFSB) Guidance Notes (GN-6) set out the HQLAs that have in general been referenced by jurisdictions. Broadly, Level 1 HQLAs (the highest level) comprise the most liquid assets such as coins and banknotes as well as the highest-rated and safest Sukuk or other Shariah-compliant marketable securities, which come from sovereigns and organisations that are assigned a 0% risk weight, such as multilaterals like the IILM. If the Sukuk and other Shariah-compliant marketable securities are issued by sovereigns or organisations that have a non-0% risk weight, they should be in domestic currencies or as securities in foreign currencies. Level 2A and Level 2B (both levels can only make up 40% of the total stock of HQLAs) are lower-rated and riskier assets than those that qualify as Level 1. The IFSB's Basel III liquidity risk management guidance drove the increase in supply of Sukuk to be used as HQLAs, with issuances gradually increasing from 2019 as different countries started implementing the new LCR rule (see chart on issuance of Capital Tier Sukuk in Chapter 4).

With the introduction of Basel IV reforms proposed by the Basel Committee on Banking Supervision, which focuses on the denominator of the capital ratio – banks' risk positions, financial institutions might face higher capital requirements as the new rules aims to standardise and limit the use of internal risk models. There was a realisation that same risk positions were valued differently by different institutions' internal models. This will cover credit, market, counterparty and operation risks.

Bangladesh bank run a reminder for continued prudence, development of liquidity management framework

Looking at banks, which hold the lion's share of global Islamic financial assets, with the exception of the average LCR of Islamic banks in Bangladesh, conventional banks and Shariah-compliant banks across seven countries of the GCC and South Asia comfortably met LCR in 2022. Malaysia's conventional and Islamic banks also met Basel III LCR requirement, averaging 154% last year, according to central bank data.

Average Liquidity Coverage Ratio in Top Islamic Finance Markets (2022)



Source: LSEG Analysis. The sample uses top five conventional and Islamic banks in each country. The data is collected based on available Pillar III disclosures.
The top Islamic finance markets used represent 95% of total global assets

Islamic banks in Bangladesh ended 2022 with 61.72% lower excess liquidity compared to 2021, according to Bank Bangladesh. The central bank's statutory liquidity reserve ratio for Islamic banks in Bangladesh is lower (5.5%) than for conventional banks (13%), part of the regulator's efforts to support the growth of Shariah-compliant financial services in the country. This lower level of liquidity was severely challenged when six Shariah-compliant banks, according to local media reports, faced intense pressure on their liquidity amid a bank run situation after allegations of loan irregularities involving one Islamic bank. This resulted in the central bank introducing a special liquidity facility in December to provide support for the Islamic banks (See Case Study in Chapter 2). While the situation was contained relatively quickly and the liquidity stress eased in the months that followed, it is a reminder for the Islamic financial services industry that weak liquidity buffers could materially increase vulnerabilities to deposit runs and that pro-growth policies must be supported by a sound prudential regime.

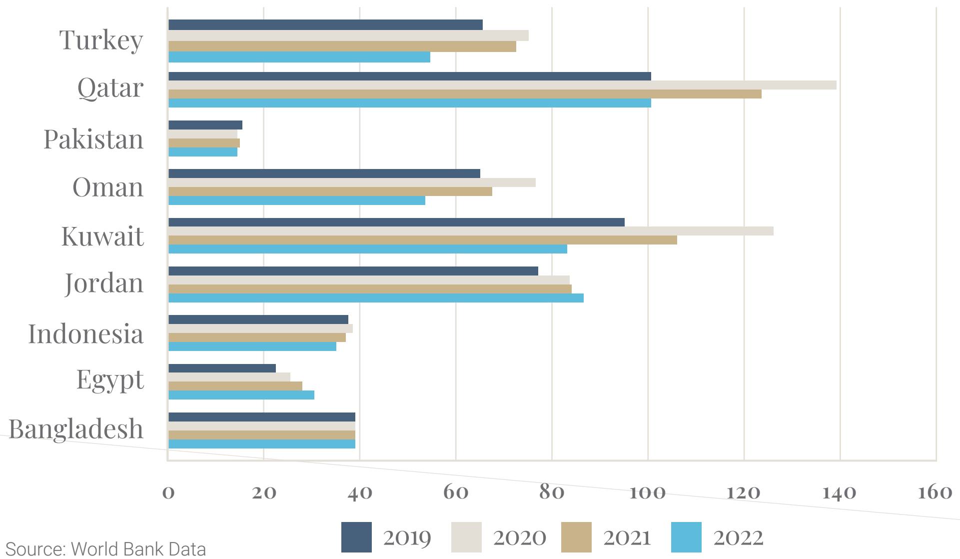
As we pointed out in Chapter 1, the unique situations of each country determine how much liquidity their banks hold. Among the bigger Muslim-majority countries where Islamic finance would have more of an appeal, the situation could not be more telling than in the case of Türkiye and Pakistan where Shariah-compliant banks hold more than double the required LCR, according to IFSB PSIFIs data.

To add to our commentary on Türkiye in Chapter 1, for a considerable period, Pakistan's banks have not fully fulfilled their role as facilitators of economic growth and intermediaries of capital to the private sector, according to assessments made by organisations such as The World Bank. For the banks, holding excessive levels of liquidity impacts profitability because of the cost in the form of lost earnings from undeployed funds. Part of the solutions for this are being addressed by the central bank's 2021 to 2025 Strategic Plan for the Islamic Banking industry that includes the development of the liquidity management framework to better support Shariah-compliant banks. For economic growth and development, Pakistan's banks are channelling a significantly low volume of credit to the private sector, even compared to Türkiye whose banks hold comparable levels of LCR.

The growth of Islamic banks' financing to the private sector in Pakistan dropped in 2022 as the country, already struggling from sky-high inflation and dwindling foreign reserves (and shortage of forex in the interbank market, according to local reports), fell deeper into economic crisis following major floods in August 2022 that heaped more pressure on its finances. Pakistan received a lifeline when in July 2023 a US$1.2 billion first tranche from an agreed US$3 billion IMF bailout came through. The trajectory of Islamic finance in Pakistan is now under heightened scrutiny, particularly since the government announced in November 2022 its intention to transition the country's banking system from conventional to Islamic by the end of 2027.

Domestic Credit to Private Sector of Pakistan and Key Islamic Banking Markets

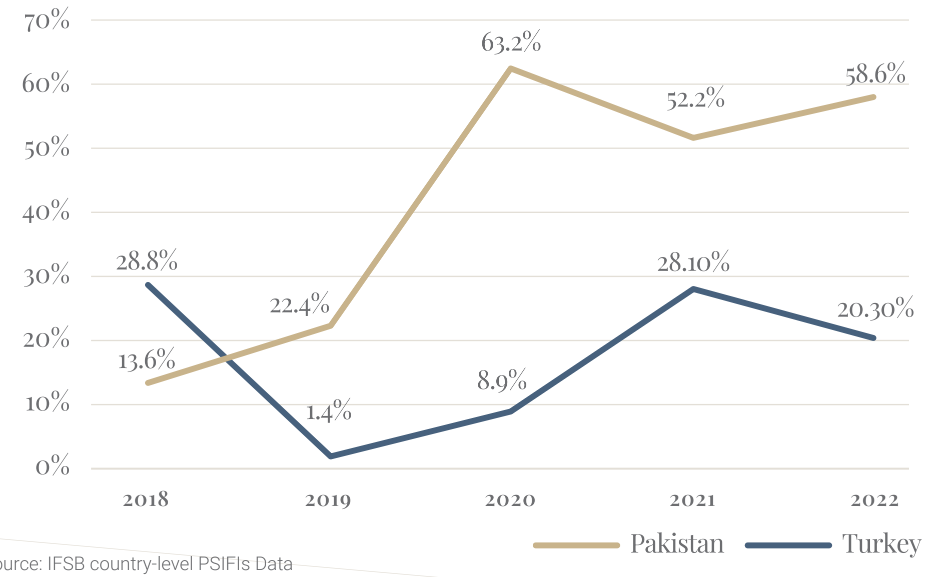
(2022, Percentage of GDP)



Source: World Bank Data

Growth of Financing to Private Sector – Pakistan and Türkiye Islamic Banks

(2018 – 2022)



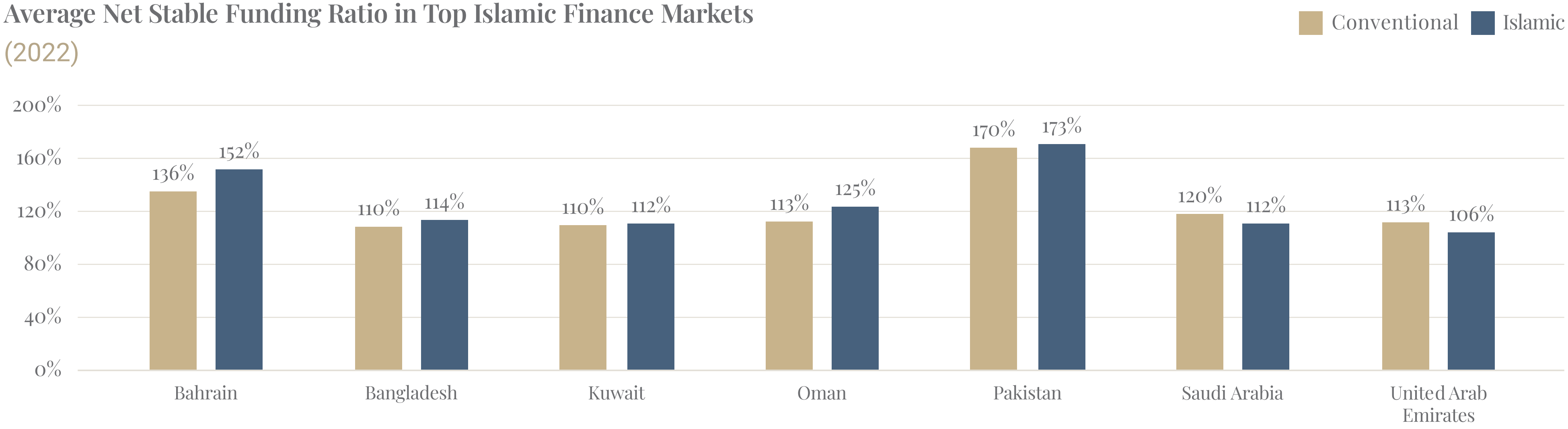
Source: IFSB country-level PSIFIs Data

Stable for the long-term

The aim of NSFR requirements is to restrict maturity mismatches between assets and liabilities and limit the reliance on unstable short-term funding to finance potentially illiquid long-term assets. The higher the value of NSFR, the higher the level of a bank's liquidity, which indicates less difficulty to meet its current liquidity obligations.

The average NSFR of conventional and Islamic banks across seven countries of the GCC and South Asia in 2022 met Basel III requirement of a minimum of 100%. In Malaysia, Bank Negara Malaysia data shows an average NSFR of 118.2% for the entire banking system. Saudi banks are also amply buffered but a closer look at their other ratios reveal how stretched they really are (see commentary in following pages about Saudi Arabia Islamic banks breaching 100% financing to deposit ratio).

Average Net Stable Funding Ratio in Top Islamic Finance Markets (2022)



Source: LSEG Analysis. The sample uses top five conventional and Islamic banks in each country. The data is collected based on available Pillar III disclosures. The top Islamic finance markets used represent 95% of total global assets.

CASE STUDY: Oman secures Islamic liquidity management instrument, addressing its immediate needs

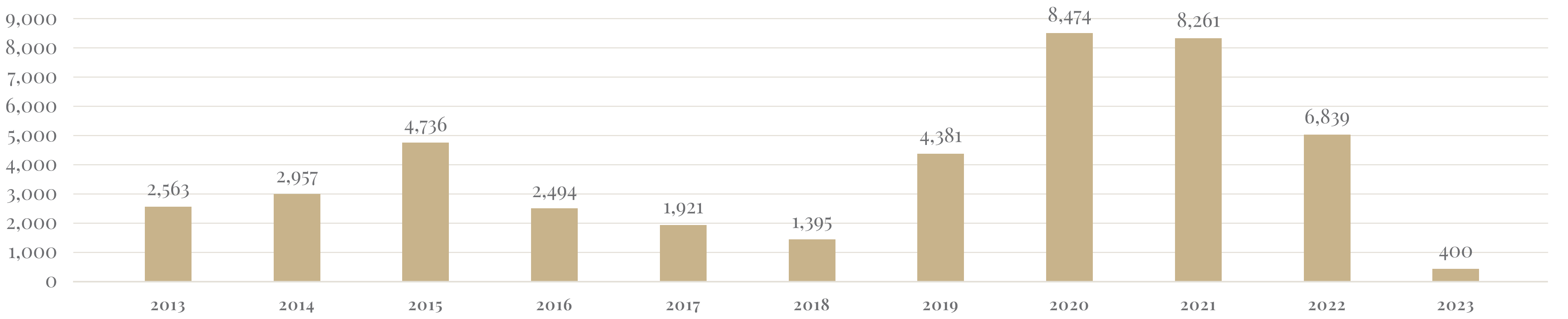
The Central Bank of Oman (CBO) in December 2022 introduced a new Islamic liquidity management instrument, which was much-needed considering the lack of these tools in the Sultanate. The Wakala Money Market instrument is the first of several Islamic liquidity management instruments that the CBO will introduce to provide liquidity support for the Islamic banks in the country. Using the instrument, Islamic banks place funds in US Dollars with the CBO for a period ranging from one day to three months. The CBO will manage and invest the funds in Shariah-compliant instruments.

There are currently no Islamic repos, short-term government Sukuk, or Islamic alternatives to treasury bills in Oman for Islamic banks to manage their liquidity or use as alternative sources to raise funding. Oman has the youngest and smallest Islamic banking market in the GCC. The CBO started an Islamic liquidity management project in 2018, around six years after Islamic banking was officially allowed to operate in the country.

Tier 1, Tier 2 Sukuk volume down on higher cost of funding

While the issuances of Tier 1 and Tier 2 Sukuk have grown since 2010 when the Basel Committee on Banking Supervision agreed on Basel III minimum capital requirements, there has been a shortage of these tradable instruments with low capital risk and predictable returns in the Islamic capital market. 2022 proved challenging. In a year dominated by higher cost of funding after central banks raised rates to contain inflation, the volume of capital tier Sukuk issuances dipped by 17.2%. Saudi financials were the biggest contributors to the Capital Tier Sukuk market.

Capital Tier Sukuk Issuance
(2013 – 2023, USD Million)



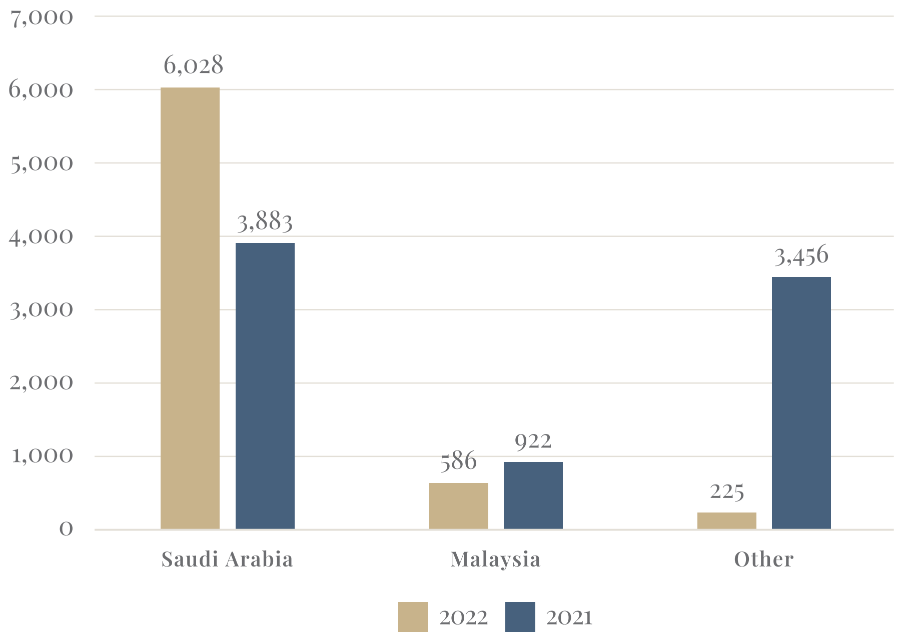
Source: LSEG Eikon

Saudi IFIs flood Capital Tier Sukuk market as they breach 100% financing to deposit ratio

Saudi Arabia's financial institutions issued a staggering 88% of all Tier 1 and Tier 2 Sukuk in 2022. Their total issuance of US$6.03 billion was a substantial 55% surge compared to 2021 as the government channelled more and more of its oil receipts to the sovereign wealth fund PIF, depriving Islamic banks of ample liquidity while they continue to provide financing for Vision 2030 projects.

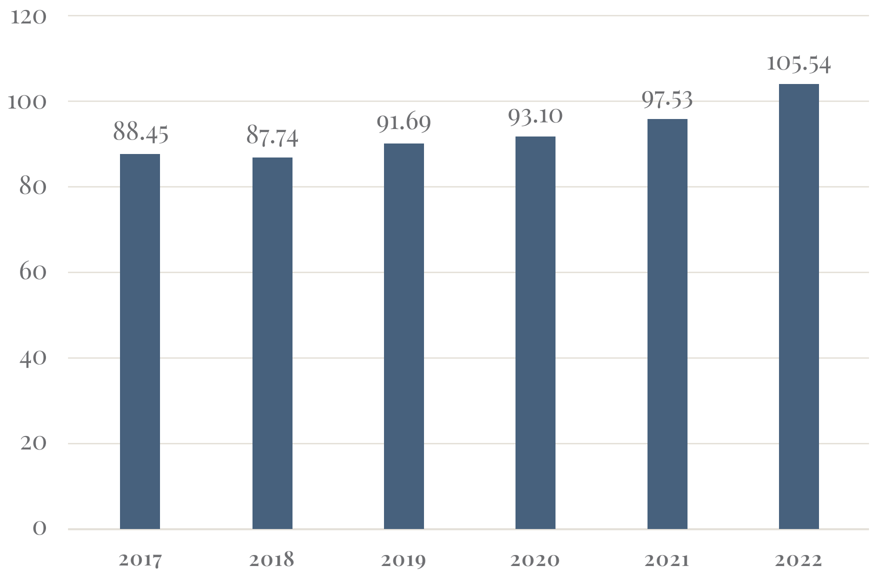
Islamic banks' financing to deposit ratio has been on the rise since 2018, breaching the 100% mark in 2022. The Islamic financial institutions that needed to buffer their capital with Sukuk were the biggest in the Kingdom: Al Rajhi (US$4.4 billion issued), Saudi National Bank (US$877.4 million) and Riyad Bank (US$750 million). Al Rajhi reported a 30% rise in real estate financing for Saudis and a huge 61% jump in financing for SMEs. SNB reported a 21% increase in mortgage financing. At the rate of growth of the financing to deposit ratio, it is clear that Saudi Vision 2030 projects need more than just bank support.

Top Countries in Capital Tier Sukuk Issuance
(2021 – 2022, USD Million)



Source: LSEG Eikon

Saudi Arabia Islamic Banks Financing to Deposit Ratio
(2017 – 2022, Percentage)



Source: LSEG Analysis of SAMA Data

Interview with S&P Global

DR. MOHAMED DAMAK

MANAGING DIRECTOR / SECTOR LEAD FINANCIAL INSTITUTIONS & GLOBAL HEAD OF ISLAMIC FINANCE S&P GLOBAL RATINGS

Mohamed Damak is a Senior Director and the Sector Lead for Financial Institutions in the Emerging EMEA region. Mohamed is also the Global Head of Islamic Finance at S&P Global Rating (SPGR). Mohamed leads SPGR's cross-practice analytical thought leadership initiatives and credit rating activities in the Islamic Finance sector globally. In addition to these responsibilities, Mohamed co-heads the Emerging Market Global Industry Focused Team and is a member of several senior forums and research labs including the Digitalisation of the Markets Research Lab.

Prior to joining SPGR, Mohamed worked as a Principal Credit Risk Officer for the African Development Bank in Tunis. From 2006 to 2010, Mohamed worked for SPGR covering conventional and Islamic financial institutions in the Middle East and North Africa region.

Mohamed holds a PhD in Finance, a Master in Money, Banking and Finance from University of Paris 2, Pantheon Assas, and a Master in Financial Institutions Management from Ecole Supérieure de Commerce de Tunis.

From your perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

Liquidity management instrument offerings remain limited in Islamic finance although Basel III liquidity coverage ratio has created opportunities for their growth. We estimate the amount of outstanding Sukuk at around $872 billion at year-end 2023. A large portion of these Sukuk are not eligible for inclusion as High-Quality Liquid Asset either because they were issued by financial institutions or because they were issued by a less creditworthy counterparty or simply because they are not actively traded. The latter is one of the reasons why Sukuk show better returns in periods of market turbulence.

The lack of issuance makes them a buy-and-hold instrument. This is why Islamic banks generally rely extensively on cash and central bank placements as their main liquidity management tools, somewhat putting them at a disadvantage with their conventional counterparts from a profitability perspective. The other challenge that Islamic banks face for their liquidity management is the fragmentation of the Islamic finance industry. Islamic finance lacks integration by geography and by sector. By geography, Islamic finance is a collection of small industries that are not interconnected. For example, an Islamic bank in North Africa will generally not use local currency or even foreign currency denominated government issuances from the Gulf as liquidity management tools. It will rather rely on local issuances if they exist or on specific instruments from its central bank. Issuances by multilateral lending institutions remain scarce as well, particularly for non-dollar denominated issuances where the offering is almost non-existent.

Given your experience and market engagement, what do you consider to be the key issues related to liquidity risk management facing Islamic banks, and how effective are current instruments at addressing these?

The key issue is the lack of instruments. Islamic banks rely primarily on placement with central banks and to a lesser extent eligible Sukuk issuance to manage their liquidity. We expect Sukuk issuance to slow down in 2023 to around $150 billion from $155.8 billion due to less supportive market conditions as a result of higher interest rates. In 2022, around 22% of Sukuk issuance were denominated in foreign currency, equivalent to around $34 billion. This is clearly insufficient for an industry where the total assets of the Islamic banks increased by around $150 billion during the same period and where banks are competing with other investors to grab a slice of Sukuk issuances.

The lack of standardisation in the Sukuk market and lack of harmonisation between the different Islamic jurisdictions are also negative factors for the availability and the effectiveness of Sukuk as liquidity management instruments. The Accounting and Auditing Organisation for Financial Institutions (AAOIFI) Standard 59, for example, requires the delisting of Sukuk from the market if the tangibility ratio falls below 33%, which could impact the liquidity of the instrument. This standard is not applicable in all the jurisdictions where Islamic banks are present. Using central bank instruments to manage liquidity can help due to the immediate availability of these resources when needed but it comes at a cost as these instruments have a low yield by design. The availability of these instruments could also be in doubt for the foreign currency denominated instruments and where the central bank would have a very limited amount of usable reserves. The other challenge that the industry faces is the absence of a lender of last resort in many jurisdictions and the debate whether profit-sharing investment account holders should or not absorb a portion of losses in case of problems. This is why Islamic banks will generally have a significant amount of liquid assets on their balance sheet, which could sometimes be viewed as inefficient use of their resources.

From your perspective, what should the industry be doing to address these issues over the next few years?

While we cannot recommend any policy action, as per our role in the market, we have observed that the industry is working toward resolving some of these challenges including:

- Some sovereigns have established large Sukuk issuance programmes and are issuing regularly to provide Islamic banks with the necessary instruments to manage their liquidity. This is the case in Saudi Arabia, for example. In our view, a higher volume of issuance is necessary to boost the availability of liquidity management instruments for Islamic banks. Listing these Sukuk on organised markets could also help improve their liquidity.
- In some countries, the central bank has created certain liquidity management instruments to help banks comply with regulation, at a cost for their profitability. Whether it is in Sukuk or placement form, banks are using central bank instruments to manage their liquidity. Sometimes, this would come with some risks if the currency of denomination of the instrument is not the same as the central bank currency.
- Standardisation of Sukuk remains difficult for now given the different interpretation of Shariah but it could be helped by digitalisation. Issuing, listing and managing Sukuk on platforms could help the industry going forward provided that some prerequisites are achieved including the presence of a regulatory framework. Digitalisation could spur a significant increase in the volume of Sukuk issuance improving their accessibility for banks.
- Some countries have clarified that their central banks could use structures such as Qard Hassan or others in order to act as a lender of last resort and provide support to failing financial institutions to avoid contagion. Having proper regulatory backstops could help financial institutions manage liquidity particularly in an environment where moving money out of banks is eased by digitalisation and social media can aggravate shocks.
- Some countries have clarified the different types of investment accounts and what accounts are supposed to absorb losses in case of issues. We understand that the contribution of these accounts is still limited in places like Malaysia, for example.

Interview with Kuwait Finance House

GEHAD MOHAMED EL-BENDARY

GROUP CHIEF RISK OFFICER,
KUWAIT FINANCE HOUSE

Mr. El-Bendary is currently the Group Chief Risk Officer at KFH since 2018 and is a Board Member at Kuwait Turk Participation Bank (KTPB). He has over 23 years of experience in risk management, auditing, and internal control systems in financial institutions. He previously held several executive positions at KFH including the position of General Manager, Risk Management from 2016 until 2018.

Mr. El-Bendary oversaw the implementation of several initiatives including the development of a robust Enterprise Wide Risk Management Program for KFH Group, in addition to overseeing the implementation of the regulators' instructions including Basel I, II and III, IFRS9 and liquidity frameworks and guidelines.

He has successfully completed specialised training programs in Enterprise Leadership from INSEAD University, Network Leadership Program from IMD University, and Advanced Risk Management from Wharton School. He holds numerous specialised professional certificates including the International Certificate in Banking Risk and Regulation (ICBRR) from the Global Association of Risk Professionals (GARP) in 2009.

From your perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

Islamic liquidity management has always suffered from a lack of products to deploy excess liquidity compared to the conventional side, specifically on the short spectrum. The IILM plays a huge role in providing solutions and diversity to deploy excess liquidity. However, we still need more solutions and initiatives to provide alternatives to the current market products, for example to address the lack of solutions in major currencies and local currencies other than the US dollar.

Given your experience and market engagement, what are the key challenges faced by Islamic banks related to liquidity risk, and how effective are current instruments at addressing these?

Islamic banks tend to be liquid in general and the challenge is always deploying excess liquidity and not sourcing liquidity. One of the main challenges Islamic banks face is transacting with conventional banks due to limitations to deal in Islamic products, which makes Islamic banks miss a huge market. With a lack of products, counterparties' lines are mostly utilised and Islamic banks are always sourcing new channels to deploy their liquidity.

As a leading Islamic banking institution, what is your bank's approach to asset-liability management (ALM) issues, and what do you think institutions can do to better mitigate such challenges?

In our bank, to have a better assets and liabilities management framework, we have invested in setting up an ALM management information system with the aim of having complete, accurate, comprehensive, reconciled and integrated data. We also adopted a well-designated ALM engine to support projecting the bank's cashflows and repricing gaps on business as usual bases and stress testing bases to help recognise the bank's future funding needs and possible sensitivities to benchmark rate changes.

In addition, governance was set in accordance with the best practices in the banking industry to avoid any disruptions in the decision-taking process and to avoid excessive use of risk. The framework adopted in the bank incorporates a comprehensive ALM risk appetite framework and early warning signals help detect any possible alerts.

Considering the changes in the market environment, the bank considered multiple ways to hedge against the increases in benchmark rates by engaging in profit rate swaps to hedge some fixed income exposures, reducing the repricing frequencies of some corporate deals and issuing long-term debt in a low-rate environment.

Nonetheless, the challenges are mainly linked to the lack of profit rate hedging mechanisms and the availability of short-term instruments to deploy the excess liquidity.

From your perspective, what are the key initiatives that need to be taken to address the current liquidity management issue?

Two key initiatives are needed: More local currency short-term liquidity products, and more major currencies short-term liquidity products other than USD.

> "Islamic banks tend to be liquid in general and the challenge is always deploying access liquidity and not sourcing liquidity."

International Islamic Liquidity Management Corporation's Role in Addressing Liquidity Management Needs

IILM Overview

The IILM was created to address liquidity management challenges faced by the Islamic finance industry

The IILM is an international organisation established on 25 October 2010 by central banks and a multilateral organisation to address liquidity management challenges faced by Institutions offering Islamic Financial Services (IIFS) through the creation and issuance of high quality, Shariah-compliant liquidity instruments.

Diverse member composition comprising central banks of Indonesia, Kuwait, Luxembourg, Malaysia, Mauritius, Nigeria, Qatar, Türkiye, the United Arab Emirates as well as Islamic Corporation for the Development of the Private Sector (ICD) paved the way for a unique collaborative, cross-border solution to a common, cross-border concern.

The IILM members place a great value on governance and oversight. To ensure effective oversight, its governance structure includes a governing board, a board executive committee, risk management and audit committees along with a Shariah committee that currently consists of four members of various nationalities. The representation on these boards and committees includes governors along with senior officials from central banks and a multilateral organisation.

IILM Snapshot

<table>
<tr><td>Date of Establishment</td><td colspan="4">October 25, 2010</td></tr>
<tr><td>Headquarters</td><td colspan="4">Kuala Lumpur, Malaysia</td></tr>
<tr><td>Primary Objective</td><td colspan="4">Provide Shariah-compliant financial instruments for effective cross-border liquidity management</td></tr>
<tr><td>Tool Used</td><td colspan="4">Sukuk Issuance based on Wakala Structure. Fully-compliant with AAOIFI Standards. Three different tenors are offered every month since the past three years with a total average monthly issuance size of US$ 1 billion.</td></tr>
<tr><td rowspan="2">Sukuk Rating</td><td rowspan="2">S&P Global Ratings</td><td>Short-Term Credit Rating: A1</td><td rowspan="2">Fitch Ratings</td><td>Short-Term Credit Rating: F1</td></tr>
<tr><td>Pool of Asset Quality and Sustained Reissuance Since Inception</td><td>Pool of Asset Quality and Track Record of Performance</td></tr>
<tr><td>Current Members</td><td colspan="2">• Bank Indonesia
• Central Bank of Kuwait
• Central Bank of Malaysia
• Central Bank of Mauritius
• Islamic Corporation for the Development of Private Sector</td><td colspan="2">• Central Bank of Nigeria
• Qatar Central Bank
• Central Bank of the Republic of Türkiye
• Central Bank of the UAE</td></tr>
<tr><td>Total Issuance Amount Since Inception (2013 – 2023)</td><td colspan="4">234 Sukuk issues of total value of US$100.94 billion</td></tr>
</table>

IILM
Key Milestones

2010

The International Islamic Liquidity Management Corporation (the IILM) was established

2013

Inaugural US$2 billion short-term Sukuk programme by IILM with a US$490 million issuance

2014

IILM lengthens tenors with first 6-month Sukuk issued

2016

First 4-month Sukuk issued by IILM

2017

Sukuk issuance programme increased to US$3.0 billion

The IILM achieved several milestones during its 10 years serving the Islamic finance industry

The IILM's Sukuk programme has shown robustness in its qualitative and quantitative expansion throughout the organisation's 10-year journey. This ranges from issuing several tenors to meet demand by different investors for short-term high-quality Islamic instruments, upsizing its Sukuk program as well as securing high short-term credit rating from different agencies.

2018

Introduction of pricing discovery process through competitive bidding auctions on Bloomberg

2019

2-week, 3-week and 1-month Sukuk introduced. Started offering three different tenors every month

2020

Sukuk issuance programme upsized to US$4.0 billion

2022

IILM received second international programme rating from Fitch

Inaugural 12-month issuance by IILM, increasing the number of tenors issued to 10

2023

Total Sukuk issues by IILM crossed US$100 billion

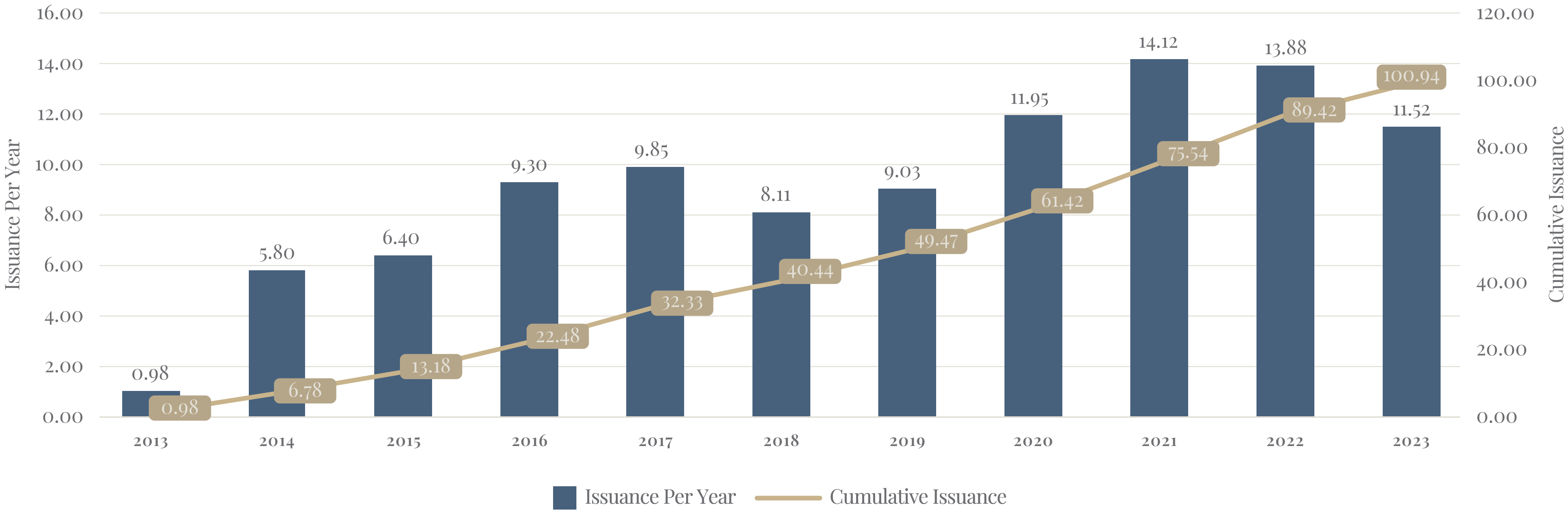
IILM Sukuk Issuance

The IILM has played a significant role in shaping the Sukuk industry globally

Since its inception until 2023, the IILM issued 234 Sukuk with a total value of US$100.94 billion. In 2022, the organisation issued US$13.88 billion of Sukuk and it has reached US$11.52 billion in 2023.

The IILM's Sukuk represent a large chunk of international Sukuk sales: according to LSEG, 20% of international Sukuk issued in H1 2023 are by the IILM. The organisation also ranks among the top Sukuk issuers globally so far in 2023, behind the governments of Malaysia, Saudi Arabia and Indonesia. It was also ranked the fourth overall top issuer of Sukuk for 2022, according to LSEG data. From 2018 to 2022, the IILM was the second top issuer for USD Sukuk, and it remains so in H1 2023.

IILM Sukuk Issuances
(USD Billion, 2013 – 2023)



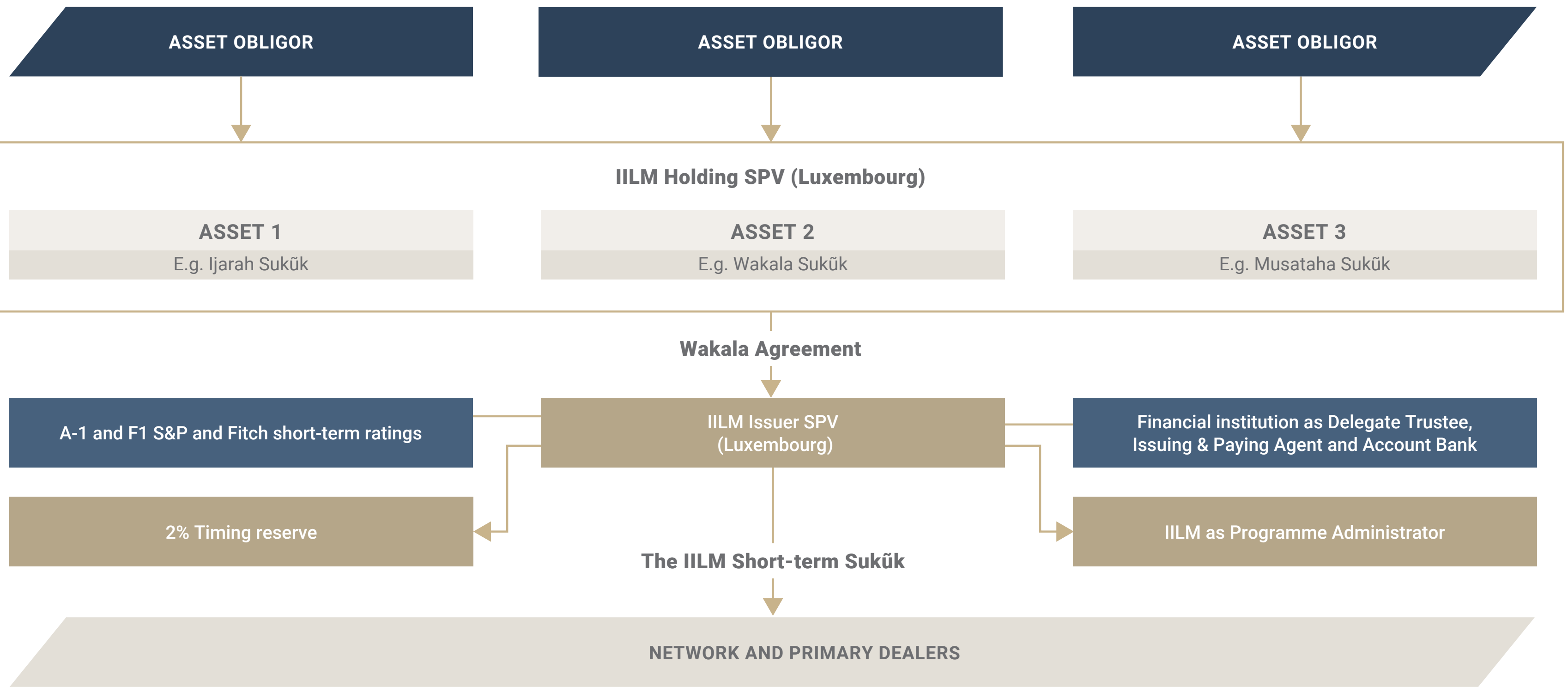
Source: IILM

Well-crafted Sukuk structure to meet market needs

The Sukuk instruments issued by the IILM are structured as Sukuk Wakala, with the issuer in this structure acting as the agent or Wakeel on behalf of the Sukuk holders. The IILM acts as the programme administrator and investment advisor that selects and recommends the Shariah-compliant investment. The Sukuk's underlying assets are based on market-standard Sukuk structures. The aim is to have the highest tangibility versus financial ratio in the asset pool. The current portfolio has a tangibility ratio of 79% with 21% receivables. The structure is as illustrated on this page. The IILM Sukuk is fully compliant with the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)'s standards and they are tradable, as discussed in the following pages. The structure of the Sukuk along with the underlying assets are approved by the IILM Shariah Committee via a fatwa that was reconfirmed in March 2023.

The value proposition of the IILM Sukuk programme is that it is structured to gain wide acceptance in terms of Shariah compliance. This will allow it to be easily marketed cross-border. The IILM Sukuk is an important milestone as an Islamic short-term instrument. Due to different requirements and opinions, it took three years before the IILM debuted its program that was backed by liquid high-quality asset-backed Sukuk.

The IILM Sukuk Programme Structure



Source: IILM

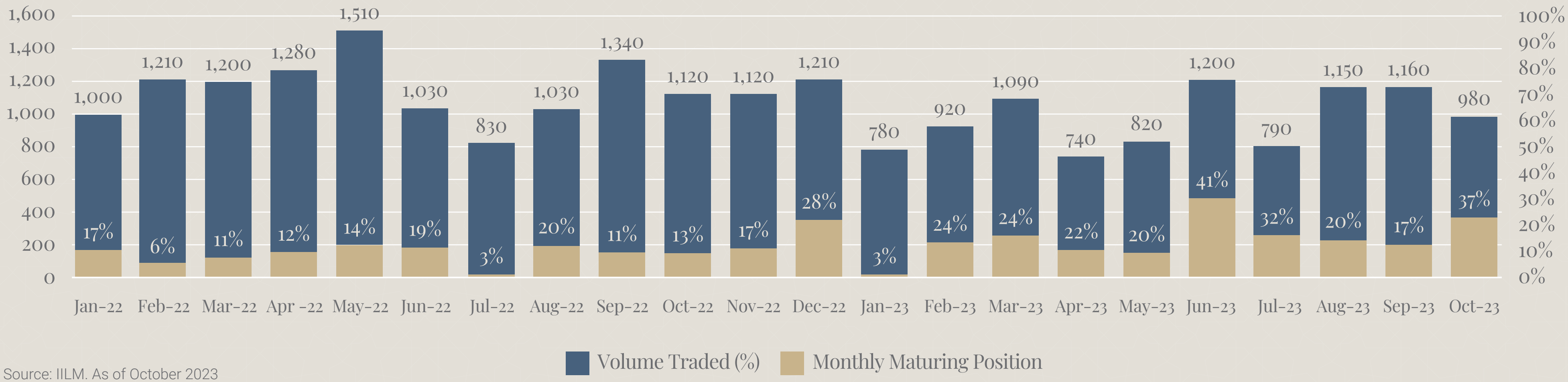
HIGHLIGHT: The IILM unique Sukuk offering allows it to be highly marketable in the secondary market

AAOIFI standard no. 59 that covers sale of debt and that took effect in several markets at the start of 2021 impacted the Islamic banking and Sukuk markets as it concerns the rollover of debts and tangibility ratio of assets. For Wakala Sukuk, where the underlying assets are a mix of other financial assets (such as Murabaha, Salam, Mudaraba, Musharaka), its tradability on the secondary market depends first on the tradability of the underlying assets. According to AAOIFI, the threshold to permit trading is at least 33% tangible assets while the OIC Fiqh Academy needs a minimum of 51%.

The IILM's Wakala Sukuk tangibility ratio passes the required limit and has always stood above 50% since the issuance of the organisation's first Sukuk. In fact, the tangibility ratio has been 79% since 2020 with the addition of two new assets, allowing it to be tradable in the secondary market in most jurisdictions. With this, the weighted average turnover for the period between January 2022 and October 2023 is 19%. The highest volume traded was seen in October 2023, totalling a volume of US$412 million and reflects the growing acceptance of the IILM Sukuk as well as wider investor distribution compared to previous periods.

For 2022 as reported by primary dealers, the highest trade activity was seen in the GCC. This is attributed to the higher liquidity in the region with investors seeking high yields given the increase in interest rates. The highest inter-regional trade was noted from Asia to the Middle East, then in the other direction from the Middle East to Asia. By country, Kuwait, the UAE, Oman and Türkiye were the most active markets. The IILM Sukuk also gained presence in non-core Islamic finance markets such as Palestine, Qatar, Switzerland and South Africa.

The IILM Sukuk Secondary Market Turnover



Source: IILM. As of October 2023

Your Partner Bank in Islamic Capital Markets

Albaraka Turk is the only primary dealer from Türkiye in IILM since 2010

alBaraka

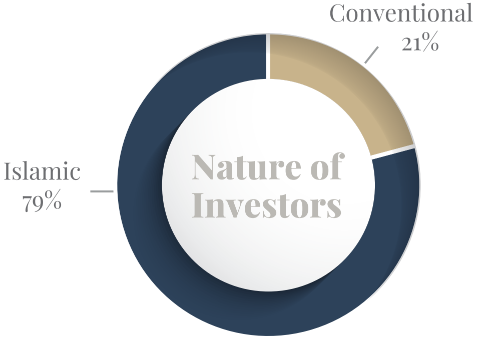
IILM Sukuk Tenor

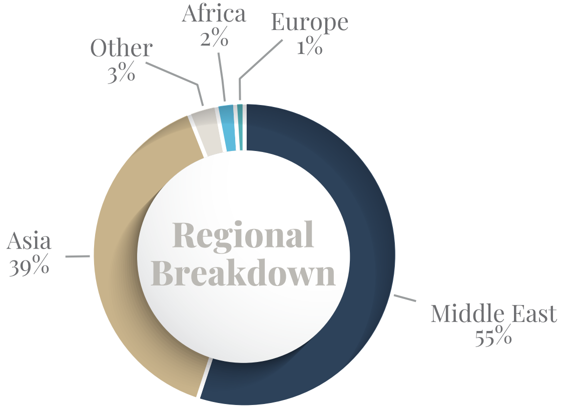
High demand for IILM Sukuk issues

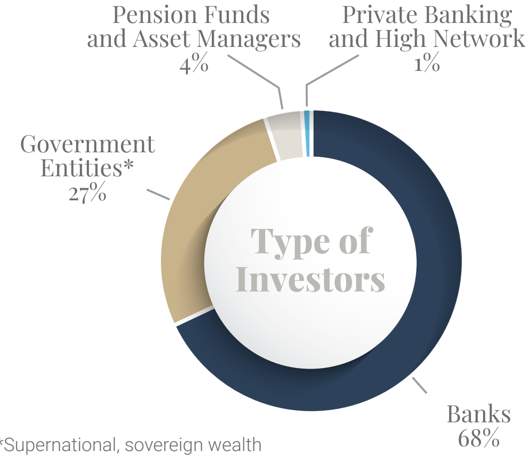
The deepening inversion of several parts of the US treasury yield curve is making the IILM Sukuk profit rates more attractive to investors especially because investors need to park their cash in less risky short-term investments while seeking to avoid volatility in the market. In 2023, the IILM Sukuk were 205% subscribed on average with the highest-recorded coverage ratio for the 1-month Sukuk in April 2023 (357%).

Islamic investors comprise the majority of all IILM Sukuk buyers. By investor category, banks form the lion's share, with Islamic banks making up 80% of total banks in 2022. By region, Middle Eastern investors lead, specifically Kuwait (39%) and the UAE (11%). They are followed by Asia with Malaysia (10%) and Brunei (23%) dominating. Brunei was a much bigger investor in 2022, from just 9% in 2021. Other countries buying IILM Sukuk are Pakistan (4%), Oman, Nigeria, Singapore, Türkiye, Qatar (2% each), Saudi Arabia, Sudan, Switzerland, Palestine, and South Africa (1% each).

Sukuk Investors Breakdown (2022)







Source: IILM

*Supernational, sovereign wealth funds, ministries of finance and central banks

HIGHLIGHT: IILM Sukuk asset portfolio position it among most highly-rated issues

To support demand for high-quality assets, the IILM follows a robust eligibility criterion for funding with credit enhancements and guarantees. It has mid- to long-term asset-backed funding with investment assets of US$3.51 billion as at December 2023 (considered as 1:1 issuance to asset ratio). Its asset portfolio is based on sovereigns, government-related entities and supranational entities via Shariah-compliant assets with a minimum long term rating of "A" by S&P and Fitch. By region, its portfolio to-date is also based on assets from the GCC and supranationals.

The IILM Sukuk received the second-highest short-term ratings from S&P and Fitch, based on their high asset quality, track record and sustained reissuance. The strong ratings meet the needs of investors seeking highly-rated Sukuk, which is already evident by the wider range of investors of such Sukuk in the secondary market.

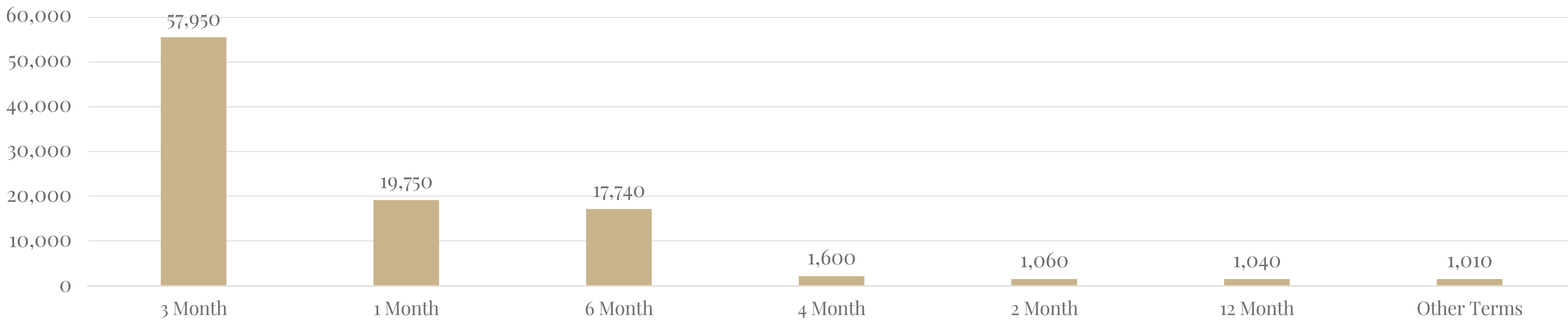
New one-year international Sukuk and upsized programme launched to meet rising market demand

The 2023 IILM Sukuk programme is issued in four different tenors: 1-month, 3-month, 6-month and 1-year. The 1-year Sukuk debuted in June 2022 and is believed to be the world's first international issuance of its kind, a sign of the growing importance of IILM issues for the industry. The 1-year Sukuk was released when issuances were slowing as market participants waited for central banks to respond to high inflation rates that prevailed at the time. The 1-year Sukuk was oversubscribed by 1.85 times. A similar issuance in October 2022 was similarly oversubscribed, by 1.98 times, another issuance in June 2023 was oversubscribed by 1.81 times and another issuance in October 2023 was oversubscribed by 242%.

Such Sukuk issuances help build a benchmark yield curve up to 12 months to address the different liquidity needs of Islamic banks and other institutions globally. The 1-year tenor supports the offering of Islamic liquidity instruments in local currency by regulators such as the Central Bank of Oman and Bank of England. Sukuk issuance by the IILM are also supported and distributed by ten multi-jurisdictional primary dealers to facilitate global distribution. Previous IILM Sukuk were 2, 3, 6-week as well as 2, 4, and 7-month tenors. Diversification is key to meet investors' demand and the IILM is on track to meet this.

Another sign of the development of the IILM Sukuk is the growth of its annual programme, enlarging from US$3 billion to US$4 billion since September 2020. This was at a time when economies were unravelled by the COVID-19 pandemic and authorities took unprecedented monetary and fiscal measures. During that uncertain period, liquidity management became even more important and IILM Sukuk served as a refuge for investments for Islamic financial institutions.

IILM Sukuk Issuance by Tenor
(USD Million, 2013 – November 2023)



Source: IILM

Interview with First Abu Dhabi Bank

NADINE WINDSOR

HEAD OF FIXED INCOME TRADING,
FIRST ABU DHABI BANK

Nadine Windsor is currently the Head of Fixed Income Trading at First Abu Dhabi Bank, which is one of the largest banks in the Middle East. She has 18 years of experience in the banking industry and started her career working at Lehman Brothers in London before moving to the United Arab Emirates in 2009. She has a comprehensive understanding of global markets, having worked as a research analyst, trader and portfolio manager in fixed income and equity markets.

Nadine has a Masters in Accounting and Market Finance from HEC Paris, a leading European business school.

From your perspective and given your market interactions, what do you consider to be the current state of Islamic liquidity management solutions in the Islamic finance industry?

Over the last few years, we have seen an acceleration in the shaping of the Islamic finance industry, in particular Sukuk. Some GCC countries are witnessing an increased level of regulation in the space. For example, the UAE has adopted the AAOIFI standards. The combined challenging market conditions since the pandemic and the high volatility in the interest rate markets are leading to a flight to quality from fixed investors seeking higher returns without wanting to compromise on credit quality. Many were sitting on the sidelines waiting to deploy significant amounts of cash, as deposits quickly became a source of wealth erosion instead of a safe haven. The IILM programme positioning in terms of tenors and maturity offerings is an attractive proposition to both regional and international investors. It has been receiving an increased level of attention along with the significant interest that money market funds are receiving, especially since the successful addition of the 12-month tenor Sukuk. With 20% of the total Sukuk issuance, the IILM programme has established itself as a strong reference in the USD short-term Sukuk market for Islamic, but also surprisingly for conventional, investors.

Given your experience and market engagement, what is the current demand for IILM Sukuk, and how is the supply side responding to meet such demand?

The structural differences between the conventional and Islamic instrument are often attributed to scarcity in both the primary and secondary markets. The demand for Sukuk is growing faster than the primary issuances. Since the peak we saw in 2014 where 40% of the newly issued instruments were Sukuk, that figure hovered between 20% and 30% between 2015 and 2022. In the first half of 2023, 33% of the GCC issuances were Sukuk. Despite acute interest rate volatility during that period, issuers found windows to address their financing and refinancing needs.

The primary markets are trying to catch up with strong Sukuk issuance growth after a lacklustre 2022, which saw the lowest Islamic issuance from the GCC and Egypt, with US$12.2 billion issued vs US$26 billion printed during 2021. During the first half of 2023, we saw a total GCC and Egypt Sukuk issuance of US$11.4 billion, with another 6 months of issuances in front of us. Looking ahead, more than US$20 billion worth of Sukuk will be maturing each year in 2024, 2025, and 2026. The Sukuk primary space will continue to be under the spotlight and we believe that the demand for the IILM Sukuk will continue to strengthen in the coming quarters, as it grows into a cornerstone role of the Sukuk world (Figures sourced from FAB Market Insights Publications).

> "Over the last few years, we have seen an acceleration in the shaping of the Islamic finance industry, in particular Sukuk."

From your perspective, what is the impact of the IILM Sukuk programme on Islamic liquidity management, and what should IILM do to continue to play an effective role in supporting the Islamic finance industry?

Given the increased amount of cash investors are sitting on, Islamic liquidity management has become a priority for local and regional banks, as well as regional and international investors and issuers. The IILM Sukuk programme is a key tool and is being increasingly seen as an effective diversification instrument given its supranational issuer. The growth of the programme has been impressive over the last few years as demonstrated by the sustained growth in the volumes traded on the secondary market. As interest in the programme grows, the market will be more demanding when it comes to additional instrument ratings. In addition, as a natural extension of the liquidity of the Sukuk programme, it will at some point become critical to develop and expand the repo market for such instruments. The IILM Sukuk programme is supported by a strong team and is perceived as a solid partner by market participants, including primary dealers and end clients. A large part of that impressive success goes to their credit. They are preparing for the next steps of the programme growth and market conditions are looking like they want to improve for fixed income instruments.

Acronyms

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
ALF	Alternative Liquidity Facility
BNIBFI	Bank Negara Interbank Bills Foreign – Islamic
BNM	Bank Negara Malaysia
BoE	Bank of England
CBB	Central Bank of Bahrain
CBO	Central Bank of Oman
CCM	Collateralised Commodity Murabaha
CM	Collateralised Murabaha
ESG	Environmental, Social and Governance
GCC	Gulf Corporation Council
HQLA	High-Quality Liquid Assets
ICD	Islamic Corporation for the Development of the Private Sector
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market

IIFS	Institutions offering Islamic Financial Services
IILM	International Islamic Liquidity Management Corporation
ISRA	International Shariah Research Academy
LCR	Liquidity Coverage Ratio
LIBOR	London Interbank Offered Rate
LSEG	London Stock Exchange Group
NSFR	Net Stable Funding Ratio
OIC	Organisation of Islamic Cooperation
RFRs	Risk-Free Rates
SAMA	Saudi Central Bank
SBBA	Sell and Buy Back Agreement
SCB	Standard Chartered Bank
SDGs	Sustainable Development Goals
SNB	Saudi National Bank

Contributors

London Stock Exchange Group, Data and Analytics	Shereen Mohamed, Senior Research Analyst
	Mustafa Adil, Head of Islamic Finance
	Shaima Hasan, Senior Proposition Manager
	Emmy Alim, Contributor
International Islamic Liquidity Management Corporation	Hichem Bouqniss, Executive Director
	Lee Wan Mone, Executive Director
	Zakaria Thiyfa, Vice President
	Danial Idraki, Associate Vice President

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