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THE SHARIAH-BASED HEDGING INSTRUMENTS USED FOR MANAGING THE FOREIGN EXCHANGE RATE-RELATED RISKS

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ABSTRACT

The foreign exchange rate-related risks are considered the most significant risks in international markets. That is because there are many currencies which exchange rates are connected with each other. One of the reasons behind such risks is the time difference between locations worldwide. That is because the foreign currencies are exchanged 24 hours/day in foreign exchange markets. The fluctuation in the foreign exchange rates is a risk to capital. Facing this risk requires employing hedging instruments (including conventional and Shariah-based hedging instruments).

INTRODUCTION

Currency is considered essential for carrying out business transactions with local or foreign parties. In fact, currency-related issues have been receiving much attention due to the major rise in the number of business transactions between countries due to the improvement of economic relationships between countries and globalism. Due to the improvement of such relationships, the exchange rates of many currencies have become connected with each other. That led to the emergence of various problems. For instance, such connection serve as a threat to the institutions that have much funds in such currencies (e.g. commercial banks, central banks and importers). Commercial banks usually have a great amount of money in many currencies. Thus, in case such banks avoid the foreign exchange rate-related risk through concluding future contracts. Through such contracts, such banks can provide the liquidity they need in any currency and at any time.

Taking measures to avoid risks is halal under Shariah. In fact, Shariah encourages people to reduce and avoid risks as much as possible. Under Shariah, preserving funds must be carried out through two methods. The first method is represented in investment and working. The second method is represented in protecting funds from damage (Al-Shatebi, 1884, p.8-9).

In this regard, the present study aimed to identify the most significant Shariah-based hedging instruments used for managing the foreign exchange rate-related risks.

Statement of the study's problem and the study's questions

There are many currencies which exchange rates are connected with each other. That led to the emergence of various problems. For instance, such connection serves as a threat to the institutions that possess much funds in such currencies. In addition, the fluctuation in the exchange rates of such currencies serve as a risk to the capital of such institutions. It may affect the market value of such institutions. It may lead to facing difficulties in determine the final value of the local currency. The fluctuation in the exchange rates of such currencies has negative impact on the companies that carry out international transactions and the companies that carry out local transactions. Hence, companies must use hedging instruments for managing the foreign exchange rate-related risks. Therefore, the problem of the present study is represented in the following question: (What are the Shariah-based hedging instruments that can be used for managing the foreign exchange rate-related risks?). The following questions are derived from this question:

1)- What's meant by the term (foreign exchange rate)? What is the significance of this rate?

2)-What's meant by the (foreign exchange rate-related risks)? What are the types of such risks?

3)-What's meant by the (hedging against the foreign exchange rate-related risks)?

The study's significance

This study is significant due to the significance of Shariah-based hedging instruments. For instance, such instruments contribute to improving economy and achieving economic stability.

The Study's Objectives

This study aimed to

1)-Identify the Shariah-based hedging instruments that can be used for managing the foreign exchange rate-related risks.

2)- Identify the meaning of foreign exchange rate and its significance

3)-Identify the meaning of the (foreign exchange rate-related risks) and their types

4)- Identify the meaning of the (hedging against the foreign exchange rate-related risks).

Methodology

The researchers of this study adopted a descriptive analytical approach. The structure of this study is identified below:

First part: Meaning and significance of (foreign exchange rate)

First section: Meaning of (foreign exchange rate)

Second section: Significance of (foreign exchange rate)

Second part: meaning and types of (foreign exchange rate-related risks)

First section: Meaning of (foreign exchange rate-related risks)

Second section: Types of (foreign exchange rate-related risks)

First sub-section: Transaction risk

Second sub-section: Economic risks (Operational risks)

First part: Meaning and significance of (foreign exchange rate)

First section: Meaning of (foreign exchange rate)

The (foreign exchange rate) can be defined as the number of units of home land currency that be exchanged with one unit of a foreign currency (Al-Hamzawi, 2004; 17). It can be noticed that the latter definition sheds a light on the local and international economy. According to Awad Allah, 2004), the (foreign exchange rate) can be defined as the number of units of a currency that be exchanged with one unit of another currency (p. 22). It can be noticed that the latter definition sheds a light on the process of converting a foreign currency into a local one and vice versa.

Second section: Significance of (foreign exchange rate)

Foreign exchange rate is the most significant rate in economy. That is because this rate affects other rates and many economic variables. It is because the change to this rate may lead to incurring much loss by governments. Such loss may surpass the financial abilities of the government. In addition, the change to the foreign exchange rate may affect the ability of governments to enjoy a high economic stability level.

The foreign exchange rate is significant because it affects the price of the local commodities in the foreign markets. It is significant because it affects many macro-economic and micro-economic variables in a direct or indirect manner (Zarari, 2016, p.2).

Second part: meaning and types of (foreign exchange rate-related risks)

First section: Meaning of (foreign exchange rate-related risks)

Such risks emerge due to having unexpected changes to the foreign exchange rate before implementing the relevant decisions. To illustrate more, such changes may lead to gaining more profits. However, they may lead to incurring major or minor financial losses. They may lead to making unexpected changes to the market value of an enterprise or investment. They may lead to making unexpected changes to the value of a loan (Sandra Winke, 2013).

Foreign exchange rate-related risks refer to the potential direct loss which may be incurred due to the unemployment of hedging instrument. They can be defined as the potential indirect which may be incurred due to the change in the exchange rate of a currency. The latter loss may occur to the company's cash flow, assets or net profit. It negatively affects the market value of the company (Michael Papaioannou, 2006).

The foreign exchange rate-related risk level refers to the extent of having fluctuation in the foreign exchange rate of a specific currency when converting it to another currency or when converting it to the reference currency (Shapiro, 2003: 534). It refers to the degree of uncertainty about the number of units in the local currency that can be exchanged with one unit in the foreign currency in the future. In other words, it refers to the degree of uncertainty about the future foreign exchange rate. It refers to the state of uncertainty about the future foreign exchange rate that shall be adopted to convert the cash flow in foreign currency into the homeland currency (Al-Shokraji, 2013:24). The fluctuation in the foreign exchange rate is considered a major market risk for the companies that carry out international transactions.

Second section: Types of (foreign exchange rate-related risks)

The foreign exchange rate-related risks emerge due to three types of risks. These three risks are: transaction risks, economic risks (operational risks) and conversion risks. If a company faced any of those three risks, the probabilities of facing foreign exchange rate-related risks shall rise (Winkel, 2013: 22)

First sub-section: Transaction risk

Transaction risks refer to the possibility of having unexpected changes to the nominal exchange rate when converting the cash flow in a specific currency into another currency (Pantzalis et al., 2001: 796). They may be defined as the possibility of having changes to the cash flow of a foreign transaction settlement due to an unfavorable change in the exchange rate in the future. Thus, they refer to the uncertainty about having changes to the financial liabilities associated with transaction settlement due to a future change to the foreign exchange rate. They refer to the possibility of having changes to cash flow of completed transaction.

The business companies that carry out international transactions usually pay the price of the imported or exported products through foreign currencies. Due to the constant changes to foreign exchange rates, all the cash flow of their completed transactions shall be associated with transaction risk.

Hedging against transaction risks is often carried out in a tactical or strategic manner in order to preserve the cash flow and profits of companies. The tactical hedging is carried out by companies in order to avoid the transaction risks associated with short-term receivables and payments. The strategic hedging is carried out by companies in order to avoid the transaction risks associated with long-term receivables and payments. Some companies carry out passive hedging strategies. Through the latter strategies, the company shall employ the same hedging framework and implement the transaction throughout several stages regardless of the expected foreign exchange rate (Michael Papaioannou, 2006: 7).

Second sub-section: Economic risks (Operational risks)

According to Basel Committee, the operational risks refer to the risk derived from the failure or inadequacy of the procedures related to human resources, systems, events or laws.

Operational risks refer to the possibility of suffering from loss due to carrying out fraudulent or manipulative acts by a person in the institution or others. They involve the possibility of suffering from loss due to inefficient professional practices by employee(s). They involve the possibility of suffering from loss due to the refrainment of the management from carrying out its obligations or having a shortcoming in the regulations of the institution. In Shariah-based financial institutions, they involve the possibility of suffering from loss due to non-compliance with the provisions of Shariah when concluding contracts (Buqari, 2005: 119).

It is difficult to measure the severity of the operational risks accurately. That is because such severity is affected by the change in the foreign exchange rate. Measure this severity requires estimating the expected change that may occur to the future cash flow due to the change in the foreign exchange rate. Such estimation is made based on the real exchange rate (Al-Shokraji, 2013: 25).

It should be noted that the operational risks are considered residual risk. It's difficult to measure the severity of the operational risks because such risks represent the potential impact of the change in the foreign exchange rate on the current value of the future cash flow. Measuring such severity requires measuring the extent of deviation of the foreign exchange rate from the standard rate. Such severity is measured to predict the future earnings and future cost flow of the company during a specific period (Michael Papaioannou, 2006: p. 8).

Third sub-section: conversion risk

Conversion risks refer to the possibility of incurring loss in the value of assets, liabilities, expenses and profits that are in foreign currency when converting them into the local currency on a future date. The severity of the conversion risks represent the estimated changes to the value of the properties of the owners of the company. Such risks arise due to the need of converting the amounts of fund in foreign currency into amounts in local currency. That is done in order to have all the financial statements of the company written in local currency (Zayed and Hajaj, 2004: 231).

The severity of conversion risks is usually measured in a non-systematic and irregular manner. It is measured to avoid the influence of the unexpected changes in foreign exchange rate on the value of net assets. Measuring the severity of the conversion risks requires measuring the value of international investments and debt structure of the affiliated companies.

The severity of conversion risks affects the balance sheet of the company rather than the income statement of the company. Therefore, the priority given by the management to hedging against conversion risks is less than the priority given to hedging against other types of risks. When the company measures the severity of conversion risks, it measures the potential losses in the balance sheets (i.e. net assets) of the affiliated companies that result from change in the foreign exchange rate (Michael Papaioannou, 2006: p. 7).

Fourth sub-section: Credit risks

Such risks refer to the possibility of incurring losses due to having full or partial failure in paying off the required payments by the borrowers (Buqari, 2005: p.113; Bu Khamkham, 2007: p.2). In shariah-based financial institutions, they involve finance-related risks. The latter risks are represented in the possibility of incurring loss due to the failure of the clients to pay off the funds they received for funding an enterprise.

To avoid credit risks, the banking system in countries must adopt the same current foreign exchange rate. For instance, if an American bank sold 200 USD to a British bank through 125 pound, the British banks must adopt the same exchange rate when converting currencies (Al-Bahteeti, 2007: 45-79).

Third part: hedging against the foreign exchange rate-related risks: Meaning, significance, and instruments

The foreign exchange rate-related risk is one of the most significant risks that face multinational companies. That is because foreign exchange rate-related risks affect the future cash flow of such companies. Since the future foreign exchange rate is associated with uncertainty, companies can carry out hedging against foreign exchange rate-related risks. Hedging against such risks shall reduce the potential loss to the future cash flow of companies (Sandra Winkel, 2013: p. 8).

Due to the significance of hedging, the researchers identified the meaning of this term below

First section: Meaning of hedging and risk management

First sub- section: Meaning of hedging

Hedging refers to taking measures in order to avoid any potential loss that may be incurred due to risks (Abu Ghada, 2013: p. 2). It may be defined as the process of avoiding risks as much as possible (Al-Sowaylem, 2007: p. 2). It may be defined as the process of taking measures to protect the funds from any loss that may be incurred due to unexpected and undesired changes (Al-Sa'ati, 1426 AH: p. 57). It may be defined as the process of exchanging the investment risks between two parties (Al-Eshbaili, 1429 AH, p. 2). It may be defined as the process of protecting the invested capital from any loss or reducing such loss through concluding contracts (Redwan, 2005: p. 317). In simple words, it refers to the process of implementing strategies in the aim of managing risks to avoid loss in capital and reduce it as much as possible (Sandra Winkel, 2013: p. 8).

The researchers of this study presented below the way some bodies specialized in accounting defined hedging:

The Canadian Institute of Chartered Accountants (CICA) defines hedging as: (the process of purchasing or selling a commodity, foreign currency, future contracts, or financial instruments in the aim of avoiding or reducing any loss that may be incurred to the fluctuations in the foreign exchange rate or interest rate).

According to the Financial Accounting Standards Board (FASB), hedging refers to (the process of taking measures in order to reduce the negative impacts of the fluctuations in the foreign exchange rate or interest rate).

In the light of the aforementioned, the researchers of the present study define hedging as the process of taking measures or carrying out operations in the aim of avoiding any potential loss that might be incurred due to unexpected change in the foreign exchange rate of interest rate. They add that hedging is mean for protecting the cash flow of investments and financial contracts from any loss due to changes in the foreign exchange rate. Hedging against foreign exchange rate can be carried out through concluding contracts (e.g. option and future, and swap contracts and derivatives).

Researchers must provide hedging instruments that are consistent with the provision of Shariah and code of ethics. Such instrument must enable companies to protect their funds from any major or minor loss. They must enable companies to avoid insolvency and failure to pay off financial obligations (Othman, 2014, p. 4). In general, the main goal of hedging is represented in avoiding financial loss and reducing it.

Second sub-section: Meaning of risk management

Risk management refers to a systematic process that aims at estimating the potential the associated potential losses due the risks facing companies or individuals. It involves choosing and employing the best strategies and methods for avoiding such risks. In other words, it refers to the process of emulating the potential risks and using the relevant instruments for handling such risks. Such instruments are chosen based on the type of the risks (Stulz, 1996: 13).

Second section: The significance of hedging against the foreign exchange rate-related risks.

There isn't any doubt that hedging against the foreign exchange rate-related risks have many great benefit that are for the favour of the institution. Some of those benefits are listed below:

1) Such hedging contributes to achieving stability in the cash flow. It contributes to reducing the fluctuations in the expected earnings. It contributes to raising the market value of the institution. It contributes to reducing the severity of the credit risks and the possibilities of suffering from bankruptcy. It contributes to raising the possibilities of having adequate liquidity to cover the debts.

2) Such hedging facilitates the process of making long term plans for investments. It contributes to reducing the costs of launching future investments (Allayannis, and Weston, 2001, 241).

Third section: The conventional hedging instruments

The researchers specialised in financial sciences realize that there are many hedging instruments used in financial markets. Many of those instruments violate the provisions of Shariah and hinder people from meeting the goals of Shariah. The conventional hedging instruments derivatives. Derivatives include: option and future, and swap contracts.

Under decision No. 63 (1/7) of the International Islamic Fiqh Academy, it is haram to conclude option contracts. Under decision No. 20 of the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), it is haram to conclude option, future, and swap contracts.

Derivatives aim at exchanging financial risks. In other words, they aim at transferring risks to the party who's more eligible. As for the other party, he shall dedicate all his efforts to the production process. For instance, the manufacturing company may refrain from manufacturing great amount of products due to having concerns about having fluctuations in the foreign exchange rate. It can eliminate such concerns through concluding future contracts. Such contracts shall transfer such risks to other institutions. They shall enable the manufacturing company to increase its productivity level.

However, researchers realize that conventional hedging instruments (i.e. derivatives) have become the most significant hedging instruments. In facts, conventional hedging instruments have been widely used for gambling on the difference between rates. They are not used for transferring the concerned right of ownership from one party to another. 90% of the derivatives are concluded before the due date of payment.

The conventional hedging instruments are classified into internal and external instruments. Information about those instruments is presented below:

First: Internal instruments: They refer to the instruments that reduce the foreign exchange rate-related risks within the company itself. That is done through utilizing the company's resources and potentials without having to enter foreign markets nor getting support from parties outside the company. The use of such instruments may be called (natural hedging or internal hedging). It requires exerting additional efforts. In simple words, the foreign exchange rate-related risks can be reduced or avoided through carrying out internal hedging (Sandra Winkel, 2013, p. 55).

The most significant internal hedging instruments are identified below
a)-Measures related to speeding up and delaying the payment: Such measures aim at spending up or delaying the payment of the receivables or the payables. They aim at reducing the severity of the foreign exchange rate-related risks. Such measures involve:

*Leading and lagging: Leading refers to speeding up a payment to avoid any loss due to future changes to the foreign exchange rate. Lagging refers to delaying a payment to avoid any loss due to future changes to the foreign exchange rate. Leading and lagging measures are carried out when carrying out import and export transactions. For instance, there may be expectations about the drop of the foreign exchange rate of the local currency in the future. In this case the exporter shall speed up the payment of the receivables and vice versa. That's done to avoid any loss due to future changes to the foreign exchange rate (peyrard, 1986: p. 105).

*Granting discounts to the ones who make payments before the deadline: Any exporting institution can avoid any potential loss derived from future changes to the foreign exchange rate through giving their clients discounts for making payments before the deadline. That can be done when there is an expectations about the drop of the foreign exchange rate of the local currency in the future. The discount rate is determined in a manner that enable the exporting institution to avoid loss in case a change occurred to the foreign exchange rate in the future. Taking this measure shall enable the exporting institution to increase the current liquidity.

*Creating bank accounts in the homeland of the customers: The exporting institution can avoid any potential loss derived from future changes to the foreign exchange rate through creating bank accounts in the homeland of their customers. That shall facilitate and speed up the process of receiving receivables. It shall enable the exporting institution to avoid the foreign exchange rate-related risks (Bu Atroos, 2013: p. 5)

b)-Netting: (Sadiq, 1997: p. 154). It aims at enabling the managements of institutions to avoid the foreign exchange rate-related risks. The types of netting are listed below:

*Bilateral netting: It is carried out when two companies in the same group net off their own positions regarding payables and receivables.

*Multilateral Netting: It is a settlement mechanism used by companies to pay for goods and services purchased from affiliated companies. Through this mechanism, the amount of money to be paid by the borrowers shall be reduced. When employing this mechanism, the parties must determine the dates of making the payments. They must also determine the currencies to be used and the foreign exchange rate to be adopted.

c)- Measures related to the cash flow of the company: Companies make predictions about the foreign exchange rate. If they predicted a change to this rate in the near future, they shall increase the amount of their imported products and speed up the delivery of such products. That is done to avoid any potential loss derived from changes to the foreign exchange rate. The opposite shall be carried out by the exporting companies.

Such measures must be carried out in a systematic and careful manner. They must be carried out with taking into consideration the financial, and storage capacity of the company, and the negotiation skills of the managers. They must be carried out with taking into consideration the demand on their products. The management must conduct a comparison between the costs of such measures and the amount of the potential loss that may be incurred due to the change in the foreign exchange rate.

d)-Choice of invoice: This measure is represented in choosing the most suitable currency for listing the amounts of money on the invoice in it. The greater the fluctuations in the foreign exchange rate of the currency, the greater the risks associated with it shall be. Thus, the one who wants to carry out a transaction can choose a currency which foreign exchange rate experience few fluctuations. He shall draft the invoices in such currency. That shall reduce the foreign exchange rate-related risks.

*Drafting invoices through using the local currency: This measures is a simple measure for avoiding the foreign exchange rate-related risks. The importer or exporter who draft invoices through using the local currency shall realize the exact amount of money he/she shall pay on the due date of payments.

* Drafting invoices through using a currency which foreign exchange rate experience few fluctuations (e.g. US Dollar and Euro). Through this measure, both parties shall incur the loss derived from the changes that may occur to the foreign exchange rate. This measure is carried out when purchasing petrol (Sadeq, 1997: p. 195).

Second: External instruments: They refer to the instruments that reduce the foreign exchange rate-related risks outside the company itself. They may include carrying out transactions with banks in order to buy or sell currencies. They may include: concluding option and future, and swap contracts. They may include: carrying out transactions with insurance companies (Bu Atroos, 2013: p. 4). Further information is listed below about hedging external instruments (Zarari, 2016, p. 44 – 45):

*Measures related to using hard currency: This measure is carried out by the company that wants to have adequate liquidity and avoid the foreign exchange rate-related risks.

*Measures related to using credit in hard currency: They are carried out by the company that wants to have adequate liquidity and avoid the foreign exchange rate-related risks. They allow the exporter to benefits from short term credit to fund its operations.

*Future contracts: They are concluded in the aim of buying or selling a currency on a specific date based on a specific foreign exchange rate. They aim at avoiding any potential loss that may be derived from changes to the foreign exchange rates in the future (Zarari, 2016: p. 45 – 45).

*Option contracts: (Darrell Doffi, 1989, p. 279). They refer to contracts which grant their owners; the holder; the right, but not the obligation, to buy or sell a specific number of units of currency on a specific date in the future based on a specific foreign exchange rate. The latter rate is identified in the option contract. Under the option contract, the holder enjoys the right to buy or sell the units of currency at any time he/she wants. The option contracts enable companies to avoid foreign exchange rate-related risks. They enable companies to benefit from any positive change that may occur to the foreign exchange rate of the currency to gain money.

*Requesting the bank to deduct the amount of money listed on the promissory notes through using a foreign currency.

*Using governmental securities: In many countries, some governmental agencies provide exporters with governmental securities in order to compensate for any potential loss derived from credit risks and foreign exchange rate-related risks. Such securities are provided in order to encourage businessmen to export products. They are provided in exchange for paying a little amount of commission to the agency. Under such securities, the governmental agency shall incur any potential loss resulting from the client's failure of payment or negative fluctuations to the foreign exchange rate.

Fourth: Shariah-based hedging instruments

The researchers of the present study presented below the way Shariah regulates hedging:

Based on the aforementioned definitions, hedging aims mainly at protecting one's capital from partial or full loss. The same goal is sought by Shariah. This goal manifests through the emphasis made by Shrariah for protecting people's right to property. It manifests through the emphasis made by Shrariah for preventing people from attaining the funds of others in an illegitimate manner. In fact, Islam provided several regulations for protecting funds. Under such regulations, one's funds should be protected through two methods. Those methods are presented below:

1)- Under Shariah, one must seek increasing his/her wealth. Thus, one must work and carry out transactions in order to gain more money. Otherwise, one shall spend all the funds he/she currently possesses. However, under shariah, one must work carry out transactions in a halal manner (i.e. in accordance with the provisions of Shariah). Halal transactions include: sale and rent halal transactions and engaging in halal partnerships.

2)- Under Shariah, one must take measures to avoid losing his/her funds. Therefore, under shariah, it is haram to engage in riba-based transaction and gambling activities. It is also haram to attain the funds of others in an illegitimate manner. Shariah prohibited such activities in order to regulate economic areas. Shariah also enforced punishments over the ones who attain the funds of others in an illegitimate manner

Today, many hedging instruments are used in financial markets. Many of those instruments violate the provisions of Shariah. The most prevalent financial markets instruments in financial markets are: option and future, and swap contracts.

Under decision No. 63 (1/7) of the International Islamic Fiqh Academy, it is haram to conclude option contracts. Under decision No. 20 of the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), it is haram to conclude option and future, and swap contracts.

Derivatives aim at exchanging financial risks. In other words, they aim at transferring risks to the party who's more eligible. As for the other party, he shall dedicate all his efforts to the production process. For instance, the manufacturing company may refrain from manufacturing great amount of products due to having concerns about having fluctuations in the foreign exchange rate. It can eliminate such concerns through concluding future contracts. Such contracts shall transfer such risks to other institutions. They shall enable the manufacturing company to increase its productivity level.

However, researchers realize that conventional hedging instruments (i.e. derivatives) have become the most significant hedging instruments. In facts, conventional hedging instruments have been widely used for gambling on the difference between rates. They are not used for transferring the concerned right of ownership from one party to another. 90% of the derivatives are concluded before the due date of payment.

Due to the significance of hedging, it is necessary to identify the provisions of shariah that hedging instruments must comply with. Such provisions include the ones listed below:

-Hedging instruments must be free from any riba-related activity and Gharar. The use of such instruments mustn't lead to attaining the funds of others in an illegitimate manner.

-The form of the hedging contract must be halal

-The form of the hedging contract mustn't be drafted in a manner that leads to selling or exchanging debts. Otherwise, it shall be considered haram.

-The form of the hedging contract mustn't be drafted in a manner that leads to selling abstract rights. Therefore, the option contracts are considered haram in pursuant decision No. 63 (1/7) of the International Islamic Fiqh Academy.

- The form of the hedging contracts must be consistent with Maqasid[1]. When drafting the form of such contracts, their effect must be taken into consideration. Such effect must be consistent with the goals of shariah.

-The hedging contracts mustn't lead to ensuring the generation or the profit or the preservation of the capital.

-The hedging contracts mustn't be associated with compensation for the loss incurring from the risk

-The hedging contracts mustn't be concluded in the aim of gambling on the difference between the foreign exchange rates. They must be concluded in the aim of preserving the funds.

This section presents the shariah-based hedging instruments without shedding a light on the views of the scholars specialized in Fiqh. Such instruments are presented below:

First: Murabaha-based hedging instrument by the purchaser:

Under Shariah, it is halal for companies and individuals to use murabaha-based hedging instruments to reduce the loss incurred from foreign exchange rate-related risks. It is halal to conclude such contracts when carrying out export or import transactions. That is because a change may occur to the foreign exchange rate before the due date of payment.

Through using murabaha-based hedging instrument, forward exchange rate are listed in the sale contract. Through this instrument, the bank shall purchase the commodities

[1] Maqasid: This term refers to the goal of Shariah

from the purchaser through using the purchaser's local currency. Then, it shall sell the commodities to the importer through using the importer's local currency. Taking this measure shall contribute to reducing the loss derived from the fluctuations in the foreign exchange rate. Through this measure, the bank shall incur the loss derived from such fluctuations. It should be noted that murabaha is an effective instrument for managing risks and carrying out hedging (Al-Basheer, 2016: p. 25)

Second: Carrying out a dual hedging-murabaha-based transaction:

A company may carry out a dual hedging-murabaha-based transaction. This transaction involves two steps. Through the first step, it shall be funded in Jordanian Dinar (as an example). Through the second step, it shall invest the funds that were received through the first transaction in an investment in Dollar through adopting a forward exchange rate. In this case, it is debtor in JDs and creditor in US dollar.

This measure is considered halal. For instance, the Shariah Body of Al Bilad Bank at Saudi Arbia suggests that it's halal to carry out this measure (Al-Emrani, 2018).

Third: Hedging through binary loans:

In application for this measure, a company may be obliged to pay a liability of 1,000,000 $ after one year. In this case, it may lend the bank the required amount of money in US dollar in order to pay off the same amount to the bank after one year. In return, the bank shall lend the company the same amount in JDs, provided that the company pay off the same amount to the bank after one year (Al-Emrani, 2018).

Under shariah, this measure is halal, provided that such loans are free riba. through the eighth (1413 AH/1993 AD) and eleventh (1416 AH/ 1996 AD) conferences of (Dalet Al-Barakeh) in Jeddah, it is halal and a matter of necessity. The same is suggested by decision No. 16 of 1410 AH that was issued by Shariah body of Alrajhi Investment.

Hedging through binary loans is halal. That applies provided that the following conditions are met:

1)-No riba is involved

2)-Both contracts are linked with each other

3)-Both loans must be equivalent in terms of duration and amount of money

Fourth: Making an offer involving selling several units of a currency

There are several requirements that must be met to consider the hedging-based offer halal. Such requirements are listed below: (Al-Dawood, 2017: 262):

- The form of offer must include the date on which shall be expired. That applies in case the approval is general. However, in case the offer is linked with a specific commodity, the offer shall expire after the period through which the value of the commodity change or the commodity itself changes. In case the offer is made on a commodity which isn't valid for use currently, the approval shall not be valid. When the commodity becomes valid for use, the approval shall become valid. The ones who make the offer must be entitled to withdraw the offer before making the approval
- The one to make the approval must have the right to reject the offer. He must be entitled to refrain from entering the contract in any way.
- Approving the long-tern offer mustn't be associated with something haram (e.g. riba) (Al-Dawood, 2017: 262):

This measure is considered halal from the perspective of some shariah bodies. It is represented in making an offer. This offer is represented in selling a number of units in a specific currency. The one making the offer assumes that this currency shall experience several fluctuations in the future. When making this offer, the form of the offer includes the number of units of this currency and the foreign exchange rate. Before this offer expires, anyone can accept the offer. The one who accepts the offer shall purchase the number of the identified units in the currency that was identified. He shall purchase such units through the identified foreign exchange rate and in accordance with the identified terms and conditions (Al-Dawood, 2017)

Fifth: A pledge to convert a specific number of units in a specific currency

To avoid the foreign exchange rate-related risks, a pledge may be made to convert a specific number of units in a specific currency based on a specific forward exchange rate. Such a pledge is executed on a date in the future. On this date, the parties shall conclude a new contract. Under this contract, the delivery and receipt shall be regulated. However, this pledge mustn't be made in a compulsory manner. Otherwise, it shall be haram (Afaneh, 2018). The same is stipulated through decision No. 40 (2/5) of the International Islamic Fiqh Academy. The same is stipulated through standard No. 1/2/9 of the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI).

CONCLUSION

Through carrying out the present study, the researchers concluded the following results:

1)- Hedging aims mainly at avoiding the foreign exchange rate related- risks or reducing the severity of such risks. The hedging contracts are concluded to avoid any loss in the capital or the cash flow

2)- The fluctuations to the foreign exchange rate have a major negative impact on the institutions that carry out international business transactions.

3)-Most of the conventional external hedging instruments are inconsistent with the provisions of Shariah. Most of the conventional internal hedging instruments are consistent with the provisions of Shariah. Islamic financial institutions can use the hedging instruments that are consistent with the provisions of Shariah to avoid the foreign exchange rate related- risks

4)-The shariah-based hedging instruments are effective instruments for avoiding loss in the capital due to fluctuations in the foreign exchange rate

RECOMMENDATIONS

The researchers of the present study recommend the following:

1)- Developing effective strategies by the companies that carry out international business transactions in order to avoid the foreign exchange rate related- risks. Such strategies must enable those companies to avoid any loss in cash flow due to the undesired fluctuations to the foreign exchange rates

2)-Taking into the fluctuations to the foreign exchange rates into consideration when making decisions by the management of companies in order to avoid any potential loss in capital or cash flow

3)- Creating a department – in the companies that carry out business international transactions- that is specializسسed in the management of foreign exchange rate-related risks. That shall reduce the potential loss derived from such risks.

4)-Creating new hedging instruments in order to avoid the foreign exchange rate-related risks. Such instruments must be consistent with shariah and free from riba or any haram activity. The effects of such instruments must be also consistent with shariah

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