

New product documentation for *Mubadalatul Arbaah* (Profit Rate Swaps)

The recent announcement by the Government of Hong Kong of a two month consultation on proposed changes to the Hong Kong tax regime in order to promote the development of an Islamic bond market in Hong Kong is a timely reminder of the on-going development of Shari'a markets and products in Asia. A further noteworthy advance for the Islamic Finance industry involves the recent development of further standardised derivatives documentation. Please read more about the publication by the International Swaps and Derivatives Association, Inc. (ISDA) and the International Islamic Financial Market (IIFM) of template product documentation for Mubadalatul Arbaah (Profit Rate Swaps) designed to be used with the ISDA/IIFM Tahawwut Master Agreement.

Following the publication of the ISDA/IIFM *Tahawwut* Master Agreement ("TMA") in early 2010, market participants identified the need for standard Profit Rate Swap templates as being the next priority for the Islamic financial industry and, since then, ISDA and IIFM have been working towards meeting this need. Two sets of *Mubadalatul Arbaah* ("PRS") templates are now available for use. We explain below how the new PRS templates are intended to work and the ways in which they enable PRS to be structured, along with a worked example of using a PRS to hedge *Sukuk*.

1) A refresher on the TMA

To put the new templates in context, it is worth a brief refresher on the TMA.

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 Transaction are evidenced by a "Confirmation". The terms of a Designated Future transaction are provided for in a DFT Terms Agreement, which is evidenced by a "**DFT Terms c**onfirmation". (The TMA uses upper and lower case "Transactions", "transactions", "Confirmations" and "confirmations" to help distinguish between the two types of

arrangement and the manner in which

Key issues

- Profit Rate Swap templates
- *Wa'ad* leading to *Murabaha* structure
- Two different structures explained: Two Sales and Single Sale
- Features of the templates
- *Shari'ah* issues to consider
- Worked example of Islamic hedging

they are documented, and we have added underlining in the terminology above to draw attention to the distinction).

Once a Designated Future transaction is, pursuant to a DFT Terms Agreement, entered into between the parties, it becomes a "Transaction" under the TMA and should be documented using a "Confirmation".

A failure to enter into a Designated Future transaction when required to do so in accordance with a DFT Terms Agreement is an Event of Default under the TMA.

2) Two sets of template documents, two different structures for PRS

Two sets of PRS templates (four documents in total) have been published, as follows:

- one set of PRS templates that are *Wa'ad*-based (or undertaking-based) and involve a Two Sales structure ("**Two Sales Structure**")
- another set of PRS templates that are *Wa'ad*-based (or undertaking-based) and involve a Single Sale structure ("**Single Sale Structure**").

The Two Sales Structure and Single Sale Structure are explained in paragraphs 6 and 7 below.

Copies of the PRS templates (and the TMA) can be obtained at www.isda.org and www.iifm.net.

3) Two legs of a PRS

Each set of templates comprises two **DFT Terms confirmations**, one relating to the Fixed Profit Rate leg of a PRS; the other relating to the Floating Profit Rate leg of a PRS. A form of **Confirmation** is provided in Annex 2 to document the Transaction that will be entered into pursuant to the terms of each DFT Terms Agreement.

In the conventional swap market, a swap, consisting of two legs (typically,

Worked example

How the PRS templates work is best explained through an example of Islamic hedging. The blue text boxes throughout this Briefing note track the development of such an example.

Hedging liability in respect of Sukuk

Imagine that:

Party A will issue an AED 10,000,000 *Sukuk* with a 12-month tenor on 1 February 2012:

- *Sukuk* pays out a capital (or principal) amount at one year maturity and periodic (monthly) floating amounts to investors over the course of its tenor.
- A variable benchmark rate (in this case, one-month LIBOR) is used to calculate the periodic floating amount payable to investors.
- Party A is exposed to any changes in that benchmark rate. In this case, the *Sukuk* is benchmarked to one-month LIBOR, so the 12-month *Sukuk* has twelve one-month calculation periods commencing on 1 February.
- Party A wishes to hedge itself against the possibility that the benchmark rate used to calculate the periodic floating amounts will increase. By entering into the PRS, it is looking to fix its exposure in relation to the *Sukuk*.

Party B is an Islamic bank with a large fixed profit rate portfolio and, for risk management purposes, it wishes to hedge itself by converting some of its fixed profit rate exposure into floating profit rate exposure.

The PRS enables Party A to hedge its floating profit rate exposure under the *Sukuk* by converting it into a fixed profit rate exposure (i.e. Party A knows that by paying the fixed amounts to Party B, Party A will receive from Party B the floating amounts necessary to pay under the *Sukuk*). Party B was highly dependent on floating income and through the PRS is able to convert some of that into stable fixed income.

The Hedging PRS

Party A and Party B enter into a PRS on 25 January 2012 (Trade Date), under which:

- Party A will pay fixed profit rate ("**FPR**") amounts under one (FPR) leg of the PRS (and receive a floating profit rate amounts under the other leg).
- Party B will pay the floating profit rate ("**FLPR**") amounts under one (FLPR) leg of the PRS (and receive the fixed profit rate amounts under the other leg).

To achieve these payments, the parties will buy or sell *Shari'ah* compliant assets to each other pursuant to a *Murabaha* Sale to be entered into pursuant to a *Wa'ad* (or undertaking).

The PRS documentation

Party A and Party B have already entered into a TMA.

Party A and Party B enter into the PRS by way of two separate **DFT Term Agreements** (each of which is documented in a separate **DFT Terms confirmation**: one in respect of the fixed profit rate leg of the PRS, and the other in respect of the floating rate leg of the PRS).

Each DFT Terms Agreement contains a *Wa'ad* (undertaking) to enter into one or more Designated Future transactions (if the *Wa'ad* is exercised).

The DFT Terms Agreements are entered into on 25 January 2012 (Trade Date).

The PRS is to have a tenor of 12 months commencing 1 February 2012 (i.e. the date on which Party A is to issue the *Sukuk* which it is looking to hedge) so that date will be the "Effective Date" under the DFT Terms Agreement and first day of the period for which the PRS will provide Party A with the hedge. The PRS hedging period will have 12 Calculation Periods of one month each (to track the *Sukuk*).

one fixed and one floating), will be treated as a single transaction and documented by a single confirmation. In the case of a *Wa'ad*-based PRS, however, instead of using a single document for both legs, there is some *Shari'ah* preference for the *Wa'ad* (or undertaking) for each leg to be clear and distinct, and not combined with that of the other leg. Therefore, to document the PRS, two separate template DFT Terms confirmations are proposed, one for each leg.

Note that whilst the PRS templates assume that one leg of a PRS will be a floating profit rate leg and the other will be a fixed profit rate leg, there is no reason why the templates cannot be used to document two fixed profit rate legs or two floating profit rate legs of a PRS, if so required.

4) Use of *Wa'ad* leading to *Murabaha Sale*

The PRS templates use a *Wa'ad* (or undertaking) structure, as is now increasingly common in Islamic finance transactions.

A *Wa'ad* is an undertaking or promise made by one party (the Buyer of assets) to the other party (the Seller of assets) that, if required by the Seller (usually called **exercise** of the undertaking or *Wa'ad*), the Buyer will fulfil its promise, in this case, to enter into a *Murabaha* (or sale and purchase) contract under which it will buy from the Seller an agreed quantity of agreed *Shari'ah* compliant assets at an agreed price (or agreed formula for calculating a price) on the relevant exercise date.

The *Wa'ad* is contained in Paragraph 10 (*Buyer's Undertaking*) of each template DFT Terms confirmation.

If and when the Buyer's *Wa'ad* (or undertaking) is exercised by the

Worked example (continued from page 2)

Terms of the PRS (Single Sale Structure)

Fixed Profit Rate (FPR) leg	Party A is Undertaking Party/Buyer Party B is Exercising Party/Seller
Floating Profit Rate (FLPR) Leg	Party A is Exercising Party/Seller Party B is Undertaking Party/Buyer
Type of Structure	Single Sale Structure
Calculation Agent	Party A
Trade Date	25 January 2012
Effective Date	1 February 2012
Term of the PRS	12 months
Calculation Periods	12 consecutive one month periods, the first commencing on the Effective Date
Fixed Profit Rate Day Count Fraction	Actual/360 as per market convention
Floating Profit Rate Day Count Fraction	Actual/360 as per market convention
Calculation Period	1 month
Conditions Precedent	To be satisfied by Effective Date
Fixed Profit Rate (FPR)	2% per annum
Floating Profit Rate (FLPR)	LIBOR
Spread	0.5% per annum
Purchase Dates	The first date of each Calculation Period (see Timeline Example 1 in Fig. 1 below)
Payment Dates	The last date of each Calculation Period (see Timeline Example 1 in Fig. 1 below)
<i>Shari'ah</i> compliant assets	For Fixed Profit Rate leg: Copper For Floating Profit Rate leg: Zinc

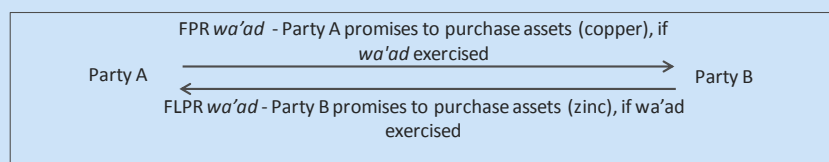
Terms of the PRS: *Wa'ad* in each leg of PRS

Each DFT Terms Agreement contains a *Wa'ad* granted by one party to the other (by "**Undertaking Party**" to "**Exercising Party**"), as illustrated in Figure A below.

- In the DFT Terms Agreement for the FPR leg, Party A is the Undertaking Party.
- In the DFT Terms Agreement for the FLPR leg, Party B is the Undertaking Party.

By its *Wa'ad*, the Undertaking Party undertakes to purchase *Shari'ah* compliant assets at an agreed price from the Exercising Party, if the Exercising Party exercises the *Wa'ad* by notice on an Exercise Date.

Fig. A: *Wa'ad* granted by each of Party A and Party B



Seller on an Exercise Date, the Buyer is required to purchase specified assets under a *Murabaha* contract with the Seller and execute a *Murabaha* Asset Sale Confirmation. A *Murabaha* Sale entered into between the parties constitutes a Transaction under the TMA.

The mechanics of the *Murabaha Sale* are set out in Paragraph 11 of each template DFT Terms confirmation, with Annex 2 providing an agreed form of *Murabaha* Asset Sale Confirmation to evidence and contain the operative provisions of the *Murabaha Sale*.

5) Timeline examples – when is the Murabaha Sale entered into?

When structuring a PRS and finalising the terms of the DFT Terms Agreements relating to that PRS, the

parties must identify when a Murabaha Sale may be entered into following the exercise of a Wa'ad. It is expected that, for each Calculation Period, the Murabaha Sale will be

required to be entered into either: (i) at the start of the Calculation Period (as shown in Figure 1 below) or (ii) at the end of the Calculation Period (as shown in Figure 2 below).

Fig. 1: Timeline Example 1 - Entry into Murabaha Sale at the start of each Calculation Period, with Purchase Date at start of Calculation Period and Payment Date at end of Calculation Period

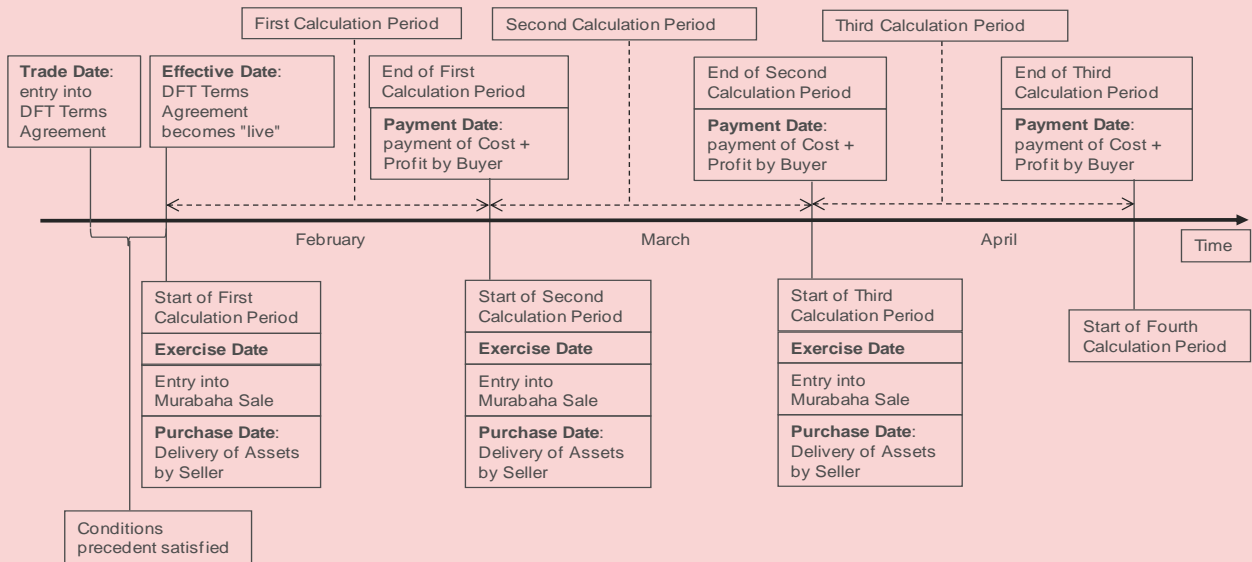
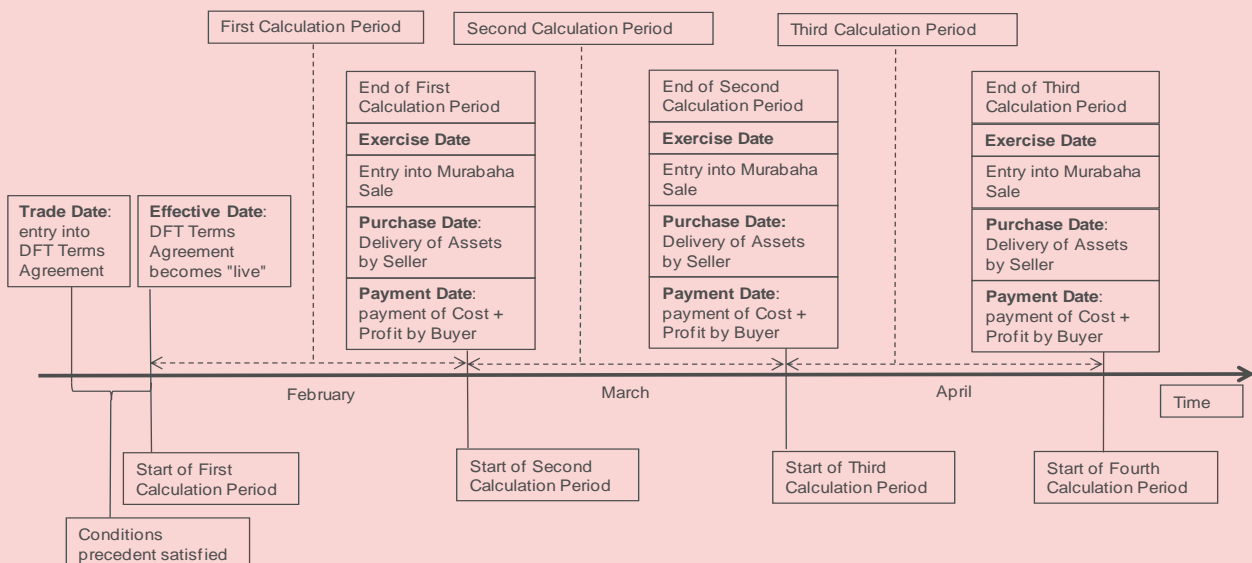


Fig. 2: Timeline Example 2 - Entry into Murabaha Sale at the end of each Calculation Period, with Purchase Date and Payment Date at end of Calculation Period



6) Two Sales Structure PRS

With a Two Sales Structure PRS, for each Calculation Period in relation to the PRS, the two *Wa'ads* set out in the DFT Terms confirmations for the Fixed Profit Rate leg and for the Floating Profit Rate leg, respectively, will be exercisable and exercised against the undertaking party (i.e. the Buyer) by the exercising party (the Seller). Therefore, **two Murabaha Sales** will be entered into between the parties; one in relation to the Fixed Profit Rate leg and one in relation to the Floating Profit Rate leg. Accordingly, there will be **two asset-flows** and **two cash-flows** between the parties in relation to each Calculation Period for the PRS. While two-way cash-flows which are matured payment obligations becoming due on the same day, in the same currency and between the same parties may be set-off against each other, the asset flows may not. Purchased assets should always be delivered.

A product description has been included in Part 1 of the relevant template DFT Terms confirmations

describing how the Two Sales Structure should work.

The overall documentary architecture for the Two Sales Structure is illustrated in Figure 3 below.

7) Single Sale Structure PRS

With a Single Sale Structure PRS, for each Calculation Period in relation to the PRS, only one of the two *Wa'ads* set out in the DFT Terms confirmations for the Fixed Profit Rate leg and for the Floating Profit Rate leg, respectively, will be exercisable against the undertaking party (i.e. the Buyer) by the exercising party (the Seller), depending on whether or not a specified condition to exercise (the **Exercise Condition**) is met in relation to a Calculation Period. The Exercise Condition is that the Profit in relation to a Calculation Period is greater than zero. The Profit is calculated by a Calculation Agent by reference to a calculation formula. Ordinarily with a fixed/floating PRS, if the Profit under one leg is positive (i.e. greater than zero) the Profit under the other leg will be negative, so leaving only one *Wa'ad* (the one with the

positive Profit) to be exercised. In respect of each Calculation Period, the Exercise Condition will be met in relation to only one leg of the PRS. Therefore, only one of the two *Wa'ads* will be exercisable, and **one Murabaha Sale** will be entered into between the parties, either in relation to the Fixed Profit Rate leg or in relation to the Floating Profit Rate leg. Accordingly, there will be only **one asset-flow** and **one cash-flow** between the parties in relation to each Calculation Period for the PRS.

Note that the Calculation Periods for each leg of a Single Sale Structure should be co-extensive (i.e. they should be of the same length and start and end on the same dates in both legs of the PRS).

A product description has been included in Part 1 of the relevant template DFT Terms confirmations describing how the Single Sale Structure should work.

The overall documentary architecture for the Single Sale Structure is illustrated in Figure 4 below.

Fig. 3: Two Sales Structure

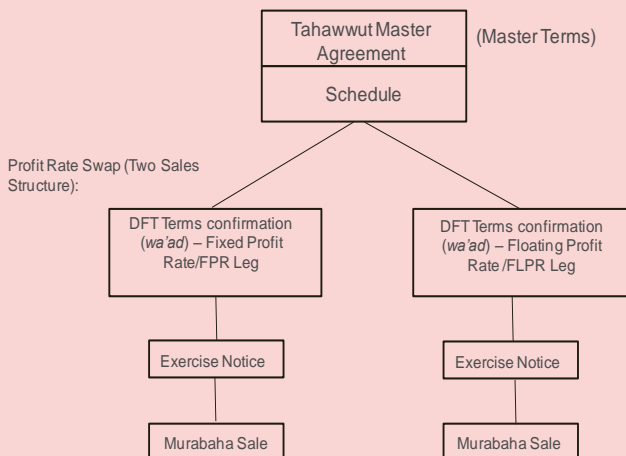
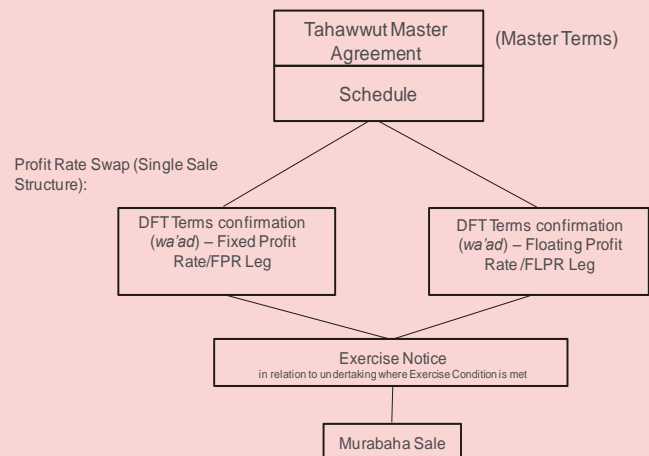


Fig. 4: Single Sale Structure



8) Features of the DFT Terms confirmations

Transaction terms

Each template DFT Terms confirmation (at Part 3) contains line items for specific agreed terms to be completed on the Trade Date (e.g. Effective Date, Business Day, Purchase Dates, Payment Dates, Buyer, Seller, etc.), as agreed between the parties upon entry into the relevant DFT Terms Agreement.

Related confirmations/legs

For the purposes of enabling payment netting (i.e. the set off of sums due on the same day and in the same currency) between the two legs of the PRS, the DFT Terms confirmation for one leg of a PRS should identify the DFT Terms confirmation for the other leg as being related to it, as a "Related DFT Terms confirmation".

Annexed pro-forma documents

A form of **Exercise Notice** is included in each DFT Terms confirmation at Annex 1. The form of Exercise Notice is intended to be extracted, completed and used by the Seller when it wishes to exercise the Buyer's *Wa'ad* (or undertaking) on an Exercise Date. This form may be used multiple times over the term of the PRS and is not to be completed upon entry into the DFT Terms Agreement.

A form of **Murabaha Asset Sale Confirmation** (i.e. a "Confirmation" for the purposes of the TMA) is included in Annex 2 of each DFT Terms confirmation. This form is intended to be extracted, completed and used to document entry into each

Worked example (continued from page 3)

Exercise of *Wa'ad*

Party A and Party B's PRS will use the Single Sale Structure and the *Murabaha* Sale will be entered into at the start of each Calculation Period with Purchase Date at the start of the Calculation Period and Payment date at the end of the Calculation Period (i.e. Timeline Example 1 (as indicated in the above table (*Terms of the PRS*)).

In the Single Sale Structure, a party may only exercise the *Wa'ad* granted to it by the Undertaking Party on an Exercise Date if the **Exercise Condition** has been met. It is possible for the Exercise Condition to be met only in relation to one of the two *Wa'ads* on any Exercise Date: the result is that only one *Wa'ad* will be exercisable in respect of the PRS.

- **If the Exercise Condition in the FPR leg of the PRS is met** (which means that it will not be met in the floating profit rate leg), the *Wa'ad* contained in the DFT Terms Agreement for the fixed profit rate leg is exercisable (and the *Wa'ad* contained in the floating profit rate leg will not be exercisable).
- **If the Exercise Condition in the FLPR leg of the PRS is met** (which means that it will not be met in the fixed profit rate leg), the *Wa'ad* contained in the DFT Terms Agreement for the floating profit rate leg is exercisable (and the *Wa'ad* contained in the fixed profit rate leg will not be exercisable).

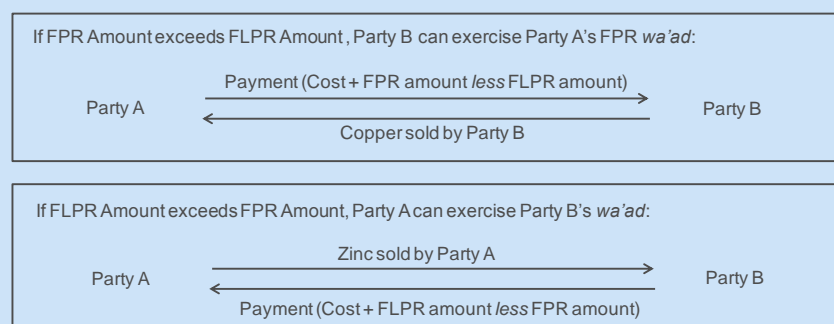
If a *Wa'ad* is exercised, the Undertaking Party must buy assets from the Exercising Party and execute a *Murabaha* Sale Confirmation evidencing the *Murabaha* Sale between the parties: there is only one *Murabaha* Sale in respect of each Exercise Date in respect of a PRS with a Single Sale Structure.

Exercise of *Wa'ad*: What is the Exercise Condition?

"The "Exercise Condition" is satisfied in respect of a Calculation Period if the Profit, as determined by the Calculation Agent in accordance with Paragraph 7, is greater than zero for that Calculation Period."
– Paragraph 5.3 of the DFT Terms confirmation

In other words, Profit in respect of that leg of the PRS for a Calculation Period must be greater than zero in order for the relevant *Wa'ad* to be exercisable, as illustrated in Figure B below.

Fig. B: Operation of the Exercise Condition



Murabaha Sale (i.e. a "Transaction" for the purposes of the TMA). This form may also be used multiple times

over the term of the PRS and is not to be completed upon entry into the DFT Terms Agreement.

Once completed and executed, the *Murabaha* Asset Sale Confirmation will constitute a Confirmation for the purposes of the TMA and the *Murabaha* Sale that it confirms will constitute a Transaction under the TMA.

Footnote guidance

Extensive footnotes are included throughout the template DFT Terms confirmations to provide guidance to the parties (in particular in respect of the some important *Shari'ah* considerations) 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 of their DFT Terms Agreement.

Shari'ah compliant assets

Only *Shari'ah* compliant assets that are suitable as the subject matter of a *Murabaha* Sale may be sold by Buyer to Seller. "**Shari'ah compliant assets**" are defined generally in Part 2 of the template DFT Terms confirmations as being "*any asset or assets which comply or are consistent with the principles of the Shari'ah and which, for Shari'ah purposes, are suitable as the subject matter of a Murabaha Sale*". (By way of example, gold is not generally regarded as constituting *Shari'ah* compliant assets for these purposes.)

To provide certainty of subject matter, the parties should agree and describe in detail the relevant assets in each DFT Terms confirmation relating to a leg of the PRS (i.e. by filling in the missing information in Part 3 of the template DFT Terms confirmation as part of the DFT Terms Agreement) and the *Murabaha* Asset Sale

Worked example (continued from page 6)

Exercise of Wa'ad: Which leg of the PRS is exercisable?

Party A and Party B have now entered into a PRS.

The **Calculation Agent determines Profit** in relation to each leg of the PRS in respect of the **first Calculation Period** to determine whether **Exercise Condition** is met and which leg of the PRS is exercisable.

Calc. 1 - FLPR leg

- Under the FLPR leg, Party A (Exercising Party) may exercise Party B's (Undertaking Party's) *Wa'ad* in respect of the first Calculation Period **if the Profit in respect of the first Calculation Period is greater than zero**

- The Calculation Agent determines Profit as follows*:

$$\text{Profit} = \{\text{Capital Amount} \times [(\text{FLPR} + \text{Spread}) \times \text{FLPR Day Count Fraction}]\} - [\text{Reference Rate Amount for FLPR}^{**}]$$

$$\text{Profit} = \{10,000,000 \times [\text{LIBOR at } 1\% + 0.5\%] \times 30 \text{ days}/360\} - \{10,000,000 \times [2\% \times 30/360]\}$$

$$\text{Profit} = \{10,000,000 \times [0.015 \times 0.0833333]\} - \{10,000,000 \times [0.02 \times 0.0833333]\}$$

$$\text{Profit} = \{10,000,000 \times 0.0012499\} - \{10,000,000 \times 0.0016666\}$$

$$\text{Profit} = 12,499.99 - 16,666.66$$

$$\text{Profit} = \text{AED } -4,166.67$$

- Therefore, **Profit is negative (AED -4,166.67)** in respect of the FLPR leg for the first Calculation Period. (The Profit element can only be positive in relation to one leg of the PRS).
- As **Profit is less than zero**, the Exercise Condition is NOT met in relation to the FLPR leg for the first Calculation Period
- Party B may NOT exercise Party A's *Wa'ad* on the Exercise Date

* This formula is set out in the DFT Terms Agreement for the FLPR leg and we are using the figures set out in the table above (*Terms of the PRS*) (with LIBOR at 1%).
 **Reference Rate Amount for FLPR* is essentially the FPR Amount calculated for the FPR leg.

Calc. 2 - FPR leg

- Under FPR leg, Party B (Exercising Party) may exercise Party A's (Undertaking Party's) *Wa'ad* in respect of the first Calculation Period **if the Profit in respect of the first Calculation Period is greater than zero**

- The Calculation Agent determines the Profit as follows*:

$$\text{Profit} = \text{Capital Amount} \times [\text{FPR} \times \text{FPR Day Count Fraction}] - [\text{Reference Rate Amount for FPR}^{**}]$$

$$\text{Profit} = \{10,000,000 \times [2\% \times 30/360]\} - \{10,000,000 \times [\text{LIBOR at } 1\% + 0.5\%] \times 30/360\}$$

$$\text{Profit} = \{10,000,000 \times [0.02 \times 0.0833333]\} - \{10,000,000 \times 0.015 \times 0.0833333\}$$

$$\text{Profit} = \{10,000,000 \times 0.0016666\} - \{10,000,000 \times 0.0012499\}$$

$$\text{Profit} = 16,666.66 - 12,499.99$$

$$\text{Profit} = \text{AED } 4,166.67$$

- Therefore, **Profit is positive (AED4,166.67)** in respect of the FPR leg for that Calculation Period
- As **Profit is greater than zero**, the Exercise Condition is met in relation to the FPR leg for the first Calculation Period
- Party B may exercise Party A's *Wa'ad* on the Exercise Date

* This formula is set out in the DFT Terms Agreement for the FPR leg and we are using the figures set out in the table above (*Terms of the PRS*) (with LIBOR at 1%).
 **Reference Rate Amount for FPR* is essentially the FLPR Amount calculated for the FLPR leg.

Confirmation. The expectation is that different types of assets will be specified in the two legs of the PRS.

Definitions

The PRS templates contain terminology that will be familiar to those with a derivatives background or knowledge of ISDA documentation. However, some new terminology has been introduced to make the document more accessible to those parties who may not have a detailed knowledge of the terminology used in the conventional derivatives market. For example, the terms "Buyer" and "Seller" are used instead of the conventional descriptions "Floating Rate Payer" and "Fixed Rate Payer" as it was felt that these terms would be more intuitive in the context of a product that is structured using Islamic asset sales.

It should be noted that the Buyer under one leg of the PRS will be the Seller under the other leg of the PRS.

Agency/brokerage

The template DFT Terms confirmations anticipate that the parties may wish to appoint an agent or broker to deliver, buy, sell or receive delivery of assets on its behalf. In these cases, the views of *Shari'ah* advisers should be sought to ensure that the use of the agent/broker and the relevant agency/brokerage procedures in the context of the particular PRS transaction do not fall foul of restrictions such as the prohibition on *Bai Al Inah*.

Worked example (continued from page 7)

Exercise of Wa'ad in Single Sale Structure: Consequences

FPR leg of PRS: In this example, Party A's *Wa'ad* to Party B **has become exercisable** in respect of the first Calculation Period. Accordingly, the expected order of events would be as follows:

- Party B exercises Party A's *Wa'ad* on the Exercise Date by notice to Party A.
- Party A and Party B **enter into a *Murabaha Sale*** (i.e. Party B sells assets to Party A).
- Party A and Party B execute a *Murabaha Sale Confirmation*.
- The *Murabaha Sale* pursuant to the FPR leg of the PRS becomes a Transaction under the TMA.

FLPR leg of PRS: In this example, Party B's *Wa'ad* to Party A has **not become exercisable** in respect of the first Calculation Period (as per Calc.1 above). Accordingly, **no *Murabaha Sale*** is transacted in respect of the first Calculation Period pursuant to the FLPR leg of the PRS.

Exercise of Wa'ad in Single Sale Structure: Murabaha Sale

Exercise of the *Wa'ad* under the FPR leg requires Party A and Party B to enter into a *Murabaha Sale*, (i.e. Party B sells **FLP Assets** to Party A at a purchase price consisting of **Cost Price + Profit**).

Delivery of assets: Party B (the Seller) delivers the **FLP Assets (copper)** to Party A on the **Purchase Date**, which, in this example, falls at the start of the each Calculation Period (see *Timeline Example 1 in Fig. 1 above*).

Payment of purchase price: Party A (the Buyer) pays the deferred purchase price of **Cost + Profit** on the **Payment Date**, which, in this example, falls at the end of the each Calculation Period (see *Timeline Example 1 in Fig. 1 above*).

- **Cost Price** is the cost of the FPR Assets (copper) to the Seller.
- **Profit** is determined by reference to the differential payment of the FPR Amount and the FLPR Amount.
- In this example, **Profit** is the *difference* between (1) the FPR Amount calculated for the FPR leg of the PRS and (2) the Reference Rate Amount (which corresponds to the FLPR Amount calculated for the FLPR leg), i.e.:

$$\text{Profit} = \text{Capital Amount} \times [\text{FPR} \times \text{FPR Day Count Fraction}] - [\text{Reference Rate Amount for FPR}]$$

- In this example, **Profit payable** by Party A in respect of the first Calculation Period is the positive amount (**AED4,166.67**) calculated above in Calc. 2 (in determining whether Exercise Condition is met).

Execution as a Deed

The usual practice in the Islamic finance market is that a *Wa'ad* (or undertaking) is evidenced or confirmed using a deed and, therefore, the DFT Terms confirmations provide for the Buyer to enter into a DFT Terms Agreement as a deed. The parties will need to satisfy themselves as to the correct form of execution block to be used by the Buyer to ensure that the DFT Terms Agreement is properly executed as a deed.

9) Shari'ah approval

While IIFM's *Shari'ah* Board has approved the PRS templates after extensive consideration, it is always the responsibility of each of the parties entering to the PRS to ensure that, to the extent that *Shari'ah* compliance is relevant to its dealings and corporate governance, its use of the documents in the context of the transactions which it enters into satisfies its own *Shari'ah* advisers that the relevant hedging transaction is *Shari'ah* compliant and that the documents are suitable for, and are being used appropriately in, the context of that particular hedging transaction.

Clifford Chance acted as legal counsel to ISDA and IIFM in the preparation of the TMA and the PRS templates.

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