Liquidity management in Islamic finance: Opportunities and challenges

As global growth returns and with the Sukuk market re-establishing itself, focus has returned to the problem presented by the dearth of liquidity management tools available to Islamic investors. BARRY COSGRAVE discusses.

There are too few short-term, liquid instruments available to investors looking for Shariah compliant products. The notable exception to this is the Bahrain government’s Salam program but the very fact that this is a unique offering is evidence of the problem. Islamic investors are essentially limited to investment in Sukuk and as such are positioned at a disadvantage to their conventional finance counterparts to whom a seemingly endless variety of investment alternatives are offered. At present, investors that might otherwise seek an Islamic investment opportunity are forced to turn to conventional finance in order to address a number of their financing needs. The end-goal for the industry must be to provide a full range of short, medium and long-term investment opportunities such that Shariah compliant products are seen by investors as the go-to option.

The International Islamic Financial Market (IIFM) recently launched its standard documentation for collateralized Murabahah transactions which is intended to provide a Shariah compliant alternative to the conventional repo transaction. This is another example of the excellent work undertaken by the IIFM in leading the push for standardisation of Islamic finance documents. As with the Tahawwut Master Agreement, the existence of this agreement alone indicates that Islamic finance is maturing and developing new instruments to address the numerous gaps in Shariah compliant products available to participants. However, much work remains to be carried out and market participants must build on these foundations to develop more innovative products for the industry to use.

Sukuk have dominated the Shariah compliant investment landscape and will continue to do so for the foreseeable future. Recent issuances by sovereigns outside traditional Islamic jurisdictions (notably the UK and Hong Kong) support the proposition that Islamic finance is again in growth mode. However, the same problems persist in that Sukuk are rarely traded and held to maturity by investors. This creates two problems: the absence of a liquid Sukuk market and lack of efficient market-based pricing. These two problems exacerbate each other creating a vicious circle that is hampering the industry. These two problems are further increased by the fact that a high percentage of newly-issued Sukuk are subscribed for by conventional investors which creates a more competitive environment for Islamic investors. Given the relative paucity of supply, Islamic investors are effectively encouraged to hold onto the Sukuk in which they have invested for fear that fresh Sukuk will not be available to them. As a result of this, secondary market trading is extremely limited and Sukuk are rarely seen as a liquid instrument.

At present, the only short-term Islamic investment of note is the government of Bahrain’s Salam program. This short-term Shariah compliant program uses Bahrain’s aluminium supply as its basis and is highly successful with each issuance regularly over-subscribed. However, this program is unfortunately all too rare. Five year Sukuk appear to be the must-have accessory for sovereign issuers in 2014, but what the market needs is for those issuers to also consider short-term instruments. If the right assets can be identified there should be nothing preventing sovereign issuers from issuing instruments similar to the Salam program. The fact that the Bahrain government’s program is so regularly

continued...
and heavily over-subscribed would suggest that the risks associated with the success of such a program should be relatively low.

However, the industry cannot rely solely on sovereign issuers to push Shariah compliant hedging products. Innovation has become increasingly popular and the structures used here can be transferred into new products such as structured investments that generate returns that may be benchmarked to the performance of certain indices or other assets. Innovation, more can and should be done with the tools that are already available. Shariah compliant hedging products have become increasingly popular and the structures used here can be transferred into new products such as structured investments that generate returns that may be benchmarked to the performance of certain indices or other assets. The collateralized Murabahah project completed by the IIFM in recent months is a good example of the development of ever more sophisticated investment products. Given that standard form documents are generally issued in response to market activity and therefore naturally lag behind such activity, it is very positive that such a document has been prepared as it shows that innovation is continuing.

Whilst problems remain, there is certainly a sense that Islamic finance is moving forward into a new phase of development. The Sukuk market is now a developed one and as such the focus is shifting to more sophisticated instruments. Islamic finance has always suffered from a perception that it should be able to run before it can walk. Conventional finance has developed over decades to the position in which it stands today. Islamic finance does not benefit from this history and, whilst the lessons learned from conventional finance and the products developed do give Islamic finance a head start, this does not mean that the full suite of products will be available immediately. However, it is clear that good progress is being made and that the future is bright.

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CALL FOR SUBMISSION

We are pleased to announce the launch of the 10th Islamic Finance news Deals of the Year Awards. Over 400 individual deals in 30 categories were nominated in 2013. The size and scope of the annual IFN Deals of the Year Awards continues to grow, ensuring it remains the most respected and sought-after accolades in the industry.

Islamic Finance news is categorically recognized as the industry’s leading publication and authority on the Islamic banking and finance industry. With a worldwide readership in excess of 23,000 industry practitioners and regulators, the Islamic Finance news Deals of the Year Awards offer its winners a truly global audience and a phenomenal vehicle in which to reach ones clients, potential clients and peers.

There are 19 global categories at stake this year, in addition to the individual country awards. This year, we have introduced one new category: The Social Responsibility Deal of the Year, for ethical transactions which act for the benefit of society at large.

Below is the full list of categories for which accolades will be awarded. Individual deals may be nominated for more than one category. However, only one deal per category. Submission guidelines and a list of criteria are also provided.

Awards will be presented to the Issuers, Lead Arrangers and Counsels in May 2015.

The Categories

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<th>Deal of the Year</th>
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* Country accolades will be awarded to those countries which have witnessed a minimum of three non-private placements during the calendar year. Verification may be required of these transactions.

Closing date for submissions: Friday, 19th December 2014

Submission Guidelines

- Submissions must be no more than two pages in length, in bullet format
- Only those deals which have been completed may be submitted
- Only those deals which were closed after the 1st January 2014 will be considered
- Submissions must be no more than two pages in length, in bullet format
- Closing date for submissions: Friday 19th December 2014
- Deals which close between the 19th December and the 31st December 2014 may be submitted up to and including Wednesday the 31st December 2014
- All submissions should be emailed exclusively to: andrew.morgan@REDmoneygroup.com
- Results will be announced in the Wednesday 7th January 2015 issue of Islamic Finance news

Submission criteria to include the following (where applicable): Instrument, Issuer, Issuer principal activities, Issue size & Pricing, Date, Issuances, Bookrunner, Arrangers, Legal counsel for issuer, Legal counsel for arrangers, Guarantor, Trustee, Shariah advisor, Method of issue, Purpose of issue, Rating, Road-shows, Subscription, Investors, Time, and a short brief on why this deal is being nominated.

The decision of the “Awards Committee” is final. A short brief will be published for each award providing the committee’s reasoning. All criteria of the submitted deals will be considered.

For more information, please contact Geraldine Chan either by email geraldine.chan@REDmoneygroup.com or call +971 4 427 3628