

GLOBAL ISLAMIC LIQUIDITY RECEIVES IILM BOOST

Islamic financial institutions receive timely support for the creation of a robust global cross-border market for Islamic financial instruments with the introduction of an A-1 short-term sukuk by the International Islamic Liquidity Management Corporation (IILM).

30 August 2013

The IILM Sukūk aims to help to address the challenges that IFIs have been facing globally with regard to their needs for liquidity management instruments and will complement the available long-term and medium-term sukūk in the global market.

The International Islamic Liquidity Management Corporation (IILM) is an international institution established by central banks, monetary authorities and multilateral organisations. The IILM's main purpose is to create and issue short-term Shari'ah-compliant financial instruments to facilitate effective cross-border Islamic liquidity management. By creating more liquid Shari'ah-compliant financial markets for Islamic financial institutions (IFIs), the IILM aims to enhance cross-border liquidity flows, international linkages and financial stability.

In fulfilling the IILM's objectives aimed at creating a robust global cross-border market for Islamic financial instruments and strengthening the liquidity management of IFIs, the Governing Board of the IILM had announced on 6 April 2013 the official launch of the IILM Sukūk Programme. The launch of the Programme follows the assigned rating of A-1 based on a public rating by Standard & Poor's Rating Services (S&P). The completion of this phase of the Programme paves the way for the issuance of the IILM inaugural sukūk.

The IILM short-term Sukūk Programme rated A-1 is a significant milestone as it is the first:

- Shari'ah-compliant USD denominated short-term rated financial instrument in the market;
- Money-market instrument backed by sovereign assets in the form of sukūk; and
- Multi-jurisdictional primary-dealer network which will facilitate distribution to investors worldwide and ensure a liquid secondary market.

This initiative represents a unique collaboration between multiple regulatory authorities and multilateral development banks to enhance the financial stability and the efficient functioning of the Islamic financial markets. The launch of the IILM Sukūk Programme is also a milestone for the IILM as it will be the first step towards creating a cross-border liquidity instrument for IFIs.

The IILM Sukūk will help to address the challenges that IFIs have been facing globally with regard to their needs for instruments to manage their liquidity compared to their conventional counterparts. The short-term IILM Sukūk that have been issued under the Programme will complement the currently available long-term and medium-term sukūk in the market.

Fulfilling Liquidity Needs

Islamic finance has increasingly expanded globally but has yet to offer the highly sought after short-term products to manage their liquidity. Globally, liquidity management is managed through the use of interbank money market products. These products work sufficiently well in normal times offering banks with either excess assets or liquidity needs.

The IILM Sukūk is an important alternative that will support inter-bank liquidity management

The IILM, meanwhile, is developing an alternative asset class that will support inter-bank liquidity management. The necessity of a product like this is not necessarily apparent in the relative calm market of the Islamic finance industry, but the recent financial crisis demonstrated how quickly inter-bank lending can decline substantially.

During financial strains, where Islamic banks become concerned about the solvency of other Islamic banks, the supply of inter-bank financing will decline or even cease. Having said this, there

are several challenges pertaining to liquidity management in the Islamic finance space, which can range from globally accepted Shari’ah-compliant liquidity management, all the way to having an integrated payment and settlement systems.

These are some of the challenges which the IILM has to maneuver in order to execute its role to provide and enhance short-term liquidity management. Among others, there are different Shari’ah interpretations and acceptances. This will be essential to address especially since the IILM will be seeking to provide an instrument that has to be acceptable to various scholars. To delve into the other challenges, the illustration below lists several challenges, which needs to be addressed.

In addition, the Basel III requirement for liquidity, particularly the Liquidity Coverage Ratio requires institutions to hold a sufficient buffer of high quality liquid assets to cover liquidity outflows for a one-month period of stress. In this respect, it would impact IFIs due to the limited range of short-term instruments. However, with the IILM and the rapid growing sukūk market, IFIs would have more supply of available sukūk and other liquidity instruments to improve its ability to comply with the liquidity requirements.

Global Liquidity Management – Macro Challenges and Development Issues



Source: IFSB, KFHR

Liquidity management supports the strength of an IFI's operation. Customers deposit their money with a bank with the notion that they can withdraw their deposits at anytime. Should the ability of the bank to provide money to its depositors on demand be compromised, it could lead to a massive bank run. The importance of liquidity surpasses the IFIs themselves, since a liquidity shortfall within any institution may lead to systemic implications that can cause pressure to the financial stability of a country.

Other Implications

The rapid growth in the Islamic financial services industry has prompted the importance of a well-functioning Islamic money market, which is an essential precondition for effective supervision and risk management of IFIs. Specifically, the existence of an Islamic money market and the supporting infrastructure should create a more conducive financial system and provide the basis for broad-based market development.

By promoting more efficient market-based monetary operations and more effective management of market liquidity with the support of more short-term liquidity instruments (following the first such instrument i.e. the IILM short term sukūk), central banks can facilitate the depth and liquidity of money markets at the domestic level. Subsequently with the support of capital market authorities, it will help to create the initial venture towards regional and, ultimately, international integration of these markets.

The issuance of the IILM short-term sukūk should help promote more efficient pricing of Islamic capital market products

While the forms in which such global money markets would develop will depend upon market forces, coordinated and harmonised development of the instruments and the necessary liquidity infrastructure at the domestic level should facilitate the marketability of IILM's short-term sukūk. These would both promote the development of Islamic capital markets and facilitate their international integration as well as enhance the sophistication of the Islamic capital market.

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