THE LEGAL AND REGULATORY ENVIRONMENT FOR MICROFINANCE IN EGYPT

DIAGNOSTIC STUDY WITH FOCUS ON NGO-MFI TRANSFORMATION ISSUES

15 June 2009

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International Inc. in coordination with the Consultative Group to Assist the Poor (CGAP)

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Contract No. 263-C-00-06-00005-00

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ACRONYMS

ABA	Alexandria Business Association
AFD	Agence Française de Développement
ATM	Automatic Teller Machine
BdC	Banque du Caire
BM	Banque Misr
BoA	Bank of Alexandria
CBE	Central Bank of Egypt
CDA	Community Development Association
CGAP	Consultative Group to Assist the Poor
CGC	Credit Guarantee Corporation
CIB	Commercial International Bank
CIS	Cooperative Insurance Society
CPA	Consumer Protection Authority
DBACD	Dakahleya Businessmen Association for Community Development
EBI	Egyptian Banking Institute
EGP	Egyptian Pound
EFSA	Egyptian Financial Supervisory Authority
EMF	Egypt Microenterprise Finance
EMFN	Egyptian Microfinance Network
ESED	Egyptian Small Enterprise Development Association
ESOP	Employee Stock Ownership Plan
EU	European Union
FDI	Foreign Direct Investment
FMF	First Microfinance Foundation
FY	Fiscal Year

GAFI	General Authority for Investment and Free Zones
GDP	Gross Domestic Product
GoE	Government of Egypt
ISS	Information Sharing System
KfW	Kreditanstalt für Wiederaufbau
KYC	Know Your Client
MENA	Middle East and North Africa
MF	Microfinance
MFC	Microfinance Company
MFI	Microfinance Institution
MFS	Microfinance Sector
MIX	Microfinance Information Exchange
MoI	Ministry of Investment
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
MSS	Ministry of Social Solidarity
NBD	National Bank for Development
NGO	Non-Governmental Organization
NPA	National Postal Authority
OECD	Organization for Economic Cooperation and Development
PBDAC	Principal Bank for Development and Agricultural Credit
SFD	Social Fund for Development
SEDO	Small Enterprise Development Organization
SME	Small and Medium Enterprises
UNDP	United National Development Program
USAID	United States Agency for International Development
USD	United States Dollar

EXECUTIVE SUMMARY

The purpose of this study was to conduct a comprehensive diagnostic assessment of the legal and regulatory environment for microfinance in Egypt, with the following specific objectives:

- Identifying key legal barriers and obstacles that would prevent NGO-MFIs from transforming into Microfinance Companies (MFCs);
- Identifying relevant Egyptian laws and regulations that should be harmonized with the recently drafted General Rules for Microfinance Companies; and
- Developing specific recommendations to resolve issues identified under both objectives.

Microfinance in Egypt is still underdeveloped relative to the large potential market. To date, banks and NGOs are the only providers of microfinance in Egypt. The estimated number of active clients as of June 30, 2008 exceeded 1.2 million borrowers (of which 60 percent were female clients) offered by more than 360 MF programs operated by NGOs and Banks with a total outstanding portfolio in excess of EGP 1.9 billion (USD 340 million). Fifteen MFIs – mostly NGOs – serve more than 85 percent of the total active clients.

In early 2008, a major breakthrough occurred when the Ministry of Investment (MoI) emerged as the regulatory champion for commercial microfinance. MoI and the General Authority for Investment and Free Zones (GAFI) – with the technical assistance of USAID-Egypt Microenterprise Finance Project (EMF) and the Consultative Group to Assist the Poor (CGAP) – developed the draft General Rules for Microfinance Companies according to internationally recognized best practices of MF regulation and supervision. In early 2009, the Law for the Regulation of Non-Banking Financial Markets and Instruments (Law No. 10 of 2009) – referred to in this report as the Single Regulator Law – was approved by the Parliament and published in the Official Gazette in March 2009. With the enactment of the law (effective as of first of July 2009) and the establishment of the Egyptian Financial Services Authority (EFSA) – referred to in this report as the Single Regulator - the General Rules of Microfinance Companies (MFCs) are expected to be finalized and adopted sometime in 2009. This is expected to affect the growth of the industry leading to increased access of the un-banked to formal financial services.

Despite the wide range of tax and duties exemptions, some NGO-MFIs with successful microfinance businesses are considering transforming into MFCs. They perceive in transformation many significant benefits, including: (i) the ability to provide a variety of microfinance services besides microcredit, (ii) the increased access to funding whether through debt or equity and (iii) the avoidance of current constraints under the NGO Law.

The study identified the following key legal barriers and technical requirements that would prevent / limit the ability of NGO-MFIs from transforming into Microfinance Companies as well as the recommendations to address them:

1. For NGO-MFIs interested in transforming into MFCs there is a legal uncertainty of whether an NGO is allowed to own shares in a commercial company. This can be overcome through creating a clear path for transformation with the consent of both MSS and the Single Regulator and with the support of the donors.

2. NGOs should take into consideration the cost of transformation, the needed time to complete the process and the required changes in their institutional, operational and financial systems (e.g. Developing a transformation, updating the business plan, determining ownership structure, conducting the evaluation procedures of the NGO's in-kind contribution…etc)

The study identified some legal challenges and the recommendations to address them in order to enhance the regulatory environment for MFCs and comply with international best practices of regulation and supervision of non-deposit taking MFIs:

1. A main challenge facing the MFCs to be established is the interest rate cap of seven percent on all civil and commercial transactions stipulated by the Civil Code. Banks are the only entities exempted from this usury rule, which constitutes a legal risk for NGO-MFIs and MFCs if interest rates were challenged by their clients in the courts of law. A legal intervention is needed to exempt MF activities from interest rate caps for both NGOs and MFCs.

2. Good practices of regulation and supervision do not recommend applying a minimum capital requirement or loan loss provisioning for non-deposit taking MFIs.

3. The General Rules Draft does not allow MFCs to act as agents for banks, NPA or Money Transfer companies to offer savings and/or remittance services, which hinders their ability to diversify their product range and respond to clients' demand for such services. Therefore, it is recommended to allow MFCs to act as agents for such duly regulated financial institutions – offering savings and/or remittances services – with the prior approval of the relevant authority.

Additionally, the study recommended some interventions to address additional barriers / challenges that would affect the growth of the industry:

1. A major challenge for NGO-MFIs and MFCs is access to funds and liquidity. NGO-MFIs before accepting any funding from abroad should ask for the prior approval of the Ministry of Social Solidarity (MSS) which is a lengthy and cumbersome process. Moreover, loans from banks require collateral not always available for either MFCs or NGOs and banks must get the approval of the CBE to extend credit facilities in EGP against deposit guarantees in foreign currency. These issues can be resolved with the support of MSS by speeding the approval procedures and the CBE by encouraging banks to extend credit facilities to NGO-MFIs and MFCs based on the quality of the loan portfolios of these institutions and to benefit from their outreach and experience in microfinance.

2. NGO-MFIs are not participating in the current credit bureau system which creates an information gap. This is due to the perception of the high cost of the service when compared to the value of microloans. The support of both the MoI and donors

is important to assist NGO-MFIs and MFCs in reaching to practical arrangement with the credit bureau with regards to pricing issues.

3. With the development of the General Rules for MFCs, donors' coordinated efforts are needed to support several interventions. A key intervention is supporting the capacity building at the level of policymakers and especially the new Single Regulator to sustain the sector's achievements and encourage new innovation aimed to advance the Egyptian microfinance sector. In addition, Donors' support and assistance to NGOs interested in transformation is also very important, given the complexity and high cost of the transformation process.

SECTION I: INTRODUCTION

Although Egypt boasts three microfinance institutions (MFIs) [1] that rank in the Microfinance Information Exchange's (MIX) Global 100 Composite Ranking[2], the country's microfinance industry overall is underdeveloped relative to the large potential market. A primary reason for such underdevelopment is that the legal and regulatory framework governing microfinance limits the sector's development in a number of ways (See Section IV). While a limited number of commercial banks are engaged in micro-lending, they have not developed large scale microcredit portfolios. NGO-MFIs, on the other hand, are the primary purveyors of microcredit services in Egypt, and are regulated by the Ministry of Social Solidarity (MSS). This too presents significant constraints to sector growth. A third category of players has started working recently in the MF market - MF service companies that currently operate as agents for banks to extend microcredit. It is anticipated that such MF service companies will eventually be permitted to directly extend microfinance services after acquiring necessary approvals and licenses.

In early 2008, a major breakthrough occurred when the Ministry of Investment (MoI) emerged as the regulatory champion for commercial microfinance. MoI and the General Authority for Investment and Free Zones (GAFI) – with the technical assistance of USAID-Egypt Microenterprise Finance Project (EMF) and the Consultative Group to Assist the Poor (CGAP) – developed the draft General Rules for Microfinance Companies according to internationally recognized best practices of MF regulation and supervision. In early 2009, the Law for the Regulation of Non-Banking Financial Markets and Instruments (Law No. 10 of 2009) – referred to in this report as the Single Regulator Law – was approved by the Parliament and published in the Official Gazette in March 2009. With the enactment of the law (effective as of first of July 2009) and the establishment of the Egyptian Financial Services Authority (EFSA) – referred to in this report as the Single Regulator - the General Rules of Microfinance Companies are expected to be finalized and adopted sometime in 2009.

The establishment of the new Microfinance Companies is expected to affect the growth of the industry, leading to increased access of the un-banked to formal financial services. This will also lead to increased competition in the market, but not on a level playing field given the different legal frameworks governing the three types of MFIs. The introduction of a new market player – the MFCs – makes it necessary to analyze the legal and regulatory environment in which they will operate. This report will pay particular attention to transformation issues of NGO-MFIs that may wish to transform into MFCs.

Objectives and Methodology of the Study

The purpose of the study was to conduct a comprehensive diagnostic assessment of the legal and regulatory environment for microfinance in Egypt, with the following specific objectives:

[1] Al Tadamun, DBACD, and ESED (2008 Mix Global 100 Composite: Rankings of Microfinance Institutions. December 2008).
[2] Mix Global 100 Composite Ranking is an attempt to present the top performing 100 MFIs (out of a sample of 652 MFIs) in three areas: outreach, efficiency and transparency. (2008 Mix Global 100 Composite: Rankings of Microfinance Institutions. December 2008)

- Identifying key legal barriers and obstacles that would prevent NGO-MFIs from transforming into MFCs;

- Identifying relevant Egyptian laws and regulations that must be harmonized with the recently drafted General Rules for Microfinance Companies; and

- Developing specific recommendations to resolve issues identified under both objectives.

In order to complete the study, USAID-EMF Project – in coordination with CGAP's Policy Advisory Team – developed the Scope of Work and identified two consultants to conduct the study, Mr. Alaa Abbassi – CGAP Policy Advisor – to lead the study and Ms. Suzanne El Akabaoui – Egyptian Legal Consultant – to assist in the legal review and diagnostic. The study was completed over a period of four months (February to May 2009) and consisted of four phases described below. Close coordination with CGAP's Policy Advisory team was maintained throughout the assignment in order to ensure the study covered all issues and reflected best practices recommendations.

The study started with a desk review of all recent reports and documents developed on the Egyptian microfinance sector and on publications covering transformation issues worldwide, and a legal review covering all issues pertaining to the objectives of the study in the relevant Egyptian laws (Annex II: List of Laws). Interviews with relevant stakeholders – Government, MFIs, Banks, Experts, and Donors – were then conducted to solicit input on the objectives of the study and the issues identified during the desk review (Annex III: List of Interviewees). The findings and recommendations of the study were discussed with stakeholders to solicit their input and develop the report.

The first part of this report gives an overview of the financial sector in Egypt. The second part sheds light on the state of development of microfinance in Egypt. The third part describes the legal and regulatory framework of microfinance for (i) MF providers, (ii) supporting infrastructure (e.g. funding, credit information sharing, taxation …etc), and (iii) transformation related technical and legal issues. The last section analyses the challenges and recommends interventions to address each challenge with respect to (i) general cross-cutting issues, (ii) MFCs General Rules Draft, and (iii) Transformation related technical and legal issues.

SECTION II: OVERVIEW OF THE FINANCIAL SECTOR IN EGYPT

The formal financial sector in Egypt is comprised mainly of Banks and Non-Banking Financial Institutions.

Banks operate under the supervision of the Central Bank of Egypt (CBE) and are governed by the Law of The Central Bank, The Banking Sector and Money Law No. 88 of 2003 (The Banking Law). The Banking Law mandates the CBE to "work on realizing price stability and banking system soundness, within the context of the general economic policy of the State."[3] The CBE adopted a few years ago a banking sector reform plan built around four pillars: "(1) privatization and consolidation of the banking sector, (2) financial and managerial restructuring of State-Owned Banks, (3) addressing the problems of non-performing loans, and (4) upgrading the CBE supervision sector".[4]

Accordingly, the CBE has focused over the past years on reducing the number of banks[5] currently operating in Egypt in order to create strong banks with higher capital.[6] Thus, for the past ten years, the CBE has not issued any new banking licenses.[7] In 2005, the CBE adopted a three-year plan to restructure the State-Owned Banks in order to "reform all departments and technological systems".[8]

There are 40 banks operating in Egypt with approximately 3,300 branches (See Table 1) in addition to the Arab International Bank and Nasser Bank – which were established under separate laws and are not registered with, nor supervised by, the CBE. There are also 27 representative offices of international banks.[9]

Table (1): Types of Banks in Egypt

Type of Banks	Number of Banks	Number of Branches
<u>Commercial Banks</u>		
• Public Sector Banks	3	837
• Private and Joint Venture Banks	27	1,145
• Off-Shore Banks	7	63
<u>Specialized Banks</u>		
• Industrial Development Bank of Egypt	1	14
• Egyptian Arab Land Bank	1	28
• Principal Bank for Development and Agricultural Credit	1	1,210
Total	**40**	**3,297**

All non-banking financial services and the respective regulatory authorities were brought under the oversight of the MoI in 2004. Non-banking financial activities

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[3] Article five of the Banking Law.
[4] Central Bank of Egypt – Annual Report 2007/2008. p.14
[5] The number of banks as of June 2008 is 40 banks compared to 54 banks as of December 2004 according to CBE's Annual Report 2007/2008. p. C
[6] Central Bank of Egypt – Annual Report 2007/2008. p. C
[7] Since 1987, due to its WTO commitments, Egypt no longer limits foreign participation in local banks.http://www.ustr.gov/Document_Library/Reports_Publications/2007/2007_NTE_Report/Section_Index.html (p. 188).
[8] Central Bank of Egypt – Annual Report 2007/2008. p. C. The three year plan ended in 2008 and e the results of the plan are to be published in CBE's annual report to be published by the end of August 2009.
[9] Central Bank of Egypt. Annual Report FY 2007/2008. p. 106

include Investment Advisory Services, Brokerage Activities and Portfolio Management, Insurance and Re-Insurance Activities, Retirement Benefit Schemes, Factoring, Leasing and Mortgage Finance.[10] Each of these activities was supervised by a different supervisory body under the MoI. Prior to the enactment of the Single Regulator Law, insurance, mortgage and capital market were supervised by the Egyptian Insurance Supervisory Authority (EISA), the Mortgage Authority, the Capital Market Authority (CMA) respectively. Other non-bank financial activities – i.e. financial leasing, factoring and securitization – were supervised by GAFI.

As of July 2009, the separate supervisory bodies under the MoI – i.e. The Mortgage Authority, the Capital Market Authority and the Egyptian Insurance Supervisory Authority - will be replaced by the Single Regulator mandated by the Single Regulator Law to "regulate and supervise the non-banking financial markets and instruments including, but not limited to, capital markets, commodity and futures markets, insurance activities, mortgage finance, financial leasing, factoring and securitization"[11]. The Single Regulator is also mandated to apply the provisions of the different laws governing each type of NBFI (e.g. Capital Markets Law, Insurance Law, Mortgage Finance Law, Financial Leasing Law …etc).[12]

Impact of the Global Financial Crisis

The global financial crisis has so far had a minimal effect on the microfinance sector in the MENA region.[13] Nevertheless, the financial crisis affected the economies in the region. A noticed impact was the decline of the growth rate in the MENA region countries from 5.5 percent in 2008 to 3.3 percent in 2009.[14] In Egypt, the GDP growth rate declined from 7.1 percent in FY 2007/2008 to 5.8 percent in the first quarter and 4.1 percent in the second quarter of FY 2008/2009[15] and is expected to further decline to 4.0 percent in FY 2009/2010.[16] Such a decline is attributed to the slow growth rate in the manufacturing sector and decreases in exports[17] and Suez Canal revenue[18]. On the other hand, the annual inflation rate decreased from 23.6 percent in August 2008 to 13.5 percent in February 2009[19] and the GDP (at constant prices) grew by 5.0 percent during FY 2008/2009.[20]

The total investments in July-December of FY 2008/2009 grew by 13.8 percent compared to the same period in the previous year and the Net Foreign Direct Investment dropped from 4.8 billion USD during the second quarter of FY 2007/2008 to 2.3 billion in the same period of FY 2008/2009. On the other hand, the balance of payments witnessed a deficit of 0.5 billion USD during the first half of FY

[10] http://www.investment.gov.eg/MOI_Portal/en-GB/NBFS/Read+More+about+NBFS/
[11] Article Two of the Single Regulator Law.
[12] Article Three of the Single Regulator Law. All laws are found on www.investment.gov.eg
[13] CGAP publications, 2009 Financial Crisis Snapshot Middle East & North Africa.
[14] Q&A on the Global Financial Crisis and MENA – April 23, 2009. http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22153569~pagePK:34370~piPK:34424~theSitePK:4607,00.html
[15] CBE – Monthly Statistical Bulletin – April 2009 (www.cbe.org.eg)
[16] Ministry of Economic Development. The Economic and Social Plan for FY 2009/2010.
[17] CBE – Monthly Statistical Bulletin – April 2009 (www.cbe.org.eg) Suez Canal revenue
[18] Suez Canal revenue decreased by 26 percent in February 2009 compared to February 2008. IDSC – Economic and Social Indicators Monthly Bulletin – April 2009.
[19] Ibid.
[20] CBE – Monthly Statistical Bulletin – April 2009 (www.cbe.org.eg)

2008/2009[21]. Banks' aggregate financial position of banks fell by 1.3 percent in July-February of FY 2008/2009. The market capitalization was 813.3 billion EGP and the price/earning ratio of the most active companies was 15.73 which dropped to 348.4 billion EGP and 10.37 respectively in February 2009[22].

The export growth rate was affected and the total export as a percent of GDP is expected to drop from 33 percent in 2007/2008 to 27 percent in 2008/2009[23]. The total number of job vacancies posted in the national newspapers dropped by 35.6 percent in January-March 2009 compared to the same period in 2008[24], however the unemployment rate decreased to 8.84 percent in the last quarter of 2008 compared to 9.12 percent in the last quarter of 2007[25].

The Government of Egypt (GoE) responded to the financial crisis impact through a number of initiatives including[26]:

- Monetary Policy – maintaining the local liquidity growth rate at 15 percent, credit facilities to family and private sector growth rate at 10 percent, and decrease inflation rate
- Financial Policy – maintaining the allocations covering the wages, compensations and social development programs at 55 percent of the total public expenditure
- Export – Allocate 2.1 billion EGP to support exports
- Stimulus package of 15 billion EGP to support infrastructure projects, local development programs and encourage local private sector to increase their investments to alleviate the projected decrease in FDI
- Injection of investments exceeding 200 billion EGP to achieve the government plan

[21] Ibid.
[22] Ibid.
[23] Ministry of Economic Development. The Economic and Social Plan for FY 2009/2010.
[24] IDSC – Trends of Demand in the Labor Market – April 2009.
[25] www.capmas.gov.eg
[26] Ministry of Economic Development. The Economic and Social Plan for FY 2009/2010

SECTION III: OVERVIEW OF THE MICROFINANCE SECTOR IN EGYPT

Key Players and Supporting Infrastructure

Microfinance services in Egypt started twenty years ago with two microfinance programs launched by the National Bank of Development (NBD) and the Alexandria Business Association (ABA). According to the MF Programs Map (MAP), the estimated number of active clients as of June 30, 2008 exceeded 1.2 million borrowers[27] (of which 60 percent were female clients) offered by more than 360 MF programs operated by NGOs and Banks with a total outstanding portfolio in excess of EGP 1.9 billion (approximately USD 340 million[28]). The largest 15 MF programs serve approximately 86 percent of the total number of active clients. The MAP estimates the penetration rate of microcredit to the total population under $2/day to be 3.9 percent and to the population under the National Poverty Line[29] to be 5.7 percent.

There are two prevailing microcredit products offered in the Egyptian market: individual loans to existing micro and small enterprises (MSEs) and solidarity group lending offered mainly to economically active poor women. Approximately 49.7 percent and 47.3 percent of the total active clients received individual loans and group loans, respectively. The penetration rate of individual loans to eligible MSEs is estimated at 24.1 percent, while the penetration rate of group loans to eligible poor women is estimated ate 5.1 percent. Other products offered on a significantly smaller scale include consumer loans, education loans, agricultural loans, computer loans[30] and microinsurance.[31]

The estimated number of NGO-MFIs exceeds 355, serving approximately 82 percent of all microcredit clients. NGOs offer all types of products mentioned above, with the prevailing products being group loans (interest rate ranges between 24 and 26 percent) and individual loans (interest rate ranges between 13.5 percent and 16 percent[32]). Two state-owned banks – BdC and BM – and two private-sector banks – BoA and NBD – offer direct micro-lending with a combined market share of 18 percent of the total active clients as of June 30, 2008. The four banks offer individual loans to existing enterprises at a 16 percent interest rate. NBD is the only bank offering education microloans at the same interest rate. The terms and conditions of the individual loan offered by banks and NGOs are very similar.[33]

Type of MFIs and Respective Regulations

The main providers of microcredit in Egypt are NGOs and Banks. Recently, Service Companies started operating by acting as agents to banks. In addition, the National

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27 Excluding Nasser Bank's and PBDAC Bank's clients.
28 At an exchange rate of 5.6 EGP for one USD
29 According to the Poverty Assessment Update Report by World Bank and Ministry of Local Development, Egyptians who spent in 2005 less than EGP 1,423 on average per year are poor and those who spent between EGP 1,424 and EGP 1,854 on average per year are near poor. (footnote 3 on page iii). June 2007. In the Map, poor and near poor people were considered as those living under the National Poverty Line.
30 MF Programs Map in Egypt. Second Issue.
31 Some MFIs have recently offered microinsurance to their clients in cooperation with insurance companies.
32 Some small NGOs offer individual loans at 8 percent interest rate.
33 Microfinance Programs Map. Second Issue.

Postal Authority offers microsaving services. The following section assesses each type of institutional set-up and its respective regulation and supervisory authority.

NGOs. The vast majority of MF providers in Egypt are registered as Non-Governmental Organizations (associations or foundations), under the Associations and Non-Governmental Organizations Law No. 84 of 2002[34] (subsequently referred to as the NGO Law) and supervised by the MSS. NGOs mostly operate in the governorates and/or districts in which they are established, but are allowed to extend their operations beyond these geographic limits through establishing branches. NGOs are permitted to engage in any development oriented activity except for activities expressly prohibited by the NGO Law.[35]

In terms of operations, NGO-MFIs can be divided in two categories. The first category of NGOs – known as Community Development Associations (CDAs) – consists of small NGOs operating on the village/district level and includes microcredit as one of several community development programs. This category of NGOs is characterized by a significantly small scale of outreach and operates modestly – not always employing international best practices. Most of these CDAs secure funding through small loans from the Social Fund for Development (SFD).

The second category consists of the "*specialized*" NGO-MFIs (which includes the largest MF providers in Egypt) mostly registered as business associations. This category of NGOs is characterized by the professional specialization in MF, strong boards with a business background, and the application of internationally recognized MF best practices.[36] They started their operations with large donor grants which were deposited in a commercial bank against which they lend from a single consolidated account in their own name (to which borrowers' repayments are also directed). Many of these NGOs currently have access to commercial funding through bank loans. However, this access is somewhat limited and a number of these NGOs expressed a need to transform into a formal financial institution in order to address the difficulty of accessing commercial funding issue along with other constraints/issues discussed in Section IV.

Banks. Banks engage in MF either through direct microcredit or through providing loans to NGO-MFIs. The vast majority of banks in Egypt do not engage in direct microcredit. There are currently four banks providing direct microcredit programs: two public banks (Banque du Caire and Banque Misr[37]) and two private banks (Bank of Alexandria and National Bank for Development). The total market share of the four banks is approximately 15.6 percent of the total number of served clients as of June 30, 2008.[38] In addition, there are two specialized banks that provide credit on a micro-level, namely PBDAC and Nasser bank. Both banks do not publish reports that show types of products or served clients, and have been recently undergoing a restructuring process.

[34] The NGO law defines two different types of institutions: associations and civil foundations with some differences between the two legal forms (e.g. different incorporation and governance procedures and requirements). For purposes of this report the term "NGO" is used to refer to both forms.
[35] Article 11 of the 2002 NGO Law prohibited NGOs from engaging in all military and political activities, activities that violate public order or threaten the national solidarity and activities whose sole purpose is to generate profits not intended to be used for achieving the NGO's objectives.
[36] National Strategy for Microfinance. P. 11
[37] A microloan is usually granted against a promissory note along other requirements such as business license proof, rent contract and other KYC procedures (Interview with Dr. Akmal Bassili, BM)
[38] Microfinance Programs Map. Second Issue.

With regards to lending to NGOs, some banks have started recently extending loans to NGO-MFIs against guarantee lines / collateral. Among the banks offering wholesale finance to NGO-MFIs are banks that do not offer direct microcredit (e.g. NSGB, BNP Paribas[39]) and banks that operate MF programs (e.g. BoA). It is worth noting that CBE's approval is required for lending in EGP against a guarantee in foreign currency.

Companies. The MF service companies' model emerged in Egypt two years ago with the establishment of Reefy – the Microfinance Enterprise Service Company – a joint-stock company established with the objective of acting as an agent for private sector banks interested in operating indirectly in the provision of MF services.[40] Reefy signed its first agreement with the Commercial International Bank (CIB), whereby CIB provided funding while Reefy handled all operational aspects, including selection of the clients, loan disbursement and follow up on collection[41]. A second company – Tanmeyah Microenterprise Services known as "Tanmeyah" – was established in early 2009 under the same model and has not yet launched operations.[42] Reefy and Tanmeyah were established under company laws as service companies and are currently supervised by GAFI.

The service model emerged due to the absence of an explicit legal framework that allows the establishment of non-banking companies to provide credit. Although lending is not considered a "banking activity",[43] commercial companies in Egypt are prohibited from directly providing microcredit. This is expected to change after the recent Parliament's ratification of the new Single Regulator Law which mandates the Single Regulator to issue executive rules[44] to license and regulate all non-banking financial activities. Reefy and Tanmeyah intend to engage in microcredit, along with other non-banking financial services, once commercial microcredit is permitted under the Single Regulator Law and the related draft General Rules for Microfinance Companies.

The National Postal Authority (NPA)[45] was established in 1865 and is regulated by law No. 19 of 1982. It offers many services categorized under four main types: governmental public services, social services, postal services and financial services. NPA has 3,669 offices all over Egypt, of which 2,841 are automated, serving 17.9 million depositors as of June 30, 2008. The number of remittances in FY 2007/2008 exceeded 2.5 million transactions, totaling EGP 2.5 billion.

Among the financial services offered by NPA are:

- Postal Savings Books: minimum opening balance is EGP 10

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[39] A wholesale Loan granted to an NGO is usually against a deposit used as collateral and a promissory note for the leveraged part of the loan. This depends on the quality of the NGO's loan portfolio and the bank's due diligence procedures. (Interview with Hesham Abbas, BNP Paribas).
[40] Microfinance Policy Framework: Regulatory and Supervisory Options for Egyptian Microfinance. April 2008.
[41] MSME Opportunity for the Commercial International Bank, 2007
[42] Interview with Tanmeya Management Team.
[43] Article 31 of the Banking Law defines a banking activity *as "any activity comprising, basically and habitually, the acceptance of deposits, the obtainment of finance, and the investment of these funds in providing fiancé and credit facilities and contributing to the capital of companies, and all that is considered by banking tradition as bank business*".
[44] These rules come under laws in the legislation hierarchy thus can easily be amended and do not need the Parliament's ratification which is a lengthy procedure.
[45] http://www.egyptpost.org

- Daily Interest Accounts: Golden accounts for amounts larger than 10,000 EGP and Silver accounts for amounts less than 10,000 EGP
- Postal Investment Books: minimum opening balance is 100 EGP
- Postal Remittances

Industry Stakeholders

SFD. The Social Fund for Development was established in 1991[46] as a quasi-governmental organization to act as a social safety net supporting the economic reform programs implemented by the government of Egypt. SFD aims to support the development of small and medium enterprises as well as microenterprises to increase families' income through both financial and non-financial services. In addition, SFD implements a number of infrastructure programs and human resources development programs. SFD comprises many sectors[47] including the Small Enterprise Development Organization (SEDO) and the Microfinance Sector (MFS). SEDO offers loans to small and medium enterprises through banks, while MFS offers credit to microenterprises through NGOs[48]. As of December 31' 2008, SFD/MFS financed 415 NGOs serving 195,645 active clients.[49]

The Small Enterprise Development Law (No. 141 of 2004) (subsequently referred to as Micro and Small Enterprise (MSE) Law) was the first law in Egypt designated to the MSE sector. The law defined: (1) Micro and Small Enterprises, (2) the role of SFD in developing this sector, and (3) the facilities granted to MSEs.[50] The definition of MSEs in the MSE law focused on the paid capital as the main criterion for defining the enterprise as per the table below however, the definition does not include informal/unregistered enterprises.

Table (2): Definition of Micro and Small Enterprises in the MSE Law

Size of Enterprise	Paid Capital	Number of Employees
Micro	Less than EGP 50,000	Not applicable
Small	EGP 50,000 to EGP 1 Million	Not more than 50

The MSE Law mandated the SFD as the body in charge of planning, coordinating and promoting the creation of MSEs in Egypt, in addition to assisting them in obtaining required financial and non-financial services (Article 2). Thus, the law assigned a "coordination" role for the SFD and not a supervisory or authoritative role. Therefore, SFD is authorized to set a framework for the development of the MSE sector, a master plan to coordinate the activities of the different players, and a mechanism to monitor the activities of the different stakeholders[51].

According to the MSE Law, eligible MSEs – according to the aforementioned definition – can register at SFD and obtain a "National ID Number" in order to benefit from the privileges granted by the law. Such privileges include:

[46] SFD was established by the Presidential Decree number 40 of 1991.
[47] Sectors are large departments or divisions of SFD
[48] http://www.sfdegypt.org
[49] Email by Nevine Badr El Din – Operations Manager at SFD/MFS – April 16th, 2009
[50] Bahaa El Din, Ziad. Issue Paper No.2: Small Enterprise Development Law. July 2004
[51] Ibid

- <u>One-Stop Shop:</u> SFD runs one-stop shops in the different governorates, where representatives of the different governmental bodies assist MSEs in completing registration procedures. The law established an EGP 200 registration fee ceiling for microenterprises and an EGP 500 registration fee ceiling for small enterprises[52]

- <u>Local Funds:</u> Establishing local funds at the governorate level using multiple sources of financing[53] to extend financial services through NGOs to MSEs[54]

- <u>Credit Guarantees:</u> SFD's credit guarantees facilitating MSE access to finance[55]

- <u>Land:</u> Allocation of at least 10 percent of the lands allocated by the government for investment zones with utilities connected to small enterprises[56]

- <u>Public Contracts:</u> At least 10 percent of the public work agreements are to be granted to MSEs[57]

- <u>Technical Assistance:</u> SFD is entitled to provide non-financial services to MSEs, including information on investment opportunities, development of business plans, consultation, access to modern technology, and marketing services.[58]

It is worth noting that the informal sector – constituting a considerable percentage of the current beneficiaries of MF services in Egypt[59] – will not benefit from the facilities granted to MSEs. However, the law could be seen as a means of encouraging the formalization of the informal sector in order to increase its ability to access formal financial institutions.[60]

EMFN.[61] In 2006, the Egyptian Microfinance Network (EMFN) was established as an association under the NGO Law - with the contributions of thirteen founding members (twelve of the largest MFIs in Egypt and the SFD). The establishment of the network came as a result of a recommendation in the National Strategy for Microfinance to establish an entity to coordinate the efforts of stakeholders, particularly MFIs, in order to play a role in the development of the Egyptian MF sector through the promotion of MF best practices. Additionally, the founding members agreed on the critical importance of creating an organization authorized to represent MFI interests and advocate for a more conducive policy environment, not only for the growth of the MF sector, but also for its integration into the formal financial sector.

EMFN drew on the National Strategy recommendations in designing its activities: (i) working with its members on improving the MF transparency and reporting standards, (ii) launching policy advocacy initiatives to improve the regulatory environment, (iii) promoting best practices on social performance and consumer protection, (iv) conducting periodic studies to provide an information infrastructure to industry

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[52] SME Law, articles 3, article 10 and article 13.
[53] SFD's own resources, donors' grants, donations, state budget, and popular councils.
[54] SME Law, article 5
[55] SME law, article 9
[56] SME law, article 10
[57] SME Law, article 12
[58] SME Law, article 14
[59] Literature estimates that 82 percent of the informal sector in Egypt are MSEs (Refaat)
[60] Bahaa El Din, Ziad. Issue Paper No.2: Small Enterprise Development Law. July 2004
[61] EMFN Business Plan

stakeholders, and (v) establishing a credit information sharing system. To date, EMFN (with the technical assistance of the USAID-EMF Project) launched the first MF policy forum in Egypt, developed the first MF Programs Map in Egypt, conducted the first MFI salary and compensation survey in Egypt, and conducted training sessions to MFI boards and external/internal auditors on "MF Audit Guidelines" and "Basics of Financial Reporting".

Donors.[62] The donors implementing microfinance projects / programs focused over the past years on creating strong MF institutions operating according to best practices of MF (See Annex 4 - Donors Programs in Egypt). However, MF programs were geographically focused, creating MFI geographic monopolies which until very recently prevented competition that could have led to more innovative and diversified products.

Donors' assistance focused on both financial and technical assistance to many NGOs – and a few banks – to support the establishment of strong, sustainable MF programs. However the vast majority of MFIs have remained dependent on donors for fulfilling their technical assistance needs, particularly staff training and product development. Donors have only recently focused on supporting the infrastructure needed for a sustainable MF industry (e.g. technical assistance providers, software developers, information centers, networks and wholesale financing mechanisms).

In general, there has been an overall lack of donor coordination, however with the development of the MF National Strategy, donors have started supporting the implementation of many recommendations listed in the strategy's action plan and have increased their coordination through the SME Sub-Donor Group.

Credit Guarantee Organizations. Some credit guarantee initiatives were launched to serve the MF industry in Egypt. Examples include the Credit Guarantee Company for Small and Medium Scale Enterprises (CGC) and the Cooperative Insurance Society for Small Enterprises (CIS).[63] Yet, both organizations have not achieved significant success in encouraging banks to finance NGOs.[64] In addition, some donor agencies such as KfW, USAID and AFD have launched or are considering launching credit guarantee programs.

CGC was established in 1981 by nine banks and an insurance company with the objective of providing a partial guarantee of the loans given to small and medium enterprises (which usually have insufficient collateral to qualify for commercial bank loans). So far, CGC signed cooperation agreements with 30 banks in Egypt. With regards to MF, CGC – in cooperation with USAID – implemented a program to open 30 lending units through banks and NGOs operating MF programs. CGC's role in this program is to: (i) support the start up and operational costs of the lending units until they reach the breakeven point, (ii) provide the needed technical assistance to unit staff, and (iii) offer a 100 percent guarantee of the microloans extended by these units.[65]

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[62] Abdel Malek, Talaat. Issue Paper No. 6: Guidelines for Donor Support to Microfinance In Egypt. April 2005. P. 5-8
[63] Small and Medium Enterprise Development Project. Research Study on Credit and Credit Guarantees: Executive Summary. November 2005.
[64] The National Strategy for Microfinance In Egypt. . P. 12
[65] http://www.cgcegypt.com

SFD established CIS in 1999 under the Insurance Supervision and Regulation Law (Law 10 of 1981)[66] for the purpose of offering insurance schemes to clients "with appropriate and cost-effective terms and conditions", as well as credit insurance programs among which is insurance of microloans offered by NGO-MFIs.[67] In order to benefit from CIS services, the client must become a member through buying shares in the cooperative (100 EGP/share). The client can then benefit from an 80 percent guarantee of the loan value.[68]

Credit Bureau. Until 2005, the only credit bureau serving banks in Egypt was owned and operated by CBE. In 2005, I-Score – the first private sector credit bureau – was established by 25 banks and SFD with an issued capital of 30 million EGP with the purpose of "providing information services and credit classification".[69] Private Sector Credit Bureaus are licensed by CBE according to the Regulations of Credit Bureaus and Information and Data Sharing Systems.[70] Until 31 March of 2009, all banks (except Nasser Bank), mortgage companies, financial leasing companies and SEDO have started reporting to I-Score. Both NBD and BdC have submitted information on their microfinance programs. Mobile network operators and retailers will be targeted in the near future.[71]

The regulation of private sector credit bureaus mandates CBE to license private sector companies to offer credit information and scoring services on the clients of banks, mortgage companies, financial leasing companies, providers of services and goods, insurance companies, SFD, MFIs, and any other type of organization – referred to in the regulation as data providers – having data serving the purpose of the credit bureau. A data provider must have the written consent of its client to submit such client's data to the credit bureau. The regulations include strict client privacy protections applicable to both the credit bureau and data providers. Sanctions of fines and imprisonment are articulated with regards to non-compliance with the data privacy rules. In addition, the regulations list many conditions to protect consumer rights, including the client's right to contest the accuracy of such client's credit information.[72]

With regards to a specialized MF credit bureau, EMFN secured funding through SFD in 2006 to establish an information sharing system (ISS) on the client history of its member MFIs with the technical assistance of PlaNet Finance. PlaNet Finance has completed the legal assessment for the establishment of the system. If this ISS is established, it is expected to exchange information with I-Score. However, there is currently some discussion of having NGO-MFIs report directly to I-Score under a reasonable price-agreement.[73]

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[66] http://www.cis-se.com
[67] Ibid.
[68] www.sfdegypt.org
[69] Http://www.i-score.com.eg
[70] http://www.cbe.org.eg
[71] Presentation by Mohamed Refaat – Managing Director of I-Score - on March 31st, 2009 at IFC
[72] The client has the right to complain about the accuracy of the data in his/her credit report within 15 days, starting on the date of receiving the report, using the complain format and attaching the documents supporting his/her complaint. The credit bureau must investigate the complaint and respond to the client within 10 days, taking necessary corrective actions (executive regulations of credit bureaus - http://www.cbe.org.eg/public/new_credit_bureau.pdf).
[73] Ibid

National Strategy for Microfinance

In 2004, CBE (through the Egyptian Banking Institute (EBI) and with the support of USAID, UNDP and KfW) led a project for the development of the National Strategy for MF in Egypt. The objective of the strategy was "to develop, within the next five years, a microfinance industry in which sustainable financial services for lower market segments are integrated into the overall development of a broad, inclusive, and diverse financial sector ... through adopting a Sector Development Approach".[74] The project lasted for almost two years, and was based on a consultative process with different stakeholders through seven roundtable discussions on key issues affecting the MF industry in Egypt. Furthermore, it included two study tours to Uganda and South Africa, and desk research on the status of the MF industry and its needs for future growth.

The National Strategy was launched in December of 2005 and identified several interventions in order to foster the sustainable growth and development of the MF industry in Egypt. In addition, the document included a five year action plan identifying the recommended actions for each intervention, the primary responsible entity for implementation and the secondary entities that should be engaged, in addition to the priority level and the proposed time table for implementation. The recommendations of the National Strategy were divided into three levels: (i) the micro level, aiming at improving the institutional capacity of MFIs to reach out to more clients, (ii) the meso level, concerned with the creation of a supporting infrastructure of information, technical assistance providers and financing mechanisms, and (iii) the macro level, focused on the needed policy and regulatory interventions to create an enabling environment for MF growth. The National Strategy was developed in coordination with SFD who decided to include the recommendations in its comprehensive strategy for the development of the MSE sector in Egypt.[75]

Among the implemented recommendations are the following key initiatives[76]:

- The establishment of the Egyptian Microfinance Network by 12 NGO-MFIs and SFD to represent the interests of the industry and support its growth and development;

- The establishment of the first MF policy forum by EMFN – with the technical assistance of USAID – to maintain a policy dialogue with the government to enhance the regulatory environment affecting MF industry;

- The development of the first MF Programs Map in Egypt and the first salary survey of staff working in MF Programs in Egypt by EMFN with the technical support of USAID;

- The establishment of credit guarantee mechanisms to facilitate the access of NGO-MFIs to wholesale lending by banks;

[74] The National Strategy for Microfinance in Egypt, 2005.
[75] Ibid.
[76] Update on Implementing Recommendations of National Strategy for Microfinance. Presentation by Nevine Badr Eldin (Operations Manager – SFD/MFS) at the Launch Event of the National Microfinance Impact Survey. 01 June 2008.

- The pilot initiative of establishing a credit information sharing system among the member-MFIs of EMFN. This information sharing system will eventually share information with the private credit bureau in Egypt (I-Score);

- The implementation of several training and technical assistance programs to support the institutional development of MFIs with the support of donors (e.g. USAID, KfW, and EU);

SECTION IV: CURRENT LEGAL AND REGULATORY FRAMEWORK

Under Egyptian law there is no explicit legal requirement to obtain permission to lend. However, the only two legal entities currently providing micro-lending services are banks and NGOs[77]. Only banks are permitted to mobilize deposits and offer other banking activities as defined by the Banking Law. While there is no legal definition for microfinance, the MSE Law defines both micro and small enterprises (see Section II). There are different laws related to the MF industry in Egypt: the MFIs' respective laws, namely the NGO Law, the Banking Law, and the Single Regulator Law (and the draft General Rules for MFCs to be issued) in addition to other relevant laws that affect the industry. This section describes the legal and regulatory environment related to MFIs in Egypt as well as relevant cross-cutting legal issues affecting the industry growth and performance.

Regulatory Framework for MF Providers in Egypt

NGOs. According to the NGO law, an NGO can be registered as an "association" or a "foundation". To register as an association, an NGO must: (i) be incorporated by at least ten individuals and/or legal entities, (ii) managed by a board of directors of five to fifteen members, and (iii) the number of Egyptian members of the board of directors should be equal to or greater than the number of non-Egyptian members of the NGO. A foundation can be registered by one or more individual and/or legal entity, who wishes to allocate funds, moveable or fixed assets to the benefit of the foundation and for non-profit purposes. The foundation is managed by a board of trustees of three to fifteen members of any nationality. Board directors and trustees of an NGO are prohibited from accepting any compensation for their work in the NGO. There are no restrictions on the participation of non-Egyptians in NGOs and the MSS may grant a foreign NGO permission to operate in Egypt based on that NGO's agreement with the Egyptian Foreign Affairs Ministry.[78]

The NGO law was issued to govern NGOs that provide community development services; thus, the law does not differentiate between NGO-MFIs and any other NGO implementing community service programs. Although they enjoy some privileges such as exemptions from taxes (including custom duties), the large NGO-MFIs are confronting constraints with their plans for rapid expansion of MF services[79] including:

- Governance
    - The template of the associations and foundations bylaws – annexed to the NGO Law - requires the NGO's treasurer to sign any check issued by the NGO, which is not a practical system for the NGO-MFIs. In an interview with MSS officials,[80] the research team was informed that the treasurer can delegate this authority to other staff members of the NGO through an official request to that effect to MSS, provided that the treasurer remains personally liable for all transactions.

[77] Extending microcredit to the poor is considered an economic development activity.
[78] Article 1 of the NGO Law.
[79] Chemonics International Inc. Microfinance Policy Forum: Second Meeting Report. P. 3-5
[80] May 5th, 2009.

— According to the law, the Board of Directors' tenure is six years, however the number of an individual director's tenure is not limited (i.e. a board member can maintain his membership in the board for an unlimited period of time).

- Financial Reporting and Audit Requirements:

The NGO law requires simple reporting on NGO operations limited to a manual book-keeping of its expenses and revenues. Such requirements are not compliant with the internationally recognized reporting standards required for MFIs, and do not enable the MSS staff to appropriately supervise and regulate the NGO-MFI sector.

— Furthermore, the supervisory framework of NGOs is silent on any MF-specific audit and control requirements for NGO-MFIs. The MSS – given its social mandate – does not have the capacity to supervise the financial operations of the specialized NGO-MFIs.

Banks. The minimum capital requirement for Egyptian banks is EGP 500 million (approximately USD 89 million) or USD 50 millions or its equivalent in free currency[81] for branches of foreign banks. There are no legal or regulatory obstacles to direct lending by licensed banks to micro-entrepreneurs or poor clients. However, in addition to outreach constraints and lack of experience or interest in microfinance,[82] the Banking Law and CBE's policies are silent with regards to microfinance and therefore do not provide incentives for banks to engage in the provision and/or expansion of their microcredit programs. Moreover, CBE's loan classification and provisioning requirements limit a bank's ability to grant unsecured loans – a common feature of micro-loans where borrowers have little or no physical collateral.

Recently, CBE issued a decree to encourage bank lending to small and medium enterprises by exempting bank loans to SMEs from the loan loss reserve requirement (14 percent).[83] However, the decree defines SMEs as enterprises with an annual sales volume between one million and 20 million EGP, and a paid-up capital between 250 thousand and five million EGP. This definition excludes the vast majority MFI clients.

Microfinance Companies. The new Single Regulator Law and the proposed draft of the General Rules for Microfinance Companies will facilitate commercial micro-lending. With the exception of deposit-taking, foreign exchange and remittance services, the proposed draft General Rules for Microfinance Companies allows MFCs, "directly or indirectly as agents, to provide direct credit to individuals, households, entrepreneurs and companies with or without tangible collateral". MFCs are also allowed to provide other non-banking financial services after complying with the conditions and requirements of the relevant laws (e.g. insurance law in case of microinsurance, leasing law in case of micro-leasing). Under the draft General Rules, there are no restrictions to opening, relocating or closing branches for MFCs. The draft Rules also sets a minimum capital requirement, loan loss provisions[84] and reporting requirements. MFCs should

[81] Currencies listed in the forex market
[82] Interview with Dr. Akmal Bassili, BM, March 16, 2009, interview with Mr. Hesham Abbas, BNP Paribas, March 18, 2009 and interview with Mr. Ahmed Elbardai, Reefy, March 19, 2009.
[83] CBE's Board Decree No. 2408/2008 with regards to "Encouraging Banks' Financing of Small and Medium Enterprises.
[84] Although MFCs are not allowed to accept deposits from the public the justification behind this prudential regulation, according to the MOI, is to protect the interests of the MFCs' creditors and shareholders (Interview with MoI and GAFI).

also preserve the rights and privacy of consumers as stated by the draft General Rules and the Consumer Protection Law and must provide periodical credit information to the Credit Bureau.

Cooperatives. Cooperatives are registered and supervised by MSS with basic reporting requirements.[85] In addition to individuals, other cooperatives and NGOs are allowed to own shares in a cooperative. With the exception of public entities, any member of a cooperative can not own more than 20 percent of its shares. A cooperative can only lend to its members and all loans should be used for the purpose of productive activities similar to the cooperative's objectives and within its geographic area. On the other hand, a cooperative is allowed to accept deposits according to its internal bylaws, but it is not clear whether cooperatives are allowed to accept deposits from the public or mobilize/intermediate these deposits.[86] Currently there is no information about any cooperative engaging in microfinance or accepting deposits from the public.

Interest Rate Cap

With the exception of banks,[87] the Civil Code sets an interest rate cap of seven percent on all civil and commercial transactions.[88] Most NGOs are currently charging interest at a much higher rate, which may constitute a violation of the Civil Code. If challenged in court, NGO interest rates run a risk of being deemed illegal. This interest rate cap also applies to commercial companies and consequently to future MFCs when registered according to the proposed General Rules for Microfinance Companies under the new Single Regulator Law. To date however, there have been no known legal challenges to interest rates.

Tax Treatment

NGOs are exempted from income tax, registration fees, customs duties, real estate taxes and stamp duties imposed on all contracts (e.g. mortgage). [89] In contrast, income tax on all commercial companies and banks is a flat 20 percent on net profit with no taxes on dividends. Moreover, lending services are exempted from sales tax but subject to stamp duties.

Credit Bureau

Under the Executive Regulations of the Banking Law, banks are required to share all finance and credit facilities granted to their clients through an online registration system linked with the central database at CBE for all loans exceeding one million EGP extended to companies. With the establishment of the private credit bureau (I-Score) (see Section III), banks as well as all non-banking financial institutions must report (i) all credit facilities made to individuals and (ii) credit facilities less than one million EGP made to companies.[90]

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[85] The Cooperatives Law no. 317 of 1956.
[86] Article 4 of the Cooperatives Executive List allows cooperatives to use up to 70 percent of deposits that have maturity dates of more than one month.
[87] Article 40 of the Banking Law allowed all banks to charge interest freely.
[88] The Civil Code gave parties the right to agree on an interest rate provided that it does not exceed 7%.
[89] Article 13 of NGO Law.
[90] Meeting with I-score – March 31st 2009.

NGOs engaged in micro-lending are not part of either one of the credit bureau systems mentioned above. On one hand, the legal status of the NGO-MFIs excludes them from being part of CBE's credit database. On the other hand, the cost of credit reports issued by I-Score is perceived so far by the large NGO-MFIs in Egypt to be high relative to the size of microloans made by NGO-MFIs.[91] The pilot project of the information sharing system established at EMFN plans to integrate with I-Score in order to create a reliable and comprehensive credit bureau system with a reasonable cost.

Under the draft General Rules for Microfinance Companies, all MFCs are required to give periodic credit information to the Credit Bureau according to the Bureau rules and regulations. MFCs are also prohibited from granting any loan to a client before asking for that client's credit report.

Access to Funding

Foreign Investment. Other than the requirement to obtain a security clearance,[92] there are no restrictions on foreign investment in financial companies. Moreover, under the Egyptian Companies Law, a limited liability company[93] must be managed by at least one Egyptian in addition to any number of non-Egyptians.[94] This management requirement does not apply to joint-stock companies[95] whose members of the board may be of any nationality.

While permitted to receive donations from third parties in Egypt, NGOs are not allowed to receive funds from abroad, whether from foreign or Egyptian sources, without the permission of the Minister of Social Solidarity.[96]

Commercial Loans. The regulatory framework of NGOs does not encourage banks to provide commercial loans to NGOs unless a guarantee is available. This is due to several reasons: the absence of sufficient knowledge among banks on microfinance as an industry in general and the NGO-MFIs operations in particular, banks do not have access to sufficient information that would help them assess the performance of NGO-MFIs[97] – especially the banks' top and middle management, and many NGOs are declared as "*public benefit organizations*[98]" and therefore their assets cannot be practically pledged as collateral for bank loans.[99] In addition, any commercial bank must ask for the CBE's approval to lend an NGO in EGP against a guarantee in foreign currency.[100]

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[91] I-Score offered to charge around USD 1 per query.
[92] Security clearance for foreign investors may take up to six months but usually the registration and licensing procedures are completed while the security clearance is under process. There is always the risk of all previous approvals or licenses being revoked in case the foreign investor fails to get a security clearance.
[93] A limited liability company has a minimum capital requirement of 200 Egyptian Pounds (approximately USD 40)
[94] The Egyptian manager represents the company at the Commercial Register and is not necessarily granted any other authorities.
[95] A joint-stock company has a minimum capital requirement of 250,000 Egyptian Pounds (approximately USD 50,000)
[96] Article 17 of the NGO Law.
[97] Chemonics International Inc. Microfinance Policy Forum: Third Meeting Report. June 2007. P. 6
[98] According to Article 50 of NGO Law, legal recourse on the assets of Public Benefit NGOs is forbidden.
[99] Chemonics International Inc. Microfinance Policy Framework: Regulatory and Supervisory Options for Egyptian Microfinance. April 2008. P. 9
[100] A policy implemented by CBE to mitigate exchange/dollarization risk (Interview with BNP Paribas)

Consumer Protection

The 2006 Consumer Protection Law prohibits suppliers and service providers, including financial services, from giving any false or misleading information on the nature of their products and services. The law created a supervisory authority, known as the Consumer Protection Authority (CPA), and gave consumers the right to file complaints through fast, easy, and free procedures that guarantee the consumers' right to get a fair remedy or compensation for any damages.

Under the draft General Rule for Microfinance Companies and in addition to rules set by the Consumer Protection Law, MFCs are required to disclose the true cost of their services, adopt a system that deals with client complaints, avoid client over-indebtedness and preserve client privacy.

A recent study[101] on the extent of application of consumer protection principles by NGO-MFIs[102] shows that the majority of clients are aware of all the terms and conditions of the loan including repayment terms and interest rate calculations. The findings reflect also that some MFIs do not provide their clients with a copy of the loan agreement / contract.[103] This is due to the legal constraint imposed by the interest rate cap of seven percent under the Civil Code. It was not clear that the clients were made aware of the existence of a specific mechanism to report their complaints by the MFI staff; yet clients knew that in the unlikely event of having an un-addressed complaint by the loan officer, the following step was to complain to the branch manager.[104]

Deposit Insurance

Egypt does not have deposit insurance.

Transformation of NGO-MFIs

Despite the wide range of tax and duties exemptions, some major NGO-MFIs with successful microfinance businesses are considering transforming into MFCs. They find two significant benefits in transforming: (i) the ability to provide a variety of microfinance services besides microcredit, and (ii) the increased access to funding whether through debt[105] or equity. Other reasons for transforming are related to escaping current constraints of the NGO Law which (i) gives the same treatment for all NGOs regardless of their types of operations, (ii) sets restrictions on governance and management matters, and (iii) limits NGOs' ability to best utilize advanced computerized management and financial systems.[106] Moreover, NGOs are required to get the approval of the MSS before accepting any funding from abroad.

[101] A market research conducted in summer of 2008 by USAID-EMF Project in cooperation with Freedom From Hunger to identify consumer protection issues facing MF clients. The findings of the research were used to adapt the financial education training module developed by Global Financial Education Program.
[102] Due to limited time and financial resources, the study was conducted with clients of NGOs only.
[103] Chemonics International Inc. Consumer Protection Report: Market Research and Training Pilot Testing Findings - Egypt. September 2008.
[104] Ibid
[105] Most banks prefer dealing with commercial companies over NGOs mostly due to governance and control issues.
[106] The NGO law requires all NGOs to use and keep paper financial and administrative records officially stamped by the MSS.

No Egyptian Legislation, including the NGO Law, explicitly prohibits an NGO from owning shares in a commercial company or from exchanging its portfolio and/or other assets in return for shares in a commercial company. Moreover, there is no Legislation that explicitly prohibits foreign NGOs from owning shares in a for-profit company. In practice, in very few cases, NGOs were allowed to own shares or partner in a joint-stock company.[107] Such precedents give way for NGOs interested in doing the same. However, when discussing the transformation options with MSS, the initial response was that NGOs were allowed to sell their MF portfolios for cash only and were prohibited from exchanging their portfolios for equity shares in a commercial company.[108] The rationale behind this prohibition by MSS is: (i) the law prohibits NGOs from engaging in speculations (MSS considers shares trading to be a speculation), (ii) an NGO can experience mission drift once it transforms into a company especially if the NGO is not the major shareholder, and (iii) the distribution of profit and tax treatment of such profits given that NGOs are not-for-profit organizations.

Under the draft General Rules for Microfinance Companies, there is no prohibition for NGO-MFIs to transform. While regulation should not require a single legal form for microfinance providers, NGO-MFIs interested in transforming must be able to do so in order to compete with new Microfinance Companies on a level playing field. In addition, donor funded NGOs must also take into consideration any contractual constraints that would prevent transformation, including for example, donor approval.

With regards to tax treatment, according to current tax regulations, there would be no tax liability in an NGO transformation whether by exchanging the NGO's loan portfolio/assets for shares or cash. This does not include any transferred assets which were previously exempted from custom duties under the general exemptions granted to NGOs.[109] For example if an NGO wishes to transfer an asset that was previously exempted from taxes and custom duties, then these duties should be paid to the concerned authorities. This does not apply on assets owned by NGOs for more than five years.

[107] In 2009 a joint stock company for pilgrimage tourist services was incorporated with Nasser Bank (affiliated to MSS) and other NGOs (offering pilgrimage services) as shareholders. The food Bank – an Egyptian NGO – accepted an endowment in the form of commercial shares.
[108] Meeting with Ms. Aziza Youssef, Head of NGOs Department at MSS
[109] Article 13 of the NGOs Law.

SECTION V: CHALLENGES AND RECOMMENDATIONS

This section identifies the challenges / obstacles resulting from the legal and regulatory framework issues (discussed in section IV). In addition, a recommendation is developed to address each of the challenges.

Cross Cutting Challenges and Recommendations

Interest Rate Caps

The Civil Code, setting an interest rate cap of seven percent on all civil and commercial transactions, is potentially prohibitive to MFIs engaged in sustainability-oriented micro-lending due to the high cost of micro-loans compared to other loans. Under the Banking Law, Banks are the only entities exempted from this usury rule, which constitutes a legal risk for NGO-MFIs and MFCs if interest rates were challenged by their clients in the courts of law. This would also prevent NGO-MFIs and MFCs from being fully transparent with their clients to avoid the legal risk which violates consumer protection rules under both the Consumer Protection Law and the draft General Rules for Microfinance Companies.

It is recommended that a legal amendment is introduced to exempt microfinance operations from the interest rate cap of the civil code. Such an amendment is expected to take place for the NBFIs supervised by the Single Regulator. However, there is no evidence based on the field work conducted that shows that NGO-MFIs can also be exempted. Therefore, it is important that any exemption from interest rate caps also include NGO-MFIs in order to create a level playing field.

Credit Bureau

A comprehensive credit bureau will not only reduce cost and credit risk for NGO-MFIs and MFCs but it will also encourage banks to increase their involvement by providing direct microfinance services. However, the perception among many microcredit service providers is that the credit bureau system is currently not a viable option for MFIs due to its high cost compared to the value of a microloan. On the other hand, the management of the private credit bureau (I-Score) clearly stated that they are willing to work out a reasonable price structure suitable for the microcredit providers.

It is recommended that MoI, in coordination with donors should lend its efforts to reaching a reasonable pricing arrangement in order to create a comprehensive credit bureau that enhances credit information sharing between all banks, MFCs, NGO-MFIs and other financial institutions.

Commercial Funding

Access to funds, whether through debt or equity, is considered as one of the major challenges for NGO-MFIs. Any funding from abroad requires the prior approval of the MSS which is a lengthy and cumbersome process. This can be overcome through adopting a simplified and speedy approval process by the MSS. The MSS can put specific criteria to allow for quicker approval of funding through reputable international organizations and work with the MSS to pre-approve these institutions.

Moreover, there are two main constraints connected with loans from banks (i), credit facilities from banks require collateral not always available for either MFCs or NGOs, and (ii) banks must get the approval of the CBE to extend credit facilities in EGP against deposit guarantees in foreign currency.

In this regard, the CBE can prevent any delay by speeding its approval process and by issuing a decree to encourage the microfinance sector similar to the CBE's Board Decree No. 2408/2008 with regards to "Encouraging Banks' Financing of Small and Medium Enterprises”. This can be done directly by encouraging banks to downscale and provide microfinance services to their clients, or indirectly by encouraging banks to extend credit facilities to NGO-MFIs and MFCs based on the quality of the loan portfolios of these institutions and to benefit from their outreach and experience in microfinance.

Donor Coordination and Assistance

With the development of the General Rules for MFCs, donors' coordinated efforts are needed to support several interventions. A key intervention is supporting the capacity building at the level of policymakers and especially the new Single Regulator to sustain the sector's achievements and encourage new innovation aimed to advance the Egyptian microfinance sector.

Donors' support and assistance to NGOs interested in transformation is also very important, given the complexity and high cost of the transformation process. In this regard, donors may focus on the following issues:

1. Determining if funds can be secured to support qualified NGOs willing to transform to MFCs.

2. Reviewing and, if necessary, amending cooperative and grant agreements to determine if monies and assets received by an NGO can be used in the establishment or shareholdings of an MFC. Also, ensuring that the MFC meets the requirements of use of grant money and assets and that mission drift is mitigated.

3. Reviewing the ownership structure to determine if NGO will be majority or a minority owner as this might have consequences for governance and mission of MFC. Moreover, to ensure that granting of shares to Employee Stock Ownership Plan (ESOP)/ individuals is any was acceptable and proper.

4. Ensuring that the new MFC BOD is in line with donor agreements and to provide funding to support the improvement of MFCs' governance.

5. Providing technical assistance or funding to upgrade system, policies and procedures to meet MFC requirements in areas such as human resources management, management information systems, internal control and internal audit, financial reporting and financing strategies.

6. Providing technical assistance to MFIs to be well prepared to meet new competitors who might have an already well established strategy.

7. Supporting industry studies with MF supervisory unit and select pilot projects to develop recommended policy and procedures, information sharing and lessons learned.

8. Developing credit guarantee and wholesale funding mechanisms to assist current and potential MFI partners.

9. Supporting and encouraging transparency by (i) requiring that any future partner pre-agreement assessment should be conducted by MF rating agency to determine ability and needs as well as provide a baseline to measure progress (in order to cut costs, CGAP Appraisal Guide Resource Manual can be used), (ii) requiring that any donor supported external audit and/or any new partner to use an external auditor who will employ CGAP's External Audit Guidelines, and (iii) requiring that any partner agreement to include reporting to Mix Market.

10. Supporting MFCs and NGO-MFIs in the negotiation process with the credit bureau in order to reach to a reasonable arrangement that would eventually develop a comprehensive and effective credit bureau system.

MFCs General Rules Draft - Challenges and Recommendations

Minimum Capital Requirement

According to the good practices of regulation and supervision,[110] applying a minimum capital requirement for non-deposit taking MFIs who intend to engage in microcredit only is considered as an unnecessary entry barrier. This should not apply on entities who intend to only engage in lending activities because these should not be subjected to prudential regulation, thus preserving the supervisor's resources and capacity.

Loan Loss Provisioning

Prudential regulation, such as loan loss provisioning, for non-deposit taking entities could add unnecessary burden on the supervisory authority. In CGAP's recommendations for good practices of regulation, it highlights the purpose of applying prudential regulations should only be to preserve the soundness of the financial system and the interests of small depositors. Moreover, there would be no point in enforcing prudential regulations on entities just because they borrow from banks that are prudentially supervised by the CBE.

Agency Agreements

The General Rules Draft allows MFCs to act as agencies for only non-banking financial service providers (e.g. leasing, insurance and credit providers) with the approval of the relevant authority. However, the MFCs are not allowed to act as agents for banks, NPA or Money Transfer companies to offer savings and/or remittance services. This would hinder the ability of MFCs to diversify their product range and respond to clients' demand for such services.

[110] Microfinance Consensus Guidelines – Guiding Principles on Regulation and Supervision of Microfinance

Therefore, MFCs could be allowed to act as agents on behalf of duly regulated financial institutions (e.g. NPA, Banks, and Money Transfer Companies) with the approval of the relevant authority. By so doing, MFCs will be able to extend a variety of needed services like micro-savings and remittances.

Transformation – Challenges and Recommendations

NGOs should take into consideration the cost of transformation, the needed time to complete the process and the required changes in their institutional, operational and financial systems. An NGO considering a transformation should consider:

1. Developing a transformation plan and hiring a transformation manager. Multiple examples have shown it is in the best interest of an NGO to have someone manage the process as opposed to senior management managing both transformation and operations.

2. Updating the business plan, mission, vision and objectives not only to meet donor, Single Regulator and MSS requirements but also to meet potential funder requirements and avoid mission drift.

3. Directors of the transformed entity will need to be active, available and have a wide array of experience and expertise to assist the new MFC's development, especially in a growing competitive environment.

4. Determining ownership structure (e.g. is the NGO going to be majority owner? Will investors be able to have controlling interest? Will there be an Employee Stock Option Plan? Will management be shareholders? What is the exit strategy of the NGO if any? What is the exit strategy of potential investors if any? What are the plans for future investors?)

5. Giving proper attention to the evaluation procedures of the NGO's in-kind contribution (whether assets or loan portfolio) in a transformation transaction,[111] human resources issues,[112] legal advisory services, upgrading management information systems, minimum capital requirements, reporting requirements, loan loss provisioning, and control over the new MFC.

Egyptian NGO-MFIs are unclear about how to transform due to the absence of a defined transformation pathway, given the legal barriers discussed in section V). Relevant policymakers, particularly the MSS, should publicly clarify a clear path for NGO transformation. This path could be achieved by:

1. *MoI / Single Regulator*. Adding a provision in the draft General Rules for Microfinance Companies that clearly allows NGOs, interested in transforming, to own share in MFCs and receive profits. There would be no conflict with the NGO law because the latter does not explicitly prohibit NGOs from owning shares in commercial companies.

[111] The exchange of a loan portfolio is permitted under the draft General Rules for MFCs, but this depends on whether the evaluation procedures of the loan portfolio will be treated the same as those for assets.
[112] According to Labor Law an employer is obliged to pay the employee upon the employment termination the equivalent of two months salary for every employment year.

2. *MoI / Single Regulator*. Ensure that the portfolio is assessed through an independent valuation system and any shares in a company that the NGO receives in exchange for the portfolio (and other assets it might transfer) should also be assessed if the market value is not apparent (e.g., if the shares are not listed in the stock market).

3. *MSS*. Approve NGO-MFIs becoming shareholders in MFCs through use of grants provided by donors and revenue generated by operations. In order to achieve this approval it is important to demonstrate that MFCs will continue to provide products and services to the unserved and underserved low income poor and that there would be an effective oversight over assets and no mission drift through awareness building of MF Industry transformation examples.

4. *MoI and MSS* should coordinate efforts to facilitate transformation – giving particular attention to developing related expertise such as transformation models, rationales, activities and needed ongoing governmental support and oversight.

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ANNEX 1 – LIST OF LAWS REVIEWED

The Banking Sector and Money Law (Law 88 of 2003), its Executive Regulations and the CBE's Decrees.

The Companies Law (Law 159 of 1981) and its Executive Regulations

The Consumer Protection Law (Law 67 of 2006) and its Executive Regulations

The Cooperatives Law (Law 317 of 1956) and its Executive Regulations

The Draft General Rules for Microfinance Companies

The Egyptian Civil Code

The Executive Regulations of the Egyptian Private Credit Bureaus

The Law for Regulation and Supervision of Non-Banking Financial Markets and Instruments (Law 10 of 2009)

The Law on Associations and Non-Governmental Organizations (Law 84 of 2002) and its Executive Regulations

The National Postal Authority Law (Law 19 of 1982)

The Small Enterprise Development Law (Law 140 of 2004)

ANNEX 2 – LIST OF INTERVIEWEES

Field Mission – March 15th to March 19th

Sunday March 15th

- USAID
  - Mr. Rizkalla Zayat (SME Project Management Specialist – PPS/PS)
  - Ms. Sally Yacoub (Project Management Assistant – PPS/PS)
- Practitioner
  - Mr. Magdy Moussa

Monday March 16th

- MoI and GAFI
  - Mr. Abdel Hamid Ibrahim (Senior Advisor to the Minister for Finance)
  - Ms. Nevine Elshafei (Vice Chairman of GAFI)
  - Ms. Dalia Ashour (Economic Analyst - MoI)
  - Ms. Eman Saeed (Economic Analyst - GAFI)

- NGO-MFIs
  - Mr. Ashraf Nassif (Executive Director – FMF)
  - Mr. Hassan Faried (Executive Director – DBACD)
  - Mr. Karim Fanous (Executive Director – LEAD Foundation)
  - Mr. Moataz El Tabaa (Executive Director – ABA)

- Tax Authority
  - Mr. Amr El Monayer (Assistant to Deputy Minister for Tax Policy)

- Banque Misr
  - Dr. Akmal Bassili (Advisor to the Chairman)

Tuesday March 17th

- Tanmeya
  - Mr. Amr Abol Azm (Vice Chairman and Deputy CEO)
  - Mr. Hazem Medany
  - Mr. Amr Aboulesh

- Donors
  - Ms. Ghada Waly (Assistant Resident Representative – UNDP)
  - Mr. Alberto Cortezone (Project Manager – EU)
  - Mr. Hesham El Bayali (Operations Officer – IFC)
  - Ms. Cherine Samir (Operations Officer – IFC)

Wednesday March 18th

- MSS

- — Ms. Aziza Youssef (Head of the Central Department for Associations and Federations)
- — Mr. Ayman Abdel Mawgoud (Deputy Manager – Registration Department)

- SANABEL
  - — Mr. Shereen Farrag (Executive Director)

- BNP Paribas
  - — Mr. Hisham Abbas (Head of Commercial Banking Desk)

- PlaNet Finance
  - — Ms. Carole Serviere (Country Director)
  - — Mr. Mohamed Shouman (Regional Technical Assistance Director)

Thursday March 19th

- Reefy
  - — Mr. Ahmed Bardai (CEO)

ANNEX 3 – DONOR PRGRAMS IN EGYPT

The following chart summarizes the 2008 UNDP Human Development Report for Egypt with respect to donor activities aimed at developing the MSME sector.

Donor	Type of Service	Region	Main Services
CIDA	• Nonfinancial services such as training, • consulting, technical assistance through facilitators and BDS providers • Micro credit (provided 3500 loans, 23% to female borrowers).	• Upper Egypt • Alexandria Damietta	• Industrial Sector • Retail trade
GTZ	• Technical training • Nonfinancial services for MSEs (R&D, Consulting services)	• 24 governorates • Alexandria, Sadat City, Cairo, and Sixth October city, Menia	• Industrial Sector • Manufacturing, Egyptian cotton, and fruits, Foreign trade sector, and Environmental Technology.
USAID	• Microfinance programs for MSEs • Technical assistances	• Most governorates	
EU	• Market consulting services • Design products and quality grantee Indentifying MSE credit opportunities from Banking systems	• Most governorates	• Industrial Sector especially, textiles, wood, and food products.
JICA	• Training and analyzing employment opportunities; • Developing the technical training systems in Egypt	• All governorates	• Industrial Sector • Exports
Italian Cooperation	• Supporting the MSEs through preparing plans and feasibility studies	• All governorates	• Industrial sector