

Shariah resolutions as determining factors in treasury products

The Dubai government hosted the 24th Conference of the OIC Fiqh Academy between the 4th and the 6th November 2019, attended mostly by Shariah scholars worldwide. Panel discussions in the conference concluded a number of resolutions which could directly impact treasury products offered by Shariah compliant institutions. In this article, DR YOUSUF AZIM SIDDIQI would like to highlight current practices and compare them with the resolutions obtained at the conference.



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Resolution on cryptocurrency

Different forms of cryptocurrencies, specifically bitcoin, are gaining a significant place in discussions among practitioners, investors, regulators, economists and even Shariah scholars. As per Resolution No 237 (24/8), the mechanism and modus operandi of such currencies were highlighted but the Shariah stand was not concluded since two matters are still open for further discussion and deliberation: (a) how to treat the currencies, whether as goods, usufruct, financial investment assets or digital assets, and (b) the possibility of considering the cryptocurrency as appraisable property from a Shariah perspective (Mutaqawwam). It is evident that the resolution followed a cautious approach, but treasury departments of Islamic banks remain undecided how to deal with their customers who might be interested in investing or transacting in such currencies.

Resolution on debt settlement during hyperinflation

How to settle debt during a hyperinflation scenario? As per Resolution No 231 (24/2), in case of hyperinflation the concerned parties may agree to settle the financing by value or to have a settlement arrangement where the loss is shared between them provided it was in light of an arbitration or judicial order, and such a condition was not pre-agreed in the contract. It is evident that the resolution will provide relief from financial hardship for an Islamic bank's treasury which might be exposed

to settlement risk in money market deals during hyperinflation.

Resolution on compensatory financing

Compensatory financing (Quru® Mutabadala) is a bilateral arrangement where both the parties agree that whenever an interest-free financing (Qard Hasan) has been taken by a party, then it will be obliged to extend, in the future, a financing of a similar period and amount to the creditor. Such a mechanism proved to be useful in correspondence banking where, sometimes, NOSTRO accounts are overdrawn so Islamic banks can extend interest-free loans to the drawee bank. As per Resolution No 238 (24/9), the mechanism of compensatory loans is prohibited. It is evident that this resolution will have an adverse impact on an Islamic bank's financial institution relations since most of the foreign banks do not accept the inclusion of any condition where the debtor pays an amount to charity.

Extended offer in currency

As per classical literature, offer and acceptance need to be exchanged in the same session of the contract. However, a new type of offer has emerged as per contemporary practices: it is known

as an extended offer wherein the offer remains binding on the offeror for a period beyond the contract session or receiving the same by the recipient. This kind of offer proved to be useful in forex transactions wherein an Islamic bank may buy or sell currencies to its customer through written correspondence. The recipient is not obliged to respond immediately to the offer which was sent by the Islamic bank. As per Resolution No 238 (24/9), the extended offer in the currency contract is not permissible. It is evident that this resolution will have an adverse impact on an Islamic bank's treasury operations due to no possibility of exchanging documents via correspondence.

Hedging of currency risk

Islamic banks have started in recent years to use Shariah compliant derivatives to hedge against currency risk. This is done mostly through executing multiple Tawarruq transactions. They applied structures that are different from conventional hedging products on the operations and legal side but financially they achieved the same purpose intended by their counterparts in the conventional industry such as hedging the risk. As per Resolution No 238 (24/9), it is prohibited to enter into products based on multiple organized Tawarruqs. It is evident that this resolution will have a

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direct and adverse impact on an Islamic bank's risk portfolio besides the treasury business which has started slowly adopting products standardized by the International Islamic Financial Market in Bahrain.

Option premium via Murabahah

Offering conventional options is not acceptable in Islamic finance because charging a premium for an obligation to buy or sell cannot be considered as appraisable income from a Shariah perspective. As an alternative, Islamic banks have started offering option products by structuring them on the basis of Murabahah. As per Resolution No 238 (24/9), it is prohibited to enter into a Murabahah arrangement for the purpose of gaining an option premium. It is evident that this resolution will have a direct and adverse impact on an Islamic bank's currency risk managed by the treasury department.

Bilateral promises

Islamic banks enter into a set of promises with variant conditions. Hence, (A) promises to buy from (B) in June 2020 for X price. On the other hand, (B) promises to sell to (A) in January 2020 for Y price. Such arrangements are applied in Tawarruq, as well as in currency hedging transactions. As per Resolution No 238 (24/9), it is prohibited to enter into such promises because they amount, overall, to bilaterally binding promises. It is evident that this resolution will have a direct and adverse impact on an Islamic bank that would like to mitigate its own risk and give customers the comfort of not being exposed to a risk of default by the Islamic bank.

Conclusion

Looking at the Shariah basis of the AAOIFI Shariah standards, it is evident that the collective efforts of jurists and Shariah scholars played an instrumental role in developing the Shariah stand on various products of the Islamic treasury. The given resolutions have a serious and direct impact on the Islamic banking treasury which is making an endeavour for small and slow progress in order to come up with an alternative to conventional treasury products. The coming days will highlight whether the given resolutions are applied, modified or ignored by industry players. ☹

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The United Nations Commission on Trade and Development (UNCTAD) recently estimated that in order to adequately fund the 17 Sustainable Development Goals (SDGs) in developing countries, US\$5 trillion to US\$7 trillion will be required in annual investments by 2030. Fulfilling this ambitious financial requirement presents not only challenges, but also significant opportunities.

The recent introduction of regulatory frameworks and initiatives promoting the development of sustainable finance across Southeast Asia has highlighted the significance and relevance of this important and fast-growing sector. With more corporates, financial institutions, government bodies and regulators becoming aware of Sustainable Development Goals, countries offering environments conducive for the growth of sustainable finance and investment will see tangible and long-term benefits.

Islamic finance plays an important role. Firstly, through the development of effective sell-side capital market products such as Green Sukuk in order to fund sustainable and humanitarian projects and initiatives. Secondly, to provide and channel investment from Shariah compliant asset managers and institutional investors to such initiatives.

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