



# REGULATORY APPROACHES TO MONITORING LIQUIDITY MANAGEMENT IN ISLAMIC FINANCIAL SERVICES INDUSTRY

*PRESENTED AT:*

**Conrad Istanbul Hotel, Istanbul, Turkey | 6-7 April 2011**

**Seminar on Managing Liquidity in the Islamic Financial Services Industry**

**Zahid ur Rehman Khokher**

**Member of the Secretariat, Technical and Research**

**ISLAMIC FINANCIAL SERVICES BOARD**



## Agenda

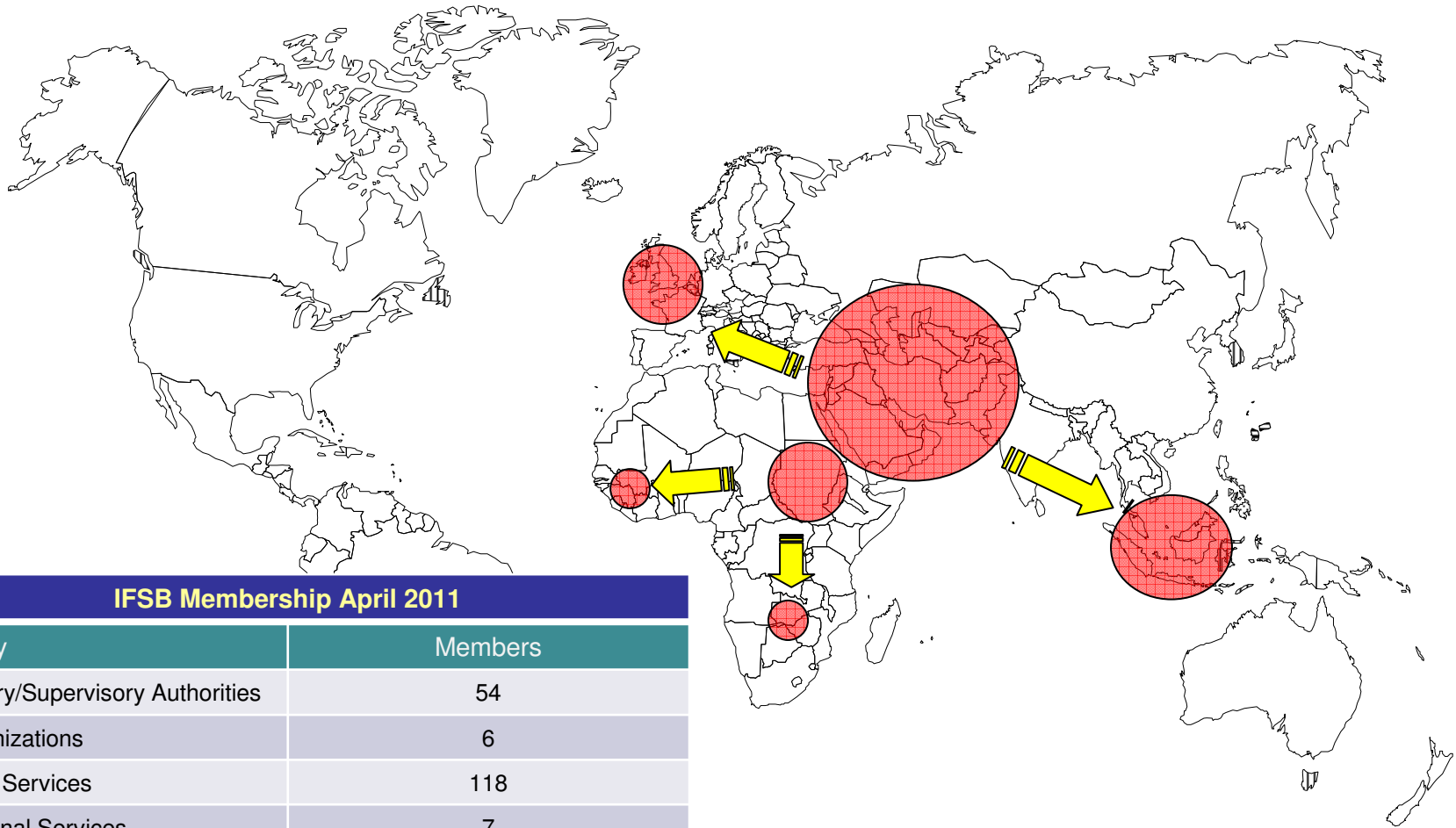
- Liquidity Supervision of the IIFS – Some specificities
- Regulatory Challenges in Monitoring Liquidity Risk in the IIFS
- Issuing Regulations and Guidelines for the IIFS
- Liquidity Infrastructure Elements and Central Banks/Supervisors
- Financial Sector Contingency Plan
- IFSB Standards and Initiatives
- Closing Remarks

*“Liquidity is the oil that greases the wheels of the financial machine”*

Extract from the Speech by Mr. Malcolm D Knight, General Manager of the BIS, at the Ninth Annual Risk Management Convention and Exhibition of the Global Association of Risk Professionals, New York, 26 February 2008.



# Geographic Expansion of Islamic Finance



**IFSB Membership April 2011**

Category	Members
Regulatory/Supervisory Authorities	54
Intl Organizations	6
Financial Services	118
Professional Services	7
Industry Associations	6
<b>TOTAL</b>	<b>191</b>
<b>Jurisdictions</b>	<b>43</b>

# Rationale of Liquidity Supervision and Monitoring

Conventional

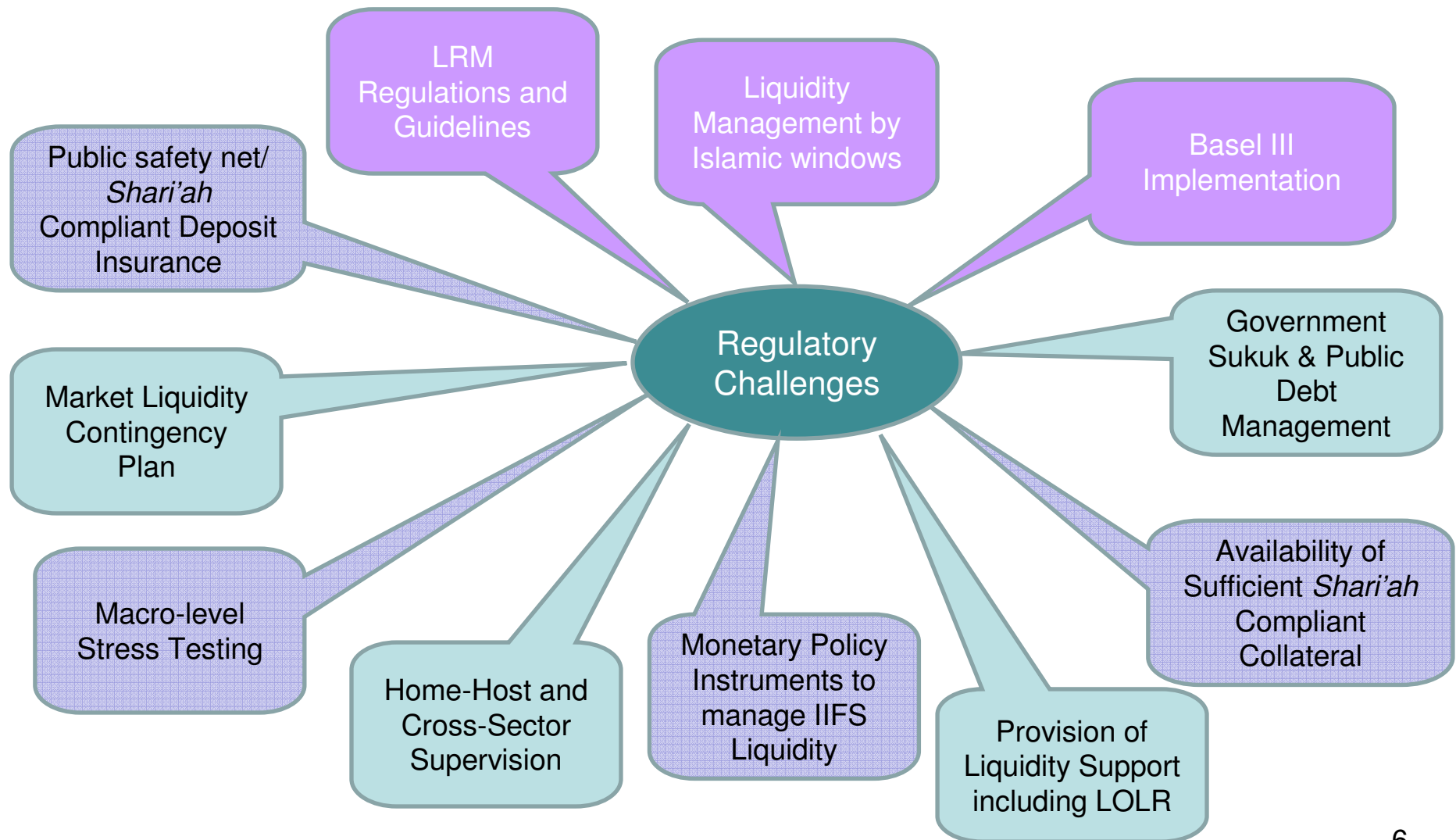
- To protect general confidence of stakeholders on soundness and stability of the financial system
- Systemic repercussions of the failure and illiquidity of one financial institution on other market players
- Depositor protection



IIFS

- Infant nature of the industry in many jurisdictions
- Few players and *Shari'ah* compliant instruments in many jurisdictions
- Liquidity support mechanisms from supervisory authorities and other IIFS
- Huge reputational contagion risk => problem in one IIFS many be attached to very business model of Islamic financial services industry
- Safeguarding the interest of IAH which contractually absorb their own risk
- Growing market share of Islamic finance in most jurisdictions

# Regulatory Challenges in Monitoring Liquidity Risk in the IIFS



# LRM Regulations and Guidelines for the IIFS

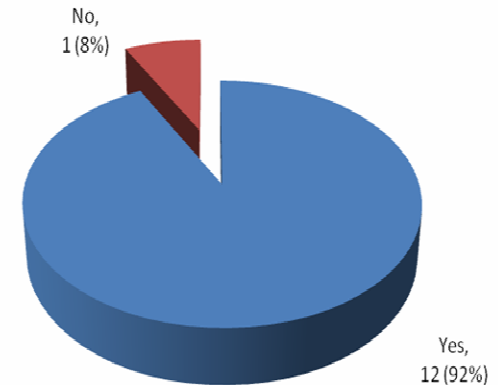
## Major Areas of Liquidity Supervision in the IIFS

- Monitoring liquidity risk management and liquidity position
- Supervision of liquidity risk in IIFS that are part of a group or Islamic operations of a conventional bank
- Need for supervisory regulation to the IIFS on liquidity risk management
- Compilation of information from the IIFS and from market sources
- Corrective action in case of need
- Home-host and cross-sector supervision
- Supervisors' contingency planning for the IIFS and liaison with official sector bodies

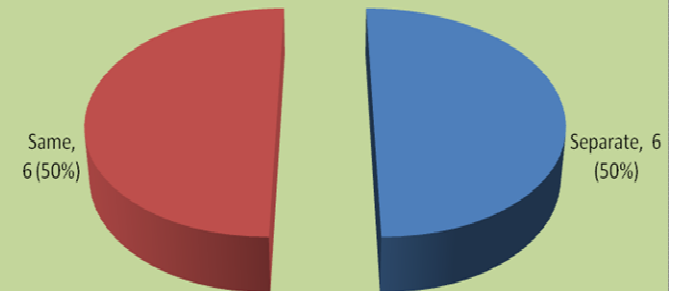
## Areas of Supervisory Guidance to the IIFS

- Managing risks arising from unique nature of IIFS funding and financing/ investment structure
- Dealing with interaction between liquidity risk and other risks distinctive to IIFS
- Maintaining liquidity buffer and preparing Contingency Funding Plan
- Defining eligible collateral for seeking liquidity support from the regulator
- Conducting stress testing
- Decreasing risk concentrations especially real estate
- Maintaining statutory reserves
- Regulatory reporting & disclosure to stakeholders

Risk Management Guidelines Issued



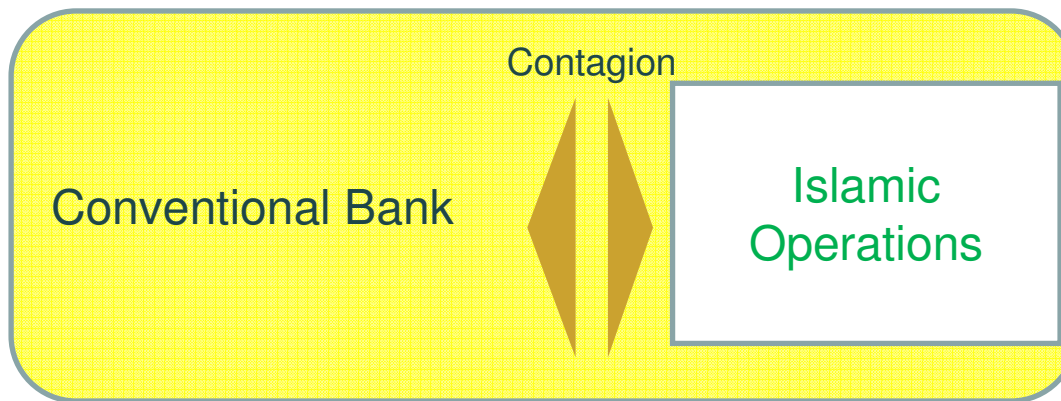
Applicability of RM Regulation



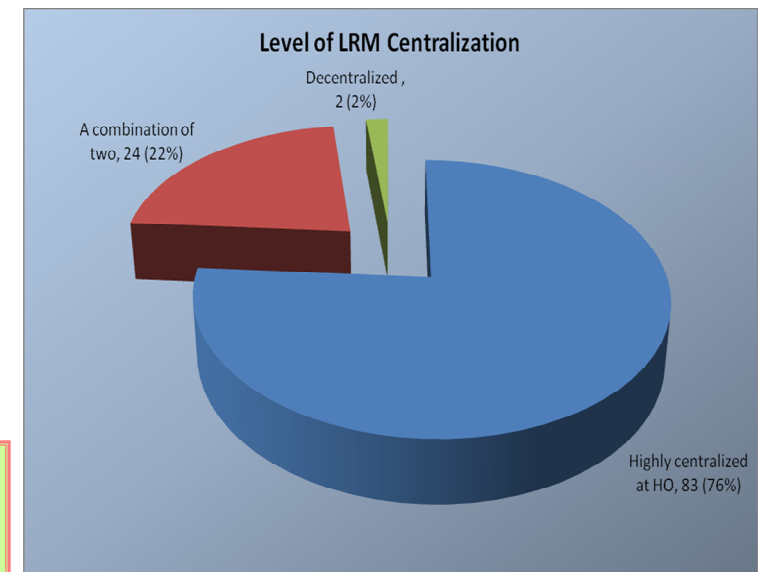
Source: IFSB Survey 2010

# Liquidity Management in Islamic Windows

Duration of liquidity stress faced by your institution, if any, during past three years?			Full Fledged	Subsidiary of Conventional	Islamic banking unit/division	Islamic investment bank	Others
Duration of Stress	Num	%					
None	73	66%	33	10	16	9	5
Less than 1 week	10	9%	4	2	2	1	1
1 to 2 weeks	7	6%	4	1	2	0	0
3 to 4 weeks	9	8%	4	2	3	0	0
More than 1 month	11	10%	4	2	0	3	2
<b>TOTAL</b>	<b>110</b>	<b>100%</b>	<b>49</b>	<b>17</b>	<b>23</b>	<b>13</b>	<b>8</b>



- Commingling of funds issue
- Increasing size of Islamic operations within the bank
- Mechanism of liquidity support from conventional to Islamic operations
- Separate statutory liquidity reserves requirements
- Separate maturity mismatch limits for conventional and Islamic ops.



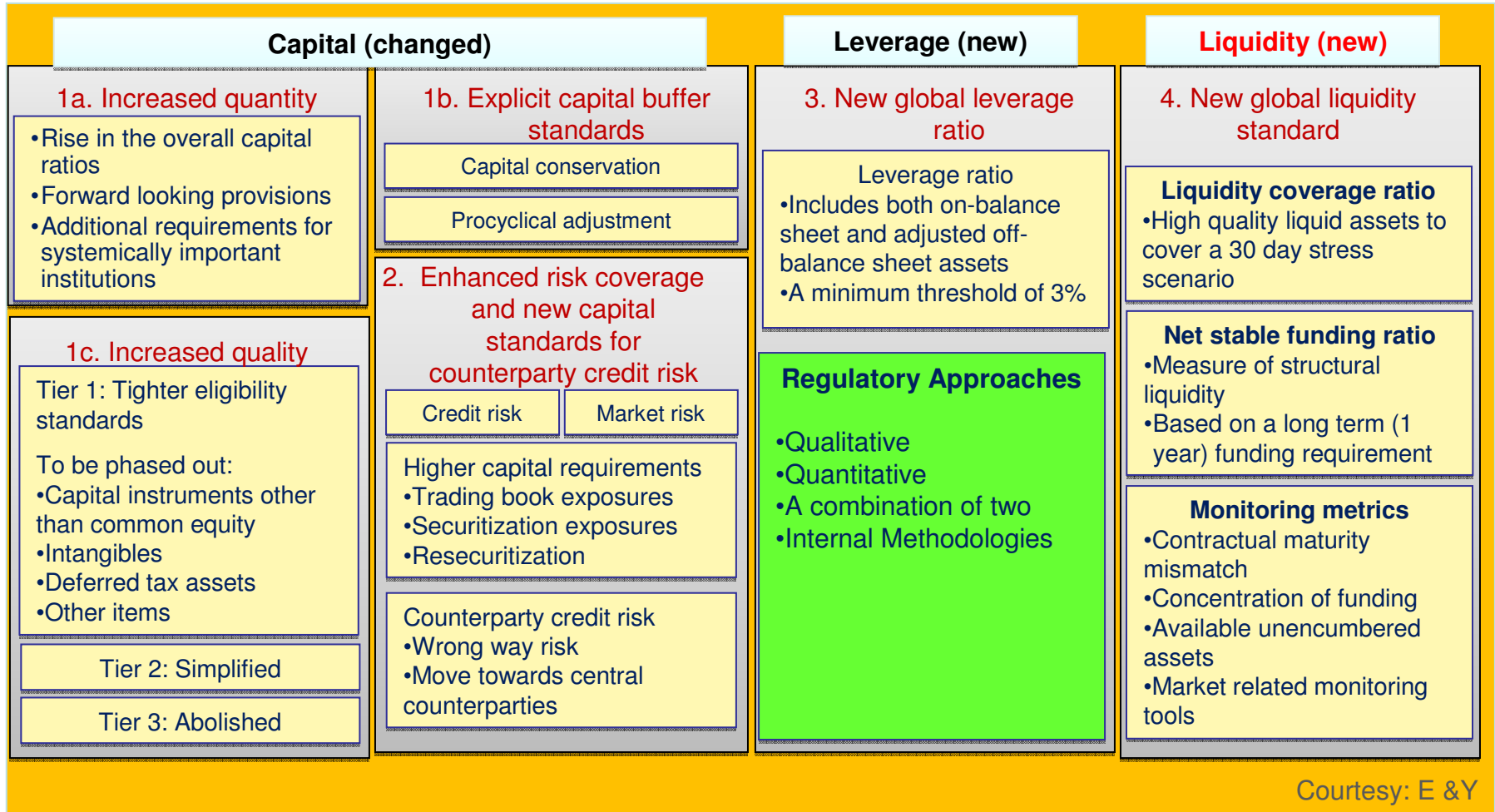
Source: IFSB Survey 2010





# Regulatory Response to Financial Crisis

## BASEL III Proposals and Current Practices



Courtesy: E & Y



# Issuance of Government/Central Bank *Sukuk* (1)

## Government *Sukuk* /Shari'ah Compliant Securities



issuance of a **regular program** of *Sukuk* in **various maturities** and using **a range of Shari'ah compliant structures**



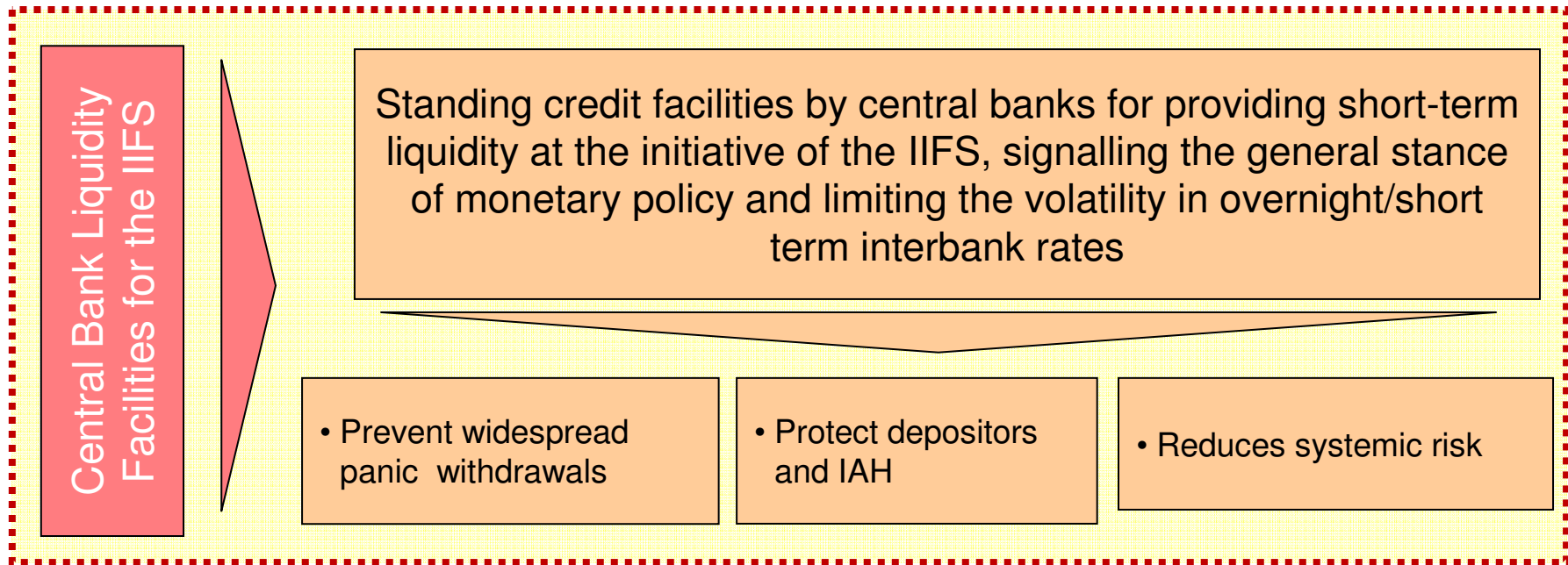
## Issuance of Government/Central Bank *Sukuk* (2)

Programme for Issuance of SC Securities by the Supervisors	Yes		No		Total
	Num	%	Num	%	
Our jurisdiction has a regular programme of issues of tradable <i>Sukūk/ Shari'ah</i> compliant instruments (either by the central bank/supervisor or the government).	4	33%	8	67%	12
here is no regular issuance of <i>Sukūk/Shari'ah</i> compliant instruments, but such instruments are issued either by the central bank or the government from time to time, as per requirement.	2	15%	11	85%	13

Name of the Country	Name of <i>Sukūk/ securities</i>	issuer	Underlying Structure	Currency	Frequency of issue	Tenor	Yield
Supervisor 1	Salam Securities/ <i>Ijārah</i> Sukuk	Central Bank	Commodity /Govt. Assets	Local Currency (LC) & US\$	Monthly/MOF Requirement	91 days, 182 days, 5 years, 6 years, 10 years	Various
Supervisor 2	various	Central Bank	<i>Ijārah</i> Tradable and Non-Tradable Sukuk	LC & US\$	1-9 per year	2-9 year	Various
Supervisor 3	various securities	National Government and CB	buy-back/ <i>Murābahah</i>	LC	Weekly/As per issuance calendar	Short-term/Long Term	Various
Supervisor 4	government <i>Ijārah</i> Sukuk	Domestic Sukuk Company	<i>Ijārah</i>	LC	When needed	3 year- 6 year	Various
Supervisor 5	Various Sukuk	Ministry of Finance	<i>Ijarah</i>	LC	Quarterly/As per policy		Various

Source: IFSB Survey 2010

# Liquidity Support/LOLR by Central Banks (1)



## Providing Liquidity Support to the IIFS

Greater clarity of regulators' role

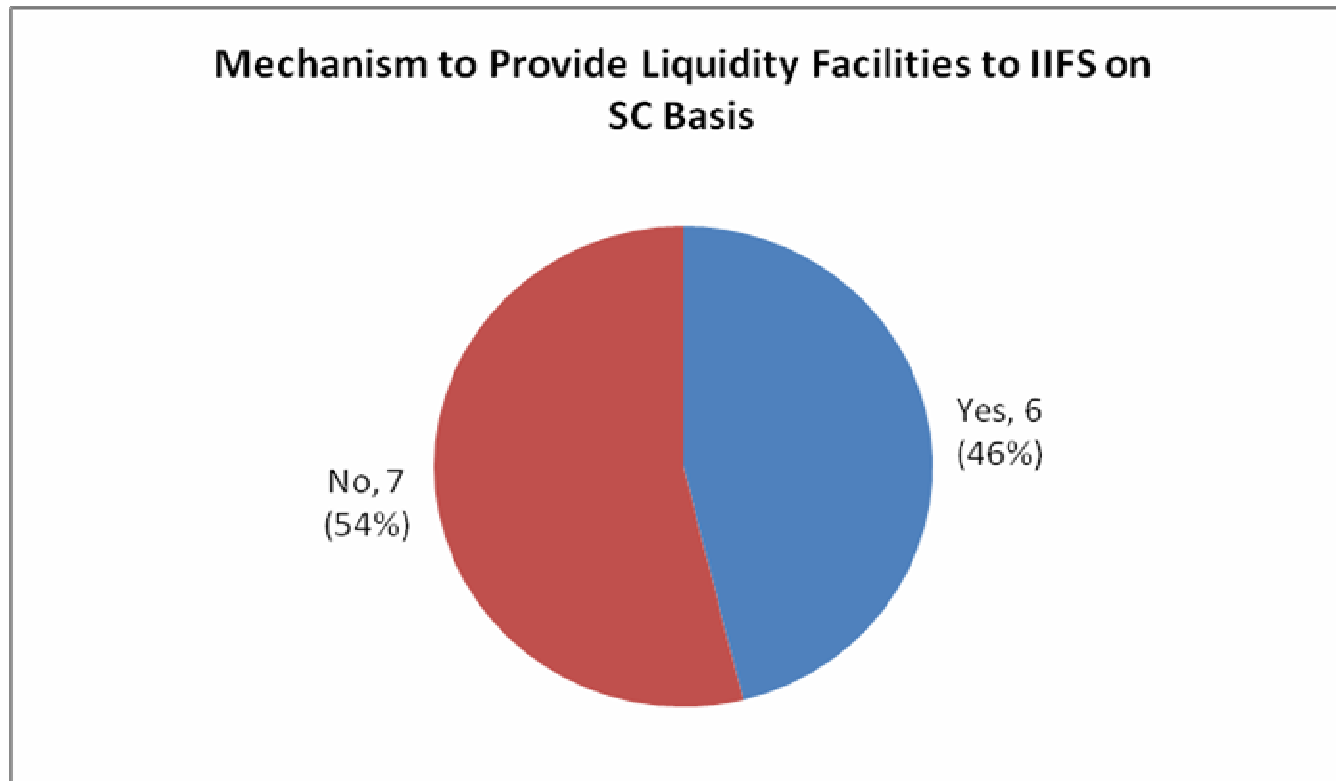
Include Islamic investment banks/companies

Expand Eligible *Sharia'h* Compliant Collateral

*Shari'ah* compliant structures for providing liquidity support???



## Liquidity Support/LOLR by Central Banks (2)



Source: IFSB Survey 2010



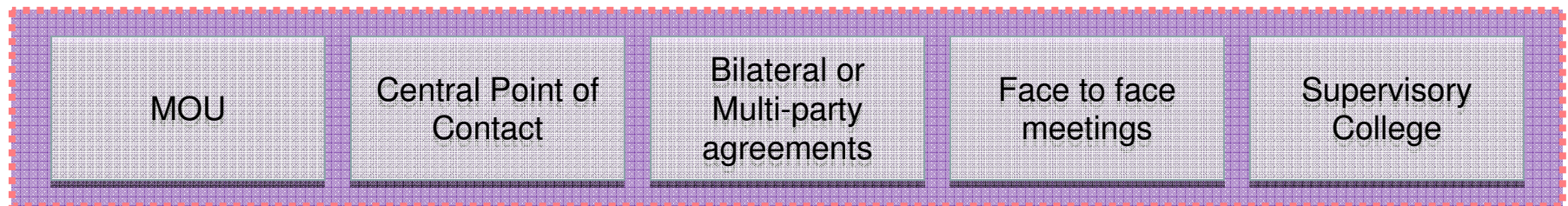
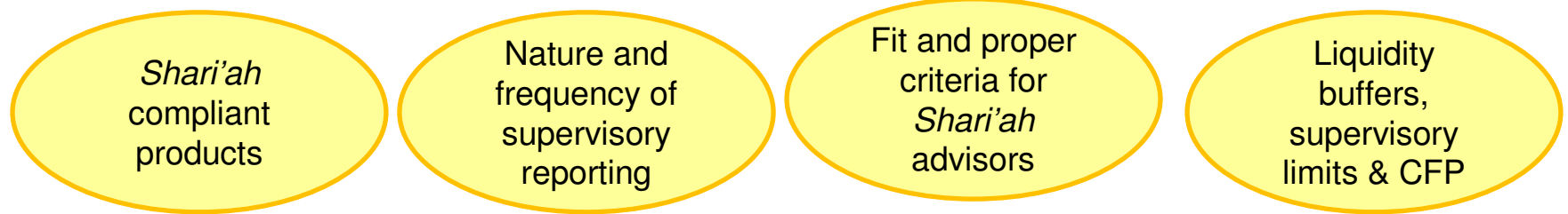
## Liquidity Support/LOLR by Central Banks (3)

Supervisor	S. No.	Name of facility(ies)	Underlying Structure	Tenor (short-term, overnight or intra-day)	Currency
Supervisor 1	1	Islamic Sukuk leasing instruments	Sale and buyback of <i>Ijārah</i> Sukuk	Overnight to longer period at discretion	Local Currency (LC)
Supervisor 1	2	Intraday credit facility	-	Intra day	LC
Supervisor 2	1	Intra day liquidity Facility	Collateral : <i>Shari'ah</i> Central Bank Certificate (ju'alah contract), and Government Sukuk (mudarabah & <i>Ijārah</i> contract)	1 day	LC
Supervisor 2	2	Short Term Liquidity Facility	Collateral : Government Sukuk, <i>Shari'ah</i> Central Bank Certificate, Corporate Sukuk with certain condition, Bank's Financing asset with certain condition ( <i>Mudarabah</i> contract)	14 days and can be extended until 90 days	LC
Supervisor 3	1	F/X Swaps	Exchange of Deposits	O/N	LC/USD
Supervisor 3	2	Aware Facilities	Reverse Commodities <i>Murābahah</i>	1W-1M-3M-6M and 1Y	LC
Supervisor 4	1	Money Market Tender Wada	Wada	Short-term	LC
Supervisor 4	2	Money Market Tender <i>Murābahah</i>	<i>Murābahah</i>	Short-term	LC
Supervisor 4	3	CB Monetary Notes-Islamic	<i>Murābahah</i>	Short- to long-term	LC
Supervisor 4	4	CB Sukuk <i>Ijārah</i>	<i>Ijārah</i>	Long-term	LC
Supervisor 5	1	<i>Murābahah</i>	<i>Murābahah</i>	Short- to long-term	All
Supervisor 5	2	Qard Hasan	Qard Hasan	Short- to long-term	All
Supervisor 6	1	Only short term deposits based on <i>Mudarabah</i> contract	<i>Mudarabah</i>	Short –term	LC

Source: IFSB Survey 2010



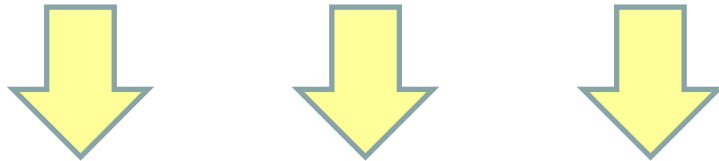
# Cross Sector and Home-Host Supervision





# Financial Sector Liquidity Contingency Plan & IIFS

Macro Level Stress Testing



Critical to identify potential emerging risks from the banking system, including IIFS, and formulate supervisory actions and policy responses timely

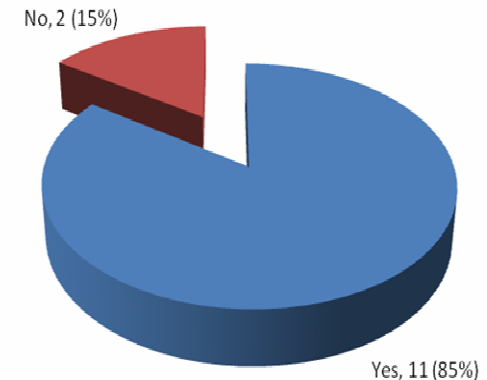
Peculiar risks of the IIFS

Growing IIFS Market Share

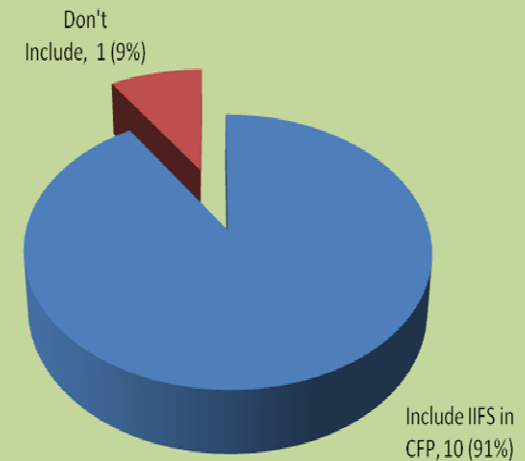
IFSB Survey

- **57.14%** (8 out of 14) respondents indicated that **macro stress testing help them to identify** particular IIFSs that are more sensitive to economic stress in their jurisdictions.
- **50%** (7 out of 14) respondents revealed that **they assessed the impact of adverse shocks on the financial system** through utilising information on balance sheet exposures submitted by IIFS in their jurisdictions.

CFP to Deal with Liquidity Crisis in the Banking Sector



Inclusion of the IIFS in the Banking Sector CFP

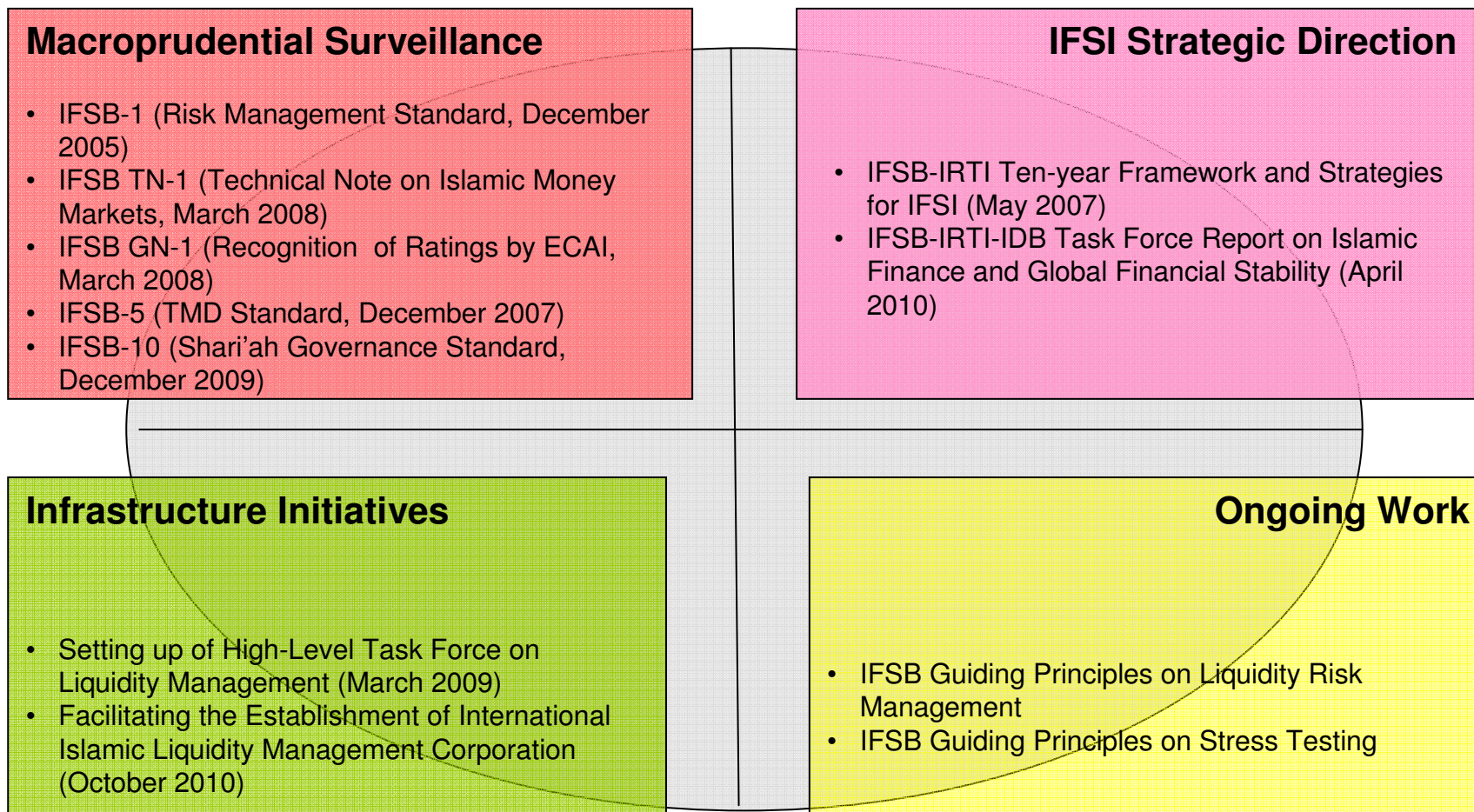


Source: IFSB Survey 2010





# IFSB Standards and Initiatives Addressing Liquidity Management in the IFSI



## Closing Remarks

- Concerted efforts by the standard setting bodies and supervisory authorities are required to provide robust infrastructure and effective guidelines for managing liquidity risk by the IIFS
- Crucial role of governments in providing facilitating environment and establishment of a regular program of Sukuk and aligning this program with public debt management strategy
- The industry players need further collaboration among themselves and should increase interaction with various stakeholders
- Given the constraints at the jurisdiction level, international collaboration is the key for further development of liquidity infrastructure for IFSI
- The IFSI needs to focus more on research which can lead to innovative products, solutions and institutions - while strictly *ensuring* Shari'ah compliance





# THANK YOU FOR YOUR ATTENTION

---

Zahid ur Rehman  
zahid@ifsb.org

