General Council for Islamic
Banks And Financial Institutions

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CIBAFI

المجلس العام للبنوك
والمؤسسات المالية الإسلامية

مؤسسة منتمية لمنظمة التعاون الإسلامي
تأسست بمرسوم ملكي رقم ٢٣ لسنة ٢٠٠١م

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Omar Mustafa Ansari
Secretary General
Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI)
Al Nakheel Tower
10th Floor, Office 1001, Building 1074
Road 3622, Seef Area 436
Manama
Kingdom of Bahrain

Dear Mr. Ansari,

السلام عليكم ورحمة الله وبركاته،،

CIBAFI Comments on the AAOIFI Exposure Draft on Governance Standard "Syndicated Financing"

The General Council for Islamic Banks and Financial Institutions (CIBAFI) presents its compliments to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) and takes this opportunity to express its appreciation of the work that the AAOIFI does to promote and enhance the Islamic financial services industry.

CIBAFI is the official umbrella for all Islamic financial institutions, whose services and products comply with the Shariah rules and principles. CIBAFI acts as the voice of the Islamic finance industry, and our members comprise more than 130 Islamic banks and non-bank financial institutions, both large and small, from 34 jurisdictions.

We welcome this opportunity to offer our comments and recommendations on the AAOIFI exposure draft (ED) on the Governance Standard (GS): "Syndicated Financing". The comments contained in this letter represent the views of the CIBAFI Secretariat and feedback received from our members.

We deal first with the four most substantial points.

First: Syndication structures commonly have a function sometimes referred to as a "facility agent"[1]. Although this role is often played by the lead arranger, it is apparent that many of our members are used to its being a separate function. In view of this, we consider that this function needs to be defined separately in the ED and proper consideration be given to its role, responsibilities and relationships with other parties.

There is an associated point of terminology. The role of the facility agent is very different from that of the security agent but, because our members were expecting discussion of a facilities agent, they sometimes misread provisions aimed at the latter as applying to the former. In addition, some financings are based on Wakalah and the Arabic word "wakil" naturally translates as "agent". There are thus at least three possible uses of the word "agent" in the context of syndicated financings, and it will be necessary to ensure that the text is absolutely clear as to which is intended at any given point.

Second: We appreciate the reasons why the ED does not pursue the suggestion in SS 24 of a common Shariah supervisory board (SSB) to govern all aspects of the transaction. However, this does create some concern among our members that a need for approval from multiple SSBs at many stages of the transaction may delay important decisions, for example on restructuring. At a few points below we suggest measures that might mitigate this problem.

[1] (See Parties involved in loan transactions—overview - Lexis®PSL, practical (lexisnexis.com) for one guide to the relevant terminology)

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Tel: +973 17 357 300 - 301 Fax: +973 17 357 307 / 17 324 902 P.O Box 24 456 Manama, Kingdom of Bahrain
C.R. No 47423 www.cibafi.org Email: cibafi@cibafi.org

Third: The ED is at some points quite prescriptive about the contents of particular documents. Although we appreciate that it is intended to be an industry standard rather than one mandated by regulators, we think that more flexibility should be given, especially in areas where it may be industry practice to split certain documents, or for matters in one document to be cross-referred to in another, rather than reproduced in their entirety. Examples of documents to which this might apply are the information memorandum (para 23) and the inter-financier agreement (para 25).

Fourth: The document needs to give greater coverage to situations in which the participants in Shariah-compliant financing are not all IFIs. One possibility is that conventional financial institutions may participate in such financing. This possibility is explicitly recognised in AAOIFI SS 24 (and is different from hybrid financing in which there is a compliant and a non-compliant tranche). The ED generally, does not provide sufficient guidance on how governance should apply in such a situation, though it does deal with hybrid financing. For example, how would the role of the lead arranger be changed if that firm were a conventional institution, which SS 24 explicitly does not forbid? A second possibility is that entities other than financial institutions may participate. This might, for example, occur in the case of a government body charged with the development of particular sectors or regions. At the very least the definitions (e.g., 7(m)) should not appear to exclude these possibilities.

Moving to somewhat more detailed points:

In **para 12(f)**, it would be helpful to recognise the possibility of a revolving syndicated financing transaction in which the financing would be renewed – though we recognise there can be Shariah issues with this - or of standby finance where the facility may not be drawn upon initially or at all. These may well pose different governance issues, but if they have been excluded for this reason it would be helpful to say so.

In **para 15**, the ED suggests that a potential customer should present its proposed terms for syndicated financing in an expression of interest request "preferably to be available

publicly". As far as we are aware it is not the practice in either Islamic or conventional markets for businesses seeking financing to state publicly the terms on which they are seeking it, and we consider that such information at this stage would normally be regarded as commercially confidential.

The ED is silent on how to address any failure in Shariah compliance during the lifetime of the transaction as may occur, for example, if there is a significant change in the business of the customer. This may be particularly relevant in the case of a hybrid syndicated transaction (**paras 20 and 21**) since such a transaction will already involve the customer paying some interest. Some provisions on this might be appropriate.

We have already noted that the list of information to be included "at a minimum" in the information memorandum (**para 23**) is highly prescriptive and that some flexibility may be appropriate. We note in particular that a detailed feasibility study (**para 23(c)**) may not be required in all cases and, where it is needed, it may be provided separately by an independent consultant/market expert.

We note that the ED, in **para 23(i)**, suggests including information on the potential risks and strategies/instruments to hedge them as applicable to the customer, the syndicated financing transaction and the syndicated financing underlying assets. Hedging commonly raises Shariah issues, and we suggest that any fatwa relating to the transaction will need to cover these aspects as well as the primary financing.

The ED, in **para 25(f)**, refers to the "summary term sheet" to be included in an inter-financier agreement, however, the "term sheet" has not been defined in the ED. This is also relevant to the point made above about cross-referencing between documents. Also, there is some overlap between para 25(f) and para 25(a), where the former is requiring a summary of the structure and the significant terms and conditions of the syndicated financing transaction which have been covered under para 25(a).

The ED, in **paras 25(g) and 25(k)**, covers pre-exit and transfer of shares of the syndicated financing transaction. These are broadly similar (though not identical) scenarios and therefore these paragraphs could usefully be merged.

In **para 27**, the ED refers to the independent and equitable status of rights and position of Shariah-compliant syndication participants. It is unclear what is intended here; is the intention to protect the position of the IFIs individually, or is it to allow them some rights of collective decision-making in relation to the Shariah-compliant tranche only? We suggest that the relevant aspects of governance need to be addressed in more detail. We suggest that as part of this the IFIs should be allowed to be a party to a "Common Terms Agreement" which ensures an equal footing of both Islamic and conventional tranches with respect to common commercial/legal aspects which do not interfere with the Shariah compliance of the transaction.

Para 39 deals with sharing of information throughout the lifetime of the transaction. However, some of its provisions would be impractical at least at the early stages, when potential participants have not committed to the transaction; it would be wrong to require sharing of potentially adverse information at this stage.

Para 44 deals with the mechanics of early settlement and includes a requirement for specific approval by the SSB of each of the participating IFIs. In a real commercial negotiation, which could move quite quickly, this requirement could be difficult, and some thought should be given in the ED as to how the difficulty can be eased. Is there scope, for example, for some possible early settlement arrangements to be covered in the initial agreements, and thus effectively pre-approved? Is there scope for the requirement to be waived where the settlement provisions meet standards approved by a national Shariah authority?

In **para 46(a)**, the ED requires a syndication participant intending a pre-exit to inform the customer about its decision. CIBAFI and its members are of the view that it would be

appropriate for the lead arranger (or, where one exists, the facilities agent), rather than the participant, to make this disclosure.

Para 46(b) requires a syndicated participant to share information with other syndicated participants on its pre-exit decision. CIBAFI and its members are of the view that disclosures relating to pre-exit should be limited to the scope which banks negotiated and agreed to in the inter-financier agreement. Normally, the disclosure of the bank's rationale behind exit is not required, and such a requirement might disadvantage IFIs required to comply with the standard by revealing confidential information such as the strategic plans of the exiting participant.

Pre-exit also raises the issue of what happens if the lead arranger exits, either from that role or from the transaction as a whole. The ED is silent on this, but it will clearly raise issues of governance which should be covered.

Finally, in para 47, the ED refers to the circumstances in which restructuring or rescheduling may take place, including default or potential default. A syndicated financing agreement normally defines events of default, which go beyond the obvious – failure to make expected payments on time – and typically include breaches of financial covenants, breaches of warranties and, importantly, defaults on other financings. This last provision is normally included to prevent customers from playing off different financiers against each other by defaulting selectively on some obligations but not others. But in such circumstances of default, any restructuring or rescheduling needs to take account of other parties who have provided finance. Some mention of how governance is to be managed in these circumstances would be helpful.

We would like to express our appreciation to AAOIFI for its great effort and commitment with respect to developing standards that accommodate the interest of the global Islamic finance industry.

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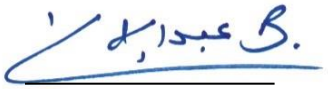
We remain at your disposal should you need any further clarifications on the above.

The General Council for Islamic Banks and Financial Institutions takes this opportunity to renew to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) the assurances of its highest respect and consideration.

Yours sincerely,



Dr. Abdelilah Belatik
Secretary General

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