



المؤسسة العربية المصرفية (ش.م.ب.)
ARAB BANKING CORPORATION (B.S.C.)

Syndicating Strategies for Saudi Arabia

Presented by: **RIYAD M. AL-DUGHAITHER**
Chief Credit & Risk Officer
Arab Banking Corporation (B.S.C)

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BACKGROUND & OBJECTIVES

- In my presentation I use the term Trade Finance in its broad sense, i.e. not only financing commodities and goods, but also contract and project finance.
- Saudi Arabia represents the largest MENA Arab Market in terms of Trade Finance
- Given the current size of this market and prospective growth due to oil, demographics, infrastructure requirements, and imminent WTO membership, the average deal size in Saudi Arabia is large.

BACKGROUND & OBJECTIVES

- As such syndication is required to mitigate risk concentrations and to make room for more deals

- This presentation deliberates on:
 - How to select and coordinate across partners to syndicate deals in and around the Saudi market.
 - What mechanisms are prevalent in Saudi syndicated financings.
 - Structuring deals according to Islamic precepts and principles.



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SUCCESSFULLY COORDINATING ACROSS PARTNERS

- Given the profile of trade in Saudi Arabia, and the structure of the economy, most transactions will involve obligors within Saudi Arabia
- As such, it is important to source Financial Institution (FI) partners who have had prior dealings with the obligor in Saudi Arabia
- This past experience addresses a number of issues ranging from understanding borrower behaviour to pricing and structuring, along with the vested interest associated with a broader relationship

SUCCESSFULLY COORDINATING ACROSS PARTNERS

- An important advantage that Saudi based Financial Institutions have is access to instruments and remedies, that non-Saudi based banks do not have access to, in the event of default, such as the Special List (of delinquent obligors).
- It is obviously helpful that such a Saudi or Gulf FI has an active relationship with your own institution

SUCCESSFULLY COORDINATING ACROSS PARTNERS

- A second key element in determining the appropriate number and profile of partners is obviously the size of the deal
- Risk appetite for the obligor, for Saudi country risk, underwriting capacity, and ultimate hold levels are all important factors contributing toward the number and profile of institutions to approach to form an underwriting group
- If the object of the financing is specialized (such as financing the set up of a petrochemical plant, for instance) it is important that, at least, one member of the syndicate has the technical resources to evaluate the prospect.



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SUCCESSFULLY COORDINATING ACROSS PARTNERS

- A third key element to forming a successful group is a minimum amount of common ground in assessment of the risk, structuring the deal, and pricing it.
- Prior common experience amongst partners in financing similar deals is a definite plus, along with current knowledge of the market

SUCCESSFULLY COORDINATING ACROSS PARTNERS

- An important feature to keep in mind relating to Saudi Financial Institutions is that they tend to have underwriting capacity, and final take levels that are significantly higher than their balance sheets imply
- This also applies, to a lesser degree, to large Gulf Financial Institutions
- The extent of this capacity obviously depends on the standing of the obligor, the structure of the deal, and the pricing arrangement



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- However, to provide a flavour for the size of this capacity for prime obligors, the presenter has (along with his team) formed syndicates to finance a \$2.2 bn (Yanpet) transaction, and a \$2.6 bn (Saudi Aramco) transaction with over 50% of each deal underwritten by around 15 Saudi and Gulf institutions
- This suggests, an underwriting capacity, at large Gulf FI's for prime obligors of around \$75-\$100 mm.

MECHANISMS TO SYNDICATE DEALS

- Pricing in the Saudi Market is relatively fine compared to other MENA markets, therefore being able to balance between what lands the deal with the obligor, and allow one to achieve targeted sell down levels, in given market conditions, is a fine art
- Furthermore, as favourable oil income projections afford Saudi Arabia a strong credit standing, pricing is likely to remain at current levels, or even decline for higher quality obligors

MECHANISMS TO SYNDICATE DEALS

- This trend, along with the larger deal sizes, on average, mean that formulating the right syndication strategy, and implementing it through the most appropriate mechanisms are key factors for success
- This begins with the underwriting group agreeing skim levels, and participation fees, that are commensurate with sell down targets
- It is also critical to carefully determine which institutions are granted book runner roles, given the FI's and markets the group is to sell down to

MECHANISMS TO SYNDICATE DEALS

- For larger transactions it is beneficial to employ two book-runners - an international money centre bank for sell down to European banks or FI's, and a Saudi or Gulf bank with a track record for local sell downs
- Important documentation issues to resolve include governing law (usually English law), legal opinion on enforceability of claims for interest (termed commission rates in Saudi agreements), negotiations of covenants (if any), etc.

MECHANISMS TO SYNDICATE DEALS

- The Facility Agent role is another that is important, to represent the interests of banks in the group, while maintaining constructive interaction with the borrower. It is customary that this role is undertaken by a house bank to the obligor (in terms of operating accounts, etc.) with a significant underwriting commitment
- Security Agency is a critical function for the group, especially when this is in the form of a Debt Service Reserve Account as there are intricate legal issues associated with enforcing on security under Saudi law



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SYNDICATING IN COMPLIANCE WITH SHARI'AH

- Syndicating on the basis of Islamic principles is an activity growing at significant rates over the last few years, as billions of dollars of 'Sukuk' and 'Islamic Securitization' structures have been set up in MENA
- The most important principle to comply with in syndicating Islamically is the concept of 'pass through' on the basis of Mudaraba and/or Musharaka
- The concept of 'pass through' entails that the cashflows associated with the underlying Islamic transaction that is being syndicated are passed through to the participants in the syndicate pro-rata to the volume of their participation, and some conveyance of title is carried out



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- The underlying transaction to syndicate must of course be structured Islamically based upon Shari'ah compliant contracts such as Murabaha, Ijara, Istisna', etc.
- The concept of Mudaraba entails that the underwriting group act as agents on behalf of the balance of the syndicate, and are compensated based on a percentage of the profits on the underlying transaction

SYNDICATING IN COMPLIANCE WITH SHARI'AH

- As Mudareb or Co-Mudareb (underwriter or co-underwriter), an institution has a level of care that supersedes that of an underwriter or Agent in conventional transactions
- The concept of Musharaka entails participating, and sharing in the profits or losses associated with a transaction pro-rata to the initial capital contributed relative to the total value of the transaction

SYNDICATING IN COMPLIANCE WITH SHARI'AH

- Islamic securitization involves a minimum level of conveyance of title to participants of the underlying asset being financed to avoid characterization as a secured loan by Islamic scholars
- In the case of Sukuk, a Special Purpose Vehicle (SPV) is usually set up to act as a vehicle carrying first hand ownership of the underlying asset, and conveying it pro rata to the certificate or Sukuk holders in the SPV.



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CONCLUSIONS

- Syndicating deals in Saudi Arabia is likely to be big and growing business given growth projections in trade, money, and capital markets.
- However it is also likely to be intricate given trends in pricing, ratings, and the idiosyncracies of the KSA market.
- Selection of partners to form a synergistic team is essential to compete effectively

CONCLUSIONS

- Trade Finance lends itself to Shari'ah compliant syndication due to the underlying goods and/or assets being an important pre-requisite to tap Islamic investor participation
- A selected number of large institutions in the Gulf are considered major players in the trade, project, syndicated and Islamic financing markets, and are desirable to have in any successful underwriting group such as that of the presenter