FRA Updated Capital Adequacy Standards

By Youssef Ihab and Malak Mounir

The Egyptian Financial Regulatory Authority (the "**FRA**") issued Decree No. 2132 in 2024 (the "**Decree**") to update the Capital Adequacy standards of companies operating in the Egyptian capital markets which undertake either of the following activities: (i) Securities brokerage; (ii) underwriters, intermediaries and brokerages; and (iii) Custodians. The decree aims to strengthen the financial solvency and stability of these companies to ensure a well-functioning, transparent financial environment that protects both the investors and the market.

Key Highlights:

The Decree introduces significant changes to key areas in the Capital Adequacy framework outlined in the prior FRA Decree 14/2007, focusing on the calculation of actual capital held by Companies subject to the Decree and not the book-value of their holdings:

Net Liquid Capital Requirements:

Companies subject to the Decree must now maintain a net liquid capital of at least 10% of their total liabilities at all times. This ensures they have sufficient liquidity to cover operational and trading risks. Companies operating as market makers are required to maintain liquid capital equal to the greater of 10% of either their weighted liabilities or their six-month operating expenses.

The Decree introduces a new form with respect to margin calls. The Decree is replacing the calculation of margin calls coverage which was based on the equity ownership of companies with actual liquidity held by them.

Minimum Equity Requirements for Specialized Activities:

The decree sets forth the minimum equity capital requirement for companies engaged in specialized financial activities (e.g., market making or margin trading) at EGP 15 million. The goal is to ensure that firms engaging in complex financial operations have sufficient capital backing. Notably, the revaluation of fixed assets is not considered in calculating this minimum equity.

Enhancements in Client and Asset Protection

The Decree outlines measures aimed at better protecting client assets, especially for firms handling large client transactions such as margin trading or securities borrowing. Some of the critical measures include:

Maintaining adequate capital to cover liabilities to clients, including cash reserves, customer balances, and investments in fixed-income securities.

Ensuring client assets are segregated and properly accounted for, including comprehensive records of customer credit balances, institutional transactions, and delivery versus payment (DVP) clients.

Adjustments in Risk Weighting and Asset Calculation

The decree introduces new risk-weighting mechanisms for asset classes and adjustments to capital adequacy calculations:

Risk Weighting for Cash and Bank Balances: The decree specifies that checks held in company safes or post-dated checks should no longer be counted as liquid assets, reducing the risk associated with non-liquid assets being incorrectly represented as liquid.

Risk-Weighted Assets and Client Liabilities: Companies must evaluate their assets based on their market value and consider the nature of the client's financial dealings

To ensure smooth adoption of these new rules, companies are given a six-month period to comply with the decree's requirements, which may be extended based on justifications presented to the FRA. This grace period allows companies to adjust their financial structures without facing immediate penalties.

Market Reaction

This update complements the current FRA policy direction towards expanding the Egyptian capital markets to withstand an increased number of foreign and local investors. The Capital Adequacy requirements updates offer a clear view as to the actual financial solvency of companies subject to the Decree, protecting investors and the market overall from sudden and unexpected solvency problems.

FRA Decree Introduces New Amendments to the EGX Listing Rules

By Passant Ashraf and Zaina Morad

Introduction

The Financial Regulatory Authority (the "**FRA**") has enacted Decree No. 181 of 2024 (the "**Decree**"), amending the rules for listing and delisting securities in the Egyptian Stock Exchange. This new regulation aims to enhance investor protection, stabilize financial markets, and support companies in leveraging growth opportunities through non-banking financial mechanisms.

The Decree introduces key amendments, mainly including:

Voluntary Delisting:

The Decree requires companies to apply for the FRA's approval to publish a disclosure report with regards to the initiation of delisting procedures, including the rationale for voluntary delisting supported by invitation for the convocation of an extraordinary general shareholders' meeting ("**EGSM**") along with the board of director's meeting minutes.

Further, the Decree sets out that companies opting for voluntary delisting must offer buying shares from shareholders objecting to the delisting at the highest of the following values (i) the fair value of the share, determined by an independent financial advisor, (ii) the highest closing price a month prior to the date of issuance of the board of director's resolution calling for the convocation of the EGSM in order to consider the delisting, or (iii) the average closing price of the shares within the three months preceding to the date of issuance of the board of director's resolution calling for the convocation of the EGSM in order to consider the delisting.

In addition to the above, listed companies, following the approval of the EGSM, can open a temporary trading account on the EGX under the name "Delisted Shares Account" for the purpose of buying the shares of the shareholders objecting to the delisting.

Said account is governed by the rules for treasury shares with an exception from the maximum limit on treasury shares relative to issued capital.

Regulation of Redemption Account in Relation to Special-Purpose Acquisition Companies ("**SPACs**"):

According to the Decree, SPACs, licensed by the FRA, might by the resolution of an EGSM approving the opening of a temporary account under the name "Redemption Account" for the purpose of buying the shares of the shareholders objecting to the acquisition. Said account is funded by the SPAC itself.

Market Reaction

These amendments are part of the FRA's broader strategy to align with market changes, and enhance transparency, stability, and growth in Egypt's financial markets, as emphasized by Dr. Mohamed Farid, Chairman of the FRA. Such government efforts are expected to be well-received by both companies and investors.

Companies may view the changes as an opportunity to operate in a more transparent and structured environment, while investors are likely to feel more secure, fostering confidence and promoting more active participation in the market.

New Licensing Regulations for Companies Undertaking Non-Banking Financial Activities

By Alexandra Arida and Malak Sobhy

The Financial Regulatory Authority (the "**FRA**") has issued Decree No. 177 for 2024 (the "**Decree**"), regulating licensing requirements for companies undertaking non-banking financial activities. By establishing clear licensing requirements, the Decree emerges in response to a growing need for increased transparency, market stability and investor protection.

Published in the Official Gazette on August 29th, 2024, the Decree comes into effect the following day and revokes Decree No. 53 for 2018.

We shall delve into the key highlights of the Decree as follows:

New Licensing Framework

The Decree introduces a new framework for the approval of licensing based on market demand and compliance with legislative requirements. The Decree further requires the FRA to assess the impact of economic concentrations on market competition when granting licenses.

Expansion of Qualified Investors Definition

In an effort to expand licensing requirements, the Decree broadens the scope of the definition of "qualified investors." Qualified investors now encompass, *inter alia*, (i) individuals with a minimum of 10 years of experience in fund management, investment, or related banking and non-banking financial activities, provided their liquid assets or financial instruments are valued at no less than EGP 5 million, down from the previous threshold of EGP 10 million, and (ii) foreign companies with equity of no less than EGP 50 million or its equivalent in foreign currencies.

New Amendments to Licensing Requirements

Financial Institutions Ownership

The Decree introduces new provisions pertaining to the contribution of financial institutions in companies undertaking non-banking financial activities.

In this regard, the Decree adds "Nasser Social Bank" to the list of financial institutions eligible to contribute to the capital of companies undertaking non-banking financial institutions. This addition facilitates the satisfaction of the standard 25% shareholding percentage of financial institutions.

Further, the Decree exempts certain companies from the aforementioned requirement. Said exempted companies include, *inter alia*, medical insurance management companies, insurance consultancy companies, and companies undertaking securities-related activities.

Companies Management Requirements

The Decree additionally introduces new requirements with regards to the governance of companies undertaking non-banking financial activities. Notably, the Decree mandates a minimum female representation of 25% on the companies' board of directors.

License Validity Requirements

The Decree mandates that licensed companies notify the FRA prior to making any amendments to the structure of their board of directors. Following the lapse of a two-week period from the notification, the FRA's lack of response would be construed as implicit approval of the proposed changes.

On another note, Special Purpose Acquisition Companies ("**SPACs**") are required to apply for the listing of their shares on the Egyptian Stock Exchange ("**EGX**") within one month of obtaining their license; failure to do so will render the license void. Additionally, if the SPAC's shares are delisted from the EGX, its license will be revoked, and the SPAC will be required to commence liquidation procedures, unless it presents justifications deemed acceptable by the FRA.

Market Reaction

In a statement issued on September 7th, 2024, the FRA expressed optimism about the Decree stating that it would ease the process of establishing and licensing companies undertaking non-banking financial activities, thereby supporting national economic growth.