FINANCIAL FLAGSHIP

LEASING IN THE MIDDLE EAST
AND NORTHERN AFRICA (MENA) REGION:
A PRELIMINARY ASSESSMENT

BILAL AL-SUGHEYER AND MURAT SULTANOV*
OCTOBER 2010

The World Bank
The International Finance Corporation

*This Preliminary Assessment was written by Bilal Rabah al-Sugheyer and Murat Sultanov, Operations Officers at the International Finance Corporation’s Advisory Services in Middle East and Northern Africa.

The authors would like to thank Diego M. Sourrouille and Zsofia Arvai for their invaluable suggestions. We extend a special thanks to Roberto Rocha for his guidance and suggestions.
Abstract

The leasing industry has long existed in MENA and is currently active in 70% of the countries in the region. However, despite its long presence in MENA, the leasing industry remains generally under-developed by international comparison and there is a lot of potential for further growth. However, this potential will only be realized if MENA policy-makers address the existing regulatory and institutional constraints hindering the growth of the industry. These include the absence of an effective legal framework that reduces ambiguities and introduces clear definitions of leasing and clear rights and responsibilities of the parties to a lease. The growth of the industry is also hampered by lack of registries of leased assets and ineffective legal mechanisms for repossessing these assets. Also, the limited access to long term fixed-rate funding has restricted providers’ ability to mitigate their operating and treasury risks, especially independent providers which do not have easy access to bank finance. Finally, tax rules do not recognize leasing as a financing mechanism and fail to create a level playing field between leasing and other forms of finance, reducing the attractiveness of leasing.
Table of Contents

1. Introduction .............................................................................................................................................. 4
2. Background: Historical Roots of the Leasing Industry in MENA .......................................................... 4
3. An Overview of the Development of the Leasing Industry in MENA .................................................... 5
   3.1. The Overall Size and Structure of the Leasing Industry in MENA .................................................. 5
   3.2. The Stage of Industry Development by International Comparison .............................................. 9
4. Main Regulatory Issues in Leasing in MENA ....................................................................................... 12
5. Opportunities for Developing Further the Leasing Industry in MENA ................................................. 15

Figures:

Figure 1 ......................................................................................................................................................... 7
Figure 2 and Figure 3 .................................................................................................................................... 8
Figure 4: Leases Distributed by Type ........................................................................................................... 8
Figure 5: Leasing Volume/GFCF (individual countries) .............................................................................. 10
Figure 6: Leasing Volume/GDP (individual countries) ............................................................................... 11
Figure 7: MENA Leasing Markets Development (% of GFCF) ................................................................. 11
Figure 8: Annual Leasing Volume Development for Selected Countries in MENA ................................. 12

Tables

Table 1: Status of the Leasing Industry in MENA Countries ....................................................................... 6
Table 2: Leasing Market Classification ........................................................................................................ 9
Table 3. Types of leasing legislation in MENA .......................................................................................... 12
Table 4 ........................................................................................................................................................ 13
1. Introduction

This paper provides a preliminary analysis of leasing markets in the MENA region. The analysis comprises an examination of the types and diversification of players/products in these markets, the status of market development vis-à-vis other countries and regions, and the regulatory and supervisory framework. Based on these preliminary findings, the paper identifies the policy agenda for the development of leasing industry in the region.

This paper represents a first step towards a better understanding of leasing markets in the region. The lack of previous research and the frequent lack of accurate and detailed published data on leasing markets and lessors have imposed certain limitations on this study. However, the study reflects the available information on almost 70% of the lessors operating in the region, and therefore, is able to provide a reasonable overview of the status leasing markets in the MENA region and the challenges for further development.

The paper is structured as follows. Section 2 reviews briefly the historical roots of leasing in the MENA region. Section 3 provides an overview of the status of development of the industry. This includes both an assessment of the industry’s structure and also an analysis of the size of the leasing industry by international comparison. Section 4 reviews the main regulatory and supervisory issues, and indentifies the major constraints hindering the growth of the industry. Finally, section 5 concludes and identifies the agenda for further development of the industry.

2. Background: Historical Roots of the Leasing Industry in MENA

In its simplest form, leasing is an asset-based financing transaction with the asset providing in most situations the security for the transaction. It is a means of providing access to finance and may be defined as a contract between two parties wherein one party (the lessor) provides an asset for use to another party (the lessee) for a specified period of time in return for specified payments.

Leasing is based on the proposition that income is earned through the use of assets, rather than from their ownership. It focuses on the lessee’s ability to generate cash flow from business operations to service the lease payment, rather than on the balance sheet or on past credit history. Being an asset base financing operation, leasing is inherently an Islamic Shari’ah friendly product. In the Share’ah context, such product is referred to as Ijarah.

Both conventional leasing and Ijarah serve the same function and involve similar transaction structures. Leasing and Ijarah institutions (lessors), purchase the equipment that has been selected by the lessee, and then allow the lessee use of that equipment for a specified period of time. For the duration of the lease, the lessee makes periodic payments to the lessor, at

---

1 The region includes: Morocco, United Arab Emirates (UAE), Saudi Arabia (KSA), Oman, Kuwait, Egypt, Algeria, Qatar, Jordan, Yemen, Bahrain, Lebanon, Tunisia, West Bank and Gaza, Iraq, Iran, Syria and Libya.

2 The study relies on desk research of industry and company data from various sources that include: World Leasing Yearbook, Lessors’ annual reports, Zawya financial website, ISI emerging markets’ financial website, Google Finance and Pak search engines. However, the desk research was analyzed by IFC’s MENA leasing team based on relevant field experience in MENA leasing markets.

3 Literally, Ijarah means to give something on rent.
an agreed rate of interest and in an agreed currency. At the end of the lease period, the ownership (title) of the equipment is transferred to the lessee at a pre-agreed residual value, or the equipment is returned to the lessor, which may then sell it to a third party or declare it worthless and obsolete.

At the same time, although conventional leasing and *Ijarah* serve essentially the same function and have similar structures, there are a number of important differences between them. The key differences include ownership responsibilities, interest related characteristics, allowable assets, and the non existence of late fees.\(^4\)

Leasing\(^5\) should be particularly attractive for MENA SMEs. For SMEs that do not have a lengthy credit history or a significant asset base for collateral, the lack of a collateral requirement with leasing offers an important advantage in countries with weak business environments, particularly those with weak creditors’ rights and collateral laws and registries. The limited collateral requirements, along with its compliance with *Shari‘ah* should make leasing especially attractive to many SMEs in MENA.

As a concept, leasing has long existed in MENA, but the actual development of *Ijarah* is more recent. *Ijarah* as part of Islamic finance has existed since the early beginning of Islam, but its development was initially limited by comparison with other Islamic finance products. In the 1970s, *Mudaraba* products (cost-plus finance) emerged as the most widely used instrument by Islamic banks, accounting for over 80% of Islamic bank portfolios.\(^6\) During the 1990s, however, Islamic financial institutions became increasingly more innovative, and the use of instruments such as *Ijarah* started to be developed in its modern form.

Interestingly, the development of conventional leasing has lagged behind the development of *Ijarah*. While *Shari‘ah* provided the basic ground legislation for *Ijarah*, conventional leasing legislation was still missing. The absence of a number of key regulatory requirements held back the development of the conventional leasing industry.

3. An Overview of the Development of the Leasing Industry in MENA

3.1. The Overall Size and Structure of the Leasing Industry in MENA

Most MENA countries have a leasing industry. Leasing, in both of its forms, conventional and Islamic, is present in 13 out of 18 MENA countries. In five other MENA countries (Iraq, Syria, Libya, Yemen and West Bank and Gaza) leasing is still in a very early stage of development.

\(^4\) The key difference between Islamic finance and conventional finance is the role of interest. Interest (riba) is prohibited in Islamic finance. The ban on interest is based on the concept that money is not a commodity in itself that can be used to create profit. Rather, money should be used for buying and selling assets. The transfer of those assets, on the other hand, is a legitimate profit-making activity.

\(^5\) Unless stated otherwise, the term leasing refers to both *Ijarah* and conventional financial leasing.

\(^6\) Source: Issues and Relevance of Islamic finance in GCC, Institute of Islamic Finance and Insurance.
Table 1: Status of the Leasing Industry in MENA Countries

<table>
<thead>
<tr>
<th>Category</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing</td>
<td>UAE, Iran, Kuwait, KSA, Morocco, Qatar, Tunisia, Egypt, Oman, Algeria, Jordan, Bahrain, Lebanon.</td>
</tr>
<tr>
<td>Very early stages</td>
<td>Yemen, WB &amp;G</td>
</tr>
<tr>
<td>Non existing</td>
<td>Iraq, Syria, Libya</td>
</tr>
</tbody>
</table>

The size of industry is generally small by international standards, although it may have been underestimated by the lack of reporting by MENA countries and the poor coverage of traditional sources of information. The size of the industry is generally small (see next section), although it may have been underestimated due to the lack of reported statistics in some countries. Euromoney (the main source of leasing data) has reported only three to five leasing markets in MENA. The list of countries often changes and in most cases, does not cover all important leasing markets in the region.

The average size of leasing markets in MENA is small, but there are significant differences across countries. With different starting points and different legislative environments, the individual leasing markets in MENA varies in size, openness of the market (Number of lessors), type of lessors, and prevalence of Ijarah.

Regarding leasing volumes, the top four leasing markets are the UAE, Iran, Kuwait and KSA. Each of these markets has annual leasing volumes that exceed USD 1 billion (USD 6.2 billion in total). These four countries constitute more than 61% of the total leasing market in MENA. The rest of the market is distributed among 12 countries, with Morocco coming at the top of the list. Three countries, (Iraq, Syria and Libya) do not have any leasing activities.

Regarding the number of lessors, there are 159\(^7\) lessors operating in MENA, out of which about 49% operating in the four top markets. The number of lessors suggests that the industry is competitive in many countries. As shown in Figure 1, Tunisia has 11 lessors, and each of Jordan and Egypt has 11 and 10 lessors respectively. The number of lessors in other countries ranges between 7 and 4 lessors.

\(^7\) Number of lessors includes 45 Iranian lessors on which no information was available. The following statistics are excluding Iranian lessors. Source: Shade Leasing Company Website
The dominant types of lessors in MENA are banks and bank-related lessors. As shown in Figures 2 and 3, banks and bank-related lessors constitute 62% out of the total number of lessors (80 lessors), while 30% (34 lessors) are stand-alone leasing companies.  

The prevalence of banks and bank-related lessors is partially due to their easier access to funding. Stand-alone leasing companies are often faced with the challenge of financing their business growth. Banks can rely on their deposit base and bank-related lessors can rely on funding from their banks, both of which consisting of relatively cheap sources of funds. By contrast, stand-alone leasing companies must rely on equity or longer-term loans at market conditions to fund their leasing portfolio, both of which are relatively more costly.

The scarcity of fixed-rate funding for stand-alone leasing companies has increased their exposure to interest rate and currency risks. In the absence of longer-term options, many leasing companies are forced to rely on short-term loans and lines of credits which create a problem of mismatched maturities whereby the terms of their assets (outstanding multi-year leases) are longer than their funding sources (mainly short-term borrowings). This problem has also led these leasing companies to either restrict its leasing portfolio or offer variable rate leases and transfer these risks to their clients, which are in many cases SMEs unable to bear these risks.

Other reasons for the prevalence of banks and bank-related lessors include regulatory constraints or market uncertainties. In some MENA countries (e.g. Lebanon and Tunisia) leasing is only allowed to banks and bank affiliates. In other countries, banks are usually the first movers into the market as part of their search for new products and efforts to expand their customer base amid the fierce competition they face in “conventional” banking products. Banks usually start their leasing activities by including leasing in the product mix which is booked on their balance sheets. Once the leasing business is proven feasible, banks tend to spin-off its leasing portfolios into affiliate leasing companies.

---

8 Bank related lessors are companies where banks have at least 20 percent of the companies’ total shares. Stand-alone companies are companies that are specialized in leasing. Captive Lessors refer to lessors that are subsidiaries of a manufacturer or a dealer established to support the sales of its parent’s products and services, with over 50% of its portfolio in the parent. Statistics exclude Iranian lessors due to lack of information.
Financial full-payout leasing seems to be common in MENA leasing markets. While there is no detailed information on the types of leasing services in MENA, it seems that financial leases dominate. About 70% of lessors operating in MENA identify themselves as financial lessors providing full-payout financial leasing services only. Those who identify themselves as operational lessors account for only 7% of total lessors (Figure 4).

The dominance of full-payout financial leases indicates that leasing in MENA is still used as an alternative to assets purchase financing, suggesting that leasing is relatively underdeveloped and under-used. Historically, leasing markets start developing with full-payouts leases only, as this is the least risky type of lease. At later stages, and as lessors get more experienced, other forms of financial leasing emerge (sales and lease back, leases with option to buy, leases without options to buy). Also, this feature is, partially, a reflection of the prevalence of banks and bank-related lessors who seek less risky financing tools (by not assuming the additional risk of residual value), and on the other hand, the inefficient repossession environment.

Movable assets are the most common types of assets leased in MENA. The limited information available indicates that in most of MENA leasing markets, leasing of immovable assets is very limited. This is due mainly to legislative constrains (like in Tunisia and Egypt, for example, where leasing laws prohibit real estate leases).

However, in some countries (e.g. Jordan, UAE and Morocco), real estate leasing exists. In these countries, there are no legislative constrains on the type of leased assets. This may be seen positively, but this liberty has led financial leasing to replace mortgages in some cases. In Jordan, real estate leases (mainly for consumer purposes) constitute more than 66% of total leasing market. Similarly, in UAE, 80% of leases were directed to real estate. In Morocco, real estate leasing is less common, constituting only 15% of total market.
Despite the larger than reported size, leasing markets in MENA remain relatively undeveloped. As shown in Figures 5 and 6, MENA’s leasing market penetration rates are low by international comparison, regardless of whether the penetration rate is defined by the ratio of leasing volume to gross fixed capital formation (GFCF) or the ratio of leasing volume to GDP. The average penetration rate of the MENA region is about 3.6% (defined by GFCF), while the equivalent ratio is about 12% in Central Europe, 6% in high income countries, and 5% in Latin America. MENA’s relative position remains the same if the penetration ratio is defined in terms of GDP.

While the average level of development in MENA is low, there are significant differences across countries, as also shown in Figures 5 and 6. Based on a classification by the International Finance Corporation (IFC), the stages of leasing market development are defined in accordance to the ratio of leasing volume/GFCF. As shown in Table 2, a ratio lower than 5% indicates that the leasing market is nascent, a ratio between 5-10% indicates an emerging market, and a ratio above 10% is evidence of a maturing market. Against this benchmark, it can be seen that most MENA leasing markets fall within the first two categories – nascent or emerging.

<table>
<thead>
<tr>
<th>Leasing Volume / GFCF</th>
<th>Market Classification</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 5%</td>
<td>Nascent Market</td>
</tr>
<tr>
<td>5% &lt; Leasing Volume / GFCF &lt; 10%</td>
<td>Emerging Market</td>
</tr>
<tr>
<td>Leasing Volume / GFCF &gt; 10%</td>
<td>Maturing Market</td>
</tr>
</tbody>
</table>

A more detailed look at the individual country positions enables a further division of MENA countries within the nascent and emerging market groups (Figure 7). The First Group is the Early Nascent Stage Group, which includes Iraq, Libya, Syria, Yemen, and WBG. In this group, the leasing industry is absent or extremely small, with a very small number of lessors, no supportive legislation, underdeveloped financial systems and high political risk.

The second group is the Late Nascent Stage Group. This group includes a large number of MENA countries: Algeria, Egypt, KSA, Lebanon, Jordan, Morocco, Oman, and Qatar. In this group, the leasing industry operates on a relatively limited scale, but with high growth and profit potential and with some leasing related legislation requiring improvements. It is also characterized by low competition and limited number of lessors offering plain-vanilla leasing products (no product differentiation).

While technically it does not comprise a group, Bahrain represents a third stage of development and stands at the very threshold between Early Nascent Stage and Late Nascent Stage. In many aspects, the Bahraini leasing market shares the strong market fundamentals of other more advanced markets in the region, but leasing is still practiced on a

---

9 The Penetration Rate was initially defined by the ratio of leasing volume to Gross Fixed Capital Formation (Global Leasing Report (1978)), but can also be defined as the ratio of leasing volume to GDP.

10 The MENA penetration rate average does not include countries with zero leasing volumes.
small scale. In general, the leasing industry at such stage has a stronger presence, large number of lessors, tight competition mostly on a pricing basis (limited margins), moderate growth, plain-vanilla leasing products, and lessors seeking external financing.

**The final group is the Late Emerging Stage Group.** This group includes Kuwait, Tunisia and the UAE. These countries have a more vibrant leasing industry, a larger number of lessors offering differentiated more complex products, more capacity to expand overseas, although they are also facing more sophisticated challenges (i.e. risk management).

**However, there are also signs that several leasing markets in MENA are growing fast.** Figure 8 shows the growth of the market in Jordan, Morocco and Egypt. In each of these countries, the growth rate has exceeded the average growth of the global leasing industry (10% p.a.) by a wide margin. For instance, in Jordan, the growth in leasing marked averaged more than 70% between 2000 and 2006 and reached 100% in 2007\(^{11}\). Likewise, in Egypt, the annual leasing growth rate went up from 5% in 2005 to an impressive 129% in 2006. Although these growth rates are partly due to the very low initial base, they do reveal a strong demand for the product and the potential for further growth.

**Figure 5: Leasing Volume/GFCF (individual countries)**

Figure 6: Leasing Volume/GDP (individual countries)

Figure 7: MENA Leasing Markets Development (% of GFCF)
4. Main Regulatory Issues in Leasing in MENA

The evolution and development of a country’s leasing sector is determined, first and foremost, by the existence of an effective leasing legislation. In countries with developed legal infrastructure and contract laws, the leasing industry can rely on the legal framework to establish and run its operations. Otherwise, a special leasing law is required to fill the gap.

There are no jurisdictions in MENA where contract law and legal procedures are sufficiently developed to eliminate the need for a separate law on leasing. In MENA, key issues like what is considered a financial leasing transaction and how to differentiate leasing from other sources of finance are still unclear. The absence of leasing legislation leads to ambiguous roles and responsibilities of the parties to a lease, while lack of effective procedures for repossession of leased assets in case of lessee’s default restricts incentives for lessors to expand their operations.

The legal framework for leasing in MENA is either absent or ineffective. As shown in Table 3, in MENA, only six countries have special leasing laws, i.e., a specialized leasing legislation is absent in most countries in the region. Moreover, while some of these specialized leasing laws are considered to be effective (e.g. Jordan and Yemen), others fail to address key issues and do not provide a sound basis for the growth of the industry.

Table 3. Types of leasing legislation in MENA

<table>
<thead>
<tr>
<th>Special leasing laws</th>
<th>Egypt, Tunisia, Jordan, Yemen, Algeria and Lebanon</th>
</tr>
</thead>
<tbody>
<tr>
<td>No special legislation</td>
<td>Bahrain, Kuwait, Morocco, UAE, Qatar, Iran, and Oman</td>
</tr>
<tr>
<td>Under development</td>
<td>KSA, Libya, Syria, West Bank and Gaza, and Iraq</td>
</tr>
</tbody>
</table>
A specialized leasing law is in most cases the best approach to provide a sound legal basis for the leasing industry, but changes in other related pieces of legislation are also required. The attempt to write an all-encompassing law may not result in conflicts with other laws. Some jurisdictions in MENA (e.g. Syria) decided to have a single act to address all necessary legal, tax, accounting and supervisory norms of leasing. However, this approach may not succeed in preventing conflicts with other key pieces of legislation. For instance, tax and accounting aspects of leasing are also addressed in the tax codes, while issues related to repossession of leased assets (which are procedural in nature) should also be dealt with in the procedural Law (Code of Civil Procedures). Experience of other jurisdictions which attempted to create a single leasing act dealing with all aspects of leasing demonstrated that such approach may not prevent contradictions with other acts. For example, tax exemptions that were provided in the Jordanian Leasing Law were not recognized by the Tax Authority since such exemptions were not addressed in the specific tax legislation.

A sound legal framework for leasing requires a well written specialized leasing law and appropriate changes in other legislation addressing a number of critical elements. These elements include: i) the enforcement of contractual and proprietary rights; ii) existence of an effective registry for leased assets; (iii) repossession procedures of a leased asset when a lessee defaults; iv) neutral tax rules ensuring a level playing field between leasing and other forms of credit; v) effective treatment of lessors and lessees under bankruptcy. These elements are examined in more detail below.

The enforcement of contractual and proprietary rights is overall inefficient in MENA. Aside from GCC (specifically Kuwait and Bahrain) and Northern African countries, which tend to do better compare to other countries, the enforcement of legal contacts in MENA suffer from systematic delays. In fact, the Doing Business report for 2009 shows that the MENA region has achieved very limited progress in enhancing its contract enforcement environment (Table 4).

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of reforms easing contract enforcement 2005-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>MENA</td>
<td>1</td>
</tr>
<tr>
<td>South Asia</td>
<td>3</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>7</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>10</td>
</tr>
<tr>
<td>OECD</td>
<td>17</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>21</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>25</td>
</tr>
</tbody>
</table>

The general absence of registries for leased assets increase risks for lessors and hinder the expansion of leasing operations. One common element required to develop leasing of movable assets is a registry in which the lessor may publicize its interest in the leased asset and protect its
ownership rights. With the lack of such registries, lessors find themselves unable to protect their interests in leased assets against third parties.

Currently, there are no jurisdictions in MENA that exercise effective registration of notices of lessors’ interests in movable leased assets. In a number of MENA countries, governments impose requirements to register the leasing contract instead of leased assets. The requirement for each leasing contract to be registered and checked for compliance with the law is a cumbersome procedure. Some governments, such as Egypt, require the registering of lease contracts whereby representatives of the lessee and the lessor must be present in a registrar’s office when the contract is signed. Unfortunately this form-over-substance practice adds no benefit to either the lessor or the lessee. Rather, it is an unnecessary administrative and expensive burden that may even prevent leasing companies entering the market (especially microleasing institutions) if the registration cost is prohibitively high (in Jordan, for example, the cost was USD 75 before this burden was removed in 2008). The 2008 Law on Leasing in Jordan now requires that only notices of lessor’s interest in assets have to be registered – a practice that can greatly benefit the leasing industry. The only country in MENA that is currently working on launching a web-based notice registry of leased assets is Yemen. This registry should become operational in 2011.

Ideally, there should be a unified collateral registry where all security interests are recorded, and lessor’s interests in leased assets would be recorded in this unified registry. In MENA, however, no unified collateral registry exists and many countries do not have even functional registries for moveable assets. Therefore, some jurisdictions may consider establishing a registry for leased assets which can later be expanded to include other types of security interests or merged into a new registry for moveable assets. For example, Yemen is developing a notice-based registry for leased assets and this registry is designed as a modern electronic collateral registry which can be used to include other security interests, once the special legislation on secured lending is in place.

Effective repossession is mostly unavailable for lessors in MENA countries. Self help repossession procedures are unavailable and repossession through regular court litigation does not enable lessors to repossess leased assets without costly and time-consuming procedures or restrictive bureaucratic requirements. Except for Jordan and Yemen, where non-judicial repossession is practiced (Urgent Matters Judge), no other jurisdictions have special repossession procedures and therefore lessors have to use regular litigation procedures. Repossession of leased assets through the regular court system remains largely a cumbersome process. In Libya, Syria and West Bank the current draft laws advocate for Urgent Matters Judge repossession, similarly to Jordan and Yemen.

Inefficient repossession procedures affect the quality of leasing portfolio and lessors’ income statements. Cumbersome and lengthy repossession procedures increase the credit and liquidity risks for lessors and weaken their position vis-à-vis lessees. The weaker position leads to higher default rates and ultimately either increase the cost of doing business for lessors (with

---

12 Self-help repossession is a unilateral act by the lessor supported by no legal process or permits.
13 Though in some countries like Tunisia and Morocco repossession cases are dealt with relatively efficiently by commercial courts.
leasing price becoming higher), or affect the profits that lessors generate. Both cases have negative effect on the development of the industry.

**Leasing in MENA suffers from the lack of clear and neutral tax rules.** Tax policy should level the playing field for leasing versus other forms of finance and to avoid special treatment for either, thus avoiding market distortions which can have a negative effect on the financial sector in general. For example, the income tax treatment of leasing and loans should be similar, as there is little difference between leasing and loan finance. Likewise, sales tax and valued added tax rules should clarify that a leasing operation is a financial service, not the sale of a good. Even in jurisdictions where leasing is treated as an exempted financial service, the legislation does not clarify which part of the lease payment is exempted – whether it is the total value of the lease contract (asset value and finance return) or only the finance return component.

**The tax rules in most MENA countries are ambiguous and have generally created a bias against the leasing industry.** This ambiguity has led lessors to increase prices to compensate for the uncertainties in the tax treatment of the leasing transaction. This situation results in leasing being more costly and less attractive to both sides of the transaction, lessors and lessees.

**The majority of jurisdictions in MENA do not clarify the rights of lessors and lessees under bankruptcy.** In cases where the lessee is bankrupt and defaults on the lease, the lessor should have the right to repossess the asset. The general norms of bankruptcy law apply, with the insolvent pool of assets consisting only of those that are owned by the insolvent company. What does not belong to the insolvent company should be returned to the owner (the lessor). In cases where the lessor is bankrupt, this should have no effect on the lessee. If the lessee respects his lease obligations, it should retain the right to use the asset. In this case, it is also important to clarify in law the party to which the lessee must make payments to avoid accusations of default when payments are made in good faith. Only jurisdictions like Jordan and Yemen made it clear in their laws the consequences of either party going into insolvency.

**5. Opportunities for Developing Further the Leasing Industry in MENA**

**Despite the improvements in recent years, the leasing industry in MENA still faces many impediments and could make a much greater contribution in MENA.** Leasing, as an alternative source of finance has a great potential in MENA. This is because of two main characteristics: a) leasing can complement and even replace bank financing, especially for SMEs which frequently lack sufficient credit history and collateral; b) leasing is fully compliant with Islamic Shari’ah law. The lack of large scale, diversified leasing operations that cut across industry lines and serve all organizations, especially SMEs, is due to several important factors. Unless these are addressed in a comprehensive and effective fashion, the leasing industry in MENA will not reach its true potential.

**To improve the enabling environment for leasing in MENA, it is important first to strengthen the legislative framework governing leasing operations.** Legislation related to leasing should be strengthened to provide a more effective and unambiguous legal framework. This would be best achieved through a specialized leasing law, combined with appropriate changes in key related pieces of legislation. Among others, the definition of leasing needs to be
clarified\textsuperscript{14} and a fairer balance established between the rights and responsibilities of the parties to a lease. It is important to establish regulations for other forms and types of leasing such as sale and lease-back and sub-leasing.

**Firstly, the process for registering leased assets should be strengthened.** One of the first priorities entails the development of registries in which lessors may publicize its interest in the leased asset and protect its ownership rights. Ideally, there should be a unified collateral registry where all security interests are recorded, and lessor’s interests in leased assets would be recorded in this unified registry.

**Secondly, there is a need to improve repossession procedures.** The right of the lessor (as owner) to repossess a leased asset in an expedient manner should be independent from the type of breach committed by the lessee. Should a leasing agreement be rescinded for any reason or if the lessee does not exercise his or her right to purchase the leased asset, then the lessee must be required to return the asset to the lessor. If the leased asset is not returned, then the lessor should have the right to turn to any legal remedy available to repossess the asset. In this regard, MENA countries should consider adopting the non-judicial repossession procedures (Urgent Matters Judge) that have already been adopted by several countries outside and even inside the region.

**Thirdly, tax rules should be clear and neutral, removing the current bias against leasing transactions.** In MENA, leasing operations on several fronts are subject to inferior treatment, in particular regarding tax policy, which is detrimental to the growth in the leasing sector. The income tax treatment of leasing and loans should be similar, as there is little difference between leasing and loan finance, and valued added tax rules should clarify that a leasing operation is a financial service, not the sale of a good or a form of rental.

**Fourthly, insolvency regimes must clarify the rights of lessors and lessees under bankruptcy.** The events and consequences of default should be clearer. In particular, lessors’ rights under bankruptcy should be preserved, as lessors are a particular class of secured lender – leased assets do not belong to the insolvent company and should be returned to the owner (the lessor).

**Finally, long-term, fixed-rate funding in local currency is essential to the long-term health of the leasing industry in MENA.** While scarce today, more appropriate funding sources will likely be made available once the enabling environment for leasing in MENA improves.

\textsuperscript{14} Ideally, the definition of leasing transactions should take into account two key important factors. First, finance leases must be clearly differentiated from other types of property hire. Second, legislation must acknowledge leasing as a financial instrument used primarily for the acquisition of equipment and other fixed assets. The status of finance leasing as a “financial instrument,” therefore, should be duly reflected in legislation so any applicable benefits awarded to “financial instruments” are captured by lessors and/or lessees as well.