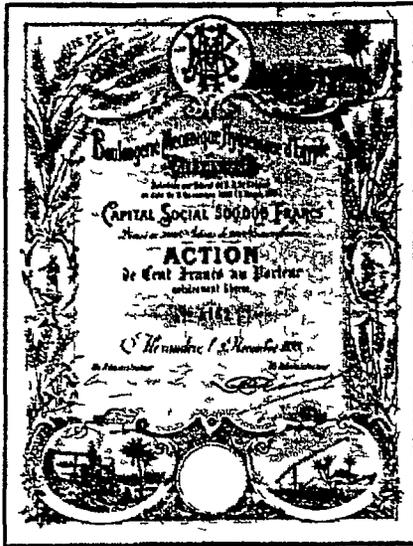


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Establishing a Settlement Guarantee Fund The Egypt Capital Markets Development Project

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TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

A INTRODUCTION 1

B METHODOLOGY AND CALCULATION OF REQUIRED SGF FUNDING 2

 B1 Largest Single Default Methodology

 B2 Estimate of SGF Amount Required

 B3 Maintaining SGF Funding on a Current Basis

 B4 Current Percentage Method

 B5 Rough Estimate

C DISCUSSION WITH PARTICIPANTS AND SUGGESTIONS FOR IMPLEMENTING SGF 4

D DISCUSSION OF FUNDING INSTRUMENTS 6

E FUNDING APPROACH AND MECHANISMS 6

 E1 Meeting the Funding Requirement

F LEGAL FORMATION/PROVISIONS FOR SGF RULE 8

EXECUTIVE SUMMARY

The purpose of this report is to start the process of establishing a settlement guarantee fund (SGF) in Egypt. The Capital Markets Development (CMD) project has been informed by the Capital Market Authority (CMA), Cairo and Alexandria Stock Exchanges (CASE), and Misr for Clearing, Settlement, and Depository (MCSD) that implementing such a fund has the highest priority of all current securities-related activities. In addition, the brokers, bookkeepers, and custodian banks with whom the project spoke agreed that establishing an SGF was of the highest importance. It is essential that the SGF be launched expeditiously.

After defining the nature of such a fund, this report lays out the relevant issues to be decided, operational guidelines (with some alternative) to be established, and suggested approaches to be implemented, and then outlines the essential elements of the SGF rule that is to be adopted. As the sections are interrelated, some of the material and concepts in the report appear in more than one. When this occurs, a different slant or point is being made.

This report is a discussion document, laying out the project's suggestions and recommendations. Legal, conceptual, operational, and other regulatory feedback is essential before finalizing the structure and legal framework of the SGF.

ESTABLISHING A SETTLEMENT GUARANTEE FUND

Charlie Rubin

A Introduction

An SGF is a pool of assets used to guarantee the successful settlement of all trades executed on the exchange. In the event a clearing member is unable to pay for the securities received through a clearinghouse or depository, the SGF is used to meet the payment obligation. The SGF exists solely for the protection of clearing members, avoiding the default of one clearing member prevents a "snowballing" effect of defaults among other clearing members and their customers. An SGF does not provide insurance against having settlement problems nor does it reduce the risk of settlement default by a clearing member. It serves as the last resort to complete settlement in the event of a default, and it is an essential element of a comprehensive settlement-risk-containment system, the other elements of which will be developed later during the CMD project.

Creation of an SGF would provide the MCSD with the resources to meet its obligations even when a participant fails to make good on a payment obligation. The SGF absorbs the amount of the default and thereby addresses the liquidity of the participant's payment default. Since both the firm defaulting and the firms receiving the benefits of payment from the SGF are members of the settlement system, the funding source should be the responsibility of MCSD members. In general, an SGF should be viewed as mutual insurance for clearing (and settlement) members.

There have been several discussions regarding the functionality of an SGF. At issue is whether an SGF should be used as a funding source for clearing members that lack adequate cash for making their settlement payment and/or should be utilized only as a last resort for successfully achieving daily settlement, since when a clearing member can not meet its obligations, it should be suspended. In most systems, clearing members are suspended if they have to utilize the fund, whereas other systems utilize the fund to relieve temporary liquidity problems, and defaulting clearing members are not necessarily suspended. The reinstatement of members is probably a moot point, as once a member is suspended, it loses its credibility, which is, of course, a paramount aspect of the securities business. When a firm's customers are not able to make new purchases, based upon our experience, they will usually go elsewhere.

In making a case for suspension, the presumption is that the clearing member has already exhausted all other sources of money, such as raising additional equity capital or subordinated capital, and securing appropriate bank loans. Since the clearing member's capital is apparently inadequate to continue settling trades, unless other investment or lending organizations will provide the needed capital and funds, the clearing member should not be permitted to continue being a high potential drain on the SGF and a settlement risk for the MCSD. Therefore the member, according to some views, should be suspended.

If it is decided that the SGF should be used for short-term liquidity problems, its use by a clearing member should be limited and only under unusual and extenuating circumstances. The SGF should not be in the business of, nor is it qualified for, making lending decisions. That would involve additional staffing for credit and risk analysis, collateral procurement, processing loans, etc. That should not be one of the SGF's functions.

Even if the SGF were used to alleviate short-term liquidity problems, one should be aware that if a clearing member has a financing or liquidity problem, he probably has a more severe and permanent capital and creditworthiness problem. A defaulting or "soon to be bankrupt" clearing member always starts out with a "liquidity" problem, and the MCSD should be prepared to handle a liquidity issue as a potential member-suspension situation. If banks would not lend the

broker funds (indicating that it is poor risk), why should the SGF? Usually, an SGF would not want to get into the business of superseding the judgment of banks in banking matters

Clearing members should have adequate capital in order to *carry* customer accounts. If not, brokers should still be permitted to be CASE members and conduct business with customers, but they should be required to make arrangements to *introduce* their customers to a more highly capitalized clearing broker or custodian bank who is able to *carry* the accounts. Carrying accounts involves the responsibility for and custody of customer funds and securities.

B Methodology and Calculation of Required SGF Funding Size

As with all contingency funds, the difficult part is determining the size of the fund and basis on which the contributions to the fund should be calculated. We believe that the fund should be large enough to cover the largest potential payment default. Since settlement exposure is the best measurement of settlement risk, it is usually the basis for participant fund contributions.

B1 Largest Single Default Methodology

In order to estimate the magnitude of the SGF that is desired, we reviewed recent trade data and made several assumptions.

In the 12-months period ending July 31, 1998 the total CASE turnover was LE16,874 million, representing the value of shares bought and sold during the period.

In utilizing a very direct approach to estimate the magnitude of the SGF, we sought to estimate the largest single possible settlement default—a default by the “largest” settlement broker. At the time of a default, we realize that we must consider all of the “pending” trades of the defaulting member. A pending or unsettled trade is one that has been executed but not settled or paid for. We also realized that there would most likely be a market “short fall” or drop in the recovery value of these pending trades.

In Egypt, there is no netting of trades and no “day trading.” This means that all purchase trades are settled versus money, without any offsets.

For 1997, the “largest” broker represented 10.05% of the total annual volume. We assumed that this broker could not meet his settlement obligation. With the data available, we were compelled to assume that the average daily trading value was every day’s trading value. Since this would tend to minimize the overall requirement (the highest actual exposure for any given period would certainly be higher than the average), we assumed an additional 20% increase.

Since the settlement cycle is T+3 (for book-entry settlement) and T+4 (for physical-share settlement), we assumed a more conservative T+4 cycle for all of the trades. If this broker did not have the funds to meet his full payment obligation for a particular day, we assumed that he would also default on all of his unsettled trades (or 4 times the daily amount).

In estimating the maximum settlement exposure, the issue of whether the MCSD merely provides short-term liquidity for this broker or suspends it is not relevant. We assumed a suspension in which the broker is out of business and all assets are liquidated accordingly.

B2 Estimate of SGF Amount Required

Based upon the above assumptions, we estimate the SGF should be funded at approximately LE11 million (equal to approximately US\$3.2 million)

This is based upon the following

- For the 12-month period ending July 31, 1998, the total turnover of LE16,874 million works out to an average daily turnover of LE68,040,512, based upon 248 trading days for the period
- The defaulting broker's unsettled amount was estimated to be 20% higher than the average daily purchase volume
- The largest broker (as a percentage of the total daily purchase volume) was selected—10.05% of 68,040,512 X 1.20% = LE8,205,686/day In reviewing additional trade data since 1996, no broker had a higher percentage of the total trading volume
- This amount was multiplied by four, reflecting the four days of pending buy trades (8,205,686 X 4) = LE32,822,742
- A 30% shortfall was estimated market loss of 30% is the difference between the contracted value of the unsettled trades and the liquidation value That is the amount required for the SGF 32,822,742 X 30 = LE9,846,823
- An additional 10% contingency was applied, since we are dealing with historical, not anticipated, settlement amounts Therefore, the estimated SGF requirement is 9,846,823 X 1.10 = LE10,831,505 or LE11 million

The shortfall estimate may be viewed as unduly conservative since some of the unsettled purchases would undoubtedly be paid for in full However, the 30% represents an average estimated shortfall Undoubtedly, there would also be some securities not paid for whose market value would drop considerably more than 30% In some instances, because of lack of liquidity, high concentrations, and a defaulting broker's unusual price support, we have seen instances where stocks become valueless This will become more of a factor when brokers are permitted to be dealers and carry positions for their own account

Assumption modifications would change this desired funding level If it is the intent to also use the funds for providing short-term financing for "defaulting" members, additional funding may be appropriate

To the extent that the customers have not paid for their purchases, the SGF would seek restitution from these customers, provided that bona-fide orders were given and executed on their behalf by the defaulting broker Also, to the extent that the defaulting member has other assets that the SGF may be able to attach, the SGF may be able to recoup its entire outlay of funds in due time

B3 Maintaining SGF Funding on a Current Basis

In order to make sure that the SGF has adequate funding, the largest potential settlement default, which will vary as market price and activity change, should be estimated according to the following

Since actual trade data retrieval is automated,

- Calculate the highest executed but unsettled purchases (4 consecutive days of buy trades) or pending trades, for every broker for a rolling 3-month period (Every day, every broker has a “new” pending amount) When doing the calculation, it is necessary to only retain a broker’s pending amount (for a given day) if it is his largest amount (i.e., larger than any other day)
- Select the single largest amount (only one amount from all brokers)
- Assume a market shortfall (we recommend 30%) from the above amount Multiply this shortfall by the above amount to obtain the SGF funding requirement
- Since the data analyzed is only current for the previous month, it would be appropriate to add an additional 10% contingency to the amount calculated
- We recommend that this calculation be performed every month, and that the current amount be used if it is greater than the previous month’s calculation
- After the above calculation is used to determine the SGF’s total requirement, it would be appropriate to establish this amount in multiples of LE1 million

B4 Current Percentage Method

In our discussions with several interested participants, their guesstimates of SGF size were quite close to the calculation presented above. These participants indicated that the current daily trading volume is running at approximately LE45 to 50 million, and they estimated an SGF equal to approximately 15% to 20% of the daily volume. Therefore, they approximated the LE10+ million amount shown above. Coincidentally, for the period we reviewed, an LE11 million SGF represents 16% of the market’s LE68 million daily turnover.

B5 Rough Estimate

In some SGF systems, individual “judgment” is used to estimate the desired size of the fund, and many fund designers and managers contend that estimating the appropriate size is not a science.

C Discussions with Participants and Suggestions for Implementing the SGF

An SGF is usually funded by contributions from clearing participants. However, in one case, the government provided initial funding because, by doing so, it helped to create a credible settlement system—one which serves to attract institutional investors and adds to the overall health of the capital markets and the nation’s economy. Although the CMA is extremely supportive of establishing an SGF (saying that establishing a fund is its highest priority), no definitive commitment to participating in its funding has been given.

Instead of contributing to the SGF as a “regular” participant, there are several other ways that the government might find attractive. Without getting into much detail at this time, the government could be established as a “preferred” participant. Under such a scenario and at the government’s

discretion, the accessing of their account at the SGF would come after the other participants' accounts are applied. Also, through the Central Bank, low- or no-interest loans might be extended to SGF participants at amounts equal to their deposit requirements.

Some participants also suggested that the government may want to establish immediate credibility for the SGF by making a large deposit (perhaps up to the desired funding level) in the form of a loan. This deposit would be repaid as clearing members' deposits are received and accumulated.

Since brokers are responsible for all money settlements, they would be the culprits and the beneficiaries of the SGF. Therefore, participation by brokers should be mandatory.

Although the settlement system will ultimately be improved by having a single MCSD clearing member settle both shares and money, the division in the current system between brokers settling money and bookkeepers settling shares, renders the participation and beneficial status of the bookkeepers in an SGF controversial and unsettled. It has been pointed out that most settlement defaults are attributable to the "sell side" of the trade, which relates to the bookkeepers' responsibility for delivering the shares. These defaults are due to the wrong amount of shares being delivered, unregistered shares, mutilated shares, different registration names, stock denomination problems, etc. These instances represent significant delays but ultimately get resolved and do not represent the need for remedying the type of financial crisis for which the SGF is intended. Regardless, an SGF would not and could not be effective in expediting the delivery of the appropriate shares in a timely manner.

As such and at the suggestion of one of the brokers, we concur that the SGF should initially be applicable only to the "buy" side of trades and only for the mutual protection of the brokers. Under this scenario, the bookkeepers, who in due course could become integrated with a single money- and share-settlement entity, would be exempt from participating in the SGF. In reality, they do not represent the relevant financial-settlement risk that we are seeking to contain.

The participation of custodian bank presents another issue. Currently, these banks are only indirect participants in the settlement process but present a settlement risk to brokers and will be the beneficiaries of the SGF in the event of broker default. Therefore, one can make a case that they should also participate in making SGF contributions. However, banks in some countries refuse to contribute to the SGF and are exempted. They are exempted because having them participate in the settlement process, even though they were not contributing to the SGF, is preferable to not having them participate in the settlement process. However, banks are not immune to defaults and bankruptcies. In many countries, banks, as well as brokers, have gone out of business, leaving behind unsatisfied obligations and creditors. Although the custodian banks usually have substantial capital (compared to clearing brokers), a banking disaster unrelated to activities in the Egyptian securities market could prevent a custodian bank from meeting its obligations to a broker. In the United States, clearing brokers as well as custodian banks contribute to the SGF.

In lieu of making SGF deposits, alternatives are available for getting custodian banks to provide additional settlement guarantees. Each bank can have a guarantor bank or contra-bank guarantee. Since more than one bank defaulting at one time would be highly unlikely, if each bank had another bank guarantee its settlements, the SGF would not have to be activated in the event of a bank default.

Since establishing an SGF is an extremely high priority, it might be expedient to start establishing the SGF without the participation of custodian banks, until such time as the banks are directly integrated into the settlement process.

If custodian banks do not participate in the SGF, an issue needs to be decided. If a Broker defaults and money is owed to a custodian bank (from a sale transaction), should the SGF make the bank whole? Not doing so would negate one of the primary purposes of the SGF—encouraging (foreign) institutions to invest in the Egyptian market by guaranteeing their trade settlements—but is paying the bank equitable if they are not SGF contributors? This may be a price that Egyptian brokers must pay to attract additional business.

In summary, although perhaps not an equitable situation, it may be expedient to commence the SGF for the protection and benefit of brokers and custodian banks, even though the banks might not initially participate in funding the SGF. However, efforts should be made to seek additional bank default protection, such as in the manner described above. Comments on this issue are important.

D Discussion of Funding Instruments

Contributions to an SGF are generally in the form of cash, securities, letters of credit, short-term government instruments, and other promissory notes. In some countries, other securities may also be acceptable. The securities of the SGF are usually pledged as collateral to a source of liquidity (such as a bank or syndicate of banks) that provides the necessary funds to the clearinghouse or depository. Because the cash from the bank loans can be utilized immediately, this mechanism is preferred when financial instruments other than cash are deposited. Also, this arrangement eliminates the necessity of liquidating securities in the SGF to obtain the required cash. This standby liquidity would be arranged as part of the operations of the SGF.

If the SGF consists only of cash deposits, then bank credit lines can be used to secure additional bank funding in the event of a greater-than-anticipated participant default. The cash in the SGF should be invested in “relatively safe” income-producing securities.

In the case of an SGF that accepts contributions in the form of securities, letters of credit, and participant-backed guarantees, the SGF should not have a disproportionately large concentration in the instruments of a single issuer. Such a concentration will expose the SGF to undue market risk and make it vulnerable to a severe decline in the value of the SGF.

To secure additional settlement-default protection, some countries have purchased settlement-risk insurance from international insurance underwriters. Under this scenario, the country's SGF funding requirements can be reduced to only the amount of the annual premiums plus the deductible amount of the insurance policy. This process could take some time since the potential underwriter(s) will want to review trading and settlement rules, activities and exposure, net capital requirements, financial statements of clearing members, and other relevant information before quoting a price for such insurance. This avenue can or perhaps should be pursued in conjunction with a self-funding SGF.

E Funding Approach and Mechanisms

Each clearing member (or broker) should be required to make deposits to the SGF, as determined by some type of governing board, in accordance with a specific non-discriminatory formula. This formula may be modified from time to time at the board's discretion. Modifications should reflect, among other factors, changes in the trading and settlement systems, direct settlement participants, rule changes, and adjustments to the settlement cycle or time period.

One approach to funding the SGF, which is used in the U.S., is for clearing members' contribution requirements to be set at approximately 1.25% of purchase trades pending settlement, or long positions, and approximately 0.50% of pending sale trades, or short positions.

(Since fails are permitted in the U S , the trades pending settlement may represent trades past settlement date) Cash and other specified securities are acceptable SGF deposits

Member contributions usually accumulate over a period of time until a desired funding level is reached

In another country, every broker is required to deposit 5% of its average daily purchases multiplied by the number of days in the settlement cycle (Although this appears to be quite high, these deposits also represent the broker's total capital requirement) In Egypt, deposits could be made in cash and bank guarantees, with a minimum of 50% in cash

In research done regarding funding for SGFs, most other countries based a broker's contribution on a percent of its average turnover, viewed either daily or for the settlement cycle, with the percentage amounts falling within the range stated above

In summary, the contributions are generally based upon some percentage of turnover, either for a day or for the number of days in the settlement cycle, representing the settlement exposure We suggest that the calculations be made monthly, using a 3 month rolling period, in order to determine either the average or preferably the highest settlement exposure for that period

E1 Meeting the Funding Requirement

Since the SGF would be used in the event of a member's settlement default and is, therefore, related to the risk of a member defaulting (much like an insurance premium), the amount of premium or member deposit should be in line with the settlement risk of that member, not just a flat amount for all members (as is the case in some countries) As a suggestion, a percentage of the member's settlement exposure would be desirable Some countries also have a minimum deposit requirement (In the following computations, we did not have the data to consider the collection of a minimum from each broker) A minimum deposit requirement would have tended to increase the total collections and thus reduce the time it would take to reach the desired level of SGF funding

In order to estimate the time it would take to meet this funding obligation, we considered the same four-day settlement-exposure period, and assumed average daily purchases were the value for every day (without any additional percentage increase to reflect maximum exposure instead of average exposure)

We also assumed that there is no interest earned on any of the members' cash contributions, which would increase the total amount collected and reduce the time required to attain the desired funding level

Based upon a continuation of the same 12 months of data and averages, 1% of the daily purchases (LE680,405) times a four-day settlement period equals an annual deposit from all brokers of LE2,721,620 At this rate, after commencing collections, the estimated desired funding level of LE11 million would be reached during the first quarter of the fifth year

If the rate of contribution was 1.5%, after commencing collections, LE4,082,430 would be collected annually, and the desired funding level would be reached during the third quarter of the third year

Since the SGF requirement would be based upon actual, not past average amounts, the funding requirement and collection amounts would be adjusted to accommodate the current "largest" default that could occur

The cash deposits, which would be invested in money market instruments or equivalents, would earn interest that should be credited to the members on a pro-rata basis, in accordance with their cash contributions, thus lowering their additional contribution requirements to the SGF or reducing the time needed to reach the desired funding level

A policy or procedure should be discussed and resolved to deal with an unforeseen “catastrophic” settlement failure that goes beyond depletion of the SGF. Rather than assessing the brokers, securing an insurance policy for additional settlement risk might be pursued for this purpose. If obtained as a catastrophic back-up, there would be a high deductible amount (the SGF), and the insurance premiums may be quite low and affordable. Also, catastrophic settlement protection could be obtained (perhaps by the government) by arranging for a line of credit from the Central Bank of Egypt.

F Legal Formation/Provisions for SGF Rule

The following rule provisions and guidelines assume that the SGF would only be utilized in the event of a settlement default by a broker. This would confine the use of the SGF to the buy side of trades, or the settling entity having the responsibility to pay for the securities purchased. Also, only brokers would be SGF contributors. Bookkeepers and custodian banks are not included. It appears as if this approach is the most realistic, relevant, practical, and effective way to launch the SGF. In view of the high priority of this project, it would also be the most expeditious.

If it is decided that the SGF could also be used to “provide liquidity” for a defaulting broker, one who will continue in business, then some of the following sections regarding suspensions, activities of the SGF, etc. will not be applicable. The defaulting broker’s account (and other accounts) of the SGF would be replenished by the defaulting broker. If it were not replenished, then the suspension, curtailed activities of the defaulting broker, etc. would apply.

Again, the following represents the CMD project’s suggestions and recommendations. It is aimed to solicit comments and opinions from the parties involved prior to finalizing the SGF.

Depending upon the SGF’s structure, these sections may represent guidelines, part of the procedural process, or rules. Because these sections are somewhat autonomous, there is some overlap and duplication in stating the provisions.

Section 1 Definitions

- 1 There should be a definition section of this rule/guideline. Members should refer to brokers (who are MCSD members). Of course, members could be expanded to include custodian banks and bookkeepers, if appropriate. The definitions would pertain mostly to the legal and organizational structure, which remains to be decided.

Section 2 Purpose

- 1 The SGF is established for the sole purpose of guaranteeing settlement obligations of the MCSD brokers for trades executed on the CASE. It is *not* to be used for guaranteeing any other financial obligations of MCSD members.

Section 3 Organization

- 1 The SGF should be established in accordance with the corporation and bankruptcy laws of Egypt. It should be established with separate limited liability in as efficient and simplified manner as possible. Ideally, it could be established as part of the MCSD, provided all of the

MCS D's other assets are protected. It could be a separate limited-liability company, and in at least one country, it is a separate trust.

- 2 The SGF should be administered, controlled, and managed by a governing body consistent with its organization. This could be a board of directors, a board of governors, a board of trustees, an advisory board, etc. This "board" should be comprised of the following five voting members:
 - a. Chairman of the CMA
 - b. Chairman of CASE
 - c. Chairman or Deputy Chairman of MCS D
 - d. two MCS D clearing representatives—from two representative brokerage firms

If it is decided at some point that custodian banks and bookkeepers should participate in the SGF, they should also be represented.

- 3 The board should also consider three non-voting or advisory members:
 - a. the chief or senior operating officer of MCS D
 - b. one attorney
 - c. one financial and/or economic expert
- 4 The board's five voting members should elect the chairman by majority vote.
- 5 The broker representatives (and other MCS D participant representatives) should serve for three-year terms, while the attorney and financial and/or economic expert should serve for a five-year period.
- 6 In addition to regular quarterly meetings called by the chairman, in the event of MCS D default or potential or possible default, any of the board members may contact the chairman or his designee to call an emergency meeting. All voting board members or their appointees should be required to attend the meeting, with the time and place decided by the chairman or his designee. Emergency meetings may be held by telephone.
- 7 For all issues to be resolved at the board level, including the activation of the SGF to fulfill a defaulting member's settlement obligation, a simple majority of the voting board members should carry the motion.
- 8 The board members should serve on a voluntary non-paid basis. However, they should be reimbursed for out-of-pocket expenses associated with conducting their duties.
- 9 All MCS D clearing members must be participants and contributors to the SGF.
- 10 All Members must agree to all articles of this rule and all actions and motions of the SGF board.
- 11 All MCS D members should have separate accounts maintained with the SGF.

- 12 If it decides to do so, the Egyptian government could also have a separate account with the SGF. This account would be treated as a preferred or privileged account, and no monies would be extracted from it unless all MCSD members' accounts were depleted. This privileged or preferred status may be voluntarily waived by the government.

Section 4 General and Specific Powers of the Board

- 1 The board should have the power to appoint person(s) to act on its behalf in carrying out its duties and functions. (This would generally be headed by an operations person and a legal person)
- 2 The board should have all such powers, authorities, and rights necessary or required for the management, control, and execution of the SGF.
- 3 In such activities, the acts or decisions of a majority of the board would be binding.
- 4 If it is in the best interests of CASE, MCSD, SGF, and the Egyptian securities markets, the board may declare certain trades to be voided. This could be a controversial point, and should only be considered if certain trades might cause the SGF to be seriously impaired or if settlement obligations go beyond the funding of the SGF. This should only be invoked if these trades are deemed to be fraudulent, unwarranted, and not in the best interests of the Egyptian securities community.
- 5 The board could take whatever action deemed appropriate to complete MCSD settlement obligations, including but not limited to
 - selling and converting into cash any SGF assets
 - borrow against those assets
 - open, maintain, and control bank accounts on behalf of the SGF
 - create, subscribe, and administer any insurance schemes or programs that add additional settlement-risk protection
 - retain and incur expenses for appropriate consulting support and staffing necessary to operate the SGF
 - pay all such expenses incurred by the operation of the SGF
- 6 As described below, the board should have the right to invest the SGF's cash assets.
- 7 The board should have the right to add to, amend, or repeal the rules of the SGF.
- 8 The SGF board should have the authority to appoint a trustee/receiver or acting CEO to manage the affairs of the defaulting member. The resultant expenditure would be deemed an appropriate expense.
- 9 To seek additional advice and/or to assist in the investigation and liquidation of a defaulting member, the SGF board should have the authority to obtain the assistance of outside experts. This additional expense would be borne by the SGF.
- 10 The board should have the authority to reverse or negate any and all trades executed on the CASE which it deems to be, or suspects to be pending further investigation, fraudulent, inappropriate, and/or not in the best interests of the Egyptian securities industry.

Section 5 Uses and Activation of the SGF

- 1 If a member can not meet its settlement obligation, the SGF would be activated to fulfill the obligation of the defaulting member, in order that all MCSD members are “made whole” and that they receive the monies due them for that settlement period. Notification to the board would come from the chairman of the MCSD or his deputy.
- 2 Any and all necessary expenses, as determined by the board, related to the SGF being activated on behalf of a member’s default of its settlement obligations, should also be appropriate SGF expenditures.
- 3 If the SGF is utilized to guarantee or complete a settlement, the defaulting member causing its usage should be suspended as described below.

This could be modified to also allow for a single (or warning) default by a member (a default in which the SGF provides the needed liquidity for the defaulting member). Under this circumstance, the applicable fines and penalties should be stated.

- 4 When the SGF is utilized to complete a settlement, the funds required should be taken from the account of the defaulting member. If the defaulting member’s account is exhausted and if the amount taken is still insufficient to satisfy the settlement requirements, any additional amounts should then be taken from all MCSD members on a pro-rata basis, in accordance with each member’s total deposit with the SGF.

If that amount is still insufficient to satisfy the settlement requirements, the Egyptian government’s account (if established) would then be utilized. The Egyptian government may waive this preferred status, and elect to have its funds deployed earlier in this process.

The board should inquire about additional outside insurance or, with government assistance, secure a line of credit from the central bank (or other banks) in the event the entire SGF is still insufficient.

- 5 The uses of the monies held by the SGF are limited to meeting member losses, liabilities, or obligations incident to the settlement of trades and appropriate expenditures. This should also include meeting loan commitments made by the board in order to meet such settlement obligations. (Appropriate expenditures may be delineated in the ‘definitions’ section.)
- 6 The SGF cash deposits may be invested in short-term government debt in order to earn additional interest income for the members.
- 7 The interest income generated by the cash deposits will be allocated to the members’ accounts on a pro-rata basis, in accordance with each member’s total cash deposit.
- 8 If an SGF loss or expenditure is subsequently recovered, partially or in whole, the recovered amount should be credited or distributed to the members’ accounts on the same pro-rata basis as the initial charge to the accounts was made. Terminated members should also receive their pro-rata share of the distribution.

Section 6 Funding the SGF/Member Deposits and Requirements

- 1 Every member is required to make deposits to the SGF as determined and required by the board of the SGF, in accordance with a specific non-discriminating formula and within a specific time frame (as stated below) At the board's discretion, the deposit-requirement formula and time frames may be occasionally changed

These deposits will continue until the desired funding level, as determined by the board, has been reached The specific formula may be included here

- 2 SGF deposits must be in cash or bank guarantees acceptable to the board At least 50% of the total deposit must be in cash (This is, of course, only a suggestion)
- 3 If a member's monthly requirement calculation is greater than the member's deposit at the MCSD (meaning that it is greater than the previous month's calculation), the additional deposit must be made within five business days after receiving the deposit-requirement notification from the MCSD
- 4 If there is a charge to a member's SGF account as a result of the SGF being used to satisfy a settlement on behalf of another MCSD member, a request for additional funds, as a result of the charge, must be satisfied within five business days after receiving the deposit notification from the MCSD
- 5 If there is a loss, expenditure, or liability incurred by the SGF and a charge is made to a member's account because of this event or if the member terminates its membership, that member is still subject to additional charges, if any, attributable to that same loss, expenditure, or liability if termination occurred after the initial charge was instituted
- 6 If a letter of credit or other debt deposit is approved as an acceptable deposit by the board and if that instrument is within 10 days of its expiration, the instrument must be substituted

Section 7 Implications of Member Default

- 1 If the SGF is utilized to guarantee or complete a settlement, the defaulting member causing its usage should be suspended, except for specific, limited business activities as described below

If one default is permitted, this point will have to be modified The CEO of the MCSD (or his representative) should still notify the board of the default and the board will have to activate the SGF anyway

- 2 All MCSD members, including any defaulting or bankrupt member, are obligated for their entire settlement obligation Any and all losses incurred by the SGF as a result of that default remain the defaulting member's responsibility, even though its account at the SGF may be depleted
- 3 For the suspended member, only customer account liquidations are permitted No new purchases are allowed If a customer has paid in full for the securities held, the customer can decide to liquidate his position or transfer his account to another member
- 4 Reinstatement of the suspended member as a firm or the employment of any of the senior officers of the defaulting member in a new or existing member firm may not occur for at least 30 days

- 5 Reinstatement of the suspended member may occur only after all liabilities and obligations to the MCSD and SGF are fulfilled and the board approves such a reinstatement
- 6 Re-employment of the senior officers, especially those most responsible for the defalcation as determined by the board, may be withheld until after all of the defaulting member's liabilities and obligations to the MCSD and SGF are fulfilled and the board deems it appropriate for re-employment
- 7 For reinstatement of the suspended member as a member in good standing with the MCSD, the SGF governing board has the authority to impose higher capital requirements and more suitable management, operations, financial, and administrative expertise on the firm

Section 8 SGF Withdrawals

- 1 Subject to the conditions stated below, an MCSD member is entitled to withdraw from its account at the SGF an amount up to the excess of its deposit requirement. This amount is to be paid from the SGF 10 days after the MCSD receives such a withdrawal request in writing from the member
- 2 Subject to the conditions stated below, a member is entitled to receive its total SGF deposit held in its account 90 days after
 - ceasing to be a member of the MCSD, and
 - all transactions have been closed and there is no further MCSD liabilities, and
 - all obligations with the MCSD and SGF have been satisfied, or
 - at the discretion of the board, appropriate indemnities or guarantees have been substituted for all transactions and obligations
- 3 Regarding the above withdrawals, if the SGF is involved in resolving a member-defaulted settlement, the waiting period would commence after all settlement obligations have been completed, and after all member-account requirements and balances have been determined

Section 9 Financial Reporting

- 1 Every MCSD member's capital and financial statements must be audited and examined annually by an independent accounting firm from Egypt
- 2 An annual audit and examination of the SGF must be performed by an independent, accredited auditing firm selected by the board