Islamic Hedging: A Critical Analysis of Existing Sharī'ah Resolutions

by

Noor Suhaida Kasri,¹ Shamsiah Mohamad,² Nor Fahimah Mohd Razif,³ Siti Syafira Zainal Abidin⁴ & Farrukh Habib⁵

Abstract

Hedging is an important concept in risk management. Deploying the right risk management strategies is pertinent in financial industry – be it conventional or Islamic finance. Alike its counterpart, the need for hedging in Islamic finance is recognised in Islamic law of contract. However the process of Islamic hedging is different from the conventional one. The difference lies in the operation and contract used for hedging namely (i) the hedging contract and its underlying assets are Sharī'ah compliant; (ii) the usage of hedging mechanism is not for speculation and gambling; (iii) the act of hedging is linked with real economic activity; and (iv) the hedging technique is free from transference, elimination or shifting of risk. Sharī'ah resolutions or fatwas pertaining to Islamic hedging have been issued by international Sharī'ah standard setting bodies namely, the Islamic Fiqh Academy of the Organisation of Islamic Cooperation (IFA-OIC), the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the International Islamic Financial Market (IIFM), the Dallah Al-Baraka (DAB), as well as Malaysian Sharī'ah standard setting bodies namely, the Shariah Advisory Council of Central Bank of Malaysia (SAC-CBM) and the Shariah Advisory Council of Securities Commission Malaysia (SAC-SCM). Though these bodies are in agreement on the need of hedging however they are not unanimous in deciding the legality of Islamic hedging instruments. This paper attempts to analyse the criteria of Islamic hedging and the extent of its application in these resolutions. Thus the question whether the criteria of Islamic hedging is captured in these Sharī'ah resolutions and how are these resolutions or the criteria of

¹ Dr Noor Suhaida Kasri, Researcher, International Syariah Research Academy for Islamic Finance (ISRA), Malaysia, noor@isra.my
² Dr Shamsiah Mohamad, Senior Researcher, International Syariah Research Academy for Islamic Finance (ISRA), Malaysia, shamsiah@isra.my
³ Dr Nor Fahimah Mohd Razif, Tutor, University of Malaya, Malaysia, norfahimah@um.edu.my
⁴ Siti Syafira Zainalabiddin, Management Trainee, International Shari'ah Research Academy for Islamic Finance (ISRA), Malaysia, syafira@isra.my
⁵ Farrukh Habib, Research Officer, International Shari'ah Research Academy for Islamic Finance (ISRA), Malaysia. farrukh@isra.my