

Islamic Forward Exchange Contracts as a Hedging Mechanism: An Analysis of wa'd Principle

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Abstract: Although, FX forward contract is required for hedging purposes, the issue arises of whether FX forward fulfill al-sarf ruling. The question is how to ensure that this contract is free from prohibited elements in Islam as it is needed in the context of the global economy? As FX forward involves the exchange of currency in the future, it violates the sarf requirement of spot exchange thus, incurring riba al-nasi'ah. This study therefore, seeks to examine Islamic forward exchange contracts that are structured by applying wa'd binding only to one party. This study has found that in order to make forward exchange contracts meet the condition of spot exchange of currencies, the majority of banks have adopted the principles wa'd mulzim at an early stage and the actual contract takes place or is executed on the delivery date. However, the practice of wa'd mulzim has its drawbacks as it only protects the right of banks while customers who are commonly the promissor in the contract are exposed to the risk of default. To overcome this problem, the principle of wa'dan should be explored to study its suitability and potentiality as a basis in structuring Islamic hedging products.

Key words: wa'd, wa'dan, hedging, FX forward contract, al-sarf, principle, ruling

INTRODUCTION

Development and innovation that is ever on the rise in the world of Islamic finance has proven that more and more market-players are increasingly interested in international trade. International trade not only involves the receipt and delivery of good or services from one country to another; it also concerns the receipt and delivery of payment from the import-export activities of a given country. This process would therefore involve multiple currencies from multiple nations.

Generally, import and export activities as well as the investments made using foreign currencies are financial transactions that are among those that are in the most dire need of hedging instruments due to their constant exposure to the risks of foreign exchange rates (Yahya, 2010; Clark and Ghosh, 2004). Forward exchange contracts are in fact, one of the more popular methods to manage such risks. In a conventional forward exchange contract, the bank and the customer will enter a contract at a price agreed today to exchange currencies at a specified future date. This contract goes against the laws of Syariah because both parties are contracting to exchange currencies in the future at a rate that has been agreed

upon today and this does not fulfill the principle of al-sarf that calls for spot exchange of assets in this case being currencies. In light of this, almost all Islamic financial institutions in Malaysia have begun to take initiative by applying the principle of wa'd mulzim in forward exchange contracts to ensure that the transactions that take place do not cross the borders of Syariah. The purpose of this study is to research the application of wa'd mulzim in forward exchange contracts that is currently practiced in the financial industry today. The usage of wa'd mulzim has in fact, enabled the eradication of the element of riba because wa'd is applied in the early stages of the contract and the spot exchange of currency occurs on the date of the actual contract. This study also acts as a basis for research into developing Islamic products that are more innovative and competitive.

Research problem: Import-export activities that use different currencies make the buying and selling of foreign currencies a necessity. However, forward exchange contracts contain the element of riba because in these contracts, an actual physical exchange of currency does not occur; at the time, the contract is drawn whereas Islam dictates that a currency exchange transaction must be in

accordance with the contract conditions of al-sarf, i.e., that there must be a spot exchange of currency. Forward exchange contracts involve buying and selling currency at a price agreed on today with the actual exchange taking place at a specified future date. This contradicts the basic rule in Syariah that the exchange of any assets must be performed directly or immediately. This is based on the hadith of the Prophet S.A.W.W.:

Do not sell gold for gold except when it is like for like and do not increase one over the other silver except when it is like for like and do not increase one over the other and do not sell what is away (from among do not sell silver for these) for what is ready

Gold and silver have been used as a means of currency since early documented history and it was also used during the time of the Prophet S.A.W.W. Any exchange of currency whether local or foreign must be performed or submitted directly as stated in the above mentioned hadith. This is especially so for different currencies where the exchange takes place in a unity of meeting place (majlis). This position is clearly confirmed in the saying of the Prophet S.A.W.W.:

Gold exchanged with silver is riba unless it is given and accepted at the same time (Al-Tirmidhi)

From the above hadiths, we find that in the contract for currency exchange or al-sarf, the exchange must take place directly and immediately with each party receiving the actual cash amount. Meaning that there is a need for direct hand-to-hand exchange of the currencies in sarf and if the actual exchange is delayed, riba will occur. Ibn Mundhir states that all fuqaha have agreed that a contract which is performed without fulfilling the principles of contract sarf, i.e., to leave the meeting place before a hand-to-hand exchange takes place is rendered fasid. Further, al-Nawawi also firmly states that the phrase used by the Prophet S.A.W.W., yadan bi yadin is sufficient argument for the ulama to deign the spot exchange of currencies a mandatory requirement even if they are of different types. If one of the parties delays the delivery, it is possible that the rate of one of the currencies will either decrease or increase in value as a consequence. Put simply, riba will therefore occur because one party will profit while the other will experience a loss.

Islamic hedging products are in reality still in their early stages at this point in time. Thus far, the products that have been introduced in Malaysia are solely focused

on hedging foreign exchange in a volatile exchange rate scenario. According to Asyraf Wajdi (2009), great risks are posed to the market players, especially in the context of market interest rates and currency given the market's volatile nature. Needless to say Islamic hedging products are very much needed toward this end. Since, the practice of currency exchange can be considered as a vital necessity (al-daruriyyat), it must therefore follow that such transactions are permitted in Islamic law. In order to ensure that forward exchange contracts are structured according to Islamic law, the application of wa'd principles which is flexible and straightforward may be taken into consideration. According to Dar, wa'd is defined as a promise which connotes an expression of willingness of a person on a particular subject matter. In a more practical sense, it can be explained as a commitment willingly made by one person (the promissor) to another (the promisee) to undertake a certain action beneficial to the other party (such as buy or sell a particular item).

The condition is that only one party (i.e., the promissor) is bound to the promise over a specific period of time. The salient feature of this agreement makes it a special one indeed where by it can easily be structured into derivative products. In fact, the nature of this agreement has already found its way into some Islamic-structured products which have been given a fresh makeover by several Western investment banks. However, the issue that arises in the execution of binding wa'd is the failure to protect corporate clients when the exchange rate drops as compared to the rate agreed upon in the wa'd.

Shariah's acceptance of the concept of wa'd is also not in its entirety as it only binds the one party. To overcome this weakness, the use of another, separate double wa'd (wa'dan) has been proposed. The proposal to use wa'dan that binds both parties has however been opposed by the majority of fuqaha because of its similarity to muwa'adah. As a binding muwa'adah is said to resemble an contract, the issue of riba will still exists with the use of wa'dan. Therefore, a study must be conducted to determine the position of the before.

Literature review: The involvement of Muslims in international trade has resulted in foreign exchange activities becoming an important necessity in the context of the Islamic world. Among the parties who are directly involved in foreign exchange transactions are central banks investment banks, corporate firms, brokers pension funds, hedge funds etc. Forward contract is defined as a contract between two parties to execute or perform a transaction in the future where the price is determined

based on the mutual agreement of the parties today (Doherty, 2000; Dubofsky and Miller, 2003; Bacha, 2007; Chance, 2008). In forward contracts, the exchange of goods and payment is postponed to the future and the total price depends on negotiations between the parties. Forward contracts are divided into two groups which are commodity and foreign currency exchange. The focus of this study however, is mainly on forward exchange contracts due to increasing needs to hedge against exchange rate movement in international trade activity. Hedging is one of the risk-management methods aimed at reducing risk and limiting the probability of incurring loss factored by instability of commodity prices, exchange rate or security. Hedging instruments are not just needed to reduce risk but they can also reduce cost and changes in commodity prices as well provide protection from insufferable loss (Metzger, 2009). Foreign exchange rating involves the risk of currency exchange because the exporter will expect to receive his funds or payment in foreign currency. If the foreign currency exchange rate is low, the exporter will receive less foreign currency units with the equivalent sum in ringgit and vice versa (Wan Mansor Wan Mahmood, 1993).

As an example, the receipt of dollars 3 months into the future will concern exporters more regarding the risk of the importing country's currency value dropping compared to local currency. This is because the drop in value of the foreign currency may cause loss to exporters if and when the currency received has been devalued. Hedging is also needed when importers expect to make payment in local currency in the future and want to avoid the local currency from devaluing compared to foreign currency thus, causing payments in local currency having to be made at an increased rate. This risk may either result in smaller profit or worse, loss. Therefore, hedging works to stem the loss that may be incurred by traders using different currencies.

Despite the fact forward exchange contracts are very much in need, this contract fails to fulfill the requirements of shariah because it violates the principles of al-sarf. In order to ensure that this contract complies with the shariah principle that calls for the condition of spot exchange of currency Islamic financial institutions have developed a product based on wa'd mulzim that binds one of the parties.

In brief, wa'd is a statement or notification recording a persons willingness to perform a specific action in the future. The principle of binding wa'd has been applied as a solution to foreign currency transactions that are incompulsory. The Syariah Advisory Council of Bank Negara Malaysia had decided that Islamic financial

institutions must execute their forward exchange transactions based on wa'd mulzim that binds the promissor in the contract who is liable to pay damages if he breaches his promise. However, this transaction is only allowed for the purpose of hedging (Bank Negara Malaysia, 2010). The Syariah Standard AAOIFI also states that a wa'd mulzim that binds one party is allowed in foreign exchange transactions.

However, muwa'adah that binds both parties is not allowed even for the purpose of hedging. Based on the above mentioned decision Islamic financial institutions in Malaysia began to introduce wa'd principle to be adopted in Islamic hedging mechanism. Therefore, customers will receive benefit by way of certainty regarding the cost required to perform the transaction or cash flow received, further allowing for linear management of foreign currency (Yahya, 2010).

In light of the above, the concept of wa'dan may be directly understood from the construction of wa'd where it may be concluded that the term wa'dan refers to two promises made by the parties involved in a particular deal or business. These two promises are given unilaterally by one party to another and vice versa whereby they are unrelated to each other and their respective fulfillment depends on two independent conditions (Aznan, 2008; Mohamad and Muhamad, 2010). The concept of wa'dan are shown in Fig. 1. According to Mohamad and Muhamad (2010), the main conditions or requirements to qualify two promises made by two parties as a wa'dan are:

- The two promises are unrelated to each other
- The effect of both promises are different and independent of each other

However, there also exists situations where a wa'dan can result in two promises having the same effect Fig. 2. From the Fig. 2, we find that the same effect will be achieved by the two agreements which is that the sale and purchase transaction of a computer will be conducted on 1 April, 2011. In this case, a wa'dan that has the same effect at the end of this transaction gives rise to the issue of it resembling an contract. If a wa'dan resembles or is akin to an contract, the occurrence of riba will take place if it is applied in an forward exchange contract.

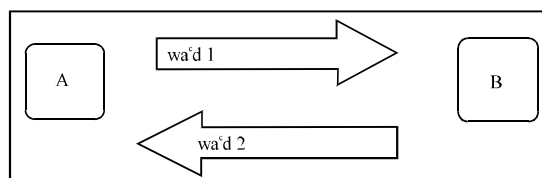


Fig. 1: The wa'dan process

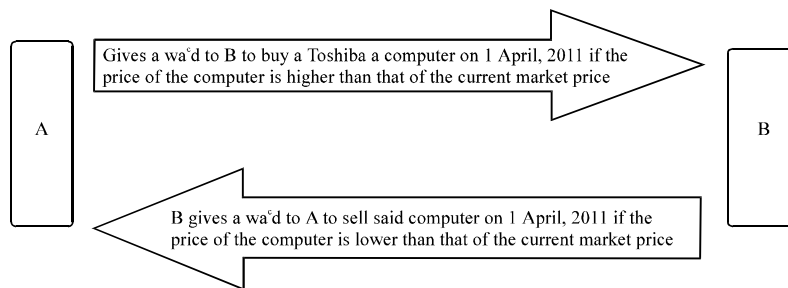


Fig. 2: wa'dan that gives the same effect

MATERIALS AND METHODS

The use of wa'd in Islamic forward exchange contracts: In Islamic forward exchange contracts, the only principle permitted to be used is that of a unilateral binding wa'd. The implication is that in the reality of today's market, only corporate clients (who may be exporters or importers of goods) will make a promise to the bank to buy or sell foreign currency from or to it at a pre-determined rate on a specific future date. The first stage in this process involves the offer of a wa'd from the customer to the bank to perform a spot exchange transaction for the type of currency requested at a future date based on a mutually pre-agreed exchange rate. So, if the date of when this stage takes place is 4 April, 2011 which is shown in Fig. 3. Therefore on the date of maturity, i.e., 3 July, 2011 if the exchange rate from US\$ to RM on the said date increases to 3.40, the bank will exercise its right (based on the mutually agreed wa'd) to buy US currency at the rate of 3.30 as agreed upon in the wa'd. The details of the contract al-sarf in this transaction are shown in Fig. 4. The corporate client will pay US\$2.0 million and the bank will pay RM6.6 million.

An interview conducted with Muhammad Fairuz discussed the procedure from a documentation perspective. For example at the first stage, i.e., on 4 April, 2011, the primary agreement is signed once the contract is defined or determined. The bank will then auto-fax a promise to sell form to the client where the client will subsequently sign the form and return it to the bank after which the bank will then confirm the promise to buy. The next stage which takes place on 1 July 2011 (i.e., 2 days before the date of maturity), the bank will auto-fax a contract to sell to the client which he will sign and give back to the bank. Finally, the bank will issue a receipt of order and on 3 July, 2011, an exchange (sale and purchase) of currency will take place.

This means that on the date of maturity, the principle of contract al-sarf is applied when the client and the bank perform a spot-on currency exchange transaction for the

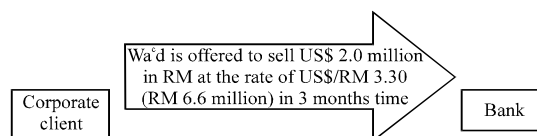


Fig. 3: Wa'd of offer to perform a spot exchange transaction



Fig. 4: Contract al-sarf

type of currency requested according to the mutually agreed rate at the time of performance of the wa'd. With this information, the transaction described above is in line with the Islamic principles of muamalat because there is no element of riba present.

The element of riba may be disposed of with the pre-application of wa'd after which the actual contract involving spot-on currency exchange can take place. The application of a unilateral wa'd as described in the illustration above basically only binds the corporate client.

The bank is not responsible for exercising its right under the wa'd that was previously made if the current exchange rate is lower than that agreed upon (say the current rate is 3.20 compared to 3.30) because the performance of the said agreement will cause a loss of RM200,000 to the bank $[(US\$2.0 \times 3.30) - (US\$2.0 \times 3.20)]$. Should the bank decide to not conclude the transaction as promised, the corporate client has no right to request the bank to fulfill its responsibility based on the wa'd?

In reality however, the bank will continue with the agreed transaction to protect its reputation and to not put at risk its name and image for the sake of a considerably small loss. Despite there not being the possibility of the bank breaching the wa'd, the fact that the application of

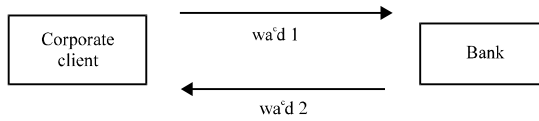


Fig. 5: Proposal for the application of wa'dan

wa'd which only binds one party is not getting attention by corporate customers. This is due simply to the fact that in principle, it is still unsuitable for application in the context of current financial markets, considering that both parties should be bound by the agreement they have entered into. Seeing that wa'd is incapable of protecting the rights and interests of the corporate client, the use of wa'dan is therefore proposed (Aznan, 2008; Mohamad and Muhamad, 2010).

wa'dan or two wa'ds as it is literally defined is potential to be applied in forward transactions and must be performed separately. The first wa'd is from the corporate client to the bank. It is important to note that an additional clause to the conditions of performance of the wa'd has been included to state that the corporate client will sell USD for RM if the exchange rate is higher than that previously agreed upon.

The second wa'd is from the bank to the corporate client stating that the bank promises to buy US\$ for RM on a future date at a pre-determined rate. A clause regarding the conditions of performance of wa'd stating that the bank will buy US\$ for RM if the exchange rate is less than or equivalent to the agreed rate will be included. The following is a proposal for the application of wa'dan as given by Aznan (2008) and Mohamad and Muhamad (2010) (Fig. 5).

Details of wa'd 1: The corporate client promises to the bank to sell US\$2.0 million for RM at the exchange rate of US\$/RM 3.30 (i.e., RM 6.6 million) within the duration of one year if the exchange rate for US\$/RM is >3.30 .

Details of wa'd 2: The bank promises to the corporate client to sell US\$2.0 million for RM at the exchange rate of US\$/RM 3.30 (amounting to 6.6 million) within the period of 1 year if the exchange rate is <3.30 . On the date of maturity 3, July 2011, there are 3 probable situations:

Situation 1: If the exchange rate US\$/RM is >3.30 (say, 3.40). In this situation, the bank will exercise its right (based on wa'd 1) to buy the US\$ for RM at the exchange rate of 3.30 as agreed upon in the wa'd because it is less compared to buying them on the open market at the rate of 3.40.

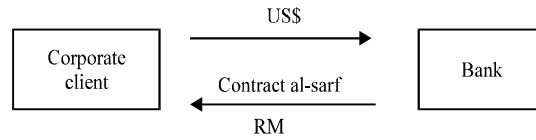


Fig. 6: Transaction process of the contract al-sarf

Situation 2: If the exchange rate for US\$/RM is <3.30 (say, 3.20), the corporate client will then exercise his right based on wa'd 2 to sell US\$ for RM at the exchange rate of 3.30 as agreed in the wa'd because the corporate client will receive more in RM compared to selling in the open market at the exchange rate of 3.20.

Situation 3 if the exchange rate of US\$/RM is at 3.30: If the exchange rate is the same, the corporate client may either exercise his right (based on wa'd 2) or he may sell US\$ on the open market because the current exchange rate is the same as in the wa'd.

Transaction details of the contract al-sarf: The corporate client will pay US\$2.0 million and the bank will pay RM 6.6 million (Fig. 6). The use of two separate wa'd, i.e., one party performs a wa'd to sell while the other performs a wa'd to buy as depicted in the above illustration gives rise to the issue of a wa'dan that resembles a contract. This is because despite the fact that the conditions are different, the result of both conditions are the same. The application of wa'dan which binds one party that promises to sell and the other that promises to buy may be considered the same as a contract. If the said wa'dan resembles a contract, the occurrence of riba will take place in that particular foreign exchange transaction because it does not fulfill the conditions of contract al-sarf. In relation to the before in order to avoid the issue of wa'dan resembling a contract from arising, the wa'dan may be performed in the following process:

On 4 April, 2011: The corporate client enters a wa'd to sell US\$20 million to the bank in 3 months time. At the same time, the bank will also enter a wa'd to sell RM 6.6 million to the corporate client in three months time. Next, on 1 July 2011 which is 2 days before the date of maturity, the corporate client will offer a contract to sell US\$20 million and the bank will offer a contract to sell RM 6.6 million. This offer and acceptance shows that the contract has taken place on that date.

About 2 days later on 3 July, 2011, an exchange of currency will take place. The MPS of Bank Negara Malaysia decided that the solution for spot exchange currency transactions made on T+2 is permitted

because the currency exchange will take 48 h or 2 days (Bank Negara Malaysia, 2010). This transaction enables the avoidance of the element of riba because this wa'dan process only involves the promise to sell by both parties, therefore not resembling an contract. The contract itself only occurs on the date of maturity which is the actual day when the currency exchange takes place (Syed Alwi in 27 May, 2011).

RESULTS AND DISCUSSION

After discussing the current application of hedging products in Malaysia's Islamic financial industry, it is clear that wa'd is the most popular principle to be adopted in hedging products. wa'd has also become a suitable avenue for Islamic financial products to compete with and replicate conventional financial products. Despite the fact that its implementation may give rise to some difficulties in terms of documentation by adding to the literal heap of existing research, the reality is that the application of wa'd has succeeded in increasing the competitiveness of Islamic banking products which are fundamentally different from conventional banking products.

In the context of hedging even though, the concept of other principles such as murabahah or tawarruq commodities have been applied in hedging products, the necessity of using the murabahah commodity principle that involves the issue of tawarruq munazzam has been challenged by the fuqaha. The murabahah commodity principle also involves high cost caused by the payment of a commission to a broker.

Therefore, it is only the wa'd principle that is broad enough and suitable enough for application in forward exchange contracts for the purpose of hedging. The wa'd that is applied must also be mulzim in order to guarantee the economy's stability. Moreover, the application of wa'd in forward contracts are no longer an issue because of the occurrence of al-taqabud which fulfills the condition of contract al-sarf.

However, one issue that requires further study is the application of wa'd that only provides protection to the bank whereas the rights of the promissor (usually the corporate client) is left unprotected. wa'd also renders the client responsible to either fulfill his promise or pay damages if the bank suffers loss as a result of the client's failure to fulfill the said promise. Based on this, Shamsiah opined in an interview conducted with her that the application of wa'dan gives more of a guarantee for fairness and can achieve maqasid al-syari'ah because both parties will receive protection when the agreement binds both the contracting parties. According to Dar, the intersecting promises made by the 2 parties are

considered as binding upon both of them, therefore is also considered to be a contract with no right of khiyar given to either the promissor or promisee. Even so, certain alterations to several aspects of the agreement may help in forming unilateral agreements that may be applied in structuring in line with incentives found in optional products forward business transactions and derivatives. Despite bilateral agreements being permitted in syarak, they are not considered as binding in most transactions that are performed either by delaying the payment or postponing the delivery of the goods which are the subject of the transaction.

However, the validity of the application of wa'dan is argued by the majority of the fuqaha because of the resemblance to muwa'adah which bears similarity to contract. Therefore, the issue that requires resolution is whether or not the two conditions in a wa'dan have truly created two separate and independent wa'd. Aznan (2008) is of the view that 2 different conditions that lead to 2 different results satisfies the requirements of wa'dan. However, a wa'dan in which the results are the same requires further research before permitting any sort of recommendation. The concern is that the conditions were created simply to avoid the contract from falling into the category of muwa'adah that is not permitted by most of the fuqaha today.

In addition, according to the Syariah Resolution in Islamic financing, the exchange of foreign currency via promises that bind both parties (muwa'adah mulzimah) is not permitted because of its resemblance to the contract of buying and selling (Bank Negara Malaysia, 2010). In fact, Aznan (2008) is of the view that the practice of sale and purchase undertaking in the the publication of sukuk in Malaysia seems to be rather careless due to the clause bearing closer resemblance to muwa'adah and not wa'd. Aznan also states that there are no clear articles that allow for the application of wa'dan in the same vein, there are also no articles on how wa'dan should not be applied.

Seeing that there is a lack of clear arguments against the application of wa'dan, the concept therefore has potential for development and application in Islamic financial products particularly Islamic hedging products. Based on the illustration of the application of wa'dan that was shown previously, it was shown that even though, the two separate wa'ds given have different conditions, the fact of the matter is they lead to the same result which is that on the date of maturity (for example, 3 July, 2011), a contract of sale will take place with a specific price. The application of wa'd must be structured in order to fulfill the principle of wa'd as outlined by the Islamic Fikah Academy. Therefore, the wa'd that is applied must be unilateral and possess different conditions to avoid it

Table 1: The differences between wa'd (wa'dan) and contract

| Different aspects | wa'dan | Contract |
|-----------------------|--|--|
| Pronouncement | Involves future events | Must occur now |
| Contract performance | The contract is not yet executed, merely an understanding or binding agreement. The real contract will take place later on an agreed date with a compulsory pronouncement of ijab and qabul | The actual contract has taken place at the time of the contract with a pronouncement of ijab and qabul |
| Delivery of goods | There is no delivery of goods because the contract has not been performed. It will only be performed on the date agreed based on the ijab and qabul | Goods are delivered at the time of the contract |
| Liability | There is no liability upon the buyer to pay the price (daynan fi al-zimmah) | The buyer is liable to pay the price in case the price not been paid |
| Implication | No debts are created because the contract has not yet occurred. This situation arises because ownership of the goods do not transfer to the buyer and the price of the goods is not considered as debt | If the buyer has not yet paid the price, the laws relating to debt thus apply |
| Transfer of ownership | The goods in question have not yet transferred in ownership to the other party | When the contract has taken place, the goods have transferred in ownership |

from becoming a bilateral wa'd that resembles a contract. Dar is of the opinion that if makes a unilateral promise to buy shares (s) from another party at a specified time in the future (D1) at a specific price and also makes a unilateral promise to sell shares (s) to at another specified time in the future (D2) at a specific price, the 2 simultaneous promises do not form bilateral promises because the both of them state 2 different dates for performance of the contract.

The situation remains as such if all aspects of the 2 promises are the same but with different prices therefore, they are still considered to be two separate promises. However, despite the conditions in the wa'dan being different, the transaction that takes place will still lead to the same effect. A wa'dan that provides the same effect is often equated with an contract, despite both having obvious discrepancies. This is because both the contract and the wa'dan differ from the aspect of the statement of ijab and qabul. In other words, the pronouncement in wa'dan cannot lead to the formation of a contract.

Generally, wa'd is not only the completing principle in structuring Islamic financial products but as a basis in determining its validity. Despite wa'd not being applicable on its own to form a contract, a wa'd must be packaged together with other principles, therefore excluding it from being similar to a contract. wa'd merely refers to a unilateral promise made by one party to another to perform a specific action such as a promise to buy or sell whereas contract means that related to a statement or similar action between one party who makes an contract to another according to syarak that effects the subject of the contract. With this, it is clear that the basic difference between an contract and a promise is that an contract forms a direct obligation or in other words forms an implication just by the existence of willingness and a valid sighthah from both parties.

On the other hand, a promise merely contains a statement or notice to create a responsibility at a particular time in the future. A summary of the differences

between wa'd and contract is shown in Table 1. Based on the schedule, it is clear that wa'dan cannot be equated with a contract. Therefore, the principle of wa'dan may be further explored to enable it to be structured into forward exchange contracts and subsequently develop hedging products that are more innovative and sophisticated. The reason is because protection of both contracting parties is very important to guarantee that the objectives of shariah are maintained. In the context of hedging not only is the purpose of asset-protection a primary concern but the protection of the rights of both parties must also be stressed. Forward exchange hedging is extremely necessary for individuals and financial institutions involved in using different currencies. This is because they will be constantly exposed to the risks of foreign currency exchange, the fluctuations in which may cause loss to them. For now, the alternative to the conventional forward exchange contract is the Islamic forward exchange contract that applies the concept of wa'd which is where one of the parties promises to buy or sell currency based on an agreed exchange rate. In Islamic forward exchange contracts that involve the application of wa'd, the actual transaction only takes place on the date of maturity whereas the wa'd itself takes place only during the early stage.

CONCLUSION

Based on the before discussion, it is clear that the application of wa'd is a necessity in structuring hedging products for forward exchange transactions because importers and exporters must protect their assets from volatile exchange rates that may cause loss. However, forward exchange transactions are prohibited in Islam because they do not comply with the conditions of al-sarf. Therefore, importers or exporters may enter a forward exchange contract based on a previous promise and later exchange the currency on a mutually agreed date. The application of the wa'd principle in Islamic forward exchange contracts prove that innovation and extensive

research have been conducted to free Muslims from transactions based on *riba*. In allowing for the application of *wa'd*, scholars of Islam are of the opinion that it is the best alternative for the time being without denying the possibility of the existence of a better instrument in the future. The next suggested research is exploration of the application of *wa'dan* because of its vast potential for development in the structuring of shariah-compliant hedging products. Because of the fact that forward exchange business is also a necessity in transactions between corporate clients, the application of *wa'dan* can be said to be of great importance. The reason for this is the fact that corporate clients require protection from breach of contract more than in a transaction conducted between a bank and its corporate customer. The bank will essentially not breach an agreement despite their performance of the contract being detrimental to it. However, a foreign exchange transaction between corporations is in dire need of protection from the failure of one of the parties to fulfill the *wa'd* they have made.

RECOMMENDATIONS

As the result on the potential of the application of *wa'dan* is required so that hedging products are able to make *maqasid al-syariah* a reality. In other words, the unique challenge that must be faced in developing Islamic hedging products is not only to produce shariah-compliant final product but the said product must also be able to protect the needs of all the contracting parties.

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