



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 - Bemo Securitisation SAL focusing on securitisation news and analysis in Lebanon and the MENA countries; It puts into perspective the different issues pertaining to securitisation in the legal, financial, tax and accounting fields.



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A-SECURITISATION NEWS

LEBANON

According to a recent article published by the English spoken Lebanese daily, The Daily Star, the Lebanese government seems willing to proceed with securitizing projected cellular revenues, as most political leaders object to privatizing the telecom sector. However, a decision should be taken in order to demonstrate to the donor states which gave Lebanon \$2.5 billion

through Paris II that the country is working on reducing the budget deficit before this year-end. Some politicians fear that Lebanon would lose its main sources of income if it sold all of the public sector to private companies while others encourage the sale of 60% of the cellular network to the private sector. An alternative to privatizing networks would be to

securitise their revenues. The actual revenues are not disclosed yet but estimated to be around \$500 million each year which means that in the next 20 years, the total revenue will be more than \$10 billion. The government hopes to get about \$5 billion from the securitisation of the mobile networks alone■

MENA AND GCC COUNTRIES

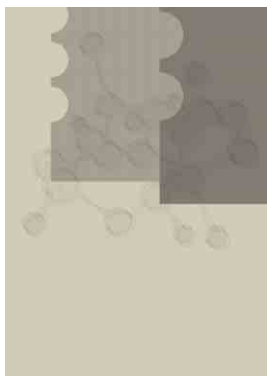
The International Islamic Financial Market (IIFM) has endorsed Solidarity Trust Services Limited \$300 million Islamic sukuk issue guaranteed by The Islamic Development Bank (IDB).The issue is unique in almost all its aspects ranging from the issuer, the guarantor, the arranger and more importantly the innovative structure of the deal, which is a combination of securitization of Ijara, Murarabah and Istisna contracts with a minimum of 51 per cent on the Ijara assets, the Bahrain Monetary Agency

(BMA) said. "The transaction is the 'first-of-its-kind' and it will definitely have a great impact in the development of sukuk or Islamic bond market in future", said Abdulrais Abdulmajid, chief executive officer of the IIFM. "Our main mandate is to encourage and facilitate the development of Islamic financial instruments and the deepening and widening of Islamic capital markets," he added. It is the first international Islamic Sukuk issue by a non-sovereign entity. The Solidarity Trust Services Limited (STSL), a special purpose

company incorporated in Jersey Channel Islands will issue the trust certificates whereas the Islamic Corporation for the Development of Private Sector (ICD) will play an intermediary role by purchasing the asset from IDB and selling it to The Solidarity Trust Services Limited (STSL) at the consolidated net asset value. The certificate holders will be entitled to receive periodic profit distribution (BMA-August 03)■

B-SECURITISATION ANALYSIS

FINANCIAL



On July 2003, Moody's Investors Service published a special comment on Fallen Angels with a 1982-2003 statistical review. While defining a Fallen Angel, the researchers referred to an investment-grade issuer whose rating has been downgraded to speculative grade. Once downgraded, the debt obligations of these companies carry bigger risk of credit losses. But if they survive, many of them can manage to adjust their business models and regain investment-

grade status. The chance to migrate to investment grade is greater for fallen angels than for firms that are speculative-grade rated at issue. "Fallen angel debt issues tend to be larger, with longer maturities, lower coupons, and fewer covenants than other, equally-rated, speculative grade debt issues". This is explained by the fact that fallen angels are more risky than other speculative grade issuers in the first two years after their downgrade. After that, they become less

risky as time progresses. Usually, they are downgraded almost two ratings notches on average as they enter speculative grade, fall another notch during the subsequent two years, and rise back up a fraction of a notch over the next three to four years. Since 1982, 1,035 companies migrated from investment grade to speculative grade; to date, 136 fallen angels have defaulted and 285 have returned to investment grade ■

TAX AND ACCOUNTING



The accounting standards are not standardized 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. Lebanon for instance, applies IAS 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 favorable 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 mixture 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. 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 ■

LEGAL



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 which is 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, and (ii) control over the assets; It seems clear that having the Owner SPV as a subsidiary of the Originator is not satisfactory in the absence of autopilot schemes 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 ■

C-SECURITISATION COMMENTARY

SPECIAL FOCUS “MURABAHA STRUCTURE”



As mentioned in the previous issue of this NewsWire, the different structures in Islamic securitisation -which are mainly Murabaha, Mudaraba, Mucharaka and Ijara- will be elaborated consecutively. Murabaha is a type of sale in which a buyer purchases items from a seller at a specified profit margin. It is assumed that the seller will divulge his costs accurately, such that the profit-margin can be agreed accurately; thus, Murabaha is a form of 'trust sale' since the buyer must trust that the seller is disclosing his true costs. Murabahah is typically used to facilitate short-term trade

transactions. It frequently appears as a form of trade finance based upon letters of credit, on which the majority of financings in Islamic financial market are based. In a trade finance securitisation transaction, the underlying structure should be construed in substance as a Murabaha contract, i.e. a sale on a profit mark-up. The creditor 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. In common with the general rules of exchange transactions in Islam, the subject matter of the murabahah contract must be in existence, under the ownership and in the physical or constructive possession of the seller at the time of contracting■

READINGS OF THE MONTH

“SPECIAL SERVICER KEY TO CMBS TRANSACTIONS”, *International Securitisation Report*, issue 80, September 2003, p.40



Commercial Mortgage Backed Securities (CMBS) deals are different from other asset classes with regards to servicing issues; CMBS do not use a back-up servicer. Instead, they use a master servicer and a special servicer. The master servicer administers the loan, while the special servicer, whose role is more important, is the real estate expert and key to managing the asset. Rating agencies usually incorporate the rating of the special servicer while rating the whole deal; however, Fitch Ratings stated that the agency will start consider the rating of the master servicer as well. By

including formal consideration of master servicer operational capabilities, Fitch will recognize the integral role of the master servicer in CMBS deals (effective on August 15, 2003, *source: Fitch Ratings*) European CMBS deals are generally more expensive than the US with regards to servicing costs; in order to reduce these costs, the roles of the paying and managing agents and liquidity facility provider are combined into the servicer role. Whether the servicer should take or not the first loss piece in the deal is a common issue in CMBS and other markets. In the US, there

are around 6 large special servicers that usually take the first loss piece in the transaction and buy and hold the bonds. While on the other hand, GMAC Commercial Mortgages in Europe do not always take the first loss position in the deal; the model they use links primary servicing, special servicing and investing, and they don't invest in the first loss position without being the special servicer■

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