Islamic FX definition

Islamic Foreign Exchange (IFX) is a contract that is designed as a hedging mechanism to minimize market participants’ exposure to market currency exchange rates which is volatile and fluctuating.

IIFM/ISDA IFX standard templates are based on Wa‘ad (undertaking) structure

The IIFM IFX Forward templates are based on the Wa‘ad structure. A Wa‘ad in this case is an undertaking / promise made by one party (the Buyer) to the other party (the Seller) that, if required by the Seller (usually called exercise of the Wa‘ad or undertaking), the Buyer will fulfil its promise, in this case, to enter into a transaction under which it will buy from the Seller one currency in exchange for another currency on the relevant settlement date.

The Wa‘ad will need to be entered into with respect to each IFX Forward transaction. For the two unilateral and independent Wa‘ad structure, each party needs to execute a Wa‘ad. For the single binding Wa‘ad Structure, only one party needs to execute a Wa‘ad.

If and when the relevant Wa‘ad is exercised by the Seller on the relevant 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 IFX Master Terms and Conditions. Forms of Undertaking(s), Exercise Notice and Offer and Acceptance are annexed to the IFX Master Terms and Conditions.

IIFM IFX Forward Structures

IIFM has worked on two structures which are commonly used in the market for Shari‘ah compliant IFX hedging arrangements namely:

1- Two unilateral and Independent Wa‘ad based structure.

2- Single Binding Wa‘ad based structure.
Structure 1

Two unilateral and Independent *Wa‘ad*

Documentation architecture/structure

Tahawwut Master Agreement (including the Schedule thereto)

IFX Master Terms and Conditions

Party A’s Undertaking* 

*Exercise Notice

*Offer and Acceptance

Party B’s Undertaking* 

*Exercise Notice

*Offer and Acceptance

*The beneficiary of the relevant Undertaking will acknowledge the Undertaking.

*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).

Explanation of documentation process and structure

Parties to this transaction will enter into the ISDA/IIFM Tahawwut Master Agreement (TMA). The parties will agree on the commercial terms of the foreign exchange transaction, such as the currency, purchase price, current spot exchange rate, etc. These terms are documented under the IFM IFX Master Terms and Conditions Confirmations/Templates which supplements the ISDA/IIFM TMA Master
Agreement. There will be two Master Terms and Conditions Confirmations/Templates one which documents Party A’s undertaking and another which documents Party B’s undertaking. **Below is the detailed explanation:**

1. The parties execute the IFX Master Terms and Conditions only once at the outset of the trading relationship or at the time of the first IFX Forward transaction.

2. In respect of an IFX Forward transaction, Party A, the Undertaking provider, will send an Undertaking in the “Form Of Party A’s Undertaking” set out at Annex I to the IFX Master Terms and Conditions to Party B so that on the relevant Settlement Date specified in the Undertaking, it will purchase the relevant currency amount from Party B, on the terms and subject to the conditions of the DFT Terms confirmation only if the **Spot Rate is less than or equal** to the Forward Rate on the Exercise Date. Party B will acknowledge the Undertaking.

3. In respect of an IFX Forward transaction, Party B, the Undertaking provider, will also send an Undertaking in the “Form Of Party B’s Undertaking” set out at Annex 3 to the IFX Master Terms and Conditions to Party A so that on the relevant Settlement Date specified in the Undertaking, it will purchase the relevant currency amount from Party A, on the terms and subject to the conditions of the DFT Terms confirmation only if the **Forward Rate is greater than** the Spot Rate on the Exercise Date. Party A will acknowledge the Undertaking.

4. The Seller being the relevant Undertaking recipient which could be either party, will send the Exercise Notice in the “Form Of Exercise Notice” set out at Annex 2 to the IFX Master Terms and Conditions to the Buyer exercising the Buyer's Undertaking requesting the Buyer, on the Settlement Date, to purchase from the Seller the First Currency Amount of the First Currency for the Second Currency Amount of the Second Currency on the specified terms.

5. The Offer and Acceptance will also be sent by the Seller, the relevant Undertaking recipient to the Buyer (who will countersign the Offer and Acceptance). The purpose of the form of the Offer and Acceptance is to confirm the terms and conditions of the sale transaction entered into between the parties, after the Seller has delivered to the Buyer an Exercise Notice.

**In brief:**

The two unilateral and independent *Wa’ad* structure provide for each party to 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* 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 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 IFX 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 Undertakings for each party are contained in Annexes 1 and 2 to the IFX 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. The above diagram illustrates how the two unilateral and independent Wa‘ad based structure works.

**ILLUSTRATIVE EXAMPLE IN RELATION TO THE TWO UNILATERAL WA‘AD STRUCTURE**

**Wa‘ad 1**
First Currency = GBP  
Second Currency = USD

Bank (Buyer) → Customer (Seller)

Promises to buy GBP 1 million at the Forward Rate of 1.51 if: USD/GBP Spot Rate ≤ Forward Rate

**Wa‘ad 2**
First Currency = USD  
Second Currency = GBP

Customer (Buyer) → Bank (Seller)

Promises to buy USD 1.51 million at the Forward Rate of 0.66 if:  
Forward Rate > GBP/USD Spot Rate

Scenario 1: on the Exercise Date if USD/GBP Spot Rate is ≤ 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.

**Structure 2**

**Single Binding *Wa‘ad***

**Documentation architecture /structure**

<table>
<thead>
<tr>
<th>Tahawwut Master Agreement (including the Schedule thereto)</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFX Master Terms and Conditions</td>
</tr>
<tr>
<td>Buyer’s Undertaking+</td>
</tr>
<tr>
<td>Exercise Notice</td>
</tr>
<tr>
<td>Offer and Acceptance</td>
</tr>
</tbody>
</table>

*The beneficiary of the Undertaking will acknowledge the Undertaking*

**Explanation of documentation process and structure**

Parties to this transaction will enter into the ISDA/IIFM *Tahawwut* Master Agreement (TMA). The parties will agree on the commercial terms of the foreign exchange transaction, such as the currency, purchase price, current spot exchange rate etc. These terms are documented under the IFM IFX Master Terms and Conditions Confirmations/Templates which supplements the ISDA/IIFM TMA Master Agreement. **Below is the detailed explanation:**

1. The parties execute the IFX Master Terms and Conditions only once at the outset of the trading relationship or at the time of the first IFX Forward transaction

2. **Undertaking/Wa‘ad.** In respect of an IFX Forward transaction, the Buyer will deliver to the Seller Undertaking to purchase from the Seller on the Settlement Date a
specified amount of the First Currency by payment of the specified amount of the Second Currency on the relevant Settlement Date.

3. **Exercise of Undertaking and Seller's Offer.** In respect of an IFX Forward transaction, the Seller, as the recipient of the Undertaking, will be entitled to deliver to the Buyer, on or prior to the Exercise Date, an Exercise Notice for the Undertaking (Wa'ad) the Seller received from the Buyer to purchase from the Seller the First Currency.

The Exercise Notice shall be accompanied by two copies of an Offer and Acceptance constituting an offer by the Seller to the Buyer to enter into the relevant IFX Sale Transaction.

4. **Buyer's Acceptance.** Following the delivery to the Buyer by the Seller of the Exercise Notice with respect to the Exercise Date, together with two copies of the duly completed Offer and Acceptance executed by the Seller, the Buyer shall accept such offer either orally by telephone or in writing via email, or any other recognized means or by countersigning such Offer and Acceptance and returning one such original to the Seller on the same day as that on which the Exercise Notice became effective. If the Buyer accepts such offer by telephone or via email, then such acceptance shall be subsequently confirmed by returning to the Seller a duly signed copy of the Offer and Acceptance form, although any failure to do so shall not invalidate such acceptance.

**In brief:**

The Single Binding *Wa’ad* Structure envisages that under the Undertaking one party (the Buyer of the relevant currency) gives a *Wa’ad* 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 one currency in exchange for another currency.

The IFX Forward templates relating to the Single Binding *Wa’ad* Structure comprise of the IFX 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 IFX Master Terms and Conditions. The diagram above illustrates how the single *Wa’ad* based structure works.

**ILLUSTRATIVE EXAMPLE IN RELATION TO THE SINGLE WA ‘AD STRUCTURE**

<table>
<thead>
<tr>
<th>Customer (Buyer)</th>
<th>Bank (Seller)</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Currency = GBP</td>
<td>Second Currency = USD</td>
</tr>
</tbody>
</table>

Promises to buy GBP 1 million at the Forward Rate of 1.51

6
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.

**The fundamental differences between two unilateral independent and single binding *Wa’ad* structures**

The main difference between the two unilateral independent *Wa’ad* based structure and the single binding *Wa’ad* based structure is as follows:

**Two unilateral and independent *Wa’ad* based structure:**

Under the two unilateral independent *Wa’ad* based structure, each party to the agreement unilaterally gives an independent *Wa’ad* (promise/ undertaking) to exchange one currency against another currency on a future date at a specified amount. Each *Wa’ad* will contain a different set of conditions such that only one of the undertakings can be exercised on the settlement date with no further obligations arising under the other promise.

**Note:** In this two unilateral and independent *Wa’ad* based structure transaction, only one *Wa’ad* can be exercised on the Exercise Date.

**Single binding *Wa’ad* based structure:**

The single binding *Wa’ad* based structure involves one party who is looking for a hedge to purchase a specified currency at a future date based on the rate determined today, providing a binding *Wa’ad* (promise / undertaking) to purchase such currency. In this transaction the party who is looking for a hedge will identify his requirement, for instance, he has surplus funds denominated in currency (a) (for example USD) and wishes to invest in currency (b) (for example Euro), but he is concerned that the exchange rate fluctuation of currency (a) and currency (b) may expose him to cash flow uncertainty and therefore wishes to mitigate this risk.

**In brief:**

The main difference between the two unilateral independent *Wa’ad* and the Single binding *Wa’ad*, is based on the number of parties giving the promises. In the two unilateral independent *Wa’ad* there are two parties giving two promises that have different conditions, whereby in the Single *Wa’ad* only one party gives the promise. However, both are similar in a sense that only one *Wa’ad* will be ultimately exercised in both two unilateral independent *Wa’ad* and the single binding *Wa’ad*. 
IIFM SHARI ‘AH BOARD GUIDELINES FOR THE USE OF THE
IIFM/ISDA IFX FORWARD PRODUCT

While IIFM’s Shari’ah Board has approved the IFX Forward templates after extensive consideration, it is always the responsibility of each of the parties entering into the IFX Forward 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.

In order to assist market participants with regard to the IFX Master Terms and Conditions provided to market participants by IIFM and ISDA, the IIFM Shari’ah Board members have provided the following guidelines regarding Shari’ah compliance of this product:

1. IFX Forward transactions should be entered into only for the purpose of hedging actual risks of the relevant party.

2. The transactions/contracts should not be entered into for purposes of speculation.

3. No interest/Riba (whether called interest or an alternative name but which represents interest) is to be chargeable under an IFX Forward transaction.

4. The exchange of two dissimilar currencies/countervalues must be spot or simultaneous (i.e. hand to hand) taking into consideration the banking rulings issued by Fiqh (jurisprudence) academies in respect of currency transactions.

5. The countervalues of the same currency must be of equal amount, even if one of them is in paper money and the other is in coin of the same country, like a note of one dinar for a coin of one dinar.

6. The contract shall not contain any conditional option or deferment clause regarding the delivery of one or both countervalues.

7. A bilateral promise to purchase and sell currencies is forbidden if the promise is binding, even for the purpose of hedging against currency devaluation risk. However, a promise from one party is permissible even if the promise is binding.

8. Under the two unilateral Wa’ad based structure, each Wa’ad should be independent and separate from the other and contingent on two different events.
ضوابط العمل بهذا المنتج:

على المستخدمين المحتملين لهذه الوثيقة أن يضعوا في الاعتبار بأنه عند إبرام أو الدخول في هذه المعاملات أو الترتيبات التي تتعلق بالشروط والأحكام الرئيسية لاتفاقية الودع بالصرف في المستقبل (وقاية من تقلب أسعار الصرف) القائم على هيك وعدين منفصلين مختصفي المورد من طرفين وقائم على هيك وعد ملزم من طرف واحد، فإن عليهم أولاً اتخاذ كافة الإجراءات لتتأكد من أن المعاملات أو الترتيبات هذه متفقة مع أحكام ومبادئ الشريعة الإسلامية. وعلى المستخدمين الذين أرادوا إدخال تعديل أو إضافة على هذه الوثيقة اتخاذ كافة الإجراءات المطلوبة للاطمئنان بأن أي تعديل أو إضافة في المستند متفقة مع أحكام ومبادئ الشريعة الإسلامية.

من أجل مساعدة المشاركين في السوق فيما يتعلق بهذه الوثيقة "الشروط والأحكام الرئيسية لاتفاقية الودع بالصرف في المستقبل (وقاية من تقلب أسعار الصرف) القائم على هيك وعدين منفصلين مختصفي المورد من طرفين وقائم على هيك وعد ملزم من طرف واحد، التي تقدمها السوق المالية الإسلامية الدولية للمشاركين في السوق، فقد قدمت الهيئة الشرعية للسوق المالية الإسلامية الدولية الضوابط التالية بشأن توافق هذا المنتج مع أحكام ومبادئ الشريعة الإسلامية:

(أ) لا تبرم هذه العقود إلا لغرض التحوط من المخاطر الحقيقية للطرف ذي العلاقة.

(ب) لا تبرم هذه العقود ولا يجوز استعمالها لأغراض المضاربات (المجازفة).

(ج) يحرم اقتضاء أي الفائدة بروية مهما كانت تسميتها (أي سواء سميت فائدة/الريبا أو باسم آخر ولكنها تمثل فائدة/الريبا) وذلك بموجب هذه المعاملة.

(د) يجب أن يكون تبادل أو صرف العملات غير المتماثلين فورًا (أي يدًا بيد) مع الأخذ بالإعتبار القيد المصرفي الذي أجازه المجامع الفقهية.

(ه) يجب أن يتم التماثل في البدينين اللذين هما من جنس واحد ولو كان أحدهما عملة ورقية والآخر عملة معدنية;

(و) المدعى للدولة نفسها.

(ز) لا يجوز أن يشتمل العقد على خيار شرط أو أجل لتسليم أحد البدينين أو كليهما.

(ح) لا تجوز المواعدة في المتاجرة في العملات إذا كانت ملزمة للطرفين ولو كان ذلك لمعالجة مخاطر هبوط العملة.

أما الوعد من طرف واحد فيجوز ولو كان ملزماً.

(.) إذا تم الاتفاقية على وعدين فيجب أن يكون كل واحد منهما منفصلا عن الآخر ومختلف المورد.