

Response to feedback received

Wa`d

Introduction

The finalised policy document on *Wa`d* (PD) for Islamic financial institutions (IFI) incorporates the policy requirements stipulated in the concept paper that was issued on 11 April 2016, taking into account the feedback received during the consultation period.

The Bank received written responses from 33 respondents, including IFIs, industry associations and regulatory authorities during the consultation period. A series of engagement sessions were also conducted to allow for a more focused and in-depth discussions on the proposed requirements.

The Bank appreciates the feedback and suggestions received during the consultation process. Key comments received and the Bank's responses are provided in the following sections. Other comments and suggestions for clarification have been incorporated in the final policy where appropriate.

Bank Negara Malaysia

2 February 2017

1 Legal enforceability of *wa`d*

- 1.1 The Shariah and operational requirements of *wa`d*, consistent with the rulings of Shariah Advisory Council made under the Central Bank of Malaysia Act 2009 and issued pursuant to Section 29 (1) of Islamic Financial Services Act 2013 clarifies the parameters and enforceability of *wa`d* in its application within the scope defined in the PD.
- 1.2 In addition to the above, the Bank also wishes to inform that there is an initiative to incorporate recognition of *wa`d* in Contracts Act 1950 pursuant to Law Harmonisation Committee's recommendation.

2 Determination of actual loss under customary market practice

- 2.1 Promisee has the right to claim compensation for any actual loss suffered due to promisor's failure to fulfil *wa`d*. Some respondents requested guidance to ascertain the acceptability of current market practice in determining actual loss (such as loss from derivative transactions).
- 2.2 The PD provides clarification that actual loss consists of actual or estimated direct costs or loss. Any estimation of actual loss shall be based on approaches or methodologies established in the market and information obtained from reliable sources. For example, in derivative transactions, if a promisor breach the *wa`d* (i.e. defaults on the derivatives), the promisee can claim actual loss due to any costs or losses incurred in a corresponding hedging arrangement with a third party. Estimations of actual loss can also be done in circumstances where actual amount cannot be easily determined such as in portfolio hedging arrangements.

3 Application of *wa`d* in currency exchange transactions

- 3.1 The application of *wa`d* in transactions involving currency exchange, is allowed only for risk mitigation purposes. The requirements are applicable for all *wa`d* in currency exchange transactions for standalone products (such as derivatives) or embedded derivatives in structured products.
- 3.2 Requirement on risk mitigation is fulfilled if the *wa`d* is applied in currency exchange transactions that are used to mitigate pre-existing risk exposures (i.e. risk which exists prior to *wa`d* inception) of at least one of the transacting parties (i.e. either the customer or IFIs). For example, an importer with USD obligations payable in one months' time has a pre-existing and genuine exposure which can be hedged. In addition, it is also important to examine the features of the currency exchange transactions as to ensure it is structured for risk mitigation purpose. For example, the party writing an option signifies the use of currency transaction as yield enhancement and not for risk mitigation.

4 Disclosure on *wa`d* during pre-agreement phase

- 4.1 Respondents were of the view that detailed disclosure on *wa`d* at pre-agreement phase (such as disclosure in Product Disclosure Sheet) is unnecessary. This is because such disclosure may affect customer's understanding on the overall product structure, especially when *wa`d* is applied as a supporting arrangement.
- 4.2 The PD has been revised to ensure informed decision making by customers. In this regard, IFIs are required to disclose the overview of *wa`d*, in particular the purpose and application of *wa`d* with other Shariah contracts, key terms and conditions (including roles and responsibilities of parties involved) and key potential risks of using *wa`d*. The key potential risks include promisor having no recourse to the promisee and implications arising from breach of *wa`d* by the promisor.

5 Governance and oversight on *wa`d*

- 5.1 Respondents stated that specific governance and oversight requirements on *wa`d* are unnecessary as such requirements have already been catered for under each business segments or products.
- 5.2 The Bank expects robust governance and oversight on application of Shariah contracts, including *wa`d*. Nevertheless, it is intended to be “outcome driven” rather than prescribing the mode of implementation. Governance and oversight can be done either on standalone basis (e.g. specific documentation of policies and procedures on *wa`d*) or embedded under business segments or products, as long as the requirements on *wa`d* are fulfilled and applied consistently.

6 Invocation by the promisee to ensure promisor fulfils *wa`d*

- 6.1 In the CP, *wa`d* is revoked if the promisee does not invoke the *wa`d* within the time period as stipulated in *wa`d* documentation. Once revoked, the promisor no longer has any obligations to honour the *wa`d*. A few respondents proposed to allow for automatic invocation by the promisee, causing the promisor to continue having the obligation to fulfil *wa`d* even when there is no specific invocation made by the promisee. While the Bank acknowledges the potential operational efficiency of an automatic invocation, the Bank is guided by *Shariah* requirements on *wa`d* which emphasises for the invocation by promisee to be maintained.

7 Non-binding *wa`d*

- 7.1 Non-binding *wa`d* is excluded from the scope of PD. Some respondents seek clarification on the applicability of non-binding *wa`d* and implications of its usage in product structuring.
- 7.2 The Bank wishes to clarify that as long as *wa`d* is attached to conditions (such as trigger events or time period), it is binding and therefore included in the scope of the PD. If non-binding *wa`d* is used, the IFIs must have risk mitigation measures in place to ensure effectiveness of the product(s) and therefore, the IFIs' institutional soundness. Where relevant, IFIs can apply the requirements in the PD to reduce potential risks arising from the use of non-binding *wa`d*.

8 Submission requirements

- 8.1 With reference to paragraph 22.3 where *wa`d* is applied in products involving currency exchange, IFIs are expected to assess its' compliance against the PD requirements as part of the overall gap analysis required for the implementation of *wa`d*. For this purpose, IFIs shall provide information on the affected products, outstanding amount and IFIs' plan to address any non-compliance.
- 8.2 In ensuring compliance by the effective date, IFIs are expected to notify the Bank well in advance of any impediments that would hinder effective implementation of the PD requirements.