Briefing note —— 6th June 2016

ISDA/IIFM launches new product documentation

Wiqayah Min Taqallub As’aar Assarf
(Islamic Foreign Exchange Forward)

Introduction

The 2010 launch of the International Swaps and Derivatives, Inc. (ISDA) and International Islamic Financial Market (IIFM) Tahawut (hedging) Master Agreement (the TMA), the first globally standardised master documentation for Islamic hedging products, laid the groundwork for a series of milestones in the field of Shari’a compliant hedging under a common framework benefitting from a Pronouncement of the IIFM Shari’a Board.

Today’s launch of the template documentation for both variations of a Wiqayah Min Taqallub As’aar Assarf (Islamic Foreign Exchange Forward) (IFX), designed to be used in conjunction with and governed by the TMA, represents the addition of a further important risk management tool for the Islamic Finance industry with regard to accessing and hedging foreign currencies.

The TMA – the general framework

This agreement, once entered into between two parties, sets out the framework terms and conditions pursuant to which the parties can enter into any number of subsequent, specific arrangements.

The TMA regulates key, general terms, including certain matters regarding Shari’a compliance:

(a) the purpose of further arrangements entered into should be solely for the purpose of hedging actual risks;

(b) there should be no speculation, i.e. there is actual settlements of assets and payments and where cash settlement occurs, it should be in relation to a deliverable asset;

(c) the assets involved must be halal; and

(d) no interest (regardless how described) is to be charged.

Other sections deal with general provisions regulating:

(e) incorporation of further arrangements entered into under the TMA umbrella

(f) obligations of parties regarding payment and deliveries

(g) basic representations; information undertaking and indemnities

(h) general events of default (eg. non-payment, failure to deliver, insolvency and others) and termination events (eg. illegality, force majeure, etc.);

(i) the operation of early termination events for fully delivered, future, and partially delivered arrangements; expenses; notices; and

(j) governing law, dispute resolution and jurisdiction.

Party specific information and individual elections (eg. applicable forum for dispute resolution) are set out in the Schedule to the TMA.

It is worth bearing in mind that the TMA caters to both of the possible types of further arrangements that may be entered into under the TMA umbrella:

(a) actual transactions occurring on entry into the required further documentation. These are considered “Transactions” under the TMA from day one, with their specific terms and conditions set out in “Confirmations”; and
arrangements such as wa‘ad (undertakings) which, if the necessary conditions are met, lead to actual transactions in the future. These arrangements initially fall under the category of “Designated Future Transactions” (DFT), the specific terms and conditions of which, taken together with the relevant product’s master agreement and specific transaction terms and conditions, constitute a “DFT Terms Agreement”.

The IFX templates

The set of templates now produced by IIFM and ISDA to support the entry into Wa‘ad Min Taqallub As’aar Assarif (Islamic Foreign Exchange Forward) on a standardised basis as DFTs under the TMA framework consists of the two product master agreements, which contain the general terms and conditions that will govern individual IFX transactions the parties enter into going forward:

1 IFX Master Terms and Conditions for the single wa‘ad based structure (IFX Single Wa‘ad Master), incorporating the forms of documents, which, when completed, will contain the specific terms and conditions for each individual IFX transaction:
   - the wa‘ad;
   - the exercise notice; and
   - the offer and acceptance.

2 IFX Master Terms and Conditions for the double wa‘ad based structure (IFX Double Wa‘ad Master), incorporating the forms of documents, which, when completed, will contain the specific terms and conditions for each individual IFX transaction:
   - each party’s wa‘ad;
   - the exercise notice; and
   - the offer and acceptance.

In addition, the IFX Single Wa‘ad Master and the IFX Double Wa‘ad Master (the IFX Masters) both contain footnotes to aid parties in their use and they are accompanied by a product description and operational guidance, including the IIFM’s Shari’a Pronouncement.

The IFX Single Wa‘ad Master and the IFX Double Wa‘ad Master are entered into by the parties at the outset of their relationship, while the forms of documents appended to the relevant IFX Master are to be completed and signed for each individual IFX entered into – the wa‘ad (single or double) when the individual IFX is agreed, the exercise notice on the relevant exercise date and the offer and acceptance within a specific time thereafter (frequently the same day the exercise notice is delivered).

IFX Masters – some considerations

Because the wa‘ad under the IFX Double Wa‘ad are unilateral and independent, each has its own condition to becoming exercisable. The parties must, therefore, ensure the conditions are mutually exclusive so as to avoid both wa‘ad becoming exercisable and disrupting the commercial intentions of the transaction. The footnotes in the precedent documents suggest that one wa‘ad becomes exercisable if the relevant currency spot rate on the relevant exercise date is less than or equal to the agreed forward rate, while the other wa‘ad becomes exercisable if the relevant currency spot rate on the relevant exercise date is greater than the agreed forward rate.

The IFX Single Wa‘ad operates without any condition which must be met before becoming exercisable.

The documentation is designed in such a way that parties can enter into individual IFX transactions by filling in the line items provided (e.g. trade date, exercise date, settlement date, currency amounts, etc.) but that does not mean that the parties cannot include additional terms to cater to their specific needs. To the extent the documents are varied, the parties should take care that it is clear how these varied terms are to be dealt with and interact with the TMA.

Failure to accept the Offer, if made, constitutes a failure to enter into a DFT under the TMA, triggering an event of default unless remedied in accordance with the terms of the TMA.

The wa‘ad is laid out to be executed as a deed, arising out of the common practice for English law governed undertakings to be executed in such form (the TMA is intended to be governed by English or New York law). The parties should consider the appropriate manner of execution to ensure the DFT Agreement is properly executed as a deed.

Shari’a approval

While the TMA benefits from the IIFM Shari’a Board’s Pronouncement and the IFX Masters have been developed together with and reviewed by the Board, it remains key that individual parties for whom Shari’a compliance is a requirement individually satisfy themselves that the TMA, the relevant IFX Master and any individual transaction entered into thereunder are acceptable to and in line with their own Shari’a advisers’ or board’s requirements.
IFX Single *Wa’ad* – the transaction

**Day One**
- **Buyer**
- **Sells** to **Seller**
- **Grants wa’ad**

**Exercise Date**
- **Buyer**
- **Exercises right under Buyer’s wa’ad**
- **Sellers**

**Settlement Date**
- **Buyer**
- **Ccy 1**
- **Ccy 2**
- **Sells**

The agreed amounts of the First Currency and Second Currency are exchanged

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IFX Double *Wa’ad* – the transaction

**Day One**
- **Wa’ad 1**
- **Buyer (Party A)**
- **Grants wa’ad**
- **Seller (Party B)**

**Wa’ad 2**
- **Seller (Party A)**
- **Grants wa’ad**
- **Buyer (Party B)**

**Exercise Date**
- **Buyer**
- **Exercises right under Buyer’s wa’ad**
- **Sellers**

Depending on which Exercise Condition is satisfied, the **Buyer will be Party A** (under Wa’ad 1) or **Party B** (under Wa’ad 2)

**Seller sends Exercise Notice, confirming:**
- exercise of the right granted by the Buyer under the wa’ad
- The amounts of the First Currency and Second Currency to be exchanged
- The Settlement Date
- attaching the completed Offer and Acceptance, signed by the Seller

**Settlement Date**
- **Buyer**
- **Ccy 1**
- **Ccy 2**
- **Sellers**

The agreed amounts of the First Currency and Second Currency are exchanged
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For further information please do not hesitate to contact:

Salman Ahmed
Partner, Head of Islamic Finance (Middle East and Africa)
t +973 17 515616
e sahmed@trowers.com

Elias Moubarak
Partner, Head of Banking & Finance UAE, Dubai
t +971 4 3025 106
e emoubarak@trowers.com

Barbara Anderson
Solicitor, Banking & Finance, Dubai
t + 971 4 3025 126
e banderson@trowers.com