Sovereign Sukuk in Djibouti: An achievable challenge

Djibouti is a strategic country located in the Horn of Africa. The constitution of Djibouti declares Islam to be the state religion and its official languages are Arabic and French. JEAN-BAPTISTE SANTELLI and LAURENCE VANDERSTRAETE write.

Jean-Baptiste Santelli *is a partner at De Gaulle Fleurance & Associés and* ***Laurence Vanderstraete*** *is the senior associate in the same firm. They can be contacted at jbsantelli@dgfla.com and lvanderstraete@dgfla.com respectively.*

According to the World Bank, the GDP of Djibouti grew at an estimated 6.5% in 2015 and is expected to rise to 7% in 2016-18. Despite these positive economic indicators, poverty remains high in Djibouti with an unemployment rate of 60% and approximately 42% of the population lives below the poverty line. Djibouti has few natural resources and little industry and remains highly dependent on foreign assistance to support its balance of payment and finance development projects. Its economy is based on service activities related to the country's strategic location (notably its proximity to the Ethiopian market), its port activities and the banking sector.

As a member of various regional organizations, such as the African Union, Cen-Sad (Community of Sahel-Saharan States), COMESA (Common Market for Eastern and Southern Africa), NEPAD (New Partnership for Africa's Development) and IGAD (Intergovernmental Authority on Development), Djibouti aims at becoming a financial regional hub and an important platform for Islamic finance in Africa to increase banking penetration, notably in its own rural areas.

As from 2011, Djibouti has started to adjust its legal framework so as to allow the establishment of Islamic banks (law dated the 22nd January 2011) and introduce the Islamic insurance instrument of Takaful (law the dated 9th June 2012). The government established, by Order of the 30th October 2016, a National Shariah Council comprising five members appointed for a renewable term of five years to oversee the sector. Djibouti's President Ismail Omar Guelleh also announced the forthcoming creation of an Islamic finance training center for legal practitioners in his 4th November 2015 speech on Islamic finance.

As a result of this strategy, to date, among all banks in Djibouti, three in ten are Islamic and hold 15 to 20% of the global financial market.

In addition, for the fifth year in a row, Djibouti hosted the International Islamic Banking Summit in Africa on the 2nd and 3rd November 2016. On the first day of the said summit, the governor of the Central Bank of Djibouti, Ahmed Osman, stated that: "Djibouti expects to see new entrants in its Islamic finance sector and the government plans to work on a framework to allow the use of Sukuk or Islamic bonds, to fund infrastructure projects (around 10 projects, including railways, pipelines and new roads with one likely candidate being the state telecom operator owning assets to structure a Sukuk facility)." To that end, Djibouti is in discussions with the IDB "to secure a technical mission to help establish a framework to issue Sukuk for either the government or state-owned enterprises".

In view of this situation, legal and regulatory aspects need to be considered to assess whether Djibouti would be in a position to issue a sovereign Sukuk facility.

Main legal and regulatory aspects to consider

1) **Local capital market**
So far, there has been no significant precedent with respect to the issuance of Sukuk in East African countries due to the lack of regional capital markets and an appropriate legal and regulatory framework.

As Djibouti does not have access to international or regional capital markets and has no market for domestic government debt (treasury bills and bonds), it is crucial for the country, through the central bank or the stock regulator to be created, to develop a domestic Sukuk market or to take part in the development of a regional capital market in East Africa that would allow Djibouti and all or parts of other East African countries to issue Sukuk.

The framework of any said market should offer a structure that facilitates trading, price transparency, a diversified investor base and the efficient clearing and settlement of transactions.

Also, Sukuk must be governed by a robust and attractive legal and regulatory set of rules, notably a minimum regime for the protection of investors, including their rights and remedies in case of default scenarios.

2) **Sovereign immunity**
Sovereign or state immunity is a principle of customary international law according to which a sovereign state cannot commit a legal wrong and is immune from civil proceedings or criminal prosecution. Pursuant to the said principle, the courts are prevented from considering any claims or enforcing judgments against foreign states (and their entities) unless the latter expressly otherwise agree (immunity from jurisdiction) and state entities are generally allowed immunity from adjudication, enforcement and execution (immunity from execution). Sovereign immunity is a major concern for investors since the Djiboutian public assets underlying the said Sukuk may be protected by sovereign immunity. In the case of a default of the Djiboutian originator to a Sukuk facility, such immunity would thus deprive the investors from any enforcement action.

Upon the investors' request, the Djiboutian state entity may expressly waive the immunity from jurisdiction

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in the Sukuk documentation (the agreement to arbitrate generally constitutes a waiver of that immunity). As the case may be, an express agreement should be needed from the Djiboutian state to accept the jurisdiction of the Djiboutian courts, which should also accept assuming jurisdiction.

With regards to the sovereign immunity from execution, there is unfortunately no universal solution to address this issue and the position adopted by Djibouti's courts – as to whether the Djiboutian state would benefit from an 'absolute' immunity or be possibly prevented from immunity in case the Sukuk facility is considered as a 'commercial transaction' – should be determined in case it is required.

3) **Domestic law issues**
Depending on the nature of the assets to be transferred and the Sukuk structure used, domestic law issues may be considered pertaining to the transferability of title to the assets underlying the Sukuk, including, among others, the formalities necessary for the transfer of title to be effective under Djiboutian law, such as registration by the Direction des Domaines et de la Conservation Foncière du Ministère de l'Économie et des Finances and the payment of any related fees and taxes.

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Djibouti will also have to ensure that its tax regime does not penalize Sukuk issuances (notably due to taxes, rights or stamp duties applicable to the transfer to the SPV of the assets underlying the Sukuk) in comparison to conventional bond issuances.

Finally, the compliance of the Sukuk structure with the Djiboutian civil law may also be considered, in particular such as when usufruct (right in rem to use and derive profit or benefit from the property belonging to another) is used as the asset underpinning an Ijarah-based Sukuk. The Djiboutian civil law remains essentially based on the French Civil Code and provides that the usufruct that is not granted to individuals may only last for 30 years. The Sukuk documentation will therefore have to comply with, and reflect, the said requirement.

Conclusion

Djibouti, due to its cultural situation and its geographic location, seems to be a perfect country to centralize Islamic investments in the East African region. The issuance of a sovereign Sukuk facility would be a good signal for the market to prepare the route of private Islamic finance transactions. In that respect, Djibouti still has to create a complete set of rules to promote Islamic finance.