Muzakarah on Failure Resolution of Islamic Financial Institutions

PIDM
Perbadanan Insurans Deposit Malaysia
Protecting Your Insurance And Deposits In Malaysia

Session 3

Partial Transfer Mechanism: Shariah Issues And Solutions

Panel discussant(s) presentation

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Partial Transfer Mechanism : The UOB Experience

- Amir Alfatakh Yusof
- SVP, Islamic Banking UOBM

- 11 September 2024

Citi and UOB announced the acquisition of Citi's Retail Banking portfolio on 14 January 2022, as part of a broader sale agreement covering consumer banking across Malaysia, Thailand, Vietnam and Indonesia and excluding the bank's institutional businesses.

October 2022

- Signing of Asset Liabilities Transfer Agreement (ALTA)
- Vesting Order Obtained from Court
- Signing of Transfer Agreement
- Signing of Sale of Debt Agreement

Legal Day One : November 2022

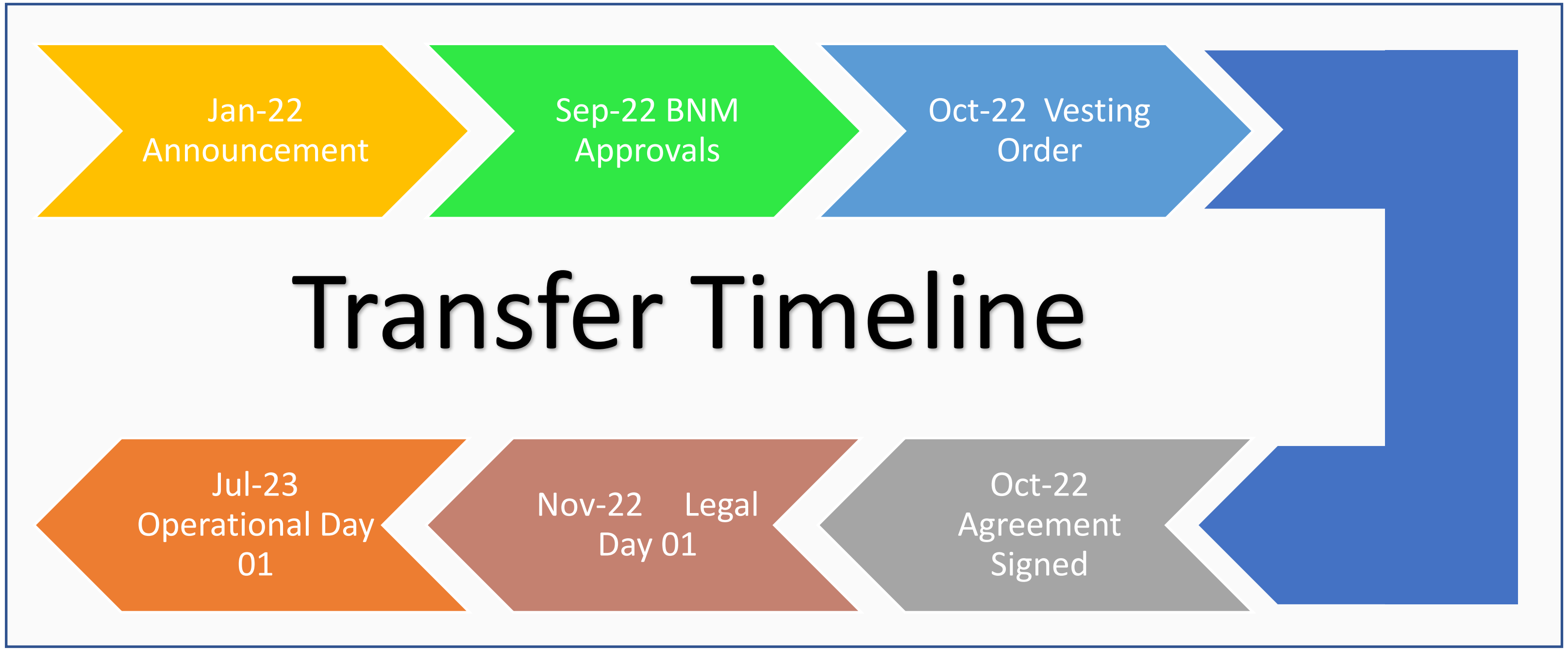
Start of Migration & Conversion Actions : December 2022

Completion of Migration & Conversion : June 2023

- Citi Home Financing (BBA)
- Citi Home Financing (Musharakah Mutanaqisah)
- Citi Current Account / Savings Account (Qard)

Operational Day One and System Cut Off : July 2023

Outlook : Partial Transfer of Citibank Islamic Retail Portfolio to UOB Malaysia



Operational Considerations

As one of the major tenets of Sale, the Acquisition Price to be determined, agreed and settlement date to be decided, without ambiguity and penalties once agreed by both the Selling Bank and Acquiring Bank

The Acquiring Bank to assess and ensure capabilities to provide similar or better products / services especially where there is no direct equivalent products in the Acquiring Bank. The essence of the original contract is to be retained as best as possible

Assessment on how in-depth the ALTA & Vesting Order covers the requirements of Shariah. Subsequent agreements to be drawn and executed to cover the Shariah gaps in the Acquisition

UOB

Plan and Process Methodology to be established with the understanding that the Acquisition will include all type of Asset / Liabilities conditions, without the ability to pick and choose desired portfolio. The “way-out” to be developed without penalizing customers

1. The Acquisition Price to be Agreed for Sale
2. The Equivalency & Availability of Products to Migrate / Purchased
3. Sufficiency of ALTA & Vesting Order for Shariah Transaction Requirements
4. Inability to Pick & Choose Asset / Liabilities (Transfer Lock, Stock & Barrel)

UOB Approach to Partial Transfer of Citi Portfolio

Financing (Tangible Assets & Debts) - Sale

BBA (Debt) – Sale & Purchase of Debt with Immediate Settlement (Bay Ad-Dayn)

Financing (Shares Receivables) - Transfer

MM (Shares) – Transfer of Rights with Immediate Settlement (Hawalah)

Deposits (Liabilities) - Transfer

Qard (Debt) - Transfer of Debt with Immediate Settlement (Hawalah)

Note : UOB did not adopt AAOIFI approach for the sale of debt (calculation of tangible assets vs intangible assets)

Contractual Relationship

- **Buyer & Seller**

1. ALTA to buy Assets and Liabilities Portfolio for cash consideration
2. Vesting Order provides the rights as per original owner
3. Shariah transfers based on Sale of Rights, Sale of Debt and Transfer of Debts
4. On Legal Day One, UOB have legal right to Citi portfolio
5. On Operational Day One, all systems are under UOB (Citi system closed down)

- **Portfolio Owner & Customer**

1. Notification to Customer on acquisition, and inform any change of terms and conditions
2. UOB takes ownership of BBA Financing, MM Financing and Qard Deposit while retaining the validity of the existing contracts
3. Customer is given choice to remain / exit / refinance / pay-off / convert / restructure the portfolio acquired by UOB within a reasonable time
4. Customer given option to refinance into Tawarruq to enjoy other benefits

The Legal Considerations

The Legal Rights

Legal Considerations for the Acquisition of Citi Portfolio

1. Asset Liability Transfer Agreement as the Main Legal Agreement
2. Vesting Order provides new Ownership rights to portfolio
3. Notice of Acquisition Provided to Customers
4. Existing Contractual Documents remains intact

Documents for the Acquisition

Asset Liabilities Transfer Agreement (ALTA)

Vesting Order issued by Court

Sale and Purchase of Debt Agreement

Transfer of Shares & Liabilities Agreement

Documents for the Acquisition

Asset Liabilities Transfer Agreement (ALTA)

1. Outlined the portfolio to be purchased from Citi, both Islamic and Conventional portfolio
2. Consideration price for overall purchase is mentioned in the agreement
3. Outlines the definition of Legal Day One & Operational Day One
4. Outlines the support period of the acquisition and post acquisition
5. Do not contain any Shariah-related clauses on the Acquisition and its contractual relationships

Documents for the Acquisition

Vesting Order issued by Court

1. Grants the same legal rights and responsibilities to UOB the same as the seller i.e. Citi
2. the scope of the acquisition in reference to the ALTA, including rights, powers and responsibilities resulting from the acquisition
3. Outlines the compliance period and validity of the Vesting Order
4. Specifies any conditions to be complied for the Vesting Order to be enforcable
5. Do not contain any specific instructions for Islamic facilities or Shariah requirements

Documents for the Acquisition

Sale and Purchase of Debt Agreement

1. Sale of Citi's Islamic Debt portfolio under Bai Bithaman Ajil Home Financing at an agreed price on specific Sale Date

2. Settlement of the Amount to be made on spot date (or within a period without further changes in price)

Documents for the Acquisition

Transfer of Shares & Liabilities Agreement

1. Sale of Citi's Islamic Rights i.e. Citi's rights to the shares under Musharakah still to be purchased by Customers in the Musharakah Home Financing product to UOB

2. Transfer of Deposits portfolio via Hawalah for Qard-based Current Account and Savings Account. The transfer do not involve movement of cash payment to Citi as it is a liability transferred from Citi to UOB. UOB agree to undertake the payment of Qard amount to customers and amount undertaken is deducted from the overall purchase price of the ALTA as it is a loan payable to customers

Shariah Consideration for the Acquisition of Citi Portfolio

Shariah Committee to deliberate on the potential concepts, contracts and transactions needed, to be documented and captured in an Aqad agreement

Considerations

1 Identification of necessary transactions, contracts and documents to execute

Considerations

Shariah Committee to deliberate on treatments where discrepancies exists such as Selling Price or Total Profit, especially where there is incremental amount in the Acquiring Bank's system, or areas where Profit is capitalized by system

1. Identification of necessary transactions, contracts and documents to execute
2. Avoidance of fictitious transactions, or transactions which may lead to Riba

Considerations

Shariah Committee to discuss on approach where the Acquisition may result in legal or financial benefits to the Acquiring Bank, and requirements to obtain consent or acceptance to the changes by customers

1. Identification of necessary transactions, contracts and documents to execute
2. Avoidance of fictitious transactions, or transactions which may lead to Riba
3. Additional Benefits enjoyed by UOB from the Acquisition, requiring consent

Considerations

Shariah Committee to deliberate the execution and methodology of the actions to ensure it complies with the rules of Shariah, to follow up with review and audit of its implementation

1. Identification of necessary transactions, contracts and documents to execute
2. Avoidance of fictitious transactions, or transactions which may lead to Riba
3. Additional Benefits enjoyed by UOB from the Acquisition, requiring consent
4. Robust deliberation by Shariah Committee to ensure validity of Acquisition

Considerations

Shariah Committee to take into consideration the best practices, Urf, guidance from past exercises as well as any references by regulators on the expectation of such Acquisition, including potential setbacks on Shariah decisions

1. Identification of necessary transactions, contracts and documents to execute
2. Avoidance of fictitious transactions, or transactions which may lead to Riba
3. Additional Benefits enjoyed by UOB from the Acquisition, requiring consent
4. Robust deliberation by Shariah Committee to ensure validity of Acquisition
5. References to existing practices, regulatory ruling and other Shariah discussions on Acquisitions

Consumer Protection

Consumer Consideration for the Acquisition of Citi Portfolio

Customer's Best Interest

UOB

1. Fairness in Terms & Conditions if there is any variations / changes
2. Sufficient Notice and Information Provided
3. Forced Conversion should Provide Benefits to Customers
4. Options to Exit to be made Available

Establishing Relationship with Acquired Citi Customers

- Main Consideration & Rationale

- **Permanent Acquisition**
- Close of Business & No Turning Back, Short time-limit for the transfer. No other option but to transfer / sell

- **Validity of Existing Aqad**
- Customers have completed the Aqad and may not want to be involved into a re-Aqad. Is there a need to re-Aqad / re-Sign legal documents in the presence of Vesting Order? Is the inconvenience / additional costs necessary?

- **Notification of Changes**
- The changes to terms and conditions are to be informed to the customers if they are material or adverse to customers

- **Option to Decline**
- The customers are given the right to reject the acquisition or change of terms, with right to switch to conventional facilities

UOB

- Types of Customers & Legal Status

1. Good customer + agree with acquisition
2. Good customer + do not agree with acquisition
3. Bad conduct customer + agree with acquisition
4. Bad conduct customer + legal action undertaken
5. Bad conduct customer + write off / charge off / bankrupt
6. Bad conduct customer + regularization
7. Dormant customer / uncontactable
8. Demised customer / under estate

The Partial Transfer Outcome

Results at Operational Day One

Retain

Comfort

Experience

Option

OPERATIONAL DAY ONE : 17 JULY 2023

Results at Operational Day One

Comfort

Experience

Option

Retain

- ✓ UOB was able to retain 95% of financing customers
- ✓ 5% customers mainly settled the balance outstanding
- ✓ Retention of Deposit was low on Operational Day one (27%), however increased to about 50% by 31 December 2023

Results at Operational Day One

Retain

Experience

Option

Comfort

- ✓ The approach taken provided customers the comfort that the existing contract remains valid without requirement to make changes
- ✓ Customer given offer to change contract but requires consent to switch the contract (with variations to terms)
- ✓ No additional charges are imposed for the change in contract including legal fees

Results at Operational Day One

Retain

Comfort

Option

Experience

- ✓ Sufficient notification and information was provided to outline the changes, including Shariah requirements
- ✓ Seamless transition resulted in good experience with minimal unnecessary disruption
- ✓ Trained personnel was key to address customers' concerns

Results at Operational Day One

Retain

Comfort

Experience

Option

- ✓ At all times during the transition and conversion, customers are provided with options to opt out from the acquisition
- ✓ Options provided includes settlement, refinancing, restructuring or exit from the bank without penalties
- ✓ If contract conversion is done, the customer is allowed one re-instatement to original contract if disagree with new contract at no cost

Summary:

While Vesting Order is deemed to be sufficient to transfer the rights to the Bank, clear Shariah consideration must be made to ensure the contract (and its roles) clearly captures the validity of the transfer. This is captured via specific agreements to address the relationships between UOB and Citi.

Right By You