Creating Stability and Enhancing Access
Helping Develop Egypt’s Financial Sector

SYNOPSIS
For the past five years, the Government of Egypt and the World Bank have worked together on the most far-reaching, substantive and comprehensive drive toward financial sector strengthening so far in Egypt and the Arab World. This partnership has led to tangible results, most notably reflected in the fact that the banking sector in Egypt is now majority-owned by the private sector and open to competition, and resilient to the adverse consequences of the global financial crisis.

Challenge
The financial sector in Egypt suffered over the years from public sector dominance. Public banks did not adhere to international best practice, financed state-owned enterprises, and accumulated non-performing loans. Private banks operated in a non-competitive environment that resulted in inefficient banking practices, limited access to financial services, and created a lack of suitable instruments. Non-banking institutions did not have a suitable regulatory environment in which to develop. However, prospects improved when the Cabinet that took office in July 2004 set a major agenda of macroeconomic and structural reforms. An integral component of this comprehensive reform program was financial sector reform that aimed to increase private sector participation, promote diversification of intermediaries and instruments, and strengthen the environment for resource mobilization, financial intermediation, and risk management. The government recognized that such reforms are needed to maintain sustainable economic growth and address economic, social, and regional inequalities, in addition to raising the efficiency of resource allocation.

Approach
Supported by the International Bank for Reconstruction and Development (IBRD), the Financial Sector Reform Program comprises a major restructuring of banks, non-bank financial institutions, and markets, which is underpinned with strengthening of the legal, regulatory and supervisory framework, as well as an improvement in the institutional infrastructure. The program can be conceptually divided into two phases. The first (2004-2008) focused on reforming the banking sector and developing non-bank financial institutions and securities markets, increasing private participation, and enhancing competition, with the objective of building a more diversified and balanced financial system. The second phase (2009-2012) focused on improving financial intermediation and enhancing access to finance with a particular focus on specialized commercial banks and non-bank financial institutions.

World Bank Group support to the Government of Egypt in implementing this financial sector reform program has been exemplary in the sense that support has been provided through a continuum of instruments: analytical work, technical assistance that includes advisory services from the Financial Sector Reform and Strengthening Initiative (FIRST) and the Consultative Group to Assist the Poor (CGAP), International Finance Corporation (IFC) investments, and IBRD lending. The synergies between these various instruments have proven critical to the success of the overall engagement.
IBRD lending includes three Financial Sector Development Policy Loans successively presented to the Board in 2006, 2008, and 2010 that have supported the restructuring of the banking sector and the development of non-banking financial institutions and markets. These three operations were complemented by another three other operations: namely, the Mortgage Finance Project and the Affordable Mortgage Finance Program loan, and the Enhancing Access to Micro and Small Enterprises Project, which focuses on developing mortgage finance, improving access to low-income housing and providing a line of credit for micro and small enterprises respectively. In addition, there are numerous trust funds including several FIRST initiatives that have contributed to improved financial infrastructure; addressing supervision and regulation, information systems, credit registry and payments system.

Results

Results under the Financial Sector Reform Program have been significant. The banking sector moved from a state dominated to a stronger, more effective, private sector led system. For the first time in recent history, the banking sector is now majority-owned by the private sector and open to competition. This was achieved by:

- Privatization of the fourth-largest state-owned bank, the Bank of Alexandria;
- Divestiture of 94 percent of state-owned bank shares in joint venture banks;
- Consolidation of the banking sector where the number of banks decreased from 57 to 39 banks;
- Other achievements include the financial, operational, and institutional restructuring of the remaining state-owned banks evident in the full settlement of all non-performing loans of state-owned enterprises, and the operational restructuring of the state-owned commercial banks in three critical areas (human resource development, risk management, and information technology).

These reforms led to a substantial strengthening of the balance sheets of the banks which was validated by the resiliency of the system to the recent global financial crisis and an improvement in returns on capital and relative to assets. Furthermore, access to finance in Egypt has been enhanced substantially in terms of lending, deposit-taking, and physical access through banks and ATMs. Between 2006 and 2009, branch density rose by 60 percent, the number of ATMs by 26 percent, number of deposit accounts by 15 percent, and number of loans by 165 percent. Egypt also has one of the two largest microfinance markets in the Arab world, with more than 1.3 million active clients and a total outstanding loan portfolio of over US$337 million.

Financial sector reforms led to significant development as well in the equity market:

- Equity market capitalization and turnover ratios have grown significantly in recent years, and the investor base has expanded significantly, with foreign investors increasing their equity holdings from 7 percent to 10 percent of gross domestic product (GDP).
- The government debt market also developed, as indicated by the increase in tradable debt from 20 percent to 36 percent of total debt, and the increase in average maturity from 120 days to 2.1 years.
- The volume of trading increased from LE 72.8 million in 2004 to reach LE 547.1 million in 2009.
- These improvements reflect efforts to improve the institutional framework and market infrastructure and the government’s debt management strategy.

Good progress was witnessed in the restructuring of the non-bank institutions, particularly the state-owned insurance firms where a comprehensive restructuring occurred. An Insurance Holding Company was created and the two major direct insurers and the state reinsurer were merged, leaving the smallest direct insurer independent to facilitate future specialization into life and non-life. The third party motor vehicle books were also improved financially. In pensions, the under-funding of defined benefit schemes were addressed. Progress in the insurance sector is evident in the increase of real percentage growth in insurance assets investments from 16.8 percent in 2004 to 34.5 percent in 2009. Also, the gross premium-to-GDP increased from 0.7 to 0.9 over the same period of time.
The mortgage sector, supported by two major bank operations, has also witnessed significant developments beginning with the introduction of - and subsequent amendments to - Real Estate Finance Law 148 of 2001 and the establishment of the Egyptian Mortgage Refinance Company, the first liquid facility in Egypt. As a result of the many accompanying legal, regulatory and institutional reforms, in the past five years the number of mortgage finance companies increased from five to 12, the length of term to maturity of a mortgage increased from seven to 15 years, bank lending for mortgages increased from LE 12 million to LE 2.5 billion and the overall volume of mortgage lending in Egypt increased from LE 300 million to LE 4.2 billion.

There were major improvements in the strengthening of the institutional framework and financial infrastructure. I-Score, Egypt’s first private credit bureau, was established and began operation and as of August 2010 has 6.6 million clients and a total of 17.3 million facilities (credit files). A law was passed for specialized economic courts and a substantial effort was made to train the judges in economic issues. In payments, the Central Bank of Egypt (CBE) appropriately began its efforts to modernize the system with changes in policies, regulations and oversight and improvements in existing arrangements that reduced processing times for payments. The CBE also purchased and put into operation a real time gross settlements payments system that is being extended to handle new functions. Furthermore, a single regulator for non-bank financial sector, Egyptian Financial Supervisory Authority, was established and began operation.

The initiatives supported under the three development policy loans have also contributed to putting Egypt on the map as a serious reformer. Egypt was ranked for the fourth year among the Top 10 reformers in the Doing Business report for 2010. Egypt also made it to the Gemloc Inevitability Index. These are all solid indicators of performance and a strong vote of confidence from foreign and domestic investors, as well as international rating agencies. Most important, these reforms have helped Egypt weather the global crisis.

Bank Contribution

IBRD has been supporting the Egyptian government in implementing this ambitious financial sector reform program, which proved to be well-designed and helped Egypt weather the global financial crisis smoothly. The main pillars of the program were largely based on the recommendations put forward in the 2002 International Monetary Fund (IMF)-World Bank Financial Sector Assessment Program. A strong partnership was established through effective policy dialogue and technical assistance through various Financial Sector Reform and Strengthening initiatives which focused on the financial institution infrastructure, and through CGAP.

In terms of lending, the first Financial Sector Development Policy Loan, amounting to US$500 million was prepared in response to the government’s request to support the implementation of Phase I of the Financial Sector Reform Program, covering the period July 2004–June 2006. The significant progress achieved under this facility was encouraging, and the Bank prepared the Second and Third Financial Sector Development Policy Loans in FY08 and FY10 respectively, each amounting to an additional US$ 500million. These three loans have been complemented by major operations focusing on developing the mortgage market in Egypt, namely the Mortgage Finance Project (amounting to US$ 37.5 million); and the Affordable Mortgage Finance Program DPL (US$300 million), aiming at achieving a more inclusive financial system reaching out to low-and middle-income households. The Enhancing Access to Micro and Small Enterprises project (US$300 million) is yet another financial sector project complimenting its predecessors by providing a line of credit to micro and small enterprises which Investment Climate Assessment (ICA) surveys have shown are the most marginalized sectors in Egypt.
HELPING DEVELOP EGYPT’S FINANCIAL SECTOR

Partners

donors in the financial sector through a Financial Sector Donors Group that it chairs in the field. The Bank has led a well coordinated cooperation program with the African Development Bank, the European Central Bank, and the European Union (EU), as well as bilateral donors including Canada, France, Germany, Greece, Italy, UK, and the US Agency for International Development (USAID). There is also good collaboration between the World Bank and the IMF in Egypt in the financial sector, through the joint Financial Sector Assessment Program and coordination of technical assistance.

USAID has provided technical assistance in many areas, including debt and financial management, credit bureau regulation and data management, and the payments system (the latter in coordination with the EU and the Bank). USAID also provides technical assistance to Egyptian Insurance Supervisory Authority, the Ministry of Finance on pension reform and the development of the mortgage market. The EU has also been actively involved in the financial sector over the past few years, supporting analytical work on reforming and restructuring the financial sector. The European Central Bank (ECB) has been providing technical support in the area of banking supervision. Several US regulators including the Federal Deposit Insurance Corporation, the Federal Reserve, and the Office of the Comptroller of the Currency have been providing training in this field as well. The first phase of the ECB’s large assistance and training program for banking supervision has been completed, and it is expected that the cooperation with Central Bank of Egypt will continue.

Moving Forward

With the success of the financial sector reform program, the Bank will undertake further analytical work to help solidify gains achieved so far and identify areas of possible future assistance. The Bank is currently undertaking a new Finance and Growth Study that will highlight priority reform areas for the coming ten years.

Related stories and publications

- Egypt: Sustaining Growth through Reform
- Improvements help Egypt weather the financial crisis
- Access to Finance and Economic Growth Report (pdf)

Partner websites

- Central Bank of Egypt
- Ministry of Investment

Multimedia

- Videos on Egypt