

Egyptian Parliament Approves Amendments to Capital Markets Law, Opens the Door for Sukuk Issuance

7 March 2018

On 13 February 2018, the Egyptian Parliament approved the most comprehensive amendments (the “**Amendments**”) to the Capital Markets Law No. 95 of 1992 (the “**Capital Markets Law**”) since its enactment. The Amendments establish a legislative framework for Sukuk issuance and trading in Egypt, authorize the establishment of an exchange for regulated trading in derivatives, including futures, options and swaps, abolishes bearer securities and expands the scope of the criminal provisions in the Capital Markets Law. The Amendments will only have a limited impact on the process of securities offerings in Egypt. The Amendments are yet to be signed into law by the President and will take effect after their publication in the Official Gazette.

The Amendments follow a series of legislative reforms aimed at promoting foreign investment in Egypt, such as the enactment of a new investment law in 2017 and a new bankruptcy law in 2018. It is hoped that the Amendments will boost activity in the Egyptian capital markets. The period following the floating of the Egyptian pound in November 2016 has seen a number of successful IPOs in Egypt, with several more IPOs in the pipeline, fueled mainly by the IPO program of the state-owned companies.

This memorandum provides a summary of key provisions of the Amendments, including their effect on securities offerings and trading in Egypt.

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I. A New Framework for Sukuk Issuance

Sukuk issuance was first regulated in Egypt under the Sukuk Law No. 10 of 2013, which was issued in May 2013 (the “**Sukuk Law**”), but due to the political changes that have ensued in Egypt since then, no executive regulations were issued to put the Sukuk Law in force, and no Sukuk were ever issued in Egypt. As a result, Egypt lagged behind its regional peers in the Gulf Cooperation Council, Turkey and other MENA markets that have an active Sukuk market, both on the sovereign and corporate levels. The Amendments aim to bridge this financing gap and allow public and private sector entities to access a largely untapped pool of savings held by investors who shun non-Sharia-compliant debt instruments.

The Amendments repeal the Sukuk Law, and set out a new framework for Sukuk issuance and trading in Egypt. Unlike the Sukuk Law, the Amendments do not require all Sukuk to be certified by a Sharia board, but an issuer cannot describe its Sukuk as “Islamic” unless it has been so certified.

Under the Amendments, Sukuk can only be issued by an SPV incorporated in Egypt, with a term not exceeding 30 years, and can be issued for either

corporate or project finance purposes. As is the norm for the Sukuk industry, Sukuk types can vary depending on the underlying contract between the SPV issuer and the originator and can take the form of Sukuk *Al-Murabaha*¹, Sukuk *Al-Mudaraba*², Sukuk *Al-Musharaka*³ and Sukuk *Al-Ijara*⁴. It is remarkable that the Amendments omit a number of other types of Sukuk, which were included in the Sukuk Law, such as Sukuk *Al-Istisnaa*.⁵ However, the executive regulations to be issued under the Amendments may provide for other types of Sukuk.

The Amendments also deviate from market practice by requiring the SPV issuer to be an Egyptian incorporated company, whereas the practice has developed in several markets such that the SPV is incorporated in an offshore jurisdiction that recognizes the concept of trust, and where the SPV can declare a trust over the Sukuk proceeds and the assets transferred to it from the originator in favour of the Sukuk holders.

Sukuk can be denominated in Egyptian pounds or in any other foreign currency.

If Sukuk are offered to the public, they will have to be listed on an Egyptian stock exchange and may only be

¹ Sukuk *Al-Murabaha* involves the establishment of an SPV that uses the Sukuk proceeds from investors to acquire commodities and sell them to the obligor against a deferred purchase price representing a mark-up to the price paid by the SPV, which would be distributed to the investors throughout the term of the Sukuk.

² Sukuk *Al-Mudarabah* involves the establishment of an SPV, which issues Sukuk to the investors, and uses the proceeds to enter into an investment arrangement with the underlying obligor, pursuant to which the SPV will acquire rights to specified business assets. The investors are entitled to share the returns generated by that investment arrangement, pursuant to the a formula prescribed in the underlying contract.

³ In Sukuk *Al-Musharaka*, the SPV contributes the proceeds of Sukuk raised from investors into a Musharaka (a joint venture), while the obligor contributes assets as in-kind contribution or cash or both. Each of the SPV and the obligor are allocated units in the Musharaka depending on

their contribution. The SPV can rent its units to the obligor or an affiliated agent against periodic payments being passed on to the Sukuk holders, with an undertaking from the obligor to purchase the SPV’s units in the *Musharaka* when the Sukuk matures or upon an event of default.

⁴ In Sukuk *Al-Ijara*, the SPV uses the proceeds of the Sukuk issuance to acquire assets or services and lease them to the obligor, who undertakes to purchase them when the Sukuk matures or upon an event of default.

⁵ Sukuk *Al-Istisnaa* typically involves an SPV using the Sukuk proceeds to procure the manufacturing of an asset or project by the obligor. The asset or project will be leased by the SPV to the obligor under a forward lease during the construction phase, and a normal lease during the operational phase, with the rental payments being passed on by the SPV to the Sukuk holders, and the obligor undertaking to purchase the underlying asset or project when the Sukuk matures or in case of an event of default.

listed on a foreign stock exchange with the approval of the Financial Regulatory Authority (“FRA”).

To promote tax neutrality for Sukuk relative to other debt securities, the Amendments exempt the transfer of the underlying assets between the originator and the SPV issuer from all applicable transfer tax and VAT.

II. A New Framework for Regulated Derivatives Trading

The Amendments authorize the establishment of an exchange for regulated trading in derivatives, including futures, options and swaps. The exchange will need to be so licensed by the FRA, and must have a paid-up capital of at least EGP 20 million (approximately US\$ 1.1 million). Orders will be executed on the derivatives exchange through licensed brokers. The Amendments require brokerage companies to make certain disclosures to their clients before opening accounts for derivatives trading.

III. Simplifying the Prospectus Publication Rules

Under laws applicable prior to the enactment of the Amendments, the public offering of any securities in Egypt must be based on a prospectus approved by the FRA and published in two daily newspapers, at least one of which must be in Arabic.

The Amendments require only a summary of the FRA-approved prospectus to be published in Arabic in a daily newspaper, while the full prospectus should be published on an FRA-designated website, as well as the website of the stock exchange where the securities will be listed.

IV. Expanding the Reach of the Criminal Provisions

The Amendments tighten the penalties for several crimes prescribed under the Capital Markets Law and prescribes several additional violations of the Capital Markets Law as criminal offences.

Under the Amendments, a deliberate failure by an issuer to perform its undertakings to the minority shareholders or the Sukuk holders, or any intentional

violation of the financial valuation rules issued by the FRA, will be criminal offences punishable by imprisonment for up to five years and a fine of up to EGP 20 million (approximately US\$ 1.1 million), or twice the amount of the gain realized, or the loss avoided, by the offender, whichever is higher.

In addition, a failure to submit a mandatory tender offer in cases where the Capital Markets Law or its executive regulations require a mandatory tender offer will be a criminal offence punishable by a fine not exceeding EGP 500,000 (approximately US\$ 28,400) in addition to an amount equivalent to the value of the underlying securities. The Amendments do not require such failure to be intentional or even negligent. Considering the technical nature of the rules regulating mandatory tender offers and their triggers under Chapter 12 of the Executive Regulations of the Capital Markets Law, significant shareholders and other traders in listed shares or convertible debt instruments need to take special care to ensure compliance with the mandatory tender offer provisions.

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