

MARKET STATEMENT

Established in 1994 and operating in the Structured Finance arena, **BSEC - Bemo Securitisation SAL** was the first MENA financial institution to introduce locally structured securitisation, credit derivatives and cross-border structured finance.

NewsWire is a monthly private newsletter of **BSEC** focusing on securitisation news and analysis in Lebanon and the MENA/GCC countries; It puts into perspective the different issues pertaining to securitisation in the legal, financial, tax and accounting fields.



A-SECURITISATION NEWS

LEBANON

Moody's Investors Service published at the end of last year an analysis on Lebanon providing a discussion of the factors behind its credit rating. Moody's admitted that the rating of the country is constrained by the debt burden, the growth rate and the difficulties that the authorities are facing while moving forward with the reforms. The regain of confidence after the Paris II conference of November 02 relieved the pressure on the

local currency; 2003 witnessed the highest level of the Lebanese pound in two years. The Central Bank of Lebanon has cut the interest rates, which meant that the yield on the benchmark two-year Treasury-Bill fell swiftly to its lowest level since the civil war. Yet, rates remain relatively high due to the financing need of the government; keeping rates at their low level remains a function of the currency stability. The confidence in

the country's economy is an important issue to increasing reserves. Reforms like securitisation and privatization would help decreasing the public debt and increasing private investments. But, until now, the sale of the two mobile phone licenses is expected to conclude in the first half of 2004, while the lending rates remain high at roughly 10% limiting therefore the investment■

MENA AND GCC REGION

The number of Sukuk issued out of the Middle East seems to be increasing. Tabreed, the provider of climate control products in the United Arab Emirates, made its debut in the market as it priced a five-year \$100m Islamic bond 250 basis points above the February 2009 Treasury. the bonds were issued via the Cayman Islands-based unit of its financing arm. Credit Suisse First Boston and National Investors managed the sale. Meanwhile, the

kingdom of Bahrain is starting a road show for its first international bond, which will take the country's total issuance to \$1bn. Bahrain's ninth bond issue is the first to be sold to foreign investors and representatives from the Bahrain Monetary Agency, the central bank, will travel across the Middle East region as well as to Malaysia to gather support for a five-year \$250m bond. The bond will have a floating rate and five-year maturity, and is being

issued to replace an existing 30-year bond. BMA spokesman stated that this issue is aimed at developing the debt capital market in Bahrain. "The international market for Islamic financial instruments has developed considerably and we are seeing an increasing appetite for such instruments", he said (*source: ft.com February 24, 2004*)■

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B-SECURITISATION ANALYSIS

FINANCIAL: STRUCTURED FINANCE RATING STUDY



In reference to the annual study of structured finance rating changes over time and by asset class issued by Moody's Investors Service, the ratio of downgrades to upgrades declined sharply in 2003, although rating volatility was still above its long-term historical average. It seems that downgrades occurred predominantly among asset-backed securities (ABS) and collateralized debt obligations (CDOs), which together constituted about 88% of all

2003 downgrades. In contrast, about 76% of all 2003 upgrades were of residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS). The downgrades in the ABS sector concerned mainly the manufactured housing, franchise loan, aircraft and equipment lease sectors, whereas the assets backed by traditional consumer credit demonstrated superior performance in 2003, with low downgrades. In the CDO

sector, the downgrades remained high compared to the 1991-2001 period with an average of 7.4%. The 2003 major CDO downgrades were related to arbitrage cash flow collateralised bond obligations and synthetic arbitrage deals; however, the upgrade rate did increase slightly to 1.3% in 2003 from 0.6% in 2002 (*source Moody's.com*)■

TAX AND ACCOUNTING: IAS 39 LATEST REVIEW



The revised versions of IAS 32 and IAS 39 have been released before year-end by the International Accounting Standards Board (IASB). IAS 39 deals with recognition, derecognition, measurement and hedge accounting; however, the only observed change was the application of SIC 12, which determines whether an SPV should consolidate under IAS 27. Looking at IAS 39 and SIC 12 independently, IASB admitted

two different outcomes: IAS 39 looks at the SPV and originator together in terms of whether or not to consolidate while SIC 12 just looks at the SPV. The latest revisions stated that SIC 12 must apply first and only then should IAS 39 be applied. The general market feeling is that IAS 39 is more restrictive than what was hoped. In the asset-backed market for example, having an off-balance sheet in the

UK seems to be impossible. Under the required accounting treatment in UK, the associated securitisation liabilities of an entity will appear on the same side as the assets' on the balance sheet, whereas, under IAS 39 the liabilities will move to the other side; this could incur serious implications for a bank's regulatory capital ratios. The industry seems to require from IASB another project on derecognition■

LEGAL: ISLAMIC BANKING IN ... LEBANON



During its session held on Jan 27, 2004, the Lebanese Parliament has enacted the project of law submitted by decree No.9351 dated Dec 27, 2003 relating to the "creation of Islamic banks in Lebanon". To date, only two Islamic banks are operating in Lebanon, as regular commercial banks. In the absence of a specific framework for their functioning and of detailed regulations for Islamic operations, these banks depend heavily on the fiduciary structure set up by Law n°520 dated June 6, 1996, and make numerous operations on an off-balance sheet basis. The new law on Islamic banking contains only nine articles and is more a declaration of principles than a detailed statute. It delegates to

Central Bank the powers to issue a directive setting the conditions which should be met in view of the licensing of such banks (article 2, para 2) and, more broadly, to issue directives relating to "all and each of the operations of Islamic banks" (article 4, para. 2). Combined with the provisions of article 1 of this law, which submit the Islamic banks to the Sharia' and to all the provisions of the laws and regulations in force in Lebanon "especially those relating directly and indirectly to the banks including each of the Code of Commerce, the Code of Money and Credit (CMC) and the Bank Secrecy Act", this delegation of powers by the legislator to Central Bank gives

an idea of the complexity of the task facing Central Bank: It has to create a full body of provisions governing, on the one hand the structure of the Islamic bank and its functioning which are not always compatible with those of the CMC applying to commercial banks and, on the other hand, the legal details of the operations to be conducted by the Islamic banks which are not always compatible with the provisions of the Code of Commerce and the Code of Obligations and Contracts■

C-SECURITISATION COMMENTARY

SPECIAL FOCUS ABCP AND MONEY MARKET FUNDS



Observing the growth of ABCP market, Moody's Investors Service recently published a commentary document with a special focus on the attractiveness of this paper to money market funds. Becoming a mature, well-established product, Asset Backed Commercial Paper has shown less credit volatility than the corporate Commercial Paper (CP); besides, increasing portfolio diversification, it provides investors with an opportunity to enhancing yield performance and liquidity, and it also has the flexibility to use various

yield curve and extended maturity investment strategies. However, Money Market Funds (MMF) have shown dramatic growth in the last five years. They have become an increasingly important cash management tool for businesses since their introduction in the 1970's. And this development seems to be a result of the economics of scale enjoyed by large institutional money funds relative to corporate treasury departments. ABCP exposure currently accounts for roughly 70% of total CP holdings i.e. funds of \$93.4 billion allocated in this asset type. "It is close to 13% of

the total \$719.8 billion ABCP outstanding reported by the Federal Reserve Bank". ABCP is an attractive investment for institutional funds since they offer higher yield and increased liquidity. In addition, since the typical maturity of an ABCP program ranges between 30, 60 and 90 day intervals, fund managers are able to increase their portfolio liquidity as necessary by "laddering" the maturities of the ABCP investments. ■

READINGS OF THE MONTH

"ISLAMIC FINANCE NEEDS SOLID FOUNDATIONS, *EUROMONEY*, VOL. 35, JANUARY 04



"There are more than 200 Islamic financial institutions, with more than \$200 billion in deposits operating in more than 25 countries, and the sector is thought to be growing at about 15% a year". This statement of the governor of the central bank of Malaysia explains the objective of bank regulators and international organizations to establish global standards for the Islamic banking industry. The Islamic Financial Services Board (IFSB) was created for this purpose: to set and disseminate prudential and supervisory standards for the industry. However, the

Islamic financial sector is negotiating with the IMF, the World Bank and the Basle Committee to set up globally accepted standards. Efforts are being held in the meanwhile by the Bahraini Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) which is estimated to have issued more than 20 accounting, auditing and ethical standards. However, many problems seem to face the Islamic financial sector; one of which is the autonomy that the board of scholars have while judging the compliance of products and services. They do not share

apparently the same interpretations. Another problem is the alleged association of the Islamic banking sector to terrorism financing. Senior Islamic parties denied this accusation and ensured that the sector is secure and transparent. Yet, the next coming years "will determine whether the industry can develop the foundations to ensure strong, stable and coherent growth". ■

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