



The ISDA/IIFM Tahawwut Master Agreement

Deborah Christian
Senior Associate

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ISDA/IIFM Tahawwut Master Agreement

Key Features

Architecture

- Multiproduct Agreement
- Available for use across market participants and geographical regions

The Risk Management approach and value of the Master Agreement

- Framework agreement covering all trades between the parties
- Single Agreement
- Flawed Asset and Conditionality
- Close-Out and Netting
- All designed to ensure that in the event of a default or termination the exposures of the parties under all outstanding transactions are aggregated and netted, in particular in order to stop an insolvency practitioner from cherry picking, that is enforcing profitable ("**in the money**") transactions entered into under the Agreement and leaving unprofitable ("**out of the money**") transactions as claims in the insolvency.

Explanatory Memorandum

- Guidelines regarding the sorts of transaction that may be entered into under the ISDA/IIFM Tahawwut Master Agreement. For the purposes of Shari'ah compliance:
 - *Transactions entered into under the TMA should only be for the purpose of hedging actual risks of the relevant party*
 - *Transactions should not be entered into under the TMA which are for the purposes of speculation*
 - *Transactions must be real transactions, involving the actual transfer of ownership of real assets, actual risk and real settlement*
 - *The asset itself must be halal*
 - *Interest must not be chargeable under the transaction*

Transactions/DFT Terms Agreements

- Under the Agreement, you can enter into
 - Transactions
 - DFT Terms Agreements
- Example: agreement to enter into a murabaha annually over five years
 - First murabaha entered into immediately – Transaction
 - The agreement to enter into those murabaha to be entered into on the first, second, third and fourth anniversaries is a DFT Terms Agreement

Section 1(c) - Single agreement

- Master Agreement, the Schedule and all confirmations together form one single agreement between the parties. The result is that there is a contractual interdependence between what might otherwise seem to be independent transactions
- Because the transactions under the Master Agreement collectively constitute one agreement, all transactions have to be dealt with and individual transactions cannot be cherry picked
- However, not every jurisdiction accepts this concept so legal position needs to be checked

Section 2(a)(iii) – Flawed Asset or Conditionality Provision

- A party has no obligation to make any payments or deliveries under a particular transaction when there is an Event of Default or Potential Event of Default with respect to the other party
- Liquidator attempting to cherry pick profitable contracts will be met by the response that the Non-defaulting Party has no obligation to perform the profitable contract as the Agreement expressly provides that no monies are due to the Defaulting Party in the circumstances
- In the TMA this condition applies to all obligations to pay, all obligations to deliver assets and *all obligations to enter into Transactions in accordance with the requirements of DFT Terms Agreements*

Section 3 - Representations

■ New Representations

- Satisfaction as to compliance with Shari'ah – Section 3(h)

Each party represents it has satisfied itself as to the Shari'ah-compliance of the Agreement, each Transaction, each DFT Terms Agreement (*and each Designated Future Transaction under it*)

Note: “*Insofar as it wishes or is required for any reason to enter*”

- Non-reliance – Section 3(i)

Each Party represents that it has not relied on the other party or on any documents (*including a pronouncement/fatwa*) prepared by or on behalf of the other party for the purposes of determining whether the Agreement, each Transaction, each DFT Terms Agreement (*and each Designated Future transactions under it*) is Shari'ah-compliant

Section 5 – Events of Default and Termination Events

- The Events of Default include:
 - Section 5(a)(i): Failure to pay or deliver
 - Section 5(a)(ii): Breach of Agreement, Repudiation of Agreement; **Failure to enter into a Designated Future transaction**
 - Section 5(a)(iii): Credit Support Default
 - Section 5(a)(iv): Misrepresentation
 - Section 5(a)(v): Default under a Specified Transaction – **extended to cover Shari’ah compliant transactions**
 - Section 5(a)(vi): Cross-default – **extended to cover Shari’ah compliant transactions**
 - Section 5(a)(vii): Bankruptcy
 - Section 5(a)(viii): Merger without Assumption.
- **New Event of Default – Section 5(a)(ii)(3) of the Agreement**

Failure to enter into a Designated Future transaction, if such failure is not remedied on or before the first Local Business Day after notice of such failure is given to the relevant party, constitutes an Event of Default

Section 5 – Events of Default and Termination Events

Section 5(b) – Termination Events

■ The Termination Events include:

- Section 5(b)(i): Illegality
- Section 5(b)(ii): Force Majeure Event
- Section 5(b)(iii): Tax Event
- Section 5(b)(iv): Tax Event Upon Merger
- Section 5(b)(v): Credit Event Upon Merger
- Section 5(b)(vi): Additional Termination Event

■ Mirrors those in the 2002 ISDA Master Agreement

■ Section 5(b)(i) – Illegality

Definition of “*law*” does not include principles of Shari’ah, hence “*unlawful*” means contrary to a secular law as opposed to contrary to Shari’ah

Section 9 – Miscellaneous

■ Section 9(h) - No Compensation or Interest on Defaulted or Deferred Payments and Deliveries

- Parties cannot recover amounts for any cost of funding they incur as a result of any late payment or delivery; however the possibility of this leading to an EOD under the Agreement is in itself a deterrent

■ Section 9(h) - No Interest Payable

- As is to be expected, all references to "*interest*" have been deleted due to interest / riba being haraam and thus forbidden under Shari'ah principles
- Section 9(h) of the TMA is essentially a waiver of the right to interest arising as a result of any arbitral or judicial award or by operation of law
- In the event that interest is "*payable or receivable under or in connection with the Agreement*" ... then such interest will be donated by the recipient to an officially recognised or registered charity
- Similarly there is no interest element (*the Applicable Close-out Rate which is usually different for the Defaulting and Non-defaulting Party*) on the calculation of Unpaid Amounts

Section 13 – Governing Law and Dispute Resolution

- No reference to Shari'ah in the governing law clause
- Parties may elect either English law or the laws of the State of New York as the governing law of the Agreement and each Transaction and Designated Future transaction made thereunder
- Both parties at the outset have the flexibility to elect whether dispute resolution should take place through the courts or through arbitration

Section 6 - Early Termination (General)

- Under the Agreement, you can enter into
 - Transactions
 - DFT Terms Agreements (relating to Designated Future transactions)
- Evidenced by:
 - Confirmations
 - DFT Terms confirmations

Section 6 - Early Termination Example

- Party A grants *wa'ad* (DFT Terms Agreement) exercisable annually for 3 years by Party B. On exercise Party A must purchase under a *murabaha* (Designated Future transaction) commodity for immediate delivery at a deferred purchase price
- *Wa'ad* exercised after one year; *murabaha* entered into (becomes a Transaction), commodity delivered, purchase price deferred and payable at end of year 2
- Early Termination after 15 months leaves outstanding:
 - deferred purchase price payable at end of year 2 under *murabaha* (Transaction)
 - *Wa'ad* potentially exercisable at end of year 2 and end of year 3 (DFT Terms Agreement)

Section 6 - Early Termination – Terminated Transactions Procedure

- Fully Delivered Terminated Transactions:
 - (Section 6(d)): accelerate all payments due after the Early Termination Date (*Close-out Amount*)
 - (Section 6(e)): add unpaid amounts
- Non-Fully Delivered Terminated Transactions:
 - (Section 6(e)): add unpaid amounts to Fully Delivered Transactions amount
 - (Section 6(f)): treat not made deliveries and future payments like a DFT Terms Agreement

Section 6 - Early Termination – DFT Terms Agreements

- For terminated DFT Terms Agreements, calculate Market Quotation (or Loss) (Section 6(h))
- Do the same for not made deliveries and future payments under Non-Fully Delivered Terminated Transactions
- Result may be positive or negative
- Becomes value of Relevant Index

Section 6 - Early Termination - *Musawama*

- Section 6(f)(v): if Relevant Index is positive (Determining Party is in the money), Determining Party can exercise the Section 2(e) *wa'ad* of counterparty requiring counterparty to enter into *musawama* and purchase asset from Determining Party at the Positive Indexed Value
- Section 6(f)(v): if Relevant Index is negative (Determining Party is out of the money) other party can exercise the Section 2(e) *wa'ad* of the Determining Party requiring the Determining Party to purchase asset from the other party at the Negative Indexed Value
- Need for real transaction with real assets
- The *musawama* price is expressed as a single number (actually calculated by adding cost of asset to Relevant Index Value plus applicable VAT or similar taxes)
- The type and quantity of the asset to be the subject of the *musawama* will be fixed and specified in the Schedule at the outset (minimises *gharar*)

Section 6(h) – Set-Off

- Following the occurrence of an Early Termination Date, the TMA provides for two separate payment amounts:
 - Early Termination Amount
 - Positive Indexed Value/Negative Indexed Value
- Once determined and payable, these two amounts (*Early Termination Amount and Positive/Negative Indexed Value*) can be set-off against one another pursuant to Section 6(h) of the Agreement
- To avoid Non-defaulting Party having to pay Early Termination Amount before any reciprocal claim to payment of the Positive/Negative Indexed value has become payable, Non-defaulting Party can defer payment of relevant proportion of Early Termination Amount until reciprocal claim becomes payable

Contacts

London and Hong Kong



Habib Motani

Partner
Clifford Chance
10 Upper Bank Street
London
E14 5JJ
England
T +44 207 006 1718
F +44 207 006 5555
E [Email habib.motani@cliffordchance.com](mailto:habib.motani@cliffordchance.com)



Priya Uberoi

Director, Islamic Derivatives &
Structured Products
Clifford Chance
10 Upper Bank Street
London
E14 5JJ
England
T +44 207 006 4173
F +44 207 006 5555
E priya.uberai@cliffordchance.com



Deborah Christian

Senior Associate
28th Floor
Jardine House
One Connaught Place
Hong Kong SAR
T +852 2826 2436
F +852 2825 8800
E deborah.christian@cliffordchance.com

The ISDA/IIFM Tahawwut Master Agreement

Deborah Christian – Hong Kong

T: +852 2826 2436

E: deborah.christian@cliffordchance.com

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www.cliffordchance.com

Clifford Chance, 28th Floor, Jardine House

One Connaught Place, Hong Kong

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