Shari'ah Standard No. (44)

Obtaining and Deploying Liquidity

Contents

IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

Preface

This Standard aims to define liquidity and the methods of obtaining, deploying and utilising it within Institutions.[1]

(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Statement of the Standard

1. Scope of the Standard

This Standard covers what is meant by liquidity and the permissible means of obtaining and deploying it.

2. Definition of Liquidity and Liquidity Management

2/1 Liquidity refers to cash or that which can be easily converted to cash.

2/2 Liquidity management means achieving a balance between obtaining liquidity as swiftly and cheaply as possible and investing and deploying it effectively.

Liquidity is achieved in various ways depending on where it is being utilised. For example, in institutions it is the ability to cover withdrawals; in the money market it is the ability to swiftly convert securities into cash; and with Sukuk and investment funds, it is the ability to redeem or sell them in the secondary market.

3. Need to Utilise Liquidity in Institutions

Institutions need liquidity to meet numerous requirements, such as:

3/1 To distribute profits, which may rely on the liquidation of assets, see Shari'ah Standard No. (40) on Distribution of Profit in Mudarabah-Based Investment Accounts.

3/2 To discharge liabilities by selling inventory assets and converting them to cash to pay what is owed to creditors, to face contingent liabilities, or liquidate investment vehicles or the institution itself, and similarly to expand its activities, or to achieve capital adequacy or to improve its credit rating, see Shari'ah Standard No. (43) on Insolvency.

4. Obtaining and Deploying Liquidity

4/1 Obtaining and deploying liquidity through interest-bearing loans is prohibited by the Shari'ah, whether transacted directly or through overdrafts or interest-bearing or commission-based facilities. Any liquidity support made available by supervisory or regulatory bodies (such as central banks) must be provided only through Shari'ah-compliant modes, such as Mudarabah and investment agency.

4/2 Permissible modes of obtaining liquidity include:

4/2/1 Selling commodities on a Salam (deferred delivery) basis, receiving payment up-front, and then purchasing the relevant commodities for delivery on the maturity date. It is permitted to secure a promise to sell (from a third party commodity broker) to mitigate the risk of fluctuation between the sale price and purchase price. [see Shari'ah Standard No. (10) on Salam and Parallel Salam]

4/2/2 Istisna'a concluding an Istisna'a-based sale contract stipulating advance payment -although advance payment is not obligatory- and concluding a parallel Istisna'a-based purchase contract stipulating deferred or installment payment. [see Shari'ah Standard No. (11) on Istisna'a and Parallel Istisna'a]

4/2/3 The institution selling some of its assets for immediate cash and then, if required, leasing the asset back on rent payable in arrears, taking into consideration what has been stated in Shari'ah Standard No. (9), item 5/8, on Ijarah and Ijarah Muntahiah Bittamleek.

4/2/4 Financing working capital to expand the institution's activities

This involves the institution inviting investors to participate in financing its working capital on a Mudarabah or Musharakah basis for a specified period of time determined by its liquidity requirements and with the ability to liquidate the Mudarabah or Musharakah at the end of such period. The investors enter into the Mudarabah or Musharakah by contributing their capital while the institution contributes its current assets, after valuation, as its share of the capital of the Musharakah or Mudarabah. The institution's fixed assets do not form part of the Musharakah; rather, fixed assets are either lent or leased to the venture and rental payments are accounted as expenses of the Mudarabah or Musharakah.

4/2/5 Issuing investment Sukuk to expand the institution's activities

This involves issuing the types of investment Sukuk explained in Shari'ah Standard No. (17) on Investment Sukuk in order to obtain funds from Sukuk investors and undertake projects required of the institution. The institution may securitise some of its assets by selling them to Sukuk subscribers, managing the assets on their behalf and promising to purchase them at the market price or at a price to be agreed. If the institution is only the lessee and not the manager of the Sukuk assets, it may promise to purchase them at face value.

4/2/6 Tawarruq

This should be done in accordance with Shari'ah Standard No. (30) on Tawarruq.

4/2/7 Interest-free loan

An application of interest-free loans is outlined in Shari'ah Standard No. (26) on Islamic Insurance in item 10/8 regarding loans given by the Takaful operator to the Takaful fund.

5. Liquidity Should Only Be Deployed Using Shari'ah-Compliant Modes, which include:

5/1 Purchasing commodities in cash and selling them for deferred payment through Musawamah or Murabahah contracts.

5/2 Leases, lease contracts that end in ownership and forward leases, whether for tangible assets or services.

5/3 Purchasing commodities on a Salam basis (immediate payment for deferred delivery), then selling them after taking physical or constructive delivery, whether personally or by appointing the seller, in a separate contract, to sell the commodities to his customers.

5/4 Istisna'a and parallel Istisna'a, which involve the institution commissioning the manufacture of products or projects on an Istisna'a basis with immediate payment for deferred delivery upon completion and then selling the same manufactured products to a third party through a second Istisna'a contract for deferred price and delivery, without linking the two contracts, or procuring the sale by appointing the manufacturer as an agent, through a separate contract, to sell the manufactured product or project to his customers.

5/5 Musharakah and Mudarabah which involve the institution as the capital provider.

5/6 Investment agency, which involves the institution appointing another institution or those with whom it deals to act as its agents.

5/7 Subscription to purchase Shari'ah-compliant stocks, investment Sukuk or shares in investment funds.

5/8 International commodity trading in the financial markets in accordance with Shari'ah.

5/9 Currency trading in accordance with Shari'ah.

6. Date of the Issuance of the Standard

This Standard was issued on 14 Jumada II, 1431 A.H., corresponding to 28 May 2010 A.D.

Adoption of the Standard

The Shari'ah Board adopted the Standard of Obtaining and Deploying Liquidity in its meeting No. (27) held in the Kingdom of Bahrain during the period of 12-14 Jumada II, 1431 A.H., corresponding to 26-28 May 2010 A.D.

Appendix (A)
Brief History of the Preparation of the Standard

On 24 Dhul-Qa'dah 1428 A.H., corresponding to 3 December 2007 A.D., the General Secretariat decided to commission a Shari'ah consultant to prepare a juristic study on Obtaining and Deploying Liquidity.

In its 25th meeting held in the Kingdom of Bahrain, during the period of 2-4 Dhul-Qa'dah 1430 A.H., corresponding to 21-23 October 2009 A.D., the Shari'ah Standards Committee discussed the draft of a Shari'ah Standard on Obtaining and Deploying Liquidity and made the necessary amendments.

The General Secretariat held a public hearing in the Kingdom of Bahrain, on 27 Safar 1431 A.H., corresponding to 11 February 2010 A.D. All the comments made in the public hearing were listened to, and a member of the Shari'ah Board answered these comments and made commentary on them.

In its meeting No. (26) held in the Kingdom of Bahrain, during the period of 24-26 Rabi' I, 1431 A.H., corresponding to 10-12 March 2010 A.D., the Shari'ah Board discussed the amendments proposed by the participants in the public hearing and incorporated the amendments that it considered suitable.

In its meeting No. (27) held in the Kingdom of Bahrain, during the period of 12-14 Jumada II, 1431 A.H., corresponding to 26-28 May 2010 A.D., the Shari'ah Board discussed the draft of the Standard, incorporated the necessary amendments that it deemed appropriate, and adopted the Standard.

In its meeting held in the United Arab Emirates, on 7 Sha'ban 1436 A.H., corresponding to 25 May 2015 A.D., the Shari'ah Standards Review Committee reviewed this Standard. After deliberation, the committee approved necessary amendments, and the Standard was adopted in its current amended version.

Appendix (B)
The Shari'ah Basis for the Standard

- The basis for the definition of liquidity as referring to cash and whatever is easily converted into cash is that the traditional terminology for liquidity is Tandid (literally, to convert to cash), actually or by estimation. Actual Tandid means converting commodities into cash by selling them. Tandid by estimation means evaluating commodities in order to arrive at the expected monetary value that can be realized from them.
- The basis that profit distribution depends on the availability of liquidity is that there cannot be any profit except after the protection of the capital, and this protection is realized by liquidating the assets.
- The basis for the prohibition of procuring liquidity through interest-based loans is the prohibition of any type of Riba (usury). The supervisory bodies are the entities most responsible for overseeing that the institutions' liquidity is compliant with Shari'ah. This is because it is these bodies that have licensed the institutions to operate by Shari'ah-compliant procedures and prohibited them from that which violates the Shari'ah.
- The basis for the Shari'ah-compliant methods of obtaining liquidity is provided in the Shari'ah standard for each method.
- The basis for the Shari'ah-compliant methods of deploying liquidity is provided in the Shari'ah standard for each method.

Appendix (C)
Definitions

Diversification of Liquidity

The deployment of liquidity in various instruments; for example, purchasing short-term, medium-term and long-term Sukuk to protect investments from sharp fluctuations in the returns.

Liquidity Preference

It means to hold on to cash instead of deploying it. That is for the purpose of financing current purchases, or investing it in securities whose prices are expected to decline, or paying for contingent expenses.

Liquidity Balance

It means reconciling the need to obtain liquidity and the need to deploy it.

Liquidity Surplus

The availability of liquidity exceeding the institution's needs.

Liquidity Deficit

The need for liquidity in order to meet financial requirements.

Good Liquidity

It is based on two principles: The best price and the shortest period for obtaining it.

Liquidity Risk

It is the risk of having to sell commodities or securities at a loss in order to procure liquidity.