IIFM Inter-Bank Unrestricted Master Investment Wakalah Agreement

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IIFM Interbank Unrestricted Master Investment Wakalah Agreement (UMWA)

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Objective
To provide the industry with an alternate liquidity management product in order to reduce the over reliance on commodity Murabahah based transactions.

Year of Publication 2013
Use: Reasonably used in Islamic inter-bank market as per the IIFM recent survey, as well as the gathered information during personal meetings by the IIFM Secretariat with banks and financial institutions globally.

Key Features

1. UMWA is a master investment agreement to be used primarily between two IFIs for interbank transactions but can be adapted to cater to other situations and counterparties.

Parties and process: The first IFI (**Muwakkil**) appointing the second IFI (**Wakil**) to invest its funds in a pool of assets selected by the Wakil in exchange for a fee (Wakalah Fee).

2. Transaction: Once the Muwakkil and the Wakil have entered into the Master Wakalah Agreement, they can enter into a series of Wakalah Investment Transactions under which a deposit in an agreed and certain amount (the Investment Amount) is invested in a pre-determined pool of assets (the Wakalah Pool) for an agreed and certain amount of time (the Investment Period) in relation to which there is an anticipated return **(the Anticipated Profit Rate).**

3. Wakalah Pool: Wakalah Pool may consist of a general treasury pool comprising of shari'ah compliant assets or, at the Wakil's discretion, a segregated pool of assets both of which must be described under the Wakalah Investment Transaction. **Wakalah Pool can then either be managed on a segregated or co-mingled basis.**

4. Profit Sharing: Anticipated Profit Rate is the rate of profit the Wakil projects that it will earn on the Muwakkil's Investment Amount by investing it in the pre-designated Wakalah Pool. If the actual rate of return (the **Actual Profit Rate**) exceeds the Anticipated Profit Rate, the Wakil may retain the excess as an incentive payment. If, however, the Anticipated Profit Rate is not met, the Wakil shall only be under an obligation to return the Actual Profit Rate. Where the Wakil determines that the Actual Profit Rate may be lower than the Anticipated Profit Rate, **it is under an obligation to notify the Muwakkil of the Revised Anticipated Profit Rate.**

5. Wakil Fee: Wakil is entitled to a fee which is to be fixed and not linked to the Actual/Anticipated Profit Rate. Wakil Fee will be deducted from the Muwakkil's Maturity Proceeds (i.e. the return of the Investment Amount and the Actual/Anticipated Profit Rate).

6. Indemnity: Wakil is not bound to indemnify the Muwakkil in the case the Investment Amount is lost or where the Anticipated Profit Rate is not reached unless there have been genuine actual losses arising as a result of the Wakil's wilful misconduct, negligence, misrepresentation or breach of the terms and conditions of the Master Wakalah Agreement.

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Why Standard is developed

- To provide the Industry an alternate liquidity management tool
- The Standard provides a robust operational, legal and Shariah certainty for institutions to transact without guaranteeing the principal and profit

Value Addition

- The early take-up of this Standard by institutions as soon as it was published signifies that it is the most viable liquidity management alternative which was needed to reduce over reliance on commodity Murabahah
- Central Bank of Bahrain has developed a deposit product for institutions based on IIFM Unrestricted Wakalah Standard and is urging the institutions to move to the IIFM Standard for liquidity management
- Islamic Banks particularly in the GCC countries are mostly using Unrestricted Wakalah for liquidity management purposes
- Comprehensive and detailed guidelines provide transparency

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Roles of Each Party	The First Party, Islamic Financial Institution (IFI) providing the Cash for investment is the *MUWAKKIL* and the Second Party IFI who will invest the funds on behalf of the First Party is the *WAKIL*
Investment Asset Pool	The Asset Pool could be either comingled with the *Wakil's* general Pool or a specific segregated pool of Assets as agreed
Indicative Profit Rate *Wakil* Fee / Incentive	*Wakil* acting as an Asset Manager will receive an agreed fee for its services. In addition, if the *Wakil* performs better than the indicated profit rate then he is entitled to retain the excess as incentive as communicated at inception of the arrangement
Investment Performance Risk	Any Loss from the investment is to be borne by the *Muwakkil*. The liability of the *Wakil* is limited to not fullfiling the liability to inform, misconduct, negligence, misrepresentation or breach of the Agreement
Event of Default by the *Wakil*	The *Muwakkil* will rank pari pasu with all other unsecured creditors

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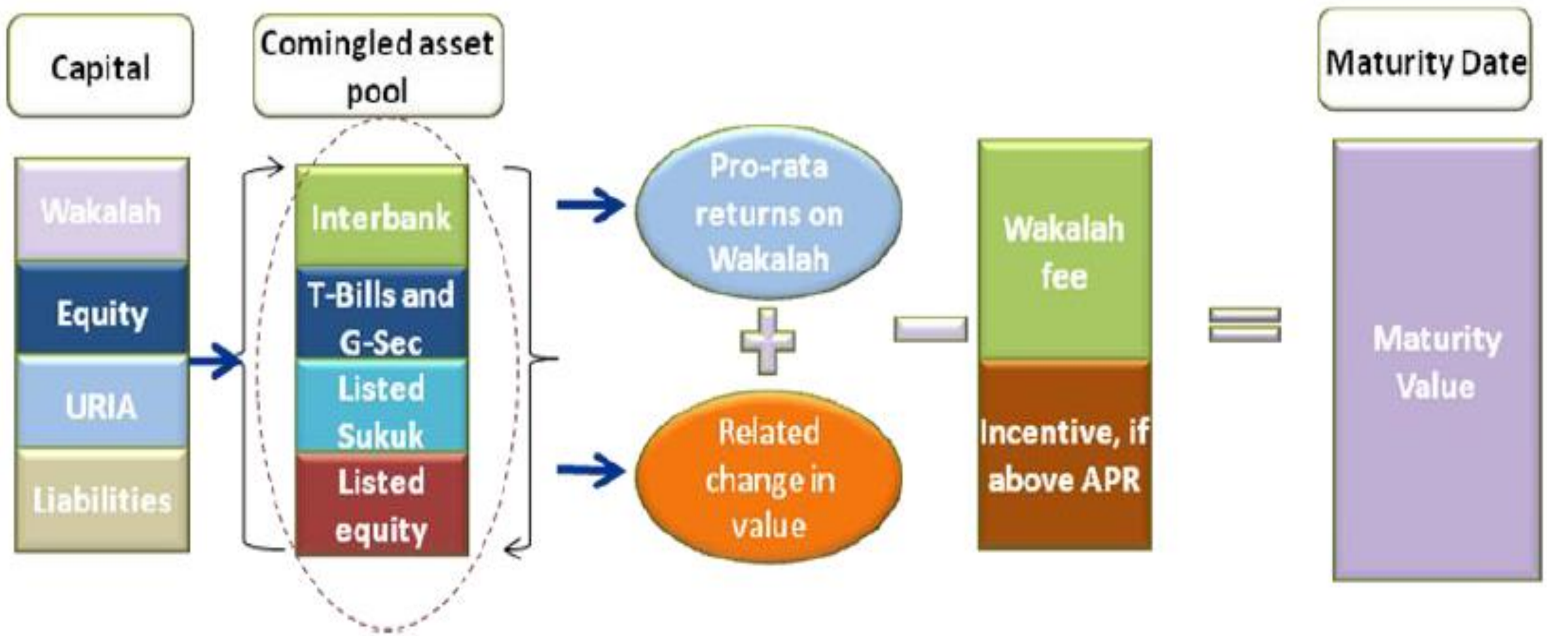
Commingle or General Treasury Pool Illustration



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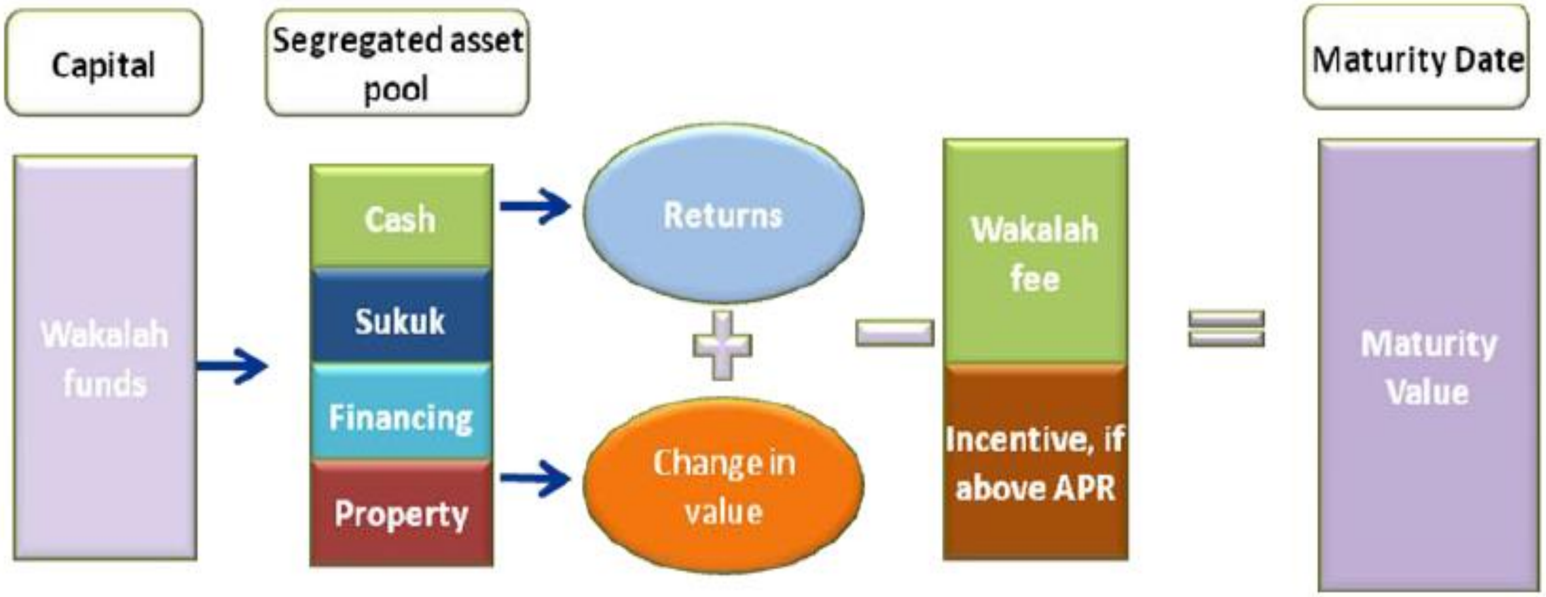
Segregated Pool Illustration



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Operational Guidance Memorandum

Can Conventional Financial Institution use IIFM Unrestricted Wakalah Agreement

Yes! Provided it follows the following:

- The funds are invested in Shariah compliant products / transactions and documented in the Wakalah Offering
- The Financial Institution must have a Shariah Board / governing body to ensure investments are deployed according to Shariah

Understanding Anticipated Profit Rate

- What is Anticipated Profit Rate?
- What if, Actual Profit Rate is lower from the Anticipated Profit Rate?

  What are the consequences?

  Early Termination?
- What if the Actual Profit is in excess of the Anticipated Profit Rate?

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What are the Key Features of the agreement?

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.

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The Schedules

1. Schedule 1 (*Form of Wakil Offer Notice*) (Offer)

2. Schedule 2 (*Form of Muwakkil Acceptance Notice*)

When the Parties wish to enter into a *Wakalah* Investment Transaction they should do so by completing Schedules 1 and 2 in accordance with the mechanics detailed in Clause 3 (*Wakalah* Investment Transactions).

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Operational Guidance Memorandum

Risk Management

As a commitment to transparent and enhanced disclosures as an agent in the financial sector, the Wakil should also consider presenting a Business Plan or a Feasibility Report to the Muwakkil before the Wakalah Investment Transaction.

Such Business Plan shall include description on the Wakil's investment plan including the targeted Wakalah Pool (mix, sector, geography, asset class, liquidity features etc.), indicative returns that the Wakil expects the Wakalah Pool to generate and the Wakil's assessment of ability to liquidate the Wakalah Pool at the time of Investment Maturity.

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Level of Subordination

What is the level of subordination of Wakalah under this agreement?

The level of subordination of Wakalah under this Agreement is highly dependent on the Wakalah Pool, whether it is managed on commingled or segregated pool basis.

Also the Wakil has no obligations to indemnify for losses.

However, on maturity or early termination, the payment obligations of the Wakil under the Agreement is expected to rank at least pari passu with the claims of all its other unsecured and unsubordinated creditors.

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Capital Adequacy

What is the regulatory capital treatment followed for the Wakalah transactions by the Muwakkil?

From a regulatory reporting perspective of the Muwakkil, usually, the Wakil is identified as the credit risk counterparty in an unrestricted inter-bank Wakalah transaction. Users of this IIFM Agreement should review and carefully consider their local regulatory requirements for classification of the Investment Amounts under such IIFM Agreements and its impact on capital adequacy.

The Wakil's capital treatment of the commingled assets funded through Investment Amounts under the IIFM Agreement is primarily driven by the on or off-balance sheet treatment of the Wakalah pool. Based on the current market practice, it is expected that, in the particular case of interbank treasury transactions, the commingled assets funded through Investment Amounts under the IIFM Agreement will continue to be presented as on the balance sheet of the Wakil as the asset de-recognition requirements may not be met. For segregated asset pools, a separate assessment would be required as per the local accounting and regulatory standards depending on:

- ❑Level of segregation (i.e. asset backed vs. assed based, ring-fencing etc.); and
- ❑Wakil's ability to change the composition of the Wakalah Pool and its continuing involvement and control over the assets.

Each party would need to assess the implication under local prevailing accounting pronouncements.

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Technical Analysis

In the case of IIFM Agreement, by design the product is structured to be an ‘Unrestricted Investment Account’. The IIFM Agreement has the following features:

Wakalah **pool commingled with** ***Wakil’s*** **general treasury** + **No restriction on decision making ability of the** ***Wakil*** + ***Muwakkil*** **relies on the ability of the** ***Wakil*** **to generate profit** = ***Wakalah*** **amount as “on-balance sheet”**

↑ Liability

↓ Equity of Investment accountholders

The IIFM Agreement when treated as on-balance sheet, could be considered for following classification

Equity of investment accountholders refers to funds received for the purpose of investment in a profit sharing or participation basis under Mudarabah arrangements. (Conceptual framework para 6.2)

Under AAOIFI, the definition of equity of investment accounts is narrow and only restricted to allow for Mudarabah based profit sharing investment accounts to be classified in the quasi-equity category. Wakalah arrangements, by nature are not considered to be profit sharing arrangements, but rather fee based arrangements.

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The factors that may influence the on-balance sheet or off-balance sheet are given below:

Off Balance sheet

- Investors making strategic policy as well as day to day decisions with regard to investing of funds
- Separate pool of assets (including ring fencing) and destination of funds for investment known to investors
- IFI has limited authority or little discretion in respect of the use of and deployment of the funds

On Balance sheet

- Investor relies on the ability of the IFI for generating a profit and is normally unaware of the precise destination of the funds
- Commingles the pool funds belonging to investors with its own funds with little legal or constructive separation of the cash and the assets
- Funds received through structured investment vehicles, would need to consider if the investment vehicle is subject to consolidation rules

Shukran
Wassalamu ‘Alaikum

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