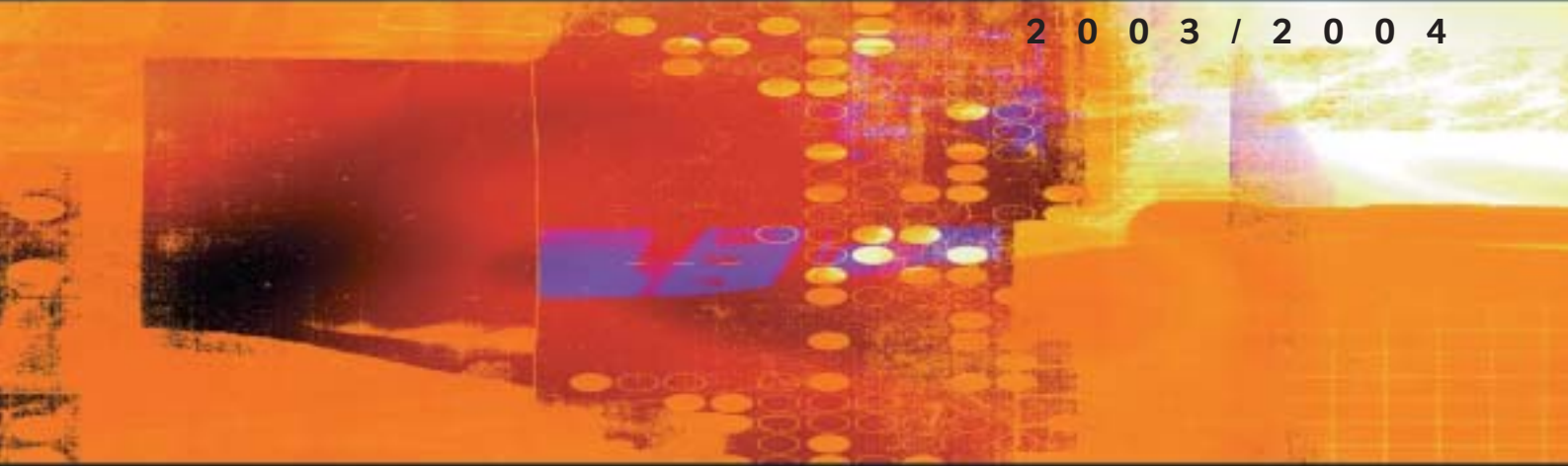


global  
securitisation  
REVIEW

# Global Securitisation Review

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A EUROMONEY PUBLICATION

# Market review for the MENA/GCC region

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The MENA market is witnessing increased activity on the securitisation front, ranging from regulatory developments to the completion of an important number of transactions, notably in Egypt, Lebanon and the GCC, and the evolution of Islamic financial structuring. This article will focus first on the importance of securitisation for emerging economies, with an assessment of the proposed opportunities. Secondly, it will review the hurdles that face structuring from regulatory, financial, accounting, tax, capital markets and rating perspectives. Finally, it will examine the new opportunities in this market, essentially through the emergence of Islamic finance.

## Why securitisation helps companies in Emerging Markets (EM)

The last two years have witnessed a regained interest in investment banking activities in emerging markets, after a tough period of stagnation and downsizing. The market has become more mature, modest and realistic. Traditionally, emerging markets' investment banks offered the same product range as in developed markets, mainly standard debt and equity solutions, such as bonds issuance, mergers or IPOs. This product range proved to be totally inadequate and reflected a deep misunderstanding of the nature of the market. The investment banks' activities were constantly and inexorably directed towards corporate finance and capital markets. The investment banks' miscalculation and permanent accounting losses contributed to promoting the idea that no investment banking activity was possible in emerging markets, while investment bankers ignored opportunities offered by the customers' growing assets. The main reasons that both corporate finance and capital market activities did not appeal to

customers are:

- the family nature of business;
- the absence of growth perspectives;
- under capitalisation of organisations;
- a massive usage of short-term funding; and
- lack of strategic vision.

Figure 1 highlights the fundamental weaknesses of traditional investment banking offerings (bonds, IPOs, mergers, etc.) to emerging market companies.

On the other hand, it seems that the development of investment banking activities in emerging markets could be achieved through the development of structured finance. In fact, the asset side of the balance sheet offers many interesting features to develop high added-value financial services.

The reasons the EM companies are appealing for structured finance activities, particularly securitisation, are:

- (1) the current assets represent 30% to 40% of the total assets;
- (2) these assets can, to an acceptable extent, be

**Figure 1: Fundamental weaknesses of traditional investment banking offerings**

	Corporate finance	Capital markets
<b>Capital</b>	<ul style="list-style-type: none"> <li>Small size transactions</li> <li>Ego problems</li> <li>Will for autonomy</li> <li>No perspectives for growth</li> </ul>	<ul style="list-style-type: none"> <li>Totally illiquid</li> <li>One way market</li> <li>Lack of serious transparency</li> <li>No culture for dividends' distribution</li> <li>No perspectives for growth</li> <li>Information shortage</li> </ul>
<b>Debt</b>	<ul style="list-style-type: none"> <li>The debt market is well served by local banks</li> <li>The size of bond issuance is related to equity which is generally weak</li> </ul>	<ul style="list-style-type: none"> <li>Small size for investment bank operations</li> <li>Lack of information and risk benchmark</li> </ul>

- transferred;
- (3) such transactions have no impact on the capital structure of the customer;
  - (4) off-balance-sheet financing does not increase debt;
  - (5) positive impact on the balance sheet, improving return and liquidity ratios;
  - (6) lower cost of funding than the traditional bank loans;
  - (7) positive marketing impact; and
  - (8) the bank lines are saved for strategic investments.

Securitisation seems to be the appropriate tool to satisfy the financing requirements of emerging market companies. Yet many legal and cultural hurdles impede the full development of the securitisation activity in these markets.

## What are the challenges?

### Absence of regulation

Although some assert that a securitisation law must be enacted prior to conducting securitisation activities, experience shows that securitisation can occur in the absence of any specific legislation. In Lebanon for instance, the transfer of assets can be done according to article 280 of “Code of Obligations and Contracts,” or based on the fiduciary Trust law N.520 of June 6, 1996 that deals with “Financial Markets Development and Fiduciary Contracts.”

The Special Purpose Vehicle (SPV) could be either a company with a variable capital regulated by the Commerce Code, a community according to “Code of Obligations and Contracts” or a Fiduciary regulated by Central Bank Directive N. 6601 of May 23, 1997. This transfer can be done on a true sale basis. Marketable securities are regulated by article 252 of Code of Commerce, and their trading on the Beirut Stock Exchange has been easier since the introduction of a new section in Decree N.7667 of December 16, 2000, which encourages innovation and allows “all other securities or financial negotiable values”.

What seems easy and straightforward in Lebanon appears more complicated in other jurisdictions such as Saudi Arabia, Turkey or Egypt. In Saudi Arabia for instance, sale of assets and receivables is of course possible, but restrictions on the nature of the purchaser make the task sometimes impossible. In this Islamic-Shariah based legal system, form can be totally disregarded by the court that can focus exclusively on substance, and hence pierce any type of legal or corporate veil. True sale can be re-qualified. Except for Lebanon, most of the MENA markets have not enacted trust or securitisation

laws. In the absence of such laws, setting up an SPV that meets the required standards of flexibility and bankruptcy remoteness becomes an issue.

The first solution that comes to mind in such markets is the usage of an offshore vehicle. In fact, offshore vehicles are, to a large extent, tolerated by MENA legislation. But in the case of Saudi Arabia and other emerging markets, sale of (some) assets to non-citizens is strictly prohibited! A way around this second hurdle is to set up a two-tier structure: an “Owner SPV” and an “Issuer SPV.” In the absence of trust laws and securitisation laws, the Owner SPV will have to be a limited liability company. This raises other hurdles, especially in light of Saudi legislation with respect to losses. In case losses exceed three-quarters of capital (and not shareholders equity!), the shareholders will face a risk of removal of the limitation of the liability. In fact, the losses must either be absorbed by an immediate capital increase or initiate immediate liquidation of the company. Failing to do so, the partners will become jointly and severally liable for the debt of the company. It is therefore easy to understand why setting up trust services, under such circumstances, continues to be very difficult.

Of course, the Arranger can always establish the Owner SPV as a subsidiary of the Originator. This solution exposes the Owner SPV to two risks: (i) consolidation risk, which in itself contradicts the purpose of the transaction, and (ii) control over the assets, especially in a situation where conflict of interest occurs; the Originator being usually the holder of a junior tranche. It seems clear that having the Owner SPV as a subsidiary of the Originator is not satisfactory in the absence of autopilot schemes (pre-determined management powers) and/or specific legislation. Specific structuring techniques can address the Owner SPV bankruptcy remoteness issues to an acceptable extent. Yet, this requires skill, imagination and flexibility from all parties to the deal.

### Accounting standards

The accounting standards are not standardised throughout the MENA region. Some countries have shifted to International Accounting Standards (IAS), others have implemented a mixture of Financial Accounting Standard Board (FASB) and IAS, and finally some countries have kept their own national standards. In Lebanon for example, IAS apply according to the financial ministerial order N.6258/1 introduced in August 21, 1996 and improved on June 14, 2001, according to N. 673/1. De-recognition, sale accounting, consolidation and claw back are then favourable to securitisation transaction.

In the case of GCC, and more specifically the Saudi Arabian market, accounting standards have

been raised up to international standards by a blend of IAS and Saudi GAAP (based on FASB). The existing standards are FASB inspired, but other accounting issues (not explicitly addressed) are to be construed in line with IAS. The usage of such a robust accounting base makes the sale of assets easier, but at the same time brings confusion as to which benchmark to take. With respect to the true sale issue, it is unclear whether the de-recognition of financial assets is risk/reward or control-based? Needless to say that IAS internal contradiction (IAS 39 and SIC 12) has not been tested yet and the way they will interact with FASB is still unknown.

### **Unstable tax environment**

Another issue to address is tax related. In the absence of adequate legislation, tax issues can erode the economics of any securitisation transaction. In a two-tier structure where the Owner SPV will have to route funds to an offshore Issuer SPV, such funds will be subject to withholding tax. Such tax can sometimes be circumvented through structuring techniques involving the Luxemburg Fiduciary Trust or a Jersey-based specific vehicle.

Another issue is when, having enacted such securitisation or fiduciary or trust laws, the government fails to understand or to grasp the substance of such concepts, and due to temporary cash shortage (which is common in emerging markets), modifies such laws in a way to levy taxes on such vehicles.

Tax legislation is one of the most unstable areas in the MENA region. Lebanon gives a good example of such risks, as it has witnessed throughout the last decade a swing in income tax, the introduction of the VAT (without lowering the customs duties), and the enactment of a tax-neutral fiduciary trust law in 1996, which was later subjected to double taxation in 2003.

### **Absence of capital markets**

Securitisation is not only about corporate finance, but also about capital markets. The absence of capital markets is yet another hurdle to overcome in the MENA region. Much has been written on emerging markets' inability to develop capital markets. According to experts, the most important reasons for this failure are the lack of infrastructure of the return measurement, and the lack of superstructure of risk measurement. The infrastructure of the return measurement is an application of the transparency concept. It boils down to setting up a public or a private institute dealing with collection, processing and dissemination of legal, financial and industry information on micro, meso and macro economical levels. This critical breakthrough requires only a slight modification in the existing laws and a

minimal capital allocation. It is a path that emerging markets have not yet decided to take, especially due to the role of transparency in uncovering corruption.

Fana and Von Hayeck, the "architects" of the information age, confirmed 20 years ago that information is the raw material of market economies. Accordingly, The European Community allocated two directives (the 4th and the 13th directives) to upgrade and harmonise information, disclosure and transparency throughout Europe in conjunction with the construction of the European Union. No similar measure was ever attempted in MENA.

In markets poorly covered and barely understood by Rating Agencies, and in the absence of transparent reliable affordable data, heavy investment is required to establish independent and objective risk measurement. Rating agencies have refused to make such investment, arguing that the return on such investment is more than hypothetical. The solution to this seems to be another governmental action setting up a "National Scale Rating." This will allow for rationalisation of risk costs and for building trusted relationships between the investor and the markets, allowing bank depositors to dis-intermediate and convert unproductive deposits into direct investments.

Capital markets cannot flourish without an independent and scientific measurement of both risk and return. Until then, banks will remain the predominant structured paper investors in the MENA region. Having banks as end-buyers of structured paper distorts the disintermediation process and dramatically narrows the spreads available for both investors and originators. This factor diminishes the attractiveness of EM securitisation and seems to be a key factor in understanding the shy move towards securitisation in the MENA at times when the industry is witnessing continuous stunning growth throughout the world.

### **Sovereign ceiling**

When dealing in emerging markets, one of the main advantages of securitisation/structured finance is the ability to breach the sovereign ceiling and hence provide lower funding costs.

The cost of funds for healthy companies in emerging markets, and more specifically, poorly rated countries, is an issue. The rating agencies have developed the theory whereby no company would be allowed a higher rating than that of the country in which it is operating. The concept, better known as the sovereign ceiling, is based on the underlying assumption that a sovereign default will force all

domestic issuers or obligors to default, as the sovereign will necessarily impose restrictive measures impeding access to hard currency necessary to service their obligations. This indicator is very hard to measure in the absence of a comprehensive intellectual framework or any conclusive experience. This concept cannot be synthesised and expressed using rating symbols due to the lack of comparative methodology and benchmarks. The sovereign ceiling theory has no scientific grounding or justification known to us, nor has it been demonstrated via a “*débat contradictoire*.” It seems that this theory is more of a dogmatic approach that provides an intellectual comfort for rating agencies with limited time and resources to deal with a variety of cultural models in business. This theory also neglects any other trade model than the one based on the written contract. It totally neglects the binding effects of know-how, notoriety, pledge and other social or cultural constraints characterising non-western societies.

Such cultural issues are also found in some industries in Europe, such as the diamond market in Anvers. One might refer here to the works of David Freidman, as detailed in his reference book *Law’s order*. One can also point out that the sovereign ceiling theory has been put aside by its own genitors for specific political reasons. Some countries have earned investment-grade rating while lacking the basics of any investment-grade requirement. Other countries like Japan and Korea, and lately even Germany, officially objected the rating agencies’ discriminatory practices. In order to make up for the above weaknesses, sovereign rating has been promoted as the best proxy for the sovereign ceiling.

**Figure 2: Sovereign ratings for some MENA countries<sup>1</sup>**

Country	Moody’s	Fitch Ratings	Standard & Poor’s
Bahrain	Baa3	A-	A-
Egypt	Ba1	BB+	BB+
Israel	A2	A-	A-
Jordan	Ba3	NA	BB
Kuwait	A2	AA-	A+
Lebanon	B2	B-	B-
Oman	Baa2	NA	BBB
Qatar	A3	NA	A+
Saudi Arabia	Baa3	NA	A
UAE	A2	NA	NA

When dealing in emerging markets, one of the main advantages of securitisation/structured finance is the ability to breach the sovereign ceiling and hence provide a lower cost of funding. Several

techniques allow breaching the ceiling and mitigating emerging markets risks<sup>2</sup>. The techniques can be grouped under three main headings:<sup>3</sup> (1) bypassing techniques, (2) outlasting techniques and (3) exemption techniques.

The bypassing techniques used by investment bankers and securitisation specialists in their effort to address sovereign risk issues are based on the ability to capture hard currency outside the scope of government intervention and beyond government’s reach. These techniques are referred to as “bypassing the exchange controls”. The first technique is Future Flows. Many securitisations emanating from Turkey, Brazil, Egypt and Mexico have achieved BBB (AAA where a monoline insurance wrap has been obtained), by capturing hard currency cash flows in bank accounts located offshore. The Originator, typically an exporter, assigns the receivables and instructs its clients to settle their due in an offshore account administered by a Trust. The only way a government can affect such a structure is consolidating the SPV with the Originator and then considering any payments to the SPV as part of his scope of intervention. It is worth noting that sophisticated structuring techniques can address such issues and avoid SPV consolidation. The structure is not totally immune from country risks, because it will always be limited to the Originators’ capacity to continue generating the needed receivables.

Another technology often used in Future Flow deals is the Supply Bonds. An insurer will cover supply risk by paying the trustee if the Originator fails to deliver the goods. Another technology used in bypassing the exchange controls and country risks is the swaps and guarantees that can be locked into a structure and triggered in the event of forced default or lack of access to foreign currency. In this case the guarantor or the swap counterparty will make hard currency payments to the SPV and will be entitled to whatever funds are available in local currency or onshore accounts. Currency swaps are used to address the devaluation issues, as well as transfer risk convertibility risks. A swap trigger promising to pay abroad if sufficient local currency funds are collected domestically will allow the cash flow to bypass government controls.

Apart from the commercial insurers, two main agencies underwrite emerging market risks: OPIC (Overseas Private Investment Corporation), a US government agency and MIGA (Multilateral Investment Guarantee Agency), the World Bank subsidiary. Rating agencies awarded insured transactions with above sovereign rating (the MSF deal in Brazil). It is worth noting that the deal will

only reach a stand-alone rating level. Should the structure collapse or the obligors default, OPIC and MIGA will not be obligated to make payments. Alternative structuring technology like the Bonex structure existed and was able to lift a deal above the Sovereign ceiling levels.

The investment banker can structure a deal in a way to outlast the exchange controls. It consists of providing access to foreign currency for the expected duration of the exchange controls. Two techniques are available here. The first is to fund an offshore account with enough cash to outlast the exchange control period. The funds should be applied to satisfy the interest due to investors. But how to determine the time frame for exchange controls? This period, as set by rating agencies was 12 to 18 months before the Argentine crisis. It is now 24 months. This technique has become a very expensive mitigation tool.

The second option available to structuring banks is the risk triggers, whose role is to legally increase the weighted average life of the notes in order for them to outlast the control period. During the periods of exchange controls, all money is captured in a GIC Account. The amounts are in hard or local currency, and used to pay the Noteholders once the controls are lifted. Combining both techniques (the offshore accounts and the risk triggers) usually proves quite efficient.

The exemption techniques refer to those techniques involving players more powerful than the Sovereign. The first most obvious one is the structuring technique based on Preferred Creditor. The underlying assumption being that the government will default on all creditors except the multilateral agencies (like the World Bank and its subsidiaries). A transaction where the lender in substance or even the Lender of record is a multilateral agency can achieve above sovereign. Experience proved that it is not systematically the case and government seems to be able to default even on those prominent players. Another exemption technique involves a company within a country with extensive powers due to historical or industrial reasons. These companies have unlimited access to hard currencies or are perceived by the Sovereign as vital players, drivers of economical growth. It is the case with PDVSA in Venezuela or to a lesser extent with Solidere in Lebanon. Hence, it is not in the best interest of the Sovereign to force these companies to default even if the Sovereign is itself in urgent need for hard currencies. The foregoing is true, subject to local politics and Emerging Markets Sovereigns sometimes do shoot themselves in the foot.

Under pressure from investment bankers and ever more innovative structures, rating agencies have loosened their requirements and somewhat undertaken a shift in their policy of proposing and accepting solutions for breaching the sovereign ceiling. In June 2001 Moody's announced that emerging market debt may not be constrained to the country ceiling where (a) the creditworthiness of the borrower is judged to be sufficiently high; and (b) the likelihood of a general moratorium in the event of a government default is sufficiently low; and (c) where the Obligor has special access to foreign exchange. Rating agencies have not yet dared question the mainstream theory they have contributed to putting in place.

## What are the new opportunities? Islamic finance

One of the main developments in emerging markets is Islamic finance. Like all conventional banks, Islamic banks are in the business of financing and asset management. Some have indeed participated in securitisation transactions. The definition of an Islamic bank as provided by the Organization of Islamic Conference (OIC) is as follows<sup>4</sup>: "A financial institution whose status, rules and procedures expressly state its commitment to the principle of Shariah and to the banning of the receipt and payment of interest on any of its operations" (Shariah being the economic, political, religious and social order of Islam). Islamic banks started operating in the early eighties at the national level in Pakistan, followed by Iran and Sudan. To date, there are more than 267<sup>5</sup> Islamic financial institutions, banks, insurance and reinsurance companies operating in different countries, mainly in the GCC<sup>6</sup> region.

Nonetheless, conventional banks of Western and European countries (including Lebanon) started taking advantage of Islamic banking techniques due to the success of Islamic banking operations, particularly using the fund in a profitable way through asset finance or joint ventures. Moreover, Islamic finance tends to relate finance to assets which makes securitisation the perfect match for Islamic institutions. Similarly, securitisation seems to be an interesting opportunity for Islamic financial institutions, due to the fact that it opens new liquid markets, new classes of investors, a balance sheet clean-up technology and fee-income earnings.

Applied to securitisation, the Shariah concepts lead to certain differences between conventional and Islamic transactions. For a securitisation to be Islamic, it must ensure a two-level compliance: (i) the underlying asset and (ii) the structure. Islamic

institutions are concerned with the Islamic acceptability of the asset classes; they tend to ensure that the underlying assets are “Halal”. Alcohol, tobacco or gambling, and other related assets are prohibited, and will not be eligible underlying assets in a Shariah compliant securitisation because they generate non-Halal revenues. Mortgage-Backed Securities are also not to be considered since they are pools of interest-bearing assets.

For a securitisation transaction to be eligible, having a Halal underlying asset is not enough. The scheme linking the parties must in itself comply with certain accepted principles. The parties’ relationships must be governed by agreement which in substance do not contradict the Shariah principles. This does not imply that a Shariah compliant securitisation can take only one form. Arrangers are not limited to one rigid scheme that ties the Obligors, the Creditors and the Assets. Nevertheless, the underlying “scheme” should in substance match with one of the accepted financing schemes. These are mainly Murabaha, Mudaraba, Mucharaka and Ijara.

In inventory and trade finance securitisation transactions, the underlying structure should be construed in substance as a Murabaha contract, i.e. a sale on a profit mark-up. The SPV would be purchasing goods and selling them to clients at a pre-agreed profit margin, rather than having a pool of interest-bearing loans. To be in consonance with the principles of Islamic finance governing exchange transactions every Murabaha transaction must meet the main following condition: Murabaha transactions may be undertaken only where the client of a bank, or financial institution, wants to purchase a commodity. This type of transaction cannot be effected in cases where the client wants to get funds for a purpose other than purchasing a commodity, like payment of salaries, settlement of bills or other liabilities<sup>7</sup>.

Another permissible scheme underlying an Islamic securitisation transaction is the Mudaraba which combines financial experience with business experience, and where one party provides capital and the other labour (the Mudareb is sometimes referred to as the Trustee<sup>8</sup>). Banks will then provide capital and clients provide the expertise, and the profit will be shared according to an agreed ratio. Under a Mudaraba scheme, the SPV would be the capital owner and contribute the capital whereas the Originator/Service provider would be the Mudarib and would provide its experience and services. The majority of the Islamic Scholars require that in a Mudaraba the capital owner contribute the capital in cash. Certain Scholars, including certain Scholars within the Hanbali School of Islamic Jurisprudence,

do allow for the capital owner to contribute capital in kind (i.e. merchandise) provided that value is mutually agreed at the time of the contract. The agreed value becomes the capital of the Mudaraba. Most of the Scholars who allow in kind contributions, however, require the business of the Mudaraba be the sale and purchase of the relevant merchandise.

Musharaka is another (similar<sup>9</sup>) mode of Islamic finance, which is represented by two or more financiers who want to establish or participate in a new project and are entitled to share the profits of this project according to an agreed ratio. The losses are shared in proportion to the capital contribution. One influential Scholar within the Hanbali School (the author of *Al-Mughni*, which is one of most influential texts used in the Kingdom of Saudi Arabia) considered that “if someone allows another person to work his mule and receives a portion of the profits arising from the mule, this would not be a partnership and would not be a Mudaraba but would be a structure close to the Muzaraa or the Musacat.” Muzaraa and Musacat (or sharecropping) are generally arrangements pursuant to which a person allows another to plant his land or exploit his farm and would receive a portion of the profits arising from the land or the farm. *Al-Mughni* defended this structure as a means of exploitation of an asset and sharing of the profits produced.

In this context, a similar structure seems to have been recently approved by the Fatwa Committee of the Jordanian Islamic Bank. In effect, the Shariah Committee of the Bank allowed (i) the purchase by the Bank of refrigerated trucks for operation by the Bank’s customer and (ii) the distribution of the profits arising from the trucks’ operation (after the payment of the capital to the Bank in full) in accordance with a pre-agreed percentage.

Equipment securitisation (using leases or leased-back underlying assets) is possible under the scheme known as Ijara. Shariah compliant structures provide for both Ijara (operating lease) and Ijara wa Iqtina (financial lease)<sup>10</sup>. Unlike conventional operating lease, Ijara does not restrict the lessee’s right to purchase the assets at anytime during or after the lease term<sup>11</sup>. Also there are no restrictions as to the term of the Ijara agreement. An Ijara agreement can range from hours to years. The Ijara wa Iqtina has certain advantages over other forms of direct participation (Musharaka) mainly because of the adequate protection of the investment and of the tax advantages attached. It is yet unclear whether a mismatching between the term of the Ijara and the amortising life of the leased assets would lead to re-qualifying the Ijara or the Ijara wa Iqtina.

An issue still unresolved (one of many) is the one related to options. We choose to address this specific topic because of its fundamental role in emerging markets securitisation. EM assets are usually local currency denominated whereas issued paper appeals to investors only if in hard currency. This inherent mismatch requires embedding currency options, forwards<sup>12</sup> or swaps within a structure. Techniques might be implemented using other accepted concepts. Salam, for instance, is a sale transaction that consists of the sale of a deferred commodity against a present price. In other words, it is a Forward Trade Transaction, which can be suitable for agriculture operations. Istisna is another kind of sale where a commodity is transacted before its existence; this kind of transaction can be used to facilitate financing in sectors like house financing, technology, aircraft and ship building industries. It is unclear whether these concepts might be applicable for currencies, stocks and other marketable securities. Yet according to a large majority of scholars<sup>13</sup>, this is not permissible on various grounds, the most important being the element of risk and uncertainty (gharar) and the possibility of speculation of a kind which is not permissible. However, another ground for rejecting such contracts may be riba prohibition. Bai Salam in currencies with fluctuating exchange rates can not be used to earn riba because of the presence of currency risk. It is possible to demonstrate that currency risk can be hedged or reduced to zero with another forward contract transacted simultaneously. And once risk is eliminated, the gain clearly would be riba. This is a substance modification of the risk patterns of the underlying assets which seems not acceptable under Shariah.

Finally, from a risk/return perspective, the investors in Islamic transactions are remunerated on a profit and loss sharing basis, while a conventional structure allows a debt issue with fixed return, with or without a right of recourse to the issuer. However, the successful application of securitisation requires available credit and financial data on the underlying asset, appropriate accounting standards and the possibility of a rating process; these conditions are not well satisfied in various Islamic countries. Moreover, it is yet unclear to which extent modification of risk/return patterns is acceptable under Shariah. This puts a question mark over all credit enhancement techniques usually embedded in a securitisation deal, and more specifically the tranching techniques.

The size of the Islamic market is said to be US\$100bn growing at a 17% rate per annum. GCC banks (the GCC is where the main Islamic banking activity is) dominate with a 71.44% of total capital for top 100 MENA banks. Saudi banks have the biggest share, followed by the UAE and Bahrain. Among the non-GCC, Egypt leads with US\$4,201bn.<sup>14</sup>

### Government securitisation and privatisation

Another new area of activity is Government securitisation and privatisation. Lebanon was the first MENA country to enact a Government Securitisation law. The 2002 enacted law N.430 allows the Central Bank of Lebanon to hold an account for the management, servicing and reduction of public debt. That way, it will receive the proceeds of the country's privatisation programme over the next 20 years.

The Ministry of Finance is also authorised to entrust the Central Bank with the structuring of securitisation transactions; SPVs could then be established by the Ministry of Finance and receive the privatisation proceeds on a true sale basis, such transfer being expressly immune against any freeze order or set-off risk. We foresee a growth in government securitisation transactions in the MENA region, as more governments reform their economies and look for efficient means to privatise or securitise segments of their economies.

### Notes:

<sup>1</sup> Official web site of each Rating Agency as of August 2003.

<sup>2</sup> Emerging Market risks include: convertibility, transfer, devaluation, expropriation, political violence, freezes on deposits, as well as legal, economic and environmental risks. The aforementioned list is not exhaustive. It is

**Figure 3: Geographical distribution per capital**

<b>GCC countries</b>	<b>US\$m</b>
Bahrain	6,378
Kuwait	4,836
Oman	892
Qatar	1,750
Saudi Arabia	12,797
United Arab Emirates	7,396
<b>Non-GCC countries</b>	<b>US\$m</b>
Algeria	829
Egypt	4,201
Jordan	2,552
Lebanon	1,863
Libya	714
Morocco	1,871
Syria	730
Tunisia	851

nevertheless considered that the main emerging market risk is the transfer/convertibility risk. Addressing the other risks is out of the scope of this article

- <sup>3</sup> See FitchRating research on Sovereign Rating and Ceiling.
- <sup>4</sup> Nassiruddin Ahmed, Islamic Banking and its Mode of Investments, *Anthology of Islamic Banking*, p. 307.
- <sup>5</sup> Nassiruddin Ahmed, Islamic Banking and its Mode of Investments, *op.cit.* p. 308.
- <sup>6</sup> GCC, Gulf Cooperation Council, includes 6 countries: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.
- <sup>7</sup> Al Rajhi Bank: an in-depth insight in Islamic Banking, <http://www.alrajhibank.com.sa/instrumurabaha.htm>
- <sup>8</sup> Afzal Elahi, Leasing in Islam, *op.cit.* p. 315.
- <sup>9</sup> Farid Scoon, Musharakah and Mudarabah - Towards Rationalisation, *op.cit.* p. 356.
- <sup>10</sup> Derek Weist, Issues in Islamic Leasing, *op.cit.* p.318.
- <sup>11</sup> Afzal Elahi, Leasing in Islam, *op.cit.* p.316.
- <sup>12</sup> Some Islamic scholars use the term forward to connote a *salam* sale. However Mohammed Obaidullah uses this term in the conventional sense where the obligations of both parties are

deferred to a future date and hence, are similar to futures in this sense. The latter however, are standardised contracts and are traded on an organised Futures Exchange while the former are specific to the requirements of the buyer and seller.

- <sup>13</sup> Mohammed Obaidullah, Financial Contracting in Currency Markets: An Islamic Evaluation, *International Journal of Islamic Financial Services*, Volume 3, Number 3.
- <sup>14</sup> *Arab Banking and Finance*, 19th Edition, 2003-2004, p. 25.

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