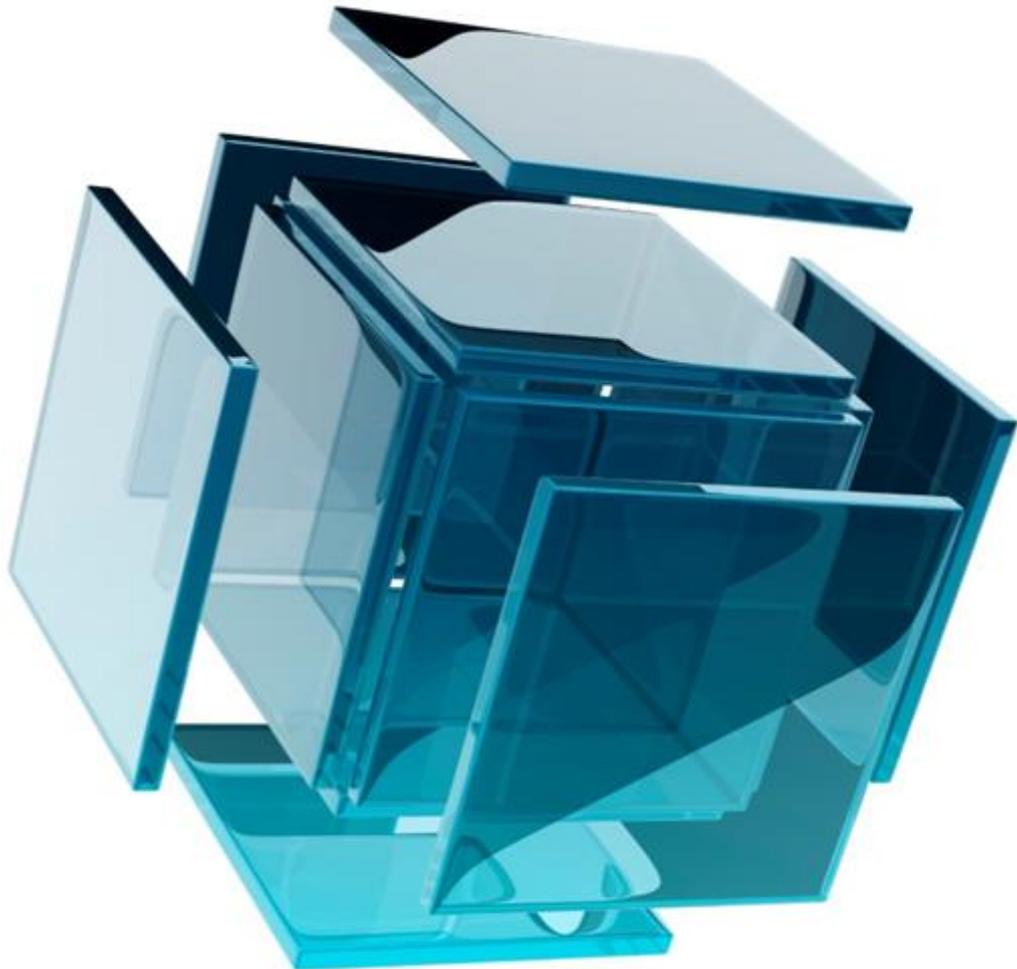


# ALLEN & OVERY



## New product documentation for Islamic Foreign Exchange Forwards

6 June 2016

## Today marks a further step in the development of standardised documentation for the Islamic finance industry with the publication by the International Swaps and Derivatives Association, Inc. (ISDA) and the International Islamic Financial Market (IIFM) of template documentation for Islamic Foreign Exchange Forwards (*Wiqayah Min Taqallub As'aar Assarf*) designed to be used with the ISDA/IIFM *Tahawwut* Master Agreement

The ISDA/IIFM *Tahawwut* Master Agreement (“**TMA**”) was published in early 2010. The publication today of template documentation for Islamic Foreign Exchange Forwards (“**IFX Forward**”) marks another milestone for ISDA and IIFM in meeting the needs identified by market participants with respect to FX transactions.

ISDA and IIFM have published template master terms and conditions (the “**Master Terms and Conditions**”) to be used to document IFX Forwards under the TMA. This briefing explains the Islamic structures used and sets out the key features of these templates.

Two sets of IFX Forward templates have been published, as follows:

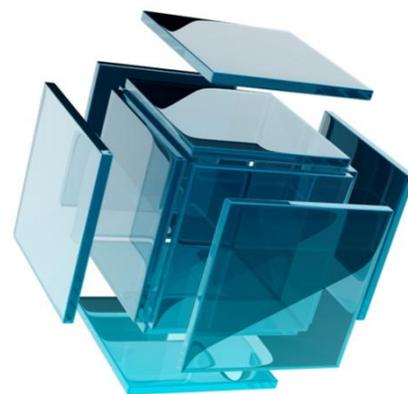
- One set of IFX Forward templates based on the two unilateral *Wa'ad* based structure (the “**Two Wa'ad Structure**”); and
- Another set of IFX Forward templates based on the single *Wa'ad* based structure (the “**Single Wa'ad Structure**”).

Both structures are explained in further detail below.

Allen & Overy LLP acted as legal counsel to ISDA and IIFM in the preparation of the IFX Forward templates.

Copies of the IFX Forward templates (together with the TMA) can be obtained at

<http://www.isda.org/publications/isdamasteragrmnt.aspx> and [www.iifm.net](http://www.iifm.net).



## THE TMA

The IFX Forward templates are designed to be used for bilateral deliverable FX forward transactions subject to a TMA entered into between the parties. Market participants will recall that the TMA is a master agreement that contains the general terms and conditions agreed between the parties and under which parties may enter into “Transactions” and/or “DFT Terms Agreements” relating to “Designated Future transactions”.

The TMA draws a distinction between “Transactions” that have been entered into between the parties and “Designated Future transactions” that will or may be entered into between the parties in the future. This is an important distinction which is key to the different close-out mechanisms which apply to these two types of arrangement.

The terms of a Designated Future transaction are provided for in a DFT Terms Agreement, which is evidenced by a “DFT Terms confirmation”. The Master Terms and Conditions of an IFX Forward, as supplemented by the relevant *Wa’ad* (Undertaking) given by the relevant party, constitute a DFT Terms confirmation for the purpose of the TMA. The Master Terms and Conditions only need to be executed by the parties at the outset of the trading relationship or at the time of entering into the first IFX Forward transaction, but the relevant Undertaking(s) relating to the IFX Forward (which will supplement the Master Terms and Conditions) will need to be executed for each IFX Forward transaction.

The terms of a Transaction are evidenced by a “Confirmation”. The Offer and Acceptance (a form of which is annexed to the Master Terms and Conditions), once executed, constitute a Confirmation for the purposes of the TMA.

A failure by the Buyer to accept the Seller’s Offer in accordance with the provisions of the Master Terms and Conditions constitutes a failure by the Buyer to enter into a Designated Future transaction when required to do so in accordance with a DFT Terms Agreement which is an Event of Default under the TMA.

## USE OF WA’ADS

The IFX Forward templates are based on the *Wa’ad* structure, as is now increasingly common in Islamic finance transactions.

A *Wa’ad* is an undertaking or promise made by one party (the Buyer) to the other party (the Seller) that, if required by the Seller (usually referred to as exercise of the undertaking or *Wa’ad* by the Seller), the Buyer will fulfil its promise in this case, to enter into a transaction under which it will buy from the Seller an amount in one currency in exchange for an amount in another currency on the relevant settlement date.

The *Wa’ad*(s) (Undertaking(s)) will need to be entered into with respect to each IFX Forward transaction. For the Two *Wa’ad* Structure, each party needs to execute a *Wa’ad* (Undertaking). For the Single *Wa’ad* Structure, only one party needs to execute a *Wa’ad* (Undertaking).

If and when the relevant *Wa’ad* (Undertaking) is exercised by the Seller on an Exercise Date (by the Seller sending an Exercise Notice), the Buyer is required to purchase a specified amount of one currency in exchange for a specified amount of another currency. The Buyer and Seller will confirm the terms of such sale by executing an Offer and Acceptance.

The mechanics of the sale and purchase are set out in Part 3 of each template Master Terms and Conditions. Forms of Undertaking(s), Exercise Notice and Offer and Acceptance are annexed to the Master Terms and Conditions.

## TWO WA’AD STRUCTURE

The Two *Wa’ad* Structure anticipates that each party will grant a *Wa’ad* (Undertaking) to the other party. It is envisaged that under each Undertaking one party (the Buyer of the relevant currency) gives a *Wa’ad* (Undertaking) to the other party (the Seller of the relevant currency) under which the Seller may, if the specified condition (the “**Exercise Condition**”) set out in the Undertaking is satisfied, exercise the Buyer’s Undertaking, therefore requiring the Buyer to purchase from the Seller one currency in exchange for another currency. Each Undertaking will be exercisable only if the relevant Exercise Condition is satisfied. The respective Exercise Conditions are such that, if the Exercise Condition under one Undertaking is satisfied

then the Exercise Condition under the other Undertaking will not be satisfied, so that only one of the Buyer's or Seller's Undertaking will be exercisable. The Exercise Condition in respect of Party A's Undertaking is satisfied in respect of the Exercise Date if the Spot Rate on the Exercise Date is **less than or equal to** the Forward Rate. The Exercise Condition in respect of Party B's Undertaking is satisfied in respect of the Exercise Date if the Forward Rate is **greater than** the Spot Rate on the Exercise Date.

The IFX Forward templates relating to the Two *Wa'ad* Structure comprise of the Master Terms and Conditions

which need to be executed by the parties only once at the outset of the trading relationship or at the time of the first IFX Forward transaction. At the time of entering into each IFX Forward transaction, each party needs to grant a *Wa'ad* (Undertaking) to the other party. Forms of *Wa'ads* (Undertakings) for each party are contained in Annexes 1 and 2 to the Master Terms and Conditions.

There is a *Shari'ah* preference for the *Wa'ads* (Undertakings) of one party to be clear and distinct from, and not combined with, that of the other.



### SINGLE WA'AD STRUCTURE

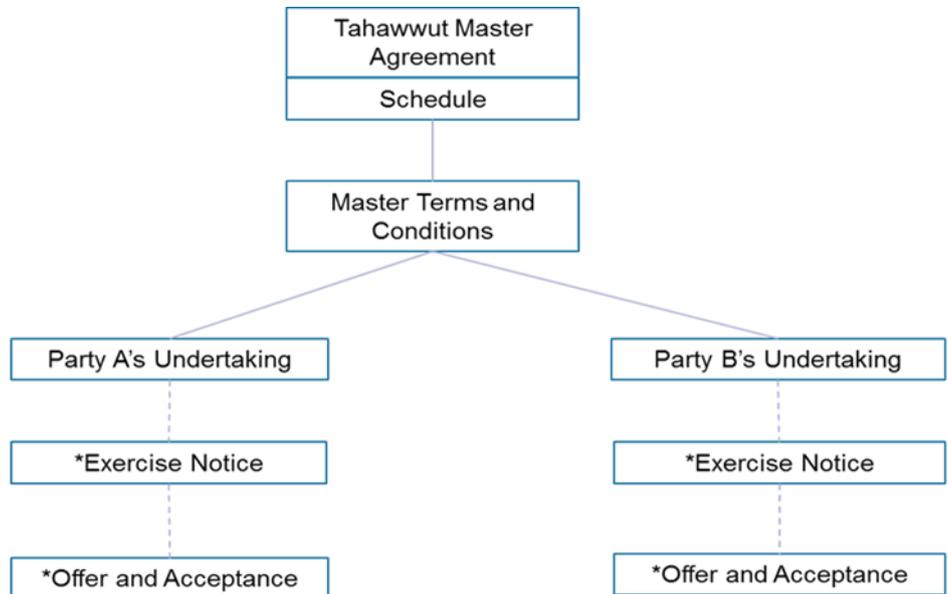
The Single *Wa'ad* Structure envisages that under the Undertaking one party (the Buyer of the relevant currency) gives a *Wa'ad* (Undertaking) to the other party (the Seller of the relevant currency) under which the Seller may exercise the Buyer's *Wa'ad* requiring the Buyer to purchase from the Seller an amount in one currency in exchange for an amount in another currency.

The IFX Forward templates relating to the Single *Wa'ad* Structure comprise of the Master Terms and Conditions which need to be executed by the parties only once at the outset of the trading relationship or at the time of the

first IFX Forward transaction. At the time of entering into each IFX Forward transaction, the Buyer needs to grant a *Wa'ad* (Undertaking) to the Seller. A form of the Undertaking is contained in Annex 1 to the Master Terms and Conditions.

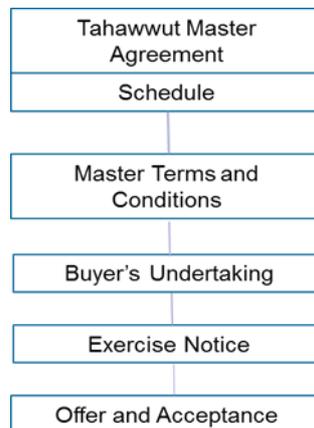
Diagrams illustrating the documentation architecture for the Two *Wa'ad* Structure and Single *Wa'ad* Structure are set out below.

## TWO WA'AD STRUCTURE DOCUMENTATION ARCHITECTURE



\*There will only be one Exercise Notice and one Offer and Acceptance under the relevant *Wa'ad* (Undertaking) that is exercised (i.e. the *Wa'ad* under which the Exercise Condition is satisfied)

## SINGLE WA'AD STRUCTURE DOCUMENTATION ARCHITECTURE



## OTHER FEATURES OF THE DFT TERMS CONFIRMATIONS

### Transaction terms

Set out below are some of the key terms relating to an IFX Forward that need to be specified in the relevant Undertaking(s) relating to the IFX Forward:

- **Buyer** is the party that undertakes to purchase an amount of the First Currency from the Seller, with the purchase price being an amount of the Second Currency.
- **Seller** is the party that will sell an amount of the First Currency to the Buyer, with the purchase price being an amount of the Second Currency.
- **Trade Date** is the date on which the parties enter into the relevant IFX Forward transaction.

- **Exercise Date** is the date on which the relevant *Wa'ad* (Undertaking) can be exercised by the Seller delivering an Exercise Notice to the Buyer.
- **Settlement Date** is the date on which the Buyer shall transfer to the Seller the Second Currency Amount of the Second Currency and the Seller shall transfer to the Buyer the First Currency Amount of the First Currency.
- **First Currency and First Currency Amount** is the currency and amount to be purchased by the Buyer. In the Two *Wa'ad* Structure, this would be the “Second Currency” and “Second Currency Amount” in the related Undertaking.
- **Second Currency and Second Currency Amount** is the currency and amount to be delivered to the Seller. In the Two *Wa'ad* Structure, this would be the “First Currency” and “First Currency Amount” in the related Undertaking.
- **Forward Rate** is the currency exchange rate to be specified in the relevant Undertaking(s). The Forward Rate in each Undertaking should be expressed as an amount of the Second Currency per one unit of the First Currency. The Forward Rate is relevant to determining whether the Exercise Condition has been satisfied. The Exercise Condition in respect of Party A’s Undertaking is satisfied in respect of the Exercise Date if the Spot Rate on the Exercise Date **is less than or equal to** the Forward Rate. The Exercise Condition in respect of Party B’s Undertaking is satisfied in respect of the Exercise Date if the Forward Rate is **greater than** the Spot Rate on the Exercise Date. The Forward Rate (and Exercise Condition) is only relevant to the Two *Wa'ad* Structure and is not used in the IFX Forward templates for the Single *Wa'ad* Structure.

### Related Undertaking

With respect to the Two *Wa'ad* Structure only, for the purposes of linking the two Undertakings which are granted by each party, each Undertaking should identify the Undertaking provided by the other party as being related to it, as a “Related Party A Undertaking” or “Related Party B Undertaking”, as applicable.

### Annexed pro-forma documents

Form(s) of Undertaking(s) are included in Annex 1 (and Annex 2 for the Two *Wa'ad* Structure) of the Master Terms and Conditions. The form of Undertaking(s) is intended to be extracted and completed by the parties on the Trade Date. For the Two *Wa'ad* Structure, each party will execute a separate Undertaking. For the Single *Wa'ad* Structure, only one party will execute an Undertaking.

A form of Exercise Notice is included in Annex 3 of the Master Terms and Conditions for the Two *Wa'ad* Structure and Annex 2 of the Master Terms and Conditions for the Single *Wa'ad* Structure. The form of Exercise Notice is intended to be extracted, completed and used by the Seller when it wishes to exercise the Buyer’s Undertaking on the Exercise Date.

A form of Offer and Acceptance (i.e. a “Confirmation” for the purposes of the TMA) is included in Annex 4 of the Master Terms and Conditions for the Two *Wa'ad* Structure and Annex 3 of the Master Terms and Conditions for the Single *Wa'ad* Structure. This form is intended to be extracted, completed and used to document entry into the relevant sale and purchase of currencies (i.e. a “Transaction” for the purposes of the TMA).

Once completed and executed, the Offer and Acceptance will constitute a Confirmation for the purposes of the TMA.

### Footnote guidance

Extensive footnotes are included throughout the template Master Terms and Conditions (including the annexes thereto) to provide guidance to the parties but these do not form part of the terms of the contract between the parties.

As a practical and drafting matter, a new clean version of the relevant template, without footnotes, will need to be created before the parties agree and finalise the relevant terms.

### Execution as a Deed

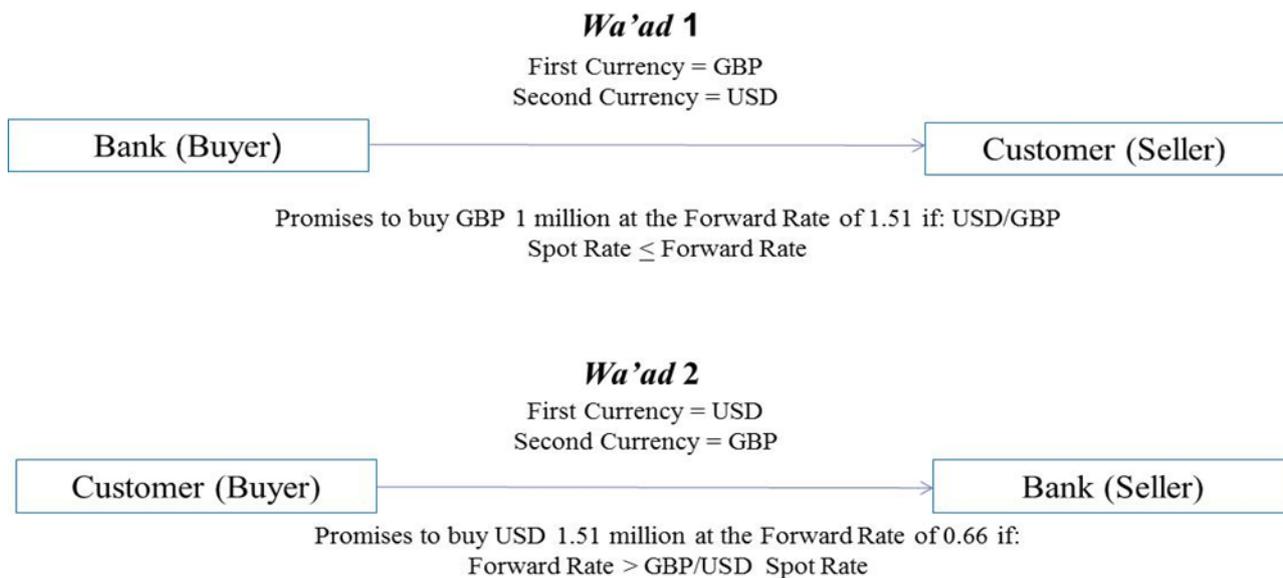
In order to comply with requirements under English law for unilateral undertakings, the usual practice in the Islamic finance market is that a *Wa'ad* (Undertaking) is evidenced or confirmed as a deed and, therefore, the IFX

Forward templates provide for the Buyer to enter into the relevant Undertaking as a deed. The parties will need to satisfy themselves as to the correct form of words to

be used in the place designated for signature by the Buyer to ensure that the relevant Undertaking is properly executed as a deed.

## PRODUCT EXAMPLES

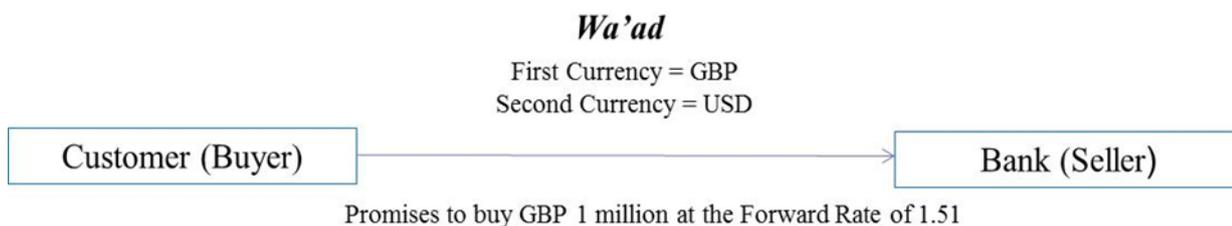
### Illustration in relation to the Two *Wa'ad* Structure



- **Scenario 1:** on the Exercise Date if USD/GBP Spot Rate is  $\leq$  1.51, the Customer exercises its rights under *Wa'ad 1*, so that on the Settlement Date, the Bank buys GBP 1 million in exchange for USD 1.51 million.

- **Scenario 2:** on the Exercise Date, if USD/GBP Spot Rate is  $>$  1.51 (i.e. Forward Rate of 0.66  $>$  GBP/USD Spot Rate), the Bank exercises its rights under *Wa'ad 2*, so that on the Settlement Date, the Customer buys USD 1.51 million for GBP 1 million.

### Illustration in relation to the Single *Wa'ad* Structure



On the Exercise Date, the Bank exercises its rights under the *Wa'ad*, so that the Customer buys GBP 1 million in exchange for USD 1.51 million. Although for *Shari'ah* related reasons the Bank is not strictly under an obligation to exercise its rights under the *Wa'ad*, given that this is an IFX Forward product the expectation is that it would do so.

## KEY CONTACTS



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