

Session 2

Shari'ah Risk in Product Development, Processes and Operations

Islamic Structured Products

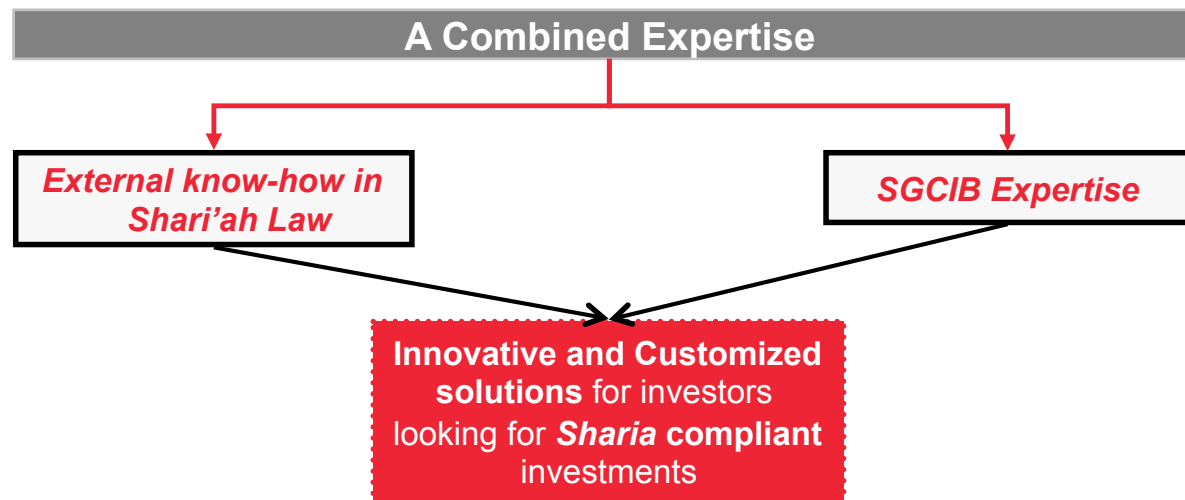
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Introduction

■ Structured Products :

- ▶ Instrument created for specific needs
- ▶ Alternative to direct investment
- ▶ Can reduce risk exposure
- ▶ View on current market trends

■ Société Générale: at the cross roads of Islamic Finance & Structured Products



Assessing Shari'ah Risk

- **Extra compliance criteria = extra considerations**
 - ▶ The corpus of criteria being Shari'ah or any other corpus

- **The particularity of Shari'ah is that it is, to some extent, subject to interpretation**
 - ▶ “*ijtihad*” and resulting commercial issues
 - ▶ Scholars’ “*ijtihad*” deserves respect
 - ▶ For banks which have no view on Shari'ah, how are these issues supposed to be dealt with ?

Possible Instances of Shari'ah Risk

- ▶ **Structural Risks**
- ▶ **Legal & Documentation Risks**
- ▶ **Scholars' Non-Consensus Risk**
- ▶ **Reputational Risk**

Structural Risks

- **Constraints resulting from providing Shari'ah compliant solutions may create :**
 - ▶ Hedging considerations
 - ▶ Extra collateral funding costs
 - ▶ Greater operational requirements

Legal & Documentation Risk

- **Governing Law of the Product Documents**
 - ▶ Shari'ah Law vs. English Law

- **Law of Jurisdiction**

- **Shari'ah Court implications**

Scholar's Non-Consensus Risk

- **Original Scholar changing his mind after the launch of the product**
- **Other Scholar(s) disputing fatwa's validity**
 - ▶ Sheikh Nizam Yaqubi & OIC on Tawarruq
 - ▶ Sheikh Yusuf Talal DeLorenzo on the “double *wa'd* structure”

Reputational Risk

- Selling “aggressive” products
- Reputational damage suffered by the bank
- Could the bank be held liable for a Scholar’s Opinion ?
- Use of disclaimers, but is it enough ?

Some Practical Considerations

- **Use of Tawarruq**
- **IIFM's standardisation effort**
- **No standardisation in Broker mechanism → Missing Link**

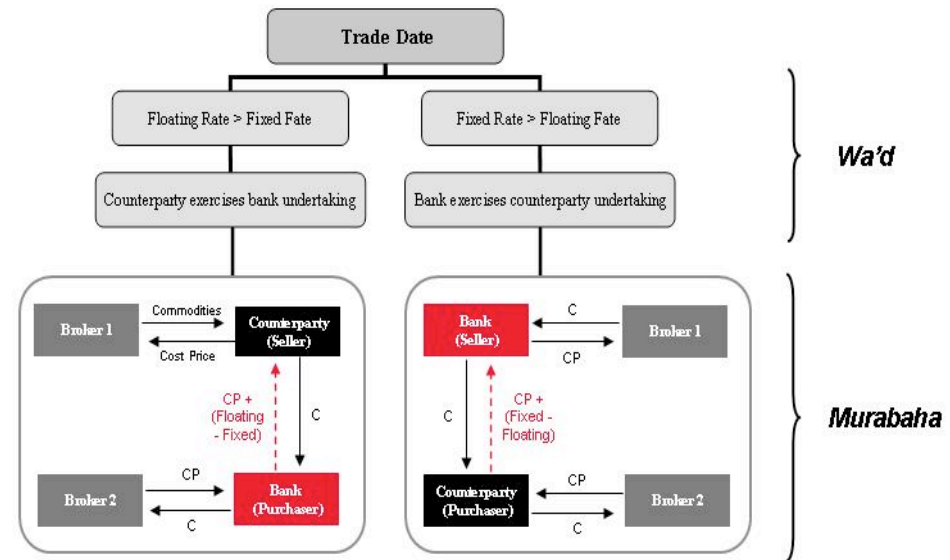
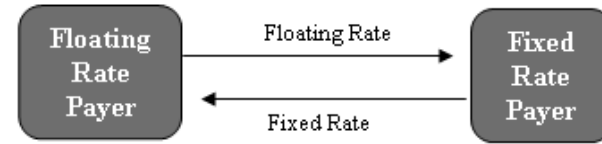
The case for Risk Management Instruments

The Prophet (peace be upon him) was asked whether it is better to tie up one's camel or trust in Allah to keep it from running off, the Prophet (peace be upon him) replied:

"Tie up the camel and trust in Allah (swt)." [Sunan al-Tirmidhî ; 2517]

e.g. the Profit Rate Swap case

- Do all the industry's players and scholars agree on the need for Hedging Instruments ?
- Is there any economical difference between these two structures ?
- Should there be more emphasis on the use of these instruments ?



Key:
 ———> Spot
 - - - -> Deferred

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Q & A
