10th Islamic Financial Stability Forum

Preserving the Soundness and Stability of the Islamic Financial Services Industry: The Development of a Financial Safety Net Infrastructure

Kuala Lumpur, Malaysia

In conjunction with the 25th Meeting of the Council of the IFSB

Organised By: ISLAMIC FINANCIAL SERVICES BOARD
Hosted By: BANK NEGARA MALAYSIA CENTRAL BANK OF MALAYSIA
10th IFSF: Speakers & Discussants

Speakers:
- Jaseem Ahmed, Secretary-General, Islamic Financial Services Board
- Zahid ur Rehman Khokher, Assistant Secretary-General, Islamic Financial Services Board

Discussants:
- Greg Cavanagh, Counsel and Vice President, Legal Group, Federal Reserve Bank of New York
- Rafiz Azuan Abdullah, Executive General Manager, Malaysia Deposit Insurance Corporation
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THE DEVELOPMENT OF A FINANCIAL SAFETY NET INFRASTRUCTURE FOR THE ISLAMIC FINANCIAL SERVICES INDUSTRY

PRESENTED AT:

10th Islamic Financial Stability Forum
Kuala Lumpur | 11 December 2014

Jaseem Ahmed
Secretary-General

Zahid ur Rehman Khokher
Assistant Secretary-General
Financial Safety Nets and Islamic Financial Services Industry

Lender of Last Resort (LOLR) Facilities
- Doctrines of LOLR
- Structuring *Shari’ah* Compliant LOLR - Challenges and insights

Deposit Insurance Schemes (DIS)
- Role of Deposit Insurance in Financial Stability
- *Shari’ah* Compliant DIS - Challenges and insights

Conclusions and Moving Forward
FINANCIAL SAFETY NETS AND ISLAMIC FINANCIAL SERVICES INDUSTRY
ELEMENTS OF FINANCIAL STABILITY

NORMAL MONITORING

EARLY WARNING

FINANCIAL SAFETY NET

1. Crisis Management & Contingency Planning
2. Lender of last resort
3. Explicit deposit insurance
4. Bank Resolution

Financial Stability
Stable and Sound Banking System
Depositors’ Protection
OBJECTIVES OF POLICY DURING FINANCIAL CRISIS

- Restoration of confidence
- Restoration of liquidity, solvency and, ultimately, profitability
- Other supporting actions: restructuring of balance sheets, NPL removal, recapitalisation
- Goal of shortening the duration of the credit crunch and restoration of credit growth
RECENT FINANCIAL SECTOR CRISSES

Asian + Global Financial Crisis

Focus on restoring liquidity early

- The central banks provided liquidity under various emergency lending and lender-of-last-resort facilities to financial institutions to offset the withdrawal of deposits and credits.

- To stabilise banks’ funding and prevent bank runs, central banks strengthened deposit insurance through blanket guarantees to provide full protection for depositors and creditors.
BANKS DURING CRISIS OF 2007

- Excessively leveraged banks
- Decline in loss absorption of capital
- Over reliance on wholesale funding of short duration (and currency mismatch)
- Decline in quality/quantity of liquid assets
ISLAMIC BANKS – DIFFERENT BUT STILL VULNERABLE

- High capital adequacy, 95% common equity Tier 1
- Lower leverage and higher solvency
- Flush with cash, But…..
- Risk sharing – the return on PSIA is not guaranteed and depends on the bank’s performance
- Higher exposure to consumer sector, which usually has a higher default rate
- Limited access to HQLA or to interbank markets
- Uncertainty over central bank support and adequacy of financial safety nets
Strengthen the foundations of the Islamic financial system

Source: IFSB-IRTI-IDB report on Islamic Finance and Global Financial Stability, April 2010
### CAPABILITIES FOR MONETARY OPERATIONS: IMPROVING WITH A LAG FOR IF

<table>
<thead>
<tr>
<th>Tools for Monetary Operations</th>
<th>Available for Conventional Banks</th>
<th>Adopted for Islamic Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open market operations (OMOs)</td>
<td>Yes</td>
<td>Base</td>
</tr>
<tr>
<td>Buying and selling money market instruments through Repo or outright sale in the secondary market</td>
<td>20 (80%)</td>
<td>5 (23%)</td>
</tr>
<tr>
<td>Issuance of Central Bank or Government Securities</td>
<td>Yes</td>
<td>Base</td>
</tr>
<tr>
<td>Primary market issuance of central bank or government securities for monetary policy purposes</td>
<td>18 (72%)</td>
<td>6 (29%)</td>
</tr>
<tr>
<td>Standing facilities</td>
<td>Yes</td>
<td>Base</td>
</tr>
<tr>
<td>Discount window or Short-Term Deposit facilities</td>
<td>20 (84%)</td>
<td>4 (20%)</td>
</tr>
</tbody>
</table>

Source: IFSB Survey, 2013

Availability of monetary policy tools in the form of OMOs, primary market issuances and standing facilities demonstrate relative progress in the capabilities of central banks and monetary authorities.
...reflects relative progress on legal framework for LOLR/SLOLR

**Nine RSAs** have not offered an SLOLR to-date but they place a high importance on developing SLOLR facilities due to the increasing IIFS market share in the banking system.

**Six RSAs** confirmed that SLOLR facilities **have been developed** for the IIFS in their jurisdictions.

Nine RSAs revealed that SLOLR facilities **have not been developed** in their respective jurisdictions, as they do not differentiate between conventional and IIFS when it comes to providing LOLR facilities.

### LOLR facility is legally embedded in the scope of the respective central bank/monetary authority

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Yes</strong></td>
<td>23</td>
<td>85%</td>
</tr>
<tr>
<td><strong>No</strong></td>
<td>4</td>
<td>15%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>27</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Note:** Approximate timeframe for the development of SLOLR facilities ranges from 1-3 years

*Source: IFSB Survey, 2013*
SIMILARLY, PROGRESS ON DEPOSIT INSURANCE SCHEMES WITH LAG

Out of 9 Jurisdictions:

=> 5 Jurisdictions: DIS Under Development/Under Consideration

=> 1 Jurisdiction: No Conventional Banks

Availability of Conventional Deposit Insurance Scheme

- Yes, 18, 67%
- No, 9, 33%

Availability of Shari’ah -Compliant DIS

- An SCDIS has been developed and implemented: 17%
- An SCDIS has not been developed and implemented: 21%
- Considers important to develop and implement an SCDIS: 62%

Source: IFSB Survey, 2014
SHARĪ`AH COMPLIANT LENDER-OF-LAST-RESORT (SLOLR) FACILITIES
DOCTRINES OF LOLR (1)

To Prevent, or mitigate, financial instability through the provision of liquidity support by monetary authorities either to individual financial institutions or to the market as a whole, in response to an adverse shock that causes increase in the demand for liquidity which cannot be met by an alternative source.

Henry Thornton (1802) & Walter Bagehot (1873)

1. Central bank, acting as LOLR, should prevent temporarily illiquid but solvent banks from failing [Exclude insolvent banks]
2. Central bank should accommodate any private bank with good collateral, valued at pre-panic prices
3. Lend, but at a high penalty rate
4. This policy should be clearly communicated. Uncertainty about central bank actions can itself contribute to panic

Classic Doctrine of LOLR

Two Operating Principles

LOLR role is discretionary, not mandatory
Systemic implications by contagion due to failure of one bank
DOCTRINES OF LOLR (2)

Critique

During Financial Crises
- Not easy to distinguish between illiquid and an insolvent institution

Moral Hazard and Stigma problems
- Self-defeating considerations

Lending Rate
- At a pre-crisis rate or at prevailing market rates

Operational Mechanism
- Direct Lending or Open Market Operations (OMOs)

“Constructive Ambiguity”

Discretionary Usage of LOLR to counterbalance moral hazard
However, the principles that would justify emergency lending should be made explicit
At present, central banks utilise a variety of mechanisms to provide liquidity support to banking institutions, such as:

1. Central bank providing an intraday liquidity facility (to support the payment system) and/or emergency short-term lending to the IIFS facing short-term liquidity problems
   - Applied in a stress-free scenario
   - Bank should meet ‘eligibility criteria’ and have qualified collateral

2. Central bank providing liquidity to the market through OMOs as a regular function of the central bank to ease market liquidity
   - To resolve liquidity drain at market level
   - As a regular function of the central bank

3. Central bank providing liquidity to a specific IIFS which is on the verge of insolvency and needs to be rescued to avoid systemic risk and contagion risks, and reputational risk to the supervisor
   - Similar to a “bail out” of an almost insolvent bank
   - Application of “constructive ambiguity”
### Structures Shari'ah Compliant LOLR for IIFS – Some Pertinent Questions

1. What are the *Sharī`ah* and operational issues with regard to providing SLOLR facilities to IIFS?

2. What is the status of pre-conditions for the development of SLOLR facilities?

3. How are existing SLOLR mechanisms *structured* by RSAs?

4. Have the *monetary tools* used by the RSAs been adapted to cater to the specificities of IIFS?

5. What is the *qualifying criteria and conditions* for providing SLOLR facility?

6. What are the *key challenges and supervisory considerations* in developing SLOLR?
1. ISSUES IN STRUCTURING SLOLR FACILITY

**Sharī`ah issues**

**LOLR as an interest-bearing loan**

The SLOLR to be structured and developed must be **free from interest-bearing elements**.

**Collateral in LOLR**

A security is permissible, provided that the **collateral is a Sharī`ah-compliant asset**.

**LOLR and high penalty rate**

A “high profit rate” may be applied to the SLOLR facility, provided that the conditions imposed by the *Sharī`ah* in connection with the principle of **mutual willing consent (Tarāḍī)** are fulfilled. The acceptability of such rate also depends upon the use of a suitable underlying **Sharī`ah-compliant contract and benchmark rates**.

**Role of Central Banks**

- The central bank, acting as an LOLR, should prevent temporarily illiquid banks from failing, including IIFS
- The central bank should make clear its readiness to providing liquidity support well in advance of crises, so that the market knows exactly what to expect, and thus removing uncertainty
## 2. PRE-CONDITIONS FOR THE DEVELOPMENT OF SLOLR FACILITIES

<table>
<thead>
<tr>
<th>Pre-conditions</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is necessary to have a robust supervisory framework in place first (i.e. in terms of setting out relevant controls on the SLOLR) before developing the SLOLR facility</td>
<td>1</td>
</tr>
<tr>
<td>A central bank will need to obtain appropriate regulatory and remedial powers, and backing of a suitable legal framework before developing and offering the SLOLR facility to IIFS</td>
<td>2</td>
</tr>
<tr>
<td>A central bank will have to assess the suitability of the SLOLR facility in relation to the prevailing Shari‘ah interpretations in its jurisdiction</td>
<td>3</td>
</tr>
<tr>
<td>A central bank will have to first have in place proper Shari‘ah governance mechanism before developing the SLOLR facility</td>
<td>4</td>
</tr>
<tr>
<td>A central bank will need to consider the cross-border implications in the development of SLOLR facilities</td>
<td>5</td>
</tr>
<tr>
<td>The development of SLOLR facility would require the central bank to commit to a substantial resource (e.g. IT and manpower)</td>
<td>6</td>
</tr>
<tr>
<td>Due to lack of eligible collaterals, there is a need for the central bank to broaden the scope of eligibility to include lower-rated securities and acceptance of bank/IIFS bills in overnight facility of SLOLR</td>
<td>7</td>
</tr>
</tbody>
</table>

3. SHARIAH-COMPLIANT LIQUIDITY MECHANISM

Six (out of 26) RSAs indicated that they have in place a structured mechanism for providing liquidity to IIFS

1. The authority (central bank) government short-term Sukūk Al-Ijārah (Al-Ijārah)

1. Tawarruq and Reverse Tawarruq (Murābahah)
2. Exchange of deposits (Qarḍ)

1. Intraday credit (Rahn)
2. Standing facility – sell and buy-back transaction (Bay` al-`Inah)
3. Standing facility – collateralised Murābahah (Rahn and Murābahah)

1. Liquidity management (Commodity Murābahah)

1. Interest-free loans (Qarḍ al-Hasan)
2. Floating speculation (deposits) (Floating Muḍārabah)
3. Restricted speculation (deposits) (Restricted Muḍārabah)
4. Partnership (Mushārakah)

1. Islamic certificates of deposit (Commodity Murābahah)
2. Islamic FX swaps (Islamic swaps)
3. Collateralised Murābahah facility
4. TOOLS FOR MONETARY OPERATIONS OF THE CENTRAL BANK (i)

It is essential to look at the existing mechanisms available for RSAs for monetary operations and how they are adapted to cater to Islamic finance. This will lead to evaluating the challenges in developing SLOLR facilities.

The development of OMOs using “repos and outright” sale or purchase is considered “important” for efficient monetary operations by the RSAs

<table>
<thead>
<tr>
<th>Tools for monetary operations</th>
<th>Tools adapted to meet Shari‘ah requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Open market operations (OMOs)</th>
<th>Existence of tools for monetary operations</th>
<th>Tools adapted to meet Shari‘ah requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buying and selling money market instruments outright on the secondary market</td>
<td>80%</td>
<td>25</td>
</tr>
<tr>
<td>Buying and selling assets under repurchase agreement (repo and reverse repo operations) in a secondary market to inject or absorb liquidity into or from the banking system</td>
<td>84%</td>
<td>25</td>
</tr>
<tr>
<td>Buying and selling of foreign exchange swaps</td>
<td>64%</td>
<td>25</td>
</tr>
</tbody>
</table>

The use of primary market issuance of central bank or government securities is considered important among the categories for monetary operations. Existence of tools for monetary operations is shown in the table below:

<table>
<thead>
<tr>
<th>Tools Adapted to Meet Sharī`ah Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existence of tools for monetary operations</td>
</tr>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>OMO-type operations (conducted using specific central bank instruments)</td>
</tr>
<tr>
<td>Lending and borrowing on an auction basis against underlying assets as collateral</td>
</tr>
<tr>
<td>Primary market issuance of central bank or government securities for monetary policy purposes</td>
</tr>
<tr>
<td>Auctions of term deposits</td>
</tr>
<tr>
<td>Foreign exchange auctions (as a tool for both banking system’s liquidity management and foreign exchange)</td>
</tr>
</tbody>
</table>

The findings suggest the need to develop new such facilities, or to adapt existing facilities, in line with the specificities of Islamic finance.

<table>
<thead>
<tr>
<th>Standing facilities (i.e. discretionary end-of-day lending or deposit facilities to provide or absorb overnight liquidity)</th>
<th>Existence of tools for monetary operations</th>
<th>Tools adapted to meet Sharī`ah requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount window or re-finance facilities (i.e. short-term borrowing of funds from central banks secured against government bonds or central bank securities as collateral, providing a ceiling for market interest rates)</td>
<td>88%</td>
<td>10%</td>
</tr>
<tr>
<td>Deposit facilities (i.e. short-term placement of banks’ funds with central banks), providing a floor for market interest rates</td>
<td>79%</td>
<td>25%</td>
</tr>
<tr>
<td>Fully collateralised Lombard facilities, secured against government bonds and loans on deeds, providing a ceiling for market interest rates</td>
<td>29%</td>
<td>0%</td>
</tr>
</tbody>
</table>

5. QUALIFYING CRITERIA AND CONDITIONS FOR PROVIDING AN SLOLR FACILITY

Aspects to be Considered before Providing SLOLR Facilities

- Access to the SLOLR facility should be at the discretion of the central bank i.e. each request should be properly evaluated before deciding whether or not to extend the SLOLR facility to the requesting IIFS
- Will only rescue certain IIFS, when they are above a threshold size and are fundamentally sound but face a sudden and unexpected liquidity outflow
- SLOLR is only provided to the IIFS on penalty rates that are illiquid, solvent and have good collaterals
- When the likelihood of system failure and contagion is the key factor affecting the central bank's incentive in providing SLOLR to certain IIFS
- When contamination becomes a main concern, even if moral hazard is also present, the SLOLR facility will be perceived as necessary and justified
- Other

Base: 27 RSAs

- 33%
- 30%
- 22%
- 15%
6. **KEY CHALLENGES IN DEVELOPING SLOLR**

<table>
<thead>
<tr>
<th>#:</th>
<th>Challenge</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Availability of a range of eligible <em>Shari<code>ah*-compliant collateral - a shortage of high-quality *Shari</code>ah</em>-compliant liquid assets</td>
</tr>
<tr>
<td>2</td>
<td>Procedures and guidelines for SLOLR - developing a process to ensure <em>Shari`ah</em> compliance of SLOLR operations</td>
</tr>
<tr>
<td>3</td>
<td>Supporting infrastructure (e.g. human resources, an effective <em>Shari<code>ah* governance mechanism, adaptation of integrated payment and settlement systems addressing *Shari</code>ah</em> concerns)</td>
</tr>
<tr>
<td>4</td>
<td>Valuation techniques for the underlying <em>Shari`ah</em>-compliant assets or collateral</td>
</tr>
<tr>
<td>5</td>
<td>Prohibition of “penalty rate/discount rate/interest rate” and development of Islamic benchmark as an alternate for an SLOLR facility</td>
</tr>
<tr>
<td>6</td>
<td>Differing interpretations of <em>Shari<code>ah* rulings, or *Fatāwa*, on financial matters across the jurisdiction (i.e. interpretations among *Shari</code>ah</em> boards of the IIFS) *</td>
</tr>
<tr>
<td>7</td>
<td>Re-financing or roll-over facilities for the SLOLR facility</td>
</tr>
</tbody>
</table>

*Most of the IIFS which have cross-border operations believe that this would be a significant challenge to them*
SUPERVISORY CONSIDERATION ON POTENTIAL STRUCTURES FOR LOLR

<table>
<thead>
<tr>
<th>Key supervisory considerations</th>
<th>Recommendations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify the appropriate Sharī‘ah-compliant financial contract to be employed</td>
<td><em>Qarḍ</em> to be used for overnight funding</td>
</tr>
<tr>
<td>Address risk management issues in providing a SLOLR, such as credit, reputational and legal risk</td>
<td>Collateralised CMT to be used for intraday and short-term funding</td>
</tr>
<tr>
<td>Establish the necessary frameworks to mitigate the incidence of moral hazard problem</td>
<td><em>Muḍārabah</em> or <em>Wakālah</em> to be used for longer-term liquidity provision</td>
</tr>
<tr>
<td>Identify the merits and weaknesses of the potential structures when developing SLOLR facilities</td>
<td></td>
</tr>
</tbody>
</table>

*Qarḍ* to be used for overnight funding

Collateralised CMT to be used for intraday and short-term funding

*Muḍārabah* or *Wakālah* to be used for longer-term liquidity provision
SHARĪ`AH-COMPLIANT DEPOSIT INSURANCE SCHEME
ROLE OF DEPOSIT INSURANCE IN FINANCIAL STABILITY

**Good Times**
- Builds confidence in overall safety of banking system
- Attracts savings into banking system
- Facilitates bank intermediation process
- Builds awareness of and promotes financial literacy through deposit insurer’s awareness programs

**Bad Times (Bank Insolvency)**
- Provides incentive to depositors to retain savings in banking system.
- Maintains confidence among depositing public in safety of their deposits.

**Role of Deposit Insurance Provider**
- In good times, to establish credibility
- In bad times, to build confidence by effective bank resolution procedures and speed of deposit insurance repayment

**Incentives for banks to improve risk management**
- Banks with riskier profile pay higher premiums
- Reduces moral hazard issues
- DI components are indicators of sound risk management framework.
- Provides financial incentive to resolve deficiencies on timely basis.
POLICY PARAMETERS FOR STRUCTURING A SCDIS FRAMEWORK

- **Insurability** of Islamic banks’ deposits
- Who guarantees?
- How is it funded?
- Choice of Shari’ah Compliant Model
- Treatment of Islamic Deposits and PSIA, including Restricted accounts

- Amendments to current statute or a separate law on Islamic bank deposits
- Insolvency Regime
- Resolution Frameworks

- Interaction with other safety net mechanisms
- Role of Deposit Insurer in Bank Resolution
- Funding Mechanism of Deposit Insurer
- Compulsory membership in a Kafalah (guarantee) structure
In a Survey undertaken by the IFSB in 2014, **67% of the RSAs** (18 out of 27) indicated that a Conventional Deposit Insurance System (CDIS) facility exists in their banking institutions.

With respect to *Sharī‘ah*-compliant deposit insurance schemes (SCDIS), only **17% (four)** RSAs confirm that SCDIS facilities have been developed and implemented for the IIFS in their jurisdictions.

---

**Protecting Islamic Deposits: Three Approaches**

- Protecting Islamic deposits under a conventional deposit insurance system
- Developing a SCDIS alongside a conventional system
- Developing an SCDIS in a fully-Islamic banking environment
## SELECTED MODELS FOR SCDIS

Choice for Appropriate Model for *Shari’ah* Compliant Deposit Insurance and insurability of Profit Sharing Investment Accounts (PSIA) Pose Primary Challenge for Jurisdictions

<table>
<thead>
<tr>
<th>Features</th>
<th>Kafalah Bil Ujr (Guarantee with Fee) [Malaysia]</th>
<th>Takaful (Joint Guarantee) [Sudan]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parties to the Contract</td>
<td>IIFS and Deposit Insurance Provider</td>
<td>IIFS, IAH, MOF and/or Central Bank</td>
</tr>
<tr>
<td>Funds for guarantee of Islamic deposits and PSIA</td>
<td><strong>One Fund</strong> covers both Islamic Deposits and PSIA. Fund is separate from conventional fund.</td>
<td><strong>Separate Takaful Funds</strong> for the guarantee of Islamic deposits and PSIA*</td>
</tr>
<tr>
<td>Contribution to Fund</td>
<td>Made by the IIFS</td>
<td><strong>Islamic Deposits</strong>: Contribution by the IIFS and/or MoF/Central Bank</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>PSIA</strong>: IAH and/or MoF/Central Bank</td>
</tr>
<tr>
<td>Fund Ownership</td>
<td>Deposit Insurance Provider</td>
<td>Respective Contributors</td>
</tr>
<tr>
<td>Role of Deposit Insurance Provider</td>
<td>Guarantor</td>
<td>Agent to Manage Takaful Funds</td>
</tr>
<tr>
<td>Reimbursement</td>
<td>Made by Deposit Insurance Provider’s Fund</td>
<td>Made from the Takaful Funds</td>
</tr>
</tbody>
</table>

*Footnote: One Takaful Fund with two portfolios: One each for Islamic deposits and PSIA (Jordan)*
DIFFERENT TREATMENT OF INSURABILITY OF PROFIT SHARING INVESTMENT ACCOUNTS

• Regulatory and Shar’iah Treatment of PSIA had an impact on insurability.

<table>
<thead>
<tr>
<th>Treatment of PSIA</th>
<th>No.</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. <strong>IAHs are treated like investors</strong> who bear all the earnings volatility and risks of losses on their investment (absent misconduct or negligence in the part of the IIFS) - Therefore, the (credit and market risks weighted) assets financed by the funds of the IAHs are excluded from the denominator of the capital adequacy formula.</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>b. <strong>IAHs are treated like a liability of the IIFS</strong>, which therefore bears the risk of the assets funded by IAH.</td>
<td>12</td>
<td>44</td>
</tr>
<tr>
<td>c. <strong>IAHs are only partially risk absorbent</strong> so that the IIFS bears part of the earnings volatility on their investment. Therefore IIFS include a proportion of credit and market risks (known as Alpha (α)) related to the assets financed by PSIA, in the denominator of the CAR</td>
<td>7</td>
<td>26</td>
</tr>
<tr>
<td>d. Others</td>
<td>6</td>
<td>22</td>
</tr>
<tr>
<td><strong>Base/Total</strong></td>
<td><strong>27</strong></td>
<td></td>
</tr>
</tbody>
</table>

• In one case, restricted PSIA are not covered by SCDIS.

<table>
<thead>
<tr>
<th>Types of Account</th>
<th>Underlying contract</th>
<th>account is protected under the SCDIS?</th>
</tr>
</thead>
<tbody>
<tr>
<td>RSA 1</td>
<td>Current accounts</td>
<td>Qard</td>
</tr>
<tr>
<td></td>
<td>Investment accounts</td>
<td>Mudarabah</td>
</tr>
<tr>
<td>RSA 2</td>
<td>Saving Account</td>
<td>Wadiah, Qard, Mudarabah</td>
</tr>
<tr>
<td></td>
<td>Current Account</td>
<td>Wadiah, Qard, Mudarabah</td>
</tr>
<tr>
<td></td>
<td>Commodity Murabahah Account</td>
<td>Murabahah</td>
</tr>
<tr>
<td></td>
<td>Unrestricted Investment Account (UIA)</td>
<td>Murabahah, Wakalah</td>
</tr>
<tr>
<td></td>
<td>Restricted Investment Account (RIA)</td>
<td>Murabahah, Wakalah</td>
</tr>
<tr>
<td></td>
<td>Money market deposit</td>
<td>Murabahah, Wakalah, Mudarabah</td>
</tr>
<tr>
<td></td>
<td>Negotiable Instrument of Deposit/Islamic Negotiable Instrument</td>
<td>Wadiah, Mudarabah</td>
</tr>
<tr>
<td></td>
<td>Investment Linked to Derivatives Offered/Structured Product</td>
<td>Murabahah, Wakalah, Mudarabah</td>
</tr>
<tr>
<td></td>
<td>Gold investment account</td>
<td>Qard</td>
</tr>
<tr>
<td></td>
<td>Islamic repurchase agreement</td>
<td>Mudarabah</td>
</tr>
<tr>
<td>RSA 3</td>
<td>Unrestricted investment accounts</td>
<td>Mudarabah</td>
</tr>
<tr>
<td></td>
<td><strong>Restricted investment accounts</strong></td>
<td>Mudarabah</td>
</tr>
<tr>
<td>RSA 4</td>
<td>Demand Deposit</td>
<td>Qard</td>
</tr>
<tr>
<td></td>
<td>Savings</td>
<td>Wadiah</td>
</tr>
<tr>
<td></td>
<td>Investment account</td>
<td>Mudarabah</td>
</tr>
</tbody>
</table>

Source: IFSB Survey, 2014
COVERAGE OF ISLAMIC WINDOWS

IFSB Survey Findings

95% of the RSAs (19 out of 20) agreed that Islamic windows’ clients should be given similar protection to clients of fully-fledged Islamic banks.

- Consistency in protection is necessary
- Necessary to have a level-playing field between Islamic windows and fully-fledged Islamic banks

Challenges and Issues in Covering Islamic Windows

1. Requirement to “ring-fence” the contributions made by parent bank for its conventional and Islamic deposits
2. Implementation of a differential premium system – categorising banks into a few categories based on their respective risk profiles for premium collection purposes
3. Priority of payments upon liquidation of assets should a conventional bank with Islamic window fail
4. Treatment of windows if conventional bank goes under resolution and is taken over by other bank
5. Reputational Risk between Islamic and conventional arms
## ASSESSMENT OF THE ARRANGEMENTS FOR THE DEVELOPMENT OF SCDIS

<table>
<thead>
<tr>
<th>Assessment of the Existing Arrangements for the Development of SCDIS Facilities</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>The necessary legal, tax and regulatory aspects have been studied to accommodate the development of SCDIS</td>
<td>5</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>The necessary legal, tax and regulatory framework has been created, but has not yet been put into operation</td>
<td>2</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>The operational procedures and processes have been set out under which the SCDIS would function</td>
<td>0</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td><em>Sharī‘ah</em> constraints and other challenges on the introduction of SCDIS have been assessed</td>
<td>4</td>
<td>11</td>
<td>15</td>
</tr>
</tbody>
</table>

RSAs who do not have sufficient experience in regulating and dealing with Islamic finance activities may find the development of an SCDIS facility a more challenging task.

**Note:** Approximate timeframe for the developing SCDIS facilities ranges from 1-5 years

*Source: IFSB Survey, 2014*
## KEY CHALLENGES IN THE DEVELOPMENT OF A SCDIS

<table>
<thead>
<tr>
<th>Challenges encountered in developing and implementing a SCDIS</th>
<th>Ranking</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal issues</strong> – formulating the necessary changes to existing laws, regulations etc.</td>
<td>1</td>
</tr>
<tr>
<td>*<em>Sharī<code>ah issues** – such as differing interpretations of *Sharī</code>ah</em> rulings, or <em>fatawa</em>, on financial matters across the jurisdiction</td>
<td>2</td>
</tr>
<tr>
<td><strong>Legislative issues</strong> – securing the necessary approvals from your legislative body, Ministers, etc.</td>
<td>3</td>
</tr>
<tr>
<td><strong>Supporting infrastructure</strong> – human resources including skills and expertise, etc.</td>
<td>4</td>
</tr>
<tr>
<td><strong>Investment tools or schemes</strong> – limitations on appropriate <em>Sharī`ah</em>-compliant instruments for SCDIS to invest in</td>
<td>5</td>
</tr>
<tr>
<td><strong>Setting procedures and guidelines</strong> on SCDIS (including developing a process ensuring <em>Sharī`ah</em> compliance of SCDIS operations)</td>
<td>6</td>
</tr>
</tbody>
</table>


Not addressing these challenges would obstruct the development and implementation of the SCDIS

Source: IFSB Survey, 2014
SUMMARY: SCDIS ISSUES

- SCDIS is relatively new
- Coverage to IIFS is provided by CDIS in many countries
- Different operational models – but possibility of clear choices emerging
- Treatment of IAH critical issue
- Convergence on need to develop SCDIS
OVERALL CONCLUSIONS AND MOVING FORWARD

The question for Islamic finance - not whether financial safety nets are required, but *how they should be structured to be Sharī`ah compliant*. Leaving IIFS without a safety net is too high a risk for the soundness and stability of the financial system.

- **Capacity building** of supervisors and deposit insurance providers
- **Sharing of experiences** by the stakeholders
- Research papers and standards to provide **policy guidelines** in order to define the structures, mechanisms and specific criteria for developing these facilities
- Having in place a **robust banking supervisory framework**
- Cooperation between various supervisory agencies within a jurisdiction for effective **cross-sector oversight**, information sharing and timely decision making

**Key aspects of evolving strategies**

- Future IFSB work programme - providing prudential guidance or standards on this subject. Consultations with IFSB TC and Council.
- Institutionalising policy coordination/sharing of experiences
THANK YOU FOR YOUR ATTENTION