

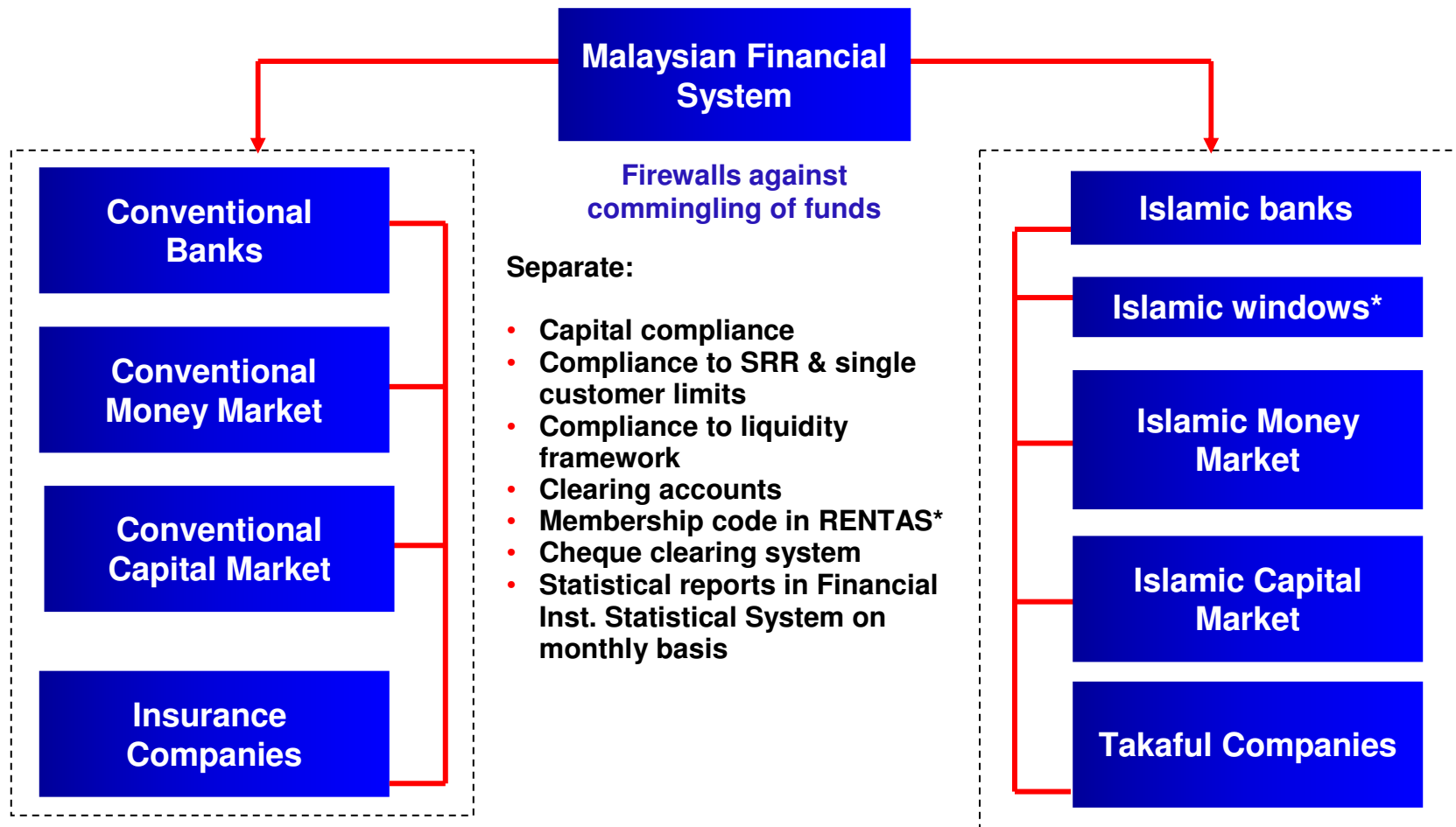
**Regulatory Approaches to Liquidity Management in the  
Islamic Financial Services Industry**  
The Malaysian Experience

Seminar on Managing Liquidity in the Islamic Financial  
Services Industry  
6-7 April 2011, Istanbul, Turkey

## Presentation outline

- Background of Islamic financial market in Malaysia;
  - Brief regulatory framework of Malaysian dual banking system;
  - Interrelationship of conventional and Islamic money market and liquidity;
- Islamic liquidity management practices of BNM;
  - Objective of Islamic liquidity management;
  - Islamic liquidity management operation and instruments;
- Challenges in developing appropriate Sharī`ah-compliant instruments;
  - Challenges to the current and developing new instruments;
  - Addressing the challenges.

# Malaysia dual banking system...comprehensive components of financial institutions to facilitate effective intermediation process...

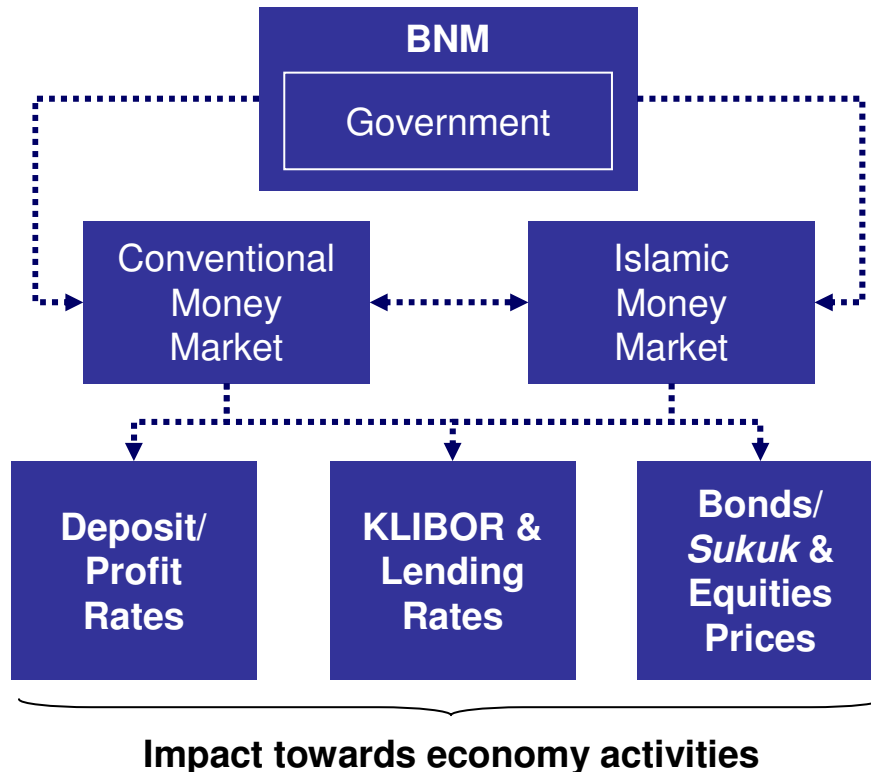


\*Islamic windows of conventional banks

- For monetary operation purposes, two distinct pools of conventional & Islamic liquidity are managed separately
- Monetary instruments applied are different in terms of concept & structure but similar in terms of its effect on liquidity

# Malaysian conventional and Islamic money market

## Transmission mechanism in the financial market



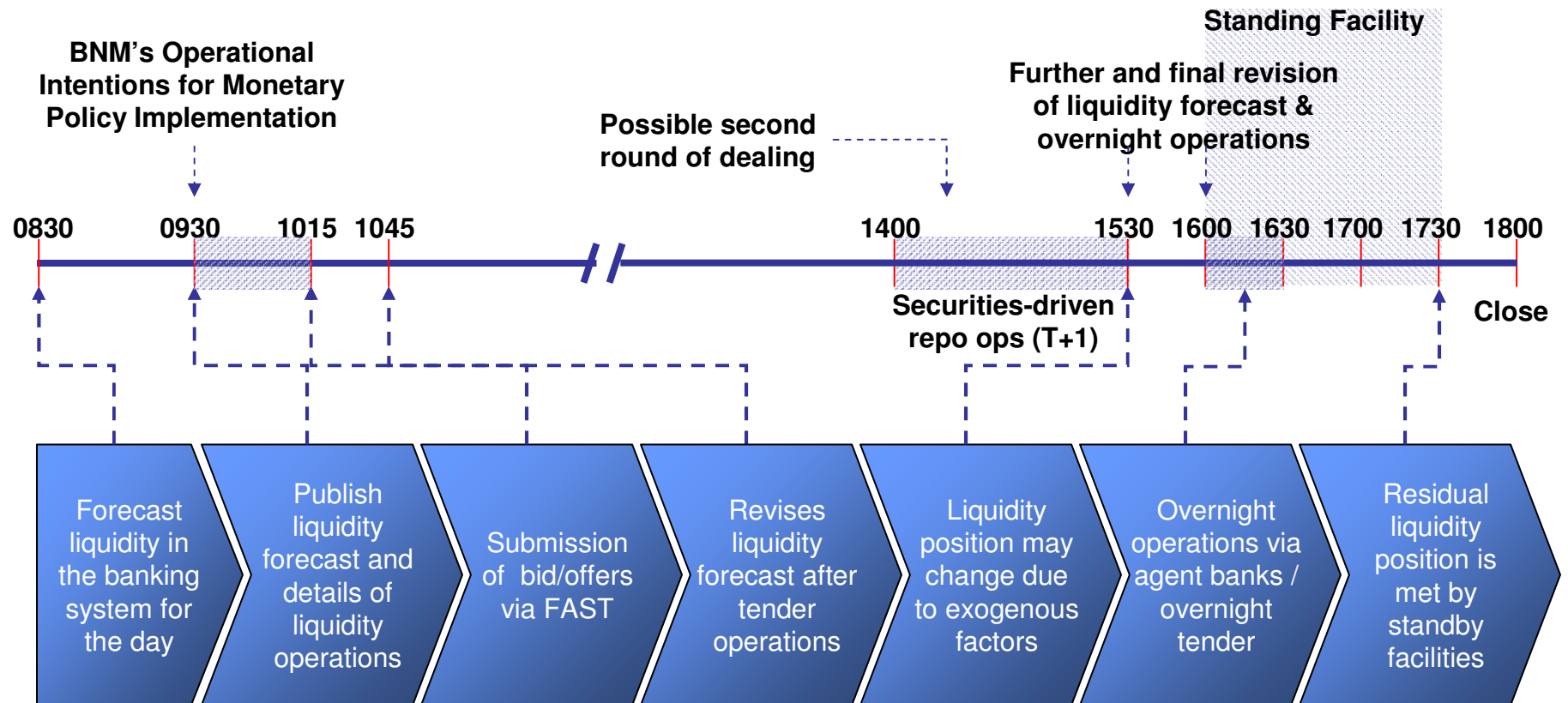
## Islamic Money Market

- **Co-exists and operates in parallel** with the conventional money market.
- **Separate cash and securities clearing accounts** under RENTAS (RTGS) platform.
- BNM conducts market operations via **segregated pools of liquidity**.
- Act as a short-term intermediary to provide a ready source of investment outlets based on Shariah principles.
- Integral to functioning of Islamic system:
- Facility for funding and adjusting portfolios over the short term; and
- Monetary policy transmission channel.

## Monetary policy, liquidity management and role of central bank

- Monetary policy aims at achieving **sustainable growth** in an environment of **price stability**;
- The policy rate is **Overnight Policy Rate**, currently at 2.75% implemented in the conventional money market;
- Objective of monetary operations:
  - meet the overnight operating target;
  - reinforce monetary policy intention, and
  - manage liquidity in the interbank market.
- Monetary operations in both conventional and Islamic money markets focus on **absorbing surplus liquidity**, hence liquidity management operation.

**Liquidity is managed twice daily..** term operation in the morning, overnight operation at end of the day



FAST: Fully Automated System for Issuance/Tendering

- **Liquidity forecast is published in FAST 4 times (9.30am, 10.45am, 3.30pm, and 4.00pm) throughout the day to reflect changes in factors that affect liquidity**
- **All monetary operations are conducted electronically via FAST**

# Transparency of operation... liquidity is forecasted and operational intention is disclosed to the market

## Liquidity Position

Liquidity Position ID : 200800000986

Last Update 0930hrs

### Liquidity Position as at 31 Dec 2008

Category	Conventional	Islamic
Aggregate Opening Balance	169.90	196.80
BNM MM & Repo Maturities	35,261.30	14,137.50
BNM MM & Repo Tender	0.00	0.00
Other BNM Market & Non-Market Activities	-17.40	0.00
Government Operations	0.00	0.00
BNM & Govt Securities Redemption/(Issuance)	0.00	0.00
Coupon & Dividend Payments	0.00	0.00
Statutory Reserve	500.00	0.00
Net payments: Conventional - Islamic	0.00	0.00
<b>Grand Total</b>	<b>35,913.80</b>	<b>14,334.30</b>

### Remarks :

#### OPERATIONS:

#### CONVENTIONAL MM TENDER

RM2,000 mill for 1 week : COMPETITIVE BORROWING 07/01/2009  
 RM2,500 mill for 2 weeks : COMPETITIVE BORROWING 14/01/2009  
 RM2,500 mill for 3 weeks : COMPETITIVE BORROWING 21/01/2009  
 RM2,500 mill for 30 days : COMPETITIVE BORROWING 30/01/2009  
 RM1,000 mill for 44 days : COMPETITIVE BORROWING 13/02/2009

#### REPO TENDER

RM700 mill for 28 days : COMPETITIVE REPO 28/01/2009  
 RM500 mill for 44 days : COMPETITIVE REPO 13/02/2009

#### WADIAH MM TENDER

RM2,000 mill for 1 week : NON-COMPETITIVE ACCEPTANCE 07/01/2009  
 RM1,000 mill for 2 weeks : NON-COMPETITIVE ACCEPTANCE 14/01/2009  
 RM1,000 mill for 3 weeks : NON-COMPETITIVE ACCEPTANCE 21/01/2009  
 RM2,000 mill for 28 days : NON-COMPETITIVE ACCEPTANCE 28/01/2009

All offers must be submitted before 1015 hrs

## Observe movement of funds

- Forecast aggregate liquidity.
- Movement of rates will be determined by availability of funds.

## Decide on monetary tools

- Appropriate instruments used to structure the maturity profile, thereby influencing short term liquidity.

## Disseminate information

- Allow market players to structure their liquidity profile.

## Five Islamic liquidity instrument introduced to-date.. for both Islamic deposit and securities instruments

Islamic liquidity Instrument*	Date Introduced	Description of Instrument
Wadiah deposit acceptance	Jan 2002	Cash funds placed on custody basis, with non-guaranteed returns on 'hibah' (gift) basis.
Sukuk BNM Ijarah	Feb- 2006	Sukuk issuance based on the Al-Ijarah or 'sale and lease back' concept.
Bank Negara Monetary Note Islamic (BNMN-i)*	Dec-2006	Issued by Bank Negara Malaysia for managing liquidity in the Islamic financial market.
Commodity Murabahah deposit	Feb-2007	CMP is a cash deposit product that utilises the Crude Palm Oil based contracts as the underlying assets.
BNMN-Murabahah	Jul-2009	BNMN-Murabahah is essentially a trustee-receipt which utilises Crude Palm Oil (CPO) based contracts as the underlying assets.

### Choice of instruments

- **Diversification** of the product base – increase the number of instruments available.
- Liquidity management purposes (ALM) – Islamic banks are biased towards liquid short-term instruments.
- **Flexibility** to meet market needs and requirement i.e. foreign banks operating in Malaysia.
- Shariah compliance issue – consent and approval from Shariah Advisory Council.

\* Replaced by issuance of BNMN-Murabahah



## Liquidity facilities to support IFI's liquidity management.. intraday credit facility and standing facility

### Intraday Credit Facility

- A credit facility extended by BNM to RTGS member for a period of less than one business day.
- Members may utilize the intraday credit facility by pledging eligible securities in their collateral account.
- Eligible securities:
  - Securities issued by the government and central bank and any other specified instruments;
  - Other securities with minimum credit rating of A and above.
- Any intraday credit obtained from BNM will be paid immediately after the intraday credit cut-off time.
- There is no cost involved other than a very minimal administrative charge.

### Standing Facility

- A facility offered to all Islamic interbank institutions to:
  - Obtain overnight liquidity via Sell & Buy-Back Agreement (SBBA) transaction using eligible collateral; or
  - Place overnight liquidity via wadiah deposit.
- Eligible collateral – Islamic securities issued by government, central bank, quasi-government entities and other specified securities.
- Margin is applied on collateral and varies between different type of securities.
- Facility is available on a daily basis, on request by the individual institution from 4pm onwards.
- No limit to the funding amount, as long as there is sufficient underlying eligible collaterals.

# Current Islamic liquidity instruments.. its challenges and implications

## Deposit instrument

## Securities instrument

### Wadiah Acceptance

### Commodity Murabahah

### Sukuk BNM Ijarah

### Bank Negara Monetary Notes-i

### Challenge & implication

- Return to depositors is in the form of hibah.
- Hibah is prerogative of custodian and it cannot be contractual, hence **return is uncertain**.
- It does **not appeal for longer term placement** for liquidity management as return, if any, is uncertain.

- Process is **tedious and time-consuming** – series of trade transaction of underlying assets.
- **Incur additional cost**, relative to wadiah, in the form of commodity brokerage.
- **Inefficient for use to manage short-term liquidity**.

- **Widely accepted** and demanded by investors.
- **Issuance is limited to the value Ijarah** asset; hence it is ineffective to manage massive liquidity.
- Due to insufficient issuance to satisfy demand, it leads to buy-and-hold strategy by investors causing lack of secondary trading of the instrument.

- Issuance not limited by issuer's assets; hence the **flexibility in managing liquidity**.
- Issuance **incurs additional cost** (commodity brokerage).

## **Going forward..** challenges in developing the Islamic liquidity instruments

- Needs to have various type of instruments to cater for different issuers and investors' requirements and limitations;
  - Flexibility in addressing significant liquidity and fund flows;
  - Financial certainty within the confine of shariah parameters;
- Wide acceptance of products by financial market institutions in view of diversity in shariah opinion;
  - Ensure effectiveness in managing market wide liquidity;
- Efficient implementation process with regards to documentation;
  - Shariah understanding of the structure and business issue.
- Efficient infrastructure supporting the development of a new instrument;
  - Cost-effective supporting infrastructure for efficient transaction.
- Market understanding on new structures and sophistication of investors.
  - Greater use of equity-based Islamic financial instrument, instead of debt-based.

## **Addressing the challenges**

- Conduct periodical consultation process with Islamic financial market participants;
  - Obtain feedbacks from market and address all the raised issues;
- Have close and early collaboration with shariah and legal practitioners;
  - Understand the parameters and concerns of shariah and legal;
  - Have clear communication on business issues and needs;
- Support market wide initiative – infrastructure, documentation and education;
  - Give fullest support, including resources, to market players/association initiative;
- Adopt culture of continuous improvement – “Kaizen”

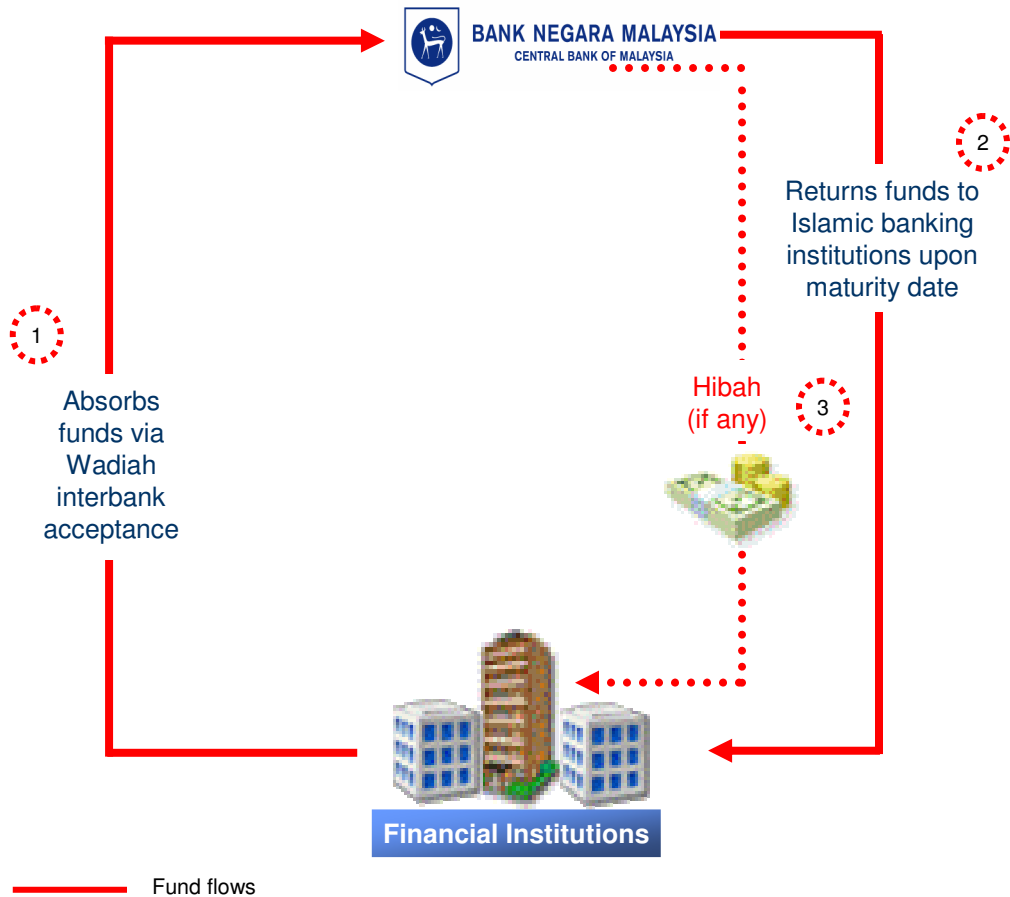
Contact details:

Azizul Sabri Abdullah

E-mail: [asabri@bnm.gov.my](mailto:asabri@bnm.gov.my)

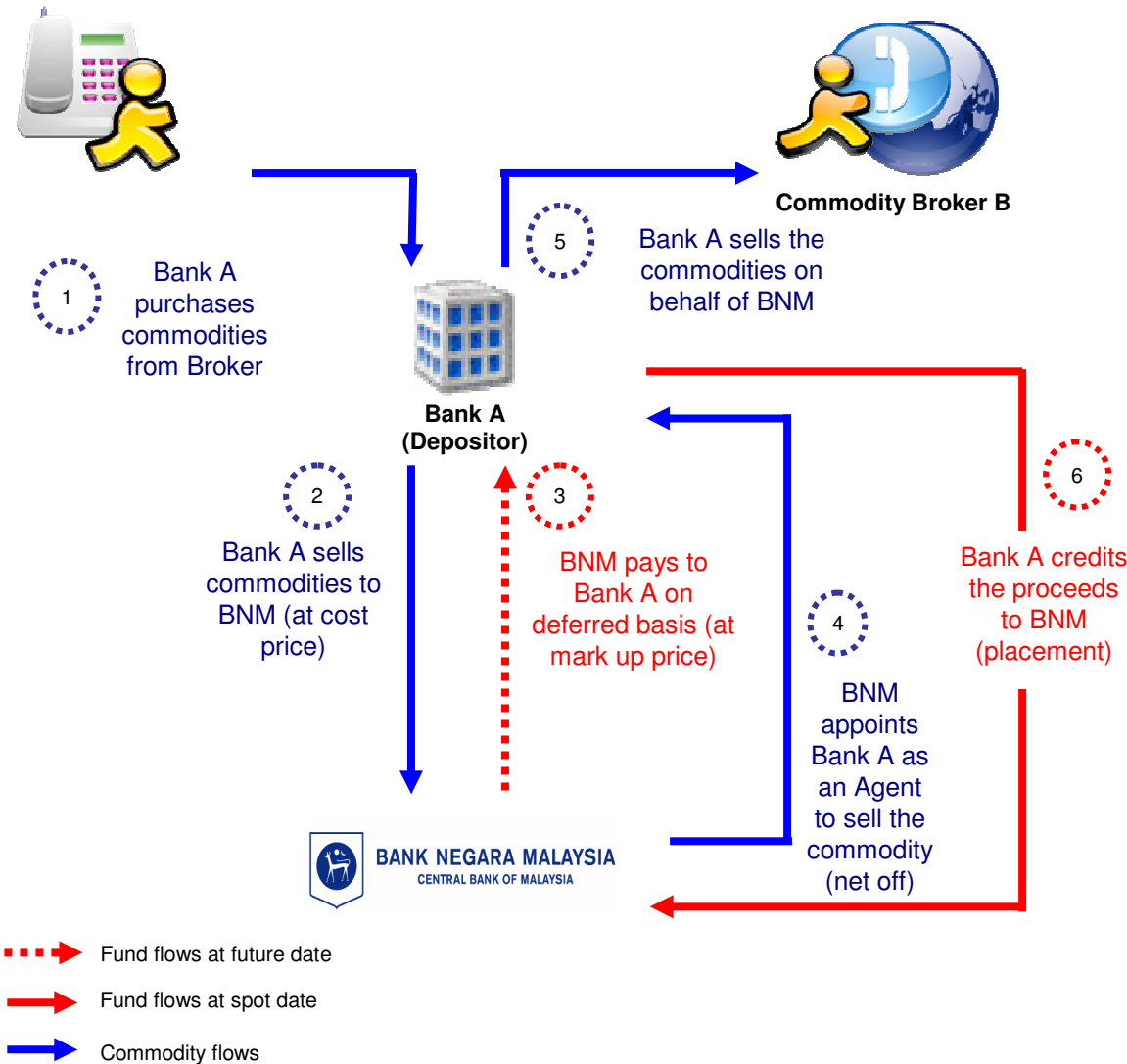
Website: [www.bnm.gov.my](http://www.bnm.gov.my) / [iimm.bnm.gov.my](http://iimm.bnm.gov.my) /  
[fast.bnm.gov.my](http://fast.bnm.gov.my)

# Wadiah Yad Dhamanah (custody with guarantee)



- BNM absorbs liquidity by accepting deposits on a **trust concept** from Islamic financial institutions.
- BNM will **safeguard and provide guarantee** to the principle of deposits.
- Deposits maybe invested for return enhancement with permission from depositors.
- BNM is **not obliged to give return** to depositors; *Hibah* (gift) can be given to depositors as a token of appreciation
- Widely acceptable by the universal scholars

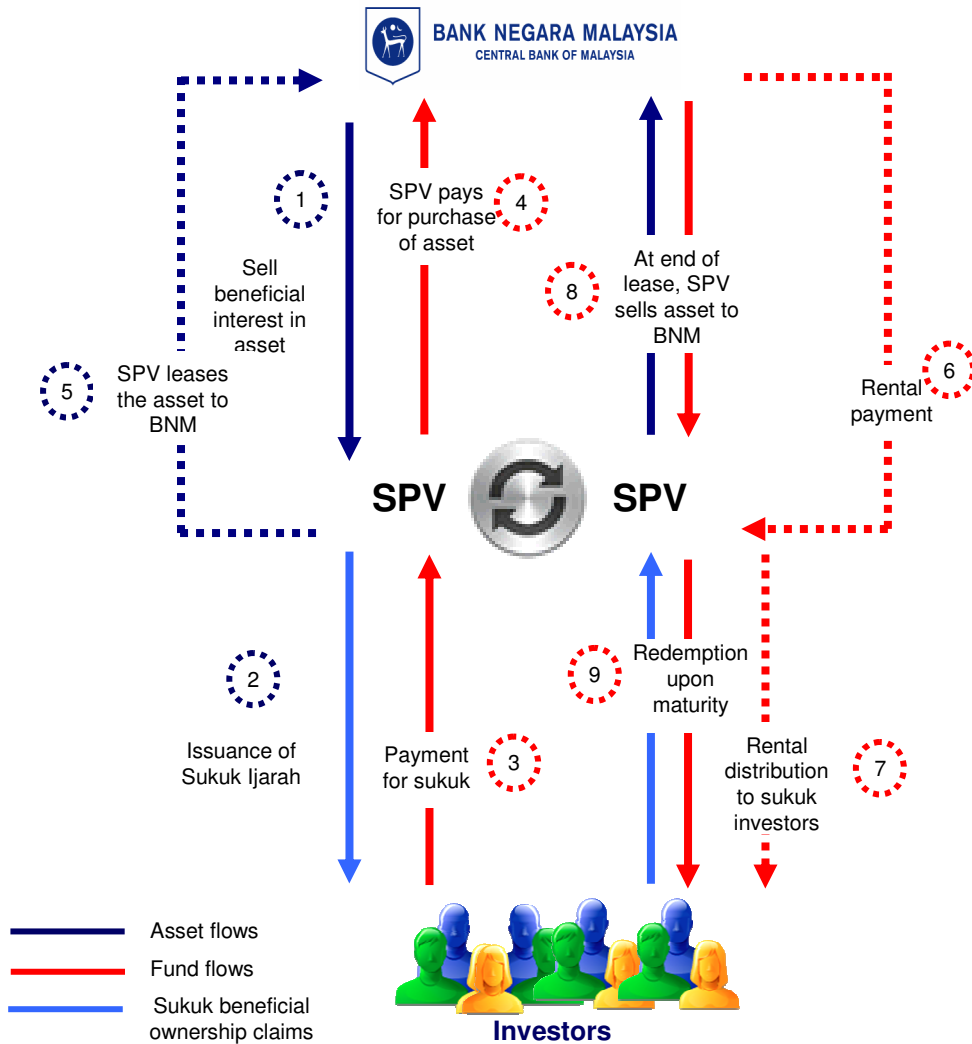
# Commodity Murabahah Programme (cost plus)



- Cash deposit product based on a globally acceptable Islamic concept of **murabahah**.
- Based on sale and purchase transactions of non-ribawi assets.
- **Cost and profit margin (mark-up) are made known** and agreed by all parties involved.
- Settlement can be made either on a **deferred lump sum or installment basis**.

Ribawi items – gold, silver, salt, date, wheat, barley

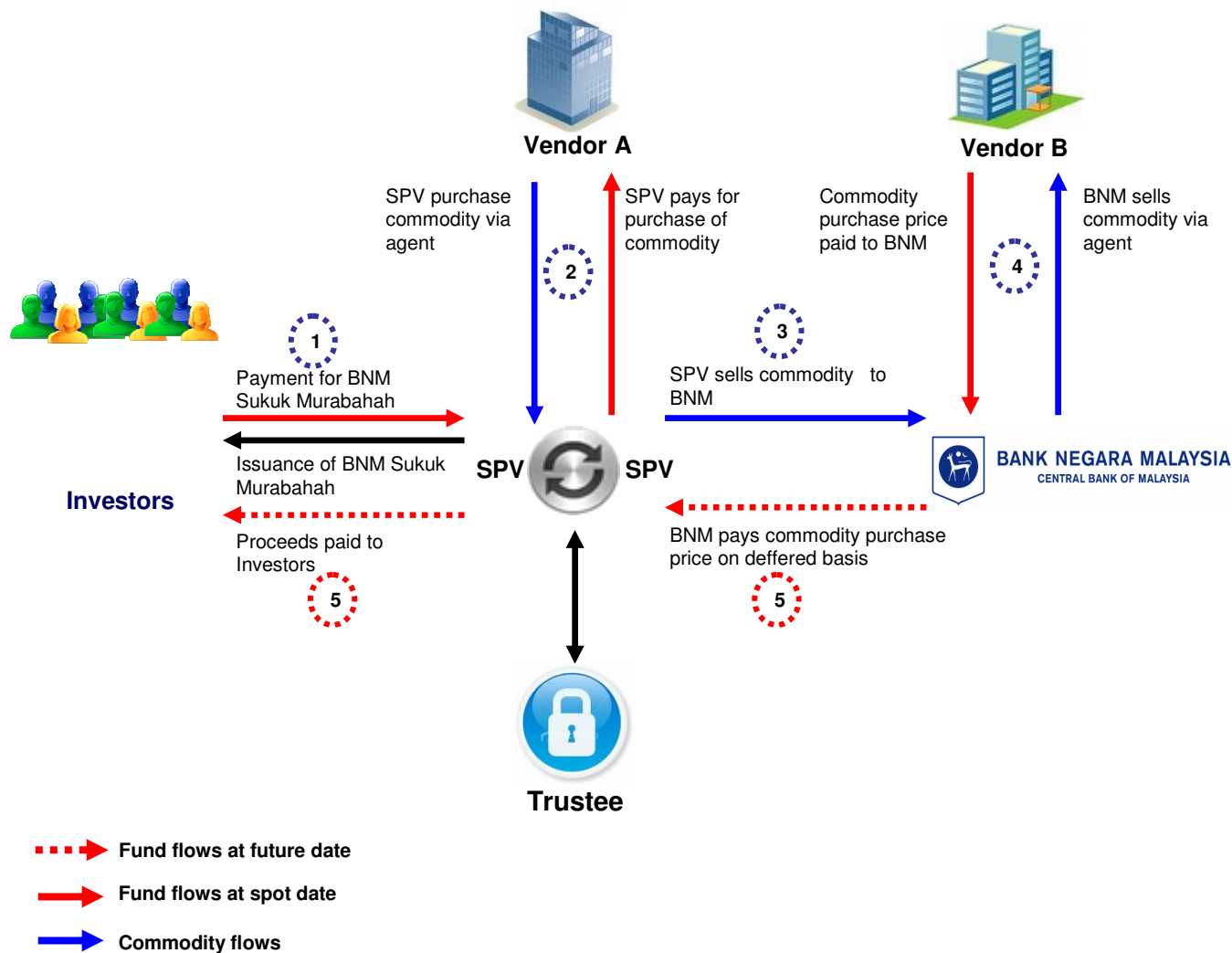
# Sukuk Bank Negara Malaysia Ijarah (leasing)



- Sukuk issued based **sale and lease-back** transaction.
- **Globally acceptable.**
- BNM sells its Ijarah assets to SPV to obtain cash and absorb liquidity from market.
- SPV will issue sukuk to finance the purchase of assets and consequently lease the properties back to BNM.
- Lease rental paid by BNM to SPV will be passed to investors as return on sukuk.
- On maturity, BNM will buy the properties from SPV, which proceed will be used to redeem the sukuk from investors.



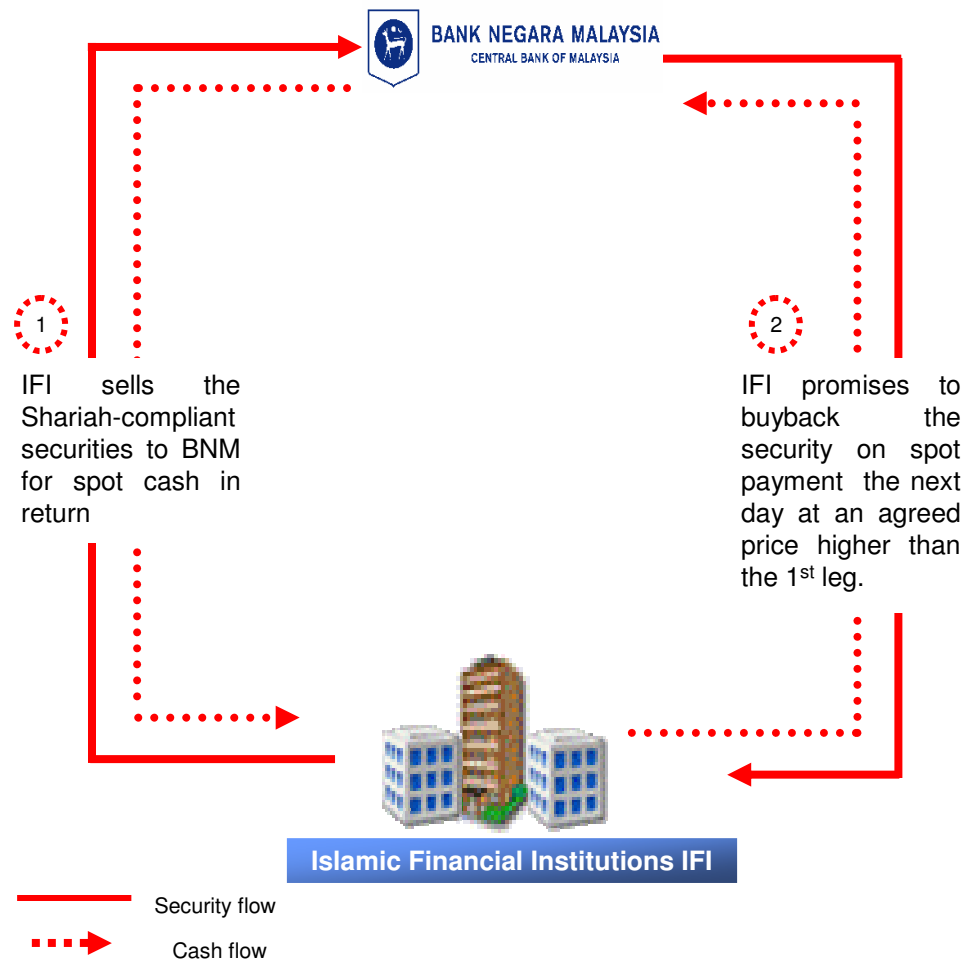
# Sukuk Bank Negara Malaysia Murabahah



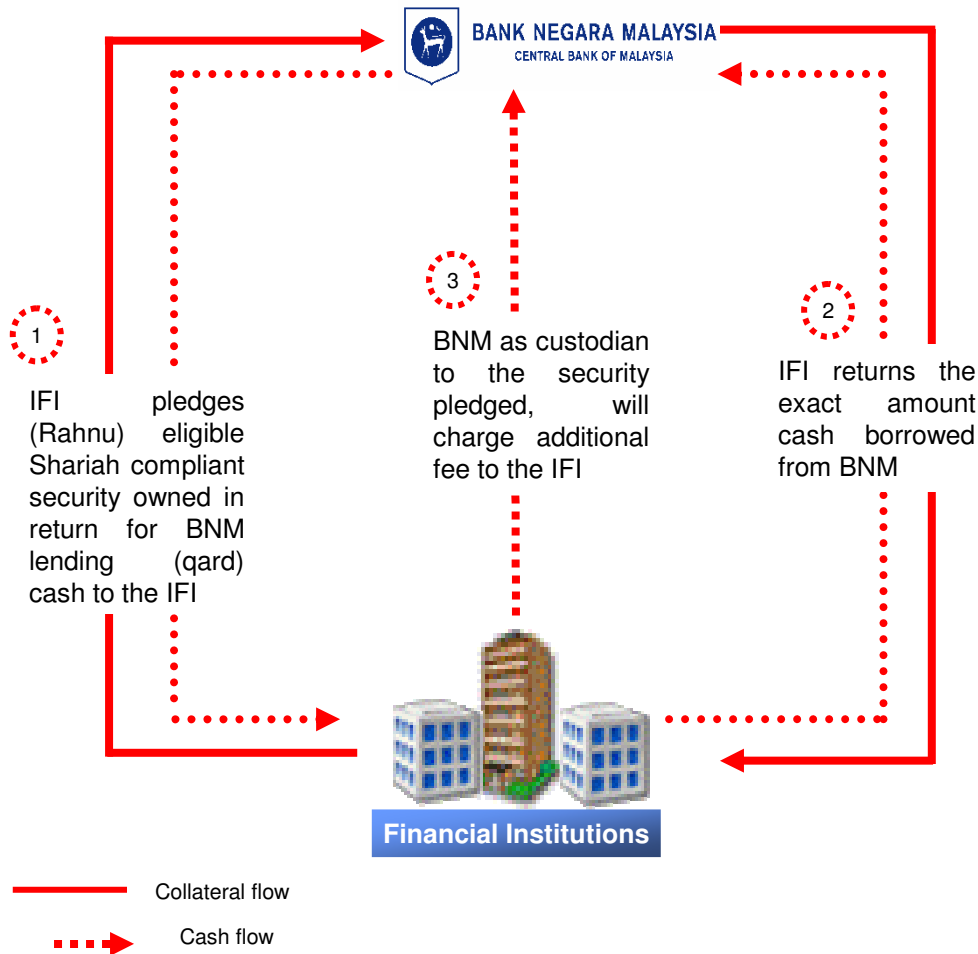
- Issued based on **murabahah** concept.
- SPV issues sukuk to investors, which proceed is used to purchase commodity.
- Commodity are then sold to BNM on murabahah basis with deferred payment.
- BNM then sell the commodity purchased to another party to obtain cash and absorb liquidity from the market.
- At maturity, BNM will pay the purchase price, which will be used to redeem the sukuk.

# Sell and Buyback Agreement (SBBA)...as a standing facility

- The SBBA consist of **two legs of transactions**.
- In the first leg, the Islamic Financial Institution (IFI) with liquidity shortage offers to **sell eligible Shariah compliant securities** to BNM.
  - Securities will cease to form part of the IFI's portfolio
- Subsequently the IFI make a **unilateral promise (wa'ad) to buy back** the Islamic securities the next day (overnight) at an agreed price.
  - treated as contingent liability
- Both contracts for each sale leg are **independent** of each other.
- The SBBA transactions enable IFI to acquire liquidity from BNM overnight.



# Intraday Credit Facility



- **Based on the concept of pledge (Al-Rahnu).**
- BNM will provide a **loan to the borrower** based on the concept of benevolent loan (Qard hasan).
- IFI will **pledge eligible securities as collateral** for the funding received.
- If the IFI fails to pay off the loan, the securities will be transferred to the BNM and will be sold in the market.
- Under Qard, IFI is obliged to return only the exact amount of liquidity borrowed.
- IFI will be charged a custodian fee for BNM to hold the collateral pledged.