



Islamic Hedging Mechanism: Emerging Trends

Arul Kandasamy
Head of Islamic Financing Solutions
Barclays Capital

Global Islamic Finance Forum
26-29 March 2007, Kuala Lumpur

Overview

- **There has been exponential growth in Islamic financing and treasury instruments**
- **This is the key driver behind demand for Islamic risk management tools**
 - **Dubai Financial entered into a US\$230m cross currency swap to hedge FX translation risk from its acquisition of a stake in Bank Islam**
 - **Air Asia needs to hedge its ijara rental rate and USD FX risk relating to its financing of 6 aircraft**
 - **Islamic banks require the use of profit rate swaps, FX forwards/options etc to adequately hedge their financing/treasury portfolios**

Why use Risk Management products?

- **Mitigate risk**
 - Movements in FX rates (e.g. an importer/exporter)
 - Movements in Interest Rates (e.g. a floating rate borrower)
- **Achieve certainty**
 - Budgeting reasons
 - Reduce P&L fluctuation
- **Requirement of rating agencies**
 - To achieve/maintain ratings
 - For structured financings e.g. securitisation
- **Speculate/ 'Take a view'**
 - Not sharia compliant!!!

Issues for Consideration

- **Lack of standardisation**
 - Of products and of documentation
 - Good progress made by ISDA/IIFM
- **Sharia Issues**
 - Need national/regional regulations to spur adoption given the stance taken by sharia boards, particularly in the Middle East
- **Accounting treatment**
 - On or off balance sheet? Form over substance?
 - Balance sheet inflation?
- **Tax, legal and regulatory treatment**
- **Complexity and unnecessary, particularly for corporates**

Suggested Next Steps

- Greater interaction between product developers, sharia scholars, regulatory authorities, accounting bodies and standard setters
- Increase client education and awareness of Islamic alternatives
- Increase expertise of practitioners/product developers to develop creative solutions- move away from 'commodity murabaha'
- Explore the notion of using 'most efficient solution' even though it may not be strictly sharia compliant

Questions & Answers