INTERNATIONAL
ISLAMIC LIQUIDITY
MANAGEMENT
CORPORATION

REPORT

CONTENT

Published by Islamic Finance *news* for International Islamic Liquidity Management Corporation

CEO Message

Dear IFN Readers,

At the start of 2023, the International Monetary Fund (IMF)'s managing director, Kristalina Georgieva, warned that the new year is going to be "tougher than the year we leave behind", with a third of the world economy expected to be in recession. After facing a challenging 2022, where the markets dealt with high levels of inflation and the impact of the US Federal Reserve's tightening monetary policy, the IMF believes that the global economy will see a tough year ahead as the main engines of global growth – the US, Europe, and China – are seeing their economic activities slowing down.

Just as the first quarter of the year came to a close, we have witnessed a spiral of banking crisis stretching across the US and Europe that rattled the global financial system. The complete and utter collapse of Silicon Valley Bank and Signature Bank in the US sent shockwaves across the global markets, and we then saw the unexpected downfall of the 167-year old Swiss financial institution Credit Suisse, raising alarm regarding the stability of the global banking industry among market participants.

The Islamic finance industry is not sparred from the global headwinds, and if anything, we are expected to be more innovative and take the bull by its horns to lead by example in resolving the pressing issues facing us. If history serves as a reminder, the Islamic finance industry navigated the 2008 financial crisis well and its Shariah compliant framework and risk-based approach sparred most Islamic financial institutions from a similar meltdown that saw giant players disintegrate and pack up their business.

While 2022 was a year faced with high inflation and sustained geopolitical risks, the IILM navigated global risks well and succeeded in achieving several key milestones, namely the issuance of its inaugural 12-month Sukuk as well as receiving the second international program rating from Fitch Ratings. The IILM has consistently offered three different short-term Sukuk tenors every month, namely one-month, three-month and six-month over the last few years, with the most recent 12-month offering in 2022 complementing its yield curve and thus fulfilling the organization's mandate of providing a wide range of Shariah compliant liquidity management instruments to the market.

Despite last year's challenging market conditions, the IILM supplied an excess of US$13.88 billion across 37 Sukuk series through four different tenors and accounted for 39% of the total global US dollar Sukuk issuances in 2022. The secondary market volume, meanwhile, reached US$2.2 billion, the highest volume since inception, representing circa 16% of the total issuance last year. The IILM's Sukuk issuance this year up to May stood at US$$4.35 billion, accounting for 26% of the total volume of US dollar Sukuk issued globally.

While we remain mindful of the multiple uncertainties that the future brings, the IILM looks forward to further increasing the resilience of the Islamic finance ecosystem, as it explores new developments of its issuance program to address investors' needs and

enhance the accessibility to its high-quality and short term Sukuk.

Given the IILM's establishment further to the global financial crisis and looking back at the volatility experienced during the recent COVID-19 pandemic, there is no shortage of risk across the financial landscape, with the expectation of further disruption in the future. The IILM will continue to build on its track record and work with its partners and stakeholders to enhance and strengthen the Islamic liquidity management framework.

Dr Umar Oseni
CEO
International Islamic Liquidity Management Corporation

About the IILM
The International Islamic Liquidity Management Corporation (the IILM) is an international organisation established by central banks and a multilateral organisation to create and issue Shariah compliant financial instruments to facilitate effective cross-border Islamic Liquidity Management.

Established on the 25th October 2010, the IILM aims to enhance cross-border investment flows, international linkages and financial stability by creating more liquid Shariah compliant financial instruments for institutions offering Islamic financial services (IIFS).

Headquartered in Kuala Lumpur, Malaysia, the IILM has a diverse membership comprising central banks of Indonesia, Kuwait, Malaysia, Mauritius, Nigeria, Qatar, Turkiye, the United Arab Emirates as well as Islamic Corporation for the Development of Private Sector (ICD). The IILM paves the way for a unique collaborative, cross-border solution to a common, cross-border concern.

International Islamic Liquidity Management Corporation
Suite 43B
Level 43, Vista Tower, The Intermark,
348 Jalan Tun Razak,
50400 Kuala Lumpur, Malaysia
Tel: +60(3) 2170 5000
Fax: +60(3) 2170 5111
E-mail: info@iilm.com

The publisher

About the REDmoney Group
REDmoney Group is the foremost global provider of specialized Islamic financial media services across three core divisions of events, publishing and training. Established in 2004, the firm has offices in Dubai and Kuala Lumpur: offering an unrivalled multi-channel service across the full spectrum of the global financial markets. The outward-facing arms of the REDmoney publishing and events portfolio are supported by REDmoney Training, which provides access to industry-leading expertise from the best in the field.

REDmoney Group covers the full range of global markets: from emerging Islamic economies across Africa and Asia to industry leaders such as Malaysia and the GCC along with developed nations in Europe and the Americas seeking to enter the sector. The company offers unequalled access to the elite of the industry: with relationships built up over a decade of trusted communication with market leaders to provide a detailed network covering every aspect of Islamic financial services.

MALAYSIA
E-12B-2.1, Level 12B, East Wing The Icon,
No.1, Jalan 1/68f, Jln Tun Razak, 50400
Kuala Lumpur, Malaysia.
Tel: +603 2162 7800
Fax: +603 2162 7810

UAE
B4-212A3, Business Center 04
RAKEZ Business Zone-FZ
RAK, United Arab Emirates

IILM Snapshot

1. OVERVIEW

The International Islamic Liquidity Management Corporation (IILM) is an international institution established on the 25th October 2010 with the primary objective of providing short-term Shariah compliant financial instruments to facilitate effective liquidity management for Islamic financial institutions through Sukuk issuance.

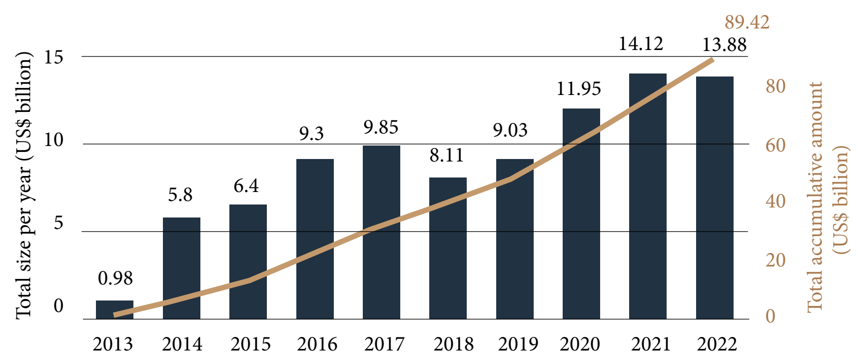
The IILM's current members comprise nine shareholders including eight central banks (Bank Indonesia, Central Bank of Malaysia, Central Bank of Mauritius, Qatar Central Bank, Central Bank of Nigeria, Central Bank of the Republic of Turkiye, Central Bank of Kuwait, and Central Bank of United Arab Emirates) and one multilateral institution (Islamic Corporation for the Development of the Private Sector).

2. IILM SUKUK MARKET SNAPSHOT 2022

A. PRIMARY MARKET

- During 2022, the IILM has achieved year-to-date cumulative issuances totalling US$13.88 billion, through 37 Sukuk series. The IILM Sukuk issuance averaged US$1 billion monthly across varying tenors: one-month, three-month, six-month Sukuk and the newly introduced 12-month tenor in 2022. In total, 10 different tenors have been issued since inception to cater the liquidity needs of institutions offering Islamic financial services. Currently, the total amount of the IILM Sukuk outstanding is US$3.51 billion.

Chart 1: IILM Sukuk issuances 2013—22



- Demand for short-term instruments including the IILM Sukuk increased significantly across all tenors in 2022, due to the continued US Treasury yield curve inversion making the IILM profit rates higher, hence more attractive. On average, the bid-to-cover ratio for IILM Sukuk issued in 2022 was 167%, with the blended weighted average yield spread over LIBOR around 14bps. This figure is relatively steady compared to 2021 issuances, amid sharp increase in the short-term yield during 2022.

- The allocation of the IILM Sukuk in 2022 was mainly distributed across five regions where the Middle East received the highest allocation of 55%, followed by Asia, Africa, Europe, and others at 39%, 2%, 1% and 3% respectively.

- By country, Kuwait, Brunei Darussalam, the UAE and Malaysia have had the biggest allocation at 38%, 23%, 11%, and 10% respectively. Among the countries, allocation to Brunei Darussalam increased significantly in 2022, compared with 8% in 2021.

- Based on the investor type, banks had the highest allocation (68%) including 91% for Islamic banks, followed by supranational/sovereign wealth fund (SWF)/Ministry of Finance (MoF)/central banks, and pension funds/asset managers at 27% and 4%, respectively.

- Islamic investors dominated the primary market in 2022, accounting around 85% of total allocation across the tenors, compare with 15% allocated to conventional investors

Chart 2: Investor breakdown by region and country in 2022

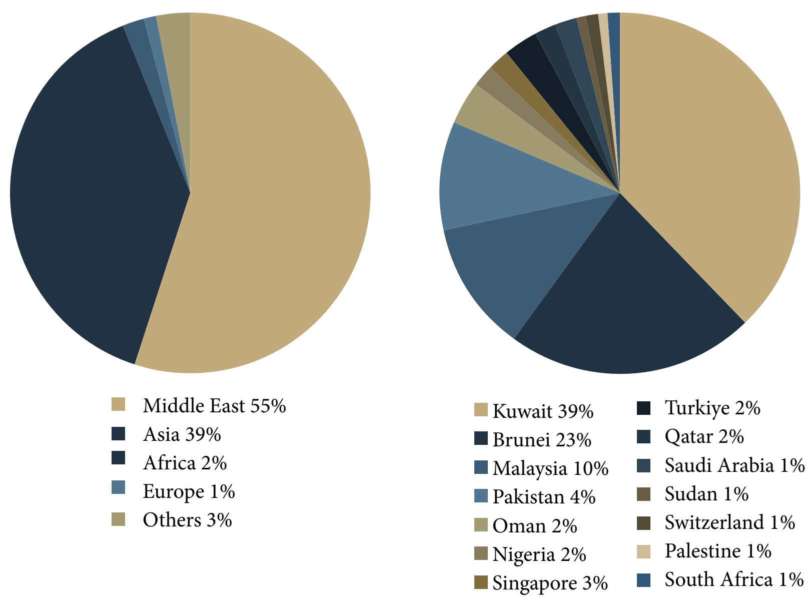
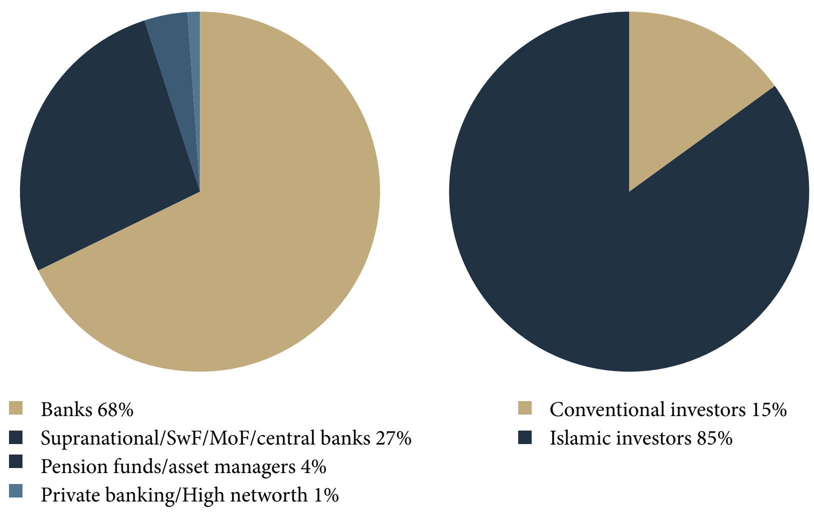


Chart 3: Investor breakdown by type and nature in 2022



B. SECONDARY MARKET

- The IILM Sukuk secondary market performance has continuously improved over the years. The total value of traded IILM Sukuk in 2022 surged up by 43% to US$2.23 billion compared with US$1.55 billion traded in 2021, and the number of executed transactions for IILM Sukuk in 2022 reached 291 deals compared with 150 transactions executed the year before. This improvement in secondary market trading volume reflects the growing acceptance of the IILM Sukuk in the market, not only because of its high quality of asset but also due to a constant high tangibility ratio (79%) as well as its wider investor distribution over the last 10 years.

Chart 4: The IILM Sukuk secondary market performance 2019—22

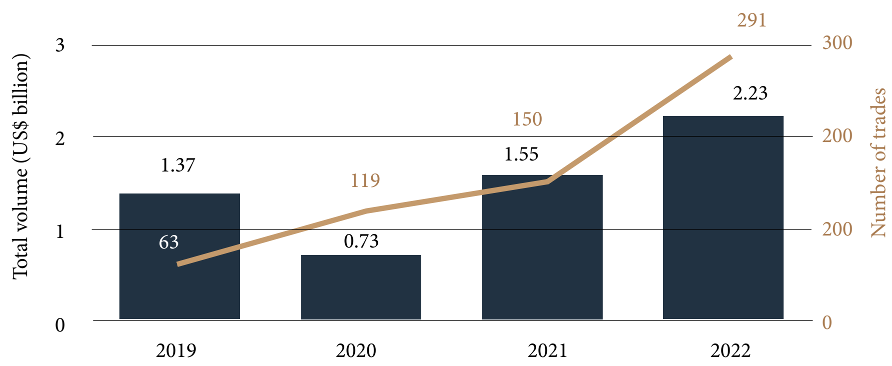
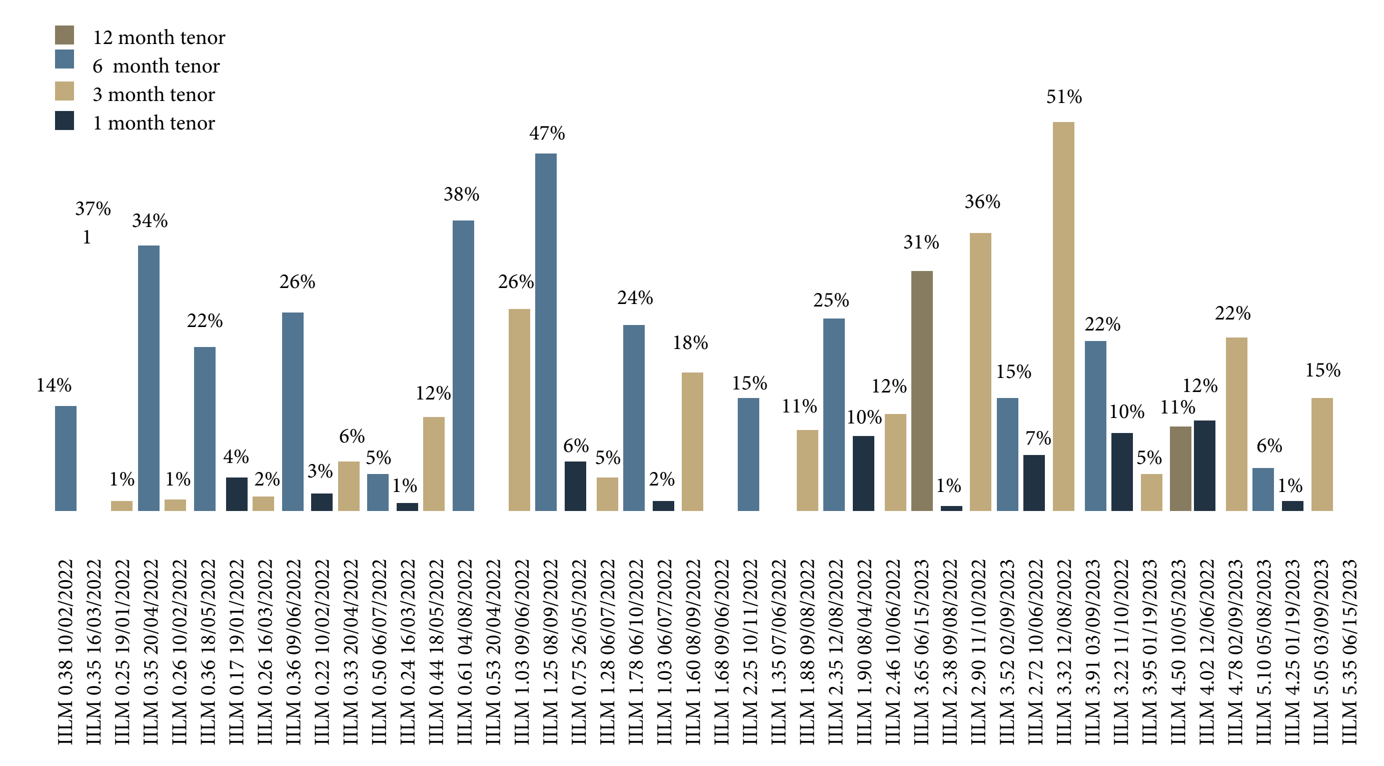
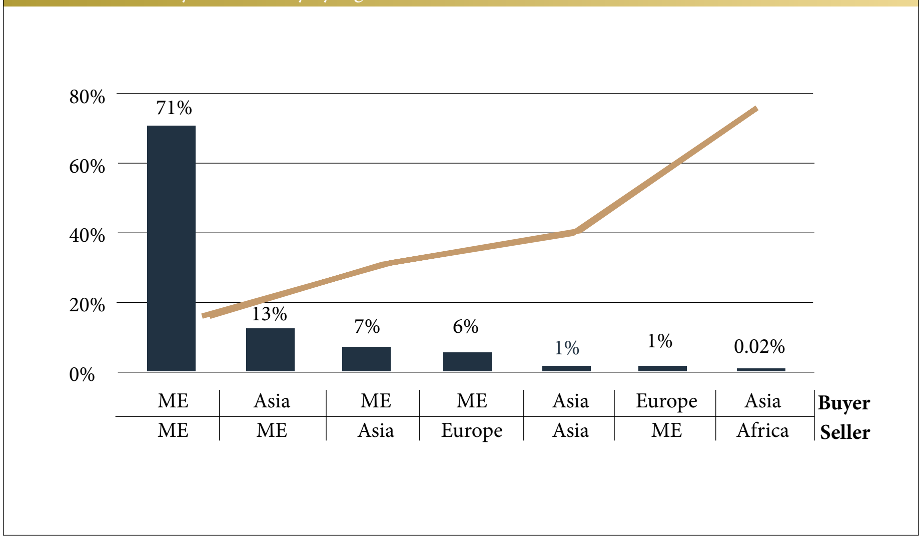


Chart 5: The IILM Sukuk secondary market turnover by series



- In line with its issuance goal to improve the IILM Sukuk liquidity and secondary market performance, the six-month and 12-month IILM Sukuk series have higher turnover compared to the one-month and three-month series as shown in Chart 5.

Chart 6: Secondary trade activity by region in 2022



Cross-border trading activity

- Based on the secondary market performance, the IILM Sukuk saw greater liquidity in the GCC market, which could be attributed to the revival of liquidity within the region, as well as investors searching for instruments that provide higher yields given the continuing rising rate environment. This is substantiated by the fact that most of the IILM secondary trades in 2022 occurred within the Middle Eastern region, accounting for 71% of the total trade volume.

- The presence of significant inter-regional trades in the IILM secondary market suggests an improvement in the cross-border liquidity of the IILM Sukuk. The highest inter-regional trades recorded were from Asia to the Middle East representing 13% of the trade volume, mainly coming from Turkiye, which had a notable rise in trading volume compared to the previous year.

- The second highest was from Middle East to Asia, with 7% of the trade volume. Furthermore, there was a considerable trade volume from Europe to the Middle East, representing 6%. However, trades from the Middle East to Europe were relatively low, representing only 1% of the trade volume. The cross-border secondary trading activity supported by the role of the IILM primary dealers has greatly contributed to an increase in the availability of the IILM Sukuk in different regions and ultimately to a greater demand for the short-term papers.

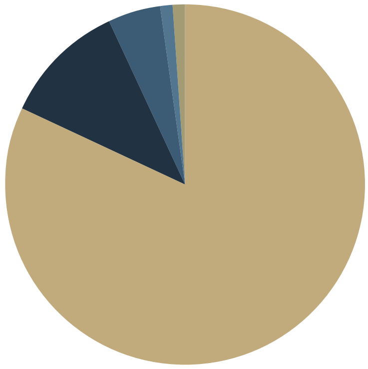
- By country, Kuwait and the UAE were the most active on the secondary market in 2022 followed by Oman, Turkiye, Brunei and the UK, as shown by the investor breakdown by trading volume in Chart 7. In 2022, the IILM Sukuk managed to gain a broader presence in countries such as Palestine, Qatar, Switzerland and South Africa, despite having a relatively small volume of trades at secondary market.

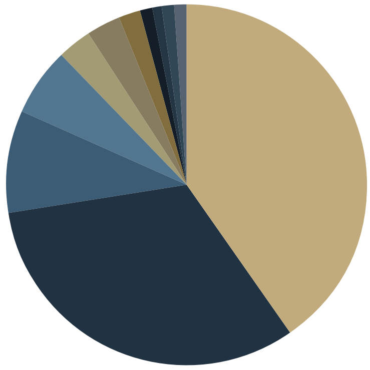
- By type of investors, banks remained as the most active investors on the secondary market with 62% of them being Islamic banks, while asset managers have increased their participation on the secondary market during 2022 with more than 10% of the total trading volume, who mainly came for the longer tenor. The IILM secondary market also has recorded several trades done with supranational/SwF/MoF/central banks at 5%, private banking and broker at around 1% each, as shown in Chart 7.

- In order to strengthen the distribution network and bolster activities on the primary and secondary markets, the IILM has established an incentive scheme, to be effective in 2023, as part of our recognition to the primary dealers for their efforts in supporting the IILM program.

Note: It is important to note that there is still limited availability of information on the secondary trades of the IILM Sukuk as it is limited by the trades reported by the primary dealers.

Chart 7: Investor breakdown by type and country





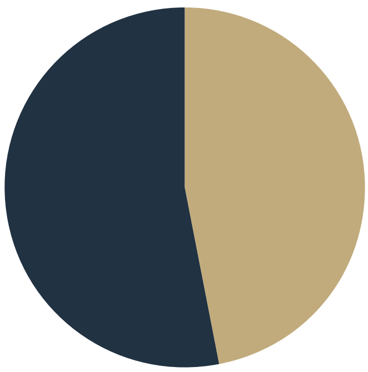
C. SPECIAL 12-MONTH SUKUK SNAPSHOT

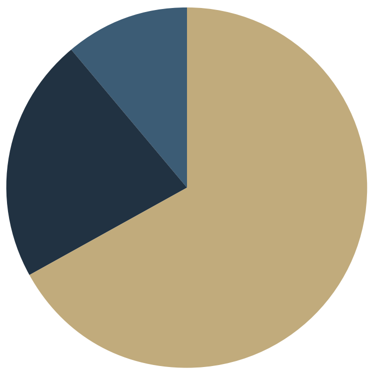
- In order to complete the short-term Islamic yield curve and improve secondary market for the IILM Sukuk, the IILM has successfully issued for the first time two 12-month tenor Sukuk in July and October 2022 with a size of US$250 million each which were oversubscribed by 1.85 and 1.98 times respectively.
- In term of investor profile, banks remained the majority, while the 12-month Sukuk also attracted more asset managers compared with shorter tenors in line with their long-term investment horizon, both in the primary and secondary markets given the attractive yield for such tenors.
- On the secondary market, the 12-month Sukuk series were actively traded reaching a turnover of 31% and 11% respectively, as of end of December 2022 (refer to Chart 5).
- The 12-month tenor is also a key tenor to support the offering of Shariah compliant liquidity instruments in the local currency by various regulators such as the Central Bank of Oman with its Wakalah deposit in Omani rial or the Bank of England with its Alternative Liquidity Facility. Central banks have indeed currently a limited choice of high-quality long term Sukuk, such as those issued by the IsDB, to back local currency Islamic liquidity tools.

Table 1: Details of the 12-month IILM Sukuk issuances

July 2022		October 2022	
Size	■ US$250 million	Size	■ US$250 million
Pricing guidance	■ 3.44% – 3.50%	Pricing guidance	■ 4.77% – 4.83%
Cut-off profit rate	■ 3.65%	Cut-off profit rate	■ 4.5%
Spread	■ 12M LIBOR+9bps ■ 12M US T-Bills +99bps	Spread	■ 12M LIBOR+30bps ■ 12M US T-Bills +54bps
Total orderbook	■ US$462 million	Total orderbook	■ US$496 million
Coverage ratio	■ 185%	Coverage ratio	■ 198%

Chart 8: The 12-month IILM Sukuk investors distribution by type and nature in primary market





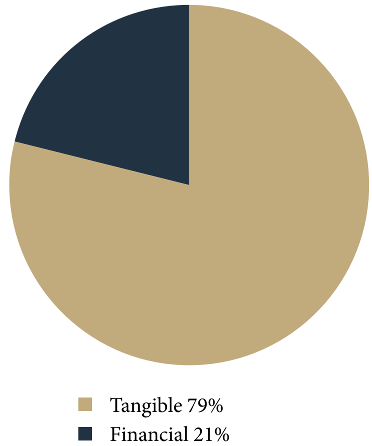
D. TRADABILITY OF THE SUKUK AND AAOIFI COMPLIANCE

- The IILM asset portfolio comprises 79% tangible assets and 21% receivables in 2022, which complies with clause 8/2/2 of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)'s Standard 59: 51% tangible versus 49% receivables. This requires the IILM to monitor and maintain the tangibility ratio above 51% throughout the Sukuk's life, rather than typically at issuance.

- Since the inclusion of two new assets since 2020, the ratio of tangible long-term sovereign-backed assets underpinning the IILM Short-term Sukuk has always been maintained at 79% minimum.

- The compliance with the latest AAOIFI standard allows the IILM Sukuk to be tradable on the secondary market as it fits the Sukuk tradability criteria in most of the jurisdictions, which also helped to widen the availability of IILM Sukuk in the global market.

Chart 9. The IILM asset portfolio tangibility ratio



E. THE IILM's SECOND RATING OF "F1" FROM FITCH RATINGS

- In 2022, the IILM achieved another milestone by receiving a second rating of 'F1' from Fitch Ratings, in addition to the 'A-1' rating from S&P Ratings for its short-term Sukuk program. These ratings are evidence of the high quality of the IILM liquidity management solutions, which have contributed to the impressive performance of the IILM secondary market.

- Fitch's assignment of a second rating to the IILM program represents a significant advancement in strengthening the IILM Sukuk as a resilient and highly rated Islamic financial instrument, which greatly enhanced cross-border liquidity management.

- The IILM's second rating has drawn in a wider range of investors on the secondary market by catering to those who prefer a specific credit agency or require assessments from multiple agencies for investment credit evaluation. This has effectively addressed the varied needs and preferences of investors, boosting their confidence to invest in the IILM Sukuk and allowing for a more thorough assessment of their investment risks.

F. ISSUES & CHALLENGES

- The IILM has identified several challenges in Shariah liquidity management. Firstly, in comparison to the conventional space, there is relatively limited number of market participants from both Islamic and conventional markets, which limits the opportunities for Shariah compliant liquidity management tools.

- Secondly, there is an increased need for short-term liquidity instruments in local and other reserve currencies (instead of US dollar) to cater to the diverse needs of investors in different jurisdictions and create a more active Islamic money market ecosystem.

- There is also a need for Shariah compliant medium-term instruments (between one and five years) to attract long-term investors who seek higher returns from their investment as well as to support the offering of Islamic liquidity tools in local currency by central banks, providing a level playing field, and enabling greater flexibility in meeting regulatory requirements under Basel III prudential rules.

- The lack of standardization of the high-quality liquid asset (HQLA) treatment of the few available short-term instruments and buy-and-hold strategy also impede secondary market trading. Additionally, the IILM is continuously working on the enhancement of its program to harmonize its Sukuk's Level 1 HQLA treatment with 0% risk weight as assigned under IFSB-15 in its Guidance Note on Quantitative Measures for Liquidity Risk Management in Institutions Offering Islamic Financial Services published in April 2015.
- There is also a need for further ESG/Green Sukuk to address the massive demand from various investors globally and support tangible projects which benefit the development of the Ummah. According to Refinitiv, ESG Sukuk grew 35% year-on-year. US$8.1 billion of ESG Sukuk were issued in 2022, up from US$6 billion in 2021.

- The IILM is dedicated to promoting the stability of the Islamic finance industry by facilitating cross-border liquidity management through the frequent offering of US dollar Sukuk in various tenors. Therefore, addressing these challenges is crucial for the growth of Islamic financial institutions to manage their liquidity effectively and efficiently.

Robust IILM Sukuk performance despite continuing global market uncertainties

Market review following recent banking system stress

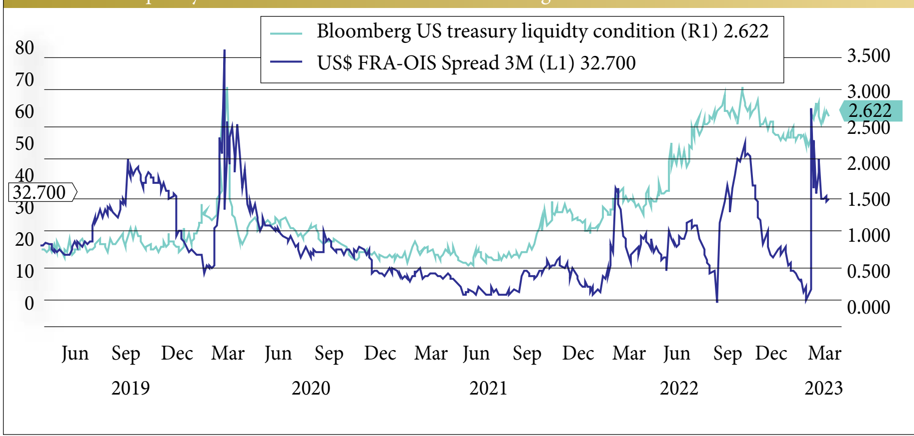
The failure of two mid-sized lenders in the US, Silicon Valley Bank (SVB) and Signature Bank, as well as the financial problem faced by European banking giant, Credit Suisse Group, in March 2023 and the rescue of First Republic Bank bought over by JP Morgan in April 2023 triggered a sell off of US regional banks shares and have shocked financial market participants all around the world and introduced a new sense of caution about global financial stability and growth prospects.

Financial conditions tightened after the stress episodes in the banking sector weighed heavily on bank stocks and funding spreads. In the days after SVB's failure, stock market volatility surged, credit spreads widened, and strains were apparent in interbank funding markets. These moves have partly retracted in subsequent weeks, although interbank funding spreads remain wide and volatile.

As reflected in the Bloomberg US Treasury Liquidity Index, significantly higher interest rates and heightened uncertainties surrounding inflation and economic output prospects have made the US Treasury liquidity worse. Bid-ask spreads in the US Treasury markets also widened as traders have demanded larger liquidity premiums to trade US Treasury.

US authorities immediately launched emergency measures on the 12th March to shore up confidence in the banking system. Two-thirds of the quantitative tightening done by the Federal Reserve (Fed) since a year ago to fight inflation have now been erased in less than two weeks. The Fed also made additional funding available through a new Bank Term Funding Program, which offer loans of up to one year to depository institutions, backed by Treasuries and other assets. As of mid-March 2023, US banks took around US$150 billion from the discount window facility and US$11.9 billion in loans from the Fed's newly created Bank Term Lending Program. The discount window jump crashed through the prior record of US$112 billion in the fall of 2008, during the most acute phase of the financial crisis.

Chart 1: US liquidity condition worsened after recent banking turmoil



To protect depositors, a US government corporation that oversees the banking industry, the Federal Deposit Insurance Corporation, took over First Republic Bank initially and invited several lenders to buy First Republic, with JPMorgan Chase ultimately sealing the deal on the 13th April 2023.

In addition to these market uncertainties volatilities, the OPEC and its allies, mainly Russia (OPEC+), surprisingly announced oil production cuts from May until the end of 2023. Oil prices have surged around 6% after the oil cut announcement.

Furthermore, the US government's efforts to raise the US$31.4 trillion debt ceiling has also sent fears that the deadline to raise the borrowing limit may come sooner than expected. As a consequence, the insurance cost against a US default hit a fresh high in early May as lawmakers wrangle over raising the debt ceiling. One-year US government credit default swap traded at 177bps on 1st May 2023, reaching highest levels since 2008.

The fallout from the recent banking crisis is increasing the probability of recession for the US economy in 2023 amid relatively high global uncertainties. However, the latest US inflation and job market data from mid-April sparked some optimism from market participants which could lead to a soft-landing scenario instead of a recession.

Market uncertainty remains high, and it is quite difficult to predict the impact of the Fed's monetary policy on the real economy. Nonetheless, the base line scenario expected by market experts is that the Fed will need to cut its benchmark rate before the year end.

Middle East's economic prospects

Amid high global uncertainties with some countries expected to experience a recession, the Middle East stands out as a global outlier. In 2022, the good performance of the Middle Eastern economy was a result of the highly effective response the region offered to the pandemic, which set the foundation for the subsequent rapid recovery in economic activities.

Thereafter, the outlook further improved as surging energy prices triggered a transfer of wealth and purchasing power from energy-consuming markets to regional producer nations. Fiscal pressures have materially eased higher energy receipts, non-oil revenue strategies as well as spending rationalization measures.

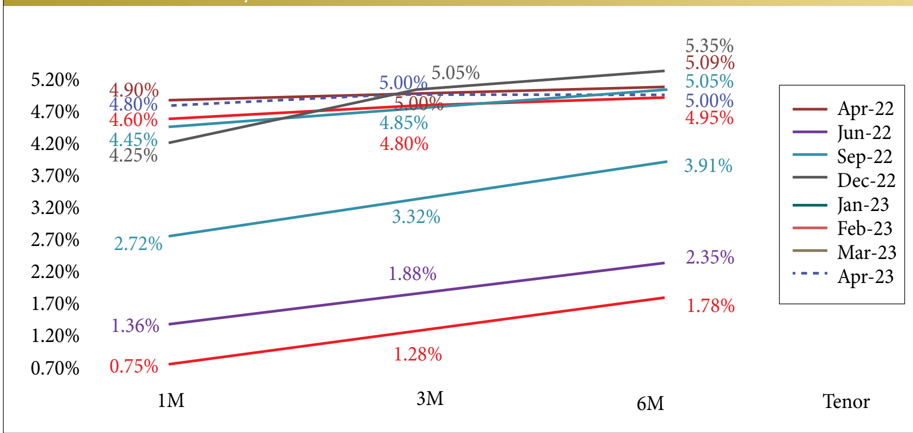
This has been reflected in a favorable rating environment observed only in the Middle East with the upgrade of sovereigns and government-related entities (ie Saudi Arabia, Qatar, Oman). Additionally, some Middle Eastern countries have benefited from strong liquidity supported from high oil prices in 2022 (2022: US$100/barrel; 2023F US$85/barrel as per Fitch Ratings forecast) which remains higher than the fiscal breakeven observed in the GCC and will continue to remain high after cuts announced by OPEC+ members.

Market impact on IILM Sukuk performance

The track record and robustness of the IILM Sukuk program have been seen from its significant qualitative and quantitative expansion so far, with a total cumulative issuance of US$92.95 billion through 210 short-term high quality Islamic instruments since its inaugural Sukuk issuance in 2013. Other notable achievements include the IILM diversifying the supply of Shariah compliant instruments with regular monthly issuances of multiple tenors (one-, three-, six- and 12-month) to address the demand; securing high short-term credit ratings from Fitch ('F1') and S&P ('A-1'); introducing a pricing discovery process in 2020 through competitive bidding auctions on Bloomberg, allowing higher transparency and market efficiency for participants; and setting an active global secondary market activity with US$2.2 billion traded in 2022.

Since the beginning of the year until May, the total US dollar Sukuk volume issued stood at US$17 billion. The 15 IILM Sukuk issued

Chart 2: The IILM Sukuk yield curve flattened in 2023



amounted to US$4.35 billion and represented 26% of the total volume of US dollar Sukuk issued globally.

The performance of IILM Sukuk in the secondary market has been continuously improving over the years. The total value of traded IILM Sukuk surged by 43% to US$2.23 billion in 2022, compared with US$1.55 billion traded in 2021. This improvement in the secondary market reflects the growing acceptance of IILM Sukuk in the market, not only because of their high asset quality but also due to a constant high tangibility ratio (79%) and wider investor distribution over the last 10 years.

IILM's performance since Fed monetary policies

From March 2022 to March 2023, the Federal Open Market Committee raised its key interest rate by 475 basis points in its pursuit to curtail inflation, bringing the Fed funds rate to 4.75% to 5%. In this tightening environment, the IILM has been performing well, as the spreads paid over the US LIBOR rates have tightened, touching negative spreads across all tenors for the first time in April and May auctions including reaching a double-digit negative spread for six-month in the third consecutive month supported by a higher investor appetite. As witnessed in the recent auctions, a lot of bids were received from new and returning investors as reflected by the average bid-to-cover ratio of 210% in the first five months of 2023 vs 147% during the same period of last year.

The overall blended weighted average spread above US LIBOR rates stands at a negative spread, -6.9bps year-to-date (YTD) in 2023 vs ~14bps in 2022 over the same period due to the tight pricing across all tenors.

In line with the uptick in global benchmark rates due to the continued tightening monetary policy by the Fed, the IILM yield curve relatively flattened in 2023 YTD. The one-month tenor profit rate continues its upward trend in line with the rising benchmark rates as well as higher interbank rates triggered by the banking sector stress. Meanwhile, the profit rate for the longer end is moving lower resulting from deteriorating global economic prospects.

Further restrictive stance from the Fed and banking sector distress could lead to higher IILM cost of funding. On the other side, the rising yield environment would continue to enhance the investor base of the IILM by attracting investors mainly from the Middle East and Asia with yield pick-up appetite. There is a significant increase from Türkiye as its buyer distribution portion reached 31% YTD in 2023 on the secondary market and 12% on the primary market while Malaysia's allocation has dropped. Islamic investors remain the main recipients of the IILM Sukuk over time.

Key challenges within the Islamic liquidity management space

In line with the IILM's goal to promote the stability of the Islamic finance industry by facilitating cross-border liquidity management, several challenges have been identified including the relatively small number of Islamic Investors globally, a limited demand for Shariah compliant instruments from conventional investors, the limited availability of short-term liquidity instruments in local and non-US dollar currencies, a lack of medium-term Shariah compliant instruments (one to five-year tenors) in the market (despite some issuances this year ie the two-year Saudi National Bank Sukuk and three-year Egypt Sukuk), as well as the need to develop a deep and active Islamic repo market with the use of Sukuk, and limited green project availability as the underlying of green Sukuk issuances.

The IILM also identified that the lack of standardization in the treatment of high-quality liquid assets of the few available short-term instruments and the buy-and-hold strategy for long-term Sukuk also impede secondary market trading. Addressing these challenges is crucial for Islamic financial institutions to manage their liquidity more effectively and efficiently.

IILM to bolster Sukuk program with new assets as it pursues investor diversification

For almost a decade, the International Islamic Liquidity Management Corporation (IILM) has been at the forefront of enhancing cross-border Shariah liquidity management since its inaugural short-term Sukuk issuance in 2013. In an exclusive interview with IILM CEO Dr Umar Oseni, VINEETA TAN learns that the supranational is considering expanding the currency profile of its illustrious short-term Sukuk program beyond US dollar-denominated offerings and broadening its asset base to include green assets in a bid to widen its investor pool and support its ESG ambitions.

Driven by a significant investor appetite for a greater variety of international short-term Sukuk, the IILM is exploring the potentiality of issuing in another reserve currency, to add another dimension to its Sukuk program which has been solely denominated in the US dollar, Dr Umar told IFN.

The IILM's move is one of several measures the supranational is working on as it looks to expand its geographical footprint and diversify its investor base in line with its mandate to enhance cross-border investment flows and boost financial stability by creating more liquid Shariah compliant financial services to support the global Islamic finance community.

> "Islamic liquidity management continues to be a persistent challenge for Islamic financial institutions anywhere in the world"

Islamic liquidity management continues to be a persistent challenge for Islamic financial institutions anywhere in the world. Since the early days of Islamic finance, the severe scarcity of short-term financial tools compliant with Shariah principles has threatened the growth and sustainability of the sector.

In fact, it was in the backdrop of this urgent need to aid Islamic financial institutions manage their liquidity more efficiently that nine central banks and a multilateral financial institution joined hands to establish the IILM in 2010.

However, coming to market with a tradable high-quality asset-backed liquid Shariah compliant instrument was no easy feat. It took almost three years before the IILM debuted its landmark US dollar global short-term Sukuk program.

The US$2 billion program, which was upsized to US$4 billion in 2020, boasted many industry firsts including being the first US dollar highly rated financial tool with maturities of up to one year, the first money market instrument backed by sovereign assets in the form of Sukuk and the first program involving a multi-jurisdictional primary dealer network to facilitate global distribution.

Current picture

Since its inaugural issuance in August 2013, the IILM has cumulatively issued about US$90 billion in Sukuk, commanding approximately 37% of total global US dollar Sukuk (excluding private placement deals) at the end of November. It has also sparked secondary market activities: average monthly trading of the IILM Sukuk stands at about US$185 million, with 2022 likely closing US$2 billion in trading activities.

In the last decade, more instruments such as interbank placements and repos have come to market to aid Islamic financial institutions in managing their liquidity. The Central Bank of Qatar in October this year introduced Islamic treasury Sukuk while Bank Negara Malaysia continues to issue its diverse range of Shariah compliant money market papers to the tune of billions of dollars every month.

> **The IILM has been steadily deepening the impact of its program. This year it extended its yield curve to 12 months and secured a second international rating for the program, both of which have attracted the attention of investors, different from its regular subscribers**

But despite this development, the industry has yet to really attain the desired level of liquidity management efficiency. There is also the challenge of excessive dependency on commodity Murabahah transactions.

While recognizing the benefits and the crucial role commodity Murabahah is playing in liquidity management, Dr Umar also expressed his concerns over the dependence on the structure.

"We do have some Shariah objections to this and using commodity Murabahah for structuring Sukuk has been quite controversial in light of the recent AAOIFI Shariah Standard 59," Dr Umar shared with IFN. "I think it's important to see the volume of trade happening on a daily basis — it's huge. So, from the perspective of systemic risk, we do feel we should explore new products."

The IILM Sukuk could be an alternative; however, Dr Umar is cognizant of the program's limitation.

"The IILM only has a US$4 billion program — this is just a drop in the ocean considering the balance sheet of Islamic banks globally," said Dr Umar, adding that the industry needs to be proactive in designing more effective cross-border Islamic liquidity management tools.

Pursuing diversification

The IILM has been steadily deepening the impact of its program. This year it extended its yield curve to 12 months and secured a second international rating for the program, both of which have attracted the attention of investors, different from its regular subscribers.

"The purpose of [extending the yield curve] is to actually address the varying liquidity needs of Islamic financial institutions across the world," Dr Umar explained.

And it worked. The IILM's first one-year US$250 million issuance in July, which was the first 12-month cross-border Sukuk in the world, generated an oversubscription of 1.85 times. and it was followed by a second tranche in October which was also well received by the market. Most notably, the IILM managed to diversify its investor pool, which had for years been largely dominated by banks.

"For the 12-month Sukuk tenor in particular which was issued in July 2022, we saw that the demand mainly came from the GCC region, and we have seen a higher participation from asset managers, which was about 12% of the total amount issued. Now this is quite important because this is no doubt an uptick given that asset managers generally account for less than 5% of the total issuance volume year-to-date, so this was quite encouraging," shared Dr Umar.

The surge in asset managers is attributed to their preference for longer-tenored instruments. Banks, which account for about 72% of the IILM Sukuk investor base, vie for shorter maturities, particularly one-month papers, to manage their liquidity as per Basel III requirements. The liquidity coverage ratio standard requires banks to maintain an adequate level of unencumbered high-quality liquid assets that can be liquidated into cash to meet the needs for a 30-calendar-day time horizon.

The increase in investor interest could also be explained by the IILM's additional rating: in September, Fitch Ratings assigned an 'F1' rating to its short-term Sukuk program, which is also rated 'A1' by S&P Global Ratings.

"We have seen some investors who actually prefer to buy a paper that has a minimum of two ratings," according to Dr Umar.

To further diversify its investor base, the IILM is also weighing issuing Rule 144A-compliant papers which would open the Sukuk to qualified institutional investors in the US. Currently, the IILM's Sukuk program, which is structured under Reg S, is available to investors in every jurisdiction globally except the US.

"We are getting a lot of enquiries, so the US is another good market for this kind of instrument [Rule 144a] — this is something that we are going to work on and it's going to take some time," Dr Umar confirmed.

The future

There is no denying that 2022 has been a productive year for the IILM which has used this past year to lay a strong foundation to scale up more meaningfully next year. Completing its yield curve and securing an additional rating are yielding positive outcomes, which have fueled the IILM's bold resolve to further enhance global liquidity management for Islamic financial institutions.

2023 is looking to be an interesting year for the IILM.

Not only is the organization working on issuing in another currency and offering Rule 144A papers, but it also intends to enter the green space. This comes just as the IILM, like the rest of the Islamic finance industry, is grappling with the phasing out of the London Inter-Bank Offered Rate or LIBOR scheduled for June 2023. IFN understands that the IILM is in 'top gear' to transit smoothly into the Secured Overnight Financing Rate or SOFR by early 2023.

"There is no doubt that climate change concerns have dominated discussions at a global level. The IILM is pro-ESG generally," emphasized Dr Umar, adding that: "We uphold this principle at a high level as we are owned by central banks, who also exhibit the highest level of professionalism and corporate governance.

"We are focused on supporting the global community to achieve the ESG goal, and we are planning to incorporate the acquisition of green assets into our portfolio anytime soon."

IILM debuts world's first one-year cross-border US dollar Sukuk

The International Islamic Liquidity Management Corporation (IILM) on the 15th June 2022 added another feather to its cap with the offering of its first-ever 12-month Sukuk, believed to be the first US dollar issuance of its kind globally.

The US$250 million tranche, issued alongside a US$250 million one-month and a US$330 million three-month series, received over US$1.59 billion in bids, representing an oversubscription of 1.85 times.

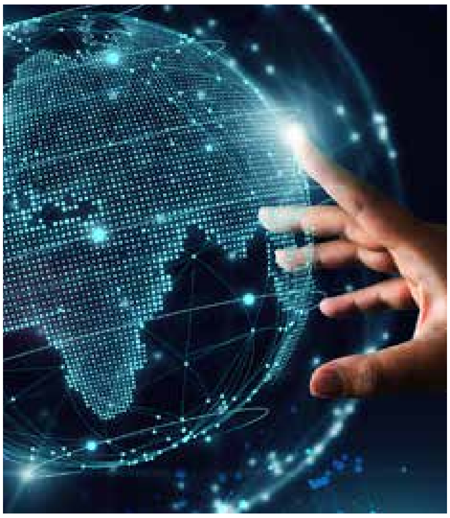
"The 12-month issuance was to meet the growing demand of investors for such tenor and the IILM is pleased to have been able to fulfil this long-lasting demand and subsequently, contribute to the stability of the wider Islamic finance industry," according to the IILM.

The one-year paper, part of a US$4 billion short-term Sukuk program, is a welcome addition to diversifying the supply of high-quality Shariah compliant liquidity instruments, particularly in commencing to build out an Islamic benchmark yield curve up to 12 months.

The Wakalah offering was subscribed mostly by investors in the GCC, with banks taking the largest portion. It was priced within market expectations at 3.65% or US Treasury bills one-year+99bps or 12-month LIBOR+9bps.

"We have to bear in mind that the IILM's 12-month tenor was issued on the back of tightened monetary conditions and investors staying cautious. Since the beginning of 2022, we were seeing sovereign issuers as well as financials and corporates staying on the sidelines as global central banks started to address the 40-year high inflation with an unexpected aggressive stance," the IILM explained. "We were also seeing central banks around the world, with currencies either pegged to the US dollar or with a majority exposure in its basket, started tightening their own monetary policy."

Building on the success of its inaugural issuance, the IILM has since issued another two 12-month papers and it intends to auction another in July as well as in October this year.



Summary of Terms and Conditions	
Issuer	IILM 2 SA
Issuance amount	US$250 million
Purpose of issuance	Providing liquidity management tools to institutions offering Islamic financial services
Trustee	Citi Bank
Tenor	12-month
Coupon rate/return	3.65%
Currency	US dollar
Maturity date	15th June 2023
Lead manager(s)	Primary dealers: • Abu Dhabi Islamic Bank • Al Baraka Turk • Boubyan Bank • CIMB Islamic Bank • Dukhan Bank • First Abu Dhabi Bank • Kuwait Finance House • Maybank Islamic • Qatar Islamic Bank • Standard Chartered Bank
Governing law	The IILM is governed under its own articles of agreement, by-laws, and resolutions issued by its governing board
Underlying assets	• Private placements in Sukuk format • Aims at the highest tangibility ratio in the asset portfolio
Rating	'A-1' by S&P 'F1' by Fitch
Shariah advisor(s)	The IILM Shariah board committee
Structure	Wakalah
Tradability	Yes
Investor breakdown	Investor regional breakdown: • GCC – 95% • Asia – 4% • Africa – 1%
Type of investors:	• Banks – 80% • Pension funds/asset managers – 12% • Supranationals/sovereign wealth funds/finance ministries/ central banks – 8%
Face value/minimum investment	Minimum purchase size of US$200,000 Sukuk issued at par