

Egypt prepares its debut in the Islamic Finance Market. The new Sovereign Sukuk Law reviewed

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On 15 August 2021, Egyptian President Abdel-Fattah El-Sisi ratified the Sovereign Sukuk Law no. 138 of 2021 (the “**Law**”), whereby the Government would securitize some of its assets and issue Sharia (Islamic Law) compliant securities, sovereign sukuk (“**Sukuk**”). The proceeds from the sale of the Sukuk would be used to finance the investment and development projects included in the social and economic development plan in the State’s general budget.

Issuing Sukuk will be the Egyptian government’s entry into the Islamic finance market. In principle, Sharia prohibits lending with interest payments, therefore bonds are not permitted in Islamic finance. Sharia only allows investment in companies as long as they do not engage in forbidden activities such as lending, gambling, or the production of alcohol or other activities that may be considered unethical. Therefore, the entry into the Islamic finance market should help the country in diversifying its funding sources and attract regional Islamic and international investors.

The Sovereign Sukuk Law

According to the Law, Sukuk are financial instruments of nominal, equal value, issued in local and foreign currencies, which are tradeable and for a specific, but renewable, duration not exceeding 30 years. Sukuk represent an undivided ownership of usufruct over Sharia-compliant assets that are privately owned by the State or a public governmental entity (the “**Assets**”). This right allows the Sukuk holder to use and derive returns from the Assets but does not allow the sale or disposal of such Assets which shall not be seized or be subject to any execution proceedings for the duration of the Sukuk.

A Supervisory Committee consisting of scholars of Islamic law nominated by Al-Azhar Al-Sharif as well as financial experts shall approve of the Sukuk structure, including the Assets over which they are issued. A cabinet decree will be issued to specify the Assets that will support the Sukuk and a Supreme Valuation Committee will be formed to evaluate the right of usufruct over the Assets or their rental value.

Sukuk structure

The Sukuk structure would involve the Ministry of Finance, seeking to raise funds, to establish a special purpose vehicle (“**SPV**”) in the form of a joint stock company to which it would transfer the right of usufruct over the Assets used to back the Sukuk. The SPV, as an agent, will then issue and sell to investors the Sukuk in the form of paper or electronic certificates, which represent a share of the ownership over the Assets. The investors being Sukuk holders, will then receive a pro-rata of the income generated by such Assets.

The SPV will be a separate legal entity that is fully controlled by the government, with its issued and paid up capital not less than one million Egyptian pounds and its articles of association, will be issued by a decree of the Minister of Finance. The Executive Regulations of the Law will specify the disclosure requirements for the SPV and will address how the SPV will hold independent accounts for each issue of Sukuk, whether inside or outside the Arab Republic of Egypt.

As an agent for the Sukuk holders, the SPV will enter into a Sukuk issuing contract with the Ministry of Finance by which the Sukuk will be issued. This issuance contract will regulate the rights and obligations of the Ministry of Finance and the SPV in its capacity as agent of the Sukuk holders as well as matters such as the investments to be entered into with the proceeds of the Sukuk, the duration of such investments and expected returns.

The Law requires Sukuk issued locally to be listed on the Egyptian Stock Exchange and kept in the Misr for Central Clearing, Depository and Registry (“**MCDR**”) while international Sukuk to be listed on international stock exchanges as per international sovereign issuances. This will help attract new Egyptian and foreign investors to invest in accordance with the principles of Islamic Sharia.

Types of Sukuk

There are Sukuk that generate pre-determined revenue and Sukuk that are based on sharing profit and loss with the most commonly used structure being the *Sukuk al-ijarah*; an example of Sukuk that generate pre-determined revenue.

Sukuk al-ijarah, similar to lease back, entails the Government transferring Assets to the SPV and the SPV issuing and selling Sukuk to investors in consideration of the transferred Asset. The proceeds collected by the SPV from the sale of the Sukuk would be transferred to the Government. Then, the SPV would lease back the Assets to the Government and the lease payments made by the Government to the SPV would be distributed among the Sukuk holders as lease income. On the termination date of the lease, the Government purchases the Assets back from the SPV and the SPV distributes the proceeds to the Sukuk holders.

Other common Sukuk structures include *mudarabah*, *murabaha* and *musharakah*, which are similar to project finance, trade finance and joint ventures respectively along with other types of Sukuk linked to certain activities such as *istisnaa*, which relates to fund manufacturers.

The Law does not address the different types of Sukuk but Articles 4 and 5 of the latter provide that the Executive Regulations will specify the forms of Sukuk with the rules and procedures related to its issuance, inside and outside of Egypt.

Sukuk and bonds

According to Article 6 of the Law, the proceeds from the initial sale of Sukuk and the returns from the trade of Sukuk shall be subject to the tax treatment of public treasury bonds. Like bonds, Sukuk are initially sold to investors and are tradeable afterwards, both also have a maturity date and grant investors a periodical payment. However, while investors as creditors receive an interest over bonds, Sukuk holders, as owners, are entitled to receive payments based on the receivables (profits or rent) of the Assets over which the Sukuk were issued.

As per the Law, the Sukuk holders of a single issue may form an association for the protection of mutual interests of its members. The association shall grant its representative the necessary powers to protect its mutual interests whether against the Ministry of Finance, the SPV or third parties. The Ministry of Finance will be notified of the formation of the association and of its representative and must be provided with a copy of its resolutions.

At the maturity date of the Sukuk, the Sukuk holders shall reclaim its reclamation value and the right of usufruct over the Assets on which the Sukuk were issued will expire. However, the Law provides that the Ministry of Finance may return the reclamation value to the Sukuk holders before the maturity date as will be stated in the Information Memorandum.

The Information Memorandum is a document that is approved by the Supervisory Committee by which the Sukuk issuance is announced and including all information, conditions and specifications related to their issuance, as well as the method of distribution of gains between the Sukuk holders and reclaiming the principal whether on the maturity date (which is up to 30 years, renewable in accordance with the Information Memorandum) or earlier.

Conclusion

While the provisions of the Law provide a general framework relating to Sukuk, the Law refers to the Executive Regulations in implementing several matters, which include the procedures and conditions of issuing Sukuk, their types and rights of Sukuk holders. The Law provides that within three months of its application, the Cabinet would issue the Executive Regulations. That in collaboration with the Financial Regulatory Authority and Al-Azhar Al-Sharif.

Once the Executive Regulations are issued, the Government will be more prepared to take the required steps into realizing the issuance of Sukuk and offering them to the local and international markets helping the Government identify the Islamic and conventional investors' appetite and further provide clarity regarding which Assets will be chosen to back the Sukuk.

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