

ARAB GAMBIAN ISLAMIC BANK
LIQUIDITY MANAGEMENT FUND
FOR ISLAMIC BANKS

1. The Problem

Banks deal with liquidities. This is the number one fact in the banking industry and it applies equally to Islamic banks as well as to conventional banks. Islamic banking often face the problem of excess liquidity and they need to find secure and profitable financial instruments in which to invest their excess liquidity. Arab Gambian Islamic Bank is facing same problem. The difficulties of Islamic banks is on account of the fact that while all transactions of the conventional banks rely on the loan contract on both sides of liquidity management, that is resource mobilization and fund utilization, the Islamic banks brought a new innovation in the banking industry whereby transactions must pass through owning real physical assets, if such transactions are to generate any Shari'ah acceptable income to either depositors of funds or to the bank itself. In the absence of investing these funds, the profitability of the bank is adversely affected.

The purpose of this proposal is to seek to create financial instruments that work as Shari'ah compatible substitutes of treasury bonds or interest bearing instruments used by conventional banks as deposits with the Central Bank of The Gambia.

2. Instruments which the Bank may consider in participating

The money and capital market in the Gambia is underdeveloped. There is no stock market and hence the opportunity for the bank to own shares in companies, and receive profit is limited. A market for trading in short term instruments apart from treasury bills does not exist. These realities pose a serious limitation on the Arab Gambian Islamic Bank's ability to invest its excess liquidity. Under the circumstance, we have sought a theoretical guideline to lead us to possible solutions to this problem.

The Islamic Development Bank in their "Research paper No. 18 have suggested the following instruments for possible adoption:

- (a) simple loan certificate
- (b) index – linked loan certificate
- (c) Islamic short term commercial paper
- (d) integrated investment, certificates/shares bond (1,2,3 –n)
- (e) expected rate of dividend certificate
- (f) rent-sharing certificate and expected rate of rent certificate
- (g) firm commitment participation certificate
- (h) Zakah certificate
- (i) human capital certificate

The Research paper prefaces the above items in the following words:

“Thus the following list of a broad varieties of new financial instruments gives a basic outline of each of the instruments. This may very well provide the basis for further examinations for the purpose of implementation”.

Comment: I think the quotation of this 8 instrument is irrelevant> I am fully aware of this publication and you may at a glance notice that all of these 8 ideas either do not suit Islamic banking (a, f, h and I) or unfit from shariah point of view (b, c, d, e and g) the rent sharing , not the expected one, comes close to what suits our purpose

Having carefully studied all available options, Arab Gambian Islamic Bank proposes to introduce an Islamic Leasing Investment Fund. (ILIF) IJERAH.

3. Islamic Leasing Investment Fund: “IJERAH”

An Islamic Leasing Investment Fund will be a pool of resources contributed by investors for the purpose of its investment to earn “halal” profit in strict conformity with the precepts of Islamic Shari’ah. The subscribers to the fund may receive a document certifying their subscription and entitling them to the pro-rated profits actually accrued to the fund. These documents can be called “ ILIF Certificate”. In order to ensure that these “ILIF Certificates” are Shari’ah compliant, the following conditions must always apply.

- a) First, instead of a fixed return tied up with their face value, they must carry a pro-rated profit actually earned by the Fund. Therefore, neither the principal nor a rate of profit (tied up with the principal) can be guaranteed. The subscribers must enter into the fund with a clear understanding that the return on their subscription is tied up with the actual profit earned or loss suffered by the Fund. If the Fund earns huge profits, the return in their subscription will increase to that proportion; however, in case the Fund suffers loss, they will have to share it also, unless the loss is caused by the negligence or mismanagement, in which case the management, and not the Fund, will be liable to compensate it.
- b) Second, the amounts so pooled together must be invested in a business acceptable to Shari'ah. It means that not only the channels of investment, but also the terms agreed with them must conform to the Islamic principles.

Under this mode of Investment, Arab Gambian Islamic Bank would purchase Islamic Leasing Investment Fund certificates (ILIFC) from the Central Bank of The Gambia. The certificates will carry different maturity dates.

In this fund the subscription amounts are used to purchase assets like real estate, motor vehicles, or other equipment for the purpose of leasing them out to their ultimate users. The ownership of these assets remains with the Fund and the rentals are charged from the users. These rentals are the sources of income for the fund which is distributed pro rated to the subscribers. Each subscribers is given a certificate to evidence his subscription and to ensure his entitlement to the pro rated share in the income.

Since these “ILIF Certificate” represent the pro rated ownership of their holders in the tangible assets of the fund, and not the liquid amounts or debts, they are fully negotiable and can be sold and purchased in the secondary market. Anyone who purchases these “ILIF Certificate” replaces the sellers in the pro rated ownership of the relevant assets and all the right and obligations of the original subscriber are passed on to him. The price of these “ILIF Certificate” will be determined on the basis of market forces, and are normally based on their profitability.

However, it should be kept in mind that the contracts of leasing must conform to the principles of Shari’ah which may differ from the terms and conditions used in the agreements of the conventional financial leases. To clarify, some basic principles are summarized here:

- 1) The leased assets must have some usufruct, and the rental must be charged only from that point of time when the usufruct is handed over to the lessee. But once the rental amount is determined for the whole usufruct period, the actual payment may be distributed on any number of installment that do not have to coincide with the usufruct period. In other words, we can make the rental payment over a longer or shorter period than the usufruct period.
- 2) The leased assets must be of a nature that their halal (permissible) use is possible.
- 3) The lessor must undertake all the responsibilities consequent to the ownership of the assets. Here again if the insurance premium and the maintenance cost can be known at the time of the lease contract, they can be charged to the lessee as a part of the rent.
- 4) The rental amount must be fixed and known to the parties right at the beginning of the contract. It can only change by mutual agreement, but the rental amount can be made in such a way that it increases at a known percentage

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from rental period to another, it can also be tied up to any index provided that each period's rent becomes known before the beginning of that period. In addition, there is a pre-agreed commitment, a binding promise, from the client to buy the equipment at the end of the rental period at an agreed price with rental fees previously paid constituting part of the price. Alternatively, if the installments are made to cover the purchase price and the profit of the lessor, the equipment can be given as a free gift to the lessee, a gift promised in the rental agreement but conditional on the complete payment of all installments. (See the resolutions of the 12th meeting of the OIC Fiqh Academy, Sept. 23 – 29, 2000)

- (5) Once the rental covers the cost plus the profit of the item concern, the ownership reverts to the user by virtue of the sale or gift mentioned in (4).

The Central Bank of the Gambia may use these funds to finance purchase of motor vehicles, air conditioner, equipment etc for government and

government agencies. Parastatal organisations such as Gambia Telecommunications Company Ltd, Gambia Ports Authority, Civil Aviation Authority may use these resources to finance short term need for supplies (through Murabahah contracts) and equipment thereby enhance their short term liquidity management. Potential beneficiaries of the fund would apply to the Central Bank for their use to purchase specific items. Once the Central Bank is satisfied that all conditions have been met it purchases the item for reselling or leasing it to the beneficiary.

Comments: 1 - do you think that the Central Bank of Gambia would accept the idea of establishing such a fund? And would it be a good idea to propose that AGIB may be willing to take the pain of follow up on the creation and later take charge of the administration of this fund on behalf of the central bank? 2 - until this fund is established, don't you think that you may need readily available depositories for present excess funds, ? How about deposits with the IDB Unit Investment fund, or participating in the short Term Murabahah program the IDB has with the Saudi bank in London, or buying units in the Salam or Mutajarah (actually Murabahah sales) funds of the National Commercial Bank of Saudi Arabia or the Ijarah fund of Faisal Islamic Bank of Bahrain, especially after the new merger of the four Islamic banks there into a big one. All these have fully convertible currencies linked to the dollar in case of the UIF, the NCB and the FIB funds or to the Eurodollar in case of short term IDB Murabahah contracts in London and Paris. Do you think that until the proposed Ijarah fund is established, the central bank of Gambia may buy the idea of overseas liquid deposits for the special case of the AGIB.

3 – Notice that the certificates you talked about are in fact Mudarabah certificates in a fund (company) whose business is Ijarah. They are not

ijarah certificates, and this ijarah fund is permitted to do some Murabahah for short run , so it can help providing supplies for the government and semi governmental agencies.

4 – Ijarah certificates can easily be issued by the central bank, or any other government agency, say the airport authority. Let us evaluate the airport and its permanent fixtures, say at 5 million Dollars, and let the airport authority sell this property to the public for 5 million in the form of 50,000 certificates of one hundred dollar each, and rent back the same property for half a million per year payable on for installments of \$ 2.50 per certificate per quarter. these certificates have fixed income and can be negotiated because they represent physical property. The issue of insurance and maintenance can be solved by deduction 20% of the rent for a special fund to pay for these costs, and +- adjustment can be made each few years. This gives us virtually fixed income Ijarah certificates that are easy to manage, and agib, as well as conventional banks can buy these certificates from the market when they have excess liquidity.

5 – don't you think that you can draw support from conventional banks and from insurance companies for either the ijarah fund you suggest or the ijarah certificates ideas? In this case you may add a few sentences that emphasize the need for creating instruments that increase monetary liquidity in the economy and the role these ideas play especially in a Muslim society, like the Gambia's, as being compatible with shari'ah.

12th October 2000

Dear Br. Khaf,

Assalamou Alaikum Warahmatullah Wabarakatuhu

RE: EXCESS LIQUIDITY MANAGEMENT

Thank you for your prayers. We all wish you great success in your endeavours.

Based on your submission on the above, I have proceeded to write a proposal which I intend to submit to the Central Bank of The Gambia for their consideration. I would like you to comment on this proposal which I attach to this e-mail. I have designed something which I believe is workable given the local economic and institutional relationship.

As soon as I receive your contribution to this paper, I will make final payments to you.

Islamic Development Bank is organising a course here on Islamic Auditing Standards. Please propose to me a course subject which I can submit to the Islamic Development Bank for possible sponsorship.

Highest Regards.

Mamour Malick Jagne
Managing Director

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