

# Standardization in Islamic Financial Services Industry

- Inter-linkages with global financial system and challenges in integration given that standards are voluntary
  - ❑ AAOIFI *versus* IFRS
  - ❑ IFSB *versus* Basel II & III
  - ❑ IIFM *versus* ISDA, ICMA etc.,
- Expectations, industry support & role of Islamic banks (IILM, Mega Bank)
- Role of regulators in the implementation of Standards at jurisdictional, regional and global level
- Market immediate need versus long term benefits
- Standards comprehensive and robust nature versus simplicity
- *Shari'ah* Harmonization

# Documentation & Product Standardization Islamic Capital & Money Market



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الإسلامية الدولية  
International Islamic  
Financial Market

## ➤ Standardization of existing practices

- Review of market practices
- Development with Industry consultation
- *Shari'ah* guidance & approval
- Legal environment & law reform
- Enforceability

## ➤ Standardization through innovation

- Market requirement & research
- Consultation by industry experts & development
- *Shari'ah* guidance
- applicability/practicality
- legal environment & law reform

## ✓ **Tahawwut Master Agreement (TMA)**

TMA is a framework risk mitigating document for hedging transactions and is developed for the entire Islamic finance industry especially for Islamic financial institutions (IFI's) as well as for Islamic windows.

## ✓ **TMA Explanatory Memorandum**

In order to provide information on key features of TMA and how these can be applied, a detailed Explanatory Memorandum is also part of the publication

# Islamic Hedging Products

## *Shari'ah* Principles

### (i) *Murabaha*

- Treatment is defined based on use of *Murabaha* under the institution's product structure
- No discounting and claim for full amount
- Fully delivered terminated transactions treatment (*Murabaha*)
- Non-fully delivered terminated transactions treatment [Designated Future Transaction (DFT)]

### (ii) *Wa'ad*

- Both parties will exchange *Wa'ad* at the time of entering into the transactions e.g. Currency Swap
- Only one *Wa'ad* is exercisable



# Islamic Hedging Products

## ISDA/IIFM *Mubadalatul Arbaah* (Profit Rate Swap)

### Introduction

The ISDA/IIFM *Mubadalatul Arbaah* (Profit Rate Swap) structures are as follows:

- a) Two Sale Structure
- b) Single Sale Structure



# Islamic Hedging Products Standardization

- **Cross Currency Swap**
- **FX Forward**
- **Credit Support Agreement**

# What is the purpose of entering into an IIFM Interbank Unrestricted Master Investment Wakalah Agreement?



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Given the strict prohibition of *riba* (interest) under the *Shari'ah* (Islamic law), the scope of *Shari'ah* compliant liquidity management is more limited than liquidity management for a conventional bank, since it is still essential for Islamic Financial Institutions (IFI's) to manage their excess liquidity in a way that produces a return for them

For many years, IFI's have relied mainly on commodity *Murabahah* for their wholesale liquidity management purposes notwithstanding issues and concerns related to commodity *Murabahah* transactions, such as the cost of commodity brokerage, or the amount of *Shari'ah* compliant commodities available at any particular moment in time to cover transaction volumes etc

In order to diversify the range of liquidity management solutions available to the IFI's, the last few years have witnessed the active use by IFI's of *Wakalah* arrangements/transactions (both restricted and unrestricted) as an alternative liquidity management tool. The objective of this activity has been to reduce the over reliance by the IFI's on commodity *Murabahah*

# What are the Key Features

## Clause 6 (*Undertakings*)

This clause requires each Party to undertake amongst other things that it will comply with all laws and regulations to which it may be subject and that it will notify the other Party of any Default.

## Clause 7 (*Events of Default*)

The occurrence of certain events will result in termination of any *Wakalah* Investment Transactions then in existence. Such events include the *Wakil* failing to pay any amounts under the Master Agreement, misrepresentation by a Party and insolvency. The clause also details what happens upon the occurrence of an Event of Default (See Clause 7.7) and the payments due thereunder (See Clause 7.8).

# What are the Key Features (continuation)

## Clause 8 (*Early Termination*)

This clause deals amongst other things with the right of the *Muwakkil* to terminate a *Wakalah* Investment Transaction, the *Wakil's* acceptance of an Early Termination Request and the ability of the *Wakil* to notify the *Muwakkil* of a Revised Anticipated Profit Rate (See Clause 8.3).

## Clause 9 (*Late Payment Amount*)

This clause obliges a Party to pay a Late Payment Amount where it fails to pay a sum on a Due Date. Clause 9.2 (*Calculation of Late Payment Amount*) deals with how the Late Payment Amount is calculated and Clause 9.3 (*Payment of Late Payment Amount*) covers how such amount shall be applied.

# Are There Any Other Features?

Yes, this agreement is supplemented with a set of items as follows:

1. Operational Guidance Memorandum which covers the operational procedures to be implemented by the *Wakil* as well as the *Wakil* and *Muwakkil* responsibilities

# Islamic Liquidity Management

## Collateralized Tool for Liquidity Management

## Collateralization Prospects for Islamic Inter-Bank Market

The product will enable Islamic Financial Institutions to better utilize their securities portfolio and provide avenue to raise liquidity on collateralized basis as clean lending/borrowing is becoming extremely difficult given current uncertainty in global financial system

# Collateralized Tool for Liquidity Management

## Collateralized Product – Utilization of *Sukuk*

In order to make use of parties *Sukuk* portfolios and to initiate the process while further research and deliberation on finding an ideal 'IS' structure may continue, the collateralized structure is one of the options which IIFM is currently developing.

# Conclusion

- The Role of the 3 main infrastructure institutions namely IIFM, AAOIFI and IFSB in the development of IFSI should be strengthened further. This is where we can achieve the required harmonization as each institution has its clear mandate where there is no over-lapping.
- In order to achieve the desired harmonization all the stakeholders need to come together to strengthen the position of these infrastructure institutions

# ***Shukaran Wassalamu 'Alaikum***

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