

Islamic Hedging Framework

Law Reform in Islamic Jurisdictions

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Background

- Introduction
- Considering conventional hedging instruments and challenges facing Islamic hedging instruments
- The case for law reform in Islamic Jurisdictions
- ISDA documentation and opinions

The Need for Law Reform

- The development and use of derivatives products has become ubiquitous spreading around the world
- This includes the Islamic finance sector (ISDA/IIFM Tahawwut Master Agreement)
- Effective risk management requires legal certainty. In the hedging context this means:
 - Enforceability of derivatives transactions
 - Clarity of insolvency law and enforceability of netting provisions
 - Clarity regarding the treatment of collateral

The Need for Law Reform

- Significant variation in national insolvency and property laws around the world affects the enforceability of derivatives transactions under industry standard netting and collateral agreements (eg, ISDA Master Agreements for global cross-border transactions, local master agreements)
- Issue affects Islamic capital market transactions as much as conventional transactions
- Industry's law reform efforts aim at addressing these concerns, working with multinational organizations as well as national authorities

Financial Market Law Reform: Key Questions

- Knowing where you stand: the practical value of increasing legal certainty
 - An abstract goal, but with concrete results: increased market confidence, more liquidity, greater financial stability
- Key questions:
 - Will my agreement be respected and enforced by a court or arbitration tribunal?
 - Will foreign law governed contracts and foreign based counterparties be treated equally?
 - Will it be enforced as written, both before and after my counterparty's insolvency?
 - How can I protect against the risk of my counterparty's insolvency?
 - Early termination and close-out netting under a master agreement
 - Set-off rights
 - Financial collateral arrangements and other forms of security
 - Guarantees, letters of credit, insurance, credit derivatives

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Law Reform Efforts in Emerging Markets

- Crucial role of intergovernmental organizations in enhancing legal certainty by promoting harmonization of capital markets legislation
- Equally relevant to Islamic financial institutions
- Involve IFSB, multilateral development banks

Since 1987 ISDA has been developing standard contracts, recommendations and model laws on netting and for collateral transactions

- ISDA netting legislation initiatives in EMEA, LatAm, Asia-Pac
- ISDA Model Netting Act and Memorandum on Implementation of Netting Legislation (latest version published October 2007)
- ISDA Master Agreements and supplemental standard documentation (collateral; clearing)
- Positive industry legal opinions to obtain regulatory capital approval (Basel Capital Accords)

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Legal opinions for ISDA/IIFM Tahawwut Master Agreement

Netting legislation:

- Malaysia, Singapore, Indonesia, UAE-DIFC, UAE-ADGM (covered by regular ISDA opinions)
- Bahrain (enacted in Dec 2014; amendments pending)
- UAE free zones (DIFC and ADGM) have enacted specific laws in Dec 2014 and mid-2015
- UAE federal law at draft stage
- Saudi Arabia: recent MoCI consultation on draft law on insolvency
- Qatar: QFC consultation on draft legislation (launched end-June 2017)
- Pakistan: SBP/SECP draft legislation about to be finalized
- Morocco: draft legislation pending (Q1 2018)

TMA Legal Opinions:

Malaysian TMA Legal opinion (published)
Singapore TMA Legal opinion (pending)
English Law TMA legal opinion (published)

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Collateral arrangements

(Chapter V Geneva Securities Convention)

Questions regarding scope

Types of counterparties
Relevant financial obligations
Financial collateral
Safe harbour provisions from insolvency rules (impact and policy justification)

Types of collateral agreements

Security collateral agreement
Title transfer collateral agreement
Including close-out netting provision

International instruments

- UNIDROIT Netting Principles and FSB Key Attributes of Resolution Regimes
- Geneva Securities Convention and Hague Securities Convention
- UNCITRAL Legislative Guides

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