

The First Annual Conference of Islamic Economics & Islamic Finance @ [ECO-ENA, Inc.](#), Canada

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# Developing Shari'ah compliant tools for the financier of last resort

## The case of Qatar

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# Overview on the importance of Liquidity management

## From the point of view of commercial banks

- ▶ Managing liquidity is a fundamental component of sound management in all financial institutions.
- ▶ Commercial banks are concerned about their liquidity position to the extent that keeps the bank solvent and allows it to maximize profit.

## From the central bank's point of view

- ▶ Central banks keep track on liquidity position as a part of their responsibility for:
  - 1– the implementation of monetary policy,
  - 2– the **smooth** operation of the inter–bank **payments settlement system**,
  - 3– and the promotion of a sound and efficient banking system.

# Islamic Banks' Challenges in Liquidity Management

- ▶ The main Shari'ah principles on Islamic finance– restrictions on interbank transactions.
- ▶ **The lack of Shari'ah compliant financier of last resort facility.**

# Countries' Experience

## Sudan

- ▶ Developed various sukuk (Central Bank Musharakah Certificate, Government Musharaka Certificate...etc).
- ▶ There was a coordination failure between the central bank and the government. It resulted in constraints that limited *sukuk* issuance

# Countries' Experience

## Bahrain

- ▶ Islamization of conventional instrument
- ▶ It lead to unaccepted principles such as tawarruq

# Countries' Experience

## Malaysia

- ▶ Transformed the funding products of conventional banks into Islamic products.
- ▶ the Islamic liquidity management instruments in Malaysia involve *bay' al inah*, *bay' al dayn* and a guarantee of the *mudarabah* principal

# Lessons from countries experiences

- ▶ Islamization of conventional instruments may lead to use instruments that involve some Shari'ah issues, such as Bay' al-Dayn, Bay' al-Inah, Tawarruq.
- ▶ In some jurisdiction there is a coordination failure between the central bank and the government.



# Assumptions to Develop Shari'ah Compliant FLR Facility

- ▶ Banks can sell their assets to get liquidity.  
(Tradable, non-tradable)
- ▶ Banks discount their assets at the central bank when there is market liquidity shortage.
- ▶ The central bank may accept only certain assets to be discounted.

# Proposed Instruments

1. **Short-term Mudarabah deposit**
2. **Selling Islamic banks' assets**
3. **Open Market operation using tradable sukuk**

# Short-term Mudarabah deposit

- ▶ The central bank signs a master agreement with Islamic banks
- ▶ The central bank places a Mudarabah investment deposit with the Islamic bank
- ▶ The maturity of deposit may vary from one night to one week and so on.
- ▶ Upon maturity, the Islamic bank pays the principal and distributes to the central bank the declared profit as per the pre-agreed profit-sharing ratio.

# Limitation of Mudarabah Deposit

- ▶ If the bank performed a rate of return that is lower than the expected,



Displaced commercial risk

- ▶ If it became known that the bank is acquiring a direct finance from the central bank



Send Negative Signal

# Discounting Islamic banks' assets

- ▶ Master Agreement
- ▶ These assets has to be tradable and of high rating.
- ▶ The discounted asset is being used in the Central Bank 's open market operation

# Limitation

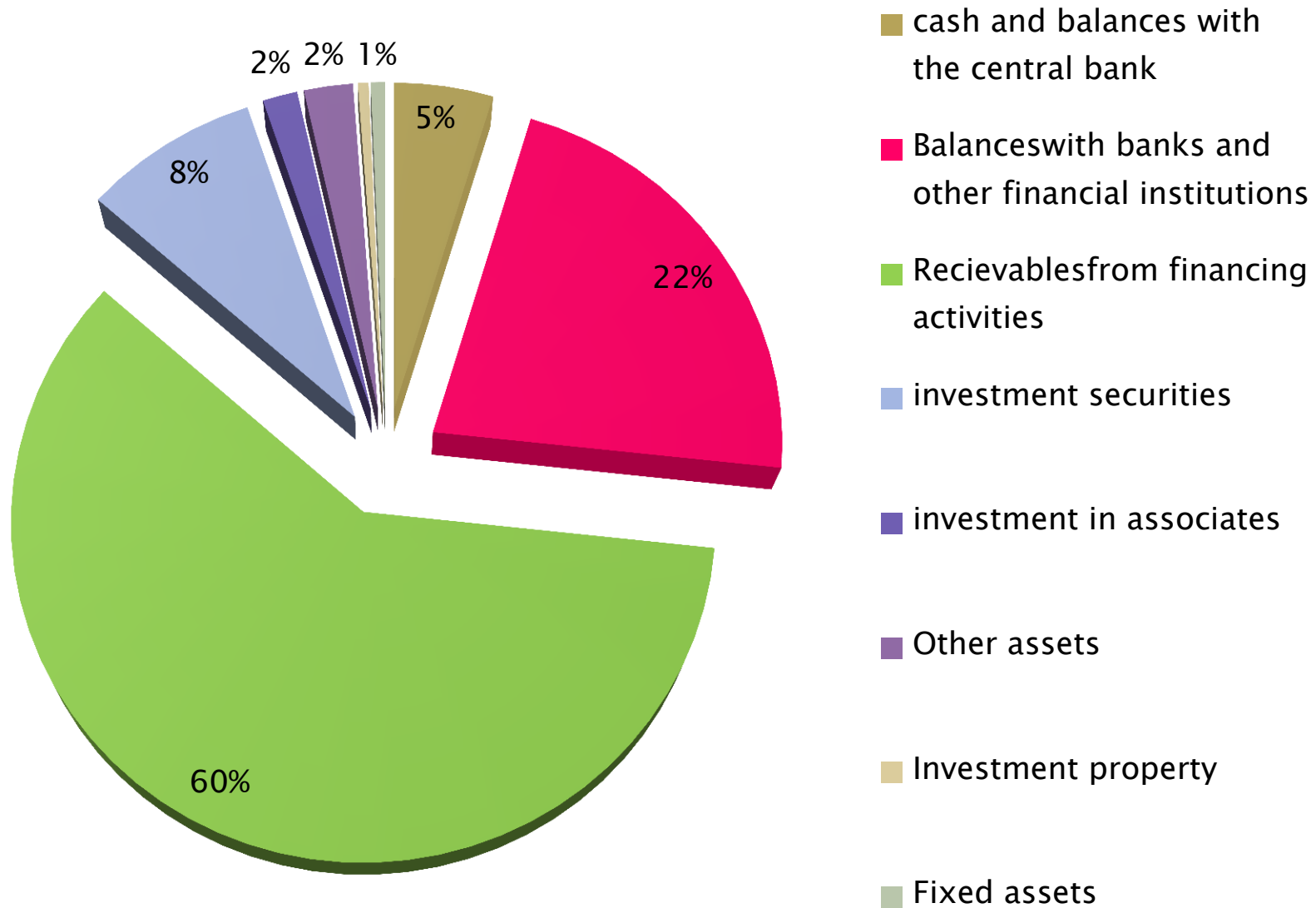
- ▶ If it became known that the bank is acquiring a direct finance from the central bank



Send Negative Signal

- ▶ Limited tradable assets

# Islamic banks' Assets



# Open Market Operation using tradable sukuk

- ▶ First Step: To develop tradable sukuk

*“sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects.”*



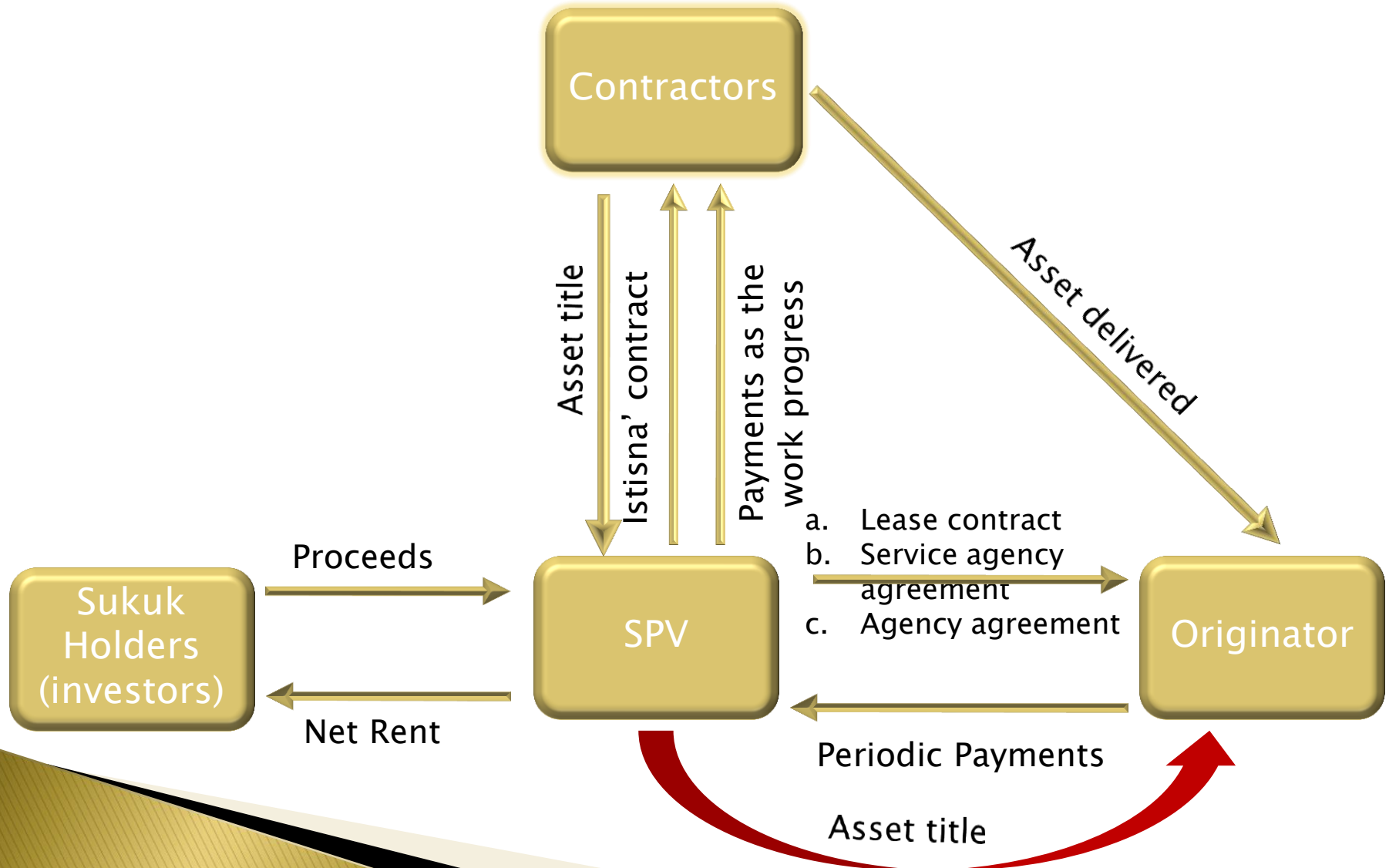
## key projects of the national development strategy 2011–2016

Project	Cost
Residential and business construction projects	QR 130bn.
Infrastructure projects including: Power and water improvement New Doha port Information technology	USD 65bn
Additional infrastructure for sustainable resource management such as treated sewage effluent distribution system	USD 8.5bn to USD 12.5bn
Digitization project in which hundreds of books, maps and manuscripts will be available through online repository	N/A
Expanding hydrocarbon related industries capacity	QR 88bn.

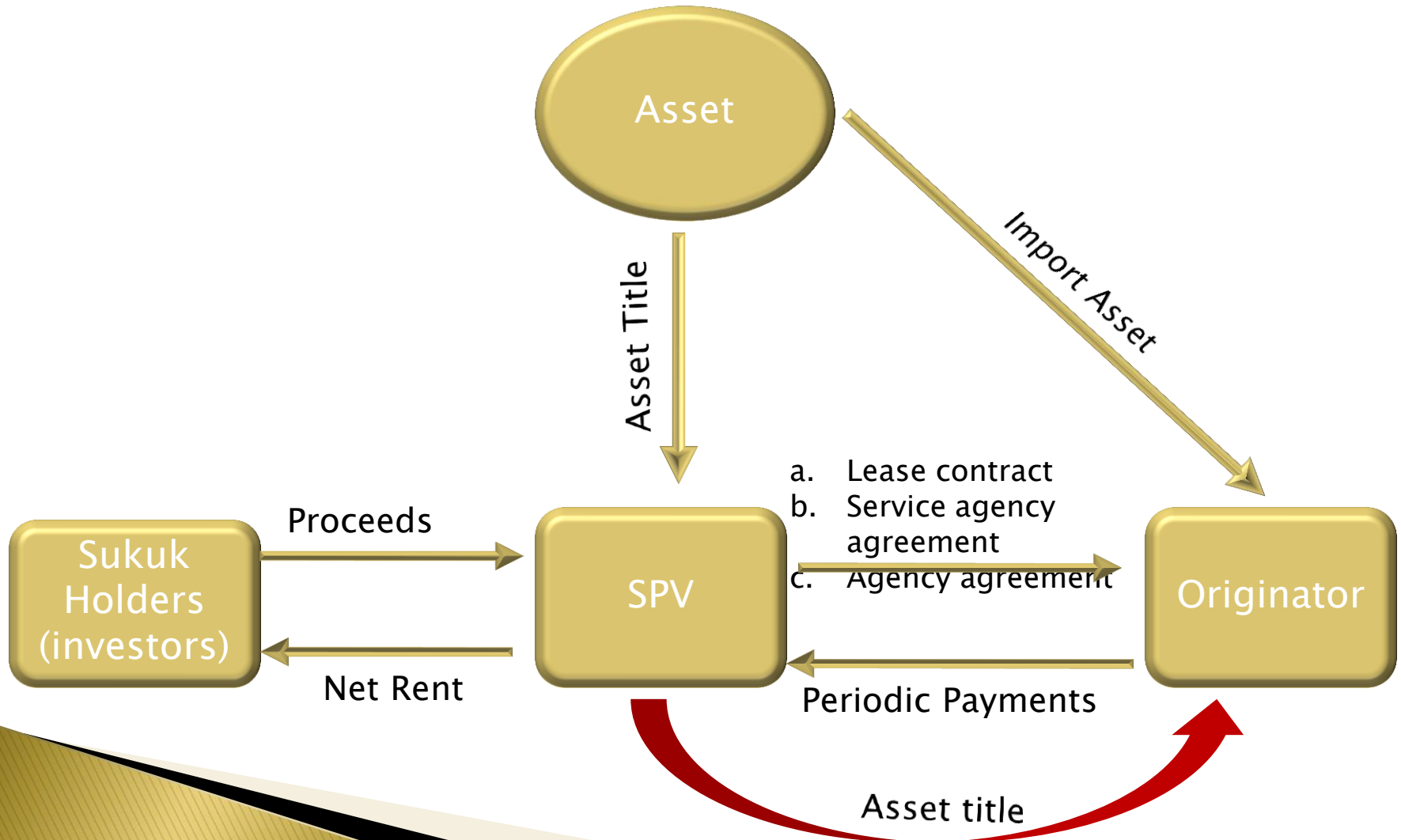
*Source: Qatar National Development Strategy 2011–2016*

# Proposed Sukuk

# Istisna'-Ijarah sukuk



# Ijarah Sukuk



# Merits of the instrument

- ▶ It serves as an instrument to raise fund for government developmental projects.
- ▶ It serves as an instrument to mop up excess liquidity resulted from the expansionary fiscal policy.
- ▶ It is used for liquidity management via open market operations.
- ▶ boost broader capital market development.
- ▶ It can be used for interbank transactions.

# Recommendation to central banks

- ▶ To set a strategic plan to enhance Islamic finance.
- ▶ Start using the open market operation to manage liquidity.
- ▶ Forecast the short-term and long-term potential liquidity.
- ▶ High level coordination between the central bank and government entities is needed .
- ▶ Shari'ah advisory board at the central bank level is recommended.

**Thank you**