

Investors & Issuers Forum
Wednesday 28 March 2007

Islamic Hedging Mechanism: Emerging Trend

Robert Pickel
Executive Director and CEO

ISDA[®]

International Swaps and Derivatives Association, Inc.

®ISDA is a registered trademark of the International Swaps and Derivatives Association, Inc.
Copyright © 2006 International Swaps and Derivatives Association, Inc.

ISDA[®]

Multiple Agreement Disorder (“MAD”)

- Multiple Masters:
 1. Waste time
 2. Cost money
 3. Invite documentation backlog
 4. Increase documentation risk (“Battle of the Forms”)
 5. Divert management attention
 6. Potentially increase credit risk (and capital costs)

Solutions: Single Agreement concept (since 1987):

ISDA Master Agreement is the basis for 90+% of all global OTC derivatives transactions

The Challenge facing IIFM and ISDA

- Joint ISDA/IIFM working group is first-ever attempt to develop standard documentation for global cross-border transactions in Islamic derivatives. Starting date October 2006
- Approx 100 ISDA and IIFM members from around the globe, including major Islamic financial markets (incl GCC, ASEAN, Pakistan)
- IIFM Council of Shariah Advisors plays key role by providing advice on Shariah compatibility throughout the drafting process
- The new joint ISDA/IIFM Islamic Derivatives Master Agreement will be kept as close as possible to the ISDA Master Agreement, subject to Shariah approval, to minimise potential for hedging mismatches

Key Topics for Discussion

- Provisions on Inconsistency and Single Agreement (Sec 1 ISDA MA)
 - Definitions
 - Inconsistency
 - Single Agreement
- Payment and Delivery Obligations (Sec 2 ISDA MA)
 - Conditions Precedent
 - Change of Account
 - Payment Netting
 - Tax Withholding/Gross-Up
 - Compensation
- Representations (Sec 3 ISDA MA)

Key Topics (cont'd)

- **Governing Law and Arbitration (Sec 13 ISDA MA)**
 - Governing Law Clause to be exclusively “secular” (English or New York law)
- **Events of Default and Termination Events (Sec 5-6 ISDA MA)**
 - Failure to Pay or Deliver
 - Breach of Agreement
 - Credit Support Default
 - Misrepresentation (incl question of connection with Shariah compliance)
- **Compensation Provisions**

Governing Law and Arbitration

With respect to Shariah compliance and governing law, the group concluded that the agreement should:

- expressly record the intention of the parties to enter into only Shariah compliant transactions
- require each party to represent its satisfaction as to the Shariah compliance of the transactions entered into
- require each party to confirm that it is not relying on the other party with regard to satisfaction with Shariah compliance
- ideally require each party to provide evidence, such as a copy of the relevant *fatwa*, of its own internal consideration and satisfaction with respect to the issue and
- contain a governing law clause which refers exclusively to the relevant secular law (e.g. English or NY law) and which would not cross refer to, or seek to incorporate, Shariah principles (on the basis that satisfaction with Shariah principles was a starting threshold condition for entering into the relevant transaction and therefore did not need to be referred to in relation to the construction of the contractual terms)