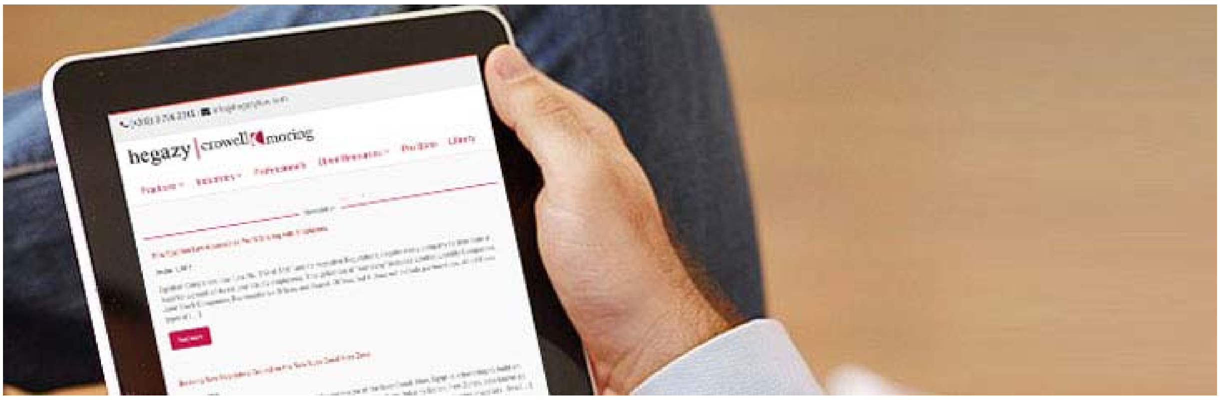
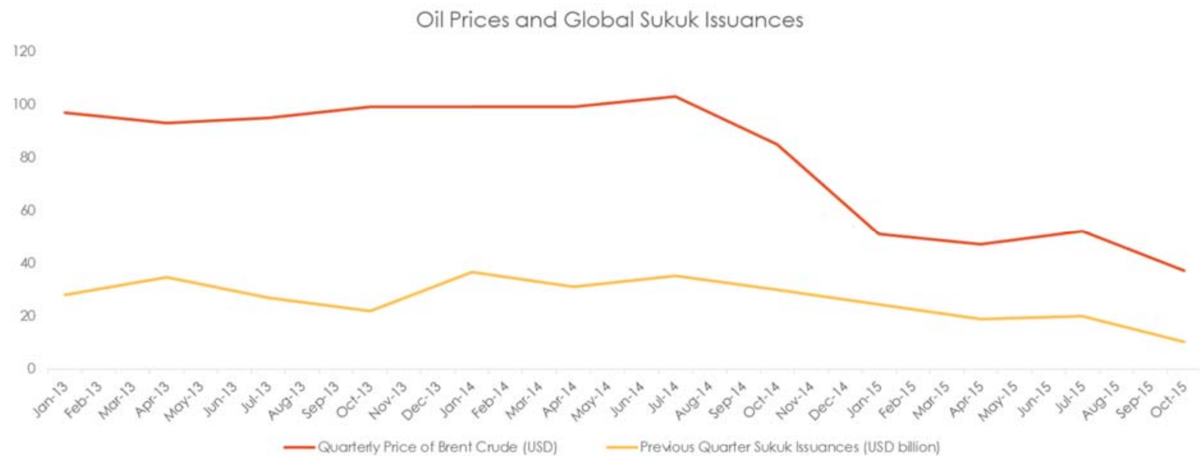


Sukuk in the Time of Low Oil Prices

Dr. Walid Hegazy & Phil Zager

Despite a recent agreement between Saudi Arabia and Russia, the price of oil stubbornly refuses to increase. One place where low oil prices are perceived to impact the financial sector is through reduced sukuk issuances. Standard & Poor's, reflecting the expert consensus, predicts that low oil prices will dampen sukuk issuances.

We decided test this consensus using data assembled from Google Finance, Kuwait Finance House, Malaysia International Financial Centre, and Standard & Poor's. The below chart, which we believe to be the first chart comparing historical oil prices and sukuk issuances, was first presented by Dr. Hegazy as part of a presentation at the National University of Singapore's Middle East Institute.



This chart suggests that there is a correlation between reduced oil prices and reduced sukuk issuances. In examining the two, one cannot forget that Malaysia, the worldwide leader in sukuk, which is not usually considered a petroleum-reliant economy, still receives roughly 30% of government revenue from Petronas, its state-owned oil company. Other leaders in sukuk, especially those in the Gulf Cooperation Council, are also heavily reliant on oil revenues.

If oil prices continue to remain low, it will be seen if increasingly cash-strapped governments use sukuk as a means of sovereign fundraising. Given that Saudi Arabia issued roughly USD 5 billion in conventional bonds in August 2015, it appears that sovereign issuers still prefer conventional debt to sukuk.

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The Growing Egyptian Takaful Market

Dr. Walid Hegazy

In early 2016, Abdel-Raouf Kotb, chairman of the Insurance Federation of Egypt stated that he expected Egypt's takaful industry to grow by 20% in 2016. This bold estimate provides us the opportunity to discuss takaful in the context of the Egyptian insurance industry, and conclude with an assessment of Mr. Kotb's estimate.

First and foremost, this high-percentage growth projection needs to be understood in the context of insurance in Egypt. A common measure for the amount of insurance in a given country is its "insurance penetration," which measures insurance premiums nationwide as a percentage of that country's Gross Domestic Product (GDP). According to KPMG in 2012, in North America, insurance penetration is roughly 8%, as opposed to 3.5% in Sub-Saharan Africa, and 1.3% in the Middle East. Egypt with an insurance penetration rate of 0.7%, lacks formal insurance, even compared to the rest of the Middle East. In understanding how the Egyptian takaful industry can grow so rapidly, it is necessary to acknowledge the underdevelopment of insurance in Egypt.

In October 2015, Moody's, one of the world's three largest credit ratings agencies, published a report entitled "Insurance--Egypt: An Insurance Market with untapped potential." In this report, Moody's noted how top-heavy Egypt's insurance market is, with the top six firms responsible for nearly three-quarters of all premiums nationwide. This dominance by predominately state-owned firms has opened room for bottom-up innovation in the market, with Moody's calling special attention to micro-insurance and takaful. This space for innovation further supports takaful's relative growth in Egypt.

According to KPMG, conventional insurance is forbidden in Islam. Given that Egypt's population is over 90% Muslim, it makes sense that Egypt would have low insurance penetration. Takaful, which can be translated into English as "solidarity," is based on mutual support within a community. In the past few years, takaful premiums have grown at over 10% annually in the Gulf Cooperation Council, so it is reasonable to see potential for parallel growth with Egypt. This growth has been more than just potential, according to its most recent published annual report, the Egyptian Financial Supervisory Authority (EFSA), which regulates insurance, states that takaful in Egypt grew over 20% annually from 2009 to 2014.

When looking at the combination of low insurance penetration, pent-up demand for Shariah-compliant protection, and rapid growth in the last half-decade, it appears that the estimate that Egypt's takaful industry will grow over 20% is a reasonable projection.

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SAGIA Changes the Rules Again

Muhammad El Haggan

On the heels on its online application platform, experimental “Special Track” service launched in the second half of 2015, and universal promises of feedback within five business days for applications lodged in 2016, the Saudi Arabian General Investment Authority (SAGIA), announced in mid-February that it intended to simplify its procedures even further. According to SAGIA, beginning 15 February 2016, for a new license, the following documents are now needed:

1. An authenticated Shareholder’s Resolution to invest in the Kingdom;
2. A detailed action plan identifying the project’s execution and contribution to the Kingdom’s economy, according to the previously-created business plan framework;
3. A proof of financial capability based on the action plan submitted for the project; and
4. The financial statements for the last fiscal year of the company.

SAGIA previously demanded substantially more documentation, and that the additional documentation was to be notarized and authenticated. Under these regulations, the only document that needs to be authenticated is a Shareholders’ Resolution to invest, which was previously a Board Resolution to invest. Another material change provided by the newest set of regulations is that SAGIA says that it no longer requires a Power of Attorney be issued to someone within the Kingdom of Saudi Arabia.

It appears that SAGIA wishes to encourage investment by simplifying procedures, which should work. However, its current tendency to simplify procedures with no notice at random intervals may prove counterproductive for investors seeking consistent regulations.

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Islamic Finance for Egyptian SMEs

Phil Zager

At the beginning of February 2016, Al Baraka Bank Egypt announced its intent to launch two new branches dedicated to retail and SME banking this year. Near the end of the month, the same bank announced its plan to invest EGP 1 billion (USD 127 million) in Small and Medium Enterprises (SMEs). This report is not a press release for a bank, but this particular bank's behavior is indicative of the increasing attention paid to Egyptian SMEs, and the potential for Islamic finance to play a role in assisting Egyptian SMEs.

Last month, Egyptian President Abdel Fattah al-Sisi said that the banking sector would inject 200 billion Egyptian pounds (USD 25.5 billion) to support small and medium businesses. To support this, the Central Bank of Egypt reduced the maximum amount of loans a bank could provide to a particular corporate customer or a particular customer and its associated entities, along with raising the minimum amount of funding that banks have to provide to SMEs. It seems that the Egyptian government agrees with Al Baraka Bank Egypt CEO, Ashraf El-Ghamrawy's statement that SMEs are the "catalyst for development."

How can Islamic finance be used to catalyze these catalysts for development? Three Islamic finance structures seem particularly useful for funding SMEs. First, the Murabaha allows an institution to purchase a large item for an SME and resell that item at a markup. The flexibility of the Murabaha, especially in setting a deferred payment schedule that best fits the SME's liquidity needs, seems like a natural way to pay for large capital expenses. Second, and similarly, an Ijara structure allows for a financial institution to purchase an item (including real property) on behalf of an SME, and then the institution could lease the item to the SME.

Finally, the Mudaraba structure appears to be a natural fit for long-term financing. In a Mudaraba, a financial institution would provide liquidity while SMEs would provide their expertise and effort. This seems analogous to venture capital arrangements, with the important Shariah-compliant consideration that both parties would share in profits and losses. Unlike with the Murabaha and Ijara, a Mudaraba structure would be a partnership with the SME itself, instead of a financing arrangement for a good or property. This means that institutions looking to invest in SMEs through Mudaraba need to be confident in the SME itself, which requires a degree of due diligence and risk management that could be costly given the size of the SME.

In conclusion, Egyptian SMEs are receiving sizeable declarations of support from a variety of sources, both Islamic and conventional. It remains to be shown if these declarations can be turned into financial support, and that this support can be turned into sustainable economic growth.

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It is likely that a similar version of this piece will be published in a forthcoming issue of Islamic Finance News.

An Update on Egyptian Rules for Trade, Industry, and Trademarks

Yehia Zakaria

On December 30th, 2015, the Minister of Trade and Industry issued Ministerial Decree No. 992 of 2015, regarding the Rules Organizing the Registration of the Factories Qualified to Export Products thereof to Egypt. This decree, which attempted to organize rules for qualified factories, stemmed from a desire to harmonize import, export, and trademark laws, which previously had been confusing. This confusion was particularly acute for Egyptian qualified factories and trademark owners who exported goods that were also imported to Egypt.

However, after around couple of weeks, on January 16th, 2016, the same Minister issued Decree No. 43 of 2016, this decree separates the rules of registration of the factories and the owner companies of the trademarks. In addition, this new decree requires some documents to register the factories or the owner companies of the trademark, and all these documents must be legalized before the competent authority abroad, the Egyptian Consulate and the Ministry of Foreign Affairs. Under these new decrees, all products which were mentioned in this decree and not registered at the ledgers of the Egyptian Exportation Supervisory Authority shall not be released from the Egyptian Customs Authorities except after said registration.

These decrees should simplify procedures for certain exporters, who face an uncertain 2016 as new Central Bank of Egypt governor Tarek Amer considers devaluing the Egyptian pound.

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