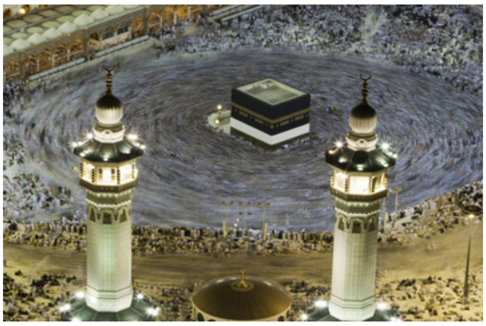
ISLAMIC INTERBANK BENCHMARK RATE

PULSE OF THE ISLAMIC CAPITAL MARKETS



The ISLAMIC INTERBANK BENCHMARK RATE (IIBR) (Arabic translit. *Muashshir al Ribh bayn al Masarif al Islamiyah*) provides a reliable and objective indicator of the average expected return on Shariah compliant short term interbank market funding for the Islamic Finance industry. Utilising the contributed rates of 16 major Islamic banks and Islamic banking windows, the IIBR is calculated for every business day and is available on Thomson Reuters terminals and enterprise products.

Established in co-operation with the Islamic Development Bank (IDB), Accounting and Auditing Organisation of Islamic Financial Institutions (AAOIFI), the Bahrain Association of Banks (BAB), Hawkamah Institute for Corporate Governance and a number of major Islamic banks, the IIBR harnesses Thomson Reuters global benchmark fixings infrastructure, responsible for calculating and distributing some of the world's famous benchmarks including the LIBOR and EURIBOR suite of fixings.

BACKGROUND

Since the establishment of the first Islamic commercial bank in 1975, the Islamic finance industry has been searching for an indigenous benchmark that can be applicable to transactions compliant with Islamic law (Shariah compliant).

As an ethical financial system, Islamic finance prohibits interest and shuns all interest-related transactions and instruments as these are contradictory to the core principles of Islam. Despite this prohibition, in the absence of a reliable Islamic interbank benchmark, Islamic banks and financial institutions have continued to utilise conventional interest based benchmarks to calculate their cost of funding with no reference to either their assets' risk profile or the regional particularities of Islamic banks.

The Islamic Interbank Benchmark Rate (IIBR) serves to address some of these concerns by developing a rate that is contributed by and is indigenous to a global panel of Islamic banks and Islamic Banking windows with fully segregated funds.

FOR MORE INFORMATION

EIKON/3000Xtra: Call up <IIBRFIX>
financial.thomsonreuters.com/islamicbenchmark
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USES OF THE BENCHMARK

- ✓ Pricing of common overnight to short term treasury investment and financing instruments such as Murabaha, Wakala and Mudaraba.
- ✓ Pricing of retail financing instruments such as property finance, car finance and other asset financing etc.
- ✓ Pricing / benchmarking of corporate finance and investment assets.
- ✓ Pricing of sukuk and other Shariah compliant fixed income instruments.
- ✓ Official incorporation possible for pricing onto confirmations/annexes related to the Shariah Compliant Hedging Master Agreements.

METHODOLOGY

- Rates for Shariah compliant US dollar (USD) funding in reasonable market size are contributed via Thomson Reuters systems each business day between 9.00 AM and 10.44 AM (Makkah time - GMT+3) by a panel of 16 Islamic banks or fully segregated Islamic banking windows.
- The panel banks contribute their rate based on a pre-defined question specified by the Islamic Benchmark Committee and approved by the Shariah Committee.
- The rates are snapped by Thomson Reuters at 10.45 AM. Thomson Reuters undertakes both automated and manual audit and review procedures at this stage to ensure that the rates contributed are genuine.
- The rates are ranked from highest to lowest and the top and bottom quartiles (25%) of the rates are excluded to ensure that outliers do not influence the distribution (From 16 contributed rates, 8 rates are excluded – 4 each of the highest and lowest rates).
- The arithmetic mean (average) of the remaining mid quartiles' values is then calculated to produce the IIBR, rounded to 5 decimal places.

GOVERNANCE

The calculation, methodology and governance of the IIBR are advised by two independent committees.

ISLAMIC BENCHMARK COMMITTEE

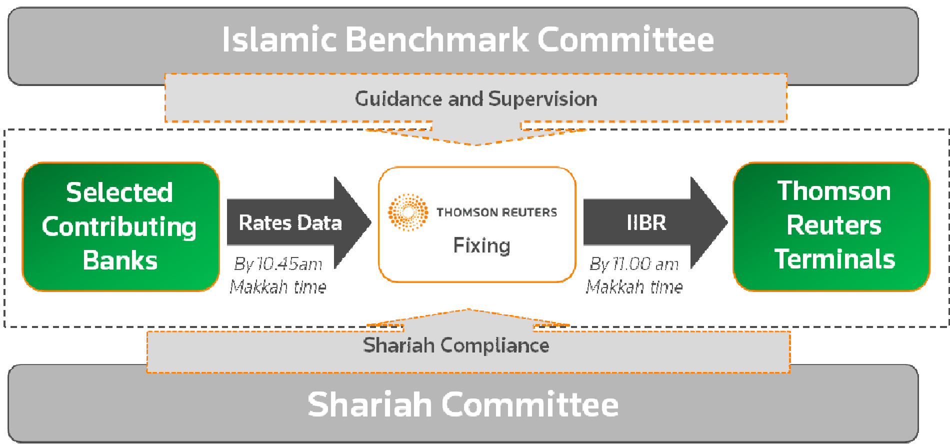
Responsible for providing the commercial and technical advice required for the proper implementation and on-going integrity of the IIBR. The Islamic Benchmark Committee is also responsible for selecting, admitting and excluding banks for the contributor panel.

- Thomson Reuters
- Islamic Development Bank
- Accounting and Auditing Organisation for Islamic Financial Institutions
- Association of Islamic Banking Institutions Malaysia
- Bahrain Association of Banks
- Hawkamah Institute for Corporate Governance
- Statistical Economic and Social Research Center for Islamic Countries (SESRIC) - OIC
- Abu Dhabi Islamic Bank
- Ahli United Bank
- Al Baraka Bank
- Al Hilal Bank
- Alinma Bank
- Al Salam Bank
- Bahrain Islamic Bank
- Bank Muamalat
- Barwa Bank
- CIMB Islamic Bank
- Dubai Islamic Bank
- Ithmaar Bank
- Kuwait Finance House
- Masraf Al Rayan
- Noor Islamic Bank
- National Commercial Bank
- Qatar Islamic Bank
- RHB Islamic Bank
- Sharjah Islamic Bank

SHARIAH COMMITTEE

Responsible for ensuring that the IIBR is compliant with principles of Islamic law (Shariah).

- Shaykh Yusuf Talal Delorenzo (Chairman)
- Dr. Abdul Rahim Sultan AlOlama
- Dr. Mohammad Daud Bakar
- Shaykh Muddassir Siddiqui



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Accounting and Auditing Organization for Islamic Financial Institutions

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FREQUENTLY ASKED QUESTIONS

Q. The calculation methodology is very similar to the calculation methodology of interest based benchmarks such as the LIBOR. If that is the case, then what's the difference?

A. The fundamental difference is that benchmarks such as LIBOR measure interest whereas IIBR measures profit.

Thomson Reuters calculates hundreds of fixings in various markets globally. The methodology utilised represents a time tested mechanism to calculate the average cost of funding for any market. A key maxim of Islamic jurisprudence suggests that in the matter of commercial transactions, everything is deemed permissible unless explicitly stated otherwise. As long as the transacting parties adhere to the principles of Islamic jurisprudence while applying the benchmark to their transaction, it is acceptable to utilise a consensus methodology for the rate fixing. The banks in conventional fixes are principally involved in interest based borrowing and lending and are contributing quotes for how much interest they must pay were they to raise funding. The IIBR contributor banks are all either Islamic banks or banks with full segregated Islamic banking windows and hence limited to only investing in Shariah compliant assets.

Further, a critical difference between the IIBR and interest based benchmarks is what exactly they are contributing when they are quoting their rates. The Islamic banks are contributing the rate they would have to distribute to an investor, if they were to raise Shariah compliant funds, considering the risk profile of the Islamic banks' underlying assets. The specific question asked to each contributing bank is:

"What is the expected profit rate that you would distribute for an interbank Shariah compliant funding transaction, were you to do so by asking for and then accepting inter-bank offers for a market amount of USD for the tenors specified below?"

Finally, the IIBR is guided by a panel of major Islamic banks and approved by a Shariah committee of internationally renowned scholars.

Q. In treasury or money market operations, banks expect to earn a return on their money or 'interest' not necessary linked to utilizing the funds for any productive activity. What's the difference here?

A. Unlike conventional treasury operations, Islamic treasury transactions are always related to real Shariah compliant trade (bay') and investment (istithmar) transactions such as Murabaha (cost plus) or Wakala (investment agency) or Mudaraba (investment management) that the bank undertakes either as a seller, an agent (wakil) or investment manager (mudarib), respectively. Hence, it is necessarily invested in assets that generate return either through sale or yields produced from the underlying investable assets.

Q. Why not build a benchmark based on real economic indicators for instance CPI, GDP growth and the performance of the financial or other sectors of the economy?

A. The ultimate criterion for the industry wide adoption of any benchmark, particularly one that is published every business day, is the simplicity, reliability and robustness of its methodology. Additionally, to engender the confidence of financial markets participants, an interbank benchmark must be calculated on every business day with a transparent and simple methodology open to public scrutiny. Benchmarks such as CPI, GDP growth and performance are subject to much more volatility, less frequency and are less opaque in the process by which the underlying metric is calculated. Further, these measures tend to lag far behind market conditions to the extent that they are rendered irrelevant by market participants by the time they are published. Instead, the IIBR will be a lead-indicator able to react to prevailing market conditions on a day-to-day basis.

Q. If the IIBR is meant to be a global benchmark for the Islamic markets, then why are most of the contributor banks in the Gulf Cooperation Council (GCC) countries?

A. To publish a reliable and realistic benchmark for any interbank transaction, the currency for the benchmark must be uniform across all contributors, as rate differentials are present and sometimes accentuated across currencies. The unique benefit of including GCC banks is that most, if not all, of these banks have substantial reserves / exposure in US dollars (USD), in addition to the fact that five out of the six countries peg their currencies to the USD. This effectively allows for a broader representation of banks from various Islamic markets while still remaining within the risk parameters of one currency. In addition, the US dollar still represents the most liquid currency and most international Sukuk continue to be issued in US dollars. It is intended that going forward, other contributor banks in non-GCC countries will apply to participate in the USD benchmark to make the benchmark more inclusive and global. On a more strategic level, the GCC based benchmark can be considered one of the precursors towards a truly global and economically integrated Islamic financial market.

FOR MORE INFORMATION

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