Appendix

IFSB's ED of GN – 6 is parameterized on the Basel paper "The Liquidity Coverage Ratio and liquidity risk monitoring tools" of January 2013 (henceforth referred to as BCBS LCR) which is framed on conventional banking deposit taking phenomena as opposed to Institutions Offering Islamic Financial Services (IIFS) operating on profit sharing and loss bearing investment principal. It is therefore possible that, assuming the same level of liquidity risk, some aspects of the Liquidity Coverage Ratio (LCR), the Net Stable Funding Ratio (NSFR) and related haircuts may not be appropriate.

IMPLEMENTATION DATE

Paragraphs 6, 14, 33, 36 and 34 of the ED of GN-6 acknowledges the common constraints and limitations in the availability of *Shariah*-compliant High Quality Liquid Asset (HQLA) for IIFS. IFSB should reconsider the types of *Shariah*-compliant instruments and the related implementation deadlines accordingly. **IIFS will require more time to assess, evaluate and agree on appropriate HQLAs with local central banks and therefore aligning the implementation dates with Basel may not be appropriate.** As discussed and emphasized in various forums, **the higher liquidity requirements will require the IIFS to reconsider and adjust their next 3 to 5 years business models** and perhaps reclassify high and medium risk investments which generate moderate return to low risk low return investments. Such reclassifications are contingent upon various maturity dates and availability of HQLAs and therefore, **the effective date of 1 January 2015 to achieve 60% LCR ratio should be reconsidered.**

In view of that, **IFSB should consider extending the implementation deadlines and attempt to form a committee representing different regions and interested parties to address this matter to achieve compliance within a reasonable time.** We believe that an immediate implementation of the ED of GN-6 may stress a number of Islamic banks and this will be a matter concern for the respected central banks. **Alternatively, IFSB or local central banks should suggest a lower LCR base to start (for example 40%) and allow Islamic banks to reach 100% by 2019.** This approach will enable Islamic banks in resolving some of the constraints stated above in the year 2015.

TECHNICAL COMMENTS ON THE STANDARDS PROPOSED BY ED OF GN-6

SECTION 2.2.2. CATEGORISATION OF HQLA, PARAGRAPH 29

The reference to AA in line two of paragraph 29 (b) ii **should be AA-** (see paragraph 52b, bullet 3 of BCBS LCR).

We also note that Paragraph 29 of the ED of GN-6 (corresponding to BCBS LCR paragraph 52) includes (as final bullet point) the reference to a maximum price decline of 10% or a 10% increase in haircut, corresponding to the third bullet point in BCBS LCR paragraph 52 (a). However Paragraphs 30 (a), (b) and (c) do not contain the references to price declines/haircuts that are contained in BCBS LCR (paragraphs 54 a) b) and c). Since the ED of GN-6 is following BCBS LCR very closely at this point, **we request IFSB to clarify the reason for this omission.**

SECTION 2.2.2. CATEGORISATION OF HQLA, PARAGRAPH 30

In Section 2.1 (Formula for Calculating LCR), Section 2.2 (Components of HQLA Level 2), Section 2.3.1.7 (Paragraph 77), Annex 1 Point D (*Tahawwut*), **we seek clarity for the risk of commodity transactions involved in the issuance of certain *Sukuks*, *Shariah*-compliant REPOs and other liquidity instruments,** which include the non-availability of commodities, disruption in the commodity markets, illegality to deal with the brokers, etc.

Section 2.2.5. ALA Treatments for IIFS, Paragraph 42

Paragraph 42 mentions the three options are available to supervisory authorities under the ALA. We evidence some jurisdictions without the presence of secondary market for *Shariah*-compliant HQLA, and we support the proposal from our members that non-marketable *Shariah*-compliant assets, representing claims on or those that are guaranteed by sovereigns or central banks, will have 0% assigned risk weight for credit risk, and **can be treated as alternative under the ALA**. This is to accommodate Islamic banks which have a large portion of this kind of instruments in their balance sheets, operating in the environment without the presence of market for *Shariah*-compliant HQLA, while local central banks have buy-back mechanisms in the event of liquidity stress in the economy.

Section 2.3.1.1. Treatment of PSIA, Paragraph 51

In Paragraph 51 related to income-earning deposits with IIFS, it is proposed for IFSB to provide clear distinction on definition and treatment for deposits *vis-a-vis* investment accounts. **Income–earning deposits should be further differentiated from investment accounts.**

Section 2.3.1.1. Treatment of PSIA, Paragraph 52

Paragraph 52 states that “only in the case of RPSIA from which the IAH may withdraw funds at less than 30 days’ notice without any “significant reduction of profit” is the IIFS exposed to run-off for LCR purposes”. **In certain circumstances, IIFS match the outflow of the RPSIA accounts with inflows pertaining to the specific RPSIA fund and in those circumstances the IIFS has no legal nor contractual obligations to fulfill the requirement of paying the IAH if such specific RPSIA fund does not perform.** In such circumstances, to mitigate reputational risk, IIFS may fund the RPSIA IAHs outflows at its own discretion. **We recommend that the specific inflows (without any limits) from the RPSIA fund should be netted against the outflows along with any HQLA that was included in the RPSIA fund.**

Section 2.3.1.1. Treatment of PSIA, Paragraph 54

Paragraph 54 states that "As the agent, the IIFS (Wakīl) manages and invests funds in Sharī`ah-compliant investment activities to deliver an expected rate of return". We believe that not all *Wakalah* and *Mudarabah*-based profit sharing investment accounts give the expected rate of return, since **it might be designed so as to pass all profit or loss to the account holder. We request IFSB to cover this specific case in this section.**

Section 2.3.1.4. Secured Funds, Paragraph 70

Paragraph 70 states that "secured funding is defined as liabilities and general obligations with maturities of less than 30 days that are collateralized by legal rights to specifically designated assets owned by the counterparty in the case of bankruptcy, insolvency, liquidation or resolution." **We believe that investment accounts should also be treated similarly to secured funding in the case that the underlying asset being tagged to the investment fund is within the similar category of secured funding asset.**

2.3.1.5. Additional Requirements, Paragraph 74

Paragraph 74 states that "undrawn credit and liquidity facilities to retail and small business customers, which are assigned a 50% run-off factor". In some jurisdictions, the 50% run-off factor for undrawn credit is too stringent and might not reflect actual behavioral pattern of cash outflow. **We believe that IFSB should consider the 50% run-off factor to be reduced.**

SECTION 2.3.1.6. CMT-BASED DEPOSITS, PARAGRAPH 76

Paragraph 76 states that "If the remaining term of the Murabaha does not exceed 30 days, then a run-off factor of 100% should be applied to the balance of the Murabaha payable". **We believe that the treatment of Commodity *Murabaha* Transactions (CMT) should be the same as other forms of deposits as stated in Sections 2.3.1.2 and 2.3.1.3.**

SECTION 2.3.2. CASH INFLOWS, PARAGRAPH 78

Paragraph 78 states that "Contingent Inflows (such as returns on profit-sharing instruments) are not included in total net cash inflows". The interbank market for IIFS usually operates either through Commodity *Murabaha* Transactions (CMT), Profit-Sharing *Mudharaba* or Profit-Sharing *Wakala* Basis. **We believe that if an IIFS is unable to consider Profit-Sharing (such as *Wakala*-based) interbank flows as eligible inflows, IIFS's implementation of LCR would be severely disadvantaged as compared to conventional banks.** We further note that under Paragraph 82, inflows from financial institutions/IIFS may be assigned a 100% inflow factor without specifically referring to the structure of the instrument. **We recommend to treat such exposures the same as paragraph 82 of the ED of GN-6 or to include such instruments with a lower than 100% inflow factor as opposed to 0% inflow factor.**

SECTION 2.3.2. CASH INFLOWS, PARAGRAPH 80

Paragraph 80 states that "IIFS should assume that the maturity of secured financing secured by Level 1 assets will be rolled over and will not give rise to any cash inflows". **We request IFSB to clarify the specific types of financing included in this category and whether financing to customers that are cash collateralized (Cash being considered to be a Level 1 asset) are included.** It will also be desirable to explain the rationale behind such classification.

SECTION 2.3.2. CASH INFLOWS, PARAGRAPH 84

Paragraph 84 states that "Inflows from securities maturing within 30 days that are not included in the stock of HQLA should be placed in the same category as inflows from financial institutions (i.e. 100% inflow). **We believe that the inflows should be based on the counterparty type, which is similar to paragraph 82. For example,** if a transaction with a corporate entity is structured as a *Murabaha*, it would have an inflow factor of 50% as per paragraph 82 whereas if the structure was changed to a *Sukuk* it would have an inflow of 100% as per paragraph 84. **We recommend clarifying the treatment of inflows of various *Sharia* structures and noting the rationale for any differences in the inflows.**

SECTION 3: APPLICATION OF THE NSFR IN IIFS

In Section 3, **we recommend aligning the NSFR calculations with the Basel III: Net Stable Funding Ratio (October 2014)**. For example, 50% the Required Stable Funding (RSF) factor should include financing to banks with residual maturity between 6 months and 1 year.