The Capital Markets and Securities (Corporate and Subnational Sukuk Bonds) Regulations, 2023

Market Insight 16 November 2023 Africa Finance

The regulations aim to regulate and provide guidance for Sukuk business operations in the United Republic of Tanzania, including supervisory mechanisms, operational standards, and disclosure requirements, with the broader goal of diversifying alternative financing products and enhancing market liquidity. Sukuk is an Islamic finance compliant bond like instrument which involves direct asset ownership. In this legal update, we analyse the new Capital Markets and Securities (Corporate and Subnational Sukuk Bonds) Regulations made under Government Notice No. 731 of 2023 (the Regulations) and highlight the key changes.

Key Definitions

The following are some terms that have been defined under the Regulations:

"asset-backed-sukuk" means raising finance where the principal is covered by the capital value of the asset but the returns and re-payments to Sukuk holders are directly financed by these assets thus enabling investors to have recourse to these assets in case of default;

"light asset-backed sukuk" is the type of Sukuk comprising of more intangible assets than tangible assets, each of them within a specified percentage;

"non-convertible sukuk" means the type of Sukuk structure in which Sukuk certificates have no option giving the Sukuk holders the right, without the obligation, to convert Sukuk into real assets;

"originator" means any entity that is seeking to transfer, dispose or assign assets or risks to a Special Purpose Vehicle (**SPV**) in a securitization transaction; and

"Shariah advisor" means a credible Shariah-compliant institution which is a member of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) or Islamic Financial Services Board (IFSB) with at least two individual Islamic scholars with a minimum of degree qualification in Shariah or Islamic Finance from a recognised institution.

"Sukuk Programme" means a facility which allows multiple issues, offers or invitations to subscribe or purchase sukuk medium term note, within a specific period of time.

Eligibility and Approval

The Regulations outline the eligibility criteria for issuers of Sukuk in which to qualify, issuers must conduct their businesses in accordance with internationally recognised Shariah screening criteria. The eligible issuers consist of a range of entities, including public companies with shares listed on a stock exchange, licensed banks, financial institutions, or investment banks. Additionally, public companies with unlisted shares can issue Sukuk if they meet specific conditions.

The required documentation for Sukuk issuance includes a Sukuk prospectus as prescribed in the First Schedule of the Regulations, asset transfer or sale documents, trust deeds, Shariah-compliance certificates, and where relevant, rating certificates. The prospectus is a vital component and must contain specified information, including the issuer's declaration, risk analysis, economic and financial data and the Sukuk structure. All important documents for the issuance of Sukuk must be submitted to the Capital Markets and Securities Authority (**CMSA**) for approval and the Dar es Salaam Stock Exchange (**DSE**) for admission.

If successful, CMSA will approve Sukuk programs and where applicable, will register the prospectus. Any approval granted by CMSA, except in the case of a Sukuk programme, must be implemented within twelve (12) months from the date of approval. In the case of a Sukuk programme, the initial issuance must be made twelve (12) months from the date of the approval of CMSA.

Responsible Parties

The issuance of Sukuk involves key parties and principles such as a Shariah Board comprising of scholars ensuring compliance, an independent Shariah advisor with at least two individual Islamic scholars with a minimum of degree qualification in Shariah or Islamic finance degree from a recognised institution, a lead advisor or arranger to coordinate parties involved, and a SPV to enforce Sukuk and protect stakeholders' rights. The originator of the Sukuk must not control the day-to-day operations of the SPV.

The SPV manages Sukuk funds, holds assets in trust, ensures transactions align with constitutive documents, and follows investment and borrowing limitations. The SPV and lead advisor must provide complete and accurate information for Sukuk issuance. It is worth highlighting that in the event the formation of an SPV would result in breach of legal or regulatory requirements, a Sukuk may be issued without the formation of a SPV. Such entities include commercial banks and financial institutions that have to meet prescribed requirements on asset and capital.

Sukuk should be listed on the secondary trading according to DSE Rules, 2016 and the SPV must ensure compliance with DSE listing obligations. Furthermore, investors must purchase or sell Sukuk through licensed market intermediaries or designated electronic trading platforms.

Default

In the event of the originator's default on contractual payments or return obligations as outlined in the Sukuk’s prospectus, the SPV can, at its discretion or as directed by a special resolution, within fourteen (14) days of the default, declare all Sukuk payments (both periodic and redemption) due and payable. Additionally, the SPV must notify CMSA, the originator, and the Sukuk holders, typically through designated Sukuk delegates, within seven (7) days of the default event.

Conditions that may lead to early redemption of Sukuk are specified under the Regulations and include default in payments, winding up orders against the originator and breaches of terms or conditions. In the event of such conditions, the SPV is required to convene a meeting of Sukuk holders to vote on necessary actions. Following the decision, control over Sukuk assets is transferred to the SPV, which may initiate a process of liquidation or take other reasonable steps.

Treatment of Sukuk Assets

Sukuk assets financed through Sukuk proceeds are required to adhere to Shariah-compliant principles and should be capable of generating income. These assets must be identified and disclosed in the Sukuk's prospectus to maintain transparency and clarity for investors. Any modifications or disposals of these assets require prior approval from CMSA, ensuring that any such changes are in the best interests of the Sukuk holders.

Additionally, it is imperative that these assets be registered in the name of the SPV designating the Sukuk holders as their legal owners or beneficiaries, depending on the specific circumstances. The transfer of these assets to the SPV should occur at their market value, and valuation of these assets should be conducted annually to keep depreciation in check. In anthe instance that where the market value significantly falls below the initial value, the originator may be obligated to contribute additional funds to compensate for the diminished asset value.

General Shariah Rulings

Sukuk, or Islamic bonds, come in various forms: asset-based, asset-backed, convertible, non-convertible, and perpetual. Despite their differences, all Sukuk share common features. They have a fixed term, and the principal and profits are paid upon maturity. The returns can be fixed or variable and paid periodically from the issuance date.

The name Sukuk must not be misleading and should accurately reflect the Shariah structure. The pricing will depend on lending rates, inflation, and risk premiums, and is disclosed in the prospectus. Sukuk can be issued in local or international currencies and can be a single issuance or part of a program. This flexibility allows issuers to adapt to financial needs and market conditions.

Private Placement of Sukuk

Approval from CMSA is required for the issuance of a private placement Sukuk. Unlike public offerings, private placements enjoy relaxed disclosure standards. This approach is open to a range of entities, including both private and public companies, legal entities, supranational institutions, specific collective investment schemes, and offerors without current public disclosure obligations. To conduct private placements, interested entities must register their private placements with CMSA and submit the register to the CMSA for approval. It iss worth noting that unlike public offerings, private placements do not involve advertising, public communications, or general marketing efforts.

Conclusion

Sukuk provides a flexible and globally compliant financial tool with various structures to cater to diverse economic and investment needs. Whether they are asset-based or asset-backed, convertible, non-convertible, or perpetual, Sukuk adheres to Islamic finance principles while meeting international standards set by Shariah advisors.

In the finance world, Sukuk have carved a niche that combines ethical principles with economic efficiency, attracting businesses and governments seeking to raise funds in compliance with Shariah standards. Their widespread acceptance in global markets emphasises the rising significance of ethical finance, presenting new opportunities for investors and issuers worldwide.

END

Authors:

Tenda Msinjili

Partner

Amreen Ayub

Senior Associate

Themes:

Corporate
Finance