



HARVARD LAW SCHOOL
Islamic Legal Studies Program

and

LONDON SCHOOL OF ECONOMICS

Workshop on
*Risk
Management*

Islamic Economic and
Ethico-Legal Perspectives on
Risk Management

Thursday, February 26, 2009

London School of Economics
Tower #3, 5th Floor (BOX)
London, United Kingdom

HARVARD LAW SCHOOL
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February 26, 2009

Dear Participant:

Harvard Law School's Islamic Legal Studies Program (ILSP), in partnership with the London School of Economics (LSE), is pleased to welcome you to this workshop on risk management in Islamic finance. As the Director of the Islamic Finance Project of ILSP, I would like to express our great appreciation to the LSE for graciously hosting this important and opportune event.

After the successful conclusion of our workshop in February 2008, participants recommended that another workshop be held at LSE focusing on a different but fundamental topic responsive to specific needs in the Islamic finance industry: Islamic risk management. The current global economic crisis has added an additional level of importance to this timely subject. The Islamic finance industry needs to understand and analyze the mechanisms that may prevent such rapid market fluctuations and be able to hedge against severe loss and market instability. As with the previous workshops, the principal impetus for this event has been the need to fill the conversational void between two of the professional groups required for the success and continuity of Islamic finance: *Shari'a* scholars and Islamic economists. These workshops are not intended to arrive at any conclusions; we hope, rather, that they will serve as an avenue for all participants to freely share thoughts and opinions.

In addition to distributing a paper and circulating comments, concerns and notes among participants before the event, as in prior years, this year's workshop adds has a case study exercise to be reviewed during the workshop. Not only will we begin this discussion as a conversation and with greater depth of understanding among ourselves, we shall now have the opportunity to apply theoretical knowledge in a more practical analysis of current risk management products. We hope that, in this way, our time here may be more productive and insightful. As always, our aim is to bring our dialogue to a higher and more advanced level.

Again, I am grateful to the visionary leadership of the LSE that has supported this partnership and I am optimistic that this relationship will give rise to other productive endeavors in the future. I would also like to take this opportunity to acknowledge the kind support and encouragement of sponsors: Abu Dhabi Islamic Bank, HSBC Amanah, and Kuwait Finance House.

These workshops provide a forum for inter-disciplinary interaction of an unprecedented nature between scholars, academics, economists, and industry professionals, all of whom are confronting the dynamic and rapidly developing field of Islamic finance. Thank you for all of your suggestions and valuable input, which have shaped this present workshop. Your presence and active participation at this event is essential to its success, and we hope to see you at future events.

Sincerely,

S Nazim Ali, Ph.D.
Director, Islamic Finance Project

OVERVIEW

As a follow-up to the workshop on *sukuk* held on February 7, 2008, and on *tawarruq* on February 1, 2007, both at the LSE, the Islamic Finance Project (IFP), a venture under the auspices of the Islamic Legal Studies Program at Harvard Law School, and the London School of Economics decided to join forces once again to gather a group of influential Islamic legal scholars, economists, and bankers for a workshop on risk management, a general areas of immense current interest in Islamic finance.

The world is undergoing tremendous economic upheaval. At this critical economic crossroads, this year's workshop topic is both timely and much needed. Risk management in Islamic finance is an expansive topic as yet poorly understood. One goal of today's workshop is to conduct an in-depth examination of certain aspects of risk management within a succinct one-day timeframe. The other goal of this gathering is to further the conversation between *fuqaha* and economists begun at earlier IFP/LSE workshops.

Through a quick review and discussion of the current financial crisis, workshop participants will first elicit lessons to be learned from the crisis in the conventional risk management market. Doing so should assist participants to define what is meant by Islamic risk management, especially in the current climate. Participants will then have the opportunity to reflect on general principles of risk management in Islamic finance, what Islamic risk management attempts to achieve, and to consider the limits on speculation and speculative products in Islam.

Then, by examining case studies, participants will take apply theory to products currently on offer in Islamic finance. The results should help participants understand the key issues that practitioners should consider when analyzing such products in the future. Finally, participants are asked to discuss the future role of Islamic risk management and how it should develop in the new economic environment.

We hope that through this workshop we can develop a better understanding of risk management in theory and in practice, and of its advisability. At the same time, we hope this will enhance cross-disciplinary dialogue between experts in the field of Islamic finance.

OBJECTIVES

1. To understand what general principles apply to risk management in Islamic finance.
2. Consistent with those principles, to understand which mechanisms for risk management are allowable, preferred, disapproved, or not allowed in Islamic finance.
3. To assess the future of risk management in Islamic finance given the current market crisis.
4. To consider any suggested theoretical solutions to the issues and concerns raised, including any alternatives to risk management as currently practiced.
5. To further the conversation among the various parties present by enhancing mutual understanding and links between methodologies and approaches. Explicit attention will be given to this aspect through more concrete discussions of risk management.
6. To make specific proposals of channels and venues through which to continue this conversation, including workshops on the development of future Islamic financial products.

WORKSHOP AGENDA

8:30 a.m. Reception and Coffee

9:00 a.m. Opening Remarks by LSE Director, Sir Howard Davies

9:10 a.m. Introduction by Workshop Moderator, Professor Frank E. Vogel

Part 1: Discussion on the Current Financial Crisis and the Lessons of Conventional Risk Management

**9:15 a.m. Presentation on the Current Financial and Economic Crisis within the
Conventional Markets –**
LSE Professor of European Political Economy, Willem H. Buiter

- What are the primary factors behind the crisis?
- What lessons can be learned from this crisis?
- How will risk management change as a result?

9:30 a.m. Participants' Views

Opportunity for each participant to share views on the crisis, especially on the above three questions.

Part 2: Definitions and Principles of Islamic Risk Management

**10:45 a.m. Presentation on definitions and principles of risk management in Islamic
finance**

11:00 a.m. Tea/Coffee Break

Discussion on Islamic Risk Management

11:15 a.m. **Open floor discussion – Participants to discuss each of the following questions:**

- What does risk management attempt to achieve within the Islamic financial framework and how does this differ from its conventional counterparts?
- What do classical legal norms and rulings tell us about the general principles that should govern the objectives and practices of risk management in Islamic finance?
- Is the distinction between risk-sharing and risk-shifting useful and important?
- How to balance the equation: “Risk management for one is speculation for the other”; clarifying the boundaries of speculation.

12:45 p.m.

Lunch

Part 3: Features and Tools of Risk Management

1:30 p.m. **Summary** - Frank E. Vogel to provide a summary of all points of view

1:40 p.m. **Case studies: Discusses responses to the questions raised.**

- Case study of hedging mechanisms used in risk management in Islamic finance: Profit Rate Swaps, Currency Rate Hedges, Total Return Swaps, and Options (*Arboon*).
- Do these products conform to the principles and objectives of risk management in Islamic finance as discussed above?
- What is the economic impact of these products?

2:00 p.m. **Open floor discussion – Structural Concerns and Documentation**

Opportunity for participants to share and discuss the results of the case studies as well as the above questions.

3:00 p.m.

Tea/Coffee Break

3:15 p.m. **Summary** - Frank E. Vogel to provide a summary of all the points of view

Part 4: The Future of Risk Management

3:20 p.m. Open floor discussion – the future of risk management

Participants to discuss—and, where possible, reach consensus on—the following questions:

- How might the current financial crisis reshape the concept of risk management in Islamic finance?
- What new transactional tools or mechanisms should be developed?
- What institutional or regulatory arrangements would be desirable?
- What trends and issues are we likely to see in the next five to ten years?

Part 5: Future Workshops

4:30 p.m. Action Plan – Participants to assist Frank E. Vogel in drafting a workshop summary and suggesting solutions.

- To compose a working draft of this workshop to be distributed to all parties after the workshop, highlighting areas for future discussion.
- To vote on the next workshop topic.

5:30 p.m. End of Workshop

5:30 p.m. Reception

6:30 p.m. Public Lecture

6:30 p.m. Venue: LSE – Hong Kong Theatre, Clement House

Workshop participants are invited to the LSE Public Event on Islamic Finance given by UK Economic Secretary Ian Pearson and Shaykh Esam Ishaq.

8:00 p.m. End of Public Lecture

WORKSHOP PARTICIPANTS

Habib Ahmed, Sharjah Chair in Islamic Law and Finance, Durham University
Ijlal Alvi, Chief Executive Officer, International Islamic Financial Market, Manama, Kingdom of Bahrain
Saud Ammari, Minister Plenipotentiary & Head of Legal Affairs, Royal Embassy of Saudi Arabia, London
Daud Bakr, Shari'a Supervisor, Kuala Lumpur, Malaysia
AbdulKadir Barkatulla, Shari'a Supervisor, London, United Kingdom
Sir William Blair, Professor of Law, London School of Economics, London, United Kingdom
Willem H. Buiter, Professor of European Political Economy, LSE, London, United Kingdom
Sir Ross Cranston, Centennial Professor of Law, London School of Economics, London, United Kingdom
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