

Way Forward for Countries to Tap Into Asset Recycling Through Islamic Finance

Full Description

Key regulatory issues

From a regulatory point of view, the key considerations for financiers of an assets recycling transaction may include certainty of legal system, clarity of tax law and recognition of foreign court judgment or arbitral award. Financiers are expected to consider, amongst others, the following before participating in an asset recycling finance transaction:

- a. What type of government authorisations, approvals, permissions or consents would be required for their financing? Will there be any fees and charges applicable to their financing?
- b. Under certain jurisdictions, specific authorisations and approvals would be necessary for a financing to take place, and it is not uncommon for fees to be applicable. Therefore, it would be common practice for financiers to consider any such required authorisations, the applicable fees to obtain such authorisations and any recurring payment obligations in relation to such authorisations.
- c. Is there any restriction in incorporating a special purpose vehicle (SPV) by the financiers to hold title to the underlying assets?
- d. Some jurisdictions impose specific restrictions in relation to incorporating SPVs by financial institutions (more so in the case of offshore SPVs). Financiers should therefore consider whether such restrictions exist and how to overcome them.
- e. What type and percentage of tax (withholding or on profit or otherwise) would be applicable to their financing? Tax implications can be a primary driver of the structure of transactions. It is common practice for financiers to consider tax implications at an early stage of any assets recycling transaction.
- f. Would the financiers be required to register or file their financings or finance documents with any government authority or otherwise comply with any legal formalities to make the same valid or enforceable? This is common for security documents. Thankfully, many jurisdictions have established online portals where such documentation can be registered.
- g. Is there any requirements for financing agreements be prepared or translated in the local language in order for validity and/or enforcement? This requirement is applicable at two levels: (i) when entering into an agreement where some jurisdictions impose language formalities requiring a document to be in a certain (usually the official local) language to be valid, and (ii) when enforcing a document where courts/enforcement agencies may only accept documents in certain languages or translations into that language.

- h. Whether the finance documents would need to be notarised for their validity and/or enforceability? Certain jurisdictions require certain documents to be executed before a notary or other witnesses for their validity and enforceability.
- i. Is there any restrictions on transferring funds in foreign currencies? Certain jurisdictions require prior approvals from their central banks for transferring funds or making any transaction in foreign currencies.
- j. Would a foreign judgement or an international arbitration award be recognised and enforced by local courts? Foreign judgements are not always enforced by local courts. This is especially important when the assets recycling transaction involves a foreign element, be it a party of the recycled asset itself.
- k. Would the choice of foreign law (for example, English law or the law of New York) as governing law for finance documents be recognised or permitted?
- l. Would a submission to a foreign jurisdiction and a waiver of immunity be effective and enforceable?
- m. How courts would apply judgments in order to be able to ring-fence cash flows both prior to and after any default?

The answers to the questions above will (i) determine the shape and structure of the asset recycling transaction, (ii) help with balancing the obligation and rights of the parties involved and (iii) make clear the risks the parties are exposed to. Islamic finance practitioners (including the financial institutions, law firms, accounting firms and financial advisers) regularly navigate through these considerations and ought to be the first point of contact for any government considering raising funds through recycling its assets or otherwise.

Key institutional / capacity issues

In relation to an assets recycling transaction the key institutional / capacity considerations may be summarised as below. It has been observed that when and where the considerations below are achieved in a country, the probability of the success of an asset recycling transaction and then the adoption of an asset recycling programme is multiplied and vice versa for the lack of these items:

- a. government leaders with decision-making power support an assets recycling plan and the relevant asset recycling transaction under such plan;
- b. identifying appropriate public assets to potentially monetize for an asset recycling transaction;
- c. having a supportive regulatory framework in place that is conducive to asset recycling purposes;
- d. regular public-private engagement so that there will be strong public support for an asset recycling transaction and more comfort for the private sector financiers;

- e. carefully considering and observing any national security concerns before launching an asset recycling transaction;
- f. having a trained and dedicated workforce to operate and manage the operation of the underlying assets;
and
- g. having competitive and private sector environment with availability of capable players and potential local and international financiers

Key commercial issues

Key commercial issues in a Shari'ah compliant asset recycling transaction have been summarised below. These issues have some time discouraged parties from entering into certain transactions. In some instances, such discouragement can and have been resolved but in others it has completely obstructed the transaction.

- a. lack of sufficient recyclable Shari'ah compliant asset which are owned by the obligor;
- b. disagreement on the valuation mechanism upon which the underlying assets will be evaluated;
- c. material discrepancy between the value of the underlying assets and the value of the proposed financing;
- d. the existence of environmental or social issues related to the underlying assets;
- e. disagreement on the financing structure between the obligor, the financiers and the Shari'ah compliance officers;
- f. lack of private sector interest in the underlying assets;
- g. high insurance costs in relation to the underlying assets;
- h. unstable currency risks;
- i. inadequate cash flow from the underlying assets which do not satisfy debt service and principal payment obligations;
- j. unreasonable expectations by government authorities in relation to the applicable fees and pricing of the financing which are not in line with general market practice;

- k. lack of sophisticated trained personnel allocated to execute the transaction pre- and post-closing or the anticipation of labour unrest;
- l. expectations of unsatisfactory ratings from the reputable credit rating agency(ies); and
- m. public sentiment (such as cultural value) that is attached to the underlying assets.

Action plan

An action plan for an Islamic finance based assets recycling transaction is not expected to be significantly different from its conventional counterpart. Furthermore, generally asset recycling practitioners (including arrangers, underwriters and financial, legal, technical, environmental or insurance advisors with assets recycling capabilities) should be able to advise on and participate in Islamic finance based assets recycling transactions as the intended purpose and end result of a conventional assets recycling transaction mirrors that of an Islamic transaction. Nonetheless, the key steps of an assets recycling transaction action plan can be summarised as follows:

a. Steps to be taken by the obligor

- i. identifying the obligor's funding gap;
- ii. identifying the underlying (Shari'ah compliant) assets;
- iii. obtaining valuation of the underlying assets (if required and to the extent possible);
- iv. appointment of the obligor's financial advisor (if required);
- v. appointment of the obligor's legal advisor (if required) and the legal advisor for the financiers;
- vi. appointment of lead arrangers and underwriters for the transaction;
- vii. appointment of technical, environmental, insurance and any other advisor (to the extent required in relation to the transaction) and receiving reports from such advisors and any major issues identified in any advisor's reports are addressed and satisfied to the reasonable satisfaction of the financiers;
- viii. preparation of an information memorandum for the proposed assets recycling transaction with the assistance of the financial advisor (to the extent a financial advisor is appointed in relation to the transaction);
- ix. preparation of a financial plan or financial model (to the extent required) in consultation with the financial advisor (to the extent a financial advisor is appointed by the obligor);

- x. considering a financing structure for the proposed transaction (with the assistance of the financial advisor and the legal advisor (to the extent a financial advisor and / or legal advisor are appointed by the obligor in relation to the transaction));
- xi. preparation of a financing term sheet for the proposed transaction with the assistance of the financial advisor (to the extent a financial advisor is appointed in relation to the transaction);
- xii. preparation and / or obtaining of authorisation, approval, consent, permit or any other document required in relation to the transaction; and
- xiii. agreeing key dates (including signing date, CP satisfaction date and utilisation date) in consultation with the lead arrangers and underwriters and other key stakeholders;

b. Steps to be taken by lead arrangers and underwriters

- i. selection of the participating banks and their respective participation amount in the proposed assets recycling transaction; and
- ii. appointment of agent, security agent/trustee, account bank, documentation bank and for any other role in consultation with the obligor;

c. Legal documents, execution, CP satisfaction and utilisation

- i. working with the financiers' legal advisor for the preparation and finalising of the legal documentation for the transaction;
- ii. complying with the execution formalities of the finance and other transaction documents;
- iii. satisfaction of the conditions precedent requirements (including signed and dated finance, security (if any) and other transaction documents; all required authorisations, approvals, consents and permits are in place; all perfection steps and requirements (including sending notices to relevant third parties and obtaining acknowledgements from such third parties, registrations of the relevant security documents with the relevant authorities) are satisfied; all "know your customer" and anti-money laundering requirements are in place) in relation to the assets recycling transaction;
- iv. submission of the utilisation documents for utilisation of the funding; and
- v. satisfaction of the condition subsequent requirements (to the extent there are any condition subsequent requirements to the financing).

Related Content

[Guidelines for Implementing Asset Recycling Transactions \(Download PDF version\) - Now Available!](#)

Additional Resources

[PPP Legal Framework](#)

[Public-Private Partnerships Laws / Concession Laws](#)

Page Specific Disclaimer

The Guidelines have not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the Guidelines be reviewed and adapted for specific transactions To find more, visit the Guidelines to Implementing Asset Recycling Transactions [Section Overview](#) and [Content Outline](#), or [Download the Full Report](#).

