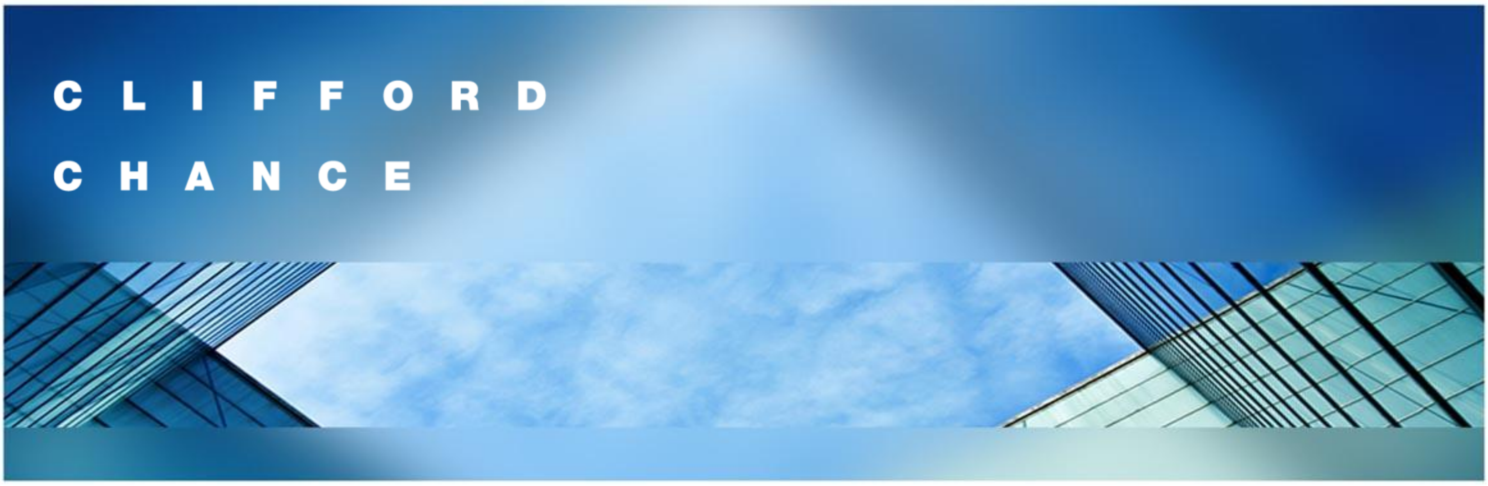

THE DEVELOPMENT OF ISLAMIC FINANCE IN MOROCCO AND THE WIDER AFRICAN CONTINENT.

Since the landmark reform of the Kingdom of Morocco's securitisation law on 5 September 2013[1] which paved the way for the first sovereign sukuk by the Kingdom of Morocco in 2018,[2] the landscape of Islamic Finance ("**IF**") in Morocco and wider North and West Africa has continued to evolve. For example, Egypt has announced its intention to issue its debut sovereign sukuk in the first half of 2022 with the adoption of a new sukuk law in 2021. Today, whilst there is a strong appetite across the African continent for IF, the pace of development varies across such African economies with only certain jurisdictions having developed the necessary legal and regulatory reforms to move the IF industry forward. The setbacks to African economies inflicted by the Covid-19 pandemic have only increased the need for African governments to pursue the reforms of their legal framework.

In the meantime, IF has continued to perform well throughout recent years globally and even through 2020 and 2021 (despite the impacts of Covid-19) the commitment from African countries to the inclusion of IF in their financial future has been made clear. For example, the West African Monetary Union ("**WAMU**") announced in January 2021 that it is preparing a new regulatory framework destined to facilitate IF. In this regard, given the high degree of similarity between the current laws in the WAMU and the previous securitisation law in Morocco (the "**Previous Law**"), Morocco's reformed

Key issues

- The landmark reforms of the Kingdom of Morocco's securitisation law on 5 September 2013 provide various new avenues for issuers looking to raise funds in the international capital markets given the increased structuring options they facilitate for international issuances.
- Whilst Covid-19 has no doubt had an economic impact, African economies are projected to continue growing overall and the opportunities for inbound IF investment in Africa remain high.
- The growing interest in IF in Africa is strongly complemented by the natural alignment between IF and the increasing emphasis being placed on ethical finance and ESG-aligned business.
- As the African continent looks to its post-pandemic future, IF offers a strong opportunity to foster economic growth. In this regard, the WAMU is able to draw from the Moroccan securitisation law reform and the Kingdom's sovereign sukuk issuance to establish its new regulatory framework on IF.

1 Clifford Chance is pleased to have advised the Ministry of Finance of the Kingdom of Morocco on the drafting of this reform. Please see our briefing outlining the main changes in the law here: LINK

2 Clifford Chance is pleased to have advised on this first issuance in what is expected to be a series of sovereign sukuk issuances by the Kingdom of Morocco.

securitisation law could serve as a useful benchmark for such jurisdictions to take inspiration from.

In this briefing, we focus on how the Moroccan securitisation law reform and the Kingdom's first sovereign sukuk can serve as a legal benchmark for other North and West African jurisdictions. We also look at some of the continued opportunities for the development of the IF industry in Africa.

MOROCCO'S SECURITISATION REFORM AND SOVEREIGN SUKUK ISSUE – A HELPFUL BENCHMARK

Inspired by some of the most reliable and secure extracts of foreign legislation, Morocco has illustrated its desire to provide a secure securitisation framework, which complements traditional financial methods, for the benefit of companies, investors and the Moroccan financial system as a whole, and to allow Morocco to position itself as the destination of choice for the development of securitisation and IF in Africa.

Notwithstanding the increased interest in doing financings via sukuk (the equivalent of an Islamic bond) – in particular as part of the wider increase in demand for Sharia-compliant savings and investment products, the development of Islamic capital markets in Africa continues to be an area which requires the attention of both governments and the private sector. Morocco's successful inaugural sovereign sukuk issuance (which was 3.6 times oversubscribed) and the reform of its securitisation law can serve as benchmarks for other African countries – in particular, those in the Francophone North and West African regions who share the same civil law base for their legal system.

The Previous Law presented certain barriers for the development of securitisation, and in turn for IF in the Kingdom of Morocco, and such barriers are often found in neighbouring African jurisdictions' laws. In particular, the Previous Law:

- restricted the scope of eligible assets in securitisation operations to certain categories of receivables and restricted eligible assignors to a limited number of originators only;
- did not permit the Moroccan securitisation vehicle (the FPCT) to own real estate assets other than in specific enforcement scenarios and so was not adapted for the development of asset-based or asset-backed sukuk; and
- resulted in certain tax disadvantages and regulatory constraints experienced by institutional investors.

The reform brought with it a range of landmark changes that facilitated the structuring of sukuk in Morocco, including:

- the extension of the list of originators to all persons and schemes, regardless of whether they have separate legal personality;
- the extension of the list of eligible assets,
- the possibility for an FPCT to acquire the shares of a company in order to allow the issuance of *sukuk al musharaka*;

- the possibility to create separate *in rem* interests in relation to property (*démembrement de propriété*) to the benefit of the securitisation vehicle – which is important for the development of genuinely real estate asset-backed sukuk;
- the possibility of granting usufruct rights to private entities over public assets to allow the establishment of *sukuk al ijara* programmes with the State or State-owned entities as obligors;
- the introduction of the concept of the 'duality of forms' (i.e. fund and company) designed to offer the maximum flexibility in the use of the issuance vehicle, notably with regards to the issuance of sukuk certificates destined to be invested in by both international investors or local investors;
- introduction of a 'level playing field' in respect of tax to ensure that the transfer of assets will remain completely neutral from a fiscal point of view; and
- a broad construction as to the definition of sukuk, permitting significant flexibility including:
  - being governed by all foreign laws and expressed in foreign currencies;
  - taking the form of a sale/*ijara* structure; and
  - be based on an investment (*sukuk al mudaraba*), or assets under construction or future assets (*salam* and *istisna*).

These changes are significant in that they provide new avenues for issuers looking to raise funds in the international capital markets given the increased structuring options they facilitate for international issuances. Overall, it is anticipated that the changes will increase the appetite of both local and international investors to consider IF products.

THE ISSUE OF 'RECEIVABLES-ONLY' SUKUK IN THE WEST AFRICAN MONETARY UNION

Notwithstanding the introduction of some sukuk-related laws, the securitisation legal framework of the WAMU countries currently reflects the position of the Previous Law in Morocco. As such, whereas Moroccan law now allows genuine asset-based sukuk and brings with it the clarity of a complete securitisation law to facilitate sukuk issuances, WAMU jurisdictions continue to have difficulty in structuring sovereign sukuks over real estate assets and largely remain restricted to issuing sukuk over receivables only. For instance, Senegal's 2016 sovereign sukuk issuance was based on WAMU Regulation n° 02/2010/CM/UEMOA which presents similar obstacles as those examined under the Previous Law.

Primarily, there remains a need to reform laws to allow the transfer of land to the securitisation vehicle to take place (this is a key component of the sukuk *al-ijara* structures) and to ensure that such reforms extend to necessary amendments in laws relating to public property and State properties and taxation. For example, in many jurisdictions, the ability to transfer land and properties owned by the State continues to create a structuring hurdle for sovereign sukuk issuances. In the case of the private sector, along with some of the wider issues listed below, the tax implications of transferring property remain as a key issue to overcome.

The WAMU declared in 2021 that it was preparing a new regulatory framework destined to facilitate Islamic capital markets transactions such as sukuk issuances.

OPPORTUNITIES FOR THE DEVELOPMENT OF AFRICA'S ISLAMIC FINANCE INDUSTRY

Whilst Covid-19 has no doubt had an economic impact, African economies are projected to continue growing overall and the opportunities for inbound IF investment in Africa remain high. For example, South Africa, which already issued sovereign sukuk in 2014, expressed that sukuk would be a viable option for government funding post Covid-19. In Chad, government officials announcing the country's first ever Industrialisation and Economic Diversification Masterplan in 2020 expressed the need to be supported by innovating financing options including IF from both local and sub-regional financial markets.

However, many African jurisdictions need to bring regulatory and legal reform to foster the development of an ecosystem that is IF friendly and conducive to achieving government-set developmental goals, and to facilitate access to IF as an additional source of funding. For example, the Nairobi Securities Exchange head of regulatory affairs stated that Kenya’s Vision 2030 goals can be reached by sustaining the growth momentum of IF, but that this requires enabling institutional and market infrastructure as well as a legislative, regulatory and tax environment supportive of IF products.

In addition to legal frameworks, the following issues need to be addressed to unlock the development of IF products:

- **IF is currently demand-based:** Given the demand-based, as opposed to systemically-backed, nature of IF in general, the lack of education and awareness of IF amongst African businesses and populations continues to restrict the development of products;
- **Cost of Capital:** The cost of capital is high as a result of the low issuer credit ratings of corporates in Africa (other than for certain large state-linked corporates); and
- **Regulatory transparency in some African jurisdictions:** Investor risks remain high due to lack of information available in respect of the laws of many African jurisdictions and processes relating to enforcement and timeframes.

ESG AND ISLAMIC FINANCE

The growing interest in IF in Africa is strongly complemented by the natural alignment between IF and the increasing emphasis being placed on ethical finance and ESG-aligned business.

With the increasing importance of ESG criteria for both issuers and investors, IF has adapted to accommodate principles of green finance.[3] This is evident in the accelerated take up of ESG sukuk in the Gulf region since 2019 across sovereigns, multilateral development agencies, financial institutions, and the private sector. This is a trend which is expected to grow in the coming years.

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[3] Clifford Chance is pleased to have recently advised on the world's first Sustainable Tier 2 Sukuk issuance. Clifford Chance also advised on the world’s first green sukuk for the Republic of Indonesia and the world’s first sustainability sukuk for a regional airline operator

In Africa, while green IF is still at its infancy, the USD 11.3 million green sukuk launched by a subsidiary of the Bank of Khartoum in May 2021 to finance renewable energy production in Sudan, a first on the continent, may pave the way towards new high-value investment avenues for ESG-oriented funds.[4]

CONCLUSION

As Morocco and the African continent looks to its post-pandemic future, IF offers a strong opportunity to foster economic growth. In this regard, the WAMU is able to draw from the Moroccan securitisation law reform and the Kingdom's sovereign sukuk issuance to establish its new regulatory framework on IF.

As a natural framework for sustainable development, IF can also easily adapt to incorporate emerging ESG criteria and establish itself as a respected sustainable financial products space with a robust regulatory framework.

[4] https://www.reuters.com/article/sudan-energy-idUKL5N2NI1R6

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