MORTGAGE FINANCE AUTHORITY PROPOSED REGULATIONS FOR ENSURING THE SAFETY AND SOUNDNESS OF THE EGYPTIAN MORTGAGE REFINANCE COMPANY

EGYPT FINANCIAL SERVICES PROJECT
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DATA PAGE

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Acronyms:

ALM	Asset/Liability Management
EMRC	Egyptian Mortgage Refinance Company
MFA	Mortgage Finance Authority

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MORTGAGE FINANCE AUTHORITY
PROPOSED REGULATIONS FOR ENSURING
THE SAFETY AND SOUNDNESS OF THE
EGYPTIAN MORTGAGE REFINANCE COMPANY

PREAMBLE

The following proposed regulations for the Egyptian Mortgage Refinance Company (EMRC) comprise a comprehensive regulatory framework for ensuring the safety and soundness of its operations. The framework derives partly from the principles and standards used in regulating the world's largest, oldest, and most successful mortgage liquidity facility -- the Federal Home Loan Bank System in the United States – and the two large secondary mortgage market agencies in the United States – Fannie Mae and Freddie Mac, and partly from international principles and standards used in regulating commercial banks.

The framework rests on four pillars:

- A solid capital base that adequately reflects EMRC's risks and is sufficient to absorb both anticipated and unanticipated loss.
- Good corporate governance, including an informed and involved board of directors, an effective system of internal controls, disclosure, and transparency.
- Discipline supplied by stakeholders and third parties, including external auditors and credit rating agencies.
- Balanced supervision, with on-site examinations and off-site monitoring.

The proposed regulations are contained in 14 sections, beginning with a statement of the major regulatory powers and duties of the Mortgage Finance Authority (MFA) with regard to EMRC's operations. Having a clear, mutual understanding of the nature of the regulatory relationship between MFA and EMRC is important for avoiding any potential misunderstanding or confusion that could result in delayed action, or inaction, in correcting any unsafe and unsound conditions or practices that may exist or develop in the future.

The proposed regulations then specify the approvals that EMRC is required to obtain from MFA. Requiring regulatory approvals provides an important mechanism for MFA to review, and order any changes MFA believes are necessary in EMRC's operating procedures, policies, and parameters that are too detailed to be prescribed in regulation.

Approvals are required for EMRC's basic founding documents, the Articles of Incorporation and By-laws, and for the major policies and procedures that will guide and govern EMRC's day-to-day business operations. The proposed regulations contain minimum content requirements for these documents.

Most of the required approvals are for documents that EMRC is currently in the process of developing, including the Business Plan, Credit Policy, Asset/Liability Management (ALM) Policy, and the Financial Management Policy. Two of the required approvals are for documents that EMRC is not currently developing: a Capital Plan and a Code of Ethics and Business Conduct.

Having an approved Capital Plan is important for specifying: (1) the classes, amounts, and rights of authorized stock; (2) the minimum stock investment that members are to be required to make and to hold; and (3) the processes and requirements for paying dividends, and for members wishing to redeem or transfer their stock. The proposed regulations provide EMRC with flexibility in determining how to set its minimum member investment requirements, but specifies that the minimum stock investment for a member shall be no less than 5 percent of that member's outstanding loans (called "advances") at all times. Requiring a minimum stock investment based on the amount of a member's borrowing, or other type of business activity that the member conducts with EMRC, is important because it reinforces EMRC's cooperative nature and structure and provides an important source of additional security that fluctuates with EMRC's potential risk exposure to each member-borrower or counterparty.

Having an approved Code of Ethics and Business Conduct that sets high standards for honesty, integrity, and impartiality is important because it highlights to EMRC employees, officers, and directors the importance and significance that both management and the regulator give to ethical conduct and the avoidance of any conflicts of interest and other improprieties.

The proposed regulations also specify the notice that EMRC is required to give to MFA. Requiring regulatory notice is an important mechanism to ensure that MFA is aware of ongoing developments and has an opportunity to intervene in a timely manner if necessary to affect such developments.

The proposed regulations then set the basic regulatory requirements for EMRC's principal line of business: lending to members on the security of members' residential mortgage assets and other qualified collateral. The regulations specify the types of collateral that a member can pledge as security for EMRC advances and the discounts that EMRC shall apply to each type of qualified collateral in determining how much it can lend to a member. The required collateral discounts reflect the relatively high degree of credit risk in mortgages that conform only to the basic underwriting standards prescribed in Real Estate Finance Law 148 and its Executive Regulations. Lesser discounts are required for mortgages that meet higher underwriting standards as required by EMRC or mortgage originators. This provision not only reflects the lower credit risk in such mortgages, but also provides an incentive for mortgage lenders and EMRC to strengthen underwriting standards as the mortgage market continues to develop.

The proposed regulations also set the basic regulatory requirements for EMRC's second line of business: purchasing member mortgage assets. The regulations permit EMRC to purchase member mortgage assets under a repurchase agreement with the member, with full recourse on the member, or without either a repurchase or a recourse agreement with the member. The proposed regulatory and eligibility requirements for each type of mortgage purchase become progressively more stringent to reflect the greater risks. Caps are set on the total amount of mortgage assets purchased with recourse (two times EMRC's core capital) and on mortgage assets purchased without repurchase or recourse (one times core capital). The regulations also require that a member selling mortgages to EMRC without repurchase or recourse provide a credit enhancement that is evaluated by a credit rating agency registered with, and recognized by, the Capital Markets Authority.

Three capital adequacy requirements are contained in the proposed regulations. EMRC's ratio of core capital to total assets is required to be no less than 10 percent, allowing EMRC maximum 9:1 leverage. This allowed leverage reflects the substantial credit, business, and operational risks that EMRC faces as a lender constrained to operate in one narrow, cyclical market segment that is newly developing in Egypt and that is historically very volatile. International capital standards for commercial banks generally allow for substantially more leverage (as does EMRC's draft Business Plan), but such standards are inadequate for EMRC because they are designed principally for large lenders with widely diversified products lines and geographical operations.

The proposed 9:1 leverage limit should permit EMRC substantial ability to grow its business. EMRC currently has paid-in capital of LE 217 million, with a substantial likelihood of obtaining more. A 9:1 leverage ratio thus allows EMRC to borrow up to LE 1.953 billion to finance its operations. Assuming that no more than LE 400 million is needed for making the investments necessary to meet the liquidity requirements contained in these regulations, EMRC should have at least LE 1.5 billion potentially available for refinancing or purchasing eligible member mortgage assets. The estimated value of all outstanding residential mortgages in Egypt, including a large number of mortgages that would be ineligible to be refinanced or purchased by EMRC under the requirements of these regulations, is currently about LE 1 billion.

The other two capital adequacy requirements contained in the regulations derive from internationally accepted risk-based capital standards for commercial banks, but are again set at higher levels to reflect EMRC's higher risks.

The proposed regulations then prescribe EMRC's permissible investments, certain investment restrictions, and EMRC's liquidity requirements, including those short duration assets eligible to meet its liquidity requirements and the short-term liabilities that are to be included in calculating its liquidity demands.

The next section of the proposed regulations requires that EMRC maintain the gap between the duration of its assets and its liabilities within a certain prescribed limit in order to limit its interest rate risk. This requirement will become more important as EMRC begins to fund long-term, fixed-rate advances and begins to purchase member mortgage assets. The regulations require that EMRC procure and use an MFA-approved model to perform these calculations, but allows EMRC the flexibility to use an alternative approach to measuring and limiting interest rate risk until such time as an approved model is available for use.

The regulations next discuss debt issuance and prescribe certain restrictions and credit rating requirements. Discipline is provided by requiring EMRC to take any action, including reducing its leverage, that is necessary for it to receive and maintain an issuer rating of at least the second highest credit rating available from a registered and recognized credit rating agency.

Since good corporate governance is often the first line of defense against unsafe and unsound practices, the proposed regulations include an extensive set of corporate governance requirements for EMRC's board of directors and senior management. These requirements are intended to ensure that the board of directors is active, informed, and responsible, that an effective internal control system is established and maintained, that an independent audit committee is established and empowered, and that senior management is aware of its major responsibility and duties.

The next sections of the proposed regulations discuss MFA examinations, reporting requirements, off-site monitoring, and document requests.

The final section of the proposed regulations contains a process by which EMRC can request that MFA waive, with its discretion, any provision or requirement of these regulations, provided that such waiver is not inconsistent with any provision of law or executive regulation. This waiver provision recognizes that regulating financial institutions is more of an art than a science, that any written set of safety and soundness regulations is never perfect, and that regulators need the ability to exercise their professional judgment based on the facts of any particular set of circumstances that may develop.

PROPOSED SAFETY AND SOUNDNESS REGULATIONS

Section I: MFA Powers and Duties

The Mortgage Finance Authority (MFA) shall have the following powers and duties with respect to the operations of the Egyptian Mortgage Refinance Company (EMRC):

1. To issue and enforce these regulations, and other such regulations and directives as may be necessary, to ensure that EMRC operates in a safe and sound manner at all times.

2. To supervise EMRC business operations, which includes:

    - Prescribing rules and conditions upon which EMRC may extend credit to its members.
    - Prescribing rules and conditions upon which EMRC may purchase mortgages from its members.
    - Prescribing rules and conditions under which EMRC may borrow funds or issue debt obligations.
    - Prescribing rules and conditions under which EMRC can issue, redeem, or transfer stock.
    - Prescribing liquidity requirements and permissible investments.
    - Requiring on-site inspections and off-site monitoring of EMRC operations.
    - Requiring approval of EMRC's business and operational policies, including its Articles of Incorporation and By-laws, Business Plan, Capital Plan, Credit Policy, Asset/Liability Management (ALM) Policy; Financial Management Policy, and Code of Ethics and Business Conduct.
    - Requiring EMRC audits, credit assessments and ratings, and other reports and assessments as needed.
    - Requiring access to EMRC records and files deemed necessary for MFA to perform its regulatory duties.

3. To ensure that EMRC remains adequately capitalized, which includes the setting of capital adequacy standards and the ability to address any capital insufficiencies that may arise.

4. To ensure that EMRC is able to raise funds in the capital markets.

5. To issue and serve notice of cease and desist orders upon EMRC or upon any EMRC executive officer or director if, in the written determination of MFA, the EMRC, executive officer, or director is engaging in, has engaged in, or MFA has probable cause to believe is about to engage in, an unsafe and unsound practice in conducting EMRC business, or in any conduct that

violates any provision of Real Estate Finance Law 148, its implementing Executive Regulations, or these regulations.

6. To issue orders requiring EMRC, its directors, or executives to take affirmative action to correct conditions resulting from violations or unsafe and unsound practices, or to limit EMRC operations until such violations and practices are remedied.

7. To suspend or remove for cause an EMRC director, officer, employee, or agent. The cause of such suspension or removal shall be communicated in writing to such director, officer, employee, or agent, who shall have available the legal recourse to challenge such suspension or removal as is contained in the laws and Executive Regulations of Egypt.

8. To call for the General Assembly of EMRC shareholders as described in Article (39) of the Articles of Incorporation.

Section II: Approvals and Notice

***Required Approvals*:**

EMRC shall submit for MFA approval the following documents. EMRC shall not extend any credit to its members, purchase any mortgage assets from its members, or issue any debt obligations, until such approvals are obtained from MFA.

1. **Articles of Incorporation and By-laws**. The Articles of Incorporation and By-laws shall dictate EMRC's business objectives and the basic operating standards and procedures that EMRC will follow in administering its business affairs. These documents shall be consistent with Real Estate Finance Law 148, its implementing Executive Regulations, and these regulations, and shall contain, at a minimum:

    - EMRC's identifying information, including name, legal domicile, and principal place of business.
    - Number of authorized directors and corporate officers, and the procedures for their appointment, selection or election.
    - Types and rights of authorized stock classes and number of shares.
    - Procedures for director and shareholder meetings, including frequency, location, and protocol.
    - Procedures for corporate record keeping and auditing, including rules for preparation and inspection of records and the appointment of external auditors.
    - Procedures for amending the Articles of Incorporation and By-laws.

2. **Business Plan**. The Business Plan shall discuss, at a minimum, EMRC's mission, governance, major business activities, organization and management, planned sources and uses of capital and other funds, and risk controls and risk mitigation strategies. The Business Plan shall also include market analyses and business projections under various scenarios and assumptions.

3. **Capital Plan.** The Capital Plan shall include, at a minimum, provisions addressing the following matters:

    - Classes of capital stock. The Capital Plan shall specify the classes of stock that EMRC can issue, and shall establish the value, rights, terms, and preferences associated with each class of stock. The Capital Plan shall describe any preferences relating to, but not limited to, the dividend, voting, or redemption or liquidation rights for each authorized class of stock.

    - Member stock investment. The Capital Plan shall specify (1) the minimum amount and class of stock that a mortgage lending institution is required to own in order to become and remain an EMRC member, and (2) the minimum amount and class of stock that a member is required to own in order to obtain credit from, or to engage in other business transactions with, EMRC.

The Capital Plan shall prescribe the manner in which a member's minimum stock investment is to be calculated, and shall require each member to maintain its required minimum stock investment for as long as it remains a member and, with regard to stock purchased to support an extension of credit (called an "advance") or other business activity, for as long as the loan or business activity remains outstanding.

The Capital Plan may establish a minimum member stock investment that is calculated as (1) a percentage of the total assets of the member, (2) a percentage of the total advances outstanding to the member, (3) a percentage of any other business activities conducted with the member, (4) any other basis approved by MFA, or (5) any combination of the above. In no case, however, shall a member's required minimum stock investment at any time be less than 5 percent of the total advances outstanding to that member.

The Capital Plan shall establish the required minimum stock investment at a level that, when applied to all members, provides sufficient capital for EMRC to comply with the capital adequacy requirements specified in these regulations. The Capital Plan shall require the board of directors to monitor, and to adjust as necessary, the stock investment requirements so that EMRC remains in compliance with its capital adequacy requirements at all times. The Capital Plan shall require each member to comply promptly with any adjusted minimum investment, but may allow members a reasonable period of time to do so.

- Stock dividends. The Capital Plan shall establish the manner in which EMRC will pay dividends on each class of stock, and shall provide that the board of directors or the General Assembly may not declare or pay any dividends if ERMC is not in compliance with its capital adequacy requirements, or if after paying the dividend it would not be in compliance with its capital adequacy requirements. The Capital Plan shall also specify that the board of directors or General Assembly can only declare and pay dividends from previously retained earnings or current net earnings.

- Stock redemption and transfer. The Capital Plan shall describe the process by which members can request that EMRC redeem their stock, or transfer their stock to other members. The Capital Plan shall not allow stock redemptions if EMRC is not in compliance with its capital adequacy requirements, or if after redemption EMRC would not be in compliance with its capital adequacy requirements, or if the member would fail to maintain its required minimum stock investment.

4. **Credit Policy**. The Credit Policy shall describe the credit products that EMRC offers to its members, including the terms and conditions for issuing

advances and for purchasing member mortgage assets, and shall set forth the standards that EMRC shall use to manage credit risk in these products.

The Credit Policy shall, at a minimum:

- Specify the underwriting criteria to be applied in evaluating applications for advances and for purchasing member mortgage assets.

- Specify the levels of collateralization, valuation of collateral, and the discounts that are to be applied to collateral values securing advances.

- Specify the standards and criteria for, and timing of, periodic assessments of the creditworthiness of borrowers, obligors, or other counterparties, and for the establishment of credit limits.

- Specify the fees to be charged for obtaining, or pre-paying, advances, and for purchasing member mortgage assets, including any schedules or formulas pertaining to such fees.

- Discuss the standards and criteria for pricing member products, including differential pricing of advances, and for purchasing member mortgage assets.

The Credit Policy shall include, among its other products, the terms and conditions for member-borrowers obtaining fixed rate, pre-payable advances with maturities as long as 10, 15, or 20 years.

5. **Asset/Liability Management Policy.** The ALM Policy shall discuss EMRC's permissible assets and liabilities, set the standards for managing its interest rate risk and liquidity risk, and delineate the composition, duties, and operational procedures of the Asset/Liability Management Committee.

   The ALM Policy shall set the standards for the methods and models EMRC shall use to measure, monitor, and limit interest rate risk. In particular, the ALM Policy shall discuss in detail the model that EMRC shall procure and use to assess whether it is meeting the duration of equity requirements contained in these regulations.

   The ALM Policy shall also discuss the methodology to be used for determining EMRC's operational and contingency liquidity needs, and enumerate the specific types of investments or credit lines that shall be used to meet these needs and the liquidity requirements contained in these regulations.

6. **Financial Management Policy**. The Financial Management Policy shall discuss EMRC's financial management policies and procedures, and its system of internal controls. The Policy shall include, at a minimum:

- Accounting policies and principles.
- Roles and responsibilities of the Chief Financial Officer and other officials responsible for financial management.
- Treasury operations, including cash management, vouchers, payroll and procurement.
- Financial record-keeping and reporting.
- Auditing and periodic internal control testing.

The system of internal controls established in the Financial Management Policy shall require, at a minimum:

- Top level reviews by the board of directors and senior management, including reviews of financial presentations and performance reports.

- Activity controls, including reviews of standard performance and exception reports by department-level managers on an appropriate periodic basis.

- Physical and procedural controls to safeguard and prevent the unauthorized use of assets.

- Routine monitoring for compliance with the risk tolerance limits set forth in the approved Credit Policy and the approved ALM Policy.

- Required approvals and authorizations for specific activities.

- Required verifications and reconciliations for specific activities.

7. **Code of Ethics and Business Conduct**. The Code of Ethics and Business Conduct shall specify high standards for honesty, integrity, and impartiality for EMRC employees, officers, and directors and provide guidance about avoiding conflicts of interest, self-dealing, and other types of impropriety.

Required Notice:

EMRC shall provide notice to MFA within 10 business days, and written copies if applicable, of the following:

1. Resolutions of its board of directors or its General Assembly.
2. Audited financial statements with accompanying management letters.
3. Internal audit reports, compliance assessments, and tests of internal controls.
4. Planned quarterly debt issuances, including written offering circulars with all terms and conditions and written affirmations from bond counsel.
5. Planned quarterly mortgage purchases and commitments, including all terms and conditions, by member.
6. Planned quarterly stock dividend payments.
7. Quarterly outstanding advances and lending commitments by member.

8. Proposed changes to EMRC's approved Articles of Incorporation and By-laws, Business Plan, Capital Plan, Credit Policy, ALM Policy, Financial Management Policy, and Code of Ethics and Business Conduct.
9. Changes in the composition of EMRC's shareholders, directors, and executive officers.
10. Changes in EMRC's external or internal auditors.
11. Transfers of share ownership.

MFA may raise objections or concerns about any of the items and developments requiring notice at any time before, during or after the notice period expires.

Section III: Credit Extensions and Qualified Collateral

- EMRC credit extensions (i.e. "advances") shall be to EMRC members and shareholders only.

- EMRC shall extend credit only to members in good standing. EMRC shall deem a member not to be in good standing if that member is delinquent on their payment obligations at any time, receives a qualified opinion on its most recent audited financial statement, is unprofitable for two of the most recent four quarters, fails to meet its capital adequacy requirements, or is a member for whom EMRC receives a written notice from the member's regulator, expressing material concerns about the member's financial condition or business operations resulting from the member's most recent supervisory inspection.

- EMRC credit extensions shall be fully secured by sufficient qualified collateral at all times, with each member-borrower providing EMRC with a specific listing of otherwise unencumbered collateral that secures each EMRC advance.

- EMRC, in its discretion, may require delivery of supporting collateral to its own custodian for safekeeping.

- Qualified collateral shall be limited to the following assets, subject to the following collateral discounts as applied to the lesser of the asset's book value or market value.

    1. Residential mortgages originated under, or that otherwise comply with the terms of Real Estate Finance Law 148 and its Executive Regulations, that meet the minimum underwriting standards prescribed in Law 148 and the Executive Regulations, and that have been performing without delinquency or arrears for at least 6 months…………………………………………..……………50 percent

    2. Residential mortgages originated, or re-characterized, under the terms of Real Estate Finance Law 148 and its Executive Regulations, and where the property investor has obtained credit, life, or disability insurance, casualty insurance on the real property that covers loss from major perils such as fire, earthquake, wind, and water, and title insurance, or otherwise meets enhanced underwriting standards as EMRC may require in its Credit Policy………………….………30 percent

    3. Securities issued, insured, or guaranteed by the Egyptian government or any agency thereof:

    - With outstanding maturities of one year or less…………….5 percent
    - With outstanding maturities of from one to five years… …10 percent
    - With outstanding maturities of more than five years………20 percent

4. Bank deposits:

- Bank demand deposits...…………………………………......…5 percent
- Bank term deposits…………………………………………..…20 percent

- EMRC credit officers shall assess both the market value and the book value of the collateral that is to secure EMRC advances before the advances are made, and at least every six months thereafter for all outstanding advances, or require that its external auditors conduct such assessments.

- EMRC shall require member-borrowers to provide additional qualified collateral to compensate for any declines in the market value or book value of the pledged collateral securing their outstanding advances.

- EMRC shall require member-borrowers to provide substitute qualified collateral if any security or residential mortgage securing an outstanding advance matures, prepays, defaults, or becomes more than 60 days delinquent.

- EMRC's outstanding advances to a member-borrower shall become immediately due and payable if that member-borrower is unable to provide sufficient qualified collateral to support its outstanding advances.

- EMRC shall not extend credit to any one member-borrower equal to more than 50 percent of its core capital, as defined in these regulations.

- EMRC may, in its discretion, require pre-payment fees on advances, but any such pre-payment fees shall be such that EMRC is indifferent to such pre-payment.

- EMRC advances shall be made to members on non-preferential terms and conditions.

- EMRC shall provide clear disclosures of the terms and conditions of its member advances.

- EMRC shall require in its Capital Plan that each member-borrower shall hold EMRC stock in an amount not less than 5 percent of the member-borrower's outstanding advances at all times. Such stock shall serve as secondary security for the member's borrowing.

Section IV: Purchase of Member Mortgage Assets

EMRC shall only purchase eligible mortgage assets from members in good standing under the following conditions:

Mortgage Purchases Under Repurchase Agreements:

- EMRC may purchase member mortgage assets subject to a repurchase agreement under which the member agrees to repurchase the same mortgage assets at an agreed upon price at a stated time in the future.

- Member mortgage assets eligible to be purchased subject to a repurchase agreement are the same as those mortgage assets eligible to serve as qualified collateral for member advances, and shall be purchased subject to the same applicable discounts.

Mortgage Purchases With Recourse:

- EMRC may purchase member mortgage assets with full recourse on the member in case of default, delinquency, or fraud. In such cases, EMRC shall require members to provide substitute eligible mortgage assets of equal value to replace those purchased mortgage assets that mature, prepay, default, or become more than 60 days delinquent.

- Member mortgage assets eligible to be purchased with recourse are the same as those mortgage assets eligible to serve as qualified collateral for member advances.

- At no time shall the higher of the book value or the market value of member mortgage assets purchased with recourse exceed more than two times the book value of EMRC's core capital, as defined in these regulations.

Other Mortgage Purchases:

- EMRC may purchase eligible member mortgage assets without a repurchase agreement or without recourse on the member. In such cases, the member shall be required to supply a credit enhancement such that the pool of acquired member mortgages receives a credit rating no lower than the second highest credit rating supplied by a credit rating agency registered with, and recognized by, the Capital Markets Authority.

- Member mortgage assets eligible to be purchased without repurchase or recourse are the same as those mortgage assets eligible to serve as qualified collateral for member advances. In addition, such mortgage assets shall have a record of satisfactory performance for at least 30 months. Before purchase, EMRC's credit officers or external auditors shall verify, on a sampling basis, the documentation supporting the underwriting of such mortgage assets, including verification of the appraised values of the financed real estate properties.

- At no time shall the higher of the book or market value of member mortgage assets purchased without a repurchase agreement or recourse exceed the book value of EMRC's core capital, as defined in these regulations.

Section V: Capital Adequacy Requirements

EMRC shall comply with the following capital adequacy requirements.

Regulatory capital definitions. EMRC's total regulatory capital shall include:

- Tier I, or core capital consisting of paid-in capital and surplus plus retained earnings and undivided current earnings, less goodwill and other intangible assets and identified losses.

- Tier II, or additional capital consisting of subordinated debt up to 50 percent of the value of Tier I capital, general loan loss reserves up to 1.25 percent of the risk-weighted value of assets, and unrecognized profits resulting from the revaluation at fair value for any available-for-sale investments.

Minimum leverage capital requirement. EMRC's minimum leverage capital requirement shall consist of a ratio of Tier 1, core capital to total assets of not less than 10 percent. EMRC shall not issue any debt obligations or incur any other liabilities that would cause its total liabilities, including any subordinated debt, to exceed 9 times EMRC's core capital. EMRC shall manage its liabilities and capital to ensure compliance with this 9:1 leverage limit at all times.

Minimum risk-based capital requirements. EMRC shall comply with the following minimum risk-based capital requirements:

- Risk-based core capital. EMRC's ratio of Tier I, core capital to the value of its risk-weighted assets shall not be less than 15 percent.

- Risk-based total capital. EMRC's ratio of total, Tier I, and Tier II, capital shall not be less than 20 percent.

The risk weights that shall be applied to EMRC's assets in computing these two ratios are contained in the annex to these regulations.

Section VI: Permissible Investments and Restrictions

The following assets shall be the only permissible EMRC investments:

- Obligations issued, insured or guaranteed by the Egyptian government or any agency thereof.

- Demand deposits, term deposits, or certificates of deposit in commercial banks licensed by the Central Bank of Egypt.

- Purchased member mortgage assets.

EMRC may enter into commitments to make member advances or to purchase member mortgage assets subject to the requirements of these regulations.

At no time shall EMRC incur any foreign exchange, commodity or equity risk, or use financial derivatives except as hedging instruments.

Section VII: Liquidity Requirements

EMRC shall maintain short duration assets or credit lines sufficient to meet its potential short term funding needs arising from credit demands, debt servicing and stock redemptions, without incurring any material loss. EMRC's approved ALM Policy shall discuss the methodology EMRC shall use to project both its daily average liquidity needs each month and the daily average liquidity levels available to meet those needs. EMRC's ALM Policy shall also discuss the maintenance of credit lines or other liquidity sources that are available to meet its projected needs or respond to unexpected demands for additional liquidity.

Eligible short duration assets. The following assets shall be eligible for meeting EMRC's liquidity requirements:

- Vault cash or balances held at the Central Bank of Egypt.

- Demand deposits or negotiable certificates of deposit in commercial banks licensed by the Central Bank of Egypt.

- Marketable obligations of the Government of Egypt or any agency thereof maturing in 36 months or less.

Short-term liabilities. The following short-term liabilities shall be included in calculating EMRC's liquidity needs:

- Payments of principal and interest on outstanding debt or other liabilities due within 12 months.

- Outstanding commitments to fund member advances or purchase member mortgage assets within 12 months.

- Operating expenses due or expected to be due within 12 months.

- Any other obligation to disburse funds, including planned stock redemptions, within 12 months.

Section VIII: Duration Gap Requirement

EMRC shall maintain the difference between the weighted average duration of its assets and the weighted average duration of its liabilities between minus 6 months and positive 6 months, using appropriate interest rate assumptions.

EMRC shall procure and use an MFA-approved model to calculate and report each month its average daily duration gap.

Until such time as an MFA-approved model is available for its use, EMRC shall use an alternative MFA-approved methodology and approach to measure and limit its interest rate risk.

Section IX: Debt Issuance, Restrictions, and Credit Rating Requirements

EMRC may issue debt obligations, including the determination of the dates of issue, maturities, rates of interest, terms and conditions thereof, and the manner in which such debt obligations shall be issued and serviced by a designated fiscal agent.

Debt issuance restrictions. EMRC shall not issue any debt obligations, either through a public offering or a private placement:

- Without obtaining the prior written approval of the board of directors and the General Assembly.
- Without obtaining a written statement from a qualified bond counsel affirming that EMRC is authorized to issue such debt and stating that EMRC is in compliance with all legal and regulatory requirements necessary for issuance.
- Without supplying a written offering circular to potential investors that clearly and completely describes the terms and conditions of the debt obligation.
- Without obtaining and maintaining a current credit rating on the debt obligation from a credit rating agency that is registered with, and recognized by, the Capital Markets Authority.
- Without meeting its minimum leverage capital requirement.

Credit rating requirements. EMRC shall operate in such a manner, and take any actions necessary, to ensure that EMRC receives and maintains an individual issuer credit rating of at least the second highest credit rating available from a credit rating agency registered with, and recognized by, the Capital Markets Authority, where such rating is a meaningful measure of EMRC's financial strength and stability, and is updated at least annually, or more frequently as required by MFA, to reflect any material changes in EMRC's financial condition or operations.

EMRC shall also operate in such a manner and take any actions necessary, including without limitation reducing leverage, to ensure that EMRC's debt obligations receive and continue to receive at least the second highest credit rating from any registered and recognized rating agency.

Section X: Corporate Governance Requirements

EMRC shall comply with the following corporate governance requirements:

Board of Directors:

Management. EMRC's management, except for the rights assumed by the General Assembly under EMRC's Articles of Incorporation, shall be vested in its board of directors. While the board of directors may delegate the execution of operational functions to EMRC's officers and employees, the ultimate responsibility of the board of directors for EMRC's management is non-delegable.

Duties. Directors shall have the duty to:

- Act in good faith, in a manner they believe to be in EMRC's best interests, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

- Administer EMRC affairs fairly and impartially and without discrimination in favor of or against any member.

- At the time of appointment or election, or within a reasonable time thereafter, have a working familiarity with basic finance and accounting principles and practices, including the ability to read and understand EMRC's balance sheet and income statement and to ask substantive questions of management and EMRC's internal and external auditors.

- Direct EMRC operations in conformity with the requirements set forth in the Companies Law and its Executive Regulations, Real Estate Finance Law 148 and its Executive Regulations, EMRC's Articles of Incorporation and By-laws, and these and other pertinent laws and MFA regulations and directives.

- Review at least annually, and amend as appropriate, the following EMRC plans and policies: Business Plan, Capital Plan, Credit Policy, ALM Policy, Financial Management Policy, Code of Ethics and Business Conduct.

- Prepare and publish EMRC's balance sheet, a report regarding the EMRC's activity during the fiscal year and EMRC's financial status as of the end of each fiscal year.

- Prepare annual budgets, financial projections, and proposed payouts of stock dividends for approval by the General Assembly.

- Monitor, and adjust as necessary, member stock purchase requirements.

Internal control system. The board of directors shall ensure that EMRC establishes and maintains an effective internal control system that addresses, at a minimum:

- The efficiency and effectiveness of EMRC activities.

- The safeguarding of EMRC assets.

- The reliability, completeness and timely reporting of financial and management information to the board of directors and to MFA.

- Compliance with applicable laws, regulations, policies, supervisory determinations and directives of the board of directors, senior management and MFA.

The board of directors shall oversee senior management's implementation of the internal control system on an ongoing basis by:

- Conducting periodic discussions with senior management regarding the effectiveness of the internal control system.

- Ensuring that an internal audit of the internal control system is performed at least annually and such audits are effective and comprehensive.

- Requiring that internal control deficiencies be reported to the board of directors in a timely manner and that such deficiencies are addressed promptly.

- Conducting a timely review of evaluations of the effectiveness of the internal control system made by internal auditors, external auditors and MFA examiners.

- Directing senior management to address promptly and effectively recommendations and concerns expressed by EMRC's internal auditors, external auditors and MFA examiners regarding weaknesses in the internal control system.

- Reporting any internal control deficiencies found, and the corrective action taken, to MFA in a timely manner.

Organizational structure. The board of directors shall establish, document, and communicate an organizational structure for EMRC that clearly shows the lines of authority, provides for effective communication, and ensures that there are no gaps in the lines of authority. The board of directors shall review all delegations of authority to specific personnel or committees and require that such delegations state the extent of the authority and responsibilities delegated.

Reporting requirements. The board of directors shall establish reporting requirements for senior management, including specifying the nature and frequency of the management reports it shall receive. EMRC's Managing Director, Internal Auditor, and Chief Risk Officer shall report directly to the board of directors, or an appropriate board committee.

Audit committee. The board of directors shall establish an audit committee. The audit committee shall be comprised of at least three directors, at least one of who has extensive accounting or related financial management experience, and all of who do not have any disqualifying relationships with EMRC that would interfere with the exercise of their independent judgment. Such disqualifying relationships include, but are not limited to:

- Serving, or having served in any of the past two years, as an EMRC employee, consultant, advisor, promoter, underwriter, or legal counsel.

- Accepting any compensation from EMRC other than compensation for service as a board director.

- Being an immediate family member of an individual who is, or has been in any of the past two years, employed by EMRC as an officer or senior manager.

The board of directors shall adopt a written charter for the audit committee that specifies the scope of the committee's powers and responsibilities, and its structure, processes and membership requirements. This charter shall provide, at a minimum, that:

- The audit committee has the responsibility to select, evaluate and, where appropriate, replace the internal auditor and that the internal auditor may be removed only with the approval of the audit committee.

- The internal auditor shall report directly to the audit committee on substantive matters and that the internal auditor is ultimately accountable to the audit committee and the board of directors.

- Both the internal auditor and the external auditors shall have unrestricted access to the audit committee without the need for any prior management knowledge or approval.

The charter shall also specify that the audit committee shall:

- Direct senior management to maintain the reliability and integrity of EMRC's accounting policies and financial reporting and disclosure practices.

- Review the basis for EMRC's financial statements and the external auditors' opinion rendered with respect to such financial statements, and ensure that policies are in place to achieve disclosure and transparency regarding the EMRC's true financial condition and performance.

- Oversee the internal audit function by reviewing the scope of audit services required, significant accounting policies, significant risks and exposures, planned audit activities and audit findings, and by assessing the performance of the internal auditor.

- Oversee the external audit function by approving the external auditors' annual engagement letter, reviewing the performance of the external auditors, and making recommendations to the board of directors and General Assembly regarding the appointment, renewal, or termination of the external auditors.

- Provide an independent, direct channel of communication between the board of directors and the internal and external auditors.

- Conduct or authorize investigations into any matters within the audit committee's scope of responsibilities.

- Ensure that senior management has established and is maintaining an effective internal control system.

Resources. In carrying out its duties and responsibilities, the board of directors and all committees thereof shall have authority to retain staff and outside counsel, independent accountants, or other outside consultants at EMRC's expense.

Senior Management:

Risk assessment. EMRC senior management shall perform, at least annually, a risk assessment that identifies and evaluates all material risks, including both quantitative and qualitative risks that could adversely affect the achievement of EMRC's business and performance objectives and compliance requirements. The risk assessment shall be in written form and shall be reviewed by the board of directors promptly upon its completion.

Responsibility. EMRC senior management shall be responsible for carrying out the directives of the board of directors and for conducting the day-to-day operations of EMRC in a safe and sound manner, including the establishment, implementation, and maintenance of the internal control system required by these regulations.

Other duties. Senior management shall also:

- Ensure that EMRC employees fully understand and comply with all policies, procedures, and legal requirements applicable to their positions and responsibilities, including adherence to approved risk tolerances and mitigation strategies.

- Ensure that there is appropriate segregation of duties among employees and that employees are not assigned conflicting responsibilities.

- Ensure that employees receive necessary and appropriate information and training.

- Develop and implement operating procedures that translate the major business objectives, strategies, and policies established by the board of directors into effective operating standards.

- Ensure adherence to the lines of authority and responsibility established by the board of directors.

- Oversee the implementation and maintenance of management information and other operating systems.

- Establish and implement an effective system to track internal control weaknesses and the action taken to correct them.

- Monitor, and report periodically to the board of directors and audit committee about, the achievement of EMRC's business objectives and the effectiveness of the internal control system.

Senior management shall not exceed EMRC's approved annual budget without prior approval by the board of directors and the General Assembly of a budget amendment authorizing such increases.

Section XI: Examinations

EMRC shall be subject to, and cooperate fully with, the following MFA examinations:

- **Regular on-site examinations.** Regular on-site examinations are to be scheduled and conducted at least annually by MFA examiners. These examinations will involve assessing and evaluating 5 major areas: corporate governance, credit risk, market risk, operational risk, and financial condition and performance. Regular examinations will result in a written Report of Examination that the MFA will present to EMRC's board of directors.

- **Follow-up examinations.** Follow-up examinations are designed to resolve major outstanding issues identified in prior examinations, or to review the progress and sufficiency of any corrective action taken to remedy a previously identified weakness or supervisory concern.

- **Special examinations.** Special examinations are to be conducted as necessary to address circumstances or situations requiring immediate supervisory attention or risk assessment.

Section XII: Reporting Requirements and Off-Site Monitoring

EMRC shall be subject to, and cooperate fully with, MFA's off-site monitoring program and shall make the following periodic reports in accordance with the forms, instructions, and schedules specified by MFA:

- Monthly call reports including statements of condition, income and capital compliance, and leverage.

- Quarterly call reports including statements of cash flow, capital, investments, purchased member mortgage assets and commitments, outstanding advances and commitments, outstanding liabilities, and member stock holdings and minimum required stock investments.

Section XIII: Document Requests

EMRC shall make its books and records readily available for inspection and other supervisory purposes within a reasonable period upon request by the MFA, and at a location acceptable to the MFA. For document requests made during the course of an on-site examination, a reasonable period is presumed to be no longer than 1 business day. For other document requests, a reasonable period is presumed to be 3 business days.

Section XIV: Waivers

MFA reserves the right, in its discretion, to waive any provision or requirement of these regulations, or any required approval, notice, or other submission of information, provided that any such waiver is not inconsistent with Real Estate Finance Law 148, its implementing Executive Regulations, or any other provision of law or executive regulation.

Applications waivers letters shall be signed by EMRC's Managing Director and shall be accompanied by a resolution of EMRC's board of directors concurring in the substance, and authorizing the filing, of the applications.

Annex: Risk Weights for Assets

To compute its risk-based capital requirements, EMRC's balance sheet assets and off-balance-sheet items shall be risk-weighted as shown below. Account definitions shall follow accepted Egyptian accounting principles. Account balances used in such calculations should be net of specific loss allowances, unearned interest, depreciation, or other such deduction or exclusion, according to such accepted accounting principles. The value of EMRC's total risk-weighted assets shall be the summation of the products from multiplying the value of each asset, or group of assets, times its corresponding risk weighting factor.

1. Cash and demand deposits, including:

    - Vault cash and balances at the Central Bank of Egypt.
    - Demand deposits in commercial banks licensed by the Central Bank of Egypt.

    Risk weighting for these assets shall be 0 percent.

2. Other liquid assets and investments, including:

    - Term deposits or certificates of deposit maturing in less than 12 months in commercial banks licensed by the Central Bank of Egypt.
    - Marketable obligations of the Government of Egypt, or any agency thereof, maturing in 36 months or less.
    - Any other investments qualifying as liquid assets under law, these regulations, or other MFA directives.

    Risk weighting for these assets shall be 20 percent.

3. Advances, purchased member mortgage assets and other defined investments:

    - Advances.
    - Purchased member mortgage assets.
    - All other bank deposits maturing in five years or less.
    - All other obligations of the Government of Egypt and any agency thereof.
    - All other deposits or investments that qualify as liquid under Egyptian law, these regulations, or other MFA directives.

    Risk weighting for these assets shall be 50 percent.

4. The risk weighting for all other assets and items shall be 100 percent.