Bank of England

UK Islamic Finance and the Alternative Liquidity Facility

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The Bank of England's role in respect of liquidity requirements

As Central Bank	As Prudential Regulator
• As the UK's central bank, firms place deposits with us in the form of "reserves" and earn interest on those deposits	• We monitor liquidity requirements which banks meet by holding a buffer of high-quality liquid assets (HQLA); of which reserves are the most liquid

While Shari'ah compliant banks must meet liquidity requirements; they cannot hold interest-bearing reserves or other interest-bearing assets such as gilts.

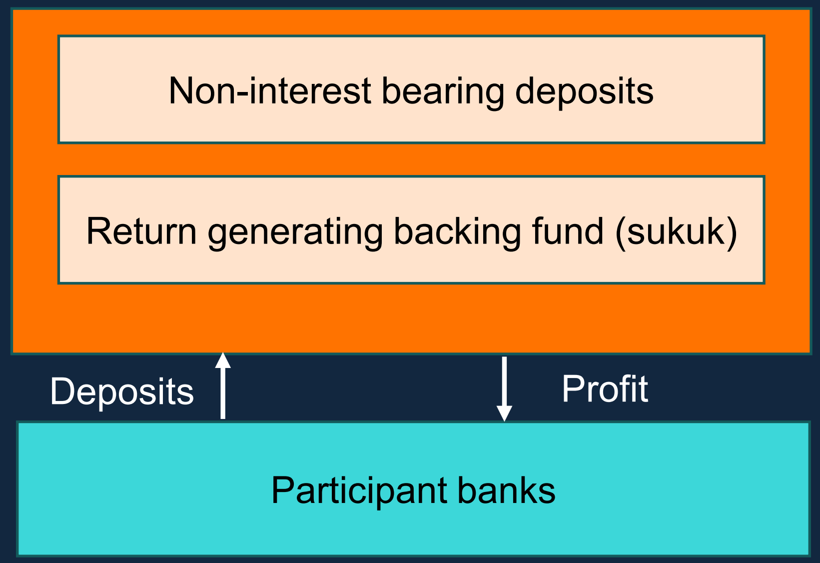
How the Bank's Alternative Liquidity Facility supports Islamic banks

- Recognising the challenges that Islamic banks faced in meeting liquidity requirements, we introduced the Alternative Liquidity Facility (the ALF) in 2021 to help level the playing field
- The ALF supports regulatory compliance by providing a non-interest-bearing alternative to reserves

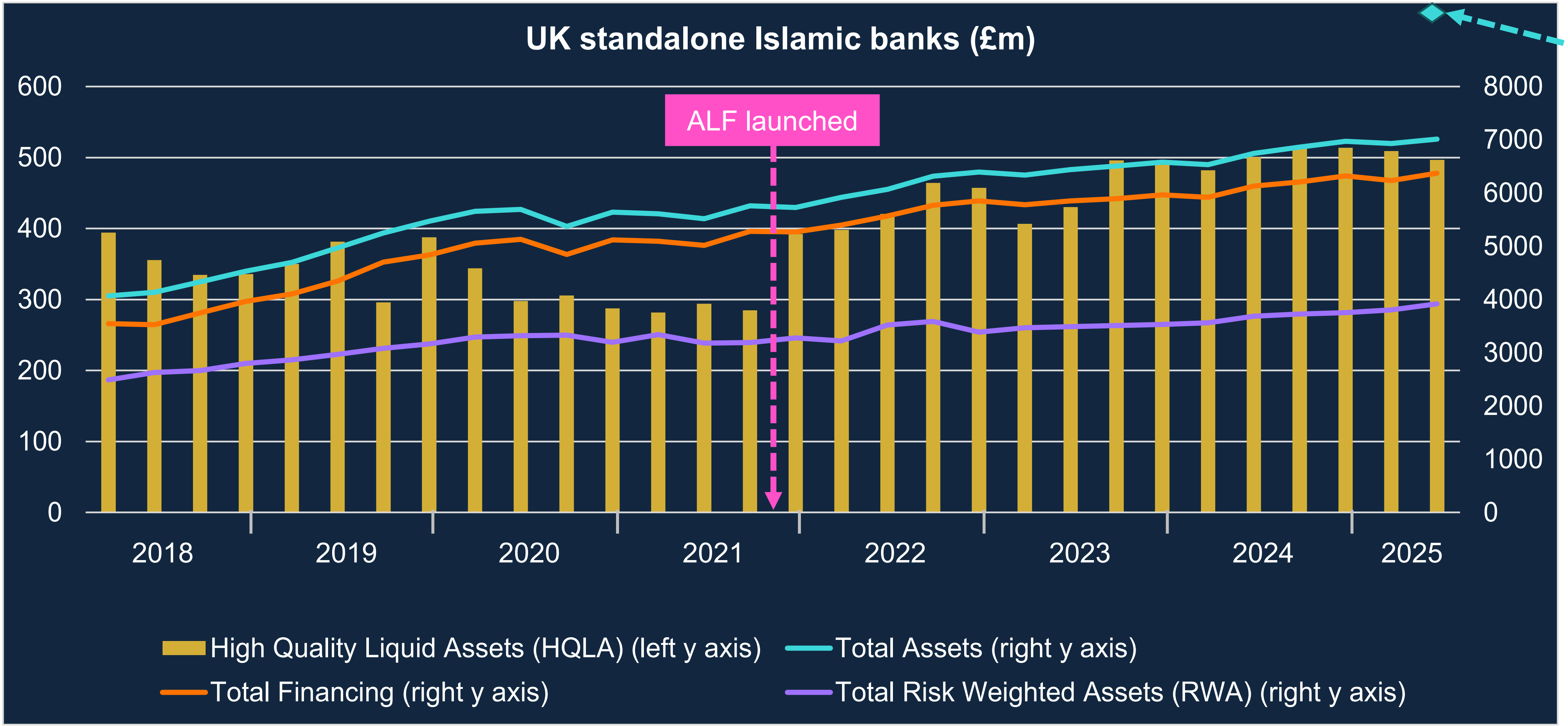
<u>Operation of the ALF</u>

- Deposits are backed by portfolio of high-quality eligible assets – including Islamic Development Bank sukuk instruments. Sukuk are financial instruments used in Islamic finance that function similarly to conventional bonds but are Shari'ah compliant.
- Returns generated from the backing fund are passed back to depositors.

Operation of the ALF: stylised diagram



Since introduction of the ALF, HQLA of UK Islamic Banks has stabilised and grown steadily



KFH UK, which is transitioning to be a Shari'ah compliant bank, would add c. £2bn in total assets if included in the chart

Source: Bank of England aggregated regulatory return data from UK Islamic banks

Note: to avoid skew, aggregate data excludes KFH (UK) Ltd

The ALF has been successful, and we have recently expanded the facility

- The ALF is widely regarded as a success in central banking innovation

- Since its launch, the facility has seen strong uptake from participants

- This year, the Bank expanded the facility for the first time - increasing facility size from £200mn to £550mn, and purchasing additional IsDB sukuk

- Further details are on our website:

[Bank of England Market Operations Guide: Our tools | Bank of England]