

Islamic Hedging Mechanism

Emerging Trends

Introduction

By

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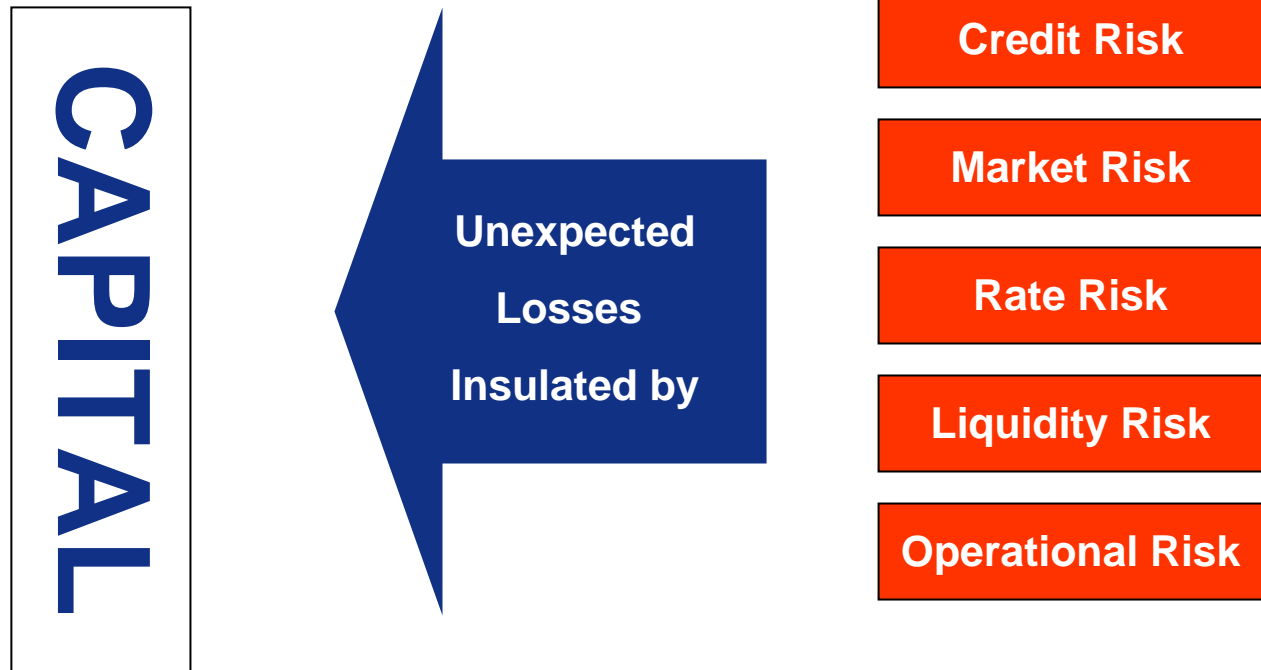
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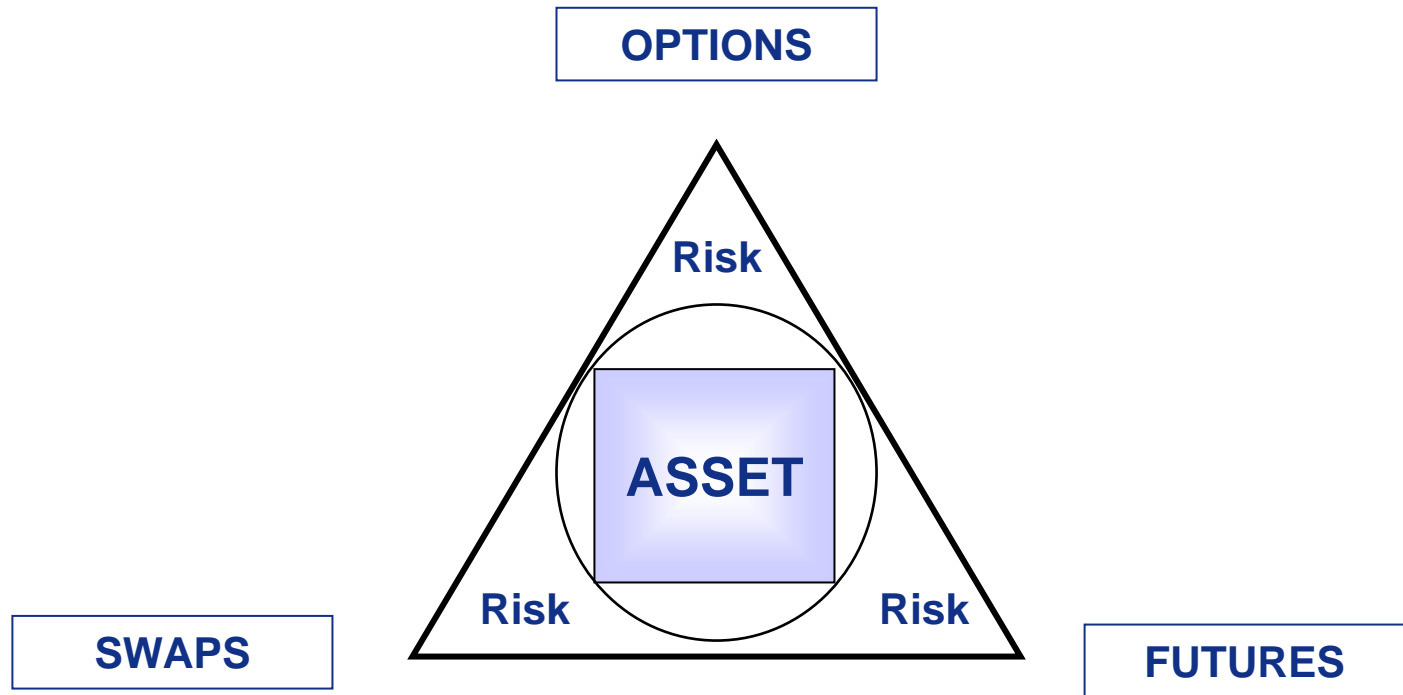


Islamic banks face the same risks



HEDGING IS ISLAMIC AS IT NUETRALIZES AND MINIMIZES RISK

Conventional banks hedge with derivatives



***DERIVATIVES SEPARATE RISK FROM ASSETS AND
COMMODOITIZE IT***

Derivatives are not desirable – one view

- During past decade responsible for huge volatilities in all markets
- Commoditized risk can be traded – hedging or speculation
- Zero sum game – gambling or *maysir*
- Not real transactions as underlying is usually not delivered
- Governments ultimately bear the risk of speculators

**DERIVATIVE STRUCTURES NEED TO BE ALTERED TO
BECOME INSTRUMENTS OF MUTUAL GAIN**

Some derivatives are desirable – another view

- Some derivatives e.g commodity futures should be permissible
- In Mauamalat specific prohibition is needed
- Full transparency of price and transaction indicates no injustice to anyone
- Some argue that derivatives if properly used reduce uncertainty
- Derivatives do not involve Riba
- Research indicates that speculation does more to smooth the price rather than to increase

SOME DERIVATIVES CAN BE REGARDED AS COMPLIANT AND SHOULD BE PERMISSABLE

Principles of Islamic financial engineering



GUIDING PRINCIPLES FOR DEVELOPMENT OF ISLAMIC HEDGING STRATEGIES

Suggested modes of Islamic hedging

→ Economic hedging

- Alignment of asset and liabilities
- Natural hedge
- Dynamic hedging

→ Cooperative hedging

- Currency risk
- Bilateral mutual adjustments

→ Contractual hedging

- Credit based
Mudarabah
- Third part hedging –
Musharakah
- Deferred price sale
- Commodity linked
bonds
- Currency risk in
Murabah
- Value based Salam
- others

HEDGING ACCEPTABLE WITHIN GUIDING ISLAMIC PRINCIPLES

Some recent emerging hedging products

- Masraf Al Rayan's profit rate Swap – based on commodities and Murabaha structure
- SABB develops a hedge of lending rates – Al Babtain Energy and Telecom and Fawaz Al-Hokair & Co.
- KFH with Air Asia – a USD 230 million Islamic finance with currency hedge
- Citigroup Singapore launches Murabah investment and Islamic hedging product
- Bank Islam Malaysia and Bank Muamalat Malaysia created an Islamic derivative product.
- And many others

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